Chapter 4

Motives for Internationalisation

The aim of this Chapter is to clarify that internationalisation is not always driven by the desire to enhance sales, but that the motives for internationalisation can be manifold, with major consequences for market entry strategies, the coordination of international subsidiaries, country selection, organisation, etc.

Heterogeneous Strategic Objectives for Internationalisation

Internationalisation into specific foreign countries, whether it is via exporting or importing, international contracts or foreign direct investment, is always driven by certain motives of the part of an MNC. In this regard, it can be assumed that the strategic conduct of a company in a particular country is always shaped by its strategic objectives with regard to this country, as an important part of the intended strategy.

Sales Objective Traditionally in the Focus

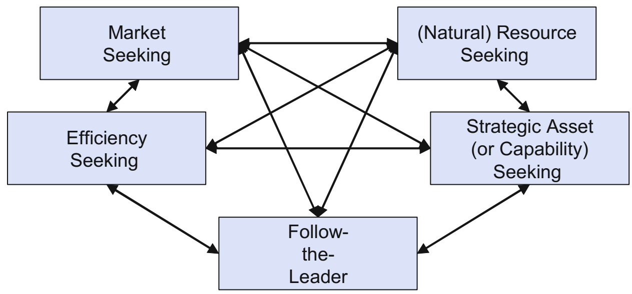
However, the literature on internationalisation often fails to differentiate between the respective objectives, assuming, often only implicitly, that sales-oriented objectives are the most relevant. The term *market entry strategy*, which is often used for the foreign operation mode, clearly indicates this assumption. Traditional concepts and studies on internationalisation (e.g. the theory of monopolistic advantage by Hymer (1978)) often assumed that companies' international activities only give them the benefit of a broader exploitation of company-specific advantages. However, very different internationalisation objective exist. As already stated in the international *product lifecycle theory* by Vernon (1966), the *production cost advantages* of a foreign market might be an important reason for relocating production to foreign countries, even if the primary sales focus is still on the home country.

In the perspective of the MNC as a *differentiated network*, as discussed in Chapter 1, different subsidiaries are assigned different tasks and roles, and heterogeneous location advantages of the different foreign subsidiaries are exploited. This perspective clearly illustrates the *multi-faceted nature of the motives* for being active in foreign countries.

The *five motives* shown in Figure 4.1 are the most relevant objectives of internationalisation (see, e.g., Dunning 1988; Shan 1991, p. 562; Morschett 2007, pp. 310-320; Dunning/Lundan 2008, pp. 67-77).

D. Morschett, H. Schramm-Klein, J. Zentes, *Strategic International Management*, DOI 10.1007/978-3-658-07884-3_4

Figure 4.1 *Alternative Motives for Internationalisation*



Market Seeking

The *primary motive* for starting activities in a foreign country is frequently the *access to new markets* and the sales potential offered by foreign markets. When the home market is saturated, as is increasingly the case for the industrialised countries of Western Europe, the USA or Japan, company growth can be maintained through international sales.

Orientation on the Sales Side

When market seeking is the motive, foreign countries are chosen by the sales potential they offer for the company. Country characteristics used as *selection criteria* in this case include (Grünig/Morschett 2012, pp. 97-112):

- market size
- market growth
- presence of attractive customer segments
- demand for the products or services of the company.

International market seeking objectives are not necessarily associated with foreign production; they may also be reached by home-country production that is being exported to the foreign market. While *exporting* can be used to exploit excess production capacity in the home country, and is usually less risky and can be carried out with lower initial investment, FDI in the target market can help to circumvent trade barriers, reduce logistics costs and develop a better understanding of the market. These scenarios are discussed in more detail in Chapter 19.

Cooperative Operation Modes to Improve Market Access

Given that access to a foreign market is not always easy and market knowledge of a foreign company is usually lower than that of a local company, first market entries are often achieved via *cooperative arrangements* with local companies (Erramilli/Rao 1990, p. 146). Local companies may provide the company with the necessary knowledge about the market, with access to distribution channels and with other local relations.

Vertical Integration

However, considering the significance of customer relations, in recent years companies on both a national and international level have tended to exert a *tighter control* over their foreign sales activities and are willing to use a higher level of ownership of these activities to provide the necessary coordination. *Internalisation* of these foreign marketing activities, i.e. vertical integration, and a full-ownership strategy instead of cooperative arrangements, are often the consequence. The reason is that a foreign subsidiary acts as a *gatekeeper* to the local market, which gives it a specific power versus the company in the home country, in particular when it controls distribution channels, marketing activities, etc.

Dynamic Changes in Operation Modes

The theory of this dynamic development, which is shaped by a low level of market knowledge in early phases of market entry (and, thus, often cooperative entry modes to facilitate the market entry), increasing market knowledge over time and the wish to exert a stronger control over activities (and in consequence a preference for full ownership of the subsidiary), is explained via *internationalisation stage models*, which are discussed in more detail in Chapter 6.

Follow-the-Customer

The market seeking motive focuses on sales in the foreign market. Usually, customers in the foreign country are consumers or companies resident in the host country. In business-to-business markets, however, customers in the foreign country might also be companies from the home country who have internationalised to this country. For instance, a Swiss company might sell in China to the Chinese subsidiary of another Swiss MNC.

Piggybacking of Service Companies

For service companies in particular it is very common to enter a foreign market as a consequence of the internationalisation of one of their main customers (so-called "*piggybacking*"). This follow-the-customer motive is often seen as the most relevant reason for service companies to internationalise. Following a customer overseas might be necessary to protect existing sales levels (if the customer relocates parts of its home country production abroad) or it can be an opportunity to enhance sales if the customer increases its production with the new foreign facility. Existing business relationships, e.g. for professional services like business consulting, advertising agencies and auditing companies, are ensured and strengthened by accompanying important clients into the foreign market (Erramilli/Rao 1990, p. 141; Cardone-Riportella et al. 2003, p. 384).

Competitive Advantage through Customer Knowledge

While this motive can be seen as a *sub-dimension of market seeking*, it makes a major difference whether the customer base of the company in the host country consists mainly of local customers or customers from the company's home country. In the follow-the-customer scenario, the company has a strong advantage because the uncertainty of entering the foreign market is much lower. An important customer is already secured prior to market entry and the demand behaviour of this customer is already known to the MNC from the home country. The *liability of foreignness*, i.e. the often-stated competitive disadvantages compared with local companies due to reduced market knowledge, is reversed in this situation, because the MNC has already accumulated knowledge and information about this customer (Erramilli/Rao 1990, p. 143).

However, following the customer also leads to major *interdependencies* for international activities. Since a dominant reason for following the client is also to deepen the business relationship with this customer in the home country (Cardone-Riportella et al. 2003, p. 385), it is important that the marketing offer and the quality level of the company in the host country mirrors the offer in the home country. This strong interdependence makes centralised coordination necessary, since decisions by the MNC's headquarters must also be implemented in the foreign market. On the other hand, *centralised coordination* becomes easier, since the headquarters might have better information available on this customer and its company objectives than the specific foreign sales unit (Mößlang 1995, p. 220).

Manufacturers Following-the-Customer

While the literature assigns this objective mainly to service companies, it seems obvious that the motive can be very *relevant for manufacturing companies* as well. Industrial supplier relations are sometimes very similar and closely linked to specific customers (Ferdows 1989, p. 7; Zentes/Swoboda/Morschett 2004, p. 394). If, for instance, a large German car manufacturer establishes production facilities in Eastern Europe, this forces suppliers to consider internationalisation to these countries as well. The same phenomenon was observed when Japanese car manufacturers established their first production facilities in the USA in the 1980s and 1990s. Consequently, more than 500 automotive suppliers from Japan established production facilities in the USA in their wake (Dunning/Lundan 2008, p. 70).

Bridgehead

The activities in a specific country can also be motivated by the opportunity to establish a bridgehead for entering *adjacent foreign countries*, either immediately or at a later date. This is particularly relevant in connection with the market seeking objective.

Foreign Country as Bridgehead for Further Internationalisation

As well as the activities in the host country, the company should identify market opportunities in other countries that are easier to enter from this bridgehead. For example, Hong Kong used to be a bridgehead for many companies to enter the attractive Chinese market, and Austria is often used by Western companies as an entry point into Eastern Europe. For example, *McDonald's*, *Aldi* and *Rewe* used their activities in Austria to enter Eastern European markets. After the establishment of activities in neighbouring countries, the bridgehead often serves as a regional headquarters.

Resource Seeking

Foreign activities can also be motivated by securing the MNC access to relevant resources. These could be natural resources, but this objective can also include specific components from foreign suppliers or certain topographical sites (agricultural land, harbours, etc.) (see Rugman/Verbeke 2001, p. 158). Companies in the *primary sector* and companies that are strongly dependent on natural resources, like oil companies, tyre producers and chemical companies, often internationalised early on, with the aim of securing the necessary inputs for their companies (Bartlett/Ghoshal 2000b, p. 5).

Country characteristics that are used as the primary *selection criteria* include

- availability of important resources
- cost of resources in the country
- allocation of resources in the country, e.g. whether the resources are controlled by a few organisations or by many.

Partnership Strategies

The resource seeking motive is closely linked to *cooperative operation modes* (Morschett/Schramm-Klein/Swoboda 2008). This is primarily due to local companies' *first-mover advantage* with regard to local resource access (Hennart/Larimo 1998, p. 524). Local companies have often secured access to important natural resources very early, often decades prior, and major natural resources are often at least partially controlled by the host government (e.g. in Russia). So while *acquisition* might theoretically be an option, legal restrictions often hinder this operation mode. A foreign company that wants to get resources thus often needs to partner with local companies to gain access to their networks, government relations, expertise, etc.

It is also plausible that foreign subsidiaries which are mainly established to gain access to resources in a foreign country intend to embed themselves tightly in the local environment, tighten the relationships they have established with the help of a cooperation partner and enhance the supply security of the critical resources. The company often has to adapt to processes and routines in the host country.

Resource seeking is simultaneously linked to strong interdependence with the rest of the MNC, since the goods and resources acquired in the foreign market are either directly delivered to other organisational units of the MNC, e.g. a factory in the home country, or are further processed in the host country by the foreign subsidiary, to be subsequently delivered to foreign countries. Resource seeking thus usually leads to *one-directional, sequential flows of material* from the foreign subsidiary to the rest of the MNC.

Efficiency Seeking

Orientation on Production Efficiency

Another major motive for internationalisation is efficiency seeking, i.e. the quest for the *improvement of the overall cost efficiency* of the MNC. The foreign subsidiary in this case is often part of an *internationally configured network* of production activities. The intention is to exploit specific location advantages for specific activities and design a production network that rationalises the production processes (Rugman/Verbeke 2001, p. 159). The foreign subsidiary is then often responsible for manufacturing components or final goods that are delivered to the parent company or peer subsidiaries in cross-border production processes (Martinez/Ricks 1989, p. 469). In services, the *outsourcing and offshoring* of call centre activities to Ireland, or of IT services to India, are typical examples of efficiency seeking (see Chapter 16 for a discussion of these phenomena).

Efficiency seeking activities can either try to exploit *differences in factor costs* (i.e. between heterogeneous countries) or be designed to enhance *economies of scale* by bundling production (i.e. between broadly similar economies) (Dunning/Lundan 2008, p. 72).

Location Selection for Efficiency Seeking

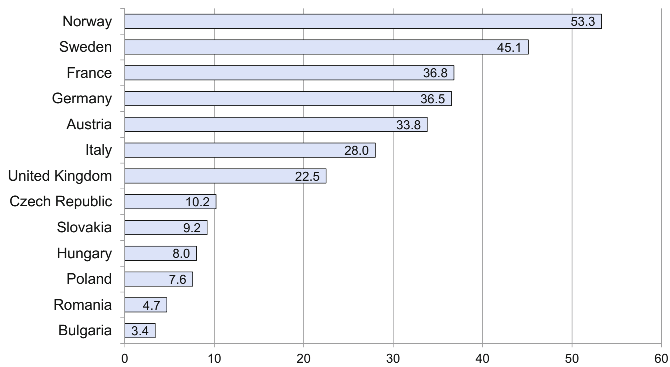
Selection criteria in the case of efficiency seeking include (Grünig/Morschett 2012, pp. 167-187):

- labour costs in the country, which differ tremendously, even within Europe (see Figure 4.2); as well as absolute wages, productivity differences also need to be considered
- distance to relevant markets (as an influence on logistics costs)

- possibilities to integrate the production process in the company's overall cross-border production processes
- availability of good and efficient suppliers.

Hourly Labour Cost in Industry in Selected European Countries 2013 (in EUR)

Figure 4.2



Source: Eurostat 2014.

The possibility of integrating the production processes across borders is obviously improved by reduced tariff and non-tariff barriers between countries. This is why efficiency seeking internationalisation often occurs in regionally integrated markets (Dunning/Lundan 2008, p. 72) such as the EU or NAFTA (see Chapter 7).

Miniature Replicas and Product Mandates

If the subsidiary produces components in a vertical supply relationship with other organisations within the MNC, then *tight coordination* is necessary to integrate the production processes into the MNC (e.g. Gupta/Govindarajan 1991). Thus, foreign subsidiaries that are mainly established as production sites for the MNC often have a comparatively low level of autonomy and a degree of central coordination (Young/Tavares 2004). Since their structures and processes are often similar to those of the parent company, they are sometimes called *miniature replicas* (White/Poynter 1984, p. 60; see Chapter 3). On the other hand, efficiency advantages in the host country can also be exploited by having the subsidiary carry out full value chains and assigning it a *product mandate* which gives it full (regional or worldwide) responsibility for one or several products. In this case they might be able to establish specialised resources and a high level of competence which promotes their autonomy. In any case, a certain level of coordination remains necessary for this subsidiary due to the high interdependence with the rest of the MNC (Young/Tavares 2004, p. 221).

If the internationalisation is mainly due to efficiency motives, *cooperative arrangements* are sometimes chosen as the operation mode (Morschett 2007, p. 515). Manufacturing in the host country – at least compared with pure sales activities – is linked to very high capital costs and consequently a *risky engagement*. Sharing large investments and high risks with a local partner is a frequent motive for cooperative strategies. Local partners can also contribute to economies of scale in production (Heshmati 2003; Kutschker/Schmid 2011, p. 892).

Outsourcing Internationally

Alternatively, seeking cost efficiency might also lead to *outsourcing*. In particular, cost reasons are often seen to influence the "make-or-buy-decision". Arguments for outsourcing include flexibility, reduced investment of own company resources, specialised knowledge, economies of scale and economies of scope (Aharoni 2000, p. 17). These are discussed in more detail in Chapter 16. As an example, outsourcing production to a contract manufacturer might give a company access to a very cost-efficient international production network with high flexibility (Morschett 2005), thus giving it the opportunity to fulfil the efficiency seeking motive by using the configuration of the contract manufacturer without their own international FDI.

Strategic Asset Seeking

Besides the motive of accessing natural resources, components or other similar inputs, a company might seek *access to local knowledge*, capabilities, technological resources and innovations. The *strategic asset seeking* motive is based on the idea that an MNC's international presence gives it a major information advantage over other companies, grounded in the *scanning and learning potential* of the company network (Bartlett/Ghoshal 2000, p. 8). Research institutions, as well as suppliers, customers or competitors, can be important sources of technological knowledge (Ferdows 1989, p. 6). For example, it is often argued that access to specific knowledge and capabilities in the host country is an important reason for direct investment in the USA (see Randøy/Li 1998, p. 91). Related to the motive of strategic asset seeking is the idea that the superiority of differentiated MNC networks is due to the enhanced *innovation capability* of such networks (Ghoshal/Bartlett 1988; Bartlett/Ghoshal 1989).

Orientation on Know-how

If strategic asset seeking is a major motive for internationalisation, the country characteristics used as *selection criteria* include:

- innovation levels

- sophistication of demand
- availability of related and supporting industries
- presence of innovation clusters in the relevant industry.

While a company obviously has to consider the innovation capacity of a potential host country in its specific industry, some general evaluations can be drawn from secondary sources like the World Competitiveness Report (see Table 4.1).

Ranking of the Most Innovative Countries

Table 4.1

Country	Rank	Innovation and Sophistication Score	Country	Rank	Innovation and Sophistication Score
Switzerland	1	5.72	Denmark	11	5.14
Finland	2	5.65	Austria	12	5.14
Japan	3	5.62	Singapore	13	5.14
Germany	4	5.59	Qatar	14	5.08
Sweden	5	5.46	Belgium	15	5.07
United States	6	5.43	Norway	16	5.07
Netherlands	7	5.36	Luxembourg	17	4.84
Israel	8	5.23	France	18	4.84
Taiwan	9	5.22	Hong Kong	19	4.83
United Kingdom	10	5.15	Korea, Rep.	20	4.82

Source: World Economic Forum 2013, p. 16.

Innovation (and, related to this, an adequate location for MNCs seeking strategic assets) requires an environment that is conducive to innovative activity, supported by both the public and the private sectors. In particular, this means sufficient investment in research and development, especially by private, high-quality scientific research institutions, collaboration in research between universities and industry and protection of intellectual property (World Economic Forum 2013, pp. 8-9).

Switzerland as Leading Innovative Nation

The leading countries for innovation are Switzerland, Finland, Japan, Germany and Sweden. The Competitiveness Report comments: “In the case of Switzerland, an excellent innovation ecosystem has been a significant part of making the country an attractive place to work for highly qualified people. Its well-functioning labour market and excellent educational system provide the fundamentals for innovation to prosper, instigating the close relationships among enterprises, universities, and research institutes that have made the country a top innovator. Its scientific research institutions are among the world’s best, and the strong collaboration between its academic and business sectors, combined with high company spending on research and development, ensures that much of this research is translated into marketable products and processes reinforced by strong intellectual property protection. This robust innovative capacity is captured by its high rate of patenting per capita" (World Economic Forum 2013, p. 14). Innovation levels are often linked to the presence of *regional innovation clusters*, which are discussed in more detail in Chapter 8.

Innovation and Coordination

If the foreign activity is mainly targeted towards gaining expertise and access to strategic assets, this has clear implications for the *headquarters-subsidiary relationship.* For example, a very high level of centralisation has been shown to reduce motivation and creativity and thus to exert a negative influence on the innovation capability of a foreign subsidiary (Gates/Egelhoff 1986; Egelhoff 1988). However, there has to be a close link between the foreign subsidiary and the rest of the MNC, because internal communication flows (horizontal with other subsidiaries and vertical with the headquarters) are major determinants of the innovation capacity of an organisation (Nohria/Ghoshal 1997, p. 39). In particular, it is important that the foreign subsidiary has both the necessary capability to generate new knowledge and the necessary motivation to share this knowledge with the rest of the MNC (Nohria/Ghoshal 1997). Normative integration via a strong organisational culture has been shown to be an efficient coordination instrument which motivates and facilitates bi-directional knowledge flows (see Chapter 12).

Cooperation to Acquire Knowledge

If access to local knowledge is a primary motive for foreign activities, cooperative arrangements are often beneficial. To acquire knowledge, being strongly *embedded* in the local environment is necessary, *local relationships* are required and a close and trustworthy contact with local institutions is useful (Fisch 2001, p. 135; Morschett 2007, p. 318). Local cooperation partners, as in a *joint venture*, can support access to the necessary knowledge sources. An alternative operation mode to gain rapid access to local knowledge in foreign markets is the acquisition of a foreign competitor, including the knowledge base that is accumulated in its patents and, in particular, its employees. In both cases, *market imperfections* in the market for knowledge can be seen as reasons for the (partial) internalisation (Williamson 1985).

Since innovation potential is closely related to a company's R&D activities, this aspect is discussed in more detail in Chapter 20.

Follow-the-Leader

As early as 1973, Knickerbocker argued that companies tend to behave similarly in an oligopolistic industry situation with the objective of maintaining stability and avoiding major changes in the competitive structure. Thus, internationalisation might occur as an *oligopolistic reaction* to a competitor's move to a foreign country (Cardone-Riportella et al. 2003, p. 390). This can influence the internationalisation decision in general as well as the selection of specific foreign countries.

Exchange of Threats

This strategy-based consideration becomes more relevant with increasing levels of internationalisation of the relevant competitors and with increasing competition concentration. In this situation, international activities in particular countries can also represent an *exchange of threats* between competitors (Graham 1978; Malhotra/Agarwal/Ulgado 2004, p. 4). If the same companies compete in several countries, an MNC can use its portfolio of foreign activities in a strategically coordinated manner. For example, it could use its strength in the USA to attack a competitor there who attacked it in a European market. This strategic flexibility is particularly relevant in highly globalised industries. It can be linked to any of the four motives mentioned above. For instance, it might be necessary to gain access to a specific resource, market, strategic asset or type of expertise in order to react to a competitor's action.

Bundles of Motives

While one of the five motives above is often the dominant reason for activities in a particular country, they seldom exist in isolation. Generally, companies pursue a bundle of objectives simultaneously (Shan 1991, p. 562). As with any bundle of objectives, it must be determined whether they are concurrent or complementary. Sometimes, an MNC might have to accept a trade-off between different location characteristics that are favourable for one motive but less favourable for another.

In any case, combinations of the five motives are very common. For example, a company might be primarily market seeking, but to address the demand in a specific country it must relocate parts of its production process into this country to enhance its production efficiency with regard to this sales market. Another company might need a local presence in a country to gain access to relevant strategic assets which are necessary to develop an innovative product for this country market. Thus, the country characteristics that lead to the selection of a specific foreign country for company activities should be considered in combination.

Conclusion and Outlook

The motives of a company when entering a foreign country are not necessarily focused solely on expanding its markets. Moreover, the motivation is often not one-dimensional but multifaceted. Since the company's motives for undertaking activities in a specific country are a major part of its strategy, other major parts of its strategy, organisational behaviour, company structure, etc., have to be aligned to these motives. This shows the necessity to classify, for example, the headquarters-subsidiary relationship according to the dominant motive for internationalisation.

In the last few decades, the principal motives for entering foreign countries have shifted. For example, for many years China was seen mainly as a country for cheap production, while now it is increasingly entered by companies as an attractive market. Eastern Europe opened and simultaneously became attractive as a market and for efficiency seeking. With the perceived increasing scarcity of some natural resources, like oil and gas, some countries (e.g. Russia) have become crucial for the long-term access to the necessary supply. In tandem with the development of prices for natural resources, the same countries are also becoming more attractive as markets. Strategic assets are no longer exclusive to the USA or Europe. For example, Korea has become one of the innovation centres of the world in consumer electronics. Conversely, MNCs from emerging countries like China are increasingly internationalising to industrialised countries to gain access to expertise. Moreover, in many foreign countries, the follow-the-customer trend has accelerated over recent decades (Dunning/Lundan 2008, p. 70).

Further Reading

DUNNING, J.; LUNDAN, S. (2008): Multinational Enterprises and the Global Economy, 2nd ed., Cheltenham, Edward Elgar Publishing, pp. 67-77.

WORLD ECONOMIC FORUM (2013): The Global Competitiveness Report 2013-2014, Geneva.

Case Study: SAP*

Profile, History and Status Quo

In 1972, five former *IBM* employees had the vision of a standard piece of application software for real-time data processing. To make this vision a

* Sources used for this case study include the website http://www.sap.com, and various annual and interim reports, investor-relations presentations and explicitly cited sources.

reality, they founded a company called *System Analysis and Program development*, later known as *SAP*, in Weinheim, Germany. After only a few months of development, the company successfully released the first version of its software to interested clients.

Within its first year, the company built up the necessary customer base, including the German branch of *Imperial Chemical Industries in Östringen*, to generate over 620,000 DM (approx. 317,000 EUR) in revenues. Over the following years, *SAP* software solutions became increasingly advanced, allowing customers to handle purchasing, inventory management and invoice verification. By the end of 1976, *SAP* and its 25 employees had generated 3.81 million DM (1.95 million EUR) in revenue.

The next decade ushered in major growth for the German-based company. After moving their headquarters to Walldorf, *SAP GmbH* was founded and efforts were taken to widen the capabilities of software solutions. These developments ultimately led to the release of SAP R/2 in 1979, enabling material management and production planning for new and existing customers. Thanks to these software enhancements and new server technology integrated into *SAP* headquarters in 1979 and 1980 the company was able to expand its customer base to over 200 companies by the end of 1981.

On its 10th anniversary, *SAP* reached the 100-employee milestone and had successfully expanded its customer base to companies in Austria and Switzerland. *SAP (International) AG* was founded in Switzerland as a starting point for *SAP's* efforts in foreign markets. In addition to this new base outside of Germany, the headquarters in Walldorf was expanded to accommodate further employees and provide a new base of operations for further growth. The transition from a private, limited-liability company into the publicly traded *SAP AG* in 1988 enabled the company to finance its further investments.

When SAP R/3 was presented to the public in 1991, *SAP* had long outgrown its initial borders. With over 14 subsidiaries in Canada, China, Australia and other important markets all over the world, *SAP* had more than 2,200 customers in 31 different countries using its software. After the fall of the Iron Curtain, *SAP* was one of the first companies to enter the Eastern European market. They released a specialised version of SAP R/2 for the Russian market. Strengthened by fruitful cooperation with software giants like *Microsoft* and expanding their workforce to over 3,600 employees, *SAP* reached over 1 billion DM (approx. 510 million EUR) revenue in 1993, establishing themselves as one of the most important players in the software market.

Mergers & Acquisitions

The end of the century saw *SAP* rise to become the world's leading provider of e-business software solutions for companies. Thanks to their overall success on the stock market and further increasing revenues, *SAP* used strategically suitable acquisitions to add to their product portfolio and thereby increase their employee and customer numbers. With the *mySAP.com* strategy introduced by co-CEO *Hasso Plattner* in 1999, the foundations of success in the Internet-driven days of the new millennium were built. The transformation for a simple component vendor to a full solution provider attracted numerous new customers, including the financial service provider *MLP*, *Hewlett-Packard* and later *Nestlé*, signing the biggest *SAP* contract to date.

The global financial crisis in the first decade of the new millennium forced *SAP* to make some cuts in reaction to a declining stock market. During that time, around 3,300 employees had to be dismissed in order to reduce expenses. Nowadays, *SAP* has recovered from the crisis and employees more than 66,000 employees to serve over 253,000 customers worldwide. Thanks to mostly successful acquisitions, partnerships and newly built subsidiaries, *SAP* has established offices in 130 countries and annual revenue of over 16 billion EUR.

The Software Industry

Very few industries undergo as many changes and developments as the software industry (see PWC 2014). Technological evolution and the fact that more and more businesses and people are relying on software solutions fuels the constant growth of numerous big software companies like *SAP*, *Microsoft* and *Oracle*. Furthermore, mobile devices, cloud technology and other developments are starting to reshape the way software is used and forcing software companies to rethink their strategies. *SAP* has already acted on those ongoing trends and in 2011 announced the acquisition of *SuccessFactor*, a leading expert for cloud technology.

Table 4.2 *SAP Revenue Categories in 2013*

Revenue categories	%
+ Cloud subscriptions and support	*4*
+ Software	*27*
+ Support	*52*
Software and software-related services revenue	**83**
+ Consulting	*13*
+ Other services	*4*
Professional service and other services revenue	**17**
Total revenue	**100**
one-time revenue; recurring revenue	

Source: SAP 2014, p. 1.

In 2013, 4% of *SAP's* revenues (see Table 4.2) came from cloud subscriptions and over 50% from support. Based on the new product elements of their latest solutions concepts, this number is likely to increase. Overall, most of the revenues in this industry are still made via the traditional *licensing model*, but experts suggest that in 2016 almost 24% of all software related revenues will be based on cloud-related, subscription revenue (PWC 2013, p. 8). These reshaped business approaches carry some potential risks. Subscription models such as a cloud make it relatively easy and interesting for customers to switch companies after a short amount of time; therefore, product solutions must be attractive enough to ensure customers' loyalty to the given solution (PWC 2013, p. 12).

The US Market as the Leading Source of Innovation

Traditionally, US companies are the leading providers of software solutions. Only a few of the biggest and most successful companies in this industry are not based in the United States (see Table 4.3). *SAP* is by far the biggest European software company. The fact that most of the biggest software companies originate in the United States also leads to a certain industry focus on this market. *SAP* has already established an office in the United States to gain access to possible cooperation partners and better access to technology that emerges from this very important market.

Table 4.3

Software Company Ranking in 2012

Rank	Company	Country	Sales (in billion USD)	Profits (in billion USD)	Assets (in billion USD)	Market Value (in billion USD)
1	Microsoft	United States	83.3	22.8	153.5	343.8
2	Oracle	United States	37.9	11.1	86.6	185
3	SAP	Germany	22.3	4.4	37.3	97.1
4	Vmware	United States	5.2	1	12.3	48.2
5	Symantec	United States	6.8	0.9	13.3	14
6	CA	United States	4.6	1	11.8	14.1
7	Fiserv	United States	4.8	0.7	9.7	14.6
8	HCL Technologies	India	4.7	0.7	4.2	16.6
9	Intuit	United States	4.2	0.7	4.7	22.4
10	Amadeus IT Holdings	Spain	4.1	0.7	7.5	18.9

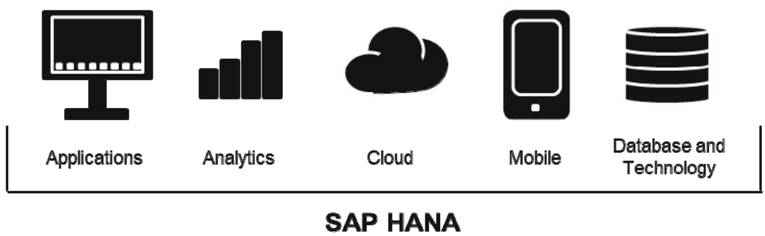
Source: PWC 2013.

Go Big – Go Global

SAP's Product Strategy

The basic product line introduced by *SAP* in the early 1970s was offered support for basic functions, such as finance, human resource management or manufacturing. Since then, *SAP* has added various functions to meet enhanced requirements. Their application suites R/2 (1981) and R/3 (1991) had a particularly large influence on their success and can be seen as industry milestones. As the Internet gained importance in the late 1990s, R/3 was rediscovered as a tool for managing globally operating businesses (Lehrer/Schlegelmilch/Behnam 2009, p. 101). Therefore, *SAP* spent the following years creating solutions suitable for different work environments and incorporating companies' major tasks.

Figure 4.3 *SAP's Product Portfolio*



Source: SAP 2012, p. 9.

Figure 4.3 shows *SAP's* product portfolio. Since the 1990s, *SAP* has added new features to its initial product line to become a *full service provider* that can cover almost every task demanded by their clients. The introduction of *SAP HANA*, a powerful database tool, in 2010 laid the foundation for the incorporation of new features, such as the support from mobile devices and cloud technology.

Differentiation of a Standardised Product to Fit Local Markets

With a global customer base in over 180 countries, *SAP* uses the internationalisation of their products as a key element to differentiate themselves from competitors. Thanks to customised packages for individual customers in line with different legal and language requirements, their widely standardised software solutions can be implemented in various companies worldwide. So far, *SAP* has delivered over 60 country versions that meet the respective legal requirements and translated products into 39 different languages.

SAP's Internationalisation Strategy

Table 4.4

Internationalisation	Localisation	Translation
technical enablement of a system to operate globally • multilanguage support • code pages/unicodes • time zones • multiple currencies • calendars	business solutions are not viable without localisation of content • local best business practices • legal requirements and statutory reporting	speak the language of the locals

Source: SAP 2012, p. 10.

Standardisation vs. Local Adaptation

For *SAP*, international expansion of software solutions involves three main ideas (see Table 4.4). *Internationalisation* covers the basic possibilities for making suitable software solutions that can be implemented during the basic development of the software, enabling customers to use different languages, work in different time zones, and adjust to the given currency and other minor features. This can be regarded as highly standardised content that provides a foundation for further adjustments to suit the given environment.

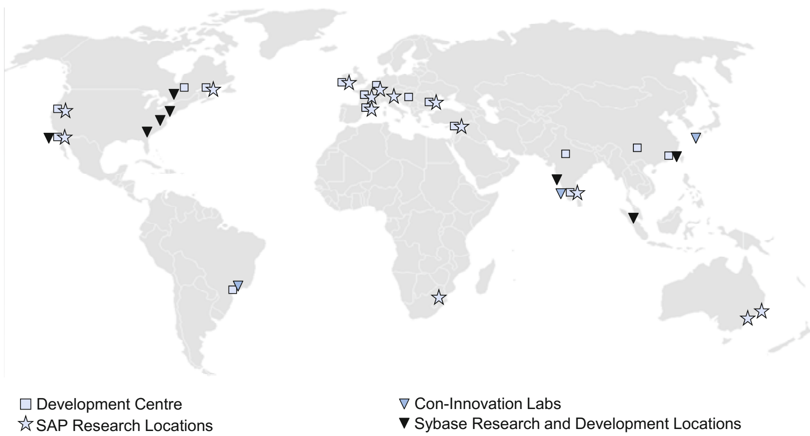
By *localising* to incorporate local best business practices and meet local requirements and statutory reporting, globally active companies and their employees can easily adjust to business demands in countries different to their usual base of operation. Finally, *translation* into the local language is necessary, as language localisation is a central factor of success to reach new customers.

Global Activities of SAP

One strength of *SAP's* global operations is that they enable their customers to run a global solution to their country-specific needs. Various subsidiaries in key markets are part of *SAP's* strategy to gain *local knowledge* that can be used to differentiate of their products. With over 1,100 employees focusing on this issue, *SAP* can successfully implement business solutions in a majority of the market. *SAP* recently announced a further investment in international growth to strengthen their market position in economies such as Brazil, India and Russia. *SAPs Globalisation Services* (GS) build on the key software features discussed earlier. It is through these local service centres, that customers get the necessary support to find the best solutions to their goals in the given market.

Another very important aspect of *SAP's* success is their international research & development facilities. The *SAP Labs* and *SAP Research* organisations cooperate with partners, customers and universities to create new global solutions.

Figure 4.4 *SAP's R&D Activities*



Source: SAP 2012.

As shown in Figure 4.4, *SAP Labs* or development centres are located in major areas worldwide. The most important facilities are located in Germany, India and the USA. Global key performance indicators and development standards to ensure a certain level of quality guide the work of every station. *SAP* research centres are always co-located with a partner university or a development centre. Thanks to these facilities, *SAP* is able to react to the requirements of customers and markets alike.

Strategically Chosen Locations Ensure Competitive Advantage

These locations are chosen for numerous reasons. Being close to potential and existing customers, gives *SAP* personal contact with them – allowing *SAP* to not only present new technology and products, but also to gain knowledge about their customers' special needs. It also ensures that *SAP* is able to find new employees, new technology and new product ideas almost anywhere in the world. Being close to all the world's major technology hubs provides them with a keen advantage over other competitors.

SAP has recently begun to build up a very strong presence in India. With over 4,000 employees in their new facilities in Bangalore, it is already their second biggest branch worldwide. India is a very attractive market for several reasons. In addition to more general advantages already listed that are true for most subsidiaries, India also offers a few additional, almost unique benefits. The highly skilled workforce is a crucial factor in possible success. Well-trained college graduates are keen to work for big international companies like *SAP*. Since an entry-level worker will only earn around 7,900 EUR a year, *SAP* saves a lot of money by shifting their production and development facilities to India (Handelsblatt 2011).

Approaching New Markets – Forming a Global Brand

With the launch of their new product line *mySAP.com* in the late 1990s, *SAP* drastically changed their brand and its perception in the market. Many critics had argued that *SAP* was late in recognising e-commerce as a serious and important aspect of the overall software market. Therefore, *SAP's* management was keen to use the launch of *mySAP.com* to reinvent their brand image. By replacing the company's original brand logo with the new *mySAP.com* product line logo, the company tried to reshape their market position.

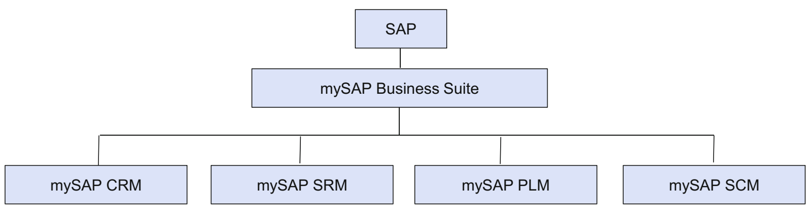
Unfortunately, this drastic step led to further confusion in the brand's perception and also had some damaging effects on brand equity. In addition, the logo appeared with different slogans all around the world, thus further confusing customers. Between 1997 and 2000, *SAP* used different slogans such as "We Can Change your Business Perspective", "A Better Return on Information", "The Time of new New Management", and "You Can. It Does." A similar approach was used for the company's online representations. With one global website, various local country sites and numerous subsidiary company sites, no clear corporate design could be identified.

This was a major obstacle that had to be overcome for future, international success. In their attempt to cater to customers' demands in numerous markets all over the world, the insufficiency of each individual offering was possibly harming their success. In order to gain the desired global market power and successfully build up a unique experience for their customers on a global basis, they had to reinvent their brand appearances. After all, the reputation they had already built was a unique resource to transfer into new markets.

Reinventing the SAP Brand

At the *SAPPHIRE* conference (established by *SAP* to present new products and solutions to the media, customers and analysts) the new Global Chief Marketing Officer, Martin Homlish, announced the new vision for *SAP* marketing efforts to give the company a fresh look. One of the ideas behind the marketing concept was the transition from a German company selling worldwide to a true global player, able to compete in every market. To align with these stated goals, the team around Homlish decided to slowly transform the overall brand from *mySAP.com* back to its original. Figure 4.5 shows the newly formed brand architecture. It features a strong master brand and several sub-brands that represent individual product solutions. These changes were complemented by newly designed Internet representations that streamlined the former websites and establish one global site that, like the product itself, was able to adjust to the language of its current viewer. Thereby, the content was easily distributed in every market in a similar fashion without adding too many local influences.

Figure 4.5 *SAP Brand Architecture*



Summary and Outlook

As shown in this case study, *SAP* has made enormous efforts in the last 40 years to develop from a small 5-man start-up to one of the most important companies in the software industry. Thanks to their strategic measures to localise most of their products and solutions, *SAP* has reached customers in over 180 countries. Supported by the newest technology, enhanced R&D institutes and diversified input from different cultures and markets, the company seems able to adapt to most market requirements. Their extremely strong brand names and clear communication guidelines have strengthened their product.

New Assets for the Company through Silicon Valley

Recently, rumours have surfaced suggesting a possible relocation of *SAP's* main operation from Germany to the United States. This indicates one of its important motives in international location selection is resource seeking: Co-CEO Jim Hagemann Snabe stated that the most important industry impulses come out of Silicon Valley and a stronger presence in that area could only benefit *SAP* (Handelsblatt 2013). In 2011, *SAP* started a project in that area, already showing their interest in this location. In their new complex named *AppHaus*, *SAP* gathered a mix of experienced developers from their German headquarters and some new employees to design and develop new technology (Somerville 2013). Through this project, *SAP* is trying to stay ahead of possible competition and gather fresh, new impulses for the rest of the company. Innovation is an important factor in this industry, and *SAP* sees Silicon Valley as a way to access new ideas.

Questions

1. What are the main motives for internationalisation that you can identify by analysing SAP's internationalisation strategy?
2. Do you see any differences between the diverse types of activities that SAP performs in its host countries? Do motives differ by country or region?
3. How do you evaluate *SAP's* desire to move their base of operations to the United States?

Hints

1. See the company website.
2. See Handelsblatt 2013.

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