

## **Impact of Internationalisation on Business Decision-making: the Australian Experience**

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*The research considered the impact on the range of decision areas available to strategy setting for organisations internationalising part of their operations to reduce costs. The research utilised qualitative research data collected from interviews with 10 CEOs based on a structured interview guide formulated around the principal issues identified in the literature. Thematic analysis was used to extract evidence in relation to issues identified in the literature as well as new issues not currently identified. It found that internationalisation significantly reduced the range of decision areas available for strategic decision making. This affected the range of inputs to the formulation process, as well as the strategic choice options available. Organisations internationalising operations to reduce costs should increase levels of staff involvement through revolutionary strategy formulation processes, adopted more centralised corporate strategy processes and utilise a clearly differentiated and sequential relationship between corporate and business level strategies. The findings indicate that different strategy formulation processes are required for different levels of internationalisation of operations to reduce operating costs. Research into international strategy must recognize the change in the approach to strategy formulation that occurs as organisations increase their level of international operations. Future research to identify whether the currently generally adopted strategy formulation processes are adequate for all levels of internationalisation of operations should be pursued.*

**Key Words:** International Strategy and Operations Strategy

### **1. Introduction**

Market forces and international competition are driving companies to seek opportunities to reduce product and service costs in order to enable them to compete on the basis of price. Companies in the air travel and electronic equipment industries are good examples of this trend. For example, the profitable Australian icon Qantas recently considered moving its maintenance faculties offshore so as to reduce its operating costs (aircraft maintenance is a significant component of their operations). The pressure to reduce operating costs is also driving many businesses in other developed countries to spread their operations between the home country and relatively low-cost and low regulatory constraint countries, such as India and China. This has created a new business strategy environment with which its managers have little experience (De Clercq et al., 2005).

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The literature has provided managers with an understanding of how to transfer and manage international operations. No research has been conducted, however, to identify the correct strategy formulation process for enterprises internationalising parts of their operations, but not their markets, to gain cost advantages. Admittedly, international business, international business strategy and transnational organisations have existed for some time and have received attention in the literature. These business activities and organisations are, however, the result of a sequential set of planned business developments aimed at internationalising the entire business (Majocchi and Zucchella, 2003) and are not a reactive change to the operations of the organisation. Furthermore, international operations have traditionally been the result of a strategy formulation process designed to achieve levels of internationalisation. Even 'born global' organisations are the result of specific planning for such a business and are not the result of reactive operational changes (Chetty and Campbell-Hunt, 2004). Organisations with inappropriate strategy formulation processes are less likely to become transnational organisations or to survive in the international business environment.

Individual strategies are the output of the formulation process. Adopting the correct strategy formulation process for the organisation's internal and external environment is the key to correct business decision-making. The actual strategy the organisation adopts will reflect the specific position of the organisation in the market, the resources and the capabilities of the organisation and will vary considerably from business to business, even under the same environmental conditions. Identifying how the decision areas have changed for businesses which have internationalised part of their operations will enable the most suitable strategy formulation process to be identified for businesses in this situation. Decision areas are the parts of the business over which the organisation has control and can change, add or eliminate as part of the organisation's strategy. The literature identifies a range of formulation processes (eg (Markides, 2004)), but it does not consider which approach is most suited to the particular internal and external environmental conditions experienced by organisations which have transferred part of their operations to low-cost countries to enable them to compete on cost.

The focus of this paper is the strategy formulation process of organisations which have internationalised part of their operations to reduce cost and not their individual strategies. The purpose is to identify which of the decision areas normally available to the strategy process are lost through the process of internationalising operations, how their loss is connected to various levels of internationalisation of operations and whether this affects the type of strategy formulation process that might be used.

The research is expected to be transferable across industries because strategy formulation processes reflect the internal and external environmental conditions and not in the specific customers and markets that the companies service. The customer and market's influence is reflected in the strategies that result from the strategy formulation processes adopted. Thus, the strategy formulation processes identified in this research can be expected to apply to organisations operating in the external environment of cost

based competition and the internal environment of partially internationalised operations involving low-cost countries.

## 2. Literature review

Little research has been conducted into strategy formulation processes for businesses entering the international environment in the manner described above and because of the pressures described above. The basic differences in the domestic and international environments mean that strategy formulation processes suited to outsourcing in a domestic environment are unlikely to be suited to an international environment (Melin, 1992). As discussed previously, the performance of any businesses trying to make major strategic decisions outside the framework of their current strategy formulation process will suffer.

Strategy for international operations has been a target of research for the last 20 years. Research into the strategy formulation processes for organisations that internationalise only parts of their operations (such as a segment of production or marketing) in order to gain cost advantages, however, is rare. The literature on multidomestic businesses strategy is stronger, but does not directly address the impact of this type of strategic action on the selection of appropriate future strategy processes.

For example, (Ingram and Baum, 1997) examined factors influencing multidomestic business failure rates (in this case, in the sector of international American hotel chains). This research concluded that more international activity will reduce the likelihood of failure due to the benefits of increasing scales of economy and the economic stabilising effect of accessing more international markets. This research did not, however, directly consider the impact of internationalising specific activities (separating them from other related processes) or the effectiveness of the strategy process.

Even more significantly, little recent research on internationalising of operations or multidomestic business strategy has been published. One of the most valuable recent papers (Henisz and Delios, 2001) examined imitating the choices of other businesses in the same country as an explanation for location choices in the outsourcing of operations. This research was based on a comparison of entire plant location decisions made by of Japanese manufacturing firms during the period 1990-1996, however, and did not consider the transfer of parts of their operations. It does support the popularity of specific countries as locations for transferred operations (e.g. China for manufacturing and India for accounting activities) that can be observed.

Other research is much more dated, for example (Fligstein, 1985) considered international factors contributing to the selection of international business structures. Although this topic is well considered today, this research did identify a relationship between international business structure and control for international operations. The identification of this link by Fligstein supports the research question considered in this paper, although the findings should not be applied today due to the changes in the international environment since this research was conducted. Fligstein's research was

based on large organisations from 1919 to 1979. Since that time, the Internet has transformed international communications, international markets (such as China) have opened up, international trade agreements and groupings had changed dramatically, skilled labour availability has significantly diminished and even the method of international exchange rate control has changed.

In more contemporary research, Blomstrom and Kokko (1998) confirmed that multidomestic organisations need to invest overseas in order to remain competitive given the increasing levels of rivalry in the international environment. Unfortunately, this article viewed the issue from an economic perspective, rather than the impact upon strategic decision making in international organisations.

There is also a body of literature dealing with international operations management and general literature associated with strategies for international businesses, including that produced by the author (Orr, 2006), however, there is no literature classifying the strategy formulation process for businesses that have chosen to internationalise only part of their operations. The research presented in this paper will provide a valuable empirical classification of contemporary strategic management theory proposed, but not tested by Markides (Markides, 2004).

Although the limited literature available on this topic appears to support the value of exploring the question adopted for this research, it provides little conclusive background evidence for this research. In addition, it provides little guidance for the identification of the variables and areas of concern to be incorporated in the research tool. For this reason, research on methodologies for examining international business performance was also reviewed to assist with the design of the survey tool. This literature is considered in the next section.

Anecdotal evidence from discussions conducted by the author with CEOs suggests that businesses which have only internationalised operations continue to utilise strategy formulation approaches designed for domestic only operations. It is therefore appropriate to review the strategy formulation process (through examining the nature of changes to the decision areas under these conditions) to identify how these formulation processes should be changed and to provide the senior decision-makers with a better understanding of the new scope of this vital business activity (Salvato, 2003).

Businesses have now operated with aspects of their operations offshore for long enough to provide a basis for this research. The scope and extent of the current internationalisation of operations, however, has never occurred before in developed countries (anecdotal evidence from discussions already conducted with CEOs). The phenomena demands that existing knowledge be collected and formalised into new strategy formulation processes for this environment. Without the appropriate strategy formulation process, these businesses are vulnerable to making incorrect decisions about their development and their performance will be likely to suffer (Fleury and Fleury, 2003), (O'Gorman and McTeirnan, 2000).

This is not just an issue for the individual businesses concerned. Because this applies across many industries, this issue may have a significant impact on a country's entire economic performance. Poor decision-making resulting from appropriate strategy formulation processes could have a detrimental effect on a country's balance of payments. For example, as business operations are internationalised, a portion of the business income that would otherwise stay in the home country is transferred offshore to pay overseas wages (Economist, 1993). If the performance of businesses conducting this type of operation is also weakened as a result of incorrect strategy formulation processes, the impact is further compounded by a reduction in the income generated.

To identify how this development may impact upon business, we need only look to the Hong Kong business sector, which is already advanced along this path due to trade agreements with mainland China (Antkiewicz and Whalley, 2005) and the relative ease of transferring operations to mainland China. The Hong Kong case indicates that there is a real risk of loss of local business sectors (such as manufacturing) if businesses do not deal appropriately with these new arrangements (Chan and Forster, 2001). Whilst there are differences between the Hong Kong and other business environments, it is still reasonable to conclude that other developed countries may face similar risks if businesses with newly internationalised operations make incorrect business decisions.

The aim of this research is to identify the impact of these environments on an important element of the strategy formulation process - strategic decision areas (Rusjan, 2005). An assessment of how the decision areas available to such organisations are altered will enable the changes necessary in the strategy formulation process to be evaluated. Identifying suitable strategy formulation approaches for specific environmental conditions by conducting empirical research into their application will make an important contribution to this area of theory development (Markides, 2004). This project considered the research question; "Have the decision areas on which businesses focus to achieve their competitive advantage been affected by transference of operations to other (low-cost) countries?"

### **3. Methodology**

The project focused on both the change in actual decision areas, as well as their relative importance. Data was collected using structured interviews with a community of CEOs that had experienced this phenomenon and to whom the CI had access. (Griffith et al., 2005) supports the use of interviews by observing that interviews provide validity for proposed models and advance theoretical insights to the importance of specific contributing factors.

The interviews were conducted with the CEO because (whether they be managing director or a nondirectorial senior employee) they are intimately involved in or actually chair the process of strategy setting. This means that the interviewees had an extensive understanding of the organisation's strategy formulation process, the factors that affect it and its strengths and weaknesses. The study was not restricted to one particular industry so that the research could identify international strategic effects

across industries as recommended by (Baird et al., 1994). These authors cite numerous previous studies that suggest a broader interpretation of results and development of basic archetypes is possible when the research brands several industries.

The interview guide was prepared using the literature on international strategy research through interviews and case studies. (Roth and Schweiger, 1991) suggested that demographic data should include organisational characteristics and growth in activities such as sales and income, new product introduction, industry turnover and new competitors, whilst (Martinez and Jarillo, 1991), identified a range of outsourcing partner question relating to the levels of integration, amount of R&D and proportion of products sold in local markets of the outsourcing partner. (Calori et al., 2000) suggested that the research should include considerations on the international development of the industry over the past decade, future developments and international strategies in the industry. In regards to the industry, (Roth and Schweiger, 1991) also suggested consideration of general industry characteristics (such as regulation, growth rate and technology), whilst (Calori et al., 2000) recommended specific questions focus on important strategy issues such as major internal changes, reliance on competitive strategies and formalisation. Martinez and Jarrillo considered the extent of planning, control, economy and informal communication is important indicators. The specific decision areas were taken from (Orr and Sohal, 1999) research.

Interviews were conducted with the CEOs of 10 medium to large Australian businesses which have recently internationalised their operations. These interviews focused on how the decision areas utilised in their strategy formulation process have changed as a result of the internationalisation of operations. Data was also reported by the interviewees, resulting from reflection and internal analysis to identify the actual changes in the decision areas (both in content and priority) that were incorporated into their strategy formulation process.

The data were categorised against known strategy formulation decision area combinations (Orr and Sohal, 1999) and mined to identify the changes in decision areas, their impact on the process and commonalities amongst the participating organisations. (Reid et al., 2005) recommended the use of content analysis, applied to grounded theory (or models) for this type of analysis.

The interview approach was selected because of the target audience. Past research conducted by the CI has shown that CEOs are generally time poor, however, are much more inclined to participate in a structured interview as there is a perception of an immediate benefit to them from this discourse as well.

## **4. Findings**

### **Background of participant companies**

The companies interviewed were Australian manufacturers in a range of manufacturing industries, such as the consumer and food industries. Most were large organisations, however, two had less than 100 employees.

### **Background of offshore partner**

In all but one case, the offshore partner to which the operations were transferred was a locally owned company into which the Australian company bought a share, enabling the offshore partner to upgrade its facilities to meet the demands of the Australian partner. Thus, these outsourcing operations represent a form of foreign direct investment (FDI) and, as such, are attractive to the host countries, as well as further complicating the arrangements by reading the outsourcing company under the local FDI regulations.

### **Industry environmental features**

The most common features of the external environment that these interviewees experienced (all of whom had transferred some of their operations for cost reasons) were highly levels of industry rivalry with strong cost based competition. This was the major motivating force. Most of industries were growing as well, which was mediating levels of rivalry, however, it also attracted new entrants from global industries. In fact, four of the companies interviewed were major international organisations with independent subsidiaries in Australia.

### **Level of internationalisation**

Most of the interviewees indicated that they had transferred several basic manufacturing and processing activities, with the factory activities going to China and record keeping activities being frequently transferred to India. In two cases, however, substantial components of the operations had been transferred as part of a continuing process over the last 10 years. This had the results of complete the altering the nature of the Australian business and required a different strategy formulation process which was much more formalised. The most frequent formulation process for the participants appeared to be the sequential process, in which data is collected and decisions made according to a set schedule, involving various layers and be overseen by the board. Although no evidence was available on this issue, it could be concluded that levels of innovation (or at least their take up) and contributions from operations transferred to other countries (China and India) would have been reduced by this process.

### **Change in decision areas**

The interviewees were asked to identify the decision areas available to them before and after the internationalisation of their operations from a list of decision areas that the CI has compiled from the literature for use in previous research projects.

The changes in the decision areas available to these organisations varied. As a rule, however, the organisations that had transferred more of their operations had experienced a greater number of changes in the decision areas available to them. Generally, however, the changes in the decision areas were characterised by a reduction of choice. In some cases, such as the case of capacity, the decision area had become irrelevant as issues associated with excess or inadequate capacity had become the offshore partner's problem and generally did not impact upon Australian operation. On the other hand, methods of communication and control over issues such as corporate culture and product design had become much more difficult decision areas to utilise. Although some control was still available, it was characterised by tighter limitations and much longer time delays associated with implementing changes.

Interestingly, skill levels and organisation controls in relation to the transferred operations had become unnecessary decision areas for some of the interview organisations. Generally, the organisations found this a positive outcome as this decision area was often perceived to be difficult to control. Decision areas associated with inventory, materials management and time control across the operations were less frequently utilised, as the lower levels of control over the offshore partners impacted upon process controls within the organisation. Thus, strategic changes requiring alterations in these areas proved to be difficult to adopt. Most interviewees indicated, however, that the price advantage associated with the transfer of these operations outweighed the materials flow issues that they experienced.

### **Model**

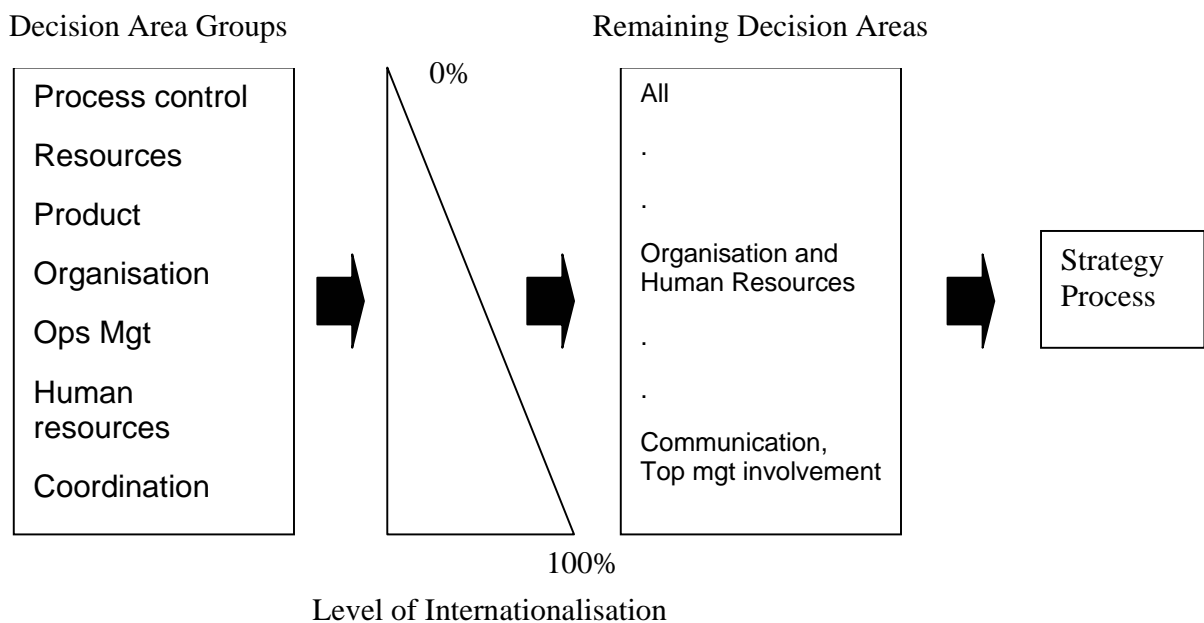
The analysis above enables the construction of the model shown in Figure 1 for the internationalisation of operations to reduce operating costs.

This model indicates that an increasing level of internationalisation of part of operations to low labour cost countries reduces the range of decision areas available, firstly in the cost management related areas (process control, resources), then in the broader output control areas (Operations Management and Product) and then in the Organisational and Human Resources areas, until only the communication and top management involvement decision areas are left.



**5. Discussion**

The findings above suggest that the range of decision areas available to organisations internationalising part of their operations to reduce costs also significantly impacted upon the range of decision areas available to them. While some decision areas became irrelevant and others moved outside the control of the organisation, both impacted on the range of inputs to the formulation process, as well as the options that were available for strategic choice. This supports the conclusion that different strategy formulation processes are required for different levels of internationalisation of operations to reduce operating costs.



<b>Decision area groups</b>	<b>Specific Decision Areas</b>
<b>Process Control</b>	Production planning and control, quality control.
<b>Resources</b>	Plant and equipment, capacity.
<b>Product</b>	Product design.
<b>Organisation</b>	Organisation design, structural decentralisation, work organisation.
<b>Human resources</b>	Labour and staffing, Role of work force, worker involvement.
<b>Operations Management</b>	Process flexibility, Process integration, supplier reliability, inventory levels, material flow, level of integration of technology.
<b>Coordination</b>	Integration of environment, top management involvement, facility management, corporate culture, time control, communication.

*Figure 1. Model for the Impact of Internationalising of Operations on Strategy Process*

Most of the organisations interviewed had transferred only a small part of operations to reduce costs. These organisations were predominately operating with a sequential strategy formulation process. As increasing numbers of decision areas became either irrelevant or the control moved from the Australian company, this strategy formulation process would produce reducing levels of benefit. As the range of controls reduced, it would be necessary for these organisations to move to more organic formulation processes, such as the revolutionary strategy process, which is categorised by high levels of input from all parts of the organisation. Following a sequential strategy formulation process when a significant number of the decision areas which would normally be incorporated were no longer available would result in a more narrow range of possible strategic outcomes, lower flexibility and more predictable market behaviours.

In addition, because the contractual nature of the transferred operations, higher levels of planning in certain areas of the strategy may also be required as more parts of operations are internationalised. In an internal environment characterised by reduced numbers of decision areas, this may be best served by a centralised decision-making process involving only specialists (for example international industry advisers and legal professionals) and the board. The requirement for different sets of strategy formulation process features would require these organisations to move to clearly differentiated corporate (and international) strategies and business unit level strategies. As the corporate level strategies would include internationalisation decisions and arrangements, there would then be a sequential relationship between these and the business unit level strategies that needed to reflect these internationalisation arrangements.

## **6. Conclusion**

This research investigated the impact of internationalising parts of operations in a range of areas available to large organisations operating in Australia. It determined that, as the amount of operations internationalised to reduce operating costs increased, the decision areas available reduced. This occurred firstly in decision areas relating to cost control, then in position areas relating to output control, followed by decision areas relating to organisational design and human resources, finally leaving only communications and top management involvement as decision areas available to organisations with 100% of operations transferred. The research also demonstrated that it was possible to produce a model reflecting the impact upon decision areas of internationalising parts of operations to reduce operating costs which could then be utilised to develop better matched strategy formulation processes.

This research has demonstrated that interesting strategy issues are developing around the internationalisation of parts of operations to reduce operating costs. Further research in this area is warranted and is likely to lead to range of new models for international strategy.

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