Successful Models for New Zealand Export Businesses

1 Introduction

New Zealand Trade and Enterprise has asked Castalia to interview a range of established and emerging export firms, and from these interviews to develop a picture of what business models help New Zealand companies to succeed internationally.

This report sets out the overall insights from these interviews. In talking to these companies, we were primarily interested in understanding if:

- There are similarities in corporate architecture that may be characteristic of successful New Zealand firms
- How these structures change from start up to maturity; and
- What lessons can be learned and applied to other New Zealand companies to improve their performance as exporters.

We begin this report by setting out some high-level observations and insights which came out of the interviews. We then explain the analytical framework we used for conducting the interviews, and set out the lessons learned.

2 Overview

Before we turn to the detail of business architecture, we would like to share some high level observations which came out of the interviews:

- Most emphatically, we were surprised by how small the international sales were, even for the iconic exporters. Even at NZ$100 million, firms saw themselves as having a very thin resource base to establish strong presence in the international markets, and perceived themselves as "battlers" using "kiwi ingenuity" and doing things on the cheap to get ahead
- A systematic global strategy appeared to be a relative novelty even for firms which have been around for a long time. We had a strong impression that even among the leading companies, there is no more than 10 years worth of experience in thinking and acting globally. This both highlights and explains the lack of global business culture in New Zealand: the leaders, who should be pulling the rest of the business community along, are themselves still in adolescence
- The businesses we interviewed appear to fall into three categories. The first, and the largest, category includes businesses whose initial development and specialist skills come from the pre-liberalisation period. Paradoxically, it is the

distortions and isolation of that period which equipped those companies with unique capabilities and products.

The second category includes firms which "needed" to export in order to survive in the domestic market.

The last category includes the emerging exporters firms. These firms emphasized that they disliked the very term "export". As one of them put it, they sell to customers all over the world and carry out various activities in different parts of the world, some of which happen to be based in New Zealand. This last category is both the most aggressive in their global objectives, and—with one exception— the least committed to a New Zealand base.

Overall, the key theme that came across from all the interviews is the very important role of the personal ambitions and appetite for risk of the key owners and managers.

3 The Framework

The primary purpose of the interviews was to understand the range of business models—also called business architecture—that firms can employ in entering or expanding into the global markets. By business architecture we mean a combination of decisions about branding, distribution, manufacturing, design arrangements, partnerships and financing, which together provide a unique structure for deriving the greatest value from operating internationally. No single solution is the best for all situations. However, we wanted to identify some key elements of business architecture which may have been particularly useful.

The key elements of business architecture are summarised in Figure 1, where we align them with the main strategic issues facing firms:

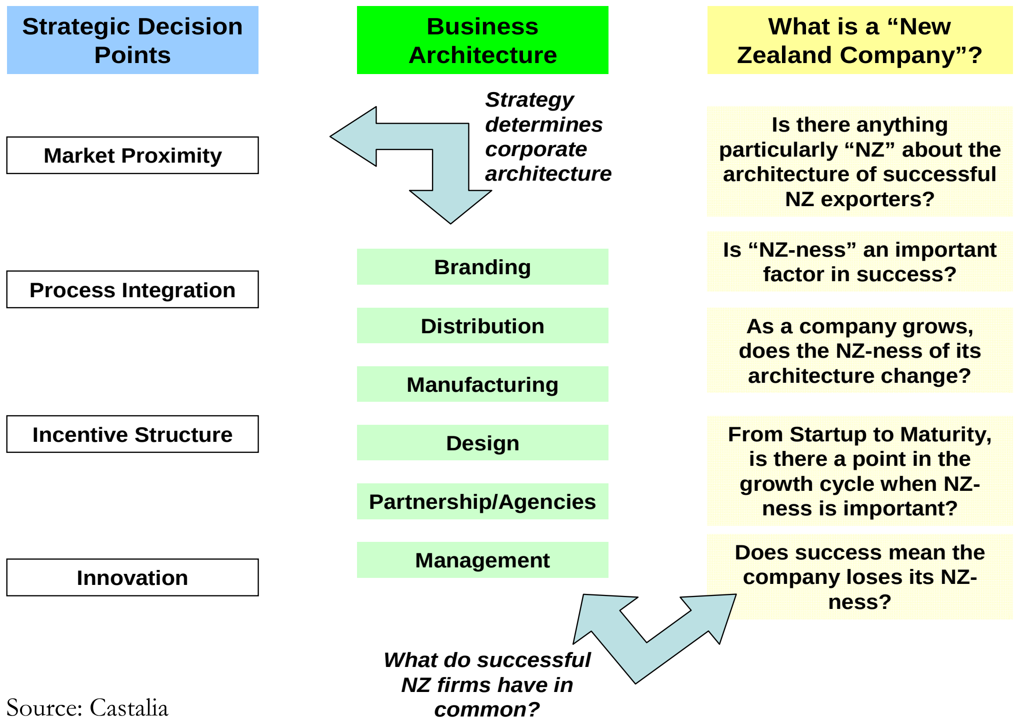
Market Proximity – *does it matter where your markets are?*

Process Integration – *How important is process control from design to distribution? How do you manage information flow to and from the market and within the organization?*

Incentive Structure – *Does a particular capital structure contribute to success?*

Innovation – *Is technology an important component of success? Where is the firm on the price versus quality landscape in its competitive environment?*

Figure 1: Framework for analysing the factors that lead to success



Source: Castalia

The issues which enter into the design of the business architecture include:

- **Branding:** One of the key issues is whether "New Zealand" should enter the brand, and how it is reflected in the brand. New Zealand has a clean green image and is well regarded in food processing and tourism. It does not have a reputation for excellence in other sectors. For some firms, it is therefore an advantage to trade on the New Zealand image in its branding, but for others firms it is better to adopt the mantle of a European, American or Asian firm
- **Distribution:** New Zealand firms which operate at a distance from their customers need to get the distribution arrangements right. Firms can place their products with existing retail outlets or chains, which are selling a range of competing brands of the same or complementary products, or they can sell their products entirely through their own outlets. Much depends on the nature of the product, the degree to which it is important to maintain the branding all the way through to distribution, and the kind of feedback that the firm needs to get from its distribution channels
- **Manufacturing:** Integration between manufacturing and other functions is another key element of a business model. Does manufacturing need to be integrated with the location of the firm (New Zealand), location of its main market (where quick and flexible response to customer needs may be valuable), or should it be outsourced where it is least cost. Some products are better manufactured in New Zealand because the costs of obtaining raw materials are lower, but in other cases manufacturing may need to remain in New Zealand because its location is essential to the iconic nature of the product. Alternatively, it may be cheaper to manufacture in a lower cost country and distribute to other export markets from there. That choice may be the result of labour representing a high proportion of the costs of the product. If manufacturing offshore is called for, there are questions of whether to

establish a new operation or to purchase an existing local operation and adapt it

- **Design:** The designers need feedback from customers in the export markets on the features that attract them to the product. That could mean that a design function is best located in the market. Otherwise, some way would need to be found for New Zealand based designers to obtain that market feedback
- **Partnership/Agencies:** In some countries firms are able to operate better in partnerships with local firms or through agencies, than with their own offices or branches. In other countries, it may not be a disadvantage to operate a branch office or wholly owned subsidiary. It depends on the way of doing business in each country
- **Finance:** Entry to a market often requires significant investment. Given the risks involved, a large proportion of the capital funding may need to come from equity. When additional capital is raised as equity, there is, on the one hand, some surrender of control, but, on the other hand there can be a gain in expertise and technology from an equity partner located outside of New Zealand.

Looking at how successful firms develop to deal with these issues, means examining their business architecture. In particular, we asked interview participants for their insights and experience on:

- How successful New Zealand products and services are ***branded***?
- Whether control of ***design*** trump the importance of having that function operating close to market. In other words, how much of product design and development is done in New Zealand and why?
- How ***manufacturing*** and ***distribution*** processes are organized?
- How are firms ***financed***? Are ***managers*** also owners? Have capital markets in New Zealand been sufficient to support global growth?

We also focused on **whether there is anything particularly "New Zealand" about the architecture of successful New Zealand global firms.** Is "NZ-ness" an important factor in success? As a company grows, does the NZ-ness of its architecture change? From startup to maturity, is there a point in the growth cycle when NZ-ness is important? Does success mean the company loses its NZ-ness?

4 Lessons

In this section, we set out the specific lessons we have drawn from the interviews.

4.1 Branding

One common theme which came through is the emphatic view from all interview participants that there is no point in entering international markets unless the firm has a unique point of difference to offer. Branding is simply a tool for making the market understand that unique point of difference.

There were a number of aspects to this observation:

- Most participants noted that New Zealand firms which grow up in the domestic market tend to be flexible jacks of all trades, doing lots of different things. This is the opposite of what is required in the international markets. To succeed internationally, it is essential to do less, but to do it well. In other words, going international requires considerable self-discipline from the business people to concentrate on a few things. One of the main risks that was highlighted during the interviews was of spending too much time and money chasing too many tails.

- Many participants also emphasised that manufacturing quality was **not** part of their branding simply because quality was the baseline that was taken for granted from all market participants. As one interview participant commented, you should not bother going international unless you have your production and logistics issues sorted out and can deliver what the customers expect. "We are not in the world of quality any more". One company though noted that its ability to deliver sustained quality—every unit in the batch will work—was essential to their branding, and allowed them to differentiate from emerging Asian manufacturers.

Overall, all interview participants emphasised the need to have a defensibly unique story, which resonates with customers and encourages purchase. It was interesting to see, however, how wide the range of such unique stories is, and how often the story is not what one would have expected to hear.

For example, one company markets itself as having unique specialist knowledge of organising out-sourcing and sub-contracting for the manufacture of raw components. These components are relatively cheap, but are essential to the smooth operation of the relatively expensive machinery. Original equipment manufacturers require low costs offered by Asian manufacturers, but the level of reliability and product design those manufacturers can not achieve. This is where the company comes in. They work with the original equipment manufacturers to design the parts they need, design production processes, and then sub-contract manufacturing to plants in another country. Interestingly being from New Zealand does not enter into their branding: customers do not care; what they look for is specialist reputation and experience.

On the other hand, another company, a specialist high-tech manufacturer—emphasises New Zealand in their branding story. The reason for this is that all their competitors at the high end of the market are from the same country, and the New Zealand story is about taking advantage of the preference for a real alternative, which includes a feeling that the other manufacturers, might be colluding.

Another company tries its New Zealand origins invisible in its offshore market. Again, this goes against what one would have expected *a priori*: surely, its New Zealand product is unique. However, the company markets to supermarkets, not to final consumers. In essence, once a supermarket chain adopts a product line, it can be expected to sell. Supermarkets are extremely concerned about logistics and on-time delivery. They are nervous about dealing with medium-sized New Zealand manufacturers—even if they have in-market distributors—because they feel that distance increases the logistical risk. By promoting itself as a local business and dissociating itself from New Zealand, the company supports its reputation with the supermarkets.

The companies which were focused on becoming international from the beginning seem to have the most sophisticated way of weaving elements of New Zealand branding with their global branding.

Overall, the lesson for other exporters appears to be that they should be careful not to jump on the "clean, green New Zealand" band-wagon, even if the products they wish to sell relate to food or life-style. Rather, they need to understand who their customers are, and what really makes a difference to those customers. Many interview participants emphasized the value they got from external brand consultants in formally working through their branding strategy.

4.2 Distribution

Most interview participants emphasized the importance of distribution to export success. Manufacturers companies, in fact, described export success as essentially being about penetrating into the distribution channels, or creating your own.

Manufacturers that have been around for a long-time described their earlier forays into export as being based on selling to local distributors, who then wholesaled their products. These forays turned out to be largely unsustainable and unsuccessful. Most companies interviewed emphasized the importance of setting up their own distribution channels, which in some cases involved acquisition of the previously independent local distributors.

One company described export markets as falling into three tiers:

- Tier 1 consists of English-speaking countries, such as United States, Australia, United Kingdom, Canada and South Africa, where it is easy to deploy in. They tend to distribute in those countries using local offices which report directly to New Zealand head-offices. Those offices employ a mix of local and expatriate New Zealand staff
- Tier 2 consists of developed countries, but with different cultures. These were described as being "fundamentally Western, but with quirks". Western Europe falls into this category. Given cultural diversity, even larger New Zealand exporters can not escape the need to operate through a network of local agents in these markets, but with considerable direct involvement from directly employed market managers, who are based either in New Zealand or in a Tier 1 country
- Tier 3 consists of developing countries, such as the Middle East, Russia, Ukraine. In those markets, it is essential to have a local partner under some kind of franchise arrangement.

Other interview participants involved in the manufacture of consumer goods, with variations, similarly divided the world into three tiers, and had similar approaches to distribution. The main reason why going through distributors was seen as a fall back, rather than a preferred option, was the fact that most distributors carried a wide range of products, and had little motivation to push the products from their New Zealand suppliers. Moreover, going through distributors increased the risk that the New Zealand firm would lose control over how it wanted to brand and position its product in the market. Some firms took this even further. One company deals directly with retailers, and deliberately sells only to a small number of highly specialized retailers, who can give adequate coverage to their products. They refuse to sell to mid-market retailers.

By contrast, companies supplying inputs into other manufacturing processes emphasize the need to deal with their customers directly in all markets, as a way of understanding customer needs and being able to signal that they don't just sell inputs but overall solutions to their customers' issues. For example, two companies highlighted their efforts to organize technical and scientific workshops for their current and potential clients, run by New Zealand-based specialists. One company also markets directly, as their technical and marketing staffs need to understand the clients' technical and business requirements in order to sell successfully. The challenge is to have the company's R&D people understand what is driving their customers.

Scale was the biggest complaint when it came to distribution. Firms felt they needed to sell directly to customers, but the costs of doing so were too high during early stages of their expansion. For example, many interview participants described the cost of setting up a local office in the United States or United Kingdom—a couple of million dollars a year—as being crippling. The main lesson which we took from the discussion of distribution was that this was the key area of risk taking—one can not dabble in export sales, and firms needed to commit sufficient resources, even if the amounts involved seemed high at the time, to establish themselves in the international markets.

One feature which surprised us was that few firms considered the possibility of attracting external equity investors to fund their export strategy. Rather, they felt they needed to make a go at it initially within the levels of funding that their balance sheet could support.

We were also surprised how few firms used internet for distribution. In fact, a number of companies emphasized that internet sales were the last step, not the first step in their distribution strategies. There were two reasons for this. First, internet sales are essentially repeat sales. Customers need to get to know the products through retail stores, but are then happy to repeat their experience via the internet. Hence, there is no point in developing internet sales channels ahead of the "bricks and mortar" distribution strategy. Second, the logistics of supporting internet sales are quite complex, and it is typically too expensive to ship out of New Zealand. Hence, international internet sales only become viable once the companies have sorted their logistics out, and maintain inventories in the target markets.

4.3 Manufacturing

In general, few interview participants saw manufacturing in New Zealand as a long-term option, or as being in any way important or desirable for their image abroad. At the same time, there was no stampede to exit manufacturing in New Zealand simply to access lower costs elsewhere. Rather, the factors which seemed to matter were:

- Importance of integrating manufacturing with R&D. Where the two were tightly integrated, outsourcing to other countries was more difficult and often more expensive. For example, one company's main competitive advantage is in the design of the manufacturing processes. These are developed closely with the manufacturing team. Under these circumstances, outsourcing is not an option. Similarly, another company's main IP is in its manufacturing process, which needed to be closely controlled
- Importance of protecting IP. In some cases, manufacturing in-house is seen as an essential element of protecting IP which can not be patented or trade-marked
- Importance of short production runs. Two companies manufacture in New Zealand because flexibility through short production runs are a key part of their strategy. New Zealand manufacturers are highly experienced and competitive when it comes to short production runs. They find it difficult to compete in large-scale manufacturing.

Overall, the main lesson in this area is the need for potential exporters to think through their overall value chain, and to decide where and how manufacturing fits into it. For example, one company commented that manufacturing was only 10 percent of the total cost. The key issue was how to integrate New Zealand design, imported materials and offshore assembly in the most efficient way.

4.4 Design

The importance of design (broadly including product and process development) was a key theme which ran through the interviews. For the old manufacturing companies, the transition to export success was essentially a transition towards being focused on design. For example, in its early days, one company did not employ a single designer. Now, the company directly employs more people in design than in manufacturing.

The same message came through again and again in every interview: significant investment in design and R&D, most design and R&D carried out in New Zealand, and design being one factor which would likely continue to link the company to New Zealand, even after most other activities have shifted off-shore.

While most participants complained about the difficulty of finding enough good designers in New Zealand, they also highlighted design capability as one of the country's strengths. In some cases, it is precisely some degree of isolation from other markets which made New Zealand design valuable. For example, one company noted that the "conversation" in the main international market centers highly homogenous. The Company's design brought freshness into the marketplace by not being part of that "conversation".

However, most firms were also pragmatic about the need to employ specialist design expertise with specific market knowledge in the target markets. Having commented on the advantage of New Zealand isolation, one company also made the point that they made little headway into an offshore market until they hired local experts, because no-one in their New Zealand team understood that market.

4.5 Capital

As we mentioned, interview participants appeared to exhibit a form of "cognitive dissonance" in thinking about capital. On the one hand, most complained about lack of resources for expansion, on the other hand, there was little interest in bringing in further capital to drive growth. One company, for example, took the extreme position of setting an objective of entirely financing growth from its own positive cash flow. Some other companies commented that their balance sheet was not strong enough to support the kind of acquisition strategy they wanted to pursue, but had no plans to do anything about it.

Overall, the focus on organic growth appears one of the limiting factors for export performance. Interestingly, the companies themselves reported acquisitions—including the purchase of distributors—as being critical to their success.

A number of interview participants commented that they saw bringing in external capital as the end-game: becoming big enough to list on an international exchange, such as NASDAQ, and hence achieving attractive p/e multiples for their shareholders.

5 Conclusion

Overall, the interviews highlighted the need to target business architecture to each firm's particular markets, and the over-riding need to see such architecture as constantly evolving and being refined. Perhaps the main message from the interviews is that new exporters really do need to focus on business architecture. As one participant commented, there is a tendency among New Zealand business people to think about product, and then about how to get it to market. Most started with capabilities—"we can make this"—and then moved to focus on procedures and structures.

By contrast, sustained international success requires the opposite: the need to think about the overall strategy, which includes identifying the unique point of difference in the product and in how it is going to be delivered to the customer, then building an overall architecture around it.

In other words, there is no single model—or even a range of models—that we can extract from these interviews, but there is a single mind-set and worldview. It may well be that NZTE can assist in the promotion of that worldview.