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Sample Business Report: UK SME's Market Expansion in China

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Executive Summary

This is report discusses the Chinese UHT milk market for children aged between three and eleven years. The UK Company chose China because of the vast population and high supply of UHT milk. A report from Statista (2018), indicated that UK dairies processed approximately 1,300 million liters of milk in 2018. The company wants to expand its business and the selected country is China. China is an attractive destination for most international businesses due to its vast market, developed legal system, and growth potential. The market is analysed using Porter's five forces of competitive position analysis, which include a threat of new entrants, competition, bargaining power of buyers, bargaining power of suppliers, and availability of close substitutes. The company intends to use the reputation of home country that is known for transparency, quality, and reliability. Trade barriers that affect a market entry in China include tariffs, government regulations, and subsidies. Essential ethical issues that the UK SME should consider include customer engagement, corporate social responsibility, human rights, and culture. The company should take into consideration the cultural preferences such as cultural awareness, Guanxi, face, and the people factor. Exportation is the best internalisation method because of the minimum cost and risk involved.

Contents

1.0 Introduction

International Business can be defined as the exchange of services, goods, capital, knowledge, or technology across national borders at a global scale. In this trade, two or more countries engage in cross-border transactions of goods and services (Daniels et al., 2009, p. 234). Progressive firms and businesses often expand by moving away from their country of production to other countries to establish international markets and attract new customers. These firms seek to tap on various international events and cultural diversity across the world other than focusing on the domestic market. This report investigates the viability of the firm's entry into the Chinese market to sell UHT milk targeting children aged three to eleven years. The paper will entail the industry background, significant business drivers, different trade barriers, business opportunities, and uncertainties. Besides, this paper will present strategies for expansion, ethical considerations, and cultural preferences to be considered by the company upon entry into the Chinese market.

2.0 Industry background

SME UHT milk business in the UK depends on vast dairy farming, an industry that is ranked the eleventh largest in milk production globally ("UK dairy industry statistics," 2021). There are approximately 14,000 dairy farms in the United Kingdom with 1.8 million cows (Statista, 2018). About ninety percent of the cows in the UK are of Holstein-Friesian breed, while the rest are Guernsey, Jersey, and Ayrshire. The annual milk production in the UK is about 13.5 billion liters. A report by Statista (2018), indicated that about 229 million liters of UHT milk were sold in the United Kingdom in the year 2018 (Statista, 2018). Further, the report showed that UK dairies processed approximately 1,300 million liters of milk the same year. These statistics demonstrate that the agricultural sector is thriving in the UK as it contributes about £4.5 billion to the economy ("UK dairy industry statistics," 2021). The firm must consider various factors and market conditions to predict industry trends. These factors include technology, government policies, competition, consumer behavior, and new product development.

UHT milk market in China is growing rapidly, thus attracting industry players to invest in the country. Over sixty percent of milk consumed in China is UHT milk (Fuller et al., 2006, p. 207). The increase in urbanization is projected to raise the UHT milk demand in China. A study indicated that about 90 billion RMB of UHT milk was consumed in China in 2017 (Clarke, 2017, p. 106). There are Chinese companies that produce UHT milk in China such as Yili, Mengniu, and Bright Dairy (Meyer, 2008, p.13). However, these supplies do not satisfy the consumer demand, and therefore, attracting foreign investors.

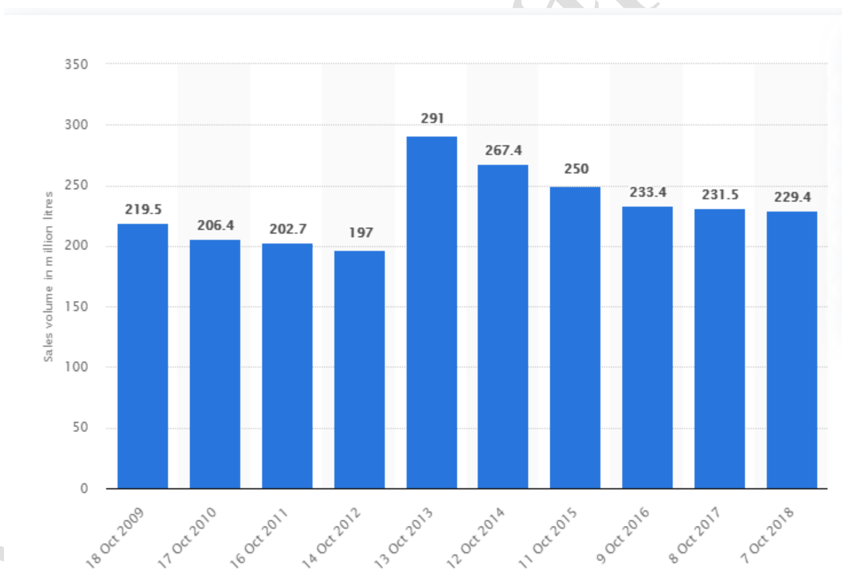

Figure 1: UHT milk sales volume in Great Britain from October 2009 to October 2018 ("statistics Portal," 2018).

As illustrated in figure 1 above, 229 million litres of UHT milk were sold in the United Kingdom in a period of 52 weeks ending in 7th October 2018. The demand peaked in 2013 where

291 million of UHT milk were sold. These figures indicate a stagnating demand in the UK, hence the need for the company to venture into new markets such as China.

3.0 Business Drivers

China is the most attractive location in the world to conduct business. Some of the primary factors that attract international investors to China include a vast market, developed legal system, growth potential, and relatively low cost of labour. The firm must understand the business environment in China in order to establish itself effectively. Porter's five forces of competitive position analysis will help to understand the business environment and trend in the country which the company intends to explore. This model also helps to understand the competition level, strengths, and weaknesses and enables the UK SME to enhance long-term profitability (Vignali and Vignali, 2016 p. 96).

3.1 The Threat of New Entry

The force of new entrants into the market affects a firm's power and profitability. The less money and time that competitors will spend to enter the new market and gain a competitive advantage, the more an established firm's position can be weakened significantly. An industry with strong barriers to entry such as patents, economies of scale, and government policies is ideal for existing companies since new entrants will face considerable barriers of entry (Obstfeld et al., 2017, p. 106). Besides, existing firms can charge higher prices and negotiate better terms. Therefore, for the UK SME, low barriers in the Chinese market will imply lower barriers of entry. The company must develop market entry strategies to overcome any barriers. The Chinese existing firms are threatened by new entrants because of the low capital needed to enter the market. Moreover, the government does not regulate the market stringently, the customer switching cost is low, and firms do not focus on customer loyalty.

3.2 Intensity of Competitive Rivalry

A large number of competitors in the industry as well as the existence of substitutes weaken the power of a company. There are 2 major players are Inner Mongolia Yili Industrial Group and China Mengniu Dairy Company. Customers and suppliers look for a firm's competitors if they can offer lower prices. On the other hand, low competitive rivalry gives a company greater power to set terms of deals and charge high prices to achieve more profitability (Hill, 2018, p. 87). The firm must differentiate its UHT milk through branding, using small sizes, and packaging with shapes that stands out such as the original Fabbri packaging.

3.3 Bargaining Power of Suppliers

This factor is influenced by the number of suppliers of the milk, their uniqueness, and the cost that the company can incur to switch to another supplier. Fewer suppliers to the industry make the firm rely on the supplier. Consequently, the suppliers will have more power to drive up input costs and gain an advantage in the business. On the other hand, low switching costs between suppliers will help the firm to lower costs and increase profits (Griffin & Pustay, 2010, p. 109). Since the company has international suppliers, the bargaining power of suppliers is low as the firm can switch freely from one supplier to the next.

3.4 Bargaining Power of Buyers

The bargaining power of buyers is affected by the number of customers that the company has, the significance of each customer, and the cost that a firm would incur to find a new market or new customers for its products. A company with several, smaller, and independent buyers will have a leeway to charge higher prices and increase profitability. The power of buyers is achieved when the customers can pay low prices for high-quality products (Obstfeld et al., 2017, p. 108). This situation is detrimental for an organization because it results in low revenues. The company has several potential buyers who are looking for unique product based on the UK's reputation as a country of quality, transparency, and reliability. Potential customers may not necessarily be willing to pay higher prices due to the availability of close substitutes. However, the customers may be willing to pay market rates.

3.5 The Threat of Substitutes

Substitute services or goods that can replace that of a given company pose a threat. A firm that produces goods and services that are unique and with no close substitutes has more power to raise prices and negotiate more favorably (Griffin & Pustay, 2010, p. 109). When there are available substitutes, the buyers will have the power to avoid a company's products and services, and hence the firm's power is weakened. The company must consider the available milk brands in the Chinese market to devise ways to penetrate the market. Other firms that produce UHT milk in China include Yili, Mengniu, and Bright Dairy (Meyer, 2008, p.13). The presence of UHT from other companies in China will threaten the UK's SME profitability and power to determine prices. The company should position its products against the substitutes by conducting sustained advertising (Porter, 1998, p. 589).

4.0 Trade Theories

International trade theories are used to explain the exchange of goods and services across national borders. Various trade theories drive businesses in the international markets including comparative advantage, absolute advantage, and mercantilism, among others. The absolute advantage was selected for analysis in this presentation since it is effective in driving business effectively. Absolute advantage emphasizes the ability of a country to produce goods more efficiently than other countries. According to this theory, international trade should not be hindered by government policies or regulations (Czinkota and Ronkainen, 2010, p. 132). This model implies that trade should be allowed to flow naturally depending on the market forces. The UK has a considerable agricultural sector that can produce enough milk for processing and exportation faster and at a cheaper cost than China. Therefore, the company should specialize in UHT milk production since it has that advantage (Clarke, 2017, p. 94). The firm can achieve higher profitability by taking advantage of the reputation and favorable conditions in the UK. Besides, most dairy farms in the UK have pedigree herds that produce milk with higher fat percentage ("UK dairy industry statistics," 2021). Therefore, the company can produce high quality milk more efficiently than other competing countries in the industry, resulting in an absolute advantage.

5.0 Trade Barriers

Trade barriers refer to foreign government policies, regulations, or practices that unfairly restrict exports. Some of the trade barriers commonly employed include quotas, tariffs, licensing, regulation, and subsidiaries.

5.1 Tariffs

Tariffs are taxes imposed on imports, and it is intended to raise revenue and limit international business. A tariff increases the price of a good beyond the market equilibrium (Swift, 2016, p. 212). This tax decreases the demand for foreign products by consumers and eventually reduces its supply. Moreover, tariffs are used to shield domestic employment by restricting the importation of foreign products and personnel. When the production cost per unit and foreign labor tend to be cheaper than in the target country, then a company can decide to import foreign products. The government protects the domestic products from foreign competition by imposing taxes on imports. China applies tariffs of between 10% and 20% on importation of dairy products (Chandra, 2016, p. 40). A report by International Dairy Foods

Association (2019), indicated that American dairy products being exported to China face 25% tariff.

5.2 Non-tariff Barriers

These are barriers other than tariffs that the government use to restrict trade. One of the most common non-tariff barriers used in China is regulation.

5.2.1 Regulation

Government regulation is another trade barrier that would hinder the UK SME from expanding to China effectively. The government has established regulations and rules that governs the expansion of business in the international market. The purpose of trade regulation is to protect local companies against foreign competition, ensure transparency of transactions, and prevent any form of discrimination in the global market. China Food and Drug Administration (CFDA) demands foreign manufacturing companies to register with Chinese authorities. Further, CFDA requires brand formula importers to provide brand recipe and the supporting research (Hoogwegt Group, 2021).

5.2.2 Subsidies

Subsidies are incentive that the Chinese government use to encourage domestic producers and reduce costs. This Chinese policy is a barrier to international business because foreign companies will be unable to compete price wise in similar market. Domestic companies benefit from direct cash subsidies, VAT rebates, and discounted utility rates. Subsidies enable Chinese firms to sell their products at cheaper prices, making foreign companies unable to compete.

6.0 Ethical and Social Issues

Corporate Social Responsibility (CSR) is an essential aspect of marketing strategy. A company must convince the citizens and other stakeholders that the business has a positive impact on society. In the era of market globalization, the business should create a positive image in the global market. CSR by the UK SME can improve their national and business brand in the emerging market significantly. Instituting desirable business practices among international customers will help multinational businesses to achieve effective subsidiary operations in the foreign market (Morrison, 2006, p. 462). Maintaining CSR will help the UK Company to attract local consumers, the community, and eventually, achieve profitability in the new market. Further, maintaining CSR will improve public image, and consequently make the firm's products more appealing to the consumers. CRS in the global market enhances social values and brings about a competitive advantage.

Another ethical issue that the company should consider is human rights. The company should take care of the welfare of employees by respecting their values, religious beliefs, and freedoms. Despite the availability of cheap labour in China, the firm must strive to treat them fairly by offering favorable compensations. Further, the UK SME should ensure the employees work in a conducive environment. Respecting the beliefs and the culture of the Chinese customers will inspire trust and loyalty (Morrison, 2006, p. 457). The company should brand its UHT milk in a manner that suits the Chinese culture and appeals to the local consumers.

7.0 Cultural Preferences

Culture refers to the shared beliefs, values, social behaviors, and customs of specific people or an organization. Cultural differences are vital barriers in the Chinese market, and foreign companies must understand and respect China's culture to trade successfully (Hofstede et al., 2010, p. 93). A company can have people from different backgrounds that represent cultural diversity. Despite the firm having its organizational culture, it should first consider the cultural preference of the customers in the international market. The UK SME must understand different aspects of Chinese culture such as religion, ethnicity, age, gender, income levels, and profession (Kirkman et al., 2006, p. 303).

National culture will be a vital point of reference in designing organizational values and business practices. Further, the firm must consider aspects of national identity such as symbols, rites, and language.

The UK SME must learn “Guanxi”, which is the network and interaction. Guanxi is a critical business strategy in China that helps foreign organizations to reduce failures, risks, and setbacks. Customers in China prefer to deal with people who trust and know (Swift, 2016, p. 34). Therefore, company must adopt this culture and start to build interpersonal relationships to ease business operations. Moreover, the concept of “face” is significant in the Chinese market. Face referring to public reputation, dignity, and pride (Hofstede et al., 2010, p. 66). Therefore, the firm must carry out business with utmost sincerity and honor to the local people to gain respect, loyalty, and a positive attitude in business negotiations. Furthermore, the UK SME should train their employees to adopt the local culture as a strategy to attract customers.

The people factor is another essential feature of culture in conducting business in China. The local people are essential because they provide a ready market and help to sustain the business. Therefore, the company must consider the behavior of the Chinese customers and endeavor to understand their preferences and choices based on cultural aspects. The UK firm should embrace cultural diversity to tap into different customer bases to achieve competitive advantage (Chung, 2011, p. 122). Chinese observe their culture strictly, and therefore, the UK UHT milk firm should aim at satisfying the local people. The company should study customer behavior to help in setting a product value that can be presented to the parents of the targeted children. Therefore, keeping the potential consumers of UHT milk at the top of the firm's mind is a crucial consideration when entering the emerging market.

The UK SME should build cultural awareness to help in making more insightful and considered decisions while avoiding chances of making bad decisions. Cultural awareness reduces cultural myopia and minimizes mistakes and wasted time. Companies that venture into foreign countries become unsuccessful due to failure to understand the local culture. The firm should train its employees to be aware of people's daily routines, language, code of ethics, and code of social relationships (Arcuri, 2007, p. 67). Through this training, the company will understand what suits its customers in China and win their trust and loyalty. The marketing strategy, product offerings, and brand messaging should reflect the value system and local culture in China.

8.0 Expansion Methods

8.1 Exporting

Exporting is a well-known method of entering an international market that enables a company to pursue an emerging market. The company can sell the UHT milk that is sourced from the home country in the foreign market. By using this method, the UK SME will avoid the cost of establishing a subsidiary in a foreign country. The company will enter into a contractual agreement with retailers, marketing agencies, and distributors (Obstfeld et al., 2017, p. 96). However, the success of the UK SME will depend on appropriate and rigorous marketing in China. An advantage of exporting is that it allows fast entry into the new market with fewer risks. One disadvantage of this method is that it has a high cost of transportation coupled with tariffs. These costs impact the profitability of the company significantly.

8.2 Licensing

The company can consider licensing agreements with foreign companies to get into the international market. This method is favorable when the firm wishes to take limited legal and financial risks. The licensing agreement will allow the Chinese company to sell products from UK SME or use its intellectual property such as trademarks in exchange for a royalty fee. Licensing primarily allows a firm in the target country to use the property of the licensor. Licensing has the potential to provide huge returns on investment because of the limited cost and risk involved.

8.3 Joint Ventures

In joint ventures, companies enter into a temporary business association where they share risks and revenues. The business partners outline the terms of the venture in the agreement. The joint venture increases the economics of scale of operation by reducing individual risks. The method enables the partners to share risks and resources required to get into the global market. This method gives a company some degree of flexibility that could not be achieved by a sole proprietor investment.

8.4 Recommendation

The most suitable internalisation method for the UK SME is exporting. The reason is that this method has limited cost and risks involved in entering the foreign market. Further, the company is not sure of the stability of the Chinese market. Therefore, exporting will give it an opportunity to monitor competition and market trends in China. Nevertheless, the firm can obtain cheap labour from Chinese suppliers and distributors.

9.0 Conclusion

The primary purpose of international business is to increase the volume of sales and revenues. The UK Company wants to expand its business to the foreign market in China targeting children between three and eleven years. It was established that UK sold 229 million liters of UHT milk in 2018. There is a high demand for UHT milk in China that the existing firms cannot satisfy. The firm intends to use the UK reputation as the land of quality, transparency, and reliability to enter the Chinese market. Some of the business drivers that the UK SME should consider include the threat of new entrants, bargaining power of buyers, bargaining power of suppliers, availability of close substitutes, and competition. Absolute advantage focuses on the ability of a country to produce goods more efficiently than foreign nations. Some of the barriers that may hinder effective expansion in China include tariffs, government regulations, and subsidies. Ethical issues that the UK SME should consider include corporate social responsibility, human rights, and culture. Besides, the company should focus on cultural preferences in China such as Guanxi, face, cultural awareness, and the people factor. The company should use exporting as the method of expansion.

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