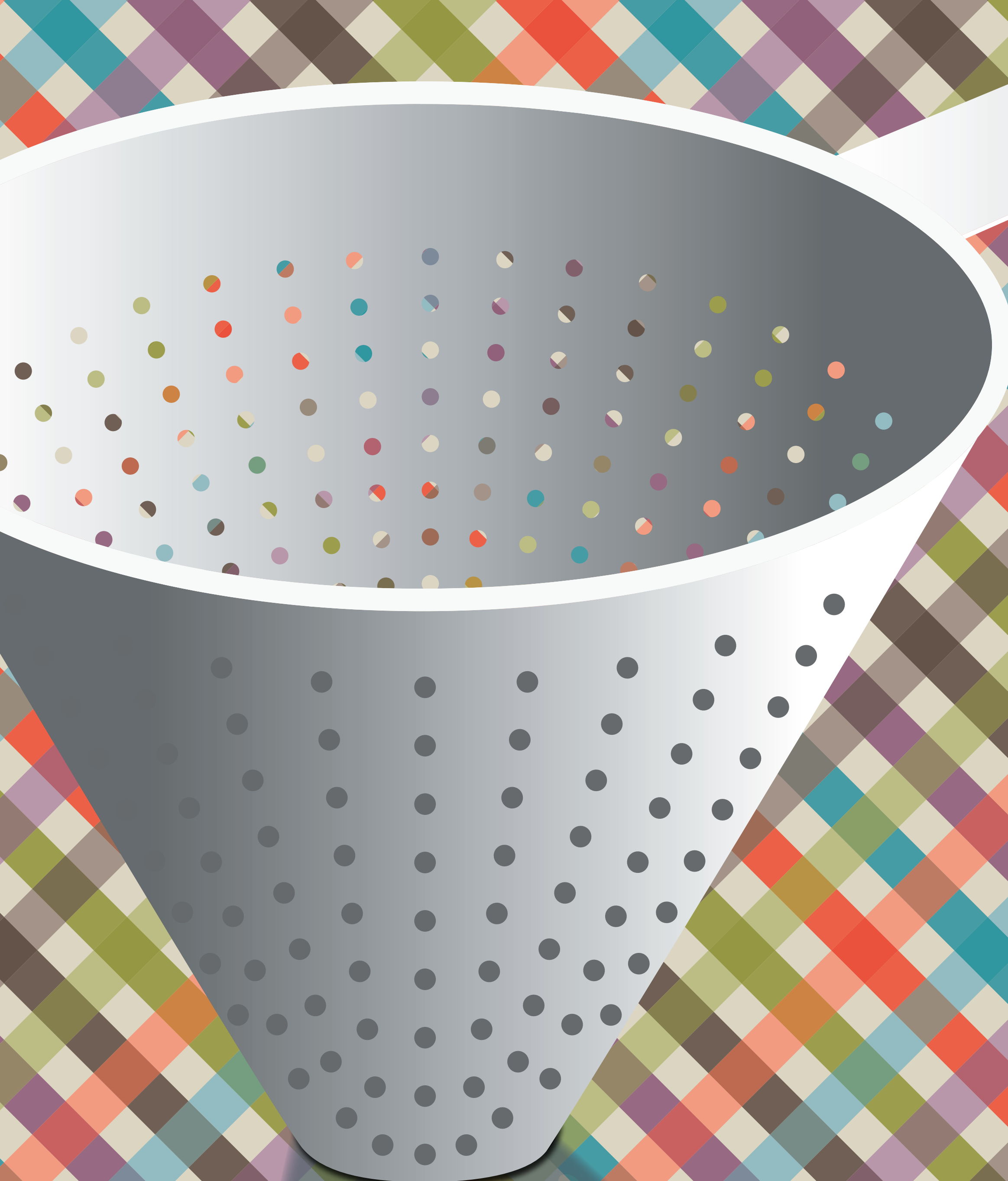

Recipe II: The Radio Model

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On Strategy & Competitiveness

10 RECIPES FOR ANALYTICAL SUCCESS

II The Radio Model

Ingredients

- ✓ *Entry strategies*
- ✓ *Entry barriers and retaliation*
- ✓ *Gate openers*

This recipe emerged when I was working on my Ph.D. dissertation. I had been fascinated by the field of industrial organization (IO); not the type of game-theoretic approaches that later emerged, but the old school of structural characteristics of competition, not the least of which were entry barriers. IO scholars had long understood that market imperfections lead to supranormal profits, which was seen as a negative to free-market economists, but of course read as a positive to strategy scholars. The building blocks of IO had been beautifully translated into the Five Forces Model by Michael Porter, which was published in his acclaimed 1980 book *Competitive Strategy*.

Four Simple Questions

A central theme in my thesis was about market entry. As I began to teach market entry strategy, I summarized the analysis in four key words: *WHY* would the company enter a new market in the

Figure 2. The Radio Model

first place? What would the company *BRING* to that market? What would the entrant *MEET* in the new market in terms of different market characteristics and competition? And lastly, *HOW* would the company go about entering the market? The first letters of these four key words form the acronym "WBMH". I think it was my brilliant colleague Dr. Peter Hagström who once pointed to the four letters and said they reminded him of the call letters of a U.S. radio station, something along the lines of, "You are now listening to WBMH KISS-107" – and I began to refer to the simple model as the Radio Model, and have done so ever since. By giving these little models names, I have noticed that students learn them much more quickly, and when I meet old students, they can often still refer to them by name, even after many years.

WHY?

So now let us go through the four lead words. The first question – "Why?" – you should pose to anyone – even yourself – who is proposing to enter a new market. Let us divide markets along the three dimensions: new geographical markets (internationalization), new upstream or downstream markets (vertical integration), and new related or unrelated product markets (horizontal integration) (see figure below). Examples of entry would be when EMI (a gramophone company) entered into the CT scanner space in the medical technology field in 1972, or when Ericsson sought to place its switching equipment in the U.S. market in 1986, and later its mobile communications equipment in Japan in 1992, selling digital switches to the new player Tokyo Digital Phone (TDP), or when Sony launched its first game console, the PlayStation, in 1994.[21]

If you put the firm on top of the model, you get an overview of the boundaries of the firm; smaller firms are often "single-box" firms, whereas larger firms often look like amoebas (shifting their arms in and out and slowly moving over the space over time). Some firms expand into new market territory, i.e., spreading their wings like Virgin, while others leave markets altogether, or outsource, and thereby contract, as Nokia did when selling its handset business to Microsoft and concentrating instead on telecom infrastructure.

Entry or exit decisions along the three dimensions are central to the strategy literature. The standard answers in the literature include "scope economies", "synergies", "transaction costs" or sometimes "complementarities". Such economic advantages can be real, but they should not just exist in theory but rather should actually be reaped by the firm. By being in both industry A and B simultaneously, an entrant potentially gains a competitive advantage vis-á-vis firms only active in one of the two markets. Let's return to this thought in a moment.

A totally different answer to this question is that there are no advantages of combination, but the market is an attractive one and the firm wants to diversify assets (rather than the capital markets

diversifying through portfolios of assets). Ask your finance professor and she would clearly state that firms should not engage in such diversification – leave it to fund managers! There could also be other explanations for entry, as explained by agency theory: the CEO wants to gain influence by building diversified corporate giants, a strategy not fully in line with the owners' preferences. Whatever the reasons, start by asking the question again: WHY do we want to enter? Ask it once, and then ask it again!

Common answers from the person proposing the strategy, typically the CEO, include: "This is a way to grow"; "It is a very large market" or "Penetration is very low, so we can expect the market to grow rapidly". Then ask again, why do we want to grow in the first place – is this our ultimate goal? And is the best way to grow to enter another industry or market? And is growth profitable? And when is it profitable?

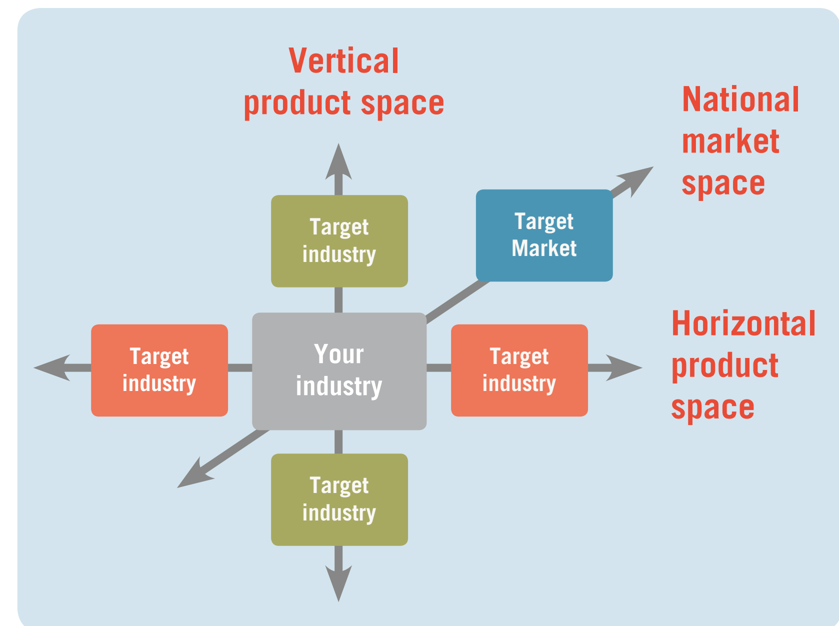

Figure 3. Three Dimensions of Entry Strategies

Why?

Profits!

…but how?

…and when?

and fit with overall strategy?

Figure 4. Asking the First Question

The other common answer is "To make more profits!" Then ask again, how will this lead to more profits? And now we are back where we began: "We will make more profits through synergies where 1+1 = 3" (or other scope economies or complementarities). Then we need to figure out where those synergies will come from, such as in increased market power (translated as higher margins) vis-á-vis buyers, or that by being in the two markets we can learn and innovate or decrease transaction costs. Entry into new geographical markets (within a company's established line of business) is often motivated by scale economies as products (or strategic parts of a product) can be exported, or fixed R&D costs can be spread over larger volumes. It is important to have an idea of exactly how the entry move will translate into increased profits, and also when this is likely to happen. In summary, the most commonly stated advantages include 1) cost efficiencies, 2) synergies and cross-border innovation, 3) risk diversification, 4) oligopolistic imitation, 5) following customers into new markets, and 6) gaining market power through complementarities.

To help you identify the answers as to *WHY* a company should enter a new market, here is a checklist.

- ❑ **Cost efficiency – Economies of scale/scope**
  - **Sharing manufacturing**
  - **Sharing components**
  - **Sharing R&D**
  - **Sharing marketing & sales (distribution)**
- ❑ **Lower transaction costs**
- ❑ **Cross-border synergies (2+2 = 5)**
  - **Complementarities**
  - **Increased market and bargaining power**
  - **Innovation through combination of resources/capabilities**
- ❑ **Tapping – a lead market/cluster, a place to learn and innovate**
- ❑ **Risk diversification (different business cycles)**
- ❑ **Oligopolistic reaction – move ahead or follow the leader**
- ❑ **Monitor competitiors in their home base**
- ❑ **Follow customers into new markets**
- ❑ **Prestige and status of global presence (basis for differentiation)**
- ❑ **Subsidies, tax breaks**

Figure 5. Asking the First Question – WHY: A Checklist

BRING?

The second question relates to what your firm will "*BRING*" to the new market. In a portfolio setting, there is no link between Industry A and Industry B, and thus you don't "bring" anything but sheer capital investment. However, when entry strategies build on some notion of connectivity and advantages of the A+B combination, the chances of success are related to what your firm actually brings. Often firms bring technological, financial or management resources and capabilities. The more the firm can bring to the table – and assuming there is interest in what is being brought (see *MEET*) – the larger the potential for success. However, be aware of the risk of "carrying coals to Newcastle". And if you decide to actually carry coal to Newcastle and want to make it a sustainable business proposition (and not just an effect of short-term inefficiencies or exchange-rate fluctuations), you'd better come up with some good answers to the issue of BRING, because there's already plenty of coal in Newcastle.

- ❑ **Products and concepts**
  - **Comparable to locally offered**
  - **Improved**
  - **Unique new offer**
- ❑ **Organizational competencies**
- ❑ **Brand**
- ❑ **Patented technologies and firm-specific capabilities**
- ❑ **Manufacturing capacity**
- ❑ **Capital**

Figure 6. Asking the Second Question – BRING: A Checklist

MEET?

As we move to the third question – *MEET* – things are starting to get a bit more exciting. By entering a new market, different actors will be judging this move as anything from very favorable to very unfavorable.

As you enter a new market, you will encounter a plethora of new laws and regulations (just imagine a foreign banking or insurance market!), new norms, a completely different business culture and so on. In the international business literature, this has been conceptualized as the "liability of foreignness". This would also apply to a firm entering a new product market or vertically related industry. The firm will also encounter new buyers, and again, the literature from the field of international marketing is full of cases of firms experiencing new demand as they enter new markets. And new demand characteristics are often hard to grasp. A classic international marketing case was the entry of Polaroid into France, where the firm did not understand why it was almost impossible to sell their "ugly" instant cameras – of course superior in many technological respects – to French families. As the case goes, in France the camera had long been regarded as an impressive status symbol with aesthetic appeal of its own. The looks were more important than the technology.

Another set of Meet issues relate to host competition. As the firm enters a new market, it enters into a new industry structure. So what about entry barriers? How about reactions from incumbent firms? And what about the vertical structure of the host industry?

By using the Five Forces model to analyze the competitive landscape of the host market, one can go a long way in anticipating the cost of entry and what will happen once the firm is actively engaging with host buyers (the model involves vertical structure, entry barriers and industry rivalry). Competitive entry barriers (not based on regulation) include:

- Economies of scale and scope
- Accumulated experience among incumbents
- Capital investments

- ❑ Host regulations
  - Technical standards
  - Tariff and non-tariff trade barriers
- ❑ Host culture and norms
  - CSR issues
- ❑ Host demand characteristics and segments
- ❑ Host five-force model
  - Rivalry
  - Other entry
  - Power of suppliers and buyers
  - Substitutes
- ❑ Host industry structure & reactions
  - Host entry barriers
  - History of retaliation at entry
  - Host vertical structure
- ❑ Host cluster environment
  - Networks and relationships

Figure 7. Asking the Third Question – MEET: A Checklist

- Brands and trademarks
- Access to distribution and service networks
- Personal networks
- Patents and innovation capabilities
- Unique access to factors of production (key staff, subsidized capital)

You will face such barriers irrespective of whether we are talking about geographical, horizontal or vertical entry. Let's take the example of entering into another national market. Since we are already in the same business, we can probably enter from a similar vantage point (access to skills, minimum efficient scale, etc.), and thus the cost of entry should be lower than for a brand-new entrant (often referred to as "de novo entry"). Another route to get past the fortress walls is to find a partner inside the fortress, or what we refer to as "gate openers"[22]. Such gate openers would welcome foreign entry for several reasons: gaining access to foreign technology and products from foreign competitors in order to better position themselves in the home market (horizontal gate openers), or gaining access to vertically related competitors outside the home market (vertical gate openers). The first case in point would be when manufacturing giant General Electric (GE) decided to source microwave ovens for the U.S. market from a Korean competitor (part of an outsourcing strategy), and the second case was when Sears, as an American distributor and retailer, sourced Korean microwave ovens. We have seen numerous such cases of Japanese and Korean entry strategies into European and U.S. markets in everything ranging from consumer electronics (appliances, cameras) to copy machines and cars. Developing partnerships with gate openers will eliminate some of the barriers to market entry.

This is the first stage of assessing the issue of "Meet". In the next step, you should examine incumbent firms in more detail and follow their actions as you begin to penetrate the market. How will they react to your initial entry? Will they notice at all? And after some time, when you have established a foothold, how will these reaction patterns change? Be open to learning.

It is not uncommon for incumbent firms that perceive new market entrants as a serious threat to start a price war to deter their entry, or initiate special bonus programs among distributors to raise the bar for newcomers, or spread false rumors to others in the industry, or lobby the government for trade protection. These "tar and feather" strategies can be quite vicious as a newcomer raises the ladder onto the fortress wall. In other cases, retaliation is negligible, particularly in early phases of entry when the "threat" has not become well known or imminent.

Host industry
Vantage point
De novo entrant
Gate opener

Figure 8. Three Entry Routes Into a New Industry

Your own notes:

- Product offer in new market
  - Segments to enter
  - Narrow or broad range
  - Product adaptations, certifications
- Access to distribution in new market
  - Logistics
  - Location of units
  - Internal vs external chains
- Brand policy
  - Own brand
  - Private label or OEM (local brand)
  - Marketing, Communication, PR
- Establishment of host resources
  - Sales, service
  - Manufacturing
  - R&D, scanning
  - Sourcing
  - Training
- Entry form
  - Green-field
  - Acquisition
  - Alliance or partnership
  - Franchise
- Local leadership
- Linkages to other corporate units
  - Component sharing
  - Sharing of back office services

Figure 9. Asking the Fourth Question – HOW: A Checklist

HOW?

The final piece in the recipe is the *HOW* question. How do we go about entering a new industry or market? Should we try it out first with a limited product scope? How do we formulate the product offer? Should we set up distribution or acquire a local brand? There are a number of decisions involved in setting the entry route, and the checklist below will hopefully provide some guidance.

In summary, the Radio Model, based on the four simple questions, is a good way to craft your strategy before you enter a new market (and the checklist can also be used as a framework to ask whether you should leave a particular industry or market). In my experience, the "Why" is rarely asked, but is often an implicit assumption, such as "We need to grow" – but why? Is it good for profitability to enter market X? How will it be profitable? And when can we expect profits from growth?

BRING is often overstated by corporate headquarters. It is easy to sit at home, often with a long track record of healthy market shares and profitability, and exaggerate your competitive advantages. But are we sure we are not offering "Trabants"? If this indeed turns out to be the case, you will notice as soon as you enter a new market. MEET can be challenging, and often the entrant has to go through a learning journey post entry[23]. Then we turn to the last question of HOW. This is often where management starts. The how questions are straightforward. Should we enter on our own or with a partner? Should we export goods into the market? Should we acquire one of our distributors? In this manner, management often starts here instead of first asking the three other questions.

There are many issues involved in crafting and carrying out a strategy for entering a horizontally, vertically or geographically related industry. There are also important interdependencies between the four parts; what you bring to the table depends on what you meet; how you should enter also depends on what you bring and what you meet, and so on. Some of my experiences using this recipe are shown in the following figure. And good luck with cooking up your entry strategy!

Over time, the answers to all four questions will change. The initial entry has its unique dimensions as you try to get a foothold in the new market. As you continue penetration (unless you decide to pull out after heavy initial losses!), you need to adapt your strategy: what did we really Bring? What did we really Meet? And How should we go about achieving further penetration? At some point, you have to think about overall fit – how does this investment into a new vertically, horizontally or geographically related industry or market fit into our overarching corporate strategy? Should the new unit be integrated (to allow for synergies or EOS) or remain semi-autonomous? One way to structure this analysis is to make use of the following table.

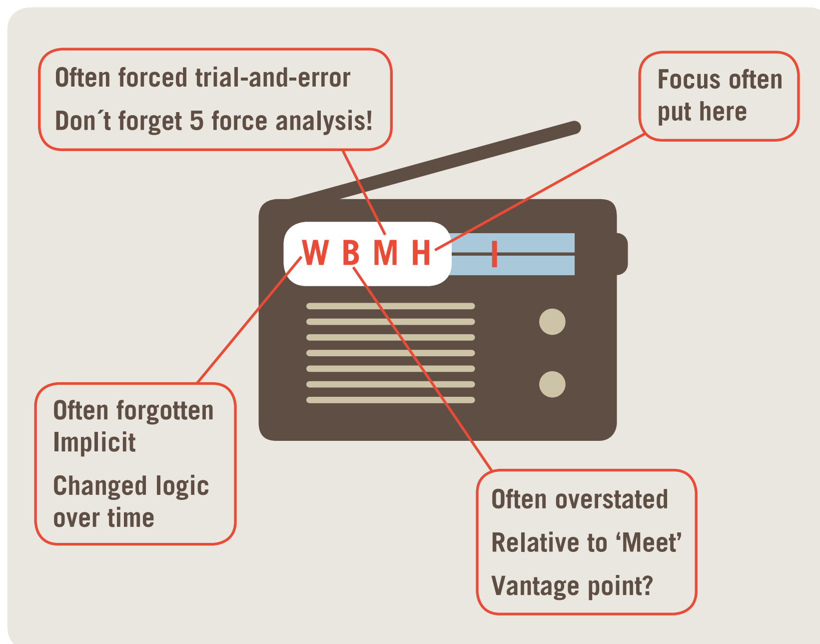

Figure 10. Summary of the Radio Model

Radio model	Initial entry	Penetration	Integration
Why?			
Bring?			
Meet?			
How?			

Figure 11. Entry, Penetration, Integration: A Checklist

Your own notes: