

# [Theories of international expansion of mncs](https://assignbuster.com/theories-of-international-expansion-of-mncs/)

The objective of this project is to examine the international business environment in the Oil and Gas industry, so as to provide better strategies to Shell Company based on the findings and research. These will allow Shell to further improve its performance and growth, through the different strategies used, and at the same time, overcome the challenges that they are facing. The aim is to provide a clearer picture on how Shell can continue to expand into market to ensure sustainability and global competiveness.

It will attempt to explore on how Shell can increase its international competiveness and its international growth in the most effective manner, and at the same time, evaluate other alternatives that would be most beneficial for Shell to pursue in international growth.

## Methodology

The methodology applied to achieve results for this project is through an analysis on the oil and gas industry, as well as to assess Shell to improve on the strategies used, and at the same time, further expansion into international business. Through the study of the general, industry and internal environments, we will be able to understand the performance of Shell’s challenges faced and the different kinds of strategies that the company can apply in the future.

## 1. 2. 1 Data Sources

The data sources utilized for this paper will be mainly secondary data collected from various sources such as, internet, journals, books and research reports.

## LITERATURE REVIEW

## Theories Of International Expansion Of MNCs

In the studies of international business strategies, researchers went on to examine the macro-level indicators of various countries. It includes economic, social, cultural, political and legal environment, and trade policy for the purpose of market segmentation and target market selection, however, there are some whom identify other factors such as firm size, prior experience and management orientation, and also, the mode of entry (Ahmad, 2008). Spada (1999), states that the key determinant of successful expansion is extent to which, a firm optimally matches its resources with the environmental contingencies.

According to Cui (2001), many multinational corporations (MNCs) are given the opportunities to go beyond their home countries into markets, thus, it is able to maintain growth and sustain long-term viability. Many firms would expand further when they are able to acquire better intangible assets such as managerial skills, patent protection, technology or when firms gain in economics of scale (Gleason, Mathur, Mathur & Harr, 1999). However, Doukas, Pantzalis and Kim (1999) concluded that the results appear to be inconsistent with the predictions of the internationalization theory, in the sense that MNCs can also be influence by the external rather than only the internal assets.

Through empirical studies, Tseng (2006) mentioned that entering a foreign market may lead to some risks because of the major difference in customer preferences and as a result, management researchers are in search of new ways to tackle problems, approaching new challenges, and to manage complex multinational corporations effectively. However, another stream of research suggests that internationalization is a gradual process, in which MNCs go through different stages of incremental development. Due to lack of familiarity with foreign markets continuous, knowledge development serves as the most important tool in reading uncertainty and perceived risk and largely determines the level of firms’ resource commitment (Hafstrand, 1995).

Accordingly to Martin, Swaminathan and Mitchell (1998), a form of international expansion can be through foreign direct investment as it helps to represents a particular useful context of assessing the competitor and community influences on organization expansion. In addition, Luo (2000) also states that foreign direct investment, joint ventures or wholly owned subsidiaries are often used for expansion, because the resources collected are often information intensive, tactic and organizationally embedded.

Studies of various multinational corporations in various industries and country markets suggest that effective strategies that deploy the firms’ competitive advantages and that fit the environmental contingencies have a great impact in the internationalization and expansion of firms. As firm’s success and longevity are increasingly defined as its ability to learn and adapt to the changing environment in a timely manner, the evolution theory offers a unique alternative perspective for analyzing MNCs’ global market expansion. A major advantage of the evolutionary perspective is its focus on the market environment as a dynamic stochastic process and the performance of individual firms as a function of the underlying causes and a consequence of the combination of competitive conditions, market structure and strategies of individual firms.

## Competitive Advantage In The Oil & Gas Industry

In today’s business, a firm that is able to sustain profits that exceed the average for its industry, the firm is said to possess a competitive advantage over its rivals (Bruce, n. d), and therefore, it is said that the goal of business strategy is to achieve a sustainable competitive advantage. According to Piccoli and Ives (2005), prediction on the successful creation of impediments to replication of strategy by competitors is one way that helps to protect competitive advantages. On the other hand, Anderson, Fornell and Rust (1997) added that, strategy to improve competiveness can be done through the combination of services and products.

In the oil and gas industry, it consist the activities of exploration, production, development, refining, storage, transportation and marketing of oil and gas. In order to remain competitive, corporate strategy is aimed to help industry to establish a profitable and sustainable position against forces that determine competition (Shinno, Yoshioka, Marpaung & Hachiga, 2006). Strategy is said to be the creation of a unique and valuable position, which links up different set of activities that allows firm’s to compete for other position in the industries (Min, 2005). Nevertheless, there are still other factors that we need to discover in order to remain competitive.

Basically in an organizations, operation management researcher is to find out how they can improve and hence, increasing the growth of company (Pagell, Krumwiedez & Sheu, 2006). Costs remain competitive when a firm is able to deliver the same benefits as competitors but at a lower cost. Customer satisfaction also plays a big role in achieving competitive advantage. Based on many empirical researches, it demonstrates that if firms are able to satisfy each customer, economic returns and market value would improve (Gonzalez, Camara and Gonzalez 2009). Manager tends to focus more on their direct rivals and thus, they had failed to notice other elements in the competitive environment.

According to Shinno et al. (2006), it is state that competiveness and competitive strategy are largely influenced by the internal and external environment. Strengths, weaknesses, opportunities and threats (SWOT) is effective as it allows us to attain systematic approaches and support for successful industry strategy formulation. However, Porter five forces also helps to identify the importance factors that we need to take into consideration for an industry, and on the other hand, allowing us to adjust accordingly and thus remain competitive (Porter, 1980). Porter’s model examines on the external factors of the environment, and competition take place when the five threatening forces are weak (Carle, Axhausen, Wokaun and Keller, 2005).

Although oil and gas industry is riddled with risk, it is still able to increase its growth by sustaining competitive advantages. Profitability is essential as it helps the industry to measure both the efficiency and the values that customers place on products and services. We must also be careful in maintaining a practical view of the potential for environment (Mansgi, Opaluch, Jin and Grigalunas, 2005). Analyzing the different strategy used can clearly allow us to examine the environment in a better view.

## Foreign Direct Investment

Foreign Direct Investment (FDI) take place when firm invests directly in facilities to produce a product in a foreign market, or when a firm buys an existing enterprise in a foreign country (Hill, 2003). In addition, Barrel and Pain (1997), citied in Gugler and Brunner (2007) suggested that FDI has an important impact in creating competiveness. However, foreign market entry is a process fraught with complexity for firms with unfamiliar operation settings. Thus, many firms ponder carefully whether to go abroad and which market to enter, taking into account of various factors. It is also said that firms go abroad only when expected benefits outweigh expected costs (Guler and Guillen, 2010).

Lee (2010) states that as trends move towards regionalism and integration in the economy proceed, FDI serve as an important resource for development in many developing countries. However, economics effects remain indistinct due to the relationship between the type of economics where multinationals choose to invest and the successive performance of multinationals. In order to set the appropriate FDI policy, it is very important to understand the role of FDI in an economy. On the other hand, Vita and Kyaw (2009) examined that it is advised for developing countries to rely on FDI as it is the most favourable form of capital inflows for boosting economic activity.

FDI into a nation can also be done through different ways. The three principal forms include joint ventures, acquisition of assets in a county, and Greenfield venture which helps firm to build its own business or manufacturing facilities in a county (Lau and Bruton, n. d). It also includes other studies on the dichotomous choice involving green-field investment and acquisition, and hence, acquisitions are sometimes combined with mergers (Darkow, Kaup and Schiereck, 2008) as a distinct entry mode and joint ventures are included in the green-field investment. However researches Papyrina (2007) points out that decision on entry mode still depends on the firm’s and environment’s characteristic.

Through various studies made by researches, it has been said that FDI has an important impact on competiveness. Results shown that through the form of FDI, expansion of multinational enterprise activity has grown at a faster rate than most other international transactions (Blonigen, 2005). As mentioned by Golub (2009), gaining benefits from FDI can be done through employment creation, managerial skills, technologies, etc.

Based from past researchers pertaining the economic development and sustainability, the door for developing countries has been left open by FDI promising the possibilities to gain more successes. Being part of the contributor of development, FDI promote global effectiveness and targets evolution of economic system. FDI can be categorized into different investments and manager must be able to select the suitable nature of firm and to where it will be investing. Based on empirical evidence, FDI contribute to long-term economic growth and thus receive a wider database specifically for developing countries.

## OVERVIEW OF COMPANY: SHELL

## 3. 1 General overview

Royal Dutch Petroleum Company and Shell Transport and Trading Company were two public parent companies of a group of companies known collectively as “ Royal Dutch/ Shell Group”. However in 2005, Royal Dutch Shell became single parent company of Royal Dutch and Shell transport, the two former public parent companies of the Group. Shell oil is wholly owned by Shell Petroleum Inc, and it is one of the largest petroleum companies in the United States. It is active in both the upstream (exploration and production) and downstream (refining) segments of the industry. The company also makes and markets chemical and provides logistical and consulting services.

## 3. 2 Product and Services

Being in a huge oil and gas company, Shell oil has developed expertise in a wide variety of management and technical fields. Shell subsidiary was formed in early 1995 to sell this expertise to companies in the petroleum industry and also, in other industries. It offers services in the subsequent fields: information technology, human resources, general accounting and procurement and invoice processing.

As shown in Figure 3. 1, it shows the services that Shell is engaged in are oil and gas exploration and production, transportation and marketing of natural gas and electricity, marketing and shipping of oil and chemicals.

In the upstream, it searches for and recovers crude oil and natural gas, liquefies and transports gas ad operates the upstream and midstream infrastructure as to deliver oil and gas to market. As for downstream, it manages Shell’s manufacturing, distribution and marketing activities for oil products and chemical.

## 3. 2. 1 Types of basic strategies

Shell Oil’s overall strategy was to restructure its operations and reduce its costs. Shell reduced its staff, and at the same time, reshaped its natural gas, refining and chemical operations through joint ventures. This strategy allows Shell to reinforce their position as a leader in the O&G industry and provide competitiveness and at the same time, helping to meet global demand in a responsible way.

## 3. 3 Performance of Shell

The company revenue was recorded at of $278, 188 million in the financial year ended December 2009 (FY2009), and as compared to FY2008, there is a decrease of 39. 3%. However the operating profit of company was $21, 178 million in FY 2009, and thus a decrease of 58. 8% as compared to the report with FY2008. The net profit was $12. 518 millions in FY2009, however compared to FY2008, there was a decrease of 52. 4%. These can be seen in Fig 3. 2, showing the income data and comparing it with the records of the past five years.

The world felt the acute effects of the global recession, and cause the oil demand to drop. Nevertheless, by the end of 2009, unprecedented economic-stimulus packages turn around the irresponsible growth of key Asian nations, which appeared to turn around the global economy. With the economy recovery, global demands resume its growth, in step with increasing population and rising wealth in developing countries.

## 3. 4 Current activities of Shell

In terms of market capitalisation, operating cash flows and O&G production, Shell had achieved and is now one of the world’s largest independent oil and gas companies. In order for Shell to sustain strong operational performance and support continued investment, it depends on the core countries that have available infrastructure, expertise and remaining growth potential. The heartlands include Australia, Brunei, Canada, Denmark, Malaysia, the Netherlands, Nigeria, Norway, Oman, the UK and the USA. However, it is to expect Qatar to become part of the heartland in the coming years.

Shell had also brought new oil and gas supplies on steam from major field developments. It is said that Shell are investing in growing its own gas-based business through LNG and GTL projects. They are working on the projects and building one of the world’s largest GTL projects in Qatar. And at the same time, Shell went on exploring for oil and gas prolific geological formations that can be conventionally developed. Similarly, these can be also found in Gulf of Mexico, Brazil and Australia. On the other hand, Shell also went on exploring for hydrocarbons in formations, such as low permeability gas reservoirs in the USA, Canada and China, which can only be economically developed by unconventional means.

## 4 PETROLEUM INDUSTRY

## 4. 1 Overview of Industry

To identify the overview of international petroleum industry, it include all companies that are involved in the oil and gas production chain as shown in Fig 4. 1 (PetroStrategies Inc, 2010), from the owners of the resources to operators, drillers, equipment manufactures, facility constructors, service providers and engineering companies. In the integrated oil and gas sector, many companies are engage in the exploration and production of oil and gas (upstream), as well as one other major activity, in oil refining, transportation or marketing (downstream).

## 4. 2 Issues

The petroleum industry has faced significant challenges that have helped define and shape its policies and procedures, with both positive and negative results. It is under increased scrutiny by consumer, industry participants, and outside interest as a result of price volatility, political uncertainty, changes in the industry structure, and the environment. All these trends affect everyone as oil prices reaches new heights. The issues facing the industry is increasingly complex due to the shift in supply and demand, investment uncertainty and risk, the role of future trading and speculation, and the emergence of new technologies. However, this would require expert knowledge and guidance in understanding the impacts on all who are affected.

It is further emphasized and concluded that highly competitive business environment of the industry, together with international regulations and other institutional arrangement continue to challenge companies and their strategies will be able to operate efficiently and effectively.

## 5 ANNALYSIS OF THE CURRENT ENVIRONMENT

## 5. 1 External Environment

The external factors are linked with forces in a firm’s external environment, which can lead to new growth opportunities (Cui, 2010), and at the same time, it can also come in the form of threats. New opportunities take place when firms can exploit differences between countries and geographical regions and achieve economies of scale in broadening the size of the markets serve. It could also stabilize earning across markets as economic growth cycles fluctuate between countries. A threat, on the other hand, could be a new competitor on the market weakening the position of the existing firm. As a result, the external factors lead to expansion that is either offensive or defensive in nature.

## 5. 1. 1 General environment

In order to analyse the external environment of a firm, we uses PESTEL framework. This model divides the macro-environmental forces into six categories: political, economic, social, technological, environment and legal. PESTEL helps us to evaluate how these forces affect the firm and it assists companies in the selection of attractive markets and appropriate entry mode. PESTEL aims to evaluate business environment in which Shell operates by analyzing the constantly changing external factors that influence company.

Political

The political environment has large impact for international growth and investment choices as it operates under demanding political conditions worldwide. The control of oil and gas resources is becoming increasingly political as many countries want to have control of its own resources. However, governments still have the authority to distribute licences as they prefer. Political risks in the petroleum industry arise from sovereign risk referring to the policies and decisions of host governments or conversely, the absence of effective regulation and governmental intervention. Furthermore, wars and local conflicts are part of the political risks oil companies are facing. OPEC plays an important role in the political arena of the oil industry and it ensures stabilisation of oil prices, and is willing to take action if the price of oil decreases, by reducing their supply.

Economic

A major issue in the global oil and gas markets is the influence of the oil and gas prices. The prices of oil and gas fluctuate over time as a result of changes in the demand and supply. Demand for petroleum has been more stable as it is influence by factors such as political instability, the availability of energy substitutes, petroleum prices, economic growth and weather conditions. Hence, it has increase despite the high levels of the oil price. However, the supply fluctuating more than demand, is influenced by access to resources, production costs, weather conditions, government polices and geopolitical risks. Climate changes and damages caused by natural disasters have affected the supply of oil and gas. Although oil prices have been record high in the past few years, many of the integrated oil companies have struggled with lower profitability, even if the net income of oil companies are currently increasing due to the high levels of oil prices, the future profitability of the industry is threatened as a result of increased cost inflation. The oil companies are concerned that if oil prices stop rising or even fall, the increased costs will further pressure their margins. Hence, due to the inflationary pressures in the industry, oil prices well above historical levels are now required for the continued profitability of many international oil companies.

Social

Social forces are ways in which companies in the industry are influenced by changes in society. Social environment of global oil industry change in demographic due to the ageing of baby boomer would cause workers to retire and thus affect oil companies. However, securing skilled human capital has become increasingly challenging and there is currently a war for talent within industry. There is a demand for petroleum increase due to the world’s population, and strong economic growth and industrialisation in emerging markets. Many improvements in the living standards in emerging economies have increased their energy consumption. These lead to significant higher CO2 emissions, and consequently an increased concern for the environment.

Technology

Technological and infrastructure have major impact on the profitability of global oil companies. Developing new technology and learning how to use it would help to increase exploration success rates thus improving oil recovery rates and reducing costs oil. Moving towards worldwide technology can assure a reliable supply of O&G at a reasonable price in years to come. The leading IOCs are most active in applying innovative concepts; however R&D investments among NOCs are growing. On the other hand, investing in infrastructure is also necessary for O&G companies, as it provides more cost effective solutions. Infrastructure for long-distance sea transport in the form of LNG, are needed to secure future supply in developing countries.

Environment

In the oil and gas industry, the most important elements are to reduce the emission of greenhouse gases and the development of renewable sources of energy. O&G exploration and production cause sever damage to the environment, furthermore increased energy consumption has resulted in large emission of greenhouse gas. The most challenging areas of environmental damages are the CO2 emissions from production, discharges to water, solid and other wastes, and contamination of land and groundwater. In order to reduce greenhouse emission, O&G companies develop and implement advance technologies to address these issues. Fuel cell technology and advance fuels, the reduction and elimination of venting and flaring and enhanced use of natural gas are other efforts that are put in place. Hence, continuing of partnerships between the public, governments, environmental organizations and the industry are needed for further progress.

Legal

In the oil and gas companies, there are many regulations and policies that government impose on. National protectionism is a large obstacle to trade when one or more companies in the industry are profitable. In achieving the same standards, guidelines and best operating practices developed by oil industry associations and nongovernmental and intergovernmental organizations (NGOs and IGOs) constitute the major efforts to achieve uniform standards and operating practices across the globe. However, absence of practices can reduce the negative impacts of oil exploration and production. Competition is vitally important to the heath of the world’s economies and with the help of antitrust, the enforcement authorities’ responsibility is to help prevent anticompetitive behaviour and collusive activities. The goal is to prevent the activities that are likely to reduce competition, and hence create higher prices. Licensing in oil industry grant the right to explore and produce oil in the particular territory. Therefore, oil companies have to adapt to whatever licensing system prevailing in the particular area of interest.

## Industry Environment

In order to determine the degree of rivalry in the oil industry, Porter’s five forces framework are being used to analyse the strength of the forces shaping the industry. This framework takes into account the competition among customers and suppliers as well as corporate rivals; it is also useful for analysing the change and the structure of the global oil industry, and to observe which of the forces that are most influential today. Moreover, the analysis aims to identify the relevant industry opportunities and threats, which enables firms to match these with their resources and capabilities, and hence gain a competitive advantage.

Rivalry among Existing Firms

Oil and gas industry is considered a competitive industry as it is highly attractive and has a large number of players. In order for an industry to remain competitive, it is crucial to be financially strong. There are several reasons that caused competition between competitors in the industry to be rated high. The industry growth would create huge competition between companies in bidding for contracts in new areas and at the same time, maintain quality so they are able to get the contracts extended. Secondly, companies that are of equal size would definitely try to out perform each other so as to gain a larger market share. Access to a large and cheap labour force will bring them the necessary manpower to new locations to develop the infrastructure in the countries they explore for oil. Lastly, service characteristic is where people would choose based on the convenience and the pricing that would satisfy them.

Threat of New Entrants

In the past, entry to industry was much easier as there were fewer companies involved, but today, many established companies exist in the industry. There are large economic of scale, as inventory for oil refiner and trader and venture upstream operational cost leads to cost advantage over any new rival. As for Capital requirement, it is crucial to be financially strong as it requires huge financial resource in manufacturing facilities. Unavailability of records and indefinite financial stability is a reason that may deter new companies from entering the industry. Government set strict rules and regulation, limit entry into industry through licensing requirement by restricting access to raw material. High switching cost machinery are being used, the companies are reluctant to switch to another machines as it involves high training cost.

Bargaining Power of buyers

Most of the oil and gas producer integrate downstream through owning of petrol station, and thus, buyers are the final consumer. Hence it is a necessary source of energy for the transport and electricity. Buyers have no influence on price and they need to accept the market prices at any point of the time. Hence if the oil prices are high, end consumer would suffer most. Oil prices in recent years increases with factors such as availability of energy, substitutes, economic growth and weather conditions. It has become difficult to substitute oil with other resources as it involves large switching costs for buyers. Due to geopolitical problem in Middle East and Russia together with nationalisation resource, supply of crude oil is controlled, causing high price in demand over supply of oil. In addition, there is no threat that buyers will integrate backwards due to the fragmentation of the buyers and their inability to coordinate their actions. Therefore, we conclude that buyers in the industry are left with little bargaining power.

Threat of Substitute Products

In the industry that serves Oil and Gas, it has yet been faced with the issues of substitutes. It provides other services like refining, terminating and distribution, marketing and trading of crude oil and refined petroleum products. None of the available substitutes can replace oil in all its multiple usages. It is clearly understood that if substitutes are found for such industry, it will definitely be badly affected. However, substitutes available today are not superior in quality and function, it requires a process that is costly and is dependent on governmental policies, which would take years to develop. Therefore, it is concluded that there is currently nothing that could replace crude oil.

Bargaining Power of Suppliers

In this industry, there are many small companies all over the world with insignificant share of the market. As such, they are unable to exert power over their customers because of the inability to substitute. The industry is dominated by few companies; therefore, many choose suppliers accordingly to the kind of services they provide. Suppliers are able to integrate forward and compete directly with present customers as they develop the highly-specialised equipment and advanced technology that the oil companies uses. The volume of goods to supplier is very important as it will lead to a long term relationship between the supplier and consumer.

## 5. 2 Internal Environment

The internal inducements are conditions within the firm itself, which desire to better exploit and employ its resources and competences. The resource based view, addresses why firms are different and concentrates on a firm’s internal strengths and weaknesses. This analysis allows us to identify the main resources and competences of Shell and how company utilize these in order to generate a sustainable competitive advantage internationally. From the external analysis, we conclude that the main challenge today is to secure access to petroleum reserves due to nationalisation of resources and increasing power of host governments. Competition is intensifying with the entry of emerging market oil companies and the independents, together with service suppliers gaining a stronger foothold in the market. These factors have made it increasingly difficult to compete in the market, and it is required to adapt to these changes in order to survive.

Financial

Financial strength is crucial in the industry as it takes on larger and more complex projects, and spread risk. Shell is a highly profitable company and achieved earnings in both upstream and downstream. Nonetheless, with the industry cost inflation, Shell margins are pressured. As a result, Shells’ greatest challenge is to ensure good balance between profitability and production growth. Shell has also invested heavily in R&D to develop the technology necessary for its resource. It engages in project sharing agreements to share the risks and costs of projects. Shell works in various projects around the world in order to diversify both project-specific and country-specific risks and maximise returns. However, we conclude that financial resources provide Shell with a competitive disadvantage in the international setting.

Natural resources

Being competitive in the industry, gaining access to the oil and gas resources is becoming increasingly difficult for oil companies. As for Shell, having access to oil and gas reserves is one of the most valuable resources as this is where the company generates its income from, and thus it is also th