

# Macro environment analysis: pest



With the increasing of international business, there has been growing interest in how a successful organization to create a appropriate international strategy. This article provides an expanded approach to an organization's strategy and linkages that exist in international business operations. Geely Holding Group as an illustrative case to be evaluated by suing PEST analysis, Porter's Five Force Model, SWOT analysis, and Integration-responsiveness Framework. By analyzing all internal and external elements and variables factors, this paper proposes a list of recommendations and solutions to promote Geely's international process.

Key words: Internal Business Environment, External Business Environment, industry globalization and localization drivers, Critical Success Factors, competitors Integration-responsiveness framework.

## **1. 0 Introduction**

### **1. 1 Background of Automotive Industry**

The automotive industry is growing with globalization since the first automobile was built in 1885. To the present day, more than 70 million motor vehicles were produced extending throughout the world. China , Russia , Brazil and India became the major markets rapidly. In 2008, the Figure 1 shows there were about 73. 2 million new motor vehicles were sold worldwide (OICA, 2009). The production has continuously increased, whereas sales started decrease in late 2007. The whole industry was weakened by a substantial increase in the prices of raw materials and fuels cost.

Furthermore, the recession began in 2008 had a profound influence on the auto industry. By 2008, a series of damaging blows drove the automobile

manufacturers include “ American Big Three” to the verge of miserable condition.

Dugigg (2008) has referred to such a language as “ The automotive industry crisis occurred between 2008 and 2010 is a part of reflection of global financial downturn.” The crisis primarily affected the American and European automobile manufacturing industry. Decline in productivity has resulted in less output, meanwhile, due to the economic crisis, oil price shock and environment expectations, more and more automobile buyers turned their attention on a higher quality and more fuel saving auto vehicles. This phenomenon of changing product demand gives many automobile manufacturers a heavily shock. Therefore, many famous automobile manufacturers have no choice to sell some of its famous brands in order to relieve financial pressure. Undoubtedly, it provides opportunities to other private enterprises entry the market. China became both the largest automobile producer and market in the world after experiencing massive growth in 2009. For example Ford, the one of “ The Big Three” of American automobile manufacturer and the fourth-largest in the world based on cars sold number annually (OICA, 2008), battled against the weak currency market and sold decline. Failing investments and an increasing unemployment rate has exacerbated the impact of the crisis.

## **1. 2 Geely Holding Group Profile**

According to the company brief of Geely (2010), Geely Holding Group is one of China’s top ten private automakers and also among the country’s top 500 organizations. Geely is founded in 1986 and is today “ a fully integrated independent auto firm with a complete auto eco-system from design and

research and development to production, distribution and servicing” (Li Shufu, 2008, p 9). Although Geely has achieved great success in domestic automobile industry, it pays more attention to explore global market. About 40000 vehicles are exported for sales in 2008, ranking second place in automobile export in China. In March 28, 2010, Geely Group signed a contract to make an acquisition of Ford Motor’s Volvo automobiles brand for the cost of \$1. 8 billion (Nordstrom, 2010). Through acquisition, Geely can rapidly accelerate its international business in automobile industry and become a leader in this area.

## **2. 0 Geely Business Environment Analyses**

### **2. 1 Conceptual Background on Business Environment**

John Kew and John Stredwick(2005) similarly argued that business environment is a situation largely outside the control and influence of an organization, and the factors in business environment can potentially have both benefit and passive impacts on an organization’s present or future activities. It is useful to divide into two the micro-environment and the macro-environment. Middleton (2003) elaborated that the macro-environment involves factors such as the economy, government policy and social change, outside of the direct control of the business. These factors such as the economy, government policy and social change can have a significant effect on a firm’s success but the relationship is fairly one way. The PEST (or PESTLE) analysis appears to be by Francis J. Aguilar in 1967 can analyze the macro-environment efficiently. The individuals and firms belong to micro-environment and have direct activities of a business. The members of it include suppliers, distributors, competitors, customers and employees.

These factors will affect the performance of any organization. Thus, the micro-environment plays a critical role in the success and behavior of a business. Use the Five Forces analysis to gain insights into the competitiveness of the micro-environment (Cliff, 1990).

## **2. 2 Macro-environment Analysis by use PEST Analysis**

PEST is an acronym for Political, Economic, Social and Technological.

Organization can use this tool to reduce risks associated with operation. The Oxford University Press was strongly shaped and influenced by PEST analysis. As the relevant article published in 2007 shows “ A PEST analysis is helpful understanding the position, potential and direction for a business.”

### **PEST Analysis on Automotive Industry**

#### **Political**

Political factors relate to government policy that firms have to operate, such as trade regulation, political stability and trading policies. Political decisions can impact on many vital aspects for organizations. Automotive industry has propelled by government incentives. For example, China government used stimulus measures to support vehicle sales, such as cuts in sales tax for engines smaller than 1. 6 liters. Indeed, Geely as a famous independent privately owned firm in China, it has a strong support from the government. Moreover, America saved the “ American Big Three” of the automobile manufacturers in 2009. Furthermore, governments make no difficulty with automobile merger of cross border or oversea purchase domestic brands. A great deal of mergers and acquisitions activity from auto manufacturers to parts suppliers (Gaughan, 2008). For instance, Geely’s international acquisition is evident to that.

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## **Economic**

Economic factors include interest rates, taxation changes, economic growth, inflation and exchange rates. Above of these impact the profit of firm and customers' purchasing power. Exchange rate fluctuation influences on vehicle international trade, a weak currency may make export easier. An economic slowdown in many parts of the world during the financial crisis. In this term, interest rate and inflation are unstable. In fact, recession let automotive industry has a huge problem. However, China has remained the only one of the world's major economies that continued to show growth through the global recession of 2008-2009. China's strong economic boom of recent years continues to lift incomes and bring more of the population within financial reach of car ownership, vehicle sales arrived at 13.6 million units in 2009 CAAM reported (Just-auto).

## **Social**

Social factors include lifestyle trends, culture, buying access and trends. These factors affect consumers demand and the size of potential markets. Focus on social trends can improve on the firm's reaction to customers need. Consider of fuel cost and environment pollution, increasing consumers need small cars. In other words, customers prefer to high quality, low price, complete service, and added value for an auto vehicle.

## **Technological**

Technological factors involve new technologies create, rate of technological diffusion and change, replacement technology and so on. Individuals and governments are set up to promote new technology in renewable energy and create electric vehicles.

## **Conclusion**

Above of these factors could be important macro-environment elements in an automobile manufacturer. It is vital to gain an insight into the macro-environment of the industry to guide strategic decision-making. In political aspects, although most governments propel development of auto industry, some of them take a system of tariffs or other measure of protecting domestic producers, especially compare with China's new stimulus measures. It doubtless impacted automobile international trade. If the firm choose a place with abnormal inflation rate, high taxation and may lead to production cost and operation fee, taxation and unstable exchange rate, the firm will have high risks associated with operation. Consider social and technological factors, companies in should focus on research and development to environmentally-friendly products like electric vehicles.

## **2. 3 The Porter's Five Forces Analysis on Micro-environment**

Porter's Five Forces analysis is a simply tool to analyze the determinants of an organization's profit; it can be summarized through his Five Forces Model in figure 3. (Chris, Stewart and martin, 2008). This model attempts to explain relationship between competitors, new entrants, suppliers, customers and substitutes. Understand of critical issues is vital to establish what the best competitive position and gap is (Michael E. Porter, 1980).

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### **Rivalry Among Existing competitors**

Rivalry competitors always have similar products or services in the same industry. Strong rivalry is likely to generate profits damage. The degree of rivalry is high when competitors have become more equal in market share and capability, tempted use price war or other competitive measures to boost sales, low barriers to entry, demand for the product is growing slowly, the costs of leaving the market is high and a little brand loyalty because of so similar that customers are easily switch products. According to automotive industry, rivalry can be intense and cut-throat due to more and more competitors undertook the vehicle manufacture.

### **2. Threats of New entry**

For other Chinese firm enter the automotive industry it is expensive to set up a nationwide network in marketing and equipment. Geely established in 5 strategy markets, such as CIS, Middle East, Africa, Southeast Asia and Central and South America. The existing automobile manufacturers have gained high reputation in market and established excellent brand image. However, the existing firms have no control of the supplies; new entries have opportunities to development. In recent years, Chinese domestic auto companies that have experience in host country like Chery, Chana, Saic and Baw, have active performance in international market. Therefore industry's profitability was affected. Like Porter's view, " In a market with low barriers



to entry, the threat of newly competing rivals is high only when the level of profitability in this industry is high as well.” To illustrate, in March 2nd, 2006, Chery had exported its own products to American. Chery has gained a certain market share in Europe, Africa, South America and North America in 2009.

### **3. Threats of substitutes**

A substitute is something has similar function as existing product in the industry. According to Porter, “ the threat of substitutes also influences the bargaining power of companies.” (Chris, Stewart and martin, 2008, p. 37)If substitutes have lower price, good performance or both, then some customers will be tempted to move new products. Substitutes are not in direct competition but have nonetheless a massive impact on existing companies, for example decrease goods price and raising investment to improve products or services. However, there was no obvious evidence of substitutes in automotive industry. Although some countries have complete public transfer, but all of these

### **4. Bargaining Power of buyers**

Powerful buyers will be able to force down prices thus can bargain away profits of firms that sales goods or services. Porter argues that “ the profitability of an organization depends on the bargaining power it exercises in negotiating prices with suppliers and customers.” Buyer power will be higher if they are scale important in this transaction. For example they purchase in large quantities or purchases represent a sizeable percentage of the industry’s total sales. However, this kind of powerful buyer are difficult appear in global auto industry, it could be happen in a small area. Especially,  
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there are a few buyer of the firm, big buyer is vital to them. Moreover, when the industry emerge large numbers of small sellers or customers can easily switch to other provides, consumers have powerful negotiation to extract a high quality service at a good price. In fact, international auto market has a great many vehicle brands not only in low-end car market but also in high-end auto market. Buyers have a very wide selection.

## **5. Bargaining power of suppliers**

The strong bargaining power of supplier is leading to a squeeze on profits through higher input costs. If there are relatively few suppliers within the industry or organizations are difficult or costly switch from one supplier to another, the suppliers of raw materials, power, skilled labors and components will have power of high prices negotiation. According to China Association of Automobile Manufacture's research (Plunkett, 2007) shows cost, design, security and extra capability are decisive factors in a car's value. It requires suppliers to enhance the quality of their products and service.

## **Global competition in auto industry:**

Along with the continuous impact of financial crisis, the international market is shrinking. Meanwhile, the profit of international auto market decrease along with the shrinking revenue. Consequently, the competition in international auto market is becoming fiercer and fiercer. The automobile market is at the maturity stage of the life cycle, locally and globally, due to an increased number of competitors from domestic and foreign markets. The automobile market is characterized by a low potential for market growth, but high sales and limited profit margins. Competitive forces are high in each

segment of the overall market, Geely currently face fierce competition against Lifan, who's marketing strategy is price oriented, its model series LIFAN520 has gain a considerable proportion of the market due to its low price strategy. After the buy out of Volvo, it is expected that Geely will shift its current strategy to differentiation. Hunt (1972) proposed a strategic group analysis to identify and group strategic characteristics, following similar strategies or rivaling on common bases. Criticism offers that the study of strategic groups is merely from cognitive perspective, notwithstanding the framework have obtained prominence over the years (Hodgkinson 1997: 623).

Profit Margin

High

Low

Sales Volume

Low

High

High sales with average margin

Toyota, Chrysler, Honda

Low Sales Volume with high margin

BMW, Mercedes, Jaguar

High Sales Volume with low margin

Lifan, Geely

Low Sales and low margin

Chery, Chana, Saic Baw

### **Figure: Strategic Group Analysis**

To sum up, along with the recovery of international economy environment, and Chinese government's policy on private enterprise's access to internationalization, it provides convenience and opportunity for Geely's international strategy. Nevertheless, due to deficient consumer confidence on private enterprise and the restriction of consumption environment, Geely faces mighty competition pressure. Thus, what is needed is the improvement of Geely's ability to respond to external factors after acquisition.

When we make an international strategic plan for a multinational enterprise, we have to take the corresponding relationship between local factors and global factors into account. The IR framework provides a visual diagram for us to demonstrate the diverse and conflicting pressures that firms confront. The two major concepts that will influence MNE are integration and responsiveness.

By integration, Prahalad and Doz (1987) refer to the coordination of activities across countries aimed at building efficient operations networks and taking maximum advantage of similarities across locations. By responsiveness, they refer to the attempt of responding to specific needs of host countries, and note that businesses can choose to emphasize one dimension over another,

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or to stress both dimensions. Thus, firms have basically three strategic options at their disposal: the global integration strategy, the locally responsive strategy, and as sort of an in-between option, the multi-focal strategy. The choice between the three strategic options is governed by the perceived intensity of two forces in the firms' operating environment: the pressure for global integration and the pressure for local responsiveness (Prahalad & Doz, 1987, pp. 18-21).

The global integration and local responsiveness pressure of Geely is listed in Figure 8

Integration Pressure(Globalization drivers)

Responsiveness Pressure(Localization drivers)

Economies of Scale. Geely needs to set a brand of subsidiaries to achieve economies of mass production.

Consumer trends and universal needs. The word “ Consumers are God” should be a basic principle of Geely's cultural.

Uniform service to global customers. Services are essential to win global consumers' enthusiasm.

### **Global sourcing of raw materials, components, energy, and labor.**

Source from large-scale, centralized suppliers provides benefits from economies of scale and consistent performance.

Global competitors. Global cooperation and coordination is necessary to resolve competitive threats in foreign and domestic markets.

Availability of media that reaches customers in multiple markets. Geely should take advantage of the Internet and cross-national television to advertise their products in different countries simultaneously.

Unique resources and capabilities available to the firm. Each country has its own abundant resources.

### **Diversity of local customer needs.**

Different people in different region have different appetite and requirements on vehicles.

Local competition. When competing against numerous local rivals, centrally-controlled MNEs will have difficulty gaining market share with global products that are not adapted to local needs. Geely should diversify its products.

### **Cultural differences.**

MNES have to adapt to local history, language, custom, ways of dealing with people and culture.

Local government requirements and regulations. Local governments usually impose trade barriers or complex business regulations to protect local trade.

Apparently, Geely has great ambitions to become a top automobile manufacturer giants in a few years. However, due to the reason that Chinese automobile industry has started later than many developed countries, Geely

has a huge gap between other large manufacturers. Although Geely has already acquired Volvo, it has numerous obstacles such as international humanresource integration and management, autonomous technology R&D, and cross-cultural conflicts. According to the analysis of Figure8 and IR framework, we can conclude that Geely has to seek to achieve both global effectiveness and local responsiveness. Geely must achieve simultaneously requirements for strong central control and coordination of subsidiary companies and decentralization and empowerment to local responsiveness.

### **3.3 Key Factors for Success in Automotive Industry**

The Critical success factors (CSF) is a notion which is applied to understand the elements necessary for an organization to archive its objectives, it is initially applied in the data analysis and business analysis (Rockart, 1979), later it extended its use in IT projects to enhance the user involvements (Boynlon, 1984).

In the automotives industry, there are a set of critical success factors for firms to achieve in order to obtain unique competitive advantage. First, engineering and innovation in car designing, a firm can gain remarkable advantage via superior quality of engineering in automotive production, skilled labour force, fashionable design and luxury taste. Second, Brand image is of essence in today's auto mobile competition. E. g. BMW claims its brand as “ ultimate Driving Machine” (BMW, 2004), excellent brand image can lead to fanatic loyalty towards the brand thus create advantage. Third, safety is guaranteed by the quality of vehicles, premium quality mobile, sophisticated testing methods and strong safety record will all contribute to competitiveness of a firm. Fourth, cost reduction, sophisticated techniques e.

g. JIT system or host country advantage can have direct impact on the cost reduction of a firm. Fourth, if a firm can tightly control its distribution network, it can manage its brand more efficiently and make more effective communication with its distributors. Fifth, a firm has an excellent grasp on supply chain management enables the firm to maintain a good relationship with suppliers in the long run, to ensure that the customer needs are satisfied.

The strategic positioning model is widely applied to demonstrate how a firm shifts its strategy in a variety of ways (Boston, 2000). Chesbrough and Rosenbloom (2002) argued that the application of strategic position model enable the user to gain a clear picture of the competitive advantages of the chosen firm. In Geely's case, due to the host country advantage now Geely possess the cost advantage in the low end market from global scale. However the acquisition of Volvo may help Geely to gain the engineering expertise and a positive brand images, consequently create more competitive advantages for the firm.

## **4. 0 International Strategy of Geely**

### **4. 1 Internal and External Factors Analysis by Using SWOT Analysis**

SWOT analysis is a simple and useful tool for strategic alternatives from a business environment analysis. SWOT formed from the initial letters of Strengths, Weaknesses, Opportunities and Threats. It through analyze the internal and external environment to help organizations understand current situation and make decision easily. The SWOT analysis was provided by Albert S. Humphrey in the 1960's, but now it development into an absolutely



necessary part of the strategic planning process (An Soff, 1965). Indeed, it is considered the first step of forming a strategic picture. SWOT analysis divide into two aspects, one is external factors as opportunities and threats, the other aspect is internal factors include strengths and weaknesses.

“ Strengths and weaknesses are essentially internal to an organization and relate to matters concerning resources, programs, and organization in key areas. Opportunities and threats tend to be external- from competing organizations, global trends, and other environmental factors.” (Charney, p 170, 2005)

The SWOT analysis reduces the relevant information from internal and external environment to a manageable quantity of primary issues. Logically, it is helpful optimize the firm’s resources and capabilities, therefore “ a firm can better leverage its strengths, correct its weaknesses, capitalize on golden opportunities, and deter potentially devastating threats.” (Menon, 1999, p 30) Thus, a comprehensive SWOT analysis of Geely contributes to a better understanding of Geely’s international business environment at internal and external.

The figure below is the SWOT analysis on Geely’s acquisition of Volvo.

## **SWOT analysis on Geely**

### **Internal factors**

### **External factors**

### **Strengths**

### **Opportunities**

Owns many patents.

The maturity of domestic market.

Ranking 2nd place in automobile export in China.

Supports from government policy.

A mass of honest customers in the low-end car market.

Geely got further research and developed new energy vehicles.

Effective cost control of manufacturing and sale while has high performance price ratio.

Increasing needs at abroad. Vehicles have gained high reputation in overseas market and established excellent brand image.

Advanced production facilities and technology in low-end car.

Local competitors have poor products. Geely can launch 4-5 brand new car models and engine models every year.

R&D is greatly improved to provide efficient guarantee for the overseas business development.

Geely successfully acquired the world's second largest automatic transmission company called DSI.

Capital rising by entrust loans from reliance group.

Product innovations ongoing.

An increasing trend on global market shares.

A billion's credit limit from China Everbright Bank and the support from Goldman Sachs Investment Bank.

Weaknesses

Threats

The scale gap with other large automobile manufacturer in the world.

Brand appeal is low, oversea consumers have little confidence on new private brands.

Marketing network is incomplete, oversea staff need training.

Consume circumstance of automobile market is depressed since financial crisis.

No takeover experience at automobile company abroad could be called up. It has risks in culture and operation.

More and more domestic private brands emerge in automobile industry likely entry of new competitors.

Management cover insufficient, Lack of management depth

A high safety standard of international import and export motor vehicles

Inadequate financing capabilities. Capital situation is unstable.

Culture difference impact management style and sales product, oversea customers maybe refuse to adapt new products.

**It will invest huge number of money to operate in the further years.**

The market system is incomplete.

**Manufacturing technique is deficient, poor quality vehicles and less value.**

New regulations exposed to political problems in the countries that operate in, besides, taxation maybe introduced on product or service.

## **6. 0 Current Situation and Recommendations**

Independent Research and Development

There is no doubt that core technology is the essential of every company in every industry. Moreover, when Geely grasp the unique core technology in automobile industry, it will have the pricing power and cost control, which is the key factor of its globalization strategy. Therefore, Geely has to put more energy on research on its own patents. It is advisable for Geely to set up its own lab. Geely can attract scientists and technicians by offering well-paid position and reputation.

2. Pay attention to domestic market

Chinese market is a huge cake which contains abundant human and raw material resources. More and more foreign have rushed into China in order to seize the new prosperous market. As a domestic enterprise, Geely has many unique advantages such as human network, government supports, and public patriotism. Domestic market is the solid back supports for Geely's international development.

### 3. Cross-cultural management

After acquisition, Geely has to take over a series of overseas factories, which means Geely has recruited hundreds and thousands of foreign employees. How to manage them effectively will be the first challenge for Geely. Cultural shock, language barriers, miscommunications, and staff turnover will be the main obstacles in Geely's management. It is suggested that Geely should pay attention to leadership theories. Empowerment, motivation and teamwork are the key factors involved in Geely's management.

### 4. Government supports

In order to expand international market, Geely has to face with different laws and regulations. Building a harmonious and cooperative relationship with governments is essential. Geely's investment and development can enhance local employment rate and increase local tax revenue. Simultaneously, government can provide unique supports for Geely. Cooperation with governments is a win-win strategy.

### 5. Building a talents training system

Experts and technology are the core productivity for a MNE. Geely can set up its own talent base through establishing independent labs and donation to famous universities. Through collaboration with universities and labs, Geely can gain a reputation for thousands and hundreds of students, who have potential to contribute for Geely in the future.