



A study by DLA Piper's Manufacturing Group

MANUFACTURING: MAKING IT GLOBALLY



Sheffield
University
Management
School.

ABOUT THE RESEARCH

This research was conducted between January and May 2014, led by Dr Tim Vorley and Dr Nick Williams of the Sheffield University Management School. The CBI played a key role in promoting the survey within their membership. The project employed a three phase multi-method approach. Stage 1 involved scoping interviews with representatives from the stakeholders listed below. Stage 2 involved a poll of 50 key decision makers, composed of UK based manufacturing business with £75 million+ turnover, conducted to examine the nature and extent of UK manufacturers' global operations as well as the challenges and opportunities that they face. Stage 3 involved in-depth interviews with 30 top-tier management decision makers in £75 million+ turnover UK based manufacturing businesses. The research focused on five key manufacturing sub-sectors: industrial goods and advanced engineering; chemicals and paint; automotive; aerospace and defence; and durable consumer goods. Overall the interview and poll findings have been anonymised apart from where case studies are provided and these are presented with the permission of each organisation. Participating organisations are listed below.

ACKNOWLEDGEMENTS

Manufacturing Businesses

- ABB ■ AESSEAL ■ Balfour Beatty ■ Binding Site Group ■ Biwater ■ Bridon International
- Calder Group ■ Caparo ■ Chemring ■ Compass Minerals ■ Dechra Manufacturing ■ Domino Printing Sciences ■ English Provender ■ GHD ■ GKN Aerospace ■ GPS ■ Greene King
- Halewood International Holdings ■ Ibstock ■ IMI ■ Infineum UK ■ Jaguar Land Rover ■ JCB
- John Crane Global Operations ■ John Guest ■ Kostal ■ Labinal Power Systems ■ Lafarge Tarmac Building Products ■ Milliken Industrials ■ NSG ■ Numatic International ■ Oliver Valves ■ Outokumpu
- Pearson Engineering ■ Pegler Yorkshire Group ■ PolyPipe ■ Promethean ■ Robert Bosch ■ Rolls Royce
- Rotork ■ Sellers Taylor ■ Sheffield Forgemasters ■ Siemens ■ Special Metals Wiggin ■ Speedo
- Tata Steel ■ Terex Equipment ■ Tetrosyl ■ Thorntons ■ United Technologies

Stakeholders

- Confederation of British Industry (CBI) ■ Department for Business, Innovation and Skills (BIS)
- The Manufacturing Institute (MI) ■ Manufacturing Technologies Association (MTA)
- UK Trade and Investment (UKTI)

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FOREWORD

Manufacturing is widely regarded to be the backbone of the UK economy. However, while small and medium enterprises (SMEs) have been the focus of much recent debate, the importance of large manufacturing businesses should not be underestimated. In this report we explore the international activities and operations of large UK manufacturing businesses. The report focuses on understanding what it means to develop international operations, and highlights the need for manufacturers to think locally while acting globally.

This research finds that the way in which large manufacturers develop international operations is necessarily heterogeneous. While it is possible to identify different strategic approaches towards internationalisation and examples of good practice, there is no single model. The challenge for manufacturers' senior management is in identifying what works in terms of why to internationalise, how to implement internationalisation and what forms international operations can take. Furthermore, judging how and when to seek external support, whether from the public or private sector, is a key challenge for many.

With improving economic forecasts and accelerating output, we wanted to explore some of the challenges faced by the manufacturing sector through gaining a deeper understanding of experiences of internationalisation. Successful international strategy is on the agenda of most ambitious companies. The survey highlights some of the pitfalls, as well as the integral aspects of cross-border operations, also raising the thorny issue of perceived protectionism, before providing some useful lessons through the benefit of hindsight for senior management teams looking to extend their reach over the coming years.

It is clear that choosing in which market to develop a presence is crucial to international business success and what we are seeing is an evolving pattern when it comes to geographic focus. International growth for many manufacturers we spoke to traditionally came from Europe and North America as geographical and culturally close markets, but whilst still hugely important, UK manufacturers are increasingly looking further afield. Emerging economies are set to dominate global GDP in the coming decades and being present is seen as key to having a foothold in these markets.

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EXECUTIVE SUMMARY

Manufacturing is at the core of the UK economy. Despite mixed performance over the past two decades, UK manufacturing is currently strong and growing both in productivity and profitability. Today, over 2.6 million people in the UK work in manufacturing, accounting for around 11% of UK Gross Value Added (GVA) and 54% of UK exports. The composition of UK manufacturing is changing, with basic metal industries contracting, while advanced manufacturing sectors have grown considerably. Almost half of the UK's manufacturing exports, accounting for £186.6 billion, come from five sub-sectors (mechanical and electrical equipment; chemicals; transport; metals; rubber, plastics and non-metallic minerals).

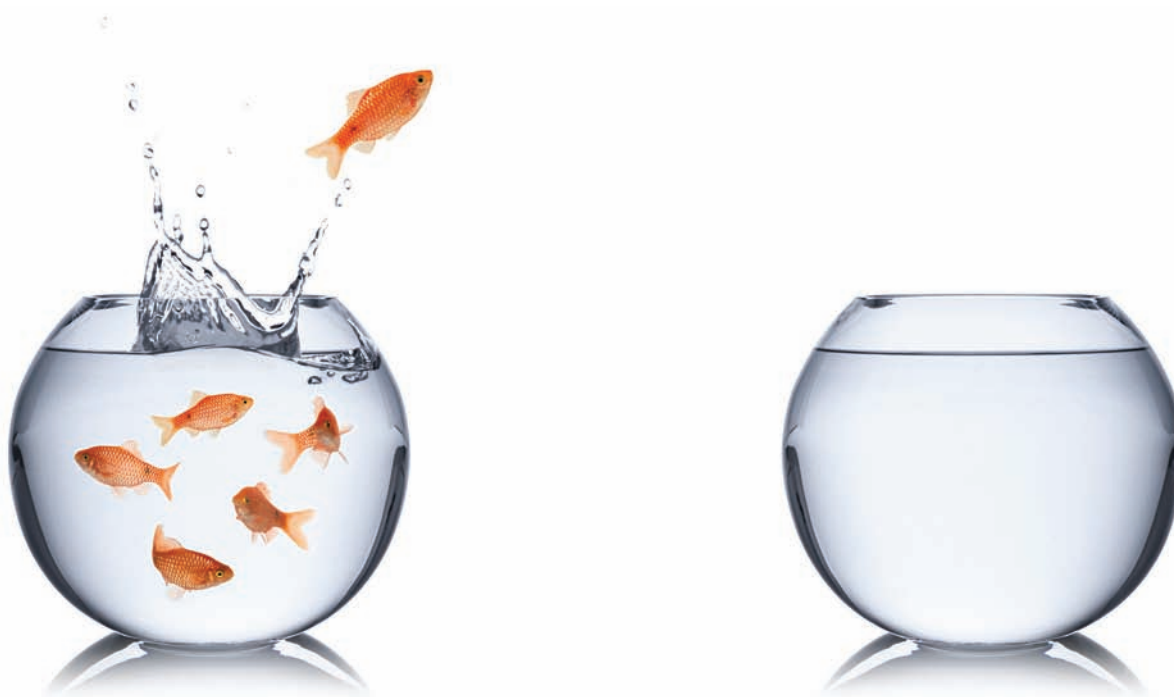
While exports are important, the internationalisation of UK manufacturing undoubtedly represents the next phase in growth, and the stakes are high in terms of risk and reward. This report starts by exploring why manufacturers extend internationally. The report then identifies four different motivations for developing international operations, but finds that such motivations must be aligned to the wider corporate strategy and be endorsed by top tier management

or C-Suite (so called because of “chief” officers of whom it comprises) if they are to be successfully enacted.

The four key motivations are:

- Growth ambition (opportunity)
- Customer-led
- Market presence
- Supply-chain co-location

The report highlights that there is no single or preferred approach towards developing international operations, but rather a series of factors that were common to many of the large manufacturers consulted during the research. The findings differentiate between strategic and operational factors, and highlight the importance of thinking about the drivers and challenges of international growth. **If the future of UK manufacturing is to realise its potential and be competitive on a global stage, then manufacturers need to develop operations on a case by case basis. Managing internationalisation is hard and if UK manufacturers are to succeed, they need to be responsive and flexible, both internally and in relation to the changing contours of the global economy.**



THE HEADLINES

- Growth for growth's sake is not a strategy, it's critical to understand the rationale behind expanding internationally
- Think global, act local and make sure the senior management team leads this and reflects this in organisational values

- North America and Europe remain the biggest markets for UK manufacturers looking to expand, but increasing competition is forcing a shift elsewhere
- 53% of manufacturers interviewed said they are looking at opportunities in the BRIC, CIVET and MINT markets
- The majority of manufacturers interviewed felt that the UK leaving the EU would have a negative impact on business
- The expansion of the EU across Central Eastern Europe (CEE) is seen to have created valuable opportunities and opened new markets for manufacturers
- China is seen to have rapidly developed as a market and become easier for manufacturers to expand

- Corruption is regarded as a key challenge – 100% of those interviewed said they had been aware of corruption when investing internationally and felt they needed to be constantly vigilant to avoid this

- Authoritative decision making is critical – make the hard calls early on, failure to do so can increase costs and slow the development of international operations
- The importance of establishing a local presence with the right people cannot be underestimated
- Seek out support, knowledge and expertise – it's out there! This means leveraging formal and informal networks from peers to professional services
- A good product or technology offering is not enough – familiarity with the local culture and business environment is critical for developing a sustainable operation

- Protecting Intellectual Property Rights (IPR) is a major issue and manufacturers would welcome a globally harmonised IPR system

- UK manufacturers must continue to assert their position on the global stage and there is an important role for Government to play in promoting the UK's manufacturing champions

- Internationalisation is a long-term game, but set limits and know when to pull back

THE UK IN THE GLOBAL MANUFACTURING LANDSCAPE



The manufacturing sector in the UK has long been the backbone of the UK economy. Yet even prior to the financial crisis in 2008 the decline of manufacturing was commonly reported, as the UK seemingly sought to position itself as a knowledge-based economy. The rhetoric surrounding the knowledge economy has seen manufacturing marginalised, although the demise of manufacturing is somewhat overstated. The reality is that the boundaries between manufacturing and services are blurring, as higher value added services are incorporated from the production process to aftermarket support. Therefore while high-tech and advanced manufacturing have retained visibility, other forms of low and medium tech manufacturing have arguably been lost from the debate despite their continued importance.

Manufacturing has long since been and continues to remain an engine for economic growth, and with the levels of growth nearly three times above the rest of the economy, UK manufacturing has been important to the wider economic recovery. This growth can be attributed to the sector's technical and managerial expertise, investing in process and product innovations, and a growing international footprint. The investment of UK manufacturers in new technologies and innovation has ensured the productivity and competitiveness of the sector and its outputs. It is the success of these outputs that is central to UK manufacturing continuing to thrive in different global markets, with the demand for UK manufactured goods rising in the Eurozone, Australia, China, Africa, Russia and in the US.

As the UK emerges from the global economic downturn, it must consolidate its position as a trading nation, both by supporting more firms to export but also by encouraging more firms to go beyond exporting to invest in new markets and therefore become truly global businesses. However, UK businesses are often considered to have underperformed on a global scale, with internationalisation often perceived as difficult to realise given the legal and regulatory barriers and a lack of contacts in foreign countries. **Given the increasing level of international competition, it is more important than ever that UK manufacturers**

build on their competitive advantage, and the Government serves an important role in promoting and supporting international growth of UK manufacturing.

The manufacturers consulted during the research all had international operations, although the nature and scale of their activities were varied, including a combination of sourcing, production, R&D and sales. The organisation of international operations not only determines the current function and output, but also the future strategy, investment, and innovation potential of businesses. These international operations form part of a 'global production network'¹ which sees UK manufacturers embedded in the global economic system. Whereas early approaches towards developing exports and international business could be opportunistic, it is not possible to sustain a portfolio of international activity on this basis. UK manufacturing businesses need to be highly strategic in their approach, focused on leveraging knowledge, accessing customers and enhancing returns. **What has emerged from our research is that UK manufacturers must assume a dynamic approach in order to grow their international footprint. Local flexibility is central to achieving sustainable international growth.**



GOVERNMENT AND UK MANUFACTURING

Whereas the economic future of the UK was once regarded to be 'beyond manufacturing' this is no longer the case. The present Government has clearly signalled the importance of high value manufacturing to the UK economy and acknowledges the need to capitalise on that value for the future of the UK economy. Previous models of support based on Government spending are no longer viable, and instead there is now a Government wide commitment to working in partnership with industry to give businesses the confidence to invest.

The UK Government's Industrial Policy focuses on 11 sectors and eight technologies and identifies a variety of measures to incentivise R&D, promote up-skilling, provide access to finance, improve regulation and develop infrastructure. In addition, UKTI remains committed to working with different sectors to develop a more strategic approach to pursuing targeted opportunities in overseas markets. A number of the large manufacturers interviewed commented on the need to ensure that domestic policy is coordinated and coherent, particularly where responsibility cuts across different Government departments.

In the wake of the global crisis there has been a rise in neo-protectionist measures which provide covert or hidden means to support domestic industry, keep out imports and boost exports. While the UK has resisted such measures, protectionist mechanisms are a threat to international growth that potentially undermine investment and expansion by private enterprise. There is an underlying frustration that neo-protectionism is disadvantaging UK manufacturing. Today's neo-protectionism includes a range of tariff and non-tariff measures, which are as prevalent in advanced economies, including the United States, as they are in the emerging BRIC and MINT economies.

Our findings suggest that the competitive strength of UK manufacturing is in the quality of its products and services, and the manufacturers polled viewed the role of Government as enhancing the regulatory landscape and protecting the open market. The nature of Smart Industrial Policy means that there is not a single model for Government engagement with manufacturing, but rather it demands a flexible approach. By providing different forms of support, the Government is committed to manufacturing-led growth by encouraging a manufacturing eco system in the UK. However, it cannot and should not act alone to stimulate growth.

SUPPORT AND SEEKING HELP: A GOOD PLACE TO START

In exploring the support that companies had received when planning or developing international operations the findings show a relatively even split in terms of those who had accessed support (52%) and those that had not (48%). This is not surprising given the size of many of the manufacturing businesses involved in the research who have a critical mass of knowledge, expertise and capacity to undertake activities supporting international growth in-house. That said, all of the manufacturers polled had used some form of business and professional services support in establishing their international operations.

Of the businesses which had used some form of external support, the primary reason for doing so was to ascertain knowledge of the local market/environment (83%). This local knowledge is of vital importance to businesses particularly in locations where they have not had previous experience and is mainly in the form of legal/regulatory advice. The knowledge of the external organisation therefore ‘plugs the gaps’ in knowledge that the business is missing. The second most important reason cited was the trust in that organisation born out of their reputation. One business described the element of trust being “like an insurance policy” whereby utilising the external organisation gives the business more confidence about its international operations. **Other reasons cited for using external support included the relationship to Government of the external organisation (33%) as this was seen to help gain access to key contracts, and to tap into the personal networks of the organisation which it had developed over time.**

“

We can't know everything about the market we are launching into, so using someone we know and trust helps ... It is like having an insurance policy that covers our backs. We are not necessarily looking for specific support but gaining advice and knowledge from an organisation that works in that geographical location gives us the confidence that we are not missing anything.

Survey respondent

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UKTI have been a great help ... They have helped us to look into expanding into Brazil and have helped us get into there.

Survey respondent

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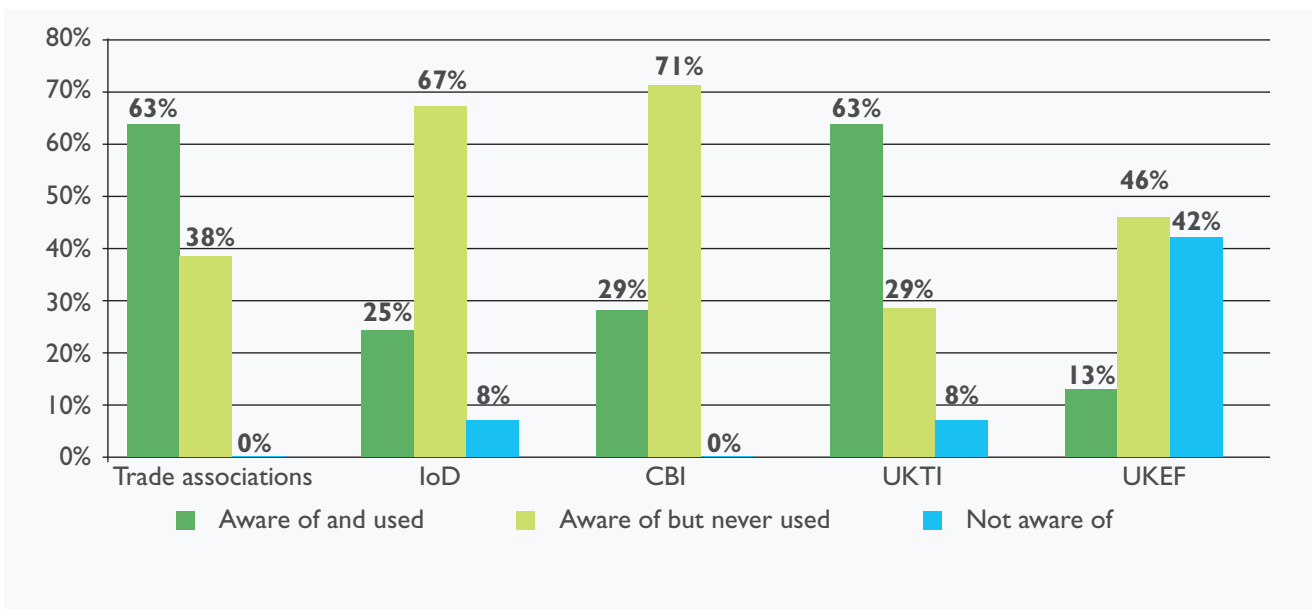
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We have worked extensively with UKTI. They have been very useful for introductions, particularly for key influencers in Government agencies.

Survey respondent

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There is an awareness among large manufacturing businesses about the different sources of information and support available, with trade associations and UKTI being the most consulted, as shown in the diagram below. In the manufacturing sector there are a number of high profile trade associations although those most cited by respondents were EEF, the manufacturers’ organisation (formerly the Engineering Employers’ Federation), and the MTA. UKTI was also regarded as an important source of information and support, although several noted that the ability of UKTI to respond has wavered over recent years due to levels of funding but this has improved. A number of manufacturers referred to the support of UKTI around tradeshows, but more significant was the local facilitation and connection with the UK’s international network of Embassies, High Commissions and Consulates. Although there were high levels of awareness about the IoD (Institute of Directors) and the CBI they were not regarded as primary sources for information. However both the CBI and IoD do provide advice and briefings on doing business abroad, emerging markets and exporting. Of those agencies providing external support the level of awareness and usage of UK Export Finance (UKEF) was lowest among those businesses polled, despite providing a free consultation with an Export Finance Adviser and offering a range of products and services.



Awareness and usage of external support

In addition to support from trade associations, industrial bodies and Government agencies, the interviews highlighted differential use of business and professional services support, which remain an important resource for UK manufacturers developing international operations. There has been an increase in the internationalisation of business and professional services firms and many of the businesses interviewed emphasised a preference for business and professional services firms with local knowledge of the host country. While many of the manufacturers had preferred business and professional services partners, the research highlighted a distinction between the nature and approach towards business and professional services to support strategic and operational matters.

On strategic matters manufacturers tended to look to business and professional service firms for their expertise and technical knowledge to develop customised responses and solutions to particular issues and challenges. In such instances manufacturers elected to use international firms with a local presence, or who were able to mobilise a local presence, as there was confidence in the existing relationship. It was almost always the case that local business and professional firms or specialist consultants were used in a supportive way rather than to lead particular activities.

For more operational matters, larger manufacturers with sizeable in-house legal and finance teams had a tendency to work directly with local business and professional services firms that were regarded to have superior local knowledge of legal and tax regulations. Other manufacturers continued to work with international business and professional services firms on operational matters, as there was seen to be value in leveraging a local presence with the benefits of a globally networked and professionally accredited business to deliver ‘global’ knowledge.

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The main thing is that we can access the expertise when and where we need it.

Survey respondent

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It’s important that the lawyers and accountants we use have the local knowledge we need.

Survey respondent

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Global market dynamics and the desire for international expansion is inevitably leading to businesses looking at value generation by means of business combinations in overseas markets. Such combinations take many forms from collaboration and marketing arrangements through to true joint venture, investment and acquisition channels – each being dependant on the level of risk, opportunity and integration that a given commercial opportunity might present. Our experience as a global adviser to such businesses is that both international and local knowledge is key because the legal and regulatory framework can be both diverse and complex. Clients require multi-disciplinary and increasingly multi-jurisdictional advice and guidance to navigate areas, from foreign investment and regulatory requirements to compliance with local labour, trade and tax legislation.



Noel Haywood, DLA Piper Partner



Whether seeking support from trade associations, industrial bodies, government agencies or business and professional advisers, the requirements of the manufacturers, although similar at one level, generally demanded bespoke responses. The nature of support sought can range from introductions, hosting and championing, through to acquiring jurisdiction-specific knowledge in order to adhere to different regulatory and legislative environments. Whereas some of this support can be provided from the UK through trade associations, the manufacturers emphasised the value of local support in much the same way as manufacturers themselves can require a local presence to grow.

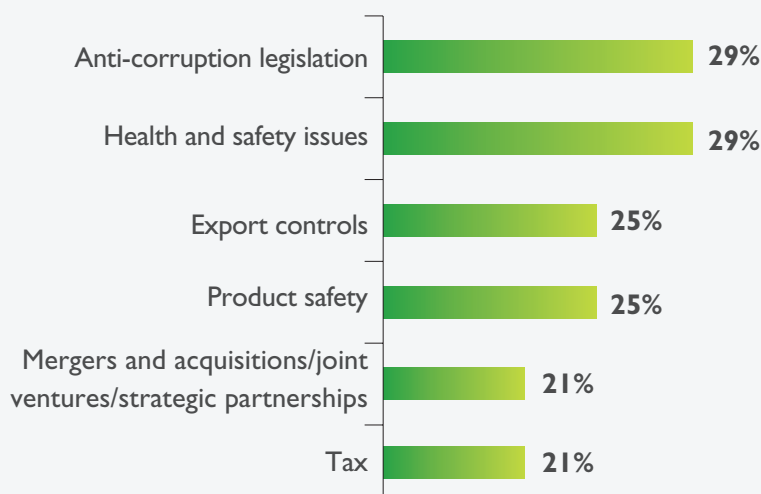


We have needed support in extending our global reach from legal firms, particularly in terms of acquisition targets. Every country is a minefield if you don't know what you are doing, so you need to get that help.

Survey respondent



IN WHAT AREA OF OPERATION IS YOUR BUSINESS MOST LIKELY TO SEEK EXTERNAL SUPPORT?



ORGANISATIONAL DESIGN, CULTURE AND VALUES

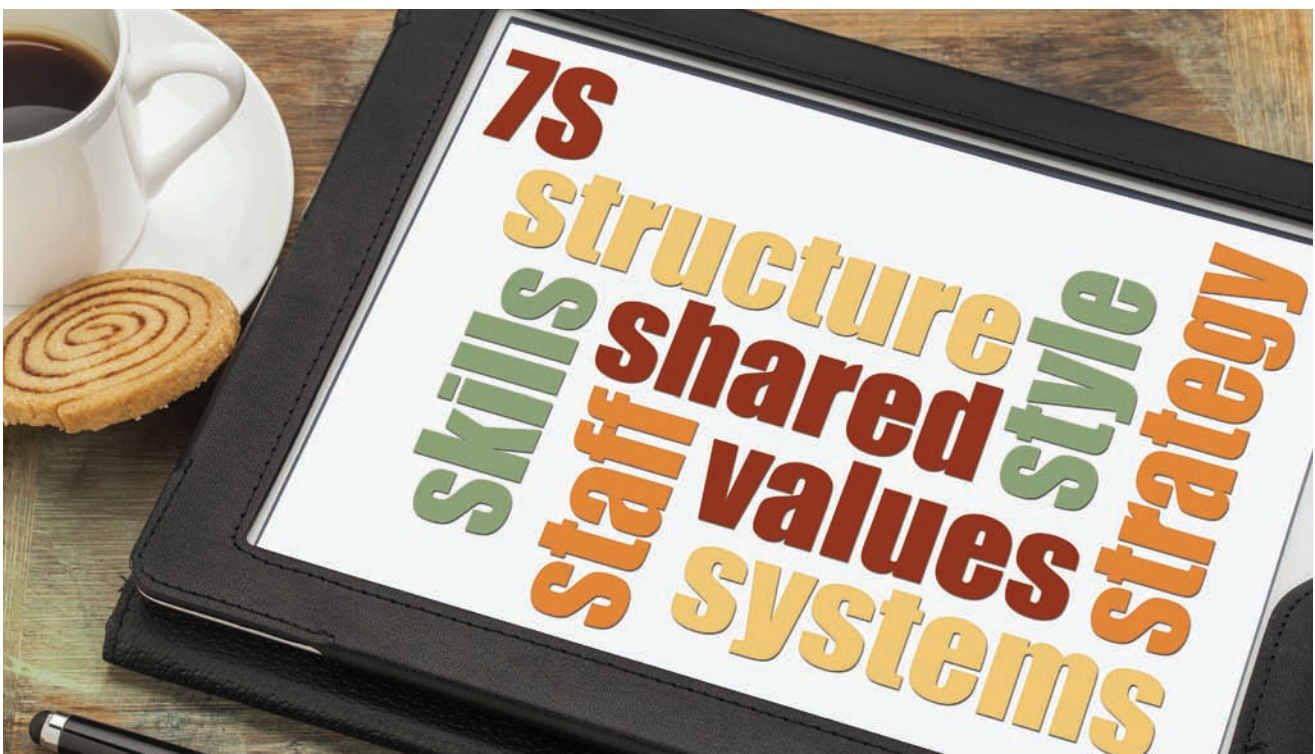
As firms develop international operations they adapt, and many of the businesses interviewed encountered strategic and operational challenges. For those businesses more experienced in developing and managing international operations, the scale of the challenge was perceived to be less as they gained experience and knowledge of growth in foreign markets. **Several interviewees identified the importance of decision making and specifically the ability to assess risk and evaluate the relative costs and benefits of a given opportunity.** Where international growth is effective, organisational change is viewed as evolutionary, rather than transformative, with minimal disruption on business operations.

As a business develops operations in different foreign markets there is a need to consider how this affects organisational design and structures. **The research highlighted a variety of different approaches towards international growth, of which the most prevalent were joint ventures, mergers and acquisitions, and establishing independent operations.** There is no evidence of trends or preferences, it is about what works on a case by case basis. The organisational configuration of these international operations is varied between businesses,

although it is generally accepted that there are four models, as shown below. Some larger manufacturers displayed a blended approach towards international growth, which is a testament to their knowledge and experience of working in different countries.



Organisational configurations and characteristics²





Not just a global business but global businesses

Established in 1968 Caparo has grown to become a niche steel and specialist engineering business of global stature with a turnover of more than €1.5bn, and operations in North America, Europe, and Asia. Despite the global footprint of Caparo, its activities across the globe are operationally distinct and geographically localised. This has proved to be a competitive advantage of the Caparo Group, which has emerged from the global economic downturn as a stronger and more resilient business. Central to this is the flat organisational structure of the business, with the core executive being able to make decisions based

on the expertise and knowledge of local senior management teams across Caparo's global operations. Looking to the future, the success of the Caparo Group is premised on its diversification into new markets and new technologies, which highlights the value of local thinking to global businesses more than ever.



Rolls-Royce

Global dexterity

Rolls-Royce operates integrated power systems and services to the civil aerospace, defence aerospace, marine and energy markets, with customers in over 150 countries and operations in more than 50 countries worldwide. While Rolls-Royce already supplies and supports markets worldwide, the company is committed to extending its global footprint in key markets in order to meet customer demands and be near the market. In the case of aerospace, this means growing a presence in the Asia Pacific region, which is estimated to account for around 50% of the market within the next 20 years.

With experience of executing acquisitions, joint ventures, risk and revenue sharing and strategic partnerships, as well as establishing independent sites, Rolls-Royce is accomplished in developing international operations. The business is committed to developing ways of working and growing that are appropriate to the place, the product and potential partners, but as a technology led business it is the technology which often determines what form a venture takes. Given the time horizons and budgets associated with developing global operations, there is a need for sustained commitment to develop consistency and excellence across all Rolls-Royce locations.

The growth of Rolls-Royce is a testament to a business that has embraced globalisation in its different forms, working with it rather than trying to impose a

Rolls-Royce model around the world. This approach has allowed Rolls-Royce to leverage the strengths of local sites which ultimately adds to its own strengths as a global manufacturing business. As a result about 85% of Rolls-Royce's revenues come from overseas markets, and this is as much about manufacturing as it is about providing the service to support their products.





Pegler Yorkshire

CONNECT + CONTROL

Sister supported growth

Pegler Yorkshire Group Limited has a history in the UK as a manufacturer of valves and other engineering products that traces back to the turn of the century. However, in 2005 the Aalberts Industries Group acquired Pegler Ltd and in 2009 Pegler merged with its sister company Yorkshire Fittings Ltd to create Pegler Yorkshire Ltd. Today Pegler Group Yorkshire

Limited is one of 17 sister companies in the Flow Control division of Aalberts Industries.

Pegler Yorkshire retains a high degree of autonomy over its operations, although a 'golden rule' of developing into foreign markets is that it must work through sister companies in the first instance. Where it is not possible for a sister company in the group to support growth in their local market then the sibling is permitted to engage independently. This strategy is a testament to the highly decentralised structure of Aalberts Industries which is

committed to achieving growth organically as well as through acquisitions.



CULTURE AND VALUES

One recurring theme referred to by many of the manufacturers interviewed was that of their business philosophy, particularly in relation to values and ethics.

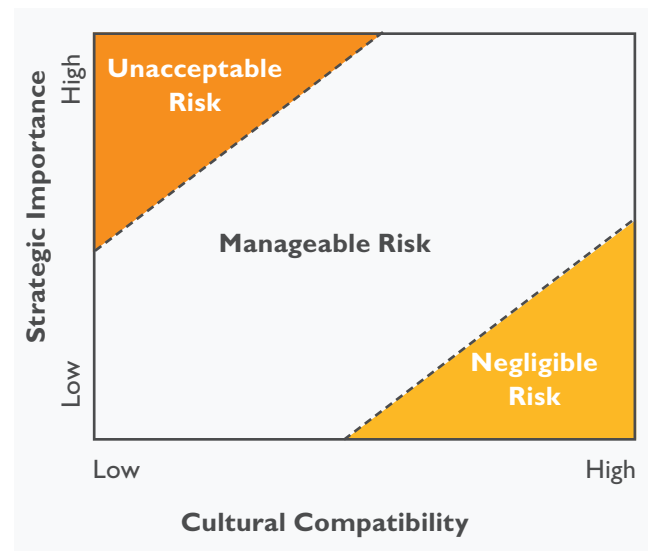
While the importance of local knowledge and market opportunities are a prerequisite for profitable growth in international markets, values and ethics continue to shape where manufacturers go, what they do, and how they do it. There was a consensus in the research that it is not the case of 'business is business' and there was a sense of responsibility to maintain organisational values and ethics. This was most notable when faced with the threat of corruption, with many manufacturers foregoing opportunities that could prove compromising. Interestingly this was regarded as concerning more than just maintaining the brand and in the case of privately owned businesses, often reflected the principles of founding individuals and families.

Developing a successful international presence is about more than organisational structure, it is about the functions, processes and strategies within the business.

Of those businesses which have been most successful, one common trend is the presence of strategic linking functions which enhance organisational communication and integration while not interfering at an operational level. As manufacturers grow their international footprint they will need to develop new organisational models to accommodate cultural differences in new markets that are beyond the typical international growth paths of Europe and North America.

Fundamentally the manufacturers interviewed emphasised that international growth demands a need for the business to adapt to different local cultures.

Where there is a mismatch between culture and strategy the risks associated with international growth and the likelihood of failure is significantly increased. This represents an increasingly real concern for manufacturers looking to develop international operations, depending on the extent to which the risk is deemed manageable as shown in the diagram below. Moreover, understanding the extent to which international growth will demand either a fine-tuning of organisational strategy and design or a complete overhaul can also influence the decision about where to develop international operations.



The culture/strategy risk matrix
(Adapted from Davis, 1984)

GEOGRAPHY

WHERE, WHY AND WHERE NEXT?

It is clear that choosing in which markets to develop a presence is crucial to making international business successful and it is not always the case that the larger the business the more markets they are based in. While large manufacturers have a number of international supply chains and an international footprint, the decision about where to develop international operations is highly strategic. The research affirms that the main reasons for growing an international presence relate to opportunities for organic growth ambition, to be near customers, to be present in a particular market or to be co-located with a particular supply chain. While in some instances the question of where to locate may appear to be a case of following the leader; large manufacturers also have the capacity to shape, and in some instances create, markets through their presence by making the first move.

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Developed markets are still the big ones.

Survey respondent

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The BRIC economies are obviously important, but most UK businesses are still looking to Europe to expand.

Survey respondent

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Understanding global antitrust and competition rules is a necessary and prudent part of successful strategy in today's global economy. It's critical that manufacturers understand the regulations governing interaction with competitors, requirements for forming supplier and customer arrangements, and also the regulatory environment as it relates to the company format. While in some areas there is increasing harmonisation of underlying principles (e.g. merger control), there will always be significant substantive and procedural differences which may require modification of the approach to the market. Even within Europe there can be key differences which need to be thought through.

Alexandra Kamerling, DLA Piper Partner



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Only one way to dig a hole

From its origins of making agricultural tipping trailers in 1945, Joseph Cyril Bamford's small business has grown from a garage in Uttoxeter to become one of the UK's fastest-growing companies and a world leader in construction machinery. While JCB is a truly global business with 22 plants on four continents and an 11,000-strong worldwide workforce, it prides itself on being a 'global family business'. The history of JCB as an

organisation is premised on innovation, but its global success as a manufacturer is built on understanding culture and making markets. Construction is a highly localised business that is characterised by different traditions and conventions, the challenge for a manufacturer like JCB is not about selling equipment to dig holes, it is about how to sell digging holes the JCB way. With a network of 750 dealers around the world, JCB (with a global presence that is almost unparalleled in the construction industry) understands the importance of being there. The JCB story highlights the ability of a manufacturer not just to build

world-class products but to make and shape markets by understanding local culture. Significantly, an important aspect of JCB's strategy is to be present at the frontier of emerging markets such as Africa, so as to ensure that the preferred way to dig a hole becomes the JCB way.



An interesting element of the internationalisation of business is the evolving focus on geography. Traditionally, Europe has been the biggest market for UK businesses and this still remains the case. Even under a pessimistic growth scenario, by 2020 the EU will account for around 17% of global output, just behind North America³. **Many of the manufacturers polled stated that developed markets such as the EU and North America are still considered to be the ones with greatest potential for UK businesses.** Indeed, many of the businesses interviewed stated that Europe was their biggest market for sales and also their most important market for sourcing new international operations, with twice as many respondents looking to invest as cutback.

The manufacturers interviewed made reference to the uncertainty around the UK's membership of the EU, describing the proposal for a referendum as "unhelpful" and viewed an EU exit as an unlikely scenario. Opinion was unanimous that leaving the EU would negatively impact on the international potential of UK businesses.



Pulling out of Europe would be a huge setback ... The debate at the moment is a massive distraction and not helpful at all.

Survey respondent



The expansion of the EU across Central and Eastern Europe (CEE) has provided valuable opportunities for internationalisation⁴, opening up new and accessible markets to UK businesses. Opinions in favour of an EU exit have been framed around the argument that growth increasingly lies outside of Europe. However, many UK manufacturing companies polled were looking to increase their market share in Europe in addition to looking at growth opportunities in other parts of the world.

While there are growth opportunities in Europe and North America, many of the manufacturers stated that increased competition had seen them look at growth opportunities beyond Europe. As new markets have emerged, businesses are looking further afield at

opportunities for international growth, but while large UK manufacturers are being more entrepreneurial there is still a conservative approach towards growth. Emerging markets are a major focus for growth, with 52% of manufacturers saying that their expansion hinges on these markets⁵. However, despite this ambition, UK manufacturing is not currently making its mark in emerging economies. In addition to the well renowned BRIC economies, there is growing interest in the so called CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa) and more recently the MINT countries (of Mexico, Indonesia, Nigeria and Turkey) according to their economic prospects for trade.

While emerging markets provide an opportunity, many of the businesses reported there are significant differences between countries and there is no single approach to developing operations in emerging markets. **The primary factors influencing the locational decision making of manufacturing businesses relate to market opportunity and proximity to customers. However, in relation to emerging markets the ease of doing business, quality management and political-economic stability were particularly important considerations, as well as the image of the company operating in that country.** Once a business has identified a preferred location there is a need to establish the entry strategy, although above all it was the local presence that was regarded as critical to the success of developing international operations.



There has been increasing competition from within the EU. We have definitely seen a change. We have had to realign our cost base to be leaner ... And we have explored opportunities elsewhere, for example by looking more towards South America and the Far East to expand our operations.

Survey respondent





Businesses with global ambitions who want to realise the promise of emerging markets need to recognise and react to the key factors associated with being a success in their target market. Whilst the specifics will vary according to country and industry, a constant factor is identifying a location and determining how they are going to establish a physical presence there. Our clients are having to decide on a location by location basis whether to rely on local expertise and join with an established business already in situ, or to go it alone and acquire and set up their own base of operations. We are increasingly being asked to advise on the unique circumstances for different countries that determine which way our clients choose to proceed.



Nigel Howard, DLA Piper Partner



One thing that emerging markets have in common is that they are comparatively fluid and at times comparatively fast moving environments. The manufacturers polled often characterised emerging economies according to particular stereotypes and while there may be a degree of truth to these, as the markets evolve so these are challenged. For example, over the past 5-10 years a number of manufacturers described how doing business in China has become more straight forward and less bureaucratic with fewer tariff and non-tariff trade barriers. While increased familiarity with the Chinese business environment is part of this, and joint ventures were once a requirement, this is no longer the case although some manufacturers still view it as preferential. Indeed, as some of the manufacturers interviewed gained confidence there were a number of examples where these early joint ventures have been acquired as wholly owned in order to establish greater levels of control. However,

piracy and counterfeiting remains rife in China and a number of the manufacturers polled identified this and highlighted the difficulties of protecting intellectual property.



There has been a bias towards China. Everyone wants to go there. There was a peak in demand but now it has dropped off so people are looking at different options ... It is partly the economic cycle and partly that demand for our products has dropped away a little.

Survey respondent



Challenging stereotypes

Founded in 1979 from the family garage, this Cheshire based business has established a worldwide reputation in the oil and gas market. Over the past 30 years the business has become one of the premier needle and ball valve manufacturers in the world, playing a central role in the global oil and gas production industry. Following a period of rapid growth during 2012, Oliver Valves is expecting sales to exceed £100 million in 2014.

A central aspect of the business' success has been investment in research and development and establishing a presence near to its customers in over 80 countries worldwide.

Oliver Valves designs, assembles and tests all of its products from its headquarters in Knutsford, with production centred in the UK and Northern Italy. However, in 2004 Oliver Valves also established a manufacturing base in India, which produces certain high volume parts to stringent quality standards under control from its UK headquarters. The strategy of Oliver Valves has been to put its own people in place to ensure that every

component that leaves the Chennai factory is finished to meet the required standard. The rapid global growth in the oil and gas sector, coupled with the launch of new quality products, has seen Oliver Valves' market share continue to grow in Brazil, North America as well as in the Middle and Far East.

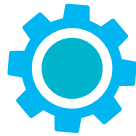




The legal environment in China has evolved massively over the last five years so that there are far fewer barriers to doing business and foreign companies are able to invest directly in a wide range of sectors that were once restricted to joint ventures only. However at the same time, the regulatory framework has become more complex and foreign companies face closer scrutiny from government authorities in relation to issues such as customs declarations, anti bribery and corruption, employment regulation, registered capital and accounting. Much of our work recently has been advising clients on compliance in relation to these matters and helping their business to manage risk and disputes with Chinese parties.



Josh Wong, DLA Piper Partner



The other emerging economies in which manufacturers were present had their own challenges, although there was not a sense that these economies have developed as much as China. India remains characterised as a low cost, low quality manufacturing base and highly bureaucratic although many interviewees regarded India as safe and politically and economically stable. While Russia was generally regarded as having strong market potential, there was an overarching concern about the perceived levels of corruption that had deterred a number of manufacturers who instead preferred to export. Many manufacturers stated that Brazil also offered significant potential for UK firms, but trade barriers made developing a presence slow. While the bureaucracy and administrative burden associated with Brazil (and other South American countries) is gradually declining, there was a sense that this tended to detract from the

opportunities available. In Mexico the economic recovery and ongoing political reforms have made it more attractive for UK manufacturers, while growth in Turkey has slowed as a result of political upheaval and high inflation.

In summary, for international growth many manufacturers traditionally looked to Europe and North America as geographical and culturally close markets, and while they are still hugely important, UK manufacturers are increasingly looking further afield. Without doubt emerging economies are set to dominate global GDP in the coming decade and being present is crucial to having a foothold in the market. Interestingly, while many of the manufacturers talked about international growth in terms of countries and global regions, a small number thought in terms of cities as hubs for future growth.



The US remains a significant market for our manufacturing clients, and the vast nature of the country, with immense regional differences does present challenges. Minimal language barriers and a stable regulatory environment, as well as the scale of commercial opportunities tend to offset these issues. With a focus on aerospace and defence, my own experience is that the US will continue to dominate the strategic direction for companies in this sector, but in the medium term opportunities in the Middle East and Asia Pacific will need to feature increasingly in global strategies.



Tim Lake, DLA Piper Partner



LEADERSHIP AND LEARNING

Two common aspects for developing successful international operations across all of the manufacturing businesses that participated in the research were effective leadership and the ability to learn as an organisation. In addressing these challenges, the importance of experience was a common theme emphasised during the interviews. However, for many this is not exclusively about individuals having prior experience of developing international operations in a particular country, but the ability of decision makers to evaluate current and future risk and uncertainty of market opportunities.

INTERNATIONALISATION AND THE C-SUITE

The C-Suite, so called because of “chief” officers of whom it comprises, has had to adapt as businesses internationalise. In recent years the spectrum of operational specialisms that comprise the C-Suite has grown, yet this poses a potential challenge for international growth. Achieving international growth, while maintaining strategic alignment across different functional areas of the C-Suite, is increasingly difficult to manage, and the integration of expertise is seemingly more valuable than specialisation. The crux of the matter is that the buy-in of the C-Suite is regarded as critical for developing international operations.

For UK manufacturers looking to grow their global operations this needs to start with the C-Suite. For top tier leadership to be effective there is a need for strategic capabilities to be identified and decisions made about strategic priorities, although these will increasingly need to be delivered through the wider global leadership network of an organisation working collaboratively.

Developing international operations needs to be understood in terms of developing the business. While C-Suite executives have always been integral to the leadership of organisations, their role is continuing to evolve and this is particularly the case in relation to international growth. For UK manufacturers the challenge of internationalisation is to make sure that the C-Suite has the right balance of operational and technical expertise which is able to develop and deliver international growth together in an integrated way.

Prior experience of developing international operations was considered invaluable in assessing potential risks and rewards, but the interviewees also emphasised the importance of acquiring information and insight through personal and professional networks.

Businesses that engage in higher levels of networking with their clients and peers tend to display more rapid internationalisation⁶, but it is more complex than networking per se. It is about being part of a community of practice. While there are opportunities for knowledge sharing that are facilitated at different levels within the UK manufacturing sector, it is the ability of top tier management to draw on their wider networks that are seen to make the difference.

The value of those leading an organisation is as much about who they know and what they know as much as it is about what the leaders know themselves. The real challenge for top tier management is in synthesising this information and insight and then acting to develop a competitive advantage through international growth. As well as drawing on their own networks, business leaders also develop new networks where firms do not have relevant or existing networks⁷. In some instances this may involve the use of intermediaries or working with partners who may represent gatekeepers in the network to access knowledge, open doors or provide a bridge into new markets. Trust, therefore, is a crucial aspect of working with intermediaries and developing partnerships, especially where this means not retaining control over the relationships.

Organisational learning is another important aspect of developing international operations, which also means making the most of knowledge within the business to drive international growth. The interviews highlighted that while large businesses have a wealth of knowledge built up over many years of operation, in practice it can be more difficult to make the most of any 'organisational memory.' Since middle management is often charged with the implementation, they represent an important knowledge base for operational growth, and maintaining good lines of communication with the senior management was viewed as especially important when developing international operations.

Promoting knowledge, sharing internally and learning from mistakes were regarded as key. While mistakes happen, among the businesses interviewed they tended to be the result of actions that had been taken without the required knowledge or expertise. This disruptive behaviour means that when things do go wrong, risk consciousness increases and businesses potentially become more risk averse about future international ventures.

A number of interviewees commented that organisational learning was not always effectively managed and the value of organisational memory not always leveraged. It is important to appreciate that organisational design and structure will affect organisational learning and memory, and is an important consideration in the prevention of organisational memory loss. This has become a real concern for leaders and decision makers, as organisational memory and learning should represent a source of competitive advantage for manufacturers going global.



We have learnt a lot in developing our international presence, but we have probably made every mistake in the book at some point. We just try not to make the same mistake twice.

Survey respondent



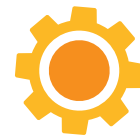
Working in international markets is a learning process. You continue to learn every day. Not all markets are the same and countries can themselves be diverse.

Survey respondent



As businesses grow internationally, a strategic HR approach is critical. The effectiveness of international growth can seriously be scuppered if the HR strategy does not work at both an international and local level. However, the challenge of realising a strategy that achieves the global versus local balance should not be underestimated. The cultural contexts and legal employment protection regimes differ vastly within and across continents. In our experience as far as managing workforces is concerned, one size rarely fits all.

*Alan Chalmers,
DLA Piper Partner*



IMPLICATIONS OF OWNERSHIP AND AUTONOMY

A growing number of large UK manufacturers are owned by a foreign-owned parent company or are part of a holding group structure. The relationship between the foreign parent company or holding group and the UK subsidiary will influence its business performance at home and abroad. The research included a number of wholly foreign-owned UK based manufacturers, and the extent/scale of autonomy determined the strategic and operational approach towards internationalisation. If the parent company/holding group is hands-off, then the UK subsidiary is likely to be able to operate with almost total autonomy at home and abroad, although significant capital investments generally require approval. Other UK subsidiaries with less autonomy are required to adhere to the strategies of the parent company/holding group, which can limit their ability to pursue international opportunities as decision making can shift from the subsidiary to parent company/holding group level.

LOCAL KNOWLEDGE, CORRUPTION AND PROTECTING IP

When discussing the challenges of internationalisation, many of the respondents stated that typical barriers, such as legislation and regulation, could be overcome with the right support. However, many also stated that support for cultural issues and tackling corruption was just as pressing but that often they acted without sufficient knowledge and insight into both. For some, failure to properly understand cultural issues had led to a direct negative impact on their operations. Similarly, while all businesses were aware of corruption and sought to avoid it, some were acting with less than complete knowledge of their responsibilities.

Market entrants often lack the expertise to overcome administrative and cultural barriers that arise with specific business cultures. Yet despite this lack of knowledge, businesses can make major investment commitments and thus accept a high degree of uncertainty⁹. **As the interviews made clear, entering a new market without country specific knowledge is a high risk strategy.** Where the business culture is very different to that of the UK, gaining in-depth market knowledge can be extremely challenging. Yet, in economies where international operations have been well established over a number of years, cultural convergence can be seen. Many of the businesses interviewed stated that operating in Europe has become much easier and cultural differences are less stark than establishing an operation in an emerging economy. However, some of those interviewed also stated that wherever an international operation was located, cultural differences presented a challenge. Many of the businesses emphasised that cultural knowledge was crucial but often they did not know where to look for help or felt that the external organisations were not well-equipped to provide cultural knowledge.

The businesses stated that cultural understanding could make or break an international venture. As one explained, business was about “working with people, so you need to understand who you are working with.” This respondent explained that cultural understanding will open up more opportunities and help to secure deals and was as important as understanding legal/regulatory requirements.

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Even if we are looking to expand our operations from the UK to a country like the Netherlands, we need to understand the cultural differences, otherwise we just won't get the most out of our expansion.

Survey respondent

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Getting help with cultural aspects is the trickiest bit. Who do you go to for help?

Survey respondent

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UKTI have been a great help to us, but mainly on the formal side. If you need support with regards to softer things like culture, which is really important if you want to get things right, the provision from external organisations is not really there.

Survey respondent

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LOCAL KNOWLEDGE

As businesses develop international operations, they encounter cultures that differ from country to country and region to region. Getting to grips with local variances is an important aspect of international growth and often requires the business to learn to get it right as not all working norms are transferable.

As businesses develop internationally there is a need to appreciate differences in business culture – put simply the way things are done.

One manufacturer interviewed described how they parachuted a UK management team into the country, which resulted in a cultural shock as frustration and tensions developed between home and host cultures. If they had brought in local people at the outset the challenges faced would have been avoided.

Beyond doing business there is a need to develop an awareness of social culture, in order to avoid embarrassment and offence. An example of this from one interviewee related to the delivery of a major order to the Middle East which they later found coincided with Ramadan. As a result the port was closed down and the shipment had to be kept in situ in another location until the docks opened again, meaning that they incurred significant and unnecessary costs. While the adverse impact of this example was limited, with a little local knowledge it could have been avoided.

As businesses have grown internationally, one challenge that has come to the fore is that of Intellectual Property (IP). Intellectual Property Rights (IPRs) have become a central dimension of industrial and innovation policy around the world, with the prevailing approach seemingly one of imposing the Western system of IPRs. It is argued

that a strong and globally harmonised IPR system is desirable, particularly by large businesses, for enforcing the protection as well as stimulating the development of IP. While the simplistic model of developed economies as sites of innovative knowledge creation, and emerging economies as the location of cheap labour and manufacturing, have become outdated, the legacies of infringing IP and counterfeiting continue to be more problematic in emerging economies.

PROTECTING INTELLECTUAL PROPERTY

The research found that UK manufacturers remain conscious about the challenge of protecting intellectual property as they grow internationally. Given that the international growth of UK manufacturing is premised on advanced engineering and sophisticated design, there was a consensus that protecting IP remains important. Where there is a case for pursuing businesses that infringe registered IP, it is often as much about being seen to identify and pursue offenders as much as it is being successful in any claim. A number of manufacturers found that this served as a deterrent to further infringement and/or counterfeiting.

Beyond relying on formal systems to protect IP, a number of manufacturers described different organisational strategies for managing IP across multiple international sites. In some instances this saw core R&D functions located in the UK in an attempt to centralise IP, while other manufactures primarily located IP sensitive activities in countries with strong(er) IPR systems. Where manufacturing was undertaken in countries renowned for counterfeiting, manufacturers tended to distribute production and assembly across different sites. The other mechanism for protecting IP was to internalise it, with a preference for wholly owned subsidiaries rather than joint ventures.



It is vitally important to think about IP protection at an early stage in the course of any international expansion. All too often companies announce their expansion plans only to find out subsequently that locally registered IP rights will stand in the way of the business's goals. For example, we have recently seen a spate of UK companies' new brand names being registered by copycat businesses in China before the UK company files its application. IP rights vary significantly between jurisdictions, and so it is important to line up a team of IP advisers able to advise wherever a company does business. We regularly assist clients with international rights clearances and freedom to operate reports, and draw on our global team of IP advisers to help our clients avoid the potential IP pitfalls of international expansion.

Peter Brook, DLA Piper Partner



A key concern of the businesses interviewed was corruption. Businesses felt that they needed to be constantly vigilant and aware of the potential for corruption so that it could be avoided. In many countries, where the formal business rules and informal cultural practices create space for corruption, businesses must navigate difficult and uncertain environments.

While countries with high levels of corruption are seen to attract less international investment, the potential gains to be made in many of these localities are too significant to avoid completely. **All of the businesses interviewed stated that they had been aware of corruption when operating internationally.** Some had been directly asked to pay bribes, while others had been made aware of the possibility for corruption and had thus backed away from investments in some countries. All of the businesses stated that they had not engaged in corruption, although some stated that they were aware that agents or intermediaries could be involved in bribery and/or kick-backs.

Corruption, typically in the form of bribes and gifts, can be normalised in some countries, as corrupt behaviours have spread and embedded themselves within the culture to the extent that it is expected and accepted although not morally approved. The interviews demonstrated that Eastern European countries were perceived to have fairly embedded cultures of corruption, but that the BRIC countries which many UK countries are seeking to expand into also present challenges. Research undertaken by UKTI has shown that the BRIC countries are perceived to present the highest level of risk to UK companies, along with Mexico¹⁰. Furthermore, the research also finds that larger firms (in this case, firms with over 250 employees) are more likely to see corruption, bribery or organised crime as a key business risk. Our interviews found that corruption is a possibility in any country, but that it was more pronounced in some localities. In particular, many companies perceived that corruption was an issue in Russia.

In countries with high levels of corruption, new entrants felt they were at a competitive disadvantage compared with indigenous counterparts. In this sense, environments with high levels of corruption can be characterised as possessing ‘discriminatory regulation’ which favours domestic firms and punishes foreign-owned investment (and can prompt relocation to more regulatory benign locations). The ‘different rules’ mentioned in the interviews mean that businesses in such localities face an enormous challenge to be competitive if they avoid corruption. **The interviews with businesses also found evidence of this, with many companies reporting that avoiding corruption put them at a competitive disadvantage.**

Despite the fact that corruption could be experienced in any locality, the interviews found optimism that things were improving. In particular, a number of businesses stated that they had seen improvements in China. The CBI has communicated that while corruption is clearly morally and legally wrong, that there are doubts about the impact of UK laws on business operations abroad, particularly in terms of the Section 7 corporate offence clause¹¹. The clause holds companies strictly liable for failing to prevent bribery committed by ‘associated persons’ on their behalf. The manufacturers stated that when UK businesses are working with an international agent which

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The world is changing. China is becoming less corrupt ... The new generation are changing things.

Survey respondent

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Although the Russian anti-corruption laws that have recently been introduced may not have had the desired effect, the business reality is not as black and white as is often portrayed in Western media. For example, we as DLA Piper are running a successful legal advisory business in two major Russian cities without any exposure to bribery or corruption. There are multiple Western businesses, including large international corporations, that have well-established operations in Russia despite the tight compliance rules that they are required to follow. In my experience, one of the main obstacles to foreign investment in Russia is not corruption itself, but the negative and often inaccurate perceptions of the country in general.

Steffen Kaufmann, DLA Piper Partner



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acts in a corrupt way they are liable, even though they would not have the control over that aspect of their supply chain. Clearly, trust is important when using agents, but the interviewees stated that for the majority of large businesses operating or seeking to move abroad, they could not hope to have total control over that aspect of their supply chain. Many manufacturers held strong corporate values that they regarded as consistent with the Bribery Act, but felt that the compliance with and the policing of the Act potentially placed UK businesses at a competitive disadvantage. For example, several manufacturers stated that while bribery legislation existed everywhere, that it was policed more stringently in some locations than others.

The interviews demonstrated mixed awareness of the Bribery Act. Some respondents stated that they were aware of it and understood their obligations. However, others stated that they were either not aware of it or did not understand it. Of those who were aware of it, many stated that they could not fully oversee the work of agents

or intermediaries working in foreign countries and there was therefore a risk attached to these operations. However, they stated that this emphasised the importance of using agents/intermediaries that they had worked with over a number of years or who had been recommended to them. The research therefore demonstrates that there is a clear need for businesses to be advised properly on their legal obligations and the extensive reach of UK law as it relates to corruption and bribery cases.

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Every country has legislation like that, but for example in Germany it appears less stringent. The legislation is there to ensure some compliance but not to punish ... We should take a similar pragmatic approach to support UK businesses.

Survey respondent

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Businesses who fail to understand the implications of the UK Bribery Act, particularly its extra-territorial reach, risk prosecution, conviction, significant financial penalties and an irrecoverable tarnishing of their commercial reputation. Given the fundamental need to ensure appropriate policies, procedures, training and awareness to prevent bribery and corruption issues are in place in every business, it is surprising to see such variance in the level of corporate understanding in this area.

Stuart Ponting, DLA Piper Partner



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CONCLUSIONS

If UK manufacturing is to continue to go from strength to strength, then UK manufacturers need to continue to assert their position on the global stage, both through consolidation and growth. The research demonstrates that there is not a 'one size fits all' model for internationalisation and the lessons to be learned are numerous and varied. While there is no blueprint for international growth and developing global operations, there are a number of common lessons that can be applied.

- Growth for growth's sake is not a strategy, in fact it can undermine strategy. Perhaps the most commonly referred to lesson was to understand the rationale about why a business would want to grow internationally.
- When reflecting on the crux of what makes for good internationalisation strategy the key message was 'think global act local', and this needs to be led by the senior management team as well as reflected in organisational values.
- One of the most insightful reflections was around authoritative decision making – by taking the hard calls early on. A number of manufacturers described how a failure to do this had increased costs and slowed the development of international operations.
- The importance of establishing a local presence cannot be underestimated, but it needs to be with the right people. Growing international operations demands strong relationships and good communication, so without the right people success is unlikely whether they are agents or employees.
- Getting the right support at the right time was another point emphasised. The knowledge and expertise is out there, so it is about knowing where, how and when to access it. For many manufacturers this has come to mean leveraging formal and informal networks from peers to professional services.
- A little local knowledge was found to go a long way, and several manufacturers highlighted that going international with a good product or technology was not enough. Becoming familiar with the local business environment and culture was seen as critical for developing sustainable operations.
- Internationalisation is a long term game. Many manufacturers had to re-evaluate their expectations in terms of establishing global operations and integrating them into the existing business. Fundamentally while international operations represent an opportunity for growth they affect the entire business.
- Perhaps the hardest lesson on reflection was setting limits and knowing when to pull back. No business wants to fail in its operations at home or abroad, but developing international operations should not be to the detriment of the business as a whole over the longer term.
- Ultimately UK manufacturing has proved resilient given the financial crisis, but there is tremendous potential to grow on an international stage. While the research has identified a number of the common strategic and operational drivers and challenges for international growth, the responses are necessarily organisationally and geographically specific. While successful manufacturers have the capability to make markets, they can only do it when working with globalisation and the dynamics of the global economy.

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DLA Piper takes its expertise in and commitment to the manufacturing sector very seriously. We have built a strong reputation for supporting organisations engaged in all aspects of manufacturing, including: industrial and advanced engineering; automotive; aerospace and defence; and chemicals and paints. We are committed to understanding the markets in which our clients operate and the specific commercial challenges they face. Our team of lawyers has considerable experience of working with a broad range of blue chip manufacturing businesses, both in the UK and internationally, across a full spectrum of issues. For more information about our manufacturing capabilities, please email us on manufacturing@dlapiper.com or contact one of our specialists below.



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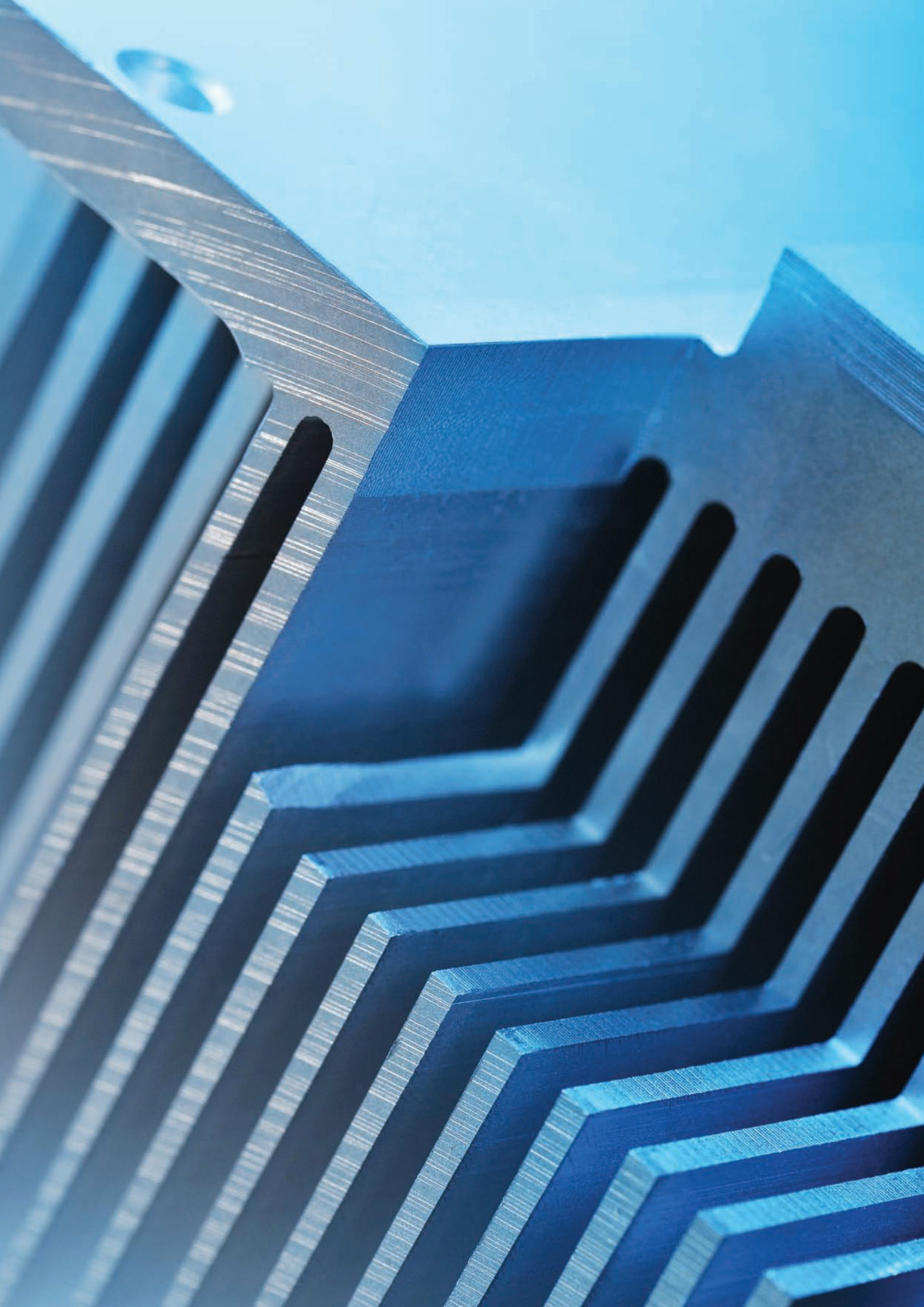
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