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# Managing Innovation in an Unstable World: Challenges of Global Competition for European Innovative and Proactive Firms

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## Abstract

Innovation and marketing strategies adopted by multinational companies in the globalized economy are subject to continuous challenges. Consider EU exporting companies that produce, for example, solar panels. Depending on political elections and the ensuing support for environmental policies (or the lack thereof), their innovative strategy may reveal either extremely successful or futile. The aim of this paper is to explore the conditions under which innovative and proactive companies survive in a global scenario that changes based not only on economic but also on political as well as social factors.

**Keywords:** Innovation, Strategy, Globalization

**JEL classification:** L2, M1, O3

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## Introduction

In occasion of its 60<sup>th</sup> anniversary, the EU celebrated this event by remembering the most important achievements obtained during such a challenging process of integration: "Sixty years ago in Rome, the foundations were laid for the Europe that we know today, ushering in the longest period of peace in written history in Europe. The Treaties of Rome established a common market where people, goods, services and capital can move freely and created the conditions for prosperity and stability for European citizens" (European Commission, 2017a). However, the anniversary of the treaty represented also a moment of reflection, not just celebration. The past decade has been especially difficult and turbulent. Challenges and concerns about immigration, trade, and globalization revealed the fragility of the European process (Mc Kinsey Global Institute, 2017). The British vote in June 2016 has been the most evident manifestation of such concerns, together with recent elections in different parts of the EU. In this difficult context, how are European firms responding to these new challenges? Where and what should they be investing in? The aim of this paper is to provide an answer to these questions. We will consider two alternative but complementary explanations.

First, we will argue that a crucial aspect is the interplay between the industrial and trade policies adopted. In particular, we will focus on the role played by trade agreements signed by the EU, and/or by the protectionist policies that it eventually implemented. Consider for example the wine sector. Following the decision of the EU to impose antidumping duties on Chinese solar panel producers, the Chinese government decided to reduce the import of European wine, thereby affecting

French producers. However, thanks to the trade agreement signed in 2011 between the EU and South Korea, France was able to become South Korea's largest wine supplier, benefitting from a 30.9% market share. Another example can be seen in Latin America. Following the new course set by Argentina's President Mauricio Macri, new business opportunities emerged in sectors ranging from agriculture to renewable energy to engineering. The Italian electricity company ENEL is considering bidding for renewables, which the local government wants to expand. This provides an interesting case study that explains how the investment in green innovation may benefit not only EU innovative companies in the local market, but also in supporting their export towards new destination markets.

Second, we will explore the "manufacturing" point of view, and will attempt to uncover the black box of the internal organization of companies that must respond to the challenges brought on by the globalization of consumption. The political and economic turbulence that we highlighted above is also responsible for the emergence of a 'social' turbulence, which for companies may mean highly volatile and unpredictable consumer behaviour. This is especially evident in such a globalized and "interconnected" market, where a vast amount of information is readily available, thereby changing consumption habits and trends at lightning speed. As a result, companies need to keep up, and the most proactive ones are able to convert perceived challenges into profitable opportunities.

## Methodology

We will first analyse the destination market for many EU producers in terms of continents and/or geographical areas and then evaluate which specific countries are more appealing for European companies. We will also explain in which sectors doing business may be more profitable. We will start from North America, and argue that presently Canada represents the most interesting destination, especially for traditional European foods and drinks. We will then continue with South America, and, apart from Argentina, we will consider Chile, Peru, and Colombia, which recently signed trade treaties with the EU. We will continue with an analysis of the Russian market. This is a challenging destination market for European producers, given that the political sanctions imposed by the US and the EU in recent years has altered their trade relations with Russia. Although many European producers suffered from these sanctions, others were able to not only survive, but also thrive. We will then explain the new business opportunities that arose in South-East Asia, especially in Indonesia and South Korea. We will not consider China since such a market has already been extensively covered by many different contributions (for example, see Gourdon et al., 2016). The last case studies will be related to new destination markets such as Iran and Lebanon, especially in terms of food and fashion. The African market, although very interesting for many EU producers, will not be considered in this paper as the authors have no direct expertise of business being created there for European companies.

Second, we will consider the "manufacturing" point of view, starting from the threat faced by companies that enjoy a dominant position in the market, and that have to continuously invest not only in new technologies but also in market research in order to keep their advantage. As one the most crucial aspects of our analysis is the interplay between different policies adopted by the governments and the strategic moves carried out by firms, we will then focus on green production processes.

## Results

The results of this paper is that the interplay between an effective industrial policy and a farsighted commercial and trade policy is crucial to increase the competitiveness of European producers not only wanting to keep exporting towards traditional markets, but also extending to new destination markets. Competition within the European boundaries is carried out by a combination of liberalization measures and antitrust policies that create the conditions for new firms to enter, as well as protecting consumers from cartels and abuses of monopoly power. This is not enough, and the recent focus on technology and green innovation demonstrates that environmental issues are crucial for both local and destination markets. The new industrial policy embraced by the European Union is therefore characterized by a combined effort in order to protect competition, promote innovation, and foster green and sustainable growth. Innovative and proactive firms are those that can contribute the most to achieve these goals, and their ability to succeed in turbulent environments depends on a combination between the commercial and trade policies adopted by the governments and their ability to adapt to such changes. We will find that, in markets where the EU negotiated new trade agreements, proactive and innovative European companies were able to achieve high levels of performance, bringing high quality goods as well as economic development and innovation within the targeted market.

## Discussion

### *The interplay between industrial and trade policies*

We start by considering the five markets that we want to use in order to support our claim that industrial and trade policy go hand in hand in providing the conditions for European producers to succeed in the global market.

The first region that we analyse is North America. Following the recent elections in the US, a new wave of protectionism is hindering EU exporters, given that the current administration has introduced new tariffs and quotas that will limit the entrance into the US market. For this reason, many European producers are directing their export activities to Canada, where the recent completion of the CETA (Comprehensive Economic and Trade Agreement) has brought upon two important changes. The first one is related to the fact that Canada has agreed to protect 143 products with Geographical Indications, *i.e.* distinctive food and drink products from specific towns or regions in the EU. They include Roquefort cheese, balsamic vinegar from Modena, Dutch Gouda cheese, and Italian Parmigiano. This implies, for instance, that cheese sold in Canada as Parmigiano will have to come from Parma and Reggio (Italy). European food and drink producers of these specific products will therefore not only expand their business in Canada, but also feel more protected against the use of their label. The second important change is the removal of many custom duties. This will help all European firms exporting to Canada. Small and medium enterprises, which represent the backbone of European business, will gain from this agreement. One such example is Graffeo Cravatte, a small producer of ties from Sicily, Italy. Canada already represents 7% of Graffeo Cravatte's market, even though it currently pays a 16% tariff on its export to Canada (for this case study and others on EU exporting companies, see European Commission, 2017b). This company, together with many others, will save hundreds of millions of euros a year in duty payments.

The second case that we consider is Latin America. Despite the high level of trades, these are far below their actual potential, partly due to the protectionist policy adopted by many countries, especially Argentina under the Kirchner

government. The new course set by Mauricio Macri starting in 2015 has put the nation at the forefront of international economic interest. Business opportunities appeared in sectors ranging from agriculture to renewable energy to engineering. Italy, which for cultural proximity represents a privileged partner, has sent a delegation of industrial representatives to discuss business possibilities. Italian Railway is interested in planning and building out a railway network in the north of Buenos Aires. ENEL, as previously mentioned, is considering joining the bidding for renewables. Electrical engineering and electronics firms were also involved. Claudio Gemme of trade group Anie said, "There are many opportunities in renewable energy, construction and transportation". Other regions of South America have recently increased trade with the EU. Following different negotiations, Chile, Peru and Colombia signed commercial treaties with the EU between 2011 and 2012, thus creating new business opportunities for European producers. Organic fertilisers were strongly required in such markets. Biolchim, an Italian producer of organic fertilisers, experienced an increase in its exports from 10% in 2008 to 50% in 2015. Between 2012 and 2015, exports to Chile, Peru and Colombia increased in value by 111%. Leonardo Valenti, Managing Director of Biolchim, recently stated: "One of the key factors has been the promotion of higher standards and a regulatory framework that encourages the use of organic fertilisers".

The third market that we analyse is Russia. The recent adoption of sanctions against Russia provoked a lose-lose situation in which the EU experienced a consistent decline in export volume, especially in the food sector and in the automotive sector. This also resulted in substantial losses of jobs and logistics investments. However, some European companies were able to survive, by no longer exporting actual products, rather the production know-how (from "made *in* Italy" to "made *with* Italy"). There were also companies that used their logistics in Russia to conquer other markets. Consider the example of Carlsberg, the biggest Danish brewery. Carlsberg exports in more than 150 countries, and Russia was one of most important destination markets (20% of sales). Carlsberg entered the Russian market in 1992 through a stake in Baltika, a local beer producer, which was afterwards acquired. Following the declining sales in Russia, Carlsberg decided to step down from the Russian market in 2015, but its subsidiary Baltika started deliveries to Oman in 2016. It was the first beer exporter to that country, focusing on alcohol-free beer. Thanks to this strategic move, Carlsberg has now a prominent position in an untapped market, thanks to the strong relations between Oman and Russia.

The fourth market is South-East Asia. We focus in particular on South Korea and Indonesia, which has become interesting destination markets for many EU producers. We already explained in the Introduction the beneficial effect of the trade agreement signed in 2011 between EU and South Korea, especially for wine exporters. South Korea is now the third largest Asian wine market for France, behind China and Japan, with an expected increase of 25% by the end of 2017. Not only French wine producers, but also their Italian competitors experienced an increase in the value of exports to South Korea from €13.5 million in 2007 to €24 million in 2015. Regarding Indonesia, its economy is growing exponentially. In 2016, it achieved a growth rate of 5.02%, and for the past 10 years it has maintained an average growth of 5.6%. PricewaterhouseCoopers predicted that Indonesia will become the fourth largest economy by 2050. Indonesian consumers highly appreciate European products, especially fashion and luxury goods. Following a report from Reebonz, an online platform for buying and selling luxury products, luxury goods sales in Indonesia have grown by 84% in the past years. Chanel, Hermès, Louis Vuitton and Prada topped the brand list in this category, particularly the sales of bags and shoes.



However, what has reduced the potential market expansion is the absence of an underground system and transportation facilities, given that Indonesians purchasing activity is concentrated in shopping malls that are not very accessible. The construction of the Jakarta MRT (Mass Rapid Transit) system will allow consumers to gain approachable access to shopping malls, thus favouring European producers that want to increase their export levels.

Finally, business opportunities may arise in markets that have been partially or completely neglected until a few years ago. Consider the recent EU-Lebanon trade agreement, based on the progressive elimination of trade tariffs, which will disappear by 2018. European beef producers are particularly interested in countries where Islam is the predominant religion, given that the absence of pork products tends to boost the demand of beef. Lebanon is a country that imports a high proportion of its beef, and the benefits brought by the new trade agreements are already visible. For example, Cecinas Nieto is a family-owned Spanish business specialised in gourmet meat products. It can now export its halal meat products to Lebanon without restrictions. Let us finally consider Iran, where the end of the sanctions represented a lucrative opportunity for European producers, especially in the fashion industry. Indeed, GDP increased by 5%, thus improving standards of living and creating a new target of consumers, especially among younger generations that already were familiar with certain brands. For example, Roberto Cavalli decided to relocate retail services from China to Iran, also because many young Iranians were used to buy Cavalli clothes in Dubai and Istanbul. It is worth mentioning that the causes of the crisis of Cavalli in China are related to a greater control on luxury spending by the Chinese government together with the introduction of import tariffs.

### *The “manufacturing” point of view*

We explore now the “manufacturing” point of view, since many of the activities (both strategic and operative) inside a company are highly impacted from this difficult and challenging scenario. One of least obvious threats a company may face, paradoxically, is having a dominant market position where managers take for granted their competitive edge. This may result in the emergence of a gradual passive attitude towards exploring the dynamic changes in consumer interest, the emergence of new trends and needs, thereby neglecting the development of those strategies that are necessary to stay one step ahead. Consider, for example, the electronics industry, which is highly exposed to the obsolescence problem. Technology moves forward at such a speed, that it forces leading companies to continuously adapt their manufacturing perspectives toward lean production and increased efficiency. If they do not comply with this reality, they risk running the accumulation of large inventories with no future use. Proactive companies can deal effectively with this problem by investing in state-of-art technology, in order to obtain real-time data on current demand (which are by nature more reliable than forecasts). This ‘best practice’ allows them to avoid producing goods that are likely to soon become obsolete. Moreover, active consumer involvement in product design has become a winning strategy, as it enables the company to fully grasp consumers’ needs and requirements.

Another important aspect is a growing request for ‘green’ strategies, mainly due to government policies or protocols (Karanovic, B., 2016). Some companies have realized that they could take advantage in leveraging these obligations, turning them into business opportunities. As before, investing in technology could be the key factor. The digitalization of documents, paperwork and mail (about 140 billion of

traditional mail was sent out worldwide in 2014) not only provides benefits for the environment, but it also increases efficiency within the company, allowing real time data to be shared and exchanged. Moreover, when facing new sustainability policies, proactive companies may decide to even go further and reshape their production process. Consider the dismissal of an obsolete or hazardous material: the opportunity of a massive bill-of-material review campaign could be considered in order to obtain other component standardizations and material reductions. The benefits of these policies are highly visible in production efficiencies, advantages in purchasing and logistics, improved quality, as well as simplified practices in returning management. The same outcome could be achieved in the reduction of CO<sub>2</sub> emissions, which can be obtained through an optimized policy in terms of transportations and deliveries. Moving a step further, organizations might be interested in tracking not only CO<sub>2</sub>, but also all their emissions and pollution together with other environmental parameters. This can be achieved by streamlining a company's tracking system, thereby reaching a high level of monitoring and control strategies.

Finally, we argue that proactive companies should focus on establishing valid strategies and processes in order to obtain significant savings, new forms of internal efficiencies, gain new markets and increase customer loyalty. Traditionally, focusing strongly on returns investigation and analysis enables a company to improve the quality of both its products and processes, reducing process costs of up to 50%. Another benefit of putting in place a structured returns management is an increased percentage of products that can be repaired and remanufactured. This results in significant savings, not only in avoiding these operations, but also in the related reduction in transportations and CO<sub>2</sub> emissions (see Stock et al., 2006). The components optimization and reduction policies previously mentioned in this paper work very well with these best practices as they increase the probability for components or modules to be reused in production of new products. Moreover, policies of reverse logistics can be encouraged, with the usage of standard containers or packages that helps in optimizing transportation and logistics, and in space savings. Providing customers with special labels and packages for returns, asking them to simply fill containers and paste labels, will help in the operations of back receiving and the put-away process. As a last consideration, statistics show that more than 90% of customers decide to repurchase when a company provides them with easy comfortable practices and facilitations in returning a product, with the final effect of increased overall loyalty.

## Conclusion

In this paper, we argued that innovative and proactive firms are those that can succeed in a turbulent environment where not only political and economic conditions continuously change, but also social factors tend to influence consumer-purchasing decisions. In the first part, we focused on European companies that decide to export, and we highlighted that they have to direct their attention towards those markets in which EU negotiated new trade agreements. In the second part of the paper, we explored the manufacturing point of view by investigating the best practises that companies should follow in order to succeed. As the boundaries of markets and consumers' needs are continuously, change, together with the different trade and industrial policies adopted by governments, successful companies should combine their need to keep up with variable and volatile demand with the directives of governments to enhance different policies.

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