



MOTIVATIONS TO GO ABROAD

2. To understand the strategic effects of internationalization on the firm

Normally, management will consider international activities only when stimulated to do so. A variety of motivations can push and pull individuals and firms along the international path. An overview of the major motivations that have been found to make firms go international is provided in Table 13.1. Proactive motivations represent stimuli for firm-initiated strategic change. Reactive motivations describe stimuli that result in a firm's response and adaptation to changes imposed by the outside environment. In other words, firms with proactive motivations go international because they want to; those with reactive motivations go international because they have to.

PROACTIVE MOTIVATIONS

Profits are the major proactive motivation for international business. Management may perceive international sales as a potential source of higher profit margins or of

more added-on profits. Of course, the profitability expected when planning to go international is often quite different from the profitability actually obtained. Profitability is often linked with international growth—yet many corporate international entry decisions are made based on expectations of market growth rather than on actual market growth.¹³ Particularly in start-up operations, initial profitability may be quite low due to the cost of getting ready for going international, and the losses resulting from early mistakes.¹⁴ The gap between expectation and reality may be especially large when the firm has not previously engaged in international business. Even



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Licensing and franchising are important methods of internationalization.

with thorough planning, unexpected influences can change the profit picture substantially. Shifts in exchange rates, for example, may drastically affect profit forecasts.

Table 13.1 Major Motivations to Firms

Proactive Motivations	Reactive Motivations
Profit advantage	Competitive pressures
Unique products	Overproduction
Technological advantage	Stagnant or declining domestic sales
Exclusive information	Excess capacity
Tax benefit	Saturated domestic markets
Economies of scale	Proximity to customers and ports

Unique products or a technological advantage can be another major stimulus. A firm may produce goods or services that are not widely available from international competitors. Again, real and perceived advantages must be differentiated. Many firms believe that they offer unique products or services, even though this may not be the case internationally. If products or technologies are unique, however, they certainly can provide a competitive edge. What needs to be considered is how long such an advantage will last. The length of time is a function of the product, its technology, and the creativity of competitors. In the past, a firm with a competitive edge could often count on being the sole supplier to foreign markets for years to come. This type of advantage has shrunk dramatically because of competing technologies and the frequent lack of international patent protection.

Special knowledge about foreign customers or market situations may be another proactive stimulus. Such knowledge may result from particular insights by a firm, special contacts an individual may have, in-depth research, or simply from being in the right place at the right time (e.g., recognizing a good business situation during a vacation trip). Although such exclusivity can serve well as an initial stimulus for international business, it will rarely provide prolonged motivation because competitors can be expected to catch up with the information advantage. Only if firms build up international information advantage as an ongoing process through, for example, broad market scanning or special analytical capabilities, can prolonged corporate strategy be based on this motivation.

Tax benefits can also play a major motivating role. Many governments use preferential tax treatment to encourage exports. As a result of such tax benefits, firms either can offer their product at a lower cost in foreign markets or can accumulate a higher profit. However, international trade rules make it increasingly difficult for governments to use tax subsidies to encourage exports. For example, to counteract the value added tax refund provided to exporters by the European Union, the United States attempted to provide tax deferment to its exporters. The deferment, originally called the Domestic International Sales Corporation (DISC) and subsequently renamed the Extraterritorial Income Tax Exclusion (ETI), was challenged by the European Union before the World Trade Organization (WTO). Following a long series of hearings and appeals, the WTO ruled definitively against the ETI, subjecting it to abolishment or retaliatory tariffs by trading partners. In 2004, the European Union put into effect a number of countervailing duties, forcing then President George W. Bush to repeal the FSC-ETI legislation in favor of broader (nonexporter specific) tax relief.¹⁵

A final major proactive motivation involves economies of scale. International activities may enable the firm to increase its output and therefore rise more rapidly on the learning curve. The Boston Consulting Group has shown that the doubling of output can reduce production costs up to 30 percent. Additionally, studies have shown that the benefits of centralized production are substantial enough to offset any increases in transportation costs. Therefore, increased production for international markets can help reduce the cost of production and make the firm more competitive domestically.¹⁶

REACTIVE MOTIVATIONS

Reactive motivations influence firms to respond to environmental changes and pressures rather than blaze new trails. Competitive pressures are one example. A company may worry about losing domestic market share to competing firms that have benefited from the economies of scale gained through international business activities. Further, it may fear losing foreign markets permanently to competitors that have decided to focus on these markets. Because market share usually is most easily retained by firms that initially obtain it, some companies may enter the international

market head over heels. Quick entry, however, may result in equally quick withdrawal once the firm recognizes that its preparation has been inadequate.

Similarly, overproduction may represent a reactive motivation. During downturns in the domestic business cycle, foreign markets can provide an ideal outlet for excess inventories. International business expansion motivated by overproduction usually does not represent full commitment by management, but rather a temporary safety valve. As soon as domestic demand returns to previous levels, international business activities are curtailed or even terminated. Firms that have used such a strategy once may encounter difficulties when trying to employ it again because many international customers are not interested in temporary or sporadic business relationships.

Declining domestic sales, whether measured in sales volume or market share, have a similar motivating effect. Goods marketed domestically may be at the declining stage of their product life cycle. Instead of attempting to push back the life cycle process domestically, or in addition to such an effort, firms may opt to prolong the product life cycle by expanding the market. Such efforts often meet with success, particularly with high-technology products that are outmoded by the latest innovation. Such “just-dated” technology may enable vast progress in manufacturing or services industries and, most importantly, may make such progress affordable. For example, a hospital without any imaging equipment may be much better off acquiring a “just-dated” MRI machine, rather than waiting for enough funding to purchase the latest state-of-the-art equipment.

Excess capacity can also be a powerful motivator. If equipment for production is not fully utilized, firms may see expansion abroad as an ideal way to achieve broader distribution of fixed costs. Alternatively, if all fixed costs are assigned to domestic production, the firm can penetrate foreign markets with a pricing scheme that focuses mainly on variable cost. Yet such a view is feasible only for market entry. A market-penetration strategy based on variable cost alone is unrealistic because, in the long run, fixed costs have to be recovered to replace production equipment.

The reactive motivation of a saturated domestic market has similar results to that of declining domestic sales. Again, firms in this situation can use the international market to prolong the life of their good and even of their organization.

A final major reactive motivation is that of proximity to customers and ports. Physical and psychological closeness to the international market can often play a major role in the international business activities of the firm. For example, a firm established near a border may not even perceive itself as going abroad if it does business in the neighboring country. Except for some firms close to the Canadian or Mexican borders, however, this factor is much less prevalent in the United States than in many other nations. Most European firms automatically go abroad simply because their neighbors are so close.

In this context, the concept of psychic or **psychological distance** needs to be understood. Geographic closeness to foreign markets may not necessarily translate into real or perceived closeness to the foreign customer. Sometimes complex cultural variables, such as language, religion, legal, and political systems, make a geographically close foreign market seem psychologically distant. Some research has suggested that these intangibles also account for concrete differences in health, education, and consumption patterns.¹⁷ For example, research has shown that U.S. firms perceive Canada to be much closer psychologically than Mexico. Even England, mainly because of the similarity in language, is perceived by many U.S. firms to be much closer than Mexico or other Latin American countries, despite the geographic distances. However, in light of the reduction of trade barriers as a result of the North American Free Trade Agreement (NAFTA), and a growing proportion of the U.S. population with Hispanic backgrounds, this long-standing perception may be changing rapidly.

It is important to remember two major issues in the context of psychological distance. First, some of the distance seen by firms is based on perception rather than

psychological distance A measure resulting from the combination of physical and mental distance.

**FOCUS
ON
ENTREPRENEURSHIP**

An International Bug

How did a small Phoenix-based environmental cleanup company boost international sales from zero to 25 percent of annual revenues? By proactively going for the world!

First, Dan Kelley, CEO of Tierra Dynamic Company, and his 30 employees had to discover a very special “bug.” Tierra Dynamic patented a discovery called the *bio sparge*, a naturally occurring bacteria that Tierra cultivates, then induces to eat spilled hydrocarbons at an accelerated rate. According to Kelley, “this technique remediates soil three times faster than other methods now on the market, a significant advantage when you’re concerned about carcinogens that can cause cancers and other health problems.”

Second, Kelley discovered a gaping hole in the international market for his product—and leaped to fill that hole. Kelley comments, “The environmental industry is new to many developing countries and we can compete better over there than we can in more developed countries . . . There’s a big void in the market and we’re happy to fill it.”

Third came the identification of locations that required environmental cleanup. Kelley focused on Brazil and Argentina, as well as Indonesia, Malaysia, and Singapore. His market

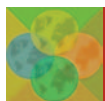
analysis was based primarily on the environmental regulation enforcement priorities of a given country.

Next came the practical issue of setting up shop on foreign soil. Kelley prefers working with a local partner, one who has the necessary local contacts, but who lacks the requisite technology. In the span of a few years, Tierra Dynamic has developed businesses overseas that account for one-quarter of its annual revenues. In addition to technological innovation and the identification and use of an international market niche, Tierra has successfully utilized outside sources of information and support, such as the Inter-American Development Bank and the U.S. Department of Commerce. According to Dan Kelley, “Our success in penetrating two of the largest markets in South America is a direct result of the substantial help and assistance provided by the Commercial Service.” He hopes that the rise of new technologies will continue to protect the health of families worldwide and that Tierra will remain an important innovation driver in the industry.

Sources: Doug Barry, “Have Microbes, Will Travel: Small Sun Belt Company Finds Niche in Cleaning Up After Others,” *Export America*, Vol. 3, No. 2, February 2002; “Global Environmental Technologies: Trends, Markets, and Prospects,” Office of Environmental Technologies Industries, *Trade Development*, July 3, 2007, http://www.ad-mkt-review.com/public_html/govdocs/wmfs/wmfs02114.html, accessed October 11, 2009.

reality. For example, many U.S. firms may see the United Kingdom as psychologically very close due to the similarity in language. However, the attitudes and values of managers and customers may vary substantially between markets. Too much of a focus on the similarities may let the firm lose sight of the differences. Many Canadian firms have incurred high costs in learning this lesson when entering the United States. Second, closer psychological proximity does make it easier for firms to enter markets. Therefore, for firms new to international business it may be advantageous to begin this new activity by entering the psychologically closer markets first in order to gather experience before venturing into markets that are farther away.

In general, firms that are most successful in international business are usually motivated by proactive—that is, firm internal—factors. Proactive firms are also frequently more service oriented than reactive firms. Further, proactive firms tend to be more marketing and strategy oriented than reactive firms, which have as their major concern operational issues. Focus on Entrepreneurship describes the proactive efforts of an exporter. The clearest differentiation between the two types of firms can probably be made after the fact by determining how they initially entered international markets. Proactive firms are more likely to have solicited their first international order, whereas reactive firms frequently begin international activities after receiving an unsolicited order from abroad.



STRATEGIC EFFECTS OF GOING INTERNATIONAL

Going international presents the firm with new environments, entirely new ways of doing business, and a host of new problems. The problems have a wide range. They can consist of strategic considerations, such as service delivery and compliance with

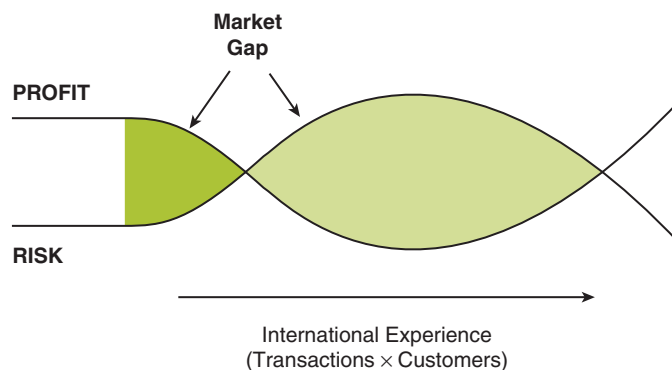
3. *To study the various modes of entering international markets*

government regulations. In addition, the firm has to focus on start-up issues, such as how to find and effectively communicate with customers and operational matters, such as information flows and the mechanics of carrying out an international business transaction. This involves a variety of new documents, including commercial invoices, bills of lading, consular invoices, inspection certificates, and shipper's export declarations. The paperwork is necessary to comply with various domestic, international, or foreign regulations. The regulations may be designed to control international business activities, to streamline the individual transaction, or, as in the case of the shipper's export declaration, to compile trade statistics.

The firm needs to determine its preparedness for internationalization by assessing its internal strengths and weaknesses. This preparedness has to be evaluated in the context of the globalization of the industry within which the firm operates, since this context will affect the competitive position and strategic options available to the firm.¹⁸ Unusual things can happen to both risk and profit. Management's perception of risk exposure grows in light of the gradual development of expertise, the many concerns about engaging in a new activity, and uncertainty about the new environment it is about to enter. Domestically, the firm has gradually learned about the market and therefore managed to decrease its risk. In the course of international expansion, the firm now encounters new and unfamiliar factors, exposing it to increased risk. At the same time, because of the investment needs required by a serious international effort, immediate profit performance may slip. In the longer term, increasing familiarity with international markets and the diversification benefits of serving multiple markets will decrease the firm's risk below the previous "domestic only" level and increase profitability as well. In the short term, however, managers may face an unusual, and perhaps unacceptable, situation: rising risk accompanied by decreasing profitability. In light of this reality, which is depicted in Figure 13.1, many executives are tempted to either not initiate international activities or to discontinue them.¹⁹

Understanding the changes in risk and profitability can help management overcome the seemingly prohibitive cost of going international, since the negative developments may only be short-term. Yet, success does require the firm to be a risk taker, and firms must realize that satisfactory international performance will take time.²⁰ Satisfactory performance can be achieved in three ways: effectiveness, efficiency, and competitive strength. Effectiveness is characterized by the acquisition of market share abroad and by increased sales. Efficiency is manifested later by rising profitability. Competitive strength refers to the firm's position compared to other firms in the

Figure 13.1 Profit and Risk During Early Internationalization



Source: Michael R. Czinkota, "A National Export Development Policy for New and Growing Businesses," in Michael R. Czinkota, I. Ronkainen, and M. Kotabe, eds., *Emerging Trends, Threats and Opportunities in International Marketing: What Executives Need to Know* (New York: Business Expert Press, 2010).

industry, and, due to the benefits of international experience, is likely to grow. The international executive must appreciate the time and performance dimensions associated with going abroad in order to overcome short-term setbacks for the sake of long-term success.



ENTRY AND DEVELOPMENT STRATEGIES

Here we will present the most typical international entry and expansion strategies. These are exporting and importing, licensing, and franchising. Another key way to expand is through a local presence, either via interfirm cooperation or foreign direct investment. These can take on many forms such as contractual agreements, equity participation and joint ventures, or direct investment conducted by the firms alone.

EXPORTING AND IMPORTING

Firms can be involved in exporting and importing in an indirect or direct way. **Indirect involvement** means that the firm participates in international business through an intermediary and does not deal with foreign customers or firms. **Direct involvement** means that the firm works with foreign customers or markets with the opportunity to develop a relationship. Firms typically opt for direct involvement based on cost decisions. **Transaction cost theory** postulates that firms will evaluate and compare the costs of integrating an operation internally, as compared to the cost of using an external party to act for the firm abroad.²¹ Once it becomes easier and more efficient for a firm to conduct all the research, negotiations, shipping, and monitoring itself, rather than paying someone else to do it, the firm is likely to become a direct exporter or importer.

The end result of exporting and importing is similar whether the activities are direct or indirect. In both cases, goods and services either go abroad or come to the domestic market from abroad, and goods may have to be adapted to suit the targeted market. However, the different approaches have varying degrees of impact on the knowledge and experience levels of firms. The less direct the involvement of the firm, the less likely is the internal development of a storehouse of information and expertise on how to do business abroad, information that the firm can draw on later for further international expansion. Therefore, while indirect activities represent a form of international market entry, they may not result in growing management commitment to international markets or increased capabilities in serving them.

Many firms are indirect exporters and importers, often without their knowledge. As an example, merchandise can be sold to a domestic firm that in turn sells it abroad. This is most frequently the case when smaller suppliers deliver products to large multinational corporations, which use them as input to their foreign sales. Foreign buyers may also purchase products locally and then send them immediately to their home country. While indirect exports may be the result of unwitting participation, some firms also choose this method of international entry as a strategic alternative that conserves effort and resources while still taking advantage of foreign opportunities.

At the same time, many firms that perceive themselves as buying domestically may in reality buy imported products. They may have long-standing relations with a domestic supplier who, because of cost and competitive pressures, has begun to source products from abroad rather than to produce them domestically. In this case, the buyer firm has become an indirect importer.

4. To understand the role and functions of international intermediaries

indirect involvement

Participation by a firm in international business through an intermediary, in which the firm does not deal with foreign customers or firms.

direct involvement

Participation by a firm in international business in which the firm works with foreign customers or markets to establish a relationship.

transaction cost theory

The thought that the carrying out of an interaction (typically in business an exchange) takes resources and will cause expenses.

Firms that opt to export or import directly have more opportunities ahead of them. They more quickly learn the competitive advantages of their products and can therefore expand more rapidly. They also have the ability to control their international activities better and can forge relationships with their trading partners, which can lead to further international growth and success.

However, the firms also are faced with obstacles. These hurdles include indentifying and targeting foreign suppliers and/or customers and finding retail space, all of which are processes that can be very costly and time-consuming. Some firms are overcoming such barriers through the use of mail-order catalogs or electronic commerce (“storeless” distribution) networks. In Japan, for example, “high-cost rents, crowded shelves, and an intricate distribution system have made launching new products via conventional methods an increasingly difficult and expensive proposition. Direct marketing via e-commerce eliminates the need for high-priced shop space.”²² In addition, particularly in industry sectors characterized by very thin profit margins, survival is determined by sales volume. Under such conditions, a large market size is essential for success—pointing many firms in the direction of international markets reached through electronic business.²³

As a firm and its managers gather experience with exporting, they move through different levels of commitment, ranging from awareness, interest, trial, evaluation, and finally, adaptation of an international outlook as part of corporate strategy. Of course, not all firms will progress with equal speed through all these levels. Some will do so very rapidly, perhaps encouraged by success with an electronic commerce approach, and move on to other forms of international involvement such as foreign direct investment. Others may withdraw from exporting, due to disappointing experiences or as part of a strategic resource allocation decision.²⁴

Increasingly, there are many new firms that either start out with an international orientation or develop one shortly after their establishment. Such born global firms emerge particularly in industries that require large numbers of customers, and in countries that only offer small internal markets. They tend to be small and young²⁵ and often make heavy use of electronic commerce in reaching out to the world. In some countries more than one third of new companies have been reported to export within two years.²⁶ Firms, managers, and governments therefore will need to be much quicker than they have been in the past, when it comes to introducing firms to and preparing them for the international market.



INTERNATIONAL INTERMEDIARIES

5. *To learn about the opportunities and challenges of cooperative market development*

Both direct and indirect importers and exporters frequently make use of intermediaries who can assist with troublesome yet important details such as documentation, financing, and transportation. The intermediaries also can identify foreign suppliers and customers and help the firm with long- or short-term market penetration efforts. Major types of international intermediaries are export management companies and trading companies. Together with export facilitators, the intermediaries can bring the global market to the domestic firm’s doorstep and help overcome financial and time constraints. Table 13.2 shows those areas in which intermediaries have been found to be particularly helpful.

It is the responsibility of the firm’s management to decide how to use the intermediaries. Options range from using their help for initial market entry to developing a long-term strategic collaboration. It is the degree of corporate involvement in and control of the international effort that determines whether the firm operates as an indirect or direct internationalist.

Table 13.2 How a Trade Intermediary Can Offer Assistance

1. Knows foreign market competitive conditions
2. Has personal contacts with potential foreign buyers
3. Evaluates credit risk associated with foreign buyers
4. Has sales staff to call on current foreign customers in person
5. Assumes responsibility for physical delivery of product to foreign buyer

Source: Richard M. Castaldi, Alex F. De Noble, and Jeffrey Kantor, "The Intermediary Service Requirements of Canadian and American Exporters," *International Marketing Review* 9, 2 (1992): 21–40; Patrick K. O. Fung, Ivy S. N. Chen, and Leslie S. C. Yip, "Relationships and Performance of Trade Intermediaries: An Exploratory Study," *European Journal of Marketing* 41, no. 1/2 (2007): 159–180.

EXPORT MANAGEMENT COMPANIES

Firms that specialize in performing international business services as commission representatives or as distributors are known as **export management companies (EMCs)**. Most EMCs are quite small. Many were formed by one or two principals with experience in international business or in a particular geographic area. Their expertise enables them to offer specialized services to domestic corporations.

EMCs have two primary forms of operation: they take title to goods and distribute internationally on their own account, or they perform services as agents. They often serve a variety of clients, thus their mode of operation may vary from client to client and from transaction to transaction. An EMC may act as an agent for one client and as a distributor for another. It may even act as both for the same client on different occasions.

When working as an **agent**, the EMC is primarily responsible for developing foreign business and sales strategies and establishing contacts abroad. Because the EMC does not share in the profits from a sale, it depends heavily on a high sales volume, on which it charges commission. The EMC may therefore be tempted to take on as many products and as many clients as possible to obtain a high sales volume. As a result, the EMC may spread itself too thin and may be unable to adequately represent all the clients and products it carries. The risk is particularly great with small EMCs.

EMCs that have specific expertise in selecting markets because of language capabilities, previous exposure, or specialized contacts appear to be the ones most successful and useful in aiding client firms in their international business efforts. For example, they can cooperate with firms that are already successful in international business but have been unable to penetrate a specific region. By sticking to their area of expertise and representing only a limited number of clients, such agents can provide quite valuable services.

When operating as a **distributor**, the EMC purchases products from the domestic firm, takes title, and assumes the trading risk. Selling in its own name, it has the opportunity to reap greater profits than when acting as an agent. The potential for greater profit is appropriate, because the EMC has drastically reduced the risk for the domestic firm while increasing its own risk. The burden of the merchandise acquired provides a major motivation to complete an international sale successfully. The domestic firm selling to the EMC is in the comfortable position of having sold its merchandise and received its money without having to deal with the complexities of the international market. On the other hand, it is less likely to gather much international business expertise.

Compensation of EMCs

The mechanism of an EMC may be very useful to the domestic firm if such activities produce additional sales abroad. However, certain activities must take place and

export management companies (EMCs) Domestic firms that specialize in performing international business services as commission representatives or as distributors.

agent A representative or intermediary for the firm that works to develop business and sales strategies and that develops contacts.

distributor A representative or intermediary for the firm that purchases products from the firm, takes title, and assumes the selling risk.

must be paid for. As an example, a firm must incur market development expenses to enter foreign markets. At the very least, product availability must be communicated, goods must be shown abroad, visits must be arranged, or contacts must be established. These activities must be funded.

One possibility is a fee charged to the manufacturer by the EMC for market development, sometimes in the form of a retainer and often on an annual basis. The retainers vary and are dependent on the number of products represented and the difficulty of foreign market penetration. Frequently, manufacturers are also expected to pay all or part of the direct expenses associated with foreign market penetration. These expenses may involve the production and translation of promotional product brochures, the cost of attending trade shows, the provision of product samples, or trade advertising.

Alternatively, the EMC may demand a price break for international sales. In one way or another, the firm that uses an EMC must pay the EMC for the international business effort. Otherwise, despite promises, the EMC may simply add the firm and product in name only to its product offering and do nothing to achieve international success.

Power Conflicts between EMCs and Clients

The EMC faces the continuous problem of retaining a client once foreign market penetration is achieved. Many firms use an EMC's services mainly to test the international arena, with the clear desire to become a direct participant once successful operations have been established. Of course, this is particularly true if foreign demand turns out to be strong and profit levels are high. The conflict between the EMC and its clients, with one side wanting to retain market power by not sharing too much international business information, and the other side wanting to obtain that power, often results in short-term relationships and a lack of cooperation. Because international business development is based on long-term efforts, this conflict frequently leads to a lack of success.

For the concept of an export management company to work, both parties must fully recognize the delegation of responsibilities, the costs associated with those activities, and the need for information sharing, cooperation, and mutual reliance. Use of an EMC should be viewed just like a domestic channel commitment, requiring a thorough investigation of the intermediary and the advisability of relying on its efforts, a willingness to cooperate on a relationship rather than on a transaction basis, and a willingness to properly reward its efforts. The EMC in turn must adopt a flexible approach to managing the export relationship. As access to the Internet is making customers increasingly sophisticated and world-wise, export management companies must ensure that they continue to deliver true value added. They must acquire, develop, and deploy resources such as new knowledge about foreign markets or about export processes in order to lower their client firm's export-related transaction costs and therefore remain a useful intermediary.²⁷ By doing so, the EMC lets the client know that the cost is worth the service and thereby reduces the desire for circumvention.

TRADING COMPANIES

Another major intermediary is the trading company. The concept was originated by the European trading houses such as the Fuggers of Augsburg, Germany. Later on, monarchs chartered traders to form corporate bodies that enjoyed exclusive trading rights and protection by the naval forces in exchange for tax payments. Examples of such early trading companies are the Oost-Indische Compagnie of the Netherlands, formed in 1602, followed shortly by the British East India Company and La

Compagnie des Indes chartered by France.²⁸ Today, the most famous trading companies are the **sogoshosha** of Japan. Names such as Mitsubishi, Mitsui, and C. Itoh have become household words around the world. The nine trading company giants of Japan act as intermediaries for about one third of the country's exports and two fifths of its imports.²⁹ The general trading companies play a unique role in world commerce by importing, exporting, countertrading, investing, and manufacturing. Their vast size allows them to benefit from economies of scale and perform their operations at high rates of return, even though their profit margins are less than 2 percent.

Four major reasons have been given for the success of the Japanese *sogoshosha*. First, by concentrating on obtaining and disseminating information about market opportunities and by investing huge funds in the development of information systems, the firms have the mechanisms and organizations in place to gather, evaluate, and translate market information into business opportunities. Second, economies of scale permit the firms to take advantage of their vast transaction volume to obtain preferential treatment by, for example, negotiating transportation rates or even opening up new transportation routes and distribution systems. Third, the firms serve large internal markets, not only in Japan but also around the world, and can benefit from opportunities for countertrade. Finally, *sogoshosha* have access to vast quantities of capital, both within Japan and in the international capital markets. They can therefore carry out transactions that are too large or risky to be palatable or feasible for other firms.³⁰ In spite of changing trading patterns, these giants continue to succeed by shifting their strategy to expand their domestic activities in Japan, entering more newly developing markets, increasing their trading activities among third countries, and forming joint ventures with non-Japanese firms.

Expansion of Trading Companies

For many decades, the emergence of trading companies was commonly believed to be a Japan-specific phenomenon. Japanese cultural factors were cited as the reason that such intermediaries could operate successfully only from that country. In the last few decades, however, many other governments have established trading companies. In countries as diverse as Korea, Brazil, and Turkey, trading companies handle large portions of national exports.³¹ The reason these firms have become so large is due, in good measure, to special and preferential government incentives, rather than market forces alone. Therefore, they may be vulnerable to changes in government policies.

In the United States, trading companies in which firms could cooperate internationally were initially permitted through the Webb-Pomerene associations established in 1918. While in the 1930s these collaborative ventures accounted for about 12 percent of U.S. exports, their share had dropped to less than 1 percent by 2009. Another governmental approach to export trade facilitation was **export trading company (ETC)** legislation designed to improve the export performance of small and medium-sized firms. Bank participation in trading companies was permitted, and the antitrust threat to joint export efforts was reduced through precertification of planned activities by the U.S. Department of Commerce. Businesses were encouraged to join together to export or offer export services.

Permitting banks to participate in ETCs was intended to allow ETCs better access to capital and therefore permit more trading transactions and easier receipt of title to goods. The relaxation of antitrust provisions in turn was meant to enable firms to form joint ventures more easily. The cost of developing and penetrating international markets would then be shared, with the proportional share being, for many small and medium-sized firms, much easier to bear. As an example, in case a warehouse is needed in order to secure foreign market penetration, one firm alone does not have to bear all the costs. A consortium of firms can

sogoshosha A large Japanese general trading company.

export trading company (ETC) The result of 1982 legislation to improve the export performance of small- and medium-sized firms, the export trading company allows businesses to band together to export or offer export services. Additionally, the law permits bank participation in trading companies and relaxes antitrust provisions.

jointly rent a foreign warehouse. Similarly, each firm need not station a service technician abroad at substantial cost. Joint funding of a service center by several firms makes the cost less prohibitive for each one. The trading company concept also offers a one-stop shopping center for both the firm and its foreign customers. The firm can be assured that all international functions will be performed efficiently by the trading company, and at the same time, the foreign customer will have to deal with few individual firms.

“Although ETCs seem to offer major benefits to U.S. firms wishing to penetrate international markets, they have not been used very extensively. As of 2009, certificates were held by 75 individuals, companies, and associations. Yet these certificates cover more than 3,000 firms, mainly because the various trade associations have applied for certification for all of their members.³²

PRIVATE-SECTOR FACILITATORS

Facilitators are entities outside the firm that assist in the process of going international. They supply knowledge and information but do not participate in the transaction. Such facilitators can come both from the private and the public sector.

Major encouragement and assistance can result from the statements and actions of other firms in the same industry. Information that would be considered proprietary if it involved domestic operations is often freely shared by competing firms when it concerns international business. The information not only has source credibility but is viewed with a certain amount of fear, because a too-successful competitor may eventually infringe on the firm's domestic business.

A second influential group of private-sector facilitators is distributors. Often a firm's distributors are engaged, through some of their business activities, in international business. To increase their international distribution volume, they encourage purely domestic firms to participate in the international market. This is true not only for exports but also for imports. For example, a major customer of a manufacturing firm may find that materials available from abroad, if used in the domestic production process, would make the product available at lower cost. In such instances, the customer may approach the supplier and strongly encourage foreign sourcing.

Banks and other service firms, such as accounting and consulting firms, can serve as major facilitators by alerting their clients to international opportunities. While these service providers historically follow their major multinational clients abroad, increasingly they are establishing a foreign presence on their own. Frequently, they work with domestic clients on expanding market reach in the hope that their service will be used for any international transaction that results. Given the extensive information network of many service providers—banks, for example, often have a wide variety of correspondence relationships—the role of these facilitators can be major. Like a mother hen, they can take firms under their wings and be pathfinders in foreign markets.

Chambers of commerce and other business associations that interact with firms can frequently heighten their interest in international business. Yet, in most instances, such organizations function mainly as secondary intermediaries, because true change is brought about by the presence and encouragement of other managers.

PUBLIC-SECTOR FACILITATORS

Government efforts can also facilitate the international efforts of firms. In the United States, for example, the Department of Commerce provides major export assistance, as do other federal organizations such as the Small Business Administration and the Export-Import Bank. Most countries maintain similar export support organizations. Table 13.3 provides the names of selected export promotion agencies from around

Table 13.3 Selected Export Promotion Agencies Around the Globe

Australia: Australian Trade Commission http://www.austrade.gov.au
Canada: Export Development Corporation http://www.edc.ca/
France: Centre Français du Commerce Extérieur http://www.ubifrance.fr/default.html
Germany: Germany Trade and Invest http://www.gtai.de/web_de/startseite
India: India Trade Promotion Organisation (ITPO) http://www.indiatradepromotion.org
Japan: Japan External Trade Organization (JETRO) http://www.jetro.go.jp
Singapore: International Enterprise Singapore http://www.iesingapore.gov.sg/wps/portal
South Korea: Trade-Investment Promotion Agency (KOTRA) http://www.kotra.or.kr/wps/portal/dk
United Kingdom: Department of Business Innovation and Skills http://www.bis.gov.uk
United Nations/World Trade Organization: International Trade Centre http://www.intracen.org
United States: Export-Import Bank http://www.exim.gov
International Trade Administration http://www.ita.doc.gov
Foreign Agricultural Service http://www.fas.usda.gov

the globe, together with their web addresses. Employees of these organizations typically visit firms and attempt to analyze their international business opportunities. Through rapid access to government resources, these individuals can provide data, research reports, counseling, and financing information to firms. Government organizations can also sponsor meetings that bring interested parties together and alert them to new business opportunities abroad. Key governmental support is also provided when firms are abroad. By receiving information and assistance from their embassies, many business ventures abroad can be made easier. The ad on the next page provides an example of active government involvement in investment promotion.

Increasingly, organizations at the state and local level also are active in encouraging firms to participate in international business. Many states and provinces have formed agencies for economic development that provide information, display products abroad, conduct trade missions, and sometimes even offer financing. Similar services can also be offered by state and local port authorities and by some of the larger cities. State and local authorities can be a major factor in facilitating international activities because of their closeness to firms.

Educational institutions such as universities and community colleges can also be major international business facilitators. They can act as trade information clearing-houses, facilitate networking opportunities, provide client counseling and technical assistance, and develop trade education programs.³³ They can also develop course projects that are useful to firms interested in international business. For example, students may visit a firm and examine its potential in the international market as a course requirement. With the skill and supervision of faculty members to help the students develop the final report, such projects can be useful to firms with scarce resources, while they expose students to real-world problems.

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LICENSING

licensing agreement An agreement in which one firm permits another to use its intellectual property in exchange for compensation.

royalty The compensation paid by one firm to another under an agreement.

Under a **licensing agreement**, one firm permits another to use its intellectual property for compensation designated as **royalty**. The recipient firm is the licensee. The property licensed might include patents, trademarks, copyrights, technology, technical know-how, or specific business skills. For example, a firm that has developed a bag-in-the-box packaging process for milk can permit other firms abroad to use the same process. Licensing therefore can also be called the export of intangibles.

Licensing has intuitive appeal to many would-be international managers. As an entry strategy, it requires neither capital investment nor detailed involvement with

foreign customers. By generating royalty income, licensing provides an opportunity to exploit research and development already conducted. After initial costs, the licensor can reap benefits until the end of the license contract period. Licensing also reduces the risk of expropriation because the licensee is a local company that can provide leverage against government action.

Licensing may help to avoid host-country regulations applicable to equity ventures. It also may provide a means by which foreign markets can be tested without major involvement of capital or management time. Similarly, licensing can be used as a strategy to preempt a market before the entry of competition, especially if the licensor's resources permit full-scale involvement only in selected markets. Licensing also relieves the originating company from having to come up with culturally responsive changes in every market. As Focus on Culture shows, the local licensees can worry about that part.

A special form of licensing is **trademark licensing**, which has become a substantial source of worldwide revenue for companies that can trade on well-known names and characters. Trademark licensing permits the names or logos of designers, literary characters, sports teams, or movie stars to appear on clothing, games, foods and beverages, gifts and novelties, toys, and home furnishings. Licensors can make millions of dollars with little effort, while licensees can produce a brand or product that consumers will recognize immediately. Trademark licensing is possible, however, only if the trademark name conveys instant recognition.

Licensing is not without disadvantages. It is a very limited form of foreign market participation and does not in any way guarantee a basis for future expansion. As a matter of fact, quite the opposite may take place. In exchange for the royalty, the

trademark licensing

Providing someone the right to use an established brand symbol in exchange for payment.

FOCUS ON CULTURE

TV Program Licenses Are International

For most of the history of television, American programming has dominated the airwaves in the United States and abroad. The most popular shows in any given country were likely to be American concepts produced by American firms. The cop show, the sitcom, and the western are all television concepts developed in the United States.

The privatization of many state-run television enterprises during the 1980s created more competition and increased demand for American programming. The new commercial stations lacked the expertise needed to produce hit shows in a cost-effective way, so they filled their many open hours of air-time by purchasing programming from the United States.

American companies took advantage of high demand and prices skyrocketed. The trend continued through the 1990s as prices increased fivefold. During a bidding war in Britain, for example, the price of each episode of the *Simpsons* went up to \$1.5 million. American companies also bundled their offerings and forced television stations to buy less popular programming along with popular shows.

Over time, the situation abroad has changed. Local stations have become more adept at developing and producing their own programming. Tastes also changed as consumers demanded television shows more reflective of their own cultural values and preferences. All this means that stations no longer rely on American programming to win prime-time ratings battles.

In addition to claiming a larger share of their domestic markets, European production companies have turned the tables with licensing agreements. Now they develop winning television shows and license the idea to other companies for production in their own country.

Some very successful U.S. reality series were pioneered overseas. One example is the Dutch hit show *Big Brother*. New concepts are being developed, tested in foreign markets, and exported all the time. The British television hit *Pop Idol* gave rise to licensed versions in Poland, South Africa, and the United States. In the new international television market, winning ideas can come from any country.

Therefore, it is surprising that the European Union has preserved its antiquated 1989 "Television Without Frontiers" directive, which mandates that EU television channels are required to reserve at least 50 percent of their output for European-made content. In a global cultural environment, where ideas originate from Mumbai to Memphis and are transformed as they travel around the world, government intervention and culture by legislation are more of an obstacle than a facilitator of human creativity.

Sources: <http://www.endemol.com>, accessed May 14, 2003; Bill Brioux, "Excuse Me, Is that a Canadian Idol?" *Edmonton Sun*, October 23, 2002; "Television Broadcasting Activities: 'Television Without Frontiers'" (TVWF) Directive, European Commission, September 9, 2008, http://europa.eu/legislation_summaries/audiovisual_and_media/124101_en.html, accessed October 2, 2009; Jean K. Chalaby, *Transnational Television in Europe: Reconfiguring Global Communications Networks* (London: I. B. Tauris, 2009).

licensor may create its own competitor not only in the market for which the agreement was made but for third-country markets as well.

Licensing has also come under criticism from many governments and supranational organizations. They have alleged that licensing provides a mechanism for corporations in industrialized countries to capitalize on older technology. These accusations have been made even though licensing offers a foreign entity the opportunity for immediate market entry with a proven concept. It therefore eliminates the risk of R&D failure, the cost of designing around the licensor's patents, or the fear of patent-infringement litigation.

FRANCHISING

franchising A form of licensing that allows a distributor or retailer exclusive rights to sell a product or service in a specified area.

Franchising is the granting of the right by a parent company (the franchisor) to another, independent entity (the franchisee) to do business in a prescribed manner. The right can take the form of selling the franchisor's products, using its name, production, and marketing techniques, or using its general business approach.³⁴ Usually franchising involves a combination of many of those elements. The major forms of franchising are manufacturer-retailer systems (such as car dealerships), manufacturer-wholesaler systems (such as soft drink companies), and service-firm retailer systems (such as lodging services and fast-food outlets).

The expansion or contraction of franchising results from the global economic climate. When financing is readily available and product demand is soaring, companies are eager to expand their franchise operations. The reverse is also true. For example, during the global credit crunch in 2009, the number of franchise establishments in the United States declined by 1.2 percent, from nearly 865,000 to less than 855,000—a net loss of approximately 10,000. Jobs in the franchise sector fell by 2.1 percent, for a loss of 207,000. Overall economic output, the gross value of goods and services produced by franchises, declined by 0.5 percent—an annual loss of \$4.2 billion. However, once credit markets and demand stabilize, franchising should rebound. After the recession of 2000–2001 and the terrorist attacks of September 11, 2001, the U.S. franchise industry expanded by more than 140,000 new businesses and created 1.2 million new jobs over a five-year period.³⁵

Typically, to be successful in international franchising, the firm must be able to offer unique products or unique selling propositions. A franchise must also offer a high degree of standardization, which does not require 100 percent uniformity, but rather, international recognizability. Concurrent with this recognizability, the franchisor can and should adapt to local circumstances. Food franchisors, for example, will vary the products and product lines offered, depending on local market conditions and tastes.

Key reasons for the international expansion of franchise systems are market potential, financial gain, and saturated domestic markets. From a franchisee's perspective, the



© Eric Nathan/Alamy

Chicken tastes good everywhere.

franchise is beneficial because it reduces risk by implementing a proven concept. There are also major benefits from a governmental perspective. The source country does not see a replacement of exports or an export of jobs. The recipient country sees franchising as requiring little outflow of foreign exchange, since the bulk of the profits generated remains within the country.³⁶

Franchising has been growing rapidly, but government intervention, or lack thereof, continues to be a major problem. Many multinational corporations (MNCs) attempting to establish franchises in China, for example, have encountered the People's Republic's reluctance to protect their intellectual property rights. Intellectual piracy is still quite common in the country, even after its accession to the WTO. Franchisors are advised to register their brands in Chinese characters. Otherwise, they could be registered by someone else. In China, recovering a trademark after it has been registered by another party (including a franchisee) can be a complex undertaking. In 2003, Starbucks Corporation began a protracted legal battle against a local competitor that had registered its Chinese name—Xingbake—and was even using the Seattle-based company's green logo. The case was not resolved until 2007, when the Shanghai Municipal Higher People's Court finally ruled in Starbucks' favor.³⁷

Selection and training of franchisees represents another problem area. Many franchise systems have run into difficulty by expanding too quickly and granting franchises to unqualified entities. Although the local franchisee knows the market best, the franchisor still needs to understand the market for product adaptation and operational purposes. The franchisor, in order to remain viable in the long term, needs to coordinate the efforts of individual franchisees—for example, to share ideas and engage in joint undertakings, such as cooperative advertising.



LOCAL PRESENCE

INTERFIRM COOPERATION

The world is too large and the competition too strong for even the largest companies to do everything independently. Technologies are converging and markets are becoming integrated, thus making the costs and risks of both goods and market development ever greater. Partly as a reaction to and partly to exploit the developments, management in multinational corporations has become more pragmatic about what it takes to be successful in global markets. The result has been the formation of **strategic alliances** with suppliers, customers, competitors, and companies in other industries to achieve multiple goals.

A strategic alliance (or partnership) is an informal or formal arrangement between two or more companies with a common business objective. It is something more than the traditional customer-vendor relationship but something less than an outright acquisition. The alliances can take forms ranging from informal cooperation to joint ownership of worldwide operations. For example, Texas Instruments has reported agreements with companies such as IBM, Hyundai, Fujitsu, Alcatel, and L. M. Ericsson using such terms as “joint development agreement,” “cooperative technical effort,” “joint program for development,” “alternative sourcing agreement,” and “design/exchange agreement for cooperative product development and exchange of technical data.”³⁸

Reasons for Interfirm Cooperation

Strategic alliances are used for many different purposes by the partners involved. Market development is one common focus. Penetrating foreign markets is a primary

6. *To understand how firms can overcome market barriers by either building competitive capabilities abroad from scratch or acquiring them from local owners.*

strategic alliances A new term for collaboration among firms, often similar to joint ventures.

objective of many companies. In Japan, Motorola is sharing chip designs and manufacturing facilities with Toshiba to gain greater access to the Japanese market. Some alliances aim to defend home markets. With no orders coming in for nuclear power plants, Bechtel Group has teamed up with Germany's Siemens to service existing U.S. plants. Another key focus is to either share the risk of engaging in a particular activity in a particular market, or to share the resource requirements of an activity.³⁹ The costs of developing new jet engines are so vast that they force aerospace companies into collaboration. One such consortium was formed by United Technologies' Pratt & Whitney division, Britain's Rolls-Royce, Motoren-und-Turbinen Union from Germany, Fiat of Italy, and Japanese Aero Engines (made up of Ishikawajima Heavy Industries and Kawasaki Heavy Industries).⁴⁰ Some alliances are formed to block and co-opt competitors.⁴¹ For example, Caterpillar formed a heavy equipment joint venture with Mitsubishi in Japan to strike back at its main global rival, Komatsu, in its home market.

The most successful alliances are those that match the complementary strengths of partners to satisfy a joint objective. Often the partners have different product, geographic, or functional strengths that the partners build on, rather than use to fill gaps.⁴² Some of the major alliances created on this basis are provided in Figure 13.2.

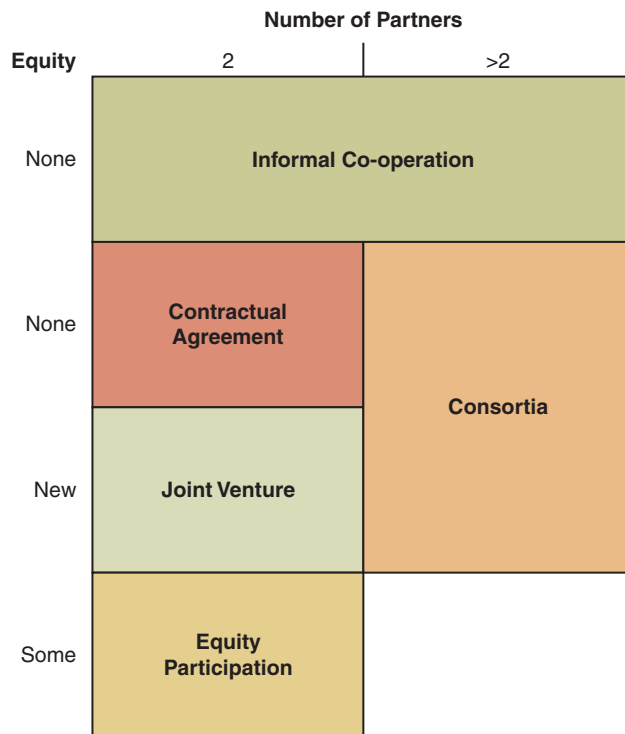
Types of Interfirm Cooperation

Each form of alliance is distinct in terms of the amount of commitment required and the degree of control each partner has. The equity alliances—minority ownership, joint ventures, and consortia—feature the most extensive commitment and shared control. The types of strategic alliances are summarized in Figure 13.3, using the extent of equity involved and the number of partners in the endeavor as defining characteristics.

Figure 13.2 Complementary Strengths Create Value

Partner Strength...	+ Partner Strength...	= Joint Objective
PepsiCo marketing clout for canned beverages	Lipton recognized tea brand and customer franchise	To sell canned iced tea beverages jointly
Philips consumer electronics innovation and leadership	Levi Strauss fashion design and distribution	Outdoor wear with integrated electronic equipment for fashion-conscious consumers
KFC established brand and store format, and operations skills	Mitsubishi real estate and site-selection skills in Japan	To establish a KFC chain in Japan
Siemens presence in range of telecommunications markets worldwide and cable-manufacturing technology	Corning technological strength in optical fibers and glass	To create a fibre-optic-cable business
Ericsson technological strength in public telecommunications networks	Hewlett-Packard computers, software, and access to electronics-channels	To create and market network management systems

Sources: "Portable Technology Takes the Next Step: Electronics You Can Wear," *Wall Street Journal*, August 22, 2000, B1, B4; Joel Bleeke and David Ernst, "Is Your Strategic Alliance Really a Sale?" *Harvard Business Review* 73 (January–February 1995): 97–105. See also (Melanie Wells, "Coca-Cola Proclaims Nestea Time for CAA," *Advertising Age*, January 30, 1995, 2. See also <http://www.pepsico.com>; <http://www.lipton.com>; <http://www.kfc.com>; <http://w1.siemens.com/entry/cc/en/>; <http://www.ericsson.com>; <http://www.hp.com>; Susanne Royer and Roland Simons, "Evolution of Cooperation and Dynamics of Expectations—Implications for Strategic Alliances," *International Journal of Strategic Business Alliances* 1, no. 1, 2009: 73–88.

Figure 13.3 Forms of Interfirm Cooperation

Source: Adapted with permission from Bernard L. Simonin, *Transfer of Knowledge of International Strategic Alliances: A Structural Approach*, unpublished dissertation (Ann Arbor: University of Michigan, 1991).

Informal Cooperation In informal cooperative deals, partners work together without a binding agreement. This arrangement often takes the form of visits to exchange information about new products, processes, and technologies or may take the more formal form of the exchange of personnel for limited amounts of time. Often such partners are of no real threat in each other's markets and are of modest size in comparison to the competition, making collaboration necessary.⁴³ The relationships are based on mutual trust and friendship, and may lead to more formal arrangements, such as contractual agreements or joint projects.

Contractual Agreements Strategic alliance partners may join forces for joint R&D, joint marketing, or joint production. Similarly, their joint efforts might include **licensing**, cross-licensing, or **cross-marketing activities**. Nestlé and General Mills had an agreement whereby Honey Nut Cheerios and Golden Grahams were made in General Mills's U.S. plants and shipped in bulk to Europe for packaging by Nestlé. Such an arrangement—complementary marketing (also known as piggybacking)—allows firms to reach objectives that they cannot reach efficiently by themselves.⁴⁴ The alliance between General Mills and Nestlé evolved into a joint venture, Cereal Partners Worldwide, which markets both companies' products in Europe and Asia. Firms also can have a reciprocal arrangement whereby each partner provides the other access to its market. The New York Yankees and Manchester United sell each others' licensed products and develop joint sponsorship programs. International airlines share hubs, coordinate schedules, and simplify ticketing. Alliances such as Star (joining United and Lufthansa), Oneworld (British Airways and American Airlines), and Sky Team (Delta and Air France) provide worldwide coverage for their customers both in the travel and shipping communities.

licensing A firm gives a license to another firm to produce, package, or market its product.

cross-marketing activities A reciprocal arrangement whereby each partner provides the other access to its markets for a product.

contract manufacturing

Outsourcing the actual production of goods so that the corporation can focus on research, development, and marketing.

management contract An international business alternative in which the firm sells its expertise in running a company while avoiding the risk or benefit of ownership.

turnkey operation A specialized form of management contract between a customer and an organization to provide a complete operational system together with the skills needed for unassisted maintenance and operation.

Contractual agreements also exist for outsourcing. For example, General Motors buys cars and components from South Korea's Daewoo, and Siemens buys computers from Fujitsu. As corporations look for ways to simultaneously grow and maintain their competitive advantage, outsourcing has become a powerful new tool for achieving those goals. **Contract manufacturing** allows the corporation to separate the physical production of goods from the research and development and marketing stages, especially if the latter are the core competencies of the firm. Benefits of such contracting are to improve company focus on higher value-added activities, to gain access to world-class capabilities, and to reduce operating costs. Contract manufacturing has been criticized because of the pressure it puts on the contractors to cut prices and, thereby, labor costs. However, such work does provide many companies, especially in developing countries, the opportunity to gain the necessary experience in product design and manufacturing technology to allow them to function in world markets. Some have even voiced concerns that the experience eventually may make future competitors of current partners.

In some parts of the world and in certain industries, governments insist on complete or majority ownership of firms. There, multinational companies offer **management contracts**, selling their expertise in running a company while avoiding the risk or benefit of ownership. Depending on the contract, doing so may even permit some measure of control. As an example, the manufacturing process may have to be relinquished to local firms, yet international distribution may be required for the product. A management contract could maintain a strong hold on the operation by ensuring that all distribution channels remain firmly controlled.

A management contract may be the critical element in the success of a project. For example, financial institutions may gain confidence in a project because of the existence of a management contract and may even make it a precondition for funding.⁴⁵

One specialized form of management contract is the **turnkey operation**. Here, the arrangement permits a client to acquire a complete international system, together with skills sufficient to allow unassisted maintenance and operation of the system following its completion.⁴⁶ The client need not search for individual contractors or subcontractors or deal with scheduling conflicts or with difficulties in assigning responsibilities or blame. Instead, a package arrangement focuses responsibility on one entity, thus greatly easing the negotiation and supervision requirements and subsequent accountability. When the project is running, the system will be totally owned, controlled, and operated by the customer. Companies such as AES are part of consortia building electric power facilities around the world, operating them, and, in some cases, even owning parts of them.

Management contracts have clear benefits for the client. They provide organizational skills not available locally, expertise that is immediately available, and management assistance in the form of support services that would be difficult and costly to replicate locally. For example, hotels managed by the Sheraton Corporation have access to Sheraton's worldwide reservation system. Management contracts today typically involve training locals to take over the operation after a given period.

Similar advantages exist for the supplier. The risk of participating in an international venture is substantially lowered, while significant amounts of control are still exercised. Existing know-how that has been built up through substantial investment can be commercialized, and frequently the impact of fluctuations in business volume can be reduced by making use of experienced personnel who otherwise would have to be laid off. Accumulated service knowledge should be used internationally. Management contracts permit firms to do so.

Equity Participation Many multinational corporations have acquired minority ownerships in companies that have strategic importance for them to ensure supplier ability and build formal and informal working relationships. An example is the 2009 equity swap

between China's Unicom and Spain's Telefónica. The partners continue operating as separate entities, but each enjoys the strengths that the other provides. For example, both telecom giants were motivated by a desire to stay competitive and gain market share in the midst of a global economic downturn. The agreement ensured cooperation in infrastructure and equipment sharing, research and development, and the provision of roaming and other services for multinational customers. The deal gave both companies access to a combined 550 million customers worldwide. Equity ownership in an innovator may also give the investing company first access to any newly developed technology.

Another significant reason for equity ownership is market entry and support of global operations. For example, Telefónica has acquired varying stakes in Latin American telecommunications systems—a market that is the fastest-growing region of the world after Asia. As of 2009, Telefónica had evolved into the third-largest global telecom operator and one of the largest in Latin America, with a subscriber base of 124.65 million.⁴⁷

Joint Ventures A joint venture can be defined as the participation of two or more companies in an enterprise in which each party contributes assets, has some equity, and shares risk.⁴⁸ The venture is also considered long term. The reasons for establishing a joint venture can be divided into three groups: (1) government policy or legislation; (2) one partner's needs for other partners' skills; and (3) one partner's needs for other partners' attributes or assets.⁴⁹ Equality of the partners or of their contribution is not necessary. In some joint ventures, each partners' contributions—typically consisting of funds, technology, plant, or labor—also vary.

The key to a joint venture is the sharing of a common business objective, which makes the arrangement more than a customer-vendor relationship but less than an outright acquisition. The partners' rationales for entering into the arrangement may vary. An example is New United Motor Manufacturing Inc. (NUMMI), the joint venture between Toyota and GM. Toyota needed direct access to the U.S. market, while GM benefited from the technology and management approaches provided by its Japanese partner. NUMMI also represents an important example of how changes in a partner's business objectives and environment can lead to the dissolution of a joint venture. GM was severely battered by the global economic recession of 2007–2009, leading to the need for an emergency government bailout in April 2009. Consequently, GM was forced to pull out of NUMMI in June 2009 and effectively dissolved the partnership. Toyota indicated that it planned to pull out by March 2010.⁵⁰

Joint ventures may be the only way in which a firm can profitably participate in a particular market since many governments restrict equity participation in local operations by foreigners. Other entry modes may be limited; for example, exports may be restricted because of tariff barriers. Joint ventures are valuable when the pooling of resources results in a better outcome for each partner than if each were to conduct its activities individually. This is particularly true when each partner has a specialized advantage in areas that benefit the venture. For example, a firm may have new technology yet lack sufficient capital to carry out foreign direct investment on its own. Through a joint venture, the technology can be used more quickly and market penetration achieved more easily. Similarly, one of the partners may have a distribution system already established or have better access to local suppliers, either of which permits a greater volume of sales in a shorter period of time.

Joint ventures also permit better relationships with local government and other organizations such as labor unions. Government-related reasons are the main rationale for joint ventures to take place in less-developed countries. If the local partner is politically influential, the new venture may be eligible for tax incentives, grants, and government support. Negotiations for certifications or licenses may be easier because authorities may not perceive themselves as dealing with a foreign firm. Relationships between the local

partner and the local financial establishment may enable the joint venture to tap local capital markets. The greater experience (and therefore greater familiarity) with the local culture and environment of the local partner may enable the joint venture to benefit from greater insights into changing market conditions and needs.

Many joint ventures fall short of expectations and/or are disbanded. The reasons typically relate to conflicts of interest, problems with disclosure of sensitive information, and disagreements over how profits are to be shared. There is also often a lack of communication before, during, and after formation of the venture. In some cases, managers have been more interested in the launching of the venture than the actual running of the enterprise. Many of the problems stem from a lack of careful consideration in advance of how to manage the new endeavor. A partnership works on the basis of trust and commitment or not at all.

Typical disagreements cover the whole range of business decisions, including strategy, management style, accounting and control, marketing policies and strategies, research and development, and personnel. The joint venture may, for example, identify a particular market as a target only to find that one of the partners already has individual plans for it. U.S. partners have frequently complained that their Japanese counterparts do not send their most competent personnel to the joint venture; instead, because of their lifetime employment practice, they get rid of less competent managers by sending them to the new entities.

Similarly, the issue of profit accumulation and distribution may cause discontent. If one partner supplies the joint venture with a good, the partner will prefer that any profits accumulate at headquarters and accrue 100 percent to one firm rather than at the joint venture, where profits are divided according to equity participation. Such a decision may not be greeted with enthusiasm by the other partner. Once profits are accumulated, their distribution may lead to dispute. For example, one partner may insist on a high payout of dividends because of financial needs, whereas the other may prefer the reinvestment of profits into a growing operation.

Consortia A new drug can cost \$500 million to develop and bring to market; a main-frame computer or a telecommunications switch can require \$1 billion. Some \$7 billion goes into creating a new generation of computer chips. To combat the high costs and risks of research and development, research consortia have emerged in the United States, Japan, and Europe. For example, Ericsson, Panasonic, Samsung, Siemens, Sony, Motorola, Nokia, and Psion have formed Symbian to develop technologies for wireless communication. Headquartered in the U.K., the firm also has offices in Japan, Sweden, and the United States.

Since the passage of the **Joint Research and Development Act** of 1984 (which allows both domestic and foreign firms to participate in joint basic research efforts without the fear of antitrust action), well over 100 consortia have been registered in the United States. The consortia pool their resources for research into technologies ranging from artificial intelligence to semiconductor manufacturing. (The major consortia in those fields are MCC and Sematech.) The European Union has five megaprojects to develop new technologies registered under the names EUREKA, ESPRIT, BRITE, RACE, and COMET. Japanese consortia have worked on producing the world's highest-capacity memory chip and advanced computer technologies. On the manufacturing side, the formation of Airbus Industries secured European production of commercial jets. The consortium, now backed by the European Aeronautic Defence and Space Company (EADS), which emerged from the link-up of the German DaimlerChrysler Aerospace AG, the French Aerospatiale Matra, and CASA of Spain,⁵¹ has become a prime global competitor especially in the development of megaliners.

Managerial Considerations The first requirement of interfirm cooperation is to find the right partner. Partners should have an orientation and goals in common and

Joint Research and Development Act A 1984 law that allows both domestic and foreign firms to participate in joint basic-research efforts without fear of U.S. antitrust action.

should bring complementary and relevant benefits to the endeavor. The venture makes little sense if the expertise of both partners is in the same area; for example, if both have production expertise but neither has distribution know-how. Patience should be exercised; a deal should not be rushed into, nor should the partners expect immediate results. Learning should be paramount in the endeavor while at the same time, partners must try not to give away core secrets to each other.⁵²

Second, the more formal the arrangement, the greater the care that needs to be taken in negotiating the agreement. In joint venture negotiations, for example, extensive provisions must be made for contingencies. The points to be explored should include: (1) clear definition of the venture and its duration; (2) ownership, control, and management; (3) financial structure and policies; (4) taxation and fiscal obligation; (5) employment and training; (6) production; (7) government assistance; (8) transfer of technology; (9) marketing arrangements; (10) environmental protection; (11) record keeping and inspection; and (12) settlement of disputes.⁵³ These issues have to be addressed before the formation of the venture; otherwise, they eventually will surface as points of contention. A joint venture agreement, although comparable to a marriage agreement, should contain the elements of a divorce contract. In case the joint venture cannot be maintained to the satisfaction of partners, plans must exist for the dissolution of the agreement and for the allocation of profits and costs. Typically, however, one of the partners buys out the other partner(s) when partners decide to part ways.

A strategic alliance, by definition, also means a joining of two corporate cultures, which can often be quite different than a joint venture. To meet this challenge, partners must have frequent communication and interaction at three levels of the organization: the top management, operational leaders, and workforce levels. Trust and relinquishing control are difficult not only at the top but also at levels where the future of the venture is determined. A dominant partner may determine the corporate culture, but even then the other partners should be consulted. The development of specific alliance managers may be advised to forge the net of relationships both within and between alliance partners and, therefore, to support the formal alliance structure.⁵⁴

Strategic alliances operate in a dynamic business environment and must therefore adjust to changing market conditions. The agreement between partners should provide for changes in the original concept so that the venture can flourish and grow. The trick is to have a prior understanding as to which party will take care of which pains and problems so that a common goal is reached.

Government attitudes and policies have to be part of the environmental considerations of corporate decision makers. While some alliances may be seen as a threat to the long-term economic security of a nation, in general, links with foreign operators should be encouraged. For example, the U.S. government urged major U.S. airlines to form alliances with foreign carriers to gain access to emerging world markets, partly in response to the failure to achieve free access to all markets through the negotiation of so-called open-skies agreements.⁵⁵

FULL OWNERSHIP

For some firms, foreign direct investment requires, initially at least, 100 percent ownership. The reason may have an ethnocentric basis; that is, management may believe that no outside entity should have an impact on corporate decision making. Alternatively, it may be based on financial concerns. For example, in 2009, Starbucks Coffee Company assumed full control of the Starbucks business in France, which was previously operated through a joint venture with Sigla S.A. (Grupo Vips) of Spain. The ownership switch was motivated by potential increases in profitability and operational efficiency in the growing French market. Starbucks had opened its first location at the Paris Opera House in 2004.⁵⁶ In order to make a rational decision about the extent of ownership, management must evaluate the extent to which total

control is important to the success of its international marketing activities. Often, full ownership may be a desirable, but not a necessary, prerequisite for international success. At other times it may be essential, particularly when strong links exist within the corporation. Interdependencies between and among local operations and headquarters may be so strong that nothing short of total coordination will result in an acceptable benefit to the firm as a whole.⁵⁷

Increasingly, however, the international environment is hostile to full ownership by multinational firms. Government action through outright legal restrictions or discriminatory actions is making the option less attractive. There seems to be a distinct “liability of foreignness” to which multinational firms are exposed. Such disadvantages can result from government resentment of greater opportunities by multinational firms. But they can also be the consequence of corporate actions such as the decision to have many expatriates rotate in top management positions, which may weaken the standing of a subsidiary and its local employees.⁵⁸

To overcome market barriers abroad, firms can either build competitive capabilities from scratch or acquire them from local owners.⁵⁹ The choice is often to accept a reduction in control or to lose the opportunity to operate efficiently in a country. In addition to formal action by the government, the general conditions in the market may make it advisable for the firm to join forces with local entities.



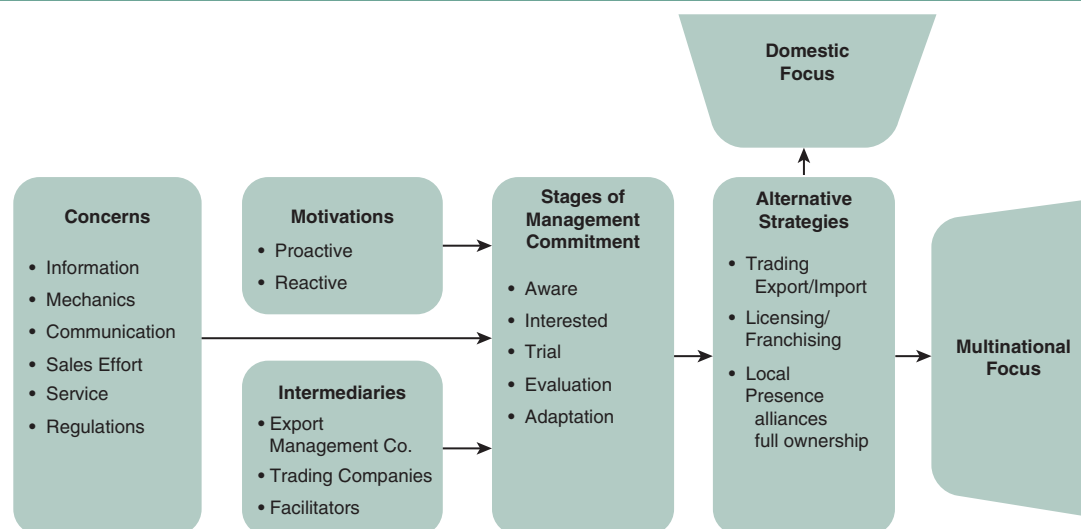
A COMPREHENSIVE VIEW OF INTERNATIONAL EXPANSION

7. To observe a model linking managerial commitment, international expansion and corporate concerns

The central driver of internationalization is the level of managerial commitment. This commitment will grow gradually from an awareness of international potential to the adaptation of international business as a strategic business direction. It will be influenced by the information, experience, and perception of management, which in turn is shaped by motivations, concerns, and the activities of change agents.

Management’s commitment and its view of the capabilities of the firm will then trigger various international business activities, which can range from indirect exporting and importing to more direct involvement in the global market. Eventually, the firm may then expand further through measures such as joint ventures, strategic alliances, or foreign direct investment.

Figure 13.4 A Comprehensive Model of International Market Entry and Development



All of the developments, processes, and factors involved in the overall process of going international are linked to each other. A comprehensive view of these links is presented schematically in Figure 13.4.

SUMMARY

Firms do not become experienced in international business overnight, but rather progress gradually through an internationalization process. The process is triggered by different motivations to go abroad. The motivations can be proactive or reactive. Proactive motivations are initiated by aggressive management, whereas reactive motivations are the defensive response of management to environmental changes and pressures. Firms that are primarily stimulated by proactive motivations are more likely to enter international business and succeed.

In going abroad, firms encounter multiple problems and challenges, which range from a lack of information to mechanics and documentation. In order to gain assistance in its initial international experience, the firm can make use of either intermediaries or facilitators. Intermediaries are outside companies that actively participate in an international transaction. They are export management companies or trading companies. In order for these intermediaries to perform international business functions properly, however, they must be compensated. This will result in a reduction of profits.

International facilitators do not participate in international business transactions, but they contribute knowledge

and information. Increasingly, facilitating roles are played by private-sector groups, such as industry associations, banks, accountants, or consultants, and by universities and federal, state, and local government authorities.

Apart from exporting and importing, alternatives for international business entry are licensing, franchising, and local presence. The basic advantage of licensing is that it does not involve capital investment or knowledge of foreign markets. Its major disadvantage is that licensing agreements typically have time limits, are often proscribed by foreign governments, and may result in creating a competitor. The use of franchising as a means of expansion into foreign markets has increased dramatically. Franchisors must learn to strike a balance between adapting to local environments and standardizing to the degree necessary to maintain international recognizability.

Full ownership is becoming more unlikely in many markets as well as industries, and the firm has to look at alternative approaches. The main alternative is interfirm cooperation, in which the firm joins forces with other business entities, possibly even a foreign government. In some cases, when the firm may not want to make a direct investment, it will offer its management expertise for sale in the form of management contracts.

KEY TERMS

managerial commitment 428
 unsolicited order 429
 accidental exporters 429
 psychological distance 432
 indirect involvement 435
 direct involvement 435
 transaction cost theory 435
 export management companies (EMCs) 437

agent 437
 distributor 437
 sogoshosha 439
 export trading company (ETC) 439
 licensing agreement 442
 royalty 442
 trademark licensing 443
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strategic alliances 445
 licensing 447
 cross-marketing activities 447
 contract manufacturing 448
 management contract 448
 turnkey operation 448
 Joint Research and Development Act 450

QUESTIONS FOR DISCUSSION

1. Why is management commitment so important to export success?
2. Explain the benefits that international sales can have for domestic business activities.
3. Comment on the stance that “licensing is really not a form of international involvement because it requires no substantial additional effort on the part of the licensor.”
4. What is the purpose of export intermediaries?
5. How can an export intermediary avoid circumvention by a client or customer?
6. Comment on the observation that “a joint venture may be a combination of Leonardo da Vinci’s brain and Carl Lewis’s legs; one wants to fly, the other insists on running.”
7. Why would an internationalizing company opt for a management contract over other modes of operation? Relate your answer especially to the case of hospitality companies such as Hyatt, Marriott, and Sheraton.