2.1. Introduction

This chapter covers three major components of learning objectives/outcomes that are likely to examine via coursework or examination. This chapter will enable students to build their knowledge on three key areas, which includes Export-based methods for internationalisation non-equity-based methods for internationalisation and equity-based methods for internationalisation.

2.2. Export-based methods for internationalisation

Most of the export-based methods for internationalisation are considered to be non-equity-based methods for internationalisations. In the exam, it is very likely to ask to explain or discuss the non-equity methods of internationalisation. In this case the examiner expects students to discuss export-based methods as well.

Export-based methods are the most commonly used methods for internationalisation. Export-based methods of internationalisation is broken down into

- Indirect export
- Direct export

2.2.1. Indirect Exporting

Indirect exporting happens when a firm does not itself undertake any special international activity but rather operates through intermediaries. The role of intermediary may be played by export houses, conforming houses and buying houses (Wall, et al, 2010).

An export house buys products from domestic firms and sells them abroad on its own account.

A conforming house acts for foreign buyers and is paid on commission basis, bringing sellers and buyers into direct contact (unlike and export house) and guarantees payment will be made to the exporter by the end-user;

A buying house performs similar functions to those of the conforming house but is more active in seeking out sellers to match the buyer’s particular needs.

The main advantage of this approach is that there is no additional costs need to be incurred or expertise acquired in order to access the overseas market. However, the disadvantage is having little or no control over local marketing issues and little contact with the end users, so there is no feedback for product development or marketing.

There are different forms of indirect exporting.

- Intermediaries(Trading company): discussed above
- **Independent export management companies**: handle the export arrangements for number of clients, providing them with purchasing, shipping, financing and negotiation services (e.g. setting up contracts, providing localised overseas knowledge etc) as regards dealing with foreign orders. For example Unilever establish Unilever Export to deal with its exports from UK. This enables any scale economies within the exporting functions to be gained on behalf of all the products and brands of the MNE.

- **Piggybacking** is a where different companies share resources in order to access foreign markets more effectively (Wall et al, 2010). Piggyback is the practice undertaken when a manufacturer uses the sales force and distribution network of another firm, in order to market its products. Piggyback exporting is most frequently used as a method of achieving an excellent level of marketing support without considerable effort and investments, so as to build a sales and distribution network in a foreign market. Piggybacking often achieving an even better level of control, while keeping both investments and cost at a low level. Recently, the piggyback method has been adopted with encouraging results by not only medium-sized firms, but also large firms such as Whirlpool when it agreed with Sony to become its appliance distributor in Japan (Katsioloudes and Hadjidakis, 2007).

### 2.2.2. Direct Exporting

Direct exporting involves a firm in distributing and selling its own products to the foreign market (Wall et al, 2010). This would generally mean a longer-term commitment to a particular foreign market, with the firm choosing local need to be developed to keep up these contacts, to conduct market research and establishing local pricing policies.

The advantages of this approach include:

- Allow the exporter to closely monitor developments and competition in the host market
- Promotes interaction between producer and end-user
- Involves long-term commitments, such as providing after-sale services to encourage repeat purchases.

Direct exporting has been encouraged in recent years by establishment of export processing zones by countries. These are designated geographical areas within a country that provide appropriate infrastructure and incentives to encourage inward FDI that is focused on direct exporting from the EPZ. Successful EPZ can be found in China Coast Rica, India and also in Singapore. The success of these EPZ depends on the incentive provided to attract more FDI.

### 2.2.3. Advantages and Disadvantages of Export-based methods

As mentioned earlier, export-based method of internationalisation is initial stage of internationalisation process and only later most of firms switch to another mode for serving a foreign market. Therefore we will look into different advantages and disadvantages of export based methods of internationalisation.
Advantages
Two key advantages are export methods were identified by Hill (2003) as follows:

1. It avoids the often –substantial costs of establishing manufacturing operations in the host country

2. Exporting may help a firm achieve experience curve and location economies. By manufacturing the product in a centralised location and exporting it to national markets, the firm may realise substantial economies of scale from its global sales volume. This is how Sony cam dominant the global TV market, how Matsushita cam dominant the VCR market etc.

Disadvantages
Also Hill (2003) discussed four drawbacks of export-based methods of internationalisation. They are

1. Exporting from the firm’s home base may not be appropriate if there are lower-cost locations for manufacturing the product abroad. Many USA electronic firms have moved some of their manufacturing to the Far East because of the availability of low-cost, highly skilled labour there. They can then export from that location to the rest of the world, including both USA.

2. High transport costs can make exporting un economical, particularly for bulk products. One way of getting around this is to manufacture bulk products regionally. This strategy enables the firm to realise some economies from large scale production and at the same time to limit its transport cost. For example, many multinationals chemical firms manufacture their products regionally, serving several countries from one facility.

3. Tariff barriers can make exporting uneconomical. An implicit threat by the USA Congress to impose tariffs on imported Japanese autos led many Japanese auto firms to set up manufacturing plants in the United States. By the end of 1990s, almost 50% of all Japanese cars sold in USA were manufactured locally-up from 0% in 1985.

4. Drawbacks also arise from exporting when a firm delegates its marketing in each country where it does business to local agent. Foreign agents often carry the products of competing firms and so have divided loyalties. In such cases, the foreign agents may not do as a good job as the firm would if it managed its marketing itself. To overcome this problem, some firms may set up a wholly own subsidiaries in the host country to handle local marketing. By doing this, the firm can control marketing activities while reaping the cost advantage of manufacturing the product in a single location.
2.3. Non-equity-based methods for internationalisation

The other non-equity methods of internationalisation often take form of

- Licensing
- Franchising
- Other contractual modes of internationalisation

2.3.1. Licensing

Licensing is an agreement to arrange whereby a licensor grants the rights to intangible property to another entity (the licensee) for a specified period, and in return, the licensor receives a loyalty fee from licensee (Hill (2003)). For example, Xerox, inventor of the photocopier, established a joint venture with Fuji-Xerox. Xerox then licensed its xerographic know-how to Fuji-Xerox. In return, Fuji-Xerox paid Xerox a royalty fee equal to 5 percent of the net sales revenue that Fuji-Xerox earned from the sales of photocopiers based on Xerox’s patented know-how.

Advantages

Hill (2003) identified three advantages associated with licensing:

1. The primary advantage of licensing is that firm does not have to bear the development costs and risks associated with opening a foreign market. Licensing is very attractive for firms lacking the capital to develop operations overseas.

2. Licensing is often used when a firm wishes to participate in a foreign market but is prohibited from doing so by barriers to investment. This was the reason that Xerox licensed it technical know-how to Fuji-Xerox. Xerox wanted to participate in the Japanese market but was prohibited from setting up a wholly own subsidiary by the Japanese government. So Xerox set up the joint venture with Fuji and then licensed its know-how.

3. Licensing is used when a firm possesses some intangible property that might have business applications, but it does not want to develop those applications itself. For example, Bell Laboratories at AT&T originally invented the transistor circuit in the 1950s, but AT&T decided it did not want to produce transistors, so it licensed the technology to number of other companies such as Texas Instruments. Similarly, Coca Cola has licensed its famous trademark to clothing manufacturers, which have incorporated the design into their clothing.

Disadvantages

Hill (2003) identified three disadvantages associated with licensing:

1. Competing in a global market may require a firm to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another. Licensing limits a firm’s ability to do this. A licensee is unlikely to allow a MNE to use its profit to support a different licensee operating in another country.
2. It does not give a firm the tight control over manufacturing, marketing, and strategy that required for realising experience curve and location economies. Licensing typically involves each licensee setting up its own production operations. This severely limits firm’s ability to realise experience curve and location economies by producing its products in a centralised location.

3. Another problem with licensing is the risk associated with licensing technological know-how to foreign companies. Most firms wish to maintain control over how their know-how is used, and firm can quickly lose control over its technology by licensing agreement. For example RCA Corporation once licensed its colour TV technology to Japanese firm including Matsushita and Sony. Japanese firms quickly assimilated the technology, improved on it, and used it to enter the USA market. Now Japanese firm have a bigger share of the USA market than RCA brand.

2.3.2. Franchising

Franchising is basically a specialised form of licensing in which the franchisor not only sell intangible property to the franchisee, but also insist that the franchisee agree to abide by the strict rules as to how it does business (Hill, 2003).

Franchiser will often assist the franchisee to run the business on an ongoing basis. As with the licensing, the franchiser typically receives a royalty payment, which amounts to some percentage of the franchiser’s revenues. Whereas licensing is pursued primarily by manufacturing firms, franchising is employed primarily by service firm (Hill, 2003).

McDonald and Coca Cola are good examples of firms that have grown by using franchising strategy. For example McDonald has strict rules as to how franchisees should operate a restaurant. These rules extended to control over the menu, cooking methods, staffing policies, and design and location of a restaurant. McDonald also organise the supply chain for its franchisees and provide management training and financial assistance (Hill, 2003).

Advantages

1. The firm is relieved of many of the costs and risks of opening a foreign market on its own. Instead, the franchisee typically assumes those costs and risks. This creates a good incentive for the franchisee to build profitable operations as quickly as possible (Hill, 2003).

2. Another advantage to franchisee is that they are buying into an existing brand and should receive full support from franchiser in terms of marketing, training and setting up. When customer walks into a McDonald’s restaurant they know exactly what to expect (Wall, et al, 2010).

3. Using franchising strategy, a service firm can build global presence quickly and at a relatively low costs and risks, as McDonald’s has. This is the advantages of global branding (Hill, 2003)
4. The advantages to franchisor are that overseas expansion can be much less expensive and that any local adaptation can (with agreement) be made by those well acquainted with cultural issues in that country (Wall et al, 2010).

Disadvantages

The following disadvantages were identified by Hill (2003):

1. Lack of control over quality. The foundation of franchising arrangements is that the firm’s brand name conveys a message to consumers about the quality of the firm’s product. Thus, a business traveller checking in at Hilton hotel in Maldives can reasonably expect the same quality room, food, and service that he would receive in New York. The Hilton name is supposed to guarantee consistent product quality. If the quality is inconsistent due to the poor attention paid by the franchisee to maintain the quality of services, and the customer may never wanted to use Hilton’s service again.

2. Franchising inhibit the firm’s ability to take profit out of one country to support competitive attacks in another.

Also Wall et al (2010) identified 2 more disadvantages:

3. Disadvantages to franchisee include restrictions on what they can and cannot do. For example, McDonald’s have very strict regulations concerning marketing pricing, training etc. A franchisee cannot simply change the staff uniform; alter prices or very opening hours as the company operates a standardised approach to doing business.

4. Disadvantages to franchiser include possible conflict with the franchisee for not following regulation and agreements as well as a threat that the franchisee may opt to ‘go it alone’ in the future and thus become a direct competitor.

2.3.3. Other contractual modes of internationalisation

There are many forms of contractual agreements such as management contracting, technical service agreements, and contract based partnership. Turnkey projects are also a type of contractual mode of internationalisation. For further reading please refer Hill (2003, p.482). As it is less emphasis by examiner, it will not be discuss in here.
2.4. **Equity-based methods for internationalisation**

This is essentially refers to the use of FDI by the firms as a means of competing internationally in the modern global economy. The major advantages of this method are that the firm secures the greatest level of control over its proprietary information and therefore over any technological advantages it might have. In addition profit need to be shared with other parties such as agents, distributors or licensees.

There are many forms of equity-based methods for internationalisation. These include:

- Joint Ventures
- Acquisitions and Green Field Investments (wholly owned subsidiaries)
- Alliance
- Consortia, Keiretsus and Chaebols

### 2.4.1. Joint Venture

Joint ventures involve creating a new identity in which both the initiating partners take active roles in formulating strategy and making decisions (Wall et al, 2010). According to Wall et al (2010) joint ventures can help:

- To share and lower the costs of high-risk, technology-intensive development projects;
- To gain economies of scale and scope in value-adding activities that can only be justified on a global basis.
- To secure access to a partner’s technology, its accumulated learning, proprietary processes or protected market position.
- To create a basis for more effective future competition in the industry involved.

Joint Ventures usually take one or two forms, namely specialised or shared value added (Wall et al, 2010).

- **Specialised joint ventures:** here each partner brings a specific competency. For example one might produce and other may do the marketing. Such joint ventures are likely to be organised around different functions. For example JVC (Japan) and Thomson (France) forms joint venture. JVC contributed the specialised skills involved in manufacturing technologies needed to produce optical and compact discs, computers and semi-conductors, while Thomson contributed the specific marketing skills needed to compete in fragmented market such as Europe.

The major benefits of specialised joint ventures include an opportunity to share risks, to learn about a partner’s skills and proprietary processes and to gain access to new distribution channels. However they carry risks such as exposure of one’s competencies may result in other part gaining competitive advantage, which might become a disadvantage if other partner uses it against by learning.
• **Shared value-added joint ventures**: here both partners contribute to the same function or value-added activity. For example, Fuji-Xerox is a case of a shared value-added joint venture with design, production and marketing function all shared.

Shared value-added joint venture pose a slight different set of risk: partners can more easily lose their competitive advantage since the close working relationship involves the same function. If venture does not work, it may be difficult to coordinate and exit.

Wall et al (2010) identified five major ‘success factors’ for joint venture to be successful. These factors are

1. Take time to assess the partners
2. Understand the collaboration is a distinct form of competition
3. Learn from partners while limiting unintended information flows
4. Establish specific rules and requirements for joint venture performance at the outset.
5. Give managers sufficient autonomy

It has been found that extensive training and team building is crucial if these joint ventures are to succeed. There are three ways in which human resource management (HRM) is critical

1. Developing and training managers in negotiation and conflict resolution
2. Acculturation (cultural awareness) in working with foreign partners
3. Harmonisation of management style

**Advantages of joint venture**

Hill (2003) identified three advantages of forming joint venture

1. Access to local partner’s knowledge. A firm benefits from a local partner’s knowledge of the host country’s competitive conditions, culture, language, political systems and business systems. Many USA firms joint venture have involved the USA company providing the marketing expertise and the local knowledge necessary for competing in that country. This was the case with Fuji-Xerox joint venture.

2. Sharing development costs and risk. When development cost and/or risks of opening a foreign market are high, a firm might gain by sharing these costs and/or risks with local partner.

3. Politically acceptable. In many countries, political considerations make joint ventures the only feasible entry mode. Again this was the consideration in the establishment of Fuji-Xerox venture. Research suggests joint ventures with local partners face low risk of being subjected to nationalism or other forms of adverse government interference. This is because local equity partners, who may have
some influence on host-government policy, have a vested interest in speaking out against nationalisation or government interferences. For example Tesco forms joint venture with Sime Darby in Malaysia called Tesco Stores (Malaysia) for this reason.

**Disadvantages of Joint Venture**

Hill (2003) also identified 3 major disadvantages associated with joint ventures. These are discussed below:

1. Lack of control over technology. As with licensing, a firm that enters into a joint venture risks giving control of its technology to its partner. For example a proposed joint venture between Boeing and Mitsubishi Heavy Industries to build a new version of the 747, the 747-X, raised fears that Boeing might unwittingly give away its commercial airline technology to the Japanese.

2. Inability to engage in global strategic coordination. Joint venture does not give a firm tight control over subsidiaries that might need to realise experience curve or location economies. Nor does it give a firm the tight control over a foreign subsidiary that might need for engaging in coordinated global attacks against its rivals. For example consider the entry of Texas Instruments (TI) into Japanese semiconductor market. When TI establish a semi-conductor facilities in Japan, it did so for the dual purpose of checking Japanese manufactures market share and limiting their cash available for invading TI’s global market.

3. Shared ownership arrangement can lead conflicts and battles to control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be. Research indicated that conflict of interest over strategy and goals often arise in joint ventures. The conflict tends to be greater when the venture is between firms of different nationalities, and they often end in dissolution of the ventures.

**2.4.2. Acquisitions and Greenfield investment (Wholly owned subsidiary)**

In a wholly owned subsidiary, the firm owns 100 percent of stock/shares. Establishing a wholly owned subsidiary can be done in two ways.

- Set-up a new operation in that country (Greenfield venture)
- Acquire an established firm in that host nation and use that firm to promote its products.

**Advantages of wholly owned subsidiary**

Hill (2003) identified three major advantages of wholly owned subsidiaries.

1. Protection of technology that gives them strategic competences. When firm’s competitive advantage is based on technological competences, a wholly owned
subsidiary will often be preferred entry mode, because it reduces the risk of losing control over that competence.

2. Ability to engage in global strategic coordination. Wholly owned subsidiary gives a firm tight control over operations in different countries. This is necessary for engaging in a global strategic coordination (using profit from one country to support competitive attacks in another).

3. Ability to realise location and experience economies. Wholly owned subsidiary may be required if a firm is trying to realise location and experience curve economies. When cost pressures are intense, it may pay a firm to configure its value chain in such a way that the value added at each stage is maximised.

Disadvantages of wholly owned subsidiary

Hill (2003) argued that wholly owned subsidiaries may face the following problems:

1. High cost and risks. Wholly owned subsidiaries must bear the full costs and risks of setting up overseas operations. The risks associated with learning to do business in a new culture are less if the firm acquires established host-country enterprises.

Now we know that a firm can enter a country through acquisition or Greenfield investment by establishing a wholly own subsidiary. However which method will be used to establish a wholly owned subsidiary? The volume of cross-border acquisition or mergers has been growing at a rapid rate for three decades. Some 80 percent of the world’s FDI flows is now in the form of mergers and acquisition.

Acquisitions of foreign entity

According to Hill (2003, p.491) acquisitions have three major points in their favour.

1. They are quick to execute. By acquiring established enterprises, a firm can rapidly build its presence in the target foreign market. ING’s rapid rise in the USA financial services market was primarily due to a number of acquisitions.

2. In many cases firms make acquisitions to pre-empt their competitors. The need for pre-emption is particularly great in markets that are rapidly globalising, such as telecommunications, where a combination of deregulation within nations and liberalisation of regulations governing cross-border foreign direct investments has made it much easier for enterprises to enter foreign markets through acquisitions. For example US$60 billion acquisition of Air Touch Communication in the USA by the British company Vodafone.

3. Managers believe acquisition to be less risky than green-field ventures. When a firm makes an acquisition, it buys a set of assets that are producing a known revenue and profit stream. In contrast, the revenue and profit streams that a green-field venture might generate is uncertain because it does not yet exist.
However, many acquisition in past has failed rather than being successful. Hill (2003) identified many reasons for acquisition failures:

1. The acquiring firm often overpay for the assets of the acquired firm. For example Daimler acquired Chrysler in 1998 for US$ 40 billion, which represented a premium of 40 percent over market value of Chrysler before the takeover bid.

2. Many acquisitions fail because there is a clash between the cultures of the acquiring and acquired firm. After acquisition, many acquired companies experience high management turnover, possibly because their employees do not like the acquiring firm’s way of doing things. This happened at Daimler/Chrysler; many senior managers left Chrysler in the first year after the merger. Apparently, Chrysler executive dislike the dominance in decision making by Daimler’s German managers, while the Germans resented that Chrysler’s American managers were paid two to three times as much as their German counterparts. These cultural differences among the two countries create tensions, which ultimately exhibited themselves in high management turnover at Chrysler.

3. Many acquisitions fail because attempts to realise synergies by integrating the operations of the acquired and acquiring entities often run into roadblocks and take much longer than forecast. Differences in management philosophy and company culture can slow the integration of operations. These problems are likely to be exacerbated by differences in national culture. Again, this reportedly occurred in Daimler and Chrysler, where grand plans to integrate the operations of the two companies were bogged down by endless committee meetings and by simple logistical consideration such as the six hour time difference between Detroit and Germany. By the time an integration plan had been worked out, Chrysler was losing money, and Daimler’s German managers suddenly have a crisis on their hand.

4. Many acquisitions fail due to inadequate pre-acquisition screening. Many firms decide to acquire other firm without thoroughly analysing the potential benefits and costs. They often move with undue haste to execute the acquisition, perhaps because they fear another competitor may pre-empt them. After the acquisition, however, many acquiring firms discover that instead of buying a well-run business, they have purchased a troubled organisation. This may be a particular problem in cross border acquisitions because the acquiring firm may not fully understand the target firm’s different national culture and business system.
Figure 2.1: Driving forces for cross border acquisitions/mergers

Greenfield investment/venture

According to Hill (2003, p.493), there are two reasons for green-field venture than acquisition

1. Green-field venture in a foreign country is that it gives the firm a much greater ability to build the kind of subsidiary company that it wants. For example, it is much easier to build an organisation culture from scratch than it is to change the culture of an acquired unit.

2. It is much easier to establish a set of operating routines in a new subsidiary than it is to convert the operating routines of an acquired unit.

3. Green-field venture are less risky than in the sense that there is les potential for unpleasant surprises.

Some of the arguments that criticise the green-field venture are highlighted by Hill (2003). These include

1. Green-field ventures are slow to establish.

2. They are risky. As with any new venture, a degree of uncertainty is associated with future revenue and profit prospectus.

3. Another disadvantage of green-field venture is the possibility of being pre-empted by more aggressive global competitors, who enter via acquisition and build a big market presence that limits the market potential for the green-field venture.
2.4.3. Alliances

Strategic alliances refer to cooperative agreements between potential or actual competitors. Strategic alliances run the range from formal joint-venture, in which two or more firms have equity stakes (Fuji-Xerox), to short-term contractual agreements, in which two companies agree to cooperate on a particular task (such as developing new products).

To determine whether to enter into an alliance rather than a joint-venture or acquisition, Jeffrey and Reuer (1999, cited in Wall et al, 2010) suggested to use “Four Is” of collaboration. These four ‘Is’ were discussed by Wall et al (2010, p.52-53) in the following ways:

**Infeasibility:** Alliances are more likely when acquisitions contain elements of infeasibility. For example, competition legislation may effectively prevent large corporate acquisitions or may impose conditions deemed unacceptable if they are to go ahead. Restrictions on inward FDI to some industrial/service sectors or countries may have the same effect.

**Information asymmetry:** Alliances are more likely the greater the degree of (actual or perceived) information asymmetry. In other words, companies may be more likely to resort to alliances rather than acquisitions when one company knows more than some other company. Even after due diligence, the acquiring company may have reservations as to the true value of the assets to be acquired.

**Investment in options:** Alliances are more likely the greater the degree of uncertainty as to the future prospects of combined activity. For example, alliance forms a high proportion of total linkages between companies in uncertain industrial sectors such as biotechnology. An alliance can develop into greater or lesser linkage between two or more companies depending on the degree of success actually achieved by initial joint activity.

**Indigestibility:** Alliances are more likely the greater the perceived indigestibility of the potential target for acquisition. (This term arises from the need of an acquiring company to ‘digest’ the assets of an acquired company). Such ‘indigestibility’ raises the anticipated transaction costs of acquisition (post-acquisition integration cost). In such circumstances alliances will prove relatively attractive, giving the respective allies greater freedom to link selected assets only.

**Advantages of strategic alliances**

Hill (2003, p.494-495) the following advantages of strategic alliances:

1. Strategic alliances may facilitate entry into foreign market. For example, Motorola initially found it very difficult to gain access to Japanese cellular telephone market. In the mid-1980s, the firm complained loudly about formal and informal Japanese trade barriers. The turning point for Motorola came in 1987 when it allied itself with Toshiba to build microprocessors. Motorola no longer complain about Japan’s trade barriers, although privately the company admits...
they still exist, with Toshiba’s help Motorola has become skilled at getting around
them.

2. Strategic alliances also allows firms to share the fixed costs (and associated risks)
of developing new products or processes. Motorola’s alliances with Toshiba also
were partly motivated by desire to share the high fixed costs of setting up an
operation to manufacture microprocessors. The microprocessor business is so
capital intensive –Motorola and Toshiba each contributed close to US$ 1 billion
to set up their facility—that few firms can afford the costs and risks by themselves.

3. Strategic alliances are a way to bring together complementary skills and assets
that neither company could easily develop on its own. An example is the alliance
between France’s Thompson and Japan’s JVC to manufacture videocassette
recorders. JVC and Thompson are trading core competencies; Thompson needs
products technology and manufacturing skills, while JVC need to learn how to
succeed in the fragmented market.

4. It can make sense to form strategic alliances that will help the firm establish
technological standards for the industry that will benefit the firm. For example, in
1992, Philip NV allied with global competitor Matsushita to manufacture and
market the digital compact cassettes system Philip has developed.

Disadvantages of strategic alliances

Hill (2003) has criticised strategic alliances on the following grounds:

1. Strategic alliances give competitors a low cost route to new technology and
markets. For example, many argued that Japanese firms gained competitive
advantages via American technology through such partnership formed in 1980s.

2. Alliances are risky.

2.4.4. Consortia, Keiretsus and chaebols

Consortia
These involve the bringing together of different companies to pool resources into an
integrative organisational design. Some overlap with ‘alliances’ but consortia usually
occur across many firms and sectors.

Keiretsus
Japanese consortia where 20/25 different companies integrate through interlocking
directorates, common bank holdings, close personal TIES, ETC.

Chaebols
South Korean consortia and have similarities with Japanese keiretsu
Benefits of Consortia, Kairetsus and Chaebols

1. Shared risk and costs
2. Building critical mass in process technologies
3. Fast resource flows and skill transfer

Costs of Consortia, Kairetsus and Chaebols

1. Skills and technologies that have no real market worth
2. Bureaucracy
3. Hierarchy

2.5. Why invest at abroad?

![Diagram showing the reasons for going abroad](image)

Figure 2.2: Reasons for going abroad

2.6. Factors influencing the internationalisation decisions

There are mainly three factors that play a vital role in influencing the decisions to go abroad. These factors include

- Supply related factors
- Demand related factors
- Political related factors

2.6.1. Supply related factors

Supply related factors include production costs, distribution costs, availability of natural resources, and access to key technology.
Production costs: Foreign location may be more attractive because of the low costs of skilled labour or unskilled labour, lower land prices, tax rates or commercial real-estate rents. Many MNEs moved their assembly lines and call centres to China and India due to the availability of low cost but highly qualified labours to perform the designated jobs. Also there is a trend to reduce corporate income tax in most of the developed and developing countries. For example in Bulgaria tax rate has been reduced from 15% to 10% in 2007 and from 38.5% to 33% in Colombia in the same year. Particular locations can change in terms of their relative popularity as low-cost centres of production. For example, South Korea was once a production centre for low-priced training shoes, but as the country began to prosper, wage may rose and this market is now dominated by China.

Distribution costs: Where transportation costs are a significant proportion of total costs, firms may choose to produce from foreign locations rather than pay the costs of transportation. Heineken, whose products are mainly water-based, finds it cheaper to brew in locations geographically closer to the foreign consumers. International business may find it cheaper to establish distribution centres in the foreign location rather than to send individual consignments directly to sellers. For example, Citrovita (a Brazilian producer of orange concentrates) operates a storage and distribution centre in Antwerp, Belgium, so that it can benefit from low shipping rates when transporting in bulk.

Availability of natural resources: This is very important in certain industries such as oil and minerals. Oil companies such as Exxon, Shell and BP, have provide well-known examples of this approach. In order to secure control of strategic raw materials in oil fields around the world, they established overseas extraction operations in the early years of the twentieth century with the aim of shipping crude oil back their home markets for refining and sales.

Access to key technology: many firms find it cheaper to invest in an existing firm rather than put together a new team of research specialists. Many Japanese pharmaceutical manufacturers have invested in small biogenetics companies as an inexpensive means of finding cutting-edge technology. For example Mitsubishi Electronics took over Apricot in the UK, while Fujitsu is now the second largest computer corporation in the world, after acquiring ICL, at that point the largest UK computer company.

2.6.2. Demand factors

There are number of demand related factors that may influence the firms in internationalisation decision making process. These may include:

- Marketing advantage
- Preservation of brand names and trademarks
- Customer mobility

Marketing advantage: There are several types of marketing advantages that may be reaped from investing in overseas enterprises or setting up foreign affiliates. The physical presence of a factory may give a company visibility and the company may also gain from a ‘buy-local’ attitude.
Preservation of brand names and trademarks: In order to maintain control over its brands, an established firm may choose to manufacture in the host country rather than merely license its name and run the risk of licensees using inferior materials.

Customer mobility: A firm may be motivated to move its operations close to a business customers if that customer sets up operations elsewhere, in order to reduce the possibility that a host-based competitor might step in and replace it as the supplier. For example, Japanese firms supplying parts to the major Japanese automobile companies have responded to the construction of Japanese automobile assembly plants in USA and UK by building their own factories, warehouses and research facilities there.

2.6.3. Political factors

Political factors that may influence the internationalisation decision making process include:

- Avoidance of trade barriers
- Economic development incentives

Avoidance of trade barriers: Firms set up facilities in foreign countries in order to avoid trade barriers. For example, US automobile companies have placed consistent pressure on their government to restrict Japanese imports of cars into the USA. At the same time, Japanese government has itself imposed a voluntary export restraints (VER) on number of cars exported to the USA. To get around these restrictions, many Japanese companies have set-up factories in the USA, not only avoiding the VER but also helping to reduce US consumer opposition to Japanese cars since US jobs are now directly involved.

Economic development incentives: Most government see FDI as creating new employment opportunities, raising the technological base and generally increasing the economic welfare of its citizens. Governments have therefore been ready to offer various incentives to firms to induce them to locate new facilities in their countries, including tax reduction or tax holidays, free or subsidies access to land or buildings, especially constructed (road, rail, air link) and so on.

2.6.4. Other factors

Other factors that can influences the internationalisation process includes

- The role of government
- Motives of the organisation
- Saturation of home market
- The bandwagon effect
- International product life cycle
2.7. Theoretical explanation of internationalisation process

There are various theoretical models that have been used to analyse the internationalisation process:

- Ownership-specific advantages
- Internationalisation
- Location-specific advantage
- Eclectic theory
- Sequential theory of internationalisation
- Simultaneous theory of internationalisation
- Network theory
- International product life cycle (IPLC)

2.7.1 Ownership-specific advantages

This theory focuses on the assets owned by the firm which might give it a competitive edge vis-a-vis other firms operating in overseas markets. Such ownership-specific advantages might include superior technology, as well-known brand name, economies of scale of scope, managerial or organisational skills, etc.

2.7.2 Internationalisation

Asks the question of when it is less costly to do something yourself in another country rather than selling your product or service. Internalization theory also asks the question of why FDI exists. Internalization theory begins with the assumption that operating in a foreign country is likely more costly than operating at home. This means internationalisation theory focuses on the costs of entering into a transaction. This means cost of negotiating, monitoring and enforcing a contract.

2.7.3 Location-specific advantage

These theories have mainly sought to answer the ‘where’ questions involving MNEs activity outside the home country as well as the ‘why’. The availability and price of natural and human resources in overseas territories, of transport and communications infrastructure, market-size characteristics and other locational attributes.

2.7.4 Eclectic theory

Dunning’s eclectic theory focuses on three advantages that a company must have to succeed with FDI. These advantages consider both the internal characteristics of the MNC and the local environment in which it operates. They also combine the ideas suggested by the three mentioned theories above.
Ownership advantages: As with monopolistic advantage theory, the eclectic theory argues that a company must have some strategic competitive advantages over local companies. Otherwise, without something like a superior technology or internationally recognized brand name, a foreign competitor could not compete with the locals. Toyota has an internationally recognized brand name for quality and has superior manufacturing technologies to its competitors. These are two reasons why Toyota owns production facilities throughout the world.

Internalization advantages: A company must gain some cost savings over exporting its product or service or licensing its production processes or brand name.

Location advantages: This means that there must be some profit motive to produce in another country. Usually, this comes from lower-cost production that can serve either local or home markets. Cost saving, and thus higher profits, can also come from reduced transportation costs in serving local markets. BMW, for example, manufactures its X5 sport utility and Z4 roadster in the US. Profits are higher because transportation costs to serve the US market are lower than if these products were shipped from Germany or other BMW plants in England or South Africa. This is important because of the strong demand for sport utility vehicles in the US. However, because US wages are lower than the approximately $30/hour paid to German workers, the US plant produces all of BMW’s X5s and Z4s not only for the US market but also for exporting to the rest of the world.

2.7.5 Sequential theory of internationalisation

This theory is based on the research done by Johanson and Widersheim-Paul who found that internationalisation is regular process of gradual change involving the firm moving sequentially through four discrete stages:

- Intermittent export
- Export via agents
- Overseas sales via knowledge agreements with local firms. For example via licensing or franchising.
- Foreign direct investment in overseas market

![Figure 2.3: Sequential theory of internationalisation](image)
2.7.6 Simultaneous theory of internationalisation

A simultaneous view of internationalisation is based on global convergence. For example, those who favour this theory suggested that customers’ taste around the world are becoming progressively homogeneous, citing the success of such global products as Coca-Cola or Soney Walkman. This approach contended that economies of scale and scope available for standardised products in such global markets are so substantial that a gradual, sequential approach to internationalisation is no longer practicable.

2.7.7 Network theory

In network perspective the process of internationalisation is seen as building on existing relationships or creating new relationships in international markets, with the focus shifting from organisational or economic to that of the social.

The series of networks can be considered at three levels:

**Macro:** network theory would see the macro environment as a set of diverse interests, powers and characteristics, which may well impinge on national and international business decisions. To enter new markets, a firm have to break old relationships and add new ones. New entrants may find it difficult to break into a market that already has many stable relationships.

**Inter-organisational:** firms may well stand in different relationships to one another in different markets. They may be competitors in one market, collaborators in another and suppliers and customers to each other in a third. If one firm internationalises, this may draw other firms into international arena

**Intra-organisational:** relationships within the organisation may well influence the decision-making process. If a multinational has subsidiaries in other countries, decision may well be taken at the subsidiary level that increases the degree of internationalisation of decision making permitted by the firm.

2.7.8 International product life cycle

The suggestion here is that the patterns and extent of internationalisation achieved by the firm, and future prospects for continuation of that process, will depend in part on the stage in the IPLC reached by the firm. This approach will be further discussed in the later sessions of the semester.
### 2.8. Barriers to internationalisation

<table>
<thead>
<tr>
<th>Rank</th>
<th>Classification of barrier</th>
<th>Description of barrier</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Capabilities</td>
<td>Inadequate quantity of and/or untrained personnel for internationalisation</td>
</tr>
<tr>
<td>2</td>
<td>Finance</td>
<td>Shortage of working capital to finance exports</td>
</tr>
<tr>
<td>3</td>
<td>Access</td>
<td>Limited information to locate/analyse markets</td>
</tr>
<tr>
<td>4</td>
<td>Access</td>
<td>Identifying foreign business opportunities</td>
</tr>
<tr>
<td>5</td>
<td>Capabilities</td>
<td>Lack of managerial time to deal with internationalisation</td>
</tr>
<tr>
<td>6</td>
<td>Capabilities</td>
<td>Inability to contact potential overseas customers</td>
</tr>
<tr>
<td>7</td>
<td>Capabilities</td>
<td>Developing new products for foreign markets</td>
</tr>
<tr>
<td>8</td>
<td>Business Environment</td>
<td>Unfamiliar foreign business practices</td>
</tr>
<tr>
<td>9</td>
<td>Capabilities</td>
<td>Meeting export product quality/standards/specification</td>
</tr>
<tr>
<td>10</td>
<td>Access</td>
<td>Unfamiliar exporting procedures/paperwork</td>
</tr>
</tbody>
</table>

**Governmental supports to overcome barriers**

- Capability supporting program
- Access to markets support program
- Business environment support programs
- Financial support programs
Reference list


