Course Learning Outcomes for Unit V

Upon completion of this unit, students should be able to:

3. Evaluate policies and factors affecting international trade patterns.

8. Examine the major marketing considerations applicable to international business.

Reading Assignment

In order to access the following resource(s), click the link(s) below:


Click here to access the Unit V Presentation. Click here to access a PDF slide view and transcript of the presentation.

Unit Lesson

Global Strategies

Global strategies begin with the level of participation a business wants. Importing and exporting are the easiest ways to participate in international business. However, if the business wants to put more “skin in the game” and can tolerate more risk, then a business looks at product licensing, joint ventures, business alliances, and foreign direct investment, which increases their commitment and risk substantially.

Companies must first choose to allocate a certain amount of their resources and efforts to international business. For example, General Electric set an objective of having international sales account for 60% of its total sales (Glader, 2010). Once a company makes that allocation, resources must be committed, and the next step is to decide where to proceed.

Country Evaluation and Selection

Many of those decisions will become apparent depending on the type of company. For example, a fast food company will need multiple locations in one country to have any kind of presence. A manufacturing company may favor producing in only a few countries and exporting to others. However, for those companies looking to have placement, the process starts with external scanning.
**Scanning:** This is the process by which companies examine many countries broadly and narrow them down to the most promising prospects. There are 162 countries currently in the World Trade Organization, and companies might overlook good prospects without first looking very broadly (World Trade Organization [WTO], n.d.). General characteristics in the scanning process might include many of the economic factors discussed in Unit II:

- Cultural comparability,
- Gross domestic product (GDP),
- Purchasing power parity (PPP), and
- Human development index (HDI).

**Analyzing:** This is the process of comparing the feasibility and desirability of each country. For import/export operations, many of the following variables would not be applicable. However, for advanced collaboration, it is necessary to consider most of them. Feasibility studies examine not only economic factors in more detail but also factors of production (especially costs):

- products/services to offer,
- costs of infrastructure and access to energy,
- transportation costs (e.g., railroads, highways, and ports),
- labor costs and availability (e.g., skilled and educated versus unskilled and uneducated),
- technology costs (e.g., labor intensive versus capital intensive),
- geographic location (i.e., proximity to customers),
- government incentives and disincentives (e.g., taxes and corruption),
- time to setup production, and
- estimated product growth.

In addition, indicators directly related to product consumption should be included. For example, disposable income might be a better economic predictor than GDP. Income brackets might also reveal a hidden middle class.

The availability of a scarce resource is one reason companies seek placement in foreign countries. In addition to natural resource availability, companies must include the costs of labor, extraction, transportation, and taxes into the total cost of resource acquisition.

Risk assessment is the last category to consider when selecting a foreign country to conduct business. There are three types of risk to consider:

- **Political risk** is the possibility of damaged and lost assets due to governmental actions or instability in a country. In this day and time, typical countries with high political risks would be Venezuela or even Syria.
- **Foreign exchange risk** is the declining value of an investment due to changes in foreign exchange rates. For example, our friend John, back in Unit IV, took a risk by buying Chinese yuan with U.S. dollars. His investment has a negative return so far. Companies do the same thing but on a far larger scale. They will take millions of dollars, purchase the local currency and build a factory where the production sells for a profit. If the local currency becomes stronger versus the currency of the home country, the profits remitted will be less than hoped for.
- **Competitive risk** is the risk of actual company operations in an environment filled with other real-world competitors. In many instances, competitors have already captured the availability of scarce resources, the best workers, the best locations, and customer loyalty. In some cases, foreign firms buy local companies to overcome those liabilities. Companies with deep pockets can afford to start anew and build their factories from scratch, but customer loyalty and acceptance takes time to build.

**Country Selection**

First, scan the countries that might have a broad fit. Second, select the variables that you will use to make the decision. Third, rank the variables depending on what is important. The ranking will depend on the type of business. For example, a company making a high-quality product, such as a Rolex, might consider the need for a skilled and well-educated workforce as an important variable. Opportunities are those places where expected revenues exceed expected costs. The decision then rests on the evaluation of risks.
Exports and Imports

Exports and imports are the most common type of international business. In 2014, commodities and products sold to foreign countries throughout the world totaled in excess of $18.7 trillion, a 1% increase per year for the last three years. The three largest exporters in the world, China, the U.S., and Germany, in that order, accounted for 29% of that total (International Trade Centre, n.d.). These statistics understate the true value of products sold to other nations. Many products, for example, are manufactured components assembled into bigger products for export.

Exports and imports represent the easiest, lowest cost, and lowest risk way to engage in international business. Other types of international business, such as product licensing, joint ventures, alliances with other companies, or foreign direct investment (FDI), take more capital, more risk, and a longer time span to pay off the investment.

Exporting

An export is a product or service produced in one country and sold to customers or consumers in another country. The key point here is the product or service earns foreign currency. For example, foreign students in a university class pay foreign currency to attend classes. The service they are paying for is an export and the foreign currency they pay goes towards the country's account balance that compares the net of exports versus imports.

Exports are beneficial to the United States and domestically based companies. According to Export.gov (2008), the benefits to exporting could be summed up in a short list:

- If the world's population exceeds 7 billion, the majority of potential customers reside outside your national boundaries.
- Free trade agreements abound in all directions—east, west, north and south—and they are being updated continuously.
- Exporting is like finding more customers who want your product—or a similar product that you can make to fit their needs.
- The more diverse your customer base is, the better you can weather economic changes in the domestic market.

For the companies that do export, most begin export operations with customers in countries that share geographic, cultural, linguistic, political, and legal similarities. For example, Canada and Mexico are the top two export markets for the United States (International Trade Centre, n.d.). Larger and more experienced companies employ their own specialists to manage an in-house export business. This is known as direct exporting. Companies without as much expertise contract with domestic agents. These domestic agents combine the products from several companies and sell them to other foreign agents to distribute the products. This is known as indirect exporting. Direct exporting is riskier and requires more commitment than indirect exporting. However, as a company develops experience with foreign trade, the risk and commitment become tolerable.

Importing and Exporting: Resources and Assistance

When a company decides to pursue some type of import or export business, there is a need for assistance. Since foreign countries involve new cultures, legal systems, currencies, tariffs and quotas, and other administrative regulations, there is some need for specialized knowledge. However, this specialized knowledge comes from numerous sources. Some of it comes free; some of it is expensive.

**Government agencies:** In the United States, the government wants private enterprise to export products and services. Consequently, the government makes a big push to help companies export. The International Trade Administration within the U.S. Department of Commerce leads a collaborative effort with 19 other U.S. agencies to assist small and medium businesses (Export.gov, 2008). Things they help with include licenses and regulations, trade shows, trade partners, international financing, and trade data analysis.

**Trade associations:** Usually, each type of industry pulls together to fund an association that promotes their products. Associations like the American Dairy Association and the US Oil & Gas Association are typical
groups that represent the industry and the companies within that industry. These trade associations are good sources of information for foreign countries. They provide information such as market demographics, product demand, advertising and sales consultations, and navigating homeland security programs.

**Trade intermediaries:** Third party firms that contract out their specialty fall into this category. These companies usually have agents or contacts in place in different countries that can facilitate your cargo in either exporting or importing. They provide services such as customs management, legal, accounting, tax compliance, security, insurance, and trade strategies.

**Customs brokers:** These are agents on the ground at the point of arrival or departure. They help the importer navigate the regulations imposed by customs agencies. They manage trade documentation, value products so they qualify for favorable duty treatment, and defer duties by using bonded warehouses and foreign trade zones.

**Freight forwarders:** These are the logistical people. They are important when the cost or timing of freight can make or break a deal. Their specialty is transportation and storage.

Exporting has the same problems and solutions as importing. Governments prefer exporting because it helps the current account balance, but there are no obvious blocks to importing. The same skills and the same risks are at play in either direction.

**Foreign Direct Investment**

Foreign direct investment (FDI) is a domestic company investing capital money into a foreign country. While exporting and importing represent reduced risk, FDI represents higher risk because more assets are involved. There are several reasons why a company would want to do this.

- cheaper manufacturing costs abroad,
- transportation costs are too high,
- domestic capacity is not large enough,
- products need tweaking for the foreign market,
- trade restrictions hinder imports, and
- country of origin is an issue.

There are different variations of FDI. The more ownership a company has, the more control over operating decisions it has. For example, if a company wants to bring in some proprietary, cutting-edge technology, the company will want to protect access to this technology. A collaborative arrangement with the foreign company will not give complete security to this technology because other owners will have access. A company, in this case, might opt for total ownership to protect their investment.

**Wholly owned:** A domestic company achieves a wholly owned facility in a foreign country by either building its own plant according to its explicit needs or by acquiring another company with similar attributes in a favorable location. Building your own plant infers a clean startup in which you have to hire and train workers, find vendors, and market and distribute an unknown brand. This type of investment is known as a greenfield investment. It originally referred to locating a new building on a cow pasture, literally a green field. Acquisition implies that the workforce is hired, trained, and employed; vendors are already established; and product distribution is already ongoing.

**Collaborative arrangements:** Collaborative implies working with other companies to achieve financial and operational goals. This type of investment does have some advantages such as spreading risk and cost; gaining access to scarce resources; securing vertical and horizontal integration; and gaining knowledge about competition. There are multiple variations of how a company can become involved with other companies in foreign countries.

**Licensing:** If a company owns a copyright, a patent, a process, a brand, an image, an invention, a technology, or some other asset that another user would use, then a licensing agreement is awarded to that foreign company. In 2013, product licensing accounted for $251 billion with The Walt Disney Company being the world’s largest licensor (Global License, 2015).
**Franchising:** In a franchising agreement, the franchisee looks to capitalize on the brand and operating processes of the franchisor. The franchisor not only allows the brand to be used but also offers assistance on operating standards, marketing, and advertising. Franchising is a form of licensing but with more involvement and more control by the franchisor. The top global franchisor in 2015 was McDonald’s, a fast food restaurant chain (Global License, 2016).

**Management contracts:** A management contract is a written agreement between the owner of a business and a third-party management company. A foreign company may pay for managerial assistance when it believes another company from another country can manage its operation more efficiently. The managing company receives fees without having to invest capital funds. This type of agreement is found mostly in hotel companies. Companies such as Marriott, Holiday Inn, and Melia have specialized knowledge about hotel operations that is hard to emulate. Thus, they contract to bring in their special management abilities.

**Turnkey operations:** Turnkey operations are essentially large construction projects contracted by government agencies with outside contractors. Some large contractors have unique specialties, such as nuclear reactors, bridges, canals, dams, or factories. When the final product is a complete ready-to-operate facility, the contracting government will arrange its own operations. What sets this category apart is the size of the project, potentially costing billions of dollars and taking many years to complete.

**Joint ventures:** Normally referred to as JVs, these arrangements are composed of two or more companies that form a jointly owned company to achieve joint objectives. When more than two companies participate, the arrangement is a consortium. Usually, each company that participates brings some unique perspective into the group for achieving its objectives. Well-known joint ventures include General Motor Corporation’s collaboration with automobile companies in China.

**Equity alliances:** This is a collaborative agreement in which at least one partner takes an equity position in the other company. The purpose of the equity ownership is to solidify a collaborating contract so that it is more difficult to break. For example, the Port of Antwerp (Belgium) took a minority position in Essar Ports (India) when the two signed a long-term alliance to improve quality and productivity (Essar, 2012).

If one does an Internet search for “export plan,” there are numerous export business plans that will come up. Most of the plans involve specific details; however, the presentation found in at the end of this unit will help explain that information.

**Problems and Success with Collaborative Arrangements**

Collaborative agreements usually work until they do not. Just like any partnership, it is easier and more fun to get into one than it is to get out of one. While alliances bring together companies with complementary skills, those companies do not necessarily have the same values or objectives. Some studies indicate alliances only have a 50/50 chance of succeeding (Bamford, Ernst, & Fubini, 2004). Thus, it is important to know and understand what causes problems and how to avoid them.

First, we must establish what causes divorce. There are five factors that account for the majority of strained relations inside the collaborative arrangement (Daniels, Radebaugh, & Sullivan, 2015):

- **Relative importance to partners:** Those companies with active involvement will resent those partners with passive involvement. The size of the partners also contributes to the relative importance of the deal. A small partner may need this arrangement to work more than the large partner, who can afford several other joint ventures.
- **Divergent objectives:** Usually, the alliance is established with stated goals or objectives. It is possible that over time, circumstances change, and the needs of a company change. One company may want dividends from the joint venture, whereas another company may want to push research and development with earnings.
- **Questions of control:** Inside the alliance, sharing assets, processes, or brand names without accountability can cause harm to one of the partners if it incurs product failure. When a joint venture uses a high-quality brand to market substandard products, the company that provides the brand receives a damaged reputation.
- **Comparative contributions and appropriations:** One company that contributes little to the outcome versus other companies that contribute more will cause resentment and ill will. Partners that
contribute little but take away more intangibles (product knowledge or market knowledge) will cause considerable stress.

- **Culture clashes**: Differences in country cultures and differences in company culture can account for some stress.

So what increases the odds of a collaborative arrangement being successful? These three factors are helpful (National Institute of Standards and Technology, 2001):

- **Prior collaborative relationships**: Companies that have worked with other companies before will be better partners in a collaborative arrangement.
- **Vertical integration projects**: Projects in which one company is working with another company, up or down the product line, seems to be more successful. These companies could have a vendor’s relationship and still be successful. Projects along horizontal lines (direct competitors) do not work out so well.
- **Personnel stability**: Joint ventures have a tendency to last a few years, and they need management stability. Management that negotiated the original objectives will more than likely keep the project on track. Often, companies will turn the project over to the more experienced company in order to learn the ropes. New managers will use the project as a stepping-stone as they promote in the organization. Frequent management turnover is not a successful trait and causes the partnership to unravel.

Collaborative agreements are like marriages. The reasons to tie the knot may sour over time, and it becomes very painful and very expensive to untie the knot. Many collaborative agreements now have built in prenuptial agreements that allow dissolution of the agreement if certain objectives are not met within a specified period. Careful selection of the partner(s) cannot be overstated.

**References**


