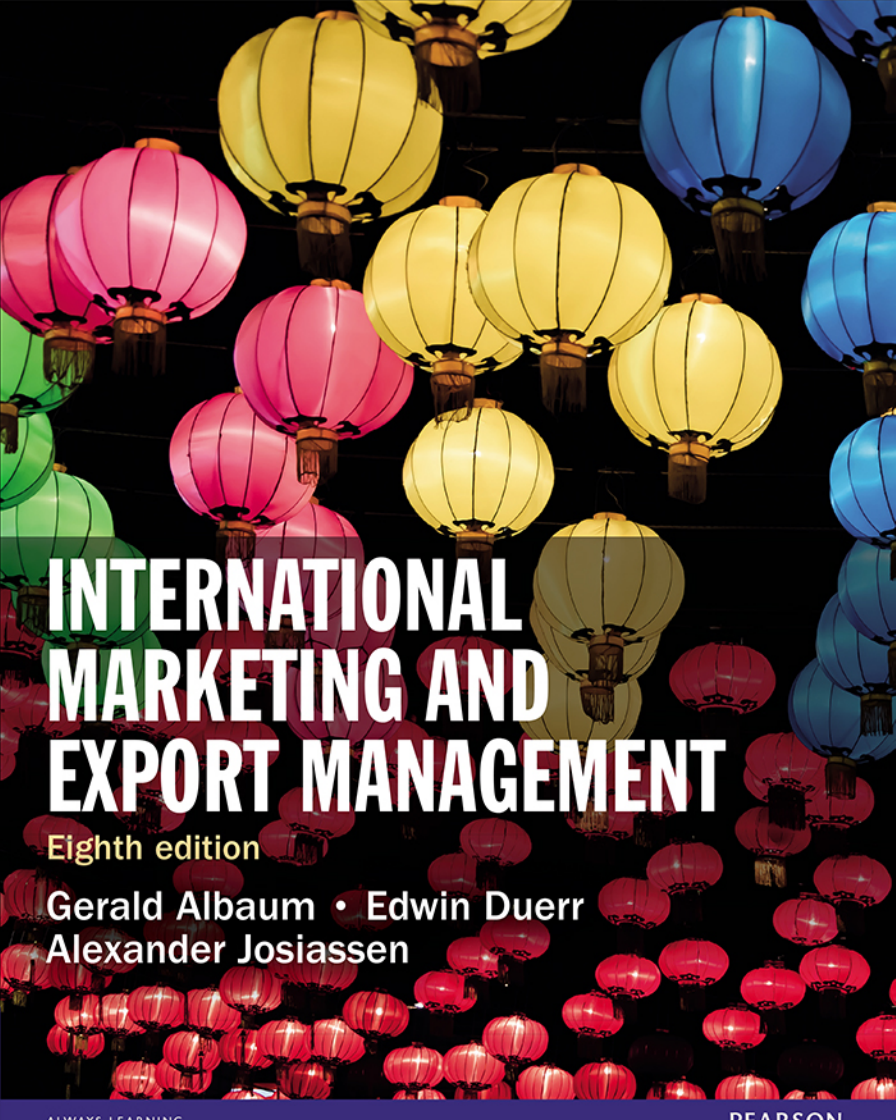

INTERNATIONAL MARKETING AND EXPORT MANAGEMENT

Eighth edition

Gerald Albaum • Edwin Duerr
Alexander Josiassen

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International Marketing and Export Management

Eighth Edition

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Gerald Albaum
University of New Mexico, USA

Edwin Duerr
San Francisco State University, USA

Alexander Josiassen
Copenhagen Business School, Denmark

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Dedication

To my wife, Carol, whose support and encouragement have sustained me in my continuing research and through eight editions of *International Marketing and Export Management*.

Gerald Albaum

To Mitsuko Saito Duerr, my wife and companion in life in teaching, consulting, writing and international adventures.

Edwin Duerr

To my wonderful daughters, Anastasia and Freya.

Alexander Josiassen

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Brief contents

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Preface

International marketing in a connected world

Most countries have more or less recovered from the financial crisis in 2008–09. Real estate prices are back up in many places around the world. Stock markets are up in most countries. Largescale unemployment characterizes Southern Europe, and Greece in particular faced issues with foreign debt. Financially, countries around the world have probably never been as dependent on each other as in this era.

The world economy is increasingly becoming an interwoven Web of connections and interdependencies. Three of the challenges which inspired this eighth edition of International Marketing and Export Management are related to this increased financial connectedness. The influence of these challenges has become clearer in recent years and they are on course to be increasingly vital to companies and consumers alike.

The first issue relates to the global connectedness of companies and consumers, large and small, in the marketplace. Hardly any company today is exempt from thinking about international marketing issues. Even the local shoe manufacturer which only sells domestically must understand international marketing because the customers are likely to have a range of domestically and internationally branded shoes to choose from. Consumers who disidentify with their own country might hinder the domestic manufacturer in being successful. Alternatively, ethnocentric consumers who want to support the domestic economy might help the domestic manufacturer gain a competitive advantage. Either way, it is increasingly critical that domestic, exporting, and multinational companies alike gain a thorough understanding of international marketing.

Secondly, the drive towards increased connectedness is evident as a mindset both among managers of companies, as well as among customers. More and more companies adopt a co-creating philosophy in which they cooperate with their suppliers, customers and wider network to provide a value proposition. Customers also drive increased international connectedness aided by technology like Trip Advisor, Meetup, and Airbnb Consumer. Using these and many other apps and sites, customer networks are getting wider and increasingly defy borders.

Thirdly, technological advances both drive and are driven by the increased connectedness. The present phase of the IT evolution is characterized by the Internet maturing. For example, companies have discovered working business plans online, and users find value in many new advances in usability. Access is relatively easy for small and large companies, as well as for consumers. However, as the Internet has matured, increasingly the deep Web and corners of the Web with shadow economies are within range of a larger part of the population. These corners have proven hard to regulate and control. The file-sharing platform Pirate Bay and the black marketplace Silk Road were both closed, only to spring into existence again. Blockchain technology led by poster boy Bitcoin is the main means of payment on Silk Road. Bitcoin can be very difficult to trace and was critical to the success of Silk Road. We must remember however that by far the majority of drugs and illegal guns are not bought with Bitcoin but dollars and other similar currency. Bitcoin and the blockchain technology promise great leaps in human productivity and wealth for consumers as well as for companies, but are still at an infant stage with many further innovations needed.

New to the eighth edition

The aim of the eighth edition is to provide a more balanced view of international marketing and export management. In the process, certain aspects have been prioritized more than in previous editions. For example, cultural perspectives of international marketing are more in focus for this edition compared to previous editions. Another example of higher priority relates to theories and models specific to international consumer behavior such as country-of-origin theory and the theories and models that focus on understanding consumers' country biases. On the other hand, information technology is viewed as a host of tools rather than a specific set of strategies or tactics. For this reason, information technology-related topics have, where possible, not been afforded separate sections but are integrated into the text.

The changes in the international marketing landscape discussed above are reflected in both new material and in expanded coverage of topics previously emphasized. The material in this new edition has been updated, integrated, or extensively rewritten.

Aims and objectives

The aims and objectives of this eighth edition are:

1. to provide a text in international marketing which will be as applicable and valuable for small and medium-sized enterprises as it is for large international corporations;
2. to provide a text which is a balance of research insights, cases and practical examples. In doing so we also continue the reputation for being one of the most comprehensive texts in international marketing and export management.
3. to provide a text which is a trusted companion for the student and manager alike.

Target audience

The eighth edition of *International Marketing and Export Management* is designed for anyone desiring to increase his or her knowledge of international marketing and export management. The book provides comprehensive coverage of both the basic marketing concepts and how they relate to international marketing, as well as coverage of models and theories unique to international marketing and export management. The text is particularly well suited for:

- managers who are involved with international marketing from CEOs to marketing managers and country managers. Export/international marketing practitioners interested in fresh insights in the rapidly changing field of international marketing;
- undergraduate and graduate students taking courses in export management or international marketing;
- those enrolled in management education courses and other tertiary non-university programs that cover export management and/or international marketing;
- entrepreneurs who are interested in starting export or import ventures.

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Finally, the Publishing Team at Pearson Education, including Eileen Srebernik deserve our appreciation for their encouragement, support and most of all, patience while we prepared the manuscript.

Gerald Albaum
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About the authors

Gerald Albaum is Research Professor at the Robert O. Anderson School of Management at the University of New Mexico. In addition, he is Professor Emeritus of Marketing at the University of Oregon and a Senior Research Fellow at the IC2 Institute, University of Texas at Austin. He received his PhD in 1962 from the University of Wisconsin-Madison and his MBA (1958) and BA (1954) from the University of Washington.

He is the author, or co-author, of eight books, nine monographs, and more than 90 articles in refereed journals, 40 papers in refereed conference proceedings, 20 papers in other publications, and 14 book and software reviews published in the *Journal of Marketing Research*. His writings deal with issues in research methods, international marketing activities, cross-cultural/national research, and retailing (especially direct selling). Many of his studies are cross-cultural/national in nature.

Dr Albaum has presented seminars for several North-American and European companies such as German GfK Research, and Danish companies such as Danfoss, Novo Nordisk, and LEGO. He has also made presentations before industry groups such as the Northern Jutland Export Council in Denmark and the Hong Kong Institute of Marketing. He has given seminars for the Hong Kong Housing Authority and for Air China in the People's Republic of China.

Edwin Duerr is Professor Emeritus of International Business at San Francisco State University, where he has served as Department Head of International Business, Director of Graduate Studies in the College of Business, and Chairman of the Board of Directors of the SFSU Research Foundation. He has been a Visiting Professor at universities in Denmark, Germany, Japan, the Netherlands, and Sweden.

Dr Duerr obtained his BS in Engineering at the Illinois Institute of Technology. After working for several years in technical and management positions in multinational companies, and establishing (and later selling) a successful importing company, he received his PhD in Business Administration from the University of California, Berkeley.

Dr Duerr has had extensive consulting experience in Brazil, Japan, Spain, and the United States. He has written widely on comparative management, productivity improvement, and international marketing, and is a frequent speaker to business and educational groups in Europe, the United States, and Japan.

Alexander Josiassen is Director of the Centre for Tourism and Culture Management at Department of Marketing, Copenhagen Business School. Alexander has published on international marketing and export management topics in premier marketing journals (e.g., *Journal of Marketing* and *Journal of Retailing*), premier tourism management journals (e.g., *Journal of Travel Research*, *Annals of Travel Research*, and *Tourism Management*), and premier journals in hospitality management (e.g., *International Journal of Hospitality Management*).

Alexander obtained his Master degree in business at Aarhus School of Business, Denmark, and his PhD in marketing at University of Melbourne, Australia. Prior to working in academia, Alexander worked in management in Europe, and Asia. Alexander now frequently consults for leading international corporations on issues in international marketing, tourism management, and export management.

List of abbreviations

(Excludes company names; *these are not spelled out in the text)

AAC	AsiaAfricaChina
ABS*	antilocking brake system
AES	automated Export Control System
AFTA	ASEAN Free Trade Area
AGV	automated guided vehicles
ANZSCEP	Australia, New Zealand, Singapore Closer Economic Partnership
ASEAN	Association of Southeast Asian Nations
Austrade	Australian Trade Commission
B2B	business to business
B2C	business to consumer
BA	business area
BEMs	big emerging markets
BERI	business environment risk index
B/Ls	bills of lading
BPI	business periodicals index
BRIC	Brazil, Russia, India and China
CACM	Central American Common Market
C&F	cost and freight
CalPERS	California Public Employees' Retirement System
CalSTERS	California State Teachers Retirement System
CARICOM	Caribbean Community and Common Market
CATI	computer-assisted telephone interviewing
CATV*	cable television
CCC	[USA] Commodity Credity Corporation
CD	compact disk
CD-ROM*	compact disk read-only memory
CE	chief executive
CEO*	chief executive officer
CEPA	Closer Economic Partnership Arrangement [between Hong Kong and China]
CER	Closer Economic Relations [between Australia and New Zealand]
CFO	chief financial officer
CIF	cost, insurance and freight
CL	container loads
CMA	German Agricultural Marketing Board
COD	cash on delivery
COFACE	Compagnie Française d'assurance pour le commerce extérieur
COMECON	Council for Mutual Economic Assistance
CPM	cost per thousand (*mille*)

CSM	customer satisfaction management
CTCs	commodity trading companies
D/A	documents against delivery
DAP	delivered at terminal
DAT	delivered at place
DDP*	delivered duty paid
DJVs	domestic joint ventures
D/P	documents against payment
DVD*	digital video disc
EC	electronic assemblies
ECGD	[UK] Export Credits Guarantee Department
EVIC	[Hong Kong] Export Credit Insurance Corporation
EDI	systems electronic data interchange systems
EEA	European Economic Association
EFIC	[Australia] Export Finance and Insurance Corporation
EFTA	European Free Trade Area
EJV	equity joint venture
EMC	export management company
EMDG	[Australia] Export Market Development Grant scheme
EMS	environmental management system
EMU	European Monetary Union
EPZs	export processing zones
ERP	enterprise resource planning
ETCs	export trading companies
EU	European Union
Eximbank	[USA] Export–Import Bank
EXW	ex works
FAS	free alongside
FCA	free carrier
FDA	[USA] Food and Drugs Administration
FDI	foreign direct investment
FMGs	federated export marketing groups
FOB	free on board
FPA	free of particular average
FAP-AC	free of particular average American conditions
FAP-EV	free of particular average English conditions
FSCs	foreign sales corporations
FTAA	Free Trade Area of the Americas
FTZ	free trade zone
GATT*	General Agreement on Tariffs and Trade
GCCP	global consumer cultural positioning
GDP	gross domestic product
GMO	genetically modified
GNI	gross national income
GNP	gross national product
GPS	global positioning system
GTCs	general trading companies

IATA	International Air Transport Association
IBRD	International Bank for Reconstruction and Development
ICAC	[Hong Kong] Independent Commission Against Corruption
ICC	International Chamber of Commerce
ICFs	insulating cement forms
IJV	international joint venture
IMF	International Monetary Fund
INCOTERMS*	trade terms of the International Chamber of Commerce
INV	international new ventures
IPO	initial public offering
IP*	Internet provider
ISF	importer security filing
ISIC*	International Standard Industrial Classification of All Economic Goods
ISO	International Standards Organization
ISPs	Internet service providers
IT	information technology
JAG	[Australia] Joint Action Group
JETRO	Japan External Trade Organization
JIT	just in time
L/C	letter of credit
LCL	less than container load
LNG	liquefied natural gas
LOV	list of values
MA	mechanical assemblies
MATV	master antenna television
MENA	Middle East and North African region
MFN	most favored nation
MII	[China] Ministry of Information Industry
MNCs	multinational corporations
MNEs	multinational enterprises
NAFTA	North American Free Trade Agreement
NCR	no licence required
NICs	newly industrialized countries
NVOCCs	non-vessel operating common carriers
OBUs	operating business units [Avon]
OECD	Organization for Economic Cooperation and Development
OEMs	original equipment manufacturers
OFC	offshore financial centers
OLAP	online analytical processing
OPEC*	Organization of Petroleum Exporting Countries
PAIS	Public Affairs Information Service
PC*	personal computer
PCT	Patent Cooperation Treaty
PLC	product life cycle
POP	point of purchase
POS	point of sale
PRC	People's Republic of China

PROEXPO	[Columbia] Government Trade Bureau
PSE	Personal Selling Ethics Scale
R&D*	research and development
RFID	radio frequency identification
RIP	Regulation of Investigatory Powers (Act)
ROI*	return on investment
RTA	ready-to-assemble
RTBs	regional trading blocs
RvA	Dutch Council for Accreditation
SAR	Special Administration Region
SARS	severe acute respiratory syndrome
SBU	strategic business unit
SDR*	Special Drawing Rights
SICA	Central American Integration System
SITC*	Standard International Trade Classification
SKUs*	stock keeping unit
SMEs	small and medium-sized companies
SRC	self-reference criterion
SUV	sports utility vehicle
SWIFT	Society for Worldwide Interbank Financial Telecommunications
SWOT*	strengths, weaknesses, opportunities, threats
TEU	20 foot container equivalent units
TGW	things gone wrong
TPOs	trade promotion organizations [public sector]
TQM	total quality management
TRIPS	Agreement on Trade-Related aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
USAID US	Agency for International Development
URL	uniform resource locator
VALS	values and life styles
VAT	value added tax
VCR	video cassette recorder
VERs	voluntary export restraints
VRA	voluntary restraint agreement
WAPs	wireless application protocols
WFOE	wholly foreign-owned enterprise
WIPO	[UN] World Intellectual Property Organization
WTO	World Trade Organization
WWW	World Wide Web

Publisher's acknowledgements

Figures

Figure 3.1 from Etiquette 101: The dictionary offhand gestures (or how to communicate without saying a word), *Condé Nast Traveler,* Conde Nast Publications (US) (Kachka, B. 2008) pp. 112–18; Figure 3.2 from Etiquette 101: China, *Condé Nast Traveler*, Conde Nast Publications (US) (Kachka, B. 2008) pp. 116–34; Figure 5.2 from *Entry Strategies for International Markets*, 2 ed. Revised and expanded, John Wiley & Sons (Root, F.R. 1998) p. 56, © 1998 John Wiley & Sons. Reproduced with permission from John Wiley & Sons, Inc. and Blackwell Scientific in the format Republish in a book via Copyright Clearance Center, Inc.; Figure 6.1 from *Marketing Research an International Approach*, Pearson Education (Schmidt, M. and Hollensen, S. 2006) p. 587; Figure 6.7 adapted from Salzberger, T., Department of International Marketing and Management, Vienna University of Economics and Management, 'Problems of Equivalence in Cross-Cultural Marketing Research', unpublished working paper, 1997, the figure on Aspects of Equivalence, p. 3; Figure 6.8 from Equivalence of survey data: relevance for international marketing, *European Journal of Marketing*, 39 (3/4), p. 356 (van Herk, H., Poortinga, Y. and Verhallen, T. 2005), © Emerald Group Publishing Ltd, all rights reserved; Figure 7.1 from International new ventures: the cross-border nexus of individuals and opportunities, *Journal of World Business*, 43, p. 191 (DiGregorio, D., Musteen, M. and Thomas, D.E. 2008), with permission from Elsevier; Figure 7.7 adapted with permission of Cengage, from *Experiencing International Business and Management*, 2 ed., Thomson South-Western (Punnett, B.J. 1994) p. 80, Thomson South-Western, a part of Cengage Learning, Inc.; permission conveyed through Copyright Clearance Center, Inc.; Figure 7.8 from The global retailer's strategic proposition and choice of entry mode, *International Journal of Retail & Distribution Management*, 36 (4), p. 284 (Park, Y. and Sternquist, B. 2008), © Emerald Group Publishing Ltd, all rights reserved; Figure 8.7 from The Gray Market Threat to International Marketing Strategies, pp. 90–116, (Bucklin, L.P. 1990) Marketing Science Institute; Figure 8.8 from Firm level export performance assessment: Review, evaluation and development, *Journal of Academy of Marketing Science*, 28 (4) (Katsikeas, C.S. 2000), with permission of Springer; Figure 9.1 from *Entry Strategies for International Markets*, 2 ed., John Wiley & Sons (Root, F.R. 1998) p. 155, Copyright © 1998 John Wiley & Sons. Reproduced with permission from John Wiley & Sons, Inc.; Figure 9.2 from Brownfield entry in emerging markets, *Journal of International Business Studies*, 32 (3), p. 581 (Meyer, K. and Estrin, S. 2001), Palgrave Macmillan, Reprinted by permission from Macmillan Publishers Ltd; Figure 9.4 republished with permission of Inderscience Enterprises Ltd, from A struggling partnership: TNK-BP joint venture, *International Journal Strategic Business Alliances*, 11 (1), p. 93 (Ekin, A.C. and King, T.R. 2009), Inderscience Enterprises Ltd - Editorial Office, permission conveyed through Copyright Clearance Center, Inc.; Figure 9.6 from Performance and survival of joint ventures with non-conventional ownership structures, *Journal of International Business Studies*, 29(4), p. 801 (Makino, S. and Beamish, P. W. 1998), copyright © 1998, Palgrave Macmillan, Reprinted by permission from Macmillan Publishers Ltd; Figure 10.8 from International marketing adaptation versus standardization of multinational companies, *International Marketing Review*, 26(4/5), p. 492 (Vrontis, D. *et al*. 2009), copyright © Emerald Group Publishing Ltd, all rights reserved; Figure 10.14 from Visual and verbal communication in the design of eco-label for green consumer products, *Journal of International Consumer Marketing*, 16(4), p. 88 (Tang, E., Fryxell, G.E. and Chow, C.F. 2004), Taylor & Francis, reprinted by permission of the Taylor & Francis Ltd (http://www.tandfonline.com); Figure 13.2 from Body language basics, Budget Travel, May 2010, p. 28 (Berger, T. and Lee, J. 2010), Courtesy of Budget Travel.

Tables

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Text

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CHAPTER 1

International marketing and exporting

Learning outcomes

In Chapter 1, we discuss:

- setting the scene in the world economy today: from recession to recovery, and longer-range prospects
- the importance, opportunities and challenges of international marketing, factors affecting its growth: current problems and long-range opportunities
- being effective: the nature and practice of international marketing
- export marketing strategy and planning, and relationship to importing
- the increasing impact of the Internet, Internet, and **e-business**; the critical importance of technological advances, increased competition and innovations; the growth of non-traditional **exports**
- how the book is designed to be of use to students, entrepreneurs, and marketing professionals

Five case studies are provided at the end of the chapter, offering examples of how the material in the chapter (and book) relate to current opportunities and problems in international business and marketing. In Case 1.1 Voice4u, a small business, looks for ways for promotion. Case 1.2, NUMMI, examines the reasons for formation of the Toyota-GM joint venture, obstacles overcome, lessons learned, benefits obtained by each of the partners and reasons for the closure of the company in 2010 after 25 years of successful operation. Case 1.3, Export of art goods, discusses questions facing a potential exporter. Case 1.4, eBay, Inc. shows how an emerging technology and entrepreneurship created a new type of international marketplace. Case 1.5, Dell Inc. shows how changing consumer demands and competition forced an international company to change its **business model**.

Introduction

The growing importance of international marketing and export management

Recession and recovery

In 2015–2016 most countries are recovering from the financial crisis and recession beginning in 2007–2008. This recession temporarily reversed a long period of economic growth and international trade. As will be shown, renewed growth in international trade is necessary for economic recovery and resumption of growth. Because of this, international marketing will continue to be of great importance in the future. While this chapter will discuss the recession, the primary focus will be on the opportunities and challenges facing business in the near and long-range future.

The recession that began in 2007–2008 has been called the 'Great Recession' because of its wide, serious, and prolonged effects (Zukerman, 2010). It sharply reduced demand in most of the nations around the world. International trade, which had been increasing more rapidly than investment and Gross Domestic Product (GDP) for several decades, was directly affected. In 2009, for the first time in 50 years, the volume and value of international trade decreased. At the time of writing, international trade and recovery from the recession are progressing slowly. There is some fear that some economies may regress into a 'double-dip' recession because of the present sovereign-debt crisis in Europe or other problems (Premack, 2010). Whatever the short-range changes in the world economy, the other factors discussed below will retain their importance. Some comments regarding the causes, development and repercussions of the recession are given in the Appendix to this chapter.

As growth has resumed in most countries in 2016, even though it was uneven and serious concerns remained, three things became apparent.

1. The importance of international business to national and regional economies, companies of all sizes, workers and consumers, in regaining growth.
2. The role of exports, along with innovation, as critical engines of economic growth (this was demonstrated again, as it had been in the past, by the experience of China and others).
3. All of the factors that brought about previous rapid growth in international business and the growing importance of international marketing will continue to drive increasing globalization and economic development in the future.

Increased international interdependence

Small and medium-size companies, as well as giant multinationals, have increased opportunities to enter foreign markets as goods, services, technologies, and ideas move more easily across national boundaries. Even an individual with a sufficiently good product, service, or idea can now find customers abroad if he or she understands international marketing and develops an appropriate strategy. Small domestic businesses with well-designed Web pages are increasingly receiving otherwise unsolicited orders from overseas, and have the potential to exploit new opportunities. Unfortunately, many small and medium-size companies are so daunted by their lack of knowledge of international business that they fail to follow up on the opportunities.

Is international marketing only of concern for large and so-called international firms? Far from it. Worldwide, most companies are now selling to, buying from, competing against, and/or working with enterprises in other nations. Many of the goods appearing in marketplaces in any country include materials or components produced abroad, have been assembled or packaged overseas, and/or use technologies developed elsewhere. Increasingly, production, and even research and development efforts are being carried out in cross-national cooperative efforts. Technological advances in communications and information processing have made it possible to provide a wide range of services across borders.

For many companies, small as well as large, international sales provide additional profits, and often are all that enable some companies to make a profit at all. Research and development costs for many products simply cannot be recovered unless they can be sold internationally. Examples of these include: new medicines and equipment to combat disease; Japanese and American computer consoles and games; major American movies; machine tools; BMW's Rolls-Royce automobiles; mid-range commercial aircraft made in Canada by Bombardier and in Brazil by Embraer; long-range commercial aircraft made by the United States' Boeing and Europe's Airbus; and many other products. For example, recently the super-hero genre has gained cinematic popularity, and Marvel and DC-based movies have been very successful. While some earlier Marvel movies did almost the same in the United States as well as in the rest of the world, the box office for all eight Marvel movies between 2008 and 2015 have all done more internationally than domestically (to Marvel) in the United States. Guardians of the Galaxy did 43% domestically and 57% internationally, while Avengers: Age of Ultron did only 33% domestically and 67% internationally. There is a clear trend toward the US domestic market being less and less important, and the international market being more important.

For consumers, international marketing and trade are providing an increasing range and selection of goods and services, often at lower prices and/or of better quality. It is no longer only better products that can enable an enterprise to expand internationally. Companies that have developed better ways of doing business or new concepts (business models) can use these in expanding overseas (eBay, Google, Canada's Cirque du Soleil, the UK's Tesco, Sweden's Ikea, the USA's Costco, etc.). Similarly, companies that have created new types of retail outlets to meet lifestyle needs or desires can successfully establish chains abroad (Japan's 7-Eleven, Starbucks from the United States, etc.). All of these companies are discussed in cases or exhibits in this text. In the increasingly competitive business environment, even very successful business models may need to be adjusted for changing competitive reasons as well as for other **cultures**.

For most nations and regions, economic health and growth have become increasingly dependent upon export sales as an engine of growth, and as a source of the foreign exchange necessary for the import of goods and services. International trade will continue to grow more rapidly than international investment and world GDP. Overall, the countries most open to international trade and investment, as we shall see in Chapter 2, have enjoyed both higher per capita GDP growth rates and lower unemployment rates. Those that have stressed self-sufficiency have generally lagged.

Exports as one engine of growth

At the time of writing this book, German industry has more or less recovered from the recession (Storm and Naastepad, 2015). Small and medium-size companies in Germany had suffered most early in the recession but are now leading in expanding exports. Countries in

Europe that have not been able to increase exports sufficiently continue to lag in recovering. Japan's fragile recovery depends upon growth in Japanese exports (Lau, 2010). 'Exports have been the key driver of growth' in the United States according to the director of economic research at AllianceBernstein LP in New York (Homan and Feld, 2010). Though the former referred primarily to high-tech products, a number of other industries are also benefiting. Exports from America's Caterpillar, Inc., the world's largest manufacturer of construction and mining equipment, allowed the company to increase its annual dividend in June 2010. US exports of high-tech products and services are increasing. Increasing exports are leading Japan out of recession, and highly specialized small and medium-size companies in Japan hold world leadership in their areas of technical superiority. The increased strength of the Japanese yen, as discussed in Chapter 11, may push Japan back into recession even as other economies grow.

During the recession, China's exports declined more than imports and the nation actually contributed to the strength of the economies of a number of its supplying countries. China was able to continue to grow during the recession because the foreign exchange it had accumulated through exports in preceding years supported a major stimulus, with continuing importing, during the international crisis. China has a continuing growth in demand for a wide range of goods from automobiles to cosmetics, agricultural products, parts for use in making final products, and raw materials for its domestic and export-oriented industries. India, which continued to grow during the recession, but at a lower rate than China, is now growing more rapidly as their exports increase.

Many companies made changes specifically to accommodate, or take advantage of, the recession and other economic changes. Some brief examples are given in Exhibit 1.1.

Exhibit 1.1 Selected company responses to economic and competitive changes

During the recession, the Japanese convenience store chain 7-Eleven began a major expansion in the United States and a retrenchment in Japan. It saw the depressed real estate prices in the United States as an opportunity to expand its number of outlets there at relatively low cost. In Japan, real estate prices had been depressed for 20 years, and the cutback in consumer spending during the recession there resulted in its weaker stores losing money. It thus began closing weaker stores there (see Case study in Chapter 5).

Avon Products, Inc., a major US cosmetics company and the world's largest direct seller, receives approximately 80% of its revenue from overseas sales. It saw the economic downturn as an opportunity to grow its representative (sales) staff and its customer base in China and elsewhere. It thus carried out its most massive recruiting campaign in its history, simultaneously carrying out a restructuring program to improve its global supply chain operations (see Case study in Chapter 7). Several years earlier, it had been necessary to change its marketing model in China because of unexpected legal changes there (see Case studies in Chapters 4 and 7).

Coach, Inc. introduced a new line of handbags selling for about 20% less than other purses offered by the company. J. Crew, Inc. opened a new boutique selling accessories that carry a higher margin than its other products. Nordstrom, Inc. and Sacks, Inc. reduced inventories of slower-selling and/or lower margin items (Jargon, 2009).

Germany's Volkswagen AG was faced with relatively slow growth in most of its European and North American markets. However, China, VW's largest single market, was growing rapidly. Thus, in 2010 the company increased its investment funds for China to $7.8 billion for the period 2010 through 2016 (see Case study in Chapter 9).

The UK's Tesco, the third-largest grocery chain in the world, encountered problems in its entry into the US market, based on problems with its small store model and the recession. The company did not withdraw but, at least temporarily, scaled back the number of stores to be opened.

In 2009, all three of McDonald's restaurants in Iceland were closed by mutual agreement between the franchise holder and McDonald's. The nation's financial crisis and collapse of the Icelandic krona made it economically unfeasible to continue to import meats, cheeses and packaging from Germany as required for quality control by McDonald's (US). While McDonald's has exited eight countries from 1996 to 2002 because of poor profits, it continues to operate in 119 countries. It is expected that the three restaurants in Iceland will be reopened under another name, and using more locally produced products, by the present franchisee (Helgason and Wardell, 2009).

Walmart's heavy **advertising** showing how families could save money on breakfasts and other purchases resulted in increased market share and profits. In 2010, it announced an international expansion goal to serve a billion customers per week by 2030. It plans to do this by developing a global e-commerce platform that includes a delivery capacity (*USA Today*, 2010; Birchall, 2010).

Newspapers in several European countries, Japan, and the United States have been experiencing falling sales as a result of both long-term trends and the recession. Papers in the three areas have taken different approaches to coping with change. In Europe, most newspapers have cut costs and gone to more online offerings. In Japan, the country's largest business newspaper, with three times as many subscribers as *The Wall Street Journal*, has developed a new pay-to-view website and greatly restricted online access to any free content. A number of other Japanese newspapers are also restricting the amount of content people can see online (Tabuchi, 2010). Most US newspapers have seen even greater declines in circulation and revenue from advertising than European and Japanese papers. Most US papers have focused primarily on cutting costs, including major layoffs. Two US papers have chosen different methods to offset the declines. (1) *The Christian Science Monitor*, sold abroad as well as domestically, moved to reduce costs by ceasing to produce its daily print edition. It established an e-edition with a subscription rate that it hoped would provide enough income to support continuing operations. Though the e-edition did not gain the hoped-for number of subscribers, the Sunday edition which it continued to publish gained enough additional subscribers to allow the company to continue publishing under the new model. (2) The regional *San Francisco Chronicle* changed its business model to increase the percentage of income from sales of the newspapers while accepting a lower percentage of income from advertising. Assuming that core subscribers would be willing to pay a higher price for an improved paper, it raised the subscription cost by over 75%, stopped offering special discounts for new subscriptions, and ceased delivery to low-volume areas where it was uneconomical. In its newspapers, it used higher-quality paper in some parts, added color printing to certain pages in daily editions (including the front page and comic strips) and to special pages in some of the advertising sections of weekend editions. It strengthened its business section through agreements with Bloomberg. The strategy returned the paper to profitability.

Innovation and entrepreneurship as engines of economic growth

China's more rapid growth, while greatly increased through exporting, actually started when the government allowed more widespread private ownership. Farmers responded by becoming more productive as they benefited more directly from their individual efforts than they had as simply members of a cooperative. Some also began increasing output of higher value-added products such as vegetables and meat. Private ownership also led to the development of additional more productive small businesses. Another major increase in the growth rate occurred when manufacturing of products for sale overseas led to increases in exports, and also brought in foreign investment, which helped to create even more factories to produce additional exports as additional technology spread to Chinese firms as well as joint ventures. The entrepreneurial spirit of the Chinese, previously demonstrated by the overseas Chinese throughout the world and those in Taiwan, increased the rate of growth in the People's Republic.

Japan was not able to begin rapid recovery after World War II until orders for purchases by the American military provided enough foreign exchange to enable the highly entrepreneurial Japanese to put their technical and entrepreneurial talents to use. Import of technology from the US and Europe further fueled Japan's export drive and rapid growth.

The US and Europe have both grown through innovation and entrepreneurial activities, many of which led to increased exports.

Five reasons why rapid growth in international business will continue to be the norm rather than the exception

In addition to the changes in short-term economic conditions, five major changes that have occurred during past decades will continue to drive increasing globalization, and the ever-greater importance of international marketing and export management. They are:

- The information revolution with the technological advances and lowered costs in communications, the development of the Internet and e-commerce, and the development of increasingly sophisticated and diverse software to support a wide variety of business functions. New companies and industries have emerged while a number of existing companies have undertaken major changes or failed. New communications networks, some of which were initially developed as social network sites, have enabled easier gathering of information by individuals as well as providing new opportunities for businesses. They have provided means for companies to more effectively interact with key stakeholders: obtaining information on consumer preferences, demands and suggestions as well as advertising to the customers; obtaining suggestions from and providing information to company personnel as well as other stakeholders and the public.
- The further development of logistics and supply chain management, drawing upon new concepts and methods, advances in information technology in its most broad sense and major advances in physical equipment and facilities. This has resulted in goods moving around the world with increasing efficiency and lower costs.
- The increased importance of innovation as ideas and advances in technologies, strategies and business models, spread more rapidly. The advantages of being ahead, and the dangers of failing to adjust to new conditions, have increased greatly.
- The recognition that increasing incomes, and the increasingly diverse populations in some countries, have provided new and often more segmented markets. Niche markets have emerged that provide additional opportunities for small companies and the need for larger companies to respond to the increasing diversity in demand.

- The lowering of governmental and other barriers to trade and investment, the changes in international trade patterns, and changes in location of some major economic activities, partly the result of the greater participation of China and India in international trade and investment. China has become a major consumer of resources and products, a major supplier of industrial goods, an important recipient of foreign investment and a major creditor country. It has become a major competitor to businesses in both developing and advanced industrial countries. India is also growing and has become a world competitor in some activities, particularly in the export of services of knowledge-industry workers, and to a lesser extent in manufacturing (see Exhibit 1.2).
- The increased competition and increased opportunities for companies of all sizes, resulting from the greater mobility of goods, services, information and ideas due to all of the changes noted above.

Exhibit 1.2 China and India in the international economy

China is the world's fastest-growing major economy, and has overtaken Japan to become the second largest in the world. At over $3.5 trillion dollars as of June 2013, its foreign reserves are also the greatest of any nation (Yi-Chong, 2014). It has enjoyed an average annual growth rate of over 9.5% over the past 30 years. While China's annual rate of investment is variously estimated to be between 36% and 45% it ranks among the world's highest. China is a major consumer of raw materials, using 47% of global output of cement, 37% of cotton, 30% of coal, 26% of crude steel and 21% of aluminum (Energy Department & Agriculture Department, 2010). In 2010, China accounted for about 40% of world copper demand. Whereas price changes on the London Metal Exchange used to trigger price changes on the Shanghai Futures Exchange, the situation is now reversed. Fertilizer is another major commodity consumed in large part by China (Farchy, 2010). China has now passed the US to become the world's largest consumer of energy according to the International Energy Agency, though China says 'this is not very credible' (Hook and Hoyos, 2010). In any event, it is both the world's largest coal producer and the world's largest importer of coal (Hoyos, 2010). China has become a major purchaser of many types of goods from a wide array of countries. As an example, it has overtaken Japan as the largest purchaser of US agricultural exports (Meyer and Hook, 2010). Overall, it is now the world's largest exporter and second-largest importer. Combined, China is the largest goods trader in the world (Anderlini and Hornby, 2014).

Beginning in 1979, China started a series of market-oriented reforms and an opening of its economy to foreign investment. Economic growth was stimulated by both increasing domestic entrepreneurial activity and increasing investment. In 2001, the nation joined the World Trade Organization (WTO) in a stepped process, further accelerating both international investment and trade. The final step in the process was completed in December 2006 (Tucker, 2007). The agreements China signed in order to gain acceptance into the WTO were concerned more with the export of cheap manufactured goods than with the problems now faced by major foreign investors, as noted further on in this Exhibit. There is thus a problem in addressing these issues because there are inadequate provisions concerning them (Beattie and Anderlini, 2010).

In the 1990s, with its population of approximately 1.3 billion people, China had appeared to offer substantial market potential in the long run. Short-run potential at the time was limited by low average incomes and remaining restrictive government regulations on foreign companies entering the domestic market. The nation did, however, offer immediate advantages as a potential source of manufactured goods based on its very low wages, high literacy rate (89%), availability of workers, and some government incentives for exports. As a result, most of the foreign direct investment in China, and substantial domestic investment, was in facilities for manufacturing goods for export. (There were notable exceptions. See Case 8.3 on VW in China and Case 4.3 on Avon.)

In the mid-1990s, low-tech manufactured goods dominated China's exports. This has changed rapidly as foreign manufacturers have worked with Chinese companies and/or set up manufacturing facilities to assemble and/or produce more advanced products. Now computers and electronics, and TVs, phones, and audio gear are the biggest categories of exports (Saminather, 2006). China is now the world's largest exporter of technology goods, though half of the goods China exports have been assembled from imported parts. China is adding massive capacity in steel, chemical, and high-tech electronics plants (Bremmer and Engardio, 2005).

Large Japanese, European, and American companies have established R&D centers in China, with 196 foreign-owned facilities in Shanghai alone. They have located in China to utilize the large pool of individuals with science-related backgrounds and relatively low wage rates (Watanabe, 2007). Much of the work being done is for products for the international market, though some is for specific products for the Chinese market. Chinese technology and manufacturing companies, encouraged by the government as well as their own recognition of the need for innovation, are increasing their own R&D expenditures. In 2004, entities in China made over 130,000 patent applications, the fifth-highest nation in the world (Einhorn, 2006a). Some of China's large companies have set up laboratories abroad to design products for markets there, and to be at centers of product innovation. For example, China's Huawei Technologies has established R&D laboratories in India, Sweden, and the United States as well as in China. The Chinese government broke new ground in 2007, appointing as Minister of Science and Technology a non-communist party member with 15 years overseas experience.

China's domestic market has grown rapidly as the economy has expanded. China's retail sales were estimated at $860 billion in 2006, and are expected to climb to $2.4 trillion by 2020. It is now the world's largest market for automobiles. European, American, and Japanese automakers are manufacturing cars in China for the Chinese market in partnership with domestic companies. China is the world's largest market for beer. London-based SABMiller is in a thriving joint venture with China Resources Snow Breweries Ltd (Einhorn, 2006b). A number of foreign retail companies are in the market, including 7-Eleven Japan, the UK's Tesco, France's Carrefour, US's Walmart and McDonald's, Malaysia's Parkson, and others. Foreign firms account for 23% of the sales of the top 100 food retailers in China (*The Economist*, 2006).

Doing business in China, in competition with China, or just buying from China continues to present a number of specific problems. These include, but are not limited to, the following (not listed in any particular order): corruption, a judicial system that is sometimes capricious and unfair, lack of protection of intellectual property, counterfeiting, production of foodstuffs including unlisted dangerous ingredients, manufactures of products that are not safe, sudden and disadvantageous changes in laws and regulations, cases of Chinese partners in joint ventures setting up parallel competitive wholly owned Chinese companies using technology acquired from their foreign partners.

For years, foreign businesses have been concerned about Chinese government policies that they felt ignored intellectual property rights, forced technology transfer, and biased government purchases toward domestic companies. Most experts agree that there still is a fairly weak enforcement of intellectual property rights in China (Cao, 2014). Chinese companies with state subsidies are also increasingly challenging the Chinese subsidiaries of Western companies in third country markets as well as in China itself (Beattie and Anderlini, 2010). In 2009, Philippe Mellier, CEO of Paris-based Alstom Transport, claimed that China was closing its market to suppliers of locomotives and other types of rolling stock from other countries. Tenders for high-speed trains to be used from Beijing to Shanghai specified that they be entirely designed and built in China. At the same time, China is attempting to sell its trains, made in China improperly using technology gained from Europe and elsewhere, in Europe. He said that China had forced foreign companies to transfer technology as a condition of getting orders, and then used that technology improperly (Wright, 2010).

While many foreign businesses have been reluctant to complain for fear of reprisals, more are now speaking out. In July of 2010, the CEOs of two major German companies met directly with the Chinese Premier, Wen Jiabao. Jurgen Hambrecht, CEO of the chemicals giant BASF complained about foreign companies being forced to transfer technology to Chinese companies in order to gain market access. Peter Loescher, CEO of the industrial conglomerate Siemens and also chairman of the Asia-Pacific Committee of German Business, criticized restrictions on trade and financial services, and lack of access to government contracts. An article in *The Financial Times* noted that Mr Wen told Hambrecht to 'calm down' and said that he was aware that there are allegations that China's investment environment 'is worsening, but noted 'I think it is untrue' (Anderlini, 2010). Earlier in the month the CEO of American's industrial giant General Electric, Jeffrey Immelt, had complained about increasing protectionism and the most difficult business climate in 25 years (Dinmore and Dyer, 2010). A few days later, he softened his statements, which some believe resulted from complaints by the Chinese government.

In contrast to some other foreign businessmen, Jim Owens, the Chairman and CEO of Caterpillar, manufacturer of construction equipment, regards China as a success story. The company is a major manufacturer of construction equipment. It started its first sizeable joint venture there in 1994. It has since increased its stake in the company to 87%, thus acquiring control. It also acquired 100% ownership of a former government-owned business in a series of steps. Caterpillar has 11 plants in China and had sales of about $2.5 billion and is now expanding. Owens credits Caterpillar's success to his convincing government authorities, by word and deed, that it will be a responsible owner of manufacturing facilities. 'We've spent a lot of time in China spelling out how we aim to be good stewards of business in China for years to come' (Marsh, 2010).

The Minister of Commerce in China addressed these concerns in an article in *The Financial Times*, pointing out that China is continuing to lower the threshold for investment in China and providing increasing market access. He pointed out the contribution to world economic recovery in 2009, the successes of foreign multinationals in China, and the continuing opportunities for international businesses (Chen Deming, 2010). It should also be noted that Japan, in its period of rapid growth from 1950 to 1990, borrowed much technology from the US and Europe, kept a number of trade barriers, and used its productive and then relatively low-paid workforce to spearhead development. (In an earlier century, the United States did much the same.)

Worker unrest has been growing in China at Japanese-owned automobile factories and at factories owned by others such as Taiwan's Foxconn. Foxconn's Longhua plant, with an enormous workforce of 300,000 workers, had an increasing number of worker suicides in 2010. Much of the problem there is growing discontent among the factory's largely migrant workers. They originally came from farming areas, leaving their families and living in dormitories under conditions that do not permit them to live in the nearby communities or to remain in the area if they quit the company. Once happy simply to have paying jobs, as the Chinese economy grew their living conditions became increasingly unsatisfactory, and their pay lagged that of comparable work elsewhere (Hille, 2010). In the months since the recognition of the problem, basic pay has been more than doubled (Hille and Kwong, 2010). At some Japanese-owned factories, in addition to concerns over pay lagging that at other foreign-owned factories, there are other serious problems that have become key issues.

These include poor communications, failure to promote Chinese to more management positions, and inability of local Japanese managers to respond to problems because of slowness in obtaining approvals from Japan (Soble, 2010; Culture Shock, 2010). After strikes at their plants, Toyota and Honda gave additional pay and benefits packages to their employees (Mitchell and Dickie, 2010). Of the estimated 200 million people who have migrated from rural areas to cities to work, most have no right to permanent residency in the cities and no access to social services (Pilling, 2010).

China continues to face a number of serious internal problems. Pollution of air, water and land is a serious and growing problem. In 2007, the country surpassed the US to become the world's largest producer of greenhouse gases. Economically, China has an excessive reliance on exports and on heavy investment in real estate, particularly government-sponsored housing, commercial properties, and factories. The country faces a continuing challenge in developing productive jobs for the large and partially under-employed population. A great economic divide continues to exist between those benefiting from the rapid economic growth, mostly urban dwellers and those working in 'model' villages with access to tourism or industrial employment, and the majority of the population who are left behind, largely those still on small farms or unable to find full-time work.

India is the world's second most populous nation with 1.2 billion people, and also the world's second-fastest-growing large economy, trailing only China in both categories (Lamont, 2010). It has had an economic growth rate of over 6% for the past two decades, though it had a slow start in developing. After attaining independence in 1947, India strove for self-sufficiency and imposed strict controls on the ability of private companies to acquire foreign technology and hold foreign exchange (Kripalani, 2005). The economy grew very slowly and was characterized by extensive regulation, protectionism, public ownership, and pervasive corruption. Liberalization measures were not undertaken until the 1980s and 1990s. Then the economy began to grow more rapidly and a sizeable middle class emerged (Library of Congress, 2004). India has become more open to trade as it must depend upon energy and other raw materials from abroad. Its exports plus imports of goods and services as a percent of GDP is now 50% compared to about 63% for China (Wolf, 2010).

Some sectors of the economy suffered from the worldwide recession beginning in 2007–2008, and others from drought in 2009. The drought has led to the highest rate of inflation in 10 years as the price of food jumped and cotton prices have surged (Pearson, 2010).

Overall the country is doing well. A number of its manufacturing companies had few problems during the recession and industrial production is now substantially higher than in 2009 (Lamont, 2010). The information technology sector, which depends upon orders from US and European business, did not suffer a decline during the recession.

Much of the international attention focused on Indian business is a result of its having become the world leader in the export of services of knowledge-industry workers. The work of highly educated Indian professionals in medicine, engineering, law, accounting, and other fields, as well as the work of call center operators, is being performed for companies and other entities in other countries. Though this has had little impact on overall trade patterns to date, it has raised concerns in a number of countries. India's strong and rapidly growing information technology sector is making the nation an IT superpower (Sakashita, 2007). It is particularly strong in development of software, installation, systems operation, maintenance and consulting. Multinationals are having companies in India design software and circuitry for use in making manufactured goods in China.

Capgemini, the European IT group now has more staff in India than in France (Leahy, 2009). Many American IT companies have substantial interests in India. The country is Oracle's fourth-largest market in the world, the largest player in the Indian market is Hewlett-Packard, over half of Indian software developers use Sun platforms, and Symantec's largest engineering center outside the United States is in India (Randolph, 2009).

Information technology and the provision of services have been estimated to reach an annual value of $80 billion by 2010. Its merchandise exports are projected to reach approximately $150 billion by the same date. Both combined, however, are smaller than China's projected merchandise exports of approximately $1.7 trillion (Engardio, 2005a). While IT and outsourcing provide valuable exports, they still provide employment for a relatively small number of largely well-paid workers, while China's manufacturing provides less well-paying jobs for many workers.

India does have several highly competitive large conglomerates that are expanding overseas through acquisitions in fields ranging from heavy vehicle manufacturers and those making forgings for engine parts through producers of pharmaceuticals to IT companies.

The economy still suffers from a number of problems. The caste system, though officially outlawed, is still strong in much of India and greatly restricts opportunities for millions of people. The illiteracy rate for the nation as a whole is over 35%, and 53% in one of the poorest states (Indian Government, 2010). In India 456 million people, 42% of the population, live on less than $1.25 per day and 300 million people still exist on less than one dollar a day (Guha and Yee, 2007). Air and water pollution are among the worst in the world (Engardio, 2005b). Millions of people have no source of electricity in their homes and no access to dependable supplies of clean water. In some areas, political posters display only symbols of animals for their party members since villagers there cannot read. A village leader may get the people in his area to vote for a certain party in return for a payment to themselves from the politicians. It may be difficult to ensure that local office holders actually distribute all of government aid funds to designated persons.

Indian economic growth is still held back by 'bureaucratic red tape, rigid labor laws, and its inability to build infrastructure fast enough' (Engardio, 2005a). More reforms are needed to move from mostly low-value-added services to higher-value-added manufacturing and services if rapid growth is to be maintained. However, many people in domestic industries and many politicians fear that India still cannot compete if open to international competition. Thus there is some doubt that needed reforms cannot be enacted (Lamont, 2010). Corruption is widespread and damaging to the economy as well as to individuals. Too many sectors of the economy are not open to foreign investors (though some protection is found in almost all nations). Foreign retailers can only operate without domestic partners at the wholesale level in India, though their wholesale operations can sell to local retail partners. These factors have hindered foreign direct investment, with the result that FDI in India amounts to less than 10% of that being received by China.

Although many of these changes have created new problems that firms must address, they have opened new opportunities for businesses ranging from one-person operations to corporate giants. E-commerce has had a particularly strong impact in furthering the globalization of business, especially for smaller and medium-sized businesses. With a viable product or service, the smallest business can now find potential customers and means of distribution across the globe. The increased ease of entry has also resulted in new entrants creating increased competition in all marketplaces.

Increasing competitive demands on business worldwide

The international marketplace has become increasingly turbulent at the same time that globalization is progressing. The entrepreneurial innovations and technological advances discussed above have resulted in the development of new products, services, and ways of doing business. These changes, coupled with the increased speed with which they cross borders, have reduced barriers to trade and increased competition and economic turbulence.

The development of the Internet and the Internet have contributed greatly to economic turbulence by enabling the creation of new businesses, new markets, and new methods of interacting with customers. The Web enabled entrepreneurs to create eBay, an entirely new type of market using online auctions. It is now a multibillion-dollar international company (see Case 1.4 at the end of this chapter). Other new entities created on the Web have provided additional ways for people to interact, for companies to advertise, and for organizations to provide information to and gather information from customers, employees, and other stakeholders.

The recession led to some delays in signing additional trade agreements, and some increases in trade barriers that should be temporary. The long-range trend will be for a reduction of trade barriers, primarily through bilateral agreements. The reductions in trade barriers already achieved have partially leveled the global competitive field as discussed by Friedman in his book, *The World Is Flat* (Friedman, 2005). Many countries around the globe have increased their international activities, and the types and amounts of goods and services they export and import. International trade patterns have been particularly affected by the developments in China. That nation's increasing exports have provided new and lower-cost competition for domestic manufacturers in countries throughout the world. Even small, local producers of handicrafts made in Mexico have found that goods made in China are replacing some of their products in local markets. Clothing manufacturers in Italy and other countries, and toy makers around the world, are losing market shares in Europe, the Americas, and other regions to the low-cost Chinese products. As China increases its exports of more technically complex and higher-value-added products, more industries in other countries will face greater competition.

All of the major changes discussed above have contributed to increasing opportunities and competition in the international marketplace. New products, services and business models are being created; improvements in logistics facilitate faster and less expensive means of moving goods; and reduced barriers to trade and investment enable more companies to expand internationally and increase exports. The increasing opportunities are, of course, accompanied by increasing competition across borders.

This has also meant that most companies must continually develop new and improved products, services, and/or ways of doing business in order to meet the intensified competition. Bhagwati, author of *In Defense of Globalization* (Bhagwati, 2007), has pointed out that the world is still characterized by 'vast numbers of bumps and gradients' in comparative advantage. These differences in comparative advantage are now changing extremely rapidly. This has led to a pressing need everywhere to continually improve competitiveness, to exploit every possible competitive advantage, and to explore all possible markets (Bhagwati, 2005). Both increased specialization and cross-border cooperation in production and other ventures have resulted.

Economic turbulence has thus put increasing demands on both large and small companies. Success in marketing internationally, and in defending domestic markets from increasing international competition, typically requires some combination of:

- customer focus (or value-network partners which includes customers, suppliers, and other partners with which the company develops value);

- innovations in products and services, improvements in quality, increased efficiency with lower costs or improved service, and/or better methods of doing business;
- identifying and exploiting appropriate market segments.

Exhibit 1.3 provides a few examples of companies that have succeeded internationally using these approaches.

Exhibit 1.3 Succeeding internationally in the 21st century: customer focus, innovation, market segmentation

- **Brazil's Embraer and Canada's Bombardier.** Most air travelers prefer to travel in the quieter and smoother riding jets rather than propeller or turbo-prop airplanes with their greater vibration. Airbus and Boeing concentrated on building large jet aircraft with engines designed to attain maximum fuel efficiency at high altitudes, and thus not well suited for shorter routes. Airline companies typically used the larger aircraft for long flights and relied on turbo-props, which had better fuel efficiency at lower altitudes, for the shorter routes between smaller cities or feeding hubs. Bombardier and Embraer met consumer preferences by designing and building mid-size aircraft with engines that provided good fuel efficiency on shorter flights. These planes, in the 50- to 100-passenger sizes, have become clear leaders in the worldwide market for shorter-range flights based on both economic competitiveness and meeting customer preferences.
- **The United Kingdom's Tesco supermarket chain.** Many larger supermarket chains have emphasized keeping prices low on all of their merchandise. A number of smaller chains and independent stores provide higher-quality produce and/or meats at higher prices. Tesco recognized that increasing incomes in the United Kingdom had created a new market segment: consumers who want low prices on the basic commodities but are willing to pay more for high-quality produce, meats, and specialty products. Meeting customer preferences, Tesco has captured 30% of the UK market and is expanding overseas. It presently has stores in six Asian countries and six European countries outside of the United Kingdom. Half of its floor space is abroad. In each country, goods carried by the stores are fitted to the local environments and customer preferences. Tesco entered the US market in 2008. Believing there is an excessive number of supermarkets in the United States, Tesco opened smaller, convenience-store-type operations. The recession, and excessive competition, caused Tesco to scale back its plans though it remained in the US market.
- **The United States' Wells Fargo & Company bank.** Latin Americans working in the United States, many of them undocumented (illegal immigrants), send $25 billion a year to their homes. Until 2001, the undocumented workers had no official identification and thus could not set up bank accounts in the United States. They had to pay for international remittances through Western Union Financial Services, Inc. or other companies, or pay for relatively expensive international **drafts** through the banks. When Mexican consulates in the United States began issuing high-tech identity cards to undocumented workers in 2001, Wells Fargo became the first US bank to accept the cards for setting up new accounts. They thus gained both new customer accounts and provided a way for the workers to transfer money less expensively. Many other banks have since followed them. Wells Fargo recently bought in to a Mexican bank to further facilitate the transfer process (Fairlamb *et al*., 2003).

- **The Netherlands' ING bank,** part of ING Groep NV., recognized that many Americans were dissatisfied with the interest rates paid on their savings and money market accounts, and saw an opportunity to raise substantial amounts of capital. The bank set up ING Direct offering FDIC-insured Orange Savings Accounts™ providing no-frills savings accounts: no checking account or other services. It provided for simple transfers to and from the individual's regular savings account by telephone or online. Because ING did not have any of the costs of regular banking services and streamlined their operations, ING Direct was able to pay much higher rates than US averages on savings and money market accounts. ING Direct has become a major growth engine for the bank. A number of other financial institutions, such as the UK's HSBC have set up similar services.
- **The United States' Costco.** The developers of the Costco chain in the United States recognized an unmet need of owners of small restaurants and some other small businesses. These small businesses did not have the purchasing power of restaurant chains and had to pay almost as much as retail prices for much of their goods, thus reducing their competitiveness. The founders of Costco believed that they could become successful merchandising wholesalers through a combination of:

  1. obtaining low prices from manufacturers and producers by purchasing in very large quantities;
  2. keeping their own costs low through efficient supply chain management and selling in fairly large quantities (no individual shelf-size canned goods and only cases of most fresh fruits, for example);
  3. charging their (business) customers little more than the big chains were paying for their supplies;
  4. charging a small annual fee to their member-customers.

Costco was successful using this business model, and soon discovered that there was an additional market segment to which they appealed. Many individual families were interested in and capable of buying in large quantities. The company allowed them to join at a lower minimum annual fee. These individual families provided an additional large customer base. The company has now successfully entered a number of markets abroad.

Problems and needs

In addition to the competitive challenges discussed above, there are a number of serious problems, and potential problems, caused by factors largely beyond the control of individual companies. Companies must be able to cope with them or make some accommodation to them. These include the following (not listed in any particular order). All of them are discussed at some point in this text.

- Piracy on the high seas, most recently affecting the seizing of petroleum tankers and cargo vessels and holding them for ransom, but a problem for private yachts for many years.
- Piracy of goods by making unauthorized copies of goods (software, music, books, etc.) or broadcasting them or using them without permission, costing many billions of dollars in losses for producers of the goods.
- Fake/counterfeit products causing widespread deaths in the case of fake pharmaceuticals, often causing injuries or other problems for users of other fake products, and causing losses for and damaging the **brands** of legitimate producers.

- Contaminated food products and other unsafe products causing injuries or deaths.
- Terrorism and threats of terrorism often causing deaths and property damage and/or declines in tourism, trade, etc.
- Wars and threats of wars, in addition to often causing terrible human suffering, disrupting trade patterns, causing direct losses to many individuals, companies, and countries, while providing opportunities for a few others.
- Prohibition of exports of certain products to any country (such as agricultural products in short domestic supply, or cotton when the government wants to provide all of it to domestic industry).
- Prohibition of exports of specified or all types of goods to certain countries for reasons of national security, public policy, etc.
- Embargos on all or certain imports from certain countries.
- Diseases leading to prohibitions of imports and/or exports, such as avian flu (bird flu), bovine spongiform encephalopathy (mad cow disease) and related diseases, hoof-and-mouth disease.
- Expropriation (nationalization, seizure) of some businesses, or types of businesses, with or without compensation.
- Armed groups of people, who feel that they have been unfairly treated or harmed, attacking government or private companies.
- Kidnapping of people for ransom.

Some protectionist regulations to assist particular special interest groups are found in almost all nations, and the threat of additional protectionist measures always exists. The rising concern over the loss of knowledge-industry jobs to other countries, as well as the continuing loss of jobs in manufacturing, is leading some governments, labor organizations, economists and others to re-evaluate economic policies.

The effects of business activities on all sectors of society, and particularly on the environment, are of great concern. These factors have made ethics, social responsibility, public policy, and company responses an essential concern. They have also led to additional costs for some companies, and to savings and/or new opportunities for others. This is discussed more fully in Chapter 2.

An example of an unexpected problem that affected one exporter is given in Exhibit 1.4.

Exhibit 1.4 The chicken feet problem

In 2004, when China appeared to be free of avian flu, some chickens in the United States came down with bird flu. China imposed a ban on imports of poultry products from the United States. At that time, 16 metric tons of chicken feet were en route from the United States (where they are a waste product) to China (where they are a delicacy). There appeared to be no options other than to try to find storage space in a frozen food warehouse until China's ban might be lifted, to try to sell them to the much smaller markets in Africa, or to reship them to a place where they could be destroyed (Pottinger, 2004).

Responding to increasing opportunities and threats

The increased opportunities for domestic companies to more easily enter markets abroad is, of course, accompanied by the increased ability of foreign companies to enter and compete in the domestic market. This is providing difficult challenges for companies and for workers whose positions were formerly protected by national boundaries and distances.

Companies that are not proactive in exploring the expanded opportunities in new or opening markets in other countries are, of course, missing out on possible new opportunities. They can also expect to face problems in their home markets if they do not recognize and respond to the challenges of foreign companies offering new or competing products or services, lower prices or better quality, new business models, or simply more effective marketing. Entering foreign markets is often the best method for learning of potential competitive threats as well as opening new opportunities.

Exporting is the most common market entry mode for small and medium-size companies, and is widely used by all large enterprises. Czinkota, in a book for marketing executives, has observed that export marketing is no longer an option for most companies; it is now an imperative for survival in the increasingly competitive business environment (Czinkota *et al*., 2005).

The driving forces behind increasing internationalization, as discussed above, are increasing opportunities, increasing competitive threats, and the need to exploit all competitive advantages and (potentially) profitable markets. For the individual company the desirability of going international depends on a combination of factors in the home country market, the (prospective) host country market (large or with attractive niches), the global environment, and characteristics of the individual company itself. A small home country market, competition from outside, and/or recognition that a competitive advantage of the firm could be exploited in foreign markets tend to encourage companies to consider exporting or entering foreign markets in some other way. This provides a sort of domestic push toward internationalization. Large and open host country (foreign) markets, or ones that have attractive niche opportunities, provide a sort of international pull.

Figure 1.1 shows how the forces of firm factors, home country market factors, host country factors, and global factors explain the movement toward increasing internationalization.

In spite of the lowering of many barriers to international business and exporting, companies expanding into foreign markets still face unique challenges. Some of these arise because of the turbulence and unforeseeable problems arising in the international environment as discussed above. The most critical challenges, however, often arise from specific differences in the cultural, socio-political, legal, and marketing environments in the foreign country. Understanding the special requirements in international marketing, and dealing with these requirements effectively, requires the development of additional knowledge not required in strictly domestic operations. International marketing is thus more complex, more challenging, more interesting, and potentially more rewarding than much of domestic marketing. Companies typically earn higher rates of return on their overseas operations than they do on their domestic operations, reflecting both the required additional knowledge and the additional challenges of the foreign environments. In most countries, people working directly for foreign firms earn more than employees of strictly domestic firms, reflecting the generally higher productivity of foreign firms and the greater skill levels they often require.

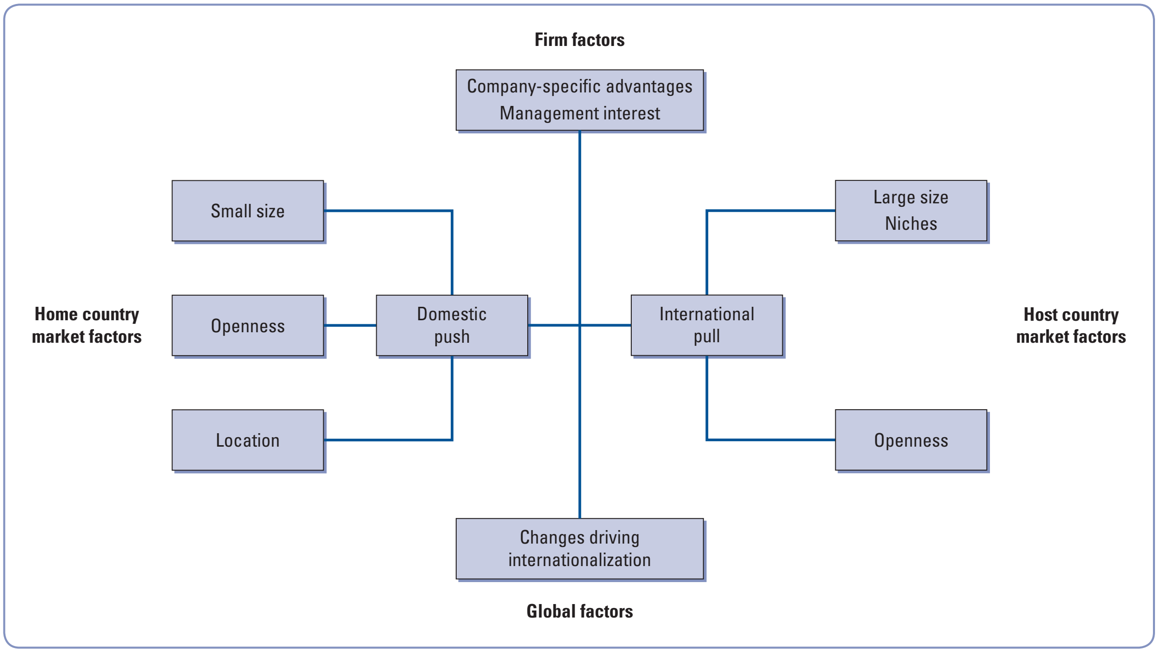

Figure 1.1 Factors explaining internationalization

Source: Adapted from Luostarinen, 1994, p. 7, and revised by this book's authors, 2007.

The nature and requirements for success in international marketing and export management are discussed below.

Export marketing planning and strategy is covered on pages *33–41* because of the key importance of export marketing to companies of all sizes.

Key changes currently affecting the course of, and requirements for, effective international marketing management in the coming years are more fully discussed on pages *42–60*.

Finally, we discuss the way in which the book is designed to meet the needs of students, entrepreneurs, and marketing professionals on pages *60–61*.

Being effective: the nature and practice of international marketing

Being effective in international marketing requires that the marketer understand: the nature of international marketing and its unique requirements; alternative approaches to organizing and carrying out international activities; the basic decisions that must be made; and the similarities and differences between domestic and international marketing.

A definition and unique requirements

The basic definition of international marketing is simple: *international marketing is the marketing of goods, services, and information across political boundaries.* Thus it includes the same elements as domestic marketing: *planning, promoting, distributing, pricing, and support of the goods, services, and information to be provided to intermediate and ultimate consumers.*

International marketing, however, is typically more complex than domestic marketing because of the need to accommodate key differences between the home country's domestic environment and the environment in the foreign market. These may include differences in culture, consumer needs and wants, economic levels and structures, market structures and channels available, ways of doing business, laws and regulations, and many other factors discussed in this book. Any one of these differences can render a company's domestic approach to marketing ineffective, counter-productive, or a violation of local law. Together, these differences require a careful and well-planned approach to entering and expanding in the international marketplace. Exhibit 1.5 provides some brief examples of adjustments that some companies have made (or failed to make) in foreign markets.

Exhibit 1.5 Examples of adjustments and potential problems in foreign markets

- Kelloggs is required to produce three different formulations of Corn Flakes in the **European Union** in order to meet the requirements of the different member nations for minimum and maximum allowable amounts of vitamin and mineral supplements in cereals.
- Kentucky Fried Chicken launched a very successful joint-venture entry into the Japanese market, having its individual store openings conform to what local businesses expected, and advertising its product based on the product's high class and its heritage from Colonel Sanders' boyhood experiences in the kitchen of his home.
- The initial entry of an American fast food company in a joint venture in the Spanish market went very well. However, when the American partner proposed a major expansion, it failed to listen to its Spanish partner's warning that this was not feasible because of differences in the real estate market in Spain and because of a lack of adequate capital availability. After a serious dispute, the joint venture was dissolved, much to the disadvantage of the American company.
- Avon enjoyed a very successful and profitable entry into the Chinese market. However, the company suffered a major setback when a new law was passed that made its large tiered distribution system illegal (see Cases in Chapters 4 and 7).
- France's Carrefour withdrew from the Japanese market when the company's offerings and approach did not fit customer tastes and habits. The company has high hopes for its new entry into China, viewing the market in that country as likely to be more receptive to their name and approach.
- Japan's very successful 7-Eleven convenience store chain has wide differences in market penetration in various other countries as a result of differing transportation patterns and consumers' buying habits (see Case in Chapter 5).
- Costa Cruises viewed China's growing middle class as providing a potentially large market for cruises sailing from Shanghai and Hong Kong. Many of the participants on the initial cruises, who came from almost a dozen ethnic regions in China, had difficulty in understanding the two dialects spoken over the ship's intercommunication system, unexpectedly didn't show much interest in the ship's casino, and expressed general dissatisfaction with the experience. Subsequent bookings by Chinese were so light that the cruise line changed its target market to Americans and discounted prices.
- Phillips, the Dutch electrical and electronics company, needs to manufacture its products in hundreds of different sizes and specifications to meet the differing product standards in use in the various European countries, North and South America, Asia, and Africa.

- A US semiconductor manufacturer operating a plant on the island of Penang (Malaysia) has provided three cafeteria lines in its workers' lunch room to accommodate indigenous ethnic Islamic Malays who do not eat pork, ethnic Hindus from India who do not eat beef, and ethnic Chinese who like both pork and beef.
- In Malaysia there is an affirmative action program for the majority ethnic Malays, and saying anything that might disrupt racial harmony, whether true or not, is an act of sedition.
- Many large Japanese companies have been fined heavily for violating American affirmative action laws for minority groups in their US operations.
- Foreign companies and governmental organizations operating in Saudi Arabia are required to prohibit certain actions by women employees and women dependents, such as driving automobiles. This, of course, would violate the laws in the home countries of most of the companies.
- Many countries have restrictions on advertising and promotion such as prohibiting comparisons of the company's products with competing products of other companies, offerings of free samples, advertising considered offensive or against the public interest, etc.

Marketing effectively to and in foreign environments requires that the international marketing manager acquire a clear understanding of each target market, the differences that exist, and what must be done to accommodate the differences. Fortunately there is a large amount of information available for virtually every market in the world. A number of useful sources are discussed in Chapter 6. The time and effort required to develop this information can be expected to be much less than the cost of making mistakes.

There are facilitating organizations that can provide assistance in most aspects of marketing, though the effectiveness and costs may vary widely from country to country. Companies providing assistance specifically for exporting, and for the legal and logistical aspects of importing, are widely available. Though facilitating organizations may be of assistance, it remains the responsibility of the marketing manager to develop an effective and efficient approach to marketing in each country. It is also of great importance that top management be aware of all requirements so that adequate support can be provided.

The business activities that must be carried out in marketing, and adjusted to accommodate differences in the international market, include the following:

- the analysis of markets and potential markets;
- the planning and development of products and services that consumers want, clearly identified in a suitable package;
- the distribution of products through channels that provide the services or conveniences demanded by purchasers;
- the promotion of products and services – including advertising and personnel selling – to inform and educate consumers about those products and services, or persuade consumers to try new, improved, or different ways of satisfying their wants and needs;
- the setting of prices that reflect both a reasonable value (or utility) of products or services to the consumers, as well as a satisfactory profit or return on investment;
- the technical and non-technical support given to customers – both before and after a sale is made – to ensure their satisfaction, and thus pave the way for possible future sales that are necessary for company survival, growth, and perpetuation;
- the organization structure, management, and remuneration of foreign employees.

Internationalization and the global marketer

Internationalization may be thought of as: (1) a process, (2) an end result, and/or (3) a way of thinking. A firm becomes increasingly internationalized as it becomes more involved in and committed to serving markets outside of its home country. This may be a planned and orderly process, or arise from perceived new opportunities or threats.

For the international marketer, internationalization is most effective when developed as a carefully planned process for increasing penetration of international markets. In entering target markets, companies have traditionally begun with exporting, later developed a sales subsidiary abroad, and finally developed production facilities abroad. Licensing may be used as an initial **entry strategy** for some companies, and at later stages for others. Strategic alliances may be formed. Whatever the approaches used they should be carefully thought out, with advantages and disadvantages carefully analyzed, before implementation.

The terms international, multinational, and global are sometimes used interchangeably when referring to international operations in general or international marketing specifically. Even though it may seem to be mainly a matter of semantics, it is useful to distinguish between these terms since they imply differences in approaches to marketing.

International marketing refers to any marketing activity that is carried out across national boundaries. Thus it could include anything from exporting one product to one other country in response to an order, to a major effort to market a number of products to many countries. It thus provides an appropriate title for a book such as this one that addresses a wide variety of marketing objectives and approaches.

The term multinational marketing came into use to describe the approach used by companies with a strong commitment to international marketing. Additionally, in the minds of some, it became associated with companies that treated each foreign market as separate and distinct, developing differentiated products and marketing strategies specifically for each of the markets.

The term global marketing originally came into use as a result of Theodore Levitt's discussion of the move toward global corporations that would operate as if the entire world, or a major region of the world, were a single entity (Levitt, 1986, Ch. 2). Such companies would sell the same product(s) in the same way everywhere. He noted that people all over the world were becoming more alike in their tastes. He argued that they would accept the same standardized products, in many cases, if the prices were low and the quality good. The economies of scale in producing and marketing a product in the same way worldwide would produce substantially lower costs, and thus allow lower prices that would overcome remaining differences in tastes. For some products, such as Coca-Cola, Mercedes-Benz automobiles, and McDonald's fast food (in most of its markets), this appears to be substantially the case.

However, three factors have served to limit the general applicability of this approach. First, very significant differences in consumer demands and in marketing requirements exist from country to country for many products. Second, as incomes rise, many consumers tend to become less price sensitive and willing to pay more to get products and services that meet their specific individual needs. Third, a move toward more flexible production systems in some industries has lowered (though failed to eliminate) the cost advantage of very large-scale production.

Thus the term multinational came to be associated with adjusting products and practices in each country, with attendant relatively high costs. The term global implied standardized products and practices, with relatively lower costs.

In the first decade of the 21st century a combination approach of 'think globally, act locally' appears to be most effective for most companies. The global strategy is based on location-specific and competitive advantages, operating without regard for national boundaries except as they affect the desirability of one course of action over another. However, adjustments are made as required to meet local requirements. Even companies noted for their overall global approaches do adjust their products and marketing methods to meet local requirements. At the same time, they strive to retain the **distinctive competencies** that provide competitive advantage.

Consumer products giant Procter & Gamble relies on continuing development and introduction of superior products, heavy advertising, and use of efficient distribution systems in all of its markets. But it adjusts product formulations, names, and packaging to meet local requirements. The General Manager of Procter & Gamble China has observed that 'The strategy that is guaranteed to fail in China is a one-size-fits-all approach' (Fowler, 2004). Even McDonald's fast food chain, long considered to have a global approach because of its use of similar production methods, menus, and store designs everywhere, has found that significant variations in presentation and adjustments to menus in France and elsewhere are the key to more rapid growth and improved profits. In France, while continuing its efficient and economical approach to food preparation, it has changed store ambience, introducing chic interiors, music videos, and a fancier menu. Dennis Hennequin, the chief executive in the French unit, has stated 'We are upgrading the experience, making McDonald's a destination restaurant' (Matlack and Gogoi, 2003).

A long-range objective, for those companies that are large enough or have other characteristics that allow it, is to develop a global view in which they treat the whole world as their market. With this global view they increasingly move toward the following:

- evaluating and entering markets worldwide based on their potential both as individual markets and as a part of a worldwide strategy;
- procuring capital and investing funds on a worldwide basis according to costs and opportunities;
- purchasing raw materials, components, equipment, and supplies from sources worldwide;
- staffing their organizations with the managers and employees best suited to carry out their operations without regard to national origin.

Internationalizing

There are a number of strategies for market entry and development available to a company that seeks to internationalize. These include exporting, establishing a sales subsidiary abroad, licensing, and establishing a production subsidiary abroad. Joint ventures may be used in establishing sales subsidiaries and production facilities. Though an approach beginning with exporting, progressing to opening a sales subsidiary, and finally establishing a production facility is common, any given company may start with any of the entry strategies and go on to other stages. Some firms use different strategies for different markets, only exporting or licensing to some smaller markets while establishing sales subsidiaries and/or production facilities in larger markets.

Small and medium-sized companies often go about internationalizing operations in a different manner and to a different extent than larger companies. Large companies may introduce their products/services globally, entering a number of markets quickly. Small and medium-sized companies are more likely to first enter markets that are close geographically and/or have the same language (such as the United Kingdom and the United States). Canada has been an appealing market for many first-time exporters in the United States because of its similar business culture, few language barriers in most provinces, and NAFTA (North American Free Trade Area). When Mexico joined NAFTA, trade between Mexico and the United States increased rapidly based on the reduced trade barriers, their common border, and different comparative advantages in a number of products.

Companies that have success in nearby markets may then move on to more distant markets in Europe, the Asia/Pacific area, other Latin American countries, or elsewhere.

There are some small companies, and divisions of large companies, that become global because they are niche marketers that must sell worldwide in order to have an adequate market, or as a way of keeping ahead of imitative competitors. Rolls-Royce is a good example.

Worldwide opportunities for small and medium-size companies have expanded as the Internet and the Internet have made it easier and less expensive to contact potential customers abroad. As companies expand their sales internationally, they may find it necessary to make purchases abroad and/or to make investments in overseas production facilities because of transport and/or production costs. While such actions are for sourcing rather than market entry, they may well be necessary for retaining existing overseas markets or entering additional ones.

International marketing management

International marketing management is faced with three basic decisions. The first is whether to engage in international marketing activities at all. Second, if a company decides that it wants to do business in international markets, then a decision has to be made concerning what specific individual markets are to be served. Finally, the company must determine how it is going to serve these markets – i.e., what method or system should be used to get product(s) into the hands of the consumers in foreign countries. This last decision can be called the basic marketing mix decision, and includes planning and strategy with regard to market entry, products, promotion, channels of distribution, and price.

International marketing management includes the management of marketing activities for products that cross the political boundaries of sovereign states. It also includes marketing activities of firms that produce and sell within a given foreign nation if (1) the firm is a part of an organization or enterprise that operates in other countries and (2) there is some degree of influence, guidance, direction, or control of such marketing activities from outside the country in which the firm produces and sells the product. Specifically, the major dimensions of international marketing are as follows:

- exporting: selling to foreign markets;
- importing: purchasing from foreign areas;
- management of international operations: all phases of business activity wherever undertaken, including such activities as operating marketing and sales facilities abroad, establishing production, assembly or service facilities in foreign areas, creating licensing arrangements and other types of strategic alliances, and engaging in **countertrade** transactions.

International marketing management involves the management of marketing not only to but also in foreign countries. From an overall perspective these dimensions relate to the broad area of foreign-market entry strategy. Thus we see that export marketing fits into international marketing as one of the major dimensions and, as such, is a significant alternative entry mode.

The planned and coordinated combination of marketing methods or tools employed to achieve a predetermined goal is called a marketing program or the marketing mix. A central feature of marketing is consumer orientation. The marketing program should be formulated with the interests and needs of consumers in mind. It must be structured in such a way as to integrate the customer into the company and to lead to creating and maintaining a solid relationship between the company and the customer. A firm operating in this manner is said to be *market driven*, and is concerned with what the consumer will buy that can be made profitably.

Market-driven marketing is oriented toward creating rather than controlling a market. It is an ongoing process based on incremental improvement, not on simple market-share-based tactics, sales volume per se and/or one-time events. The real goal of marketing is to 'own' a market, not just to make or sell products. When a company owns a market it develops products to serve that market specifically. A good example of this is Intel with its microprocessor. Intel developed what is essentially a computer on a chip, not a semiconductor, and created a new product category that it could own and lead as long as its technology stayed ahead of that of its competitors. Microsoft's Word for Windows has been so widely used that it has virtually taken over the market for word processing software, though it is being challenged on several fronts.

In contrast, some companies are product or technology driven. They believe in the old saying, 'If you build a better mousetrap the world will beat a path to your door.' While there are successful companies that are not market driven, these are often found in industries where market demand greatly exceeds industry productive capacity and there is less concern among competitors (if there are any) about consumers and market share than about product performance. Since conditions can change rapidly (i.e., markets change, competition grows, products become obsolete, etc.), product-driven companies cannot adapt as quickly or as easily as market-driven companies. A good example of this is the personal computer industry. At the outset, hardware and software companies could be product and technology driven. However, those that did not become market driven experienced severe problems or were forced out of the market by competition. Hewlett-Packard and Toshiba are examples of companies in this industry that are market driven.

Another way of understanding how firms may differ in their understanding of the relationship between market and firm, is inside-out and outside-in. Inside-out firms concentrate on themselves and their own resources. They believe that if they optimize internal processes based on their unique sets of resources then they will be as successful as they can be. Human resource management, operations management, and employee-management relationships are some of the key issues. On the other hand, outside-in firms start from the needs and demands of the market and seek to figure out how they can best satisfy the market based on their unique resources.

Yet another way of understanding the relationship between firm and its environment is the dominant logic perspective. In 2004 Vargo and Lusch published a seminal paper which proposed that marketing is evolving from a traditional product-dominant logic to a service-dominant logic. They argue that the product-dominant logic understands the relationship between the firm and the market through the product (and the money) as the object of exchange. This understanding has a range of implications. For example, that value is encapsulated in the product. The firm makes the product, and thus creates and delivers value to the market. In contrast, the service-dominant logic has a different understanding of the relationship between the market and the firm. For example, according to this perspective, value is created by value-network members (the firm and its suppliers, and other partners as well as the customer) through interacting with and integrating local and global resources and value is determined by the beneficiary such as the customer. Service-dominant logic as a mindset has been the focus of much research since the initial article that introduced the concept. In terms of practice, one aspect of the service-dominant logic has caught on more than other aspects: Value co-creation. Co-creation postulates that value is co-created and that the firm can only do its best to come up with a value proposition and support other value-network partners' resource integration activities. While a very important development in marketing understanding, research into service-dominant logic has lacked empirical investigation. The next important development has been the conceptualization and first empirical investigation of a service-dominant orientation in the articles by Karpen *et al*. (2008; 2011; 2015).

The elements in the marketing program are interrelated and interdependent. Sometimes they are substitutes for each other; sometimes they are complements; sometimes both. For example, advertising in a business or trade publication with circulation in the United Kingdom may be an alternative to hiring two additional sales persons, one to be located in London, the other in Edinburgh; it may be used to supplement the efforts of existing sales personnel in these areas; or it could be used to perform both functions. Advertising on the Web has been increasing rapidly while certain types of advertising in some traditional publications have been decreasing.

Since a marketing program consists of a set of interacting and interrelated activities, it can be viewed as a system. Marketing activities are the *controllable* (by the firm) variables, and the profusion of geographic, economic, sociological, political, and cultural circumstances (in both domestic and foreign environments) as well as certain firm characteristics are the *uncontrollable* (by the firm) variables. The state of the uncontrollable variables influences the composition of the marketing mix and the functional relationships between the elements in the marketing mix. A business firm engages in marketing activities to adapt to its environment in a way that the goals of the firm are being achieved. This is the essence of marketing management, whether domestic or international (or export). The relationship between the controllable and uncontrollable variables can be used as the basis for formulating and testing a theory of the export marketing mix. A schematic model for analyzing such a marketing mix is shown in Figure 1.2.

This model can be supplemented and further explained by the following proposition:

- The *relative export profitability* of any marketing program or component is situation specific, and is influenced by the variables shown in Figure 1.2.
- Figure 1.2 itself does not indicate which components are most profitable for any specific situation.
- The export channel used will determine which export structure and dealer support is most profitable.

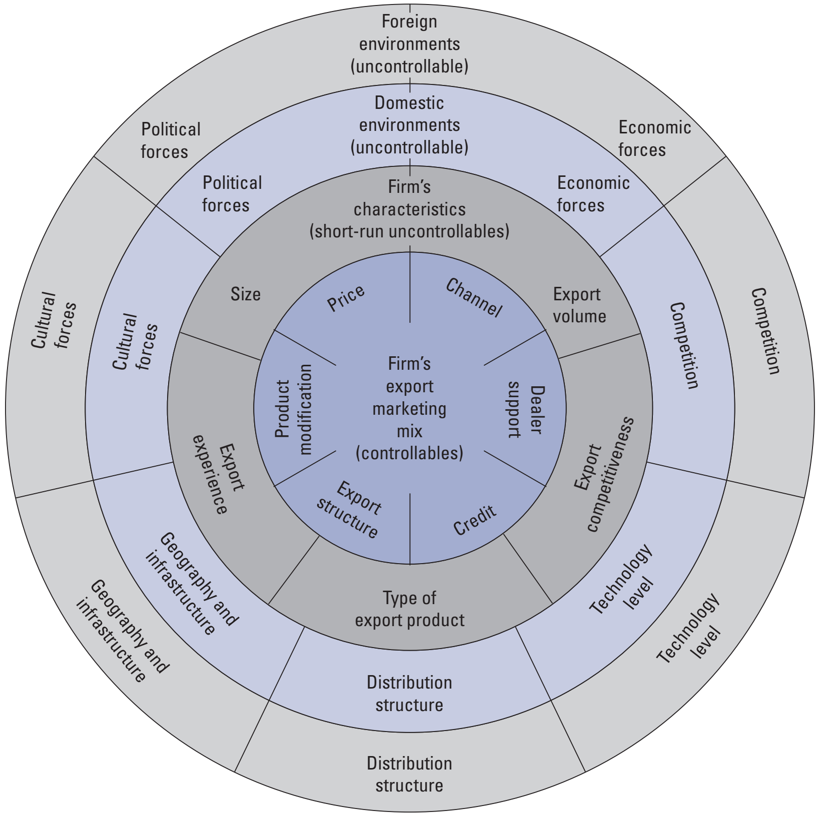

Figure 1.2 Schematic model of the export marketing mix

The relationship of exporting and importing

When one initially thinks of international marketing, it is often in the context of a sale being made by penetrating a foreign market, either at the time or in the future. However, in the previous section, importing was included as a major dimension of international marketing. This is because foreign sourcing activity (inward internationalization) may lead to exporting, may be the most effective and efficient way to develop products for the international marketplace, or may be required explicitly or implicitly for market entry in some countries.

Final products, such as aluminum components for aircraft, may have been through more than one import-export cycle. In some current models of Boeing aircraft, aluminum produced in the United States was exported to Japan, machined in Japan, the components then exported back to the United States, and finally used in making aircraft, some of which were exported to Japan (as well as to many other countries worldwide). Machine tools made in the United States and Japan, and more recently in China, have been imported by companies in a number of countries. The machine tools have then been used to make components or final products for export.

Japan, China, and many countries in Southeast Asia and around the world have imported technology and other intellectual property that they have then used in creating products or services for export. Joint development of technologies abroad has increased substantially.

Boeing is sourcing over 50% of its components for the 787 aircraft overseas, 35% from Japan alone in a risk-sharing joint development project using lightweight component materials. Airbus expects to import up to 45% of its components for the new A380 from America (Lynn, 2005; Cameron, 2007).

Some similarities and differences

The task of international marketing managers is the formulation and implementation of a marketing program that will enable a company to adapt to its environment in such a way that its goals are attained as completely as possible. There are similarities and differences in all markets, domestic and foreign, but the concepts of marketing science are universally applicable. Basic marketing concepts such as the product life cycle and traditional marketing tools such as market segmentation are as applicable in Wales, United Kingdom, as they are in New South Wales, Australia.

The broad categories of environmental factors are the same (i.e., social, economic, political, and geographic). The broad approach to the solution of marketing problems is identical, namely, the consideration of various marketing methods to achieve the goals of the firm, in light of the firm's environment.

Therefore it may appear that experience in domestic marketing management will be transferable to international and export marketing (see Exhibit 1.6).

Exhibit 1.6 Some characteristics of export marketing executives

What characteristics and background qualify a person for export marketing management? In simple terms the answer is as follows:

- technical competence in marketing;
- specialized knowledge of the factors in the international environment that are dissimilar or absent from the domestic environment;
- the ability to utilize such knowledge in working with others, at home or abroad, to develop and implement sound marketing programs.

Technical competence and a specialized knowledge of environmental factors can be achieved in part in the classroom and, of course, by experience and international travel. Developing the ability to use such competence and knowledge to implement decisions may be more difficult. It has been argued by many that the essential ingredient in a person who will be successful in exporting is **cultural empathy**, not only being able to recognize cultural differences, but also being able to understand them in a manner that permits effective communication and effective direction of human efforts to implement marketing decisions.

Many have observed that there is a large distinction between understanding the need for cultural empathy and the ability to practice it well. There is some evidence that a knowledge of the need for cultural empathy can be obtained by studying anthropology and sociology. But skill in the practice of cultural empathy will most likely be best obtained through action-oriented case studies. However, such studies and case analyses are not entirely sufficient. There is no substitute for learning a language as a means of understanding another person's beliefs, way of life, and point of view. Further, more is required than only a superficial or a reading knowledge of a language. Cultural empathy may be achieved by the thorough development of the language skill to the point where a person can think, feel, reason, and experience emotions in a language other than his or her mother tongue.

A survey of 1,500 senior executives from 20 countries revealed that ideally international marketing managers should have the following traits:

- global perspective and an international outlook;
- experience outside one's home country;
- knowledge of, or at least some training in, a foreign language.

Other studies concluded that the most common elements (i.e., exporter manager characteristics/skills) are adaptability, cultural sensitivity, and language skills. Considering international marketing investment decision-making, three personality variables seem to account for variances:

- international experience;
- international orientation (this includes cultural empathy/sensitivity and language skills);
- international business commitment.

However, the evidence seems to indicate that only orientation and commitment have been consistently correlated with performance.

Factors in a foreign or domestic environment can be grouped so broadly that all are included in the same classification, but in a more detailed breakdown it will be noted that some factors are not present in domestic environments. For example, although both domestic and international marketing activities are conducted in a legal environment, the components of the legal environment differ; certain types of regulations and laws are found in some countries but not in others. Taxes and tariffs vary widely between countries, as do various restrictions on trade, such as quotas or **exchange controls**. Likewise, although both domestic and international transactions may be conducted in a currency, there are differences in the type and characteristics of currencies and in the exchange rates imposed by countries.

Although domestic business is conducted over intranational (e.g., state and county) political boundaries, international business is conducted over the boundaries of sovereign nations. Governmental institutions and banking systems vary widely from country to country and often have significant influences on marketing activities. These influences as well as those from the legal environment may be affected by the nature of political systems.

Other commonly recognized environmental differences arise from language, religion, customs, traditions, and other cultural differences, not to mention geographical distances and climate variations, and basic infrastructure. Thus the analysis and solution of international marketing problems requires skills, background, and insights in addition to those required to solve strictly domestic marketing problems.

So far we have discussed two basic dimensions of international marketing and, of course, exporting: the *environment* and the *crossing of national borders*. There is a third dimension that arises because a *company markets its products simultaneously in more than one national environment*. This results in problems as well as opportunities different from those associated with crossing national borders. The international marketer must analyze respective national market opportunities, and a decision must be made regarding who should perform marketing activities in the company. The company should relate its activities in multiple nations to each other such that the effectiveness of the individual national marketing programs is enhanced as well as the effectiveness of the total world marketing effort.

The approach to the solution of international marketing problems requires, first, an international (or global) outlook – viewing the world or relevant parts of the world as a single market consisting of a number of segments, defined in a manner appropriate to the product to be sold, and not necessarily along national boundaries. Second, market targets must be realistically assessed and the segments of the 'world market' to be exploited should be selected. Third, the relevant environmental factors in the market segments must be assessed, and fourth, a marketing program must be formulated. In going through this process, the size and extent of markets must be determined, customer behavior must be evaluated, domestic and foreign competition must be assessed, legal and political factors must be reviewed, and costs must be calculated.

Export marketing planning and strategy

From a broader planning and decision-making point of view, there is a need to be concerned with both *strategic* and *tactical* issues as they relate to export marketing decisions. Strategic decisions concern such things as choice of countries, product markets, target segments, modes of operation, and timing of market entry. In contrast, tactical decisions are concerned with operations within a given country as they concern such things as product positioning, product **adaptation**, advertising copy adaptation and media selection, and specific promotional, pricing, and distribution decisions. An essential first step, particularly for the 'newcomer' to international markets, is for the company to assess its *readiness* to enter such markets (see Exhibit 1.7).

Exhibit 1.7 Is a company ready to enter foreign markets?

An essential first step in planning and strategy development is the company's need to assess its readiness to enter foreign markets. Any firm, regardless of its size and experience, must determine just how ready it is to make the move. Two expert systems – *Export Expert: Judging your export readiness* (Columbia Cascade, 1997) and CORE (Company Operational Readiness to Export) (Cavusgil, 1994) – are decision support tools that can be used to assist in determining readiness.

These expert systems are designed to provide an evaluation of *internal company* strengths and weaknesses in the context of exporting. Although the two pieces of software are not exactly the same, the major areas covered are quite similar:

- competitive capabilities in the domestic market;
- motivation for going international;
- commitment of owners and top management;
- product readiness for foreign markets;
- skill, knowledge and resources;
- experience and training.

The end result of the analysis is a report that includes scores for each of the dimensions and overall readiness with an assessment of what this means to the company and what the company should do next.

Export Expert is somewhat broader as it helps to analyze risks, assists in developing an international business plan, and helps to define target markets.

The systems are especially useful for small and medium-sized companies considering initial export experience. However, they are also useful for larger companies that want to reassess their strengths and weaknesses regarding present international marketing activity.

Analysis of readiness to enter foreign markets – by export or any other form of international marketing such as strategic alliance – using evaluation systems such as these provides a good starting point for making the decision. But it should only be a start! A company should not base its decision solely on this type of analysis. The next step would be a comprehensive analysis of strengths, weaknesses, structure and competitive advantage and opportunity (i.e., a type of SWOT analysis: strengths, weaknesses, opportunities, threats). Competitive advantage can provide the niche needed to succeed in a new market.

At a very simple level, export planning and strategy development have three distinct components:

1. **Goal.** The company exporting will have certain objectives that it wishes to achieve, and which will serve as criteria for assessment of progress. The basis of company goals will be identifying and measuring market opportunity.
2. **Program.** This involves developing the marketing mix at both strategic and tactical levels.
3. **Organization.** Developing an organization means putting together company resources in order to operationalize the marketing mix. In short, the strategy and tactics are put to work.

Figure 1.3 summarizes what we have said about export planning as well as international marketing planning in general. These components, though distinct, are interrelated and

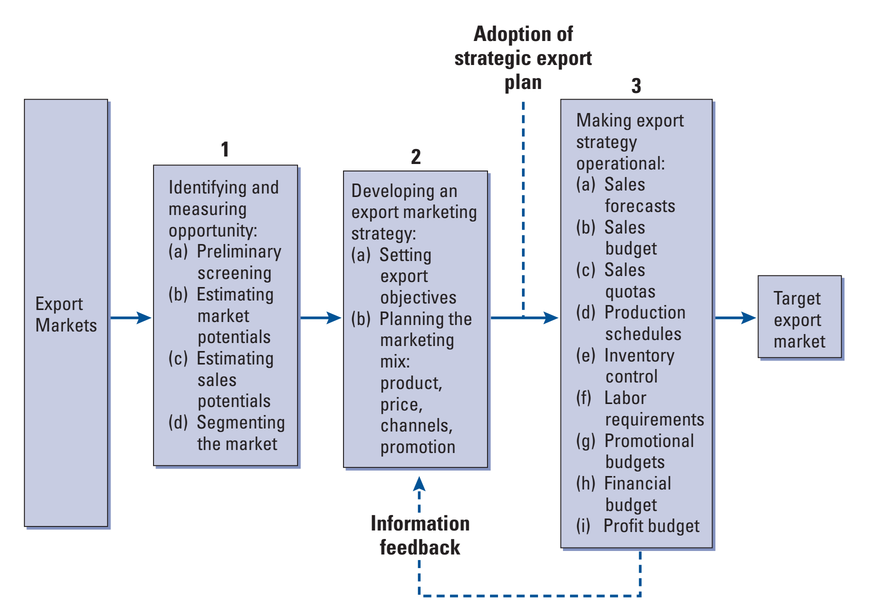

Figure 1.3 Export marketing planning process

thus dependent upon each other. For example, if a company for any reason cannot put together the organization needed to implement the program developed to achieve the selected goal, then either the program or the goal (or perhaps even both) will have to be changed. Underlying all this, including the initial decision to export in the first place, is the nature and level of *perceived risk* associated with such activities. There may be times, for instance, when the risk that is perceived to be associated with an export marketing program is too great for management to go ahead. When this occurs the program will be changed, the goals restated, and/or the organization adjusted. In all cases the desired result is perception of a level of risk that management will accept.

The export performance (i.e., its growth, intensity, etc.) of a company is affected by the firm itself, the company's markets and industry, and the export strategy chosen. Two major components of export strategy are product policy and market selection. The question of product strategy ultimately results in deciding upon the extent of product adaptation. This can range from no or minimum adaptation (i.e., selling what is essentially the domestic product) to developing a product specifically for export markets. Market selection concerns the countries exported to, and the nature and level of segmentation within these countries.

Demand management

The role of marketing in business is often concerned with more than attempting to increase sales. A number of factors have led to efforts to control rather than just stimulate demand for some products. These factors include concerns over the environment, pressures due to increasing populations and higher income levels often leading to increased consumption of limited natural resources, the cost and availability of resources (such as fuels and electrical power generation facilities), changing regulations related to restrictions on automobile emissions and the mix of traditional and low-emission vehicles required, conscious attempts to restrict supply so as to keep prices at desired levels (as in the case of OPEC and petroleum production), attempts to reduce waste and increase recycling, etc.

Shortages of products or services may be temporary (occurring only once or occasionally), periodic (occurring repeatedly, though possibly at irregular intervals), or chronic. Lost sales, and avoiding damaging relations with present and potential customers because of unavailability of goods or services, are major concerns. The cost of having excess unused capacity is also a problem. The following are some examples of problems and efforts to solve them:

- McCarran International Airport in Las Vegas, which is one of the largest in the United States and services one of the nation's most rapidly growing cities, needs to accommodate a growing number of international and domestic flights. There is no room left for expanding economically, and traffic from private jets is growing rapidly. McCarran is addressing the problem by subsidizing small local Las Vegas airports to take more of the relatively low-revenue private jets so that it can handle additional relatively high-revenue larger commercial jets.
- Airlines (and hotels, restaurants, etc.) experience periods of little demand and periods of excess demand. For many years, higher prices in peak seasons or times and lower prices in off-seasons or times have been used to shift as much demand as possible from high to low seasons or times. The Internet has made it possible for the system to become much more flexible and responsive. In addition to regular seasonal differences in airfares

offered, the Internet can be (and is) used to change prices in real time by companies such as United Airlines. Prices are increased as load factors for particular flights rise more rapidly than expected, and/or prices are decreased as the load factors on certain flights are unexpectedly low. The author has observed substantial increases in the Internet prices of long-range flights in less than a five-minute time period, and substantial decreases in prices at other times.

- Demand for Boeing's new 787 Dreamliner has been the greatest for any aircraft launch in history. Rather than jeopardize quality or incur excessive problems or costs in manufacturing, Boeing has lengthened the promised times for delivery on new orders. It has also increased list prices from $125 million to $150 million. This strategy appears not to have caused a serious problem because of the long delays in the scheduled introduction date of the Airbus A350.
- During Christmas seasons, some Internet marketers have been unable to fill many orders because of inability to forecast demand, lack of adequate inventories, and insufficient staff. Performance has been improving as experience led to improved staffing, better inventory control, use of air rather than surface shipments in cases where justified, and/or arrangements with suppliers. Some problems continue to exist (as they do with 'brick and mortar' stores) because of problems in predicting demand for individual items.
- Nintendo's new Wii console, introduced at the end of 2006, proved so popular that the company could not meet demand. The company substantially increased its production rate for the console, but seven months later it still could not meet demand. Nintendo felt they could not further increase demands on their contract suppliers without jeopardizing quality or incurring unwarranted additional costs. They are working to distribute the consoles being produced on an equitable basis. The company expected customers to wait if Wii consoles were not immediately available. Nintendo continued to have the best-selling console until it temporarily lost this position in 2009 (Kim, 2009). It regained top position later in the year. In 2010, it launched a new console that has 3D projection. But now it has competition in the 3D area from Microsoft's new console (Nuttal, 2010). In early 2011 Nintendo will introduce an improved version of its 3D games that does not require special glasses (Kageyama, 2010).
- Electric power companies, faced with excess capacity in certain periods and excess demand during other periods, have tried a number of methods of changing demand levels. These include charging higher prices at peak times, offering lower overall rates to customers that are willing to have power cut off in exceptionally high-demand periods, and contracts with suppliers from other areas or countries to exchange power at differing peak periods.
- An additional approach for electric power companies has been to build a combination pumping station-generating station between reservoirs above and below a dam. In periods of low demand, electrical power is used to pump water back up to the higher reservoir. In periods of excess demand, water is released down through the same flumes and turbines to generate electricity. Where the terrain allows building such a system, it is cheaper to build and operate, and more environmentally friendly, than simply adding overall fossil fuel-generating capacity that will seldom be needed.
- Overall excess demand for electric power, fuel, and/or water in a number of countries has led to governments and some companies actively promoting conservation.

A concept of marketing management has evolved, namely that of the problem of regulating the level, timing, and character of demand for a company's products in terms of its objectives at the time. Eight different demand states can be identified – four states represent underdemand, two states make up adequate demand, and two states constitute overdemand. Each of these gives rise to a specific export marketing task, which varies because different variables, psychological theories, and managerial requirements are involved or emphasized (see Exhibit 1.8).

Exhibit 1.8 Various states of demand

1. **Negative demand.** This is a state in which segments of a potential market dislike the product and may even pay a price to avoid it. This condition applies to a rather large number of products and services. The marketing task is one of conversion through changes in one or more of the marketing activities. This type of demand state often arises because of political actions and beliefs of national governments. Examples are consumer boycotts on products from certain countries (for example, South African gold coins), and tourism in countries where government is disliked. However, cultural and religious beliefs can also be a source of dislike, as with the Muslim feeling toward alcoholic beverages, or the strong opposition that arose against Nestlé baby formula.
2. **No demand.** In this demand state, segments of a potential market are uninterested or indifferent to a particular product, service, or idea. The object of concern may be perceived as having no value per se, no value in the particular market, or may be an innovation, of which the market lacks knowledge. There is a need to stimulate the market by demonstrating product benefits. When attempts were first made to introduce modern farm machinery into certain underdeveloped countries, farmers saw little value in changing their methods.
3. **Latent demand.** When a substantial number of people share a strong need for something that does not exist as an actual product, a state of latent demand exists. The marketing problem is that the right means of satisfying the need (that is, a product) must be developed. The development of a low-cost, high-protein food to help solve the malnutrition problem in many Latin American and African countries is an illustration. Again, there must be concern for any cultural and religious beliefs that exist.
4. **Falling demand.** This state exists when the demand for a product is less than its former level and where further decline is expected unless changes are made in the target market, product, and/or marketing program. Something must be done to revitalize demand. An example is when a market becomes inaccessible due to government action, such as quota limitations, even to the extent of prohibiting all imports of a product because it is desired that a local industry be created. The marketing job in this case is straightforward – invest in production facilities (if allowed) or forget about the specific market and redirect efforts to other market areas.
5. **Irregular demand.** In this type of situation concern is not with total demand, but rather with its temporal pattern in that seasonal or other fluctuations in demand differ from the timing pattern of supply. This is a very common occurrence in all national markets for many products, and can be easily illustrated by international tourism. The greatest period of demand by Americans and Canadians for travel to Europe, and vice versa, is the summer. The task facing hotels, transportation companies, and so on, is to convince tourists to travel during other times of the year. Lowering prices is one marketing technique that is widely used. Another example of irregular demand is foreign airline purchases of aircraft from companies such as Airbus Industrie (Airbus 330) and Boeing Aircraft Company (Boeing 777).

6. **Full demand.** This is the most desirable situation for an exporter since the level and timing of supply and demand are in equilibrium. While such a state may be more ideal than real, products do achieve this condition on occasion. Unfortunately, a full demand state cannot be expected to continue indefinitely because needs and tastes change, and competition does not become passive. Consequently, the exporter with a highly successful product has no easy job in the task of maintaining demand.
7. **Overfull demand.** For many reasons the demand for a product may be substantially greater than the level at which the seller wants to supply it. Consequently, the exporter deliberately attempts to discourage customers in general, or a certain group of customers. This involves marketing in reverse as the attempt is made to reduce demand by 'demarketing.' Perhaps the classic example in the international marketplace was the action of the oil-producing nations of the Middle East in the early 1970s. Their action was prompted by their desire to conserve their most important resource and foreign exchange earner, their desire to become more economically developed quicker, and perhaps even by a feeling of 'getting back' at the industrial nations that had exploited them for many years. Another example was the action of Wilkinson Sword (United Kingdom) during the introduction of stainless steel razor blades in the United States in the early 1960s, when the product was demarketed because the demand could not be met.
8. **Unwholesome demand.** This is a state in which any demand is felt to be excessive because of the undesirable qualities associated with the product. In most situations of this type the attempt to destroy demand is generally carried out by a government agency or organized group(s) of concerned citizens. Vice products (such as alcohol, cigarettes, drugs) and military arms sales to certain parts of the world are examples. A company may deliberately try to destroy the demand for its own product when it has an innovation for which it wishes to develop a market.

Source: Adapted from *Marketing Management: The millennium edition*, 10 ed., Prentice Hall (Kotler, P. 2000) p. 6, Pearson Education, Inc., Kotler, Philip, Marketing Management: Millennium Edition, 10th, © 2000. Printed and electronically reproduced by permission of Pearson Education, Inc., Upper Saddle River, New Jersey.

In assessing the significance to the exporter of the focus on demand management it is important to keep in mind the simple fact that different overseas markets may have different demand states. Thus export marketing potential will differ, perhaps necessitating different export strategies. Also, a company may be facing different demand states within any single national market because of differing reactions by individual major market segments. This can be especially relevant in national markets that are not culturally or socially homogeneous, such as Belgium, or economically homogeneous, such as Italy.

Obstacles to exporting

Some companies never take the first step and get involved in international marketing, particularly exporting, because they feel that there are obstacles or barriers that cannot be overcome easily enough. These obstacles may be real or may only be perceived to exist. Other companies may proceed at a slower pace in their international involvement because of the obstacles. For the most part, it is the smaller-sized (and to some extent the medium-sized) companies that have the hardest time handling these barriers.

Whether barriers exist, or are perceived to exist, for any given potential or actual exporter at any point in time is, of course, an empirical question. For our purposes, we address the issue by looking at potential barriers. These are the obstacles that have been reported by companies to have influenced their decision to export. Overall, a major obstacle that appears to affect many companies is the greater operational effort involved in export and foreign-market penetration in general as compared to domestic marketing. In particular, it is the 'mechanics' of export (e.g., means of payment, documentation, physical distribution, and terms of trade) that 'frighten' many companies. Also, there is the belief that the risk involved is greater.

Many of the barriers are controllable by the company while others are not; some barriers are foreign-market based while others are home-market based. Table 1.1 presents some results on underlying dimensions of export barriers that emerged from a study of Danish exporters. On an overall basis, all listed barriers were perceived to be not particularly important. However, this should not be surprising as the group studied was 'practicing' international marketers. In contrast, a study of small and medium-sized US companies found that they tended to view many of these barriers as very important. Moreover, trading companies felt that the barriers were more important than did manufacturers.

Both of the studies mentioned above dealt with perceived obstacles rather than 'documented' real ones. In the end it makes no difference whether obstacles are real or imagined as managers will make decisions on the basis of their perceptions of the situation that they face. Obviously barriers are important because of the impact they have on the behavior of potential and actual exporters at different stages of internationalization. Exhibit 1.9 gives some advice to small companies about how to cope with, and handle, some of the barriers that are perceived to exist.

Table 1.1 Dimensions of export barriers

	Dimension of export barriers			
Barrier	Internal controllable I dimension	Foreign non-controllable dimension	Internal controllable II dimension	Local non-controllable dimension
Communication with foreign unit	✓			
Lack of export training (experiences and language skills)	✓			
Lack of market information	✓			
Controlling international activities	✓			
Documentation requirements	✓			
Foreign government attitudes		✓		
Foreign public attitudes		✓		
Trade barriers (tariffs, quotas)		✓		
Arranging transportation, packaging, etc.			✓	
Providing services			✓	
Higher than domestic risk			✓	
Financing sales				✓
No assistance from home government				✓

Source: Adapted from Shoham and Albaum, 1995, p. 93.

Exhibit 1.9 How can a company cope?

Does a small company have to accept the barrier situation as it appears to it to exist? Of course not! There are many things that a small company can do to overcome any barriers, in addition to applying sound business practices. *Businessweek* presents the following global guidelines for small business (Barrett, 1995, p. 97):

- **Look to existing customers.** Many companies can penetrate foreign markets by selling products or services to their domestic customers' units overseas.
- **Make a commitment.** Exporting is not a part-time effort. It requires extensive research. Foreign business should be run by seasoned managers.
- **Seek advice.** Universities often have MBA students who work as consultants on exporting. Some consulting firms, such as Accenture (formerly Arthur Andersen), provide a free first-time consultation.
- **Use trade shows.** Trade promotions sponsored by government agencies abroad draw big crowds. Cost-conscious companies can send a product without attending.
- **Pick markets carefully.** While potentially lucrative, fast-growing markets can tank unexpectedly, consider customer quality, not just nationality.
- **Manage growth.** It takes time to line up financing and expand an organization to handle exports. Many small exporters are overwhelmed by big orders.
- **Use letters of credit.** Some first-time exporters ship a product and hope they get paid. A letter of credit protects against default by a weak or shady buyer.
- **Be patient.** Many foreign customers do business based on relationships. Small companies must spend time cultivating contacts before racking up export orders.
- **Choose partners carefully.** An experienced freight forwarder at home is crucial for handling Customs paperwork. An inept **distributor** abroad can ruin a company's reputation.

The impact of technology

Advances in information technology and other areas of technology have affected international marketing in at least two ways. First, trade in technology-related products and services has grown rapidly. Secondly, the improvements in communications technology and organization have led to the development of new channels of communication, lowered costs, and an increased flow of information. This, in turn, has led to the development of increasingly efficient and responsive production and distribution systems.

Information technology (IT)-related trade has surpassed $1 trillion in value, amounting to approximately 18% of the total value of world trade. The importance to China and India of IT-related trade was noted in Exhibit 1.2. Several of the European Union member nations are major exporters of IT-related products and digital-related products account for approximately 26% of all exports from the United States.

Advances in communications technology have included increasing bandwidth, improved methods of compressing data, more secure connections, and sharply reduced prices. The excess capacity of cable lines installed during the dot.com boom of the late 1990s has now been used up and transmission capacity doubled, but the percentage of space available has dropped. Prices are now rising in some areas with the greatly increased demand due to greater broadband use and the heavy demand from companies like YouTube, Facebook, Google, and many others.

High definition TVs, cellular phones and wireless communications networks have changed the amount of information people receive, the way it is received, and what it costs. From the standpoint of international marketers, additional products are available, additional markets can be reached, and the costs of doing business are reduced.

Radio-frequency identification systems (RFID) are increasingly being used to improve the effectiveness and efficiency of supply chain management. The RFID technology uses sensors that can be installed on containers, pallet loads, or even individual items as discussed in Chapter 14. They may be designed to provide various types of information from product information to real-time location and physical condition of containers.

An indication of the scope of IT applications to health care in Europe, all requiring both hardware and software, can be seen from a very small and partial list:

- telemedicine and video-conferencing over the net;
- monitors on patients sending data to health research centers;
- privacy of patient information through the use of smart cards for European Union citizens;
- UK-based B2B trading exchange for pharmaceuticals;
- computer-enhanced 3D imaging of the human body allowing less invasive surgery.

The development of new information about the human genetic system has provided additional tools in the search for and development of new medicines. These medicines have a worldwide market among the people and countries able to pay for them, and efforts are being made to increase their availability to those less able to pay.

The development of e-business software has had an important effect on international marketing. In addition to creating international markets for the software products themselves, it has enabled and encouraged companies and individuals to take entrepreneurial approaches to the international marketing process (as discussed in the following section).

Technological advances in traditional products and in manufacturing processes have also accelerated in recent years. While innovations in high technology often receive the greatest publicity, advances have been made in many fields and at many levels of technology. An indication of the range of advances is given in Exhibit 1.10.

Improvements in cargo ships and handling equipment, increasing containerization, applications of IT to scheduling and controlling shipments and to Customs procedures, new bridges and roads, high-speed trains, and a host of other technological advances and innovations have reduced the costs of international marketing of goods, services, and information. Satellite-supported global positioning systems (GPS) allow continuous accurate tracking of ships, other forms of transportation, and individual shipments.

The **euro** has lowered costs of international trade among member nations, eliminated exchange risks, and allowed more efficient cash management. Though its home base is outside the eurozone, the UK's Pilkington glass manufacturing company was able to reduce its European continental treasury operations from three offices to one central operation. This enabled it to substantially lower the amount of idle cash tied up in unbalanced loans and overdrafts, putting the money to work generating interest.

Exhibit 1.10 Examples of international markets for products with various levels of technology

- A plastic mechanical device that allows swimmers to talk to each other was invented by a US schoolboy. He patented it, formed a company, sold 5000 units of his 'Water Talkie' to Toys я Us, and then developed other toys that he sold to retailers around the world. After three years, and with projected sales of a million units, he sold his business to a larger company for over $1 million.
- Michael Tseng appeared on the TV show 'Shark Tank' in 2014. He pitched a cover for food which using suction can work with any normal kitchen plate. Lori Greiner was the most interested, but in the end no deal was struck. The product was still a success with annual sales of more than $10 million and shelf place in more than 1000 Wal-Mart stores.
- New products using wood treated with specialized non-toxic processes are producing very strong materials that can be used to replace concrete and steel in forming the structure of buildings. Earlier versions of such products have been used for many years in Scandinavia, Switzerland, Germany and Austria. Current products are being used in other parts of continental Europe, the United Kingdom and the United States. They have an additional advantage in producing less CO_2 than masonry with timber framing with brick or wood siding (Richardson, 2010).
- A mechanical engineer in India developed a hand-operated air pump with an attached cylindrical device to send smoke down into rat holes and force the rats out. Catching rats is the primary job of the men of the 3 million members of an impoverished community in Tamil Nadu state. The men formerly used a traditional system in which they inhaled smoke and blew it into the rat holes to force the rats up. The pump enables the men to catch more rats per day, increasing their incomes from the farmers who pay per rat killed, and thus enabling the men to buy more food for their families. The pumps are provided for free by a non-governmental organization and are now being distributed to other states in India (Chopra, 2008).
- European builders developed construction techniques using insulating forms (ICF) to improve fire safety, increase sound insulation, reduce maintenance costs, and require less wood in smaller buildings.
- An Italian firm developed a small-sized, lightweight floor polisher for hard-to-reach places. In 2001 it found an additional market in Japan where many buildings have relatively restricted spaces.
- Several German companies have developed recycling sorting processes, biological organic-based waste treatment systems, and other environmental technology with worldwide applications.
- A Belgian manufacturer of innovative wheelchairs designed for special types of disability now exports its products to 35 countries.
- A US producer of walnuts found an export market for the shells, which are used by a Japanese producer of plant-based powders for industrial polishing, cleaning, and as a porosity adjuster for sharpening-stones.
- Combining mechanical and a number of electronic-related technologies, BioTrac of the United States has developed a magnetic capsule with attached microchip that may be inserted into cattle and other ruminant animals, with the same device used to administer large pills. It permanently identifies each animal, records its temperature, keeps track of its location, and can be read automatically at the slaughterhouse. It provides information of particular value to problems involving *E. coli* and mad cow disease.

Licensing of new and improved technology has become increasingly important for both large and small companies. The obtaining or sharing of technology is also being accomplished through acquisitions, mergers, and joint ventures, all of which have tended to stimulate trade.

In addition to contributing directly to an increase in international trade, technological advances have encouraged, and in some cases made possible, entrepreneurial approaches to international marketing.

Entrepreneurial approaches to international marketing

New approaches to international marketing are being undertaken by both small and large firms. Some of these have been made feasible by technological advances, particularly in communications, e-business, and logistics. Others have come about as emerging opportunities have been recognized or created.

E-business software has allowed companies to incorporate a number of key administrative functions online in a coherent system. These can include supply chain management and distribution chain management, expediting order and bill processing, providing cost and budgeting data, providing up-to-date sales information, and facilitating the analysis of sales trends and targeted markets. Specialized tools or programs are available to handle specific processes such as integrating online and offline sales channels, facilitating contract management, and handling online financial services. Online applications can result in major cost savings. Some companies are specializing in developing integrating software; others are attempting to provide virtually the whole range of applications. Applications may also be designed to meet all of the information and interaction needs, outside of direct personal contact with the buyers, of specific business segments such as retail jewelers.

Specific software is available for developing and conducting customer relations programs.

Online marketplaces

The Internet has allowed the development of online marketplaces. Automobile manufacturers Renault, Nissan, Daimler, Ford, and General Motors, together with Japanese parts supplier Denso Corporation, set up an online global electronic market designed to increase efficiency and reduce costs in procurement. The system enables suppliers and auto manufacturers to show requirements, products, quantities, and delivery dates, with prices to be determined by bidding. With the addition of Toyota, Honda, Mitsubishi, and Mazda, it substantially changed the traditional exclusive automobile company–supplier relationships in the Japanese market. Food manufacturer General Mills Inc. has teamed up with 16 competitors to set up an e-commerce network to work with transportation companies in combining shipments and in maximizing cargo space utilization. Chevron, Oracle, and a subsidiary of Walmart teamed up to create an Internet exchange where convenience stores can order merchandise. Leading computer manufacturers created an online market where members can buy and sell computer components worldwide.

eBay created an online marketplace where individuals can buy and sell items worldwide. This site is increasingly being used by businesses. Other companies have also created online marketplaces.

Exhibit 1.11 Novica: providing marketing opportunities for producers of arts and crafts

The Internet and Internet have dramatically increased opportunities for small and medium-sized companies to export their products and services worldwide.

Novica.com, a Los Angeles-based company 19% owned by National Geographic, is making a business out of assisting artists and artisans from the developing countries to market their products. Before the advent of the Internet the marketing channels available to most small-scale makers of arts and handicrafts in the less-developed countries were typically quite inefficient. In areas frequented by tourists, producers might set up small stands themselves, or they might sell directly to local stores run by others. Most artisans and artists, however, had to rely on local buyers and a chain of wholesalers that created high distribution costs. The small scale of operations made advertising of individual products unfeasible in most cases.

Through its website (www.novica.com) Novica is now providing small producers with an additional, widespread, and efficient marketing channel connecting the makers with prospective buyers, both individuals and companies. Listing on the site is free, and more than 2000 artists from seven countries are featured. Products include handcrafted jewelry, textiles and carvings. Novica evaluates the product to determine what it believes it can pay for it, and then estimates what the product can be sold for in the international market. Novica charges 15% to 50% of the price to cover its costs. Because of its efficiency in marketing through the Internet the company is usually able to raise substantially the amount paid to the producer and simultaneously offer prices to the international buyers that are much lower than they are currently paying for such goods. Novica makes its money on the difference between what it pays the producer and the price it charges for the product.

The operation is being financed by the venture capital arm of the *National Geographic* magazine and a number of individuals, institutions, and other venture capital firms. While at least some of the investors have social objectives related to assisting the artists and artisans in the developing world, the company is being operated as a business venture.

Small producers and individual artists and artisans who formerly had no economically feasible method to export can now use Novica's Web-based system to sell abroad.

Source: Adapted from Craig, 2001, Valeriano, 2005 and Novica.com's website, 2010.

Online marketplaces thus are not restricted to large companies. Individuals and small companies around the world are finding new opportunities. Exhibit 1.11 shows how the Internet has enabled small producers of handicrafts to join the international market.

The virtual company

An interesting example of innovative approaches to business and marketing is the development of the virtual company. The virtual company is one that has no substantial physical headquarters or other physical facilities, and few or no employees. It contracts with other organizations or individuals to perform almost all business functions, such as design, procurement, production, warehousing, shipping, accounting, etc. The outside organization's employees and the independent contractors never need to visit the 'company.' In the ultimate example, the virtual company comprises only an individual with a desk, computer, communications linkages, and knowledge.

There are two factors that make the virtual company possible. The first is the owner's ideas, vision, knowledge, contacts, and ability to organize and coordinate the activities of others. The second is the Web-based communications linkages that permit the transmission of information, including pictures.

An example of a virtual company is one that develops systems for gathering, compiling, analyzing, and displaying information gathered from an extremely large number of sources. In order to comply with incorporation laws, it has a legally registered home office but no permanent staff at that location. No two of the company members happen to live in the same city. Periodic staff meetings are held in cities in the United States and Europe. Meetings with customers are typically held at the customers' offices. The primary means of communication is over the Internet. Virtually all work is done on computers and the outputs delivered electronically.

A second example of a virtual company is an individual who organizes trade show arrangements for large real estate companies requiring display set-ups for existing and potential customers and logistics for the large number of its own employees who attend. A third example is an individual who develops curricula, organizes programs, and contracts with instructors to provide training for client corporations. All three operate from their homes. A number of consulting organizations in the Netherlands and elsewhere also operate in this manner.

Business–government alliances

Joint ventures and strategic alliances between government or quasi-governmental organizations and private businesses are being used more widely than before. In the year 2000 ten private–public joint ventures were formed in the United Kingdom. The largest of these alliances have been with national postal systems. The German postal system, Deutsche Post, has spent $3.1 billion acquiring stakes in 20 companies across Europe, the United States, and elsewhere. This included buying 97.4% of Danzas AG of Switzerland, the leading European logistics business.

When Deutsche Post became privatized (with some ownership still held by the German government) its delivery system was the market leader in most of Europe and much of Asia. In the United States it had acquired Airborne, Inc. of Seattle for $1.05 billion, and operated as DHL (Roth and Esterl, 2008). It encountered a number of problems in the United States. Some were due to mistakes Deutsche Post made in running the operation, others because the fact that UPS and FedEx were both very efficient operations and between them dominated the market. DHL never made a profit, lost $1 billion in 2007, and anticipated a loss of $1.5 billion in 2008. In 2008 it closed a number of facilities in the United States and had UPS take over most of its local services, though each company retains its name and logo in the country (Esterl and Dade, 2008).

The US Postal Service formed a partnership with Emery Worldwide aircargo company to deliver heavy items to homes. The US Postal Service also formed a strategic alliance with FedEx. It combines the complementary competitive strengths of FedEx's fleet of 665 aircraft worldwide with the coast-to-coast retail strength of the Postal Service in the United States. In 2007, Avon Cosmetics and Thailand Post announced a cooperative agreement in which the latter is delivering products to selected Avon Beauty Boutiques and representatives in 30 provinces. The two partners additionally worked together in setting up beauty shows at 31 of its post offices. Thailand Post is also working with other companies (Asawanipont, 2007).

The growth of non-traditional exports

Two types of non-traditional exports are becoming increasingly important in the first decade of the 21st century. One is the export of a new type of service. Of course the construction industry has a long history of sending employees overseas, and the travel and shipping industries provide services for both domestic and foreign individuals and companies. Now a new industry has arisen in the exporting of services of knowledge-industry workers who remain in their own countries while performing work for a wide variety of clients abroad. India and China are the major providers of such services but eastern European nations, smaller Asian nations, and other countries including the United States have also entered the market. This type of cross-border supplying of services is usually called outsourcing.

Secondly, a growing number of successful companies have found that the particular business models they have developed can enable them to successfully enter foreign markets. While business models have not traditionally been considered an export, it has become increasingly apparent that it is not only products or services per se that can give companies a competitive advantage abroad.

Exporting services of knowledge-industry workers

The improvements in communications technologies and capacities, together with lower communications costs, enabled the development and rapid growth of cross-border sales of the services of knowledge-industry workers. Indian companies were leaders in effectively exploiting this opportunity and the three giants in the industry are all headquartered there: Tata Consulting Services (TCS) with over 83,500 employees in 150 offices in 35 nations; Infosys Technologies with 70,000 employees, all of whom speak fluent English and most of whom have degrees in information processing; and Wipro Ltd.

Companies from countries in North America, Europe, and elsewhere have also set up offices in India to perform services, software development, and other IT functions for their operations in other nations. France's Capgemini IT group now has more staff members in India (21,000) than in its home country (Leahy, 2009). Other foreign companies, including IBM which had 53,000 Indian employees in 2006 and Accenture which had 30,000 in 2006, are increasing the number of Indian workers (Sakashita, 2007; Saracevic, 2007; Leahy, 2009).

The initial objective of much outsourcing was primarily to reduce costs. Costs are still a major consideration in much outsourcing, as discussed first below. For other companies, discussed secondly below, the objectives have changed as the possible strategic advantages of international specialization and multi-sourcing have become apparent. Technical and managerial expertise is the deciding factor in still other cases. In what might be considered a sort of reverse offshoring to Americans, IBM won a 10-year contract to provide computing and information technology services to India's Bharti Tele-Ventures private communications company (Taylor and Marcelo, 2004). Hewlett-Packard and Microsoft jointly won a $150 million contract from New Delhi's government to computerize its tax and revenue departments (Kripalani, 2004a).

The cost advantage in outsourcing arose because companies in lower-wage nations could hire well-educated but relatively lower-paid talent to provide services to organizations in higher-wage nations. India and the Philippines were leaders in providing services to English-speaking countries. Now China is growing rapidly as a service provider for neighboring Asian countries as well as for North American and European firms. China has a **comparative advantage** in working with Japan and some other nearby countries because of its large number of people who speak Japanese and Korean as well as Chinese dialects (Watanabe, 2006). Businesses in some western European countries are outsourcing from nearby eastern European nations where German and/or French and/or English are spoken. Hundreds of small software companies in Bulgaria, and both freelancers and employees in support centers in Romania, provide programming for customers in Europe and America (Reinhardt, 2004). Russia is also providing customer support and IT services (Condon and Butler, 2003).

Initially, both India and the Philippines primarily provided call centers and back-office support for financial services, telecom, software, and retail companies. Increasing numbers of customers in the West who call their banks, telecommunications providers or other companies with questions about bills, for reservations, or for other information that can be handled by telephone have their inquiries answered from a call center overseas. The physical location of the call center is irrelevant as long as the employees of the call center have all the necessary records, information, access to reservations systems, etc., and the ability to speak the language of the callers. The only indication to the callers that the providers of the information are not nearby might be the accent of the employee. In the United States, Canada, and a number of other countries accents are not necessarily indicative of where the call center is since even many domestic employees have accents associated with nations abroad. Routine accounting, order processing, and other administrative tasks were also handled by people overseas who were employees of local companies or, more frequently, employees of subsidiaries of the home country companies.

The outsourcing of much more sophisticated services is now growing rapidly, made possible by the large number of highly educated professionals in some developing countries, their relatively low wages, and the installation of high-speed fiber-optic networks in some major Indian cities. Wipro Ltd., TCS, and Infosystems each provide a wide range of outsourcing services, software development and installation, systems operation, maintenance, and consulting. Services provided by foreign suppliers and overseas centers of European and American organizations extend from accounting services through cutting-edge design. Radiologists in India can immediately receive and analyze CT scans and chest X-rays of patients in US hospitals. Some European and American pharmaceutical companies are doing contract drug research in India to reduce costs and speed development of new drugs (Kripalani, 2004b). Bulgaria hosts a number of software labs of international companies. Germany's SAP has a laboratory employing 180 engineers in Bulgaria. Small as well as large organizations are benefiting from the provision of services by knowledge-based workers abroad. One US company has only three employees in its Menlo Park, California, home office, but employs 35 artists, designers, programmers, 3D modelers, animators, and Web developers at its subsidiary in India.

Legal-process outsourcing is a growing field in India where there is an increasing number of qualified lawyers trained in the United Kingdom and United States. The revenues have increased from \$146 million in 2006 to \$440 million in 2010 (*The Economist*, 2010).

The focus of India's largest outsourcers, and of American firms locating offices and laboratories overseas, is no longer simply on labor costs. IBM is increasing employment in India, China, Brazil, and Europe, as well as at new locations in the United States, as part of a global reorganization. Its services workforce will be assigned to competency centers set up according to skill sets and to meet customer needs, rather than having a mini-IBM in each country (Hamm, 2007). TCS has changed its business model to include a focus on building up competences in markets in other countries so that it can gain more knowledge of its customers and be of greater use to them (Marsh, 2007; Hamm, 2007).

It has been estimated that the total number of US service jobs moving offshore will be 1.6 million by 2010 and 3.3 million by 2015. While approximately half of these are expected to be in back-office work, a wide range of fields including architecture, computers, law, medicine, and management will be affected. In a survey by Diamond-Cluster International Inc. of firms that already outsource some technology abroad, 86% planned to send additional jobs overseas (Kirby, 2004).

In general, European companies have been less aggressive than North American corporations in moving support services and jobs offshore. This is due to a combination of factors including a desire to achieve social outcomes, less flexibility in cutting domestic jobs, greater private and governmental concerns, and the less widespread use of some European languages. A Rand Corporation report has indicated that the flexibility and hospitable domestic environment will enable the US technology industry to maintain world leadership. Even in the United States, however, the loss of jobs in the technology sector worries employees in the industries affected, some economists, and some politicians, with some demanding legislation to slow or stop job exports (Konrad, 2003). There are also concerns in the United States about perceived potential risks of workers outside of US jurisdiction having access to detailed financial, medical and other information on US citizens. Possible identity theft and privacy issues are among the concerns (*San Francisco Chronicle*, 2003).

The concern over the loss of jobs in the United States has raised questions about the ethics of sending so much work overseas. Chapter 2 provides some comments on how ethical issues may influence public policy when taken up by groups (unions, companies, politicians, etc.) that have or can gain political power.

While companies outsourcing work to firms overseas sometimes expected cost savings to be as high as 50%, the actual cost savings for many have been nearer 10–20%. Most, however, intend to do additional outsourcing (Kirby, 2004).

Exporting business models

Every company has a business model for what it does and how it does it. That is, each company offers some combination of products and/or services, develops methods for promoting, pricing, distributing, and supporting what it provides, and develops systems for management and control. In some companies the model is carefully thought out and its effectiveness periodically evaluated while in other companies it may simply be thought of as 'what we do.'

An organization that develops a new or different business concept, finds a better way of organizing its operations and doing business, identifies a potential new market and a way to exploit it, or develops some other innovative approach may gain a unique competitive advantage. The most valuable assets of highly successful Walmart in the United States is not its stores or factories but its business model using unique expertise in organizing its supply and distribution systems. The formation of Star Alliance, with its code-sharing, coordination of flights, and improved reservations and ticketing, generated greater traffic and higher load factors for each of the 28 member airlines that has joined as of 2016.

Case 1.5 provides an example of how one company changed its business model as market conditions and competition changed. A number of companies that have developed improved business models have been able to successfully apply these models in expanding internationally. While their operations may include the export (or import) of products, it is really the model being used (exported) that gives the companies their competitive advantage. Exhibit 1.12 gives examples of innovative business models that have proved to be very successful in some markets outside of their home countries.

Exhibit 1.12 Examples of successfully exported business models

- **eBay.** Company founders recognized that the Internet could be used to develop an entirely new type of market in which potential buyers and sellers could participate in online auctions without ever having to meet. It grew rapidly in the United States and then quickly spread overseas where its business method, organization, and size gave it a competitive advantage. In 2009, eBay had over 90 million active users worldwide and received 54% of its revenue from overseas (see Case 1.4).
- **Cirque du Soleil.** The Canadian-based circus without animals 'is one of the rare companies that utterly redefined their industries.' It has a dozen full-time talent scouts searching the world for outstanding performers, heavy emphasis on research and development, elaborate staging and costumes, and New Age music. The company has put on performances in 300 cities on five continents. It has 5,000 employees worldwide, including over 1,200 artists speaking 25 different languages. Over 14 million people will see a Cirque du Soleil show in 2010.
- **Starbucks.** There are coffee shops and chains around the world, but Starbucks has successfully expanded to many countries by using a particular brand of 'lifestyle marketing,' selling the 'Starbucks experience' rather than just their coffee (Sullivan, 2003). It aims to provide a community-gathering place to enrich people's daily lives through its particular ambience, friendly service, and consistent quality of the coffee drinks and related products served. Started in the United States, the company now has 13,500 stores in 39 countries (Helm, 2007).
- **Ikea.** The Swedish producer of high-quality furniture initially failed in its attempts to market its products overseas because of their high cost. The company lowered costs by developing ready-to-assemble products, reducing manufacturing costs through standardization and mass production, and going to international sourcing of materials. In a new and very successful effort at international expansion they emphasized very large stores with easy freeway/motorway access and plenty of parking. This enabled them to provide furniture that is accessible, approachable and economical (see the Case in Chapter 5).
- **7-Eleven.** This chain of convenience stores was started when a store selling blocks of ice realized that their customers would be willing to pay premium prices for food products if the company would supply them at hours when traditional food stores were closed. It

used this model, adding additional products and new locations, as it grew to become the world leader in convenience retailing. 7-Eleven maintains its competitive advantage by making continual improvements in its demand tracking, stocking, and delivery systems to keep costs low and increase responsiveness to customer demands. The introduction of additional services and products serves to create additional customer traffic (see the Case in Chapter 5).

- **McDonald's.** There were many hamburger stands and some chains of stores selling hamburgers in the United States before McDonald's was started. The McDonald's approach, unique at the time, was to organize the production and delivery (sale) of hamburgers and associated products (French fries, milk shakes, etc.) on the model of a factory assembly line. The products themselves, steps in production (assembly), and presentation to the customer were all standardized in order to produce food quickly, cheaply, and of consistent quality. Its initial advantage, coupled with a franchise system of opening new outlets, allowed it to expand rapidly. It remains the world's best-known fast food chain.

A business model that is successful in its home country will usually need some modifications to fit the differing economic, political, legal or cultural environments in other countries. In its international expansion of theme parks, Disney had to make a number of adjustments in Japan, and achieving success in France was even more difficult and tenuous. As with any international venture, management must carefully evaluate conditions abroad before entering new markets. Some concepts and approaches simply are not exportable to certain countries.

The companies introducing a new business model often lack the patents and particular technological advantages enjoyed by many exporters of products, though they typically have trademarks and brands that may become more valuable as they grow. In order to retain competitive advantage, they generally must rely on developing brand recognition, economies of scale, wide coverage, and/or innovations – as well as maintaining consistent high quality in service and products. The companies listed in Exhibit 1.12, as well as many others, have continued to be very successful in some or all of their international markets, even when imitators or other competitors have emerged.

Importing customers

Many companies (and nations) have relied to a greater or lesser extent on getting income from foreign visitors as tourists, students, business travelers attending meetings, and/or coming for recreational purposes. Increasing numbers of countries are now seeking to attract 'medical tourists.' The Korean government is building a group of medical clinics with luxury apartments and a golf course and other recreational opportunities in the same complex. Countries attracting medical tourists include India, Singapore, and other nations. The number of Americans traveling abroad for medical treatment in 2007 was estimated to be 750,000, with substantial growth expected in future years. Advantages, besides the low cost, often include more luxurious accommodations and less delay in getting diagnosis and treatment. Possible problems may include language and cultural differences and misunderstandings (Choe, 2008).

Purpose and approach of the book

This book is designed to provide a solid introduction to *international marketing*, covering all types of international marketing entry modes and activities, with an additional emphasis on *export management*. The approach has been used in order to make the text as applicable and valuable for small and medium-sized companies as it is for large international or global corporations. Many of the smaller enterprises, which comprise most of the firms involved in international business, use exporting as their foreign-market entry mode. All of the international giants do extensive exporting and importing.

The knowledge and understanding required for successful exporting provides a valuable foundation for undertaking any of the modes of market entry. Competence in domestic marketing, by itself, is a necessary (but not sufficient) condition for success in exporting and other modes of international marketing. Marketing across national boundaries, in any entry mode, requires interacting effectively with those in other cultures whose tastes, values, practices, economies, laws, and administrative systems may differ from your own. This involves a distinctive set of competencies that must be acquired. Thus the knowledge, examples, and cases in this book are applicable for all entry modes.

In addition to knowledge, competence, and experience in foreign markets, success also requires the proper attitude and commitment by company management. Kenneth Butterworth, chairman of Loctite Corporation, has stated that 'the biggest non-tariff barrier for Americans in the world is the attitude of the CEO.'

This book should be of interest, and use, to all those who will benefit from increased knowledge of international marketing and exporting< Business students at the postgraduate, undergraduate, and diploma levels, entrepreneurs, business executives and board members in internationally interested firms.

Every chapter of this book illustrates how the special requirements of exporting and marketing internationally affect the execution of the traditional functions of marketing.

While the basic principles of marketing are much the same whether it is being done in a domestic or overseas market, the international marketer will find significant differences of degree, and of kind. These differences, and any related difficulties, stem from the fact that environmental conditions vary, products are crossing national borders, and there may be marketing in two or more overseas areas at the same time.

The main focus of this book is on examining those marketing activities and institutions that are 'unique' to international and export marketing. Chapter 2 looks at the bases of export marketing, both from a macro and from a micro perspective, and discusses ethical issues.

Chapters 3 and 4 are concerned with the international environment and examine effects of all the dimensions indicated previously in Figure 1.2. Since these dimensions are uncontrollable, adaptation to them is very important. Often business people tend to take for granted certain aspects of the environment such as culture, since this is generally well known in the domestic market. In export marketing this cannot be done since overseas markets represent unfamiliar cultures.

Chapter 5 covers the all-important market selection problem. Of concern are both strategies to employ and methods of assessment. This is the essence of market opportunity analysis. Chapter 6 deals with issues relevant to market(ing) research.

The components of the international marketing mix are discussed in Chapters 7 to 13. Chapters 7, 8 and 9 cover the various market entry modes and channel of distribution strategies. Chapter 10 looks at the product, brand and origin variables. This chapter also discusses the country of origin effects, and country biases which are essential to the understanding of marketing in an international context. Pricing a product for export markets and methods of financing transactions are the topics covered in Chapters 11 and 12. Finally, export promotion and market communication issues are discussed in Chapter 13.

Chapter 14 covers supply chain management and the practical aspects of the handling of export and import orders. Where appropriate, strategic implications are discussed within the context of the particular topic of concern.

Appendix
The worldwide recession and recovery of 2007–2016

The recession beginning at the end of 2007 was the most widely spread and deepest in over 40 years. The basic problems surfaced first in the United States, but spread rapidly through much of the rest of the world. The real estate market and the stock market had become overvalued (as can easily be seen in retrospect). Long and increasingly sharp rises in prices had occurred as both individuals and corporations bought additional properties and stocks based partly (or primarily) on expected further increases in prices rather than on current economic usefulness. The real estate market began to soften, and then went into freefall in the year bridging 2007–2008 as speculators and those selling for other reasons could no longer find buyers willing to pay asking prices. Even while this was happening, Lehman Brothers, a large financial firm doubled its own real estate holdings and increased short-term property financing of property that it hoped to resell at a profit.

Changes in real estate values were then accompanied by a sharp drop in the valuations of companies and stocks. On 9 October 2007, the US Dow Jones Industrial Average of stocks had reached an all-time high of over 14,164. It subsequently fell to a low of 6,547 on 9 March 2008, and did not get back even to 10,000 until mid-2009. It continued to range between the upper 9,000s and the low 11,000s far into 2010.

The McKinsey Global Institute stated that in 2008 there was a decline of $16,000 billion or 8% in the value of global financial assets, the largest absolute fall on record. It was accompanied by falls in equity and property values of $28,800 billion in 2008 and the first half of 2009 (Wolf, 2009). Losses in consumer wealth in stocks and real estate resulted in drops in consumer spending (and company spending). This led many companies to make cuts in their labor forces, leading to further reductions in consumer income and spending. The US government allowed some large financial institutions to fail, while it bailed out others and some large manufacturing companies. Many smaller financial institutions and companies went bankrupt, leading to more losses of jobs. In the United States, with one in six American workers either unemployed or under-employed, low personal incomes and concern about the future, robust growth in the short term seemed unlikely (Zukerman, 2010). About the only bright spot in the picture was that exports held up better than imports. The

US government implemented a stimulus package that was very large, but not adequate to make up for lost incomes and values.

The problems in the United States spread rapidly to other countries. Some direct losses occurred where packages of American real estate loans had been widely sold. Greater losses occurred as local/regional real estate markets and stock markets in the developed countries, and most of the developing and less-developed countries, fell sharply. The magnitude of the drop in each country was determined by local/regional differences and problems. While labor laws in some European countries lessened reductions in their workforces (and incomes) during 2007–2010, additional financial problems in the eurozone in 2010 caused more problems there.

While the GDPs of most of the countries in the world dropped substantially during the recession, notable exceptions were those in the two fastest-growing large nations in the world, China and India. In those nations, GDP growth slowed, but continued to be positive. While real estate and stock markets have risen in many markets since the low of the recession, in 2015/2016 levels are still below their highs in some markets.

Questions for discussion

1.1 Why has there been such an increase in interest by business firms in international and export marketing? Will this interest continue to increase? Why, or why not?

1.2 What is meant by internationalization and how does this relate to the global marketer?

1.3 Is taking a global view limited to companies that view themselves as global companies? Explain.

1.4 Is it meaningful to attempt to measure the degree (or amount) of internationalization of a firm? Explain.

1.5 What does it mean for a company to be 'market driven'? Is this really important in today's environment or can a company be successful without being so driven? Explain.

1.6 Explain the meaning of the following statement: 'If a company is to be successful in foreign markets its management must have a good understanding of all aspects of the environment within which it will be operating.'

1.7 Give two or more examples of how external factors (**exogenous variables**) in the international environment make export marketing more complex than domestic marketing.

1.8 What is the relationship between importing and exporting for an individual company?

1.9 What are the three distinct components of export planning and strategy development and how are they related?

1.10 Identify the potential barriers (or obstacles) that face companies considering – or expanding – international marketing operations. Which are most important and which are less important? Explain.

1.11 Is the role of the international marketer only to attempt to increase sales? Explain.

1.12 Is use of the Internet appropriate only for large companies? Explain.

1.13 What is 'e-business'?

1.14 Are online marketplaces useful only to businesses? Explain.

1.15 Does e-business present a threat or an opportunity to traditional stores and wholesalers? Explain.

1.16 What factors have resulted in the rapid rise in outsourcing of jobs overseas?

1.17 Give an example of a 'business model' and how it can give rise to an opportunity to enter markets overseas.

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CASE STUDY 1.1

Voice4u

(This case was written by Mitsuko Saito Duerr, Director (Ret.), US Japan-Institute, San Francisco State University)

Mrs Yumi Kubo is the developer of a program that is designed to help parents with autistic children. The program, Voice4u, has been sold in 21 countries in three languages (English, Japanese and Spanish) and has been highly praised by users and associations concerned with autism. She hopes to reach many more parents, and others trying to help people with autism.

Mrs Kubo is the mother of an autistic child who fortunately was diagnosed when still very young. In order to help him develop word skills when he was still a small baby, Mrs Kubo started cutting out pictures/simple icons from magazines and other sources – pictures that could easily be associated with an object or action and a word. She laminated the pictures and put them in a binder. She could then show him a picture, tell him the word, and encourage him to say the word. This process has been effective for working with most autistic individuals, but is most effective if started when the person is young. As her son's word bank began to grow, the binder grew until it reached a weight of 15 pounds.

Mrs Kubo has devoted her life to raising her son and eventually to developing programs to help others. Her son had been born when she and her husband were living in the United States while her husband was stationed here. Her husband is a senior member of a Japanese corporation and must live wherever in the world his company assigns him. As is still typical for large Japanese corporations, managerial personnel are simply assigned wherever the company feels they are needed and the company does not necessarily take any personal situations into account. Mrs Kubo decided to remain in American where she felt better care was available for her son, he would have less problems in interacting with others, and there would be more opportunities for him. Mr Kubo's company was very supportive in helping to arrange for Mrs Kubo and her two children to remain in the United States.

Wherever she went with her son, she carried the binder with her. In his younger years, she also had to carry around his clothes, food, diapers, and even the boy himself when he would throw a tantrum and refuse to walk. This ended up becoming an average of 70 pounds to carry, and Mrs Kubo herself only weighed 80 pounds at the time. She developed tendonitis, leg problems and finally had to use crutches. Her son is now 16 years of age. He has made remarkable progress with her tutelage, and technology has now made her life easier for her.

A major advance came for Mrs Kubo, and others, when she was able to develop an application for an iPhone that would allow anyone using it to call up any icon/picture at any time wherever they were, and the iPhone would say the appropriate word for the autistic person. The **app** can be used by the autistic person themselves as well as by someone helping them. As an autistic person begins to use it by themselves, parents or caregivers can sleep longer and easier. One disadvantage of the iPhone was the small size of the picture, so when Apple introduced the iPad Mrs Kubo made an app for that also.

The iPad's larger screen made another application possible: it could be used to enable some older people with speech problems, and others who had difficulty talking, to more easily communicate by pointing.

Despite the widespread sales of Voice4u, Mrs Kubo is still concerned about the number of parents and caregivers that do not know about it. She wonders how knowledge about it could be spread more widely.

Question

1. What other means might be helpful for spreading information about Voice4u?

CASE STUDY 1.2

New United Motors Manufacturing Inc.

(This case was written by Mitsuko Duerr and Edwin Duerr, based on a combination of primary and secondary research)

Introduction

In 2010, New United Motor Manufacturing, Inc., a unique and highly successful joint venture between America's General Motors and Japan's Toyota, went out of business.

NUMMI, as the company was commonly known, had been formed in 1984. It had required a special anti-trust exemption from the US government for the two competitors to form a joint venture. NUMMI demonstrated that unionized American labor could work cooperatively with management, quickly become highly productive and produced automobiles of top quality. It provided its workers with an unprecedented level of control over the production line, a high level of employment security, and created a level of mutual trust unknown in any other American-owned automobile plant. NUMMI enjoyed excellent management–labor relations with no strikes, except for a symbolic one-day protest, in its 26 years of operation. It produced both GM-branded and Toyota-branded cars on an assembly line designed so that it could make more than one model at a time without having to shut down for a change.

The announcement that the company was actually to close came as a shock to its workers, and the business community. The NUMMI plant was operating at full capacity. It was well known for its high productivity, the high quality of its vehicles, and its cooperative labor–management relations.

There had been a celebration of NUMMI's twentieth anniversary in San Francisco on February 12, 2004. It included a by-invitation-only meeting, a dinner, and a press conference (Meetings, 2004). The CEOs of all three companies involved had participated, and emphasized the benefits of the joint venture to each company. Fujio Cho, President of Toyota Motor Corporation, stated 'NUMMI was Toyota's initiation into North American production. We are very proud to build quality products with GM. Without their partnership 20 years ago, Toyota would not be where it is today' (Hokubei Mainichi, 2004). G. Richard Wagoner, Jr., Chairman and CEO of General Motors Corporation, said 'From the start, NUMMI has succeeded in bringing jobs and economic development to California, in showing that global auto manufacturers can work together and learn from each other, and in demonstrating the value of global trade and cooperation.' At the dinner, there were laudatory remarks by NUMMI President Yukio Azuma, Bruce Lee of the United Auto Workers, and various dignitaries (Meetings, 2004).

In spite of the value of NUMMI, there had been problems before the closure. General Motors Corporation had gone bankrupt during the recession beginning in 2007–08. In June 2009, just before it emerged from bankruptcy in July with its new name of General Motors Company, it announced that it was abandoning the NUMMI joint venture. It turned out that the joint venture was one of the 'discarded assets' of GM turned over to Motors' liquidators in the reorganization. This left Toyota as the sole owner, and Toyota was having its own problems. After having been highly profitable for many years, the company projected an annual loss of $2.2 billion for its 2009 fiscal year (Ohnsman and Kitamura, 2009). While this loss amounted to very little compared to its accumulated earnings and liquid reserves, it caused great concern among the company's leaders.

Toyota announced on August 27, 2009 that it would close the NUMMI plant at the end of March. It actually occurred at the end of the shift on April 1, 2010. This resulted in the direct loss of the jobs of the 4,700 workers at the plant, plus the loss of thousands more jobs at supply companies in the region (Abate, 2010). It also meant a serious loss to the economy of the region.

This case discusses the objectives of General Motors and Toyota in starting the joint venture, the reason that the United Automobile Workers agreed to cooperate, and the benefits that the participants gained from it.

Background

In the 1970s, Toyota and several other Japanese automobile manufacturers had established themselves as producers of high-quality, low-cost small cars. At the time, the large American manufacturers did not take the inroads seriously. They produced the large automobiles that most of the American public preferred. Though they had made attempts to produce small cars, in general they had not been able to make them cheaply enough and with high enough quality to compete in the small market for small vehicles. One exception was Studebaker that had developed a popular small automobile, but Studebaker had ceased to exist as a separate company shortly thereafter and the production was abandoned. In one other attempt to meet Japanese competition in compact car manufacturing, General Motors had built a highly automated plant, at a cost of billions of dollars, at Lordstown, OH. Labor strife had prevented the plant from reaching the level of labor productivity required to justify the investment.

Oil crises in 1973 and 1978–79 greatly increased the cost of gasoline and led to increasing demands for compact and subcompact cars. The US manufacturers were not in a position to meet this increasing demand. Some European companies producing small vehicles increased their sales to the United States, but the Japanese had a comparative advantage with their high-quality, low-cost vehicles. Thus the Japanese captured a growing share of this growing market, and enjoyed a rapidly increasing share of the total US market for automobiles (Duerr *et al.*, 2005). Employment in the US automobile industry fell by 33.6%, a loss of 347,000 jobs (Wong, 1989). The US companies tried to place the blame on unfair competition, the cheap and exploited or unreasonably hard working Japanese labor force and/or on American unionized labor that produced poor-quality products at high cost.

Faced with lost jobs and lost profits, American industry and labor combined to lobby for a restriction on imports. The US government convinced the Japanese government to restrict automobile exports to the United States with a Voluntary Restraint Agreement (VRA). From the standpoint of the Japanese government, imposing the VRA seemed preferable to the possibility that the US might impose even stricter quotas. The Japanese based the quotas for individual companies on their prior exports to the United States.

The Japanese companies did not lose profits under the VRA. They made even greater profits because they had been selling their cars at prices well below the competition in order to rapidly increase market share. Faced with an absolute limit on the number of cars they could sell, they raised prices and/or introduced more expensive models. It has been estimated that the profits of Japanese companies were increased by some $1 billion to $1.6 billion in 1983, and by some $1.6 billion to $2.6 billion in 1984 (Smith, 1989).

The Japanese manufacturers still wished to increase market share in the United States beyond what the VRA would permit. Honda thus started manufacturing automobiles in a plant in Marysville, Ohio in 1982 and Nissan began production in Smyrna, Tennessee in 1983 (Wong, 1989, p. 89). These factories produced automobiles of higher quality and at lower costs than American-owned plants did.

Given the Honda and Nissan examples, American automobile manufacturers began to realize that at least part of the Japanese success was due to management policies and production systems. Still, most of the Japanese plants used non-union labor while all of the major American automobile companies had workforces with strong unions and entrenched managements, both of which were resistant to change.

Objectives

Toyota's objectives

Toyota's primary objective in beginning manufacturing in the United States was to protect and increase its market share. It had a long-range goal of surpassing General Motors as the world's leading manufacturer of automobiles (Armstrong, 1985). It had earlier overtaken Nissan to become Japan's largest automobile manufacturer, and did not want to have its position in America eroded. Toyota preferred to manufacture only in Japan and export their cars to world markets (Duerr *et al.,* 2005). However, with the VRA, and Honda and Nissan now producing cars in the United States, Toyota felt that it also had to establish manufacturing facilities there.

A US plant would be Toyota's first overseas manufacturing facility, and the company had many concerns. A joint venture was viewed as an approach that would lower the risk while providing help in overcoming difficult potential problems. Toyota stated that it wanted to (1) gain experience with American unionized labor, (2) gain experience with American suppliers, and (3) help diffuse the trade issue between the United States and Japan (Community Relations Department, 1990). Regarding the third objective, the job-creating effects of foreign direct investment were believed to defuse the protectionist sentiment caused by imports (Wong, 1989). Douglas Fraser, then president of the United Automobile Workers union, had earlier gone to Japan to urge Toyota and Nissan to build factories in the United States, but had received little encouragement at the time (Gelsanliter, 1992, 10–11). When then GM Chairman Roger Smith approached Eiji Toyota, then Chairman of Toyota Motor Company, about the possibility of a joint venture, the idea for NUMMI was born. Mr Toyota said that they hoped NUMMI would be 'a model of economic cooperation between Japan and the United States – one that contributes to the American economy' (NUMMI, 2004a). With regard to the overall results to be achieved from NUMMI, Toyota placed gaining of market share above profits.

GM's objectives

General Motors had two major objectives in entering the joint venture: 'to gain first-hand experience with the extremely efficient and cost-effective Toyota production system' and to obtain high-quality automobiles for its Chevrolet division (Community Relations Department, 1990). GM hoped that it could apply what it learned at NUMMI in its other plants, and thus gain great benefits company-wide.

The car to be produced at NUMMI, the Nova, was one of a family of GM subcompacts. It was to be priced so as to enable GM to compete more effectively in that part of the US market.

Approaches taken

The joint venture was located in Fremont, California in a facility that had been a General Motors plant. The GM plant had been closed in 1982 because of its history of low productivity, low quality, and very poor labor relations.

In the original division of responsibilities for the joint venture, Toyota was to be responsible for manufacturing while General Motors was to market all of the output.

The only car to be produced was the Chevrolet Nova, one of a family of GM subcompacts, most of which were imported.

Toyota entered into the agreement with the full intention of using its own approaches to manufacturing (Meeting, 1984). While preserving the basic Japanese model, as discussed below, they wanted to learn everything they could about American labor relations and American values. Some modifications were made to the Japanese model as discussed below.

A General Motors executive commented that:

> The nature of Toyota is not to copy anyone. They are avid learners and carefully watch what others do, learning from the mistakes of others as well as from their own mistakes . . . They wanted a lot of counsel and advice – they knew nothing about (our) labor unions or the psyche of American workers . . . They wanted more information about US labor relations than GM felt comfortable in divulging. (Interview, 1990a)

Some of the modifications to policies used in Japan that Toyota made at NUMMI were relatively minor, though quite effective. Suggestions from GM led them to take actions to appeal to the egalitarian nature of American workers. They provided only one cafeteria to serve both workers and managers, something that is not done in their Japanese plants (nor in typical American plants). The parking lot at NUMMI was on a first-come, first-served basis without reserved spaces for managers (though reserved spaces are provided for visitors). Again, this is not done in Japan. In a visit to the NUMMI plant in 2004, the authors noted that the employees waved to visitors going by in plant tour vehicles. This had not been done in earlier years, but the value of it was apparent. Besides giving a good impression to visitors, the visitors tended to give friendly waves in return, creating a more friendly environment overall (Factory visit, 2004).

NUMMI stressed consensus decision-making and channels for staff feedback. A GM executive who worked at the plant indicated that this resulted in slow decision-making, but that the managers never experienced surprise changes when they arrived in the morning (Interview, 1990a).

Key factors in Toyota's approaches were:

1. developing cooperative management–labor relations;
2. carefully selecting workers;
3. providing extensive training to workers;
4. stressing teamwork and the responsibility of the individual to the work group;
5. putting safety and quality first, assigning the responsibility for safety and quality to each worker, and giving them the authority to assure it;
6. implementing Toyota's 'lean production system' based upon the foundation of the first four key factors.

Developing cooperative management–labor relations

(Duerr and Duerr, 1998)

The NUMMI joint venture could not offer Japan's traditional 'lifetime employment' in which an employee is expected to give total loyalty, dedication, and long working hours to the company in return for continuing to be employed even if the company no longer needs him. Even in Japan this system, though still used in many large companies, was on the decline.

However, the United Auto Workers union was invited to participate in the development of a Collective Bargaining Agreement along with Toyota and GM representatives, and including former US Secretary of Labor W.J. Usery. The Letter of Intent stated: 'Both parties are undertaking this new proposed relationship with the full intention of fostering an innovative labor relations structure, minimizing the traditional adversarial roles and emphasizing mutual trust and good faith' (International Labor, 1990).

The final result was a labor agreement offering the highest level of security in the US automobile industry. It provided for advance consultation with the union on major business decisions, non-confrontational problem-resolution procedures based on discussion and consensus, and provisions giving team members (workers) the right to stop the line combined with a limited no-strike provision (Collective Bargaining Agreement, 1985).

A unique feature of the contract was that the company would not lay off employees unless compelled to do so by severe economic conditions threatening the company's long-term financial viability. This commitment was put to the test in 1987 when reduced demand for the automobiles caused line slowdowns and an excess number of workers. The company did not lay off any workers. They reduced the number on the assembly line, but reassigned the excess workers to 'continual improvement teams' and to training to upgrade their skills. While the Company and UAW together applied for and received some training funds from the State of California, NUMMI lost $80 million in 1988 and additional money in 1989 (Hof and Treece, 1989).

Similarly in 2004 when the company shut down the truck line to set up for a new model, it did not furlough any workers. Instead, the time was spent in retraining team members to work more productively on the remodeled line (Wallack, 2005).

The General Manager of Human Resources at NUMMI indicated that the real key to labor–management relations was the way people dealt with each other on a day-to-day basis (Meeting, 1985). When a work dispute arose on the production line and could not be handled there, a call for assistance was sent to the personnel office. Union officers and company personnel people were stationed together in that office, and one of each would go together to attempt to solve the problem. Employees who were late or absent were counseled by their team leaders, and assistance offered to them to solve their problems (transportation, etc.) if possible. Disciplinary actions were taken only in chronic cases and only after consultation with union representatives (Duerr, 1992, 10).

Careful selection and training of workers

Applicants for positions at NUMMI were carefully selected (Interview, 2004). They were told that all employees needed to be willing to contribute to an atmosphere of trust and cooperation. Potential production employees went through a three-day assessment that included production simulations, individual and group discussions, and written tests and interviews. Those hired went through a four-day orientation covering the team concept, production system, quality principles, attendance policies, safety policies, labor management philosophies, and the competitive position of the auto industry (NUMMI, 2004a).

In 1984, the first 26 production workers hired included most of the former officers of the UAW local union. This might seem like a strange choice, given the difficult labor problems GM had when it operated the Fremont plant. However, the union had worked cooperatively in designing the new management–labor system. Furthermore, having been elected union officers in the past indicated that the individuals had leadership potential.

The former union officers, now NUMMI hourly workers, were invited to help in interviewing and evaluating additional applicants for jobs. They participated in orientation sessions, played an important role in training, and participated in discussions about the selection of supervisors. Approximately 85% of the initial total workforce comprised former GM Fremont plant UAW workers (Duerr, 1992, 5).

Though hiring began in May 1984, initial assembly did not start until December of that year and actual full production on the first shift wasn't reached until 11 months later. The reason for the slow start was Toyota's plan to provide a high level of training. Beginning in June 1984, several groups of 32 members each were sent to Toyota's Takaoka plant in Japan for three weeks of classroom and on-the-job training. The membership typically included group leaders, team leaders, and union representatives. Returnees became the trainers for newly hired workers.

Stressing teamwork and responsibility of the individual

From the beginning of discussions with the union, there was an emphasis on a team approach. Each worker was assigned to a four- to eight-person team with a team leader who might also be a union coordinator. Above the team leaders were group leaders who coordinated three or four teams each (Holden, 1986).

Each team was responsible for doing the work assigned to it, and each team member was responsible for supporting their team. Individual members were responsible for improving their own productivity and efficiency, and teams were responsible for improving operations in their areas of responsibility. Teams were kept informed of company objectives in quality, cost, production, and safety, and the teams' parts in meeting these objectives. There were periodic reviews and evaluations of performance.

Team members received training in problem-solving methods. In accordance with the Collective Bargaining Agreement they were responsible 'for participation in Quality/Productivity improvement programs such as QC circles' (Collective Bargaining Agreement, 1985). The company, teams, and individual employees took pride in the improvements made due to their suggestions, particularly the suggestions that were subsequently adopted in the similar Toyota plant in Japan (Factory visit 2004 and earlier visits).

In the production groups, each member was cross-trained to do every job. For production line workers, there were only two work classifications. Workers in the skilled trades were divided into three functional areas. Under GM, there had been over 100 different job classifications in the plant.

The company did not employ so-called 'relief workers,' individuals who are multi-skilled and without permanent assignments who could fill in for absent employees. Because each team member was cross-trained and there was a lack of restrictive job classifications, other members of the team could fill in for a member who was missing. When a person was absent from his team, the other members were expected to do that job in addition to their own. Thus if an employee was late or absent, it placed an additional burden on all of their teammates. This provided peer pressure to be on time and do a full share of the work (Meeting, 1985).

The company used a consensus-style decision-making process for major decisions, obtaining input from all areas concerned, and holding discussions until agreement was made. Where the union was concerned, for example when adding additional capacity for manufacturing compact trucks was proposed, they were consulted. In this case the company indicated that, in order to make such an expansion economically feasible, they would hire additional workers but would also need to be able to assign involuntary overtime. The union leaders objected to any mandatory overtime so the company said they would not make the trucks in Fremont. The union members, in turn, objected to what their leaders had decided and immediately recalled the existing leaders and elected new ones. The expansion then went ahead.

For decisions affecting only their own team or area, team members were encouraged to make their own decisions.

Obviously, all considerations of consultation were ignored when the most important decision was made. The closure of the plant, and the loss of all jobs, was done unilaterally by Toyota's upper management in Japan.

Putting safety and quality first

From the beginning, NUMMI recognized that for safety and quality to be given primary emphasis, the workers had to be able to have some control over the process and operations. This was accomplished in two ways. First, any assembly line worker could stop the line in the event of safety or quality problems simply by pulling an overhead cord. No prior consultation with a supervisor was required.

Secondly, there were electric signboards located throughout the plant that were controlled by the workers. Each board had three lights: green, yellow, and red. Green indicated that everything was okay, yellow indicated there was a problem that required assistance but did not require shutdown of the line, and red indicated line shutdown. Yellow or red lights could be triggered by sensors on the machines themselves or by the workers pushing a button. The yellow light typically resulted in assistance being provided by the team leader or group leader.

Each worker and each team was responsible for ensuring that the materials, parts and components coming to them did not have identifiable defects and fitted properly into the assembly they were making. They were also responsible for ensuring that their work was done properly.

The company's commitment to quality was clearly illustrated in August 1990. It was discovered that parts arriving from a new supplier were defective. Rather than continue production with parts that might later require replacement, the plant was shut down for three days until new parts could be obtained. Cars that had already been produced were not shipped to dealers but were held for part replacements. Since it was not the workers' fault that the parts were defective, and NUMMI wanted to encourage them to report defects, the company offered the workers full pay for the period the plant was shut down (*San Francisco Chronicle*, 1990, B1).

Implementing the Toyota Production System

The successful implementation of the Toyota Production System at NUMMI required and was based upon the development of cooperative labor–management relations, careful selection and training of workers, development of teamwork, and giving workers the authority to assure safety and quality as outlined above. The elements of the lean production system used by Toyota included a just-in-time inventory system; a quality assurance system under which workers do not allow defective parts to pass from one workstation to the next; continuous improvement to eliminate waste in machinery, material, labor, and production methods; and standardizing of improved procedures (NUMMI, 2004b).

The just-in-time (JIT) inventory system is designed to produce only what is being ordered or sold rather than to produce for inventory that will be used to absorb ups and downs in demand. Lowered (or eliminated) inventories of incoming, in-process, and finished goods saves space and costs of money tied up. It also:

- results in quicker identification of problems arising due to defective inputs or processing problems;
- results in increased emphasis on avoiding breakdowns (and thus on preventive maintenance); and
- provides additional pressure to make production processes more flexible (such as being able to produce more types and styles of vehicles on one assembly line, as is done at NUMMI).

The JIT system was modified at NUMMI to account for the fact that that some parts were obtained from suppliers located at a distance from the plant, may be subject to delays, and need to be purchased in quantities that may be shipped economically. Modification was also required by the need to run assembly lines at constant speeds in order to maximize productivity. Therefore some inventories of incoming materials and finished goods did occur, but were kept at a minimum. Finished parts were kept on the premises for 48 hours or less (Factory visit, 2004).

Worker responsibility for ensuring that defective parts did not move from one station to the next, coupled with the ability of the worker to shut down the line, supported an emphasis on quality.

Continuous improvement and standardization of improved processes resulted from suggestions made by teams and individual team members. Adopted by the company and made into standard practices, these resulted in making work safer, easier, and/or more productive (Factory visit, 2004 and earlier visits).

A continuing pressure for improvement came from the electric signboards indicating the status of each process step at all times. A team leader who met with the authors away from the plant, and requested anonymity, indicated that some of the workers believe management wants all of the green lights to be on most of the time, but not all of the time. If the line is on green all of the time, except for unanticipated breakdowns (which should be virtually eliminated by preventive maintenance), it means things are too easy. Then the line speed should be increased until yellows and/or reds appear occasionally. These distress signs will point up the weakest parts of the system, which can then be studied to find ways of improvement. When the line is back to all green again, another speed increase can be used to identify the next bottleneck (Duerr, 1992). (The speeding up of a production system to identify and fix weak points was observed by the authors during consulting work for other companies, but none used the electric signboard system that results in workers directing attention to weak points.)

A question arose over the effect that the continued increases in line speeds had on worker support of NUMMI's overall approach. Ken Higashi, when president of NUMMI, indicated that the workers went through several stages after the beginning of production at the plant. First, they were very happy just to have jobs with good pay and benefits, and did not complain. Then they began to feel that they were being pushed too hard. However, in 1987 when there were no layoffs in spite of low demand and cutbacks in production, 'the workers realized that they were greatly appreciated' and 'began to fully realize that we really do value them as an important part of the company' (Interview, 1990b). Since then, the company has continued to add more workers as production has increased, and it appears that the workers do realize that their hard work is giving them secure employment.

Results achieved

Manufacturing at NUMMI, under the exclusive control of Toyota, has been a success since the beginning of operations. Marketing, with only GM-branded vehicles being produced, was a problem from the start. It was solved only by changes in strategy, with NUMMI beginning to also produce Toyota-branded cars and Toyota taking over the responsibility for marketing them.

Operating results

The NUMMI plant quickly became 40% more productive than the average US American-operated automobile manufacturing facility (AJBS Meeting, 1988). Researchers at the Massachusetts Institute of Technology estimated in 1988 that productivity at the NUMMI plant exceeded that of all American-owned US automobile plants, except for Ford's Taurus facility with which it was approximately equal.

Labor relations improved dramatically. At the end of the time when GM had been running the Fremont plant there was a backlog of over 1,000 grievances and 60 disputed firings. Absenteeism was over 20%, and there were many days on which the plant could not start on time because not enough workers had showed up (International Labor, 1986, p. 15).

In the first two years under NUMMI management, attendance was at 98% with most of the absences occurring for excusable reasons. Only one grievance was not solved informally (International Labor, 1986, p. 16). Absentee rates are still low by US standards, though higher than at Toyota plants in Japan. Labor relations remain very good.

Marketing results

There were serious problems in marketing. Falling sales of the Chevrolet Nova resulted in a need to cut back production at NUMMI in the 1980s. Four problems have been suggested as accounting for Nova's poor sales: ineffective advertising (Treece *et al*., 1989, p. 126); 'experience with small Chevrolets had imbued customers with brand disloyalty that's hard to overcome' (Consumer Reports, 1986, p. 81); somewhat dull styling; and the fact that the Nova seemed expensive when compared with other small Chevrolet cars.

The first attempt made to alleviate the problem was Toyota's authorizing the production of some Toyota Corolla FX automobiles at the Fremont plant. This meant that the original division, with Toyota simply handling production and GM doing all of the marketing, was no longer valid. Unfortunately, the Corolla FX was nearing the end of its life cycle and its sales were not enough to maintain full production at NUMMI, leading to diminished output and financial losses.

Introduction of a new Geo Prizm (for General Motors) and a new model of Toyota Corolla brought production at the Fremont plant back up. The new Geo Prizm, with similar styling to the new Toyota Corolla and of identical quality, did not sell as well as expected while the new Corolla sold better than expected. Consumers simply believed that Toyotas were better cars. An article in *Fortune* in 1988 stated that 'It may take years to turn around GM's reputation for bad quality and uninspired design' (Moore, 1988, p. 35). It did.

With General Motor's agreement, Toyota built its own separate and wholly owned facility for manufacturing trucks at the NUMMI site. Production of Toyota compact pick-up trucks began in 1991 and redesigned models of the Tacoma were introduced in 1995 and 2004. The last Geo Prizm was built in 2001, and production of the Pontiac Vibe started in 2002. A right-hand drive model of the Vibe named the Voltz, built for Toyota to export to Japan, also went into production in 2002 (Armstrong, 2002, B1). Sales in Japan were disappointing and the model was discontinued.

The marketing situation for General Motors automobiles produced at NUMMI remained cloudy as the company continued to lose market share. At NUMMI in 2004, only 20% of current production was for the Pontiac Vibe, with the other 80% taken up by Toyota Corolla and Toyota Tacoma light truck (Factory visit, 2004). In 2010, only 10% of the NUMMI output was GM-branded cars.

Customer perceptions proved to be difficult to change and long-lived. When NUMMI started making GM-branded cars along with the Toyota-branded cars, they were made on the same assembly line by the same workers with the same attention to quality. The independent and highly respected US magazine *Consumer Reports* evaluated them as of the same quality based on tests made by Consumer Reports. However, buyers still preferred the Toyota-branded versions to the GM-branded ones. Of even greater interest, surveys by J. D. Powers indicated that owners of the Toyota-branded vehicles reported fewer problems and were more satisfied with their vehicles than did the owners of the GM-branded vehicles.

Applying lessons learned and evaluating the benefits

There appear to have been substantial differences in what Toyota and GM were able to learn and apply from the joint venture. The authors' evaluations of what each achieved compared to its original objectives is as follows:

Toyota

The experience of Toyota at NUMMI helped the company to realize its primary objectives. It successfully applied what it learned in the joint venture, and increased its confidence in its ability to successfully manufacture in other countries. It quickly moved ahead internationally in building new wholly owned factories in the United States, Canada, Europe, and Asia (in countries where it was not required to have a partner).

At NUMMI, Toyota learned that it could work effectively with American unionized labor. It has made some adjustments to the approaches it used in Fremont while keeping others the same:

- Its next factory was established as a wholly owned subsidiary, and located it in Georgetown, Kentucky where it could hire a non-union workforce.
- Having found that it could achieve high productivity and quality with a moderate level of automation, it decided that it could do even better by investing in a higher level of automation for its new plant.
- Its favorable experience in Fremont has been followed by the implementation of similar policies in selection, training, sharing of information, and the use of the team approach in Georgetown and elsewhere (Duerr, 1991).

Toyota made the greatest possible use of the experiences gained by the executives and managers initially assigned to NUMMI. Most of them were transferred as a group to the Georgetown factory. The personnel manager was later transferred from Kentucky back to Japan, where he was eventually put in charge of worldwide personnel relations for Toyota.

The company did learn to work effectively with American suppliers or, to put it another way, American suppliers learned to work with Toyota.

Toyota's share of the American market has been increasing steadily since it began manufacturing in the United States. In 2003 its worldwide vehicle sales passed those of Ford Motor Company to make it the world's second largest automobile manufacturer (Zahn, 2005). Toyota began producing large trucks in the United States in 2006 (*The Nikkei Weekly*, 2006). By 2004, Toyota was producing, in North America, 60% of the cars it sells there. It was also earning more than 70% of its profits in the United States (*Financial Times*, 2004). In 2004, it became the world's most profitable automotive company and its market capitalization was greater than that of GM, Ford, and DaimlerChrysler combined (Ibison, 2004). Toyota continued to be the world's most profitable automobile company until 2009 when the recession, declining sales, and the high value of the yen meant that earnings overseas did not translate into enough yen to offset losses in Japan. (Where \$100 once provided ¥110 or more to

Toyota in Japan, the exchange rate in mid-July 2010 translated $100 into only about ¥84.5, a drop of over 23% in receipts for Toyota for profits on US sales. Earnings in euros and British pounds also dropped when converted into yen. The problem of exchange rate changes is discussed in Chapter 11, Pricing decisions.)

General Motors

General Motors only partially achieved its two objectives of learning the Toyota production system and producing higher-quality vehicles. General Motors did gain valuable experience with the New United Motor Manufacturing, Inc. joint venture, but found it difficult to apply what it had learned to other GM plants. They were able to obtain high-quality small cars from NUMMI, but had difficulty selling them.

General Motors provided a number of managers with experience in working at NUMMI, and thousands of workers and managers with visits to the Fremont facility. Several factors prevented this experience from being as valuable as GM had hoped. One reason was that in their assignments following work at NUMMI, the GM managers were not kept together, but rather distributed to various positions around the company. In their individual post-NUMMI positions they were surrounded by workers and managers whose traditional adversarial relationships were so entrenched that they simply could not be changed by one individual, or even a small group of people (Interview, 1990a).

In more recent years, teams of managers with experience at NUMMI have been sent as a group to some GM plants. This appears to have helped General Motors in making substantial improvements in productivity and quality.

Experience with NUMMI was also applied by GM in an innovative small-car project named Saturn, originally conceived by GM CEO Roger Smith in 1983. It was designed to 'make superb little cars to beat the Japanese at their own game' (Taylor, 2004, p. 119). In order to free the project from the bureaucratic constraints of GM, allow the development of cooperative labor–management relations, and to provide it with its own identity, it was set up as a separate company. Any GM employees desiring to work for Saturn had to give up their positions and seniority with GM. After seeing the results achieved at NUMMI with just an average level of automation, GM scaled back the level of automation to be used at Saturn – the opposite approach Toyota took at its next US facility in Kentucky.

Saturn was a success in achieving a high level of labor–management cooperation, and gaining sales to people who had previously purchased Japanese or European cars: 70% of first-time Saturn buyers had previously owned foreign-nameplate cars. It also achieved high customer loyalty. However, until recently, Saturn produced only small cars. Thus Saturn buyers did not have any larger Saturn cars to trade up to, and often switched to European or Japanese cars. The company also suffered periodically, depending partly upon who was in top management at GM, from lack of advertising, lack of new models, poorly designed models, lack of adequate funding for advertising and other activities and/or lack of updates to its vehicles. When GM did decide to make other 'Saturn' models, it decided to produce most of them at existing GM plants. It also intended to have Saturn work closely with other divisions on engineering, designs, sharing of platforms, parts, and production facilities. Saturn would thus have had a wider range of vehicles, but possibly at the cost of losing its unique identity. Some Saturn-branded cars were produced, but further development ceased when GM decided to close the Saturn subsidiary. Saturn had attained high quality, high productivity, and good employee relations. However, because of the problems noted above, the company was never able to have the production level and variety of cars required to support a separate company/division. Saturn never made money in the 26 years it was in operation.

While what General Motors learned at NUMMI did help them to make substantial improvements in productivity, they still lag behind Toyota. They have also made great strides in improving quality, surpassing some overseas manufacturers but still lagging behind the major Japanese companies. At the same time, Ford made major productivity and quality improvements based on its long-term partnership with Mazda, its learning from Japanese companies, and its own leadership. It was the only major US manufacturer that did not require a substantial loan from the US government to survive the recession.

All three of the major US manufacturers have increased the use of shared platforms and parts (Welch and Kerwin, 2004), developed faster and cheaper methods of designing new vehicles, and adopted aspects of lean production.

General Motors does recognize the need to improve its quality image. In July 2005, it took out full-page advertisements in some leading US newspapers showing recent favorable ratings by J. D. Power and Associates. They still have a long way to go. 'Toyota's appeal to the American driver is built on decades of high quality standards – something Detroit manufacturers are only just starting to rival' (Mackintosh, 2004). Toyota continues to have a better global reputation for 'good mileage, ecological features and reliability' (Kagemaya, 2005), or at least it did until the recalls in 2009–10 (see the Toyota Case in Chapter 2).

Summary

Toyota appears to have benefited more than General Motors from the New United Motors Manufacturing joint venture.

Toyota learned how to work effectively with the American workforce and suppliers. It used this knowledge, and the confidence it gained, in its subsequent worldwide expansion of manufacturing facilities. It has greatly increased both worldwide market share and profits, becoming the world's second-largest automobile producer and, until 2009, the most profitable. It did substantially reduce trade friction resulting from automobile imports by the US, though some concerns remain regarding international trade in parts.

General Motors did gain from the joint venture, but because of both past policies and current problems largely beyond its control, has not been able to gain as much from the joint venture. Image and marketing problems resulted in its not being able to sell the expected number of small cars produced by NUMMI. Though it did learn and apply much from the Toyota production system, it was unable to fully replicate the system in any existing plant. Workers and managers at existing GM plants have such a long history of confrontational relations, and such a distrust of each other, that a system based on mutual trust and cooperation apparently could not be implemented in existing factories.

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Questions

1. Why did Toyota want to enter a joint venture with GM?
2. Why did GM want to enter a joint venture with Toyota?
3. Does the willingness of Japanese workers to devote their working lives to a company make it impossible for American companies to achieve similar levels of productivity and quality?
4. Why did Toyota use a higher level of automation in their Kentucky plant than NUMMI had?
5. Why did GM use a lower level of automation in their Saturn plant than NUMMI had?
6. Briefly, what was the value to Toyota of what they learned from NUMMI?
7. What basic factors kept Saturn from becoming profitable?

CASE STUDY 1.3

Export of art goods from Hungary

A professor and her husband, while on vacation in eastern Europe, found some beautifully handcrafted, fired-clay figurines for sale in Budapest. Displayed by the artist in a stall in a small open market near the Danube, the pieces were exquisitely fashioned in unique designs. In a long conversation with the professor, the maker commented that no one should buy one of the figures 'unless it spoke to him.'

During two visits to the market, and a trip to the artist's small studio in his home across the river, the professor bought three pieces. Two were different poses of a boy in a type of jester's costume and one a figure of a young woman in contemporary dress. The models, the artist's son and wife, were introduced at the studio. The studio contained a large number of finished individual pieces, no two alike. The artist indicated that he spent over half of his time at the stall selling his goods – time that he would rather spend creating. The relatively small number of tourists and the occasional local well-to-do individuals who visited his small open market stall simply did not provide enough customers.

Upon their return home, the professor and her husband displayed their new art pieces in their living room. They were surprised at how many of their friends admired the figures, and asked where they might obtain similar works.

Since the professor was teaching a course in international marketing, it occurred to her that she could use the development of a marketing plan for the figures as a classroom project. Such a plan could be either from the standpoint of the artist who wanted to sell his figures abroad, or from the standpoint of a dealer abroad who wanted to import and distribute the art goods. Such a plan would have to include at least a determination of potential demand, marketing channels to use, methods of promotion, export, import procedures, physical distribution, and economic feasibility.

Questions

1. How might a textbook such as this one be of use to: (a) the class in the assigned project, (b) the artist if he decided to try to export his works, and (c) a potential new importer in another country?
2. List some of the items that should be included under each of the major dimensions of a marketing plan for the art goods.

CASE STUDY 1.4

eBay, Inc.

eBay was started in 1995 by an entrepreneur, Pierre Omidyar, working from his home. In 2009, the company he founded had over 90 million active users worldwide and a net profit of over $8.7 billion, up from just under $442 million in 2003. eBay is an international company with 54% of its earnings coming from overseas (eBay Annual Report, 2009, published in 2010).

eBay's success was based upon its use of the Internet to create a new online marketplace. In essence, a market can be defined as the sum of all of the people who have possible interest in buying or selling a particular product or service and who are in contact with each other. The use of the Internet has enabled eBay to broaden markets to include people and organizations that otherwise would not have known of buying or selling opportunities. As could be expected, the expanded markets have usually provided benefits to both sellers and buyers. eBay helps make inefficient markets more efficient.

With the growth of its original online business in the United States slowing, eBay has been moving into related areas of service and creating a global network of strong brands. In addition to its purchase of PayPal, which was a major success, Skype, which was a disappointment and was sold at a loss, a number of other acquisitions in the United States and overseas were designed to complement and extend the company's reach and services.

In the rapidly changing world of e-commerce, the danger of falling behind in new developments is always a threat, and capitalizing on strengths or finding new opportunities is a necessity. A case in point is the rapid growth of the market segment involving mobile commerce. Mobile commerce, sales made through cell phones and other mobile electronic devices, had become an $18.3 billion industry in 2009, estimated at $25 billion in 2010, and projected to grow to $119 billion globally by 2015. Mobile apps, applications for using electronic devices for specific purposes that are often developed by companies other than the producers of the electronic devices, are specifically designed to help consumers to make purchases using their iPhones, Apple's iPads, BlackBerrys, and handsets with Google Inc.'s Android software. Though eBay's mobile commerce sales were growing, eBay was losing market share to Amazon.com.

Seeking additional growth, eBay undertook a major development effort to bring out more mobile apps. By mid-2010, it had already gained a market share more than double that of Amazon.com in this highly fragmented market. eBay is presently developing a number of new mobile apps each month for use in buying, selling, and searching for deals, including one to alert mobile shoppers on the status of online auctions. It has also designed an eBay fashion app that combines a slide show of clothes that people can peruse and virtual dressing rooms where they can try on garments (MacMillan and Galante, 2010). eBay faces both opportunities and challenges in selection of additional markets to serve, types of services to be provided, security issues, growing competition, and further expansion of operations overseas.

Other initiatives and approaches, domestically and internationally, are discussed later in this case after looking at how eBay was formed and developed.

An idea becomes a company

Pierre Omidyar, the founder of eBay, had been a computer science major at Tufts University when he moved to the San Francisco Bay Area and began working in the software engineering business. He had a combination of technical, creative, and entrepreneurial interests, and co-founded Ink Development Corporation. That company was subsequently sold to Microsoft. In 1995 his future wife, who collected Pez dispensers, complained that it was hard to find people in the area to trade with (Cohen, 2000). He decided that he could set up an auction site on the Internet and developed a simple and easy-to-understand mechanism for trading. In the autumn of 1995 he started AuctionWeb as a hobby on his home Internet service. The domain name was www.ebay.com (ebay.com website). It was started as a free service but there was so much traffic on the site that he began to charge a small fee. Omidyar made money the first month and revenue kept going up rapidly (Cohen, 2000). As the volume grew and problems emerged, it became necessary to increase the capacity, adding equipment and making changes to the software.

With business booming, Omidyar brought in a Stanford University MBA. They hired technical people, customer-support staff, and finance people. He worked with a venture capital firm and arranged an Initial Public Offering (IPO), turning his CEO position over to Meg Whitman (who was a Hasbro Inc. executive before joining eBay). The IPO took place in 1998, and all of the staff members found themselves rich (Cohen, 2000). Every year since then eBay revenues and profits have increased.

The number of employees also increased rapidly. The supporting software for the site, one of the most complicated applications ever created, had to be continually expanded and improved. Along with the rapid growth, there were some spectacular problems. In 1999 the eBay site went dark for 22 hours, resulting in lost fees of $4 million and a drop of $5 billion in eBay's market valuation. Maynard Webb was hired as president of eBay Technologies and Lynn Reedy was hired as senior vice president for software development after the crash. Technology became a core strength for eBay.

Making use easier and entering new markets

eBay has continued to innovate, providing new sites and new services, and made acquisitions to support its online marketplace. It has also benefited as more individuals and organizations find that they can profitably offer items on eBay sites.

eBay offers a wide variety of features that enable members to buy and sell on the site quickly and conveniently. In addition to the auction format for purchases, items may be purchased at fixed prices through the Buy-It-Now feature or through eBay's Half.com. The company offers a number of workshops and courses to teach people how to promote their products more effectively on eBay. They also provide discussion and chat boards to encourage open communication between members and the company. They have a feedback system in which buyers and sellers rate each other on each transaction, and the company watches for fraud. They have developed software to limit sales of merchandise such as guns and Nazi memorabilia (Hof, 2003b).

In spite of eBay's continuing efforts to make their site easier for customers to use, some people still hesitate to learn how to do it and to take photographs where appropriate. Separate companies with storefronts have been started where people can take items they want to sell. For a fee, these companies then take photographs and handle all other aspects of the listing for the customer. eBay does not discourage the formation of such companies, believing that any additional customers benefit eBay. eBay itself does not want to get into the business of opening stores.

eBay purchased PayPal, a company that enabled users to send and receive payments through credit cards or bank accounts, for $1.5 billion in October 2002. This provided better service for eBay users than did eBay's previous system, and also processes payments for other websites, increasing eBay's profits.

eBay started a new Internet-postage venture with the US Postal Service in 2004 (Bandler, 2004).

After an eBay manager saw that some people were listing real cars in its category for die-cast model cars, the company developed a site for real cars (Hof, 2003a). eBay Motors, launched in 1998, has since become the top online automobile site, with sales of over 4,000 cars per month by 2003. It is used both by individuals and by dealers, for some of whom it provides the majority of sales. Advantages cited include wide selection, quick responses, and often lower overall transaction costs (Ross, 2003). Buyers can hire someone to inspect a vehicle offered for sale, but most rely on photographs and sometimes on e-mails to the sellers. One poll indicated that the majority of buyers believe the cars they purchased are as good or better than described, 47% find them slightly or significantly worse than described.

Since the late 1990s parents looking for a hard-to-find toy have turned to eBay. In 2002, eBay kept in contact with toy makers and monitored its own sites to see which toys appeared to have high demand. They then supplied a list of the top 20 of these toys to regular sellers on eBay, mainly mom-and-pop merchants. The merchants then sold the toys on eBay when the toys became scarce in stores. A number of merchants did quite well in reselling these toys, though a few of the recommended toys did not sell well (Wingfield, 2002).

The types as well as the numbers of sellers on eBay have increased. Sears Roebuck & Co., Walt Disney Co., and others have sold brand-new items. These are often offered at fixed prices (Hof, 2003b). The site has not worked as well for corporations to move large stocks of unsold merchandise. One company found that when it offered more than a few dozen digital cameras or laptops, it tended to crash the price. eBay core merchants remain the small entrepreneurs for whom the site offers excellent opportunities (Wingfield, 2004).

At least 12 state governments in the United States have found eBay an effective and profitable way to dispose of surplus items. Traditional auctions are often poorly publicized, inconvenient, and reach relatively few people. The result is that the governments typically receive very low prices for the goods. Sales through eBay commonly double or triple the prices received, and the government may even be able to sell something that appeared unsaleable. The state of Massachusetts had been trying unsuccessfully to sell a 128-foot lightship for a year and a half. They finally posted it on eBay, and it eventually sold for $126,100 (Whitaker, 2000). Everything from tools and furniture to confiscated jewelry is being sold.

Since 1999 billionaire financial guru Warren Buffet has offered himself once a year as a lunch companion to the highest bidder. The money goes to Glide Memorial United Methodist Church in San Francisco, an institution that provides many social services. Up until 2002 the bidding was done live at a fund-raising gala in San Francisco. Winning bids were in the range of $25,000 to $35,000 every year. In 2003 Buffett suggested that the auction be conducted on eBay. It was, and the winning bid in the five-day auction was $250,100 (Kopytoff, 2003a).

A home where former President Bill Clinton once lived was put up for sale on eBay, as was a whole small town in California (the latter bringing a much higher price than expected).

Small businesses may find the site useful for purchasing items from testing meters to bulldozers, lathes, and dental X-ray machines. The equipment, often surplus at another company, is generally available at a fraction of the cost of new equipment from the manufacturer. In 2002 sales of business products on eBay reached $1 billion, up 90% from the year before (Kopytoff, 2003b).

Expanding internationally

eBay operates its core platform in 24 countries, and earns 54% of its profits from international operations. 'Our international expansion has been rapid and our international business, especially in Germany, the UK, and South Korea, has become critical to our revenues and profits' (eBay Inc. Annual Report 2006, p. 12). In 2009, eBay purchased a controlling interest in Korea's Gmarket Inc. in an attempt to make eBay the biggest player in the online shopping market there. One of the setbacks was in Japan where Yahoo had entered ahead of eBay, and eBay also made some missteps that resulted in an inability to build adequate volume (Belson *et al.*, 2001). In 2002, they withdrew their eBay marketplace offerings from the Japanese marketplace. In 2006, they changed their strategy in China by entering into a joint venture with a local company. They are still experiencing some problems in China in 2010. In their 2006 Annual Report, eBay provides a list of 20 risks to which they are subject in doing business internationally (p. 13).

Looking to the future

There are challenges facing eBay. Other online sellers and auction sites provide competition. Activists protest if items they deem offensive because of race or other reasons appear on the website. Varying laws regulate what can be sold in various countries. Taxes on online sales have been imposed in some countries. Vigilance against fraud and non-payment are required. The high degree of market penetration in the United States would seem to indicate that more growth must come from other countries if eBay is to continue to expand at the present rates.

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Questions

1. Evaluate eBay's marketing strategies to date. What changes, if any, would you suggest?
2. Evaluate its technical and personnel strategies. What changes, if any, would you suggest?
3. Has eBay really created a new kind of market?
4. Are eBay's efforts to increase and improve interactions with members worth the cost?
5. Is continued rapid growth desirable for eBay?
6. Where does growth appear to be feasible?

CASE STUDY 1.5

Dell, Inc.

(This case study was written by Mitsuko S. Duerr and Edwin C. Duerr, both of San Francisco State University.)

Introduction

Dell, Inc. was the world's market leader in personal computers using direct sales through the Internet and over the telephone until 2005. In 2006, it experienced an unexpected decline in market share in the United States. In 2007, the company had a continuing slide in worldwide market share as it experienced difficulties in penetrating the growing Chinese and Indian markets.

In early 2007 Michael Dell, the founder of the company and still Chairman of the Board, took over direct control as Chief Executive Officer. In addition to making changes in advertising and customer support that had been promised earlier, he made changes in the basic business model. He began selling through Walmart stores in the United States. The company has since begun selling through selected stores in a number of countries worldwide.

In 2010, Dell was operating under a new business model but still experiencing some of the same problems that it had encountered under its previous model. In its fiscal year 2010, both sales and profits declined from 2009 (Dell, Inc. Annual Report 2010).

In this case, we look at: (1) the reasons for Dell's success in using direct selling; (2) the problems that arose and reasons for changing the business model to include distribution through retailers; (3) how the model had been adjusted in three of its overseas markets; and (4) the constraints on its actions as it attempts to turn the company around.

Innovation and growth

Dell, Inc., founded in 1984, became the world market leader in PC sales through its business model of selling directly to purchasers online or by telephone. The company believed that its

> direct business model eliminates retailers that add unnecessary time and cost, or can diminish Dell's understanding of customer expectations. The direct model allows the company to build every system to order and offer powerful, richly configured systems at competitive prices (www.dell.com, 29 September 2006).

The company further indicated that this model allowed them to introduce new technology more rapidly than companies selling through distributors since there are no existing inventories to consider. Dell attempts to maintain cost (and price) leadership through production efficiency and through using its size and high rate of growth to obtain the best prices on component parts.

By directly interacting with the customers, the company also had success in attracting customers to its website with very low-cost models, and then getting the customers to buy much more expensive models with 'all the bells and whistles' (Byrnes *et al.*, 2006, 28). Together, these policies led to rapid growth in sales and increasing profits. Dell's marketing model was so successful that it was cited as one of 'The world's 25 most innovative companies' by *Businessweek* (McGregor, 2006). Thomas Friedman, in his book *The World Is Flat*, devoted a whole chapter to the Dell system (Friedman, 2005).

Dell has three regional business units:

- Dell Americas, with manufacturing facilities in the United States and Brazil, and regional offices in nine countries;
- Dell Europe, Middle East and Africa, with manufacturing in Ireland, and regional offices in 29 countries; and
- Dell Asia Pacific and Japan, with headquarters in Singapore, manufacturing in Malaysia and China, and regional offices in 11 countries.

Dell Americas provides 65% of the company's revenues, Europe Middle East and Africa, 21%, and Asia Pacific and Japan, 14%.

The company was doing very well in 2005. It was the leading seller of PCs in the United States with 33% of the market (Pimentel, 2006a). In Germany, it increased its share of the more fragmented market to 12.6%, putting it in third place behind Fujitsu Siemens Computers and Hewlett-Packard (Ewing, 2006). Overall in Europe, it was number two in the market. In midyear, Dell increased its share of the highly fragmented Japanese market, at least temporarily meeting its long-term goal of passing Fujitsu to become number two in the market for PCs (*The Nikkei Weekly*, 2006). It was number one in the world overall market for PCs.

In addition to notebook and desktop PCs, Dell produces other standardized product categories, including network servers, workstations, mobility products, printers, and other electronic products and accessories. PCs still provide most of their revenue, and are the major product discussed in this case study. References are made to Dell's experiences with other products where appropriate to illustrate differing approaches and problems.

In 2006, Dell was displaced as market leader in the United States, and in the world overall, by Hewlett-Packard Inc. In 2002, HP had purchased Compaq Computer Corporation, a major producer and marketer of PCs, for $19 billion. Over the next three years, HP had reduced PC manufacturing costs substantially in order to compete more effectively with Dell, and took the marketing steps noted in the next section. While HP was increasing both sales and market share, Dell lost position. In 2006, for the first time in over ten years, Dell's sales grew more slowly than the overall US market for PCs (Lawton, 2006; Pimentel, 2006a).

One major difficulty for Dell was that it remained overly dependent on its home market where HP was particularly strong. Dell also continued to struggle in the rapidly growing markets of China and India where people prefer to buy in person from vendors rather than over the Internet or by telephone (Slagle, 2006). In the two countries in which its market share had increased, Germany and Japan, Dell had adjusted its business model.

Dell's problems and successes appear to be the result of a combination of the changes in the types of computer demanded by the US market, and by culture-specific factors in other markets. In the United States, the problems included changes in the types of PC demanded, problems related to quality and service, and the company's reluctance to change its business model in the face of changing market conditions. In Germany, its success appeared to be due to modifications to its basic marketing model that provided a better fit to the German culture (as discussed below).

In Japan, Dell is providing PC models well suited to current Japanese customer preferences. There the availability of the unique delivery-and-payment system provided through the ubiquitous convenience stores (again as discussed below) facilitates direct sales. However, the rapid growth in private brands sold by major Japanese consumer electronics retailers is a threat. In China and India, its basic business model of online and telephone ordering is not consistent with consumer preferences.

Problems and possible responses in the US market

Dell's declining market share in the United States was the result of a combination of factors: changing market demands; problems with customer satisfaction regarding sales and service; and increasing competition.

Sales to businesses (rather than individuals) have been Dell's primary target market and account for 85% of its revenue. Its model of keeping marketing costs low through selling over the Internet and by telephone was very successful. With the large number of desktop units typically sold to any given business, a small Dell sales staff could, if necessary, go to the purchasing company's offices to meet with appropriate decision makers. Additionally, with the large numbers of units in any given company, arrangements for service were relatively easily made. With the desire of most companies to have the same brand and similar models of computers at every workstation, the preferences of individual workers were of little or no importance.

Dell also made sales to individuals, though this was not the primary market. There were drawbacks to Dell's traditional model that were of concern to a number of potential individual customers. The purchaser did not have an opportunity to compare Dell computers with other brands at retailers. Some parts were only available directly from Dell and some repairs had to be made at Dell's factories or service centers. Thus an individual purchaser might have to send his or her computer back to the company for service, involving additional trouble and the loss of the computer for possibly long periods of time while it was gone.

A shift in demand in the United States away from desktop models to laptop models exacerbated the problem for Dell. An increasing share of the sales of laptops is being made to individuals rather than to companies. While individuals make up 30% of HP's sales of PCs, they provide only 15% of Dell's PC sales. Individual consumers tend to like to compare, hold and test PCs, and, particularly with laptops, often want to take their purchase with them when they have made their selection, but Dell has not had its computers in stores. The share of direct sales of notebook computers in the United States has fallen from 50.2% to 43.7% in two years (direct sales by all companies included). The problem for Dell is growing: it is forecast that sales of laptops to individuals will be substantially higher than those to companies by 2010 (Lawton, 2006).

An attempt to boost profits in fiscal year 2005 by deeply discounting prices increased unit sales but reduced profits for a period of time. Elasticity of demand with respect to price for PCs in the United States was lower than expected and prices of component parts did not drop as rapidly as the company expected. Unit sales in Europe and China did increase for a period of time, but Dell subsequently lost market share in China (McWilliams, 2005).

Dell also experienced increasing problems with customer satisfaction regarding sales and service. As a cost-cutting strategy, Dell had changed from using a majority of full-time employees at its call centers to 75% part-time employees. Turnover had reached 300% by late 2005 (Lawton, 2006). One former large customer who switched to HP complained that Dell PCs and servers proved too hard to maintain and operate. He felt that Dell had tried to produce too many different products at once (Byrnes *et al*., 2006). Their problems in introducing plasma screen TVs, a product probably not well suited to Internet and telephone sales, would seem to be a case in point.

Another problem is changing competition. Hewlett-Packard, second in the US market with a share of 27% and increasing, has made key changes in its position in the market (Pimentel, 2006a). In addition to cutting costs and prices to become competitive with Dell, as noted above, it added additional features to its laptops in order to make them more attractive. HP has also stepped up marketing efforts. It opened build-your-own PC operations within a number of Walmart stores, directly challenging Dell's strength in building to order. It sent district managers to meet with retail stores to improve customer service and provide greater assistance to customers during back-to-school times. Other PC makers such as Lenovo and Acer Group are also growing and eroding Dell's cost advantage by obtaining notebook PCs from some of the same Asian original equipment manufacturers that Dell uses. Dell's competitors are making such powerful PCs that Dell's made-to-order pitch may be losing its cache (Byrnes *et al*., 2006).

Dell is taking a number of steps to try to fix their problems. The company is spending money on improving customer service by hiring more support people and offering an over-the-Internet support service for Dell PC owners. It is overhauling its website, changing its pricing structure, and increasing advertising. Until 2006, Dell refused to make PCs with anything except Intel processors, even though an estimated 20% of the market prefers PCs with processors from AMD. Now it has begun to offer some PCs with processors from AMD (Pimentel, 2006b). Finally, Dell experimented with two retail stores that displayed its products and where customers could place orders for computers. However, potential customers still could not compare different brands there, and even if they decided they wanted a Dell PC they could not actually leave with one since the stores carried no inventory. In 2005, it sold some PCs through Costco Wholesale Company for the first time, but it indicated that this was a one-time deal for PCs coming to the end of their product life cycle (Lawton, 2006; Slagle, 2006). How successful any or all of these programs may be has yet to be determined.

The major problem with Dell's approach in the US market was considered to be top management's continued strong adherence to the traditional model that served it so well in the past. That is, the company still seemed to remain 'slavishly loyal to its core idea of ultra-efficient supply-chain management and direct sales to consumers' while competitors' sales through stores appeared to be increasingly effective in the changing market (Byrnes *et al*., 2006, 27). Former Dell managers indicated that new ideas that move away from the direct sales model were discouraged.

Approaches in the German market

Dell entered the German market in 1988, but initially had problems in gaining market share. In 2006, conditions were improving under Alain D. Bandle, the Swiss citizen who now runs Dell's German operation. Dell was the only company there, besides HP, to be increasing sales in the declining market for PCs, and moved from 5th to 3rd place in market share. The key appeared to be that Bandle was allowed to make adjustments to the company's basic approach.

Bandle understood that German customers, including the business customers who account for 90% of the revenue, still prefer a high level of personal contact at the beginning of business relationships. Once a business has made an initial purchase from a salesperson, it is willing to make further purchases over the Internet. Additionally, while most Germans are willing to deal with foreigners on technical issues, they prefer to make purchases from native speakers. Bandle thus hired almost 500 new salespeople to serve business customers. Though the company has an existing facility in Bratislava, Slovakia, he opened a new center in Halle, Germany, to promote sales to small businesses and government offices.

Bandle also managed to increase sales to individuals. He discovered that one of Dell's models had features attractive to advanced computer game players. Additional promotion of that model made it a best seller. He also advertised the advantages of Dell's build–to-order system. This system is able to provide custom-made PCs with more power and options than the discount chain offerings of basic identical PCs selling at very cheap prices. The promotion has increased sales in this area. (This section drew largely on information in Ewing, 2006.)

Approaches in the Japanese market

Dell's current success in Japan is based on an approach that is different from that taken by the German subsidiary and differs in some ways from that used by the company in the United States.

Many Japanese are reluctant to buy over the Internet or by telephone if they must make an advance payment. The major concern is about the security of giving out credit card information over the Internet, and there is also some concern about whether suppliers will actually make shipments after they have received payment. The 7-Eleven convenience store chain developed a service in which customers can order products over the Internet and have them shipped to a nearby 7-Eleven store. The customer then pays the store for the goods by credit card, or in cash as many Japanese prefer, when picking up the merchandise. The store then forwards the money, minus a small fee, to the marketer. The system works efficiently because of a combination of factors. Most Japanese live within a short distance of, or pass by on the way to and from work, at least one of the over 10,000 7-Eleven outlets in Japan (see Case study 4.2). Private delivery systems are quick and reliable and, with the difficult-to-find addresses of many individuals in Japan, it is easier to deliver packages to the stores than to individual homes. The store benefits from the small fee and, more importantly, from additional purchases made by many of the people stopping by to pick up merchandise. This system, which is widely used by the Japanese, facilitates Dell's Internet and telephone sales model.

In Japan, Dell sells to business and government users who require substantial personal interaction before making initial purchases. They adjusted their marketing to business and government users appropriately. For individual consumers, Dell targeted the markets for inexpensive desktops with simple specifications and low-end laptops. An article in *The Nikkei Weekly* noted that many of today's PC buyers in Japan are in the market for an additional machine or a replacement, and are looking for 'a machine with barebones specs' (*The Nikkei Weekly*, 2006). Japan's brand-name manufacturers, such as NEC, Fujitsu, and Toshiba, have focused primarily on multi-function PCs costing two to three times as much as the lower-end PCs. The Japanese market share of the more expensive PCs is presently declining, though the long-run trend is not clear. The major threat to Dell Inc. in the low-end desktop market is from private-brand manufacturers serving as original equipment manufacturers for retailers. In early 2006, Dell replaced Fujitsu as number two in the market, in part due to a one-time order from the Japanese Defense Agency (ibid).

Problems in the Chinese market

The market in China is large and growing rapidly. Dell entered the Chinese market in 1998, initially focusing on corporate customers. They did use some 'outside sales' staff making visits to organizations, the largest being governmental bodies and government-owned corporations. But in order for an individual to purchase a PC, he or she had to visit a Dell office or contact the company through their website or through newspaper advertisements. At first, Dell did use some distributors, but subsequently stopped using them. Some retailers purchased directly from Dell and then resold the PCs at higher prices. Dell had hoped that after dropping distributors and stopping sales to unauthorized retailers, it could use its US business model of direct selling. However, direct selling did not result in a satisfactory level of sales. (Ng *et al.*, 2003).

Dell's model of direct selling via the Internet and telephone is still not working well in China. The Chinese market is growing rapidly, but even among business people there is a strong preference by buyers for seeing the products before they make purchases. Competitors Lenovo, HP, and Founder are selling through retail stores in both large and smaller-size Chinese cities. Lenovo, the market leader, has over 4,800 retail outlets, and also has installed education software on a desktop model designed specifically for families. Consumer demand is growing more rapidly than that of the businesses that comprise Dell's primary target, and relatively few Chinese have credit cards and fewer still are used to buying over the telephone or Internet (Lee *et al*., 2005). While China has an increasing number of 7-Eleven stores, the pattern of distribution does not appear to make the Japanese model of distribution feasible. With the rapid growth of manufacturing by Chinese companies, the lower end of the market may become too competitive to provide an acceptable level of profit unless Dell can become even more efficient.

It appears that Dell must make substantial adjustments to its model if it is to succeed in China.

Constraints in addressing the worldwide problems

By the end of 2008, Dell's market share of the worldwide market for PCs had dropped to 14.2% while HP's had increased to 18.8%, and Acer was challenging with 12.5% (Scheck and Vranica, 2008).

Some cost cutting, including reducing the number of employees, has kept the bottom line from falling further. Unfortunately, one legacy from the past business model has kept Dell from making even greater cuts in costs. A key advantage of its online and telephone model was a build-to-order system that allowed the company to provide a quick response for specific capabilities in each PC. As part of this system, Dell did not keep inventories. It kept up with increasing demand by building more US plants in the United States while competitors were shifting production to cheaper Asian countries. Dell is now stuck with higher manufacturing costs than its competitors, thus keeping its profit margins lower.

Dell had tried a number of initiatives in its overall business. It had placed high hopes on becoming a leader in the growing market for servers, which is making money for them and providing a higher profit margin. HP has taken the lead in the market, but Dell still hopes to grow its server business. Dell had looked at entering the mobile phone business but was held back by concerns over the high cost of entry (Scheck, 2008).

How well Dell can deal effectively with its various problems remains to be seen.

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Questions

1. Should Dell have made changes to its marketing model in the United States earlier?
2. What problems may Dell encounter in its change in approach in the United States and elsewhere?
3. Is the use of native speakers, as in Germany, important elsewhere in Europe?
4. Is Dell's Japanese marketing model likely to be successful in the long run?
5. What marketing model should Dell use in China?
6. What marketing model should Dell use in India?

CHAPTER 2

Bases of international marketing

Learning outcomes

In Chapter 2, we discuss:

- the economic benefits of trade:
  — international trade theories: traditional theories and change
  — observations on results
- the reasons that individual companies export and import
- the development of exporting in the firm:
  — possible models
  — the importance of networking and relationship marketing
- the growing impact of social responsibility concerns on business:
  — ethical/moral issues
  — the changing social and political/environment

Three cases are presented at the end of the chapter. Case 2.1, BP, discusses the UK company's oil well blowout in the Gulf of Mexico, the resulting public anger, government actions and the company's heavy financial losses. Case 2.2 looks at the difficulties faced by Toyota after its massive automobile recalls. Case 2.3 considers the problems faced by a British company regarding changing market conditions and problems in pricing pharmaceuticals.

Introduction

Chapter 1 laid out the factors underlying international trade, the globalization of business, and the increasing importance of international marketing to companies and economies. In Chapter 2 we review key concepts, models, and elements of both the macro- and microeconomic bases of international trade and exporting. Considerations regarding the distribution of costs and benefits are discussed. Finally, moral/ethical considerations and issues regarding social responsibility of business and their employees are discussed.

While written primarily from the perspective of exporting, the analysis is applicable to most types of investment and strategic alliances. In short, what is discussed is relevant for all types of international marketing activity.

Potential benefits from export marketing

Ideally, international marketing occurs on the premise that it results in benefit to all participants and injury to none (other than perhaps competition), regardless of whether we are considering nations or individual firms. For the individual business concern this usually means that profits are realized, either directly in the case of the seller (exporter) or indirectly for the buyer (importer). The discussion in this section will be primarily in the context of international trade for it is here that the macro effects are more readily apparent.

Generally speaking, the benefit of international trade to a country is determined by its impact on consumption and production. No country is entirely self-sufficient in terms of its ability to satisfy effectively and economically the entire range of the ever-changing desires of its populace. Since consumption is the end of economic activity and production is but a means to that end, the most basic of all contributions of international trade is that to the welfare of domestic consumers. Active trade relationships among countries create employment opportunities, and consumers gain as employment is their source of purchasing power for both domestic and foreign goods and services.

A discussion of the problems of possible injuries to particular groups of workers, companies, or economic sectors is discussed below (see pp. 114–16).

The effects of imports

Interestingly, to economists the real benefits of trade lie in importing rather than in exporting. Thus the only real reason for exporting is to earn the funds to pay for imports. This was clearly stated almost 200 years ago by James Mill when he said the following: 'The benefit which is derived from exchanging one commodity for another, arises, in all cases, from the commodity *received*, not the commodity given' (cited in *The Economist*, 1997, p. 85). The nature of potential benefits of importing consumer goods are obvious – namely, lower price, an increase in the supply and variety of goods from which consumers can choose, and being able to access the results of technological developments and advancements. While not quite so obvious, the effect of importing industrial goods is the same. However, it is not a direct benefit, but depends on the impact that such imports have on the domestic production sector of the economy.

In the first place, importing certain industrial products, whether raw materials or capital equipment, brings about lower domestic costs of production than would be possible if the consumer goods manufacturer bought only from domestic suppliers. Another way of looking at some raw material imports is that they tend to conserve precious resources.

Second, importing many industrial goods, particularly certain raw materials such as copper and tin, enables the production of goods that depend almost exclusively, and in some cases entirely, on nondomestic sources of supply. It may be that a country has to import because it is not capable of supplying domestic buyers with all their requirements from domestic resources. Oil-producing countries of the West that also import from the Middle East are examples. Again consumers gain by paying lower prices but, in addition, gain through the greater quantity and variety of goods made available to them in the marketplace.

A major benefit of importing to a nation and to individual companies is the acquisition of technology to add to whatever innovations are developed locally. This happens in three ways. First, countries can *import directly* technology in the form of capital and consumer goods (e.g., cell phones, machine tools for use in industrial production, etc.). Second, they can *license* technologies from those who developed them. Third, a country can attract *foreign direct investment* (FDI), so that a multinational company can establish production facilities within its borders (e.g., Intel's plants in Ireland and Malaysia). Licensing and FDI represent a direct import of the technology itself, which is the preferred acquisition method of developing countries. In all cases, however, countries must also be successful as exporters in order to pay for the imports of technology or to pay dividends on foreign investment.

Clearly, there may also be adverse effects in the importing country. In order to pay for imports, there must be a capital outflow. Not only does this have a negative effect upon the country's balance of payments, but there would be a reduction in the amount of foreign exchange available for other needs. Increased competition to locally produced goods may exist, and labor could be affected if this competition led to lost sales and profits and redundancy in employment. Since a significant amount of imports into a given country can result from intracompany 'sales' this situation could occur more often than would be apparent.

On balance, the effect of imports will, in practice, vary on a country-by-country basis.

The effect of exports

In order to finance a country's imports in a way that does not adversely affect its balance of payments and cause a drain on its international monetary reserves, a country must export. Consumers have a stake in the exports of domestic firms to the extent that high volume creates economies in the production process which are then passed on. That is, selling abroad helps to gain economy in production at home, which means lower prices to consumers of domestic products. For the individual firm, a lowering of product costs tends to improve its competitive position both at home and abroad, and helps to diversify the risk inherent in conducting business.

Exports may also have an influence on, and be influenced by, the general business conditions of a country. During a domestic business downturn, exports generally tend to hold steady and sometimes even increase, thereby softening the effect of the recession. Since the business cycle in some countries is on the upswing while on the downswing in others, exports may even increase during a domestic recession. This has been the case in Japan since 2004, based in part on the upsurge of orders from China, helping to improve Japan's weak economy.

In the late 1990s the so-called Asian crisis emerged. The currencies of Southeast Asian nations crashed to the extent that many were at less than one-half their old values against the US dollar. This would indicate that export prices from these countries would be lower and that exports would increase. However that did not happen, as many manufacturers in the countries of the region were so short of cash they could not buy the imported materials needed to produce the goods to fill the export orders that were out there 'for the grabbing.' Even though sharp falls in currencies lowered labor costs, manufacturers still had to pay more for imported raw materials and components and they could not easily obtain the financing to fill export orders. This applied to all kinds of firms ranging from small Indonesian shoemakers to South Korea's largest conglomerates.

Although, on balance, exports will tend to have a positive effect in a country, there may be individual countries that at certain times face negative effects as well. Shortages of goods could exist, leading to higher prices for domestic consumers. In 2004 the United

States considered placing an embargo on the export of scrap copper to Japan, its major market for the material. The rapidly rising export demand for scrap copper was felt to be hurting the US manufacturers that used the material. Many years before, the United States had also briefly imposed an embargo on soybean exports because of concerns over shortages and rising prices in its own market. In that case, it opened new markets for Brazilian producers. Some years ago Japanese companies set export prices lower than domestic prices on a number of products from automobiles to color television sets. The Japanese domestic market accepted the high prices and Japanese businesses were seeking more rapid market penetration of international markets through low prices (as well as high quality). The Japanese government, seeking a higher level of exports, approved of these policies. When such pricing policies are used now, they are likely to bring charges of '**dumping**' (as discussed in Chapter 11). Some industries and companies, particularly those that are less export oriented, may find it difficult to hire qualified people if the export-oriented industries are growing. This has not been a serious problem for most of the more industrialized countries in recent years.

Increasing productivity and efficiency

The previous comments on imports and exports suggest that to some nations a substantial amount of international trade will primarily foster efficient use of productive resources. This implies that trade is a way to increase, and perhaps even maximize, productivity. Industry and trade are dynamic, and methods of production and marketing are changing continuously. In old industries, new production techniques are developed and they migrate from one country to another. Furthermore, technological advancement creates entirely new industries all the time. These changes are transmitted around the world by international trade or through direct foreign investments or strategic alliances. This means that established domestic industries are constantly confronted with new competitors. In some instances new industries displace old ones. For example, nylon practically ruined the silk industry of Japan, while the development of synthetic materials, such as synthetic rubber, has limited the expansion of their natural counterparts and may, in some cases, entirely replace them. Transistors, silicon chips, computers-on-a-chip, and newer technologies have completely changed the electronics industry.

There is great interest throughout the world in *technology transfer*, which can be viewed as the sending of new products, processes, and production inputs from one country to another. Eastern European countries have been acquiring technology from the West, and at the same time have been supplying technology there. The developing countries of the world are constantly seeking technology from the developed countries. China, with the allure of its potentially huge market and its large purchases of industrial equipment, is being particularly aggressive in seeking technology transfer. General Electric, with potentially billions of dollars of orders at stake, is providing high technology. In 2004, in order to secure a $900 million contract for electrical generation turbines, GE agreed to provide advanced technology to two Chinese partners that eventually want to make such equipment themselves. Siemens AG is working with a Chinese academic institute to develop technology for a national mobile phone standard for the nation (Kranhold, 2004).

In addition to the technology per se, countries may benefit by employment opportunities for their citizens, housing, schools, and management development programs. Earlier, in addition to transferring technology and building a $720 million computer chip factory, Motorola Inc. built 2200 apartments and two schools for its employees – and provided a fast-track management training program for local Chinese (*The Economist*, 1996a, p. 48).

With industrial change, therefore, international trade becomes a potential engine of progress. Whether this potential becomes actualized, and productivity is increased, depends upon the response of domestic industries to the challenge created by competition from new industries and new methods. In the United States, for example, some industries such as bicycles and watches responded to rising competition from imports by seeking government protection. The semi-conductor industry, on the other hand, virtually abandoned domestic production of high-volume standardized chips and turned to an emphasis on specialized and custom-made computers-on-a-chip. This enabled the US industry to regain its position as the world's largest supplier of computer chips (on a dollar-value basis). Some industries have been able to persuade their government to seek and obtain from foreign governments 'voluntary' reductions or limits in the amounts of products exported. When such government protection is granted to domestic companies the stimulus from import competition causes no gain in productivity because the reaction is negative; the situation in the protected industry is literally frozen.

The tourism industry is an example of an important growth industry, and countries and firms are interested in understanding which determinants are particularly important to the tourism productivity of a destination. In their award-winning article, Assaf and Josiassen (2011) for the first time identify the key determinants which determine the efficiency of 120 country destinations. The three determinants most likely to promote the performance of a destination are government expenditures on the tourism industry, strong environmental regulations, and service-mindedness of the population toward foreigners, while the three determinants most likely to hinder destination performance are high crime rates, high fuel prices, and high oil prices. When ranking the actual destination efficiency the three most efficient destinations are Switzerland, France, and Spain. The three worst performing countries are Senegal, Chad, and Madagascar.

Another type of response to the competition from imports that leads to increases in productivity is that of cost reduction. Incorporated by many industries in western Europe and the United States, that has been accomplished through improved management, automation, economizing in personnel, elimination of parts, and product simplifications. These efforts have been greatly assisted and supported by improved information systems and logistics.

International trade theories

The underlying influences that govern the trade among countries are complex and many. It is clear that many nations, many businesses and the people of many countries have benefited from increasing international trade. The countries that have attempted to restrict a wide range of imports in order to protect domestic industries or labor have suffered from more slowly rising standards of living compared with those that have embraced more open trade. Nations that have moved from more restrictive policies to more open policies, such as China and India, have enjoyed substantial increases in economic growth. Yet the benefits of trade do not appear to be evenly shared among nations, nor equally shared by different groups within individual economies.

A number of theories have been developed to explain the patterns of trade among countries and how the benefits of trade are distributed. These include:

- the classical theory of international trade, which demonstrates with fairly simple 2-country, 2-product models the conditions under which both countries in a trading relationship benefit;
- the factor proportion theory, which offers an explanation for the differences in comparative costs between trading partners;
- the product life-cycle theory, which attempts to explain why international trading patterns began to change in the 1960s.

All of these theories concern the question, 'What determines the nature and amounts of goods that a country buys and sells in international markets?' None of them has proved to be the ultimate general theory applicable to all traded goods at all times, but each provides useful insights. A more comprehensive treatment of the subject is given in textbooks on international trade theory covering one or more of these theories.

Some of the current questions regarding growing international trade regard the effects on different groups of people within nations, whether some countries benefit so much more than others that the system is becoming less fair, and whether totally free trade would be a desirable objective. We will look briefly at these questions after a short survey of the three theories noted above.

The classical theory of international trade

What a country exports and imports is determined not by its character in isolation but in relation to those of its trading partners. The concept of **economic advantage** states that countries tend to specialize in those products in which they have an advantage, namely, lower cost of production. This means simply that a country produces for domestic consumption and for export those items that it makes better or more cheaply than other countries, and imports those products that it can acquire more cheaply from abroad than at home. The essence of the logic behind economic advantage is that any nation can only hurt itself by excluding imports that can be obtained more cheaply from abroad than at home.

Furthermore, this logic applies even if countries such as France and Germany, for example, may be able to produce domestically most kinds of products more cheaply than can be produced in foreign countries. In such circumstances, Germany and France will gain by importing those goods for which each has a *relative* disadvantage in production, and thus gain the opportunity to export goods for which each has a relative advantage, by reason of superior natural resources, labor and management skills, capital resources, manufacturing processes, or technology.

There are three different situations concerning international differences in costs that must be considered – *absolute* differences, *comparative* differences, and *equal* differences. The extent to which trade is carried on and its very nature depends on which of these three conditions exists in any given potential trading relationship and upon the nature of reciprocal demand structures. In the classical theory it is assumed that the supply price is the same as the money cost of production, that is, transport costs, marketing costs, and individual firm profits are not considered. In the real world, of course, these costs certainly exist, and are quite significant in most cases. But the concept of supply price remains unchanged; only absolute magnitudes are affected.

Absolute advantage

A condition of **absolute advantage** exists when one country has a cost advantage over another country in the production of one product (that is, it can be produced using fewer resources) while the second country has a cost advantage over the first in producing a second product. In a two-country two-product world, international trade and specialization will be beneficial to each country when the country is absolutely more efficient than its trading partner. For a given set of productive resources (capital and labor inputs), specialization and trade lead to a greater output of both products.

The absolute advantage theory also sought to explain why costs differ among nations. Cost differences exist because productivities of factor inputs (in particular labor) represent the major determinant of production cost in different countries. Such productivities are based on natural and acquired advantages – localization advantages. Natural advantages include factors relating to climate, soil, and mineral wealth, whereas acquired advantages include special skills, technical and marketing know-how, and so on. Another advantage in the 21st century is technology. With such advantages for producing an item, a nation would produce that item at lower cost than a trading partner without the same advantages.

Comparative advantage

In order for trade to be profitably carried on it is not necessary that a country have an absolute advantage over other countries. If one country has an absolute advantage over another country in the production of all products, trade will be beneficial if the domestic exchange ratios in each country are dissimilar; in other words, if the country with the absolute advantage has a greater advantage in producing one product than it has in producing another. This situation is known as 'the principle of comparative advantage.'

When this condition exists a country benefits by specializing in and exporting the product in which it has the greatest advantage, or a superior (comparative) advantage, and importing the product in which its advantage is less, or in which it has an inferior advantage (that is, a comparative disadvantage). Thus, the other country, even though it is at a disadvantage in producing all products, can benefit by specializing in and exporting the product in which its disadvantage is least. An illustration is presented in Exhibit 2.1.

In the real world, the power of comparative advantage seems weaker than this simple model of trade implies (*The Economist*, 1996b). For instance, countries specialize less than one would expect. There is much intra-industry trade – France sells cars to Germany and vice versa. Competition from foreign suppliers does sometimes lower wages in the importing countries. Clearly, geography and the role of similar but different products appealing to varying tastes also explain why trade occurs. In addition, comparative advantage is often the result of history and chance. A good example is the commercial aircraft industry of the United States (*The Economist*, 1997). There is no inherent reason why the production costs of large jets, for example, the Boeing 747, relative to other goods/services should be lower in the United States than in, say, Japan. But, due to the early acceptance of air travel, airmail, and large purchases of military aircraft, such costs are lower. This suggests that comparative advantage can be created and that perhaps government should help create it. The European consortium Airbus Industrie is doing this with its new Airbus 380.

More complicated versions of this model help explain these apparent anomalies. Moving from two goods and countries to many goods and countries greatly complicates the mathematics, but otherwise changes little. In the real world labor is not the only factor of

Exhibit 2.1 Comparative advantage: gains from trade

To see how this theory works, think about why two countries – call them East and West – might gain from trading with one another (*The Economist*, 1997, p. 85). Suppose, for simplicity, that each has 1,000 workers, and each makes two goods: computers and bicycles.

West's economy is far more productive than East's. To make a bicycle, West uses 10 workers while East uses 100. Suppose there is no trade, and that in each country half the workers are in each industry. West produces 250 bicycles and 50 computers. East makes 125 bikes and five computers.

Now suppose that the two countries specialize. Although West makes both products more efficiently than East, it has a bigger edge in computer making. It now devotes most of its resources to that industry, employing 700 workers to make computers and only 300 to make bikes. This raises computer output to 70 and cuts bike production to 150, as shown in Table 2.1. East switches entirely to bicycles, turning out 250. World output of both goods has risen. Both countries can consume more of both if they trade.

At what price? Neither will want to import what it could make more cheaply at home. So West will want at least five bikes per computer; and East will not give up more than 25 bikes per computer (these are the *domestic exchange ratios* that set the limits within which the *international exchange ratio* must fall for gains to accrue to both trading partners). Suppose the terms of trade are fixed at 12 bicycles per computer and that 120 bikes are exchanged for 10 computers (the exact international exchange ratio will depend upon the existing reciprocal demand situation). Then West ends up with 270 bikes and 60 computers, and East with 130 bicycles and 10 computers. Both are better off than they would be if they did not trade.

Table 2.1 Comparative advantage: gains from trade

	Output and consumption under autarky		Output after specialization		Consumption after trade	
	Bicycles	Computers	Bicycles	Computers	Bicycles	Computers
East	125	5	250	0	130	10
West	250	50	150	70	270	60

production. There is capital, human resources, etc. Thus, the domestic exchange ratio is not in general linear, but is curvilinear, bending outward in the middle. This in turn implies that complete specialization is unlikely. As the international exchange ratio or price based on reciprocal demand changes, a country shifts production slowly in accordance with comparative advantage to complete specialization.

Equal advantage

A condition of equal advantage exists when one country has an absolute advantage over another in production of all products but no superior advantage in the production of any one product.

This can be simply illustrated by the data for shoes and clothing in Table 2.2.

In producing both products Italy has an absolute advantage over Guatemala. In fact Italy is twice as efficient in both products. The domestic exchange ratio of shoes to clothes in each country is the same, 1 : 2. Using the reasoning above, there is no range of possible

Table 2.2 Production costs for shoes and clothing

Country	Production costs per unit (in hours of labor)	
	Shoes	Clothing
Guatemala	30	60
Italy	10	20

international trade ratios, which means that each country will neither gain nor lose anything by trading. Under such conditions, trade could not possibly exist as the incentive of gain is lacking.

It is reasonable to ask what the limitations and implications of this analysis are. The equal ratios for these two products might be the same for any number of reasons, such as better machinery being used in Italy. However, it seems unlikely that ratios of labor costs for all products in both countries would be the same. Therefore, while trade in some products might not be feasible, it might be advantageous for other products where the ratios differ. But could trade still be advantageous if Guatemala had higher costs in hours of labor for every product than Italy? The answer is yes. Over time the monetary exchange rates would change to reflect the differences in productivity in the two countries – not precisely, but enough to make trade feasible in some products in which Guatemala had less of a comparative disadvantage in labor costs.

The factor proportion theory

The classical trade theories argue that the basis for trade stems from differences in international production conditions and factor productivities, owing to domestic differences in localization advantages (natural and acquired advantages). But other than offering this general explanation, the classical theories do little to explain what causes discrepancies in comparative costs.

The factor proportion theory, in contrast, offers an explanation for the differences in comparative costs among trading partners. According to this theory, international differences in supply conditions, for example, factor productivities and factor endowments, explain much of international trade. It is assumed that trading partners have the same tastes and preferences (demand conditions), use factors of production that are of uniform quality, and use the same technology. The productivity or efficiency of a given resource unit is thus identical for both trading nations.

The factor proportion theory argues that relative price levels differ among countries because (1) they have different relative endowments of factors of production (capital and labor inputs) and (2) different commodities require that the factor inputs be used with differing intensities in their production (factor intensities – capital/labor relationships). Given these circumstances the factor proportion theory can be formulated as follows:

> A nation will export that product for which a large amount of the relatively abundant (cheap) input is used, and it will import that product in the production of which the relatively scarce (expensive) input is used.

The principal explanation of the pattern of international trade lies in the uneven distribution of world resources among nations, coupled with the fact that products require different proportions of the factors of production. While the production of clothing, for example, is very labor intensive, the manufacturing of machines is much more capital intensive.

The product life-cycle theory of international trade

For various reasons, the traditional theories based on economic advantage or factor endowments have been shown to be deficient in explaining international trade patterns as they evolved starting in the 1960s. Because of rapid technological progress and the development of multinational enterprises, there has been a need to search for a new international trade theory to fit the changing realities of the trading world as it began to evolve and now exists. The product life-cycle theory of international trade has been found to be a useful model for explaining not only trade patterns of manufacturers but also multinational expansions of sales and production subsidiaries, that is, it has been useful in explaining certain types of FDI.

According to the product life-cycle concept, many manufactured goods, in particular technologically advanced products such as electronic products and office machinery, undergo a trade cycle.

During the process, which can be described in various stages, the innovator country of a new product is initially an exporter, then loses its competitive advantage vis-à-vis its trading partners, and may eventually become an importer of the product some years later. The introduction stage of the trade cycle begins when the innovator company establishes a technological breakthrough in the production of a manufactured item. The country where the innovating company is located initially has an international technological gap in its favor, and is typically a high-income developed economy. At the start, the relatively small local market (home market) for the product and technological uncertainties imply that mass production is not feasible.

During the trade cycle's next stage, the innovator manufacturer begins to export its product to foreign markets, which are likely to be countries with similar tastes, income levels, and demand structures, that is, other developed countries. The manufacturer finds that during this stage of growth and expansion, its market becomes large enough to support mass-production operations and the sorting out of inefficient production techniques, which means that increasing amounts can be supplied to world markets.

As time passes, the manufacturer realizes that to protect its foreign sales and export profits it must locate production operations closer to the foreign markets. The domestic industry enters its mature stage as innovating firms establish subsidiaries abroad, usually in advanced countries first. A major reason for this is that the cost advantage initially enjoyed by the innovator is not likely to last indefinitely. Over a period of time, the innovating country may find that its technology has become more commonplace and that transportation costs and tariffs play an important role in influencing selling costs. The innovator may also find that the foreign market is large enough to permit mass-production operation near the marketplace, either by a direct investment or strategic alliance arrangement.

Although an innovating country's monopoly position may be prolonged by legal rights (for example, patents and other intellectual property rights), it often breaks down over time. This is because knowledge tends to be a free item in the long run. The Internet contributes to this. Once the innovative technology becomes fairly commonplace, foreign producers begin to imitate the production process. The innovating country gradually loses its comparative advantage and its export cycle begins to experience a declining phase. The trade cycle is complete when the production process becomes so standardized that it can be easily utilized by all nations, including lesser-developed countries. The innovating country may finally itself become a net importer of the product as its monopoly position is eliminated by foreign competition.

This model is 'fueled' by technology. As is well known, technology is less likely to converge (i.e., close the gap between rich and poor countries) than capital. Innovation shows increasing returns to scale, meaning that countries with advanced technologies are best placed to innovate further.

At the individual company level, a situation that leads to the breakdown of monopoly positions based on patents and intellectual property rights is counterfeiting and piracy. In some cases governments become involved in order to assist national firms. A good illustration is the threatened sanctions by the US government over selected exports from China over piracy of compact disk software for computers. The US government felt that the government of China was not doing enough to stop such piracy.

The product life-cycle model of international trade has been helpful in explaining the history of trade patterns of a number of products, particularly textiles, shoes, radios, televisions, semiconductors, industrial fasteners, and standardized components for different uses. These products, available in the United States, western Europe, and Japan, are being imported from Korea, Taiwan, Hong Kong, India, Singapore, other newly industrialized countries (NICs), and China.

This theory explains some of present international trade, but does not fully cover all of present trade. Research and development centers have been established in several less industrially advanced nations, some as offshore centers of foreign companies and others by domestic industries for their own use. Tata Industries in India is an example of R&D centers established by domestic industries. This has resulted in increased innovation in a broader range of nations. The subject was discussed briefly in Chapter 1 (see also *The Economist*, 2010).

There are also additional changes affecting patterns of trade development. Some companies in the industrially advanced countries will immediately have their innovative products, or parts thereof, manufactured abroad. (Cell phones sold by some companies are an example.) Other companies in the industrially advanced countries go from manufacturing new products in their own country to establishing production centers abroad to sell to people in those countries: a number of automobile companies have done this.

Concerns over free trade

The concerns over increasingly free trade are threefold:

- Are reduced barriers to trade really beneficial to all countries?
- Are they needed to protect particular industries or groups of people?
- Are open markets really politically feasible?

The benefits of trade have been demonstrated by the experiences of several groups of nations. Edward Prescott, a winner of the 2004 Nobel Prize in Economics, has noted several examples of the effects of varying levels of protectionism, based on his own analyses and studies by others (Prescott, 2007). In 1950, five years after the end of World War II, the Latin American nations as a group had per capita GDPs 75% higher than the Asian nations. While Latin American countries as a whole erected many trade barriers to protect local industries and jobs, several Asian countries focused on exporting. The European nations increasingly moved toward increased integration with lowered trade barriers. The changes in per capita income for these groups of countries, relative to the already large, increasingly open, and growing US market, were as follows:

- Europe: 68% increase
- Asia: 244% increase
- Latin America: 21% *decrease*

Prescott also noted differences in growth in productivity of the nations according to the times when they entered what is now the European Union and reduced trade barriers. The six nations that originally signed the Treaty of Rome moved forward most rapidly while those who were not members fell behind. The next three that joined in 1973 have caught up or are making much progress in catching up, and other countries that joined later are showing improvement.

China's rapid growth since it began to emphasize exporting has already been discussed. India's growth has also been impressive as it moved away from an emphasis on self-sufficiency, but has lagged behind that of China as it has been slower to reduce barriers to incoming investment and goods and services.

In an analysis published in 2004, the first winner of the Nobel Prize in Economics, Paul A. Samuelson, argued that the classical trade theories are still valid. Overall, the gains from free trade will always outweigh the losses. However, specific groups of people in any given country may be worse off (Samuelson, 2004). As an example, garment workers in a number of countries in Africa, and other continents, have been hurt by competition from lower-cost garments coming from China (*The Economist*, 2007). In a 2007 report, the IMF has stated that 'labor globalization has negatively affected the share of income going to labor in the advanced countries.' But the study also states that, while the share of labor's pie has decreased, workers have still gained as prices have declined and the overall pie has grown from globalization (Guha, 2007). A report in *The Economist* noted again the observation that workers, who may suffer job losses or lower wages, are generally better organized and more vocal than the consumers who benefit. It was argued that governments need to find ways to more fully share the benefits of globalization without reducing the ability of the countries to gain the benefits (*The Economist*, 2006).

Companies or whole industries are often more effective than workers in obtaining protection. In the individual case, giving protection to one domestic industry typically raises the costs and reduces the competitiveness of other domestic industries. An example from the United States was where steel makers received a 30% protective tariff that led to higher prices and resulted in American makers of steel drums losing their international competitiveness and export markets. A study of the effects of earlier protection of the US steel industry through tariffs and quotas found that, for every job saved in the steel industry, three jobs were lost elsewhere in the economy (*The Wall Street Journal*, 2002).

Protectionism, whether to save industries or workers, leads to higher costs, lowered competitiveness, and in the aggregate to lower rates of growth and lower per capita GDP. Completely free markets are probably not politically feasible, but the interests of nations, companies, workers, and consumers as a whole require less rather than more protectionism. Where labor markets are less free, more government actions may be required to assist displaced workers to train for and find new employment.

Export behavior theories and motives

Exporting is still the most common way for manufacturers to do business in foreign markets, especially in the early stages of internationalization. The export behavior of firms has received significant attention – by researchers and practitioners. Although conceptualization and theory development have been scarce, contemporary international business theory development considers exporting as a continuous process with the firm gradually increasing its level of foreign involvement and commitment. Export expansion is generally viewed as involving discrete changes in organizational structure as firms increase their commitment to serving foreign markets. The first is thus perceived as passing through a sequence of export entry modes which ultimately lead to direct foreign investment.

In contrast to the international trade theories as presented above, export behavior theories attempt to explain why and how the *individual firm* is engaged in export activities and, in particular, how the dynamic nature of such activities can be conceptualized. Export theories focus explicitly on the firm's motives and strategies of exporting (and not only economic rationales for exporting), the firm's marketing and other capabilities in exporting, and its interaction with the foreign market environment. Risk, uncertainty, and imperfect knowledge are important determinants in export behavior since companies engaging in foreign marketing activities often lack prior knowledge, experience, and adequate marketing information.

Why do firms engage in international marketing in general and exporting in particular? We can assume (realistically, we might add) that the driving forces for either starting or exploiting export activities are that the firm wants to utilize and develop its resources in such a way that its short-term and/or long-run economic objectives are served. As a consequence, export motives will be strongly connected to the basic goals of the company. Broadly speaking, companies expand abroad when they can no longer achieve, to their satisfaction, their strategic objectives by operating solely in the domestic market.

For an increasing number of companies, the strategic objectives are international in nature. Companies such as Switzerland's Nestlé, Embraer of Brazil, Honda of Japan, and Boeing, and, increasingly, companies like India's Tata Consultancy Service, look at the whole world as their market, with some countries just more difficult or expensive to penetrate. These companies also look for potential locations of operations and sources of supply on a worldwide basis.

Basic goals

Every business firm has a major goal that it strives to achieve. This goal may be profit or nonprofit oriented. Profit-oriented objectives include those of return on investment, return on sales, profit maximization, growth, or stability. Objectives that are nonprofit in nature include a desired volume of sales, market share, preservation of the status quo, serving customers and specific markets, financial liquidity, security of existing management, and various humanitarian goals such as maintaining employment and producing products that the firm honestly believes are good for consumers.

Regardless of how the business firm explicitly states its major objective(s), if in fact an explicit statement exists, there is really only one basic or primary incentive – *to make a profit*. Thus, a nonprofit-oriented objective may be desired only to the extent that a profit is forthcoming, either directly or indirectly. It is only through the generation of profits that a firm can continue its operations and afford the luxury of having objectives that are non-profit in nature. Export business, to those who are already exporting, is frequently the difference between a profit and a loss for the entire company. In addition, foreign operations, including exports, lead to stability of profits.

Samsung Electronics' current profitability is the result of a 1998 decision not to give greater emphasis to gaining market share than to profits. The Korean conglomerate decided not to pursue the opportunity to flood export markets during the economic crisis in Korea and Southeast Asia at the time. The company's president, Yun Jong Yong, stated that Samsung factories would produce only goods after orders were in hand and profitability assured. Putting profitability ahead of gross sales was a radical concept at Samsung and other Korean conglomerates. Samsung's actions stand in contrast to those of Daewoo, as discussed in Case 10.1 in Chapter 10.

For many companies a significant share of their sales revenue and earnings can come from export and other foreign operations. Examples abound. In 2003 BMW sold more automobiles in the United States than in Germany. As much as 80–90% of sales and profits of companies such as Sweden's Ericsson and Electrolux have come from exports and foreign subsidiaries. By 2000, Finland's Nokia was generating 96% of sales and French retailer Carrefour 44% of sales from foreign operations. Other examples of companies in which a significant share of earnings comes from international operations are not difficult to find: Coca-Cola, IBM, Unilever, Procter & Gamble, Motorola, Exxon, CPC, N.V. Philips Gloeilampenfabrieken, Sony, Nestlé, C. Itoh, and Toyota. For many companies the bulk of foreign earnings comes from foreign-based operations rather than export sales.

Specific reasons

In addition to the basic objective of attaining profit, there may be specific goals underlying a firm's commitment to foreign markets, however strong or weak that commitment might be. As previously stated, each of these becomes a valid goal only to the extent that there is a contribution made to achievement of the basic goal. That is, underlying each of these specific goals is the expectation that profits will be enhanced in the long run.

A classification of specific export motives is shown in schematic form in Table 2.3. Basically, the schema suggests that different kinds of stimuli or influences cause a firm to engage in exporting. Two main distinctions can be drawn. First, the motivational factors are specified as either due to stimuli initiated from influences *internal* to the firm or due to stimuli originating from the company's *external* environment (home market or export

Table 2.3 A classification of export motives

	Internal	External
Proactive	• Managerial urge • Marketing advantages • Economies of scale • Unique product/technology competence	• Foreign market opportunities • Change agents
Reactive	• Risk diversification • Extend sales of a seasonal product • Excess capacity of resources	• Unsolicited orders • Small home market • Stagnant or declining home market

markets). Second, the motives are categorized in terms of whether the export activity is due to *reactive* behavior, that is, the firm responds to internal or external pressures (push factors), and acts passively, or is a result of *proactive* and/or aggressive behavior based on the firm's interest in exploiting unique competencies or market possibilities (pull factors). Another way of looking at this is that the decision can be *innovation oriented* (i.e., there is awareness of the existence of a market opportunity) or *problem oriented*. Such a distinction may be important because it identifies the nature of the export decision task: is the foreign activity initiated because of the need for exports or is it initiated on a purely voluntary basis, to improve an already secure situation of the company? Exhibit 2.2 reinforces the importance of some motives.

Managerial urge

Managerial attitudes play a critical if not a major role in determining the exporting activities of the firms. Managerial urge reflects the desire, drive, enthusiasm, and commitment of management toward exporting and other types of international marketing. In smaller and medium-sized companies export decisions may be the province of a single decision maker; in bigger firms they can be made by a decision-making unit. Irrespective of the number of people involved in the export decision process, the choice of a foreign market entry

Exhibit 2.2 Should a company market overseas?

How does a company decide whether foreign marketing is 'right' for itself and its product(s)?

The keys to achievement in foreign markets are *information*, *preparation*, and *commitment*. A study of successful medium-sized companies showed that success overseas was due to management commitment, quality, better marketing, innovation, and acculturation – not company size, financing, or a favorable currency.

A company's main incentive, of course, is opportunity for growth and profit. In addition, sales in foreign markets can aid in stabilizing revenue/ turnover fluctuations whether these fluctuations are caused by seasonality, technology changes, saturated markets, or economic conditions. New markets help a firm to use its production capacity better, to extend the product life cycle, to increase competitiveness, and perhaps even gain tax advantages.

There are four steps to guide the decision whether to become involved internationally or not:

- *Make sure that there is sincere commitment and involvement* from the president down, and that such commitment becomes integral to business strategy.
- *Allocate research and evaluation time and resources*.
- *Gather information on which to base the decision*:
  - Study market characteristics (including need and propensity to buy), competition, possible entry barriers, export/import regulations, customs, and licensing considerations of targeted markets.
  - Evaluate company and product strengths and weaknesses by market.
  - Evaluate how to adapt products and services to meet local requirements, standards, and tastes. Anticipate export financing, pricing, payment methods, and the additional costs of doing business in foreign markets.
- *Audit the foreign marketing know-how, capabilities, and expectations of personnel, suppliers, and other stakeholders*.

strategy is still dependent on the decision maker's perceptions of foreign markets, expectations concerning these markets, and perceptions of the company's capability of entering those markets. This suggests that individual decision-maker characteristics may act at two levels: (1) information stimuli related to export activities are ultimately processed and (2) the characteristics are related to subsequent decisions to engage in export activities or not.

There is a distinct relationship between individual decision characteristics and export behavior. Favorable attitudes toward foreign activities have been considered an essential prerequisite before firms go into or expand in international markets. Decision-maker characteristics, including cognitive and affective factors, can explain in certain instances the systematic differences between managers in attitude and behavior toward foreign activity.

A process of cultural socialization which exposes the decision maker to information and contacts with foreign markets is likely to make stimuli received from or related to foreign countries more familiar. Managers who either were born or have the experience of living or traveling abroad may be expected to be more internationally minded than other managers. Prior occupation in exporting companies and early socialization, and continued contact with external reference groups (such as membership in trade and professional associations), may also reinforce key decision makers' perceptions and evaluations of foreign environments.

Unique product/technology competence

There is a definite role that unique products and/or unique technology competence plays in stimulating exporting behavior. First, a firm producing superior products is more likely to receive inquiries from foreign markets because of perceived competence of its offerings. Several dimensions in the product offerings affect the probability that a potential buyer will be exposed to export stimuli. Although little is known on this issue, significant elements in describing the export product may be its degree of standardization, degree of complexity, and, where 'software' and 'hardware' are involved, the distribution of sales (turnover) between them.

Second, if a company has developed unique competencies in its domestic market, the possibilities to spread unique assets to overseas markets may be very high because the opportunity costs of exploiting these assets in other markets will be zero or very low. Explanations of why a unique competence leads to seeking the exploitation of exporting are usually based on the fact that there would have been certain sunk costs incurred in developing the competence or product.

Risk diversification

Many, but not all, exporting companies probably face less total market risk than non-exporting firms by virtue of their having diversified geographical markets. Typically, countries do not face the same type and timing of business cycle. The expectations are that an economic downswing does not manifest itself necessarily at the same time or with the same intensity in different foreign markets. Selling in several markets (market spreading) reduces the risk associated with declining sales and profits in any one market. Such diversification in markets helps the firm to cope with the ever-changing general business conditions in the domestic market. If the home market should be in the midst of a recession, export sales can still be made since world markets are seldom equally depressed at the same time. When the wood products industry in the Pacific Northwest region of the United States was depressed during the first half of the 1980s due to a quiet domestic building industry, some companies did better than others because they were able to export logs and wood chips to Japan. Companies that also developed competencies in cutting wood to the precise dimensions and configurations required by Japanese construction companies continue to have a market not open to US lumber mills which only cut to US specifications.

Foreign market opportunities

Revealing market opportunities abroad has often exerted a strong influence upon the firm's willingness to export. It is evident that market opportunities act as stimuli only if the firm has or is capable of securing those resources that are necessary to respond to the opportunities. In general, decision makers are likely to consider a rather limited number of foreign market opportunities in planning their foreign entry. Moreover, such decision makers are likely to explore first those overseas market opportunities perceived as having some similarity with the opportunities in their home market.

Change agents

Government agencies, industrial trade associations, banks, chambers of commerce, port authorities, and other organizations may be major promoters of export activities. Major export promotion activities include giving and guaranteeing loans, providing credit facilities and insurance, publishing basic market data on foreign markets, exhibiting at trade fairs and exhibitions, sponsoring and participating in trade missions, providing trade leads and reports on individual companies, and being party to a trade agreement or convention. For example, government stimulation measures can have a positive influence, not only in terms of any direct financial effects that they may have but also in relation to the provision of information regarding market opportunities in a foreign country.

Economies of scale

If scale economies exist in production, advertising, distribution, or other areas, a broader market scope created by exporting can give rise to a decrease in unit costs of products produced. The scale effect reflects the natural efficiencies associated with size. Through exporting, fixed costs arising from administration, facilities, equipment, staff work, and R&D can be spread over more units. For some companies a condition for exploiting scale effects on overseas markets to the fullest extent is that it is possible to standardize the marketing mix internationally. For others, however, standardized marketing is not necessary for scale economies; such companies can accrue economies on the basis of their size alone.

Foreign marketing advantages

Specialized marketing knowledge or access to information can distinguish an exporting firm from its competitors. A good and perhaps unique product, a strong sales force, an efficient marketing infrastructure, and a good service technical support system, for example, may act as incentives for exporting because a company has built up competitive marketing advantages. Past marketing success can be a strong motivator for future marketing behavior. Competence in one or more of the major marketing activities will often be a sufficient catalyst for a company to begin or expand exports. Doing any type of marketing job well, together with having a strong product and/or brand franchise, means that a company can be better shielded from competition in export markets. In short, marketing advantages can serve as entry barriers for potential competitors in foreign markets.

Extend sales of seasonal product

Some industries, for example textiles, clothing, sports equipment, tourism, and toys, may be less resistant to business cycles than others. Seasonality in production and demand conditions in the domestic market may be industry specific and can act as persistent stimuli for foreign market exploration. In the first place, export markets are likely to be pursued in order to remove fluctuations in the product cycle. Second, eroding of the home market may force pursuit of export markets to secure continued growth and profitability. Consequently, firms may be expected to pursue an appropriate strategic response to cope with such changes.

By selling seasonal products in countries where the seasons are opposite to those at home, a greater stability in sales can be achieved. This, of course, makes possible more balanced production throughout the year. For example, ski equipment and clothing from such companies as Saloman, Rossignol, Olin, Head, Columbia, and North Face have markets in the northern hemisphere (North America and Europe) during the months of November–March whereas markets in the southern hemisphere (Chile, Argentina, New Zealand, and Australia) would be best during the period May–September.

Excess capacity of resources

When the domestic market served by a company is unable or unwilling to absorb the output that the firm is capable of producing or is actually producing then export markets can serve as outlets for this surplus production or productive capacity. Both domestic and foreign competition in the home market often force a firm to seek overseas markets. In many cases additional production can be obtained from existing equipment and labor without adding greatly to cost, the effect being an increase in the productive efficiency of the firm. Such economy in production will enhance the firm's competitive position both at home and abroad.

There is one potential problem that should not be overlooked when engaging in this type of activity. Sometimes companies with excess inventories attempt to 'unload' them in overseas markets at attractive prices. When the price that is offered in the overseas market is lower than that at which a product is sold in its home domestic market, *dumping* occurs. Under WTO rules, investigations are made into antidumping charges on products that importing countries say are being sold at unfairly low prices and are harming their domestic industries (de Jonquieres, 2003; Prusa and Vermulst, 2015). Many countries and groups of countries have enacted laws making dumping illegal or the dumped products subject to higher **duty** rates designed to adjust for the situation. Though usually lower, **antidumping duties** as high as 454% have been assessed. Not all of the national laws are the same, contributing to possible different interpretations of what actually constitutes dumping. US laws were written over 80 years ago and define dumping not only as selling in other countries at prices lower than those in the home markets, but also those selling at prices below the 'total cost' of production, and that are harming domestic industries. Examples of some recent charges of dumping, by both industrialized nations and developing countries, are given in Chapter 11, Pricing decisions. Countries that do not have antidumping laws may simply frown on the practice of dumping with the effect that local importers are discouraged from buying products that are being dumped. In addition, the government involved most likely will not view very favorably a foreign company engaging in the practice. Consequently, any short-term immediate gain from dumping may be offset by adverse longer-term effects.

Under certain circumstances entire industries begin to produce a permanent surplus for export. This occurs when further growth of the domestic market is blocked, or when, because of lack of an adequate domestic market, price degeneration appears to be forthcoming unless new markets can be discovered and developed.

Unsolicited foreign orders

The receipt of an unsolicited inquiry for product, price, or distribution information may be a very common method by which firms become aware of opportunities in export markets. These inquiries can result from advertising in trade journals that have a worldwide circulation, through exhibitions, and by other means. The evidence has been overwhelming that in different countries for the majority of exporting firms their initial orders were unsolicited. Such an involvement may emphasize an unplanned or passive (reactive) export market entry, but unsolicited orders as an explanatory factor for export activities raises at least one fundamental question. Why should some companies receive more of these inquiries than others, if in fact they do?

In general, it seems to be too simplistic to attribute exporting behavior to any single order explanation. It should be expected that those factors that make a firm a likely target for an unsolicited order do not cease after it has started to export. So besides unsolicited inquiries, there must exist certain enabling conditions that facilitate export activities. In a study by Simpson and Kujawa (1974), there was evidence presented supporting the view that firms are differentially exposed by such external stimuli as unsolicited orders. In this study more than 80% of the exporting firms were exposed to inquiries from foreign customers in contrast to approximately 30% of the nonexporters being so exposed. This points out that there are firm- and industry-specific factors at work that provide an environment that encourages receipt of unsolicited foreign orders. Relevant characteristics may be related to the firm's technology, product mix, experience, and present exposure in the marketplace.

Small domestic market

A company may be pushed into exporting because of a small home market potential. For some firms, domestic markets may be unable to sustain sufficient economies of scale and scope, and these companies automatically include export markets as part of their market entry strategy. This type of behavior is likely for industrial products that have few, easily identified customers located throughout the world, or for producers of specialized consumer goods with small national segments in many countries. The strategy is also possible for firms producing consumer products that are targeted to international consumers with common lifestyles and disposable incomes.

Although domestic markets may be very large this does not necessarily imply that a firm would want to expand within its home market before choosing to export. For example, for some Canadian firms, markets in the United States might be far more accessible and economically feasible than markets in west Canada. For an Australian firm that has attained full expansion in its regional market, economic factors such as transport convenience may make Singapore, Japan or South Korea the most attractive market for entry rather than another Australian state.

Stagnant or declining home market

Market saturation can provide a major incentive for firms to search for new opportunities. Foreign expansion may become a feasible strategy if the home market is stagnant or declining. Home market saturation occurs when a company is, at best, receiving declining marginal revenues from its marketing effort, or, at worst, is in a situation where required incremental sales revenue is less than the costs of the related incremental marketing effort.

But another perspective on market saturation is relevant for understanding why firms may expand overseas. Home market saturation suggests that unused productive resources (such as production and managerial slack) exist within the firm. Production slack is a stimulus for securing new market opportunities, and managerial slack provides those knowledge resources required for collecting, interpreting, and using market information.

Resources

The ability to undertake any form of international activity is clearly limited by the means available to the firm to carry out such activity. While export motives drive the process of internationalization, the resources that are available may limit the expansion at any point in time. There is more to the resources question than just production or financial capacity. Several critical factors in the ability to carry out chosen export activities are the possession of appropriate export knowledge, the ability to make personal contacts, and a greater willingness to take risks compared with doing domestic business.

Multinational, global, world companies

International marketing opportunities including export opportunities are the major reason for the existence of some companies whose operations are truly global in nature. These companies have been called different names (for example, multinational, transnational, global, world) and there are some differences in operating characteristics. However, they all share the common characteristic that decisions are made on the basis of comparative opportunities worldwide. Markets are not limited to the confines of any political entity and global resources are utilized. Such companies tend to be increasingly market driven in their strategic and tactical decision-making.

Other relatively common characteristics are that these companies sell, market, and manufacture in many countries. This means that global business strategies are needed, including research and development in multiple areas. Global marketing means a fully integrated worldwide strategy based on consistent brand selling. These companies are progressive. The dynamic forces inherent in all progressive companies are logically directed toward growth and expansion. When the opportunities for growth become limited in domestic markets, for whatever reason, there is no place to turn but to foreign areas.

Examples of these types of companies are General Motors (US), Philips (Netherlands), Samsung (Korea), Intel (US), Unilever (Netherlands; United Kingdom), Nestlé (Switzerland), and Hitachi (Japan). Of course, not all such companies are as large as the ones mentioned above.

Other goals

In addition to the goals already mentioned, marketing internationally can enhance the development of management personnel and stimulate the development of improved products and methods. The successful handling of situations in different foreign countries gives managers the opportunity to show how capable they are, and brings into the open new ideas and techniques that have been designed to handle particular situations. Moreover, although technology is such that invention and innovation are distributed unevenly, no one has a monopoly on success.

Another goal for exports is to provide a source of supply for the home market. This is the phenomenon known as the 'offshore plant' and can be defined as a plant owned by a company in one country (usually an industrialized country) but located in a less developed country whose principal mission is to manufacture products to be exported to the home country. One type of offshore plant operation has been used in Mexico since the early 1970s by US manufacturers with the encouragement of the Mexican government. These are assembly plants, known as *maquilalora* operations, mainly in the electronics industry, that have been established in designated duty-free areas. Originally, these plants were established in areas along the US–Mexican border in Tijuana, Mexicali, Ciudad Juarez, and Nuevo Laredo. However, due to rising labor costs along the border, firms located in the interior of Mexico, where labor costs are as much as 50% lower. For example, Motorola and Burroughs Corporation operate in Jalisco, near Guadalajara, and other similar facilities are in San Luis Potosí, Durango, and the remote Yucatán peninsula. Japanese manufacturers are also moving offshore, to lower costs. Regardless of the specific reason for investing in such ventures, for example intense import competition in the home market or the availability of extremely low-cost labor, the objective underlying the setting up of an offshore plant is the desire to export to the home market.

Related to the 'offshore production' phenomenon as an objective for exporters sourcing overseas is buying overseas (importing) from independent sellers simply because quality is better and/or prices are lower. For example, in 1989 a subsidiary of the US company Johnson & Johnson bought a water-purification system from a Finnish company because the system was better than anything available in the United States.

A concluding comment

To conclude our discussion on goals or objectives of individual business units it should be emphasized that companies usually operate with multiple goals in mind. However, one goal is often primary, while the others will, be secondary and set up so-called boundary conditions. Also, some goals may be 'given' to the export marketing executive by higher management, and he or she has to operate within the confines of such goals.

The development of export in the firm: internationalization stages

For most companies, export operations are the first step in internationalization. While some firms may first become international through other means of market entry, the process of **export development** is the key to increased internationalization for the majority of companies. The rates at which firms increase their international activities differ substantially. From the standpoints of both individual firms and organizations promoting exports, it is important to understand what factors determine the process followed and the rate at which it moves.

A number of studies of the export development process (i.e., the internationalization process) have been conducted over the past 30 years. From the viewpoint of the firm, internationalization is an evolutionary process in which foreign experience gained over time results in accumulated organizational learning. The learning cycles include processes by which the firm adjusts itself defensively to foreign markets as well as processes by which knowledge and experience are used offensively to improve the fit between the firm and its foreign market environment. Export development can be described as a stimulus–response process, in which experimental learning has been considered as an important determinant. Information activities, willingness to commit resources, and managerial risk-taking behavior are all essential in describing the process.

Within the research on export behavior, researchers have concentrated almost exclusively on finding industry and firm determinants of international activities. Relationships between market environmental variables and foreign activities have rarely been subject to systematic empirical analysis. In the 1970s and 1980s research dealt with identifying technology and product-specific variables as important structural factors contributing to the process of export expansion. Structural factors have often been regarded as critical determinants in the exporting activity of a firm, but the evidence to support the effect of size, product, and technology orientation is conflicting.

More recently, attention has been directed toward behavioral determinants of the process of internationalization. Research in this respect has been dealing with the role of the decision maker's perception of foreign markets, expectations concerning these markets, and the firm's capacity to enter such markets. The available research does give tentative support to the existence of individual managerial factors influencing the export behavior of firms.

Empirical evidence indicates that as companies increase their level of international involvement there is a tendency for them to change the methods by which they serve foreign markets. As well as increasing commitment, the pattern appears to be one of greater operational diversity as internationalization proceeds. This appears to be related not only to the greater experience, skills, and knowledge of foreign markets and marketing that develops within the firm, but also to the exposure of a wider range of possibilities and threats.

As the company increases its involvement in international operations there is also a tendency for its offering to foreign markets to become deeper and more diverse, whether through an expansion within an existing product line, a new product line, or by changing the whole product concept to include nonmaterial components such as services, technology, know-how, or some combination. In the same way, firms tend to export initially to those customer markets and/or countries that are familiar and/or similar (close psychological distance) in terms of history, culture, and industrial economic development, where barriers to information retrieval are low, and where resource commitment can proceed incrementally.

Theories of export behavior identify several stages in the process and, although each theory uses a different classification scheme, the theories all portray one common view: the decision to go international is a gradual process that can be subdivided.

It should be stressed that the concept of a sequential, cumulative process of internationalization does not necessarily mean a smooth, immutable path of development. The actual paths are often irregular. Commitments are frequently lumpy over time and particular steps are affected by the emergence of opportunities and/or threats that do not usually arrive in a continuous or controlled manner. The outcome tends to be derived from a mixture of deliberate and emergent strategies. Exhibit 2.3 briefly outlines the stages of exporting.

Companies do not necessarily internationalize in an orderly way.

As mentioned earlier, for many companies exporting is only the first step in internationalization. A more comprehensive view of, say, the stages of manufacturing firms is:

1. export operation stage;
2. foreign sales subsidiary stage;
3. licensing and contracting alliances;
4. foreign production subsidiary or alliance stage.

Each of these modes is discussed in subsequent chapters of the text.

Exhibit 2.3 Levels of exporting

Level 1: Export of surplus. The firm is interested only in overseas sales of surplus products, or is without resources to fill overseas orders for most products on a continuing basis.

Level 2: Export marketing. The firm actively solicits overseas sales of existing products and is willing to make limited modifications in its products and marketing procedures to accommodate overseas buyers' requirements.

Level 3: Overseas market development. The firm makes major modifications in products for export and in marketing practices in order to be better able to reach buyers in other countries.

Level 4: Technology development. The firm develops new products for existing or new overseas markets.

Exporting and the network model

Empirical research has demonstrated that firms in industrial markets establish and develop lasting business relationships with other businesses. This is known as *relationship marketing*; examples are shown in Exhibit 2.4. In particular, this is true in international markets, where a company is engaged in a network of business relationships comprising a number of different firms – export distributors, **agents**, foreign customers, competitors, and consultants as well as regulatory and other public agencies (see Figure 2.1). These business relationships are connected by networks, where the parties build mutual trust and knowledge through interaction, and that interaction means strong commitment to the relationships.

Industries such as textiles, clothing, and machinery can be regarded as networks of business relationships. Often the specific firm in question will be involved in different industrial networks because it exports to several countries. However, different industrial networks may be more or less international to the extent that the connections between networks in different countries are more or less intensive. A global industrial network can be partitioned in various ways. Delimitation can be made concerning geographical areas, products, techniques, and so on.

When the grouping is made on the basis of national borders, different 'national nets' can be identified. Correspondingly, 'production nets' refer to relationships between those companies whose activities are linked to a specific product area. For example, it is possible to distinguish a 'heavy truck net' including firms manufacturing, distributing, repairing, and using heavy trucks. The firms in the net are linked to each other and have specific dependence relations to each other. The 'heavy truck net' can further be distinguished by its nationality, for example a French heavy truck net operates in France.

The network model has consequences for the meaning of internationalization of the market. For example, a production network can be more or less internationalized. A high degree of internationalization of a production net implies that there are many and strong relationships between the different national sections of a global production net. On the other hand, a low degree of internationalization of a global production net means that most national nets have few relationships with each other.

Exhibit 2.4 Relationship marketing

Observers of the corporate scene in Europe and the United States might be forgiven for confusion. On the one hand, firms are busy subjecting once-stable relationships within companies to market pressures, contracting out noncore businesses and forging 'profit centres' within firms to compete for cash. On the other hand, they are turning away from market transactions with outsiders in favor of gentlemen's agreements.

Traditionally, firms would force their suppliers and distributors to compete on the basis of price. Today they increasingly rely on informal partnerships. Instead of having many suppliers compete for their business, they are reducing the number of suppliers they use (in the space of just three years in the 1990s, Ford reduced the number of its suppliers by 45%, 3M by 64% and Motorola by 70%) and forming closer relationships with the ones that survive. They are even helping their suppliers to tackle difficult problems, from financing to design. At the same time, they are breaking down the traditional boundaries that divided one company from another.

Companies are realizing that, far from being the prerogative of a particular company, creating value is the responsibility of an entire chain of firms, starting with suppliers and ending with distributors. Firms should be willing to improve the performance of their distributors and their suppliers in addition to improving their own performance.

In the West, this started first in the car business. Humiliated by Toyota in the late 1970s, US and European companies began to study Japanese business methods. They discovered that the *keiretsu* system of long-term relationships between firms and their suppliers helped Japanese firms to outperform them on quality and timeliness, as well as price. Now partnerships are so established that the US's General Motors and Germany's BMW even allow their suppliers to help design their cars.

One advantage of partnerships is that they can reduce transaction costs. Dealing with a handful of trusted suppliers is much easier than negotiating with hundreds of potentially hostile ones. Companies need to put less time and effort into cultivating relations, forecasting demand, processing orders, filling in invoices and hoarding stocks as a precaution against disaster.

In the first phase of the business craze of 're-engineering,' firms focused on their internal processes, obliterating here and contracting out there. When they discovered that they were still losing money, or that their employees were overstretched, they started looking outwards, to their relations with suppliers.

The Internet is making relationship marketing easier and more effective. A Special Report in *Businessweek* listed many examples including: (1) Lockheed Martin is linking 80 major suppliers from around the globe in a $255 billion project to design and build a new type of stealth fighter. The company expects the networking of designers and engineers to reduce costs by an average of $25 million per year. (2) In 2002 Sony linked teams of editors in different countries in order to get *Lord of the Rings: The Two Towers* back on schedule. The cost was about $1 million, but enabled on-time completion of the project. (3) Bovis Lend Lease construction company had a $600 million contract to modernize 10,000 BP gas stations in the United States. In 2001 the vice president of Bovis sent out 22,500 faxes just for parts orders. In 2002, he used Constructware software to coordinate the builders, architects, and 25 suppliers and subcontractors over the Web. The system has helped to reduce costs and double the pace of renovations. (4) Other examples include toy-maker Mattel connecting designers and licensees worldwide, IBM using an intranet for workers' brainstorming, and Eli Lilly drug company establishing a website where scientific problems are posted and anyone solving one of the problems can receive a reward ($600,000 paid out in two years) (Green *et al*., 2003).

Swapping electronic data, which allows customers and suppliers to share business documents in a few seconds, is proving so popular that many big companies are shunning nonusers. Tesco, a British supermarket chain, and Walmart, the US super-retailer, will not deal with suppliers who are not part of their automated system for ordering and paying for products. At its most extreme this integration ignores corporate boundaries and manages suppliers as though they were subsidiaries. Sherwin-Williams, a paint company, lets managers from Sears, Roebuck help select people who would service the Sears account. Eastman Kodak, a chemicals and films group, allows outsiders to run one of its supply rooms. Xerox and General Electric send people to each other's in-house training sessions.

Though partnerships are the height of popularity at the moment, they are not without their problems. For a start, they entail a loss of those two crucial competitive weapons, confidentiality and freedom. A firm that hands its production schedule over to a supplier may see that supplier run off with a rival. The car firm that pays its supplier for what it uses may have reduced its paperwork but it has also made itself dependent on a supplier that may raise prices or go bust.

And partnerships are difficult to manage. If managing one firm is difficult, managing several, with different cultures and strategies, can be a nightmare.

When relationships develop through interaction the people or companies in the local or international environment are tied to each other through a number of different bonds: technical, social, administrative, legal, economic, and so on. These bonds can be exemplified by, respectively, product and process adjustments, knowledge about counterparts, personal confidence, special credit agreements, and long-term contracts.

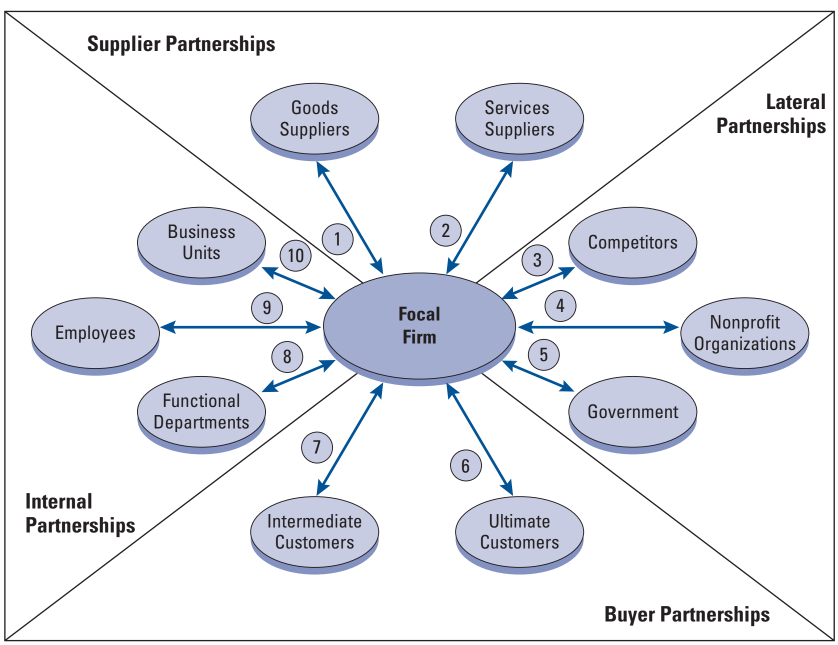

Figure 2.1 Relational exchanges in relationship marketing

Source: Morgan and Hunt, 1994, p. 21.

According to the network model, the internationalization characteristics of both the firm and of the market influence the process (Johanson and Mattson, 1988). In terms of networks, internationalization means that the firm develops business relationships in networks in other countries, that is, network positions. But the firm's internal assets (a unique product line, an efficient production process, and so forth) have a different structure when the company is highly internationalized than when it is not. Similarly, the competitive strength of the assets may differ if the market has a high or low degree of internationalization.

A basic assumption in the network model is that the individual firm is dependent on resources controlled by other firms. The companies get access to these external resources through their network positions. Since the development of positions takes time and depends on resource accumulations, a firm must establish and develop positions in relation to counterparts in foreign networks. This can be achieved by (1) *international extension*, through establishment of positions in national nets that are new to the firm, (2) *penetration*, by developing an existing foreign position, and (3) *international integration*, by increasing coordination between positions in different national nets. Which option the firm may choose depends on the internationalization degree of both the firm and the market.

In sum, the network approach of internationalization offers a model of the market and the firm's relationship to that market. The model stresses the cumulative nature of the firm's activities in developing international market positions and seems especially important in understanding key issues involved in cooperation in industrial systems and of global industry competition.

Ethical/moral issues

Marketing activities are being subjected to increasing scrutiny and challenges on ethical grounds. There are growing demands from consumers, special interest groups, and the public for companies to behave in a socially responsible manner. At the same time, governments continue to expand restrictions and requirements governing corporate behavior. For international marketers, meeting these expectations and demands is particularly difficult. With activities in more than one country, they frequently deal simultaneously with more than one set of ethics, different views of what constitutes socially responsible behavior, and different legal requirements. The issue is an important one. In the short run, failure to act in an ethical and socially responsible way may result in a wide range of problems including protests by customers or special interest groups, possible loss of markets/market shares, and/or lawsuits, penalties and fines. In the long run, failure to act in accordance with changing societal expectations results in additional laws and restrictions on business activities.

The objective of this section is to provide the export/international marketer with a basic understanding of the ethical factors that should be considered in evaluating proposed actions or activities. In doing so, it is useful to discuss what is meant by **ethical behavior**, some criticisms of the behavior of international companies, and possible ethical models to use in evaluating possible different courses of action.

Defining ethics

Ethical behavior, at its most basic level, is what most people in a given society or group view as being moral, good, or right. Some societies emphasize moral conduct based on abstract moral principles, the violation of which is expected to cause feelings of guilt. Other societies emphasize correct or proper conduct based on what is expected in the situation/relationship, the violation of which is expected to cause a feeling of shame (Sullivan, 1999). The judgement as to whether a decision is considered ethical is 'firmly anchored and steeped in a set of individual, corporate and social values, which derive from the cultural underpinnings of a society' (Sanyal, 2001, p. 150). Stated another way, what is considered ethical in one society may be considered unethical in another.

Three examples that illustrate these basic differences may be seen in the varying views of the paying of interest on loans, the attitudes toward women in the workforce, and differences regarding the payment of bribes. Lending money for the payment of interest is ethical in many societies, but considered unethical in some Islamic societies. Providing equal employment opportunities for women is considered morally right in many countries (and required by law in some), but is specifically prohibited by law in other countries. There are great differences in attitudes toward the payment of bribes or gratuities between countries.

In testimony before a Select Committee of the British House of Commons in 2001, Unilever and BP argued that small 'facilitating payments' or bribes are a commercial requirement in some countries (Mason, 2001). Even though their job requires it, Customs personnel may refuse to clear merchandise or other local government workers may refuse to process paperwork unless a small 'gratuity' is paid. Lower-level government officials are so poorly paid in some countries that they simply cannot survive without such payments. In some areas, gifts to local officials are traditional and considered ethical (if they are even thought about from this perspective). In other areas, the local people view them as unfair and exploitative, though perhaps necessary.

Large-scale bribery is more generally condemned, though it has been widely practiced, and is still a fact of life in some nations. It has been reported that leading exporters in the construction and arms industries have traditionally paid 10% or more of the value of a contract to a senior official or officials to obtain the contract (Mason, 2001). Payments made by international corporations, though sometimes legal in the countries in which they were made, are often considered unethical in the corporation's home country, and receive widespread unfavorable publicity in the international press. Such publicity resulted in the passage of the Foreign Corrupt Practices Act in the United States in 1977. This Act specifically prohibited the payment of bribes to foreign government officials, directly or indirectly, in order to obtain sales or contracts.

From 1977 to 1998, few other industrialized nations passed such comprehensive and punitive anti-bribery legislation. This put the United States at a serious disadvantage in the many countries where government officials were accustomed to receiving facilitating payments, and failure to do so was sometimes considered unreasonable or even unethical. Some other industrialized nations continued to allow their own companies to deduct money paid as bribes as a tax-deductible expense, or as an 'unexplained' but taxable expense.

In 1998, the OECD, together with five other nations, developed a proposed convention making bribery of public officials a criminal offense. However, it was up to each of the participating nations to pass legislation to make it apply to their own companies, and to enforce the law. That is, there was no supranational body authorized to do so. The United Kingdom passed legislation in 2001 making the bribing of foreign officials a criminal offense. In December 2006, in the midst of a two-year probe into allegations that their BAE Systems paid kickbacks to members of the Saudi royal family in connection with a £40 billion arms deal, the United Kingdom government called a halt to the investigation with the Attorney

General stating that the United Kingdom had 'to balance the need to maintain the rule of law against the wider public interest' (*Financial Times*, 2007a). It was unclear whether this was done to avoid a Saudi threat to cease cooperating with the United Kingdom in intelligence operations or because it would jeopardize an additional £40 billion sale of British Eurofighters (Adams, 2007). Germany and France are currently pursuing investigations of domestic companies accused of bribery, but Italy, Denmark, Canada, the Netherlands, and Japan have so far failed to enforce anti-bribery laws (*Financial Times*, 2007a).

The US Department of Justice is now undertaking prosecutions of foreign companies that do business in the United States for bribes paid in third countries (for example a subsidiary of UK's Vetco was fined for paying bribes to Nigerian officials; Masters, 2007). In 2006, the United States launched 15 new investigations. Sweden is investigating the Swedish engineering company Saab, 20% owned by BAE Systems, over allegations of bribery in a contract to sell fighter aircraft to the Czech Republic. They are trying to determine if Saab was involved in the alleged bribery (*Financial Times*, 2007b).

The issue of making facilitating payments or bribes may present a difficult dilemma to the international marketer. To do so may violate his or her personal ethical code and the laws of the home country, and possibly those of the host nation. To fail to do so may, in some cases, result in lost sales, profits, and jobs for the company – and perhaps purchase by the host nation of inferior products from a company that will make such payments. The desire to remain fully competitive may account for the reluctance of most industrialized countries to pass laws against making facilitating payments abroad.

In 2015, the world organization for the most popular sport worldwide football (also known as soccer in the United States) FIFA, came under heavy fire for unethical behavior. FIFA officials had long been suspected and accused of taking bribes from the countries applying to host the World Cup. The head of FIFA Sepp Blatter had for years denied such accusations and FIFA had carried out internal investigations finding virtually no wrongdoings by anyone. The FBI in 2015 just a few days before the election of the next FIFA president at an annual meeting held in Switzerland asked the Swiss police to arrest several FIFA top people. Un-phased, the sitting president Sepp Blatter declared business as usual and the elections went ahead. Blatter won the vote and his fifth term over the rival Prince Ali bin al-Hussein. Blatter has been accused of using FIFA money which mainly stem from sales of television rights paid by companies from the major European and North-American countries to be associated with the most famous players from Europe and South-America – to pay smaller countries (in a football sense) mainly in Asia and Africa. Blatter argues that this money is a form of football aid to poorer countries or countries with less of a football culture while critics argues that this is the way Blatter has bought votes from these countries over the years. Only a few days after getting reelected Blatter resigned amid the FBI investigations and in particular a case where $10 million allegedly were paid from South Africa to certain FIFA officials in return for their vote (*The Economist*, 2015). South Africa hosted the World Cup in 2010. Accusations of bribery and other unethical practices continue to haunt FIFA.

Companies have also been accused of unethical behavior in a number of other activities or practices. In 2000 Bridgestone Corporation of Japan was accused of failing to promptly recall defective tires that resulted in a number of accidents, injuries, and deaths in the Middle East, Latin America, and the United States. An earlier case that received widespread publicity was Nestlé's introduction of baby formula in areas where breastfeeding was the norm and the product was improperly used by many mothers. Also widely criticized have been business activities that tend to support oppressive regimes where human rights are viewed as being violated, such as Royal Dutch/Shell in Nigeria and UNOCAL in Myanmar (Burma) in the 1990s and continuing to the present time. Charges have been raised that some companies are providing inadequate pay or poor working conditions to employees in the less developed nations, or buying products produced by foreign companies or government organizations that mistreat workers. In 2003 a lawsuit in the United States against two dozen large clothing retailers over alleged labor abuses in the Pacific island of Saipan was settled for $20 million. Also in 2003, for the first time, a dozen international companies that belong to the Fair Labor Association (www.fairlabor.org), including Phillips-Van Hensen, Reebok, Adidas, and Levi Strauss, made public labor audit findings on overseas factories that produce their products. This is expected to increase pressure on other firms to release information on conditions in their overseas factories (Bernstein, 2003).

An increasing number of companies, such as oil giant Chevron and Ford have started issuing annual reports on their corporate social responsibility performance.

An issue of particular and increasing concern is the effect of business activities on the environment, including global warming, pollution, wasting of natural resources, the destruction of forests, residual waste, destruction of animal and plant species, etc. Emphasis on these concerns tends to be greatest in the industrialized world, while many of the lesser-developed countries still prioritize promoting economic growth or other objectives. One way for the international marketer to operationalize its concern for the environment is to develop an internal environmental management system (EMS). At the international level in the late 1990s the International Standards Organization set a standard known as ISO14001 and companies could gain registration by meeting specified criteria. As discussed below, conforming to ISO14001 is becoming necessary for many companies.

Larger international and global enterprises are the ones most often identified as violating ethical standards. This is due primarily to the fact that they are 'high-profile' companies. Failing to meet ethical (and legal) standards is often as damaging for small and medium-sized businesses as it is for larger entities.

Possible bases for ethical decision-making

The international marketer would like to have some guides to action regarding ethical behavior. Unfortunately, there is no universally agreed upon, or even widely accepted, standard or model that will always lead to decisions that will be viewed as ethical. Carroll and Buchholtz (2000) have provided a useful summary of a variety of approaches to ethics that may give helpful insights to decision makers. These include the following:

- **Principle of Utilitarianism:** the correctness of an action is determined by its results, such as the efficiency in use of resources or overall benefits to society. A weakness is that it may lead to a failure to consider the morality of the means used.
- **Principle of Rights:** individual or group rights should not be overridden simply because overall benefits to society occur. What is claimed as a 'right' by one individual or group may be validated by law or claimed on some other basis. Various rights may be in conflict (smokers vs non-smokers).
- **Principle of Justice:** fair treatment. Distributive Justice refers to the distribution of benefits and burden; Compensatory Justice refers to making up for past injustices; and Procedural Justice refers to fair treatment.

- **Additional approaches:** include the Principle of Caring, focused on people; Virtue Ethics, concerned with the development of virtuous people; and others including the Golden Rule.

Sanyal (2001, pp. 451–2) has discussed three extreme positions including individual relativism (based solely on what the individual decision maker thinks is right), cultural relativism (based on values in the host country alone), and ethical imperialism (based solely on home country values). He indicates that these extreme views indicate a need for universalism (based on core values and principles that are applicable everywhere). The core values that are universally accepted tend to be very general and subject to different interpretations in specific situations.

The different approaches will not always lead to the same conclusion or course of action. Thus the individual still must make decisions based upon his or her understanding of the way in which people in both the home and host countries will view the decisions from the perspective of ethics and morals.

Applying ethics in international marketing

Certainly international marketers need to be concerned with issues related to products (or services), promotion, and their customers. A number of the issues are also the subject of legal requirements in many countries. A more complete discussion of these issues is found in Maidment and Eldridge (2000, Ch. 14):

- the product (or service) should be safe and effective for use in the intended manner. Potential hazards or problems, both when used as intended and with possible misuse or use in other applications, should be identified. The product or service should not damage the people or the environment in the target market;
- in activities related to market entry and expansion, care should be taken to ensure that methods used do not conflict with either local or home country values, and will not be construed as including bribery;
- advertising and promotion should honestly represent the product or service, avoiding misleading or confusing claims. The international marketer must also be aware of what approaches and subjects are considered as acceptable in the target market, and conform to local requirements. Control of activities by sales persons in the field is difficult, and efforts should be made to ensure that false claims and pressure tactics are not used. Proper training of field personnel is necessary, and sales incentives should be carefully designed to avoid putting pressure on people in the field to behave in ways not proper with respect to the product or customers;
- prices should be set at a level that will be viewed as reasonable or fair, given the conditions in the target market. Both dumping (selling at below the cost of production or the cost of the product or service in the home market) and prices that will be viewed as excessively high should be avoided;
- customers, employees, and suppliers should all be treated in a manner viewed as equitable and proper in their country.

Some specific 'dos and don'ts' are found in Fritzsche (1985, p. 95).

The international marketer must also be aware of ethical issues that are currently receiving increased attention. Some involve the marketing chain and others involve the procurement chain. One issue is the promotion of goods and sales to children of toys or games that may encourage or promote violence or other improper behavior. Another is the use of misleading advertisements and pressure tactics in selling to people who may be particularly impressionable or easily influenced (such as children and the elderly). Procurement activities are also of increasing concern, including the production of goods or the purchase of goods made by underpaid or unfairly treated workers, use of child labor, pollution of the environment in extractive or processing industries, and the waste or destruction of natural resources in procuring and manufacturing goods. In all company activities, the best practice is usually to base actions on the highest ethical standards, whether the standards are those of the host country or of the home country.

In brief, the international marketer needs to understand that his or her beliefs about what is right and wrong may not be shared by those in the countries in which this marketing occurs. Knowledge of the ethics, values, and customs in the overseas markets, as well as those in the home market, is necessary for successful marketing and avoiding possible problems. The great importance of the legal framework is dealt with in Chapter 4.

Social responsibility and the business environment

Traditional British and US views have held that the primary goal of business organizations was to maximize profits/returns to the stockholders. In much of continental Europe it was believed that businesses had broader obligations including specific responsibilities toward customers, employees, suppliers, and society as a whole. In Japan, the reason-for-being of private business organizations was to advance the interests of the nation, including economic growth, social and political stability, and international recognition. Stability of employment and market share were more important than the level of profits, values that are changing only slowly even in the 2010s. However, they are changing, particularly in foreign-controlled companies such as Nissan (Renault) and Mazda (Ford). Even in the traditional large Japanese companies, fewer employees are being covered by the lifetime employment system as companies rely more on temporary workers, and companies in serious financial difficulties have encouraged or even forced regular workers into 'early retirement.' Some new university graduates no longer seek 'jobs for life,' though most who are able to obtain regular employment with a large company do so. With some increases in employment opportunities in Japan in 2007, there is also some return to a preference for 'lifetime employment.' There is also a small cadre of university graduates who prefer to work for foreign companies that are believed to offer less security but greater opportunities.

Even in the United States, the foremost proponent of a laissez-faire economy with severely limited government intervention, the government has in fact been placing restrictions on businesses for social reasons for over 100 years. Laws were passed to protect the public and promote competition (1890s onwards), and later to promote social goals (1930s and 1950s onwards). Business as a whole opposed the majority of these initiatives, viewing them as impediments to maximizing profits.

A broader concept of corporate social responsibility began to receive widespread attention in the 1960s. Changing social values, and therefore a changing social environment of business, led to a discussion of whether companies should go beyond legal requirements and proactively attempt to improve society and the environment. There were a number of arguments in favor of companies going beyond what is required, including the following:

- business must respond to changes in society and its demands/expectations;
- profit maximization in the long run requires a socially and physically healthy environment;
- it was necessary to do so in order to avoid increasing government regulation;
- it would provide a better corporate image, with benefits in the ability to attract better employees, increased sales, improved access to capital, and improved stock performance;
- it might open up additional opportunities profitably to meet existing or emerging demands.

Arguments against companies going further than required in attempting to improve society included the following:

- it would reduce the company's ability to meet its primary objective of maximizing profits to stockholders;
- it would undermine free enterprise and result in business assuming functions that should be handled by the government or social institutions;
- it would place individual business leaders in the position of personally making nonbusiness-related decisions about spending corporate money;
- the whole concept is fuzzy.

The stakeholder concept

An expanded view of what corporations should be responsible for doing was fostered by the recognition that businesses have more than just shareholders/owners. They also have 'stakeholders' who have an interest or some share in the undertaking. The shareholder/owner is a stakeholder with a legal right to certain treatment. Other stakeholders, such as employees, customers, suppliers, and the government, also have certain legal rights. In addition to these legal rights, stakeholders may claim moral rights. An employee may feel that he has a moral right to his job, beyond the requirements of the law, because of his long service to the company. A customer may feel that she has a right to have a product that is better or safer than the warranty specifies because of the money she spent on it.

Primary stakeholders who have a direct or financial interest in the firm usually exert the most influence. Owners/shareholders/strategic alliance partners, employees/managers, and customers have obvious interests. Governmental bodies, through regulation, collecting taxes, providing benefits, and acting as customers, are particularly influential.

While many small investors in stocks may feel that they have little influence, the institutional investors who now own 49% of US equities are becoming increasingly active in attempting to bring about changes in corporate behavior (*The Economist*, 2003). Public employee pension funds are at the forefront of this effort. CalPERS (the California Public Employees' Retirement System) and CalSTRS (the California State Teachers Retirement System), together with similar funds from Connecticut, New York, North Carolina, and Ohio, manage over $500 billion in assets. The majority of their funds are invested in equities in large US corporations, and their votes can be crucial in elections of corporate directors. CalPERS annually publishes a list of companies that it judges are poor performers and do not follow good corporate governance practices. It encourages them to change, and if they do not may take more direct action. Research indicates that a number of companies targeted by CalPERS in the past did take action to improve and, on average, have enjoyed substantial increases in returns (Earle, 2004). CalPERS also removes investments in whole countries from the list in which they will invest if the countries do not meet criteria regarding labor standards, press freedom, financial transparency, and shareholder protection (Engardio, 2002).

In March 2003 the six funds listed above worked together in declining to support the reelection of Michael Eisner, the president and CEO of Disney. Since no alternative candidates were listed on the slate proposed by the company, votes were simply withheld for Eisner on 43% of all shares. The board of directors acted quickly to split the positions of CEO and chairman, appointing a new chairman but retaining Eisner as CEO (Burt and Parkes, 2004). Eisner subsequently retired. Since then, CalPERS has acted to nominate a critic of the New York Stock Exchange to its board of directors and, working with other funds, decided to withhold support for the CEO and six other directors of Citigroup, the CEO and two directors of Safeway, and the entire board of Pacific Gas & Electric (Raine, 2004; Brewster, 2004).

Secondary stakeholders may also exert significant influence. Competitors and potential competitors are of obvious importance. The media has a direct effect on public opinion, and also an influence on legislation affecting business. Special interest groups and individuals have become increasingly important in recent years, promoting causes and directly or indirectly influencing the media, the public, and legislators. Some of these groups/individuals are directly involved with business as a whole (such as labor overall that is concerned with unfair competition from poorly paid/badly treated foreign labor, and minority and women's groups concerned about discrimination and equal opportunities). Others are affected by the actions of business in which they are not direct participants (such as those living near sources of pollution). Yet others act out of overall concern for the environment, human rights (including labor), or other causes (such as animal rights). The stakeholder concept is discussed in detail by Carroll and Buchholz (2000).

Changing views of social responsibility

The actions of the media, educational institutions, special interest groups, and others have led to increasing public awareness of social, economic, and environmental problems, and increasing demands for businesses to act in a socially responsible manner. The definition of what is socially responsible, as with the definition of ethics, varies from society to society. However, the strong tendency is for societies to demand that companies act with increasing concern for the overall societal and environmental needs, as well as economic needs.

There is still debate about what and how much companies should do voluntarily. A number of US companies have undertaken initiatives to help the communities in which they do business, encouraging employees to put in volunteer work on specific projects from building children's playgrounds to refurbishing schools and tutoring (Grow *et al*., 2005). Silicon Valley billionaires as individuals, through their nonprofit foundations, and through their companies are funding a wide range of projects ranging from promoting social equity through health to housing improvement (Jack, 2007). However, the argument is still being made that businesses should not try to be social institutions. Robert B. Reich, a Professor at the University of California's Goldman School of Public Policy and author of *Supercapitalism: The Transformation of Business, Democracy, and Everyday Life* (2008), has argued that company CEOs do not have the authority or legitimacy to decide where the public interest lies. In an interview, as in the book, he has argued that the government should set social goals and make rules for companies to follow (Coy, 2007). The public, however, does seem to expect companies to do more than just follow the minimum requirements of the law. Implementing a green export strategy may also be financially beneficial for firms. Research (Leonidou *et al*., 2015) shows that firms which follow a green export strategy enjoyed a differentiation advantage but no cost advantage. Whether or not firms implement a green export strategy is driven both by internal and external forces. For example, deciding drivers are environmental concern in the host country, top management sensitivity, and organizational culture.

In free market economies, social responsibility for a company with widespread private ownership would seem to include, as a minimum, the following objectives:

- conducting business in accordance with the owners' desires; including
- maximizing profits, or at least returning a satisfactory level of profits; while
- conforming to the law in both the host and home nation;
- conforming to the ethical values of both the host and home nation.

Even in free market economies, companies that are privately held, such as the US's Ben & Jerry's Ice Cream before its acquisition by Unilever, may be willing to sacrifice substantial profits in order to pursue social goals. Volkswagen AG, whose largest stockholder is the German state of Lower Saxony and with the apparent acquiescence of other shareholders, has always been more concerned about providing jobs for local workers than about profits and share prices (Miller, 2000).

Many large US and western European companies have developed codes of ethical conduct and/or social responsibility, though not all have made their codes available to every employee and the public. All leading business schools in the United States, and elsewhere, address the topics of ethics and social responsibility in their curricula. The United States leads the way in corporate giving to educational, humanitarian, and cultural organizations. European corporations have traditionally been less socially proactive, partly because the European governments tend to play a more central role. In Japan, there is no tradition of corporate giving and businesses have concentrated their efforts on protection of the company and its employees.

The international marketer must be aware of the need to act in a way that is viewed as socially responsible in both the host and home countries. The guidelines listed in the discussion of ethics above should be of help in evaluating current and proposed activities. An interesting account of the differences between Japan and the United States in legal practices, business–government relations, and views of the social responsibility of business is presented in Exhibit 2.5. What this illustrates is the need for companies entering markets with subsidiaries or with other modes to understand that things are most likely not as they are used to.

It is not inherent that social responsibility and corporate profit are incompatible. A good example of this is companies' signing on to the ISO 14001 standard that is concerned with the environment, and requires a specified type of EMS (Fielding, 2000; Lister, 1998). As market pressures start to dominate, more companies are considering the international environment standard a *necessary* business tool. As of the end of 2000, more than 10,000 companies worldwide have had their facilities registered to ISO 14001. Along with this, companies such as IBM, Ford Motor Co., Xerox, General Motors, and Honda of America are asking – even requiring – their suppliers to develop an EMS similar to ISO 14001 or be registered to ISO 14001. Many companies are finding that profits are increasing as costs such as those for energy go down due to ISO 14001.

Exhibit 2.5 Legal practices, business–government relations, and social responsibility in two countries

Japan and the United States have significantly different legal practices, business–government relations, and views of the social responsibility of businesses. These differences need to be taken into account in company policies and practices of Japanese subsidiaries in the United States and US subsidiaries in Japan. While the Japanese public is becoming more concerned about corporate behavior than it has been in the past, often Japanese companies are still not quite subject to the detailed scrutiny or potential liabilities that they are in the United States.

Legal practices

The United States has the most litigious society of any industrial nation. Lawsuits are a widespread and accepted means of settling disputes between and among individuals, businesses, and government agencies. Judgements are made as to who was right and who was wrong, and often result in monetary awards for laws violated, losses incurred and/or punitive damages meant to punish an organization or individual for misdeeds. Penalties and monetary awards are often large, frequently in the millions and sometimes in the billions of dollars. A number of large US corporations, including Dow Corning, Johns Manville, and several asbestos-related companies, have been driven into bankruptcy by lawsuits claiming injury resulting from the products of the companies or exposure to environmental hazards at work. Lawyers may take cases on a contingency fee basis for plaintiffs seeking damages; the lawyers collect a part of the damages awarded if they win, and the clients pay nothing if they fail to win. This does give greater access to the legal system for individuals, particularly for individuals with limited financial resources, but also results in many additional lawsuits.

As in most other countries, in Japan, recourse to the legal system is much less common than it is in the United States. The nation has less than one-twentieth of the number of lawyers per capita as the United States, 17 lawyers per 100,000 population in Japan compared to 352 per 100,000 population in the United States (Naohiro, 2000, p. 41). The Japanese public and neighbors tend to react badly to lawsuits (Hendry, 2003, p. 237). There is an emphasis on conciliation, both informal and formal, rather than recourse to the courts. For cases that do reach the courts, the judge usually tries to satisfy both sides, not make declarations about right and wrong. An attempt is made to restore harmony. In Japan, all cases are decided by judges; the nation does not use the jury system available to most litigants in the United States. In criminal cases, apologies may serve to lessen sentences since the objective is to correct behavior and not to punish (Hendry, 2003, p. 235). For corporate failures or misdeeds, acceptance of responsibility and resignation of the president may be considered an adequate response by the company.

Examples of the relatively infrequent resort to courts and the small penalties are found in both governmental and private actions. The Japanese government imposed only a relatively small fine (by European and US standards) on Mitsubishi Motor Company for concealing automobile defects from the Japanese government for a period of over 30 years. Even major cases of product-related injuries and deaths do not usually result in a number of lawsuits. Payments for damages are rare and are usually relatively small. The Snow Brand recall, discussed below, provides an interesting example of a company that was sensitive to customer and public concerns, but acted in a very non-Western way. In recent years, there have been an increasing number of lawsuits between individuals resulting from automobile accidents, but even these are still very uncommon.

Business–government relations

While there are many ties between government and business in the United States, and companies often contribute to both major political parties' fund-raising for elections, business–government relations are basically adversarial. Underlying the relationship is a societal emphasis on the rights of the individual, a strong belief in property rights (and profits), and a belief that free competition is both fair and results in the availability of more goods and services for consumers. The government, which has the objectives of protecting the public and promoting competition, has passed many laws, established agencies, and taken actions that most businesses have felt (at least at the time) have interfered with their property rights, efficient operations, and profit. With differences in some basic goals, business and government often tend to be in an adversarial relationship.

The United States enforces its laws through a bureaucracy that is usually aggressive in investigating violations of laws and regulations, and through heavy financial and sometimes criminal penalties for non-compliance. The government levies penalties and/or sues on its own initiative, and also acts on complaints or enters cases brought by individuals or organizations where it deems appropriate. The aggressiveness and adversarial stance taken by US government agencies, and the large penalties that may be assessed by US courts, is often a surprise to Japanese companies (and sometimes companies from other countries). Almost every large Japanese subsidiary in the United States, for example, has been charged with discrimination or sexual harassment, and many have paid multi-million dollar settlements. Most of the actions in which the companies engaged would not have been violations of Japanese law, and none would have been subject to large fines.

Business–government relations in Japan are so cooperative that many outsiders have viewed them as conspiratorial. The generally close cooperation, however, is actually based primarily on Japanese beliefs that cooperation is often more effective than competition, that the group is more important than the individual, that the nation is the most important group of all, and that strong industries are needed to promote national interests. Industry and labor, as well as the government, have shown a sense of national purpose in promoting economic growth and stability. Thus, similar objectives and mutual dependence are the basis of cooperation.

Japanese antitrust laws on the US model do exist – as a result of actions taken during the Allied Occupation after World War II – but are seldom enforced. Since the end of the Occupation in 1951 no significant legislation affecting business has been drafted and passed without substantial consultation with and input from businesses. Where business has had serious concerns about the effects of a proposed law, modifications are almost always made to the law before it is passed by the legislature. For example, in the case of the 1985 Equal Employment Opportunity Law that addresses the rights of women in the workforce, business pressure resulted in the law having no enforcement provisions at all. The law can be, and is, violated without legal penalty by many companies (Duerr, 1997, p. 67; Nakanishi and Duerr, 1999, p. 130). In the relatively few cases where the government has taken formal administrative or legal actions against companies, penalties usually have been small or nonexistent.

Views of the social responsibility of business

The public in the United States shows a high level of concern over business behavior that affects consumers, workers, suppliers, minorities, the public, the environment, the community, international activities, and other areas. A study of over 22,000 people in 23 countries indicated that the United States has the highest percentage of consumers who say they have punished a company for not being socially responsible by refusing to buy its products or services (*San Francisco Chronicle*, 2000b). The media is active in investigating and publicizing corporate misdeeds or problems, including those related to unsafe products. A number of individuals and public interest groups have goals of putting pressure on companies to change their behavior in ways that are believed to be more socially responsible. The government, as noted above, is active in trying to at least ensure compliance with the law. The national legislature conducts hearings about problem areas, and additional laws believed to be in the public interest are enacted. Curricula in university schools of business address the topics of ethics and social responsibility. While the pursuit of profit remains a primary goal, most large companies have policies or statements regarding corporate social responsibility.

The Japanese public has generally shown much less concern with issues of the social responsibility of business. The primary responsibility of companies has been believed to be to provide jobs and economic growth, and business and government together have been credited with creating Japan's highly prosperous society and high level of employment. The greater importance of the group as compared to the individual, or the larger group (total company) compared to the smaller group (some workers or a small community) tended to make complaints seem selfish (Hendry, 2003, p. 58). The media in Japan has been less likely than their US counterparts to report certain types of misdeeds. Where serious corporate misbehavior has received public attention in the media, an apology or resignation by the president of the company has often been viewed as a sufficient response.

Changes are now occurring in Japan as a result of several factors. The economic slowdown and increasing unemployment during the last 10 years, the collapse of a number of companies due to mismanagement or bad judgement, and scandals involving payoffs to gangsters and bribes to government officials have reduced the faith of many Japanese in their government and companies. The June 2000 case of Snow Brand Milk Products, where nearly 15,000 people were made sick by contaminated milk from the country's biggest dairy, and the revelation that some of the recalled products were secretly reshipped to other stores, created distrust in the minds of many Japanese consumers. The response of the company to the problem was uniquely Japanese. Snow Brands made a payment to everyone who indicated that they had been made ill, without trying to evaluate the validity of the claim, and without lawsuits being filed. The company also paid a fine to the government. Additionally, a manager from the company personally visited every person who reported they had problems, and made a personal apology for the company's actions. Then the president, vice presidents, and other senior executives of the company all resigned in apology. The process was time-consuming but consumer confidence was restored and the company enjoyed a rebound in sales. Though there were 18 food-contamination recalls in July 2000, the Japanese Consumers Cooperative claims that contamination is not on the rise but that the problem is just getting more attention (*San Francisco Chronicle*, 2000a). The increased media attention to such problems should also encourage change.

Effects on the political/legal environment

Any issues related to the social responsibility of business may result in changes in the political/legal environment discussed in Chapter 3. These will occur when some group is successful in identifying a problem/issue and proposal for change, developing support for their position, and finally obtaining legislative or administrative changes implementing the objective. The group may comprise members from any of the primary or secondary stakeholders. Changes impacting a large number of people usually trigger the push for change, and the media normally play a role in bringing the problem, related issues, and possible solutions to the attention of the public as a whole. Legislators and officials who can bring about changes in appropriate laws or regulations are affected both by the press and by their constituents.

Issues currently receiving substantial attention from special interest groups, the media, and government officials include (with the degree of emphasis varying from country to country):

- environmental issues, pollution, global warming;
- outsourcing of jobs;
- unsafe products;
- discrimination;
- corruption;
- child pornography;
- exploitive marketing of products to children;
- executive compensation deemed to be excessive (particularly in the United States, the United Kingdom, and Switzerland);
- personal security and security of personal information;
- problems in education;
- poor standards of treatment of workers in some underdeveloped nations by local suppliers to international companies, or by subsidiaries of the international companies.

Environmental issues have been pushed to the forefront by global warming and the degradation of the environment. This has been the subject of much legislation. Many companies, particularly those involved in international business, have made action on environmental issues and actions to help solve problems in the lesser-developed countries key parts of their corporate objectives.

The outsourcing of jobs, discussed in Chapter 1, is another subject that has received much attention in the industrialized nations. This is now affecting highly educated people in the knowledge-intensive industries. It has raised concerns about the loss of valuable segments of the economy, as well as the jobs themselves, and the security of private health and financial information sent abroad.

Arguments for avoiding restrictions on sending work abroad include the need to remain internationally competitive. In the United States, arguments revolve around the demonstrated resilience of the economy to past changes, the benefits derived from past openness to change, and the expectation that new jobs will be created, as has been true in the past. For example, Peter Drucker has emphasized the number of jobs that have been created in the United States by foreign companies setting up facilities there, including 60,000 by Germany's Siemens and tens of thousands more by Japanese and European automobile manufacturers. US unemployment reached record lows after the implementation of the NAFTA trade agreement with Canada and Mexico, and remains the lowest among the Western industrialized nations (Drucker, 2004). Unemployment rates in the United States increased substantially after the recession discussed in the Appendix to Chapter 1.

Some state and local restrictions on outsourcing of jobs have been passed, but the likely effects are small. Given the overall business and political environment, it would be difficult to pass legislation that would seriously impede the freedom of US business to increase outsourcing.

Executive compensation has become a matter of greater concern, particularly after the recession and revelations of large payouts even to executives of failing or failed companies. In 2009, the US government ordered seven companies that had received large amounts of bailout funds to cut total compensation for their top executives in half (Crutsinger, 2009).

Total compensation for CEOs in the United States, including annual bonuses and long-term incentives, is approximately twice that of European CEOs and ten times that of Japanese CEOs (Hayashi and Dvorak, 2008). The largest differences were in annual incentives and long-term incentives. In the G7+, the share of national income going to workers has been dropping sharply and the share going to corporate profits has been rising sharply since 2002. Legislators in France, Germany and the Netherlands are moving to curtail boardroom excesses (Thornhill *et al.*, 2008). There is broad concern across Europe, Asia, and China that income inequality between rich and poor is too wide and taxes on the rich should be raised (Thornhill, 2008).

There are not clear answers to many ethical questions, though almost every individual has an answer she or he thinks is correct. Exhibit 2.6 presents an example of a company action that some would think was the only right thing to do, and others might think was the wrong thing to do. It would be interesting to see how the members of a class might view it, especially if there were students from several different countries in the class.

Exhibit 2.6 An ethical question

Mark Hurd, Chief Executive Officer of Hewlett-Packard, was forced out of the company on August 6, 2010. He was one of the industry's most highly regarded executives (Waters, 2010). Hurd had been named CEO of HP in March 2005 and was 'widely credited with turning the company around after the volatile reign of Carly Fiorina' (Temple, 2010) (see also Case 15.1 in Chapter 15). During his tenure, the company's sales and reputation grew and profits increased to well over twice what they had been when he was appointed (the value of HP stock dropped $10 billion when his resignation was announced).

The forced departure was the result of an allegation of sexual harassment by a former contract employee. The allegation resulted in a broader investigation into Hurd's conduct. It is not clear why the complaint had been made since the woman, identified as Jodie Fisher, settled the claim out of court, possibly for some amount of money. Fisher said through her attorney 'that there was no affair and no intimate sexual relationship' (Kim, 2010). HP's own investigators had already revealed that what the woman claimed did not constitute sexual harassment (Robertson and Metz, 2010).

Fisher had worked as a host for over a dozen events put on for CEOs by HP between 2007 and 2009. If these events required setting up the conferences and seeing that they were run properly, which has not been disclosed to date, they would have required a lot of preparation time outside of the events themselves for which Fisher should have been paid. No information has been made public regarding this.

In any event, the investigation had uncovered 'numerous' cases in which Hurd had made 'invalid expense claims.' HP's general counsel (their top lawyer) said the inaccurate financial reports related only to Hurd's personal expenses, and 'It has to do with integrity, has to do with credibility, has to do with honesty' (Waters, 2010).

A number of the disputed claims for reimbursements apparently were in regard to dinners put on by HP after events. It has been reported that Hurd insists these were legitimate, but offered to reimburse HP anyway (Robertson and Metz, 2010).

Oracle Corporation's CEO, Larry Ellison, publicly criticized the HP board for forcing Hurd's resignation. In a letter to the *New York Times* he stated: 'The HP board just made the worst personnel decision . . . the board failed to act in the best interests of HP's employees, shareholders, customers and partners' (Evangelista, 2010). Others have supported the action while many have disagreed.

The board of directors immediately appointed an interim CEO, who has declared she is not a candidate for the permanent position, as it searches for a replacement CEO for Mark Hurd.

Summary

This chapter has examined the bases and economic rationale for export marketing. In essence the thrust of the chapter has been to understand the motives that underlie company involvement in exporting. These motives are also the basis of the broad and specific goals and objectives that individual companies seek to achieve through export strategy.

Our first concern was with a more macro understanding. The potential benefits from exporting and relevant international trade theories were presented. Next we turned to micro considerations by exploring alternative theories of export behavior of the individual firm. This necessarily led to discussing the process by which companies can become 'internationalized.'

The nature of networks – that is, business relationships among companies – was discussed from the perspective of national and international networks. Where the individual company fits in such networks and the alternative positions that a firm can develop in such networks were identified.

Finally, ethical and moral issues that potentially face all companies doing business in foreign markets were discussed. It is important to understand that what is 'right' and 'wrong' is not always easy to determine as there is no universally accepted code of behavior to aid decision makers. Knowledge of the home market and foreign markets is essential to arriving at one's own behavior code for each situation faced.

Questions for discussion

2.1 What are the benefits to consumers arising from international trade? Are they the same for industrial goods as for consumer goods? What costs to consumers arise from international trade?

2.2 Discuss how exports and imports help to increase productivity and efficiency.

2.3 The productivities of factor inputs with respect to different products are determined by a combination of natural and acquired advantages. Is the productivity of the Japanese due primarily to natural or acquired advantages? How about the French, or the Chinese? Explain.

2.4 (a) Briefly explain the different types of economic advantage for two countries, A and B, each able to produce two products, X and Y, and discuss the conditions for trade to be advantageous (assuming no transaction costs).
(b) How is it possible for an individual business firm to have a comparative advantage?

2.5 Find an example of a country that is exporting a product for which it has an absolute disadvantage with a trading partner but where there is a comparative advantage. Explain the nature of this trading relationship.

2.6 Explain the product life-cycle concept as it relates to international trade and investment. What does the concept mean to the individual firm?

2.7 Export motives can be classified as internal or external and as reactive or proactive. What is meant by these terms with respect to export marketing? Give examples of each of the combinations of export motives.

2.8 Why might some companies be willing to undertake new or additional international/export marketing even though it apparently offers only similar (or even lower) levels of profitability?

2.9 What is meant by a 'change agent' in export marketing? Give examples of activities of each type of change agent.

2.10 Find an example of a company that has expanded its export/international marketing activity, or started such activity, and determine the company's objectives for doing so and the results achieved.

2.11 How can a company make operational use of the network model and relationship marketing in planning and implementing international marketing programs?

2.12 There are many who believe that 'whatever is legal is ethical.' Do you agree with this belief as it might apply to the international marketer? Explain your position and give examples of behavior in the global marketplace that would support your position.

2.13 Is being 'right' or 'wrong' about moral issues in international marketing activities an absolute or is it relative? Explain.

2.14 With what particular issues must international marketers be concerned?

2.15 Are traditional views about the goals of business the same in Britain, the United States, and the continental western European countries? If not, how do they differ?

2.16 In general, are businesses becoming more or less sensitive to social responsibility issues? Why?

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CASE STUDY 2.1

BP

(This case was written by Mitsuko Saito Duerr and Edwin C. Duerr, San Francisco State University)

On April 20, 2010 there was a blowout and then an explosion aboard the Deepwater Horizon platform of the Macondo oil well being drilled in very deep water in the Gulf of Mexico. Eleven people aboard BP's drilling rig were killed and a heavy flow of oil coming from an underwater rupture of the pipe began to contaminate the water. The drilling platform itself sunk into the sea (Hatcher, 2010).

In the following weeks, it became apparent that the continuing flow of oil was creating an environmental disaster of unprecedented magnitude in the Gulf of Mexico. The contamination of the Gulf waters, coastal lands and habitats was coupled with increasing business losses and failures, and widespread loss of jobs in the fishing, tourism, and all related economic activities. As complaints and losses in the Gulf area rose rapidly, the Obama Administration proposed to BP that the company set up a \$20 billion trust fund to pay claims for losses suffered by individuals and companies in the affected areas. BP did so, but it increasingly appeared that even that amount would not be adequate to cover all of the eventual damages. Highly successful American tort lawyer Daniel Becnel Jr. indicated that over 110 lawsuits had already been filed by the end of May. He estimated that lawsuits against BP and its contractors 'could add up to half-a-trillion dollars or more' (Wells, 2010). This may well be the case in the United States where lawsuits, and large monetary awards by juries, are very common.

BP's handling of the disaster brought widespread criticism. The company's initial downplaying of the extent of the problem, the CEO's public comments and subsequent testimony before US Congress committees, and the difficulties the company experienced in its many efforts to reduce and stop the flow of oil, angered both the US public and government officials. It also became apparent that the company had sacrificed safety in order to save money in the operations at the well. Some of the other major international oil companies also criticized BP, and distanced themselves from it.

BP and the White House jointly selected a lawyer, Kenneth Feinberg, to administer the \$20 billion fund set up to compensate victims of the oil spill. He has had experience in a number of other cases involving disasters, and has said his main concern will be fairness. This will be complicated by some variations in law between different US states, and possibly by maritime law. Claims filed before the oil flow is stopped will be paid without requirements for signing forms releasing BP from future claims. After the flow stops, Feinberg will propose final settlements that the claimants will not receive unless they sign forms agreeing not to sue BP in the future. Since many people feel that health problems resulting from the spill may not show up until some years later, they will face a difficult (and some feel unfair) decision. In the meantime, many who have claims find the provision of detailed information required and the delay in receiving payments to be annoying and/or unacceptable (Fifeld, 2010). Of course, the claims administrator must also try to guard against paying when false claims are filed.

This case briefly discusses the events leading to the disaster, BP's handling of it from both the technical and public relations standpoint, and questions about the company's apparent policies compared to what society expects.

Technical efforts to contain the blowout

Soon after the explosion on the Deepwater Horizon platform, BP assembled a team of 600 people who worked around the clock on the problem. The team included BP engineers and other personnel, plus experts from outside of BP including engineers from ExxonMobile, Chevron, and contractors from some 160 companies. In this command center, ideas were developed and tested, plans made, equipment and tools – some fabricated specifically to work on this job – ordered, plans made for operations, and orders sent to technicians on ships near the site of the well. These technicians controlled the remotely operated vehicles (ROVs) that positioned and operated the tools and machines being used in attempts to reduce or stop the flow of oil (Crooks, 2010a). The many efforts made in the first three months, including trimming the underwater pipe gushing oil, placing different caps at the break point, and attempting a 'top kill' to plug the well, failed to stop the leak (*The Economist*, 2010b). Though the flow of oil was reduced somewhat during part of this period, oil flowed freely into the Gulf during times when new initiatives were undertaken (Breen, 2010). Two remaining efforts, started on May 2 and May 16 respectively, were to drill relief wells to intersect the Macondo well (Crooks, 2010b). In July, the first was getting near to its target after going 5,398 meters. In the meantime, other efforts continued including one to place a new, tighter cap on the well. The US government estimates that during this period the well was sending 1.5 to 2.5 million gallons of oil a day into the Gulf (Breen, 2010).

The members of this team and the technicians worked extraordinarily hard, and for very long hours. However, they were unable to stop the flow until August, over three months after the explosion. Their extraordinary efforts have drawn praise (especially after the oil flow was stopped).

The command center also had people around the clock to handle angry calls from Americans who were being harmed, or expected to be harmed. It also received calls from around the world from people who were angry about the environmental damage being done.

A basic difficulty in dealing with the continuing flow of oil was that no one anywhere in the world had drawn up in advance any adequate plans for controlling a problem of this magnitude at this depth in the ocean.

The flow was finally completely stopped on July 15, just under three months after the explosion, by a 'top kill' with sealant pumped in from the top. A final step, in August, was a permanent sealing by cement to be pumped into the well far under the sea floor by an intersecting pipe already very near the original well hole.

Company responses to the public

In the first weeks after the April 20 explosion, the comments of BP personnel and their responses to questions greatly damaged the reputation of the company. They seemed to minimize the importance of the effects the oil flow would have on the environment of the Gulf and surrounding areas. Additionally, company e-mails disclosed to government investigators and in governmental hearings seemed to indicate that the company, in comparing possible loss of life and expenditures for safety, would simply take the least-cost solution. It also appeared that a desire to reduce time on the drilling rig caused less safe methods to be used.

Mr Tony Hayward, the Chief Executive of BP, had been brought in three years earlier to make safety the top priority at the company after a 2005 explosion at its Texas refinery that killed 15 people (Fifield and Luce, 2010). As a spokesman for BP, CEO Tony Hayward's comments and testimony were particularly damaging to the company. An article in the UK's *Financial Times* argued that though BP has about one-third of its reserves and more than half its refining capacity in the United States, it has few Americans in senior roles and didn't understand local sensitivities (Crooks and Edgecliffe-Johnson, 2010). The article included several quotes from Hayward that had been published in various other sources. Some of these comments, the sources used by the *Financial Times*, and the comments of one of this book's authors about them are as follows:

- From *The Guardian*, May 14, 2010: 'The Gulf of Mexico is a very big ocean. The amount of volume of oil and dispersant we are putting into it is tiny in relation to the total water volume.' From Sky News, May 18, 2010: 'I think the environmental impact of this disaster is likely to be very, very modest.' These statements would seem at least to demonstrate a lack of a basic understanding of ecology. It is hard to understand why no one in the BP organization with a feeling for public relations was consulted before such statements were made, especially after the angry responses to the first one by the media and the public.
- From Fox News, May 30, 2010: 'There's no one who wants this thing over more than I do. You know, I'd like my life back.' On CNN on June 9, 2010 there was a follow-up comment: 'A man whose brother was killed wants his brother back, as does his brother's wife and children.' How can a company CEO seem to publicly compare his being under stress to the loss of 11 lives?
- Analysts' briefing, June 4, 2010: 'I'm so far unscathed . . . They've thrown some words at me. But I'm a Brit, so sticks and stones can break my bones but words never hurt me, or whatever the expression is.' If he thinks that he is unscathed or that his company is unscathed, clearly he did not understand the situation.
- The *Financial Times* article cited above also noted that the *New York Daily News* said Mr Hayward had become the 'most hated and clueless man in America' because of his remarks.

In a June 17 appearance before a US House of Representatives hearing, Mr Hayward came across as 'evasive,' 'stonewalling,' and impatient as he denied knowing virtually anything about the series of alleged shortcuts taken on the well before it blew up (Fifield and Luce, 2010). One of the authors of this case study watched part of the hearings on CNN. Mr Hayward answered questions as if he knew absolutely nothing about the rig disaster, or virtually anything else about the company. While this may have been a tactic designed to prevent his being charged personally with anything, he came across as a person who knew nothing and, unfortunately, cared nothing about operations.

The Fifield and Luce (2010) article cited above included 'The five-point case' listing accusations by Congressional investigators regarding key decisions made by

BP leading up to the April 20 explosion (original source: US subcommittee on oversight and investigations):

- that BP chose the 'riskier' option when it was installing the casing, or lining, in the well before the accident;
- that BP failed to use enough 'centralizers' to keep the casing in the center of the borehole as it was lowered into the well;
- that the company and its contractors failed to run an acoustic test to check whether the cement used to attach the casing to the rock walls of the well had formed a seal to prevent gas escaping;
- that BP did not properly pump enough drilling fluid through the well to check for and remove pockets of gas before cementing the well;
- that the company failed to secure the top of the well properly with a 'lockdown sleeve' to keep it in place and sealed tightly, thereby allowing oil and gas to leak out and rise up the pipe to the rig at the surface.

Concerns about BP company policies and actions

Earlier BP had clearly indicated Mr Hayward's and the company's objectives: 'As CEO Tony Hayward constantly makes clear, safe and reliable operations are his number one priority for BP and the company has a strong record of safe and reliable operations in the Gulf of Mexico.' A number of BP documents, statements by a survivor of the explosion, and testimony by others indicate that company actions at many levels showed a lack of concern for safety and/or gave higher priority to moving ahead quickly and keeping costs low.

Over time, much additional information surfaced about the conditions and actions taken prior to the explosion. On May 17 the widely respected weekly CBS television program *60 Minutes* aired an 'Interview with Mike Williams' (Pelley, 2010). Mike Williams worked for Transocean offshore drilling company and was the Chief Electronics Technician in charge of computers and electrical systems aboard the Deepwater Horizon.

In the explosion, Williams was blown overboard from the rig and managed to survive. In the interview, he stated that in seven years on the Deepwater Horizon, no worker had been seriously injured, considered remarkable in a very difficult environment. However, in the period leading up to the disaster, they had already spent six weeks on a drilling job that had been scheduled to take only 21 days. BP managers told the crew to speed up the rate of drilling. After this was done, the bottom of the well split open and swallowed up the 'mud' and drilling tools. ('Mud' is a very heavy fluid, continuously recirculated as it is pumped down into the well and back up. It serves to maintain sufficient pressure to prevent gas and oil from coming up the well pipe.)

Four weeks before the explosion, the rubber gasket seal of the blowout preventer (BOP) (POV) had been accidentally subjected to extreme pressure. (The POV is a set of valves designed to automatically prevent a blowout when unexpected pressure comes up from the well hole.) Subsequently, an operator discovered pieces of the critically important and extremely heavy-duty rubber gasket of the BOP coming up in the drilling 'mud.' He was concerned and took the pieces to the manager, but the manager said it wasn't important. After wires leading from the surface to the BOP and associated equipment seemed to be unreliable, the manager for Transocean held a meeting to explain how the problem could be fixed. He was interrupted by a BP manager who said he was going to do it a different way.

The day of the explosion, Williams was in his office when the BOP failed and methane gas came up from the well. The rig's diesel generators sucked in the methane gas and then speeded up, sending a powerful surge of electricity through the lines. The light bulbs and some other electrical equipment exploded. Several other explosions ripped a three-inch thick steel door from its hinges. Williams ended up in the water, and was eventually rescued.

Other facts surfaced as additional people provided information, more than 50,000 pages of company e-mails, inspection reports, engineering studies, and other company documents were seized from BP, and analysts studied various materials.

On May 27 the *New York Times* obtained a document from a US Congressional investigator indicating that BP officials had used a cheaper but less safe type of casing for the well because of economic considerations. The method the company used was 'without a doubt a riskier way to go' according to the director of the Petroleum Extension Service at the University of Texas at Austin, an assessment with which several other engineers agreed (Urbina, 2010a).

A May 30 article in the *New York Times* cited many problems that had been called to the attention of the company by its own personnel long before the disaster, but on which the company had not taken corrective action (Urbina, 2010b). It was determined that in June of 2009, 11 months before the blowout, BP's own engineers had warned that the well casing the company intended to use might collapse under high pressure. The company needed to obtain permission from other company personnel to use this type of casing because it violated BP's own safety policies and design standards. Nevertheless, company officials approved its use. In April of 2010, a company document stated that the plans for cementing the casing would not meet regulations of the US Minerals Management Service. A second version of the report was then made saying that it would meet the regulations.

In the same article, several other problems were discussed. It stated that in March 2010, BP had informed US regulators that they were struggling with a loss of 'well control,' and a post-explosion BP internal investigation found that before the explosion there had been warning signs that gas was entering the well and a blowout was coming. The director of the Petroleum Extension Service at the University of Texas, Austin subsequently said that BP should have stopped drilling at that point to get the operation under control. What BP did, however, was to ask the US Minerals Management Service for permission to delay a regular test of the BOP and continue drilling. In their dealings with BP, it appears that the Minerals Management Service did not adequately regulate BP's operation.

A June 6 article in the *San Francisco Chronicle* provided comments and analysis by Robert Bea, a UC Berkeley engineering professor (formerly manager of Shell Oil's offshore technology development group, and later a consultant to BP). He discussed not only BP's problems at the Deepwater Horizon, but the earlier experiences with BP that have led him to fault continuing problems in BP's culture. In a 2002 consulting report to BP on organizational issues in its US refinery operations he identified a number of problems. The refineries had been acquired through a series of acquisitions and some of the different workplace cultures clashed with BP's corporate culture. In particular, he and a colleague identified serious problems at one of the Texas refineries and made recommendations for changes. As far as Bea can determine, BP did not really use the report or its recommendations. Three years later, the facility suffered an explosion and fire that killed 15 people. Bea indicated that BP made a number of specific bad decisions that led to the disaster at the Deepwater Horizon. These included allowing quality control procedures to slip, 'displacing drilling mud with lighter seawater that didn't exert as much downward pressure on the oil' and failing to properly address evidence that the BOP had been damaged. The fact that the drilling was costing much more and taking much more time than had been forecast added exceptional pressure on the managers involved. He also cited the US Minerals Management Service for inadequate oversight (as others have also done) (Baker, 2010).

Anadarko, a 25% partner in the project, has accused BP of 'gross negligence' in the operation (*The Economist*, 2010a).

The US House energy committee found no trace that any information about potential problems at the Deepwater Horizon had reached Tony Hayward or any other member of senior management (Jackson, 2010).

Effects on worldwide operations of oil companies

In late May, the Obama Administration declared a six-month moratorium on new drilling in the deep waters of the Gulf, subsequently challenged in the courts. The Gulf provides 33% of America's domestically produced oil and 10% of its domestically produced natural gas. The moratorium directly affected not only BP, but also other major oil companies ExxonMobile, Shell, and Chevron working in the Gulf, Anadarko Petroleum (which is a 25% partner in the project), Mitsui (which is a 10% partner), smaller companies Murphy and Noble, associated partners and contractors, and workers (Crooks, 2010c). While BP had indicated that the accident represents industry-wide challenges in deepwater drilling, a number of other major oil companies defended the safety of their own practices and tried to distance themselves from BP (McNulty and Blas, 2010). All companies fear that more US requirements and restrictions on deepwater drilling might affect requirements and practices in other producing areas in the world.

Norway has suspended any new deepwater drilling until the investigation of the oil leak is complete. Other countries are also taking actions of some kind regarding deepwater drilling. Brazil was still planning to go ahead, though the issue was under discussion.

BP cancelled its 2010 dividends. Though it had enough money to handle the $20 billion fund set-up, it was concerned about potential additional losses. The company needed an additional $10 billion and sold off some major assets to obtain it.

PetroChina, the country's largest listed oil and gas producer offered closer cooperation with BP, and might enter into joint ventures or purchase some of BP's assets. CNOOC, China's largest offshore exploration company, is also likely to be interested in buying assets from BP.

Chinese companies have already made major investments in raw material producers overseas, as mentioned in Chapter 1, and are actively looking for more (Hook, 2010).

Some closing comments

An article in *The Economist* noted that Mr Hayward, with his background in exploration, has emphasized 'a commitment to safety with ambitious company-wide schemes meant to bring it about.' But it also notes that years of effort are required to bring about a change like this (*The Economist*, 2010c). The authors of this case have some brief additional comments based on their experiences in industry and consulting.

BP does give recognition for safety achievements as it was about to do at the Deepwater Horizon for seven years of operation without an accident. However, managers in many organizations perceive that they will receive large rewards, such as bonuses, promotions, or simply avoiding criticism, for achieving high productivity, cost-cutting and/or on-time completion of jobs/projects. They may also believe that they will receive lower rewards if they emphasize safety when it may result in lower productivity or higher costs. It is also true that many individuals tend to discount the extent of the potential damage to the company or their own careers when they take risks. The larger the organization, and the longer safety or quality have had lower priority, the longer it takes to change the corporate culture. One of the key BP managers involved in the decision to save time and expense by using fewer 'centralizers' when placing and cementing the pipe running from the wellhead to the drilling rig sent an e-mail before the explosion: 'Who cares, it's done, end of story, will probably be fine' (*The Economist*, 2010c).

After the leak was stopped, Tony Hayward was replaced by another BP executive who is an American. Hayward was assigned to head up one of BP's major divisions.

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Questions

1. How can BP now go about attempting to create a real 'safety first' attitude in the company's managers and employees? What are the problems and how could they be solved?
2. How fair to those having claims is the approach being used by the claims administrator? Is there any other solution that would be fair to both those filing claims and BP?
3. Should the US government try to prohibit any more deepwater drilling in the Gulf of Mexico? Why, why not? What factors should be considered in coming to a decision?
4. Should other governments consider restricting deepwater drilling in their territories? Why, why not? What factors should be considered in coming to a decision?

CASE STUDY 2.2

Toyota Motor Corporation

(This case was written by Mitsuko Saito Duerr and Edwin C. Duerr, San Francisco State University)

Toyota's vehicle recalls: responses, problems and concerns

Introduction

Between October 2009 and July 2010, Toyota Motor Corporation recalled 8.5 million cars and trucks. The design and quality problems that caused the recalls, and expenses related to the recalls, were obviously of great concern to the company. Repairing defects will cost several billion US dollars and it is not clear whether the company will suffer serious long-term effects due to the recalls. Its reputation for quality had become well established over several preceding decades, particularly in North America (its largest and most profitable market). Media attention to its problems has now been somewhat lessened by the BP disaster discussed in Case 2.1.

While recalls are relatively common in the automobile industry, Toyota's problems gained widespread attention because of: (1) the number and size of the recalls; (2) the company's longstanding reputation for producing high quality vehicles; (3) the company's slow and inadequate responses to the problems; and (4) concerns that Toyota's commitment to quality may have been impaired by its rapid expansion and emphasis on profits.

Of the 8.5 million recalls, the majority were related to unintended acceleration problems (Nation, 2010), or failures to respond to pressure on the brakes. At least 52 deaths were linked to these problems (Thomas and Krisner, 2010). The unintended acceleration problem was largely solved by securing loose floor mats that could snag gas pedals. The problem of accelerators that could sometimes stick required a design change.

Separately, Toyota recalled some of the hybrid Prius automobiles because the company found a design problem with the brakes that could cause poor performance on slippery or uneven roads (Sobel and Simon, 2010). Other problems were claimed to be due to failures in the electronic control systems. Following a number of complaints regarding vehicles that sped up, another one came from a Prius owner who said his accelerator stuck while he was driving on a Southern California Freeway. Investigators from the US National Highway Traffic Safety Administration and from Toyota found no problems with the vehicle (Spagat and Thomas, 2010). In July 2010, it was disclosed that at least some of the reported cases of unintended acceleration were caused by driver error rather than defects in the Toyota control systems. In these cases, a preliminary investigation by a US government agency has indicated that onboard instruments showed that the drivers had their feet on the accelerators rather than on the brakes at the time of the crash. Figures or estimates of how many of the problems were due to driver error will not be available for some time (after further investigation and analysis).

Some of the many recalls during the period were required because of a wide range of other problems.

Two other examples of the reasons for and scope of the recalls

In China in December of 2008, before some of the more massive recalls, Toyota recalled 120,000 Crown, Reiz, and Lexus cars produced there between 2005 and 2006. The Chinese Administration of Quality Supervision, Inspection and Quarantine said a manufacturing defect could cause the electric power-steering systems to fail (Toyota, 2008).

On Friday, July 2, 2010, Toyota recalled a total of 270,000 Lexus and Crown vehicles, their luxury brands. This recall affected their vehicles worldwide, and was to fix valve springs that could cause the vehicle to stall in traffic. Of this number 138,000 were in the United States; 91,903 in Japan; 15,000 in Europe; 10,000 in the Middle East; 6,000 in China; and 8,000 elsewhere. About 200 complaints had been received, but no accidents or injuries reported. This covered models produced between July 2005 and August 2008. On Monday, July 5, 2010, Toyota began recalling another 90,000 Lexus and Crown branded vehicles, though this time only in Japan (Kageyama, 2010).

Poor communications and slow responses

Of great concern to many Americans was Toyota's slow, and in US culture inadequate, initial responses to reports of problems with the company's vehicles. The company was fined a record $16.4 million by the US government for responding too slowly to the crisis. Even nine months after the recalls began, an analyst with Nomura Securities in Tokyo said the company is not doing a good job in communicating with the public about what it is doing to improve quality checks, and thus it is difficult for people to believe that the company is taking the customers' view as it promised it would (Kageyama, 2010).

Outside observers, and eventually Toyota officials themselves, blamed poor communications upward for the slow response to problems. Managers in Japan responsible for overseeing American operations received many warnings from Toyota's top US management about complaints. But they were slow, or failed entirely, to pass on these warnings to top management in Japan. An eventual response of top management in Japan was to remove one intermediate level of managers between top US and top Japanese management (Sobel, 2010), assumedly transferring the middle managers to other positions or allowing them to retire.

An additional problem may have been a feeling in some large Japanese companies that the Chief Executive Officer should not become directly involved in details of operations. Akio Toyoda had been appointed as CEO of Toyota in June of 2009, but until February 5, 2010 he had not made any public comments about the quality problems that had been occurring since before he took the top position, or even about the major recall of 2.3 million US cars on January 21, 2010 after he became CEO. He finally 'emerged from seclusion' on February 5, 2010 (Kageyama and Foster, 2010). Toyoda said: 'I personally regret that we have caused worry for so many people' and 'I apologize from my heart.' He said that the problem had created a 'crisis situation' for the company, but did not explain what had gone wrong (Sobel *et al*., 2010). In Japan, an apology goes a long way toward being forgiven, but in the US people are generally more concerned about what will be done to correct the problem. Even in Japan his message is not getting through. Complaints about confusion are coming from even 'ultra-loyal Japanese suppliers' (Sobel and Reed, 2010).

It has also been suggested that the people who run Toyota had been 'unable to comprehend that its cars could be less than perfect.' Its marketing group continued to refuse to accept that its cars might have problems, though some accounts indicate that acceleration problems may have come to light as early as 2002. This lack of awareness of the problems, especially by top management, may have been what led the company to continue selling cars with faulty accelerators and brakes (Pilling, 2010).

Concerns about Toyota's commitment to quality: effects of rapid growth and stress on cost-cutting

Of even more concern to some is the surfacing of information that Toyota's increasing emphasis on continually controlling/reducing costs, coupled with very poor upward communication, has actually threatened quality. An independent study by J.D. Power and Associates in the United States, based on 82,000 responses regarding the number of problems new car owners found after having their cars for 90 days, indicated that Toyota owners now report more problems than Ford owners (Simon, 2010).

In 2006 Katsuaki Watanabe, then Toyota's CEO, was increasingly worried that quality was slipping, that Toyota's engineering practices and factories weren't efficient enough, and that the company was losing its competitive edge. In the United States in 2005, Toyota had recalled more cars than it sold. Watanabe wanted radical change to reduce the number of components used in its cars, and to build new more efficient and more flexible plants. His objective was to cut costs by about $4,000 per vehicle. Additionally, he pushed rapid expansion overseas. The rapid growth, as Toyota attempted to overtake General Motors, also led to excess capacity and eventually to losses in the recession in 2009.

In his previous positions before becoming CEO, Mr Watanabe had introduced innovations that did make the company much more efficient (Shirouzu, 2006). Complete redesign did not prove to be attainable, and rapid growth was causing rapidly increasing quality problems. Part of Toyota's present quality problem is believed to be due to the increased complexity and use of electronics, and the need to buy more components from outside suppliers. Engineers have become more specialized and fewer people understand how everything works together (Harding and Sobel, 2010).

One analyst has suggested that the company's pressures on suppliers to keep costs low, and to keep the costs of its own labor down by using more part-time labor, have compromised quality (Pilling, 2010). An executive in a US supplier company said that Toyota required that his firm reduce prices by 10% for each new generation of parts. This led some analysts to conclude that scrimping by suppliers has caused quality problems for Toyota vehicles (Welch, 2010). In recent years, some Japanese workers have felt underpaid, overworked, and less loyal to their companies, thus contributing to production line problems. Part of the labor troubles in Toyota's plants in China was due to the fact that their workers there felt they were underpaid relative to what workers at plants operated by other foreign companies were receiving. They also felt that their grievances were not being responded to within a reasonable amount of time. Of course, the local Japanese managers could not make any changes without approvals from Tokyo. These took a long time to obtain – if they could be obtained at all.

In 2010, Toyota announced that they would reduce their labor force in Japan by 15%, on top of a previous 15% cut, in order to move more production to lower-cost overseas plants. This was a great change for a company that years ago wanted to keep as much of its production as possible in Japan to maintain employment in the country and to maintain strict quality control. Status in 2015 is that Toyota is continually troubled by quality issues and has recalled 637,000 cars because of airbag problems.

Concluding comments

Toyota should of course attempt to determine the underlying causes of continuing quality problems, and methods for fixing them. Toyota also needs to provide faster and more well thought-out responses to reports of potential quality problems. This involves improving internal communications, and improving communications with customers and the public as to the extent of problems and what is being done about them. It has even been even suggested that if the recalls are a result of serious problems in the company's procurement policies, labor policies, and/or manufacturing policies, Toyota may need to overhaul its design, engineering and manufacturing systems (Welch, 2010).

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Questions

1. What do you think the long-term effects of the recalls will be on Toyota?
2. What, if any, cultural issues appear to be involved in this case?
3. Why did Toyota's American managers appear to have such trouble in getting action from Toyota's top management in Japan?
4. Why was Toyota's CEO so slow to talk to the public about the company's problems?
5. What are the apparent views of Toyota's top management with respect to social responsibility?

CASE STUDY 2.3

GlaxoSmithKline PLC

(This case study was written by Edwin Duerr.)

In August 2010, Britain's GlaxoSmithKline PLC (GSK) was facing the possibility that its highly profitable diabetes drug Avandia would have to be withdrawn from the US market. Sales of Avandia had already been prohibited in Germany, and the drug was being investigated in another European country. The problem was the possibility of an increased risk of heart attacks when taking the drug. GSK had already set aside £2.3 billion for its potential risk from lawsuits (The Lex Column, 2010).

An even bigger problem facing the company, and the whole pharmaceutical industry, had been resolved with little public concern earlier in the year. The US comprehensive health care plan, passed in 2010, had not mandated ceiling prices for prescription drugs purchased under the plan. It did provide for some ceilings on government reimbursements for medicines under the government program, but otherwise left companies free to set their own prices. The United States is the only country among the industrialized nations that does not effectively have price controls on prescription drugs. Had the United States imposed them, it would have had a major impact on the industry. Because of the lack of price controls, the American market provides 60% of the profits of the whole international pharmaceutical industry.

The many other problems facing GSK, and the industry as a whole, are discussed below, after discussing some of the challenges faced by GSK in its formation.

Forming GlaxoSmithKline

Britain's GlaxoSmithKline, the second largest pharmaceutical company in the world, was formed on 27 December 2000 by the merger of Glaxo Wellcome PLC and SmithKline PLC, one British company and one American company. The merged company had over 7% of the world market for ethical (prescription) drugs. GSK has had an increasing trend in both sales and profits since its formation, except for a small drop in sales in 2007. Total turnover (sales) was £28.4 billion in 2009.

Because of the international nature of the companies involved, the proposed merger had required approvals by three governments as well as the stockholders of the companies involved. The European Commission had granted approval in May 2000, stockholders of both companies had endorsed it in July, and both the US Federal Trade Commission and the British High Court had given their approvals in December 2000. As a condition of approving the merger, the three governmental authorities had required the companies to divest themselves of specific patents and drugs. These conditions were imposed in an effort to avoid reducing competition in pharmaceutical markets where the companies had overlapping products.

The companies expected that the merger would provide economies of scale and scope in marketing and production, spread the risks inherent in the high cost of new drug development and testing, and provide a smoother income stream as new drugs reach the market and the patents on older drugs expire. The chief executive of the new company, and former chairman of SmithKline, was Jean-Pierre Garnier. One of his major objectives was ensuring that customer loyalty is maintained so that as patents expire on older medicines they can be successfully marketed as over-the-counter medicines. This strategy worked well for SmithKline with its ulcer drug, Tagamet. While the merger and policies to increase customer retention can be very beneficial, they may not be sufficient to meet changes in the market.

A primary problem for GSK, as for other international pharmaceutical companies, is the worldwide challenge to their pricing practices. Though GSK is a British company that markets worldwide, much of its earnings come from the United States and are therefore subject to prices received there. The United States is the only industrialized nation that does not have price controls on prescription drugs. It accounts for 40% of the billion sales of prescription medicines sold worldwide, and an estimated 60% of pharmaceutical company profits. Demand in the United States is growing at twice the rate of that in Europe as governments there attempt to limit their spending on drugs. However, there is growing dissatisfaction in the United States with the way in which the companies price their drugs. This presents not only a threat to the profits of the drug companies, but in the longer run may limit their ability to develop new drugs.

The problem arises from several interrelated factors: the basic cost structure of developing, testing, and producing drugs; the growing number of individuals who need high-priced drugs, but cannot afford them; the publicity given to these unmet needs, particularly but not exclusively related to the AIDS epidemic in Africa; and an increasing public acceptance of the idea that all people (or at least all people in their own country) are entitled to needed pharmaceuticals.

Even after offering the AIDS drug Combivir in Africa for less than 12% of its price in the United States, GSK continues to be criticized for high prices there and elsewhere. Garnier has commented: 'Do you want us to give away these drugs for free? Then there won't be any more drugs to treat AIDS or anything else. Isn't it ironic that the companies that brought the drugs to market are the ones being criticized for people dying?' (Harris and McGinley, 2001).

While the problem may be clear, what GSK should do about it is not apparent.

Costs of producing pharmaceuticals

The development of new drugs to the point where they can be marketed is both very expensive and risky. The marketing itself is expensive. The manufacturing costs, and particularly the marginal costs of production, are relatively low. In order to sustain (or increase) overall profitability, the drug companies must charge enough for their drugs to cover the high development costs. This has been possible primarily because of the patent system that allows the company holding the patent to be set a far higher price than it could obtain if other companies could begin to manufacture and market it. Of course, some system allowing companies to recover research and development costs is necessary or the development of new drugs by private enterprise would cease.

The total cost of simply developing a single new drug, including research and testing, is estimated to be upwards of $700 million. The cost of actually bringing a new drug to market, including meeting regulatory requirements and marketing, has risen to $1.7 billion (Flynn, 2004). The costs of both the initial research and the expenditure on trials may be lost if the drug proves to be ineffective or has serious adverse side effects. Approximately 80% of drugs in development never win FDA approval in the United States, though some are dropped before the expensive trials are conducted. Some drugs are banned after they have been in use for some time as side effects emerge that were not found during the trials.

New technologies for developing some additional drugs, including those designed to tap the potential of new knowledge of genetic triggers of disease, require extremely large investments. Application of bioinformatics, merging information technology and molecular biology, holds the promise of assisting in developing new candidates for pharmaceuticals. The great computing power and specialized software required are very expensive. The manufacturing equipment required for producing new drugs is also very costly when new technologies or additional capacity are needed. Once these are provided the marginal costs of manufacturing the medicines are relatively small compared to the fixed costs already incurred.

Pricing of pharmaceuticals

David Stout, the head of GSK in the United States, called the country the last free market in the world for pharmaceuticals (Shales, 2001). Most of the European countries have programs under which their citizens have some sort of entitlement to prescription drugs. Their national health systems have become monopsony buyers of pharmaceuticals exerting downward pressure on prices. The governments of each of the countries has set a different price structure. Overall, the result is that patients in Europe pay one-third less for drugs than do Americans.

The low marginal costs of producing drugs, combined with the high prices that can be charged in the United States, have made pharmaceutical companies willing to supply drugs to markets outside of the United States at much lower costs than they charge within it – when they are forced to do so. That is, insofar as they can charge more than production costs, and sales to the outside market do not decrease sales in their primary market, they profit by selling abroad at lower prices than they obtain in the United States. This is, of course, the situation that gives rise to 'dumping' in steel and a wide range of other products. Even within the United States very large purchasers of pharmaceuticals can obtain lower prices when the alternative for the company is selling less product overall.

The result has not only been that drug companies make most of their profits in the United States; the country has also become the center for research on new drugs, with companies working there spending approximately twice as much on research as those in the EU. This is in spite of the fact that the European Union has a larger population and a bigger economy than that of the United States. Of the 17 antiretroviral drugs used in AIDS treatment, 13 were developed in laboratories in the United States.

Growing dissatisfaction

US drug companies have argued for many years that they must continue to have patent protection and be able to charge high prices in the United States for their current drugs in order to support the costs of research and development for new drugs. They have been successful to date, but face the increasing probability that a combination of factors will result in downward pressure on prices.

Public dissatisfaction with the prices of prescription drugs in the United States has been rising both because of the increasing prices and because of greater knowledge of what is charged for the same drugs in other countries, including Canada and Mexico. Increasing numbers of US residents who live sufficiently near to Canada are driving over the border to purchase their prescription medicines there. On average, brand-name prescription drugs cost over 60% more in the United States than they do in Canada, but importing them from Canada into the United States is technically illegal. US law forbids the importation of prescription drugs by anyone other than the original US manufacturer (who may bring them in from its plants overseas). Thus a US company can, for example, bring in drugs from its plants in Europe, but an individual or other company cannot buy the same medicines in Europe and legally bring them in. US pharmaceutical manufacturers imported $40.7 billion of drugs into the United States in 2002 (Barlett and Steele, 2004). The US national government has not, however, cracked down on individuals bringing in prescription medicines.

Escalating prescription drug costs, coupled with an aging population increasingly in need of more medication, are a concern of governmental bodies at different levels as well as individuals and consumer advocate groups. In the United States, the amount spent on prescription drugs as a percentage of total health costs has been escalating rapidly. It has been stated that the higher prices US residents pay for drugs in turn pay for half of the industry's research, and that US taxpayers also pay for most of the world's government-funded basic biomedical research. Commissioner McClellan of the US Food and Drug Administration has stated 'That is not a sustainable or fair situation' (Carey, 2003). Still, the US national government has not come up with a feasible solution to the problem, and is opposed to efforts by individuals, consumer groups, and some local governments to make imports of less expensive drugs easier. In addition to industry objections to easing imports, there are also potential problems with counterfeit drugs (as discussed below).

While the US national government has not stopped individuals from bringing in medicines for their own use purchased in Canada, it has warned that it will go after third parties assisting US residents in buying Canadian drugs (Colliver, 2003). A number of Canadian-based Internet companies are providing prescription drugs to US residents. The process is legal from the standpoint of Canadian law as long as a somewhat complicated procedure is used to obtain proper prescriptions. In spite of warnings by US officials, as of mid-2004 no action has been taken against the Internet companies (Parloff, 2004).

In 2003 GSK and several US pharmaceutical companies stopped selling to Canadian pharmacies that supply US patients. They indicated that they did so because it is illegal and is undercutting their business. A nonprofit organization in San Francisco then tried to organize a boycott of GSK products but the company indicated it had not felt any effects (Colliver, 2003). In 2004, drug industry giant Phizer, Inc. threatened to cut off all sales of its products to Canadian pharmacies that help the cross-border trade. In Minnesota, where there is much opposition to US national government restrictions on imports, the state Attorney General is looking at whether the actions by the companies constitute antitrust violations (Barry, 2004). Political pressure is building at both the local and national levels to allow such imports, or to find another solution to the high prices of drugs for US residents.

It is not only in the United States that the price of drugs has been criticized. Concern over the AIDS epidemic, and particularly the recognition that the drugs needed to fight the disease are too expensive for most of the population affected in Africa, has led to widespread criticism of the pharmaceutical industry. Strong public pressure resulted in a number of pharmaceutical companies, including GSK, offering lower-cost AIDS drugs for African nations. This action, or any other to reduce the costs of AIDS drugs for Africa, appears unlikely to do much to help the vast majority of people affected (Knickmeyer, 2001). Problems of distribution and education, and the reluctance of some African leaders to admit that there is a problem, are likely to limit the effectiveness of the efforts. It has been pointed out that even where medications have been available at low cost for other diseases in Africa, it has still not been possible to control the diseases. However, the extensive attention given to the problem by governments and the media has increased concern everywhere about the pricing of prescription medications.

Governments have also taken action to make lower-cost AIDS drugs available. The US government announced in February 2001 that it would not seek sanctions against poor countries that legalize the importation of generic copies of patented anti-AIDS drugs (McNeil, 2001). Some reputable drug manufacturers in India, Argentina, and other countries do not honor traditional patents, and produce properly labelled pharmaceuticals for sale outside the United States and Europe (Capell and Timmons, 2001). This practice is, of course, objected to by the original developers of the drugs.

Another potentially serious problem for the pharmaceutical industry was raised by an agreement negotiated by the World Trade Organization (WTO) in August 2003. It provides a method by which developing countries can overrule drug patents in certain cases. The Brazilian government threatened to use the procedures on a leukemia drug patented by Novartis of Switzerland before successfully negotiating a lower price from Novartis. In the meantime, a generics drug company in India has been given the right to produce a copy of the Novartis drug (Dyer, 2004).

Another critical problem, for both consumers worldwide and for pharmaceutical companies, is that of counterfeit drugs or substandard drugs originating in a number of less-developed countries. Various studies have found drugs with no active ingredients and others with so little of the required active ingredients that they may serve only to increase the resistance of microbes to the active ingredients (Johnson, 2000). Some counterfeit drugs contain poisonous substances. The World Health Organization estimates that 8% of the bulk drugs imported in the United States are counterfeit, unapproved, or substandard (Capell and Timmons, 2001).

Critics of the pharmaceutical industry argue that it could lower cost without sacrificing innovation. They note that the industry is one of the most profitable in the United States. The industry is also criticized for the amounts it spends on advertising. Since the Food and Drug Administration began to allow the advertising of prescription drugs on TV and radio in the late 1990s, spending has increased rapidly. The industry claims that advertising is an effective way to inform the public of advances in medicine. Critics complain that much of the money is going to promote heartburn, allergy, and hair-loss medicines, and even some expensive drugs that might be less effective than cheaper medicines. The growth in staff is also criticized. The number of sales people employed by the top 40 drug companies has grown rapidly.

Others argue that the rising cost of health care is a result of the changing demographics of the population and the continuing search for new drugs to solve health problems previously untreatable. A contributing writer for the *New York Times Magazine* become a supporter of the pharmaceutical companies after he was diagnosed with HIV. Though his medications cost $10,000 per year, he argues that having effective drugs that are expensive is better for the health of the nation than not having the drugs at all. In the long run, as patents expire, cheaper generic versions will become available. He further argues that if Americans do not carry the burden of high drug costs, innovation will dry up (Aoki, 2001).

The pharmaceutical industry is now spending some of its advertising money on producing TV commercials featuring individuals whose lives have been saved or vastly improved by newly developed prescription medications.

As noted earlier, the US government has increased prescription drug coverage, tending to push down that price of drugs for a portion of the population. How this will affect the pharmaceutical companies will depend upon how much volume will be increased, and the policies followed by the pharmaceutical companies.

Some options for GlaxoSmithKline

In general, when patents expire and generic drugs become available, prices overall may drop as much as 90%. Companies selling prescription drugs on which the patents are about to expire have used various methods in attempts to maintain as much of their income stream as possible. One approach has been to actually raise the price of the product. Though some (or many) users will switch to cheaper generic products, others are relatively price insensitive. It may thus be more profitable to sell substantially less of the drug at a higher price rather than try to maintain a higher level of sales at much lower prices.

Another approach, which may be combined with the first, is for the company to introduce its own generic product before the patent expires. The company can then advertise the new generic product and gain a dominant position in the generic market before the competition is allowed to enter that market. Combining heavy marketing in the original drug with dominance in the generic market allows the company to continue to earn a high margin on the original drug while having most of the lost sales on that version go to its generic version.

The former SmithKline's policy of developing lasting customer loyalty for patented products, through a combination of advertising and pricing, may allow a company to continue to successfully market the product on an over-the-counter basis after the patent expires.

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Questions

1. Are the present pricing policies of the major pharmaceutical companies ethically justifiable? Explain your answer.
2. Are companies in less developed countries ethically justified in producing and selling generic copies of patented drugs without obtaining the permission (and paying) the patent holders? Explain your answer.
3. With Americans paying substantially higher prices for prescription drugs than people in other countries, are US consumers unjustifiably having to subsidize the development and sale of drugs to people in other countries?
4. Is the selling of drugs abroad at lower prices than in the United States actually a case of dumping? If not, why not? If so, why do other countries force 'dumping' of pharmaceuticals while they try to stop 'dumping' of steel?
5. Is advertising by pharmaceutical companies socially desirable?
6. What policies should GlaxoSmithKline adopt with regard to:
   (a) pricing of patented products during the early years of protection and as patent protection is due to expire;
   (b) attempting to influence public policy through advertising or lobbying?

CHAPTER 3

The international environment: culture, economic forces, and competition

Learning outcomes

Chapter 3 covers the impact on international marketing and export management of:

- culture and the socio-cultural environment
- economic forces
- competition

At the end of the chapter are two cases: (1) the Supreme Canning Company case involves cultural misunderstandings that prevented agreement on a potentially mutually advantageous export–import agreement and (2) Ford Motor Company discusses Ford's actions in relation to the social, political, and **economic environments**.

Introduction

As was discussed in Chapter 1, the international marketer operates within both a domestic environment and one or more foreign environments. However, we also mentioned that even exclusively domestic marketers are operating in an international market place (e.g., by competing with foreign companies). While the elements of the marketing mix and the functions that must be carried out are the same in all markets, differences between environments can affect every aspect of marketing activities. The environment in the home market is usually well understood by most marketing professionals, and may erroneously be assumed by some marketers to be the way it is (or should be) everywhere. However, this is not the case, as was noted in the first chapter, and is further discussed below.

This chapter and the next one focus on the four major environmental components that affect behavior in markets everywhere, and that often require different marketing strategies abroad than are used in the home market. These are:

- culture and societal structure;
- economic forces;

- competition;
- political and legal forces (discussed in Chapter 4).

They directly affect information requirements and accessibility, negotiations, market entry strategies and modes, channels of distribution, product and pricing decisions, financing and methods of payment, promotion and marketing communications, logistics, and organization structures. Other components of the environment that affect international marketing include differences in geography, infrastructures, and levels of technology. More detailed analyses of these other factors, and additional information about culture, economic forces, competition and the political/legal environment, can be found in specialized books on the particular subjects.

Culture and the socio-cultural environment

Culture and the socio-cultural environment influence the behavior of customers who comprise markets, the managers who plan and implement international/export management programs, negotiations, and the marketing intermediaries (e.g., advertising agencies and media) that participate in the international marketing process. Culture influences the political/legal environment of a country, the way in which its economic system works, and the attitudes toward competition. Each of these, in turn, has an effect upon culture in the long run. Some examples of the pervasive effects of culture on international/export marketing are given in Exhibit 3.1.

Exhibit 3.1 The pervasive effects of culture on international/export marketing

The most apparent effects of culture may be on the types, designs, styles, and colors of products that can be sold in overseas markets. Pork products are not normally acceptable in Islamic cultures, although a US-owned international chain of barbecue restaurants received permission to import pork into Malaysia (which has a sizable non-Islamic Chinese population). Personal tastes, as well as road conditions, taxes, and income levels determine what colors, sizes, and horsepower are preferred in automobiles. The high-tech Japanese toilets, which feature heated seats, water sprays and warm-air drying, did not sell in Arabic countries because the seated individual had to operate it with the right hand. A Middle East company that made a similar toilet that was flushed with the left hand did find a ready market among the most affluent.

Culture also affects the themes and presentation of advertisements that will be most effective in selling products. In promoting diamonds, television ads that pictured a sophisticated man and woman in a romantic setting, which worked well in European countries and the United States, were not very effective in Japan. There, sales increased substantially when the theme was changed to a man in ordinary business dress giving a diamond to his wife, who indicated (very pleasantly) that he was stupid for spending so much money on her.

Methods of negotiation also are culturally influenced. US negotiators typically prefer direct statements, vigorous defense of their positions, agreements on a point-by-point basis, the covering of all contingencies in a written contract, and rapid progress toward a settlement. Japanese negotiators typically prefer to take time to get to know their potential associates first, prefer to avoid argument and confrontation, wish to consider the agreement as a whole, and need to consult frequently among themselves and with their colleagues at the company before agreeing to anything. If these differences are not recognized and allowed for, feelings of mistrust may cause failure in reaching agreements that would otherwise be beneficial to both parties.

Dealing with foreign managers or subordinates in overseas offices presents potential for misunderstandings and conflict. A senior US executive, visiting a large office in Italy, called a meeting for 8 a.m. (against the advice of his resident US manager). Only the resident US manager showed up on time, and everyone was greatly irritated: the Italian staff for the outsider's having called a meeting at a completely unacceptable hour, the US executive because people who 'worked for him' did not do as he told them to, and the US manager because he was embarrassed. In some countries, the manager who invites suggestions from subordinates or gives them too much latitude in deciding how to do a job may be viewed as not doing his own job, as weak, or as incompetent. Managers and professional people from many European countries, Canada, and the United States expect a degree of individual freedom, discretion, and responsibility that they may not receive if assigned to work for someone from a country emphasizing a higher degree of collectivism and group cooperation. In the United States, the Japanese owners of gambling casinos in Las Vegas reportedly ran into problems when they tried to use Japanese management techniques – specifically, making decisions the Japanese way by consensus. The approach may work well in Japan, but it was deemed too slow and cumbersome in the fast-moving casino environment.

Understanding the effects of culture on dealing with people in other societies, whether they are customers, partners, employees, or subordinates, is necessary if one is to avoid costly mistakes. It is also valuable in helping one to avoid the feelings of discomfort and stress that occur when others do not behave in the way we expect, or fail to respond to us as we believe they should. Thus, culture influences the selection of foreign market entry mode especially when choosing among joint ventures, greenfield (new start-up) investments, and acquisitions (Kogut and Singh, 1988); influences the ability of businesses to effectively organize intra- and intercultural relationships with their international partners and whether or not the *process* of fostering and evaluating relationships can be globally standardized (Griffith *et al*., 2000); and through social ties can influence export initiation in small and medium-sized enterprises (Ellis and Pecotich, 2001).

Personal relations are an important input into social and economic life. If the international marketer wishes to be successful in doing business in China, for example, it is important that *guanxi* be established. *Guanxi*, which is based on reciprocity, refers to personal connections/relationships, which can range from strong personal loyalties to semi-bribery. Three components operationalize *guanxi:* trust, relationship commitment, and communication. In a study of Chinese managers regarding knowledge transfer, results showed that trust and communication were the two main channels for such transfer (Ramasamy *et al.,* 2006). The lack of significant relationship between relationship commitment and knowledge transfer is attributed to the situation where Chinese managers perceive knowledge transfer as an instant process which can be executed within a short time period and are confident in grasping knowledge and learning from others. One way to cultivate *guanxi* is to show respect for business partners and government contacts, especially in social settings. This gives them 'face.' Small gestures count. Avoid giving lavish gifts such as jewelry and avoid using white gift wrap. The former may appear to be bribery and the latter connotes death. In effect, having good *guanxi* amounts to having a good network operating in China. The realities of doing business in China, or with Chinese companies, are such that one cannot get anything done easily, reasonably quickly, or even at all without good *guanxi* (Liu and Roos, 2006). *Guanxi* has been a norm in China for hundreds of years.

Understanding and dealing effectively with the pervasive effects of culture on export management and international marketing is both interesting and challenging. People who simply accept most or all of their own beliefs, values, and ways of doing thing as simply being the correct, right, best, and/or only way of doing things inevitably encounter problems. Consumers in foreign countries typically differ from domestic consumers to some extent in all aspects of buyer behavior – the what, why, how, when, and where of buyer behavior. The employees and business people with whom they come in contact also can be expected to differ in what they believe is correct and acceptable behavior, and in virtually all other aspects of doing business. An illustration of such differences is the view of business ethics in China and the United States. In China, research has categorized people into six groups: (1) high expectations for others, (2) challenge avoidance, (3) other directed, sympathetic, (4) religiosity, (5) ethically challenged, and (6) empathetic (Sardy *et al.*, 2010). In contrast, research in the United States identified business ethicality as having two components: (1) behavioral and (2) philosophical (Albaum and Peterson, 2006). While these two studies are not directly comparable (scales of measurement differed), they did study similar populations (students as future business leaders) and they do show that ethical views vary among cultures. Countries such as the United States, Canada, Australia, and many European countries are truly multicultural in nature, due largely to immigration. To illustrate this, the following are approximate percentages of population that is foreign-born in selected metropolitan areas (*Businessweek*, 2006, p. 39): Miami (50%), Toronto (45%), Vancouver (40%), Los Angeles (38%), Melbourne (28%), Amsterdam (25%), London (25%). In marketing to people within these subcultures, many of the same approaches used in overseas marketing will improve marketing performance.

In order to be successful in the international marketplace, marketers need to develop an understanding of the foreign culture(s), its differences from their own culture, and how it affects the desires, objectives, and behaviors of potential customers and others with whom they will come in contact. They need to learn how to manage the cultural differences. In short, there is a need for managers to interact effectively in foreign cultures, often in multiple cultures. This is known as acquiring *cultural intelligence*, which has been defined as 'a multifaceted competency consisting of cultural *knowledge*, the practice of *mindfulness*, and the repertoire of *behavioral skills*' (Thomas and Inkson, 2004, pp. 182–3). Recent research has shown that certain types of exposures to other cultures such as education and/or employment abroad and the level of exposure from the experiences increases cultural intelligence (Crowne, 2008).

Managing cultural differences

Cultural differences are sometimes viewed as obstacles in doing business across cultures. Examples of problems that can arise in exporting and in all aspects of the management of international marketing operations can certainly be found. Some of these were noted in Exhibit 3.1 and others are discussed below. But it should also be noted that understanding cultural differences has enabled many companies, both very small enterprises and multinational giants, to market successfully and profitably across cultures.

Understanding cultural differences and developing strategies to work effectively in the multicultural or foreign environment can be used as a competitive tool. There are multiple examples from the past as well as the present. Kentucky Fried Chicken became an outstanding success in Japan using approaches that fit every aspect of the culture, while another American company with a similar product withdrew from the market after failing to make appropriate adjustments to its managerial approach, relationships with Japanese companies, and advertising. After carefully studying the Japanese market many years ago, McDonald's decided that Japanese consumers could be persuaded to change their habits and patronize a fast food chain. They, also, were very successful. The 7-Eleven chain, as discussed below, brought about changes in Japan's marketing system and has also been very successful in other countries, as they have adapted to local cultures.

A few additional examples of ways in which culture has affected particular companies in international markets can be seen from the variety of experiences of three large-scale retailers and five automobile companies briefly discussed below. Successes and failures have been largely determined by the ability and/or willingness to adjust to the cultures and other environmental factors in each of the countries.

Retail giant Walmart has had both successes and some serious problems in its overseas markets. It is doing well in China and Mexico, where its low-price model is very attractive to consumers. In China, it felt that it was necessary to go against normal company policy by allowing 31,000 workers to unionize. Walmart has pulled out of Germany and South Korea. In Germany, it had experienced a number of problems: existing hard-discounters with minimum service and bare-bones stores beat Walmart's prices; many people still prefer to purchase a number of types of products from specialty stores (bakeries, butchers, etc.) rather than having the one-stop shopping experience that many Americans prefer; Walmart's smiling face emblem was disliked by some potential customers; and the company's insistence on employees being very friendly and helpful was disliked by some employees and viewed by many customers as being unpleasantly intrusive. In the United Kingdom Walmart's Asda chain grew until it became the country's second largest retailer in 2003. However, the company failed to recognize changing consumer tastes. As incomes rose, people began spending a lower percentage of their income on groceries and simultaneously demanding higher quality foods, particularly in fresh fruits, vegetables, and meat (*The Economist*, 2006).

Walmart is struggling in Japan where the question is one of 'cultural fit with employees and customers' (Holstein, 2007, p. 78). Consumers sometimes view low prices as meaning low quality; some products the company imported from China did not meet Japanese tastes, the company fired a number of employees, thus alienating many workers, and it irritated the business community by too rapidly cutting out middlemen (Holstein, 2007; Agence France-Presse, 2007).

One clear success story is that of 7-Eleven, originally an American company that eventually became even more successful under Japanese management. The original company believed that Japanese consumers would be attracted by innovative convenience stores that would be open for longer hours, would offer a wider range of products than typical small shops, and could still offer attractive prices by changing the distribution system supplying the stores. They formed a joint venture with an established Japanese company that could provide valuable connections and advice about cultural relationships. The model it used for success in the Japanese market has been adjusted to meet differences in the cultures of other countries where it operates (see Case 5.2).

IKEA (see Case 5.1) has successfully adapted to differences both among and between countries. It has found that its customer base comprises people with different values and objectives in different countries: in some nations, most potential customers place the greatest emphasis on furniture being well-made, solid, and inexpensive; in other countries, the company caters for those who view their products as modern and making a fashion/lifestyle statement. Advertising and product selection are designed for each of the major targeted groups. The company advertises in more than one language in countries or parts of countries (such as California and other American states where there are large numbers of Spanish-speaking people) to meet more than one targeted group.

Toyota provides examples of both great successes and some problems in the automotive sector. In the US market, it initially gained customer acceptance through providing high quality, low fuel consumption small cars at prices below those of the large US competitors. As its reputation for quality, value and innovation increased, it was able to raise prices and expand its line of vehicles. In response to American concerns about the flood of Japanese automobile imports, Toyota opened its first US plant in California in a joint venture with General Motors. Before beginning hiring, Toyota executives and managers studied American labor practices at great length, worked with the union to establish a new and cooperative labor agreement, and established a climate in the plant to meet American workers' desires for greater participation and equality. The plant has enjoyed high levels of productivity and quality, and relatively low rates of turnover, ever since it began production. In opening other plants in the United States, however, it went to areas where it could hire less-experienced, non-union labor that it felt could more easily be taught the Toyota way. It has been a leader in developing hybrid vehicles to meet the desire for less-polluting automobiles.

Toyota has encountered several problems with customer acceptance in the Chinese market. Two of its models were seen as overpriced and prices had to be cut in 2004. Its build-to-order sales system, with little inventory, caused lost sales. It also had two brand-name problems. First, in 2003, the sound of the character it used for its Land Cruiser SUV was offensive to many Chinese and the character had to be changed. A year later, in 2004, Toyota rebranded its Lexus from an English name to a phonetic rendering of the name in Chinese characters, which unfortunately turned out to sound similar to SARS in one dialect and one of which had a connotation of death (Miyazawa *et al.*, 2005). The names had to be changed. In 2006, prices for the newly introduced Prius hybrid appeared to be too high for the market and had to be cut.

Mercedes had problems with the labor force at its first US factory (before the formation of DaimlerChrysler). In spite of the expenditure of much time and money on training its workforce, it was not able to attain the high levels of quality and productivity it desired. The workers did not respond as expected to the German style of management. When the company acquired/merged with America's Chrysler to become DaimlerChrysler, and then acquired controlling interest in Japan's Mitsubishi Motors and a stake in Korea's Hyundai Motors, it had problems in the marketplace and with its partners. The marketing problems, part of which could not be foreseen and part of which occurred because of bad decisions made by executives in all four countries, resulted in large losses in the United States and Japan. Japanese managers found the attitudes and manners of German executives to be offensive. Clashes occurred between US management and German headquarters over several issues. Some senior US executives quit, and others were fired and replaced by German executives. DaimlerChrysler eventually withdrew from both Mitsubishi Motors and Hyundai Motors. Problems with the partners had also diverted German management from growing problems at the Mercedes division, and BMW took market leadership away from Mercedes in some countries. In 2007, DaimlerChrysler sold the Chrysler Division to US investors at a price far below what they had paid for it.

In 1999, France's Renault SA purchased a controlling interest in the nearly bankrupt Nissan Motors of Japan. The Brazilian-born, French-trained, and multilingual Carlos Ghosn, with executive-position experience on four continents, became CEO. He set about changing Nissan's corporate culture, creating cross-functional teams, including employees from various levels, to help formulate a revival plan. Ghosn managed to set and meet ambitious goals for closing plants, cutting costs, and developing new vehicles without actually laying off regular employees, though he made changes in some traditional Japanese practices. The company returned to profitability in two years. His remarkable accomplishments, based upon an exceptional level of cross-cultural understanding and an ability to create a sense of urgency, have resulted in many articles being written about him and the transformation he accomplished (see, e.g., Taylor, 2002; Edmondson *et al.,* 2005). The Renault–Nissan Alliance formed a new overall strategic management group in 2002 in the Netherlands as Renault–Nissan BV (Besloten vennootschap, a closed limited liability under Dutch law). It has been profitable ever since.

General Motors, while struggling in the United States, enjoyed rapid growth in China with its Buick brand. Marketed as a luxury vehicle it has appropriate special features. For example, the controls for the radio are in the rear since people in China who can afford luxury cars typically have chauffeurs. In 2005, GM added Chevrolets to its lineup and became the 2nd largest automobile producer in China.

VW entered the Chinese market early, understood *guanxi* and formed a very useful alliance in a joint venture with a Chinese automobile manufacturer. The joint venture then took in a government bank and other government entities as partners. It produced inexpensive cars, held 58% of the automobile market in 1997, and was very profitable. Its market share and profitability have since dropped sharply as competition has increased, it has found improving quality and reducing costs difficult, and the company has been slow in introducing newer models.

Problems that others have encountered can be as informative, or more informative, than the successes.

Export managers all too often lack cultural awareness, which can lead to errors or loss of potential gains in marketing policies. For example, Ricks (1999, pp. 31–2) reports an example of use of multiple-unit packaging that backfired. A US golf ball manufacturer attempted to sell golf balls in Japan packaged in groups of four. Pronunciation of the word *four* in Japanese also sounds like the Japanese word for *death*. The number four, therefore, is considered undesirable and items grouped into fours simply do not sell well. As another example, Adler (2002, p. 26) cites the case where a North American expatriate manager in Hong Kong chose an office of large size, regularly shaped, and located next to the vice-president's office. Chinese customers were uncomfortable visiting him in this office as they felt that the office had bad *feng shui* and would create bad business. *Feng shui* reflects the belief that people and their activities are affected by the layout and orientation of their workplace and home, and the goal is to be in harmony with the environment. The manager's choice of office reflected his culture – maximize status and influence through office size and proximity. But to the Chinese, the office was unlucky because it lacked harmony with nature. Fortunately, the manager was sensitive to Chinese cultural values and changed offices.

A general approach to managing multiculturalism is given in Exhibit 3.2.

Exhibit 3.2 Managing multiculturalism

Managing multicultural organizations is not easy. A paper by Vence (2003) reported that Elmer Dixon, senior associate at US-based Executive Diversity Services, Inc. specified some vital characteristics of a manager for this task:

- **Cultivate self-awareness.** If a manager is to understand the styles and behaviors of other cultures he or she has to be able to understand his or her own actions and their cultural origins.
- **Work with differences.** A key question to ask is whether the difference in behavior or culture really makes a difference.
- **Learn various styles of communication.** To be successful and effective in a multicultural organizational environment a manager needs to be fluent in a number of communication styles, which are tied to individuals' experiences, values, and nuances in every culture. This includes cultures that one works with and markets to.
- **Ability to settle cross-cultural conflict.** Some conflict is inevitable within organizations, distribution channels, and the marketplace. A manager needs to be able to distinguish between misunderstanding and real differences.
- **Be curious.** One should be willing, in fact be eager, to seek out and be fascinated with information that is different.

Within organizations, and channels of distribution as well, managers from different cultures can have differing management styles, which can have a negative impact on the success of relationships. A management style is 'a recurring set of characteristics associated with the process of making decisions.' Research has been reported that shows such styles differ among managers from five European Union countries (Albaum and Herche, 1999) and among six Asia-Pacific region countries (Albaum *et al*., 2007).

The nature of culture

Cultural factors exert the major influence on consumer behavior as it is the most fundamental determinant of a person's wants and behavior. Since so much of success in international marketing depends upon an understanding of culture, one might ask: what is it? For anthropologists, culture has long stood for the way of life of a people, for the sum of their learned behavior patterns, attitudes, and material things (Hall, 1973, p. 21). In a real sense, culture is human-made. It is learned and, as such, is communicated from one generation to another. Culture is shared by members of a society, and the behavioral traits of which it is composed are manifested in a society's institutions and artifacts. It is something that shapes behavior or structures one's perception of the world. In sum, culture is a shared system of meanings, it is learned, it is about groups, and it is relative (that is, there are no cultural absolutes); it is not right or wrong, inherited, or about individual behavior (Hoecklin, 1995, pp. 24–5). Thus, culture can be viewed as the homogeneity of characteristics that separates one human group from another (Griffith *et al*., 2000, p. 304). Yet another view looks at culture as the collective programming of the mind that distinguishes one group or category of people from another (Hofstede, 2001, p. 9). Table 3.1 presents a set of indicators identified by Brislin (1993).

To understand a culture one must understand its origins, history, structure, and functioning; how its artifacts and institutions developed to cope with the environment; and the effects of the geographical environment on the culture, acculturation, and assimilation. Culture

Table 3.1 Indicators of a person's culture

1.	Concepts, values, and assumptions about life that guide behavior and which are widely shared by people.
2.	The person-made part of the environment.
3.	Ideas that are transmitted generation to generation, rarely with explicit instruction (by parents, elders, teachers, etc.).
4.	This means that there will be identifiable childhood experiences that lead to the transmission of culture.
5.	An image that may be helpful is to think of a group of 18–20-year-olds; respected elders can look at all the 18–20-year-olds and can make the summary judgement, 'Yes, that person is one of us,' or, 'No, that person is not one of us.' The people judged as 'one of us' have learned the culture.
6.	Culture is not talked about – much of it is taken for granted (much as the air we breathe), and what is taken for granted is not discussed. Also, since culture is widely shared, it is uninteresting to talk about what everybody shares. This means, however, that people have little practice in discussing how culture affects their behavior, and so are ill-prepared to explain their culture to people from other countries.
7.	Behaviors influenced by culture are done for their own sake – people are not expected to defend these behaviors.
8.	Practices strongly influenced by culture stay despite mistakes and slip-ups.
9.	Culture becomes clearest when people interact with others from very different backgrounds. Culture becomes clear in 'well-meaning clashes.' People are engaging in proper behavior according to their own culture, but there is a clash when the interaction is between people from different cultural backgrounds.
10.	There is an emotional (not just intellectual) reaction when cultural assumptions are violated.
11.	Behaviors influenced by culture can sometimes be summarized in very clear pictures, or in short scenes (scripts) that are much like those in a movie.
12.	Culture allows people to 'fill in the blanks' when faced with the basic elements of a set of behaviors familiar in their own culture.
13.	Related to point 12, culture allows people to say 'and all that sort of thing' and 'you know what I mean' when the basics of familiar behaviors are mentioned.
14.	People can reject aspects of their culture at one point in their lives and can move back into an acceptance of these aspects at other times in their lives.
15.	Some culturally influenced behaviors can be summarized in very sharp contrasts (individualism–collectivism, punctuality, spatial orientation of people, theory vs empiricism).
16.	There is a feeling of 'this will be difficult and time consuming' when attempts at culture change are considered.

undergoes change over time, with change typically being slow to occur. Sometimes 'rapid' changes occur. These, however, are often not 'natural' but are due to outside pressures, for example from government or other groups such as religious organizations. When the Shah lost power in Iran and the religious leaders gained control of the government, the culture changed relatively rapidly from its 'Westernized' direction to a more fundamental Islamic orientation. A similar situation occurred in Afghanistan. Government influences culture in other ways that may not be as quick in becoming effective. For example, there are movements in many countries to develop a legal framework for cohabitating couples. If laws are passed that recognize these legally, unmarried couples would become eligible for many fiscal and legal rights now enjoyed by married couples. Such 'legalization' would ultimately lead to a change in values about marriage. Needless to say there is, and will continue to be, strong opposition to this from religious groups. International marketing managers need to know how the culture changes, and also how their decisions interact with and sometimes serve as a change agent in the culture. Culture provides norms for behavior of buyers, consumers, and sellers, and these norms control behavior in ways that are not always well understood.

There are many dimensions to culture as summarized in Table 3.2. Some of the great religions of the world, for example, transcend national boundaries and thus contribute to cultural homogeneity among certain nations. Or the educational opportunities in 'developed' nations for people from 'developing' nations can contribute to similarity of habits and customs, tastes, and values. Foreign languages are often used by the educated classes of nations and contribute to cultural homogeneity. On the other hand, the diversity of languages, religions, education systems, and numerous other cultural factors contributes to different ways of life, habits, and customs. Even within nations there is great cultural diversity, for example between those from Hamburg or Munich in Germany, or between the numerous ethnic and racial groups in the United States, or among the many major language groups in India and in China.

Another way to learn about cultures is to examine *cultural universals*, and seek generalizations that apply to all cultures. Murdock (1945) identified more than 70 cultural universals

Table 3.2 Cultural dimensions

Values and attitudes about	
Time	Wealth
Work	Change
Risk taking	Achievement
Education	
Formal education (primary, secondary, higher)	
Literacy level	
Vocational training	
Human resources planning	
Language	
Spoken, written, official	
International languages	
Mass media	
Linguistic pluralism	
Religion	
Beliefs and norms	Rituals
Sacred objects	Prayers
Taboos	Philosophical systems
Holidays	
Law	
Common law, code law	Foreign law, home country law
Cntitrust policy	Overall regulation
International law treaties	
Social organization	
Interest groups	Kinship
Social mobility	Social satisfaction
Social institutions	Authority structures
Status systems	
Politics	
Nationalism, national interests	Sovereignty
Imperialism	Power
Political risk	Ideologies
Technology and material culture	
Communications, invention, science, etc.	

including such diverse things as athletic sports, education, feasting, games, language, mourning, music, status differentiation, and visiting. While the means of, say, *status differentiation* or the preferences for *music* may or may not be the same in each culture, every culture has some means of differentiation and some preferences for some kind of music.

Although one can study and compare cultures by seeking regularities or irregularities in cultural universals, this task is made difficult by the fact that much of the routine of living is governed by cultural characteristics of which people are only dimly aware, or perhaps even unaware. This phenomenon is known as the *iceberg principle*. There is a surface culture that includes the more obvious dimensions of music, art, food and drink, greetings, dress, manners, rituals, and outward behaviors. But the most powerful elements of culture may very well be those that lie below the surface and include so-called value orientations, which are preferences for certain outcomes over others – for example control of the environment over harmony with the environment. Illustrations of selected value orientations toward selected variables are shown in Table 3.3.

Table 3.3 Selected value orientations

Variable		Description of different value orientations toward variable
Environment	Control:	People can dominate their environment; it can be changed to fit human needs.
	Harmony:	People should live in harmony with the world around them.
	Constraint:	People are constrained by the world around them. Fate, luck, and change play a significant role.
Time	Past:	High value placed on continuance of traditions.
	Present:	Short-term orientation aimed at quick results.
	Future:	Willingness to trade short-term gain for long-term results.
Action	Doing:	Task-centered. Stress placed on productive activity in goal accomplishment and achievement.
	Being:	Relationship-centered. Stress placed on working for the moment, experience rather than accomplishment.
Communication	High context:	Shared experience makes certain things understood without them needing to be stated explicitly. Rules for speaking and behaving are implicit in the context.
	Low context:	Exchange of facts and information is stressed. Information is given primarily in words, and meaning is expressed explicitly.
Space	Private:	Individual orientation to the use of physical space. Preference for distance between individuals.
	Public:	Group orientation to the use of physical space. Preference for close proximity.
Power	Hierarchy:	Value placed on power differences between individuals and groups.
	Equality:	Value placed on the minimization of levels of power.
Individualism	Individualistic:	The 'I' predominates over the 'we.' Independence is highly valued.
	Collectivist:	Individual interests are subordinate to group interests. Identity is based on the social network. Loyalty is highly valued.
Competitiveness	Competitive:	Achievement, assertiveness, and material success are reinforced.
	Cooperative:	Stress is placed on the quality of life, interdependence, and relationships.
Structure	Order:	High need for predictability and rules, written and unwritten. Conflict is threatening.
	Flexibility:	Tolerance of unpredictable situations and ambiguity. Dissent is acceptable.
Thinking	Inductive:	Reasoning based on experience and experimentation.
	Deductive:	Reasoning based on theory and logic.

Source: Adapted from *Doing Business Internationally*, Irwin Professional Publishing (Brake, *et al.*, 1995) pp. 46–7, Reproduced with permission of The McGraw-Hill Companies

Learning about cultures is made even more difficult because societies or groups may share certain common culture traits, but there are also many possible *subcultures* with characteristic traits that explain variations in behavior within cultures. Major subcultures may be based on nationality, religion, race or ethnicity, and geographical area. For example, the Catalonian Spanish are fiercely proud of their distinct culture that differs in many ways from the rest of Spain. Some people may share common cultural traits with citizens of other nations; but these same people may also have some distinctly different characteristics. Although members of the Catholic Church in France and Latin America have cultural similarities, there are other socio-cultural characteristics such as lifestyles associated with poverty or affluence that cause diverse behaviors in this religious group. As another example consider the clusters of countries formed on the basis of similarity of cultural values as shown in Table 3.4. Although the countries within a cluster have similar values (or shared preferences) there are differences in other cultural characteristics. For example, in Cluster 4 the language of Finland differs from that of the others. A final example is from Asia. Asian values have been held by certain political leaders in the region such as the former Prime Minister of Malaysia, Dr Mahathir, and former president and Senior Minister Lee Kuan Yew of Singapore to be 'homogeneous' and to differ greatly from values of the West. Moreover, these same leaders asserted that these values were inherently superior and explained East Asia's economic success of the 1990s and prepared

Table 3.4 Country clusters ranked on similarity of values*

Cluster 1 – Anglo:	
	Canada, Australia, New Zealand, United Kingdom, United States
Cluster 2 – Germanic:	
	Austria, Germany, Switzerland
Cluster 3 – Latin European:	
	Belgium, France, Italy, Portugal, Spain
Cluster 4 – Nordic:	
	Denmark, Finland, Norway, Sweden
Cluster 5 – Latin American:	
	Argentina, Chile, Colombia, Mexico, Peru, Venezuela
Cluster 6 – Near Eastern:	
	Greece, Iran, Turkey
Cluster 7 – Far Eastern:	
	Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Vietnam, Taiwan
Cluster 8 – Arab:	
	Bahrain, Kuwait, Saudi Arabia, United Arab Emirates
Independent (not closely related to other countries)	
	Japan, India, Israel

*Countries within a cluster are considered similar with regard to their cultural values. Clusters are arranged in an approximate order of cluster similarity; i.e., the Anglo cluster is more similar to the European cluster (Germanic, Latin European, and Nordic) than it is to the Latin American, Near Eastern, Far Eastern, and Arab clusters.

Source: From *Experiencing International Business and Management*, 2e, Wadsworth (Punnett, B. J. 1994) p. 15, Exhibit 1.4, Thomson Learning, From Punnett, Experiencing International Business and Management, 2E. © 1994 South-Western, a part of Cengage Learning, Inc. Reproduced by permission. www.cengage.com/permissions the region for future global dominance. In addition, the research of Hofstede (2001) indicates there is measurable variance among Asian nations in four of the five dimensions of culture he has identified. The one value dimension that has the most consistency in the index scores developed is individualism/collectivism. Asian countries are essentially collectivist in nature.

With regard to international marketing management, it seems best to study cultures not only from a broad perspective to learn about relevant patterns and themes, but also from a narrow perspective as behavior relates specifically to certain products or marketing efforts. This approach to studying culture can lead to information that will guide international marketing efforts, especially to determine when the same strategies and tactics can be employed in multiple countries and when they cannot.

It may be well also to identify some of the limits of culture as an explanation of behavior. For example, linguistic relativity (or the Whorf hypothesis) is still cited in some circles, namely, that the world-view of individuals depends on the structure and characteristics of the language they speak; that different languages provide different segmentations of experience; and that perhaps language and thought are synonymous (Kess, 1976). Many nations are linguistically homogeneous and others are heterogeneous. Examples of linguistically homogeneous nations are the United Kingdom, Korea, Japan, Costa Rica, Egypt, Norway, and Brazil. Nations where more than one language is spoken include the United States, Belgium, China, South Africa, India, Ivory Coast, Switzerland, Guatemala, and Canada. In linguistically heterogeneous countries, one language may still be predominant for many uses. China provides a good illustration. There are seven major languages spoken in the country (*The Economist*, 1999). There is, however, a unified national language, *Putonghua*, which is based loosely upon the Beijing dialect of Mandarin. More than 60% of the population speaks Mandarin of one form or another. *Putonghua* is the universal language of government, and it is used in schools and universities (regional dialects are banned).

Those who have had experience with another language often find that certain ideas are difficult to translate, or the 'best' translation seems incomplete somehow. Ricks (1999, p. 90) cites an example of what can happen in translation of idioms and expressions. The English expression 'touch-toe' created an adverse reaction for a manufacturer of dental equipment. In a brochure written for the Russian market, the company featured the 'touch-toe' control of its dental chair equipment. The translator rendered the description of this feature in such a way that the Russians thought that the dentist had to be barefoot in order to operate the equipment. Some languages seem to express certain ideas, feelings or experiences more briefly or more clearly than others.

Research by the international marketer on these and related topics would be likely to have meaningful strategic and tactical applications in selecting brand names, or packages, or in designing advertising in multiple countries. Such information, for example, would be helpful in determining when brand names, packages and/or advertisements that are appropriate for one culture could also be appropriate for others (and when not).

At times government acts on business practices in support of cultural values. In 1996 the central government of the PRC announced that Chinese businesses could no longer use Westernized names as brand names if they were viewed as detrimental to Chinese culture and society.

Culture and communication

Each culture reflects in its language what is of value to the people. Language – whether written, spoken, or silent – becomes the embodiment of culture and is a means whereby people communicate to other people, either within their own culture or in other cultures. More broadly, communication includes any behavior that another person perceives and interprets. As such, it is one person's understanding of what another person means. According to Adler (2002, p. 74):

> Communication includes sending both verbal messages (words) and nonverbal messages (tone of voice, facial expression, behavior, and physical setting). It includes consciously sent messages as well as messages that the sender is totally unaware of sending . . . Communication therefore involves a complex, multilayered, dynamic process through which we exchange meaning.

Behavior itself is a form of communication. Each culture may differ in the way that it experiences and uses such things as time, space, relationships, and a host of other aspects of culture. This form of communication is known as the *silent language*. In a general sense, Hall (1973, Chapter 3) has defined ten *primary message systems* as the means by which cultures communicate to their members and to other cultures. These primary message systems are shown in Table 3.5.

Only the first primary message system involves language. All other primary message systems are non-linguistic forms of communication. More specifically, Hall (1960) has defined the major dimensions of the silent language as they operate within international marketing as being: (1) time; (2) space; (3) things; (4) friendship; and (5) agreements.

These five dimensions can form the basis of a real understanding of foreign cultures. The international marketer must, if there is to be a successful and mutually profitable relationship, *know* how the persons whom he or she will be contacting use each of the languages. For example, it is essential to know that when communicating verbally, Middle Easterners and Latin Americans stand much closer to each other than do western Europeans. Figure 3.1 shows the meaning of gestures in selected countries. Figure 3.2 shows how personal space is used in Chinese culture. Needless to say, nonverbal communication is important in business dealings, and meanings vary across countries. Many cultural

Table 3.5 Primary message systems

- *Interaction*: the ordering of people's interaction with those around them, through language, touch, noise, gesture, and so forth.
- *Association*: the organization and structuring of society and its components.
- *Subsistence*: the ordering of people's activities in feeding, working, and making a living.
- *Bisexuality*: the use of sex lines to differentiate roles, activities, and function.
- *Territoriality*: the possession, use, and defense of space and territory.
- *Temporality*: the use, allocation, and division of time.
- *Learning*: the adaptive process of learning and instruction.
- *Play*: relaxation, humor, recreation, and enjoyment.
- *Defense*: protection against the environment, including medicine, warfare, and law.
- *Exploitation*: using the environment through technology, construction and extraction of materials.

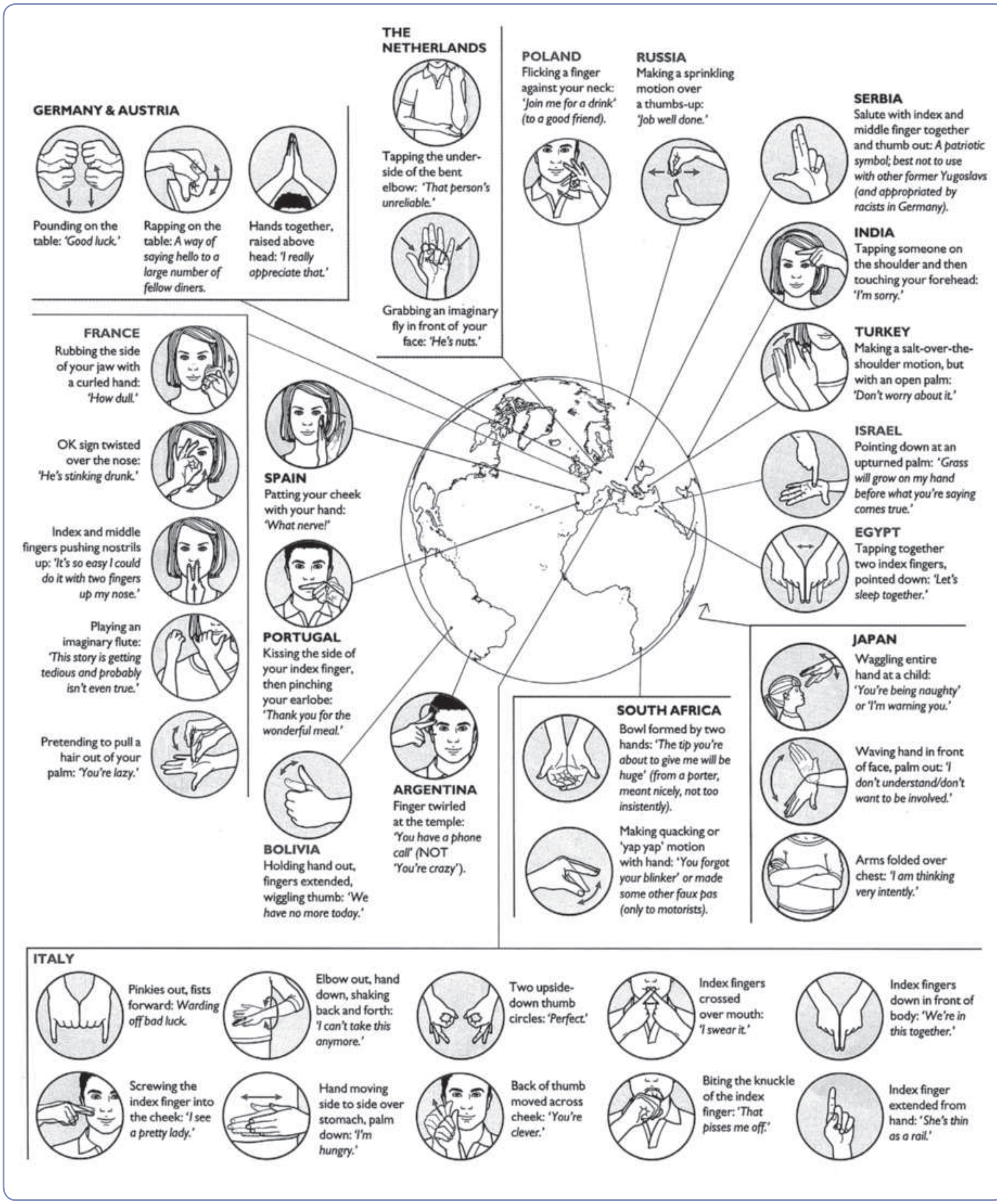

Figure 3.1 Country-specific gestures

Source: Kachka, 2008a, p. 118.

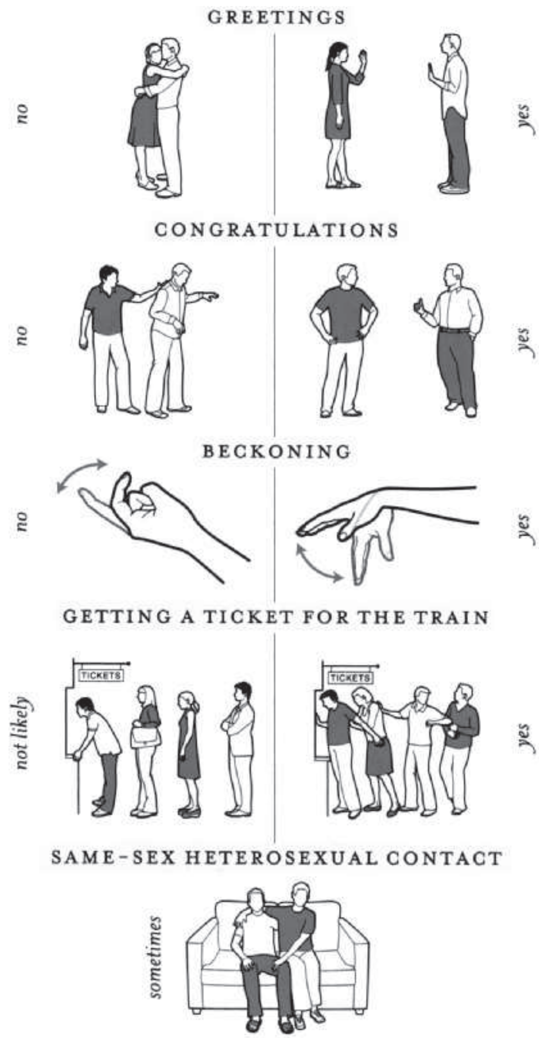

Figure 3.2 Personal space in the Chinese culture

Source: Kachka, 2008b, p. 128.

practices are treated differently based on gender, and in business travel, protocol for women differs from how men are expected to behave (Tulshyan, 2010).

Another example can be derived from how agreements are arrived at. Agreements involve negotiation, and cultural differences do arise in techniques of negotiating. In some countries in Asia, for instance, the specified price is often the starting point for negotiations, not a 'final figure' as in many Western countries. In addition, the value of using logic or emotion when negotiating can vary among cultures.

Cultural context is important for understanding differences among cultures in their reactions to communication and behavior. High context cultures are those that need to know in what context you find a person or a product in order to evaluate it, or, in the case of language, how a word or words are used. By themselves words carry little meaning. In contrast, low context cultures can evaluate a product based on, for example, test results and without knowing what kind of people use it, when it is typically used, and so forth. With respect to language, in a low context culture most of the meanings are in the words themselves, and the meaning of a message can be isolated from the context in which the message occurs. Example of low context countries are those in Northern Europe and North America whereas high context countries are found in Asia and Latin America (Gesteland, 1999, pp. 38–40).

Finally, the international marketer needs to recognize that doing business in foreign markets involves **cross-cultural communication** in all aspects of the relationship. When the person from the other culture does not receive the sender's message in the manner intended, cross-cultural miscommunication occurs. The greater the differences between the cultures of the seller and the buyer, the greater the probability for cross-cultural miscommunication to occur. Miscommunication involves misunderstanding due to misperception, misinterpretation, and misevaluation. Thus, in becoming involved in a cross-cultural situation, the international marketer should heed the following advice: 'always assume difference until similarity is proven.'

Self-reference criterion (SRC)

Lee (1966) coined the term 'self-reference criterion' as a useful concept to avoid cultural bias. He suggested that problems should be defined first in terms of the cultural traits, habits, or norms of the home society. Then they should be redefined without value judgements, in terms of the foreign cultural traits, habits, and norms. He indicated that the difference between these two specifications is an indication of the likely cultural bias, or SRC effect, which can then be isolated and carefully examined to see how it influences the concept or the problem. Following this examination, the problem is redefined with the bias removed. The value of this approach lies in forcing the manager posing the problem to make specific his or her assumptions about the cultural elements affecting the problem and to question whether or not they hold for another culture.

A concluding comment

Culture is a pervasive environmental variable affecting all international and export marketing activity. Of concern to the manager are the influences of the religious, family, educational, and social systems of a society. Often these are manifested in the values, attitudes, and motivations of people and can affect business customs such as personal manners, colors, advertising, 'gift' giving and receiving, and pride and status. All too often in domestic transactions we have a tendency to take culture for granted and not explicitly incorporate its effects into our decisions. When dealing with the foreign markets, even those whose **cultural distance** from ours is not great, this should not be done.

Economic forces

A major characteristic of the international marketer's world is the diversity of marketing environments in which business may be done. In particular, the economic dimensions of the world market environment are of prime importance.

Economic forces affect the international marketer by the impact that they have on market potential and, at any point in time, market actualization. In addition, economic forces in a country may be influenced strongly by the infrastructure that exists, including the communications, energy, and transportation facilities.

Significant variations in national markets originate often in straightforward economic differences. *Population* characteristics represent one major dimension. Of relevance are such attributes as total population and location of the population within the country (for example, degree of urbanization). The *income and wealth* of the people, both absolute magnitude and location, are relevant because they determine purchasing power. It is well documented that income is a major determinant of ownership of consumer durable goods. Of course, sales of some durable goods are affected by other factors such as climate and geography. For example, purchases of air conditioners and dehumidifiers are affected by climate as well as income. High-income people in Sweden can easily afford an air conditioner but are unlikely to buy one. In contrast, low-income people in Algeria have a need for an air conditioner but are unlikely to buy one since they cannot afford it.

Distribution of income and wealth and the affluence of particular groups in a nation or region are also of great interest. Even in a society with low average income, there may be a population segment with a high income level and the desire to purchase luxury goods. While the average income in Hong Kong, as measured by Gross National Income (GNI) per capita, is well below that in the major industrialized nations, it has the highest per capita ownership of Rolls-Royce automobiles in the world. For 2013, Monaco, Lichtenstein, Bermuda, Norway, and Qatar make up the top five highest GNI per capita. Australia was ranked 9th, Sweden 11th, and Denmark 12th, Singapore 16th, and the United States 17th.

Market development

On a broader scale, the extent of *economic development* of a market influences the lines of business and methods by which business can be carried out in a country. Infrastructure is affected, as are all types of institutions within the country.

Foreign markets may be at different stages of economic development, each stage having different characteristics. A common way to group countries is as *developed* (for example Australia, New Zealand, Denmark, the United Kingdom, Japan, the United States) or *developing* (for example Malaysia, Costa Rica, Egypt, Uruguay).

Another approach to categorizing the world's economies is illustrated in Table 3.6, where the World Bank groups countries on the basis of GNI per capita as follows:

1. **low-income economies** (GNI per capita <US$1025);
2. **lower middle-income economies** (GNI per capita US$1026–US$4035);
3. **upper middle-income economies** (GNI per capita US$4035 but <US$12,475);
4. **high-income economies** (GNI per capita >US$12,475).

A small number of countries in central Europe, Latin America, and Asia experienced rapid growth in the 1990s, and have been identified as having major marketing opportunities. These countries have come to be known as big emerging markets (**BEMs**). Ten countries generally recognized as BEMs are China (PRC), India, Indonesia, South Korea, Brazil, Mexico, Argentina, South Africa, Poland, and Turkey (Keegan and Green, 2000, p. 54). These countries cut across all stages of economic development. China is the largest with a population of over 1.3 billion and Poland is the smallest with a population of

Table 3.6 Classification of selected countries by the World Bank based on GNI per capita as of 15 June 2015

Low-income economies			
Afghanistan Ethiopia	Madagascar	Somalia	
Bangladesh Gambia, The	Malawi	Tajikistan	
Benin Ghana	Mali	Tanzania	
Burkina Faso Guinea	Mauritania	Togo	
Burundi Guinea-Bissau	Mozambique	Uganda	
Cambodia Haiti	Myanmar	Uzbekistan	
Central African Republic Kenya	Nepal	Vietnam	
Chad Korea, Dem Rep.	Niger	Yemen, Republic of	
Comoros Kyrgyz Republic	Rwanda	Zambia	
Congo, Dem. Rep Lao PDR	Senegal	Zimbabwe	
Eritrea Liberia	Sierra Leone		
Lower-middle-income economies			
Albania Egypt, Arab Rep.	Maldives	Solomon Islands	
Angola El Salvador	Marshall Islands	Sri Lanka	
Armenia Georgia	Micronesia, Fed. Sts.	Sudan	
Azerbaijan Guatemala	Moldova	Swaziland	
Belize Guyana	Mongolia	Syrian Arab Republic	
Bhutan Honduras	Morocco	Thailand	
Bolivia India	Nicaragua	Timor-Leste	
Cameroon Indonesia	Nigeria	Tonga	
Cape Verde Iran, Islamic Rep.	Pakistan	Tunisia	
China Iraq	Papua New Guinea	Turkmenistan	
Congo, Rep. Jordan	Paraguay	Ukraine	
Côte d'Ivoire Kiribati	Philippines	Vanuatu	
Djibouti Kosovo	Samoa	West Bank and Gaza	
Ecuador Lesotho	São Tomé and Principe		
Upper-middle-income economies			
Algeria	Dominica	Malaysia	Serbia
American Samoa	Dominican Republic	Mauritius	Seychelles
Argentina	Fiji	Mayotte	South Africa
Belarus	Gabon	Mexico	St Kitts and Nevis
Bosnia and Herzegovina	Grenada	Montenegro	St Lucia
Botswana	Jamaica	Namibia	St Vincent and the Grenadines
Brazil	Kazakhstan	Palau	Suriname
Bulgaria	Latvia	Panama	Turkey
Chile	Lebanon	Peru	Uruguay
Colombia	Libya	Poland	Venezuela, RB
Costa Rica	Lithuania	Romania	
Cuba	Macedonia, FYR	Russian Federation	
High-income economies			
Andorra	Denmark	Italy	Puerto Rico
Antigua and Barbuda	Estonia	Japan	Qatar

(continued)

Table 3.6 Classification of selected countries by the World Bank based on GNI per capita as of 15 June 2015 *(continued)*

Aruba	Equatorial Guinea	Korea, Rep.	San Marino
Australia	Faroe Islands	Kuwait	Saudi Arabia
Austria	Finland	Liechtenstein	Singapore
Bahamas, The	France	Luxembourg	Slovak Republic
Bahrain	French Polynesia	Macao, China	Slovenia
Barbados	Germany	Malta	Spain
Belgium	Greece	Monaco	Sweden
Bermuda	Greenland	Netherlands	Switzerland
Brunei Darussalam	Guam	Netherlands Antilles	Trinidad and Tobago
Canada	Hong Kong, China	New Caledonia	United Arab Emirates
Cayman Islands	Hungary	New Zealand	United Kingdom
Channel Islands	Iceland	Northern Mariana Islands	United States
Croatia	Ireland	Norway	Virgin Islands (US)
Cyprus	Isle of Man	Oman	
Czech Republic	Israel	Portugal	

Source: World Bank website, http://data.worldbank.org/about/country-and-lending-groups#Low_income. International Bank for Reconstruction and Development © The World Bank.

38 million. Some barriers to their emergence as major global players are their past behavior on human rights, environmental protection, and other issues of concern to potential trading partners. Another emerging group is known as **BRICs**, which includes Brazil, Russia, India, and China. These countries are the four largest economies outside the OECD (Organization for Economic Development, the so-called rich man's group). They are the only developing economies with annual GDPs of more than US$1 trillion: thus they have great economic weight, or at least the potential for such weight. Except for Russia, these countries sustained better growth than most countries during the recession of the first decade of the 2000s. During this time China became the world's largest exporter. One measure of BRICs' importance is their share of foreign exchange reserves. In 2010 South-Africa joined the BRIC countries to form BRICS. The BRICS countries count more than 40% of the world population and more than 20% of the world GDP.

Countries differ widely in risk to business profitability. *The Economist* on its website www.economist.com makes available to subscribers a number of country rankings based on such measures as credit risk, quality-of-life, political instability, executive confidence, and ease of doing business (and its dimensions). In addition, *The Economist* ranks countries on the basis of *business environment* and there is an index of *operational risk*. This index is an aggregate of ten categories of risk: security, political stability, government effectiveness, legal and regulatory, macroeconomic, foreign trade and payments, tax policy, labor market, and infrastructure. Another type of index, the Country Risk Classification, is prepared by the OECD. This classification is based on a country's credit risk – that is, the likelihood that a country will service its external debt (www.oecd.org). The classification is based on both quantitative and qualitative analyses. Countries are categorized into one of eight risk groups, scored from 0 (least risky) to 7 (most risky). A final example of classifying countries is the Human Development Index which is calculated by the United Nations for its members. The rankings are based on life expectancy, education enrolments, literacy and per capita GDP adjusted for purchasing power.

These types of classification are of only limited usefulness to an international marketer and should not be used as the sole basis for deciding whether or not to enter foreign markets and how to market to such markets. Such classifications rest upon many factors involving trade-offs within this system. Thus, two countries that differ in many ways may be classified in the same group. An example of a classification schema developed by a company for its own internal use is shown in Exhibit 3.3. Although this schema is more than 30 years old, it illustrates what a company can, and often must, do when it has a specific need and there is nothing available that fits this need.

Exhibit 3.3 Economic development variable in countries' use of electricity and electrical goods

Occasionally, a company may develop its own schema. For example, the classification system once used by the General Electric Company is summarized below:

- **Less developed.** These countries have primarily agrarian and/or extractive economies. High birth rates, along with limited infrastructures, account for the low per capita income and usage of electricity. Electrification is limited to the main population centers. Generally, basic electrical equipment is imported.
- **Early developing.** These countries have begun initial development of an infrastructure and have infant industries, especially mining and selected cottage manufactures. Target economic sectors may enjoy high growth rates even though per capita income and electricity consumption are still modest. Progressively more sophisticated electrical equipment is imported, frequently to achieve forward integration of extractive industries.
- **Semi-developed.** These countries have started an accelerated expansion of infrastructure and wide industrial diversification. Thus, per capita income and electricity consumption are growing rapidly. Increased discretionary income and electrification allow greater ownership of autos and electrical appliances among the expanding middle class. Larger quantities of high-technology equipment are imported.
- **Developed.** These countries enjoy well-developed infrastructures, high per capita income and electricity consumption, and large-scale industrial diversification. They are also characterized by low rates of population and economic growth, as well as shifts in emphasis from manufacturing to service industries – notably transportation, communication, and information systems.
- **Communist.** The separate listing for these countries does not imply that they represent either a higher or a lower stage of economic development. They could have been distributed among each of the above four categories.*

This approach incorporates general country variables – for example, geography and population, income – and industry-specific variables of interest, for example, usage of the product and total imports.

*Today, this category is obsolete.

Source: Reprinted with permission of The Conference Board from V. Yorio, *Adapting Products for Export* (1978), p. 11.

Any classification scheme assumes a certain homogeneity among markets in the same category, which often is not correct. Even the more traditional countries may have groups of people who, due to their income and other sets of values, will be a market for sophisticated products and services, while some of the developed countries still have portions of their population to some extent outside the money economy.

If complemented with the use of socio-economic, cultural, demographic, and structural data, then it becomes possible to use classifications to assess the existence of a potential market for a given product or set of products in a given country. However, the results of such analysis may yield nothing better than the knowledge that a market exists for the product *concept* without ensuring the success of any given marketing mix. At best, then, any classification schema is an indicator that further investigation is or is not warranted.

Some areas of change

One of the major areas of rapid growth and change has been Asia and the Pacific Rim countries. The countries of Asia are expanding trade, investment, and technology links by themselves, rather than depending on Europe or the United States as in the past. The growth that has occurred in the BEMs and BRICs is evidence of this.

China is now the world's largest exporter. The distribution of China's exports has shifted since 1996, as exports have grown from US$151.2 billion in 1996 to US$1,201.7 billion in 2009 (www.uschina.org/statistics/tradetable.html). The United States, the European Union, Hong Kong, Japan and South Korea are the five top major markets. As China has become more a force in the world's economy so has India. China and India are being continually compared and are referred to by some as the new 'giants' of the world (Woodall, 2006).

Another major area of change is Latin America, where a number of countries – such as Argentina, Chile, Mexico, Colombia, and Peru – are growing rapidly and economic conditions have improved significantly. Industries such as utilities, manufacturing, construction, and telecommunications are still in their early growth stages in countries such as Argentina, Brazil, Chile, and Mexico. One indication of the appeal of Latin America has been the investment there by Asian companies.

Another area of change as we move into the 21st century concerns Russia, where a middle class is making itself known and 'heard.' Such a group is very appealing to international marketers as they have the income to consume. This group's influence is being boosted by a resurgent national economy and by its own efforts. The middle class is concentrated in the western cities of Moscow and St Petersburg, but is also found in major provincial cities such as Samara and Vladivostok. By profession, most are entrepreneurs who own their own businesses. Some are lawyers and accountants. Still others are managers for large Russian and multinational corporations.

Finally, the area known as the Middle East and North African (MENA) region, which includes 24 Arab countries and territories and almost 500 million people, has lagged behind in economic growth and globalization. Although the region still dominates the global oil market, the benefits from oil in the 1970s and 1980s failed to generate a sustained growth dynamic or bring about greater regional integration. Income levels continue to vary widely within the MENA region. However, MENA countries are poorly integrated with the world economy. The region receives only one-third of the foreign direct investment expected for a developing country of an equivalent size. Most of this direct investment tends to be concentrated in enclave sectors of a few countries.

Competition

One of the most dynamic environmental forces affecting the marketing strategy of individual exporters is competition. Every firm must seek and find a function in order to maintain itself in the marketplace. Every firm occupies a position that in some respects is unique (for example, its location, product, customers).

A company entering foreign markets should never underestimate local competition. A good example is the experience of the United States company Starbucks, the largest coffee chain operator in the world, in Australia. The company opened its first store in 2000, and by the end of 2007 it had 87 stores in the country. In mid-2008 the company closed nearly three-quarters of its stores. The evidence indicates that Starbucks not only misjudged the Australian coffee culture but also misjudged the extent of competition, and failed to adapt its offering to the local market (Patterson *et al.*, 2010). Gloria Jean's, McCafé, and the Coffee Club turned out to be serious competitors.

Competition comes about because business firms, in their search for a niche in the economic world, try to make the most of their uniqueness. The result, hopefully, is the establishment of a *differential advantage* that can give the firm an edge over what others in the field are offering. It is this unending search for differential advantage that keeps competition dynamic. Hoecklin (1995) argues that understanding and *managing* cultural differences can lead to innovative business practices and sustainable sources of competitive advantage. Indeed on a broader level we see that more sustainable competitive advantages are changing from 'harder' efficiency sources to 'softer' effectiveness sources. Competitive advantage lies in doing the *right* things effectively, not in doing the 'wrong' things efficiently. However, knowing what the right things are in terms of consumer perception is central to strategic thinking. According to Haybyrne (1998), information used effectively is *tactical competitive advantage*. Thus, an international marketer must have a way to develop and manage knowledge as part of its competitive advantage. In determining what knowledge to manage, the marketer must first have a clear strategic direction for itself. This strategy becomes both a 'magnet' and a 'filter' – a magnet in terms of pulling relevant information into the company and a filter in terms of converting that information into usable competitive knowledge. This means that the international marketer must focus resources on core skills rather than trying to develop knowledge and skills in a broad range of categories. Nike, for example, concentrates on shoe design and promotion, and subcontracts (outsources) to others the rest of the value chain such as production and distribution. Nissan decided that it could gain competitive advantage by dedicating its knowledge base at the distribution and marketing points and concentrated on superior dealer service. It developed the most intensive dealer training program in the industry, involving everyone from salespeople to the receptionist, training them in identifying and meeting customer needs.

Sometimes competition is not 'fair.' A large German electronics company pays bribes to get export orders, France once demanded 20% of Vietnam's telecommunications market in exchange for aid, and a European aerospace company threatened to block European Union membership for Turkey and Malta unless their national airlines purchase its planes. These and other practices have been reported to exist in the competitive arena for global business, and other evidence seems to be that such practices will increase, particularly in key sectors. Companies and governments seem to be more willing to use these unconventional methods to make a sale. Not all countries (or cultures) view practices such as these as illegal, or even unethical.

Sometimes it is simply 'moral suasion' by government. For example, Japan's Ministry of Economy, Trade, and Industry (METI) persuaded the large electronics company NEC to sell its plasma-display business to local rival Pioneer rather than a foreign investor, as a way to keep its technology in Japan. On a broader scale, many Japanese manufacturers have responded to competition, particularly in low-cost mass-production items, by keeping core technologies secret and at home, while moving low-value-added production and **assembly operations** abroad (*The Economist*, 2004a, p. 57).

Nature of competition

Export marketing planning requires a knowledge of: (1) the structure of competition: the number and types of competitors; and (2) the action of competitors: the competitive tools available to marketing executives in the decision areas of product, channel, price, and promotion. Managers must be continually monitoring, for instance, competition in international markets.

This may concern products for which prices in various nations bear a known relationship, products that are standardized or graded according to accepted international standards, products that normally flow from one country to another in accordance with market needs and competitive conditions – in short, products for which there is a recognizable international market. Raw materials and semi-manufactured products (for example steel, coffee, rubber, textiles, industrial chemicals) are examples of such products. These products are homogeneous, or capable of being graded into homogeneous classifications; they are the 'components utilized in a wide variety of products by industries in virtually all nations.'

However, an international market also exists in some degree for products that are only somewhat alike, not quite homogeneous but sufficiently similar so that they may be considered to be acceptable substitutes; for example aspirin, razor blades, soft drinks, automobiles, clothing. Such products should to some degree be tailor-made and tailor-marketed to each market segment. For example, a foreign company producing automobiles will be more competitive in markets that drive on the left side of the road (the United Kingdom, Japan, Thailand) if they market right-hand drive automobiles. When an international market exists, producers must compete with those in other nations. If producers in one nation set the price too high or if they set the quality level too low, consumers may view foreign products as a superior 'buy' for the price. Often domestic producers or multinational firms producing for a given domestic market will recognize the boundaries within which they must remain in order that their products meet the needs of the local market more precisely than foreign products. Thus, a manufacturer of aspirin may market the product in different-sized packages in various national markets; a manufacturer of an orange soft drink might vary the formula (for example, amount of natural orange juice in the drink) according to various national consumer tastes. Although it may appear as if such products do not experience direct competition from similar but somewhat different products produced and marketed elsewhere, this conclusion is an illusion. Competition can exist in a meaningful sense.

Factors influencing competition

When products are homogeneous in the sense that the output of one producer is a good substitute for the output of other producers and when there is a sufficient number of buyers and sellers so that the actions of any one of them, acting alone or in concert with others, are of virtually no consequence to other buyers and sellers, the price of such products are determined by natural market factors. The quality and nature of the product (or product grades) tend to settle to a level that the market feels is consonant with the price, and physical distribution, selling, and advertising costs tend to be reduced to the lowest possible level. Under such conditions the structure of competition is the chief factor that exporters take into consideration when determining marketing policies. In a sense exporters need not have much more of a policy than to reduce product quality to the minimum acceptable level, reduce other marketing costs to a minimum, and offer their products for sale at the market price. The net result is that price tends to be forced down to average unit costs, low-cost producers tend to prosper and less efficient competitors (in a cost reduction sense) tend to be driven out of business or into other enterprises in which they are able to function more efficiently.

A key factor in the above-described circumstances is the assumption of product homogeneity. For some products this is a reasonable assumption; for others it is not. Thus, as a practical matter, producers often find it desirable to distinguish their products from those of their competitors in ways that consumers find meaningful. Such efforts include not only physical changes in the product but also changes in the package, product line, marketing channels, personal selling, advertising, and price; that is, changes in any of the elements in the marketing mix. When sellers react in such ways, competition acquires new dimensions in addition to its structural aspects.

Sometimes competitive conditions evolve under which the needs of consumers are met adequately; but sometimes the needs and interests of consumers are subservient to the interest of sellers. In the latter instance laws or government regulations sometimes become necessary to protect the interests of society as a whole from the interest of 'minorities.' Laws or government regulations may be a substantial factor in promoting 'effective competition' or in some other way protecting society and competitors. Thus, laws or government regulations become factors that determine, in part, competition.

In summary, then, competition is influenced largely by: (1) general business, cultural, economic, and social conditions; (2) costs; and (3) laws and regulations. In addition, the activities and policies of *competitors* themselves affect competition. In the 1990s two of the largest producers of telecommunications equipment were from small Nordic countries – Finland's Nokia, in the mobile (cellular) telephone business, and Sweden's L. M. Ericsson, in mobile telephones and digital exchanges for mobile networks – supplied about one-third of the world market for mobile communications equipment. The success of these two companies offers the following lessons to all telecoms equipment firms everywhere and perhaps lessons for other industrial goods firms as well: (1) compete at home; (2) look abroad; and (3) invest in new technology.

From a marketing viewpoint, the exporter may compete on a *price* and/or a *nonprice* basis. Nonprice competition can be quite intense, particularly in markets where incomes and wealth are such that buyers can look for things other than the 'best buy.' At the same time domestic companies also compete on these bases. Exhibit 3.4 discusses the practice of **coopetition**, which involves both competing and cooperating at the same time.

Exhibit 3.4 Coopetition and competition

An emerging facet of global competition is *coopetition*, which is the simultaneous competition and cooperation between two or more rivals competing in global markets. Under coopetition, the relationship between global rivals is a simultaneous, inclusive interdependence with cooperation and competition as two separate yet interrelated activities. Competition and cooperation occurs in the pursuit of global reach, expansion, and profit. Cooperation and competition exists between the same rival global firms. Examples are GM and Toyota assembling automobiles, Siemens and Philips developing semiconductors, and Thomson and JVC manufacturing VCRs. Under this scheme rivals cooperate in some areas while competing in others. Coopetition may occur at corporate, division, or subsidiary levels, depending on an MNE's strategic intent and organizational needs.

Intensity of coopetition is the extent to which a specific global company is both competing and cooperating with a major global competitor. Four coopetition situations have been identified:

1. **Contending.** This exists when an MNE competes with another major global firm for market power, competitive position, and market share in key international markets, maintaining high competition and low cooperation with its counterpart. In this situation the MNE may emphasize intelligence gathering, niche filling, or position jockeying as strategic tactics in responding to the high competition-low cooperation relationship with its major competitor.
2. **Isolating.** This arises when the MNE does not interact significantly with other global rivals, maintaining low competition and low cooperation with another leading global company. The company acts independently in its international markets, and makes its decisions by itself in isolation from its competition. MNEs in this type of situation may consider domain specialization, scale expansion, and vertical integration as their strategic responses to a low competition–low cooperation situation.
3. **Partnering.** This situation exists where a MNE voluntarily maintains high cooperation and low competition with another major MNE for purposes of joint synergies created by both company's complementary resources and capabilities. High resource complementarity and low market commonality are two necessary conditions under which competing MNEs may become partners. Companies in this situation look to synergy extension, value sharing, and attachment enhancement as strategic responses.
4. **Adapting.** This situation results when two MNEs mutually depend on each other to achieve their respective goals, maintaining both high cooperation and high competition with each other. Potential strategic tactics include boundary analysis, loose coupling, and strategic balance.

While the intensity of coopetition discussed above involves the dynamics of competition and cooperation between competing MNEs, the *diversity* of coopetition involves both geographic breadth – that is, the number of foreign markets in which a company seeks coopetition – and the number of companies with which an MNE simultaneously competes and cooperates. The possible situations range from coopeting in a small number of markets with a small number of competitors to coopeting in a large number of markets with a large number of competitors, and combinations of small and large between.

The increase in coopetition can be attributed to increasing interdependence between global competitors and the need for collective action, risk sharing, and strategic flexibility.

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Summary

This chapter has discussed three of the major components of the international environment as they have a bearing on marketing efforts of international marketers. Our interest has centered on the socio-cultural, economic, and competitive environments. Although each is distinct, each may also interact with one or more of the others. It is imperative that the international marketer/exporter never forgets that 'a business firm is a product of its environment.' In Chapter 4 we discuss the impact of government, political and legal forces.

Questions for discussion

3.1 Explain the meaning of 'cultural universals.' Do these provide universal guides to behavior in all societies? How can the international marketer use these universals? Do values fit within cultural universals? Explain.

3.2 Do you agree that the international marketer does not need to study a culture from a narrow perspective but rather needs only a broad perspective to learn about general patterns and themes? Explain your answer.

3.3 Explain the meaning of the following statement: 'Managing multiculturalism within the international marketing organization and within and among the markets its serves is what makes international marketing exciting and frustrating.'

3.4 What is the 'silent language' of international marketing and how does it relate to the concept of 'culture is communication'?

3.5 What is the self-reference criterion and how should the international marketer apply it? Explain.

3.6 Various classification schemes are sometimes used to give an indication of the potential of a particular foreign market/country. Explain why these schemes should or should not be used as a basis for deciding what markets to enter.

3.7 What is really meant by a company having a differential advantage over its competitors in one or more foreign markets?

3.8 Select a culture with which you have had contact. How does it differ from your own culture? How might these differences affect international marketing activities, business negotiations or ongoing business relationships? Explain!

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CASE STUDY 3.1

Supreme Canning Company

(This case study has been written by Mitsuko Saito Duerr, San Francisco State University.)

The Supreme Canning Company (the true name of the company is disguised) is an independent US packer of tomato paste and other tomato products (whole peeled tomatoes, chopped tomatoes, tomatoes and zucchini, ketchup, tomato paste, and pizza and other sauces). The company is located in the state of California. Although it produces some cans with its own-brand label, much of its output is canned for others and their brand names and labels are put on the cans. It produces shelf-size cans for eventual sale at retail, and gallon-size cans for use by restaurants and industrial users. It also packs tomato paste in 55-gallon drums, and in plastic containers holding approximately 0.7 cubic meters (with the flexible plastic container held inside a heavy shipping container). Supreme Canning Company's annual processing capacity is in excess of 100,000 tons of tomatoes (processed during an operating season of approximately three months).

The market for tomatoes is divided into three segments with distinct characteristics:

1. Fresh tomatoes are produced in many countries, with much cross-border trade and frequent trade disputes. Canadian and US farmers have had a series of trade disputes with each country claiming dumping by companies in the other of fresh tomatoes of different varieties at different times. In 2004 the year-round supply of fresh tomatoes from Mexico was depressing prices for US farmers (www.dailydemocrat.com/2004). Special varieties of hothouse tomatoes from the Netherlands are sold in other European countries and overseas.
2. Canning of tomatoes is carried out in fewer countries because of the market size required to support economically sized factories.
3. Even fewer countries (and packers within countries) produce the tomato paste used by other tomato-canning companies to make end products such as tomato soup. Economical production of tomato paste requires an extremely large supply of tomatoes that could be harvested by machines (or very cheap labor) and easily transported to the processing facility. California's Central Valley was an ideal location for such processing because of its vast amount of relatively flat land, large farms, and good road network. China, with its low wage rates, was also a producer of tomato paste, and exported paste to Italy.

Italy is a major exporter of canned tomato products, but a net importer of tomato paste. The tomato paste is used along with domestic fresh tomatoes in making and canning various tomato products. Italy exports canned tomato products to many countries.

Supreme Canning Company, along with other US producers, was pressed by a combination of heavy competition from factories overseas (particularly in Italy) and inadequate domestic demand. Tri Valley Growers, California's largest agricultural cooperative and processor of 10% of the canned tomato products sold in the United States, had gone bankrupt in 2000. A surge in demand from Italy, which decreased its imports from China in 2003–4 when the SARS epidemic occurred, provided a temporary increase in demand for Californian tomato paste. But Supreme Canning Company still needed additional markets.

One potential bright spot for the Supreme Canning Company had been the possibility of getting into the Japanese market. Japan was reducing trade barriers and attempting to encourage imports. At the same time, the popularity of pizza and Italian-style foods and restaurants had grown rapidly, creating an increased demand for specialty tomato products. Because of the scarcity of land, the nation had not gone into the large-scale production required to support an economical domestic tomato-canning industry. The insistence of Japanese consumers (and companies) on high quality had resulted in relatively low sensitivity to the prices of food products.

An inquiry that had been received from a food packer and distributor in Japan indicated interest from that side. The Japanese firm handled a large number of products, was well known in Japan, and was much larger than the US firm. Since Supreme Canning Company did not have well-known brand names of its own, it was interested in acting as a large-scale supplier of products made to customers' specifications for use by the customer or distribution under the customer's label. Thus the inquiry from Japan was most welcome.

The Japanese company invited senior executives of the US firm to visit their production facilities and offices in Japan. Both the president and chairman of the board of Supreme Canning Company had a four-day visit with the executives of the company in Japan. The president of the US company, who had some knowledge of Japanese business practice from studies at Stanford University and from his widespread reading, attempted to act as a guide to Japanese business practice. The chairman of the board had little knowledge of Japan, and viewed himself as a decisive man of action. Although there were a few minor misunderstandings, the visit was concluded successfully and the Americans invited the Japanese to visit their plant in California for four days.

The Japanese indicated their interest in the signing of a mutual letter of cooperation. The chairman of the board of Supreme Canning was not interested in this, but rather wanted some specific agreements and contracts. As the time for the Japanese visit to the United States drew near, the Japanese indicated that their president would not be able to come. Some senior executives would be able to meet, but they would only be able to spend two days instead of four. The vice-chairman of the board of the Californian company wrote asking why the Japanese were not going to send their president, and inquiring why they could not spend four days instead of two, 'as we did in Japan.' The letter was frank and direct. The tone was that of a person talking to an equal, but not with any great deal of politeness. The Japanese company decided to cancel the visit, and no further negotiations or serious contacts were made.

Some months later, a local businessman of Japanese extraction asked the president of Supreme Canning Company if some representatives of another (and even larger) Japanese food products producer and distributor could visit the plant. Four Japanese showed up along with the local businessman, who acted as interpreter and go-between. The three middle-aged Japanese produced their *meishi* (business cards) and introduced themselves. Each spoke some English. The older man did not present a card and was not introduced. When the president of the US company asked who he was, the go-between said 'He's just one of the company's directors.' The visit concluded without discussion of any business possibilities, but this was to be expected in an initial visit from Japanese businessmen.

Supreme's president later found out the family name of the unknown visitor, and immediately recognized it as being that of the president of the Japanese company. He assumed that the president of the Japanese company had come but had hidden the fact. He felt that he had been taken advantage of. He telephoned the go-between and told him that he never wanted anyone from that company in his plant again.

From a description of the unknown visitor, a consultant to the company realized that the visitor was not the president of the Japanese company. Rather, it was the semi-retired father of the president. The father retained a position on the board of directors and maintained a lively interest in company activities, but was not active in day-to-day affairs. Unlike his son who was fluent in English, he spoke only Japanese. The consultant suddenly realized that the chairman of the board of the US company apparently did not understand:

- the Japanese preference for getting to know people well before doing business;
- the significance of a letter of cooperation (which could be expected to be a first step in concluding a long-term business agreement);
- the status relationship in Japan of little companies to big ones (larger companies have greater status, and their managers are shown greater respect);
- the status relationship in Japan of sellers to buyers (buyers have greater status, and their managers are shown greater respect).

Questions

1. Was the chairman of the US company wrong for not having found out in advance about Japanese business practice? Explain.
2. Were the Japanese wrong for not having found out about US business practice before they initiated contacts? Explain.
3. What should the president of the US company do now?

CASE STUDY 3.2

Ford Motor Company

(This case study was written by Edwin C. Duerr, San Francisco State University.)

Introduction

The Ford Motor Company issues a Corporate Citizenship Report each year. The first, *Connecting with Society*, was issued at its annual shareholders' meeting held in Atlanta, Georgia in May 2000. That report was unique in its recognition that the company face a dilemma because its most profitable products, sports utility vehicles, contribute to environmental problems and may be considered not socially responsible. In spite of these recognized problems the company stated that it intended to continue to manufacture and sell these vehicles. In an interview, Chairman William C. Ford, Jr. cited the Ford Explorer as an example: 'If we didn't provide that vehicle, someone else would, and they wouldn't do it as responsibly as we do.' He indicated that Ford Motor Company's approach combined altruism with a foundation for long-term planning. The press noted that Mr Ford had been one of the most enthusiastic supporters of the company's 1996 decision to introduce the full-size Ford Expedition, an SUV with a high gasoline consumption rate (Bradsher, 2000).

Ford's report and comments can be viewed in a number of ways: as an exceptionally honest recognition of the conflicting demands placed upon the international corporation by its various stakeholders (society, suppliers, customers, employees, and stockholders); as an admission that corporate interests in this case are in conflict with social responsibility; or as the foundation for building a corporate approach that will attempt to reconcile conflicting demands.

In evaluating the approach taken by Ford, it is useful to briefly review the company's overall approach to corporate citizenship and key stakeholders before looking at some of the specifics regarding the SUVs and their place in the product line.

Corporate citizenship and key stakeholders

With 114 factories located in 40 countries and selling to markets worldwide, Ford Motor Company operates within a wide variety of ethical, political, and legal systems to which it must adapt. The company's approach to international corporate citizenship has been influenced substantially by William Ford, who has been active in environmental causes since his school years. When he joined the Ford Motor Company Board of Directors in 1988, colleagues suggested that he drop his contacts with environmentalists. He refused to do so and indicated that he believed he could help build bridges and understanding between the company and environmentalists. In 1997, he chaired a newly established Environmental and Public Policy Committee of the Board of Directors. Since becoming Chairman of the Board of Directors in January 1999 he and Jacques Nasser, the President and CEO of the company, have been working to improve corporate citizenship and social responsibility.

Ford's *Connecting with Society* states that good corporate citizens are distinguished by their behavior, and by the social, environmental, and economic impacts of their actions. They should generate sustained profits from products that meet human needs with greater value to society and a smaller environmental impact. The company has established an administrative structure and strategic plans for developing a more comprehensive set of business principles, increasing interaction with all stakeholders, transforming goals into action, and providing transparency and verification of problems and progress. Specific problem areas have been identified, and the report provides a justification for undertaking additional efforts in the area of social responsibility. In 2001 Mr Nasser reported that quality problems in new and redesigned vehicles launched in Europe and the United States in 2000 had cost the company over $1 billion in profit, and added 'That will never happen again' (White and Lundegaard, 2001).

The company is already a leader in many areas of social responsibility. Several years ago it lobbied for higher gasoline taxes in the United States (a position opposite to that taken by other automobile companies). Such taxes would, of course, encourage fuel conservation by consumers and influence manufacturers to make more fuel-efficient vehicles (as the high taxes in Europe already do). Ford is also increasing the amount of recycled materials in vehicle manufacture, using more than 2 million tons of recycled metals per year. It has indicated that it views the European laws requiring manufacturers to take back vehicles at the end of their lives as an opportunity rather than a threat. It has emphasized the development of new factories and the redesign of existing plants to reduce pollution well below the legal requirements of the countries within which it operates. The company has achieved ISO 14001 environmental management certification for all of its facilities and in 1999 became the first US automobile maker to develop a program requiring certification of all of its suppliers with manufacturing facilities. Ford has offered to support its suppliers in the United Kingdom, Germany, Australia, and the United States with assistance in ISO 14001 training. In Europe, the company works with more than a dozen environmental organizations, environmental investment funds, and other not-for-profit organizations focusing on transportation issues. Since 2000, Ford has designed all of its SUVs and its F-series pickup trucks to meet US standards for Low Emission Vehicles, cutting smog-forming emissions by over 40% compared to government requirements. In 2000 Ford opened its newest research laboratory, devoted primarily to developing new environmental technologies, in Aachen, Germany. The company works cooperatively with local governments internationally in projects to address environmental concerns.

In its 2000 publication, *Connecting with Customers*, Ford indicated that its goals are to build shareholder value by putting customers first and enabling employees to develop their potential to the fullest. The company views its primary responsibility as meeting the needs of three major stakeholders: stockholders, customers, and employees.

Ford has also undertaken a number of initiatives with respect to the welfare of its employees. It has made efforts to show that they are economically justified, thus benefiting stockholders as well. In cooperation with part-supplier Visteon and the United Auto Workers, Ford will be opening 30 Family Service Centers in 14 states during the coming years. They will offer round-the-clock childcare, classes, and other services to employees. Jacques Nasser, Ford President, stated: 'It's not a low cost, but we're not wasting a cent.' He indicated that it would help both the company and the workers. 'This is an effort to attract talent and retain talent because turnover costs money' (Pickler, 2000).

Internationally, the company is attempting to help overcome the digital divide between the richer and less-developed countries. Ford indicated that companies and individuals that want to be successful in the 21st century will need to be leaders in using the Internet and related technologies. In 2000 the Chairman of the Board announced that employees worldwide will be provided with a computer, printer, and Internet usage at home for a small monthly fee, $5 in the United States (Ford, 2000). This effort is tied into the development of employees who will be more valuable in the changing international environment.

The company's marketing of SUVs is directly related to the interests of shareholders, customers, and employees. How well it fits, or does not fit, with the company's environmental objectives is discussed in the following two sections.

SUVs and major stakeholders

Ford pioneered the development of the modern sports utility vehicle market. The SUVs were designed to provide those who spent time in the outdoors, whether for work or for recreation, with a vehicle that could function effectively off regular roads and was more comfortable than typical pickup trucks. Eventually, the SUVs appealed to individuals who just wanted a sporty vehicle, as well as to the original target market of those who really needed off-road capabilities.

When Ford introduced its Explorer model in 1990 the vehicle quickly became the most popular SUV in the United States. It also proved popular in Latin America and in the Middle East. Over 3.5 million Explorers were sold and they brought in billions of dollars in profits.

US government regulations classed large SUVs as trucks, allowing them to emit 5.5 times as much smog-causing pollution per mile as automobiles do. (New rules will require that SUVs meet the same standards as automobiles by 2009.) This allowed companies to put larger engines in the vehicles, adding to their attractiveness to many buyers. The largest US auto makers all worked on developing larger SUVs that they priced so as to return a high level of profit. The major Japanese automobile manufacturers initially lagged behind in developing SUVs, but have caught up in some model types and are continuing to develop new models and expand production capacity in the United States. European auto makers have similarly been expanding their line of SUVs.

In 1990, only 5% of Ford's sales were of SUVs. In 2000, SUVs accounted for 20% of its sales, and most of its profits. It has been estimated that Ford earns $10,000 to $15,000 on each Ford Expedition and Lincoln Navigator sold, and as much as $18,000 for each Ford Excursion (Bradsher, 2000).

Safety and environmental issues and viewpoints

Environmentalists and consumer groups have been critical of the SUVs with respect to three factors: (1) the high level of smog-causing pollution they create; (2) their high rate of fuel consumption; and (3) safety concerns. Both the high level of pollutants that SUVs are allowed to generate and their high rate of fuel consumption are being addressed by legislation, as are some safety considerations.

Ford's basic argument with regard to the development and marketing of SUVs is that customers want them and Ford produces vehicles that are more environmentally friendly and safer than those of their competitors. They have pointed out that all of their SUVs are certified Low Emission Vehicles, and that the Ford Excursion, a vehicle criticized by some environmentalists, produces 43% less contaminants than are allowed by US government standards. They continue to work both to improve fuel efficiency and reduce pollutants.

Safety is an issue because SUVs are generally designed with greater ground clearance and therefore higher centers of gravity, higher bumpers, and are heavier than automobiles of the same size. In collisions with automobiles, they tend to ride up over the bumpers of the cars and crush them. They have also been involved in a number of accidents in which the SUVs rolled over without being involved with another car. These rollovers may have occurred in some cases because of their off-road uses, in others because of the way they are sometimes driven on roads, and in still others because they are less stable than many automobiles.

It has been claimed that Ford could have made the Explorer safer by redesigning it before taking it to market, though this would have been costly and delayed its introduction by more than a year. This would have allowed other manufacturers to beat it to the market. Further, Ford has pointed out that the overall safety record of the Explorer is better than that of the comparable SUVs and passenger cars from other vehicle manufacturers. The car has a 26% lower rate of rollover fatalities than other SUVs (Levin, 2000). Thus it could be argued that delaying its introduction could have resulted in customers buying less safe vehicles from competitors.

In 2001 the US National Highway Traffic Safety Administration released its first report on the expected tendency for 43 types of vehicles to roll over. It was based on calculations involving the vehicles' track widths and heights of centers of gravity. Of the 19 SUVs analyzed, 9 received poorer ratings and 2 received better ratings than the 4 Ford models evaluated.

Another view regarding the safety of SUVs was provided by State Farm Insurance Company, the United States' largest insurer of vehicles. In December 2000, after an analysis of its claim rates, the company changed its pricing policy to give sizable discounts to drivers of SUVs, vans, and luxury cars. Their records indicate that these vehicles are safer. Consumer groups have countered that they may be safer to the occupants of the vehicles, but not to those in cars they may hit (Lazarus, 2000).

Both Ford and General Motors introduced new versions of their key midsize SUVs in 2001, redesigned to provide greater stability. Ford also redesigned the bumpers to reduce the danger of riding up on other vehicles in the event of a collision.

In the Chairman's Message in Ford's *2002 Annual Report* (published in 2003), William C. Ford, Jr. stated that the company would be producing the cleanest and most fuel-efficient SUV in the world by the end of the year (http://ford.com). In 2004 Ford signed **cross-licensing** technology agreements with Toyota for the purpose of further development of hybrid vehicles. Ford also plans to sell a limited number of a fuel cell-powered version of the Ford Focus for use in commercial applications (http://ford.com). In 2004 demand for SUVs in the United States continued to be strong, with Toyota enjoying an increasing market share on its entries in the market (Zaun, 2004).

It can be argued that continuing to produce SUVs, and developing new vehicles as new markets emerge or can be created, meets Ford's goals of building shareholder value and of putting customers first. It provides customers with a larger choice of vehicles from which to choose while also meeting stockholders' profit objectives. It also provides employees with a higher level of employment than they would otherwise enjoy. It could be further argued that by continuing to improve design, and exceeding government safety and pollution requirements, they are meeting their social responsibility to society.

On the other side, an argument could be made that the company should not make vehicles that pollute the atmosphere or which have potential safety hazards.

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Questions

1. Are Ford's report and comments:
   a. an exceptionally honest recognition of the conflicting demands placed upon the international corporation by its various stakeholders (society, customers, employees, and stockholders);
   b. an admission that corporate interests may be in conflict with social responsibility; or
   c. a foundation for building an approach to research and development that will attempt to reconcile the conflicting demands?
2. Is Ford behaving in a socially responsible manner when it continues to make SUVs? Discuss.
3. Should the government be more aggressive in setting safety standards? Why or why not?
4. Should the governments of the world ban vehicle types that they consider unsafe or not socially responsible? Why or why not?
5. Should Ford oppose or support tighter environmental standards that would apply equally to all vehicle manufacturers? How should Ford react to varying environmental standards in different countries?
6. Is spending corporate funds on nonrequired socially responsible activities an unjustified expenditure, or a recognition that in the long run companies must exercise social responsibility in order to avoid societal or government actions that will damage them? Explain.

CHAPTER 4

The international environment: government, political, and legal forces

Learning outcomes

In Chapter 4, we discuss:

- the role of the government
  - government controls
  - promotional activities
  - state trading
- **economic integration**

Two cases are presented at the end of the chapter: Case 4.1, Avon Products, Inc. (A), examines the effects of a sudden change in government regulations on the company's marketing strategy in China, and Case 4.2, Woberg Company of Denmark, which looks at potential mistakes a company new to exporting might make and asks about the types of assistance available from government that would be helpful in getting started.

Introduction

International marketing decisions by business firms are affected by the actions of government bodies at all levels – supranational, national, and subnational. The extent to which any government becomes involved in international marketing, and the specific nature of such involvement, depends in part upon the type of economic system in the country (e.g., capitalism, socialism, or communism), the type or form of government organization (e.g., monarchy, republic, or dictatorship), and the type of legal system (code law or common law). To illustrate, consider the differences between legal systems. The bases for common law (in countries such as the United Kingdom and Canada) are tradition, past practices, and legal precedents set by past court decisions. In contrast code law, which is found in most countries of the world, is based on a system of written rules of law that are considered to be all inclusive.

Role of government

As an environmental force affecting international/export marketing, government *intervenes* in a single country's (and the world) economy by being a participator, planner, controller, or stimulator. Such intervention activities can be categorized into the following three groups:

1. those that *promote* (i.e., encourage or facilitate) international/export marketing transactions;
2. those that *impede* such transactions;
3. those that *compete* with or replace international/export marketing transactions by private business firms.

These basic types of intervention activities exist to some extent at all levels of government, but with varying emphases. At the supranational level, the actions taken are primarily those whose effect is to encourage and facilitate international marketing relationships, especially exports. Illustrations include the many agreements and conventions that are made between countries, such as international commodity agreements, and bilateral agreements such as the agreement between Australia and New Zealand (Closer Economic Relations, ANZCER) signed in the late 1980s, South Korea's first-ever Free Trade Agreement – with Chile – in 2004, the Closer Economic Partnership Arrangement (CEPA II and CEPA III) between Hong Kong and China in which the mainland, starting 1 January 2005, applied zero tariffs to 713 products from Hong Kong, giving a total of 1,087 products with no tariffs (www.tdctrade.com, 7 November 2006) and the Free Trade Agreement between Colombia and Guatemala ratified in 2009. There appears to be a 'movement' on the part of Asian countries to sign regional and bilateral trade agreements with each other as well as with others. Table 4.1 shows some off the many such preferential trade agreements in the Asia and Pacific region. Regional economic integration schemes are discussed in the next major section of this chapter (pp. 242–7). The liberalization of trade and FDI that underpinned the development of regionalization schemes in Asia was market-led and profit-motivated (Das, 2005). On a broader scale, the popularity of bilateral and regional trade agreements has continued since the early 1990s. For example, as of December 2008, 421 regional trade agreements had been reported to the GATT/WTO (www.wto.otg/english, accessed 3 February 2010). Although there are many such agreements in existence, recent survey data show that in Asia only 22% of the firms are taking advantage of the trading preferences offered by such agreements (*The Economist*, 2010).

Government controls

It will be noted from Table 4.2 that many of the government-derived impediments to international marketing in general, and exporting in particular, are in the form of restrictions and controls. There are different kinds of restrictions and controls that are specifically concerned with exports and imports. Such controls directly affect both the types and amounts of products that can be exported and imported. Other restrictive controls may indirectly affect trading relationships by directly influencing the advisability and/or profitability of individual transactions. **Export controls** typically are intended to restrict the shipment

Table 4.1 Preferential trade agreements in the Asia and Pacific region

Regional trade agreements[1]	
AFTA (ASEAN Free Trade Area), 1993	Pacific Island Countries Trade Agreement (PICTA), 2001
ASEAN-China Free Trade Agreement, 2005	South Asian Preferential Trade Agreement (SAPTA), 1995
ASEAN-India, 2008	South Asia Free Trade Agreement (SAFTA), 2006
ASEAN-Japan, 2004	Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA), 2006
ASEAN-Korea, 2004	
Asia-Pacific Trade Agreement (APTA), 1975, 1976[2]	
Bilateral trade agreements[1]	
ASEAN-Japan, 2008	Japan-Malaysia, 2006
ASEAN-China 2010[6]	Japan-Mexico, 2005
Australia-New Zealand (ANZCER), 1983[3]	Japan-Singapore, 2002
Australia-Singapore, 2003	Lao PDR-Thailand, 1991
Australia-Thailand (TAFTA), 2005	Lao PDR-United States, 2005
Australia-United States, 2005	Malaysia-Pakistan, 2006
China-Chile, 2006	Malaysia-United States, 2004
China-Hong Kong SAR, 2004, 2005, 2006 CEPA I, II, III	New Zealand-Singapore, 2001
China-Macao SAR, 2004	New Zealand-Thailand, 2005
China-Niger, 2005	Singapore-EFTA, 2003
China-Thailand, 2003	Singapore-Jordan, 2005
China-Switzerland, 2014	Singapore-Panama, 2006
Costa Rica-Singapore, 2013	Singapore-United States, 2004
India-Afghanistan, 2003	South Korea-Chile, 2004
India-Bangladesh, 2006	South Korea-EFTA, 2006[5]
India-GCC, 2006[4]	South Korea-Singapore, 2006
India-Nepal, 1991	Sri Lanka-Pakistan, 2005
India-Singapore, 2005	Thailand-Bahrain, 2002
India-South Korea, 2009	Vietnam-United States, 2001
India-Sri Lanka, 2001	
India-Thailand, 2004	

[1]As of June 2007 and later. Years after agreements named refer to the year it entered into force.
[2]Previously called Bangkok Agreement.
[3]Closer economic relations.
[4]Gulf Cooperation Council.
[5]European Free Trade Association.
[6]ASEAN also made bilateral agreements with India, Korea, and AANZFTA in 2010.
Source: Tumbarello, 2007, p. 151; 'Free Trade Agreement between Switzerland and China.' State Secretariat for Economic Affairs SECO, 2015

of defense products, protect the domestic economy from a drain of scarce materials, and enhance national security (physical and economic). Concerning the latter, increased terrorism and the events of 11 September 2001 in the United States have led to a drastic change in the world and in how governments treat people. Primary and secondary impacts have been on export earners such as airlines, tourism, transport in general, investment, global supply chains, etc. Responses by governments have included increased spending on security and more regulation of business practice and individual behavior. The extreme of this

Table 4.2 Political–legal constraints

1. *Political ideology:* The political viewpoints of existing governments as demonstrated by the prevailing pattern of rule, philosophy of leading political parties, and similar factors.
2. *Relevant legal rules for foreign business:* The special rules of the game applied only to foreign-owned firms, including special discriminatory labor and tax legislation.
3. *International organization and treaty obligations:* Formal obligations of the country in terms of military responsibilities; political obligations; copyright, postal, and patent obligations; and similar matters.
4. *Power or economic bloc grouping:* Membership in formal and informal political, military, and economic blocs such as Communist, Marxist or neutralist groups; explicit and implicit obligations of such blocs.
5. *Import–export restrictions:* Formal legal rules controlling exports and imports, including tariffs, quotas, export duties, export restrictions, and similar matters.
6. *International investment restrictions:* Formal legal and administrative restrictions on investments by foreigners within the country.
7. *Profit remission restrictions:* Formal legal and administrative restrictions on remittance of profits of local operations to foreign countries.
8. *Exchange control restrictions:* Formal legal and administrative controls on the conversion of the local currency to any or all foreign currencies or gold.
9. *Membership and obligations in international financial organizations:* Obligations and responsibilities of the country toward international organizations such as the World Bank and the IMF; rights of the country as a member of such organizations.

Source: Adapted from Farmer and Richman, 1984, p. 68.

has been the restriction of rights or enforcing existing laws more harshly, with the net effect of restricting citizens' – and noncitizens' as well – freedoms. In short, in some countries there has been a considerable loss of liberty.

Government controls are used as a tool to further both the foreign and trade policy of the government as well as controlling technology and resources. Although export controls may be important in isolated cases, import controls create the most significant barriers to export transactions by the firm. For example, in 1998 the government of Myanmar banned the import of a range of products that could be produced locally – soft drinks, beer, alcohol, cigarettes, fresh fruit, biscuits, canned food, and seasoning powder. At the same time many products were banned for export including rice, sugar, minerals, rubber, and cotton.

Actions such as these are forms of protectionism or trade barriers, which were rising in 2009–2010 as the world economy was in trouble. One form of this is the so-called stimulus packages that governments gave citizens and companies, and which were designed to keep the payments received at home, such as the 'Buy American' requirements in the US stimulus of 2009. Some countries believe these are industrial subsidies and that they should be able to retaliate under WTO rules. In another protectionist situation China keeps its currency undervalued against the dollar, has tax breaks on exports, and tells government entities to buy Chinese products (Engardio, 2009). In another situation involving China, the US government filed a complaint with the World Trade Organization alleging that China reserved raw materials such as magnesium and zinc for its own companies. In 2009 the US government imposed tariffs on Chinese tires: China threatened to retaliate by imposing tariffs on some US products. In addition, China threatened to bring the matter before the World Trade Organization. As it turns out, this may have become a non-issue. Under the terms of joining the World Trade Organization, China gave other countries the right until 2013 to impose temporary 'safeguards' against surges of Chinese imports (*The Economist*, 2009). It is clear that despite efforts by many to liberalize world trade, protectionism still exists, and will continue to do so.

Sometimes a company exporting to a specific country may run foul of laws governing marketing practice. In mid-1999 the Supreme Court of Germany ruled that Lands' End's use of its lifetime guarantee that it uses everywhere, 'Money Back Guarantee, No Matter What,' was a violation of law and represented unfair competition to German competitors.

In addition to export/import controls there are regulations that affect foreign operations and ownership resulting from direct investment and strategic alliances such as licensing arrangements. A country that regulates foreign direct investment does so in order to limit the influence of the foreign investor, typically a multinational (or global) corporation, and at the same time have a pattern of investment that contributes in desired ways to the achievement of the country's economic, social, and political objectives. Interestingly, China has been 'encouraging' foreign service-oriented companies such as lawyers, architects, etc. to invest more capital (Areddy, 2010). Although not an exhaustive list, the following are areas that countries may regulate and limit within the broad dimension of foreign investment:

1. Decision-making through procedures affecting selecting type of investment, control of takeovers, how mergers and acquisitions may be achieved, restrictions (including prohibition) of investment in certain industries, and similar matters.
2. Regulation of ownership, managerial control, and employment through local participation requirements in ownership, management, product content, and employment. In India, for example, companies are not allowed either to close down a factory or to sack workers without government permission. In Vietnam, foreign companies are now allowed to wholly own local subsidiaries or buy out joint venture partners. Until the end of 2005 international advertising agencies had to operate a joint venture in China. This no longer holds.
3. Taxation and regulation of financial transactions, control of capital and profit movement and remittance, and sources and types of foreign and local borrowing.

Individual countries may regulate investment by placing limits on specific international marketing practices. For example, the government of India approved PepsiCo's request for establishing a joint venture bottling plant. Among the many conditions of approval imposed by the Indian government was one concerned with branding. PepsiCo agreed not to use its Pepsi brand name. The Indian government felt that global brands gave an international marketer an advantage over local companies. In China, direct selling (defined as a process of marketing products and services to consumers face to face away from a fixed retail location) which had been banned since 1998 is now legal. However, one form is still banned – multilevel marketing, a method whereby distributors recruit others to sell, and then collect commissions on what the recruits sell. In fact, any type of pyramid selling is banned in China. Direct selling companies such as Amway, Avon, Shaklee, Herbalife, and others are licensed to do business in China.

There are government controls that affect all companies, foreign and local alike. In 1993 all tobacco advertising (including sponsorship of sports and cultural events) and most liquor advertising in France was banned. Most wines were excluded from the law. Similar laws exist in other countries including Australia, New Zealand, Malaysia, and Canada. In Vietnam, Malaysia, and Hong Kong, tobacco advertising by sponsoring sports events is banned. Going even further, alcohol-company advertising is also banned by Vietnam for sports events, and both products are banned from cultural events. Tobacco advertising and tobacco vending machines are banned in China. These measures are designed to prevent minors from buying tobacco. In 2007, officials of the Malaysian government reported that fast food advertisements on children's television shows might become illegal. The intent is to curb obesity and diet-linked diseases. In the United Kingdom, television advertising regulators ruled in 2006 that the word 'bloody' which was used in a Tourism Australia campaign was offensive, and its use was banned.

For another illustration we turn to the regional trade group Mercosur and its regulations covering labeling requirements for textile and apparel products. The following information has to be included in a label, stamp, decal, print or similar means that is permanent, indelible, legible and clearly visible: (1) name of registered brand and tax identification of the domestic producer or importer; (2) country of origin; (3) fiber content; (4) care labeling instructions; and (5) size or dimensions, as applicable. Certain textile and apparel articles sold in packages are allowed to bear the required information on or inside the package instead of the article itself if that information can be seen from the outside (Hong Kong Trade Development Council, 2008). In 2009, the European Union initiated similar requirements regarding labeling of textiles.

The latest area where regulation is becoming increasingly prevalent is companies' use of the Internet and the Internet as means of exporting. This is an area of law and regulation that is continually evolving, and it will take years for the development of a cohesive legal/regulatory structure. An example of a law passed in 2001 that will have a great impact on Internet use is the Regulation of Investigatory Powers Act (RIP) in Great Britain. In essence, RIP requires public telecommunications services to install interception equipment to make their networks tappable, and it enables police to demand decryption keys that unlock coded data. A warrant is needed, but the warrant is not issued by a judge; it is issued by a politician – the head of the Home Office. Any multinational company doing business in Britain is going to have to redesign its systems, or install special systems, if it has an ISP component to its work (Grossman, 2001).

There are differences in the approaches to e-commerce taken by the United States and the European Union. Broadly, concerns involve the extent of self-regulation within the industry, single market rules, and jurisdiction. The United States tends to favor self-regulation while the European Union desires more regulation, especially to protect consumers. Regarding jurisdiction, the United States tries to follow the traditional laws, meaning that the home state of the purchaser (the consumer) normally has jurisdiction. In contrast, in the past the European Union emphasized 'home country' control, meaning the seller's home country had jurisdiction. There is a European Union directive requiring each country to harmonize certain regulatory laws relating to e-commerce.

China represents an extreme case in this type of regulation as all Internet content is regulated and controlled by the government. To do this, China uses such things as so-called choke points, sensitive search techniques by censors and search engines, blocked blogs, and 30,000 Internet 'cops' (Einhorn and Elgin, 2006). In addition, China relies on compliance by multinational companies. Regulations extended to include e-mail, where sending e-mail for advertising purposes to people without their permission is banned. Also, all advertising e-mail must be titled 'advertisement' or 'AD' (Visser, 2006).

License requirements

One way in which various countries regulate the nature of their external trading relationships is by requiring that licenses be obtained before goods may be exported or imported. For products the government desires to restrict, licenses would not be granted or only granted for limited amounts. The extreme case is where there are specific prohibitions against exporting or importing certain products. For example, the United States controls the export of products that are deemed to have military value. Mexico prohibits the importation of selected products in order to encourage development and growth of local industry. In China, it has been claimed by foreign banks and insurers that there is so-called 'footdragging' on licensing such that access is restricted and preference given to local rivals (Roberts, 2010, p. 35). The most comprehensive prohibition is when one country prohibits all trade with another country, usually for political reasons.

Tariffs

A tariff is a tax on imports, and is stated either as a percentage of value (*ad valorem*) or on a per unit basis. A government may have a system of tariffs for purposes of keeping products out of the country (*protective tariff*) and/or to generate tax revenue (*revenue tariff*). As might be expected, protective tariffs tend to be relatively high since they are designed to protect domestic industry. The purpose of a protective tariff also may be simply to bring the price level of the imported goods up to that of domestic substitutes. In contrast, revenue tariffs are often quite low since they are designed to generate maximum revenue for the government.

Governments may impose a tariff surcharge on their imports. Generally this is a somewhat temporary action taken when the government wants to discourage imports for some reason, such as the existence of an unfavorable balance of payments. A surcharge will be removed once the condition that led to it being imposed has been corrected.

A more permanent kind of surcharge takes the form of **countervailing duties**. These may be assessed to offset some special advantage or discount (e.g., an export subsidy) allowed by the exporter's government. The intent is to bring protection in the country of importation up to the level originally intended. In 2004, the European Union put retaliatory tariffs on a wide range of US agricultural and manufactured goods. This action was taken in response to an export tax break for US companies, a practice that the WTO had ruled two years previously was illegal.

Another type of countervailing tariff is one imposed as an *antidumping* measure. Dumping has been defined as selling in a foreign market at a significantly lower price than on the domestic market, or at below cost if there are no domestic sales. Antidumping tariffs are 'popular' in Australia, the European Union, South Africa and the United States, and the main targets have been China, South Korea, Taiwan, and the United States. India, Mexico, and Brazil have also been heavy users. Probably the most important factor in the rise of antidumping protection has been changes in international trade laws (Crowley, 2004). These tariffs are legal under WTO rules when domestic producers can show they are being harmed. Although market conditions can change relatively quickly, these tariffs tend to be reviewed relatively infrequently. Proponents of these measures argue that they are needed to prevent *predatory pricing* (i.e., prices below domestic prices) that is used by foreign companies to drive domestic companies out of business, and after that occurs the foreign firms raise their prices to recoup their losses. The evidence seems to be that genuine predatory pricing is rare, and even if it exists higher prices will attract new competitors. Moreover, predatory pricing is not mentioned in WTO rules nor in US or European law. Antidumping laws do not take into account developments such as floating (rather than fixed) exchange rates that make dumping appear to be more widespread than it really is.

The impact of tariffs upon individual business firms is usually direct. Costs and prices of competitive products are affected. Companies often do things that they otherwise would not do, particularly in response to a protective tariff.

Quotas

Quotas are specific provisions limiting the amount of foreign products that can be imported. In some countries they are also imposed on exports as part of national planning. The application of quotas may be global or on a country-by-country basis.

In general, quotas may be classified into the following three categories:

1. Most restrictive are *absolute* quotas, which limit absolutely the amount that can be imported. The most extreme case is the zero quota, or embargo. There are times when quotas may be changed.
2. *Tariff* quotas permit importation of limited quantities at low rates of duty, with any amount in excess subject to a substantially higher rate.
3. There are different types of *voluntary* quotas. These are known as *voluntary export restraints* (VERs) and are generally to protect domestic companies until they have had time to make necessary adjustments to regain external competitiveness.

One type of VER results from an explicit international agreement. Another type is unilateral in form but results from diplomatic negotiations, or other types of pressures at the governmental level. For example, during the period from the early 1980s until 1992 the United States 'persuaded' a number of foreign governments to limit steel exports to the United States. A third type of voluntary quota is also unilaterally imposed by the exporting country, but as a result of an evaluation of the market situation in the importing country and without any commitment with respect to the amount or duration of the quota.

All VERs arise from some pressure from an importing country. The inherent vice of all quotas is that their use creates confusion and frequently destroys normal marketing processes. Indeed, companies sheltered from the demands of competition by foreign companies because VERs exist have less reason to stay current and up to date in R&D, for example. Often, when governments guarantee an industry's survival regardless of performance, that performance is almost certain to worsen.

Yet there are times when quotas can work to the advantage of the export company and the organizations selling its products overseas. An illustration is the voluntary restraint agreement (VRA) that the Japanese government, under strong pressure from the US government, imposed on its own exports of automobiles to the United States beginning in 1983 (Duerr, 1992). When the number of automobiles that they could export to the United States was reduced below demand, the Japanese automobile companies responded by sending fully equipped automobiles at the top of their product lines. Because of the demand by US consumers, everything that was exported was sold at a premium price by the local retailers. This resulted in substantial increases in profits for both the Japanese companies and their US dealers. The losers at this time were the consumers who had to pay substantially more for their automobiles.

Quotas can have an impact on an international marketer's sourcing decisions. A Hong Kong-based manufacturer of textiles, Milo's Knitwear, moved its production of ramie and silk from China to Thailand to avoid having its goods barred from Europe due to the European Union quotas on certain Chinese textile products that existed in 1994.

Extra taxes

Some countries have excise or processing taxes on certain products. Although such taxes are intended to provide government revenues from domestic sources, the manner in which they are levied can restrict imports and thus affect an exporter. For instance, European road taxes on automobiles have served effectively as a means of discriminating against US automobiles when they were of larger size, weight and horsepower.

A much broader form of taxation of importance to international marketers are the so-called **border taxes** that were levied on imports by European countries, which are in addition to tariffs. A border tax adjustment imposed by a country is intended to place a tax burden on imports equivalent to that which similar domestic products bear. Consequently, the rate supposedly is equal to the amount of internal excise and other indirect taxes paid by domestic producers of competing products. The idea behind border taxes is to put local goods and imports on the same competitive basis. Thus, the tax basically is a type of value-added tax, but one that does not affect domestic producers.

Qualitative controls

Although these controls limit the profitability of exporting, foreign products can be imported with few exceptions provided that the seller is willing to accept a lower net return and/or the buyer pays a higher price. In this way, they are far less restrictive than the various quantitative controls such as tariffs and quotas. Of importance are customs procedures, mark-of-origin and other labeling regulations, and so-called 'buy domestic' legislation. In a study of Australian grocery shoppers, Miranda and Konya (2006) reported that their results demonstrated that country-of-origin labeling itself may not be persuasive enough to convince consumers to adopt a particular product. 'Buy domestic' regulations are imposed also by subnational governments. In various ways, each of these can be used effectively to impede the importation of certain products.

Exchange controls

Government control over the supply of, or demand for, foreign currencies can be used effectively to restrict international/export marketing. Exchange controls limit the amount of foreign currency that an importer, for example, can obtain to pay for goods purchased and that an exporter may receive and hold for goods sold to a foreign country. Limitation of the ability to obtain foreign currencies effectively stops purchasing abroad, since the seller, with very rare exceptions, can engage in profitable business only if his or her own currency, or a currency other than the buyer's, can be secured in payment. In some instances the quantitative restriction is combined with a qualitative restriction of placing an unduly high price, or official exchange rate, on the foreign currency desired. By establishing a very unfavorable official exchange rate the actual domestic currency cost of an import may serve to price it out of a domestic market.

When an exporter has an overseas sales subsidiary for certain markets, or has a direct investment or licensing arrangement, *profit or income remittance* restrictions may become of concern. These restrictions are part of a country's general exchange control program over the conversion of local currency to foreign currency. They pertain specifically to the remittance of profits or earnings of 'local' operations to the parent organization located in another country.

Some multinational companies seek out so-called 'tax havens' for reincorporation and establishing a legal domicile for the company. These are countries that have a more favorable tax treatment than a company's original home country. In the western hemisphere, Bermuda, the Cayman Islands and the British Virgin Islands have been popular. In Europe, Switzerland and Ireland are the favorite countries. Both these countries have well-established tax treaties, which decide which country has primary taxing rights and help avoid double taxation.

Promotional activities

The policies and programs adopted by governmental organizations to promote exporting are an increasingly important force in the international environment. Many of the activities involve implementation and sponsorship by government alone while others are the results of the joint efforts of government and business. An example of the latter are the so-called company grouping programs that have evolved in a number of countries, often under the label of network schemes. Encouraged and facilitated by government, these schemes are designed for small and medium-sized enterprises (SMEs) and are used primarily – but not exclusively – for export activities. In general, an export grouping scheme provides the opportunity for member companies to spread the initial costs and risks of international market entry, to share information and experiences, and to pool resources to support stronger promotional efforts. Illustrative uses of network schemes are the 'export circles' in Finland which have the requirement that each circle be kept small and that the companies must be noncompetitive (Luostarinen *et al*., 1994) and the Joint Action Group (JAG) scheme in Australia which was initiated by the semi-government agency the Australian Trade Commission (Austrade) as a way of improving performance of Australian exporters (Welch *et al*., 1996a, 1996b). One requirement of such groups is that member companies must accept group-determined goals and activities, which is often difficult for smaller companies to do especially when the group comprises competitors. Two approaches have been used to form groups: (1) supply based, which starts with formation of a group and then seeks an opportunity and (2) demand driven, which starts with an international prospect or opportunity and then the group is formed. The JAG approach is an example of the latter.

In addition to becoming parties to agreements and conventions and being members of supranational organizations, national governments promote international marketing through so-called *regulatory supportive* activities. These activities generally fall within the political or legal jurisdiction of the national government, and are essentially regulatory-type activities that are used as promotional tools. By the use of such tools, a government attempts directly to make its country's products more competitive in world markets. Also, there is the attempt to encourage greater participation in exporting, particularly for smaller companies, as illustrated in Exhibit 4.1.

With respect to exporting, two types of government activity are of special significance: state trading and the granting of subsidies. When engaging in state trading, a government either directly involves itself in business transactions through buying and selling (by state-owned enterprises) or regulates export activities. Export subsidies are to the export industries what tariffs are to domestic industries. In both cases the aim is to assure the

Exhibit 4.1 Assisting small business firms

Small and medium-sized businesses need assistance in international marketing that large companies do not. Very simply, the large companies have the resources and the expertise to develop and implement international marketing programs, especially export marketing programs.

Government, quasi-government, and private organizations offer various types of assistance. To illustrate, Austrade has a comprehensive program designed to assist Australian small businesses. Austrade is represented in more than 50 countries. An export counselor at a local Austrade office can do a quick market assessment of the level of demand for a company's product in a foreign market and provide information on all relevant regulations there. If the market looks promising more detailed research can be conducted covering market size, competitive situations, alternative marketing intermediaries to contact, and so forth. An overseas Austrade office will assist in getting appointments and providing information on practical aspects of doing business in that market. In addition, Austrade runs the Export Market Development Grant scheme (EMDG), which helps SME exporters locate and develop overseas markets. Grants of up to A$200,000 are given to SME exporters or intended exporters to pay for up to one-half of their overseas marketing and promotional costs incurred to earn export revenue.

Other aspects of the Austrade assistance program include trade fair participation, and grants and loans to assist in such activities as marketing and travel.

Another example of a national government agency that was created to assist small and medium-sized companies gain export markets is the Japan External Trade Organization (JETRO). Along the way, JETRO's major goal changed to import promotion: helping foreign companies sell their products to Japan. One thing did not change: the focus on small businesses.

JETRO offers companies interested in exporting to Japan many services. Information is one of the most basic services, and JETRO has long put special emphasis on collecting and making available accurate, high-quality, and up-to-date information. Individual trade inquiries are handled, seminars on how to export to Japan are held, and a broad range of publications on the Japanese market and business practices is published. JETRO also plays an active role in organizing and promoting trade fairs in Japan as well as in facilitating participation by foreign companies in such events.

One of the most innovative activities is the Senior Trade Adviser Program, under which seasoned Japanese business people are mobilized from private firms, such as trading companies, and dispatched to countries for periods of two years to assist local companies in developing their exports to Japan. Assistance is not limited to simply providing advice but also includes introducing customers in Japan, mediating technical tie-ups with Japanese companies, brokering individual transactions, and so forth.

An illustration of what subnational governments can do is provided by the Trade Division of the state of New Mexico in the United States. Its mission is to promote New Mexican products and services worldwide, primarily for the state's small and medium-sized companies. The trade specialists in the Division, most of whom speak several languages, travel worldwide presenting New Mexico companies at trade shows and expos, and occasionally will accompany business people on trips. The Trade Division has two small offices abroad, both in Mexico, and has contracts with part-time consultants in Germany, Taiwan, and Israel. The Division's aims are as follows:

- support and educate state companies by giving seminars on doing business abroad;
- provide guidance, advice, and matchmaking;
- identify niche markets;
- showcase products at international trade shows.

The Division does not make actual business deals. Its role is strictly supportive.

Turning to the private sector, an illustration is the Rotterdam Distriport, which is a nonprofit foundation including 16 Dutch companies. These companies are active in the Netherlands in physical distribution, container handling, insurance, accounting, and banking, as well as in financial, legal, and fiscal areas. The prime objective of Rotterdam Distriport is to assist and support the foreign exporter to get the most efficient distribution to the markets of Europe by way of the Port of Rotterdam.

Sources: Adapted from Matsutuji (1992), *VIA Port of NY–NJ* (1988), and Bullock (1995).

profitability of industries and individual firms that quite likely would succumb if exposed to the full force of competition. For export industries, revenue is supplemented by subsidies, or costs are reduced by subsidies to certain input factors. Subsidies can be given through such tactics as lower taxes on profits attributable to export sales, refunding of various indirect taxes (e.g., some countries refund 'value-added' taxes), lower transportation rates for exported merchandise, and manipulation of the system of exchange rates. Moreover, a subsidy may take the form of a direct grant, which enables the recipient to compete against companies from other countries that enjoy cost advantages, or may be used for special promotion by recipient companies. Subsidies should be used with care as many are illegal under WTO rules.

In a broader sense, government export promotion programs, and programs for international marketing activities in general, are designed to deal with the following major barriers:

1. lack of *motivation*, as international marketing is viewed as more time-consuming, costly, risky, and less profitable than domestic business;
2. lack of adequate *information*;
3. *operational/resource-based* limitations.

These programs are quite popular in developing countries, where they are known as public sector trade promotion organizations (TPOs). In many instances TPOs have not proved suitable for the emerging needs of countries, particularly developing countries. However, such organizations can be effective in providing marketing assistance if the following apply:

- they enjoy the support of the business community;
- they are adequately funded;
- they are staffed with qualified people who are paid salaries commensurate with the private sector;
- they are somewhat independent of government.

Financial activities

In some ways a national government assumes the role of an international banker. One way in which this role is carried out is through membership in international financial organizations such as the International Monetary Fund, the World Bank, and the International Finance Corporation. The granting of legal subsidies is another financial-based promotional activity of national governments.

Some national governments grant direct loans to business firms. For example, in the United States under certain conditions loans are available from the Export–Import Bank (Eximbank), the Agency for International Development (AID), and the Commodity Credit Corporation (CCC). Although Eximbank loans and AID dollar loans are granted to foreign sources, they must be used to purchase goods and services from US exporters. In Australia grants and loans are available to small business firms by Austrade.

One of the most vital determinants of the results of a company's export marketing program is its credit policy. Exporters throughout the world are finding that in today's highly competitive international marketplace the traditional factors that normally determine competitive advantage – price, quality, and speed of delivery – are sometimes playing a secondary role. The supplier that can offer better payment terms and financing conditions may make a sale, even though the price may be higher or the quality of the product inferior to that of any competitors. For example, in the United Kingdom, the Export Credits Guarantee Department (ECGD) guarantees credit and subsidizes export credit offered through commercial banks. Credit rediscounting is available in many countries including France, Korea, and Sri Lanka. Turkey has used an export credit subsidy.

As the credit terms necessary to make a sale are extended, the risks of payment increase, and many exporters are reluctant to assume the risks. Consequently, if a national government wants to encourage the growth of exports, it is necessary that it offers exporters the opportunity to shift the risk through credit insurance. Credit insurance and guarantees cover certain commercial and political risks that might be associated with any given export transaction. In Australia, for example, the Export Finance and Insurance Corporation (EFIC) provides payment risk insurance – or a guarantee – to a bank as well as improved access to working capital. Most of EFIC's clients are small exporters. Hong Kong has the Hong Kong **Export Credit Insurance Corporation** (ECIC), which provides credit insurance to exporters against the risk of nonpayment for goods and services; it also has a Credit Guarantee Scheme. On a regional basis in 2001 the African Trade Insurance Agency was created to provide insurance for exports to, from, and within Africa. Insurance is available for political upheaval, expropriation, and problems with exchange controls.

Information services

For a company to be successful in international marketing, its managers must be able to make the right decisions consistently. Over the long run, sound decision-making is next to impossible without adequate and timely marketing information. Marketing information is indispensable in making such decisions as what market(s) to be in, when to be there, and how to be there. This is discussed further in Chapter 6. This includes both strategic and tactical decisions.

National governments can provide much of the basic information upon which international marketing decisions are based. Obviously not all business firms need to use such information services. Many large companies can collect the information they need themselves. Other firms, even if they do not possess the expertise to do their own research, can afford to hire outside research agencies to do the needed research or can turn to the Internet. However, there are a large number of companies that are not in a position to take either of these approaches. For these firms, generally smaller companies or newcomers to international marketing, their national government is the major source of basic marketing information. It should also be mentioned that there are many times when those companies that can do their own research or can afford to hire a research agency will utilize government information services. This will occur when the government is the only source of a particular type of information, a more common situation as the government expands its information services.

Although the information relevant for international/export marketers varies from country to country, the following kinds are available from a number of leading nations:

1. economic, social, and political data on individual countries, including the infrastructure;
2. individual reports on foreign firms;
3. specific export opportunities;
4. lists of potential overseas buyers, distributors, and agents for various products in different countries;
5. summary and detailed information on aggregate international marketing transactions;
6. information on relevant government regulations both at home and abroad;
7. sources of various kinds of information not always available from the government, for example, foreign credit information;
8. information that will help the company to manage its operation, for example, information on export procedures and techniques.

Most of the above-mentioned types of information are made available to business firms through published reports or documents. In addition, government officials often participate in seminars and workshops that are aimed at helping the international marketer.

Another approach is to have a company evaluate political risks associated with its international marketing operations. Many of these risks have been discussed in this chapter. These are macro risks which apply to industries, all companies, an entire country, etc. Equally important, and maybe even more important to some companies, are micro political risks within a host country, which stem from economic, societal, and governmental forces, and which can affect the individual firm. Alon and Herbert (2009) propose a model that identifies each of the determinants of micro political risk (internal, external, firm-related) and suggest variables that managers can use to gauge the relationship of a firm to the host country. Table 4.3 shows the variables that affect micro political risk.

Export facilitating activities

There are a number of national government activities for stimulating exporting that can be called export facilitating activities. These include the following:

1. Operating trade development offices abroad, either as a separate entity or as part of the normal operations of an embassy or consulate.
2. Sponsoring trade missions of business people who go abroad for the purpose of making sales and/or establishing agencies and other foreign representation.
3. Operating – or participating in – trade fairs and exhibitions. A trade fair is a convenient marketplace in which buyers and sellers can meet, and in which an exporter can display products. For example, in 2008 the Hong Kong Trade Development Council partnered with the Guangdong (China) Province Department of Foreign Trade and Economic Cooperation in organizing a major overseas trade promotion in Budapest, Hungary. More than 170 Hong Kong and Guangdong companies were showcased.
4. Operating permanent trade centers in foreign market areas, which run trade shows often concentrating on a single industry.

Table 4.3 Variables affecting micro political risk

Internal antecedents
Economic-related factors
1. Labor conditions
2. Congruence with national economic interests and goals
3. Availability of alternative suppliers
Society-related factors
1. Degree of power distance
2. Degree of uncertainty avoidance
3. Degree of collectivism
Government-related factors
1. Firm-specific regulatory actions
2. Degree of nationalism
3. Subsidization of local industry
4. Transparency and corruption
External antecedents
Economic-related factors
1. Degree of economic dependence on the home country
2. Involvement in regional economic agreements (e.g., WTO, NAFTA)
3. Balance of payments
Society-related factors
1. Influence of adverse international activist groups
2. Extent of cultural distance
3. Extent of international societal disputes
Government-related factors
1. Diplomatic stress within the home country
2. Involvement in regional political agreements (e.g., NATO, UN)
3. Extent of currency (in)stability
Firm-related factors
Contribution of the firm/project to the local economy
1. Level of technology transfer
2. Exports generated by firm/project
3. Size of operation
Bargaining power of the firm relative to the government
1. Dependence of firm on local market
2. Extent of natural resource seeking
3. Level of firm diversification
Governance structure
1. Degree of ownership
2. Extent of financial policies adverse to the BOP (e.g., transfer pricing)
3. Intra-corporate transfers

Source: Adapted from Alon and Herbert, 2009, p. 131. This table was published in *Business Horizons*, Vol. 52. Copyright Elsevier 2009.

From the point of view of the national government, each of these activities represents a different approach to stimulating the growth of exports. From the point of view of an individual company, they provide relatively low-cost alternative ways to make direct contact with potential buyers in overseas markets. Thus these services provide a way to expand overseas market coverage at a relatively low cost.

While promotion of exporting by the national government serves useful purposes, it is usually not directed to any specific political subdivision of a country. Political subunits such as states, provinces and municipalities in some countries (e.g., Canada, the United States, Germany) have actively moved into the promotion of international business with the purpose of aiding business firms located within their boundaries.

Both long- and short-range programs have been developed to tap foreign markets and grasp the many opportunities available. These programs have been aimed at helping those already active in export marketing as well as those to whom exporting may be an entirely new venture. Most of the subnational government activity occurs at the state or provincial level, but there is some activity at the local or municipal level (e.g., the Office of Economic Promotion for the City of Düsseldorf in Germany). The kinds of activities that subnational government agencies engage in are similar to those of national governments, including sponsoring trade missions and trade shows and operating trade development offices, but are targeted to more 'local' business firms. For example, the Canadian provinces of Alberta, Quebec, and Prince Edward Island were operating trade offices in Hong Kong in mid-1996 as were the US states of New York and California. As previously mentioned, the US state of New Mexico operates overseas offices in Mexico and has part-time consultants in Berlin, Germany; Taipei, Taiwan; and Jerusalem, Israel. One success story is that in early 2000 the German circuit board manufacturer Sennheiser Electronic GmbH opened a manufacturing plant in the state. Also previously mentioned were the trade missions from the US state of New Hampshire.

Somewhat related to these activities are the government-authorized free trade zones, free ports, and free perimeters. A *free trade zone* is basically an enclosed, policed area without resident population in, adjacent to, or near a port of entry, into which foreign goods not otherwise prohibited may be brought without formal Customs entry or payment of duties. Examples are the Colon Free Zone in Panama and the Barranquilla free trade zone in Colombia. A *free port* encompasses a port or entire city isolated from the rest of the country for customs purposes. An example of a major free port is Hong Kong. Finally, a *free perimeter* is similar to a free port in the kinds of activities allowed, but is generally confined to a 'remote' underdeveloped region. Certain areas in Mexico extending about 7 km from the US border illustrate this type of operation. Since all these areas have the effect of encouraging and facilitating international transactions, the exporter may find them useful in the distribution of products not only to a single country but to an entire region. Hong Kong is a much used distribution center for the entire Far East.

Some developing and newly industrialized countries have established *export processing zones* (EPZs) as a vehicle for promoting industrialization. Examples are the Jakarta Zone in Indonesia, the Penang Zone in Malaysia and the Batran Zone in the Philippines. An EPZ is a relatively small, geographically separated area within a country, the purpose of which is to attract foreign investment in export-oriented industries. The EPZ allows imports of products to be used in producing exports on a bonded duty-free basis. An exporter can use such zones as a base for serving several markets.

Promotion by private organizations

Various nongovernmental organizations play a role in the promotion of international marketing. Many of the activities overlap and duplicate those of government agencies. Others, however, can be viewed as a supplement to government endeavors. A general listing of the types of nongovernmental organizations engaging in international marketing promotion is as follows:

1. chambers of commerce: local chambers of commerce; national chambers, national and international associations of chambers; national chambers abroad and binational chambers;
2. industry and trade associations: national, regional, and sectoral industry associations; associations of trading houses; mixed associations of manufacturers, traders, and other bodies;
3. other organizations concerned with trade promotion: organizations carrying out export research; regional export promotion organizations; world trade centers; geographically oriented trade promotion organizations; export associations and clubs, international business associations, world trade clubs; organizations concerned with commercial **arbitration**;
4. export service organizations: banks; transport companies; freight forwarders; port authorities; export merchants and trading companies.

The types of assistance available to business firms include information and publications, education and assistance in 'technical' details, and promotion in foreign countries. Our discussion has, of necessity, been quite brief.

State trading

The extreme level of government involvement in international marketing is *state trading*, which is defined to include government engagement in commercial operations, directly or through agencies under its control, either in place of or in addition to private traders. Examples of countries with active state trading activities are China and Russia, and other countries where all exports and imports and exchange are handled by government monopolies or where individual state-owned enterprises are involved in international marketing activity. Many of these countries are now allowing or experimenting with some private trading activities either through joint ventures or as a result of privatization of state-owned enterprises. In addition, Australia and certain African countries have marketing boards to handle foreign trade.

In capitalist countries state trading is not a normal and regular activity of the state. It is undertaken to achieve specific objectives that are related to problems of a relatively temporary nature. Exceptions are activities of companies that may be owned by the state but which operate as if they were privately owned.

In general, whether communist or capitalist, a country may undertake state trading to achieve one or more of the following objectives:

- further its political goals;
- dispose of surpluses in various products;
- encourage export trade;

- enhance domestic planning programs by purchasing products needed to fill a gap in the plans;
- improve the country's balance of international payments;
- control foreign exchange;
- maintain national security and defense;
- acquire specific products, either because they can be obtained at lower cost or because they are scarce at home and/or abroad;
- help domestic interests by improving trade bargaining power or by protection against foreign competition.

Private business firms are concerned about state trading for two reasons. First, the establishment of import monopolies means that exporters have to make substantial adjustments in their export marketing programs. They cannot sell directly to markets and develop customer loyalty as in private enterprise economies. The state buying office buys certain goods to fill a gap in the total state plan, and the seller's marketing know-how cannot be used to the extent possible in private enterprise economies to influence or change the buying plan.

Second, if state traders wish to utilize the monopolistic power they possess, private international marketers are not really equipped to compete and deal with them. Backed by almost unlimited funds and untroubled by the need to operate at a monetary profit, they can be powerful bargainers, and they can extract payment from international marketers for marketing rights in their country.

Economic integration

Since the 1950s a key economic force affecting all forms of international business activity, especially exporting and FDI, has been the formation of regional economic integration arrangements, also known more generically as regional trading blocs or RTBs. In its broadest sense, economic integration means the unification in some way of separate individual economies into a larger single economy. In effect, such integration goes beyond purely economic issues, and involves socio-cultural and political–legal matters as well. Consequently, we can view regional economic integration schemes as arrangements designed to promote closer economic ties within an area comprising several politically independent countries, which minimize the economic consequences of political (and perhaps even cultural) boundaries.

Various schemes for achieving regional economic integration have been attempted, are operational, or have been suggested. These range from bilateral agreements to eliminate trade barriers as discussed briefly earlier in this chapter to complete economic integration with supranational institutions (e.g., the European Union). As shown in Table 4.4, the major types of integration schemes range from the least complex and exacting one of a *free trade area* to the most comprehensive *political union*. Illustrations of each type that exist today are presented in Table 4.5.

Regional integration schemes typically establish *Rules of Origin*, which include provisions for the amount of content that must be region based in order for a product to be exported/imported between countries in the region without tariff, or at a reduced tariff if tariffs have yet to be totally eliminated. Using NAFTA as an illustration, a company exporting a motor from the United States to Canada would have to prove that a specific percentage of the motor originated in one or more of the three countries in NAFTA. Various products may have different NAFTA content requirements. Rules of Origin are established to ensure that a nonmember country such as say, Taiwan, cannot get in 'through the back door' by first shipping a product to a warehouse in Mexico and eventually exporting it to the United States duty free. Other regional areas operate in a similar manner.

Table 4.4 Characteristics of economic integration

Characteristics	Free trade area	Customs union	Common market	Economic union	Political union
Removal of internal tariffs	X	X	X	X	X
Common external tariffs		X	X	X	X
Free flow of capital and labor			X	X	X
Harmonization of economic policy				X	X
Political integration					X

Table 4.5 Existing economic integration arrangements

Free trade area

European Free Trade Association (EFTA):
- Iceland
- Liechtenstein
- Norway
- Switzerland

Association of Southeast Asian Nations (ASEAN):
- Brunei
- Cambodia
- Indonesia
- Laos
- Malaysia
- Myanmar
- Philippines
- Singapore
- Thailand
- Vietnam

ASEAN-China
- China and the members of the ASEAN free trade area

ASEAN-Australia
- Australia and the members of the ASEAN free trade area

ASEAN-New Zealand
- New Zealand and the members of the ASEAN free trade area

Latin American Integration Association:
- Argentina
- Bolivia
- Brazil
- Chile
- Colombia
- Cuba
- Ecuador
- Mexico
- Paraguay
- Peru
- Uruguay
- Venezuela

Central American Integration System (SICA):
- Belize
- Costa Rica
- Dominican Republic
- El Salvador
- Guatemala
- Honduras
- Nicaragua
- Panama

Observers
- Chile
- Republic of China
- Germany
- Mexico
- Italy
- Brazil
- Argentina
- Spain

North American Free Trade Area (NAFTA):
- United States
- Canada
- Mexico

Customs union

Benelux:

- Belgium
- Netherlands
- Luxembourg

Common market

European Union (EU):

- Austria
- Belgium
- Bulgaria
- Cyprus
- Croatia
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Latvia
- Lithuania
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom

Applied for admission

- Turkey
- Macedonia
- Iceland

Andean Common Market:

- Bolivia
- Colombia
- Ecuador
- Peru
- Venezuela

Mercosur:

- Argentina
- Brazil
- Paraguay
- Uruguay
- Venezuela*

Associate members

- Bolivia
- Chile
- Colombia
- Ecuador
- Peru

Caribbean Community and Common Market (CARICOM):

- Antigua and Barbuda
- The Bahamas
- Barbados
- Belize
- Dominica
- Grenada
- Guyana
- Haiti
- Jamaica
- Montserrat
- St Kitts and Nevis
- St Lucia
- St Vincent and the Grenadines
- Suriname
- Trinidad and Tobago

Associate members

Anguilla
Bermuda
British Virgin Islands
Cayman Islands
Turks and Caicos Islands

Central American Common Market (CACM):

- Costa Rica
- El Salvador
- Guatemala
- Honduras
- Nicaragua

Economic union

The closest is the EU. The creation of the so-called EU 'internal market' at the end of 1992 was a step toward fully integrated economic cooperation between the then 12 (now 27) member states.

Political union

The British Commonwealth of Nations can be viewed as a voluntary union. Similarly, the EU is moving in this direction under various provisions of the Maastricht Treaty, including the creation of a single currency, the euro.

*awaiting ratification of its membership

Exporting business firms may be affected in two basic ways by the formation of any type of regional scheme. There may be a *preference* effect and a *growth* effect. For exporters located outside any particular region a preference effect means that there will be a decrease in their exports to that region (perhaps even a total loss of market) because of the preferential treatment given to competitors located within the region. Of course, up to a point the 'outsider' can become more competitive by having a superior product, lower price, entering into one or more strategic alliances, or at the extreme by developing a production base within the region. In some situations the development of a production base is 'encouraged' by the integration group. ASEAN, for example, since its inception in the late 1960s, has had a program for complementary sectorial development of various industries. The governments promote foreign investment in 'approved' industries. Any action taken by an outsider to respond to the preference effect can necessitate a change in strategy and/or tactics by exporters to the region.

To an extent this preferential effect may be offset by the growth effect. Since a larger total market has been created, this together with the increased rate of economic growth means that consumers and industrial users will have more money to spend on products from abroad.

Preference and growth effects also touch companies located within the regionally integrated area. The results of economic integration to inside companies will probably be lower costs and increased sales. Input costs should decrease since inputs of all kinds become available from larger areas and without a tariff charge. Sales should increase because of expanding markets. Of course, not all companies will benefit to the same extent.

Economic integration can also be expected to result in the redistribution of economic activities to more efficient producers of goods and services. Less efficient producers, who were able to sell their products domestically only because of protective national barriers, will need to improve efficiency, combine with others, find new niches, or decline and go out of business. Companies already exporting when further integration occurs have already demonstrated their competitiveness and should be able to improve their positions.

One potential problem of the preference effect is that it may cause trade to flow in inefficient ways, a process known as *trade diversion*. In Chapter 2 we discussed comparative advantage as a basis of trade. If the United States imports Mexican televisions merely because the Mexican goods are tariff free, even if, say, Malaysia has a comparative advantage in television manufacturing, the main benefit of trade will be lost.

A second issue is that regionalism may block efforts to liberalize trade throughout the world. There is no clear-cut theoretical answer to the question of whether regional trade agreements are good or bad, and empirical results are disputed. There is disagreement about the extent of trade diversion. One basis for judging regional arrangements is how much they discriminate between members and nonmembers. For example, there is evidence that Mercosur's high tariffs cause the countries to import from one another when it would be more efficient to buy products elsewhere. Given the mixed evidence, regionalism is not necessarily good or bad for free trade. In the end, the success of global efforts to liberalize trade depends mainly on whether governments want to move in that direction, not whether they seek or reject regional agreements.

It is tempting to think that, from a marketing viewpoint, a region (such as the European Union) could be treated by an exporter as a single market area, and the European Union has a single currency – the euro – in use in most, but not all, member countries. The exporter that conducts operations using such a strategy will soon find that things are not as they seem. Within a region, separate markets do not cease to exist. The relevant demographic characteristics and social, legal, and cultural influences that define a market do not change just because a country is part of an area with free internal trade and perhaps even free movement of resources. In addition to variations in consumer needs and attitudes, other factors may still lead to such market differences – government regulations of marketing activities, distribution structures, and media availability, to mention just a few. Finally, there are many languages spoken within the European Union, for example.

Regional economic integration is a dynamic activity. Because of this it is not easy to describe and analyze what is happening throughout the world. What exists today may not exist tomorrow, at least in the same form. What is proposed today may never even come about.

It is in Europe where the most dynamic events have occurred. In 1987 the 12 nations of the European Union approved the Single European Act. This Act called for the implementing of 285 accords by 1 January 1993. The end result was to be the creation of the *internal market*. Although there already was free movement of products and resources within the community, there were gaps that needed to be closed. Moreover, all border controls and technical barriers to trade were to be removed, government purchasing was to be opened to non-nationals, and financial services were to be opened up competitively. These issues are covered in the Maastricht Treaty, which was finally ratified by all European Union members in 1993. On 1 January 2002 the common currency, the euro, began circulation and its coins and bills replaced the currencies of the member countries of the **European Monetary Union (EMU)**. All countries except Denmark, the United Kingdom, and Sweden are members of the EMU. The single currency has caused marketers to restructure pricing strategies and will lead to increased competition between firms in Europe as price comparisons are easier among countries. There will be cross-border trade due to differences in taxes. Not having to worry about foreign exchange costs and risks will also impact on supplier relationships and internal organization and investment. But it is in pricing where the most significant impact will be.

The long-run goal of European Union leadership is to expand membership to other countries. Former EFTA members Austria, Sweden, and Finland entered in 1995. The European Union and EFTA agreed on an alliance – the **European Economic Association (EEA)**. As of mid-2007, the EEA consisted of the 27 member states of the European Union and the EFTA countries of Iceland, Liechtenstein and Norway. In a referendum, Switzerland's citizens chose not to participate in the EEA. Rather, Switzerland is linked to the European Union by Swiss–European Union bilateral agreements, with a different content than that of the EEA agreement. Turkey, Macedonia, and Croatia have applied for membership in the European Union.

Much of the business done by the European Union is subject to majority voting among the member countries. But there are some areas where any national government can use its national veto power to stop the European Union from adopting new laws or policy decisions, including: revision of European Union treaties, admission of new members, defense, international agreements, use of European Union money for promoting employment, new European Union or national subsidies to industry, obligatory harmonization of national tax legislation, financial assistance to a member in serious economic difficulty, and external trade in services and intellectual property.

As the European Union illustrates, these regional groupings often are concerned with more than economic issues. Another illustration of this is the Central American Integration

System (SICA). SICA is the economic, cultural, and political organization of Central American states, and has been so since 1993. This organization extended earlier cooperation among countries in the region in search of regional peace, political freedom, and economic development (http://en.wikipedia.org/wiki/Central_American_Integration_System, accessed 21 July 2010).

Summary

This chapter has discussed the major components of the political, legal, and governmental environment that all companies face, both at home and in foreign markets. The role of government, and thus the political and legal aspects, is to promote, impede, and/or compete. Each of these intervention activities have been discussed and, where appropriate, examples given. Bilateral trade agreements and regional economic integration have been given specific attention.

Questions for discussion

4.1 Government can play many roles in international marketing. What are these roles and how does each affect individual business firms?

4.2 Why is it that some exporters would support voluntary export restraints agreed to by their government?

4.3 For a country of your choice, determine what its government does to promote exports and other international marketing activity.

4.4 What is regional economic integration, what is its objective, how is it supposed to achieve its objective, and what impact is there on individual exporters?

4.5 Should an economically integrated region be considered as one market area? Explain your answer. Would your answer vary for the European Union in contrast to, say, ASEAN?

4.6 Can the European Union become too big? Is there a point of diminishing returns for a regional economic area? Explain.

4.7 Distinguish between legal, political, and government influences on the international marketer.

4.8 Explain how a single government can promote, impede, and compete at the same time.

4.9 What role should subnational government bodies play in the international environment?

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CASE STUDY 4.1

Avon Products, Inc. (A)

(This case study was written by Yim-Yu Wong and Edwin Duerr, both of San Francisco State University.)

In the decade of the 2010s, the plans and operations of Avon Inc. in marketing, research, and manufacturing throughout Asia are still being affected by actions taken after a 1998 meeting. The US cosmetics giant had considered China the keystone of its marketing effort in Asia. Years of effort and the development of a large **direct marketing** organization in that country had made operations in China its most profitable and most rapidly growing market in Asia. On 21 April 1998 senior company officials from the New York headquarters and throughout Asia had gathered in Guangzhou for what was supposed to be a festive occasion. During the meeting William Pryor, Avon's head of China operations, was called away from his table to take a phone call. When he returned, it was with devastating news. The Chinese government had just announced an immediate ban on all direct selling.

In 113 years, Avon had used only direct selling and had no experience in traditional retailing. Thus the large financial investments they had made in China beginning in 1990, and the expected potential for growth in the Chinese market, were in immediate and very serious danger. While Avon had enjoyed eight consecutive years of profit in China, the implications went beyond the possible loss of the Chinese market itself. Avon had planned to use China as a manufacturing base for its export activities, thus strengthening its status as a global company. At corporate headquarters in the United States the ban not only demonstrated that regulatory and bureaucratic uncertainty continued to be a major problem for foreign businesses in China, but also provoked reconsideration by Avon of its strategic approach to the global market.

The company and its competitors

Avon Products, Inc. was founded in 1886 by David McConnell as the California Perfume Company. The name was officially changed to Avon Products, Inc. in 1939. In the late 1990s the company was operating in over 135 countries with a sales force of more than 2.3 million independent representatives. These representatives, called Avon Ladies, handled 650 million customer orders and generated more than US$2 billion in commissions per year.

The company is the world's largest direct seller of beauty and related products. A leader in skin care products, it is also a manufacturer of costume jewelry, and markets an extensive line of apparel, gifts, decorative items, collectables, and family entertainment products. Of these products, cosmetics account for over 60% of total sales. With US$4.8 billion in annual revenue, Avon was ranked 293 among Fortune 500's list of the largest US companies in 1998.

The vision of Avon is: 'To be the company that best understands and satisfies the product, service, and self-fulfillment needs of women – globally. The vision influences the company's research, product development, marketing and management practices' (www.avon.com).

Avon is in some of the most competitive consumer-product markets in the world. Their target market is women in a wide age range, from teens to the over 40s, in two different market segments. The Avon Skin Care line, targeted at the lower end of the mass market, offers modestly priced, daily-use-type products. This line is designed to be 'simple' and appeal to customers who prefer a 'less involved' skin care regime. It is expected to be a beginning step for some consumers to skin care, and Avon hopes that these customers will eventually move to its higher-scale products. The major competitors in low-end skin care products are Oil of Olay (Oil of Ulan in China), Neutrogena, Ponds, Biore, Almay; there are many others. In coloring products, competitors include Maybelline, Cover Girl, Almay, Revlon, L'Oréal, Oil of Olay, among many others. Other products, such as Anew, target the lower end of the premium segment, where competitors include Estée Lauder, Lançome, Christian Dior, and Clinique. Two major direct marketing competitors, at both the domestic and international levels, are Amway and Mary Kay.

The high-end products have been developed through an ongoing research effort that has resulted in a number of innovations and new products. Avon scientists developed Anew, a skin care cream containing alpha-hydroxy-acid, which provided anti-aging benefits beyond what was available in other products. Its Bio Advance was the first product to use stabilized retinol, a form of vitamin A, and Collagen Booster facilitated the use of vitamin C. In the late 1990s the company obtained US Food and Drug Administration approval of the use of Parsol 1789 to fight damage caused by UVA rays. It used this material in a new Age Block Daytime Defense Cream. The company has 19 laboratories worldwide that develop products and packaging. In addition to its own research staff and independent experts, Avon uses focus groups in evaluating potential new products, and has company employees use the products.

In 1996 Avon spent US$30 million on an advertising campaign, which focused on the Avon Lady, the core of the company's success, and a new product image. Avon is now projected as having a contemporary product with a consistent, high-quality image in all markets. Its advertising program uses celebrities, such as fashion designer Josie Natori and Olympic athlete Jackie Joyner-Kersee. Avon moved away from mature, matronly appearance to updated, sophisticated, and glamorous images. The result is a more vibrant beauty image, similar to other US brand names such as Revlon, Mabelline, and Cover Girl. Also under this campaign, Avon advertised on television for the first time in 20 years, and began direct selling on the Internet in April 1997. Its website now attracts 300,000 visitors per month.

Avon credits the maintenance of its competitive position to several factors including attractive product designs, high product quality, reasonable prices, company and product image, innovative products, guarantees, and commitment to product satisfaction. The personalized, friendly customer service offered by Avon Ladies is considered a key competitive strength.

Avon does not require its sales representatives to spend money in advance to purchase a starting kit and inventory. As a matter of policy, the company attempts to avoid having representatives use a hard selling approach or hard-core pressure tactics. There is an effort to create a relaxed, approachable, and friendly image through the Avon Ladies and a few gentlemen. The ability to attract and hold an effective direct sales force has been an important factor in Avon's success. For those who like interacting with customers, Avon Lady positions provide opportunities for women to be their own bosses in jobs with flexibility, simplicity, and low stress. For women who wish to move on to more responsible jobs, the company offers career positions and opportunities to move up in the organization. Avon is one of the few companies in the Fortune 500 that has six women on the Board of Directors.

The company emphasizes its international character. Under the Chairman and CEO, policy is developed by a senior management team called the Global Business Council. Members of the Council include the top executives of Avon's Operating Business Units (OBUs), the chief financial and administrative officer, and the president of global marketing. The company groups its operations, by region, into five OBUs: the United States; Asia-Pacific; Mexico-Central America-South America; Brazil-Colombia; and Europe. Each OBU has a headquarters within its respective region.

Avon overseas

Avon's first overseas operation was in 1954 in Venezuela. Its success there motivated the company to continue expansion. It went to Europe in 1957, Australia in 1963, Japan in 1969, Malaysia in 1977, the Philippines and Thailand in 1978, Taiwan in 1982, and Indonesia in 1988. From 1990 to 1998 Avon entered 18 new markets, mostly in Asia, including China. Avon's products are distributed through subsidiaries in 45 countries and through other marketing channels in 89 additional countries.

Over 65% of Avon's sales earnings come from overseas operations, and the growth of overseas production and sales outpace those in the United States. Rising incomes in Asia during the 1980s and early 1990s led to a greater demand for beauty products there, and encouraged expansion in that area. Additionally, the importance of appearance to the increasing number of Asian women in the workforce added to the number of customers. Analysts also attribute Avon's success in foreign markets, particularly those in developing economies, to the earning opportunities the company offers to women who have little chance to work outside the home or even find a job. Increasing demand had been combined with an expanding number of women interested in direct selling, a key strength of the company.

Overseas operations continue to be Avon's first priority for growth. The economic crisis in 1997 in Asia did not frighten the company. Instead it planned to take advantage of the favorable exchange rate to invest between US$65 and US$75 million to construct manufacturing plants in the Philippines and China. Avon believed that the financial problem in Asia was short term whereas the company is in Asia for the long term.

Global strategies and products

Avon is an example of a company that 'thinks globally and acts locally.' That is, it pursues economies of scale and scope in manufacturing, logistics and marketing by selecting the most cost-effective facility locations and scales of operation on a worldwide basis. Product variations, which increase costs, are limited to those demanded by the various markets served. Overall, it balances the cost-saving potential of standardization with responsiveness to individual market needs in pursuing both profits and market share. Avon has production facilities in 45 countries and a market covering over 135 countries.

Beginning in the 1990s, the company developed 'global product' lines that could be sold in multiple markets, with only limited variations in packaging and marketing to meet differing national requirements. Avon's global products are first developed in the United States and tested in the mass US market. Next, the potential of the product's marketability is validated by Avon's Global Product Council and global market research. Some of the criteria for creating successful global products include market viability in at least six of Avon's major markets, the potential to be among the top three brand names in each market, and the potential to generate at least $75 million in annual sales. Most of Avon's global products are actually sold in 50 to 60 markets simultaneously.

The eight global product lines introduced in the 1990s (Avon Color, Far Away, Rare Gold, Millennia, Natori, Josie, Anew, and Avon Skin Care) have been highly successful. They accounted for 26% of Avon's total sales of cosmetics, fragrances, and toiletries in 1996 and 39% in 1997. Developing global products will continue to be a major emphasis of Avon.

China's overall market and business climate

The Chinese market has grown rapidly since China began its open door policy in the early 1970s. During the following two decades, foreign businesses increased investment and marketing activities in an attempt to attain first mover advantages in this nation of 1.2 billion consumers. The suppression of student protestors in 1989 at Tiananmen Square resulted in the cessation of almost all new foreign investment, but within two years both foreign and domestic investment were again booming.

Although there was a lack of accurate, reliable information on which to base economic forecasts, many economists and businesses believed that China was a promising consumer market in the long run. When Avon was considering a substantial commitment to marketing in China in the early 1990s, the per capita income was below $400 per year. However, there was a growing middle class with a high level of discretionary income. By the mid-1990s consumers in big cities, such as Shanghai, spent up to 80% of their disposable income on entertainment, clothing and cosmetics. According to US Department of Commerce statistics, retail sales in China reached US$297 billion in 1996 as many entrepreneurs, professionals in private companies, and workers in township enterprises became more affluent.

The common cultural background of Chinese people allows, to some extent, product standardization and coordination. Yet regional differences in levels of economic development, infrastructure, consumer purchasing power, distribution, and transportation logistics result in very different levels of market attractiveness in various parts of the country. Fortunately for foreign firms, the Chinese generally regard foreign-made products to be of better quality and a symbol of prestige and status.

One major challenge to foreign business in China is the regulatory uncertainty. New laws, reinterpretation of laws, disagreements between arms of the central government, and differences in national and regional regulations present continuing hazards. In 2001 the State Postal Bureau claimed a law gave them the exclusive right to deliver international express mail. The Ministry of Foreign Trade and Economic Cooperation indicated that a 1995 order by the State Council granted foreign freight forwarders, such as DHL, FedEx, and UPS, the right to do so. In the meantime, postal offices in some parts of China set up roadblocks and confiscated deliveries. In another example, as an inducement to capital investment, the government had offered tax breaks on imported capital equipment at one point, abolished the incentives in 1996, and then restored them in 1998.

The cosmetic and skin care market

Skin care products have a long history in China, but their use was discouraged, and at times prohibited, during much of the Communist period. But with reform and modernization women again began using make-up and skin care products. Cosmetics sales in China grew 40% from 1990 to 1995, reaching a level of US$1.5 billion annually. A department store in Shanghai found that sales in a 100,000-square-foot cosmetic department space were: 10–18% for fragrances, 60–70% for skin care, 20% for color cosmetics, and 0.5% for body care products. In 1996, 70% of cosmetics were sold through state-owned businesses or selling cooperatives. In 1998, 80% of women living in big cities bought cosmetics at large shopping malls and 16% at general department stores or supermarkets. One important factor in the growth of cosmetics sales was the introduction of more expensive, up-scale international cosmetic brands into China.

In spite of the inroads of foreign brands, high-quality local brands still dominate the market. There are around 2800 local cosmetics manufacturers in China, of which over 90% are small in size. Of these companies, 470 now have partial foreign direct investment. The official record of cosmetics imports is around US$23 million per year, but there is a large and unrecorded smuggling operation in southern China. Altogether, there are about 300 brands sold in China, of which the 28 largest dominate the market. Yue-Sai Han, a Coty-backed joint venture, is important in the cosmetic and skin care product market. Kan, the Chinese partner in that joint venture, is a television celebrity and is known as China's 'Barbara Walters.' A Hong Kong-based brand, Cheng Mingming, has also done well in China. Foreign brands are mostly the choice of the younger consumers whereas older or more conservative people prefer domestic brands. Other best-selling foreign brands include Estée Lauder, Christian Dior, Lançome, and Clarins.

Marketing tactics for foreign brands are similar to those used in the United States including the offering of free gift sets. However, while a five-piece gift set is commonly offered by cosmetic companies in the United States, seven-piece gift sets are offered in China. The primary advantage of Chinese-made cosmetics is their lower prices. China levies duties amounting to 120% of the landed price on imported cosmetics.

Direct selling in China

Direct selling is a relatively new concept in China. Avon pioneered direct selling in China beginning in 1990, and was followed by Amway and Mary Kay. The Chinese government knew very little about direct selling and therefore had virtually no control of or regulations on it. China appeared to be a promising opportunity for direct selling for several reasons:

- Direct selling is labor intensive, and China has an abundant supply of labor.
- Direct selling relies on personal contacts for promotion instead of extensive mass advertising (mass advertising does not reach the majority of Chinese consumers).
- Unlike traditional retailing, direct selling does not rely heavily on a well-developed infrastructure for transportation and delivery; China lacks a well-developed infrastructure.
- Direct selling allows China's long-suppressed entrepreneurial spirit and opportunity to develop and creates earning possibilities, especially for women.
- Direct selling is very flexible and the financially conservative Chinese do not have to risk their primary jobs.
- Direct selling relies on personal networking, which is already built into the Chinese culture.
- China has a very large group of financially stable people who are retired by the State in their early 50s but who are interested in seeking more activities that would improve their retired life.

Entering the Chinese market: *Ya fang daojia* (Avon calling home)

Although Avon had over 30 years of experience in a number of countries internationally, entering and operating in China offered new problems as well as successes. The company had experienced an indirect relationship with China since the late 1970s when it had established a regional headquarters in Hong Kong that sourced a wide variety of gifts and decorative products in China. In the mid-1980s, Avon's first attempt to open the Chinese market via official channels in Beijing failed due to a commonly cited problem: Chinese bureaucracy. In 1990, Avon adopted a cautious, short-term approach to China. Going through its Hong Kong connection, the company established a joint venture with the state-owned Guangzhou Cosmetics Company factory. Avon purchased 60% of that joint venture. It was estimated that 60 million people lived within a 100-mile radius of the factory, making it a convenient location for Avon Ladies to order and deliver products. Business in China was an overnight success. Avon sold what was estimated to be six months' supply of inventory in the first 30 days.

In the first year of its operation, 1 million units of cosmetics and skin care products were sold. Sales reached US$4 million in 1991, far beyond Avon's original US$1.5 million target. In 1992, sales grew to more than US$8 million, and 8,000 women were working for Avon. Many of them earned 12 times more than typical Chinese women. At that time, Avon operated through a chain of 10 branches in the vicinity of Guangdong, but the area the Avon Ladies covered extended south to Hainan Island and northeast to Fuzhou. China became Avon's first priority in terms of market growth.

In 1994, Avon's sales in China grew to US$20 million. At that time Avon was building and training a 70,000-woman sales force with 15 sales branches in China's southern region. It was also the year in which Avon opened a distribution center in Shanghai as its first move into central China. In 1995, Avon's sales in China climbed to US$40 million and were expected to continue growing.

In 1996, Avon had 40 branches and 27,000 sales representatives, and a total of US$35 million invested in China. Nearly all of the products sold in China were made in China using local materials. Avon also planned another US$35 million investment for a new joint venture with a state factory, which would triple its production capacity in China. On 16 August 1996 Avon opened a branch office in Beijing, signifying further success and commitment to the Chinese market. China was now one of the most important markets for Avon in Asia, and Avon was enjoying government support at both provincial and local levels. In 1997 Avon's sales in China reached US$75 million.

By 1998 Avon had approximately 150,000 sales representatives and over US$200 million invested in China. The representatives in China recruited friends and colleagues, bought in bulk, and distributed products themselves. In the same year Avon extended its operations to Urumqi, the capital of Xinjiang, which later became Avon's fastest-growing market.

In China, Avon's target was the mass market consisting of teen to middle-aged women with adequate discretionary income. It succeeded in China, up until the April 1998 ban, for the following reasons:

- Avon had brand recognition throughout Asia. Many Chinese had learned about Avon from its television commercials in Hong Kong.
- In China, Avon was synonymous with direct selling. Its reputation also came from how it treated sales representatives and employees and its ethical business practices. Avon also taught hygiene, proper dress, and other values to the sales representatives and district managers. More important, Avon taught them personal empowerment and a balance between work and family responsibilities. The company was even able to attract college-educated women into becoming Avon Ladies.
- Avon distinguished itself from other direct selling companies. It used a single-level structure. There was no expensive starter kit that the sales representative had to buy. Avon district managers trained the sales representatives, and then the sales representatives functioned semi-independently afterwards. That is, they took orders, picked up products, and distributed them. There was no product-introduction party necessary or large motivational training conference involved.
- Avon in China specifically promoted the idea of using skin care or make-up products to bring fulfillment and self-confidence to women. Other marketing techniques included a nationwide talent contest. By Chinese standards, this was a rather bold approach. Although it was first greeted with suspicion or even rudeness, the public later accepted it. Avon also reached its goal of raising public awareness of the company.
- Avon in China had strong leaders and talents. For example, Bill Pryor, the former president of Avon in Japan, came out of retirement to work with the company's China sales effort. Andrea Jung, Avon's current President and Chief Executive Officer, was named eighth among *Fortune* magazine's list of the 50 Most Powerful Women in the United States.
- Avon in China had modern offices and facilities. The company imported modern technical and management know-how in production, packaging, computer, and delivery systems to manufacture and distribute products in China. Some of the company's operations incorporated offices, production workshops and warehouses to promote efficiency.
- Avon's ability to build businesses in the markets of developing economies was a key to its success.
- Avon provided enticing export opportunities for the Chinese government. The company planned to export products and ingredients from China to other Asia-Pacific countries, the United States and Europe.
- By manufacturing in China, Avon avoided paying high tariffs, which amounted to 120% of the wholesale cost. Other foreign brands did not always seek a similar advantage.

The company had to meet several challenges in developing its business in China. In its initial years in China, Avon was able to source only 10% of its suppliers from local manufacturers and had to absorb the resulting high import tariffs. Because direct selling was new to the Chinese, extensive training had to be provided. Due to the underdeveloped and unreliable nature of the Chinese transportation and postal systems, Avon had to use its own trucks for transporting supplies to the branch offices. These problems hindered Avon's business development. Another problem was the limited supply of qualified managers, and their fast turnover. Foreign companies in China often struggled with compensation problems for expatriates as demand for executives in China grows rapidly. Last but not least, bureaucrats at local, regional, and national levels had to approve company actions, and the various levels of bureaucracy were not always in agreement. The ground rules for doing business were frustrating and subject to unexpected changes.

Avon did enjoy great success in China, up to the 1998 crisis, as a result of a combination of business approach, attitude, appealing products, good timing, and an appropriate marketing strategy.

The 1998 crisis and its background

Because foreign direct selling companies were doing well in China from the early to mid-1990s, many local direct selling activities cropped up. The Chinese government gradually recognized the need to control this type of business. In 1995 China ordered all direct selling companies to register with the government, but this order was ignored by most of the indigenous companies. The unregulated market continued to concern the Chinese government because unscrupulous direct selling companies were deceiving the public. A number of companies started pyramid schemes. There were also schemes in which dealers sold products to distributors at inflated prices. A herbal-medicine 'dealer' cheated 2,300 peasants out of US$170 each in a direct selling operation. In an incident in Hunan Province, 10 people died and more than 100 others were injured when disgruntled representatives in some direct marketing companies rioted. Many indigenous direct sellers went out of business, leaving their dealers with overpriced goods of no interest to consumers.

There were other reasons that the government was concerned about direct selling. First, the government thought that direct selling provided supervisors and district managers with too much freedom to travel around the country. Second, the Chinese government was concerned that there were individuals using the pyramid method to exercise influence on the public and perhaps engage in a scheme to establish sects and cults that could be a threat to the social order. Motivational seminars given by direct selling companies were criticized as superstitious and as encouraging 'excessive hugging.' Mary Kay had to eliminate the word 'God' from its promotional slogan in China and had to stop hiring teachers, soldiers, and party members. Third, the position of sales representatives was perceived to be of relatively low professional status in China. Pursuing such a job lowered the overall image of the primary professions of individuals holding other positions. Fourth, direct selling was enthusiastically received by women who worked in the traditionally more highly respected professions in China, such as education, health and medical care, and the civil service. The notion of earning extra income seemed to reflect dissatisfaction with their current income, and the desire for more money contradicted Communist economic ideology.

These events culminated in a State Council's decision to ban direct selling on 21 April 1998. The new regulation also required that these companies change into conventional retailing and that their distribution centers be converted into retail outlets by 31 October 1998, or they would lose their business licenses. An apparently contradictory existing government regulation, however, prohibited foreign companies from conducting retail business in China.

Charlene Barshefsky, the US Trade Representative, discussed the problem with both company executives and Chinese government officials on a visit to China shortly after the ban was issued. The US companies hoped that Secretary of State Madeline Albright would also discuss the subject with Chinese officials when she visited China, but this did not happen.

The Chinese government did subsequently indicate that it might again allow direct selling in the future. But this did not alleviate the immediate problem, and it is estimated that the ban against direct selling would cost US direct marketing companies a total of US$2 billion in sales.

In the meantime, the US direct sellers had to decide on both immediate courses of action and longer-run strategies in response to the ban. Avon chose to cease sales operations in China immediately, and concentrate on planning for a new approach. One of its competitors decided to continue its direct sales efforts temporarily, perhaps until the October cut-off date.

It was not until 2006 that the direct-selling Avon model was authorized in China. By then, the effects of the 1998 ban and Avon's reactions to it had determined the options still open to the company to pursue in the decade of the 2010s (as discussed in Avon Products, Inc. (B) in Chapter 7).

Questions

1. In what way does Avon follow a global strategy? Does this experience indicate that it should pursue a different strategy?
2. What options did Avon have in responding to China's ban on direct selling?
3. What effects will the use of traditional retailing in China have on Avon's overall marketing strategy?
4. What actions and organizational changes are required by Avon's new marketing strategy in China?
5. What are some other tactics and strategies that Avon could pursue in China?
6. What cultural dimensions of the Chinese people would affect the future success of Avon in China?

CASE STUDY 4.2

Woberg Company

The Woberg Company, located near Aarhus, Denmark, manufactured dishwashers and garbage pulverizers for home use, and cooking equipment and commercial pulverizers for restaurants. A relatively young company, its products were highly regarded by housing contractors and builders. The company had a reputation for quality construction and for good and prompt after-installation service.

Although sales were still growing, the managing director of Woberg, Oli Woberg realized that the Danish market was limited and would level off within a few years. There is a relatively small population and it is not growing appreciably. Therefore, he proposed exploring the possibility of exporting as a way to maintain growth.

The Copenhagen Business School was holding a two-day seminar in Copenhagen, the national capital, on opportunities for export by Danish companies. The director of marketing, Pernil Woberg, along with her assistant B. Woberg, decided to attend this seminar to see what these opportunities were and what types of assistance would be available to a company such as Woberg Company, which had no export experience at all.

One of the presentations at the seminar was by Michelle Akory, an expert on export marketing and a visiting university lecturer from New Zealand. Among the items that Ms Akory gave to the seminar participants was a listing of potential mistakes made by new exporters. This list is reproduced below:

1. Failure to obtain qualified export counseling and to develop a master international marketing plan before starting an export business.
   Correction: Get qualified outside guidance.
2. Insufficient commitment by top management to overcome the initial difficulties and financial requirements of exporting.
   Correction: Take a long-range view and establish a good foundation or do not get involved.
3. Insufficient care in selecting overseas agents or distributors.
   Correction: Conduct a personal evaluation of the personnel handling your account, the distributor's facilities, and the management methods employed. Remember, your foreign distributor's reputation is your company's reputation wherever he represents you.
4. Chasing orders from around the world instead of establishing a basis for profitable operational and orderly growth.
   Correction: Concentrate efforts in one or two geographical areas at a time, then move on to the next selected geographical area.
5. Neglecting export business when the domestic market booms.
   Correction: Make a long-term commitment to export business and do not neglect it or relegate it to a secondary place when the home market booms.
6. Failure to treat international distributors on an equal basis with domestic counterparts.
   Correction: Do not isolate your export distributors from domestic programs. Expand institutional advertising campaigns, special discount offers, sales incentive programs, special credit-term programs, and so on, to include foreign distributors as equal partners. Otherwise, you run the risk of destroying the vitality of overseas marketing efforts.
7. Unwillingness to modify products to meet regulations or cultural preferences of other countries.
   Correction: Modifications necessary to be legal and locally competitive are best made at the factory. If modifications are not made at the factory, the distributor must make them – usually at greater costs and, perhaps, not as well. As a result, the added cost may make your account less attractive for the distributor and less profitable for you.
8. Failure to print services, sales, and warranty messages in locally understood languages.
   Correction: Print instructions, sales messages, warranty, and so on, in the local language. Just think how it would be if operating instructions on your new camera were in Japanese.
9. Failure to consider use of an export management company or other marketing intermediary.
   Correction: If the company does not have the personnel or capital to invest in experienced export staff, engage an appropriate intermediary.

Questions

1. Evaluate the nine 'common mistakes' in terms of their relative importance and impact on a company such as Woberg.
2. What types of assistance from the Danish government and the European Union might be helpful in making a decision regarding whether, and how, to export?
3. Assume that a company similar to Woberg was a national company located in your home country. What types of assistance from your national government, and any subnational government bodies, would be available and useful for the company in making decisions regarding export? Discuss.

CHAPTER 5

Market selection: definition and strategies

Learning Outcomes

In Chapter 5, we discuss:

- the processes for determining what foreign markets to enter and what direction to take in those markets:
  - alternatives are presented here as dichotomous – endpoints of a continuum – for discussion
  - specific company approaches often lie between the end points
- market selection: what product(s) for what potential market(s):
  - approaches: reactive versus proactive; expansive, contractive
  - market segmentation: differentiation, attractiveness of market, company's competitive position
  - fit between market requirements and company's offerings/capabilities; possibility of changing products and/or market
  - need to consider the place of each product and each market in company's overall portfolio
- marketing direction for existing products:
  - position for each product in each market
  - decisions to build, hold, divest
- evaluating overall foreign market portfolios

There are three cases at the end of the chapter. Sweden's IKEA (Case 5.1) and 7-Eleven Japan (Case 5.2) are both companies that have stressed innovation and have successfully adjusted to the varying opportunities and requirements of their foreign markets. Better Way Company Limited (Case 5.3) has been very successful using direct selling and offering quality cosmetics products with an Asian appeal in its home market in Thailand. It is now expanding to other markets in lower-income countries, Southeast Asian nations, and is considering entering more developed countries.

Introduction

The aim of this chapter is to describe alternatives of international, especially export, market strategy decisions and the base of export competition. It deals specifically with the company's selection of international markets, that is, the number and types of countries and market segments. Although the orientation of this chapter is strategic in nature and is aimed at export marketing, the discussion applies equally to non-export entry modes, when entry by such methods is for market penetration (i.e., serving a market) rather than for sourcing.

In ensuring an effective international and export marketing strategy, the process of market selection and direction has at least three major implications for export managers. First, the marketer should not focus only on individual products and their foreign markets; there is the need to consider the role of each product and/or market within a company portfolio. Second, in addition to the traditional focus on the detailed issues of segmentation and differentiation, the process of market selection needs to focus also on the broader strategic measures representing the overall attractiveness of a market and the overall competitive position of the company in that market. Third, export marketers have a key role in the strategic planning process, since many planning tools depend heavily on marketing concepts such as market share, market definition, segmentation, positioning, customer relationship management (CRM), and the product life cycle. On the one hand, the export manager needs to contribute the more detailed view of foreign markets that strategic planners by necessity cannot have. But on the other hand, the export manager also has to use aggregated measures in order to communicate effectively with company strategists.

An important step in formulating an international marketing strategy is *export market selection*: 'The process of opportunity evaluation leading to the selection of foreign markets in which to compete.' This process requires an appraisal of the fit between a prospective market's requirements and a company's ability to meet those requirements (or conversely, the company's ability to alter the requirements of the market). In addition, market selection cannot be decided on purely marketing grounds; broader considerations of the company's skills, capabilities, and goals require that the market selection process has to be placed in the context of an overall strategy. Exhibit 5.1 presents some examples of insufficient and overlooked markets.

A second decision in marketing strategy, closely related to market selection, is *export market direction*. Should the company seek to *build*, *hold*, *divest* or *abandon* its position in a given foreign market? This decision is almost inextricable from that of market selection because the factors that determine a country's degree of attractiveness for selection are highly relevant to the decision on the company's direction in that market. Furthermore, the build option often leads to selection of additional export markets while the end point of the divest option is the dropping of a market altogether.

A major aspect of the market selection process is the sequence of market entry. That is, which country should be entered first, which one second, etc. This is applicable to a firm's initial entry into foreign markets as well as expansion decisions of firms already doing business in foreign markets. The wrong entry sequence could have a negative effect on the success of entry. At the very least, it would delay any meaningful profits to be earned; at the extreme, it could ruin foreign market entry and cause a firm to withdraw from those markets already entered.

Exhibit 5.1 Insufficient and overlooked markets

One of the worst errors a company can make is failing to determine if a market exists for its product(s) or service(s) prior to market entry. The market may not be as promising as anticipated or there may have been inadequate market assessment studies performed. For example, Asia represents a problem in assessment in market size as the exact size of its middle class is difficult to measure, as purchasing power and tastes vary. A case in point is China. Lee (2010) estimates China's middle class at between 100 million and 200 million, whereas Adler (2008) puts the number at 197 million. Another example is India where Lee's estimate of the middle class is 300 million while Adler states it as 100 million. Table 5.1 shows for the year 2008 the size of the middle class and what proportion of the total this represents for the selected markets.

The countries with the largest growth in 2008 were China, India, Russia, and the United States, and the countries projected to have the largest-sized middle class in 2025 are China, United States, India, and Japan (Adler, 2008, p. 23). In 2014, of the larger countries, India and China still stand out with growth rates of around 7.4% growth in GDP (CIA World Factbook, 2014). Notably several African countries such as Chad, Ivory Coast, and Mozambique grew even faster in 2014. Other notable high growing countries were Qatar (6.5%), Laos (7.4%), Myanmar (8.5%), and top scorer Macao (11.9%).

The other side of this is *overlooked markets*. An example would be the 4 billion people worldwide who live in abject poverty, subsisting on less than US$1,500 per year. To some foresighted companies such as Hewlett-Packard and Unilever, and Citibank, these are underserved markets in Africa, Asia, eastern Europe, Latin America, and the Middle East where a profit can be made while having a positive impact on the sustainable livelihoods of people not usually considered potential customers. These people rarely have extra cash,

Table 5.1 Size of middle class – 2008

Country	Size of middle class (millions)	Proportion of total population of middle class (%)
United States	271	91
China	197	15
Japan	108	85
India	100	9
Germany	62	75
Russia	48	34
United Kingdom	48	80
France	48	78
Italy	46	80
Brazil	43	23
South Korea	33	67
Indonesia	28	12
Australia	17	85
Thailand	17	26
Taiwan	17	72
Philippines	12	17

Source: Adapted from Adler, 2008, p. 21.

often live in remote areas where they shop at small kiosks, and many have low literacy. In order to be successful, companies will be required to form unconventional partnerships – with entities ranging from local governments to nonprofit organizations to pop stars – to gain the community's trust and understand the environmental, infrastructure and political issues that may affect business. Being able to provide affordable, high-quality products and services often means new approaches to marketing – new packaging and pricing structures, and using unfamiliar distribution structures. In order to learn about this rather large global segment, traditional marketing research techniques will have to be modified and adapted to the population. For example, where literacy is low, researchers should use visual rather than numeric and verbal scales. In 2006, Prahalad published the famous piece 'The Fortune at the Bottom of the Pyramid' in which he discussed the assumptions that business people make about catering to the poorest segments in the developing world. One of the main conclusions is that many of the assumptions which hold firms back are mistaken, and firms can indeed purposefully target these segments as a viable business opportunity.

There are many examples of individual company market entry mistakes based on insufficient markets (Ricks, 1999). Two examples are given below. A United States manufacturer of cornflakes tried to introduce its product in Japan, but failed. The Japanese at the time, it turned out, simply were not interested in the general concept of breakfast cereals. CPC International met some resistance when it tried to sell its dry Knorr soups in the United States. Even though the company had test marketed the product using a taste test, such a test was not capable of detecting the American tendency to avoid most dry soups …

The lessons to be learned are few and simple. Never assume that a market is of sufficient size to make it profitable to enter just because it has a large number of people. There is no substitute for performing a formal analysis of a market. Spend the time to research and analyze a potential market, including visiting the market. Formal market analysis is discussed in Chapter 6.

Together with strategies for and choices of market entry and operating decisions, market selection and direction are perhaps the most aggregate of export marketing issues. The marketing mix transforms these high level decisions into concrete policies. Segmentation, positioning, and differentiation are some of the traditional analytical tools applied in developing the marketing mix.

For both market selection and market direction, the importance of analysis done prior to commitment to international expansion cannot be stated too strongly. This analysis (an *external* analysis) needs to focus on the targeted markets themselves. To illustrate, a study of external factors in the decision of United Kingdom industrial companies that were international in scope to enter a new foreign market looked at the impact of five broad external factors that potentially could affect that decision (Whitelock and Jobber, 2004). The factors were: (1) the country environment, (2) psychic (or geocultural) distance, (3) market-based factors, (4) competition, and (5) information and market knowledge. The findings revealed five factors that were important in discriminating between entry and non-entry (in order of importance):

1. Developed economy
2. Good market information
3. Unsympathetic government attitude
4. Geocultural/political similarity
5. Attractive market

According to these researchers, their results support a marketing strategy-based theory of market entry (Whitelock and Jobber, 2004, p. 1450), which was discussed above.

Equally important is an *internal* analysis of the company's abilities to support the expansion. This approach is discussed in Exhibit 5.2 in the context of the direct selling industry but it is applicable to all companies.

Exhibit 5.2 Analysis for international expansion

External analysis

The external element of the analysis should focus on the targeted markets and their characteristics, both those common to a company's current operations and those unique to the market. Specifically, there is a need to evaluate the potential of the market for the business in the areas of population size, economic environment, stability of currency, political stability, and receptivity to market entry by foreign companies, including investment.

A company should also look at the successes and failures of other companies in the industry and their efforts within the country being analyzed. What did they do successfully, and can one emulate those actions? Perhaps more importantly, what did they not do successfully and what can be learned from it?

While most countries targeted for international expansion would be expected to have a good size population base, a key question is: What percentage of the population can afford the price of our products or the cost to participate in the business as an independent representative? If this percentage is low, then a company will run the risk of entering a market that does not have as much potential as it may seem on the surface.

Language and other cultural differences also affect the success, or lack thereof, of an international expansion. Do brands and brand names translate effectively into the local language? Are there any negative connotations attached to the company's brand or product names that could send an unintended message to local consumers? Does the very nature of the product offering favorably reflect the cultural norms and values within the market? Perhaps most important, will the product or service provided be viewed as unique, distinct, and representing value from the perspective of the local consumer? If any of these questions are answered negatively, or answers are uncertain, further analysis of the market is required.

Internal analysis

In addition to being knowledgeable about the targeted market, it is equally important to know that the resources of the company can effectively support the existing business and the added complexity of an international operation. Rather than similarities, differences are relevant. It is important that managers avoid thinking along the lines of 'We've always done it that way.' The better alternative is to look for ideas that could improve not only the potential for success in the new market(s) but also a solution that might bring an overall improvement to the total business.

A perfect blend

When there is a perfect blending of the components, the results are positive and impressive. In establishing a successful international presence, that perfect blending is the effective implementation of the adage 'Think globally, act locally.' Generally, this is often easier said than done!

While it is important to maintain the essence of the business worldwide, it is equally important to realize that every country is unique and that a country-specific plan will be necessary if growth within the country is to be maximized. The ability to be culturally sensitive to the market, to its values and norms, and to develop an approach with these sensitivities in mind is a major step toward getting things done right.

Finally, it must be realized that the international business is a start-up and should not be expected to be driven in the exact same way or have the same challenges as the larger parent company.

Have realistic expectations

In an international expansion there arises the pressure of time-to-market. However, the scope and importance to the company of replicating itself in foreign markets is great, and allowing adequate time to conduct proper diligence and in-depth analysis prior to making a decision to expand is crucial to being successful.

While time-to-market is important, some flexibility in the timeline should be built in to deal with unexpected delays or other issues that could arise. After all, 'getting it done right is more important than getting it done fast!'

Source: Adapted from Crowley (2006). Reprinted with permission from *Direct Selling News*.

Market definition and segmentation

Market definition is not a mechanical exercise, but a crucial and complex component of export marketing strategy. Correct market definition is obviously crucial for the measurement of share and other indicators of performance, for the specification of target customers and their needs, and for the recognition of important competitors.

Issues of market definition lead inevitably into issues of *market segmentation*. Given the heterogeneity of most markets, segmentation means breaking down the market for a particular product or service into segments of customers that differ in terms of their response to marketing strategies. More formally, market segmentation is the process of classifying customers into homogeneous groups with similar demand and/or preferences (Bruning *et al*., 2009, p. 1500). In the context of international markets, segmentation can be viewed as a process whereby unique customer groups can be identified, whether they are country-based or individual consumer-based groups (Bruning *et al*., 2009, p. 1500). The goal of such segmentation is to identify those persons who show similar behaviors, and thus are more likely to react uniformly to marketing stimuli such as promotion, price, sales techniques, etc. (Griffith, 2010, p. 59). By doing so, the firm can tailor its marketing policies to the need of each specific segment, hoping to obtain greater profits than are possible by following a uniform strategy aimed at the entire market. For example, on the basis of language only, there are French, German, and Italian-based segments in Switzerland. As another example, consider the United States where ethnic background is the basis for many potential segments in different areas of the country including Hispanic, Irish, African–American, Chinese, Italian, Korean, and other Southeast Asian areas. Yet another example comes from China, within which there are wide differences. For China, it should be recognized that it is several fragmented, regional markets that can be further broken down into niche markets based on cities, rural versus urban, types of people, and income levels (Andruss, 2001, p. 11). A growing segment within China is the more than 400 million young people aged 5 through 24 (Gong *et al*., 2004). These youths have power and influence over personal and household purchases. One other characteristic to consider is accessibility. China's rural dwellers are not easily accessed. Trying to take advantage of segmentation on these bases would, at best, be extremely difficult.

So-called niche firms that are internationally oriented do not follow the usual segmentation, targeting, and positioning (STP) process. Rather, they largely depend on resource-based advantages, products that are of high quality (based perhaps on tradition, chance, or production philosophy), and long-term personal relationships and commitment in developing their niche strategies (Toften and Hammervoll, 2009, p. 1388).

A major strength of market segmentation is that it can generate specialization. At the same time, segmentation involves costs, risks, and possible weaknesses in some cases, especially where accessibility is not easy.

In export marketing a common way of defining and describing markets is in terms of export countries. This is only one level out of an immense number of potential market levels. To be of value, analysis of market behavior should be conducted at multi-levels including such dimensions as channels, customer segments, or use occasions as well as the geographic dimension. Market definitions are often made on the basis of only one dimension (e.g., customer groups) which may be in conflict with definitions based on other dimensions (e.g., product function). Competitors also define markets, and their definitions often may not coincide with each other. Ignoring competitors' definitions may result in both lost opportunities and bases for future competitive action.

An analysis of marketing a product or service should be undertaken within every relevant market segment and at higher levels of analysis across market segments, markets, and countries. Evaluating the company's performance or potential for a given product within the boundaries of a market segment provides an indication of the interrelationship among the products offered by a number of competitors. At this level of analysis interest is centered on the individual customer. The single market segment's perception is important to marketers for determining market boundaries. A narrow definition can satisfy the short-term, tactical concerns of the marketing mix.

Product mix (i.e., structural pattern of imports) may also define markets. Green and Srivastava (1985) used cluster analysis to group 80 nations on the basis of their imports (18 product categories, two-digit SITC, were used), and concluded that there are dangers in segmenting international markets on single geographic or demographic bases. The resulting 12 clusters that were identified are not to be viewed as definitive in their own right, but as indicative of complex interactions that occur which help to determine the relative magnitude of different national markets for individual product categories. The findings and techniques used in this study are appropriate for direct investment and associated marketing activities as well as for export market segmentation. For example, countries that import relatively large amounts of a product and which possess a sufficiently large market may represent candidates for direct investment or strategic alliances. Similarly, large countries that might be excluding a product by restrictions (e.g., Mexico's past behavior) may also be potential candidates for direct investment or a strategic alliance.

At higher levels of market segmentation the analysis tends to ignore the individual customer and focuses more on the performance of each product in its relevant market segment. A broader definition of a market then results in a dilution of effort and competence in the business's current activities. Defining product markets and country markets gives rise to the selection of the most attractive combinations of products and markets and thus to resource allocation of *a portfolio of strategic elements*. The broader definition of the market reflects long-term, strategic planning concerns, including changes in technology, price relationships, potential substitute products, potential 'new' markets, and so on. In identifying new opportunities or competitive threats, the market definition must not only reflect *the served market*, for example the customers to whom the business directs its marketing effort, but also those portions of the unserved market that in the long run are critical for the competitive success of the company.

Export market segmentation

The issues of segmentation are at least as important, and often more important, for export markets as for domestic markets. Because of differences in the economic, cultural and political environments between countries, international markets tend to be more heterogeneous than domestic markets. The range of income levels and the diversity of lifestyles and of social behavior are likely to be significantly greater when considering the world as opposed to a national market. The existence of such heterogeneity provides substantial potentials for identifying different segments.

Given limited financial and organizational resources, the export firm should try to identify the most attractive market segments that it can serve in terms of segment preferences, patterns of competition, and company strengths. This offers several benefits including better market opportunities in terms of competitive positioning, tailoring marketing programs to meet the needs of different customer segments, and clearer criteria in allocating marketing funds to the different segments in line with their likely levels of purchase response. But in identifying market segments these benefits have to be greater than the costs of reaching them with the company's marketing strategies.

The success of any market segmentation scheme depends heavily on the choice of variables by which to perform the segmentation (Souiden, 2002). There are many possible ways to segment on a worldwide or regional basis, and applying mixed criteria can create the most meaningful segments. For example, in selling sowing machines the use of the level of economic development (measured by, say, GNP or GDP per capita) as a base for country segmentation could identify export markets with high purchasing power but with no or, at most, insignificant agricultural sectors. Thus, more complex and combined measures have to be used, including, for example, the importance and composition of the agricultural sectors, purchasing powers, education levels, level of technology, buying decision criteria, and so forth.

It is important to note that any decision to segment on a particular basis should be evaluated in terms of the following characteristics.

Measurability

Measurability is the degree to which segments can be *identified* and to which the size and purchasing power of the segments can be measured. In export marketing management, important qualitative indicators such as cultural characteristics are intuitively appealing bases for country segmentation, but difficult to use due to conceptual and measurement problems. Suppose a clothing manufacturer from Hong Kong wanted to export to the European Union countries and was interested in the following two segments based on age: 16–24 years, 25–40 years. The company must be able to identify which potential consumers belong in each group and must be able to measure the size and, say, income of each group. If these age categories do not correspond to those used in the various countries, which may differ among themselves, then it would be difficult to assess the size and purchasing power of each group.

Accessibility

Accessibility is the degree to which the resulting segments can be effectively reached and served. In the case of China, for example, not only is it difficult to access per se its rural segment, but the composition of it also changes as there is migration from the country to the cities, particularly of younger people. Such migration is a characteristic of Asia in general. In export marketing, communication problems pose distinct difficulties in reaching the end user (often also the foreign distributor) because of inadequate language skills, nationalistic attitudes, the difficulties for an exporter in understanding foreign media systems (structure and format), and so on. Continuing with the Hong Kong clothing company manufacturer, are there media that can be used to reach the two segments efficiently and effectively? It is very unlikely there are print or broadcast media that are read or listened to by only members of the segments. Thus, some promotion – or information providing – cost would be wasted. Moreover, there are differences in the segments between the countries.

Profitability

Profitability is the degree to which the resulting segments are large and/or profitable enough to be worth considering for separate marketing attention. In export marketing there can be excessively high costs involved in segmenting markets because of necessary adaptation to local markets' specific needs and demands. Market conditional factors such as the imposition of tariffs or taxes on certain goods create a basis for product modifications. Product conditional factors, such as specific legal restrictions (patent agreements, quality standards, and controls) may also influence product specification and costs. The company has to realize that segmental export marketing is expensive, and there is a trade-off between profits and costs. If costs of export tend to be high, the segments may be approachable by investment or strategic alliance. For the Hong Kong manufacturer one question here is whether the two age segments in the European countries are large enough to warrant spending funds to market its product line.

Actionability

Actionability is the degree to which effective programs can be formulated for attracting and serving the segments. Segments that are measurable, accessible, and potentially profitable are 'worthless' as segments unless marketing programs can be developed and implemented for each of them. In addition, to be effective the segments need to respond differentially to marketing efforts. The Hong Kong clothing manufacturer needs to assess whether it has the resources and organization capable of developing and implementing the needed marketing program(s) for the segments. Profitability will depend in part on how responsive the two segments are to the company's marketing efforts.

Bases of segmentation

A classification scheme of various bases for export market segmentation is shown in Table 5.2. It is evident that the relevance of any particular criteria for segmentation will depend on the specific market situation and company characteristics, and the suggested

Table 5.2 Bases for export market segmentation

	General market indicators	Specific product indicators
Country market level	Demographic and population characteristics	Economic and legal constraints
	Socio-economic characteristics	Market conditions
	Political characteristics	Product-bound culture and lifestyle characteristics
	Cultural characteristics	
Customer market level	Demographic characteristics: age, gender, life cycle, religion, nationality, etc.	Behavioral characteristics: consumption and use patterns, attitudes, loyalty patterns, benefits sought, etc.
	Socio-economic characteristics: income, occupation, education, etc.	
	Psychographic characteristics: personality, attitudes, lifestyles	

criteria are only possible elements to be considered. Two types of segmentation variables are distinguished – *general market* indicators and *specific product* indicators – and these are viewed from both country and customer market levels. General market indicators are those that do not vary across purchase situations, whereas specific product indicators vary with the individual purchase situation or particular product.

It is clear that there are many different bases upon which international markets can be segmented. In addition to 'specific' segmentation (i.e., for a product class or for a company), many schema have been proposed that are more general in nature. One example is a study of consumers in 20 countries on four continents by Dubois *et al*. (2005), in which they proposed international segmentation based on attitudes toward luxury and luxury products. Three segments emerged: elitist, democratic, and distant. The elitist attitude proposes a traditional view of luxury as appropriate for a small elite group. Few people should own luxury products, and it is these products that allow elitists to separate themselves from others. In contrast, the democratic attitude views luxury as available to a larger audience. Everyone should have access to luxury goods. There are no specific restrictions from the democratic segment. Finally, the distance segment believes that luxury is a different world to which they do not belong. Among the three segments, the distance segment is most likely to view luxury as useless and too expensive.

Consumers in the developing countries of Saudi Arabia, Oman, and Kuwait were studied to assess whether meaningful segments could be based on ethical beliefs, Machiavellianism, ethical orientation, opportunism, and trust (Al-Khatib *et al*., 2005). Three segments were identified. *Principled Purchasers* tended to be less Machiavellianistic, less opportunistic, more trusting of others, less relativistic, and perceived questionable actions in a negative light. *Suspicious Shoppers* were less trusting, tended to proceed with caution in their dealings, were somewhat opportunistic, but placed a high emphasis on ethical behavior. Finally, the *Corrupt Consumers* were not trusting, were Machiavellianistic, took advantage of opportunities, were not ethically oriented, and were more likely to act in an unethical manner. Obviously, a company must alter its approach to relationships when dealing with these different types of people. Whether these types of consumer exist in other countries is a question that companies need to answer if they want to segment on the basis of ethicality.

The advertising agency Backer, Spielvogel Bates Worldwide identified five distinct consumer segments globally, based on studying 15,000 adults in 14 countries on five continents. The research they conducted found global similarities in values, attitudes, and actual purchasing patterns. The consumers were then defined by demographics. The first group, called *strivers*, has a median age of 31 and leads active lives. They are under stress most of the time and prefer products and services that are sources of instant gratification. Another group, *achievers*, is also young but its members have already found the success they seek. They are affluent, assertive, and society's opinion and style leaders. Achievers value status and quality in the brands they buy, and are largely responsible for setting trends. The *pressured* are mainly women, in every age group, who find it extremely difficult to manage all the problems in their lives. They have little time for enjoyment. A fourth segment are older consumers who live comfortably, the *adapters*. They recognize and respect new ideas without losing sight of their own values. They are willing to try new products that enrich their lives. Finally, *traditionals* embody the oldest values of their countries and cultures. They are resistant to change, and they are content with the familiar products.

Values have been used to define other broad schemes for consumer segmentation. Although these typically have been developed based on consumers in one country they are purported to be applicable to consumers in all countries. In fact, values tend to reveal cross-cultural differences. One approach to the use of values as a segmentation tool in international marketing involves using the List of Values (LOV), which measures eight values that people feel are relevant to them (Kahle *et al.*, 1987). These values are a sense of belonging, fun and enjoyment, warm relationships, self-fulfillment, being well-respected, a sense of accomplishment, security, and self-respect. Specific application areas for this schema, as well as others, include environmental scanning, product introduction and positioning, and advertising. Studies have been done in many nations of the world in Europe, North America, South America, and Asia (Kahle *et al.*, 1999; Albaum *et al.*, 2010). A similar schema based on values is shown in Exhibit 5.3.

Exhibit 5.3 Core values segmentation

Is it nationality, culture, or personal values that makes, say, Austria so different from China or the Philippines? The answer is: *it depends*. Each of the three factors plays a role in determining the nature and development of global consumer markets. But the relative importance of each depends upon the product/service category the international marketer is dealing with.

Core values are key ingredients in all of this. In a study conducted in the late 1990s Roper Starch Worldwide interviewed 1,000 adults, residing in 35 countries (Miller, 1998). One task was for these adults to rank 56 values in terms of the importance they hold as guiding principles in their lives. Six global values segments were identified, residing in all 35 countries, but to varying extents in each. The segments are:

- *Strivers*: the largest group; slightly more likely to be male, and they place more emphasis on material and professional goals than the other groups; about one in three in developing Asia and one in four in Russia and developed Asia fall in this group.

- *Devouts*: 22% of adults are in this group, which includes more women than men; tradition and duty are very important; most common in developing Asia and the Middle Eastern and African countries; least common in developed Asia and Europe.
- *Altruists*: 18% of all adults fall into this group, with slightly more females then males; are interested in social issues and the welfare of society; median age is 44, making this group older; more live in Latin America and Russia than in other countries.
- *Intimates*: comprising 15% of the world's population, this group values close personal relationships and family above all else; about equally split between the genders; one in four Americans and Europeans fall in this group compared to just 7% in developing Asia.
- *Fun Seekers*: accounts for about 12% of the world's population, although found in disproportionate numbers in developed Asia; the youngest group, with males comprising about 8% points more than females.
- *Creatives*: the smallest, with 10% of the world's population; have a strong interest in education, knowledge, and technology; more common in Latin America and Europe; has a balanced gender mix.

Some values cut across many categories and countries, although most people tend to fall into a particular category. People in different segments tend to engage in different activities, buy different products and use different media for information acquisition. This, of course, is the essence of segmentation, targeting, and positioning!

Source: Miller, 1998.

Values play a role in one other approach to segmentation, which is the approach based on age cohorts. Environmental events experienced during one's coming-of-age years create values that remain relatively unchanged throughout one's life. Such values provide a common bond for those in that age group or cohort. Cohort analysis is known to work in the United States, and Schewe and Meredith (2004) provide an illustration of generational (age) cohorts in Russia and Brazil.

Is there such a thing as a global market segment? The youth segment (15–24 years of age) provides an example. The advertising agency DMB&B studied the cultural attitudes and consumer behavior of more than 6,500 teenagers in 26 countries (Miller, 1995). The results indicated that in the mid-1990s teenagers throughout the world led very similar lives. In fact, they could be viewed as truly global consumers. This is a group that has grown up with MTV. Even though teenagers appear to be a global segment, there will still be regional and local differences that require subtle differentiations in marketing. There are certain fundamental values that teenagers around the globe share, but opponents to the global teenager idea argue that the cultural differences are so prominent that it is very difficult to speak in one voice throughout the world. Another example is segmentation based on gender.

To a company, the relevance of international market segmentation is related to its ability to contribute to company performance. In order to determine this, appropriate measures of performance are needed. A study of 62 segmentation decision-makers in companies marketing to consumers internationally showed that sales growth was viewed as the most important of 16 international segmentation performance dimensions, as

Table 5.3 Importance of international segmentation performance dimensions

Performance dimension	Mean value[a]
Sales growth	6.03
Successful brand building	5.77
Profit	5.65
Market share	5.56
Reputation as successful	5.47
Market development	5.40
Return on investment	5.29
Growth of product portfolio	4.95
Profit to sales ratio	4.77
Share of customer	4.66
Return on equity	4.42
Share of wallet	4.27
New product innovation	4.23
Partnering opportunities with local industry	4.13
Reduced costs	4.06
Extended product life	3.50

[a]Based on a seven-point scale where 7 = extreme importance and 1 = of little importance.
Source: Adapted from Craft, 2004, p. 84.

shown in Table 5.3. Other important measures were successful brand building, profit, and market share.

In addition to consumer markets, industrial (or business-to-business) markets also can be segmented. Generally, this is done on a more macro basis and involves selecting national markets. One such framework allows the selection of specific product sectors and target markets for export promotion. The framework is developed along the axes of existing global markets and related export products of an industrial marketer's home country (Shankarmahesh *et al.*, 2005).

Market selection process, procedure, and strategy

The choice of a market expansion policy is a key strategic option in export marketing and provides the foundation for decisions about the elements of the export marketing mix. Expansion strategies deal with issues on how the company identifies and analyzes the selection of export markets over time, determining the *number* of markets in which to operate and the desired *characteristics* of these markets. An expansion policy can be seen in several dimensions including the nature of market research activities in choosing export markets, the procedures of screening export markets, and the ways of allocating efforts and resources among different export markets. The purpose of this section is to present a framework for analysis of alternative market expansion strategies.

Market selection process: reactive versus proactive approaches

Many companies have moved into exporting and international marketing in a piecemeal and unplanned manner. The *reactive market selection* approach characterizes a situation where the exporter acts passively in choosing markets by filling unsolicited orders or awaits initiatives on the part of foreign buyers, foreign representatives (importers, agents, and so on) or other export change agents who indirectly select the market for the company. The selection process then remains very informal, unsystematic and purchase oriented, making export (and also other types of international) marketing more or less sporadic. With this approach, the exporter is *responding* to a situation that has emerged.

Typical approaches used with passive market selection are inquiries from foreign firms either through active buying on their part or through contacts established by indirect media used by the exporter in the home country for purposes of attracting the attention of foreigners. Exporters may advertise or be listed in national or subnational export directories; they may also participate in internationally oriented fairs and/or exhibitions in the home country. Developing company websites is increasing in importance as we move further into the 21st century.

Market selection by passive means has been primarily used by small and medium-sized exporters with little or no experience even though larger and more experienced exporters may find the strategy useful in certain cases (e.g., when an unsolicited order comes from a market never before exported to by the company). One of the driving motives is short-term profit, which is often provided very easily by the low costs usually associated with filling an unsolicited order.

The *proactive market selection* approach is, in contrast to the reactive approach, marketing oriented. The exporter is active in initiating the selection of foreign markets and the further customer segmentation of these markets. Since active market selection is systematic and formalized, rather heavy organizational burdens are put on the exporter requiring personnel with international experience and access to international market information, including using the Internet, to access potential buyers' websites.

Proactive market selection is a *formal* process. As such it then may involve systematic market research, and even one or more visits abroad, such visits being to assess the potential market. There is another approach to finding markets that is used widely. More or less *informally*, an executive may select a foreign market on the basis of discussion with a business acquaintance who has experience in a particular market or the executive may 'stumble' on the opportunity while on holiday. For every new export market uncovered by systematic market research there are more that are developed on a more intuitive basis. With formal export market research being very costly, this may not be such a bad way of finding some types of markets.

Obviously there are no clear-cut divisions between the reactive and proactive approaches since many exporters will tend to apply the proactive strategy to what are considered primary markets and the reactive strategy to what the company considers to be secondary or marginal markets. Papadopoulos and Jansen (1994) report that many studies have shown that most managers, whether reacting to an inquiry or proactively seeking an opportunity, are heavily influenced by one or more of the following:

- *psychic distance* – feeling of uncertainty about foreign markets, and of the perceived difficulty of finding information about them;

- *cultural distance* – the perceived differences between the manager's own and the destination culture;
- *geographic distance* – proximity.

Exhibit 5.4 gives one viewpoint regarding distance.

Exhibit 5.4 Distance: psychic, cultural, psychological?

When considering which foreign markets to enter, the international/exporter marketer considers many variables. One such variable is how close the potential market area is to the marketer's home country. Although geographic proximity may be a key determinant, often what has come to be known as *psychic*, *cultural*, or *psychological* distance may be even more important. Many exporters and other international marketers prefer to enter market areas that are not too distant from their home markets on these bases. To them, the risk is less when entering a market they might know more about because of similarities between it and the home country.

Over time, the use of these three concepts has become interchangeable by most authors. However, psychic and cultural distance – as originally defined – are distinct phenomena. Psychological distance has been developed as another name for psychic distance as it is now viewed. Psychic distance was defined as the difference in perceptions between buyer and seller regarding either needs or offers (Hallen and Wiedersheim-Paul, 1984), and is strongly influenced by culture. More formally, it was defined as 'the sum of factors preventing or disturbing the flows of information between firm and markets' (Johanson and Wiedersheim-Paul, 1975, p. 308). In contrast, cultural distance was meant to look at differences in language, political systems, educational levels, and other culture-based dimensions. Today, psychic (psychological) distance between countries encompasses differences in many things including culture, history, and economic and industrial development. One way of distinguishing between psychic and cultural distance is to consider the level of analysis (Sousa and Bradley, 2006, p. 52). Psychic distance is measured at the individual level by assessing the individual's perceptions of differences, whereas cultural distance deals with measures at the societal or country level.

In the late 1980s Kogut and Singh (1988) devised a formula to measure psychic distance between the United States and various countries based on Hofstede's (2001) cultural dimensions of power distance, individualism/ collectivism, masculinity/femininity, and uncertainty avoidance. Since then, Fletcher and Bohn (1998) have added the fifth cultural dimension – Confucian dynamism, now called long-term orientation (Hofstede and Bond, 1988) – and modified the formula to measure psychic distance between Australia and a number of countries. The smaller the index number the closer the country to Australia. Examples of the index are United States (0.1), Great Britain and Canada (0.6), New Zealand (0.7), Sweden (8.8), Japan (15.2), Hong Kong (20.5), and Panama (31.4).

More recently, Dow and Karunaratna (2006) have developed a multidimensional approach to measuring psychic distance using stimuli such as differences in culture, language, religion, education, and political systems. These researchers propose that using 'new' scales that measure differences in language, industrial development, and degree of socialism together with education, political systems (democracy), and religion offer promise for better measurement of psychic distance.

Brewer (2007) constructs an index to measure psychic distance based on 15 variables. Using Australia as a base, 25 other countries are used to calculate the psychic distance index. The larger the number, the closer the country is to Australia. Representative index values are as follows: United Kingdom (10.65), New Zealand (10.00), United States (9.90), Canada (6.81), The Philippines (5.19), South Korea (3.75).

Ellis (2008) measured psychic distance, using China as the anchor. He asked informants to rate 55 countries on a scale of 1 to 100 with China anchored as 1. Prior to this rating task, informants were provided with two Chinese-language definitions of psychic distance. Illustrative distance rating values are China (1.00), Singapore (21.36), United Kingdom (26.79), United States (33.43), Australia (36.43), Mexico (44.71), Nigeria (62.50).

Furthermore, several authors (e.g., Shenkar, 2012) have criticized the Kogut and Singh Index (KSI) for (a) assuming that the cultural dimensions carry equal weight, (b) neglecting that the dimensions may be correlated, and (c) assuming that the cultural distance is the same from country X to country Y, as it is from country Y to country X. Several studies have demonstrated these issues to be flaws of the KSI. In response, Yeganeh (2014) attempted to develop an improved cultural distance index, labelled the weighted, Mahalanobian, and asymmetrical approach to calculating national cultural distance. The scale addresses specifically the previously mentioned flaws in the KSI.

Managers must be careful to not assume that there are no major differences between countries that are considered close in psychic distance. A case in point is the United States and the United Kingdom. Using Brewer's index values, the two countries are quite similar: US, 9.90; UK, 10.65. A study of the general public in each country commissioned by *The Economist* in 2008 found more differences than similarities. For example, there were differences in attitudes regarding religion, social values, military action in the Middle East and whether free trade is good or bad.

Going beyond cultural and psychic distance and export marketing was a study on the role of market potential as a moderating force on the role of distance factors on foreign market acquisitions, specifically multinational companies from developing countries in cross-border acquisitions (CBAs) (Malhotra *et al*., 2009). Using the so-called CAGE distance framework (Ghemawat, 2001), cultural, administrative, geographic and economic distances were included. Findings were that cultural and geographic distance factors had a significant negative impact on the number of CBAs, and administrative and economic distances had a significant positive effect. Market potential did significantly moderate the relation between the distance factors and the number of CBAs.

While the distance concepts are fascinating and their influence on international business intuitive, there are also sceptics who argue that most (if not all) distance concepts are either not sufficiently developed or just not that important. Harzing and Pudelko (2015) for example, argue that after accounting for differences in the home and host country contexts the distance concept added very little extra information. The authors argue that international marketers should deeply understand the context of each country, and that this understanding might explain any difference which would otherwise be measured as 'distance.'

Current research regarding the impact of these distances has been mixed. For example, it has been shown that types of alliances, for example, joint ventures (to be discussed in Chapter 9), are influenced when the partners are culturally distant (Kaufmann and O'Neill, 2007). In a study of foreign investments made by west-European MNCs in Central and Eastern Europe it was found that a positive relationship between psychic distance and subsidiary performance was observed only in the absence of market-specific knowledge (Dikova, 2009). Other research has looked at Chinese exporters, and it was found that psychic distance moderates the relationship between foreign market size and the sequence followed in entry of markets (Ellis, 2008). A final example is a study that examined the role of cultural distance in international acquisitions (Reus and Lamont, 2009). Results from a sample of US multinationals were mixed. Cultural distance impedes the understandability of key capabilities that need to be transferred, and constrains communication between acquirers and their acquired units. On the other hand, cultural distance can have a positive effect on acquisition when the parties recognize that understandability and communication affect acquisition performance. What does all this mean? Such distances can have positive and negative effects on international operations of all types. Using distance to influence decisions is no substitute for formal market analysis (to be discussed in Chapter 6).

Market selection procedures: expansive versus contractible methods

When implementing a proactive, or initiative-based, market selection policy, two distinct procedures for screening export markets can be applied: expansive or contractible methods.

Expansive methods

In general, this approach takes as its starting point the home market or the existing market core. Market selection over time is based upon similarities between the national market structures of a political, social, economic, or cultural nature, so that the export marketer expands from one market to the next, introducing a minimum of further adaptation to the product as well as other export marketing parameters. This is a type of experience-based market selection.

Among the national market characteristics either environmental proximity or trade policy proximity can determine the market selection process. In the first case, immediate neighboring markets seem to be the optimal expansion area because of a high degree of similarity in economic, political, sociological, and cultural standing, therefore making the marketing program more or less identical in these markets. Often this policy is referred to as the *nearest neighbor* approach, which is a type of clustering or grouping of markets based on geographic proximity. In marketing to a nearest neighbor the marketer may or may not adapt products and/or segments. The more general clustering market selection method presupposes that a company has one single market that can be treated as the base market area. The base market is selected either because it represents the company's strongest marketing center or because it is intended to turn into the focal point for export marketing. Therefore, the foundation for clustering markets is a marketing opportunity in its own right, often based on qualitative environmental factors measuring how close other markets come to the base.

Striking illustrations are the heavy trade propensity among neighboring countries in the Scandinavian area (Denmark, Norway, and Sweden), the British Isles (United Kingdom and Ireland), the South Pacific area (Australia and New Zealand), and the North American continent (United States, Canada, and Mexico). Other illustrative clusters can be the North African countries (Algeria, Egypt, Libya, Morocco, and Tunisia), Arab Gulf States (Bahrain, Kuwait, Oman, Qatar, and United Arab Emirates), the Andean countries (Bolivia, Chile, Ecuador, Colombia, and Peru), and different Asian countries (e.g., Malaysia and Singapore).

One final cluster can illustrate trade policy proximity as well. This cluster has established a common market and economic union structure. In a European context, the European

Union is a relevant illustration. Being located inside a trade bloc it is only natural for an exporter to look for market opportunities first in markets where Customs duties and other trade policy measures have been or are in the process of being harmonized or eliminated, before looking outside. From a trade policy point of view the exporter has essentially a home market situation in all member countries. Of course, other barriers may still exist, such as cultural and technical barriers.

In choosing a base for clustering markets, other considerations are important. For example, if a company wants to penetrate simultaneously up to as many as five country markets, establishing an export sales branch in one of the markets should be seriously considered. In this case, tax conditions are important elements to look at. A sales office established in a small country such as Switzerland could function as an export base to markets such as Germany, France, Italy, and the Netherlands – each having a high market potential. Because of tax benefits, Switzerland could be the best location for a foreign sales branch but, as a benchmark for clustering markets, the choice may not be particularly good, due to the different national market characteristics that have to be served. On the other hand, choosing a large country such as China as a benchmark for clustering markets in Southeast Asia would be understandable. In marketing terms China is still a 'desert' in that it is difficult to measure, it is not fully accessible and purchasing power is low.

On a more formalized basis, the multivariate statistical technique of *cluster analysis* has been used to group countries that are similar. For example, Papadopoulos and Jansen (1994) used 27 variables representing seven environmental factors to cluster 100 countries into four groups. This study involved use of the so-called *temperature-gradient approach*, in which countries are classified as *super hot*, *hot*, *moderate*, or *cold*, on the basis of a composite evaluation of seven variables: political stability, market opportunity, economic development and performance, cultural unity, legal barriers, physiographic barriers, and geocultural distance. As one moves from super hot to the cold clusters, markets become poorer, GNP per capita declines, economic indicators such as steel and energy consumption decrease, ethnic homogeneity declines, legal and geographic barriers increase, and cultures tend to differ. Table 5.4 lists the countries by cluster. In the years since this study was made, India and Brazil have enjoyed rapid economic growth and might now be rated more highly.

Analyses such as these are quite general, and they are best suited as starting points for individual company analyses. A more product-specific study classified 173 countries and territories on the basis of market potential using seven screening criteria (Russow, 1992). The seven criteria are market size growth (product-specific), trade (product-specific), indirect market size, level of economic development, population density, infrastructure and capital spending. The analysis was done for six products. Cluster analysis applied to data pertaining to calculators, for example, generated eight country clusters.

Closely related to the proximity principles just presented is the analogy principle, which is based on similarities in market trends between markets as related to complementary or substitutable products. When direct market data cannot be collected, indirect data relevant for analogies can be introduced for market selection purposes. An example from the hospitality industry can be drawn from the attractiveness of destinations to large international hotel chains. It is critical for the hotel chain to choose the right locations for their hotels. Research (Assaf *et al.*, 2015) has shown that destinations reap several benefits from attracting major hotels to their areas. There are seven classes of destination characteristics which are important to hotel management when assessing the attractiveness of a destination: 1. Quality of

Table 5.4 Country placement in temperature-gradient clusters

Super hot		
United States		
Hot		
Belgium	Ireland	Norway
Denmark	Italy	Singapore
France	Japan	Sweden
Germany	Luxembourg	Switzerland
Hong Kong	Netherlands	United Kingdom
Moderate		
Argentina	Finland	Portugal
Australia	Greece	Saudi Arabia
Austria	Jamaica	South Korea
Bolivia	Mexico	Spain
Chile	New Zealand	Turkey
Ecuador	Panama	Uruguay
Egypt	Paraguay	Venezuela
Cold		
Brazil	Malaysia	Peru
Indonesia	Morocco	Philippines
India	Nigeria	Senegal
Kenya	Pakistan	

Source: Papadopoulos and Jansen, 1994, p. 42.

tourism infrastructure, 2. Opportunities for tourism, 3. Quality of human resources, 4. Restrictions and regulations, 5. Political stability, 6. Development and cultural proximity, and 7. Price advantage.

Contractible methods

When using a contractible method the optimal market selection starts with the total number, or a large number, of national markets, which are eventually broken down into regional groupings on the basis of political, economic, language, or other criteria. Contractible methods involve a systematic screening of all markets leading to immediate elimination of the least promising markets and to further investigation of those markets that are more promising. In doing so, relevant elimination or 'knock-out' factors have to be stipulated. Two sets of factors, as discussed previously, are: (1) general market indicators and (2) specific product indicators. An example of a contractible method is presented in Figure 5.1.

Although the overall approach appears to be complex, the procedure involves three stages:

1. Preliminary screening criteria for examining countries are identified. The result is a list of feasible countries.

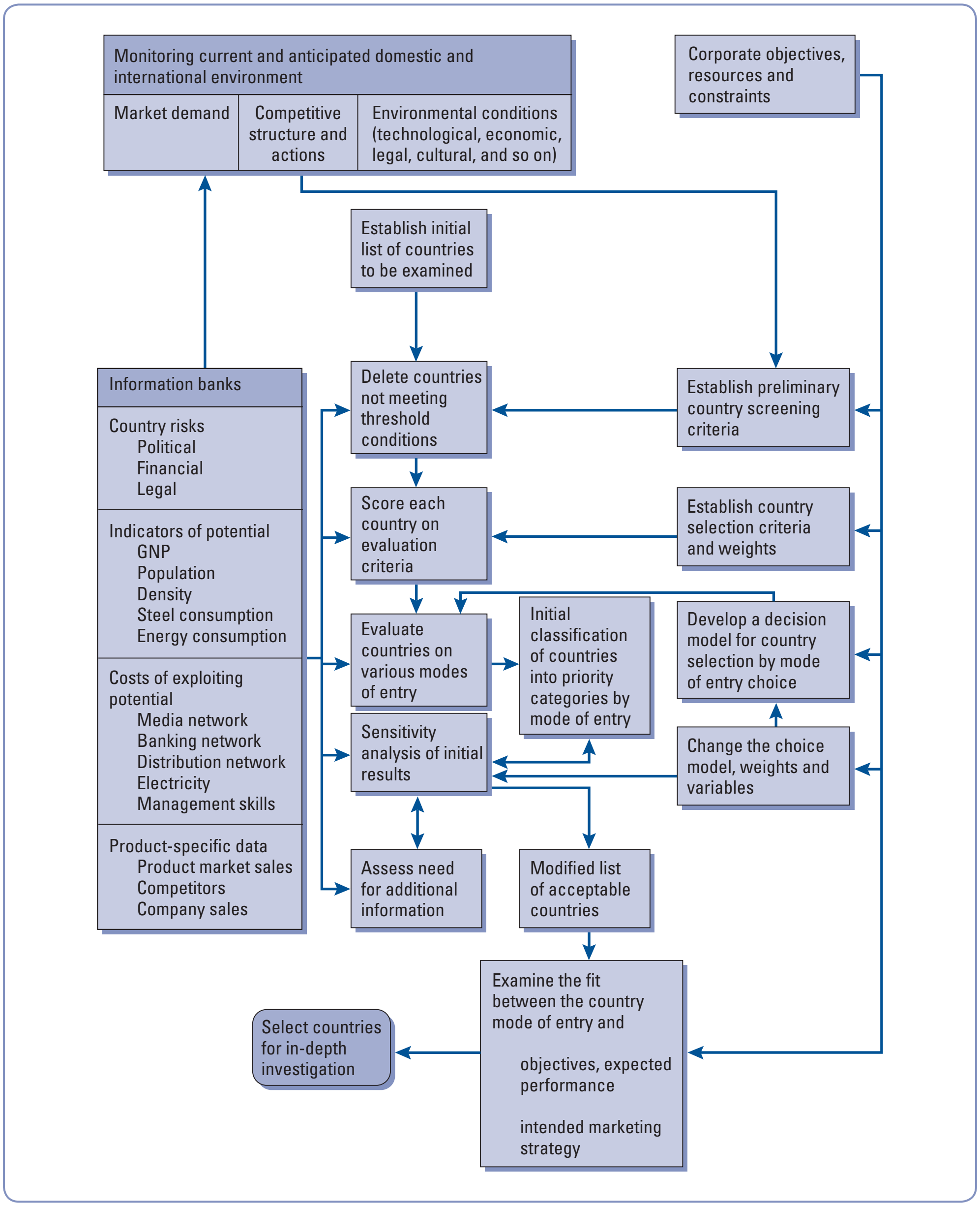

Figure 5.1 **A conceptual framework for country/mode-of-entry selection: an illustration of a contractible method**

Source: Douglas and Craig (1983), p. 111.

2. The second stage determines which country characteristics are to be used in evaluating marketing opportunities and how each should be weighted. Four types of variable are examined: operating risks, market potential, costs, and potential local and foreign competition.

3. Countries are evaluated on the basis of the criteria selected in the second stage, and they are rank ordered on the basis of scores derived.

The end result of this is an ordering of countries such that a number of these can be selected for further in-depth analysis. A similar process is advocated by Root (1994, pp. 55–71), which is based on identifying the country market with the highest sales potential for the company's generic product. Starting with the preliminary screening, industry market potentials are then estimated for a relatively small number of prospective target countries. The last stage is to estimate company sales potentials for the high industry market potential countries. This procedure is summarized in Figure 5.2.

An example of a market screening process is shown schematically in Figure 5.3. The screening of potential markets is organized in a systematic two-step procedure, starting with geographic market segmentation and ending with customer market segmentation.

Step 1: Geographic segmentation

The first screening stage can be further divided into an *information stage* and a *decision stage*, depending upon the proximity of the market and the degree of accumulated experiences the exporter has in collecting data on a set of general market indicators. In addition to geographic indicators as such, demographic, economic, political, and infrastructure market characteristics are also of interest. Since some of these characteristics fluctuate more than others, primary concern should be for the changes and perspectives rather than for past statistics per se. In a world of ever-changing economic policies by national governments and international authorities, it is of the utmost importance that the exporter draws out of the vast information supply in this field what is relevant to the marketing situation faced in order to adjust strategies and policies accordingly.

Apart from general market indicators, a set of product-specific market indicators have to be compared to secure optimal market selection. These data can be divided further into two sets of prohibitive factors: a set of *prohibitive product characteristics* (i.e., product-inherent factors that are obviously in conflict with the above general market indicators for climatic, cultural, religious, or other reasons), and a set of *prohibitive market factors*, that is, when the market itself for various reasons prevents or makes further investigations meaningless because of prohibitions, bans, boycotts, embargoes, import quotas, and prohibitive Customs duties and nontariff barriers. A prohibitive product characteristic would be illustrated by trying to sell a beverage or food product with alcohol in a country where religious beliefs prohibit its use. A prohibitive market factor is exemplified by a company wanting to export a product to a country that has embargoed its importation, or a company wanting to sell to another company in a country while UN economic sanctions were in force.

Specific consideration needs to be given to the economic, legal, and cultural environments. To a large extent the economic environment is the easiest to evaluate as there are quantitative indicators available. The legal environment can be very complex as it covers many areas and differs from one country to another. A company cannot extensively analyze all of the major laws in each potential market. Analyzing foreign cultures can also be a complex undertaking as it involves looking at such things as the people, their attitudes and values, customs and courtesies, lifestyle, and the nation as it relates to the culture. So much of the analysis will, of necessity, be subjective. However, the value of such analysis should not be understated just because of subjectivity.

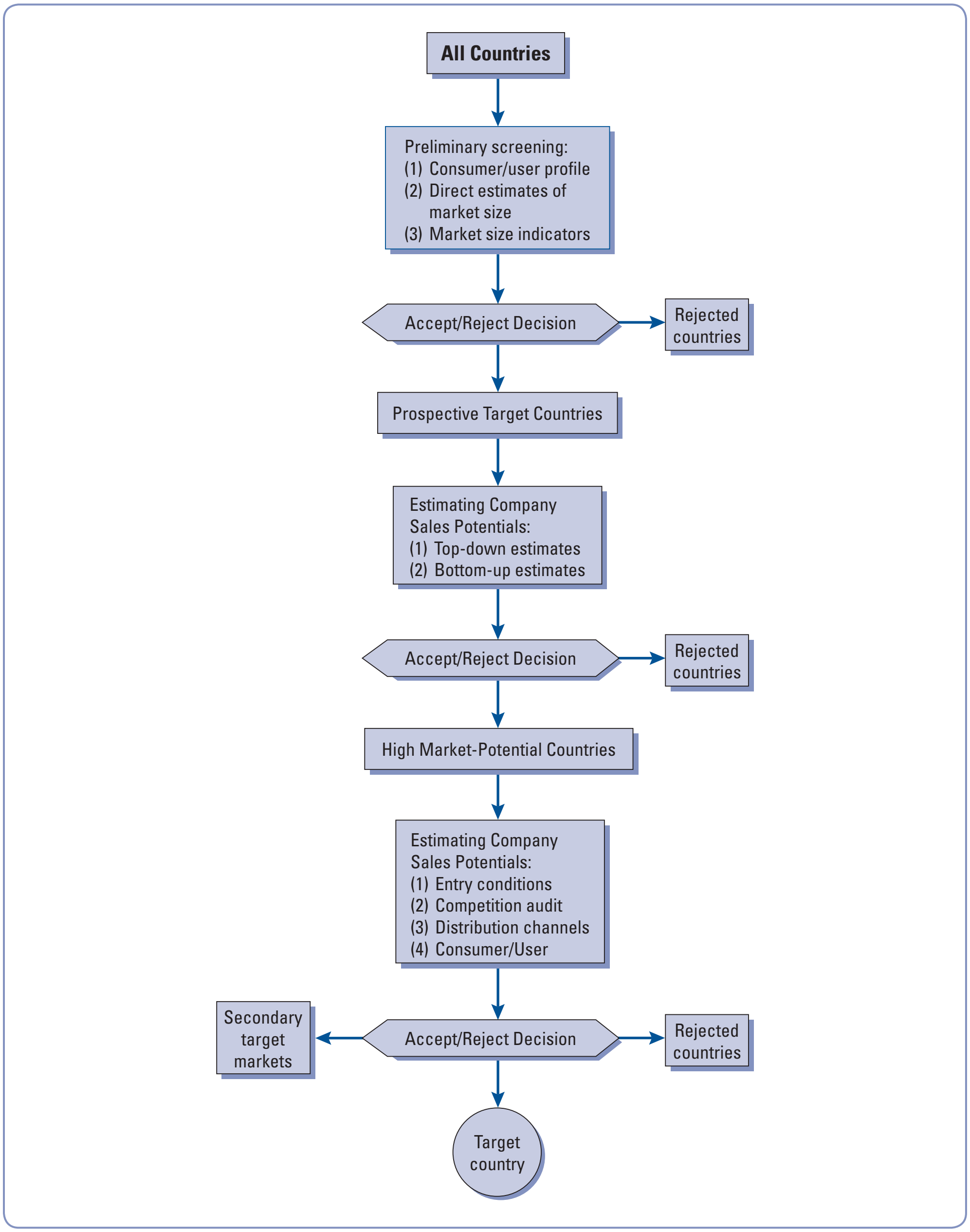

Figure 5.2 Model for selecting a target country

Source: From *Entry Strategies for International Markets*, 2nd ed. revised and expanded, John Wiley & Sons (Root, F. R. 1998) p. 56, Fig. 8, Model for selecting a target country, Entry Strategies for International Markets, 2nd ed. revised and expanded, Root, F. R. Copyright © 1998 John Wiley & Sons. Reproduced with permission from John Wiley & Sons, Inc.

The geographic segmentation based on macro market indicators reduces further the number of potential markets; for the remaining markets the total annual capacity of each market (i.e., market potential, sales, or demand) can be estimated by means of national production, inventory, and foreign trade statistics. These calculations present the exporter

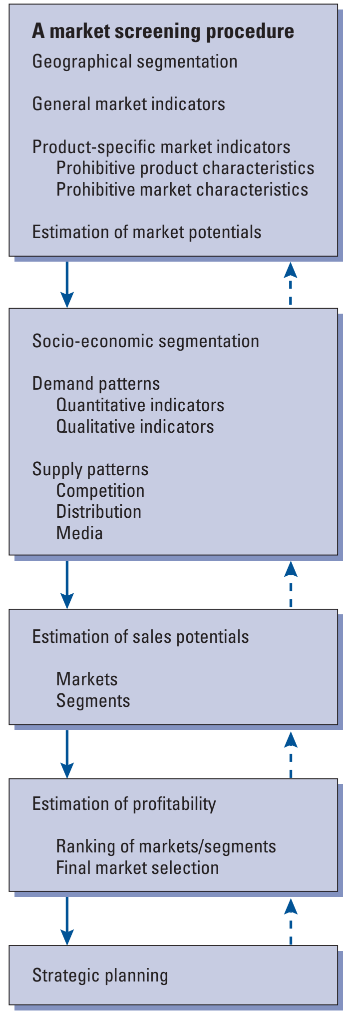

Figure 5.3 Export market selection: a market screening procedure

with a comparable quantitative basis for further elimination of markets in order to decide which of the remaining markets warrants collecting more detailed information (see Exhibit 5.5).

Step 2: Customer segmentation

For the markets that remain under consideration after Step 1, a further segmentation on the basis of customer market data should be initiated in order to establish the final rankings of potential markets. Among customer segmentation indicators the demand and supply patterns are crucial, both being measured by quantitative as well as qualitative data.

On the demand side the characteristics differ considerably between consumer and industrial markets, although for both types of markets psychographic indicators such as behavior,

Exhibit 5.5 Detailed foreign market analysis

A number of so-called indicators (i.e., variables) are relevant for evaluating the export potential of foreign markets. When there is a need for a complete and detailed analysis, each should be examined for its impact on the potential for a given market. In some instances a variable may not be relevant to that market, or its 'value' may not be significant.

In general, the value of an overseas market is affected by its physical characteristics, political tendencies, socio-cultural characteristics, and economic factors. More specifically, indicators would include the following:

- physical geography of the country (area, topography, climate, distances from other countries, geographical division);
- population characteristics and purchasing power (total population, gender and age distributions, income, wealth, purchasing power, social classes, urban and rural groups);
- cultural factors (religion, languages, habits, customs, preferences, values, attitudes);
- resources;
- industries (major ones, location, importance, growth of industrialization);
- foreign trade patterns and partners (exports, imports, patterns of development);
- competition (local, foreign);
- basic infrastructure including transportation and communication facilities;
- financial matters and credit conditions (currency, exchange rates, availability of capital, interest rates);
- marketing channels and business customs;
- government and its restrictions and regulations on trade;
- legal factors (copyright, trademark and patent protection, contract negotiations, etc.).

Relevant past, present, and expected future conditions should be assessed. All significant trends and changes must be included in the analysis.

lifestyle, attitudes, buying patterns, and decision-making must be included. On the supply side competitors have to be characterized according to nationalities, capacities, activities, and so on. In addition, distribution channels have to be identified in terms of such characteristics as availability, capacities, and activities performed. Finally, also on the supply side the media situation has to be presented according to availability, costs, circulation, and priorities.

Having collected data on both the geographic and the customer market level, the exporter should then adjust the findings on market potentials to estimate market share (sales potential) leading to a final ranking of markets based on estimated profitability. Market selection can then be made and those markets not selected can be held 'in reserve' for possible later entry. Specific techniques for assessing market potential are discussed briefly in Chapter 6.

Market selection strategies

The major strategic alternatives of market expansion are *market concentration* and *market spreading*. In previous presentations, the expansion strategy alternatives have been identified by the number of markets. A market concentration strategy has been described as a slow and gradual rate of growth in the number of markets served by a company. In contrast, a strategy of market spreading is characterized by a fast rate of growth in the number of markets served at the early stages of expansion. It is evident that these two strategies represent extremes on a continuum of different expansion alternatives.

The choice of a market expansion policy is a key decision in export marketing and in other international marketing modes as well. First, different patterns are likely to cause development of different competitive conditions in different markets over time. For example, a fast rate of growth into new markets characterized by short product life cycles can create entry barriers toward competitors and give rise to higher profitability. On the other hand, a purposeful selection of relatively few markets for more intensive development can create higher market shares implying stronger competitive positions.

Second, the two market expansion policies lead to selecting different levels of marketing effort and marketing mixes in each market. With the same levels of financial and organizational resources, the allocation of resources to each market will be higher in the case of market concentration strategy than with the strategy of spreading. This has implications for the marketing mix investments in a marketing infrastructure, resulting in greater commitments and controls (and also risks) in the choice of market entry modes, heavy promotional outlays and so on. A strategy of spreading, on the other hand, implies less promotional expenditures and more reliance on foreign distributors (importers, agents, etc.).

Are concentration and spreading synonymous with few and many numbers of markets respectively? In general, export market strategies and plans have been measured in terms of country markets. However, some conceptual and analytical problems with such measurement arise. First, which absolute approach to market numbers should be adopted? If a company is using a concentration strategy, does that mean it is serving only no more than, say, five target markets? A company's ability to sell to several export markets will vary according to the resources and capabilities of the firm, the existence and degree of export market differences, and the extent to which products and marketing efforts are differentiated by markets. Thus, market number can be viewed as a relative concept. For the smaller firm selling to more than, for instance, eight relatively heterogeneous markets, this would not be considered as adopting a concentration strategy. For the larger company, where adaptation costs have only a minor influence on the company's resource situation, eight markets could well represent concentration. Because there are differences – some great, some minor – between the small and medium-sized enterprise and the larger companies, an assessment of whether any company is following a concentration or spreading strategy must take into account the size of the company.

Second, how should the number of markets be conceptualized? In some cases real market differences may be unrelated to national boundaries. In other cases markets differ within national markets and this may be due to differences in socio-cultural characteristics and/or behavioral attitudes. For example, does a company that exports only to the United States – adapting the marketing program to regional and state differences in socio-cultural and economic characteristics – concentrate its effort in contrast to a company exporting the same product to Denmark, Sweden, Norway, and the Netherlands? In this example market numbers are of minor importance. The relevant issue is the degree of market differences affecting the resource allocation of marketing efforts between different target markets (geographical markets *and* market segments).

Instead of using the number of markets to characterize the different expansion strategies, it seems more appropriate to apply measurements on how the *size of the export marketing budget* is allocated between different types of country markets and market segments. There is, however, a positive relationship between numbers of country markets and amount of resources allocated to each market, which means that number of markets cannot be ignored. Exhibit 5.6 shows alternative strategies for allocating marketing efforts.

Because it can be difficult to operationalize how marketing expenditures are distributed among export markets (the distribution of shared costs, costs of entry to various countries and markets, overall transaction costs, etc.), a company, alternatively, can calculate its *degree of export concentration* and compare it over time or with other firms, using the *Herfindahl index*. This index is defined as the sum of the squares of the percentage of sales in each foreign country.

$$C = \sum S_i^2 \quad i = 1, 2, \ldots, n \text{ countries}$$

where C = the export concentration index for the firm

S_i = exports to country i as a percentage of the firm's total exports

$$\sum_{i=1}^{n} S_i = 1$$

Maximum concentration ($C = 1$) occurs when all the export is made to one country only and minimum concentration ($C = 1/n$) exists when exports are equally distributed over a large number of countries. In discussing factors affecting choice of market expansion strategy the following definitions are used.

Exhibit 5.6 Allocation of marketing resources during market penetration

Companies that introduce new products into multi-markets or regions often face a dilemma of how to allocate their marketing resources during entry. Three major resource allocation strategies are available:

1. *Uniform strategy*: a company distributes the marketing efforts evenly among its markets regardless of market development.
2. *Support-the-strong strategy*: a company invests its efforts proportional to the number of adopters in the market or region, at least up to a certain market coverage.
3. *Support-the-weak strategy*: a company invests its efforts proportional to the remaining market potential.

In one study it was found that strategies that disperse marketing efforts – support-the-weak and uniform strategies – are generally superior to support-the-strong strategy (Libai *et al*., 2005). This finding was found to be robust to market conditions and variations on these strategies. The conditions under which a support-the-strong strategy might become more effective include fixed entry costs above a certain level and substantial variance between markets in responsiveness to marketing efforts.

A *market concentration strategy* is characterized by channeling available resources into a small number of markets, devoting relatively high levels of marketing effort and resources to each market in an attempt to win a significant share of these markets, for example, to provide export growth by market penetration. After building strong positions in existing markets the company slowly expands the scope of its operations to other countries and/or customer segments.

A *market spreading strategy* is characterized by allocating marketing resources over a large number of markets in an attempt to reduce risks of concentrating resources and to exploit the economics of flexibility, for example, to provide export growth by market development.

Considerations affecting the choice of export market expansion strategy

There are several major factors influencing the export market expansion strategy of the company. In most cases an explicit choice between market concentration and market spreading is not feasible to reach, because the balancing between various situational factors often leads to strategic decisions in between. But it is important that a company has an analytical framework to assess the match between its export position and the opportunities faced. Such a framework should provide an overall picture, showing whether the company's marketing situation favors concentration or spreading. It is important to note that although there are objective determining factors involved, the strategic option that the company may actually choose depends largely on management's subjective judgement of the degree and type of risk associated with the alternatives faced and with the nature of the company's objectives (profit vs volume). The perception of commercial (economic) and political risks in export marketing, and other types of international marketing as well, is a result of the management expertise in the firm, accumulated export experience, and the availability and quality of information of export market environments, customers, competitors, and so on. For example, doing business in very poor countries (such as the African countries Congo and Lagos) or in dangerous countries (such as Colombia) is perceived as involving such great risk that many firms tend to invest in projects that promise quick profits and/or where profit and return on investment is expected to be quite large (*The Economist*, 2000). Risks involved range from expropriation (including partial government ownership) to sudden changes in government (triggering changes in existing agreements) to economic implosion where needed resources (foreign currency, fuel, etc.) are scarce and the infrastructure is in chaos, to terrorism and concern for physical security. Political risk, which can be viewed as the application of host government policies that constrain the business operations of a given foreign investment operation, has multidimensions. There are transfer, operational, ownership/control, and general instability dimensions. The company's objectives are primarily determined by the driving motives and reasons behind the current export activities.

Arguments for applying a market concentration strategy are drawn from the *power of market specialization*, *scale and market penetration*, *greater market knowledge*, and *higher degree of control* in export marketing. Improvement takes place through the export learning process and the experience curve. Simply, the company gets better at tasks because of improvement in knowledge and expertise dealing with a small group of markets. Gains arise because some problems are recurrent and have to be solved once the experience of export personnel develops, personal contacts are established, influence patterns emerge, and control is increased.

According to Attiyeh and Werner (1979), a marketing concentration strategy can be based on the concepts of critical mass and selectivity. *Critical mass* means that a minimum level of size and effectiveness has been achieved. Typically, profits tend to increase once critical mass has been reached and the exporter is better able to meet the competitive demands of the marketplace. As a company approaches the critical mass threshold, all that is needed to gain a substantial increase in sales and/or profit is a relatively small increase in time and resources. This can be illustrated by a home appliance manufacturer that put a great amount of investment and resources into several European markets, including Germany, with very low profit being earned. After analysis of the German market the company found that by making an additional investment in dealer support, training, and closing a gap in its product line – all of which was a small incremental outlay relative to its prior investments – there was a step-function improvement in profits. Companies typically have limited resources and this means that they cannot be successful in an unlimited number of foreign markets. Hence, there is need for *selectivity* in choice of markets. Over the long term, markets so selected should be developed in a sequence that will best balance resources to be used with requirements for critical mass.

After markets have been evaluated and selected there still remains the matter of how to proceed within each market. This may involve market segmentation. A company needs to specify a time schedule and the resources needed for reaching critical mass in each segment of a market. For example, a number of years ago a company exporting electrical equipment to France decided that the market had a number of distinct customer segments. The company's sequential market development plan, utilizing time and resources, was: (1) shipyards, (2) regional contractors, (3) small contractors, (4) indirect customers, and (5) original equipment manufacturers. For some segments the company set up a sales subsidiary or used regional sales offices, whereas for others assembly operations were established.

The rationale for market spreading is based on the weaknesses of market concentration. Market spreading offers a position of *greater flexibility*, *less dependence on particular export markets*, and *a lower perception of risk and uncertainty* in the international marketplace. Small market shares are gained at low costs.

In Table 5.5 we summarize many of the significant company, product, market, and marketing factors that bear on the relative attractiveness of expansion alternatives. Rarely will all the factors operating for a company point toward one strategy. Thus companies often arrive at a strategy through an evaluation process involving trade-offs.

Product factors

The nature of the product transaction (volume, frequency, and diversity), the degree of product specialization, standardization, software content, repeat purchase, and the stage of the product life cycle influence the choice of expansion strategy. High volume and low frequency products with nonrepeat purchase characteristics may be associated with market spreading. Selling, for instance, heavy industrial systems such as steel and cement plants requires a worldwide perspective in identifying export possibilities. On the other hand, for low-volume and high-frequency products (e.g., a broad range of common consumer goods) the concentration strategy may appear relatively more attractive.

Table 5.5 Export market concentration versus market spreading

Factors favoring market spreading	Factors favoring market concentration
Company factors	
High management risk-consciousness	Low management risk-consciousness
Objective of growth through market development	Objective of growth through market penetration
Little market knowledge	Ability to pick 'best' markets
Product factors	
Limited specialist uses	General uses
Low volume	High volume
Nonrepeat	Repeat-purchase product
Early or late in product life cycle	Middle of product life cycle
Standard product saleable in many markets	Product requires adaptation to different markets
Market factors	
Small markets – specialized segments	Large markets – high volume segments
Unstable markets	Stable markets
Many similar markets	Limited number of comparable markets
New or declining markets	Mature markets
Low growth rate in each market	High growth rate in each market
Large markets are very competitive	Large markets are not excessively competitive
Established competitors have large share of key markets	Key markets are divided among many competitors
Low source loyalty	High source loyalty
Marketing factors	
Low communication costs for additional markets	High communication costs for additional markets
Low order handling costs for additional markets	High order handling costs for additional markets
Low physical distribution costs for additional markets	High physical distribution costs for additional markets
Standardized communication in many markets	Communication requires adaptation to different markets

Source: Adapted from Piercy, 1981, p. 64.

For specialized products, where most countries have only small market segments, the adoption of a spreading strategy is requisite to gain a sufficient share of the market potential. The specialization character of the product can either be due to technology, service, or marketing features.

The software content of the product, for example the service feature, is also important in assessing the market expansion strategies. If the need for customer advice, after-sales service, delivery arrangement, and warehousing is high, a company has to concentrate its resources and marketing efforts to encourage buyers to maintain a custom of repeat purchasing. Especially in industrial markets where buyer/seller relationships based on trust and confidence are important, a foreign manufacturer often has difficulties in gaining credence because of nationalistic buyer attitudes or *buyer* **ethnocentrism**. So in many cases only service-oriented efforts can compensate for not being a local company. In the United States, for example, there are many consumers concerned about the lack of availability of US-manufactured products in retail stores. Consequently, so-called patriotic shoppers are merging (Webb, 2005). The Internet is making searching easier. Two websites that are operational, and serve as good examples of what can be done in every country, are www.madinusa.com and www.howtobuyamerican.com. Individual clothing manufacturers such as American Apparel Company (www.americanapparel.net) and Union Jean Company (www.unionjeancompany.com) also are developing websites to promote their US-made alternatives to imported clothing commonly found in department stores. The Internet will make it easier for similar developments in other countries where imported goods dominate, and where concern for local manufacturing and jobs become more important.

The position that the product holds in its life cycle in each geographical market has implications for the expansion choice. If positions differ largely over a broad range of countries, a successive concentration strategy, where the company penetrates and expands from one market to the next, may appear logical. On the other hand, if product life-cycle differences between markets do not exist, it is meaningful whether the product is in the earlier or later stages of the cycle. For example, in both the introduction and decline stages it seems advantageous to serve as many markets as possible, first to gain experience and volume, and later to maintain volume as the market declines. In contrast, market concentration appears more appropriate in the stages of growth and maturity where price competition becomes stronger.

Environmental factors

The nature of the markets (market size, growth, stability, the degree of market uncertainty, heterogeneity, competition, and loyalty of buyers to suppliers) affects the choice of an export expansion strategy. High market potentials with stable and mature characteristics tend to favor market concentration whereas low potentials together with new and unstable markets are more suited to a spreading strategy. In the same way, when the company can compete on its own terms effectively against competitors, and when major key markets are not dominated by strong international competitors, market concentration may be an appropriate choice.

Also the growth rate of each market is important. When the rate of growth of the industry in each country or market segment is low, a company can frequently achieve a faster growth by diversification into many markets. However, a spreading strategy at the same time can be advantageous for companies with limited resources. High rates of growth in many countries can be accomplished by relying on marketing efforts of independent sales agents, who are interested in promoting the firm's product in their own growing markets.

One environmental factor that can affect choice of strategy, although it tends primarily to affect specific market choices, is buyer **ethnocentrism**, or preference for local products and services. Such bias against imported goods can have a consequence of turning a desired spreading strategy into a concentration strategy or making a concentration strategy more concentrated.

If there are not many fundamental differences in the environmental conditions (there is low market heterogeneity), market spreading appears to be the more attractive strategy.

The same conclusion holds when barriers to entry of major markets (e.g., tariffs) are high and difficult to overcome, and when there is low buyer loyalty.

Export marketing factors

The costs of serving a market, and the nature of these costs, are probably the most important determining factors of the expansion choice. Marketing costs are a result of the nature of the product and the character of the market, and depend, in general, on the chosen entry mode of foreign operation and the need for adaptation to local conditions and demands. Considerations of market entry modes relate to the question of resource commitment to international markets and specify an essential element of distribution strategy in market expansion. Extensive use of independent agents is frequently associated with market spreading, while a resource commitment to sales subsidiaries is a more likely strategic element of market concentration.

However, a major consideration is how a company can achieve and generate the highest sales volume with the lowest marketing costs. This issue is associated with the sales response function for the marketing effort. To the extent that export managers have a good feel for (or knowledge of) relevant sales response of a given product, the better are the possibilities to formulate an effective expansion strategy. The sales response function describes the relationship between sales volume and a particular element of the marketing mix. Two alternative shapes of response functions are common: an S-curve function and a concave function, as shown in Figure 5.4 (see p. 296).

The S-curve function (A) assumes that small efforts of penetration to a new market are beset by various difficulties and buyers' resistance. For example, small advertising budgets do not buy enough advertising to create more than minimal brand awareness. But when marketing efforts and expenditures reach a higher point, any increase in costs will produce a large increase in sales until diminishing returns to the increase of additional efforts are reached, for example, very large marketing expenditures may not produce much additional response because the target market is already familiar with the brand.

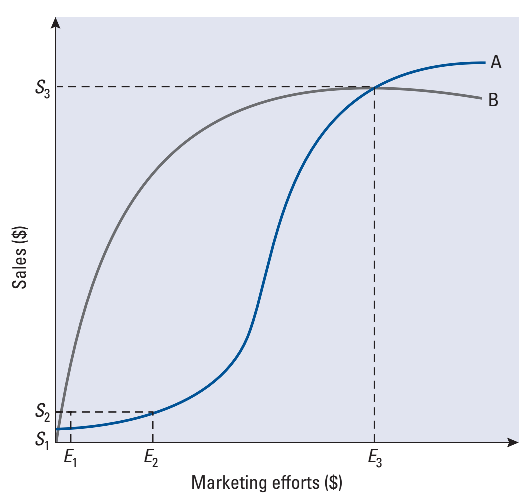

Figure 5.4 Sales response functions: low share versus high market share strategies

The concave function (B) illustrates a situation where sales volume is increasing throughout but at a decreasing rate. This implies that the highest return on marketing effort comes from lower levels of marketing expenditures. This function relationship is based on the assumption that the markets under consideration include a number of customers who are particularly interested in the exporter's product. A unique product in terms of such things as quality, differentiation, and marketing program creates such an interest, but spending additional marketing expenditures only affects sales volume marginally over a given point.

What are the implications for the choice of market expansion strategy? Conventional wisdom often argues that if a company faces an S-curve response function, a market concentration strategy based on seeking a large market share of a few markets usually is preferred. This relies on empirical evidence that shows that higher market shares are associated with high profitability. To provide a high market share often requires a strong resource commitment to a sales subsidiary in export marketing. For many small and medium-sized exporters who are not in a position to increase marketing expenditures to a level where efforts lead to increasing returns in sales response, a concentration strategy may not be feasible. Facing an S-curve sales function, the smaller exporter may use its marketing resources more productively (see Figure 5.4) by spending E_1 costs for sales S_1 in several markets rather than spending E_2 for sales S_2 in one or two markets. This means that there may be advantages in accepting a low market share in a larger number of markets as opposed to pursuing market concentration even in the case of an S-curve function.

On the other hand, when a company believes that it faces a concave response function, there should be a strong motivation to follow a strategy of market spreading. Such a strategy is based on the premise that it is easy worldwide to capture a small (but acceptable) market share for very low marketing expenditures, for example, by extensive use of independent agents. This is an especially attractive strategy for the small and medium-sized exporter where efficient use of a limited marketing budget creates a great market value and gives rise to particular advantages. A small market share over a broad range of export markets is not necessarily a handicap. It can be a significant strategic challenge that enables the smaller firm to compete in ways that are unavailable to its larger rivals.

The above discussion on the type of sales response function a company faces is determined first by the nature of the product itself. Other export marketing factors associated with the choice of expansion alternatives are largely a result of incremental costs and fixed costs of serving the export market. The degree of heterogeneity between various national markets and the possibilities to apply a standardized marketing mix approach determines the kind and the absolute amount of adaptation costs. If the international environment is characterized by fragmented submarkets, which would suggest a need for local adaptation, market concentration appears to be the more attractive strategy.

Another key consideration concerns the level of marketing costs associated with dealing with additional markets. In some cases the incremental costs of communication, distribution, and so on to additional markets may be low. For example, a firm with a good reputation may generate significant export business by using such relatively low-cost approaches as international exhibitions, direct mail or sales catalog, publicity through technical journals, and customer recommendations. Conversely, where the incremental and fixed costs for additional export markets are very high, it is necessary to use such approaches as establishing a sales office, running local advertising, and employing additional sales staff. In general, low incremental marketing expenditures favor market spreading and high incremental costs tend to reinforce market concentration. When examining concentration versus spreading as an appropriate strategy, the same considerations and issues arise when entry modes other than export are being used.

Foreign market portfolios: technique and analysis

As competition for world market shares intensifies in many industries, guidelines and systematic procedures for evaluating foreign market opportunities and threats, and for developing a strategic plan to take advantage of opportunities, are much needed. For the international or export-oriented firm, planning on a country-by-country or even regional basis can result in a spotty international market performance, especially for industries in which major companies are competing on a global scene. There is a need to adopt a worldwide perspective to determine the optimal combination of countries and market segments.

Standardized approach to portfolio analysis

Portfolio analysis is an excellent technique to evaluate the degree and nature of a company's involvement in international markets, where opportunities for improving profitability by reallocating resources and efforts across countries, product lines, and modes of operations, for example, can be assessed. Included among the portfolio models that have been proposed to guide the formulation of marketing strategies are the Boston Consulting Group (BCG) model, the business assessment array, and the directional policy matrix.

The BCG approach to product portfolio analysis is the best known and most widely used of these models. The BCG portfolio analysis centers on two determinants of marketing strategy:

- *market strength* – the relative market share (unit sales of the company's product divided by unit sales of the major competitor);
- *market attractiveness* – market growth rate.

In a formalized product portfolio analysis, each product in the portfolio is represented graphically on a relative market share/growth matrix by a circle, the diameter of which is proportional to the sales volume of the product. By classifying the products into the matrix, four broad categories are distinguished: *stars*, *problem children* (also known as *question marks*), *cash cows*, and *dogs*. Cash cows are expected to be cash generators and problem children are expected to be cash users, while stars and dogs should generally break even in cash flow.

Most of the standardized portfolio models are domestically oriented. The traditional models do not incorporate considerations such as:

- costs of entry to various countries and markets;
- shared costs in international (and export) marketing;
- the risks involved in foreign business operations.

These are all critical issues in developing international, including export, marketing strategies, and managers should consider them explicitly. On the *cost side* exporters may experience price-escalating factors such as transport costs, costs of product adaptation, and restrictions to competition. Furthermore, overseas differences in wages, inflation, exchange rates, tariffs, and government subsidies may have a considerable effect on a company's competitive advantages. The BCG portfolio approach assumes that market dominance (measured by relative market share) is associated with high profitability explained by the existence of experience effects. Competitors with higher market shares are expected to achieve a greater profitability than competitors with lower market shares. However, in foreign markets the association between market power and profitability may not be as valid as in a home market.

Concerning *shared costs* in export marketing, a number of advantages can arise when a company operates in several countries. Prohibitively high R&D costs of developing a new product for an individual market might be spread out over a number of countries and create a higher return on capital of the R&D investment. Establishing an overseas sales subsidiary might function as an export base to other foreign markets, and lowering the entry costs might be economic for multiple product lines in contrast to a single product line.

In all of the standardized portfolio models, the *risk dimension* is not included. The political, financial, and commercial risks (foreign exchange, legal and regulatory risks, and so on) are increased when companies operate in international environments.

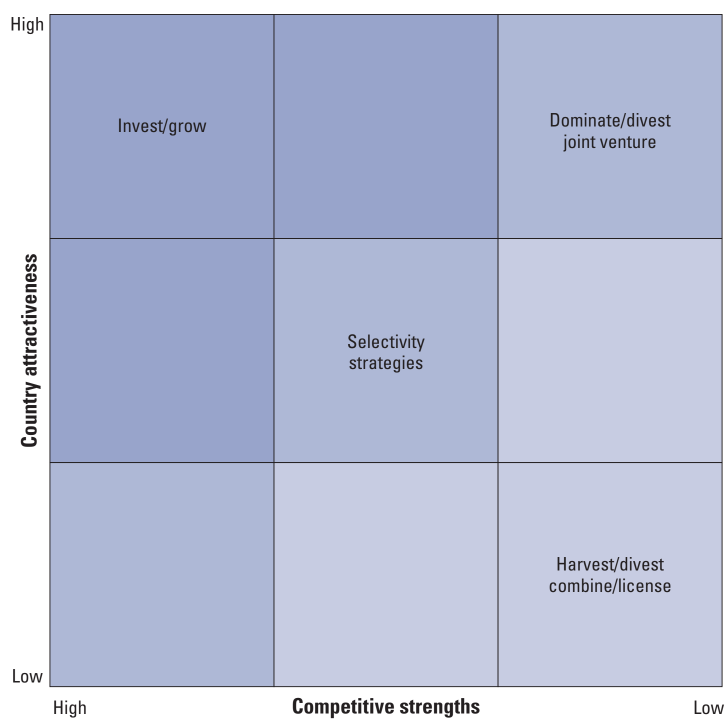

Figure 5.5 **Market portfolio analysis: a country attractiveness/competitive strength matrix**

Source: Harrell and Kiefer, 1981, p. 288. Reprinted by permission of Eli Broad Graduate School of Business, Michigan State University.

Applying a portfolio model to export market selection decisions

Given the limitations of applying the standardized models to international portfolio analysis and since there are some problems in applying such analysis to the needs of small and medium-sized firms (the typical exporting company), an export market portfolio approach should focus simultaneously across a broad range of foreign markets to help balance capital requirements, competitive economies of scale, entry costs, and profitability to gain stronger long-term market positions. An example of such an approach is shown in Figure 5.5. Although this matrix was proposed about 30 years ago, it is as valid today as it was then.

This country attractiveness/competitive strength matrix can be used as an important tool in the process of export market selection and direction (Harrell and Kiefer, 1981). The *country attractiveness/competitive strength matrix* replaces the two single dimensions in the BCG growth-share matrix with two composite dimensions applied to export marketing issues. Measures on these dimensions are built up from a large number of possible variables, as depicted in Table 5.6.

Using these variables, and some scheme for weighting them, countries are classified into one of the nine cells depicting relative market investment opportunity. The flexibility and comprehensiveness of this approach raises some distinct issues in application, as follows:

- The relevant list of contributing factors in any given situation has to be identified.
- The direction and form of the relationship have to be determined.
- Some scheme, whether explicit or implicit, has to be used to weight the contributing factors in each composite dimension. One issue is whether the same weights are used for different countries or markets within the same company.

In using Figure 5.5 in practice each key country would be located on the market portfolio matrix based on the ratings assigned for country attractiveness and competitive strength.

Invest/grow countries

These call for company commitment to a strong market position. A dominant share in a rapidly growing market will require substantial financial investment. Equally important are the investments in people at the country level to sustain a strong competitive position. Product development and modification will be important to match products closely with specific market requirements. Foreign direct investment in sales and service facilities is often

Table 5.6 Dimensions of country attractiveness and competitive strength

Country attractiveness	Competitive strength
Market size (total and segments)	Market share Marketing ability and capacity
Market growth (total and segments)	Product fit Contribution margin
Market seasons and fluctuations	Image
Competitive conditions (concentration, intensity, entry barriers, etc.)	Technology position Product quality
Market prohibitive conditions (tariff, nontariff barriers, import restrictions, etc.)	Market support Quality of distributors and service
Economic and political stability	

required for the sake of rapid market response, delivery, and service, because major competitors will also operate in such growth markets. Marketing support of all kinds should be expansive – related to personnel, advertising, and quality of services.

Harvest/divest/license/combine countries

These often call for strategies to harvest profits or sell the business. Generally, any cash they generate will be required to maintain share; therefore, share generally is given up for profits. Cash flow timing becomes critical. Since the company's market share and competitive position are probably low, and the market is relatively small and the growth low, plans should focus on harvesting near-term profits until the day the export activities are abandoned. Finance should concentrate on frequent cash flow calculations to ensure that variable costs are covered. Pricing policy will be keyed to short-term considerations. By increasing price and reducing the marketing costs, the firm generally can produce cash from those export sales that do occur. Exceptions to abandonment occur when several of these countries can be combined to give enough volume for a sizable export or subsidiary business.

Dominate/divest countries

These present a particularly difficult strategic choice because the firm is competitively weak but the market appealing. Movement toward stronger market positions requires long-term cash flow deficits; divestiture requires the presence of a buyer and cuts the company off from cash and profit opportunities.

The decision demands a careful analysis of cash requirements and cash availability, as well as most of the other factors pertinent to entering a new venture. It would be wise, for example, to match an export market environment with product design strength with one possessing distribution and marketing strength.

Selectivity countries

These present yet another problem. In some situations products in these sections generally are perfect candidates for milking. They produce strong cash flows. In general, in these countries market share will be difficult to maintain even if the company is in a second- or third-ranking competitive position. Competition is extreme and intense. These markets clearly suggest maintenance strategies that build cash flow. On the other hand, if technological and other advantages exist, the strategy may be on building market share.

An illustration of the use of the country attractiveness/competitive strength matrix is provided by the International Tractor Operations of Ford Motor Company. Using ratings assigned for each factor and a specific weighted model relating the factors making up each dimension, Ford Tractor located European countries on the matrix such that the United Kingdom was plotted as having high country attractiveness and high competitive strength, Germany was middle country attractiveness and low competitive strength, and Sweden was middle on both dimensions. Considering other key countries, Ford assessed Kenya and Pakistan as being high on both dimensions whereas Australia and Japan were in the middle on both dimensions. Although this actual application was used many years ago, the worthiness of the model is not invalidated by age. Moreover, it illustrates the creativity that any firm can use when developing analytical models for decision-making.

There seem to be several benefits deriving from using portfolio analysis of export markets. First, portfolio analysis combines the dimension of the company's internal strengths/weaknesses and the foreign market environment's opportunities/threats and focuses on interdependencies among various decisions and the forcing of a tool for resource allocation among alternative strategic market choices. Compared with the traditional model of market selection, where the focus is on a systematic screening of all markets leading to immediate elimination of the least optimal markets, the analysis of the company's strengths and weaknesses enters very late in the selection process, which may mean that some opportunities or threats are overlooked.

Second, the portfolio analysis helps to determine the primary role of each specific export market in the international context. The role may be, for instance, to generate cash, to provide growth, to contribute to production volume, or to block the expansion of competition. Once this role has been defined, objectives can be determined for each export market to ensure that country marketing strategies are consistent with the overall international marketing strategy. It should, of course, be noted that market portfolio analysis is a tool that only provides a part of the total export marketing picture, and therefore other analytical tools and considerations have to be included.

It should be noted that the approach discussed above is as applicable to investment and strategic alliance entry modes as it is to export.

Summary

This chapter has looked at the foreign market selection decision. Export market strategy decision alternatives were discussed. Throughout the chapter available alternatives were presented as dichotomous. This approach was used to emphasize that continuums were involved and that only the opposite extremes were being presented. Individual companies will often develop strategies and policies that lie between these extremes. Indeed, many may seem to have features of each 'pure' strategy.

The chapter ended with a discussion of a type of portfolio analysis applied to foreign market selection and market direction decisions. This analysis is indicative of the kinds of 'creative' management that any company can use.

Questions for discussion

5.1 Strategic export planning requires the development of an effective marketing strategy, including market selection and direction (development). What major implications does this have for the company's export manager?

5.2 Explain the difference between export market selection and export market direction.

5.3 What is market segmentation, and why is it more complex for foreign markets than it is for domestic markets?

5.4 What is the best way for segmenting export markets? Explain.

5.5 Give examples of global market segments and companies that are marketing on that basis. Can small and medium-sized enterprises market successfully to such segments? Explain.

5.6 Explain the difference between a proactive market selection approach and one that is reactive. Is one approach better than the other? Why?

5.7 What are psychic, psychological, and cultural distances? How useful is it to a manager to be able to measure (by index or by scales) such distances between countries? Explain.

5.8 Which distance measure is most important to a manager who is considering foreign markets to enter? Explain.

5.9 Distinguish between expansive and **contractible market selection** procedures. If you were making a decision on such a procedure, which would you favor, and why?

5.10 Differentiate between market concentration and market spreading as expansion strategies. Is one universally better than the other for a given product?

5.11 If sales response functions are S-curves, is it more cost effective to expend a little marketing effort in each of several markets, or to concentrate efforts in fewer markets? What if the response functions are concave?

5.12 Using the variables shown in Table 5.6, develop operational measures of each, specify differential weights that you feel are realistic, and apply these to a matrix analysis (such as that shown in Figure 5.5) of the European Union and ASEAN countries using a consumer durable product of your choice.

5.13 Repeat the exercise stated in question 5.12 for an industrial product. Explain any difference in the resulting matrix from that derived in question 5.12.

5.14 What changes would you make in the variables used in Table 5.6 to measure country attractiveness and competitive strength? Explain why you have added or deleted variables to those shown.

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CASE STUDY 5.1

IKEA

(This case study is adapted from Sharen Kindel (1997). IKEA: furnishing a big world, *Hemispheres*, February, pp. 31–4, used with permission of the author; *Businessweek*, 1997, IKEA's new game plan, 6 October, 99–102; Lisa Margonelli (2002). How IKEA designs its sexy price tags. *Business 2.0*, October, 106–12 and the company website www.IKEA.com); Kowitt, Beth (2015). How IKEA took over the world. *Fortune Magazine*.)

In 1943 a 17-year-old Swedish boy started what was to become a multibillion euro company by selling work pants and other farm supplies door-to-door. Ingvar Kamprad began selling farm implements under the name IKEA, which is an acronym for his name and where he was born. Today Inter IKEA Systems BV is the owner and franchiser of the IKEA concept. IKEA retailers worldwide operate on a franchise basis. As of 2015 there were a total of 318 stores across the world, not including around 40 franchised stores. IKEA Group activities are coordinated by INGKA Holding BV, which is the parent company for all IKEA Group companies and is owned by a charitable foundation in the Netherlands. IKEA of Sweden AB is responsible for the entire product range on behalf of Inter IKEA Systems BV. In the year 2009 the company had a turnover (sales volume) of euro 22.7 billion. IKEA is the world's largest furniture and home furnishing retailer as of March, 2010 (www.IKEA.com, accessed March 3, 2010).

Company history

Well into the 1950s Sweden was a fairly poor country that was still struggling through sharp class differences. Kamprad, who grew up poor during that period, was struck by the notion that beautiful things should not be limited solely to the well-to-do, but should be available to everyone. With that appropriately egalitarian sentiment in mind, in 1950 he decided to add a line of well-designed, functional home furnishings to his list of farm products.

They were an immediate hit. To expand the territory he could cover, Kamprad soon added a catalog, and then a showroom. By 1955, as Scandinavian-designed furniture was beginning to enjoy a worldwide reputation, IKEA began designing its own furnishings. The first IKEA retail store opened in 1958 in Almhult, a village not far from Kamprad's boyhood home. By 1965, when IKEA opened its first store in Stockholm, a 450,000 square foot behemoth, thousands queued for a chance to sample the wares.

While those in the Scandinavian design community embraced Kamprad's ideals of furniture that is aesthetically meaningful *and* available to a wide, non-elite market, it was not until the postwar period that its members began turning out the designs that would win such prestigious international competitions as the Milan Triennale. The international acclaim led the Scandinavian countries to market their home furnishings seriously to the world at large. By this time furniture and household decorative arts that used simple, unadorned, geometric forms had become known as Scandinavian design.

Company operations: tactics and strategy

The problem with Scandinavian design, however, was that it was still too expensive for the average consumer. As a result, several attempts to market Scandinavian furnishings beyond Sweden's borders all failed. Bonniers, a Swedish chain, and Design Research in the United States both came and went in the 1960s and 1970s. But Kamprad, convinced that there was a broad, as yet unserved middle class that would want this beautiful furniture if it was reasonably priced, set out to cut his costs to the bone. In 1997 a line of children's furniture and toys was added.

Price had been the key competitive idea behind IKEA since its inception, but to drive prices still lower Kamprad turned the ready-to-assemble (RTA) concept into an art form by manufacturing parts that can be easily put together. Even today most IKEA furniture can be assembled with only one tool, an Allen wrench, which is generally included as part of the kit.

The RTA proposition also saves money for IKEA on shipping and storage. Most of the company's products are packed in flat boxes, reducing transportation costs, minimizing the risk of damage, and making them easy for the customer to take home. IKEA's RTA approach works, says Jan Kjellman, president of IKEA North America, because consumers realize that 'by doing half the job they will pay so much less than they would at a traditional furniture store.'

Thus IKEA recognized that the value added in making furniture was not necessarily in manufacturing. IKEA designed kits that put the consumer in the middle of the value chain, giving them lots of things to do that were traditionally done by the manufacturer. This took incredible amounts of cost out of its system.

IKEA further reduced its costs by becoming production oriented. The company strives to carry out product development on the shop floor. It sends its ten in-house designers into its suppliers' factories to learn the capabilities and limitations of their machinery so that product designs can be adapted to the machines, instead of the other way around. 'Most designers look at the form and the function, but ours must also look at the price,' explains Kjellman. 'We don't want to make limited edition products. We want to mass produce them.'

Sometimes keeping costs down means that an IKEA design will be made of a lesser-quality material. For example, the company does not hesitate to make a painted tabletop out of a lower grade of wood, or substitute a simpler material for a base that is not seen. And furniture that would be too expensive to make in birch is made out of pine.

While the company aims to provide a good quality product, price is still the main reason that people shop at IKEA. Its furniture, toys, and housewares typically are priced 20% to 30% below competitors.

International expansion

International expansion started in the 1960s when the company was forced to source products outside Sweden. Local Swedish furniture retailers felt that IKEA's low-price policy was unfair competition and they tried to prevent local manufacturers from supplying them with goods. Rather than raise prices, IKEA sourced their own designed goods outside Sweden. Today the company sources its products from 1,800 suppliers in more than 50 countries and contracts for capacity rather than a set number of items from its manufacturers. In some instances IKEA has taken ownership positions in factories that supply it with furniture and household goods. In other cases it acts as a financier, especially in eastern Europe. IKEA also operates 28 distribution centers worldwide.

It took IKEA 30 years to grow beyond its boundaries as a local, seven-store chain and penetrate foreign markets. When it was time to expand, explains Kjellman, 'We decided to go to the most conservative market we could find and that was Switzerland.' With success there, IKEA began a slow, steady expansion that has gradually taken it into northern Europe, especially Germany, central Europe, Australia, and Canada. The market expansion history indicating when the first store was opened in a foreign country and the number of stores in operation as of March, 2010 are shown in Table 5.7. In addition to stores owned by the IKEA Group, there are stores owned by franchisees in 14 other countries/territories as shown in Table 5.8.

During the 1980s IKEA was opening between five and ten stores a year. But expansion slowed considerably in the 1990s as the company consolidated its holdings and worked on increasing per-store sales and raising overall profitability.

Worldwide expansion has brought new challenges, among them the need to gauge demand and then stock accordingly. 'We have had a lot of shortages,' acknowledged Kjellman. 'One of the biggest problems we have faced as we have moved out of Sweden was having enough of the right product in the stores. We underestimated how much we would sell when we first entered the North American market.'

The US market

An even bigger problem that IKEA has had to overcome is its limited name recognition. 'The first thing we did when we entered the United States was to teach people how to pronounce our name,' Kjellman says. To do so, IKEA ran

Table 5.7 International expansion of IKEA Group stores

Country	Year	Number of stores
Sweden	1958	17
Norway	1963	5
Denmark	1969	4
Switzerland	1973	7
Germany	1974	45
Australia	1975	3
Canada	1976	11
Austria	1977	7
The Netherlands	1978	11
France	1981	26
Belgium	1984	6
United States of America	1985	37
United Kingdom	1987	18
Italy	1989	15
Hungary	1990	2
Poland	1991	7
Czech Republic	1991	4
Slovakia	1995	1
Finland	1996	3
Spain (mainland)	1996	11
China (PRC)	1998	7
Russia	2000	12
Portugal	2004	2
Japan	2006	5

Source: www.IKEA.com 3 March, 2010.

ads featuring an eye, a key, and a plus sign followed by the word 'ah.' After this initial campaign the company began advertising its value proposition of well-designed home furnishing at affordable prices in ads that featured the tag line: 'It's a big country. Someone's got to furnish it.' In 1990 IKEA expanded by acquiring five stores owned by Stor Furnishings International in California.

During the period 1985–2002, sales in the United States grew from US$50 million for one store to US$1.3 billion for 17 stores. Its first profit was not earned until 1993. A major reason for this growth is that US consumers view low prices as a given.

Realizing that the United States is a highly mobile society with a large rate of household formation and change,

Table 5.8 IKEA franchisees

Country
Cyprus
Greece
Hong Kong
Iceland
Ireland
Israel
Kuwait
Malaysia
Romania
Saudi Arabia
Singapore
Taiwan
Turkey
United Arab Emirates

Source: www.IKEA.com 3 March, 2010.

IKEA has changed its television advertising to link the value of its home furnishings to easy, affordable lifestyle choices. Kjellman understands that he is not just competing with other furniture chains, but with anyone vying for disposable income. 'We have to convince people that they should come to us to buy a new sofa,' he says.

While establishing its presence in the United States has not been easy, the company has no intention of leaving. The US furniture market is enormous and highly fragmented.

'The United States is the toughest market in the world, but we can learn a lot from it,' says Kjellman. The furniture trends that begin in the United States, such as home entertainment units or home office furnishings, gradually work their way to other parts of the world. By being where those trends are starting, IKEA can develop new designs to meet those trends and then amortize its costs by selling them into other parts of the world.

IKEA's appeal is that its furniture is accessible, approachable, and economical. 'We have met a need that nobody bothered about,' Kamprad says. 'And the response has been fantastic.'

Questions

1. Evaluate the market expansion approach taken by IKEA.
2. Is it better for IKEA to own its factories or to contract for its products?

CASE STUDY 5.2

7-Eleven Japan

(This case study was written by Yim-Yu Wong and Edwin Duerr, both of San Francisco State University.)

Introduction

This case describes how America's innovative 7-Eleven stores ended up being acquired by a Japanese company and how, through continuing innovations under Japanese management, it became the world's leading convenience store chain. It opens with a discussion of current and past actions by the Japanese company that have contributed to its success. The final section covers the insights of that led to the development of a new type of retail store by an American company, and the subsequent events that led to the change in ownership of the company from American to Japanese.

Throughout the discussion, it will be seen that the company has benefited from its ability to: (1) recognize opportunities where others may see potential problems; and (2) continue to lead the industry in innovations. The resulting company policies have led to its becoming the leading convenience store chain not only in Japan, but also in the US and in the world as a whole. In 2010, the company had 12,553 stores in Japan, 6,515 in the United States, 15,841 in the rest of Asia, 1,177 in Mexico, 457 in Canada, 446 in Australia, 191 in Norway, 177 in Sweden, and 129 in Denmark: a total of 37,486. The parent company has no presence in Europe outside of Scandinavia.

As discussed in the final section of this case, 7-Eleven Japan began as a joint venture started by America's pioneering 7-Eleven and a Japanese partner. While the Japanese joint venture grew rapidly in size and profitability, 7-Eleven's American parent company, The Southland Corporation, encountered serious financial difficulties. Southland then sold 7-Eleven Japan to the Japanese parent company, Ito-Yokado. Southland's financial difficulties continued, and eventually it was acquired by Ito-Yokado. With the growth of 7-Eleven Japan, it eventually became larger than its Japanese parent. In a series of reorganizations, the name of Ito-Yokado disappeared and its various components were brought together under a holding company, Seven & i Holdings.

Insights and innovations

In 2009, 7-Eleven Japan Co. Ltd. saw an opportunity rather than a threat in the depressed US economy. While most other American companies were still in the process of cutting workers and plant capacity, 7-Eleven Japan embarked on a major expansion program in its US subsidiary. The program, which will last into 2012, will add 100 new stores in Southern California plus additional new stores in Metro New York, the Dallas-Fort Worth area, Washington, D.C., Baltimore, Northern California, and the Puget Sound area in the state of Washington.

With the severely depressed US real estate market, properties for new stores can be acquired at what 7-Eleven viewed as bargain prices. The company will also benefit from the strong value of the yen against the dollar, making the acquisitions even cheaper in terms of funds from the parent company.

At the same time, the parent company is reducing the number of its outlets in Japan. There, the real estate market has been depressed for 20 years, and an overall economic malaise has kept consumer spending low. Therefore, in Japan the opportunity lies in increasing earnings per store through continuing innovations in introducing new products and services, increased distribution efficiency, improved information systems, and more efficient store operations while eliminating stores where there is inadequate local market potential.

The growth of shopping via the Internet was viewed by Japan's 7-Eleven convenience store chain as an opportunity rather than a threat. Because of conditions in the Japanese marketplace, 7-Eleven Japan was not likely to be able to sell its own food and other products over the Internet. The company could, however, provide a service for the large number of Japanese who did not have credit cards or who had a strong aversion to providing credit card information over the telephone. With over 11,750 outlets in Japan at that time 7-Eleven has stores within a short distance of most of its customers and, in fact, of most Japanese. Their customers tend to visit the stores frequently for relatively small purchases.

Thus 7-Eleven Japan developed a plan to serve as a distribution point for the products of other companies that were selling over the Internet. Customers who wanted goods from an Internet marketer could order the goods over the Internet, and the Internet marketer would ship the goods to a 7-Eleven store near to the customer. The store would then give the goods to the customer when he or she came in, accept payment in cash (as most Japanese customers prefer) or by credit card, and remit the money to the shipper. The ubiquitous and efficient delivery services available in Japan would facilitate quick delivery to the stores, which would, in fact, be easier than locating the often difficult-to-find address of individuals. 7-Eleven would collect a small fee for this service. More importantly, the stores would bring in additional potential customers, or bring in regular customers for additional visits. These customers might buy some of 7-Eleven's own products in addition to picking up their Internet order.

In November 1999, the company started this system of handling merchandise for Internet marketers, delivering goods to customers from their stores, accepting payments from the customers, and remitting the payments to the sellers. They entered into agreements with Softbank Corporation, Tohan book wholesalers, Yahoo Japan, and others to create a venture to sell books and videos using a website on Yahoo Japan. In February 2000 7-Eleven partnered with seven others, including Sony, NEC, Mitsui trading company, and Japan Travel Bureau, to distribute a wide range of products, to provide music and photos online, and to handle book and ticket sales. In another venture, they are involved with Internet automobile sales agencies. In July 2000 they opened a virtual mall named 7dream.com, allowing customers to order goods online and pick them up at the 7-Eleven store of their choice. The services proved to be a great success, increasing the sales of their own products while they also collected small fees from the sellers.

The company has continued to build on its innovations. 7-Eleven Japan was the first marketer in Japan to introduce a point-of-sale system (POS) for merchandise control. The company continually upgrades its information systems, introducing satellite communications in its fifth generation system and now in its sixth generation system. It was also the first to start accepting payments for utility companies, a service now earning commissions on US$6 billion per year. It subsequently started handling insurance company payments for NHK (the national broadcasting company), and many others. 7-Eleven Japan also introduced refrigeration and control systems to keep prepared rice food products at 20 degrees centigrade (68 degrees Fahrenheit) through factory, delivery, and in display cases – a feature much desired by Japanese consumers to preserve the flavor of the cooked rice while inhibiting spoiling.

The company's wide range of services combined with continuing updating of its product line means that on average, each store in Japan attracts 950 customer visits per day.

In 2007, 7-Eleven Japan's parent company became the first Japanese retailer to issue an 'e-money card.' This name is given to cards in Japan issued to specific organizations for use at designated outlets. They may be either prepaid cards or cards linked to a bank account from which money can be immediately withdrawn (like a debit card but it can only be used at designated outlets). The cards have been a success and now other retailers are offering the same type of card. For people with properly enabled cell phones, the phones can be used to make purchases. It is estimated that over 40% of cell phones now have this capability.

7-Eleven Japan continually tracks sales data so as to determine the best mix of products, and make changes in 70% of their products each year. The company develops tie-ins with manufacturers where mutual advantage can be attained in advertising or offerings. It is increasingly looking overseas for suppliers where superior products or lower prices can be attained.

Using its market analyses and expertise in merchandise development, material procurement, and quality control, 7-Eleven Japan developed a range of products combining high quality and value pricing, to be sold under a new private label brand, Seven Premium. It introduced a line with 49 items offered in 2007, and plans to have over 1,000 in this line by the end of February 2011.

How 7-Eleven became a Japanese company

The 7-Eleven chain has a long history of innovation and growth. It was originally a US company that was subsequently acquired by Japan's Ito-Yokado Co., Ltd. The original US 7-Eleven, owned by Southland Corporation of the United States, was designed to meet the needs of the growing number of dual wage-earner families and single workers in the United States who worked nonstandard hours. These people often had difficulty in getting to large grocery stores and supermarkets during the hours that they were open. The increasing affluence in the United States, particularly among the target customers, suggested that they would be willing to pay something extra for the convenience of being able to shop at other times, and preferably 24 hours per day. The company opened a number of outlets, carefully selecting the items to be carried, used centralized purchasing to obtain low prices, monitored sales to improve the mix of products offered, carefully controlled inventories, and used frequent delivery to achieve high turnover in limited spaces.

In 1973 7-Eleven's parent company, Southland Corporation, saw an opportunity in the Japanese market where many other companies saw only potential problems. The Japanese distribution system was very complex with multiple levels of wholesalers and many very small 'Mom and Pop' stores. Compared to the United States there were twice as many wholesalers per capita and over twice as many retailers per capita in Japan. Though many of those in the distribution chain in Japan operated on very small margins, the multiple levels resulted in high distribution costs. Additionally, all participants in the distributions system were notoriously reluctant to change distributors or suppliers.

While many foreign marketers viewed the Japanese market as too difficult to penetrate, Southland felt that they could set up their own marketing chain and operate it more effectively than Japanese competitors who retained their existing systems. Japanese society appeared to be ripe for the 7-Eleven concept. The number of women in the workforce had increased, and most men worked such long hours that they could not visit stores during the regular hours of operation. The typical neighborhood food stores were small and carried a limited range of products, often specializing in only one type of food (fish, or vegetables, or rice, etc.) Traditional housewives were accustomed to visiting local shops once per day to get fresh foods, but the number of households where women had the time to do so was decreasing. Japan was becoming increasingly affluent and people had always been willing to pay extra for convenience. The concentration of the population in a few metropolitan areas, and the widespread use of trains and buses for commuting to major business districts, meant that there were many locations with high traffic volumes.

Japan was still viewed as a very difficult place in which to do business if you did not have the right connections plus detailed knowledge of the legal, political, and social environment. Southland therefore formed a strategic alliance with Ito-Yokado, a large Japanese supermarket chain operator. The joint venture was highly successful, with 7-Eleven becoming the largest convenience store operator in Japan. In an attempt to avoid being acquired by a Canadian company in 1987, Southland sold its shares of 7-Eleven Japan to Ito-Yokado. 7-Eleven Japan thus became Japanese owned. Subsequent financial problems at Southland in 1990 led to the US company selling 75% of its stock to Ito-Yokado. In doing so it turned its approximately 7,000 company-owned stores in 21 countries over to the Japanese company. The name of Southland Corporation, now Japanese owned, was changed to 7-Eleven, Inc. Subsequently, as 7-Eleven stores became the major part of Ito-Yokado, the latter changed its name to Seven & i Holdings. The chains in each country are still named 7-Eleven.

Under Japanese leadership at home

During the period of Japanese ownership from 1987 to the present, the company has enjoyed remarkable further growth and increasing profitability in Japan, and has expanded its overseas operations. The number of its stores in Japan has grown from 3,304 in 1987 to over 12,553 in 2010. Sales per store have steadily increased, market share has increased, and earnings have grown rapidly. On average, each store in Japan now attracts 950 customer visits per day.

Continuing expansion abroad

7-Eleven Japan's profitable expansion in Japan led to its entering a number of markets abroad. One of its early moves was into Taiwan. Taiwan has a high population density, even greater than that in Japan and also concentrated in cities, thus giving easy access to 7-Eleven stores for most of the population. Like the Japanese, Taiwanese have an aversion to giving out information over the Internet. They also cannot, or do not want to, stay at home waiting for delivery services. Thus it is easier for them to pick up items at the convenience stores. 7-Eleven Japan adapts its system to each nation into which it expands, adjusting products, services and distribution systems to meet local requirements and tastes. In 2001, 7-Eleven Japan expanded its virtual mall system to Taiwan.

Thailand's rapid economic growth in recent years, and its concentration of population around Bangkok, made it another attractive market. 7-Eleven Japan's subsidiary there now has the third-largest number of stores in the world.

In spite of its low per capita income, China's enormous population, with large concentrations in major cities and very rapid economic growth that created large numbers of people with higher incomes, made its market potentially attractive to many companies. However, government regulations, concerns about their application and potential changes, and differences in market structure caused 7-Eleven Japan to take a conservative approach in entering the market. They first determined market potential through licensing agreements with a Hong Kong firm that then opened stores in Shenzhen and Guangzhou. When they decided to make an equity investment, they did so in the capital city with local companies as partners. (The great majority of European, American and Japanese companies already in China had entered with local partners.)

In operations, their Chinese outlets are similar in some ways to the approach in Japan. They handle mainly prepared dishes and foodstuffs in lunch boxes, although handling about 20% fewer items. In 2006, 7-Eleven became the first retailer in China to receive a franchise certificate from the Chinese Ministry of Commerce, thus allowing it to begin franchising. This allowed it to expand rapidly to a total of 1,670 stores in China, 92 of them in Beijing 2010.

In the US, in addition to the expansion discussed above, 7-Eleven has made many accommodations and changes to fit the American market. In 2000 it divided its product development department into eight regional groups. Together with local suppliers they develop market-specific products such as corned beef sandwiches in the Chicago area. In 2010, the company has been adding gasoline (petrol) pumps at outlets where this is feasible.

Strategy in China

7-Eleven took a conservative approach in entering the Chinese market, determining market potential by licensing agreements with a Hong Kong firm that opened stores in Shenzhen and Guangzhou. When they decided to make an equity investment they did so in the capital city with local firms as partners. In operations they are similar in some ways to the approach in Japan. The outlets are open 24 hours per day. They handle mainly prepared dishes and foodstuffs in lunch boxes, although handling about 20% fewer items. The per capita income in China is low, but it is growing rapidly and there are increasing numbers of busy people with comfortable incomes in the larger cities.

7-Eleven as of 2013 has around 1,000 stores in China and another 1,000 stores in Hong Kong SAR. Thus Hong Kong has the world's second highest density of 7-Eleven stores after Macau. Some stores are joint ventures and some franchised. In 2006, 7-Eleven was the first retailer in China to receive a franchise certificate from the Chinese Ministry of Commerce, allowing it to begin franchising.

Questions

1. What factors accounted for 7-Eleven's initial success in Japan?
2. What factors accounted for 7-Eleven's continuing success in Japan?
3. Would it appear to be a good idea for 7-Eleven in the US to offer payment services? Why or why not?
4. What might be the reasons for 7-Eleven's not being in most European countries?
5. Is the offering of more services in Japan, including banking, provision of in-store terminals for use by customers, and so on, likely to cause problems for part-time workers in the franchises?
6. Does China offer good potential for further expansion for 7-Eleven?
7. Was 7-Eleven's entry strategy appropriate for China? Explain why or why not.

CASE STUDY 5.3

Better Way Company Limited

(This case study was written by O. C. Ferrell and Linda Ferrell, both of the University of New Mexico. Copyright 2006 O. C. Ferrell and Linda Ferrell. Used with permission.)

Better Way (Thailand) Company Limited was founded in 1988 by Thailand's 'king of direct selling,' Dr Amornthep Deerojanawong and Boonyakiat Chokwatana. Dr Amornthep had worked as a medical doctor at Avon in Thailand where he got the idea to start his own Thai-based cosmetics company. The company has become highly successful in Thailand using direct sales to launch its Mistine cosmetic brand. Although Thai people were not very familiar with the direct sale of cosmetics, within six years Mistine had become the leader in the consumer cosmetics market in Thailand, a market worth an estimated 25 billion baht (US $635 million) and growing at a rate of 5–10% annually.

Better Way began with fewer than ten employees and 100 products. Today, there are approximately 600,000 Mistine salespersons nationwide selling more than 4,000 makeup, skin-care, fragrance, and personal-care products. In addition, the company operates one retail store on the outskirts of Bangkok. Its warehouse is considered the largest cosmetics depot in Southeast Asia with 1,170 regular employee staff.

The company primarily targets women who have a high school, occupational certificate level, or high occupational certificate level of education, and have a monthly income of about US $125–200, as well as working women who have a monthly income of about US $200–300. Mistine's core target group, which accounts for 70–80% of its total revenues, are housewives with low to medium incomes. The company is expanding its customer base by targeting working people, men, and vocational school students, especially working people who have high purchasing power. There are now more than 420,000 customers nationwide.

Mistine positions itself as an Asian company marketing products developed and formulated specifically for the Asian woman. They are designed to blend well with the Asian skin tone and complexion. They are also made to better suit the warmer, more humid climate of the Asian region, so that the product stays on longer and looks fresher.

Mistine's marketing mix

Mistine products are manufactured by the best quality cosmetics manufacturers all over the world. Additional support is provided by Kolmar Laboratories, the largest and most experienced cosmetics manufacturer in the United States. An experienced production team develops hundreds of new and unique products each year, with at least two to three new products launched each month.

Every Mistine product is thoroughly inspected and tested before being delivered to the warehouse. Customers can be assured that they will receive the highest quality products, and, indeed, Mistine will replace or offer a full refund for any product with which a customers is not completely happy. 'Our customer's satisfaction is what we care about the most' is one of Mistine's slogans, which helps it to maintain its leadership in a competitive market.

Direct selling companies normally depend on word-of-mouth to develop brand awareness, recruit salespersons, and encourage product purchases. Better Way decided to do things differently by being the first direct selling company in Thailand to use mass media advertising. The company's continuous and award-winning advertising campaigns have been executed to build brand image and positioning in the customers' minds. Many products are promoted by popular celebrity actors and musicians.

Sales force

Mistine's direct sales system is a simple, single-level marketing (SLM) approach. The company recruits district managers who in turn recruit as many salespersons as they can manage. This approach meshes well with Thai culture and lifestyle. The benefit of this approach is that each salesperson earns full commission without having to share his or her earnings with others. Thus, the more sales a salesperson makes, the more income he or she receives.

The company welcomes anyone—male or female—who has some free time on their hands and would like to earn money, make new friends, and develop their self-confidence to become a salesperson. Salespersons can plan their own schedules and routes in order to reach sales targets and obtain rewards. If a salesperson achieves no sales within three selling periods, then he or she is automatically terminated. The turnover rate for salespersons is 200% per year because, for most salespersons, selling Mistine products is a second job. Moreover, most of the salespersons do not have any sales experience. Although they receive up to 25–30% commission, if they are not determined and committed, they leave. By rule of thumb, 70 salespersons out of 100 are eventually terminated within six selling periods.

Goals and target sales are set according to the sales promotion plans and advertising budget spent for a particular distribution period. The company offers major incentives, such as trips to Europe and gold, to all district managers to achieve target sales.

With the belief that the salespersons can live without Mistine, but Mistine cannot live without the salespersons, several programs have been launched to create employee loyalty to the company. Internal relationship programs such as the 'Mistine Thank You Concert' was organized in nine provinces around Thailand aimed to gather Mistine salespersons together as a family as well as show that the company cares and is responsible for its employees. The company also provides life insurance with coverage of US $50,000 for each salesperson, which is an unusual benefit in Thailand. Nonmonetary rewards and recognition incentives for salespersons include crystal trophies and photos in the hall of fame.

Operations

In direct sales, the length of a selling period is crucial and shapes business operations. Normally, direct selling companies operate three-week selling periods, totaling 18 periods within a year. Mistine, however, found that most salespersons do not actually start selling products to customers until the last week of a selling period, meaning that the first two weeks are essentially wasted. Consequently, management decided to reduce the selling period to two weeks, resulting in 26 selling periods per year. This dramatic change was implemented despite objections. Ultimately, sales increased by 80% over the previous year and salespersons became more active in selling the products.

These impressive sales results were not only the result of reducing the distribution cycle; they were also due to the positive attitude fostered throughout the company that motivated all salespersons and personnel in adapting to the changes and cooperating with the company's direction. One motto that employees of all levels still pledge to this day is 'We will make Mistine No. 1.'

Growth and expansion

Despite Mistine's great success with direct cosmetic sales, the company continues to strategize to maintain its market share amidst intense competition. To achieve its goals, the firm intends to continue recruiting new salespersons in order to increase sales and expand its marketing coverage area. It has increased its local promotion budget by 50% and developed 400 new product items to maintain its leading position. After observing that the sales of men's personal-care products have been increasing in department stores, Better Way launched nine men's products including shampoo, deodorant, day and night cream, and sun protection lotion.

The company has formed a strategic alliance with DTAC, a leading telecommunications service provider, under the name 'Mistine Corporate Solution' or MCS, which enables Mistine salespersons to call the 24-hour Mistine Call Center for free when using the DTAC cellular phone network system. This innovative direct selling tactic will facilitate the salespersons in ordering products, requesting product information, and asking about promotions. This strategic alliance will help the company cut costs of about US $25,000 per month on phone call fees.

To penetrate the teenage market segment, Mistine partnered with RS Promotions and employed D2B, an RS Promotions 'boy band' popular among Thai teens, to present Mistine's Pink Magic lipstick. The campaign helped boost sales to teens by as much as 10%.

Recently Mistine has an aggressive strategy in its products and marketing communication in both domestic and international markets. The company opened a manufacturing site in the Philippines and Vietnam. Mistine has successfully offered products in Cambodia, Laos, and Myanmar. The success is due to its affordable price that matches the income of the people in those countries. Moreover, its advertising campaigns that use popular actresses who are well known to people in those countries support its sales. Mistine will be exporting its cosmetic products to distributors in Taiwan and to China within 2–3 years. Hungary and Russia are potential markets in the future.

Sources

Better Way (Thailand) Company, www.mistine.co.th; Grammy Entertainment Public Company, www.gmmgrammy.com; RS Promotion Public Company, www.rs-promotion.co.th; Total Access Communication Public Company, www.dtac.co.th; 'Mistine,' Superbrands International, 24 November, 2004, www.superbrandsinternational.com/thailand/vol1/images/member/pdf/Mistine_TH20041229.pdf; Jaturong Kobkaew, *King of Direct Sales* (Bangkok: Thai Public Relations and Publishing, 2002); Anuwat Dharamadhaj, 'How Direct Selling Is Regulated and Managed in Different Markets in Thailand,' 2002, www.hkdsa.org.hk/symposium/anuwat_ppt.pdf; Ara Wilson (1999), 'The Empire of Direct Sales and the Making of Thai Entrepreneurs,' *Critiques of Anthropology*, 19 (4) pp. 402–22; 'U*Star and GMM Grammy Artists,' *Krungthep Turakij*, 2 October, 2004, www.bangkokbiznews.com; 'Branding for Direct Selling,' *Business Thai*, 12 December, 2003, http://bcm.arip.co.th; 'Direct Selling,' *Marketeer*, September 2003, p. 62; 'U*Star to the Market,' GoToManager, 13 September, 2003, www.gotomanager.com; 'Direct Selling War,' *Krungthep Turakij*, 24 March, 2003, www.bangkokbiznews.com; 'Big Five Direct Sellers,' *Business Thai*, 12 October, 2001, http://bcm.arip.co.th.

Questions for discussion

1. What are the major considerations in Mistine's attempt to continue its growth and dominance in the market?
2. Evaluate the growth strategy that Better Way has been using both domestically and internationally.
3. What actions would you recommend over the next five years? How would you apply specific marketing mix decisions to those actions you recommended?

CHAPTER 6

Information for international marketing decisions

Learning outcomes

Chapter 6 focuses on:

- export marketing research: information for planning, evaluation, and control
- methods for gathering data
- issues of concern

Two cases are presented at the end of the chapter. Both are concerned with the gathering and evaluation of information required for decision-making. SAN A/S, Case 6.1, is a Danish company considering entering the Australian market. Aquabear AB, Case 6.2, is a Swedish company considering entering southern hemisphere markets.

Introduction

In Chapter 5 we discussed the market selection problem and covered market selection processes, procedures, and strategies. A basic ingredient of any market selection program is the availability of market information. As a general observation, the sources of international market and product information can be characterized as overwhelming, the problem being to identify the relevant data when needed. For large-size exporters and other types of international marketers this identification problem can be partly solved through the establishment of computerized databases, which must be continually screened and updated. When selecting new markets, and to support ongoing decisions, many companies have developed *marketing decision support systems*. Such a support system should be able to provide data that are all of the following:

- *relevant*: have meaning for decision-makers;
- *timely*: current and available quickly;
- *flexible*: available in the forms needed by management;
- *accurate*: valid information for the 'problem' at hand;
- *exhaustive*: data bank should be reasonably exhaustive as international marketing tactics and strategies can be affected by many things that do not enter into domestic markets;
- *convenient*: access and use must be relatively easy to accomplish (Czinkota *et al.*, 1995, pp. 55–6).

For the most part it will be larger, more internationally experienced companies that can afford the cost of building and maintaining a formalized decision support system. For the smaller and medium-sized companies, however, formalized information systems are seldom available, leaving the exporter still with a more-or-less traditional information problem. However, the continual development of the Internet makes information readily available to all companies, large and small alike.

An integral part of any international marketing decision support system is an international marketing information system (MIS). Such a system involves data management procedures of generating data or collecting existing data, storing and retrieving data, processing data into useful information, and disseminating information to those within the organization who need it. Figure 6.1 shows an outline of such a MIS. A more detailed discussion of the general nature of an international MIS is provided by Schmidt and Hollensen (2006, Chapter 18); an overview of export MISs is given by Leonidou and Theodosiou (2004).

The major issue is the *collection* of information, which involves an organization in facilitating the collection effort, sources and methods of collection, processing, analysis, interpretation, and, where necessary, intracompany dissemination of information. The collection of information involves seeking sources of existing information and selecting research methods to obtain additional information. The overall process starts with determining information requirements or 'problem definition' (and this includes determining the research objectives) and ends with the completed report and ultimate integration of findings into management decision-making. As shown, the research process is really no different from a general approach to marketing research.

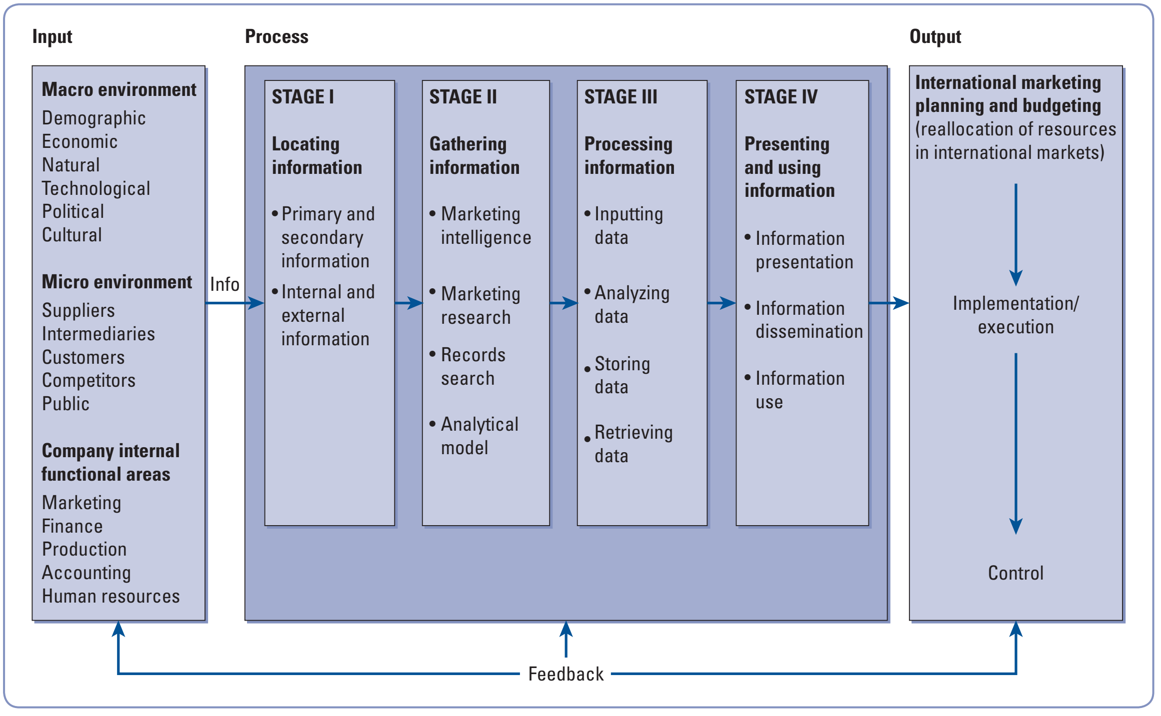

Figure 6.1 International marketing information system

Source: From *Marketing Research: An International Approach*, Pearson Education (Schmidt, M. and Hollensen, S. 2006) p. 587, Fig. 18.1.

This process can be carried out internally with a so-called in-house research group or it can be done by an outside research organization. The global non-in-house research industry is large. It has been reported that in the year 2008 total expenditure for research services by the global Top 25 marketing/public opinion/advertising research organizations was US$18.86 billion (Honomichl, 2009, p. 21). The home countries for these organizations include Japan, Germany, Brazil, France, the United Kingdom, and the United States. The largest firm, Nielsen Co., based in New York and Haarlem, the Netherlands, has operations in 108 countries, mostly though wholly or partially owned subsidiaries, and had revenues of US$4.575 billion in 2008. Slightly more than 50% of its global revenues came from outside the United States (Honomichl, 2009, p. 24). Overall, 58% of the revenues of the Top 25 in 2008 came from either subsidiaries or branch offices outside their home countries. In addition, other countries have a research industry. Exhibit 6.1 presents issues in dealing with an outside research firm in a B2B situation, although the issues apply to B2C as well.

It should be obvious that a critical aspect of this process is the first stage – determining what kind(s) of information is (are) needed. This is not to say that the other stages are not critical. It is just that if the needed information is not properly defined, it will not be obtained, thereby negating the value of the other stages. When analyzing potential markets, information is often needed on the various environmental constraints (and attitudes) facing the exporter/international marketer including *educational* (e.g., literacy level, higher education, attitude toward acquisition of knowledge), *sociological* (e.g., class structure and

Exhibit 6.1 Dealing with an outside research firm

When working with an outside research organization there are several things to consider. First and foremost, the international marketer should find an outside research firm that has expertise in acquiring and analyzing international data. Second, it has been suggested that for B2B marketers, such a firm should be able to 'focus on the client's clients, manage language differences and negotiate the ins and outs of business culture in the target countries' (Vence, 2003). Project costs can be expensive, running into hundreds of thousands of US dollars, or they can be as low as a few thousand US dollars. Third, since it helps if the research firm has offices in, or established relationships with partners in the client's target market countries, clients should be asking such questions as the following:

1. Which companies does the research firm have good relationships with?
2. How long have these relationships existed?
3. How much ongoing business does the research firm have with such companies?

According to Levy (2009), finding effective local marketing and marketing research help in foreign countries starts with knowing what one wants, where to look, and what to look for in local partners. And it should be done while keeping in mind one overriding principle – one size does not fit all. A local partner teaches the international marketer and international research firm about local issues and helps to overcome local market challenges. To find the right local help a company should do its homework – check references, understand market conditions, and connect with knowledgeable associations. Once a so-called 'shortlist' of potential local partners has been identified, the international marketer needs to examine how closely each candidate's strengths align with its needs.

The desired end result is global data consistency, or so-called **data equivalence**. This enhances comparisons between markets and potential markets.

mobility; views toward authority, achievement and work, wealth and materialism, risk taking, change), *political–legal* (e.g., rules of the game, political stability, and organization), and *economic* (e.g., stability, factor endowment, market size) constraints.

More specifically, the major types of information needed for making decisions about what markets to enter, the appropriate mode of entry in a chosen market and the specific export (or other) marketing mix and strategy to use will include the following: (1) political, financial, and legal data; (2) data about the basic infrastructure of markets; (3) marketing data; and (4) product-specific data. Thus, the information needed goes beyond that directly related to marketing decisions and includes all other aspects of the company's operations. More specifically, exporters would find the following types of information extremely useful: reports on potential customers, identifying potential overseas agents, specific export opportunities, market reports, and information on export payments, transport, and distribution. Czinkota *et al*. (1995, pp. 22–5) provide a checklist of research questions on broad strategy issues, foreign market assessment and selection, and the marketing mix. They argue that the list of information requirements should be detailed and complete. Examples of such research questions are shown in Table 6.1. As we progress in the 21st century another

Table 6.1 Examples of international marketing questions and information requirements

Broad strategic issues
What objectives should be pursued in the foreign market?
What are the best product, place-distribution, pricing, and promotional strategies for the foreign market?
Foreign market assessment and selection
What is the market potential abroad?
Are there foreign markets that the company can serve?
Who are the firm's present and potential customers abroad?
What are their needs and desires?
Who makes the purchase decisions?
How are the products used?
How difficult are certain government regulations for the firm?
How well developed are foreign mass communication media?
Does the foreign market offer efficient channels of distribution for the firm's products?
Marketing mix assessment and selection
Which product should the firm offer abroad?
At which stage in the life cycle is the product in the foreign market?
At what price should the firm sell its product in the foreign market?
What should the firm do about product line pricing?
What are the characteristics and capabilities of the available intermediaries?
What are the costs of physical distribution?
What are the communication needs of the foreign market?
Are there foreign laws against competitive advertising?
Is there a need for personal selling to promote the product abroad?
What should the nature of foreign sales efforts be?

research question that all firms are seeking an answer to is: 'How can the company best use the Internet and the Internet in its international marketing activities?' This question involves use both as a research tool and as a marketing tool.

Export marketing research

Often the export marketing data-collection effort is a more difficult and complex task than the domestic collection effort. However, the same principles and practices of conducting secondary and primary research that are available to domestic marketers are available, to a large extent, to export and other international marketers. There are a number of sources that discuss these techniques and we refer the reader to the books by Craig and Douglas (2005), Kumar (2000), Smith and Albaum (2005), and Schmidt and Hollensen (2006). A general framework for conducting in-house international market research projects and some of the challenges that must be addressed when conducting research across national borders is presented by Young and Javalgi (2007).

Marketing research defined

Marketing research can be defined as the systematic and objective search for, and analysis of, information relevant to the identification and solution of any problem relevant to the firm's marketing activity and marketing decision-makers. The process was outlined in Figure 6.2 earlier in the chapter.

Very broadly, the functions of international/export marketing research include *description* and *explanation* (which are necessary for *understanding*), *prediction*, and *evaluation*. More narrowly, the function of such research within a company is to provide the informational and analytical inputs necessary for effective *planning* of future foreign market marketing activity, *control* of international marketing operations in the present, and *evaluation* of results. One such type of research that can influence all three functions is customer satisfaction. Hewlett-Packard runs three programs as part of its overall personal computer customer satisfaction program in Europe and elsewhere: (1) customer feedback input, (2) customer satisfaction surveys, and (3) total quality control. So-called worldwide relationship surveys are run about every 18 months. These surveys include some product questions but ask how satisfied the customer is with the company as a whole and how Hewlett-Packard rates against its competition.

In European markets, European companies recognize the need to go beyond simply measuring satisfaction and identifying sources of dissatisfaction and view the goal of customer satisfaction management (CSM) programs as customer loyalty and retention. One of the major challenges in implementing CSM programs in Europe is comparing the results across countries (Sivadas, 1998). There are cultural differences across the countries that comprise the European Union, for example. Further, respondents in southern Europe tend to overstate their satisfaction while northern European respondents tend to understate it, making valid comparison of satisfaction scores difficult. In a similar manner, it is erroneous to assume that the same questionnaire can be used with consistent effectiveness in all countries. Rather, a set of core survey questions can be used, but the final instrument should be customized with the assistance of local, research-firm partners or managers in an in-house operation. Data-collection time and costs will vary across countries as there are differences in language structure and conversational habits. A 10-minute survey in one country may take 20 minutes in another.

In non-European markets, studies of customer satisfaction are becoming recognized as valuable in the planning stages of sales and marketing activities. In some markets customers may actually be a type of 'barricade' as they are not used to being asked for their opinions and suggestions in customer satisfaction research. In doing this type of research one must resist the temptation to query all aspects of customers' buying behavior – customer satisfaction research should explore only those issues relating to the company product/services among current and former users. Service companies, particularly in the travel and tourism business, continually monitor customer satisfaction with a formalized questionnaire at both local and regional levels. At the B2B and B2C high technology sectors, Marketing Metrics, Inc., a US marketing consulting firm, has been doing customer satisfaction surveys in China since 1992 for Motorola and Rolls-Royce. It has a completion rate of more than 70%, which compares very favorably with a worldwide industry average of 30–60%. Such a response rate will not be retained. In China CSM is a new phenomenon, and it is also somewhat new to be able to offer constructive criticism. The Chinese business-person likes the idea of being able to critique a supplier and to recognize that the supplier will listen and respond (cited in Andruss, 2000a).

CSM is part of a broader program known as customer relationship management, or CRM (see Exhibit 6.2).

Marketing research has many uses in export marketing. First, research is used to estimate demand, which is critical to the market selection and product positioning decisions. Second, it may be designed to help decide which bases of international market segmentation are most appropriate. Third, marketing research can be invaluable in assessing the merits and problems of alternative modes of market entry. Fourth, marketing research can be helpful in planning and implementing specific export marketing activities such as advertising and pricing. Often of interest is whether strategy should be aimed at standardization or adaptation to the specific needs of individual markets.

Exhibit 6.2 Global customer relationship management

Very broadly, CRM is a process for achieving a continuing dialogue with customers through differentially tailored treatment, based on the expected response from each customer to available marketing initiatives. CRM, thus, is a company-wide process that potentially affects decisions relating to marketing communications, pricing, product development, resource allocation across different customers and customer groups, and customer support services (Ramaseshan *et al*., 2006, p. 196).

Global customer relationship management (GCRM) occurs when a company operates in many countries or serves customers who are in many countries. Information is critical to the successful operation of a GCRM program. The depth of information collected depends more on the characteristics of the company (large MNCs vs medium-sized companies, consumer goods companies vs industrial goods) than on cultural differences of nations where companies have their headquarters, although culture can make a difference in that certain pieces of information may not be feasible or appropriate to collect or use in some countries. US companies tend to collect a lot of data, compared to non-US companies. In Europe, there is greater concern about the privacy of data that is obtained than in the United States. An overview of GCRM and a conceptual framework are discussed by Ramaseshan *et al*. (2006).

Fifth, research can be helpful, if not essential, in times of crisis. For example, in 1998 Unilever Holdings Thailand had an ongoing program of consumer focus groups to assist in handling the Asian economic crisis at the time.

The export market(ing) research process

As we mentioned earlier in this chapter, the international/export market(ing) research process has several distinct, though often overlapping, dimensions to it (see Figure 6.2). We now discuss each briefly.

Problem formulation

In a very real sense, problem formulation is the 'heart' of any research process. As such it represents the single most important step to be performed. Problem formulation from the researcher's point of view represents translating the *management problem* into a *research problem*. In order for this to occur the researcher must understand the origin and nature of management's problem and then be able to rephrase it into meaningful terms from an analytical point of view. The end result is not only a management problem that is analytically meaningful but one that specifies the types of information needed to help solve the management problem.

At some point during the problem formation process, sometimes only at the end, a decision must be made as to whether a formal study is justified. This choice involves communication between the manager and the researcher. Of interest to the decision-maker is whether the marketing decision should be made using only experience, judgment, and existing knowledge or whether the decision should be delayed until the proposed project is completed. This discussion situation involves comparing the additional value to the marketing decision that the researcher will provide with the cost of conducting the research.

Method of inquiry

In establishing investigative methods, international market researchers look primarily to the scientific method. Even though this method is not the only one used, it is the standard against which other investigative methods are measured. This approach involves an *objectivist* view of research. To the researcher everything is open and above-board. At the opposite end are the *subjectivists* who differ in kind or degree of requirement for publicity of procedures or investigator-independence. These approaches to inquiry are discussed in more depth by Smith and Albaum (2005, pp. 50–2).

Research method and design

The choice of appropriate methodology for a research problem depends in large part on the nature of the problem itself, the extent or level of existing knowledge, and the method of inquiry being followed. Two broad methodologies can be used to answer any research question – *experimental* research and *nonexperimental* research. The major difference between the two methodologies lies in the control of extraneous variables and manipulation of at least one variable by the intervention of the investigator in experimental research. In nonexperimental research there is no intervention beyond that needed for purposes of measurement.

Once the methodology has been selected, the next step is to develop a research design. A research design is defined as *the specification of methods and procedures for acquiring the information needed*. It is a plan or organizing framework for doing the study and collecting the data. In short, research designs are unique to a methodology.

Data-collection techniques

The research design begins to take on detailed focus as the researcher selects the particular techniques to be used in solving the problem formulated and in carrying out the strategy or method selected. There are a number of techniques available for collecting data, and these can be used with either methodology.

In general, data collection uses the process of either *communication* or *observation*. Communication involves asking questions and receiving (it is hoped) a response. This process can be done in person, by mail, by telephone, by e-mail, or by the Internet, and in most instances constitutes the broad research technique known as the *survey*. In contrast to this process, data may be obtained by observing present or past behavior. Regarding past behavior, techniques will include looking at secondary data (e.g., company records, published studies by external sources) and physical traces (e.g., erosion and accretion). Research is known as 'qualitative' or 'quantitative' depending upon the extent of structure and directness (disguised or not) of questions asked.

Not all data-collection techniques are necessarily usable in individual countries. For example, in countries such as Mexico and other Latin American countries it is almost impossible to use telephone surveys for general population research as telephone penetration is low. Therefore, the in-person, house-to-house survey or personal interview street intercepts are better techniques to use. In China, both mail and telephone consumer surveys are less likely to provide generalizable data than the in-person survey, conducted either in the home or using some type of intercept-based method. For high-technology-based B2B and B2C relationships, Marketing Metrics is using e-mail and the Internet for contacting Motorola's customers. About 40% of Motorola's customers' e-mail addresses are available, which is relatively high for China. Although Internet penetration in China is low – less than 16% – it is increasing. But, this 16% represents 210 million people, and more than 70% of Chinese Internet users are under the age of 30 (*The Economist*, 2008). In Europe, due to differences among the countries, different 'favored' data-collection methods can be found. According to Naresh Malhotra (cited in Andruss, 2000b), about three-quarters of the interviews conducted in Portugal are face-to-face. In the Nordic countries, however, the populations' higher education levels make mail interviews more common.

Response to surveys will vary among countries for different reasons. For example, in a cross-national industrial mail survey in 22 countries, response rates varied from 7.1% to 42.1% (Harzing, 2000). Language differences and affinity to the country where the research request came from (i.e., closer psychic distance) were two reasons contributing to the difference. In a more recent study of managers in 20 European countries, Lyness and Kropf (2007) reported wide differences in response rates. They concluded that the likelihood of responding was higher for women than for men, and was also higher in countries with more gender equality than in countries with less gender equality.

Another potential problem is making sure that data from different countries are compatible. For example, research methodologies in Europe will never match 100% perfectly because of the different cultures and customs that make people respond differently. By way of illustration, compared to people in the United States, Europeans tend to be less open to talking about personal information as it relates to certain aspects of their lives. In fact Europeans tend to be more formal in many ways (Andruss, 2000b). There are also legal issues. In Italy, for instance, researchers cannot use the mail to send product test samples to panel members (Miller, 1997, p. 22). There are strict privacy laws in European countries such as

Germany that make customer lists and other lists less accessible to researchers than, say, in the United States.

In some parts of the world *gender* – of the person being asked, the person doing the asking, and the research manager – is a potential problem. This is particularly true in predominantly Islamic countries where, for example, female research managers or project directors can expect only limited acceptance. Females can head research projects in some liberal Islamic nations such as Egypt, but are barred completely from Saudi Arabia (Jarvis, 2002). Conducting focus groups in Islamic countries is another area where gender becomes an issue. For the most part mixed gender groups – if allowed – are not usually a good idea as males tend to be dominant and females will defer to them. When interviewing is done in these areas the interviewer and interviewee should be of the same gender. In time, use of the Internet for data collection will ease this problem, but at present Internet penetration in the Islamic nations of the Middle East is very low.

In order to communicate or observe there must be a means of recording responses or behavior. Thus the process of measurement and the development of a measurement instrument are closely connected to the decision of which data-collection technique(s) should be used. The relationship is two-way. That is, while the structure and content of the measurement instrument can depend on the data-collection technique, measurement considerations often influence technique selection. A study was conducted many years ago by *Reader's Digest* (Ricks, 1999, p. 147). A conclusion drawn from the findings was that more spaghetti was consumed by West Germans and French than by Italians. This 'false finding' was ultimately attributed to how the questions were asked. The survey questions concerned the purchase of branded and packaged spaghetti. Italians, however, tended to buy spaghetti in bulk. When dealing with a heterogeneous population that has not been exposed much to marketing – for example in developing countries – it is often useful to ask the same question(s) in different ways and in different sections of the instrument. This is one approach to quality control.

Response options (i.e., response scales) need to have consistency in meaning. The problem that can arise is that different countries have different paradigms. According to the RDA Group, a global market research and consulting company headquartered in the United States, some countries relate better to even-numbered scales than to odd-numbered scales. For example, in Germany the respondent's preference is often for a 6-point scale, whereas in the United States the 5- and 7-point scales seem to better reflect the respondent's 'true' rating. If a verbal scale is used, the meaning of 'very satisfied' in one market may be interpreted to mean something different in another market (RDA Group, 2005, p. 2).

More generally, multiple methods should be used. Although the structured questionnaire is a familiar tool in marketing research, it may fail to capture key information regarding the intangible characteristics of a culture, resulting in the overlooking of important nuances. A structured questionnaire also can rarely account for contextual influences on purchase and consumption as it is typically based on assumptions about this behavior and what people can recall about it. In short, depth of understanding may be lacking. Combining qualitative methods with the more traditional quantitative ones will add some flexibility to the research process. One such approach is *ethnographic* research. Ethnography is a qualitative approach to research that studies human behavior within a cultural context. With its multiple methods, ethnographic research can pick up contextual information that is not always available through the more traditional reflective self-reports. For consumer research, for example, ethnographic research attempts to enter the consumer's world directly as much as possible. Multiple methods are often used, including observation, interviews, documents, and material possessions such as artifacts. Some problems associated with ethnography in global cultures are discussed by Canniford (2005).

Use of ethnographic research is increasing in emerging economies/markets, particularly in Asia and Africa. The widespread use of cell phones among consumers, increased Internet access, and acceptance of ethnography as a research tool have influenced its use in these markets (Fielding, 2006). In Asia, for example, ethnographic research has been replacing focus groups. A focus group is a mode of data collection in which a small group of people (no more than 10 or 12) jointly participate in an interview that does not use a structured questionnaire-and-answer method to obtain information (Smith and Albaum, 2005, p. 250). According to Sue Phillips, director of qualitative research for Asia Pacific for the research firm Synovate. Inc., 'people don't say what they mean, and they don't mean what they say (in group interview situations), so researchers are now actually watching people shop, watching them in their homes' (cited in Fielding, 2006, p. 18). Focus groups are still used, but they tend to have higher costs than ethnographic studies due in part to transportation costs between rural and urban areas in assembling a focus group.

A major concern in questionnaire design and research implementation is language. A potential problem arises when the study is conceived, and the questionnaire first written, by a person from one culture speaking one language for use in another culture that speaks a different language. The usual way of handling this is by applying the process of translation and back-translation. It is desirable to have 'outsiders' handle the back-translation and any further retranslations needed. This process may be time-consuming and costly, but it still works! Figure 6.2 shows the English and Chinese-language versions of the first page of a questionnaire used to measure consumer ethnocentrism in Hong Kong. The questionnaire was first written in English and then translated into Chinese. The translation/back-translation process was done twice before a satisfactory translation into Chinese characters was achieved. Data were collected by self-report with an interviewer present.

Rather than a single back-translation, Douglas and Craig (2007) recommend the use of a collaborative and iterative approach to translation, as shown in Figure 6.3.

There are times when knowing a language may be a hindrance rather than a benefit. Under such conditions, so-called image research based on visual language and symbols may be beneficial.

Cross-national studies often involve surveying people with different native languages. If the potential respondents also speak another language a question of whether this other language should be the language of the questionnaire arises. Often this is done so that the same language is used in all countries. This may lead to erroneous results. To illustrate, in a 24-country study where all respondents spoke English in addition to their native language one-half of the potential respondents received the questionnaire in their native language and one-half received the same questionnaire in English (Harzing, 2005). For questions that comprise an element of culture, and even those that might not, the use of English language might obscure important differences between the countries. The results of this study showed that respondents responding to the English-language version responded more closely to a sample of United States respondents than did the native language group. Thus, there was a *cultural accommodation* present in a substantial proportion of the comparisons for all questions. If cost and other factors seem to dictate that a single language should be used, if at all possible those doing the research should pretest the questionnaire to assess whether cultural accommodation might be present. If so, it is better to prepare

SURVEY ON ATTITUDES AND PURCHASE INTENTIONS

A. Original English language

SURVEY ON ATTITUDES AND PURCHASE INTENTIONS

1. Do you qualify for permanent residency in Hong Kong (i.e., lived here for more than seven years)?

_______ Yes (continue with Question #2)

_______ No (thank person and terminate the interview)

2. What is your age? _______

If a person is aged 18–65, continue the interview. Otherwise thank the person who is under 18 or over 65 and terminate the interview.

3. Attitudes

Following is a series of statements pertaining to consumer attitudes and behaviour. Please indicate the extent to which you agree or disagree with each statement by circling the approriate number where

1 = strongly disagree
2 = disagree
3 = neither agree nor disagree
4 = agree
5 = strongly agree
6 = no opinion

	strongly disagree	disagree	neither agree nor disagree	agree	strongly agree	no opinion
a. Hong Kong people should always buy Hong Kong made products instead of imports.	1	2	3	4	5	9
b. Only those products that are not available in Hong Kong should be imported.	1	2	3	4	5	9
c. Buy Hong Kong made products. Keep Hong Kong working.	1	2	3	4	5	9
d. Hong Kong products, first, last, and foremost.	1	2	3	4	5	9
e. Purchasing foreign-made products is un-Hong Kong.	1	2	3	4	5	9

Figure 6.2 English- and Chinese-language versions of a questionnaire

《對產品意見及購買意欲問卷調查》

1. 閣下是否香港永久居民（即居港七年或以上）？

________ 是（繼續回答問題二）

________ 否（多謝被訪者，並終止訪問）

2. 閣下年齡是 ________

若該被訪者年齡介乎 18 至 65 歲之間，繼續訪問；若非，多謝被訪者，並終止訪問。

在回答本問卷時請注意：香港意指香港本土，並不包括中國；而中國則指中國大陸本土，並不包括香港。

3. 對產品之意見

以下是一系列有關消費者意見及行為之陳述句子。請在適當數字上劃圈表示您對該句子之意見。

1 = 極之反對　　4 = 同意
2 = 反對　　5 = 極之同意
3 = 既非反對亦非同意　　6 = 無意見

	極之反對	反對	既非反對亦非同意	同意	極之同意	無意見
a. 香港人應該永遠只購買在港生產的貨品（港貨）而非進口貨	1	2	3	4	5	9
b. 香港應該只進口本土不能提供之貨品	1	2	3	4	5	9
c. 買港貨，保飯碗	1	2	3	4	5	9
d. 港貨永遠是最要緊的，應該永遠被放在第一位	1	2	3	4	5	9
e. 買外國貨等於反港	1	2	3	4	5	9

Figure 6.2 (continued)

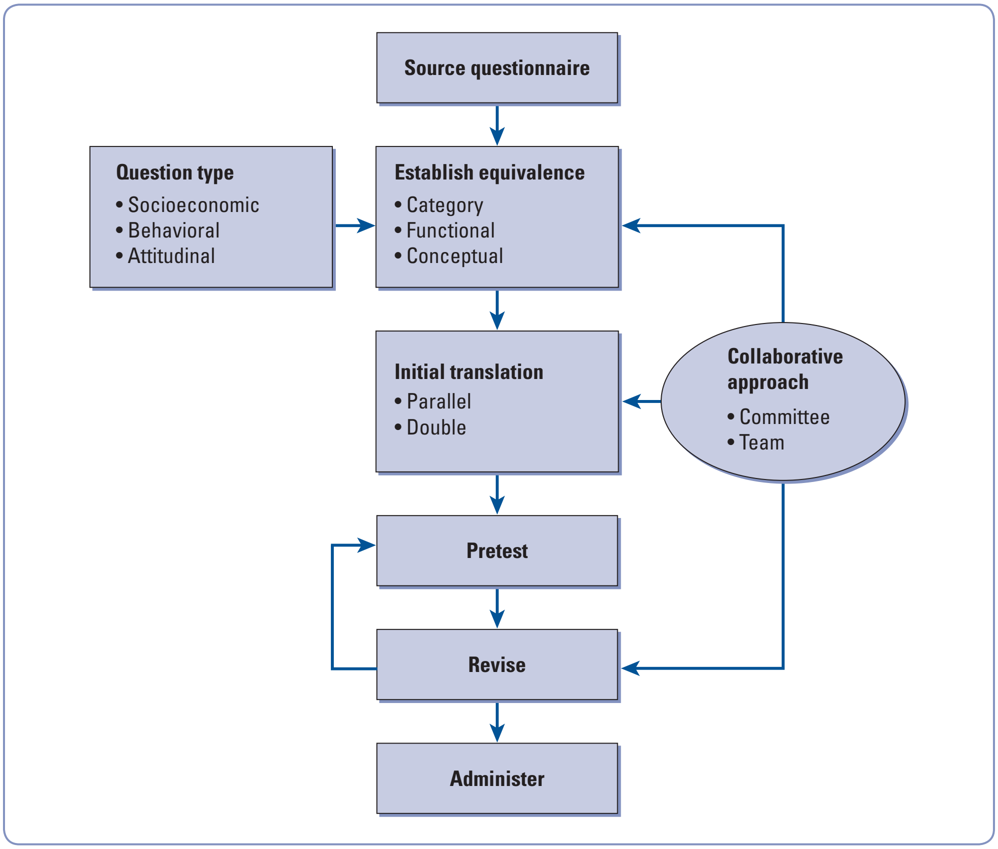

Figure 6.3 Collaborative and iterative questionnaire translation

Source: Douglas and Craig, 2007, p. 40.

questionnaires in native languages. As mentioned above, this would involve a type of translation process.

Observation can be a useful technique for international marketers who are not familiar with the situation they are entering. Often it is difficult to assess behavior by asking about it – observing it is more revealing. For observing people, it is important to realize that culture may play a major role in how people react to having their behavior observed. This can be especially important for consumer goods research using in-store research techniques.

Sample design

Rarely will a marketing research project involve examining the entire population that is relevant to the problem. For the most part, practical considerations (e.g., absolute resources available, cost vs value) dictate that a sample, or subset of the relevant population, be used. In other instances the use of a sample is derived from the trade-off between systematic and variable errors.

In designing the sample, the researcher must specify three things: (1) where the sample is to be selected from, (2) the process of selection, and (3) the size of the sample. The sample design must be consistent with the relevant population, which is usually specified in the

Exhibit 6.3 Using visual data

It is obvious that fluency in a language and familiarity with local idioms are helpful in collecting research data. But complete reliance on understanding verbal communication is based on the assumption that people can and will provide the information needed, an assumption that often does not hold. Words are not the only symbols available to the researcher. *Images* can overcome the weaknesses of words and effectively complement information verbally available. In some foreign markets low levels of verbal literacy can be a problem, whereas visual literacy is almost universal.

In verbal research there are usually at least 10,000 words that need to be understood to achieve cultural knowledge. A culture's visual language contains about 200 active symbols on any particular topic. Thus the visual language of a target culture on a given topic can be learned during the time frame of a typical normal project, unlike the spoken language. In this type of image research people can provide more information when selecting images. Therefore patterns emerge with greater clarity, and with smaller samples (and lower cost).

An example of this type of research is a study done to determine how to sell cosmetics to Muslim women in Indonesia. Data were collected from 150 respondents participating in 12 group interviews. Recruiting and moderating were done by native Indonesians in their own language. Each interview group completed ten picture-sort tasks on average, answering questions by selecting pictures from a set of more than 10,000 magazine images collected from throughout the world. The picture-sorts were developed to measure perceptions, values, and motivations regarding skin-care products. One finding is that almost 80% of the images selected in answer to the question 'How would you most like to smell?' featured people, usually children. In the West, by contrast, the most frequent image response would

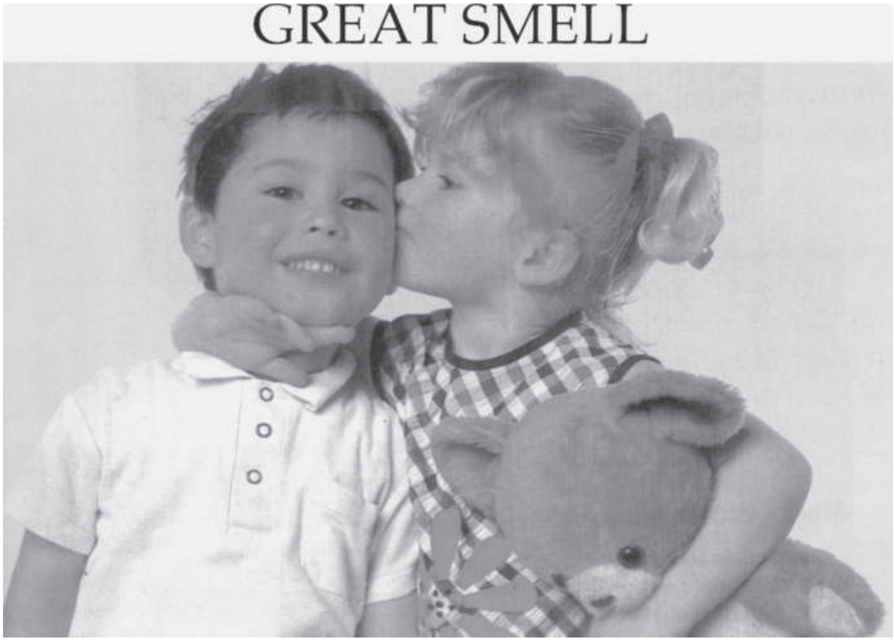

Figure 6.4 Great smell: Images can be a powerful tool for collecting data and can overcome some of the shortcomings of verbal or written data-collection methods

be flowers. The interpretation was that the people being studied are comfortable with natural human odor as well as their general appearance. Further, it was seen that youthful health was associated with a strong human 'fragrance' related to odor but totally consistent with a habit of smelling a child's head as a gesture of affection (see Figure 6.4). Additional images selected to represent the concepts of 'enhancing beauty' and 'repairs skin' were strongly associated with healthy eating and drinking (see Figure 6.5).

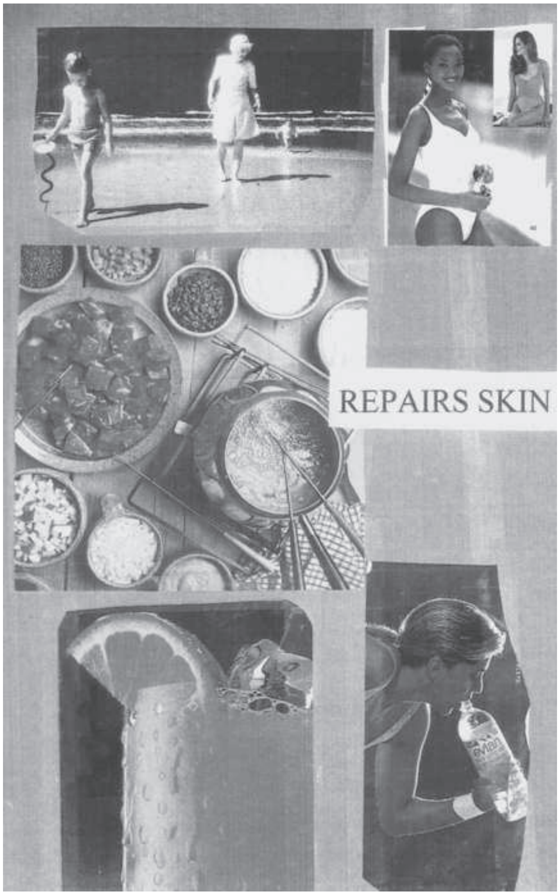

Figure 6.5 This approach to research in different cultures is based on a concept of *practical ignorance*. One starts with a lack of knowledge about language and cultural issues and moves on from there. Once the visual data patterns have been collected and interpreted, ignorance has to be left behind. Developing culturally appropriate marketing strategies and tactics requires a thorough understanding of relevant cultural values, messages, and communication channels.

Source: Adapted from Sack (2000).

problem formulation stage of the research process. This allows the data obtained from the sample to be used in making inferences about the larger population.

In sampling for research in multiple countries there is often a conflict between the need for within-country representativeness of each national sample and between-country comparability of the samples. Resolution of this conflict depends largely upon the type of research being done. Reynolds *et al.* (2003) have identified four types of international marketing research:

1. *Descriptive* research is focused primarily on understanding behavior and the market environment in a single country.
2. *Comparative* research is concerned with comparing attitudes, behaviors, and so on in two or more countries with the intent to identify similarities and differences between them.
3. *Contextual* research is concerned with studying cross-national groups, or so-called 'pan-cultural' research.
4. *Theoretical* research looks at the extent to which theories, models, methods, and constructs developed in one country are valid in other countries and cultural contexts.

Table 6.2 presents sampling choices based on these types of research in international marketing research.

When deciding on sample size, two important questions need to be answered (Ball, 2004): (1) Are the data going to be analyzed by the entire sample or by subgroups within the sample? (2) What is the desired level of accuracy?

A detailed discussion of sampling procedures that can be used in international marketing research is found in Kumar (2000, Ch. 12) and Schmidt and Hollensen (2006, pp. 159–70).

Table 6.2 Sampling choices in international marketing research

		Desired sample attributes		
Type of international research	**Research objective**	**Sampling characteristics**	**Preferred sampling method**	**Sampling objective**
Descriptive	Examine attitudes and behavior within specific countries	Within-country representativeness	Ability to estimate sampling error	Probability within each country
Contextual	Examine attributes of a cross-national group	Representatives of specifc population of interest	Ability to estimate sampling error	Probability sampling of population of interest
Comparative	Examine differences or similarities between countries	Cross-national comparability	Homogeneous samples to control extraneous factors	Nonprobability acceptable
Theoretical	Examine the cross-national generalizability of a theory or model	Cross-national comparability	Homogeneous, or deliberately sampled for heterogeneity	Nonprobability acceptable

Source: Reynolds *et al.*, 2003, p. 82.

Implementing data collection

Once the previous steps have been performed, data collection can begin. Data collection, whether by communication or observation, requires the use of people, which then raises questions regarding the management of these people. Data collection can be costly.

Organizational issues center on: (1) the extent to which research is to be centralized or decentralized within the company and (2) whether the research is to be done in-house or purchased from outside suppliers. Some major potential problems that can arise when using outside suppliers include communicating in different languages and translating project material. Other problems may be as follows:

- distance and time differences;
- communicating the goals of the research to suppliers;
- maintaining quality control over data collection;
- locating and evaluating qualified overseas suppliers.

Problems facing outside research suppliers are the following:

- communication;
- difficulty with different methodologies;
- varying professional standards;
- low-quality suppliers.

A way to overcome these problems starts with defining the research and objectives using a bottom-up approach. The second aspect concerns defining the specific tasks to be carried out and incorporating them on to extensive specification sheets. Included are everything from the sample determination to analysis, including all aspects of translation and back-translation.

The **centralization** decentralization issue is largely a function of whether standardized or adaptation strategies are being followed. It will also be influenced by the size of the exporting company and the significance of export sales. The question of in-house versus external purchase is also influenced by the size of the company. Additional considerations include the number of distinct national markets being serviced. Many exporters simply do not have the in-house expertise to design and conduct research for all their foreign markets. The need for familiarity with the local environment and multiple language capability means that purchase of outside research is necessary, unless of course a study is primarily desk research using secondary data. In addition, the amount of research to be done may not warrant the cost of having a permanent research staff.

Analysis and interpretation

The data that have been obtained must be analyzed. Once obtained, the data must be edited, coded, and tabulated before formal analyses (e.g., statistical tests) can be performed. The types of analyses that can be performed (that can be 'properly' performed) are a function of the sampling procedures, measurement instrument, and data-collection techniques used. One thing to remember is to avoid using overly sophisticated analytical tools for unsophisticated data. The tools must be appropriate for the quality of the data. Just because a market is a developing country is not, by itself, sufficient reason for applying vigorous analysis for high-quality data.

At times companies are faced with analyzing large amounts of data, quantitative and verbal. One technique that is finding greater use is *data mining*. Data mining has been defined as 'the exploration and analysis of data in order to discover patterns, correlations, and other regularities' (Stephens and Sukumar, 2006, p. 456). Data mining can be related to two broad classes of tasks: profiling and predicting. Profiling is related to pattern description and predicting to pattern identification. A detailed discussion of this technique is given by Stephens and Sukumar (2006).

Reporting results

The culmination of the research process is the research report. Everything that has been done should be included and the results, conclusions, and – whenever possible – recommendations for courses of action should be included and presented clearly, accurately, and honestly. Two critical attributes of the report are that it provides all the information that readers need using language that they understand (*completeness*) and that it be selective in what is included (*conciseness*). These attributes are often in conflict. A marketing research report – regardless of its length, beauty, use of pedagogical techniques, and so on – contains no information unless it has the potential for changing the state of knowledge of the reader.

Issues of concern

Regardless of its use in export marketing, a number of conceptual, methodological and organizational issues that impede data collection and the conduct of research have been identified. These include the following:

- the complexity of research design, due to operation in a multicountry, multicultural, and multilinguistic environment;
- the lack of secondary data available for many countries and product markets;
- the high costs of collecting primary data, particularly in developing countries;
- the problems associated with coordinating research and data collection in different countries;
- the difficulties of establishing the comparability and equivalence (construct, measure, and sampling) of data and research conducted in different contexts;
- the intrafunctional character of many export marketing decisions;
- the economics of export marketing decisions.

The issue of comparability takes on special importance. To an extent, each foreign market may be characterized by its own pattern of socio-cultural behavior patterns and values. This means that attitudes and behavior may be expressed uniquely. Relevant constructs and their measures will be unique to a particular country (i.e., culture specific). At the other extreme, there may be similarities (culture-free). The existing situation determines the preferred research process. Equivalence should never be assumed to exist. To illustrate, a US company assumed that similar languages indicate similar tastes. When it tried to sell its after-shave lotion in England it failed because the average British male saw no functional value in the use of the product (Ricks, 1999, p. 144). Similarly, a Japanese bicycle manufacturer would find different functional views of its product in the United States (a recreational vehicle) and China (a vehicle for nonrecreational activities such as traveling to and from work).

Table 6.3 How consumption is defined by PepsiCo

Country	Definition
Mexico	Number of occasions product was consumed on day prior to interview
Venezuela	Same as for Mexico
Argentina	Number of drinks consumed on day prior to interview
Germany	Number of respondents consuming 'daily or almost daily'
Spain	Number of drinks consumed 'at least once a week'
Italy	Number of respondents consuming product on day prior to interview
Philippines	Number of glasses of product consumed on day prior to interview

Source: Adapted from Keegan and Green, 2000, p. 233. Reprinted by permission of Pearson Education, Inc., Upper Saddle River, NJ.

As another issue in comparability and equivalence, consider how consumption is measured by PepsiCo in seven different foreign markets. As shown in Table 6.3, it would be difficult to make any cross-national comparisons of Pepsi Cola consumption except for Mexico and Venezuela. Other examples of problems concerning measure equivalence are shown in Exhibits 6.4 and 6.5. Measurement is but one concern when looking at equivalence. As shown in Figure 6.6, when multicountry research is being done – and firms doing business in multi-foreign markets often do this – there are other issues concerning equivalence. These are discussed in more detail by Salzberger (1997) and Albaum and Baker (2005).

Exhibit 6.4 Equivalence in international marketing research

Data equivalence is defined as 'data that have, as far as possible, the same meaning or interpretation, and the same level of accuracy, precision of measurement, or reliability in all countries and cultures' (Craig and Douglas, 2005, p. 141). These authors further distinguish three forms of equivalence: construct, measurement, and equivalence in data-collection techniques. Three forms of construct equivalence are relevant:

1. *Conceptual.* This refers to interpretations or meanings that people place on objects, stimuli, or behavior, and whether these even exist or are expressed similarly in different nations/cultures.
2. *Categorical.* The category in which objects or other stimuli are placed. Are the same categories used in different countries/cultures?
3. *Functional.* This refers to whether the concepts, objects, or behaviors being studied have the same role or function in all countries/cultures.

When doing marketing research involving multiple countries, other equivalence issues arise concerning measurement. First, there is *translation* equivalence which arises when a measurement instrument such as a questionnaire originally developed in one language is translated to another language. Second, *calibration* equivalence refers to units of measurement, such as yards or meters. Third, *metric* equivalence refers to the specific scale or scoring procedure used in measurement. The issues and how to deal with them are discussed by van Herk *et al*. (2005). To obtain equivalent results, attention should be paid to possible sources of bias and their impact. Three kinds of bias can be identified (van Herk *et al*., 2005, pp. 355–6):

1. *Construct* bias may exist if the construct being studied differs across countries.
2. *Method* bias refers to instances where all or most items in a questionnaire (i.e., measurement instrument) are equally affected by a factor that is independent of the construct being studied.
3. *Item* bias refers to distortions in specific items in the instrument.

Figure 6.7 summarizes bias in the research process (van Herk, *et al*., 2005, p. 356). A classic discussion of assessing measurement invariance in cross-national research is provided by Steenkamp and Baumgartner (1998).

Exhibit 6.5 Questions need to be pretested

Although individual questions – indeed, entire questionnaires – should be pretested in all studies, the need is even greater for multicountry research. Concern is for uncovering poorly worded questions and questions that potential respondents do not really understand. In addition, the issue of *measure equivalence* – specifically *translation equivalence* – can arise in such studies. Among the concerns regarding translation equivalence is how perceptual cues are interpreted in a research context. Respondents may misinterpret stimuli because the associations evoked by the stimuli differ from one country or culture to another.

A good illustration of what needs to be done, and why, is cited by Oppenheim (1992, p. 48) when discussing an international study of health problems. The researchers decided to include a set of factual questions about domestic facilities available to respondents. These questions had been used in previous studies conducted in several countries. One of the items asked about was 'running water.' Results from pilot work (Oppenheim's term for pretest) indicated that respondents in developing countries often interpreted 'running water' to mean a river or a brook near their home. So the item wording had to be changed. It now became 'piped fresh-water supply' and this new wording, too, had to be piloted – just to make sure.

It should be noted that if the pilot work had not uncovered this unintended interpretation, the item might well have been used in the main field work, since respondents found it easy to answer the question. Only much later, during the analysis phase, might the researcher have noticed a remarkably high proportion of respondents who apparently had no piped fresh-water supply; but by then it would have been too late. A poorly worded item is not necessarily one that causes respondents difficulties in answering; far more dangerous are apparently unproblematic items that, unwittingly, produce data that are not valid.

Scales of measurement that are used in international marketing research studies are developed in one country within one culture. Often, they are used in other countries without concern for equivalence. Are scales generalizable? Not always! For example, Donoho *et al*. (2001) assessed the 'transportability' of two measures – the Personal Selling Ethics Scale (PSE) and the List of Values (LOV) – across cultural boundaries associated with the United States, the Netherlands, Australia, and Canada and concluded that they are not easily transportable. Blindly transporting research measures and instruments from one culture to another may produce measures that are less useful in describing and explaining phenomena in the country of interest than developing a measure unique to that country.

Often, scales are developed to measure a specific construct – some object, behavior, and so on. These most typically involve multi-item measures. Some measures have been used in many studies and in different countries. But there still are potential problems in using scales

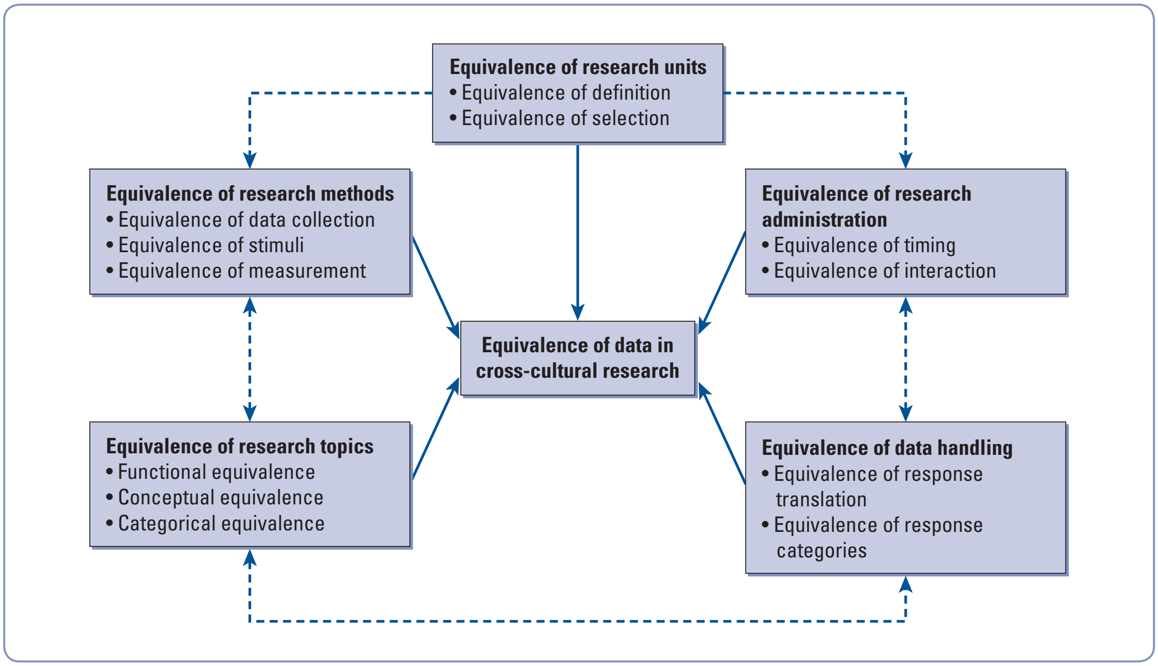

Figure 6.6 Aspects of equivalence in cross-cultural/national research

Source: Adapted from Salzberger (1997, p. 3). Reprinted with permission of the author.

	Stages in the marketing research process	Source of bias	Issues	Prevalent types of bias
I	Problem formulation	Concepts Category Function	Purpose of the study	Construct
II	Research design	Operationalization	Type of study Type of questions	Construct
		Instrument design	Item selection Type of response format	Item Method
		Translation		Item
		Method	Personal, mail, telephone	Method
III	Sample selection	Sampling	Target population Sampling frame	Method
IV	Data collection	Fieldwork	Procedures Interviewer selection Time frame	 Method
V	Data editing and coding	Editing Coding Calibration	Data editing Data coding	Item
VI	Analyzing and interpreting data		Statistical procedures	

Figure 6.7 Bias in the research process

Source: van Herk *et al*. (2005, p. 356). ©Emerald Group Publishing Ltd., all rights reserved. Used with permission.

in a nationality/cultural context where the scale was not originally developed. Within the context of scales being used in Chinese management research, Farh *et al*. (2006) propose four approaches to scale development:

1. *Translation*. Literal or simple translation, adopting parts of the instrument or assembling a new instrument.
2. *Adaptation*. Included are altering the wording of items, dropping inappropriate items, and adding new items to the scale.
3. *De-contextualization*. A new scale is constructed. Assumptions are made about the **etic** (culture-free) or emic (culture-bound) nature of the construct. This is an etic-based approach.
4. *Contextualization*. An emic approach, which involves indigenization.

Summary

This chapter has looked at issues relating to some key issues in export marketing research. The methods involved in the research process tend to be technical and the reader was referred to specialized sources for detailed discussion.

Questions for discussion

6.1 How would you respond to a person making the following statement: 'As a general rule, the export marketing manager has few sources of information available for use in market selection.'

6.2 What is the market research process that the international/export marketer uses and what are the major issues that can arise to provide 'complications'?

6.3 Marketing research is beyond the capabilities and needs of the small exporter. Only larger companies doing business in many countries have need for research services.' Discuss.

6.4 What is the nature of the equivalence 'problem' in doing research in multiple foreign markets, and how can it be resolved?

6.5 Explain how the Internet may be a valuable source of information, for even the smallest-sized exporter.

6.6 How can an international marketer overcome the incompatibility of research methods usable in different countries when doing a comparative study?

6.7 If a company cannot use the same methods of data collection for the same study in its different markets, how can a valid comparison be made? Discuss.

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CASE STUDY 6.1

SAN A/S

SAN A/S,[1] a company incorporated in Denmark, manufactures electric heating products for the industrial market. The company was founded in 1950 and was involved in a limited way in the production of heating elements. Its primary activity originally consisted of acting as a trading company handling products for other manufacturers. This relationship has gradually shifted and the company now generates the greatest part of its sales volume from its own production, handling only a few products of other manufacturers that complement its own production. Production, sales, and profitability have grown steadily, and by the early 1970s the company had a dominating share of the Danish market for its products.

Growth has been achieved mainly by an increase in export sales. The company's recent export expansion is the result of increasing involvement in larger-scale projects. Production of small products is set to be unchanged in the coming years, and the company has not been very active in seeking to export these small products due to intense competition in overseas markets.

Company objectives

The company's stated primary function is the coverage of industrial needs for electric heating products in Denmark and abroad. The company seeks to compete primarily on the basis of its know-how, product development, and service. Expansion is sought through export, as the Danish market no longer offers expansion possibilities. The company aims to increase its sales by at least 15% per year, and this expansion is not to occur through competition with mass-producers.

[1]Disguised name

The company's products, resources, and organization

SAN A/S develops and produces custom-made load resistors and electric heating systems, and standard heating elements and cables. The company describes this as a narrow, deep, and consistent product mix. Heating systems are designed to customer specifications and include heaters for water, fluid, chemical, plastic, and oil heating; industrial ovens; air duct heaters; unit and battery heaters; defrosting elements; space heating systems; and tunnel ovens. The know-how acquired through the development of heating systems to customer specifications enables the company to develop new standard heating elements and cables that have a technological lead over similar products. The products are consistent in that they have similar production requirements, distribution channels, and, with the exception of load resistors, the same market.

The company is economically sound, and its steady expansion has not caused profit or financing problems. The company now operates at its full production capacity and is in the process of expanding its production facilities. In spite of this capacity expansion, the company anticipates that its continuing sales growth will result in a continued full utilization of capacity. This high capacity utilization has led to delivery delays in the past, and the company has now decided that delivery time for its standard products must not exceed six weeks.

SAN A/S is a Danish company that is 100% privately owned, with its own production facilities located near Copenhagen. At present there are 70 employees, of whom eight are civil engineers and 12 are technicians. Product development is typically organized in project groups. The company sells directly to customers in Denmark, and both directly and through import agents overseas.

Market

The company's customers are mainly industrial processors. Heat processes have almost countless applications. The petrochemical industry and industries with a drying process are of particular importance in SAN's market. The company concentrates solely on electric heating processes. These can be divided into those in which heating requirements can be covered by standard and mass-produced products, and those in which requirements demand the development of tailor-made products or systems.

The market for standard and mass-produced heating elements and cables is well developed; there are established producers in all industrialized countries and competition is intense. The buyer is seeking a product that can fulfill specifications that can be met by many suppliers. The market demands high quality, quick delivery, good parts availability, and a competitive price. The buying decision is typically made by an engineer seeking to reduce operating costs. Competition in the market for special products and systems is less intense, as there are fewer suppliers. Here the buyer is seeking a supplier whose know-how will help to develop a product or system that can fulfill new specifications – for example, higher heating temperatures, better heat-to-energy ratios, resistance to corrosion – that are not available with existing products. The buyer still demands high quality and good back-up (parts availability and service) but is not seeking quick 'off-the-shelf' delivery. Price is also of less importance, as the product or system is required to pay for itself through either reduced operating costs or increased productivity. Again the buying decision is typically made by an engineer. Direct contact between the buyer and the supplier is important in the buying process, as the product development is a new task for both parties.

Export markets

SAN is a niche marketing company and has had a typical export history. As the home market became saturated, the company started exploiting the possibilities in geographically and culturally close markets through import agents. Exports started with the Scandinavian countries and have since expanded by agents to most of western Europe (except Germany and the United Kingdom), Poland, Greece, and North America. At the present time the company has no international investments in the form of sales or production companies or joint ventures. As export now accounts for a rapidly increasing share of sales, management is becoming increasingly interested in being able to control its international marketing efforts. The company's expansion strategy, therefore, is to establish sales companies wherever economically possible, and agents are seen as a second-best solution.

The growing share of sales accounted for by project-export has also led to a changing emphasis in marketing strategy. While import agents have fulfilled a useful role in establishing SAN's export of products, their use in project-export is much more limited, as direct information exchanges between the supplier and the buyer are very important. For the company this means that increased expansion will lead to increased direct involvement in foreign markets. In some foreign markets there is a dual-distribution system in which SAN is responsible for projects and special products and agents are responsible for small and standard products.

Expansion to Australia

As part of its long-term expansion strategy, SAN is considering entering markets in other parts of the world. One such market is Australia, where SAN has had no export experience. Due to the company's present expansion in Scandinavia and western Europe, it has limited resources to devote to the Australian market. The company is somewhat cautious and not anxious to expand too quickly. In the short term, therefore, if the company were to enter the Australian market its goals would be twofold: (a) to establish the company's reputation in Australia, with a view to more intensive market development at a later stage when resources permit and (b) to obtain a quick return on its investment in order to avoid delays in its expansion in other markets as a result of a financial overextension in Australia.

Management has authorized a comprehensive market study with the following objectives: (a) analyze the Australian market and determine the sales potential for the company's products; (b) evaluate the different marketing strategies and policies that might be used; and (c) choose the strategy and policies that harmonize best with the company's expansion strategy and current resource availability.

Questions

1. Explain how secondary information can be used to meet the objectives of the market study.
2. What kind(s) of data and sources of such data would be useful?
3. Should SAN A/S enter the Australian market? Defend your answer.

CASE STUDY 6.2

Aquabear AB

Aquabear AB was founded in 1970 in Stockholm, Sweden, as a small private company that manufactured maritime leisurewear clothing. In 1975 the company started a line of ski clothing using the brand name Snowbear.

By the end of 2009 the company employed about 175 people. The sales volume for 2010 was about SKr250 million. (Assume an exchange rate of US$1 5 SKr7.21. and euro 1 = 9.66 Kr.) The company has experienced a period of rapid growth in the past 10 years due to the market growth in sportswear and leisurewear and is financially sound. The Snowbear line of ski clothing has become the dominant product line due largely to the efforts of a creative designer (and skiing enthusiast) who joined the company in 1979.

Aquabear AB has all its manufacturing capacity in Sweden, and as a result of the previous year's success its plant and equipment has been brought up to date. In Sweden Aquabear sells directly to department stores and specialty retailers. The company has for decades been exporting to the western European market, mainly Germany, Austria, and Switzerland. Aquabear exports directly by using agents in the respective countries.

The skiwear products

Aquabear AB's Snowbear line of ski wear consists of high-quality clothing for Nordic and alpine skiers. Snowbear's trademark is a striking design in bold yet simple patterns and colors, a good cut, and high-quality material and finish. The garments are very functional with details such as closures at neck, hands, legs, and pockets very thoroughly thought out. The Aquabear production/design has followed market developments in fabrics for skiwear closely as well as successfully keeping up with fashion trends. The company has even become something of a market trendsetter for some items.

The collection of jackets, vests, ski suits and ski pants for men and women are matching and can be mixed at will. A typical collection consists of a couple of models and colors of each garment, although there are more jacket styles, since jackets are also bought for nonski winter wear.

The price level of the product line is in the upper ranges but not in the same top price bracket as the designer-label ski-wear collections. Approximate retail prices in Sweden during late 2010 were as follows:

	SKr
Ski suits	2,500
Jackets (alpine)	1,600
Jackets (Nordic)	1,100
Vests	900
Pants (alpine)	1,000
Pants (Nordic)	800

Management's search for new markets

Aquabear has been very successful in the past 10 years, especially with its Snowbear line of products. The increasing number of skiers, and the increased use of ski wear as winter and leisure wear as well as the Snowbear clothes' quality are the main reasons for this. The company's sales personnel judge that the primary customers are people of both sexes, both young and older people, belonging to middle- and upper-income groups, who rate quality and functional and original design higher than the price.

Ski wear is a seasonal commodity. In Europe the retail season is from late October until March, although this can vary with the weather. Encouraged by its success in the home and European markets, and a sound financial and organizational situation, management is interested in expanding its export markets to the southern hemisphere. The main advantage of this compared to entering new European or US/Canadian markets is expanding the market as well as being able to even out some of the seasonal variations in production and sales; the southern ski wear season complements the northern hemisphere season.

Selection of potential markets in the southern hemisphere

The countries in the southern hemisphere where skiing is possible and where the company is looking are: Chile, Bolivia, and Argentina in South America; Australia; and New Zealand. There is now a ski resort in South Africa catering to a rich, young clientele that may eventually prove of interest. The company has decided to exclude Bolivia because skiing is limited to one ski run (the highest in the world, however). The four remaining countries

Table 6.4 Economic and population indicators

	Chile	Argentina	Australia	New Zealand
Population (2009) Percentage of population in 15–64 years age group (2010 est.)	16.60m	40.9m	21.26m	4.21m
	67.9%	63.6%	67.8%	66.5%
Gross National Income per capita (2008)	US$9,400	US$7,200	US$40,350	US$27,940

can be analyzed in terms of geographic, demographic, economic, and political data in order to select the most promising export market(s) in the southern hemisphere.

The export manager, Wil Hønacker, has done some preliminary background research and has found that the ski season tends to run on average from May or June through September in Argentina, Chile, and Australia, while in New Zealand it may last as late as October or November. Each country has a number of major ski areas, including the following:

Argentina:	Cerro Catedral (Bariloche), Chapelco, Las Leñas and other areas.
Chile:	Portillo, Valle Nevado, La Parva, Farellones-El Colorado, Termas de Chillán plus other areas.
Australia:	Thredbo Village, Perisher Valley, Blue Cow, Mount Selwyn, Charlotte Pass (all in the Snowy Mountains of New South Wales); Mount Buller, Mount Hotham, Mount Baw Baw, and other areas in Victoria.
New Zealand:	Treble Cone, Coronet Peak, Mt Hutt, Mt Ruapehu, The Remarkables, Cardrona and other areas.

Mr Hønacker realizes that the process of market selection should include consideration of a number of characteristics. Accordingly he asks his assistant Harald Gornisson to do some further research. Mr Gornisson recently received his MBA from Simon Fraser University in Canada. After some searching, the basic information in Table 6.4 was obtained about the four countries from United States Census Bureau and Wikipedia.

Mr Gornisson reported back to Mr Hønacker and stated that the above information included only general indicators useful for screening potential export markets. To obtain a more comprehensive analysis of the four potential target countries, many other kinds of data such as purchasing patterns of ski wear and competitive situations should be obtained, as well as consumer expenditure on clothing and footwear, consumer expenditure on leisure, and tourist arrivals at frontiers. More specifically, the following types of information are suggested:

- number of skiing resorts, and number of active skiers;
- income level and standard of living;
- distance of skiing resort(s) from largest cities and other populated areas;
- customs duty, other import-related fees, and sales and value-added taxes;
- import restrictions such as import licenses and quotas;
- political situation (maturity, stability);
- extent of nationalism;
- growth potential of the market;
- language barriers that may exist;
- number (and source) of tourists;
- competition;
- transportation costs;
- foreign exchange situation.

When he was back in his office after meeting with Mr Hønacker, Mr Gornisson was thinking about what he had just done. He wondered why South Africa had not been included in the request made by Mr Hønacker. In the past few years, one major resort, Tiffindell, and four other ski areas had been developed.

Questions

1. Should Aquabear AB enter southern hemisphere markets with its line of ski wear?
2. If so, which market(s) should it enter and why?
3. If not, why not?

CHAPTER 7

Market entry strategies

Learning outcomes

In Chapter 7, we discuss:

- aspects of market entry:
  - channel structure
  - costs, prices, and control
  - relationships with company headquarters and other corporate units
  - locations of production and distribution facilities
- the whole channel concept and its importance
- alternative entry modes
- factors influencing choice of entry mode
- managing the channel
- using free areas

There are three cases at the end of the chapter. In Case 7.1, Avon Products, Inc. (B), is a sequel to Avon Products, Inc. (A) in which the company had been prohibited by the Chinese government from using its established marketing channel. This case discusses the actions taken by Avon, and the resulting outcomes. Klako Group, Case 7.2, offers services to companies interested in setting up businesses in China. Case 7.3, Li & Fung Ltd, is a Hong Kong company which manages the supply chain activities for many brands and retailers throughout the world.

Introduction

A market entry strategy consists of an *entry mode* and a *marketing plan*. The mode of entry is what is used to penetrate a target country while the foreign marketing plan is used to penetrate a target market. More formally, an entry mode has been defined as

> a structural agreement that allows a firm to implement its product market strategy either by carrying out only the marketing operation (i.e., via export modes) or both production and marketing operations there by itself or in partnership with others (contractual modes, joint ventures, wholly owned operations).
>
> (Sharma and Erramilli, 2004, p. 2)

A special case is entering a country only for production purposes and exporting the product (known as outsourcing or offshoring). The entry mode is important as it determines the degree of a company's control over the marketing mix (program), and to an extent the degree of its commitment, in the target market. Implementing an entry strategy for each market is analogous to establishing a *channel of distribution*. This may be for initial or continued entry.

Entry as a channel decision

Channel structure

A company's international marketing channel is the path in the structure of distribution through which the products of the company reach the final consumer or user. From the company's point of view, the structure of distribution consists of the marketing channels currently available in a foreign market together with those channels by which the market is reached in the first place. Thus, the structure of distribution for reaching any foreign market includes all of the intermediary marketing agencies or institutions that are in use by all companies at any given time, their capacities and capabilities, and their geographic coverage.

In developing its entry mode(s) a company must plan for the flow of two things that are involved when its products pass through the structure of distribution: (1) the flow of transactions, and (2) the flow of the physical product. The transactions flow, also known as the flow of ownership, is accomplished by the series of sales transactions negotiated or facilitated by the channel members that ultimately transfers ownership of the product to the final buyer. The physical flow moves the product itself to the final buyer through a series of physical movements and storage points. Throughout international marketing channels these two elements tend to coincide, but exceptions do occur. For example, the use of an export **broker** (to be discussed in Chapter 8) involves only the element of transactions; but when an export merchant (to be discussed in Chapter 8) is involved, both elements typically coincide. Of the two flows, that of ownership is perhaps more significant to management because ownership carries with it both risk and control. This is not to say that physical distribution (supply chain management, logistics) is unimportant. On the contrary, there may be instances where the physical flow has a definite impact on the transactions flow. A company may be able to make a particular sale only because the physical distribution system it uses gets the product to the buyer when and where it is wanted and at a reasonable cost, relative to other alternatives available to the buyer. In a similar manner, what happens after the sale is made (after-sales service) is also important as such service performance affects future export sales.

Many specific types of organizations may be involved performing the transactions and physical flows in a given international marketing channel of distribution. Of primary significance are the *marketing organizations* – independent companies of various types, overseas sales offices, and so on – that directly participate in these flows. They perform a direct role in the sales function. The independent companies, which may or may not take ownership of the products involved, are not under any direct control by the producer. In addition to marketing organizations there are other types of organizations – for example, banks, transportation companies, and advertising agencies – that provide useful and necessary services to the international marketer. Such institutions or agencies are not members of the marketing channel, but are *facilitating* or *service organizations*.

We can now define an international marketing channel of distribution as follows:

> a system composed of marketing organizations that connect the manufacturer to the final users or consumers of the company's product(s) in a foreign market.

Sometimes a channel is quite simple (or short), perhaps direct from a manufacturer to the final user or consumer. Often it is more complex (or long), utilizing many marketing organizations – independent or manufacturer owned.

Importance of the entry decision

In a number of respects the choice of entry modes or international marketing channels is important to management. Consequently a great amount of effort and patience must be provided by management when considering this decision.

Decisions on international marketing channels influence the price that final users or consumers will pay. For example, the margins required, and obtained, by independent organizations such as export merchants or wholesalers in the foreign market often constitute a significant share of the price paid by the final buyer. In some instances, if the marketing agencies can be eliminated from the channel, the price can be reduced. On the other hand, it should be recognized that eliminating such an organization may lead to an increase in price simply because the remaining channel members cannot perform certain activities as efficiently as a marketing agency that is able to specialize in the performance of these activities.

Policies concerning channels are related to production decisions. In the first place, location of production base (or sourcing) is the first channel decision that has to be made. Second, fluctuations in production may be reduced by proper selection of such channels. Greater production stability tends to eliminate or reduce problems of inventory control that face all the channel members. Moreover, production stability leads to security of employment, which is of increasingly great concern to individual workers, labor unions, and national governments both at home and abroad.

Another reason that entry mode selection is important is that the procedure of developing international channels can be slow and costly. The time and cost required in development can hinder a company that wants to expand its international operations by entering new foreign markets or a new industry. Also the future locational patterns and structural changes in distribution must be predicted, which may be difficult to do because of the great spatial distances involved and the limited availability of reliable data.

A typical manufacturer may do business in many countries, each one having a 'unique state' of general economic activity at any one period of time and each one exhibiting its own cyclical pattern of economic activity. The existence of such fluctuations, and their differences from country to country, makes the entry mode decision and the management of existing channels most difficult. For example, when there is a scarcity of supply in relation to demand (a seller's market exists), the practice of *selective distribution* (utilizing only the most profitable outlets and ignoring all others) may seem particularly inviting. However, for the long term, this can be a dangerous practice to follow since a seller's market cannot last indefinitely. Unless management is continually aware of existing economic conditions in each of its foreign markets, it may find itself operating in a buyer's market without really knowing that conditions have changed. A policy of selective distribution may not provide the outlets needed to compete effectively in such a market.

Many factors can have a major impact on market entry mode choices The economic situation in Asia in the late 1990s and the situation facing the world in the first decade of the 2000s affected manufacturers and other international marketers as well. In a meta-analysis of studies of the choice between wholly owned subsidiaries and cooperative entry modes, Morchett *et al*. (2010) found that the following antecedents had an impact:

1. *Market attractiveness* (market size and market growth).
2. *Uncertainty in the host country* (country risk, including the economic environment).
3. *The legal environment in the host country* (legal restrictions).
4. *The culture of the home country*, assessed by power distance (Hofstede, 2001) acceptance.

All antecedents had a negative relationship on the likelihood to establish a wholly owned subsidiary except for acceptance of power distance (i.e., culture of home country). A surprising finding was that increasing market size and growth led to market entry through cooperation. A study of telecommunications companies in the United States examined the role that resource variation plays in affecting a company's foreign market entry decision (Dowell and Killaly, 2009). Resource variation, represented by amplitude, frequency, and unpredictability of changes in market demand did deter entry, but experience with prior market entries moderated the effect. In another study, one of ventures of Swedish manufacturers in Germany, it was found that high relatedness (product/market and intangible resources) between a parent firm's core business unit and the foreign business unit and corporate international experience were antecedents of a full-control market-entry mode (Pehrsson, 2008). These examples illustrate the following – there is no one best entry mode for a product/market situation. Each situation is, in effect, unique.

But not everything works out as planned. A case in point is the US retailer Walmart, the world's largest retailer (and the world's largest company). In 2003, in addition to its stores in the United States it operated more than, 1,300 stores in 10 countries, ranking as the largest retailer in Canada and Mexico (Bianco and Zellner, 2003, p. 106). The road to success abroad has not always been smooth. Walmart's original ventures into Argentina, Indonesia, and Germany were 'failures,' resulting in large losses. In Germany, for example, in 1997 Walmart acquired 21 hypermarkets from Wertkauf, and 74 Interspar stores a year later. For many reasons, Walmart never made a profit in Germany. In 2006 it pulled out by selling its operations to Metro, a local retail company. A major error that Walmart made in Germany was to think small and ignore its competition, particularly the discount operator Kaufland (*Businessweek*, 2006).

Also in 2006, Walmart withdrew from South Korea, where it had 16 stores. The stores were sold to a local competitor. Since it was established in 1998, the wholly owned subsidiary, Walmart Korea, had ranked at the bottom among five major discount store operators (Olsen, 2006). The Walmart method of operation did not mesh well with the Korean housewife, and the company failed to attract customers to their stores. To cite another example, Lidl, a large German discount retail supermarket chain, pulled out of Norway in 2008 after four years of trying to establish itself. Lidl's stores were sold to Rema 1,000, a local Norwegian discounter (*The Economist*, 2008).

These examples illustrate that foreign markets are not guaranteed. Local, or world, economic conditions can change and lead to a change in buyer behavior. To illustrate, within the European Union, shoppers in Belgium, the Netherlands, and Britain began trading down during the economic downturn in the 2007–2008 period by purchasing their groceries at 'local' discounters. Thus sales at international retailers such as Carrefour, Tesco, and Walmart suffered (*The Economist*, 2008).

Economic conditions also can affect exporting manufacturers. China provides a good example. When orders from foreign buyers began to drop, the manufacturers turned to the domestic market more and more (Zhu, 2008). Such action has been encouraged by the Chinese government.

Withdrawing from a specific market should not always be considered final. Failure is not always due to bad management. One of the reasons for being unsuccessful is timing. Entry was at the wrong time. Another reason is lack of familiarity with foreign chains (at the retail level) and perhaps the products, which may be 'new' to the market. Exhibit 7.1 outlines the experience of a United States company in Mexico.

Entry mode is a vital part of the international marketing mix. Decisions on channels can limit the alternatives available to a manufacturer in the other activities making up the marketing mix, or at the very least constrain the tactical implementation of the other marketing variables. In exporting, for instance, if a manufacturer decides to use the services of an export management company (to be discussed in Chapter 8), wholesalers, and retailers, the general nature of the pricing problem to marketing organizations is determined. Also, the selection of specific marketing channels reduces promotion alternatives. The need for promotion support might affect selected dimensions of the total promotion program. Sometimes an international marketer will eliminate intermediaries in a foreign market because they do not promote the product(s) to the extent desired. Such an action

Exhibit 7.1 Try, try and try again

In 1992 Taco Bell, a United States fast food chain entered Mexico by opening a few outlets next to KFC restaurants. Taco Bell's restaurants did not last two years before they were closed. It seems that Mexican consumers were less familiar with foreign chains, the economy was on the verge of a crisis, and the North American Free Trade Agreement (NAFTA) had not been signed.

Since then, free trade and growing migration have made US brands ubiquitous in Mexico, influencing everything from how people dress to how they talk. Other US chains, such as KFC and Chili's Grill & Bar have been quite popular. Taco Bell, in 2007, decided to re-enter Mexico after 15 years since withdrawal. Their offerings reflected a more American fast food image using the same menu as that used in the US. The plan was to eventually have 300 stores.

However, the new plan was scrapped in 2010 due to low patronage.

Source: "Quiebra Taco Bell en México" (in Spanish). MSN. 2011 http://web.archive.org/web/20111001030934/http://noticias.prodigy.msn.com/analisis/articulo-contenido.aspx?cp-documentid=23188113

Exhibit 7.2 Eliminating wholesalers can 'backfire'

Warner-Lambert ran into major problems trying to sell its brands of chewing gum to the Japanese. Its wholesalers were not promoting the products to the extent desired, so a decision was made to change its strategy. The company attempted to eliminate its wholesalers from the channel of distribution. This turned out to be a big mistake. In addition to upsetting the wholesalers, the move created suspicions among the retailers, who often viewed companies as being unreliable if they switched business tactics. The decision was reversed, and Warner-Lambert asked its sales force to collect the retail sales orders for the wholesalers (Ricks, 1999, p. 113).

can turn out to be a mistake, as shown in Exhibit 7.2. A tested principle of marketing is that you can eliminate an intermediary, but you cannot eliminate the functions the intermediary performs.

Finally, the relations between the manufacturer and marketing organizations, and between two marketing organizations at different levels – such as wholesalers and retailers – can create some difficult problems for both. The basic source of difficulty is the inherent conflict of interest between the two. The selling organization wants the buying marketing organization to sell as much as possible for the minimum possible margin. In contrast, the marketing company buying for resale wants to maximize its own profits. This conflict is compounded by the complication in relations that arise because the companies involved will come from different cultures, societies, political systems, and so forth. In general, however, the area of mutual interest is far greater than that of conflict.

The whole channel concept

Management should be striving always to select the 'best' international marketing channel; the one that comes closest to completely satisfying target customers, fits the entire international marketing mix, and still satisfies the company's overall objectives. In this endeavor, the channel of distribution should be viewed as an integrated system with the manufacturer on one end and the final user or buyer on the other end. This can be called the *whole channel concept*. For the international marketing channel system there are three basic components, as follows:

1. the *headquarters' organization* developed by the manufacturer to implement its international marketing operations;
2. the methods used or channels through which the products are sent to foreign markets – the *channels between nations*;
3. the means by which these products reach the target, final user or consumer in the foreign markets, assuming that the importers are not the final users or consumers – the *channels within nations*.

Company organization has a unique relationship with the entry mode decision. In the first place, it is the headquarters' organization that supervises the channels used, including any intermediary marketing organizations. As such, then, it is an integral part of the channel itself. Second, the specific channel alternatives used can influence the structure of the headquarters' organization. For example, a company that is relatively new to international markets and/or one that markets only one product will need a different (and simpler) organization than one that is an established international marketer selling in many foreign markets and perhaps also having many products. Similarly, a company engaged in only exporting will need a different (and perhaps simpler) organization than one that also has overseas operations such as licensing or production facilities. Third, companies with fairly rigid organization structures will find themselves in a position where the existing headquarters' organization can limit the alternative avenues to serve foreign markets. For a multiple subsidiary company, the parent often influences what a subsidiary (strategic business unit, SBU) does in its foreign market entry by 'forcing' the subsidiary to do what other company business units have done facing a similar environment. This practice may not be best for a specific subsidiary as the country environment is only one of the factors that influence what entry mode would be most beneficial and profitable to a company. As we discuss later in this chapter, there are many external and internal factors that need to be considered. For any given company the nature of the interdependence between its headquarters' organization and international marketing channels and between the international channels themselves will depend on its present stage of internationalization development, and different managements find themselves at varying stages of development.

The international marketing channel is viewed as a two-phase system to emphasize the whole channel concept. This is particularly important when independent marketing organizations are part of the channel since many exporters think that their channels end with these organizations. Since a channel is only as good as its weakest link, international marketers should be concerned with *all* the links in the channel. To do otherwise is an invitation to trouble, particularly for the firm entering a foreign market for the first time. Certain actions of intermediaries, especially overseas 'domestic' wholesalers and/or retailers, may at best hinder and possibly even completely destroy the long-run profit potential of doing business in a market.

Entry as a strategy

Entry into foreign markets, initially and on a continuing basis, should be made using methods that are consistent with the company's strategic objectives. From a strategy perspective, entry mode is influenced by the international strategy pursued by the firm for its foreign venture or market expansion. All market entries may not be motivated by the same international strategy. Thus, the choice of entry mode is made to facilitate the firm's international strategy for a particular foreign market entry. When a firm becomes committed to international markets (becomes more than a casual exporter) it is well on its way to becoming *internationalized*, even if limited only to export operations. Exporting may be the best international learning experience, something that takes a firm toward more and more sophistication and commitment to other modes of international marketing such as establishing a manufacturing facility in a foreign market.

The elements of entry strategy

The strategy for how foreign markets are to be entered (the international marketing channel strategy) should be viewed as a comprehensive plan, which sets forth the objectives, resources, and policies that will guide a company's international marketing operations over some future time period which is of sufficient length that the company can achieve sustainable growth in foreign markets. For the firm new to international marketing or new to specific foreign markets it has been suggested that the entry strategy planning horizon be three to five years.

Rather than view entry strategy as a simple plan, in practice it is actually a summation of individual product/market plans. Each target market is unique in some ways and each product has unique market needs. Therefore managers need to plan the entry strategy for each product in each foreign market. In short, managers must think in terms of a *product/market* as the relevant unit for decisions. While the end result of this process may exhibit similarities, one cannot assume that market response to a particular entry strategy will be the same for different products and country markets. In some national markets it may be necessary to vary, or at least consider varying, the entry strategy within the market itself, especially when the entry is to serve the market rather than for sourcing only. Very broadly, a foreign market entry strategy can be viewed as a plan for the marketing program to be used for the product/market. As such, then, it requires decisions on the following:

- the objectives and goals in the target market;
- needed policies and resource allocations;
- the choice of entry modes to penetrate the market;
- the control system to monitor performance in the market;
- a time schedule.

The dominant objective should be to build permanent market position and whatever resources are needed for this should be committed.

The last two decisions are part of a broader activity, namely, managing the international marketing channel. In addition, an international marketing plan should include an analysis of the target market and the market environment, a financial analysis, and an evaluation of competitive conditions. Yet such an approach may be useful for the 'newcomer' firm and to companies needing to gain export experience and greater confidence in their own ability.

The extreme case of the newcomer firm is the totally new firm. Viewing internationalization, such a company must choose between an international new venture (INV) or a sequential entry strategy. An INV is a company that, from its inception, looks to multiple countries for its markets (Mudambi and Zahra, 2007, p. 333). As a start-up, the INV establishes its presence internationally in more than one country straight away, rather than sequentially over time. The INV appears to be the approach favored by 'entrepreneurial' companies.

INVs are not alike. A typology of INVs is proposed by DiGregorio *et al*. (2008) that is based on a combination of foreign-based resources and individuals versus actions that involve introducing domestically based resources and individuals into a foreign market. Figure 7.1 shows this typology. The types of INVs range from domestic new ventures (quadrant I) to international resource and market combination (quadrant IV).

In addition to being affected by its newness, the INV may also be affected by liability of foreignness (LOF), which can affect all companies' foreign market entry. LOF refers to the fact that foreign companies incur additional costs when operating internationally (Hymer, 1976). Within the context of market entry in China, a study by Chen *et al*. (2006) concludes that LOF does play a significant role in determining market entry strategy. LOF could influence the perceptions of marketing managers driving strategy decisions. Thus, there is need to incorporate LOF into the strategic decision-making process.

Extensive cross-border combination of resources and individuals	**III. Cross-border resource integration**	**IV. International resource and market combination**
Domestic combination of resources and individuals	**I. Domestic new ventures**	**II. Accelerated international sales**
	Domestic market opportunities pursued	Extensive cross-border market combination opportunities pursued

Figure 7.1 Typology of international new ventures
Source: DiGregorio *et al.*, 2008, p. 191.

In planning international/export marketing channels, the first step after delineating the target market(s) is to specify the objectives of the channel or channel group, that is, what the channel is to accomplish. After the target markets and channel objectives have been determined, the international marketing mix to be used in serving the target markets must be outlined. There is a two-way relationship between channels and the international marketing mix. Ideally, all elements of the marketing mix should be determined simultaneously. In practice, however, some must be determined first, and it is these elements that provide the base upon which the others are determined. For example, in determining the price of products, a manufacturer limits pricing alternatives once a channel has been selected. In the same way, if a price has been established first, then the alternative channels available from which one can choose may be limited severely.

Alternative market entry modes

An international market entry mode is an institutional arrangement necessary for the entry of a company's products, technology, and human and financial capital into a foreign country/market. To the international marketer, different entry modes represent varying levels of control, commitment, involvement, and risk. A study of how the interaction of opportunity for control and firm capability of managing risk moderates the amount of risks that managers perceive to be present with various entry mode strategies was conducted for three modes: export, 50-50 joint venture, and sole ownership (Forlani *et al.*, 2008). The study was of US firms entering the Japanese market. Managers in the lower capability firms saw the least risk in the export entry mode whereas those in higher capability firms saw the least risk in the joint venture mode.

Concerning channels between nations, there are major alternative strategies for entering a foreign market, as shown in Figure 7.2. The first decision that must be made concerns where the production base should be located – in the home country, overseas, or in a free area (free port, trade zone, perimeter). After this decision has been made, a company must decide whether or not areas are to be served outside of the countries in which production facilities are located, and, if so, what channels between countries are to be used. We discuss briefly each of the major alternative entry modes. More detailed discussions are presented in Chapters 8 and 9.

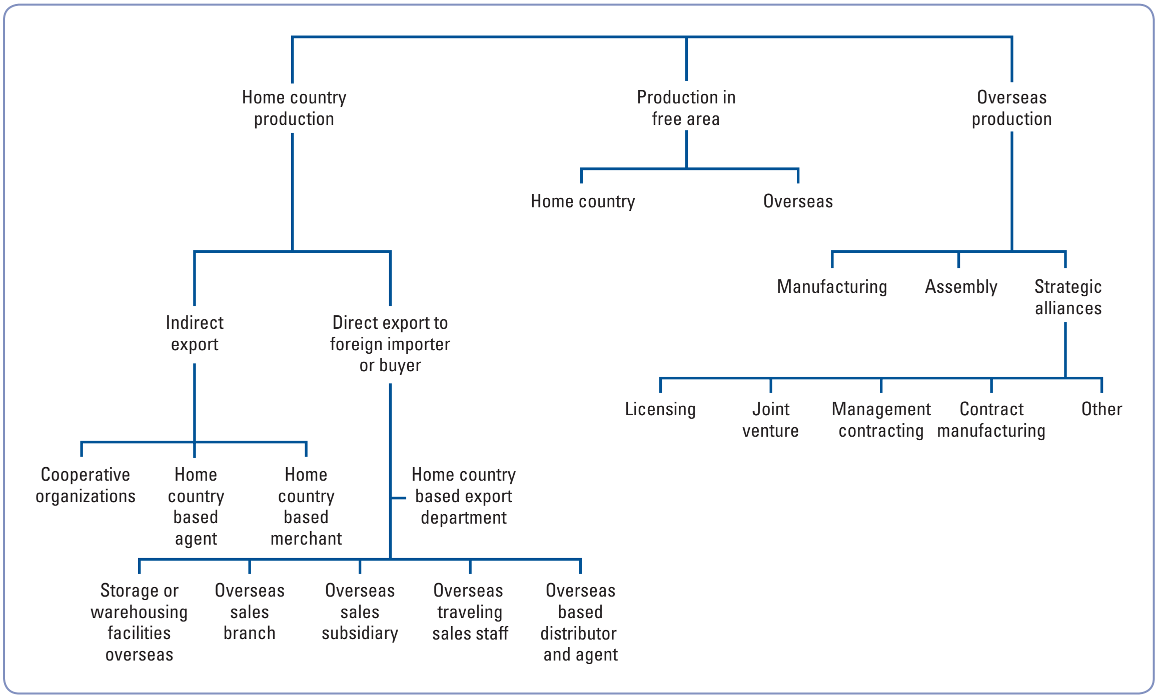

Figure 7.2 Outline of alternative basic international marketing channels

Channels between nations

Exporting

Perhaps the simplest and easiest way to meet the needs of foreign markets is by exporting. This approach generally has minimal effect on the ordinary operations of the firm, and the risks involved are less than other alternatives. At the same time, many companies long involved in foreign markets still export on a regular and permanent basis. Nike and other casual shoe manufacturers, for example, use export to do business in North America and Europe, with products actually produced in China, South Korea, Indonesia, and Taiwan by contract manufacturers. Similarly, clothing manufacturers – including those with 'designer clothes' – have their products manufactured in China and other countries in Southeast Asia and Central America and use export to serve North American and European markets.

Management can choose from two broad avenues of exporting – *indirect* or **direct export**. These two basic forms of exporting are distinguished on the basis of how the exporting firm carries out the transactions flow between itself and the foreign importer or buyer. In indirect export the manufacturer utilizes the services of various types of independent marketing organizations or cooperative organizations that are located in the home country. When a manufacturer exports indirectly, the responsibility for carrying out the foreign selling job is transferred to some other organization. On the other hand, in direct export the responsibility for performing international sales activities is in the hands of the producer. These activities are carried out and managed by so-called dependent organizations that are administratively a part of the manufacturer's company organization. In essence, then, the choice facing a company is whether market entry and/or expansion is to be handled by an integrated channel (captive or company owned) or by a channel that includes independent intermediaries.

Increasingly, some companies are turning to the Internet as a means of exporting to foreign markets. This is *e-commerce*. The Internet has potential usefulness for companies that can sell direct to the foreign market or direct to intermediaries within the domestic market who would then handle the export transaction. The Internet seems to be better suited for B2B than for B2C marketing, although B2C will increase as the percentage of the population having Internet access increases. The Internet is open to all types of companies – manufacturers, wholesalers, 'regular' retailers, service companies, and companies that started as Internet-based and which do all their business using this method (the so-called dot-coms), such as Amazon.com and eBay. This is a tool that either supplants or supplements other techniques such as direct mail or telemarketing, or even personal selling. However, as with all newer technologies, the international marketer who chooses to use the Internet should do so selectively, and with caution. There are still many legal issues to be resolved that could affect relationships consummated by this means (Wijnholds and Little, 2001). Exhibit 7.3 discusses the role of e-commerce drivers in export marketing strategy. There still

Exhibit 7.3 E-commerce drivers

E-commerce is more than simply buying and selling goods electronically. According to Gregory *et al*. (2007, pp. 31–2), e-commerce is an environment for presenting, trading, distributing, servicing customers, collaborating with business partners, and conducting transactions using electronic technologies such as the Internet.

There are four major e-commerce drivers that are relevant to export marketing strategy (ibid. p. 32).

Internal drivers

1. *Product online transferability.* This is the extent to which a product can be digitized for transfer over the Internet.
2. *E-commerce assets.* These are allocated technology and human resources in the service of e-commerce activities. These assets are a means to acquire resources that are critical to developing technical infrastructure and human skills, and so on.

External drivers

1. *Export market e-commerce infrastructure*. The set of resources that enable reliable and affordable access to all parties involved in e-commerce transactions in the export market. There are several layers of infrastructure.
2. *Demand for e-commerce*. The extent to which the parties involved in the export business pursue a greater usage of e-commerce in business relationships and transactions.

E-commerce drivers are more than the antecedents to export marketing strategy. They can operate as so-called enablers of a firm's adaptation of export marketing strategy to export market conditions. That is, in addition to driving export marketing strategy directly, e-commerce drivers also moderate the effects of traditional (external and internal) drivers on export marketing strategy (ibid. p. 34). The direct and moderating effects of e-commerce drivers on export marketing strategy are summarized in Figure 7.3.

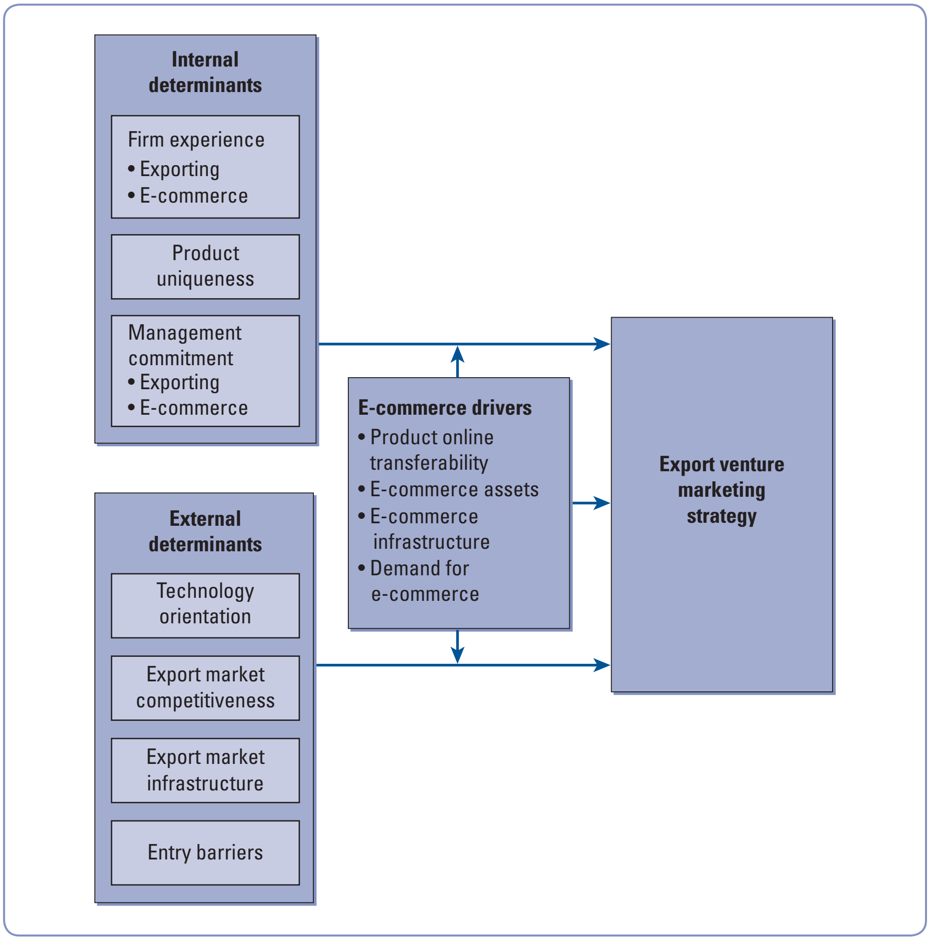

Figure 7.3 A model of antecedents and drivers of export marketing strategy

Source: Gregory *et al*., 2007, p. 34. Reprinted with permission from *Journal of International Marketing,* published by the American Marketing Association.

is the potential problem of government censorship and filtering of the Internet. For example, China has completely shut off YouTube, Facebook, and Twitter. In early 2010 Google stopped censoring the Internet for China by moving its search engine from the mainland to Hong Kong (Olesen, 2010).

Licensing

One of the first means that a manufacturer can use in expanding international operations beyond exporting is licensing agreements. Licensing includes arrangements for the foreign licensee to pay for the use of manufacturing, processing, trademark or name, patents, technical assistance, marketing knowledge, trade secrets, or some other skill provided by the licensor. Franchising is a special type of licensing.

Licensing is a viable means of developing investment footholds in overseas markets, and a complement to exporting and direct investment in manufacturing facilities. It often constitutes a prelude to a more permanent equity investment.

Contract manufacturing

This strategy involves contracting for the manufacture or assembly of products by manufacturers established in overseas markets, while still retaining the responsibility for marketing. Under certain circumstances, for example in the book-publishing field, the contractor firm may distribute the products through its own outlets. This method allows a company to break into international marketing without making the final commitment of setting up complete manufacturing and selling operations; yet the way is kept open for implementing a long-term development policy at an appropriate time. Often this approach is used for sourcing because of lower cost of production. When used only for sourcing it is known as outsourcing or offshoring. Nike and other shoe producers, as mentioned earlier, use Asian contract manufacturers.

Management contracting

In management contracting a local investor in a foreign market provides the capital for an enterprise, while a company from 'outside' provides the necessary know-how to manage the company. Such an approach to entering international markets is a low-risk way, if used with some type of purchase option. It allows a company to manage another company without equity control or legal responsibility.

Manufacturing

The decision to manufacture abroad may be forced upon a company because of competitive pressure, market demands, government restrictions on imports, or government actions that would result in imports being at a disadvantage. Or the decision may be part of a company's long-run plan to strengthen its international operations. Rarely should a company establish manufacturing facilities as its first international business operation. Exceptions exist, however, if the policies and regulations of the foreign government are such that the best way to enter the market is through direct investment in a manufacturing facility, which may be by 'starting from scratch' or by acquisition.

Assembly operations

The establishment of assembly facilities represents a cross between exporting and foreign manufacturing. When following this strategy, a manufacturer exports components or parts. At the foreign assembly site these parts, often with those from other suppliers, are then put together to form the complete product. When a product is exported in this manner, savings may be realized in freight charges, various foreign government fees and in some countries (for certain products) Customs duties. Assembly has been widely used in the global automobile and personal computer industries.

Joint venture

This strategy is followed in a foreign market when a non-national company joins with national interests, or with a company from another foreign country, in forming a new company. The central feature of a joint venture is that ownership and control are shared. A company may be forced into a joint venture in a specific foreign market because of local government policies (e.g., in China), nationalistic feelings, or intense competitive pressure. Yet some companies select this approach voluntarily, because it is more profitable in the long run than other approaches.

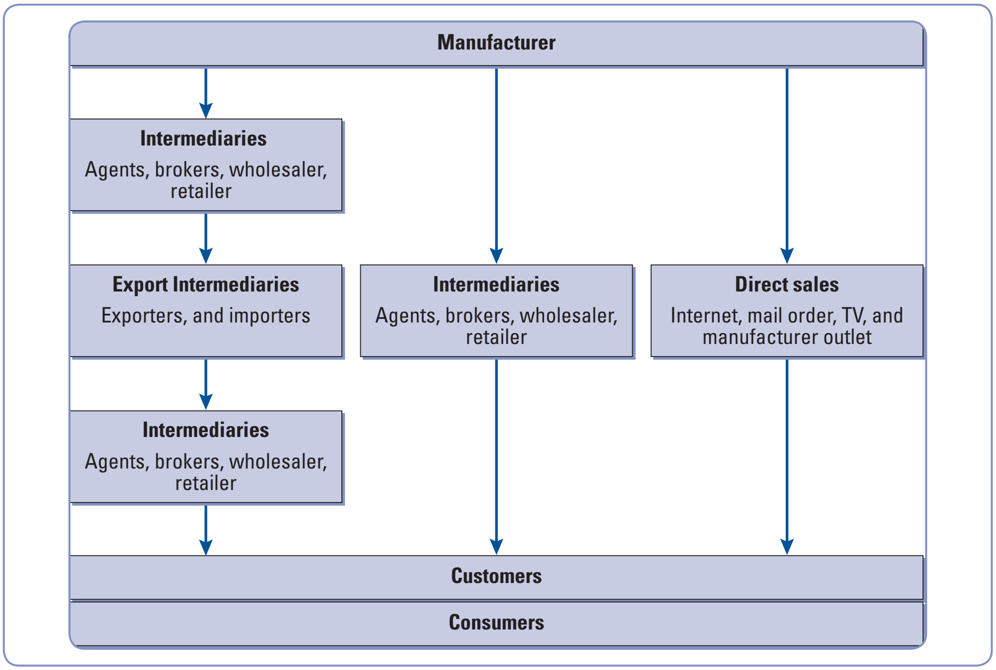

Figure 7.4 Some alternative channels within a nation

Other

An emerging type of alliance is the *outsourcing* of service work. Major countries where this is being done are India, China, and the Philippines. India, for example, is being used by US companies for creating call centers. India offers better-educated (college educated) workers than its US counterparts (high-school educated).

China is rising fast as a services and manufacturing outsourcing hub. In 2004, China's role was largely focused on providing back-office support for financial service, telecom, software, and retailing companies in neighboring Asian countries (Einhorn and Kripalani, 2003). Since then, companies from English-speaking countries are starting to look to China for call centers, back-office work, and manufacturing.

Channels within nations

There are many different ways that a manufacturer's product can reach consumers or users after the product has entered the foreign market. Some broad alternative channels within a nation are shown in Figure 7.4. When products are produced abroad these channel decisions are 'domestic decisions' in each market. Often a channel within a nation can be long and complex.

Oftentimes, the channel within a nation that is selected is a result of *extending* the domestic channel to gain economies of scale, because product characteristics are generally similar and because of strategic momentum. Extension of distribution channels is one application of the broader practice of extending all types of marketing activities and strategies from domestic to foreign markets. Extension has been defined as *the amount of change from home market use of a marketing activity, program, or strategy when used in a foreign market* (Albaum *et al*., 2003, p. 107), and can range from total extension to no extension at all.

Factors influencing choice of entry mode

The decision concerning what specific international marketing channels to use is not a simple one for the manufacturer. The existence of a great variety of types of international marketing organizations and the many ways they may be linked together have generated different types of alternative marketing channel systems, as we have just discussed.

Selection of mode of entry can be based on either or both of two broad approaches: through experience or through analysis. A company, through its own experience or that of other firms (competitive or otherwise), may decide that a particular entry mode is desirable for its product. In contrast, the same mode, or any other, may be arrived at after making an analysis of the marketing task, needs and buying habits of potential customers, and the competence of marketing organizations to perform various activities. In either approach, the end result is based essentially on needs and capabilities. Thus, the decision revolves around both internal and external considerations.

Regardless of the approach used in entry mode selection, the choice should be based on the alternative expected to give the greatest contribution to profit. Generally speaking, this may be easier said than done, particularly for those foreign markets where relevant data that are normally useful in making this type of decision are lacking. Many of the selection criteria are qualitative in nature, often defying any attempt at quantification. These criteria are relevant for the needed entry mode strategy decisions that have to be made. Such decisions involve formulating policies for the following areas:

- the type or kind of entry mode to be used, and, thus, the channel length;
- the selection of individual channel members;
- managing the channel, including relations with channel members and provision for feedback from the channel.

Type of mode

Questions about type or kind of entry mode or channel involve the types of marketing organizations, if any, to use. Thus, the international marketer decides how far its own organizational structure should be extended toward the consumer or user.

Target market

There are certain market-related factors that operate as international marketing channel determinants. These can be categorized into the following three groups:

1. the nature, size, and geographical distribution of customers;
2. the needs, requirements, and preferences of these customers;
3. the level of economic development of the market.

In addition, the question of 'market access' may arise in a given situation. The extent to which there is access to a market will depend upon other factors such as the location and needs of customers, the competitive situation and the infrastructure development and intermediary availability within the market. Finally, political stability and legal barriers can be significant entry mode determinants.

If potential buyers are diverse in character, if they are widely dispersed geographically, and if they buy frequently and in small quantities, there must be broad product availability, which would require the use of wholesalers and retailers (for consumer goods) within the market. Of course, were the opposite conditions to prevail, direct sale to retailers or industrial users would be more likely to be feasible. The more highly specialized the market and the more geographically concentrated it is, the shorter the channel is likely to be. At the same time, the preferences of customers cannot be ignored. If customers expect to find products in certain types of marketing organizations then they must be there, regardless of what the size and geographical concentration conditions indicate.

The level of economic development of a foreign market is an entry mode determinant in that it affects the overall organization of alternative channels, that is, the structure of distribution. Although this is a market-related factor, its impact is felt through the factor of availability of suitable marketing organizations within the target market.

Finally, the degree of political stability and extent of legal barriers that exist can affect the choice of channel in a target market. Both factors are derived from governmental policy and are attributes of a market. For example, a market with a high degree of political instability would involve a high degree of risk for a firm using direct export or production abroad in that payment (or profit repatriation) may be slowed or blocked altogether or desired currency may be in limited supply. If such a situation were to exist or be suspected, then indirect export (if a buyer could be found) would be better for the manufacturer.

Product

The nature of the product affects channel selection because products vary so widely in their characteristics (e.g., unit value, weight and bulk, technical complexity, and perishability) and use and because the selling job may differ markedly. For instance, the technical nature of a product may be such as to require service work both before and after sale. In many foreign market areas, especially in the developing nations, marketing intermediaries may not be able to handle such work. Also, the size and weight of the product or even the temperature, as in the case of frozen foods, may indicate the need for special handling facilities that marketing organizations might not have. These are situations where wholesalers are not likely to be used. Similarly, product perishability, either physical or in the form of fashion, often makes speed in distribution both necessary and desirable. Thus the international marketer will use a shorter channel than might otherwise be used, and direct export may be preferred.

The stage of development of a product as well as its relative newness to a foreign market can have a bearing on the channels to be used. If a company has a relatively unknown product, it might find it more beneficial to rely upon wholesalers and/or agents rather than try to sell direct. One exception to this would be when the product is part of a wider product line that is known to customers.

Availability of marketing organization

An international marketer's choice of entry mode is affected by the existing structure of distribution both in the home country and in the target market, and by the availability and competence of intermediary marketing organizations within the structure. An example of small retailers in a developing country is shown in Figure 7.5. Figure 7.6 shows examples of small retailers and larger 'designer' retailers in a more developed area. If 'good' marketing intermediaries do not exist or are already committed to handling competitive products, the international marketer/exporter may have to use a more direct mode of entry both between nations and within the target market. In some instances the lack of suitable

Figure 7.5 Shoppers at Chatuchak weekend market in Northern Bangkok, Thailand. It is the largest market in Thailand.

(a)

(b)

(c)

Figure 7.6 Retailers of all types are key to the successful marketing of consumer products in foreign markets. The images here depict (a) a street market in Kowloon, Hong Kong, (b) Queen Victoria market, Melbourne, Australia, and (c) a shopping mall in Lisbon, Portugal marketing organizations may even be a deciding factor in a company's decision not to enter a foreign market.

Company considerations

A number of factors can be classified as company related. Most of these factors are influential in determining the marketing strength of the international marketer. Included are the following:

- marketing management capability and know-how;
- newness of the company to international marketing activities;
- size of the company and width of its product line;
- financial strength and ability to generate additional capital if needed;
- parent institutional norms.

Generally speaking, the greater the marketing strength, the better able, and more likely, a manufacturer will be to sell direct. A counterbalancing factor, however, is that the best and most aggressive marketing organizations often prefer to deal with established manufacturers that have marketing strength.

Another company-related factor that can affect the choice of a channel is management prejudice. There are times when influential executives have a preference for a particular channel. Regardless of their reasons, if these managers are truly influential, their choice will be selected even if analysis or experience indicates that some other alternative is more desirable. This is more likely to happen when choosing a channel between nations than when choosing channels within foreign nations. For example, the managing director of a Norwegian company may decide that the entry mode for Spain should be a sales branch or sales subsidiary, or some form of investment, perhaps even locating the facility along the Costa del Sol. This decision may have been influenced primarily by the executive's wish to have a nice place to visit on a business trip, particularly in the winter months.

As discussed earlier in this chapter, another company-related factor is the extent of control that is desired by the international marketer. This factor may affect the choice of both the channel between nations and channel within a nation. For the export mode of entry, for example, the use of indirect export gives weaker control over export sales than does exporting directly. Indeed, the truly integrated or captive channel gives the greatest control over export operations. For nonexport operations, the greatest control (and risk as well) is derived from a wholly owned overseas production (or service) facility. In the case of the internationalization or globalization of a retailer, when choosing between wholly owned and franchising, the greater control is achieved by wholly owning the units, but the cost will be higher (Park and Sternquist, 2007, p. 283).

A final company-related factor is related to the overall internal institutional environment that affects subsidiary behavior in a multisubsidiary company. This environment can place on individual SBUs in a company pressures to conform with what other units in the company are doing.

Governmental policies

There are many actions by national governments that can affect channel selection, particularly the channel between nations. General regulatory activities may discourage export entirely and dictate production abroad if the market is to be served effectively. Also, some governments regulate their foreign exchange and import licenses in a way that local importers cannot get enough foreign exchange (or the necessary license) to buy what they want from various countries. This may be due to a shortage of particular currencies or it may be that only a small amount is available for importing certain products that are not believed to be important in a country's overall development plan.

Another governmental factor in channel selection is the nature of any existing international business promotional program. Although governments tend not to promote imports, it may be that when such promotion is done it is carried on selectively, and certain products are excluded. Thus, although there may be no formal trade restrictions against its product, an international marketer may be forced to select a channel between nations that compensates for the discouragement by the government. The same type of situation may prevail in the international marketer's home country if its government's policies toward direct investment and/or export promotion are such that some form of export will have to be used, despite any greater value that can be obtained by using some other entry mode.

There may be actions by subnational government bodies that have an effect. For example, an exporter of Scotch whisky (from the United Kingdom) to the United States finds that in certain states the channel within a nation is predetermined; the product must be sold through a state-owned distributor and state-owned retail stores.

Finally, the actions of governments (regulations, etc.) on e-commerce and the Internet are evolving and changing, making it difficult for the international marketer using, or wanting to use, this method of market entry to gauge any effects upon its operations with any degree of certainty. The newness and rapid changes in technology have led to what amounts to a regulatory vacuum in many areas. In China, for example, the Ministry of Information Industry (MII) has issued many rules restricting what dot-coms can do and censoring what they can say. In Europe, companies face a patchwork of conflicting local regulations. Europe's privacy laws, for instance, are much tougher than those in the United States. A digital signature may be legal in one country, but invalid in another. Thousands of different business and sales taxes are levied around the world. The globalization of the Internet is creating pressures to develop a globally accepted commercial code (Wijnholds and Little, 2001).

Concluding comment

The criteria for selecting international marketing channels that have been discussed in this section, while not all inclusive, are sufficient to show the complexity of the problem. Seldom, if ever, will the international marketer find the channel determinants all pointing in one direction. Management must find a balance among them and evaluate alternative systems. A good, detailed discussion is given by Root (1994, pp. 28–40).

Qualitative criteria can be used to limit the possible number of channel alternatives to a feasible few. Hopefully, these alternatives can then be evaluated on the basis of quantitative criteria. In the end, however, necessary trade-offs will most likely have to be made. This emphasizes the need to recognize that the determinant factors influencing firms' entry choice are interrelated. A study by Agarwal and Ramaswami (1992) based on the framework of Dunning (1988) provides evidence of interrelationships among a company's *ownership* (ability to develop differentiated products, size, and multinational experience), *location* (market potential and investment risk), and *internalization* (contractual risks) advantages when choosing among exporting, licensing, joint venture, and sole venture as a means of foreign market entry. These three sets of factors have an impact on a company's entry mode decision by affecting management's perception of *asset power*,

Table 7.1 Logistic regression models' coefficients for types of services

Variables	Type of variable	Capital-intensive services	Knowledge-intensive services
Constant		−13.952***	−8.164
Country risk	TCA	.041**	−.011
Cultural distance	TCA	−1.029†	−.281
Marketing intensity	TCA	.804*	.173
Tacit know-how	OCP	−.269	.171***
Size	OCP	.955	.134
International experience	OCP	−.050*	.143
International strategy	S	.665	3.948**
Trend-following motives	S	1.550***	1.240
Market-seeking motives	S	.584	−2.273**
Exploitation motives	S	.523	1.649*
Exploration motives	S	.308	−.777***
Experience in the entry mode	S	−.525	1.240*

*$p < .05$ ** $p < .01$ *** $p < .001$ †$p < .10$ (one-tailed).

[a]TCA 5 transaction cost analysis; OCP 5 organizational capability perspective; S 5 strategic.

Note: Dependent variable: shared control (0) and full control (1).

Source: Adapted from Sanchez-Peinado *et al.* (2007, p. 84). Reprinted with permission from *Journal of International Marketing*, published by the American Marketing Association.

market attractiveness, and *costs of integration* (Agarwal and Ramaswami, 1992; Park and Sternquist, 2007). In a study of Spanish-based multinational service companies comparing full-control versus shared-control entry modes, the impact of transaction cost analysis variables (TCA), organizational capability variables (OCP), and strategic variables on the choice between the two modes was examined (Sanchez-Peinado *et al*., 2007). The relative importance of these variables differed depending upon whether a company was capital-intensive (e.g., transport) or knowledge-intensive (e.g., financial services). As shown in Table 7.1, for capital-intensive companies, TCA and OCP variables were more important than strategic variables. In contrast, in knowledge-intensive services, strategic variables influenced the entry mode decision more than the traditional TCA and OCP variables. Another approach is shown in Exhibit 7.4.

In Chapter 5 we discussed the 'temperature gradient' approach or model to international market expansion. This model uses a number of measures to assess the attractiveness of a market's environment. Four categories of environments are identified, ranging from 'super hot' to 'cold,' and there is a presumed relationship between market temperature and entry strategy. The results of a study of Canadian companies indicate that companies follow entry strategies involving greater control and commitment as the country's environment becomes hotter, which is what the temperature gradient model itself would predict (Papadopolous and Jansen, 1994).

In general, 'foreign entry mode' has tended to be viewed as a singular entity, even though companies often use multiple or mixed modes in the same foreign market. Firms that start with export to a market and then move to an alliance or manufacturing operation often

Exhibit 7.4 Entry mode and involvement

One approach to the entry mode decision considers *extent of involvement* as the key question to be answered (Punnett, 1994, pp. 79–80). Each mode of entry can be viewed in terms of desired degree of involvement – indirect export would have the least involvement while equity investment would have the most involvement. Involvement depends upon location attractiveness, firm capability, and perceived risk. With each of these determinants having two options (high, low), eight possible scenarios emerge, as shown in Figure 7.7.

1. High location attractiveness High capacity High risk	5. Low location attractiveness High capacity High risk
2. High location attractiveness High capacity Low risk	6. Low location attractiveness Low capacity High risk
3. High location attractiveness Low capacity Low risk	7. Low location attractiveness Low capacity Low risk
4. High location attractiveness Low capacity High risk	8. Low location attractiveness High capacity Low risk

Figure 7.7 Alternative levels of involvement

Cell 2 is most attractive – a company wants to maximize involvement given the limiting factors; that is, if full ownership is allowed this would be the choice.

Cell 6 is least attractive – a company wants no involvement or minimal involvement; that is, if it is approached by someone who wishes to buy its products and will take all the risk the company would agree, but would not go after this market otherwise.

Cells 1, 3, 4, 5, 7, and 8 are mixed – a company must decide what degree of involvement will maximize the advantages and limit the effect of the drawbacks.

Source: Adapted from *Experiencing International Business and Management*, 2 ed., Thomson South-Western (Punnett, B.J. 1994) p. 80, Exhibit P4.1, From Punnett, Experiencing International Business and Management, 2E. © 1994 South-Western a part of Cengage Learning, Inc. Reproduced by permission, www.cengage.com/permissions.

continue to export to that market. Four forms of multiple entry modes have been identified, as follows (Petersen and Welch, 2002):

1. *Unrelated modes*: occurs when a company uses more than one mode in a foreign market, but there is no connection between their uses within that market. An example is a company that does business in different industries or markets and uses a different mode for each.
2. *Segmented modes*: occurs when a company uses multiple modes in the same industry or market to serve different segments.

3. *Mode complementarity*: multiple modes are used in a combined mutually supporting way to achieve the firm's objectives. The same segment may be involved, but different activities in the value chain are handled by different modes. For example, the manufacturing activity may be handled by licensee or contract manufacturer, but marketing is done through a sales subsidiary established in the country.
4. *Competing modes*: the different modes compete with each other by targeting the same segment(s) and performing the same activities. Ownership and location differ.

Particular modes may be used in different ways to achieve different objectives such as supporting the impact of another mode or by achieving outcomes beyond that possible with a single mode. So-called *mode packages* have been used to increase revenues and foreign market penetration, and other benefits as well.

Exhibit 7.5 illustrates the nature of a complex decision-making process regarding entry mode.

Exhibit 7.5 The entry mode decision process

Often the decision process for choosing entry mode can be simple or complex. Simple processes occur when the decision is based on one or two variables such as desire/need for control, risk, cost, and so on. There are companies, however, that consider many factors when making this decision. To illustrate, using Dunning's (1988) framework, if a retailer was deciding between wholly owning or franchising its outlets in a foreign market or markets, a model such as that shown in Figure 7.8 might be involved in its decision process (Park and Sternquist, 2007). As shown, growth experience and resource availability can affect the impact of ownership advantages, internalization advantages, and pioneering (i.e., location) advantages. Carried to the extreme, this would involve a complex decision process.

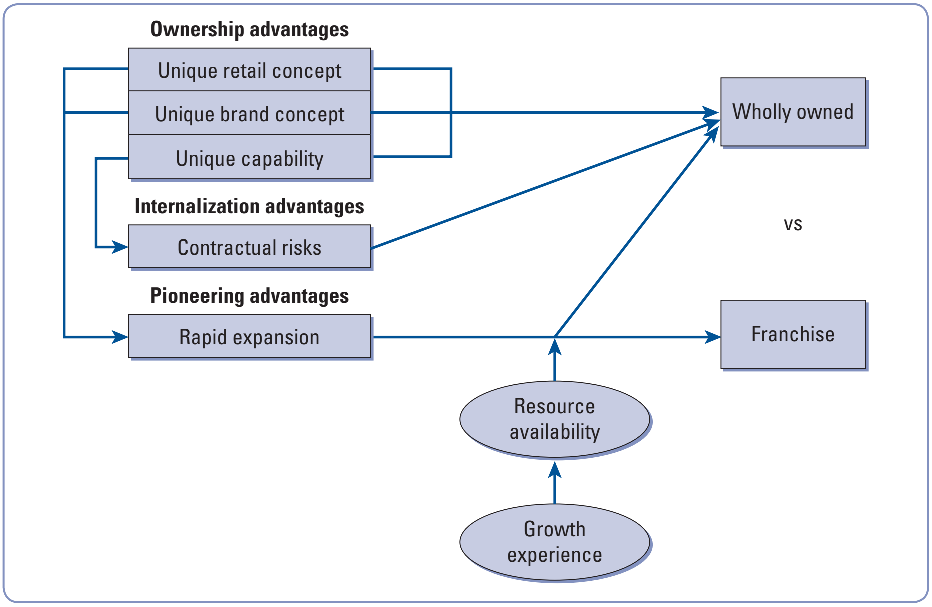

Figure 7.8 Model of a global retailer's entry mode choice

Source: Park and Sternquist, 2007, p. 284.

Channel members

Along with deciding upon the *type* of entry mode, the international marketer must select those marketing organizations that are to be members. While our discussion of selection criteria might lead one to believe that selection is autocratic, this is not the case. For at least two reasons the international marketer does not necessarily control the choice of individual firms in the channel.

First, in view of the realities of the competitive situation in the world's marketplaces, a marketing organization, particularly a good one, has many products from which to choose. Therefore such a company can be selective in the decision on whether or not to carry a product. This means that the channel to be used depends upon the relative strength of the international marketer, its product, and the marketing intermediary. An example of where the marketing organization can be the stronger party is with the giant Japanese trading companies, the *sogo shosha*.

A second reason that the international marketer lacks complete control over the members of the channel is that generally the international marketer can select marketing organizations only at one level in the channel. For example, in the distribution of consumer goods the selection of retail outlets typically is left entirely to those institutions selected at the wholesale level; the choice of wholesalers is left to the importers and/or export marketing organizations (if indirect export is used). The international marketer, however, can come closer to consumers or industrial users by selecting those exporter organizations, importers and/or wholesalers or distributors who sell to the kinds and quality of desired marketing intermediaries within the target market. Of concern to the manufacturer are such characteristics of the marketing intermediary as trading area covered, product lines carried, sales organization, potential sales volume of the manufacturer's product line, capacity to provide **auxiliary services**, financial strength to maintain inventories and extend credit to customers, and the willingness and ability to promote the manufacturer's product line. In the extreme case the international marketer can deal directly with the consumer.

Interpersonal links can play an important role in the selection of channel members. Foreign market entry by export is essentially a situation of exchange between companies and/or individuals. This exchange may be initiated by the exporter, the importer, a third party, or may be due to a chance encounter at a trade fair or some other type of meeting. In a study of Hong Kong toy manufacturers, individual exchange partners were commonly acquired via existing *social ties* (Ellis, 2000). An individual's social network and existing connections with others played a much stronger role than formal search behavior. Within China and Hong Kong this is known as *guanxi*, or personal connections. *Guanxi* as a phenomenon, alternative interpretations of its causes and its impact on business and the economy are discussed by Davies (1995) and Haley *et al*. (2004).

Managing the channel

In general, the overall task of managing the international channel involves finding ways to improve performance. A channel is viewed as a network and consists of a number of *stakeholders* – that is, independent or dependent companies that are interrelated and all have a stake in the success of the network. Exhibit 7.6 presents a view of stakeholder relationship marketing.

Exhibit 7.6 Stakeholder relationship marketing in China

Stakeholder relationship marketing involves creating, maintaining, and enhancing strong relationships with customer, employee, supplier, community, and shareholder (owner) stakeholders of a business with the goal of delivering long-term economic, social, and environmental value to all stakeholders in order to enhance sustainable business financial performance (Murphy *et al*., 2005, pp. 1050–51). Viewed as a model of how to conduct business, stakeholder relationship marketing goes beyond the channel for distribution. Since the model embodies Western cultural values and has been tested in Western countries (Murphy *et al*., 2005), a question can be raised regarding its applicability elsewhere, such as in China.

On the surface we would expect the stakeholder relationship marketing model to be applicable to Chinese business firms. Relationships, or *guanxi*, are very important to Chinese people, as discussed above. Murphy and Wang (2006) used stakeholder performance analysis of two Chinese business firms and concluded that the foundational principles of the stakeholder marketing model were not new for Chinese businesses. In Chinese culture, stakeholder relationship marketing has been understood as:

- doing business sincerely, honestly, ethically (*wenming jingshen*);
- paying attention to decorum no matter what the situation;
- implementing business with ethics, that is *dao*. The concept of *dao* goes beyond ethics. It includes sustainable use of natural resources and preservation of the environment;
- treating customers, suppliers, employees, and community with sincerity;
- fair trading;
- looking for long-term rather than short-term profit;
- ensuring that what the customer needs and wants is the direction for the business.

In short, in China, as elsewhere, stakeholder relationship marketing makes good business sense.

Relations with intermediaries

Policies dealing with the relations between the international marketer and those marketing organizations that are members of the marketing channel revolve around the kinds of assistance *offered to* them and the cooperation to be *received from* them. The underlying premise is that whatever is done should be for the mutual benefit of all the parties concerned. This is the essence of the system and stakeholder concepts.

One critical aspect of relations with intermediaries centers around international promotional activities of the intermediaries. In this regard three types of policy can be distinguished: gravity, push, and pull. A *gravity* policy is one of nonpromotion in that the international marketer merely sells to an intermediary and lets the product find its own way to ultimate consumers and users. A *push* policy is one of promotion through the marketing channel. Channel members must aggressively sell and promote the product to other channel members at lower levels. This policy is one that many companies in Western Europe, the Americas, and Australia have come to accept and even in some instances demand. A *pull* policy is one whereby distribution is 'bought' by establishing consumer demand. The international marketer engages in mass advertising to the target market so that consumers are presold; consumers then 'pull' the product through the channel by demanding it from intermediaries. Such a policy is more appropriate for certain types of consumer goods than for industrial goods because it is difficult to presell the industrial user.

The problems encountered by the international marketer in attempting to establish proper relations with intermediaries are perhaps compounded because of certain communication gaps. Four such gaps – cultural, nationality, environmental, and distance – are relevant. The *cultural* gap comes from the problems associated with communication between people from groups with different values, social mores, and attitudes. The *nationality* gap is more obvious than cultural differences. Although there may be a few individuals who have a binational or multinational outlook, most people will clearly identify with the single country to which they have pledged their nationalistic loyalties. The *environmental* gap pertains particularly to the problems of individuals in one country attempting to make decisions that are best for another country, and other individuals. The *distance* gap comes about from geographic distance together with imperfections in existing communication media. Both time impediments and obstructions in the flow of information are engendered. These gaps must be overcome or closed if the international marketer is to have an effective, smoothly functioning channel system. Unfortunately there are no easy guidelines for international management to follow.

A study of Hong Kong intermediaries who facilitate exchange between sellers from mainland China and buyers from the West, concluded that the communications necessary for well-functioning business network participation and collaborative management activity appears to be constrained in the interactions between the intermediaries and sellers and buyers (Trimarchi and Liesch, 2006). Even so, the importance of intermediaries in Hong Kong in their ability to facilitate interactions between mainland Chinese sellers and Western buyers must not be underestimated.

Channel feedback

The international marketing manager must develop an effective communication system within which 'feedback' information flows from channel members. This puts the manager in a position to evaluate rationally the channel's effectiveness. The manager must know how well the channel system is operating, in terms of such things as where sales are going, the adequacy of the quality of cooperation from channel members, and whether conflicts within the channel are causing tensions. At the same time marketing organizations may expect similar feedback. Thus the need is for two-way communication. Without feedback the task of evaluating results would be impossible.

Selecting the entry mode

We have now discussed the various entry modes that are available to companies that wish to take advantage of foreign market opportunities. At this point we are concerned with an answer to the question, 'How should a decision-maker choose the foreign market entry mode for a product and target country market?' Three distinct decision rules for entry mode selection have been identified by Root (1994, Ch. 7), and can be distinguished by their degrees of sophistication: the *naive* rule (use the same entry mode for all foreign markets), the *pragmatic* rule (use a workable entry mode for each target market), and the *strategy* rule (use the right entry mode for each target market).

Naive rule

Managers follow the naive rule when they consider only one way to enter foreign markets, for example, when a manager says 'We only export through foreign-based agents' or 'Once we are beyond export, we only use licensing as our overseas-based mode.' This rule obviously ignores the heterogeneity of individual foreign markets and entry conditions. A manager who uses this rule might be viewed as having 'tunnel vision.' At some point in time this manager will make mistakes of two kinds: either a promising foreign market that cannot be penetrated with their 'only entry' mode will be given up or a market will be entered with an inappropriate mode. The inflexibility of the naive rule prevents a company from fully exploiting foreign market opportunities. A special application of this rule is when the domestic channel is extended to foreign markets.

Pragmatic rule

An illustration of the pragmatic rule is the company that ordinarily starts doing business in foreign markets with a low-risk entry mode. Only if the particular initial mode is not feasible nor profitable will the company continue to look for a workable entry mode.

The pragmatic rule has certain advantages. The risk of foreign market entry with the wrong type of entry mode is minimized since unworkable modes are rejected. Also, costs of information collection and management time are reduced since not all potential alternatives are investigated once a workable mode has been found.

These advantages are not insignificant, but neither is the cost of lost opportunity. The fundamental weakness of the pragmatic rule lies in its failure to guide managers toward a determination of the entry mode that best matches the company's capabilities and resources with the market opportunity. In short, a workable entry may not be the best entry or the *right* entry.

The strategy rule

This decision rule simply states that the company should use the right entry mode. This approach requires that all viable alternative modes be systematically evaluated and then compared.

As we stated earlier in the chapter, a company's choice of foreign market entry for a given product/market is the result of evaluating many forces, which often conflict with each other. Comparing alternative approaches to entry may be complicated by the multiple objectives that a firm may have in each foreign market, and at times such objectives may appear to be inconsistent. Thus, trade-offs among objectives will have to be made. The end result of this analysis is a set of feasible entry modes that are then subject to further analysis.

Entry comparisons need to be made between projected costs and benefits over a future time period. Thus, *expected* costs and benefits are being estimated, and these are subject to changing uncertainties. Different entry modes are affected by different market and political risks.

An application of this decision rule would be to choose the entry mode that maximizes the profit contribution over the strategic planning period subject to: (1) the availability of company resources, (2) risk, and (3) nonprofit objectives. Since there is no objective procedure that results in a single number representing the profit contribution, risk, and nonprofit objectives analyses, decision-makers have no choice but to use their own judgement in making the overall assessment.

Using free areas

A third major option for 'sourcing' for entering foreign markets is to use a free area. These areas are located in a particular country, but are considered to be outside the customs area of a country. Thus products may be brought into and exported from such areas easily, and other activities such as repacking, assembly, and manufacturing may be allowed. From an entry strategy and mode perspective, all options available for home country and overseas production may be available when a free area is used for a production site, depending upon the specific free area and market involved. Free areas may range in size from an entire port or perimeter to a specific zone. Free areas are discussed in more depth in Chapter 14.

Summary

Our discussion of foreign market entry strategies has been in some detail. Although many different alternatives have been described and analyzed, by no means do these constitute the entire set of possibilities. The manner in which we have presented the material constitutes merely a subset of the possible alternative channels between countries, albeit a subset containing the most general and widely used alternatives.

It should be reemphasized that a particular manufacturer wanting to engage in international marketing may use more than one of these methods at the same time. The individual products within the product line may require different entry modes, as may the distinct foreign market areas. We discussed briefly the forms of multiple mode entry. It cannot be stated categorically which alternative mode is best. There are many conditions and criteria that affect the choice. The best we can do at this point in our discussion is to conclude that an international marketing channel should be 'form fitted.' That is, it should be unique and situation specific in the sense of being based on the requirements arising from the mix of the specific product, market, and manufacturer involved.

To conclude our discussion of entry strategies, a consultant to smaller companies suggests that the successful companies he has seen have three common characteristics (Pacheco, 2005):

1. They have patience. It can take a long time from the date one initially visits prospects to actual dates when a sale is made in a foreign market.

2. There is a willingness to create an alliance or joint venture with a company in the foreign market. The use of a local partner can save the company a great amount of time, heartache, and money.

3. The company has the ability to know when not to enter a market.

These principles can apply to larger companies as well, although the second one would depend upon the prior international experience, operating practices, and need for control of the company making the decision.

Questions for discussion

7.1 Explain how the flow of transactions and the flow of the physical product relate to foreign market entry mode.

7.2 Why is the decision regarding foreign market entry mode a particularly important decision for international marketing managers to make?

7.3 Discuss the nature of the 'whole channel concept.'

7.4 Evaluate the use of the Internet for export and other international marketing market entry modes.

7.5 Governmental regulations can affect the viability and effectiveness of a company using the Internet as a foreign market entry mode. Contrast the government regulations governing e-commerce in the United States, a European Union country (e.g., the United Kingdom or Germany), China, and an Australasian country. Is the Internet easier to use – regulation-wise – in one of the countries? Explain.

7.6 A number of alternative entry modes were identified in the chapter. Locate a company that uses export and one using overseas production or a strategic alliance. Describe their market entry strategies and determine why the companies differ in the entry mode being used.

7.7 Identify the major factors that have a bearing on the type of market entry mode that an international marketer might select. Is there any one or more that are more important than others? Explain fully.

7.8 Under what conditions would a strategy of multiple entry modes be most appropriate and when would it not be appropriate? Discuss.

7.9 Why should a company make a specific channel decision for each product going to each overseas market?

7.10 Select an industrially developed country (perhaps Japan or a European country) and a relatively less developed country (perhaps a Latin American or African country). Contrast the relative importance of the factors that should be taken into consideration by a foreign-based manufacturer of a low-unit priced packaged good selling in both markets, when determining policy on selecting appropriate channels of distribution in those markets. In which case is the managerial decision easier to make? Discuss.

7.11 How can a company possibly satisfy all five stakeholder groups so each maximizes what it is trying to maximize? Explain.

7.12 Contrast the naive, pragmatic, and strategy approaches to choice of foreign market entry mode. Is any one superior to the others? Explain.

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CASE STUDY 7.1

Avon Products, Inc. (B)

(This case study was written by Edwin Duerr, Yim-Yu Wong, and Mitsuko Duerr, all of San Francisco State University.)

In 2010, Avon was still in the process of rebuilding its marketing operations in China after the turmoil caused by the Chinese government's ban on direct selling in 1998. The imposition of this ban had been totally unexpected [see Case 4.1, Avon Products, Inc. (A)]. The company had no way of knowing when or if the ban would be lifted.

In the period from the imposition of the ban to its eventual lifting eight years later, the company had critical decisions to make. With the lifting of the ban in 2006, and the granting to Avon China of the Chinese government's first license for a direct selling operation, the company faced a new set of decisions about organizational structure. These included deciding upon transitional structures and the relative emphases to be placed upon direct sales activities and the distribution methods that had been used from 1998 to 2006.

Responding to the crisis

With the imposition of a ban on direct selling, Avon had the choice of changing its marketing model or withdrawing from the Chinese market. The company chose to go ahead immediately with developing plans to convert to new types of operation, pending Chinese government approval. It would operate as a wholesaler to Chinese retail stores, convert its 75 distribution centers into retail outlets to serve regular customers, and conduct limited direct selling activities. For the latter, representatives would not purchase and resell the product, but would work on commission. In short, sales representatives would become employees of Avon.

In early June 1998 Avon received government permission to resume operations as a wholesaler and to open retail outlets. They did not receive permission to resume any direct selling, though they could use sales representatives for delivery and service. The company was planning to apply for permission to use sales promoters or representatives on a commission basis when Beijing clarified how sales representatives would be allowed to operate. Amway did not receive permission to operate as a retail business until mid-July, but they also received permission to operate through representatives at that time. As of mid-July, Mary Kay still had not received approval of its application.

Avon was optimistic about the future. Since resuming operations in June, they had run a 'preferred customer' program under which individuals purchasing large enough amounts of products would receive substantial discounts. A number of former representatives were buying enough to become preferred customers, thus maintaining contact with the company. Avon was investing in advertising and point-of-sale material, and recruiting retail specialists in order to adapt to the new system.

Avon had a network of 80 sales centers in 14 provinces, but the sales centers were not designed and built for retailing so they presented some problems. Stores could be closed or added as appropriate, though government regulations regarding employment and facility openings and closures might present some legal and financial difficulties.

Building a new marketing structure

Avon (China) opened its first retail store in March 1999, and a flagship store in Beijing in October 2000. It followed with a group of concept stores in Beijing, Shanghai, and Guangzhou in 2002. It began Internet marketing, with primary coverage in Beijing's outer areas, in the same year. By 2004 Avon (China) Company Limited had 5,000 franchise stores (beauty boutiques) and plans to add 500 more each year. It also had almost 2,000 beauty counters in malls, shopping centers and hypermarkets in 74 large and medium-size cities.

Avon (China) uses its web page to communicate with the public. In addition to product information, the company includes its history, press releases, and franchisee success stories. *Businessweek*'s selection of Andrea Jung, Avon's CEO, as one of the best managers in the world was reported. Other activities featured included Avon's donations to fight SARS, a modern dance program sponsored by Avon, and their annual Miss White Angel pageant (see below). Information about the company's corporate culture, guiding principles, operational objectives, managerial doctrines, and management styles is also posted. Avon lists its guiding principles as 'high quality, leading technology, and diversity, designed for Oriental women,' with the motto 'A Company for Women.' Potential new franchisees can find information on Avon China's web page about capital requirements, store size, applicant qualifications, and the type of lease that prospective franchisees are required to sign.

Currently Avon offers a wide range of products on the market in China, including skin care, cosmetics, personal care, fragrances, underwear, health foods, and others.

The company incorporates both Asian and western components in projecting its product image. It uses a research laboratory in Japan, a country known for its advanced technology, to make it more convincing that Avon products are made for Asian skin. At the same time, it selected a trendy English name, 'Up2U,' for a cosmetics line developed by that lab and intended to appeal to the mindset and attitude of younger Chinese women. Recognizing that the traditional concept of beauty in China favors fair, light skin, Avon offers a line of whitening products. It also sponsors an annual 'Miss White Angel' pageant in which a young lady is selected to be the spokesperson of the year. The program is broadcast on regional television channels. Additionally, since Caucasian women have features that are admired by many Asian women, most of the models used on Avon (China)'s web page are Caucasian. This also serves to present a prestigious image of Avon as a US company (that provides products suited to Asian skin).

Permission to again use direct selling

Avon China had eventually been successful in using the new marketing and distribution approaches it used from 1998 to 2004, with sales in 2003 reaching over twice what they had been in 1997. However, the company still desired to return to the direct selling model they used in the rest of the world.

In April 2005, seven years after the Chinese had placed a ban on all direct selling operations, the Chinese Ministry of Commerce and the State Administration for Industry and Commerce officially approved a test of direct selling by Avon Products (China). The testing sites included Beijing, Tianjin, and Guangdong. The president of Avon China, S. K. Kao, said that this was a test to help the Chinese government find a direct selling model that would suit the Chinese market and promote social stability. As a part of the test, Avon China was to develop a program to educate consumers as to what is right and responsible so as to protect consumers from illegal direct selling.

Mr Kao said that Avon China was extremely honored to be the only direct selling company authorized to conduct a test. It was viewed as demonstrating the trust and confidence the government had in the company, and the company indicated it was committed to cooperating with the government. The results of the test were to be used as the basis for developing legislation covering direct selling.

In March 2006, Avon China received the nation's first direct selling business license from the Ministry of Commerce. It provided for a single-level selling model nationwide. A new sales force of 114,000 (direct) sales representatives was added to the 6,000 franchised Beauty Boutique stores the company had added since direct selling had been banned. Approximately 90% of the Beauty Boutiques qualified to act as service centers under the government regulations, indicating that the Beauty Boutique owners want to be involved in direct selling. The Beauty Boutiques offer after-sales service (order pick-up, product returns, product trials, billing assistance, etc.) to sales representatives, and beauty consultations to consumers, while continuing to sell products at retail. According to Avon, their direct selling model now brings together the best features of retail and single-level direct selling.

Avon China's limited investment in storefront operations enabled local competitors, and international companies willing to make large investments in joint ventures and retail operations, to gain market share. In the market for high-quality makeup, Maybelline gained 20% of the high-quality market nationwide and 60% in some second-tier cities. Avon China suffered a sales decline in its Up2U makeup brand for young ladies, and withdrew that brand from the Chinese market.

The heavy advertising expenditures, reorganization costs, and hiring associated with the launch of direct selling caused heavy losses in 2006. In 2007, however, these began to pay off and Avon China reported a 44% increase in sales in the first quarter of the year, with most of the increase coming from its direct selling operation.

The hybrid model, and further commitment to China

Avon has continued to use the hybrid sales model in China, with both store operations and direct sales, but continues to use only direct sales in the rest of the world.

Even in China, it has increasingly emphasized its direct sales effort. Total revenue in China increased in 2008 and again in 2009. A greater number of field representatives increased direct sales by 24%, while the revenue from Beauty Boutiques decreased by 40%. The increasingly important direct sales effort was supported by television advertising and the provision of additional incentives for the direct salespeople.

A news release from Avon on March 18, 2010 stressed that Avon Products, Inc. in the US was demonstrating its commitment to China by opening a state-of-the-art research facility in Shanghai. It will include continuing developmental work on *Anew* anti-aging skin care, *Avon Color* cosmetics, and the whitening category. Though designed primarily to serve China, it will also support other markets in the Asia Pacific region. Avon China also has a regional R&D facility in Guangzhou that will continue to work on nutritional supplements.

Additional comments

Avon is the world's largest direct sales company with sales of $10 billion per year, and approximately 80% of that revenue comes from outside the United States. During the 2008–2010 recession, 'where others saw only challenge, Avon saw an opportunity to grow our representative and consumer base' (Andrea Jung, Chairman and Chief Executive Officer, in the 2009 Annual Report, March 2010). The company carried out the most massive recruiting campaign in its history. It has also continued and increased its restructuring program designed to improve global supply chain operations, move some local business support functions to a more regional basis, streamline transaction-related services, and do some selective outsourcing to reduce costs and improve organizational relationships and effectiveness. The result has been stronger growth.

It appears to the authors of this case that the opportunity for China to become the hub of Avon's manufacturing as well as its primary R&D center in Asia was lost because of (1) the nation's initially disapproving Avon's direct selling model; (2) the nation's slowness in approving direct selling; and (3) Avon's concern that the Chinese government might take other unilateral actions adversely affecting the company without consultation.

Additional information

Avon's web page http:/_/www._avoncompany._com/_about/_index._html and its associated English language and Chinese language websites, its Annual Reports, and Company News Releases.

Questions

1. Does it appear that the marketing strategy that Avon used in China from 1998 to 2006 worked well? Might some other strategy have been more effective?
2. Discuss the usefulness of the 'preferred customer' program in the short term and the longer term for Avon. How do you suppose the program might have been used by some of the 'preferred customers'?
3. What might be the advantages and disadvantages of Avon applying some of the marketing models it developed in China to other markets?
4. Should Avon continue to experiment with new marketing approaches? What are the possible costs and benefits?
5. Was it wise of Avon to return to a direct selling method when the Chinese government allowed it to do so?

CASE STUDY 7.2

Klako Group

(Adapted from 'Knowledge built on first mover advantage,' *Hong Kong Trader*, 1 February 2007, www.tdctrade.com. Courtesy of *The Hong Kong Trader*, a monthly online publication of the Hong Kong Development Council.)

After many years of international consulting and trading activities with Hong Kong and China, Klaus Koehler established a services company, the Klako Group, in Hong Kong in 1979. The company provided consultancy for incorporation, accountancy, and taxation. Since then, the company has expanded its services into other areas such as recruitment, quality control, and inspection for overseas companies who want to access and benefit from the Chinese market.

Since its beginning, using the first mover advantage for growth, Klako Group opened offices in Beijing, Shanghai, and Shenzhen in China besides its Hong Kong headquarters. By early 2007, Klako had nearly 100 employees in its four offices. The Hong Kong office is headed by son Sven, the Shanghai office by daughter Kristina, and founder Klaus oversees the family business as the managing director.

Global mix

'When my father first started the firm, about 90 percent of our clients were from Germany, but now it is a global mix. Nowadays, about 30–40 percent of our customers are German, while the rest come from the United States, Canada, Australia and Europe including the United Kingdom, France, Italy,' explained Sven, who joined the family firm six years ago.

Generally, Klako's clients already do business in China, or are at the stage of entering the market. 'Our customers either want to buy, sell or manufacture in China,' added Sven. One thing remains constant: Klako always advises overseas companies to make use of Hong Kong's advantages and set up a base in the city to access the mainland market. 'For many international businesses, structuring investments into China via Hong Kong can make a lot of sense. Concerns over direct exposure to China liabilities, ease of a future sale of a China investment, and certain tax and profits distribution capabilities can make the insertion of a holding company as part of their China strategy an interesting option,' advised Sven.

Cultural edge

That is where a service provider like Klako comes in. It has client managers able to converse with the clients in their own languages. 'In Hong Kong, we provide a complete outsourcing solution whereby our clients set up a holding company for their Chinese investments with our address and they avoid fixed costs like rent, staffing, and so on. Our staff handle the accounting, as well as, for more active trading companies, their banking, letters of credit, shipping and if necessary, product inspections,' explained Sven.

Since its inception in 1979, business has been steady. 'Most people are of the opinion that in order to stay competitive in their own markets, they have to include China in their business strategy, often as soon as possible. But our advice to them is to start slowly and take a phased approach. People tend to go in too quickly in all sectors. In China, it is not so easy to have a profitable business. Many companies do not set up their structures properly from the beginning and will then have to restructure,' advised Sven.

There is an important role for service providers like Klako in China and Hong Kong as more and more overseas firms enter the China market. 'We offer them experience, expertise, and a hassle-free approach,' said Sven.

Questions

1. Are service companies like the Klako Group most valuable in 'unique' situations like China or do they have a role in assisting companies wanting to enter markets elsewhere, as, for instance, the European Union or North America? Explain.
2. In what ways would you expect the Klako Group to be able to assist a company interested in finding and making arrangements with:
   - **(a)** a Chinese supplier;
   - **(b)** a Chinese marketing organization;
   - **(c)** a Chinese partner?

CHAPTER 8

In depth with entry modes

Learning outcomes

In Chapter 8, we discuss:

- indirect exporting using independent organizations: types of organizations and evaluation of advantages and disadvantages
  - — home-country-based merchants (take title)
  - — home-country-based agents (do not take title)
  - — cooperative organizations
- direct export by company to overseas buyer: types of organizations and evaluation of advantages and disadvantages
  - — home-country-based departments
  - — foreign sales branch or subsidiary; traveling salespersons
  - — foreign-based distributors and agents/representatives
- relations with, and agreements with, foreign-based distributors and agents
- the importance of the Internet and e-commerce as entry modes
- gray market exporting

Four cases are presented at the end of the chapter. Case 8.1, Sinova Management Consultancy Ltd., provides services to companies in Europe and elsewhere interested in doing business in China. In Case 8.2, the owner of Quint Winery in Germany is considering the possibility of exporting to Japan. Case 8.3 is about Nestlé's expanding e-commerce initiatives to improve its global management of e-procurement, supply chain management, customer relationships, and financials. Case 8.4, Urban Outfitters, discusses the export expansion into Europe by a retailing firm.

Introduction

Several entry modes available to the export marketer were identified and categorized in Chapter 7 as indirect or direct. These two basic forms of exporting are distinguished on the basis of how the exporting firm carries out the transactions flow between itself and the importer or foreign buyer. In this chapter we discuss these entry modes in detail.

The decision between the two forms involves determining the level of vertical control desired by the exporter, and this involves considering two types of costs: (1) the costs of actually performing necessary functions and (2) transaction costs that arise in the organization of an activity or of contracting with other parties.

As an illustration of the two approaches, Figure 8.1 outlines both indirect and direct export by a manufacturer of consumer goods, and Figure 8.2 shows a broader view of the paths that export can take. Exhibit 8.1 provides an interesting example (from Germany) that may be a model for similar companies elsewhere to follow. In Japan, for instance, the small and medium-sized companies represented 99.7% of companies in 2008 (*The Economist*, 2008). These companies tend to specialize in fields such as electronics manufacturing, precision engineering, and fine chemicals. Unlike Germany, however, Japan's *Mittelstand* is becoming the exception rather than the rule, due in part to world economic conditions during the past few years.

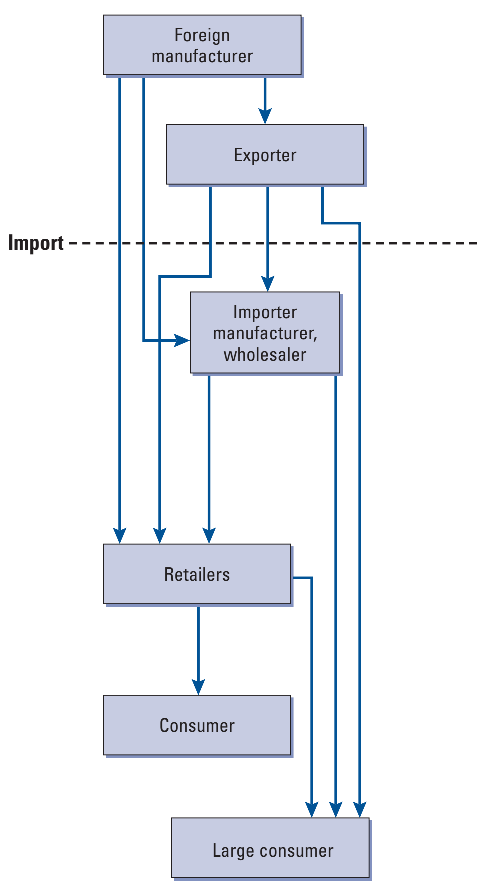

Figure 8.1 Indirect and direct export of consumer goods

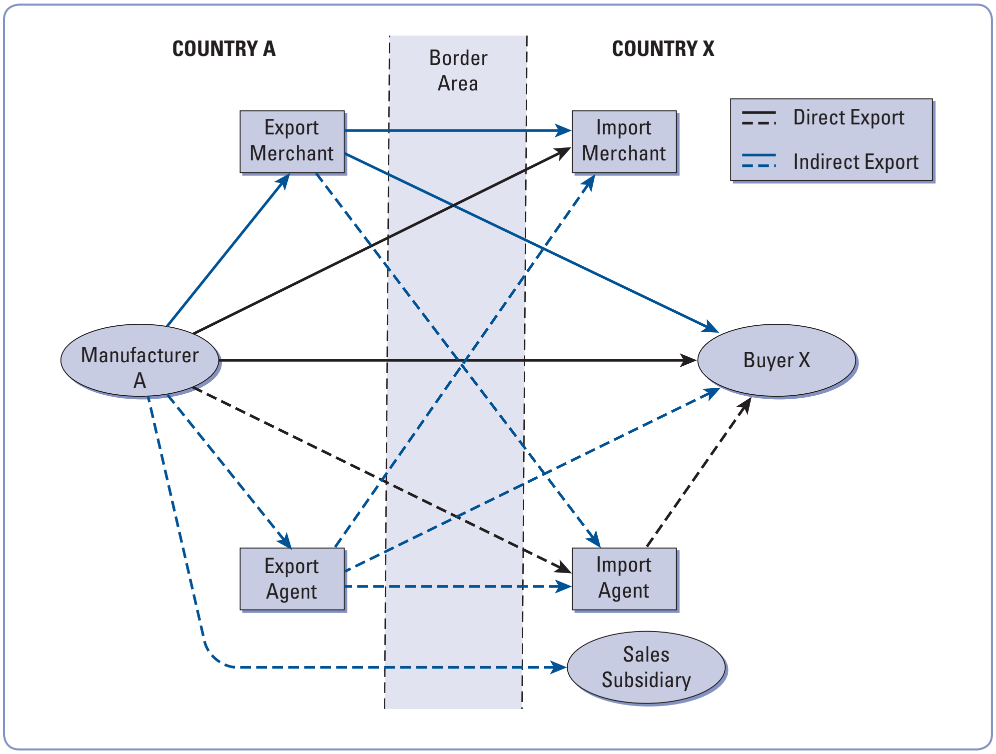

Figure 8.2 Direct and indirect exporting

Exhibit 8.1 Germany's export champions

Although Germany is now the second largest exporter in the world, having been replaced by China, its exporting prowess remains undimmed (*The Economist*, 2010a). In order to get a good look at one aspect of Germany's export strengths, one does not have to go any farther than the Glasbau Hahn factory on the outskirts of Frankfurt. Glasbau Hahn is the top of the line of glass showcases. Its products protect the world's most valuable art objects. Customers such as New York's Metropolitan Museum of Art and London's British Museum have paid up to US$100,000 apiece for custom-built wall-size showcases from Hahn, complete with heat-free, fiber-optic lighting and precision climate control.

Founded in 1836 and with affiliates in 30 countries, Hahn is an example of the *Mittelstand* (midranking) company in Germany. These are small and medium-sized companies. Although large companies such as Volkswagen and Siemens are best known abroad, it is these smaller ones with less than 500 employees or with a turnover between e25 million and more than e1 billion that produce a large percentage of Germany's business turnover, train more than half of all apprentices, employ a large share of the workers in the private sector and generate a significant amount of German exports. They make everything from motors and machine tools to such consumer goods as camping equipment and high-fashion garments. Many specialize in making complex and valuable equipment for factories, such as cigarette rolling machines or printing presses. Doing this has helped these companies dominate their niches, with global market shares as high as 90%. Concentrating on such products, however, makes these companies vulnerable to deteriorating economies as orders for them tend to be the first to be cancelled. The recent recession throughout the world during the first decade of the 2000s is an example as demand for many of the *Mittelstand* companies' products declined (*The Economist*, 2009, p. 64). As of early 2009, these companies accounted for more than 40% of all manufactured exports from Germany (*The Economist*, 2009, p. 64).

The *Mittelstand* companies are already important exporters, used to competing with the world's best companies. They know how to use innovation and applied research to overcome high labor costs and a strong currency that makes their exports more expensive. The best *Mittelstand* companies combine dynamism and flexibility on the one hand with caution and tradition on the other. Many, such as Haribo, the largest manufacturer of gummy and jelly sweets in the world, enter a new market only if they can dominate it (*The Economist*, 1998).

The *Mittelstand* have grown collectively big by thinking small. They work out of small plants often located in towns that are unknown to most people, and they target small but highly profitable niches in global markets. Investing large amounts of their revenue into research and development, *Mittelstand* companies routinely beat the large companies to market with new products. One reason is that they are mostly run by owner-managers. Many are family owned. However, most of these firms are dedicated to improving their products rather than taking risks with new ones (*The Economist,* 2006, p. 71). To promote activity abroad, the number one tool used is advertising on their own Internet site, followed by involvement in trade fairs (*Europages Observatory*, 2007).

There are some *Mittelstand* companies that do not export directly, preferring to work through large companies. That is similar to the Japanese model in which smaller companies supply big exporters in their *keiretsu*, or industrial group. But in contrast with Japan, the vast majority of *Mittelstand* companies are fiercely independent. However, changes are occurring as companies go public and raise needed capital. In addition, professional managers are being hired.

Another feature is that the *Mittelstand* has been creating mini-conglomerates through mergers and joint ventures, a new activity that was frowned upon in principle in the past.

Finally, *Mittelstand* CEOs argue that it is their own efforts that make the difference between success and failure. These companies have good labor relations. The *Mittelstand* workforce is highly trained, in the past due to apprenticeship programs that ran from two to four years.

In Germany, too few companies are being born. The successful exporters are increasingly using imported materials or are outsourcing much of their production. Many of these companies are small and still family owned, but are niche marketers in the global marketplace and constantly reinvest in high-end innovation, and are not overly concerned with quality (*The Economist*, 2006, p. 72).

Indirect export

Indirect export occurs when the exporting manufacturer uses independent organizations located in the producer's country. In addition, the producer may have a dependent export organization (e.g., an export department) that works with the independent marketing organizations and coordinates the entire export effort. In this situation the dependent organization does not actively engage in any international sales activities.

There are two broad alternatives available to the manufacturer wanting to export indirectly: (1) using international marketing organizations and (2) exporting through a cooperative organization.

Marketing organizations

In export marketing there are two basic types of independent wholesale marketing intermediaries: *merchants* and *agents*. The basic distinction between the two is that the merchant takes ownership of the products to be sold, while the agent does not.

Home-country-based merchants

Export merchants

The domestic-based export merchant buys and sells on its own account. Generally engaged in both exporting and importing, it operates in a manner similar to a regular domestic wholesaler. When this type of marketing organization is used in an export marketing channel the marketing job for the manufacturer is reduced to essentially domestic marketing. All aspects of the international marketing task are handled by this merchant except for any needed modifications in such things as the product itself, its package, or in the quantity included in the unit package to meet any special needs of individual overseas markets. This also includes selecting the channels within foreign markets as well as activities relating to sales, marketing, merchandising, advertising, delivery, and services.

The export merchant company is free to choose what it will buy, where it will buy, and at what prices. The same freedom exists for sales. This type of company may have a far-flung organization that may include branch houses, warehouses, branch offices, docks, transportation facilities, retail establishments, and even industrial enterprises in foreign markets served. As a consequence, the export merchant is likely to be a powerful commercial organization, well able to exist without the cooperation or the products of any one manufacturer or any one group of manufacturers. In some instances this type of enterprise dominates the trade of certain localities or even certain nations.

There are some potential limitations to using export merchants. First, they may not be available for all markets. Export merchants are principally interested in staple commodities, which are generally open-market items not subject to a high degree of identification by the producer; and they are reluctant to undertake the development details and expense of the introduction and sale of any article that approaches the status of a specialty and which might require a considerable amount of sales effort.

The export merchant, occupying so commanding a position, is usually unwilling to allow the manufacturer much more than a manufacturing profit on any merchandise. The export merchant company feels that it meets any terms of payment the manufacturer demands; that it performs every function connected with marketing and selling; and, finally, that it has all the manufacturers of a given line to choose from since their importance in the market gives them command of the outlets for any products that they may care to sponsor.

Trading company

In many countries export merchants known as *trading companies* are quite common. Different types of trading companies have been identified, as shown in Table 8.1.

Although international trading companies based in Brazil, Hong Kong, South Korea, Taiwan, Thailand, Turkey, and other countries, including some in Europe, have been active throughout the world, it is in Japan that the trading company concept has been applied most effectively and perhaps most uniquely. There are thousands of trading companies in Japan that are involved in exporting and importing, and the largest firms (varying in

Table 8.1 Typology of export trading companies

Type	Rationale for grouping
(1) General trading companies (GTCs)	Historical involvement in generalized import/export activities
(2) Export trading companies (ETCs)	Specific mission to promote growth of exporters
(3) Federated export marketing groups (FMGs)	Loose collaboration among exporting companies supervised by a third party and usually market specific
(4) Trading arms of multinational corporations (MNC-ETCs)	Import/export and trading activities specific in parent company's operations
(5) Bank-based or bank-affiliated trading groups (Bank-ETCs)	Extension of traditional banking activities into commercial fields
(6) Commodity trading companies (CTCs)	Long-standing export trading in a specific market, secretive, fast-paced and high-risk activities

Source: Adapted from Amine (1987), p. 203.

number from 9 to 17 depending upon source of estimate) are referred to as general trading companies or *sogo shosha*. This group of companies, which includes Mitsui & Co., Ltd., Mitsubishi Shoji Kaisha, Ltd., and Marubeni, handle a large share of Japan's exports and imports. While the smaller trading companies usually limit their activities to foreign trade, the larger general trading companies are also heavily involved in domestic distribution and other activities.

The Japanese general trading companies are engaged in a far wider range of commercial and financial activities than simply trade and distribution. They also play a central role in such diverse areas as shipping, warehousing, finance, technology transfer, planning, resource development, construction and regional development (e.g., turnkey projects), insurance, consulting, real estate, and deal making in general (including facilitating investment and joint venture of others). In fact, it is the range of financial services offered that is a major factor distinguishing general trading companies from others. These services include the guaranteeing of loans, the financing of both accounts receivable and payable, the issuing of promissory notes, major foreign exchange transactions, equity investment, and even direct loans.

The *sogo shosha* differ from multinational corporations chiefly in that their wide-ranging investments are all in some way directly connected with trade, with the broad aim of stimulating international business. They also differ from other companies in that they are not necessarily user or manufacturer oriented. Rather, they are supply/demand oriented and function as problem solvers. Recognizing demand for goods or services, the *sogo shosha* look for ways to supply it, either taking the intermediary role in trade deals between a number of parties or independently directing the flow of trade. To an extent these actions have been in response to the increased direct export activities of Japanese manufacturers such as Toyota, Hitachi, and Sony. Exhibit 8.2 illustrates many of these activities.

Some of the general trading companies, including C. Itoh & Co., Mitsubishi International Corporation, and Mitsui & Co., have established global sales networks consisting of branch offices overseas or wholly owned subsidiaries. For example, in Canada and the United States the subsidiary approach has often been used. C. Itoh America itself has more than 20 subsidiaries and affiliates in the United States – it imports Mazda and Isuzu automobiles, exports Beechcraft airplanes, and manufactures chain link fence and piping.

Exhibit 8.2 Japan's general trading companies

Japan's general trading companies, known as the *sogo shosha*, may seem like prehistoric dinosaurs to some. Their core business of acting as middlemen is under attack from others as Japanese companies are increasingly willing to deal directly with suppliers and customers.

The *sogo shosha* are the world's largest 'jack-of-all-trades.' This diverse attention means that they often are able to do a lot of things well, but few – if any – really well. At various times they act as commission agents, importing and exporting on behalf of clients; merchants, trading in their own right; middlemen in transactions between members of their *keiretsu*; financiers for smaller *keiretsu* members; investment trust managers; venture capitalists; project developers and managers; and consultants. They at times diversify into being oil companies, power generators, telecom operators, television stations, and even satellite communicators.

The companies, obviously, take on risks and management challenges that many western conglomerates would shy away from. But the *shosha* have a long history of entering new fields. Their core competence seems to have been built on their customers' lack of knowledge – of 'abroad' and what that meant. Once ignorance turns to enlightenment, as it did for many Japanese automobile and electronics companies in the 1970s, such business tends to dry up. This causes the *shosha* to move into new fields.

The old and the new

The *shosha* reduced their agency business in the mid-1990s, where gross margins tended to be lower than in the 1980s. Although profits have risen again, they have not reached former levels. They also dropped their role as 'nonbanks' to the smaller *keiretsu* members. Instead they started buying and selling more on their own accounts, where margins can be as high as 20%, and moving directly into the businesses they used to service.

Many *sogo shosha* have become significant energy companies, building on their experience as oil traders. Other *shosha* also moved into energy where they had 21 oil and gas concessions producing or about to produce. Some of these are long-term gambles.

Another area where these companies have moved from being traders to operators is electricity generation. With support from the Japanese government they have been investing in power plants in other Asian countries. Despite the high yen value in the mid-1990s, Mitsubishi kept working with its *keiretsu* partner, Mitsubishi Heavy Industries, as its main equipment supplier. But Marubeni often works with foreign companies such as the Swiss-Swedish firm Asea Brown Boveri and the Anglo-French consortium GEC-Alsthom instead of its *keiretsu* partner Hitachi. The most dramatic move, however, has been the *shosha* rush into the communications industry.

Venturer merchants

The tendency to acquire and hang on to new businesses is being tempered by a new willingness to divest once they have matured. The *shosha* have always held large ownership stakes in other companies. Some are ownership in other *keiretsu* members and some are subsidiaries, which is how the *shosha* have preferred to run their noncore activities. Finally, some have been bought as investments.

One distribution area that the *sogo shosha* have been active in is retailing. In the 1960s, Sumitomo and Safeway collaborated via joint venture to form the retail chain Summit. Safeway withdrew shortly after. In 1994, Daiei collaborated with Marubeni. Most recently, joint ventures have been replaced by the General Trading Company taking direct control over retail companies such as convenience store and food supermarket subsidiaries. Particularly active have been Mitsubishi, Marubeni, and Sumitomo (Meyer-Ohle, 2004).

Unless Japan changes and becomes totally 'westernized' the *sogo shosha* will continue doing things as they always have – adapting to fit whatever niche Japan's environment presents them with.

As another example of the far-reaching impact of trading companies, consider Jardine Matheson, the oldest trading company, or *hong*, based in Hong Kong (but legally domiciled in Bermuda). The group of companies is all over Asia, engaging in such activities as trading per se, retailing, hotel development and management, vehicle distribution, merchant banking, and mutual fund management. Unlike Japan, in the past trading companies in Hong Kong have not been directly influenced by government policy (Ellis, 2001). With Hong Kong now a Special Administrative Region (SAR) of China, Hong Kong-based trading companies, particularly the now foreign-owned ones such as Jardine Matheson, have to be sensitive to the effects that their decisions might have on the PRC government in Beijing. Operations in Hong Kong as well as China itself might be affected. Interestingly, the operations model being followed by Hong Kong trading companies is changing from being a middleman to being involved in supply chain management (*Economic Forum,* 2008). Thus, they are an integral part of the global supply chain. A good example is provided by Li & Fung, Hong Kong's largest trading company. The company has become a one-stop shop for customers through a coordinated package which runs from product design and development through raw material and factory sourcing, production planning and management, quality assurance and export documentation to shipping consolidation (*Economic Forum,* 2008, p. 4).

Trading companies, whether the very largest from Japan or those increasingly emerging from such countries as South Korea, Brazil, China, countries within Europe or the United States, should be of concern to all export marketers. First, they may be necessary for market entry. This would include direct export by the export marketer as well as indirect export. It may be that in order to penetrate, say, the Japanese market the direct exporter would have to do business with a Japanese importing trading company. Second, since trading companies appear throughout the world they may be competitors to the export marketer. It is quite obvious that a trading company can be a very formidable competitor. Consequently, strategies may have to be changed in those markets where trading companies are major competitors.

Ellis (2003) discusses how trading companies or what he calls 'international trading intermediaries' contribute to the economic development of host countries. This applies to both new foreign markets and offshore sources of supply. Three distinct contributions are identified:

- The efficiency of distribution in an economy is improved by minimizing costs incurred in overcoming barriers to trade – that is transaction costs are lowered.
- Productivity may be increased by opening new markets and finding new sources of supply. This creates international exchanges where none existed before.
- Marketing technology and credit may be introduced into local distribution channels, which is known as a catalytic contribution.

Export desk jobber

One type of export merchant often helpful to manufacturers deserves special note. This is the export **desk jobber**, who, because of the method of operation, is also known as an *export drop shipper*, and may be called a *cable merchant*.

Used primarily in the international sales of raw materials, the desk jobbers never see or physically acquire the goods that they buy and sell. In all other respects, however, the desk jobber operates as a regular export merchant, except that goods are typically owned for a very short time. The manufacturer using this type of export merchant comes a little closer to direct export in that he or she is responsible for the physical movement (including documentation requirements) of his or her products to the desk jobber's customer. For example, a company in the United States may negotiate a sale of mercury to a buyer in Japan from a supplier in Spain. Title moves from the Spanish supplier to the US firm and then to the Japanese buyer. Actual shipment will be directly from Spain to Japan.

Export desk jobbers are specialists in knowing sources of supply and markets. They relieve the producer of the problem and risk of determining the reliability of the purchaser. However, they are not conducive to the establishment of continuous markets for a manufacturer's product. They simply conduct business too quickly for there to be any permanent market relationship.

Home-country-based agents

There are several distinct types of wholesaler agents located in the country of export who are potentially available as members of a manufacturer's export marketing channel. When such an agent is used, the manufacturer generally assumes all financial risks.

Export commission house

The export commission house (export buying agent) is a representative of foreign buyers who resides in the exporter's home country. As such, this type of agent is essentially the overseas customer's hired purchasing agent in the exporter's domestic market, operating on the basis of orders or 'indents' (offers to purchase under conditions stipulated by the prospective buyer, including the price to be paid) received from these buyers. Since the export commission house acts in the interests of the buyer, it is the buyer who pays a commission. The exporting manufacturer is not directly involved in determining the terms of purchase; these are worked out between the commission house and the overseas buyer.

The export commission house essentially becomes a domestic buyer. It scans the market for the particular merchandise that it has been requested to buy. It sends out specifications to manufacturers inviting bids. Other conditions being equal, the lowest price gets the order and there is no sentimentality, friendship, or sales talk involved.

From the exporter's point of view, selling to export commission houses represents an easy way to export. Prompt payment is usually guaranteed in the exporter's home country, and the problems of physical movement of the goods is generally taken completely off its hands. There is very little credit risk and the exporter has only to fill the order, according to specifications. A major problem is that the exporter has little direct control over the international marketing of products.

Confirming house

The basic function of a confirming house is to assist the overseas buyer by confirming, as a principal, orders already placed, so that the exporter may receive payment from the confirming house when the goods are shipped. Some exporters may believe that confirming houses should be classified as financial institutions and not as a type of marketing organization. However, the confirming house does perform some functions usually performed by a commission house, even if it does not perform all the functions. The confirming house is not a common type of export enterprise everywhere in the world, but it is in Europe, particularly in the United Kingdom.

The confirming house interposes its credit between the buyer in the importing country and the exporter or manufacturer in the exporting country. It finds its greatest usefulness in those markets where credit conditions are uncertain or where the cost of money is high.

In addition to the payment aspects, the confirming house may also be involved in making arrangements for the shipper. Typically, all contact between buyer and exporter would go through the confirming house. Due to the functions that it performs, its greatest users would be small and medium-sized companies.

Resident buyer

Similar in operation to the export commission house are resident buyers. Resident buyers represent all types of overseas buyers and are domiciled in the exporter's home market. These buyers represent foreign concerns that want to have close and continuous contact with their overseas sources of supply, and are either sent to the market or are local people appointed as representatives. Large retailers utilize this type of intermediary extensively. Thus, retailers such as Galeries Lafayette (France), Harrods (UK), and Nordstrom (US) may have resident buyers in the clothing centers of Italy, Hong Kong, China, and wherever else clothing is produced. Although the resident buyer operates almost exactly like the commission house, that is, the buyer places an order, specifies the terms of sales, handles all shipping matters and other details of the exporting process, and either pays cash or furnishes the manufacturer with a low-risk means of financing – there is one important difference. Because resident buyers are 'permanently' employed representatives of foreign buyers, the exporting manufacturer has a good chance to build up a steady and continuous business with foreign markets. To a large extent, the existence of established brands, trademarks, and a historical record in the market do not count as heavily as being price competitive.

One advantage of an importer utilizing a resident buyer and of the exporter dealing with such a buyer is that any problems that might arise due to language difficulties and cultural and business customs differences are minimized, if not eliminated. It is especially important for the buyers to be fluent in the language of the exporter's country (or have translation help, which is not as desirable as first-hand knowledge) and be familiar with the local culture and customs. A resident of the exporter's country would have this knowledge. To illustrate what can happen when language is not understood, a buyer from Italy, who felt she knew English fairly well, was sent to Britain to purchase clothing (Ricks, 1999, p. 116). She found some appropriate sweaters at Bourne & Hollingsworth, and attempted to order 'four to five thousand pounds worth.' Upon her return to Italy it became clear that a major misunderstanding had occurred – delivery was made of the 'forty-five' thousand pounds worth that she had actually ordered. Exhibit 8.3 discusses another type of buyer.

Exhibit 8.3 Traveling buyers

Some retailer companies use buyers who are not resident in the exporter's home market. Rather, these buyers go to different parts of the world to purchase goods that represent the latest market trends and brands. These are *professional merchandisers*. As an illustration, Chinese mainland department stores such as Hangzhou Mansion in Hangzhou are hiring professionals familiar with consumer preferences. These merchandisers go to Hong Kong, Shanghai, and Shenzhen to observe what sells before going abroad to make purchases. For example, Ms. Qian Dan, a merchandiser and sales manager for Riqing Trading Company in Wenzhou is Hangzhou Mansion's merchandiser for goods from Ferragamo, Escada, and other brands. She goes to Hong Kong and Shanghai to observe the better-selling products before going to Florence and Milan in Italy to make purchases. She is responsible for giving her clients professional guidance and advice on how to mix and match the goods they buy.

Source: Adapted from Business-Alert China (2007).

Broker

Another type of home-country-based agent is the export/import broker. The chief function of a broker is to bring a buyer and seller together. Thus the broker is a specialist in performing the contractual function, and does not actually handle the products sold or bought. For its services, the broker is paid a commission by the principal. The broker commonly specializes in particular products or classes of products, usually staple primary commodities such as grains, lumber, rubber, fibers. Being a commodity specialist, there is a tendency to concentrate on just one or two products. Because the broker deals primarily in basic commodities, for many potential export marketers this type of agent does not represent a practical alternative channel of distribution.

The distinguishing characteristic of export brokers is that they may act as the agent for either the seller or the buyer. For example, an export broker in the lumber business may be contacted by a sawmill and asked if he or she can dispose of a quantity of lumber of a size and grade not readily salable domestically. The broker will then get in touch with potential foreign buyers with whom he or she is acquainted and either offer the lumber to them at a predetermined price or ask them to make an offer. When several foreign offers are received, the broker accepts the best offer or relays the information to the sawmill to ascertain whether the price is acceptable. When the transaction is successfully concluded, the sawmill pays the broker's fee. Alternatively, the broker may be contacted by a foreign buyer and asked to secure quotations on a quantity of a certain size and grade of lumber. Quotations are then sought from sawmills with which he or she is also acquainted. If the broker is not authorized to place the order with the mill making the best quotation, the prices are sent to the foreign buyer for determination on whether the price is acceptable. When the transaction is concluded successfully, the foreign buyer pays the broker's fee.

Export management company

Simply defined, an export management company (EMC) is an international sales specialist who functions as the exclusive export department for several allied but noncompeting manufacturers. That is to say, an EMC may serve five sailboat parts manufacturers, each making a different part. For the individual manufacturer the EMC is to exporting what the sales agent is to domestic marketing.

Although EMCs are independent intermediary organizations, as far as potential overseas buyers are concerned these firms are the manufacturing firm. Being the 'export department' of several manufacturers, the EMC conducts business in the name of each manufacturer that it represents. All correspondence with buyers and contracts are negotiated in the name of the manufacturer and all quotations and orders are subject to confirmation by the manufacturer. Different contractual arrangements with principals may be used.

In actual operation, the EMC in many instances is perhaps more a manufacturer's distributor or an export merchant than a commission representative, since export managers often operate on a buy-and-sell rather than a commission basis. Many still work on a straight commission basis, but the majority today do their own financing, assuming all credit risks abroad and paying the manufacturer cash for every order. Thus the EMC often takes over all the risks and problems of export and the manufacturer just fills the orders.

The possible benefits to a manufacturer of using an export management firm in the channel of distribution are many. In the first place, a tailor-made export department is obtained without adding any extra selling expense. Since this export department is fully functioning at the time that it is obtained, using the EMC is one of the quickest ways for a manufacturer to enter foreign markets. In addition to handling the selling activities, the EMC does research on foreign markets, chooses the best type of channel within an overseas market and usually does its own advertising and promotion. Also, the EMC may serve as a shipping and forwarding agent, and may furnish its principals with legal advice such as patent and trademark situations. Second, where a buy-and-sell arrangement is involved, the manufacturer receives financing assistance. Even without buy-and-sell, an EMC is able to collect and furnish credit information on foreign customers to their principals. Third, the EMC offers experience, which is important in export marketing since no two foreign markets are alike. Being in daily contact with varying conditions in different foreign markets, the EMC knows which markets are receptive to a manufacturer's products and how to sell them in those markets. Fourth, specialization can lead to significant benefits. Handling a wide line of related but noncompeting products can help the sales of each individual product. If a buyer is interested in buying one product there may also be a need for other related products. Since many buyers prefer to work with as few suppliers as is practical, the fact that a supplier can offer a line of products may mean the difference in whether a sale is made or not. Specialization, of course, exists in degrees. Thus, if an EMC represents too many manufacturers, selling efforts may, of necessity, be extensive rather than intensive. Another potential benefit may be derived through savings on shipping expenses. By consolidating orders from different manufacturers into one shipment the EMC can help the overseas buyer make substantial savings. In short, using an EMC is a good way for a manufacturer to overcome any obstacles/barriers to exporting that exist or are perceived by companies to exist (Rameseshan and Soutar, 1996).

In retrospect, it appears that using an export management firm will perhaps be most advantageous to the small to medium-sized manufacturer. In general, however, these independent agents can provide valuable export marketing services to any manufacturer that either cannot afford to set up its own export marketing organization, that does not want to get involved in the more or less 'unique' problems found in export marketing, or that wants to let someone help break it into the business. There are reasons for the small or inexperienced firm producing a branded or specialized product to seriously consider utilizing an EMC. Export sales activities are handled by an expert. Since expenses of export promotion are shared with other producers, they are not unduly burdensome to anyone, especially in the developmental stages of export business. Representing only a limited number of accounts, the EMC pays adequate attention to each account. Since they accept accounts only from producers of related types of products, the danger of promotion of competitors' products is obviated. Small producers gain the prestige of association with related products. The experience and knowledge of the export manager provides the producer with immediate access to established foreign markets.

The truly successful EMC may expect and hope to work itself out of a job, as far as any single producer is concerned, by developing the principal's business to the point that it becomes preferable (cost wise or profit wise) for the producer to establish its own export department and perhaps even shift to direct export. Often the EMC will assist their principals in setting up such an export department.

Manufacturer's export agent

In contrast to an EMC, the manufacturer's export agent retains its own identity by operating in its own name. Also, the manufacturer's export agent is paid a straight commission and does not engage in buy-and-sell arrangements with the manufacturers represented.

Because of these basic differences, the manufacturer's export agent does not offer a manufacturer all the services that an EMC does. Most notable is the lack of advertising and financial assistance. However, there are occasions when the manufacturer's export agent assumes foreign credit risks and charges a *del credere* commission in addition to the regular commission. With a **del credere** arrangement the export agent either guarantees payment for all orders sent to the manufacturer or finances the transaction.

The manufacturer's export agent may be most effectively used when the firm wants to sell small orders to overseas buyers, enter a new overseas market, or sell a product that is relatively new to consumers in overseas markets. Because this type of export agent retains its own identity, it usually desires to remain the foreign sales representative on a permanent basis. Thus producers are seldom encouraged to establish their own export departments.

Evaluation of marketing organizations

In assessing the various types of independent marketing organizations it must be recognized that it is often difficult to categorize a specific company completely into one of the types discussed. Frequently, over a period of time a single firm will perform the functions of several types. For example, an export merchant may on occasion participate in transactions in which it functions as some type of an agent, say, a broker. Similarly, a manufacturer's export agent may on a single transaction sell for its own account products it has previously bought. In addition, many marketing organizations may perform some or all of the services necessary to physically transport a shipment; in this case they operate as *freight forwarders* (see Chapter 14). Since the profit motive underlies the operations of independent export marketing organizations, they may engage in all related functions from which profits may be forthcoming.

It should be apparent that by using some type of independent export marketing organization in the channel of distribution, certain advantages accrue to a manufacturer. A minimum financial outlay by the producer is required, which is particularly desirable for the firm with limited financial resources or facing a small potential demand in foreign markets. Since these agencies are experts in export marketing they know foreign markets, have established contacts in foreign countries, and are able to pinpoint ready markets for certain products. Thus, foreign sales volume can be built up in a relatively short amount of time and seemingly out-of-the-way markets can be tapped. The best markets for particular products are not always the largest countries or those most developed economically. Finally, the manufacturer can determine the foreign potential for its product with a minimum of risk, something that is quite valuable to the company that is new to exporting.

There are also potential drawbacks to using independent marketing organizations. Because of the many different products handled, a marketing organization may not be able to promote the sale of any particular one. This is especially true for export merchants. Furthermore, since such agencies seek profits for themselves, they tend to handle only those products that appear to be the most profitable to them. If a more profitable product appears they will accept it and drop some other one. Thus a manufacturer may be in a position where its marketing channels are not permanent. In many instances the manufacturer may not be able to engage directly in sales effort and promotion. This can be a serious drawback if a product requires a great amount of specialized attention, since most marketing organizations are not able or willing to provide the needed effort. Finally, with the exception of the export management company, there is a risk that the product goodwill that has been generated accrues to the intermediary marketing organization and not the manufacturer.

A matter of some concern to both the manufacturer and intermediary marketing organizations is the conflict that is to some degree inevitable. Conflicts can arise from many sources: (1) differences in major factors such as goals and objectives, desired target customers, desired product lines, and interpersonal relations and (2) differences in channel design and channel policies. What really matters is not whether conflict exists, as it usually always will to some extent, but whether it is hurting the relationship and the channel and whether it can be managed. To be successful, the relationship must be managed, ideally by the exporting manufacturer, and not allowed to function without direction. Of course, trust plays a critical role in managing such a relationship (Marshall, 2003). In addition, cultural empathy is also essential for successful relationship management.

Cooperative organizations

A **cooperative exporter** is a manufacturer with its own export organization that is retained by other manufacturers to sell in some or all foreign markets (Rai, 2010, p. 273). Cooperative exporting organizations represent a cross between indirect and direct export. For a manufacturer using this type of organization in an export marketing channel, indirect export is being engaged in, since the specific cooperative organization is not administratively a part of the manufacturer's organization. On the other hand there is, in a sense, direct export occurring, since a manufacturer can exert some 'administrative' control over the operating policies of the cooperative organization. There are two distinct types of cooperative international marketing organizations: (1) piggyback marketing and (2) exporting combinations.

Piggyback marketing

Piggyback marketing, also known as 'mother henning,' occurs when one manufacturer (the 'carrier') uses its foreign distribution facilities to sell another company's (the 'supplier') products alongside its own. As shown in Figure 8.3 (Duerr and Greene, 1969, p. 5), there are alternative ways in which this can be handled. All types of products have been exported by this technique including textiles, industrial and electrical machinery and equipment, chemicals, consumer soft goods, and books.

Piggyback marketing is used for products from different companies that are noncompetitive (but related), complementary (allied), or unrelated. The particular relationship depends to a large extent upon the motives of the large, already-exporting companies. In the past, some companies, such as General Electric and Borg-Warner in the United States, have viewed piggybacking as a way of broadening the product lines that they can offer to foreign markets. They feel that marketing allied products helps them to market their own products. Other companies engage in this type of operation in order to bolster decreasing export sales. Pillsbury Company, for instance, first began to sell the products of other companies – packaged foods, farm machinery – when export sales of its flour began to decline. Finally, some companies actively seek out smaller manufacturers because piggybacking can be profitable. In general, the carrier's compensation takes the form of a discount from the supplier's domestic distributor list price plus a markup. The discount varies widely depending upon the product and the services provided by the carrier. Although the usual arrangement is for the larger company to buy outright the products of the smaller company, the

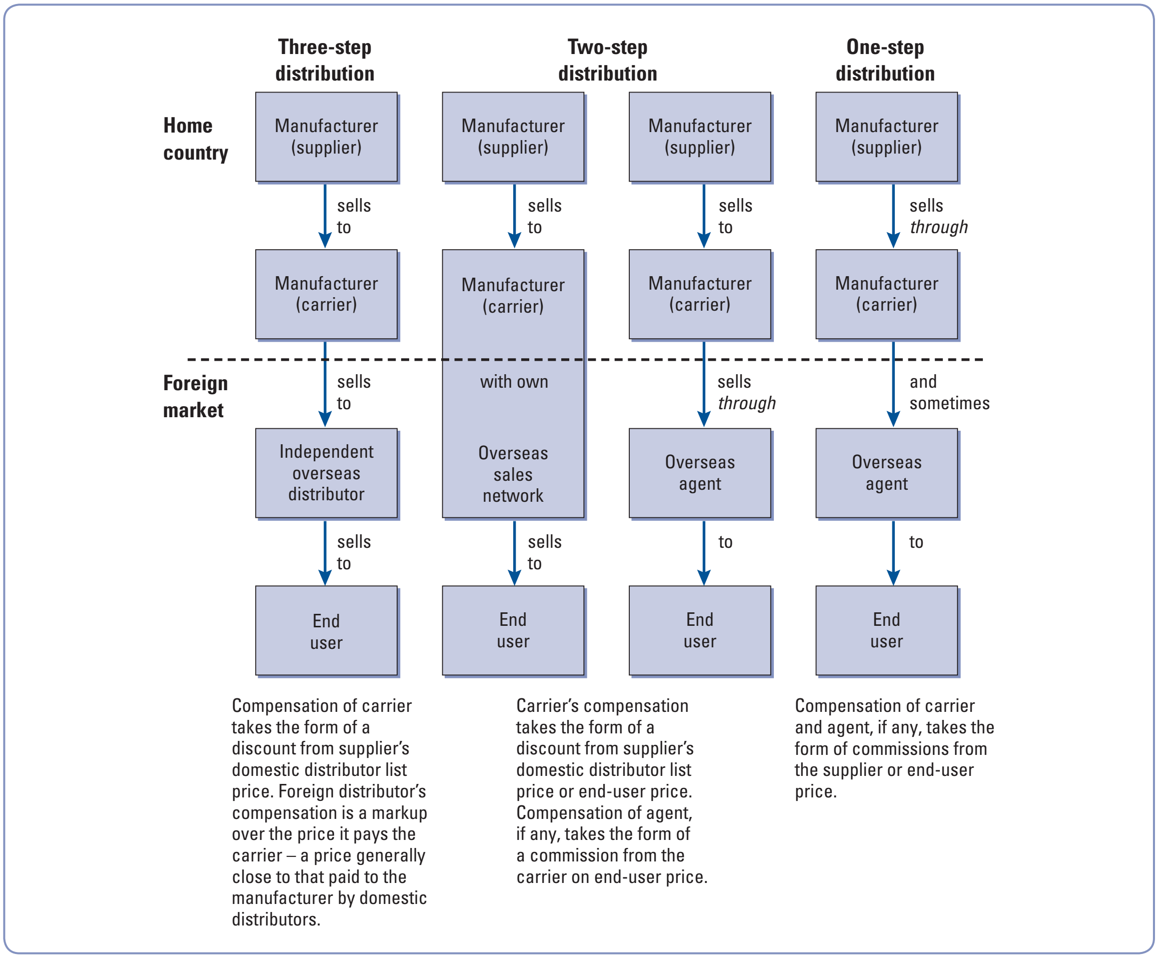

Figure 8.3 Chains of distribution in piggyback marketing

Source: Duerr and Greene 1969, p. 5, reprinted with permission of the Conference Board.

larger company may prefer to act as an agent and be compensated by a commission. Some companies engage in this practice because of government encouragement or regulations. For example, in the late 1980s Rhone-Poulenc, a French chemical company, sold the products of hundreds of other companies through its extensive global sales network (Karamally, 1998, p. 113). The French government encouraged this to assist smaller exporters that lacked abilities to do extensive exporting. Another example is Polymark Laundry Systems, which in the late 1980s marketed the products of many other companies in Poland. Polymark was licensed by the government and other firms did not find it worth the effort at the time to get the required government approvals.

There may be differences concerning which company's name the product will be sold under. Some companies have a policy of using either the actual manufacturer's name or creating a private label – but never their own name. Other exporting companies have the policy of using the corporate name that is best known, whether that is its own name or that of its supplier.

Piggyback marketing provides an easy, low-risk way for a company to begin export marketing operations. It is especially well suited to manufacturers that are either too small to go directly into exports or which do not want to invest heavily in foreign marketing. As far as the smaller manufacturer is concerned, its transactions are domestic in nature. The larger firm can provide a well-established export department and export marketing channels geared to the needs of the smaller firm. Yet for the smaller company this type of agreement means that the control over the marketing of its products is given up, something that many firms dislike doing, at least in the long run.

Exporting combinations

A manufacturer can export cooperatively by becoming a member of some type of exporting combination, which can be defined as a more or less formal association of independent and competitive business firms, with membership being voluntary, organized for purposes of selling to foreign markets. There are two basic general types of exporting combinations:

1. marketing cooperative associations of producers or merchandisers that engage in exporting members' products;
2. export **cartels**.

The first type of exporting combination is the normal domestic marketing cooperative as is commonly found in certain primary product industries, for example, citrus fruits, nuts, and other types of agricultural products. The export operations of such organizations are essentially the same as the export operations of manufacturers and intermediaries. A producer normally cannot join the cooperative for the sole purpose of entering foreign markets.

Of more interest to the manufacturer is the possibility of becoming a member of an export cartel or cartel-type arrangement. A cartel is said to exist when two or more independent business firms in the same or affiliated fields of economic activity join together for the purpose of exerting control over a market. More specifically, a cartel is a voluntary association of producers of a commodity or product organized for the purpose of coordinated marketing that is aimed at stabilizing or increasing the members' profits. A cartel may engage in price-fixing, restriction of production or shipments, division of marketing territories, centralization of sales, or pooling of profits. Three types of international cartels can be distinguished:

1. The traditional international cartel formed for the purpose of truly dominating a market for certain products. This type of cartel is perhaps best illustrated by pre-World War II steel and chemical cartels in Germany and the more current Organization of Petroleum Exporting Countries as well as the marketing of diamonds by the DeBeers Central Selling Organization.
2. International Commodity Agreements such as those that exist in wheat and tin. These differ from the pure cartel in that both selling and buying countries are parties to the agreement.
3. Cartel-type organizations engaged solely in exporting that are formed so that the individual members can compete more effectively in overseas markets. The Webb-Pomerene associations in the United States are of this type, as are certain cartels in Japan. Also, the same type of US export trading companies (perhaps with commercial bank participation) can be such a cartel.

Exhibit 8.4 Privileged companies

Some forms of cartel arrangements, or arrangements where would-be competitors may join together, may be per se illegal business practice in some countries such as the United States and countries of western Europe. But cartels are not illegal per se in other countries – Singapore and Hong Kong are examples. To overcome this a country may pass special legislation to allow such cooperative business ventures. These types of arrangement will vary by country. For example, in the United States the Webb-Pomerene associations and export trading companies formed under the Export Trading Company Act are exempt from **antitrust regulation** if they meet certain conditions.

Arrangements such as the above are encouraged by national governments that want to promote increased export business. Another approach to this is to use *tax incentives* by allowing certain types of organizational arrangements. The United States provides an example by its fostering of foreign sales corporations (FSCs).

Our major concern is with the type of cartel formed solely for the purposes of export. For a manufacturer, the cartel takes over all export responsibility. Also, there may be little or no direct competition from other 'domestic' manufacturers. There are, however, certain limitations to this approach to exporting. In the first place, the association may become ineffective because the members cannot agree on key matters. Thus cooperation may be missing. Second, if a manufacturer's products are branded or trademarked there is a measurable risk that the independent identity of both the firm and its products might get lost along the way. Finally, related to the last limitation are the difficulties inherent in this type of arrangement of adequately representing individual interests. However, a single manufacturer does not have complete freedom of choice. Either an association must already exist or a manufacturer must find others willing to form one, something that is often difficult to do. Other approaches are illustrated briefly in Exhibit 8.4.

Direct export

Direct exporting occurs when a manufacturer or exporter sells directly to an importer or buyer located in a foreign market area. Thus the actual transaction flow between nations is handled directly by a dependent organization of the manufacturer or a foreign-based marketing organization or customer. As we indicated in Figure 7.2 (in Chapter 7), a manufacturer can export directly to a buyer domiciled in a foreign market in many different ways.

Although our discussion of these alternative methods of direct export will look at each individually, in addition to being alternatives they are also complementary. A manufacturer may use more than one to serve any specific foreign market. Perhaps the best example of this concerns the role played by the home-country-based export department or division. Generally speaking, regardless of the method used, some type of home-country-based department should exist.

Entry modes should not be viewed as sacred. When conditions change, so should the channel. In a more general sense the changing of export arrangements is evidence that export development occurs in stages (Exhibit 8.5), as we discussed previously in Chapter 2. There is some evidence suggesting that for small and medium-sized companies export does

Exhibit 8.5 'Stages' models of export development

Export development can be viewed as occurring in stages. One such model consists of at least six stages, as follows: (1) no interest in exporting, (2) fill unsolicited order, (3) explore feasibility of exporting, (4) export on experimental basis to psychologically close country, (5) experienced exporter to country of stage 4, and (6) explore feasibility of exporting to other countries, (Bilkey and Tesar, 1977).

In stage 1, management would not even fill an unsolicited order, whereas in the second stage, although an unsolicited order would be filled, there would be no attempt to explore exporting on a more formalized basis. It is at stage 3, which can be skipped if unsolicited orders are received and filled, that a formal commitment to export marketing is really being considered. At stage 4 the model postulates that it is most desirable to begin exporting to countries that are psychologically close to the exporter's own country. Such a country has the same culture, is at a similar stage of economic development, etc., as the exporter's country. Thus Australia is psychologically closer to most United Kingdom firms than is Mexico, even though the latter is closer geographically. In stage 5 the exporter has become experienced in dealing with psychologically close countries and is now ready to expand to countries more psychologically distant (stage 6). The model would then progress, presumably ending with the firm no longer being solely an exporter; some form(s) of overseas production base(s) would be integrated into the international operations.

Limited empirical tests of this model suggest that the export development process does indeed tend to proceed in stages; considerations that influence firms' moving from one stage to the next tend to differ by stage; and quality and dynamism of management tend to make size of firm relatively unimportant.

Although from 1977, this schema is as applicable today as when first proposed.

not necessarily follow a stages model. Rather, companies may be 'born global' in that their future involvement in export is to a large extent influenced by their behavior shortly after their establishment – that is their 'birth' (Moen and Servais, 2002; Kuivalainen *et al.,* 2007). A born-global firm has been defined as a company in which a minimum of 25% of its total sales come from exporting and it has to have internationalized within a few years (generally three) after its creation (Kuivalinen *et al.,* 2007, p. 254). A typology of born globals based on turnover (i.e., sales) from foreign markets and market distance, which is a measure of internationalization, is shown in Figure 8.4. True born globals operate in multiple and distant

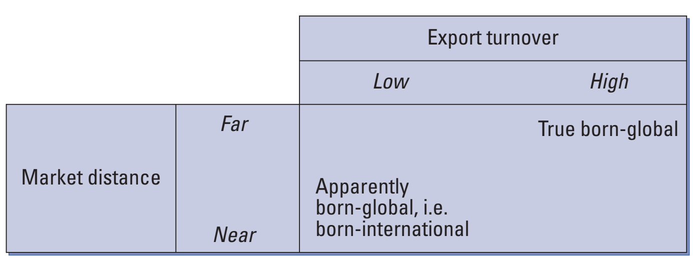

Figure 8.4 Typology of born-global firms

Source: Kuivalainen *et al*., 2007, p. 255.

markets, whereas born internationals do not have a global spread or scope. What happens to born globals as they mature? The born-global concept has traditionally focused on how these companies start differently from other companies, but has been unable to shed much light on what happens to them as they mature. In 2014, Cavusgil and Knight published a follow-up article to their highly influential 2004 article on the born-global firms. The 2014 article is concerned with what happens to born globals as they mature, and among other aspects the authors argue that technological advances mean a lot to the manner in which these firms mature.

Home-country-based department

The manufacturer who wants to engage in direct export will most likely have to establish some type of export department or division in the home country. This dependent organization may either be involved directly in making export sales or serve as the home-based export marketing department to coordinate and control the activities of other dependent organizations located in foreign markets.

There are basically three different types of home-country-based export organizations:

1. **built-in export department**;
2. separate or self-contained export department;
3. export sales subsidiary.

The specific type that is appropriate for any manufacturer at a particular point in time depends upon such factors as the nature of the product, the size of the company, how long the company has been exporting, the expected potential volume of foreign sales, the underlying management philosophy toward doing business internationally, the corporate organizational structure, and the extent to which either existing company resources can be allotted to export activities or additional needed resources can be acquired.

Built-in department

The built-in type of export organization is the simplest in structure and, thus, the easiest to establish. In its most simple form this organization will consist of an export sales manager with some clerical help. The primary job of the sales manager is to do the actual selling or direct it. Most other export marketing activities – for example advertising, logistics, and credit – are performed by the regular domestic market-oriented departments of the company.

Although the built-in arrangement is simple in structure, and flexible and economical in use, these features may be more apparent than real. Many complications can arise when the export manager tries to coordinate activities that must be performed by organizational units not under his or her direction. Since these other departments are usually oriented toward domestic marketing activities there is the danger that they will view tasks associated with export marketing as something to be done only when there is spare time available. In addition, these departments may not be knowledgeable in the special intricate details connected with exporting and must be willing and able to learn them. Such conditions may lead to unnecessary delays and a disorganized and far from optimal export marketing program. So much depends upon the extent to which these domestic-oriented departments are permanently committed to the domestic end of the business, that is, upon the amount of 'capacity' that is available for export marketing tasks. Much of the success of this type of export organization depends upon the individual occupying the manager's job, and this person's ability to secure the cooperation of the other department managers.

Under the right conditions, a substantial amount of foreign sales can be adequately handled by this type of organization. Despite this, for direct export the built-in form is best suited – relative to the other types of departments – to a manufacturer operating under any of the following conditions:

- small in size;
- new or relatively new to export marketing;
- expected foreign sales volume (turnover) is moderate to small;
- management philosophy not oriented toward growth of foreign business;
- existing marketing resources capacity not fully utilized in the domestic market;
- either the company is unable to acquire additional resources or, if able to do so, *key* resources are not available.

In addition, this type of arrangement is potentially very useful for coordinating the indirect export activities of a manufacturer using that method to serve foreign markets.

Separate export department

Although the built-in type of organization may be adequate in the early stages of direct export market development, if sales continue to increase a point will be reached where a more fully integrated organization is needed. One way to meet this need is to set up a separate export department.

In contrast to the built-in type, the separate export department is a self-contained and largely self-sufficient unit in which most of the export activities are handled within the department itself, making it a relatively complete export marketing department. The separate export department may be structured internally upon the basis of function, geographic region, product, customer or some type of combination, depending largely upon how the export marketing task varies the most.

Most of the conditions that may cause trouble in the built-in form are eliminated when a separate department is established. In the first place, there is no inherent possibility for clash between the international and domestic sides of the firm regarding the time to be spent by domestic marketing personnel on foreign business matters. There is, however, a chance for conflict regarding allocation of resources to each side of the business. Second, export operations can be conducted on a full-time basis by personnel knowledgeable and specifically committed to exporting. Finally, the separate export department has a fairly high degree of flexibility in terms of where it is located. A built-in export department by its very nature must be located at the same place as the domestic departments with which it works. Yet there may be reasons for the export organization to be located not at the headquarters of the company but in one of the major centers of international business. For example, a manufacturer in the Netherlands may be located in Maastricht on the border with Germany, but have its export department in Rotterdam because of the need to keep close contact with the many specialist facilitating agencies with which it must work – banks, forwarders, consulates, and so on.

Export sales subsidiary

In attempting to divorce completely export marketing activities from domestic operations, some companies have established an export sales subsidiary as a separate corporation. Although an export sales subsidiary is wholly owned and controlled by the parent company, it is essentially a quasi-independent firm.

All authority and responsibility attached to export operations, including profit responsibility, may be 'assigned' to one subunit of the parent manufacturing firm. Thus, with this form of export organization, a manufacturer may be better able to ascertain the profitability of its foreign business. In addition, the chance of conflicting pressures arising from domestic departments is minimized.

In terms of its internal organization and the specific activities performed, the sales subsidiary differs very little from the separate export department. There is, however, one major difference that can cause top management some concern. Being a separate corporation, the export sales subsidiary must purchase from the parent manufacturer the products that it sells in overseas markets. This means that the manufacturer must develop a system of internal transfer pricing. There are numerous complexities and management problems associated with transfer pricing. These are discussed in Chapter 11.

Although the export sales subsidiary is in many respects similar to an export department, there are important reasons for its existence:

- *Unified control.* All authority relative to exporting is centered in one organization not subject to conflicting pressures from various domestic departments.
- *Cost and profit control.* Since all revenues and expenses are separated from the domestic organization, export costs and profits can be seen readily.
- *Allocation of orders in multiple plant enterprises.* The subsidiary company can place an order with the most suitable plant more readily and can supervise traffic management responsibilities more effectively.
- *Ease of financing*. Since the subsidiary is a separate corporation it is easier to ascertain its financial position. As a result, financial institutions may be more willing to advance funds for export purposes.
- *More complete line of products*. Being a separate company, it can purchase products from outside sources to offer overseas buyers a more complete line.
- *Tax advantages.* Corporate income tax laws in some countries may result in some savings in total corporate taxes.

The subsidiary export company can serve a variety of useful purposes, most of them corporate in character and comparatively unrelated to the practice of exporting.

Foreign sales branch

A manufacturer that has been exporting direct through some form of home-country-based department, possibly even in conjunction with foreign-based distributors or agents, may reach the point where it is believed necessary to have closer supervision over the sales made in a particular market area. In this kind of situation the company can establish a foreign sales branch.

A foreign sales branch handles all of the sales, distribution and promotional work throughout a designated market area and sells primarily to marketing organizations (wholesalers and dealers) or, under certain conditions, industrial users. Thus, where used, the foreign sales branch is the initial link in the marketing channel within a foreign market. Often there will be storage and warehousing facilities available so the branch can maintain an inventory of the product itself, replacement parts, maintenance supplies, or operating supplies. Whether a storage facility is used or not, shipment may often be made direct from the manufacturing plant to the initial buyer, especially when large purchases of high value are involved. Thus, the operating characteristics of a foreign sales branch are much the same as those of a foreign distributor except that the manager is an employee of the company and is directly responsible to the home office. In fact, foreign sales branches are often established after a market area has been developed and built up by local distributors and agents. The point at which this transformation should occur is when the size of the sales volume (turnover) justifies the cost involved in establishing and operating a branch office, and it is believed that this turnover level will be maintained or will grow over time.

A foreign sales branch may serve other useful purposes. In the first place, where it is desirable for the manufacturer to display part or all of its product line, the branch office can set aside facilities for this purpose. The value of this as a marketing and sales promotion tool is obvious. Second, for many manufacturers a more important use of a branch office can be as a service center. For various reasons, many foreign business firms, particularly independent marketing organizations, are not willing or able to provide the service for products that might require it. If it is not made available by the manufacturer, the buyer will have to do it himself. While some buyers, particularly those of industrial equipment, prefer to do their own servicing and only require that the necessary parts and supplies be readily available, other buyers consider service as something to be handled by the seller.

Foreign governmental policy may exert an influence on the actual operations of a sales branch as well as on the decision to establish a branch. For example, adverse tax laws may exist and there may be problems involved in repatriating profits. This is particularly important when the sales branch is organized as a subsidiary. Equally troublesome, potentially, is the question of the personnel who staff the sales branch. In general, it is perhaps most desirable to have personnel, particularly at the managerial level, who have actually worked or been trained in the domestic organization. Ideally, these people should be nationals of the country in which the branch office is situated. In some countries the government requires that a minimum proportion of branch office staff be citizens. One final comment is that operating a foreign sales branch is a very costly activity. Consequently, this method of doing business overseas is usually best suited to the larger and financially established manufacturer, but there are numerous examples of smaller companies that successfully operate sales branches.

Establishing what is essentially a sales branch, or a sales subsidiary, is what most direct selling companies do when entering a foreign market. A direct selling company is one that employs independent contractor salespersons to sell directly to consumers away from a fixed business location whether one-to-one or by party plan. In China, some companies such as Avon Products also have fixed locations, but this is due to government regulations. One example of the sales branch is US-based USANA, a direct seller of science-based products that in 2007 established a facility in Malaysia containing administrative offices, a distribution center, associate (salesperson) meeting rooms, and a call center. Another example is Jafra Cosmetics, which has 9,000 sales people, 30 managers, and a service team in Munich for its market in Germany. Some direct selling companies such as Amway and Avon may also have a manufacturing facility in a foreign market.

Storage or warehousing facilities

When it is necessary and profitable for a manufacturer to maintain an inventory in foreign markets, a storage or warehousing branch should be established. Such facilities may be part of a sales branch. If so connected, the buyer is afforded greater convenience and a potentially powerful marketing tool is created in that a greater volume of business may be generated than would be the case if storage facilities were absent. The same situation occurs when the warehousing branch is a separate entity, set up to fill orders made by foreign distributors or agents.

It is not necessary that a foreign storage or warehousing branch provide stocks for a single market area. In fact many manufacturers, as they increasingly apply the total cost concept to their physical distribution or logistics problems, are establishing such branches as central distribution points to serve a wide area. Where several market areas are to be served by a single storage or warehousing branch, it may be best for these facilities to be located in a free port or trade zone such as Hong Kong, New York, Rotterdam or Colon, Panama. By locating in a free area, it is relatively easy for a manufacturer to serve many markets since the usual Customs procedures and regulations of the country where the free area is physically located do not apply.

Foreign sales subsidiary

The foreign-based sales subsidiary is a variation of the home-country-based export sales subsidiary. As such it operates much the same; it is also similar in operation to a foreign sales branch office. One major difference is the somewhat greater autonomy enjoyed by the foreign-based subsidiary because of its foreign incorporation and domicile. In addition, the foreign-based subsidiary in many cases has broader responsibilities and performs many activities beyond those of a foreign sales office. The foreign-based subsidiary is a flexible type of organization, and in terms of its physical facilities and operating activities can include anything from a complete operation to a small office set up merely to fulfill the residence requirements of the incorporation laws of the country in which it is incorporated.

The subsidiary type of organization can be used for many different functions (business activities) in foreign markets. When organized as a *sales subsidiary* (or when sales activities are performed) all foreign orders are channeled through the subsidiary that then sells to foreign buyers at normal wholesale or retail prices. The foreign sales subsidiary purchases the products to be sold from the parent company either at cost or some other price. This, of course, creates the problem of intracompany transfer pricing.

The reasons underlying the establishment of foreign-based sales subsidiaries as well as the reasons for choosing a particular country as the base for a subsidiary stem from two major sources: taxes and business practices. One of the major influences on the popularity of overseas-based subsidiaries has been potential tax advantages that can accrue to a company utilizing this form of organization in its international operations. This has been particularly important for companies headquartered in high tax countries. With proper planning, companies could establish subsidiaries in countries with low business income taxes and gain an advantage by not paying taxes in their home country on the foreign-generated income until such income was actually repatriated to them. Of course, the precise tax advantages that are possible with such subsidiaries depend upon the tax laws in the home country of the parent company. There are, moreover, potential tax advantages beyond tax deferral. These stem from the practice of the parent company having subsidiaries retain a large share of their profits and then using such funds for further expansion abroad either in the country in which the profits were generated or in other countries. This can be quite useful in areas such as the European Union.

Taxes have not been the only reason for establishing foreign-based subsidiaries, nor have they even been the major reason in many instances. In selecting a foreign base, companies look for good banking connections, good operating conditions, a stable political situation, clarity in legal rulings, and proximity to markets. Other characteristics considered in selecting a base for a foreign subsidiary include such things as ease and simplicity of incorporation, restrictions concerning ownership and operation of a business, and availability of adequate local staff and clerical personnel. Thus, business motives are intermingled with those of tax.

Traveling salesperson

A traveling export salesperson is one who resides in one country, often the home country of the employer, and travels abroad to perform the sales duties. In contrast, a resident salesperson is sent out of the home country to live and work in a foreign market. In essence the resident salesperson is a foreign sales branch of the company. Of course, the company may establish a formal branch office, to which a resident salesperson is assigned. However, a branch office often also employs as sales people nationals of the country in which it is located.

In making the decision whether to use traveling sales personnel in any particular foreign market, a company should consider just what the salesperson is to do. There are many types of sales jobs ranging from so-called order making to order taking. If a company finds that the type of sales job that needs to be carried out in a foreign market tends toward the order-taking side of the sales-job pendulum, in most cases it probably would not be economical to use traveling salespersons. On the other hand, where the sales job tends toward order making, using a competent and well-trained salesperson may prove to be the best method. Much depends upon the relative costs and returns in the form of sales generated.

There are three basic functions that all sales personnel operating in foreign markets must perform, although the relative importance of each will vary depending upon such things as the nature of the product to be sold and the nature of the market. In the first place, there is the actual selling activity to be performed – the communication of product information to customers, and obtaining orders. Second, a salesperson is always deeply involved in customer relations. The sales force must at all times be concerned with maintaining and improving the company's position with customers and the general public. This is not always easy to do, and is one of the reasons that so many firms employ local nationals as sales personnel in a specific market. Where customer relations are critically important, the use of a traveling salesperson is less likely to be the best method of direct export. The reason is simply that there generally would not be enough customer contact. There is, however, one type of traveling salesperson whose main job is in the general area of customer relations. Sometimes called a *demonstrator* or *tutor*, this type of traveling salesperson works closely with foreign-based agents or distributors already representing his company. Since the sales task primarily is to help agents and distributors do a better job, the tutor operates more or less as a troubleshooter.

The third function performed by the field sales force, one that has often been neglected, is that of information gatherer and communicator. The salesperson is management's front-line intelligence agent, and, as such, is in a position to provide information on such things as what competitors are doing, what customers are thinking, how products are performing, and what the future is of any given market. In addition, the salesperson is often able to supply information pertaining to particular customers, and perhaps other types of information that might be useful in planning advertising and trade promotion programs. Where it is important that a salesperson provide information to the company regularly, then a resident, rather than a traveling salesperson probably should be employed.

To a large extent the effectiveness of any salesperson in performing these three basic activities depends upon mutual *trust*. Ongoing trust is crucial to long-term relationships.

Obviously not all companies should be using traveling sales people. Although there are no ready answers to when they should be used, there are general criteria that can be evaluated and conditions that generally are most favorable to their use.

To a certain degree the nature of the product has an influence. If the product is technical in nature and the prospective buyer needs detailed explanation and demonstration, a traveling salesperson may be able to do the required job. In fact some companies have technical experts employed in specific foreign markets for this very purpose. If, however, servicing is required and a supply of parts, and so on, are necessary, the traveling salesperson is not as effective nor efficient a method of export as one involving some type of permanent overseas base.

Another criterion concerns the potential sales volume of a market. Since a selling trip can cost a great deal, a minimum sales volume must be possible for the use of traveling sales people to be profitable. Also relevant is whether the sales volume is spread out over a year or is seasonal. If seasonal, a traveling salesperson becomes a potentially more profitable vehicle since there would be no fixed costs to worry about in the slack periods.

Technology in the form of the Internet is playing an increasingly greater role in sales and is affecting the role of the salesperson, especially the traveling salesperson. This is particularly the case for B2B marketing. E-commerce, or Internet marketing, has a growing global presence, and is being used to complement or replace salespersons. Using e-commerce to replace a salesperson could be a mistake in situations where person-to-person interaction is crucial to a relationship, especially for the small and medium-sized enterprise. E-commerce is discussed further later in this chapter.

Evaluation of dependent organizations

Producers that have established their own organizations and have found them to be successful include the following among the reasons for doing so:

- *A full return from export sales*. As export business develops, there is no sharing of profits with other organizations.
- *Protection from neglect in active performance of the selling function*. There is complete control of marketing methods and sales promotion. Moreover, there is no worry that competing lines may be pushed at the expense of the producer's sales volume.
- *Thorough knowledge of foreign markets*. The producer can determine readily what adaptations of his or her product are necessary to fit the needs and desires of foreign buyers.

Table 8.2 Export sales characteristics associated with direct export

Unified and high degree of exercised control
A 'sales push' approach can be implemented with relative ease
Greater customization of product solutions is made possible by designing tailor-made packages
Direct customer feedback improves firm responsiveness
Flexibility is possible across all marketing programs
Greater commitment of own sales staff encourages increased levels of sales turnover
Sales staff exhibit a high degree of product knowledge
Customer loyalty can be heightened for the exporter's brands
The most persuasive forms of promotion in the overseas market
Role clarity is common among representatives

Source: Katsikeas and Morgan (2003, p. 470). Copyright Elsevier (2003).

- *Export sales channels are permanent*. The producer does not have to worry that a marketing organization will suddenly drop its line in preference for that of a competitor.
- *Product goodwill accrues directly to the manufacturer* rather than to a marketing organization. This can prove quite favorable when new or different products are introduced into foreign markets.
- *Per unit cost decreases as sales volume increases*. Fixed costs are spread over growing sales volume rather than remaining a constant proportion.

Table 8.2 presents selected transaction-specific assets (i.e., advantages) that are applicable to direct export where a company has its own export sales force or local sales department responsible for sales in foreign markets.

There are also some potential drawbacks to the use of dependent organizations. A large initial monetary outlay is required to establish export markets, and this may be too large relative to sales volume. This includes provision for offices and equipment, salaries of personnel, costs of maintaining larger inventories necessary to fill foreign pipelines, and, most important, the costs of sales effort that may yield only insignificant returns.

The manufacturer is required to assume greater risks. There is always the chance that the product may not be acceptable in foreign markets or that foreign preferences may change suddenly. More important, the producer may be required to assume credit and financial risks.

Successful foreign marketing requires specialized knowledge that may not be available in the manufacturer's organization or may require excessive expense to obtain. Marketing techniques for successful foreign sales frequently differ materially from domestic sales and the techniques of export traffic and financial management are also considerably different.

Satisfactory sales volume may take an excessive time to build up, or it may never be achieved. Independent organizations have the contacts, knowledge, and experience necessary to develop export potential.

In general, the use of a dependent organization is preferable when the following conditions prevail:

- the product is differentiated, specialized, or has a brand appeal and requires particularized selling effort;

- there is an existing large and steady export sales volume; or export sales potential is concentrated in a relatively small number of markets so that available selling effort does not have to be spread too thin;
- future sales potential is growing and has an apparent large total volume;
- export costs can be spread over a growing volume so that per unit costs decrease as volume increases.

Although the discussion has been in the context of manufacturers, it should be recognized that marketing organizations such as retailers have exported their concept or operations abroad. Indeed some retailers such as Benetton from Italy, IKEA from Sweden, and Urban Outfitters from the United States use their retail operations expansion as the means of exporting products that they produce and sell in their own captive stores, as do many of the so-called designer label companies.

Foreign-based distributors and agents/representatives

So far our discussion of the various methods of direct export has been concerned with the use of dependent organizations. We now turn to a form of direct export involving independent marketing organizations – distributors and agents. This method of exporting is distinguished from the method of indirect export using similar type (in terms of operating characteristics) intermediaries in that when direct export is being conducted, the distributor or agent is foreign based. The terms 'distributor' and 'agent' are often used synonymously. This is unfortunate because there are distinct differences. For instance, a distributor is a merchant and as such is a customer of the exporter. An agent, on the other hand, is a representative (and is often referred to this way) who acts on behalf of the exporter and is not a customer. Thus the distributor actually takes title to the exporter's goods while the agent does not. In short, the distributor imports the products involved whereas an agent leaves importation to the buyers whose orders have been passed on to the principal. A second major point of distinction arises through the method of compensation by which each is paid. The agent is usually paid on the basis of a commission while the distributor's income comes from the margin taken as determined by the trade discount granted by the exporter. A third difference is that a distributor normally carries an inventory whereas an agent does not, except perhaps for showroom purposes.

In most cases, the agent or distributor is a manufacturer's exclusive representative in a given foreign market area and is the sole importer. As such, the agent or distributor is granted sole rights for the sale of the manufacturer's products in the market area covered by the agreement. There are instances, however, where exclusive selling rights are not granted. For example, sales to foreign government agencies are often reserved for the manufacturer itself, who uses one of the other types of direct export involving a dependent organization. In this type of situation the agent or distributor receives no compensation. A second possible modification occurs when an agent is appointed as a general agent. In this case the manufacturer can appoint other agents in the general agent's market area. The general agent, however, is paid a commission – less than what would normally be received – on all sales made through the other agents.

The functions performed by distributors and agents are basically the same as those carried out by the domestic-based marketing agency of the same type or the manufacturer's own foreign-based organizations. However, some basic differences should be noted. First, since these foreign-based outlets are granted exclusive rights, there is every reason to expect that they will put extra effort into promoting the sale of a manufacturer's products. All the rewards of this extra effort accrue to them rather than having to be shared with other agencies. A second basic difference concerns the servicing of the manufacturer's products. If a product is of a type that may require service, the distributor stands ready to provide such service by having the proper facilities, well-trained personnel, and a complete stock of the necessary parts and materials.

In general, therefore, a manufacturer can usually expect better sales and related services from foreign-based outlets with exclusive market areas than if these outlets had to share markets. The activities performed and operating characteristics of foreign-based distributors and agents will vary greatly, and depend upon such things as the nature of the products, the characteristics of the market area, the particular type of foreign-based outlet chosen and its operating philosophy, and the general operating situation of the manufacturer. In addition, for the agent approach more than any other method, the extent of success rests largely on personalities and personal relationships. Although the exporter and its foreign distributor or agent are dependent upon each other, they are also separated by ownership, geography, culture, and law.

The general advantages and disadvantages of using these marketing organizations do not vary greatly from those associated with their home-country-based counterparts. If a manufacturer is committed to direct export, then using exclusive agents or distributors is the easiest and least costly way of doing it. This method also appears to be the one most capable of development. For these reasons, manufacturers new to direct export often choose this way, particularly where only a moderate sales volume is expected in a market area. Many agents and distributors are so successful that they work themselves out of a manufacturer's marketing channel. After sales in a foreign market pass a certain level, the manufacturer may find it more effective and profitable to establish a sales branch or subsidiary. However, even if a large sales volume is generated, often there are good reasons why the agent or distributor should not be eased out of the manufacturer's channel. His or her intimate knowledge of the market and dealers and access to various sources may not be capable of being equaled by the manufacturer's foreign-based dependent organization. In addition, an agent or distributor may have political influence that can be of benefit to a manufacturer. This may be particularly helpful in a country such as China.

On the other hand, a manufacturer may not want to use an independent marketing organization as an exclusive distributor in a particular foreign market area. The possible reasons for this are many and varied, and may include such things as wanting to have complete control over the marketing channel between nations, and the lack of a firm capable of assuming all the duties of an exclusive distributor. In addition, for both agents and distributors, the other product lines that they handle from other companies may make it difficult for an exporter to introduce new products into the foreign market. Much will depend upon the competitiveness of the new product(s) to those already handled by the intermediaries. In cases such as this, rather than entering into a contractual agreement the manufacturer may form a subsidiary to act as the sole importing distributor in a given foreign market area. This subsidiary may be wholly owned or jointly owned with nationals of the country involved.

Exhibit 8.6 Distributors and product quality

From the viewpoint of the distributor, there is one potential problem that may cause havoc, which concerns product quality. In certain situations the distributor sets design specifications which may not be met by the manufacturing supplier. Or the manufacturing supplier on its own 'cuts corners' to save money. When complaints about quality are raised by customers the end result may be a product recall, which can be very costly. For example, a US-based distributor of tires made in China in 2007 estimated that a recall of the tires, which may be necessary, would cost US$90 million (Welch *et al*., 2007, p. 48). Although clearly not limited to goods produced in China, there have been recent recalls in the United States of such products as wooden railway toys, space heaters, tool bench toys, halogen table lamps, and lounge chairs (Welch *et al*., 2007, p. 48). In addition to the cost of recalls, there may be a long-run impact on customers' and potential customers' image of the brand and trust of the distributor.

In some situations, the distributor sets the specifications of the product to be imported, and seeks a manufacturer in a foreign country to produce the product. Exhibit 8.6 illustrates what can happen if quality is not up to specifications or if the manufacturer substitutes components.

A closer and tighter form of relationship between a manufacturer and its foreign representative than that obtained with the exclusive distributor or agent occurs when a *franchise* is given. The distinguishing features of the franchise are that it gives the holder the right to carry on certain manufacturing processes by which the product is prepared for the market, it delegates to the holder the right to use the brand name and trademark of the manufacturer's product for an unlimited period under stated conditions, and it is designed to be a long-term arrangement. These privileges make necessary the extremely meticulous protection that the manufacturer must have in order to safeguard its profit, property, and rights.

The franchise-holder's business is characterized by a relatively small but exclusive territory. The best illustration of this type of representative in foreign markets is to be found in the nonalcoholic beverage industry, and includes companies such as Coca-Cola and PepsiCo where a major component of the product is exported by the manufacturer to the franchisee. There also are examples from the retailing sector. Gloria Jean's Coffees, an Australian-owned global company, has more than 900 stores and has signed 36 master franchise agreements across 35 countries worldwide (Austrade, 2009, p. 13).

Relations with foreign-based distributors and agents

The importance of careful selection of overseas-based distributors and agents cannot be overstated. Not only are the usual business considerations involved, but there are some legal issues as well, namely those covering termination and compensation. Therefore it is essential that a good contract be developed, clearly covering all relevant aspects of the relationship and spelling out obligations and expectations of both parties. Having a contract is no guarantee that everything will work out as planned and that both parties will be 'happy.' A case in point is a tire distributor in the United States, Foreign Tire Sales (FTS), which imported tires from its Chinese partner Hangzhou Zhangce Rubber Company. The two companies have had a relationship since 1990. In 2006, FTS received complaints that the tires were not holding up. The US government ordered a recall. The result of this is that FTS is suing its Chinese partner for fraud, breach of contract, and recall costs. The manufacturer claims that they could not find the defect that FTS says exists.

As mentioned previously, relationships are enhanced by mutual trust between the parties involved. Trust should be built early in all relationships within an international channel of distribution. Research has shown that building trust early is more dependent upon matching, rather than exceeding, a partner's expectations (Marshall, 2003).

As time passes some relationships between exporters and importers will end, or be cut back. An internally triggered dissolution occurs due to the inability of the partners to meet their mutual expectations regarding the business relationship – price, product quality, delivery, etc. (Shankarmahesh *et al*., 2003). There is another type of dissolution, the externally triggered one. This can occur when there are changes in the global environment or the operating national environments of the partnering firms that make the cost structure of either firm noncompetitive, causing one of the firms to seek dissolution to remain profitable. The lesson here is that *relationships once formed should not be taken for granted*.

Selecting a foreign representative

Unsatisfactory relations with representatives can be reduced with proper selection of the foreign representative. Positive answers to questions such as the following will go a long way toward ensuring that the exporter ends up with the best possible representation in a foreign market:

1. Is the representative satisfactory in character, moral reputation, and integrity? Is it likely that he will live up to the agency agreement?
2. Is he able to promote sales effectively? Does he have proper facilities for storage, distribution, and service? How large a territory can he canvass successfully?
3. In the case of a commission representative, does he have good credit sense? Does he submit orders only from reliable firms that can be depended upon to pay in accordance with the sales terms? Does he adjust the sales terms to the creditworthiness of the customers?
4. In the case of a wholesale distributor, are his financial resources adequate both for normal times and for periods of business depression?
5. Has he represented his principals for a sufficient length of time to indicate that they are satisfied with his accomplishments?
6. Does he handle competitive products? Has he taken on too great a variety of lines, or has he specialized in a small group of related lines, thus making for more effective agency representation for each line of the group?
7. Is he progressive or conservative? Does he believe in and make use of up-to-date advertising?
8. Does his location have adequate transportation facilities with the rest of the territory?
9. What is the nationality of the agent; the names and nationality of his other principals; and the probable effect of his nationality on his attitude toward the manufacturer?
10. What is his position in the trade, and the attitude of the trade toward the agent? Will the trade deal with him?
11. Do his qualifications with respect to the features mentioned indicate that he will grow in importance in his own market?

Online technologies

One of the major technological impacts during the past decades on international marketing has been through the Internet. All phases of business from purchasing through supply chain management through sales and payments/financing have been impacted. The Internet is used both as a *source of information* and as a *place to buy*. Often communication is immediate, and distance and length of communication have little or no impact on cost. As a source of information, the Internet is demand driven in that users have the option of getting the information they want – if it is available – when needed.

The importance of the Internet to international marketing, or e-marketing, has been growing during the past 15 or so years. An entire issue of the *International Marketing Review* (Krishnamurthy and Singh, 2005) was devoted to this topic. Since then, many research studies have examined various aspects of e-marketing. Representative of this research are the following: Nguyen and Barrett (2006) studied the factors that affect the intention to adopt the Internet by export companies; Beckers *et al.* (2007) looked at whether the Internet contributes to sustainable export marketing performance; and Lu and Julian (2008) studied the impact of the Internet, firm-specific characteristics, market characteristics, and export marketing strategy on export marketing performance.

The major advantages of using the Internet for e-commerce are reducing costs and enhancing reach (Sheth and Sharma, 2005, p. 612). These apply to both providing information and a place to buy. Companies using e-commerce are able to reach customers that may not be accessible due to time and location limitations of existing channels of distribution. Thus, overcoming time and distance limitations are advantages.

Companies intending to start e-commerce activities should look at the Internet as a means of enhancing international expansion. Although advantages and benefits exist for B2B, there are also some caveats to be recognized:

1. *No substitute for travel*. The Internet is not a substitute for international travel, despite its merits as a communication device. In the end, there is no substitute for regular face-to-face contact with marketing intermediaries and customers. The need for travel may be reduced, but it is not eliminated.
2. *Internet is not truly global*. Not everyone nor every company in the world has as much access as there is in the United States, Europe, and other developed countries.
3. *Imposters*. One never really knows who is at the other end of the Internet. There is a strong potential for fraudulent use.
4. *Open to misuse*. Access to a website is open to many different companies and people. Thus the international marketer needs to control the information made available. Any truly sensitive and/or secret information should not be placed on a website.
5. *No cure-all*. If a company is having problems in one or more foreign markets, shifting to an e-commerce approach is not necessarily the 'magic bullet' one would like it to be.

Another area of concern is government regulation, which varies widely. For example, in France all websites aimed at French customers must be in French. In Germany, certain types of B2C promotions, such as 'two-for-one' may be illegal. In Sweden, toy advertising may not be directed at children. While regulations and laws such as these and others such as liability for faulty products apply to all modes of market entry, companies may fall into a trap of assuming they do not apply as long as the website is in another country. The European Union, for example, has a law where European consumers can sue EU-based Internet sites in their own countries, and this rule in mid-2001 was being considered to apply internationally. One area of law that directly affects e-commerce is *privacy* law and transfer of data. In Europe these are much stricter than in the United States and Asia. According to a directive issued by the European Commission, marketers must tell consumers what data they will collect and retain, exactly how it will be used in the future, and then give them the option of opting in or out of the process. The Commission, if it has not already done so, is likely to make opt-in the rule rather than opt-out. Opt-in is already the law in Germany, Austria, Italy, Denmark, and Sweden, and has been so since at least the early 2000s. Rules like those in the European Union as a whole, and in individual countries, tend to make e-commerce more time-consuming and expensive, especially in B2C situations.

There are some things that governments can, and will, do – filtering and IP-address tracking (*The Economist*, 2001). Filtering involves software installed on a PC, in an Internet service provider's equipment or in gateways that link one country with the rest of the online world that can block access to certain sites. Websites themselves can block users by tracking the Internet service provider's 'IP address' to reveal where a user is. In a court ruling in late 2000 in France, Yahoo! was ordered to find some way to ban French users from seeing Nazi memorabilia posted on its US sites, or pay a stiff daily fine. IP-address tracking was judged to be able to spot more than 60% of French web-surfers. Although not perfect, as there are ways to get around the blocking and address tracking, governments do feel they can help reduce the problems that arise. Moreover, given the rapid changes in technology, these techniques will improve relatively quickly.

An extreme case is that of China. In their desire to keep the Internet under State control, the government, through the Ministry of Information Industry (MII), has issued a vast number of rules restricting what dot-com companies can do and censoring what they say (Einhorn *et al*., 2000). The government is using blocking, banning use of foreign encryption software, Internet policing, and news monitoring (i.e., only news that has already been published by a State outlet is allowed on the Internet) to keep sites from the rest of the world with unwanted content from entering China's cyberspace (*The Economist*, 2000b). In effect, China has established an intranet that is isolated from the rest of the world. There are people who can get around these barriers. However, the majority of the people access the Internet from work or from a public place, where the government controls the software and can track what users do, and where they risk being seen if they go to an illegal site.

To examine the effect of country on e-commerce and the use of the Internet, Sheth and Sharma (2005) classified countries on two dimensions – the infrastructure development of a country, and the country's marketing institutional development. This resulted in a two-by-two matrix (see Figures 8.5 and 8.6). A natural question to ask is what type of e-commerce (marketing) strategy will succeed in different countries. Answers are shown in Figure 8.6.

A different type of currency is discussed in Exhibit 8.7.

The Internet is clearly here to stay. But, like all new developments it will seek its place in the business world and level off. As a communication device it has no equal for speed, lack of distance effects, cost, and flexibility. But the international marketer must remember that it is not a panacea for ills and that it is only one tool in the tool box that should be used with and facilitate other market entry modes.

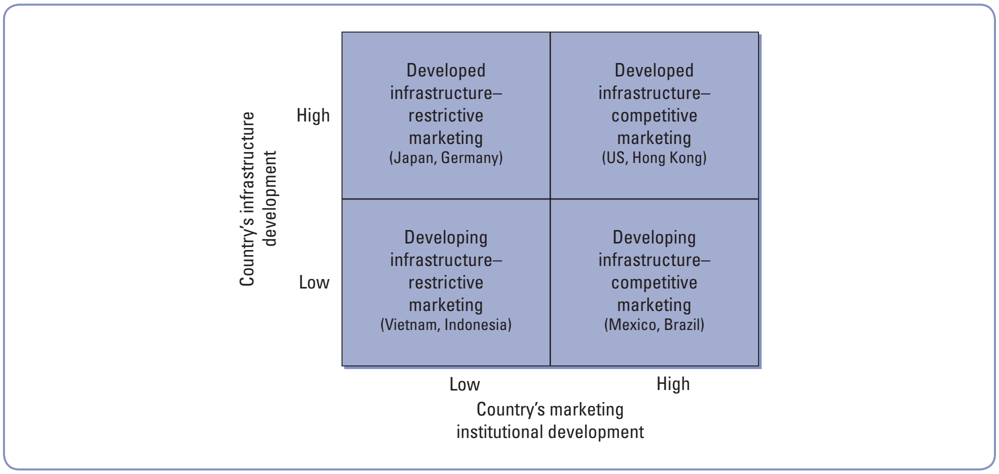

Figure 8.5 **Country's infrastructure and marketing institution development**

Source: Sheth and Sharma, 2005, p. 614.

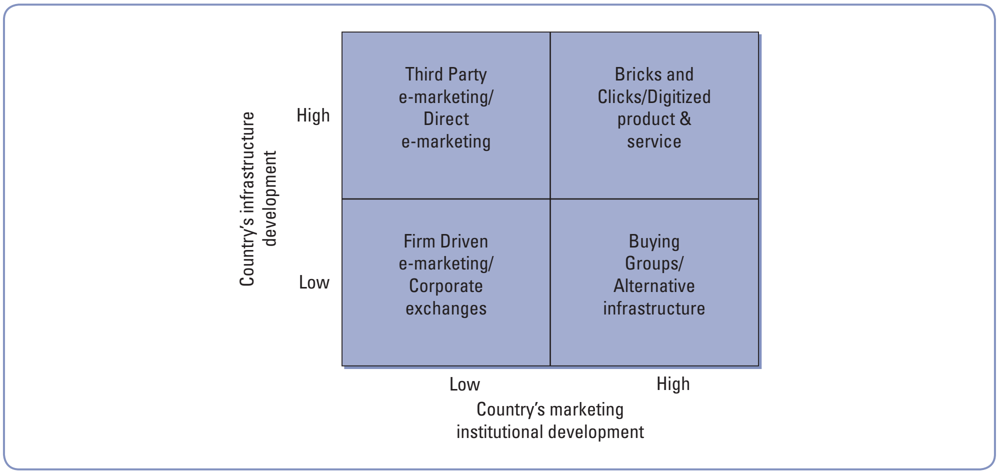

Figure 8.6 **Successful e-marketing strategies**

Source: Sheth and Sharma, 2005, p. 617.

Exhibit 8.7 Bitcoin: What is it, and what are the consequences?

An article by Satoshi Nakamoto appeared in 2009 in which 'he' described a currency and a payment system based on a distributed ledger. This ledger is called the blockchain. Historically, currencies have been backed and thus received their value by objects of similar value, typically gold. However, the dollar is no longer a gold backed currency. There is a critique against the dollar that the current monetary system can (and does) continuously print money (which has a range of negative effects) to cover debt. Bitcoin has a range of utilities. For example, it allows for anonymity of money transfer, and it is not inflationary as a maximum of 21 million Btcs will be created.

Early on it took 10.000 Btcs to buy a pizza. The value quickly grew to 5 cents, then $100, and then $1,000. However, the price has seen a dip as a popular trading site, Mt. Gox, filed for bankruptcy, and the price went down sharply. Nevertheless, the dollar price of one Btc is again up to Please replace with 440 as of April 2016. Several pundits expect that the Btc still has a lot more growth and some expect the value of a Btc to reach $1 million within a few years.

Users of bitcoin need two things to start owning and trading bitcoins: a bank, and some bitcoins. A bank is often referred to as a wallet. Currently the biggest bitcoin bank is the original one: Blockchain.info. Opening an account is simple and anonymous. On Blockchain.info users will get an address (this corresponds to a bank account) and will need to pick a password. Connected with the address there is a QR code to make payments easier. An address could look like this (this is the actual bitcoin address for one of the authors):

Secondly, bitcoins can be bought and spent at a host of places – from books online to beers in pubs. One of the larger bitcoin markets is localbitcoins.com. Localbitcoins.com functions like an exchange where sellers and buyers meet. Bitcoins can also be mined. Bitcoin mining involves using computers to solve complex algorithms and thus facilitating the blockchain while getting rewarded in 'new' bitcoins. Bitcoins are released at a fixed rate, and as mentioned the maximum of 21 million is estimated to be mined by 2140. Bitcoins can also be earned. There are, for example, several so-called faucets online that reward users for visiting and viewing their web pages. Currently one of the faucets that pays its users the highest amount of bitcoins (around 5,000 satoshis per day) is http://moonbit.co.in/?ref=4d739ea8f994. Moonbitcoin works such that users simply provide their account number (or in bitcoin lingo – their address) and answer a simple question. A satoshi is a 100th of a million of a bitcoin. Apart from earning bitcoins from answering questions, users may also earn bitcoins by referring other users. Being referred will not affect one's own earnings. For example, the above link to Moonbitcoin is an example of a referral link (the authors of this book's actual referral link). It is worth mentioning that bitcoin is not the only digital currency based on a blockchain. There are several other blockchain-based currencies such as litecoin. Nevertheless bitcoin is by far the one with the most adoption and if any digital currency is going to take over a large amount of the use currently performed by dollars, euros etc., it is most likely to be the bitcoin. Finally, and interestingly fitting, the actual identity of Satoshi Nakamoto is unknown.

Gray market exporting

One type of channel conflict that can arise in exporting is that of *gray market* exports. Also known as parallel importation, gray market channels are those that are not 'authorized' by the exporter for a particular foreign market (see Figure 8.7). More formally, we can define gray marketing as the legal importation of genuine goods into a country by intermediaries other

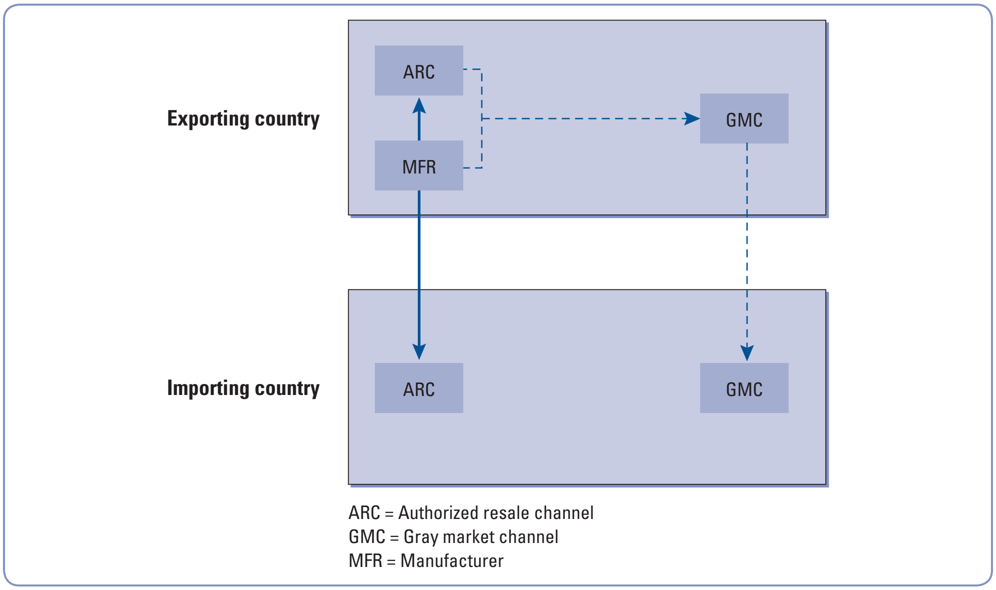

Figure 8.7 International gray market

Source: Bucklin (1990), p. 5.

than authorized distributors. Distributors, wholesalers, and retailers obtain an exporter's product from some other business entity in another country. Thus, the exporter's 'legitimate' distributor(s) and dealers face competition from others that sell the exporter's product(s) at a reduced price. Sa Sa, a discount cosmetics retailer in Hong Kong and the largest cosmetics retailer there, in the late 1990s sourced about 10% of its make-up, perfume, and skin and haircare products from independent overseas traders and 90% from authorized distributors in Hong Kong. Another example of parallel importing into Hong Kong is the luxury-car market, including BMW, Mercedes-Benz, Lexus, and Jaguar. Cars destined for other Asian countries such as Thailand and Indonesia found their way into Hong Kong in the late 1990s, at prices up to 40% lower than those charged by authorized dealers. Of course, the economic slowdown in Hong Kong at the time helped fuel the appeal of gray market luxury cars. Although legal in a criminal sense, under Hong Kong law authorized distributors have the right to file civil charges against companies using parallel imports and sue for damages or compensation.

Parallel imports between European Union countries are legal. However, the European Court of Justice, with the support of the European Commission and many European Union governments, has banned such imports into the European Union. Thus companies can freely import Levi jeans into the United Kingdom from Greece, but not from the United States. Obviously consumers can benefit, while authorized dealers do not. Motorcycles provide another product where parallel importing is prevalent in the United Kingdom. Motorcycles such as a Honda 900cc Fireblade were available at a price as much as one-third less than the price at the authorized dealer. This parallel importing is legal as sourcing is from within the European Union and it takes advantage of differing prices within the European Union.

Parallel importing is a concern in China. However, the concern relates more to smuggling of high-technology consumer products as they avoid payment of import duties, which have ranged from 20% for computer goods to 150% for automobiles, and VAT of 17%. A major source of such goods in the past has been Hong Kong-based middlemen.

In 1998 New Zealand introduced a law making parallel importing legal. Local licensed dealers for products produced elsewhere would no longer hold a monopoly. Other businesses are able to import the same goods, potentially cutting prices on everything from cars to clothing and compact disks. Increased protection against piracy of such products as computer software, videos and CDs was added.

High-priced, branded consumer goods (e.g., jewelry, cameras, watches, ski equipment) where production lies principally within a single country are particularly prone to gray market activity. Brand reputation is a critical aspect of the marketing mix and distribution is typically through exclusive wholesalers and selected retailers. Would lower prices of prestige brands undermine the 'snobbery' of a brand? It is unlikely! For example, Calvin Klein products cost less in the United States than in the United Kingdom, but they still command a premium price.

According to Bucklin (1990, p. 2), the very conditions that foster global strategies also magnify the gray market opportunity. As products sold across national boundaries with the same brand name become more similar, the potential for gray market arbitrage becomes greater. A key question for the exporter of branded products is whether gray markets will cause global strategies to be less desirable.

Imports of gray market goods can potentially adversely affect manufacturers in at least the following four ways:

1. The trademark image can be damaged.
2. Relationships between manufacturers and dealers can be strained.
3. The manufacturer can incur unanticipated legal liabilities, especially when a product does not meet safety requirements in the country where it is being sold in the gray market.
4. The manufacturer's global marketing strategy can be disrupted.

Some reactive approaches that can be taken are as follows:

- *participation*, where dealers supported by manufacturers actually purchase goods from the gray marketer;
- price cutting;
- *supply interference*, where dealer or manufacturer finds where the goods are sourced and purchases there, depriving the gray marketer of a supply;
- *acquisition*, where a dealer acquires the gray marketer.

Potential proactive approaches include the following:

- offer unique features or benefits that the gray market product cannot;
- strategic pricing to encourage or deter gray market activity;
- dealer development;
- establish legal precedence;
- long-term image reinforcement to bond customers to existing dealers.

Obviously, the best solution is prevention, which means strong proactive actions.

Bucklin (1990, pp. 26–8) concludes that market shares held by gray operators need not be so large and that closer control over international marketing decisions can reduce these to a level where they are more a symbol of ineffective global marketing than a barrier to such a strategy. One key is better management of global marketing policies. The major appeal is lower prices.

Measuring performance

Managers obviously want to know how well the export organization is performing. There are two major questions that need answers regarding performance:

1. What are the determinants of performance?
2. How should performance be measured?

On a broader level, these questions apply to all types of international marketing activities.

Regarding determinants, Figure 8.8 shows a simple model consisting of three groups of variables: environmental, organizational, and managerial (Katsikeas *et al.*, 2000, pp. 496–7). Environmental factors are forces which shape both the domestic and foreign task environment: they are external and are beyond the control of the exporting organization, for example economic conditions, trade barriers, and competition. Organizational factors are those internal to the exporting company, such as resources, objectives of the company, and product characteristics. Managerial factors are those that are derived from the export decision maker(s) such as experience, expertise, attitudes, and past and current behavior.

Targeting factors are those that relate to export market identification, selection, and, where appropriate, segmentation. Market strategy factors relate to the company's export marketing mix, and the strategies used for product, pricing, promotion, and distribution.

Export performance is the dependent variable in this simple model. It is defined simply as the outcome of a company's activities in export markets. But what measure is appropriate? This question is easier asked than answered. Sousa (2004) has identified a number of measures that can be used that are sales-related, profit-related, and market-related (see Table 8.3). These measures include both objective and subjective ones, and are either absolute (i.e., related only to the company itself) or are compared to competitors. A state-of-the-art review (Assaf and Josiassen 2015) of performance measures reveal and promote a move

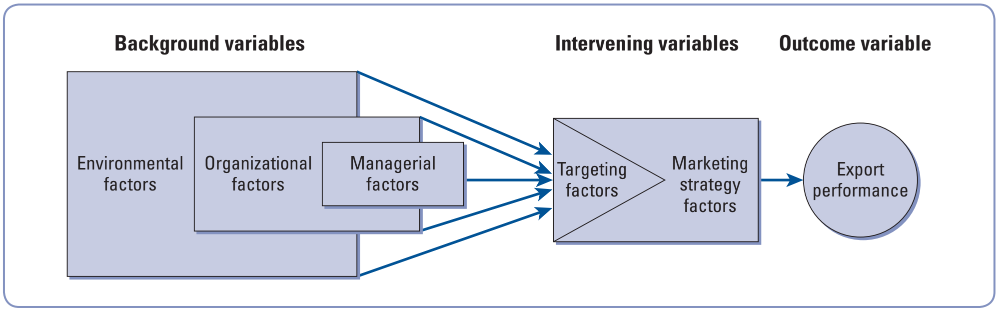

Figure 8.8 A simplified model of export performance

Source: Katsikeas *et al.*, 2000, p. 496.

Table 8.3 Alternative measures of export performance

Objective measures
Sales-related
Export intensity
Export intensity growth
Export sales growth
Export sales volume
Export sales efficiency
Profit-related
Export profitability
Export profit margin
Export profit margin growth
Market-related
Export market share
Export market share growth
Market diversification
Subjective measures
Sales-related
Export intensity
Export intensity growth (either absolute or compared to competitors)
Export sales volume (either absolute or compared to competitors)
Export sales growth (either absolute or compared to competitors)
Export sales return on investment (either absolute or compared to competitors)
Profit-related
Export profitability (either absolute or compared to competitors)
Export profit margin
Export profit margin growth
Market-related
Export market share (either absolute or compared to competitors)
Export market share growth (either absolute or compared to competitors)
Market diversification
Rate of new market entry (either absolute or compared to competitors)
Gaining foothold in the market
General
Overall export performance (either absolute or compared to competitors)
Export success
Meeting expectations
How competitors rate firm's export performance
Strategic export performance
Miscellaneous
Contribution of exporting to the growth of the firm
Contribution of exporting to the quality of the firm's management
Quality of distributor relationships (either absolute or compared to competitors)
Customer satisfaction (either absolute or compared to competitors)
Quality of customer relationships compared to competitors
Product/service quality compared to competitors
Reputation of the firm compared to competitors
Gaining new technology/expertise
Building awareness and image overseas
Achievement of objectives regarding response to competitive pressures

Source: Adapted from Sousa, 2004, pp. 9–10. Courtesy of the Academy of Marketing Science.

to more complex and appropriate performance measures (such as efficiency measures). But what is the best measure to use? There is no easy answer to this question. At this point all that can be said is that it depends upon what management wants to do with the measure. However, more frequently than not, firms use performance measures that are too simple and inappropriate for the task.

Summary

In this chapter the alternative modes of export were discussed in some depth. Indirect export was defined as involving the use of independent marketing organizations located in the exporter's home country. In contrast, direct export occurs when the exporter sells directly to buyers in foreign markets, either by its own dependent unit or by using a foreign-based marketing organization. There are many alternative avenues that the exporter may follow in either approach, and all result in a channel of distribution. Both marketing and legal considerations make it imperative that the exporter be extremely careful in making this decision, particularly in the selection of any intermediary marketing organizations. This has become increasingly critical with the emergence of the Internet and e-commerce. The international marketer must not fall victim to all the 'hype' surrounding the Internet; instead reality must prevail. The final section discussed the problem of gray market export activity.

Whether exporting directly or indirectly, relationships must be built with foreign customers. Leonidou *et al*. (2002, pp. 108–11) suggest the following guidelines:

- Treat exporting as a bundle of relationships.
- Appoint people who are suitable for managing relationships.
- Adopt an approach to exporting that reflects it as a strategic option open to the firm.
- Get closer to the foreign customer.
- Build and sustain trust in the relationship, and cultivate mutual understanding.
- Reduce foreign business uncertainty.
- Demonstrate greater inter-firm commitment.
- Engage in direct and indirect communication.
- Accept that some conflict is inevitable, but try to keep it at a manageable level.
- Work to maintain sustained inter-firm cooperation.

The Appendix provides an overview of questions to be answered as a company develops its export plan.

Questions for discussion

8.1 When exporting indirectly, is it better to use a merchant or an agent in the export marketing channel? Explain.

8.2 Under what conditions is it best that an exporter use an export management company and when is the manufacturer's export agent a better choice?

8.3 For a small manufacturer, is it better to engage in piggyback marketing or join an exporting combination? Why is this so?

8.4 'Cooperative exporting organizations are most suited for small and medium-sized enterprises.' Discuss.

8.5 What types of channel conflict may arise in indirect exporting? Because of such conflict, is it not better for the exporter to do it directly?

8.6 What impact does the nature of the foreign market area to be served have on the exporter's choice of type of channel?

8.7 Distinguish among the built-in, separate, and sales subsidiary as forms of export departments.

8.8 'The decision facing the export marketer concerning establishing a foreign-based sales subsidiary is a difficult and complex one to make.' Discuss.

8.9 Is there one best way to export directly? Defend your answer.

8.10 Why is it important that the exporter be very careful in the selection of foreign-based distributors and agents?

8.11 Is e-commerce (or Internet marketing) eventually going to replace traditional approaches to export? If so, which one(s) is(are) to be replaced and why is this so? If not, why not? Discuss.

8.12 Why should an exporter worry about gray market distribution of its products in foreign markets? What can be done to protect against this practice?

8.13 Trust has been described as a key element of any relationship between exporter and importer. How does trust affect relationships, and how does an exporter adapt when cultures differ in their view of trust?

8.14 Is it not better for an exporting company to use an objective measure of performance rather than a subjective measure? Discuss.

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Appendix
Developing an export plan

(Adapted from Unz & Co., *Basic Guide to Exporting*, 1998–9. Used with permission)

Once a company has decided to sell its products abroad, it is time to develop an export plan. A crucial first step in planning is to develop broad consensus among key management on the company's goals, objectives, capabilities, and constraints. In Table A there are a number of questions to be answered as a starting point. In addition, all aspects of an export plan should be agreed upon by the personnel involved in the exporting process, as they will ultimately execute the export plan.

The purposes of the export plan are (a) to assemble facts, constraints, and goals and (b) to create an action statement that takes all of these into account. The statement includes specific objectives, sets forth time schedules for implementation, and marks milestones so that the degree of success can be measured and help motivate personnel.

At least the following ten questions should ultimately be addressed:

1. Which products are selected for export development? What modifications, if any, must be made to adapt them for overseas markets?
2. Which countries are targeted for sales development?
3. In each country, what is the basic customer profile? What marketing and distribution channels should be used to reach customers?
4. What special challenges pertain to each market (competition, cultural differences, import controls, etc.), and what strategy will be used to address them?
5. How will the product's export sale price be determined?
6. What specific operational steps must be taken and when?
7. What will be the time frame for implementing each element of the plan?
8. What personnel and company resources will be dedicated to exporting?
9. What will be the cost in time and money for each element?
10. How will results be evaluated and used to modify the plan?

The first time an export plan is developed, it should be kept simple. It need be only a few pages long, since important market data and planning elements may not yet be available. The initial planning effort itself gradually generates more information and insight. As the planners learn more about exporting and a company's competitive position, the export plan will become more detailed and complete.

From the start, the plan should be viewed and written as a management tool, not as a static document. Objectives in the plan should be compared with actual results to measure the success of different strategies. The company should not hesitate to modify the plan and make it more specific as new information and experience are gained.

Table A Management issues involved in the export decision

Management objectives
What are the company's reasons for pursuing export markets? Are they solid objectives (e.g. increasing sales volume or developing a broader, more stable customer base) or are they frivolous (e.g. the owner wants an excuse to travel)?
How committed is top management to an export effort? Is exporting viewed as a quick fix for a slump in domestic sales? Will the company neglect its export customers if domestic sales pick up?
What are management's expectations for the export effort? How quickly does management expect export operations to become self-sustaining? What level of return on investment is expected from the export program?
Experience
With what countries has business already been conducted, or from what countries have inquiries already been received?
Which product lines are mentioned most often?
Are any domestic customers buying the product for sale or shipment overseas? If so, to what countries?
Is the trend of sales and inquiries up or down?
Who are the main domestic and foreign competitors?
What general and specific lessons have been learned from past export attempts or experiences?
Management and personnel
What in-house international expertise does the firm have (international sales experience, language capabilities, etc.)?
Who will be responsible for the export department's organization and staff?
How much senior management time (a) should be allocated and (b) could be allocated?
What organizational structure is required to ensure that export sales are adequately serviced?
Who will follow through after the planning is done?
Production capacity
How is the present capacity being used?
Will filling export orders hurt domestic sales?
What will be the cost of additional production?
Are there fluctuations in the annual work load? When? Why?
What minimum order quantity is required?
What would be required to design and package products specifically for export?
Financial capacity
What amount of capital can be committed to export production and marketing?
What level of export department operating costs can be supported?
How are the initial expenses of export efforts to be allocated?
What other new development plans are in the works that may compete with export plans?
By what date must an export effort pay for itself?

A detailed plan is recommended for companies that intend to export directly. Companies choosing indirect export methods may require much simpler plans.

Many companies begin export activities haphazardly, without carefully screening markets or options for market entry. While these companies may or may not have a measure of success, they may overlook better export opportunities. If early export efforts are unsuccessful because of poor planning, your company may be misled into abandoning exporting altogether. Formulating an export strategy based on good information and proper assessment increases the chances that the best options will be chosen, that resources will be used effectively, and that efforts will consequently be carried through to success.

CASE STUDY 8.1

Sinova Management Consultancy Ltd.

(Adapted from 'Firms Place Their Trust in a Rising Star,' *Hong Kong Trader*, 1 January 2007 (www.hktrader.net/200701/success/success-Sinova200701.htm) and from the Sinova website www.sinova.com)

Hong Kong's unequalled bridging role linking European firms with China presented itself as an ideal opportunity for former corporate banker Jennifer Chan. After founding Sinova Management Consultancy Limited in 2002, Ms. Chan has seen her business boom, up from one employee to 20, and from a single office to a growing international network. The consultants are multilingual. 'If you'd asked me a few years ago, I could never have dreamed of such an expansion,' Ms Chan said. And with China continuing to boom, Hong Kong provides the sound fundamentals for a predicted further growth of 40% in the next one to two years.

Born in Hong Kong, Ms. Chan spent most of her young life in the Netherlands before returning to Hong Kong at the end of 1991, following her university education. Utilizing her financial training and cross-cultural experience, Ms. Chan worked for 11 years with Dutch banks Rabobank and ABN Amro and Belgian-Dutch bank Fortis, with a portfolio covering both small and medium-sized enterprises (SMEs) and multinational companies (MNCs).

Flying start

'I had trusted relationships with clients who had followed me from bank to bank, when one asked me if I could assist them with a big investment in China. They wanted someone who knew the language and the culture,' said Ms. Chan, who, along with diverse cultural experience, speaks English, Dutch, Cantonese, Mandarin, French and German. 'I asked my clients to give me a couple of projects so I could start, and they did.'

Referrals soon followed, as Ms Chan leveraged her own network and Hong Kong's established infrastructure to advise clients on doing business in China, sourcing from China, or moving their production to China. Being 'on the spot' gave Sinova the edge over European-based China consultancies that cannot offer the same local knowledge.

Unlike most of its competitors in Europe, Sinova is able to locally implement some of the recommendations they give to foreign firms on doing business in China. The information Hong Kong has on mainland China is tremendous. Europe can get information out of China, but it is likely to be censored or, even if it is not, European businesses are heavily reliant on translators. Hong Kong has the best of both worlds: free Internet, free press, and it is right next door to China.

First step Hong Kong

Ms Chan's advice to European firms with China on their radar is always to use Hong Kong as their platform. 'Even if firms are not yet intending to sell to China, I advise them to set up the structure here,' Ms. Chan said. 'Most of my clients want to have a sourcing entity (a buying office) for China and, if it is a Hong Kong company, the corporate finance situation is very favorable to them should they later want to set up a regional sales office.' Hong Kong corporate tax rate is lower than most European countries, it has a stable financial system, and its workforce has international exposure, which is a great advantage.

Hong Kong's rule of law and established arbitration system also cushions firms making the entry into China. Disputes are settled promptly, eliminating the worry that a lawsuit could drag on for years without either clarity or resolution, affecting their daily operations. And, in the worst case scenario, you can always liquidate a company in Hong Kong.

Going global

In April 2005, Sinova opened an office in Shanghai. In November 2006, it opened in the Netherlands. Its clientele now comes from around the globe, including the Netherlands, Belgium, the United Kingdom, Germany, Austria, the United States, Australia, and Taiwan.

Services

Sinova offers clients many services. Some of the services most relevant to exporters include the following:

- *Business advisory*: market research and feasibility studies; business partner identification and matchmaking with local organizations; arrangement for financing and funding.
- *Corporate services*: registration and administration of branch operations of foreign companies in mainland China and Hong Kong; general administration of Chinese, Hong Kong, and offshore companies to comply with local statutory requirements; introduction, negotiation and liaison with bankers and law firms and audit firms.
- *Management services*: administration of international financial transactions; representation and assistance in business start-up and interim management.
- *Accounting and treasury*: order administration/reinvoicing, accounting and related business administration; invoicing; acting as bank account signatory.
- *Business support*: monitoring overseas operations, local troubleshooting, negotiations with local parties; day-to-day operations.
- *Trade services*: processing of trade documentation under Letters of Credit (L/C), from application to receipt of L/C by banks, **documents against payment (D/P)**, **documents against acceptance (D/A)**, and open account; handling all shipping correspondence on behalf of clients; arranging introductions to banks and financial institutions for establishment of trade finance facilities.

Questions

1. What advantages are there to an exporter wanting to enter China and/or Hong Kong for using an agent like Sinova?
2. Are the benefits of using Sinova most valuable to small exporters or can the multinational larger firms also benefit? Explain.
3. If an exporter has used a company like Sinova, at what point in the exporter's market development would it be more profitable to stop using them? Discuss.

CASE STUDY 8.2

Quint Winery

(This case study was written by Prof. Dr Alfred Joepen, Fachhochschule Aachen, Germany, and Dr Neil Evans, San Francisco State University.)

Mr Michael Quint has recently taken over the family owned, independent producer of quality wines in Germany's picturesque Mosel River Valley. With the enthusiastic support of his wife and the continuing support of his parents, he is developing new strategies for the winery to remain successful in the face of increasing competition. These strategies include new products, new packaging, and changing emphases in marketing. In all of these developments Mr Quint's objective is to retain the traditional and individual character of the company while increasing productivity, sales, and profitability. The rapid growth of the wine market in Japan, with its increasing emphasis on imports from countries around the world, may provide an additional opportunity for Quint Winery.

Background

The Mosel River Valley has been a producer of high quality wines since Roman times. The river has a series of low-rise dams that provide a broad, smooth surface reflecting the summer sunshine on to the shale-laden soil of the valley's steep slopes. Both the shale and the water itself absorb heat during the day, releasing it during the night. The result is a microclimate, in the valley alone, ideal for the production of high quality wine grapes. The suitability of the region for growing grapes was recognized by the Romans. They introduced viniculture, and wines have been the specialty of the river valley ever since.

The steep valley walls require that in some places winches and cables be used to move platforms from which cultivation and harvesting are carried out. This, together with the unsuitability of the climate above the valley walls for growing grapes, has resulted in a pattern of small, independently owned vineyards. In order to make the small-scale operations economically feasible, each family grows its own grapes, makes the wines, bottles them, and does the marketing themselves.

Many small German wineries market their wines directly to consumers. One of the major tools for attracting customers is the holding of 'wine tasting parties' in a traditional cellar bar close to the winery. For a low package price, the participants have the opportunity to sample a variety of the winery's products along with a steak dinner. The owner of the winery additionally provides a tour of the vineyard and of the winery itself. The participants in such parties often buy bottles of wine on the spot, sometimes become long-term customers, and may recommend the parties to friends. This type of marketing approach has worked well in the past for small wineries with very limited funds available for promotion.

European integration and the move toward a single market have intensified competition. As a consequence, there are limits in the range of prices the wineries can charge for their wines, even if they are of high quality and unique. A number of wineries have experienced greater than desired carryover of stock from one year to the next, indicating that additional marketing efforts are required.

Strategies

Quint Winery specializes in higher quality wines with individuality in taste and flavor. The target market is people in the upper middle class, particularly those who appreciate excellent wines and are interested in information about wine, culture, and history. With his own background in the formal study of wine engineering, Michael Quint has a wealth of information that he enjoys sharing with others.

The overall strategy is to remain small, and use traditional recipes and processes. However, it is increasing productivity by outsourcing specialized bottling to others that have machinery which Quint cannot economically purchase. In adding to its product lines the winery is working with others that have core competencies which cannot be economically developed by Quint. These cooperative activities have allowed the winery to enjoy benefits of being both small and large at the same time.

Until the 1990s, a regulation issued by an archbishop several centuries earlier had prohibited the production of red wines in the region. Many vintners in the area still produce only white wines. However, when the restriction was removed, Quint Winery began to produce some red wines whose production proved to be very successful and increased the range of their offerings. It subsequently began to produce sparkling wines, based on its white wines, in cooperation with a small subcontractor in the village. In the early 2000s it began to produce brandy, again with the assistance of friends who had technical expertise. The company has also been developing and experimenting with new bottle designs that will stress the Quint Winery brand while linking it to the traditions of the house.

Quint Winery's major marketing effort is still the holding of traditional wine tasting parties. Michael has added the family imprint by showing remarkable generosity in serving wines and food, and by providing interesting and informative presentations on the history, culture, and processes of wine making. He firmly believes in avoiding any sort of pressure to buy, letting the quality and individuality of the wines inspire a desire to purchase. In an unusual addition to typical service, he also offers to personally deliver the wines to his customers anywhere in Germany.

This approach has been working well. People attending the wine tasting events usually buy a number of bottles of the wines, and subsequently recommend both the events and the wines to their friends back home. In spite of the increase in customers generated by these activities, additional markets are desired.

A Japanese visitor, brought to a wine tasting by German friends, commented on the excellent quality of the wines. She believed that they might prove salable in Japan. If properly marketed, this should allow both increased sales and possibly greater margins. An initial step for Michael Quint would be to contact the Japan External Trade Organization (JETRO) office in Dusseldorf.

Information on marketing in Japan

There is much information available from JETRO on the wine market and wine marketing in Japan. Their *Japan Trade Directory* lists companies that import wine into Japan. The names of the top ten Japanese importers of wine from Germany and their import volumes are available on the JETRO web page, http://www.jetro.go.jp. The JETRO office in Dusseldorf stands ready to assist potential exporters with information, contacts, and opportunities for participation in trade shows in Japan. German organizations that may offer assistance include Deutscher Weinfonds and CMA (the German Agricultural Marketing Board).

Wine consumption in Japan has increased substantially during the last 10 years. A red wine boom occurred in Japan in the late 1990s after researchers associated the drinking of red wine with a lowered incidence of cardiovascular disease. Germany, with its emphasis on the export of white wines, lost market share. Now white wines are growing in popularity again. JETRO has noted that 'Germany's wide variety of wines (especially white wines), its unique soils, and its North Country climate are what distinguish German wines from all others' (JETRO Marketing Guidebook for Major Imported Products, available on the JETRO web page, 2004). There is increased competition in the Japanese wine market from South America, Australia, and the United States. However, there is still a good market for high quality white wines from Germany.

There are a number of channels available for selling wine to the Japanese market: direct sales to department stores and mass merchandisers, direct sales to wholesalers and discounters, sales to large trading companies, sales through joint venture projects, and sales in bulk or in bottles to domestic liquor producers. A number of small trading companies, specializing in or emphasizing wine, have opened. These small trading companies supply stores or restaurants which do not import directly, or that wish to supplement their own imports with small amounts from other producers. Together, these changes have substantially increased opportunities for small exporters abroad.

The market in Japan has become increasingly sophisticated. Larger department stores carry a wide variety of wines and may hold special promotions and displays. An increasing number of wine specialty stores have been opened. Several Internet wine shops are now serving the Japanese market, offering a very wide range of wines. According to JETRO, price is a key factor in wine purchase decisions, followed by taste, color, and brand. However, consumers have little interest in poorer quality wine.

JETRO offers several types of assistance to prospective exporters in foreign countries. It can help in arranging participation in government-sponsored trade shows of consumer goods. These allow potential foreign exporters to introduce their products to a wide range of Japanese consumers and companies. JETRO offices abroad provide information on markets and methods of penetration. JETRO Business Support Centers in Japan provide office space at no charge for up to two months to foreign business people seeking to export to or invest in Japan.

The possibility of marketing to Japan

Sales to a small Japanese trading firm or directly to a Japanese chain store might offer two advantages to Quint Winery. First, it could provide an outlet for current surplus production. Second, away from the intense competition in the domestic market, it might be possible to obtain a higher price for the unique and high quality wines, particularly if there were some way to inform the Japanese public of the history, romance, and culture of the Mosel River Valley vintners. It does not appear that Quint Winery could supply a whole container load of their own wine, nor could a smaller chain purchase a whole container load of one vintner's wine. What should Michael Quint do next?

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Questions

1. Does the Japanese market appear to offer enough potential for Quint Winery to export to Japan? Explain why or why not.
2. How can Quint Winery locate potential Japanese purchasers?
3. Should the winery owner visit Japan, or should he attempt to attract company representatives to come to his winery? Is your answer influenced by specific aspects of Japanese culture? Explain.
4. Should Quint Winery work by itself in any attempts to enter the Japanese market, or should it attempt to work with other local wineries in a type of cooperative effort?
5. What kind of market(ing) research should be done with respect to potential Japanese consumers?
6. What other questions should the owner ask? What problems may he expect to encounter?

CASE STUDY 8.3

Nestlé

(This case is adapted from E. Echrikson, 2000, 'Nestlé: an elephant dances,' *Businessweek* E. Biz, 11 December, EB44–8. Reprinted by special permission, copyright © 2000 by the McGraw-Hill Companies.)

The town of Verey, Switzerland, perches among the vineyards above Lake Geneva. Wealthy retirees take in Alpine vistas as they pass their afternoons strolling along the waterfront. The most exciting event is the annual grape harvest. Silicone Valley and the hubbub of high tech seem worlds away. On the edge of town, however, stands the glass and steel global headquarters of Nestlé, the world's largest food producer.

This setting has now become the epicenter of one of Europe's most ambitious e-commerce initiatives as Nestlé undertakes a plan to make the company more agile, more responsive to its customers, and more profitable. Over the next three years it will invest as much as US$1.8 billion in a phased development plan. The company will continue to expand its use of the Internet and Web, acquire additional specialized software and solutions, build data centers, and work toward creating a coherent global information system. Peter Brabeck-Lemathe, the company's chief executive, calls the process an 'e-revolution' – albeit one that will take several years to complete. He has commented that 'This might sound slow for Silicon Valley, but it's very fast' for a company like Nestlé.

The company

Henri Nestlé founded the company in 1867 in order to market the baby formula he had developed. In 1938, Nestlé scientists were the first to produce instant coffee. These two products fueled much of the company's growth for its first century. Twenty years ago Nestlé began a US$40 billion buying spree, acquiring a number of companies including Friskies in 1985, saucemaker Buitoni in 1988, and Perrier in 1992.

Now, with 1999 revenues of US$46.6 billion, 509 factories in 83 countries, 230,000 employees, and over 8,000 products, Nestlé is the world's leading food and beverage company. However, profits margins have been low compared to industry standards, and the stock price has stagnated.

Nestlé is involved in all phases of the food industry, from buying raw materials such as cocoa beans to processing, packaging, marketing, and selling products. Many food items remain local products. As Brabeck says: 'You can't sell a Bavarian soup to a Taiwanese noodle-lover.' The company thus must make adjustments to product lines, packaging, pricing, advertising, etc. to suit the demands of each of its many markets. Nestlé's size and complexity, as well as the diversity of environments in which it operates, create problems in all phases of operations, with substantial duplications of effort and difficulties in getting all of the required information to some decision makers.

Nestlé has viewed the improvements in intercompany and intracompany communications made possible by the Internet and the Web, and the software available for use in e-commerce, as providing great potential for reducing costs in everything from obtaining materials and supplies to marketing. It also makes feasible certain types of restructuring that should lead to improved responsiveness and control. 'For big companies like us, the Internet is particularly good because it shakes you up,' says Mario Corti, Nestlé's chief financial officer and head of its Internet offensive. In its e-commerce initiatives, Nestlé must practice a delicate balancing act: using the net to both reduce transaction costs and gain economies of scale while still catering to a variety of cultural preferences.

Nestlé's early e-commerce initiatives, coupled with restructuring efforts, led to an increase in net profit of almost 35% in the first half of 2000 (to US$1.7 billion). Now the company is undertaking a major additional effort in e-commerce.

Expanding e-commerce initiatives

In June 2000 Nestlé signed a US$200 million contract with German-based SAP to provide support in this effort. SAP is the world's largest provider of ERP (enterprise resource planning) software and solutions designed to support a broad range of integrated management systems including financials, supply chain management, e-procurement, customer relationship management, etc. For SAP, it was the largest sale ever. For Nestlé, the objective is to streamline the company's operations and give far-flung employees quick access to information from around the globe. This should enable Nestlé to better leverage its size by tying together long-independent national fiefdoms. Expected results are as shown in Table 8.4.

Although Nestlé is a consumer-driven company, most of the changes will be invisible to diners sipping Perrier or kids munching Nestlé Crunch bars. But behind the scenes,

Table 8.4 Changes at Nestlé due to e-commerce development

Before e-revolution	After e-revolution
Technology mishmash: The company runs five e-mail systems and 20 versions of accounting, planning and inventory software. Country operations use different computer codes for the same products so it is hard to share supplies and data.	**Standardized software:** Nestlé is moving to one software package. The Web-linked program creates a single set of product codes, allowing buyers in one country short on, say, corn powder to get supplies from other Nestlé divisions.
Bad communication: Most employees have no access to production and sales figures from countries other than their own because they are not linked. A planner in France cannot see data about KitKat bars being made in a German plant – making it tough to adjust the order.	**Centralized data:** Nestlé is building up to a half-dozen data centers so employees can get quick access to information via the net. For the first time, Nestlé will know how much it is buying from suppliers with far-flung operations. That will let it negotiate better contracts, centralize production, and buy more across borders.

the way Nestlé buys, manufactures, and delivers its products is going digital. The company is a founder of online food-supply marketplaces Transora and CPGmarket.com, which aim to use the Web to streamline purchasing. The emphasis, though, will not be on slashing raw material prices or eliminating distributors. Instead, Nestlé wants to link its disparate operations, partner with suppliers to cut waste, and move its food products more quickly from farm to factory to the family dinner table. Rather than desiring to squeeze suppliers, these actions are designed to increase the company's internal productivity.

Nestlé's reinvention is a work in progress. The company's margins, while improving, remain a third lower than those of competitors H. J. Heinz, Cadbury, or Procter & Gamble. The giant SAP deal is at least three years away from giving all Nestlé employees access to information from other countries' divisions. Transora and CPGmarket.com are only now beginning operations, and online marketplaces in many other industries are encountering severe teething problems.

That is where the Web comes in. The first order of business has been linking to retailers. Since July, store owners in the United States have been able to order Nestlé chocolates and other products online at NestléEZOrder.com. The benefit for Nestlé: the system cuts out expensive manual data entry and slashes processing costs for each order from US$2.35 to 21 cents. Similar initiatives are on tap for other countries, which could trim as much as 20% from the company's US$3 billion in yearly worldwide logistics and administrative costs.

The net helps cut inventories, too. In the past, when Nestlé held promotions it had to guess at demand. By linking up electronically with its retail partners it can now adjust production quickly. In Britain, supermarket chains Sainsbury and Tesco send in daily sales reports and demand forecasts over the Web to Nestlé headquarters, while Nestlé managers check inventory levels on the supermarkets' computer systems. 'It's been a revolution in the way we work together,' says Tom McGuffog, director of e-business at Nestlé UK.

Nestlé is seeing similar results from sharing information online inside the company. Pietro Senna, a buyer for Nestlé Switzerland, was recently having trouble getting kosher meat. He posted a message online, and a colleague in the United States found him just the right supplier – in Uruguay. The time savings are immense. Each country's hazelnut buyer, for example, used to visit processing plants in Italy and Turkey. Hazelnuts, a key ingredient in chocolate bars, are prone to wild price swings and uneven quality. But after Senna stopped by some Turkish plants he posted his report on the Web – and within a week 73 other Nestlé buyers from around the globe had read it, saving them the trouble of a trip to Turkey. 'For the first time, I get to take advantage of Nestlé's size,' he says.

When leveraged, that size can slash procurement costs. Until recently, Nestlé had 12 buyers throughout Europe, dealing with 14 suppliers of lactose, an ingredient in infant formula and chocolate bars. By linking via the net, the company has been able to cut its suppliers to just four. 'We can only do this because of online information,' Senna says. Lactose costs have come down by as much as 20%.

Nestlé's Web charge is being led by its dairy farm in Carnation, Washington, USA. Nestlé's US CEO Joe Weller asks workers how to unify Nestlé. The answer: e-business. If the US division leads, the rest of the giant is likely to follow. The sheer weight of the US operation has wallop: it booked more than US$10 billion in sales last year, nearly a quarter of the company's total.

If the US division is quarterbacking the effort, Brabeck is its chief cheerleader. He does not have a computer in his office – e-mails have to go through his secretary. And far from passing his leisure time surfing the net, 56-year-old Brabeck spends his weekends climbing the Alps that tower over Vevey. But he was an early backer of e-tailing experiments the company participated in. Those trials were eventually shelved, but Brabeck says they demonstrated the power of technology and the net. 'This opened my eyes,' he says.

Nestlé's disparate Internet ventures present a mountain of opportunity that will require all the strength and savvy Brabeck can muster. He does not underestimate the challenges ahead. But he does not seem fazed either.

Some comments on Nestlé's subsequent performance

Nestlé appears to be making substantial progress with its e-commerce initiatives, streamlining and integrating operations, and overhauling the information technology systems. Information systems improvements have given management the data they need to compare performance of units worldwide, and to identify those needing help. They have also enabled the company to avoid some of the costs of highly decentralized buying and logistics. Since 2001, the company has realized US$1.5 billion in cost savings, and expects an additional US$2.5 billion savings by 2006 (Matlack, 2003). While still trailing the operating margins of Unilever and Kraft, Nestlé's have risen by almost 50% in the past five years (Ball, 2004).

The company has made three acquisitions, at a total cost of US$15.5 billion to increase its presence in the United States (Weintraub and Tierney, 2002). The company is still pursuing sales growth and is keeping its broad and diverse product line with about 8,000 brands (Matlack, 2003).

Under Mr Brabeck's direction, Nestlé has continued to focus on improving IT, has purchased higher margin businesses, and has trimmed its portfolio of lower-margin product lines. The company is enjoying a fifth year of strong profit growth, and its share prices have grown more rapidly than those of Unilever and Kraft (Simonian, 2007).

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Questions

1. Evaluate Nestlé's use of the Internet and the Web to this point. How will its marketing operations be enhanced?
2. What other uses of the Internet should Nestlé explore?
3. Does the signing of a contract for such major software and solutions development with SAP seem appropriate at this stage? Should the company take one step at a time rather than attempt to do so much at once?
4. Will the Internet and the Web revolutionize international marketing? Explain.
5 What are the advantages and disadvantages of having some 8,000 brands?

CASE STUDY 8.4

Urban Outfitters

(Adapted from M. Arndt (2010). Urban Outfitters' grow-slow strategy. Reprinted from March 1 2010 issue of *Bloomberg Businessweek*, by special permission, copyright © 2010 by Bloomberg L.P.; en.wikipedia.org/wiki/Urban_Outfitters; and the Urban Outfitters website www.urbanoutfitters.com.)

European retailers from Ikea to Zara have done quite well marketing their products in the United States. But United States retailers have had a much more difficult time in exporting their products to Europe by opening their own stores. For example, sales of Gap in Europe have been declining since 2005, while Walmart stores withdrew from Germany in 2006.

United States-based Urban Outfitters is increasing its efforts in Europe and hopes its designed-for-Europe strategy will be successful where others have failed. Urban Outfitters owns and operates five retail brands: Urban Outfitters, Anthropologie, Free People, Terrain, and Leifsdottir, a luxury brand for Anthropologie.

The company was founded in 1970 and focused on so-called 'funky' fashion and household products. The product line has evolved from vintage, bohemian, retro, hipster, ironically humorous, kitschy apparel and furniture to include luxury brands and several designer collections. The company operates more than 140 locations in 37 states in the United States, Canada, and Europe (see Table 8.5).

Urban Outfitters currently has more than 40 stores across Europe, and the company intends to pick up the pace to get to 100 European stores within the next decade.

Urban Outfitters began its European venture differently, too. US-based chains such as Abercrombie & Fitch stock their European stores with the same merchandise they sell at home. But before opening its first store in Europe in 1998, Urban Outfitters set up a separate design and merchandising unit in London so it could tailor its goods to European tastes. The duplicate operation increased overhead and delayed profitability in Europe, but the mix of American and European styles helps Urban Outfitters stand out.

Urban Outfitters could use the euro-growth. After increasing worldwide revenue an average of 22% annually from fiscal 2003 to 2009, the company said sales expanded just 6% in the year ended Jan 31, to $1.94 billion. While per-store revenue rose 10% at Anthropologie and 18% at the newer Free People women's clothing subsidiary, sales at the namesake chain slipped 1%.

Table 8.5 Urban Outfitters locations in the United States, Canada and Europe

United States	United Kingdom
Alabama	Belfast
Arizona	Birmingham
California	Bristol
Colorado	Kent
Connecticut	Leeds
Delaware	Liverpool
District of Columbia	London
Florida	Manchester
Georgia	**Canada**
Idaho	Alberta
Illinois	British Columbia
Indiana	Ontario
Kansas	Quebec
Louisiana	**Ireland**
Maryland	Dublin
Massachusetts	**Belgium**
Michigan	Antwerpen
Minnesota	**Denmark**
Missouri	Kobenhavn
Nebraska	**Germany**
Nevada	Hamburg
New Jersey	**Scotland**
New Mexico	Glasgow
New York	**Sweden**
North Carolina	Stockholm
Ohio	
Oregon	
Pennsylvania	
Rhode Island	
South Carolina	
Tennessee	
Texas	
Utah	
Vermont	
Virginia	
Washington	
Wisconsin	

Source: http://en.wikipedia.org/wiki/Urban_Outfitters

Europe is known as a crowded and high-cost market for retailing, and competition from other US clothing chains is growing. American Apparel has 51 stores across 11 countries, and Abercrombie has 12 Hollister stores in shopping malls in the United Kingdom and Germany, with plans to triple that number this year. In fact Abercrombie opened a flagship store in Milan, Italy and Japan in late 2009 and a flagship store opened in Copenhagen, Denmark in 2010 and in Mexico in 2015. Meanwhile Hollister stores are opening up across Europe (Boyle, 2009). On a per-unit basis, though, Urban's European stores have the same healthy results as those in the United States. Europe now accounts for nearly 10% of total revenue.

The company's expansion does not stop on the Continent. Senior managers recently scouted locations in China, Japan, and South Korea for what eventually could be 100 stores in Asia. Scouting ahead of such expansion gives the company plenty of time to study local tastes.

Reference

Boyle, M. (2009). Abercrombie bargains for a rebound. *Businessweek*, 30 November, 62.

Questions

1. Evaluate Urban Outfitters designed-for-Europe strategy in light of decreased profitability due in part to increased overhead. Was this a wise decision? Explain.
2. Is the company moving too fast or too slow in expanding its export markets in Europe? Explain.
3. Should Urban Outfitters expand to Asia before solidifying its position in Europe? Why or why not?

CHAPTER 9

Nonexport entry modes

Learning outcomes

In Chapter 9, we discuss:

- the reasons for using other-than-export market entry forms in addition to or instead of exporting
- the alternative modes of entry or expansion available
- considerations in establishing manufacturing facilities
  - location
  - degree of ownership: levels of risk and control
- assembly operations: motivations, advantages, disadvantages
- strategic alliances: the wide range of types available
  - licensing, contracting, joint ventures, other forms

The six cases provided at the end of the chapter illustrate the topics covered in the text. Case 9.1, Imagination Entertainment, an entrepreneurial games and media Australian company, discusses a proactive approach to growth in very competitive markets and the entry strategies used. GG Farm Machinery, Case 9.2, is concerned with developing an entry strategy. Case 9.3, VW in China, discusses the company's early entry into the Chinese market, its substantial successes, and the problems that then developed. Case 9.4, Gloria Jean's Coffees, explores a rapidly expanding coffee franchise company. The case highlights the company's brand recognition, both nationally and internationally, and its franchise business systems. Case 9.5 concerns exporting by a fashion designer in Hong Kong that is considering opening offices in the United States. Case 9.6 is about an alliance that produces eco-friendly toys, powered by fuel cells, for global markets.

Introduction

Companies not only look abroad for marketing of products, but many manufacturers have also expanded their international marketing operations to include some type of production activity in foreign markets. Such expansion may be either a defensive or an offensive move, and it may be for reasons of market entry and/or sourcing. When the expansion is *defensive*, generally it is done to protect a profitable market or to maintain a beachhead in a potentially profitable market. It could also be to secure cost-efficient sourcing abroad to be able to compete domestically or abroad. In this case the manufacturer's action is not of its own choice but in response to pressure from some outside source – a foreign government, competition, or origin-biased (e.g., ethnocentric) buyers.

Government tariffs and other import barriers (including a ban on imports), currency restrictions, and general nationalistic attitudes may be such that if a firm wishes to do business in an overseas market it must establish either a partial or complete production base in that country. This, of course, may involve making some type of direct investment of capital or some other asset of the firm (e.g., know-how). This is the reaction taken by many 'outside' companies to the developments of, and growth in, regional economic integration areas such as the European Union and NAFTA. Traditionally, the features that made a country a desirable place for such foreign direct investment (FDI) have been a favorable investment regime, market size, natural resources, market growth prospects, technology knowledge and development, and labor market conditions, depending upon whether the FDI was for purposes of market penetration or sourcing. China and India, for example, fit this profile. Each has abundant cheap labor, many talented engineers, and good infrastructure. Many of these features are now 'taken for granted,' and companies are looking for places to invest that offer specific advantages, or *created assets*, including communications infrastructure, marketing networks, and intangibles such as attitudes toward wealth creation and business culture, innovative capacity, the stock of information trademarks, and goodwill. The created assets have become crucial for a firm's competitiveness and can make countries without more traditional advantages attractive locations for FDI. These advantages are sought by companies in the service industries and in distribution (such as retailing) as well as manufacturers. Thus much of what we will discuss in this chapter about nonexport modes of market entry will apply to investments of service and distribution companies, as well as manufacturing companies. Many of these features also encourage companies to *outsource* business activities to a foreign country, as well as to manufacturing companies.

Outsourcing occurs when a company extends a portion of its operation to a third party, in contrast to buying already-produced goods or components from a supplier. For a manufacturer who engages in this type of activity for components, or even the complete product, this is also known as contract manufacturing, which we discuss later in this chapter. Outsourcing is often called offshoring when it involves movement of white-collar jobs to low-wage countries. For example, the large US chemical company DuPont has offshored legal services to India and the Philippines by contracting with Office Tiger, an offshoring company in India (Engardio, 2006). In addition, offshoring has also been used to refer to the situation when a company relocates an activity to another country, but ensures that it remains under the control of the company doing the relocating. At one time, the major activity of outsourcing companies in India, and other countries, was call centers. This is now changing and companies are now doing R&D work (Kripilani *et al.*, 2005) and business processing outsourcing, or BPO (Kripilani, 2006).

Competition exerts its influence in such a way that a manufacturer which relies on exporting may not be able to compete on price in foreign markets. In some instances a manufacturer's exports are priced out of foreign markets because of the tariffs that must be paid when the product is imported. Although tariffs may be significant, they alone do not always account for a difference in price. A manufacturer may lose out in competition with either or both domestic or foreign producers in a given foreign market because of the more favorable production costs enjoyed by these competitors. Consequently an exporting manufacturer often finds that it can remain competitive by making a direct investment in some type of production activity, or by forming a strategic alliance in a foreign market, or by outsourcing some business functions where it can take advantage of lower costs.

Finally, buyers may be influential in that they tend to buy products from firms that they consider to be national. In some countries it may take a direct investment or strategic alliance to be considered a 'local' national manufacturer.

As an *offensive* device, expansion into overseas production operations is done for many of the same reasons outlined above. The difference, of course, is the attitude of management and the fact that such expansion is done by choice and typically according to a plan. A manufacturer that takes the offensive recognizes that it can go into certain foreign countries and beat its competition on their home ground with its greater experience, know-how, methods, and marketing ability and capacity. In addition, if a market appears to have good potential, this alone may be reason for foreign-based production. A manufacturer may reason that if it does not do this some other company eventually will. And there are always some benefits that accrue to the firm that is first (*first-mover advantages*), and some of these are never really lost when other firms appear on the horizon.

Of course, being first does not guarantee continued market leadership. Constant adaptation and flexibility in marketing to changing demand and more aggressive competitors is needed to maintain first-mover advantages.

Typically, FDI involves companies from the more developed industrial areas of the world investing in both developed and developing countries. But major exceptions do exist, as evidenced by Chinese companies during the first decade of the 2000s.

Alternative modes of entry

In Chapter 7 we defined an international market entry mode as an institutional arrangement necessary for the entry of a company's products, technology, and human and financial capital into a foreign market. Site of production base was identified as the first decision that had to be made, and foreign-market-based production was a major alternative. Our discussion of production from a foreign-based location takes a broad viewpoint of the meaning of production. There are three basic alternative ways that a manufacturer can engage in overseas production (as shown in Figure 7.2 in Chapter 7):

1. a manufacturing plant can be established;
2. assembly operations can be set up;
3. a strategic alliance can be formed with one or more companies.

Although all forms of nonexport market entry mode involve some kind of an investment by the company entering the foreign market, a capital investment typically is required for the manufacturing plant and assembly operations options and may be necessary for a strategic alliance, depending upon the type of alliance.

As companies change their mode(s) of foreign market entry, either by evolution or deliberate and planned change, from export to overseas-based operations organized as an affiliate, their strategic orientation shifts in several respects from the country of origin to the host country. There is a relationship between involvement of management and infusion of capital in foreign activities and mode of market entry and the extent to which the resources are invested in either the home or the host country. As management involvement increases toward emphasis on the host country and infusion of capital increases in the host country at the expense of the home country, the mode of market entry often will follow a sequence: exports, licensing agreements, franchising, joint venture, foreign branch, production plant, and affiliate. The affiliate will have 100% management involvement in the host country with resources invested in the host country as well. In any given market, some of the steps in this sequence may be skipped.

While many host countries provide incentives in order to attract direct private investment there are also many obstacles that tend to bother investors and obstruct, or at least slow down, the flow of private foreign capital. Some of these obstacles stem from government policy, such as exchange controls, restrictions on foreign companies and persons, political uncertainty, nationalistic attitudes, and unsatisfactory tax conditions. Others come from the nature of the economy itself, such as labor problems, inflation, and concern for the environment. In 2008 the world economy changed and what had been an upward trend in global FDI came to an end. Many planned projects were put on hold or even dropped. Entire industries, such as the automobile industry, were affected. The FDI downturn created a major policy challenge for governments worldwide, and in the newer EU members (from Central and Eastern Europe) in particular. As FDI inflows decline and some foreign multinational companies even divest, employment at foreign subsidiaries is adversely affected and fiscal revenues dwindle (Kalotay and Filippov, 2009). This puts pressure on host-country governments to compete more efficiently and more aggressively for their share of a shrinking pool of FDI. FDI fell again in 2014 by 16% (World Investment Report 2015). This drop is despite the global key metrics such as GDP, trade, and employment all growing worldwide in 2014. While FDI fell, the sales and assets of MNEs grew faster than that of domestic firms.

The situation in China provides an example of another potential obstacle to investment – management of the labor force there. In Western countries labor is viewed as a variable cost and workers can be temporarily or permanently let go when demand for products decreases, often at an extra cost to the company. In China, however, a business enterprise is viewed as a key unit in a giant social welfare system, and the worker's unit has an implied responsibility for the welfare of the worker. This is particularly so for joint ventures that may have to provide all the services needed by employees of the company – homes, stores, and schools. The joint venture is a **danwei**, the basic work unit in China (Pearson, 1991). Under these conditions, labor is in effect an overhead cost that must be covered regardless of fluctuations in demand. In some instances there are barriers to overseas investment placed by the government of the potential investor's country. Most generally this is limited to policies concerning the use of currency and taxes, although there have been cases where limitations on the absolute amount of investment have been imposed.

We now turn to a discussion of each of the alternative nonexport modes of entry into foreign markets. Before doing this we need to clarify a distinction between a joint venture and other types of investments that are not wholly owned. For the purposes of this text, a joint venture is a type of strategic alliance in which companies from at least two different countries, generally one being local, form a *new company* to manufacture/produce products or provide a service on a joint basis. This would involve what is known as a *greenfield investment*. This type of entity is quite different from one in which there is simply shared ownership in general, which usually involves an acquisition by one of the partners, although there are many overlapping characteristics.

Moreover, it must be recognized that companies may be using more than one approach. During a 12-month period in the mid-1990s, for example, the South Korean Samsung Electronics Company set up eight strategic alliances and acquired or took equity positions in six companies, mainly US and Japanese companies. This was done to have access to the technology needed to achieve the goals that it had set for itself.

The decision regarding which nonexport market entry mode to use cannot be entirely separated from the 'generic' decision to enter the market. Thus the bases of entry mode choice generally include the overall attractiveness of the market itself; costs of entering the market (i.e., what might be viewed as transaction costs); the timing and ability of a company to enter and develop necessary resources, assets, and competencies; local and home government requirements; the competitive situation; and political and operational risks that are involved.

Manufacturing facilities

General considerations

Rarely does a company set up manufacturing facilities as its first international business operation. Most often a factory is not established in a foreign market area unless and until the market has already been served by export channels, unless it is being set up purely for sourcing for other markets. Exceptions might exist, however, if a company is new to an area, and the policies and regulations of the foreign government are such that the best way to enter the market is through a direct investment in a manufacturing facility; or it might very well be desirable to form a strategic alliance either through a licensing agreement or a joint venture. In such cases it is desirable that the particular market offer great sales potential; however, in some cases it is adequate that the specific country is situated so that it serves as a good base from which surrounding foreign market areas can be served. For example, in the early 2000s Japanese, European, and US automobile manufacturers were using manufacturing facilities in Mexico as an export platform for some of the world's hottest cars (*Businessweek*, 2000a). DaimlerChrysler's PT Cruiser was made only in Toluca; General Motors assembled the Aztek sports utility vehicle exclusively in Ramos Arizpe; Nissan's Sentra was centralized in Aguacalientes; and VW manufactured its new Beetle exclusively in Puebla. One thing that makes Mexico a very attractive place for an export base is that the country has signed free trade agreements with more than 30 countries as well as being a member of NAFTA. This makes Mexico one of the world's most prolific signers of free trade agreements. Moreover, Mexico has long been used by US auto manufacturers as a sourcing production base for the US market. The US computer manufacturer Dell manufacturers and assembles computers and monitors in Mexico as well.

Many of the possible reasons that companies establish manufacturing operations in a foreign market were discussed in Chapter 2 in the broader context of international marketing. At the same time it should be realized that a direct investment in manufacturing will require a significant investment in capital. In addition to the business risks involved there are personnel and other problems. For instance, there may be local labor laws to contend with, and often there is difficulty in repatriating profits and capital. These problems, while real, can be minor when compared to the many advantages that can emerge from having a foreign manufacturing facility. A few important advantages are: it offers control of sales policy and a flexibility not possible with a license; it provides product control of the market, including third countries; it seizes advantages offered by foreign governments as investment incentives; it makes the protection of trademarks and the building of a brand equity easier and creates a better image in the host country; it is much easier to use manufactured components in a worldwide integrated production program; it gives control of cost cutting, expansion programs, production policies and quality control; and it makes local financing easier and provides flexibility in currency agreements, etc.

Once the decision to manufacture in a foreign market has been made, then a company has three basic questions to answer. The first concerns where the manufacturing facility is to be located. Often this question is directly tied in with the decision to manufacture abroad. That is, the decision is made with a particular country in mind. Second, the question of degree of ownership must be answered. This involves deciding whether the operation is to be wholly owned or only partially owned. Finally, a company must decide what is the best way to implement its decision: should it start from scratch (e.g., a greenfield investment) or acquire an existing firm located in the selected market? These three questions are in fact interrelated such that the answer to one will affect the answers to the others. Each company must establish a priority, which is not necessarily the order in which we have presented them. Thus, for some companies, the degree of ownership that it desires will be the controlling factor while for others the desired location will be of primary importance.

Location

The selection of one country over another calls for careful analysis of a host of important factors. These factors can be categorized under several broad headings, as follows:

1. **The climate for foreign capital**
   a. political considerations;
   b. economic and industrial dynamism of the people;
   c. size of market and potential for growth;
   d. geographic and climatic conditions;
   e. financial considerations; taxation.
2. **Production considerations**
   a. availability and cost of personnel and labor – skilled and unskilled;
   b. availability and cost of personnel to perform managerial duties;
   c. facilities;
   d. availability and cost of water, power, transport, real estate, and so on;
   e. availability and cost of raw materials, capital equipment, and so on.
3. **Special conditions** in respect to industry conditions and regarding one's own product line in particular, for example the competitive situation.

These are general categories. What is needed is a guide so that a more detailed analysis can be made of the potentialities offered by a particular country. Many checklists for this purpose are available.

The job of appraising a country is not easy. A great and important burden will be placed on many people in the company, particularly those involved in international marketing research. Many of the data sources discussed earlier in Chapter 6 will have to be utilized. For example, basic industrial surveys have been published for many areas, market reports and preliminary feasibility studies are often available, assistance in finding suitable partners for possible joint ventures is available, and fully serviced sites are available for industrial use. Finally, at some time during the appraisal process – though not at the beginning – the country should be visited.

It should be apparent that an appraisal will be costly – both in terms of time and money. However, it is better to spend the necessary time and money to make a thorough study and analysis than to invest in a manufacturing plant in the wrong place.

Often the choice of a location for manufacturing facilities is based on costs. As an example of cost orientation, Manganese Bronze Holdings, the UK maker of the black taxicab that the United Kingdom is known for, is having the cabs manufactured in China starting in mid-2008 by a joint venture, Zhejiang Geely Holding Group. Similarly, Eastern Europe, with its cheap labor cost and high skills is attracting investment by automobile manufacturers Toyota, Honda, Ford, and others (Edmondson *et al.*, 2005).

Low cost, particularly low wages, is the main reason for the emergence of the *maquiladora* (or *maquila*) factory in Mexico. A maquiladora is a factory that imports materials and equipment on a duty-free and tariff-free basis for assembly or manufacturing and then re-exports the completed product, usually back to the originating country. This is a form of offshoring or outsourcing, and many are located along the United States–Mexico border. Many such companies are 100% foreign owned, usually by US companies. However, Japanese, German, and Korean companies also have invested in maquiladoras, mostly in Mexico but elsewhere as well, usually in association with US companies. The appeal of Mexico to US firms in particular is based on its proximity to the US market, its manufacturing skills, and affordable labor (Pacheco, 2010). One major negative factor is the current violence caused by the drug wars. As of 2010, while some companies have been looking elsewhere to locate, there has not yet been a mass exodus. Maquiladoras are found throughout Latin America.

For products that are higher in technology, other considerations such as the skill and education of labor are important. Computer companies such as the US's Intel Corp., Japan's NEC Corp., Taiwan's Acer Inc., and the US's Cypress Semiconductor Corp. in the mid-1990s established operations in the Philippines. In addition to low wages, the Philippines is attractive to such high-tech companies because the labor force is well educated and well trained (DiCicco, 1996). China is a country where labor costs offer advantages for a production or simply an outsourcing site, and it is increasing its skill and education levels to attract higher technology investments. Intel, Google, AstraZeneca, and Dow Chemical are just a few of the multinationals that are increasing investment in R&D in China (Einhorn, 2006). The US home appliance multinational Whirlpool operates two R&D centers in China.

A third reason why a company may choose a particular country for locating manufacturing facilities is that the country's demand is strong enough and offers promise for growth. Thus, the investment is made for *market penetration* rather than, or in addition to, sourcing. The Japanese automobile maker Honda reported that it was building new plants in the United States, Argentina, and Thailand to keep up with growing demand, especially for its fuel-efficient cars (Kageyama, 2007). Similarly, Ford Motor Co. planned to build a new auto parts plant with its Japanese affiliate Mazda Motor Corp. in China.

A special concern in the appraisal process should be for *political risk*. This can be defined as 'the application of host government policies that constrain the business operations of a given foreign investment' (Schmidt, 1986, p. 45). Political risk is multidimensional and includes the following (Root, 1994, pp. 150–7):

- *Transfer risk*. Risk arising from government policies that restrict the transfer of capital, payments, products, technology, and persons into or out of the host country.
- *Operational risk*. Risk due to host government policies, regulations, and administrative procedures that directly constrain the management and performance of local operations in production, marketing, finance, and other business functions.
- *Ownership-control risk*. Risk brought about as a result of host government policies or actions that inhibit ownership and/or control of the local operations of an international company.
- *General instability risk*. Risk that relates to the future viability of the host country's political system.

Such risks can be either macro risks in that all foreign companies are more or less affected the same, or they may be micro when only specific industries, companies, or projects may be affected.

A significant aspect of the evaluation of a proposed foreign investment is obtaining answers to many questions, including the following:

- What are the chances of there being general political instability in the country being examined over the relevant investment planning period?
- How long is the present government expected to be in power?
- How strong is the present government's commitment to its agreements with investors in light of its attitudes toward foreign investors and its power position?
- If a new government is to come to power, will it honor existing agreements and regulations or will changes be made?
- If changes in government policy are made, how will this affect the firm's profitability and safety of a project?

Answers to questions like these are not easily found, particularly when a proposed investment is to be in a developing country. In this situation political maturity as well as political stability needs to be assessed.

In order to evaluate the political risks of a proposed foreign investment, managers need information relevant to the situation and they need a structure for analysis. One such approach is shown in Figure 9.1, which is based on the four dimensions defined above. This structure looks at each dimension as a hurdle to be overcome, with general instability risk being first, and transfer risk being last. In order for top management to approve the investment it must pass all four political risk hurdles and, obviously, satisfy the desired rate of return. Another approach is to use a syndicated service measure such as the **Business Environment Risk Index (BERI)** discussed in Exhibit 9.1.

When hotel chains determine which location to open a new hotel in next, hotel management must consider a range of factors. These factors include quality of human resources, quality of infrastructure, and political stability. For the full list of factors considered by hotel see Assaf *et al*. (2015).

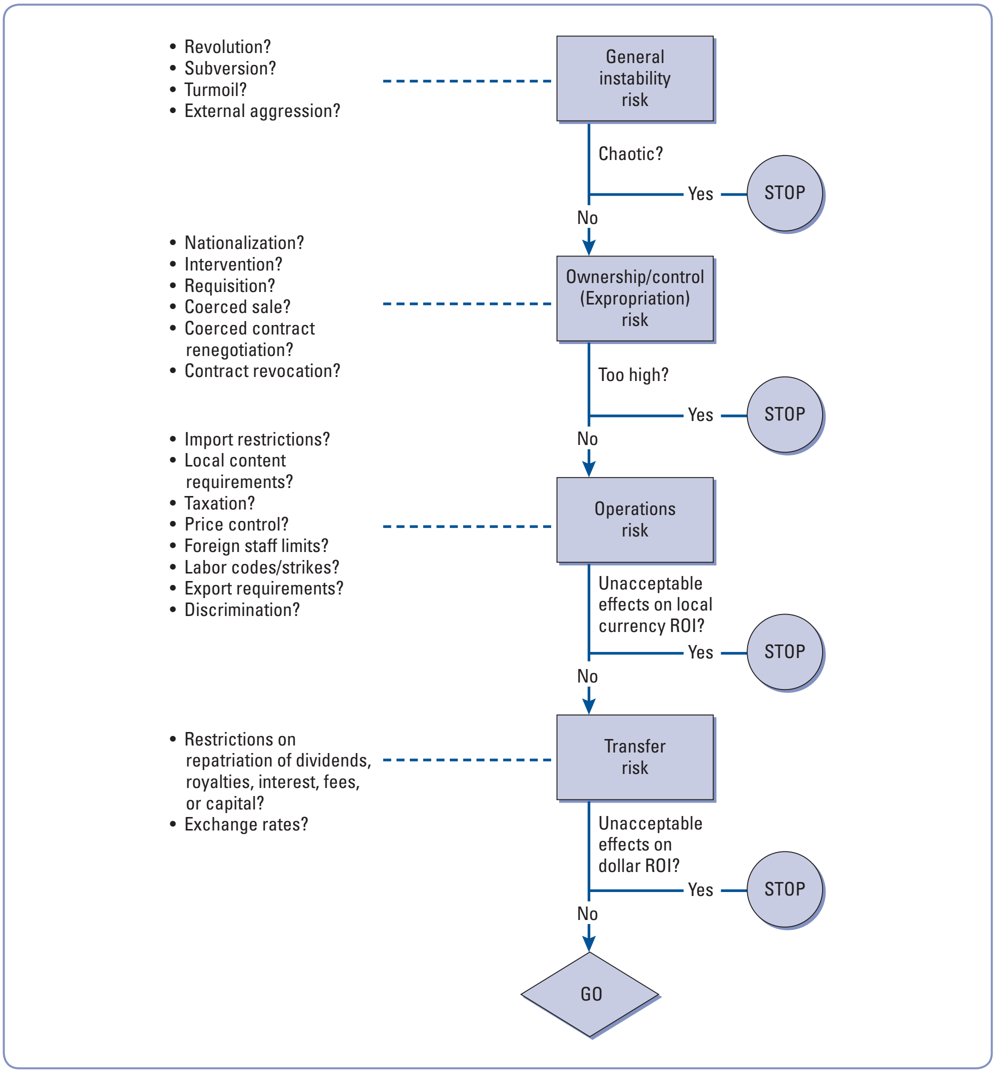

Figure 9.1 Evaluation of political risk

Source: From *Entry Strategies for International Markets*, 2 ed., John Wiley & Sons (Root, F.R. 1998) p. 155, Fig 15 ('Evaluation of political risks of a foreign investment entry decision process'), Entry Strategies for International Markets, 2nd ed. revised and expanded, Root, F.R. Copyright © 1998 John Wiley & Sons. Reproduced with permission from John Wiley & Sons, Inc.

Ownership

The question concerning degree of ownership desired is basically that of deciding whether the foreign manufacturing facility is to be wholly owned (either as a branch or as a separate subsidiary) or only partially owned. Exhibit 9.2 provides two examples of how this decision is made. If the foreign operation is to be only partially owned, then a decision is to be made concerning whether it will be a joint venture (i.e., a partnership arrangement with a foreign company or government), whether an acquisition is involved, or whether stock ownership will be made available to the nationals of the country in which the operation

Exhibit 9.1 How can political risk be assessed?

Political risk has been defined as the application of host government policies that constrain the business opportunities of a given foreign investment. This can be viewed further as the likelihood that political forces will cause drastic changes in a country's business environment which affect the profit and other goals of a business firm. Such risk is also of concern to the international marketer, particularly one with an investment in a plant or in a sales and marketing operation in a foreign country. Exporters and international marketers are affected also by the *transfer risk* aspect that includes risk derived from government policies restricting the transfer of capital, payments, products, and so on. In short, tariffs, taxes, nontariff restrictions, and payment for goods exported are of concern.

The Business Environment Risk Index, which has been available since 1972, measures the discrimination of foreigners as compared with nationals as well as the general quality of a country's business climate. BERI is reported for more than 140 countries and is published quarterly. The overall index is based on 15 weighted criteria, and ranges from 0 to 100 (see Table 9.1). Scores can be interpreted as follows: unusually stable (86–100), typical environment for an industrialized economy (71–85), moderate risk (56–70), high risk (41–55),

Table 9.1 Criteria included in overall BERI and in sub-indices*

	Weights				
Criteria	**Overall index**	**Political**	**Operations**	**Financial**	**Nationalism**
Political stability	3	6			
Economic growth	2.5		5		
Currency convertibility	2.5		5	5	5
Labor cost/productivity	2		3		
Long-term loans/ venture capital	2			5	
Short-term credit	2			5	
Attitude toward the foreign investor and profits	1.5	5			8
Nationalization	1.5	5			8
Monetary inflation	1.5	3		3	
Balance of payments	1.5	3		3	
Enforceability of contracts	1.5		4	2	
Bureaucratic delays	1	3		2	4
Communications: Telex, telephone	1		3		
Local management and partners	1		2		
Professional services and contractors	0.5		3		
	25	25	25	25	25

*Rating conditions: superior = 4, above average = 3, acceptable = 2, poor = 1, unacceptable = 0 unacceptable business conditions (0–40). Four sub-indices also are derived: political, operations, financial, and nationalism. The desirability of using this index in business environmental analyses has been questioned on general grounds regarding risk indicators per se as well as poor empirical evidence to support one of the sub-indices. If risk indicators are to be used they should be supplemented by special information services and in-depth country reports.

Other country risk concepts have been developed by various market research institutes and economic magazines. For example, the Heritage Foundation together with the *Wall Street Journal* published the Index of Economic Freedom which covers 183 countries (Heritage Foundation, 2010). Economic freedom is defined as the fundamental right of every human being to control his or her own labor and property. The index is based on ten components of economic freedom: business, trade, fiscal, government, monetary, investment, financial, property rights, freedom from corruption, and labor.

Exhibit 9.2 Choosing between sole ownership and joint venture

A recent study of Taiwanese companies by Chiao *et al*. (2010) found that the decision between wholly owned subsidiaries and joint ventures is affected by the following factors: (1) firm-specific assets, (2) international experience, (3) whether a company is investing abroad in pursuit of a specific customer, (4) whether a company seeks complementary assets abroad, and (5) the perceived institutional differences between a company's home country and the host country.

A study of Chinese companies on this issue finds that the entry mode choice is primarily influenced by the variables related to the company's strategic fit with the host country and its strategic intent regarding a direct investment (Cui and Jiang, 2009). The results from this study suggest that a Chinese company prefers the wholly owned subsidiary entry mode when it adopts a global strategy, faces severe host industry competition, and emphasizes asset-seeking purposes in its FDI. A joint venture is preferred when the company is investing in a high growth host market.

What do these two examples show? The decision between wholly owned and joint venture depends upon a number of factors such as why the investment is being made, where this decision fits in the company's 'big picture,' environmental (e.g., government) restrictions, etc. Companies from outside Asia face the same situation.

is to be located. In addition, where partial ownership is involved, the investor must decide between a majority or minority interest.

There are no easy answers to the question of how extensive ownership should be. Much depends upon such factors as the attitudes of management, the resources available, the nature of the market, the availability and capabilities of potential partners, and policies of foreign governments. Some companies will insist upon 100% ownership and there are advantages to this pattern, particularly that of retaining full control over the operation. However, if a company wishes to implement its decision to manufacture abroad by acquisition of an existing firm, complete ownership is often impossible. Furthermore, if operational control of the venture is the main criterion then this can be achieved by holding a majority interest and in some instances even a minority interest. In the latter case this can be accomplished by spreading the ownership throughout the public at large. In cases where political stability is an issue, then joint ownership – even as a minority owner – seems prudent, if the investment is even made. There are instances when the answers to the ownership question are somewhat automatically limited. When a company has limited resources (money, labor, and know-how) it will have to seek out a foreign partner. Also, government policy may limit the choice. For example, in the past, typically China has required shared ownership in many, but not all, ventures there. With the exception of some industrial sectors where they are not allowed, increasingly China has been allowing wholly foreign-owned enterprises (WFOEs) in more and more industries. More and more companies are pursuing the WFOE route rather than equity joint ventures (EJVs) as good partners are hard to find, it takes less time to establish a WFOE, and regulations governing the two types of enterprises are much the same (Vanhonacker, 1997; Johnstone, 1997). In China, gaining control of a Chinese company can come at a price. For example, in 2005 Carlyle, a private-equity firm, bought 85% of Xugong, China's leading maker of construction equipment. Not only did Carlyle pay twice the book value (compared with 30% premium of previous Chinese private-equity deals), it also had to agree to take on Xugong's 43% share of a listed road-building subsidiary that had just posted big losses (*The Economist*, 2005).

Sometimes government changes its policy about ownership after the investment is made. To illustrate, India in the late 1970s required Coca-Cola and IBM to transfer 60% of their equity to an Indian company. Rather than comply, both companies pulled out. As India's economy has opened more to foreigners, companies that left have been returning, including IBM. In 1993 Coca-Cola returned by establishing a strategic alliance with India's largest soft drink producer, Parle Exports Ltd.

There are times when 100% ownership is not advisable even when government regulations allow it. In some countries local companies set up 'road blocks' as they do not want newcomers in the industry, especially those from abroad.

Implementation of the decision

As previously mentioned, implementation of the decision has only two basic alternative answers: (1) to start from scratch in what is known as a greenfield investment, or (2) to use the acquisition route. From the perspective of market entry, starting from scratch is at best time-consuming. Involved in this approach are such activities as setting up manufacturing facilities, recruiting and training labor, organizing a management team, and so forth. In short, all of the major internal management problems in international business are encountered. Furthermore, a major outlay of cash will be needed.

More and more companies today are turning to acquiring established foreign companies, either wholly or in part, as the fastest and most economical way to enter a foreign market (see Exhibit 9.3). There are many examples of acquisitions that represent minority ownership, majority ownership, and total ownership. In the early 1990s in Japan, Eastman Kodak had a 20% interest in Chinon Industries (a supplier of cameras), a 51% share in Kodak Imagica (a photo-finisher), and wholly owned Kodak Information Systems, which had been part of a supplier called Kusuda. In the late 1990s the company was allowed to take over three local companies in China without any debt or labor obligations. Two limited-liability partnerships were formed. Kodak promised to bring to mainland China its best technology and management practices as well as a commitment to raise the country's photographic goods manufacturing industry to global standards. Another example comes from the beer industry in Hungary where the Dutch company Heineken NV acquired 51% of the company

Exhibit 9.3 Merger and acquisition mania

Some examples of cross-border mergers and acquisitions are presented below. These are not meant to be all inclusive, but are illustrative.

Following the financial crisis of 1997, cross-border mergers and acquisitions increased greatly in East Asia, particularly in the nontradable services sectors (Mody and Negishi, 2001). Triggering this activity were important policy changes, especially in Korea and Thailand. Although many had hoped this would speed up economic recovery in the region, this did not happen. At the same time such acquisitions were not predatory, although some were based on 'bargain' prices.

During the late 1990s multinationals looked to Latin America for companies to buy. Many so-called 'bargains' were available due to the economic volatility in the area. Some examples are the US-based energy group GPU, Inc. buying the Argentine electricity distributor Emdersa, the French supermarket chain Carrefour taking over Brazilian department store chain Lojas Americanas, Citigroup agreeing to purchase Chile's second-largest consumer finance company, Corp. Financeria Atlas, and the Dutch bank ABN Amro looking to buy Banco Real of Brazil. Most acquisitions were for strategic, long-term reasons and buyers were looking to strengthen their positions in key markets (Katz, 1999). In 2010 the Dutch beer producer Heineken purchased Mexico's second-largest beer producer from Femsa. This gives Heineken valuable brands (Dos Equis, Tecate, Sol).

European companies have been active in the United States. One of the major reasons is that the US market appears to have growth rate prospects two to three times that of Europe. In addition, taxes and labor rules are relatively less restrictive. Also, the European companies look to mergers and acquisitions as a means to solve many of their strategic challenges. Illustrative examples are the UK's wireless company Vodafone's acquisition of AirTouch Communications, Dutch insurer Aegon buying Transamerica, and the Daimler-Chrysler and British Petroleum-Amoco mergers. European companies have also been busy in cross-border acquisitions within Europe itself (*The Economist*, 2007a). Interestingly, in 2007 there was a surge of nationalism in France and Spain as politicians there blocked foreign takeovers of national companies. However – these two countries look favorably on their companies' acquisitions elsewhere.

Even in China, cross-border mergers are on the increase. Where a cross-border merger is involved it has been the local Chinese company – state owned or otherwise – that has acquired the foreign company which already had a Chinese operation, although not all have been of this type. Examples are Sanyuan Foods' purchase of the Beijing dairy operations of the US-based Kraft Food International, beer brewer Tsingtao's acquisition of a 75% stake in Danish Carlsberg's Shanghai brewery (Roberts and Webb, 2001), Lenovo's purchase of IBM's PC operations, and TCL Corp merging its television business with France's Thomson. An example of a Chinese company purchasing a European company which had been exporting to China is the automobile company Seely which purchased Volvo from Ford in 2010.

Companies from India have been very active in acquisitions. In the first three months of 2007, for example, Indian firms announced 34 foreign takeovers. A specific example is Hindalco's acquisition of the US firm Novelis, making Hindalco the world's biggest aluminum-rolling company (*The Economist*, 2007b).

Russian companies are also joining the ranks of acquirers. Moscow-based Veneshtorgbank's purchase of 5% of the European aerospace company EADS and the purchase of the US company Oregon Steel Mills by the Russian steelmaker Evraz are but two examples (Bush, 2007).

Retailers have also been active in cross-border mergers, none more so than US-based Walmart, the world's largest retailer. Its entry into Germany was made by acquiring the

21-store Wertkauf chain, which was then followed by its purchase of 74 Interspar hypermarkets. In 2006, Walmart left Germany and sold its stores to Metro. Walmart had underestimated German labor unions and local competitors such as Aldi. In 1999 Walmart acquired the UK's third largest supermarket chain and leading discount marketer, Asda. It appears that Asda will be used as a base for a further assault on Europe as Walmart sees acquisitions as the main route to take. In 2003 Walmart acquired a controlling interest in Seiyu, a Japanese supermarket. Other examples of retailer acquisitions are the Dutch food retailer Ahold, which has acquired a number of chains in the eastern United States including Giant Foods, Stop & Shop, Tops Markets, and First National Supermarkets, the UK's Kingfisher, which in 2003 acquired control of a French DIY-chain, Castorama, and the US home improvement company Home Depot's purchase of Home Day, a 12-store chain in China. In contrast, other retailers such as the Swedish home furnishing company IKEA and the UK's Marks & Spencer have entered foreign markets by 'greenfield' investments in starting stores from scratch, although Marks & Spencer once owned the US-based Brooks Brothers before selling it to Italian entrepreneur Claudio Del Vecchio in 2001.

Komaron and the Austrian brewer Brau-Union purchased a 70% stake in Martfu and a 51% share of Sopron. Occasionally, a so-called cross-acquisition is created. In 1999 Japanese automobile maker Nissan formed an alliance with the French company Renault which resulted in a cross-acquisition situation. As of the year 2010, Renault owns 44% of Nissan, which in turn owns 15% of Renault (*The Economist*, 2010).

Using the acquisition approach does not mean that internal management problems will not exist, because they most certainly will. Acquiring an established firm has perhaps greater advantages than starting from scratch – and there are advantages to both parties. From the point of view of the company doing the acquiring, such action may represent, in the long run, a lower cost despite the fact that it may need an initial cash outlay greater than would be needed to set up a new operation. The reason is simply that, if properly planned and executed, acquisition provides much more than just plant and production facilities. An established and effective marketing organization, market knowledge, overseas management ability, and good government and customer relations are but a few of the possible extras. A major reason underlying Ford Motor Company increasing its ownership in Mazda of Japan to 33.4% (from 24.5%) in mid-1996 was the expectation of great savings in development costs and extending its reach in Japan and Southeast Asia. Moreover, many acquisitions require relatively little cash while others may require none. In the latter case, the investor uses his own stock in payment. Immediate market share may be obtained and competition reduced, as was the situation for the MNC Procter & Gamble's acquisition of the Czech company Rakona.

Underlying many mergers and acquisitions is the wish to create a large enough market share in one principal business, or a small number of related businesses, in order to become a major factor in a market area. To illustrate, consider the situation of the United Kingdom company Thorn EMI. Through several acquisitions Thorn gained market leadership in the fragmented western European commercial and industrial light fittings market. More than 50% of its sales in these businesses came from outside its United Kingdom home market. Sometimes acquiring a number of companies in a market does not work too well. The Swiss watchmaker Asuag A6 needed to acquire technology and did this by purchasing 12 different firms in the United States. Although some of the companies were useful they did not seem to fit together well. Many were not even compatible. Eventually, all 12 were sold – at a big loss (Ricks, 1999, p. 125). Heineken's acquisition of Mexico's second-largest beer producer is another example of the benefits to the acquiring company. The acquisition gave the Dutch company greater access to all of Latin America.

The advantages to the acquired company are just as real. A badly needed infusion of cash may be forthcoming, which can be used to finance R&D, market development, and similar activities. Needed expertise may also result from acquisition. Also, the acquired company may have access to a wide-ranging sales network.

There are, however, some potential limitations to the acquisition approach. To begin with, finding available companies is not always easy. Many of the potentially good ones are hard to convince that it would be advantageous for them to sell while those that are up for sale are quite likely to be in some type of distressed condition. Thus often an exhaustive study of the possibilities must be made and, once a candidate is selected, negotiations are entered into. There may be situations where prospects for acquisition simply do not exist, or where government policies make acquisition difficult, if not impossible. There is increasing scrutiny of mergers by the antitrust regulators in the United States and by the European Commission in the European Union. For example, mergers blocked in the European Union during the period 1998–2000 included MCI World Com/Sprint, Volvo/Scania, and Deutsche Telekom/BetaResearch.

In addition to the usual concerns in acquiring a company – paying a fair price, melding two management teams, and gaining the elusive 'synergy' that is supposed to add to profits – there are special risks and costs attached to cross-border mergers, as follows:

- Foreign acquirers usually pay more than a domestic buyer would, often with unrealistic hopes of future synergies.
- Differences of language and national and corporate cultures aggravate integration of two management teams, and possibly two headquarters.
- Misperceptions about the home market of the acquired company can lead to marketing mistakes.
- Vertical integration is much harder in cross-border deals than intracountry deals.
- Employees tend to be even more frightened of new management if bosses are from another country. This was a concern of Chrysler employees in the DaimlerChrysler merger.
- These challenges often involve wide differences in distance, language, and cultures that can lead to misunderstandings and conflicts.

There are two important potential problems that may arise. First, there is often a difficult problem of integrating practices and operating methods of the acquired company into the overall company structure and philosophy. This includes a need often to integrate *management styles*, or the patterns of decision-making that exist in each company. In a study of European Union managers, Albaum and Herche (1999) concluded that there were differences in the management styles of Danish, Spanish, Dutch, French, and Finnish decision makers, using five underlying dimensions of decision-making. In addition, a recent study reported differences in the management style of managers in six Pacific Rim countries – Australia, China, Vietnam, New Zealand, Hong Kong SAR of PRC, and the Philippines (Albaum *et al.*, 2007). The Pacific Rim managers differed from those in Europe. In addition to its relevance for acquisitions, integration of management styles is crucial to the success of strategic alliances. This situation also existed in the joint venture TNK-BP (Ekin and King, 2009, p. 102).

Second, there may arise the problem of how to gracefully and diplomatically remove any former owners who may be impeding the development of the new company and who still own an important share of, or have some type of a contract with, the acquired company. These last two problems are avoided by starting from scratch. Furthermore, acquisition will seldom be the best route to take if a company wants to build its overseas operations according to the pattern of its home operation. However, a company must be careful here as it is not always desirable to extend a home country approach to a foreign-based operation.

A hybrid approach has been termed **brownfield investment**. A brownfield investment represents a special form of acquisition, and has been defined as:

> A foreign acquisition undertaken as part of the establishment of a local operation. From the outset, its resources and capabilities are provided by the investor, replacing most [but not all] resources and capabilities of the acquired firm (Meyer and Estrin, 2001, p. 577).

This form of entry is attractive if high transaction costs inhibit the more traditional approaches and if local resources are necessary, but not sufficient for the venture.

Needed resources include resources held by the local firms (assets, technology, etc.), the investor (managerial services, financial capital, transferable knowledge, etc.), and the markets (real estate, labor skills, etc.). The choice of entry is illustrated in Figure 9.2, which shows the conditions favoring the conventional acquisition, brownfield, and greenfield approaches.

Regardless of the route generally favored by a company, it is quite important that the attitude and policies of management be flexible. Each foreign market area and each potential project is unique, and management must approach its decision-making with an open mind. In addition, FDI, whether by acquisition or starting from scratch (brownfield or greenfield), is affected by the governance environment (e.g., rule of law) in a country. In general, governance refers to the mechanisms that an investor uses to control and protect his or her investment (Li, 2005). The type of governance and its effectiveness depends to a great extent on the economic, social, and legal environment in the country where the investment is made. A normal belief is that countries with a poor governance environment would not attract FDI. However, using China as an example, Li (2005) shows the opposite. When there is a poor governance environment investors choose *direct* investments over *indirect* (portfolio) investments as FDI can be better protected by private means. A government environment index (GEI) has been developed by Li and Filer (2007). These researchers estimated GEI for 44 countries. Table 9.2 shows GEI for the five countries with the highest values and

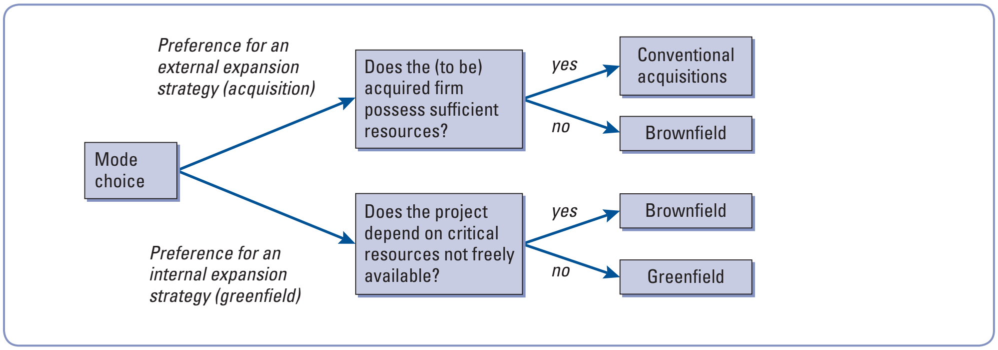

Figure 9.2 Entry mode choice

Source: Meyer and Estrin, 2001, p. 581.

Table 9.2 Estimated government environment index (GEI), selected countries

Country	GEI[a]
Highest Values	
Norway	6.02
Ireland	4.69
Sweden	4.61
United States	4.47
The Netherlands	4.35
Lowest Values	
Egypt	–4.81
Turkey	–5.04
Russia	–6.23
Iran	–6.27
China	–7.26

[a]The higher a GEI score the more a rule-based governance environment.
Source: Adapted from Li and Filer, 2007, p. 93. Copyright Elsevier (2007).

five countries with the lowest values for the year 2007. A high GEI score means a country is more rule-based, whereas a low score indicates a country is less rule-based.

An example of a global organization that was built largely by acquisition is Rupert Murdoch's News Corp. Figure 9.3 shows News Corp.'s worldwide distribution footprint for satellite and cable systems, including Direct TV, BSkyB, Sky Italia, Start TV, Innva, Sky Brasil,

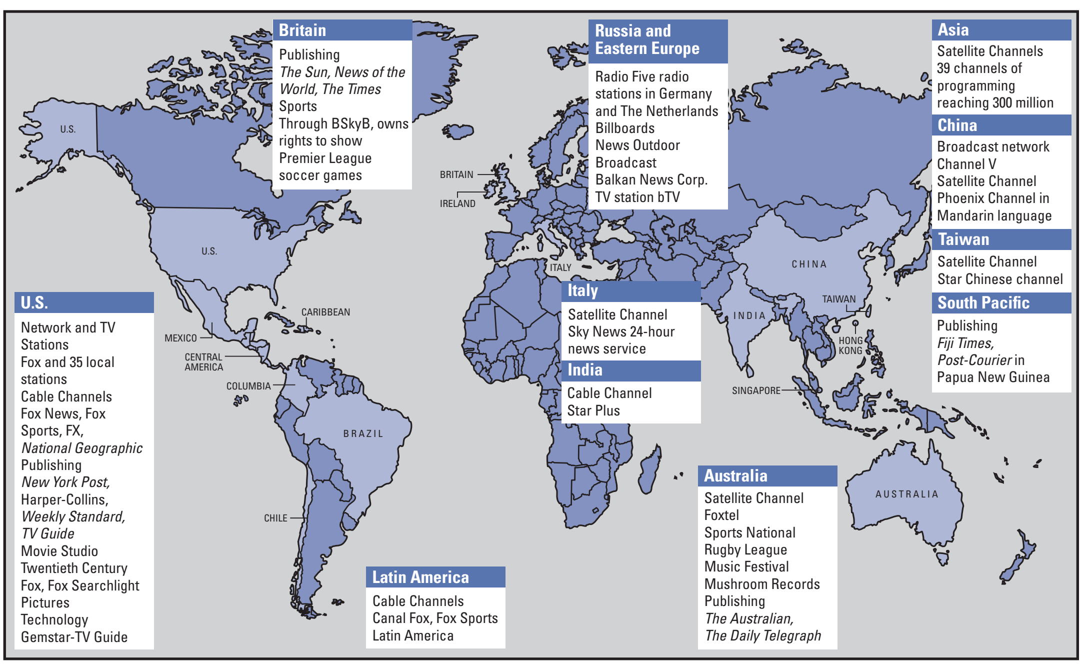

Figure 9.3 The News Corp. media empire

Source: Yang *et al*., 2004, p. 54.

Figure 9.4 BP global exploration and production operations

Source: From A struggling partnership: TNK-BP joint venture, *International Journal Strategic Business Alliances*, Vol. 1, No 1, p.93 (Ekin, A.C. and King, T. R. 2009), © Inderscience Enterprises Limited.

Sky Chile, Sky Colombia, Foxtel, and Direct TV Latin America. Adding the 175 newspapers published, News Corp. has a global media empire (Yang *et al*., 2004). Figure 9.4 shows the British oil company BP's global exploration and production operations as of the year 2006, some of which resulted from acquisition.

Assembly operations

A manufacturer that wants many of the advantages associated with having overseas manufacturing facilities and yet does not want to go that far may find it desirable to establish overseas assembly facilities in selected markets. In a sense, the establishment of an assembly operation represents a cross between exporting and overseas manufacturing. Often it is difficult to distinguish assembly from full manufacturing, especially in industries such as automobiles and personal computers.

In its purest sense, when engaged in foreign-market assembly operations a manufacturing company exports all or most of its product in a 'knocked-down' condition. That is, the various components or parts of the product are exported. At the foreign assembly site these parts are then put together to form the complete product.

When a product is exported in this manner in large quantities some potential cost savings may be realized (relative to what the costs would be if the item exported was the complete product). Often freight charges and various foreign government fees are lower; and in some countries for certain products Customs duties are frequently less for component parts than for the complete product. There is a cost saving in manufacturing at the home plant, especially costs permitted by automation or economies of scale. On the other hand the assembly operation may be labor intensive and lower wages abroad may permit a cost reduction. In addition to being cheaper, a company may prefer assembly because it allows most of the production, value added, and technology to remain at home where it can be better controlled.

Of course not all of this cost saving is realized by a manufacturer in the form of greater profit. The costs incurred in assembling the product at the overseas site may offset some, all, or more than the saving associated with this type of export. In addition, overseas assembly operations require a capital investment, although generally it will be much less than that needed to operate a branch manufacturing plant. For various reasons some of the component parts may have to be sourced either in the country where the assembly operation is located or in some other foreign location.

There is a certain amount of flexibility in foreign assembly that can be turned into a cost saving. By assembling its product overseas, a manufacturer is in a position to buy some of its manufactured components from local low-cost sources of supply. In fact it may be forced into using these sources if the nature of the foreign market requires that it modify its product in such a way that key component parts with the necessary operating characteristics are not normally available in its home country. From a cost point of view, therefore, it may be better for the manufacturer to export its product (either as components or as a semi-complete unit) and assemble it in the foreign market using parts from local sources than it would be to try to export a complete product by either importing the necessary parts, manufacturing them, or arranging for another firm in the home country to produce them. To illustrate, a German manufacturer of small appliances will have to modify its products when the foreign market uses 110 volt current. This will have an effect on the components to be put into the appliances. Under certain conditions this manufacturer will find it advantageous to assemble the product overseas, using components manufactured in the country where 110 volt current is being used.

Assembly overseas can, under the right conditions, be turned into a useful marketing tool. Much depends upon whether the assembly facility is regarded by the potential customers as being a national or indigenous company of the country in which it is located. This can be extremely important in those countries where there is a fervor of nationalism that leads to favoring national companies over foreign companies.

Nationalism can also exert its influence through foreign government attitudes and policies. Local assembly may satisfy the government so long as some local employment is created or a certain share of the finished product's content is of local origin. This, however, might indicate the need to eventually establish a full manufacturing operation, as some companies have found out!

Another dimension of government that can influence where an assembly facility is located is the tax code and the tax bureaucracy that goes along with it. This situation in Russia, together with the risks associated with the crime status there, led the Taiwanese firm Acer Computers to establish its assembly facility for serving the Russian market in Finland in the mid-1990s. In addition to a relatively short time from start of assembly to being available in the marketplace, locating in Finland had the advantage of a special customs regime tailored to firms trading with Russia allowing them to bring in goods from outside the European Union and reexporting them to Russia with a minimum of formalities. Acer maintained a representative office in Russia. The products were to be sold to Russian distributors at the factory gate in Finland. These distributors had to arrange for the import into Russia. An incidental benefit to Acer was that Finnish assembly would make the product more desirable to Russian buyers than assembly in Russia would have done.

Whether by choice or by pressure applied from outside, foreign-based assembly may represent one stage in the evolutionary process of a manufacturer changing from a domestic-oriented company to a truly multinational marketer.

Foreign assembly points can be an integral part of a multinational or global manufacturer's worldwide marketing organization and can be tied directly to manufacturing plants, wherever these plants are located. Although foreign assembly costs much less than establishing a basic manufacturing facility, an assembly plant will not be good for every manufacturer or product. However, even when this type of operation has no production cost advantages, the needs of the local market for product variations may make it desirable to assemble locally. In addition, one assembly plant can serve many nearby markets. If this is the case, then a manufacturer might find it advantageous to locate its foreign assembly facility in a free area. Whether this is practical, of course, depends upon relative tariff rates of the markets to be served by this facility.

An approach to assembling automobiles involving modular assembly is being used by Volkswagen and General Motors in Brazil. Both companies have their suppliers located at the assembly site where they manufacture their components. In the case of Volkswagen the employees of seven main suppliers are attaching their components to the cars on the assembly line. In short, they are directly involved in the final assembly of finished trucks and buses (*Businessweek*, 1996). In contrast, the suppliers at the GM facility deliver pre-assembled modules to GM's line workers, who then piece the car together (Wheatley, 2000). In both cases these plants are viewed as potential models for assembly plants throughout the world.

Strategic alliances

Nature of strategic alliances

Licensing, contracting, and joint ventures are three types of activity between companies from two or more countries that have come to be known as *strategic alliances*. Other types include R&D consortia and partnerships, cross-marketing agreements, cross-manufacturing agreements, and cross-distribution agreements. Strategic alliances involve equity or non-equity commitments by the partners, as shown in Figure 9.5. Equity block arrangements are similar to joint venture except that a new company has not been created. Rather one company buys a share of another. This has been discussed earlier in this chapter. All these can be considered strategic marketing alliances as they enhance marketplace leverage. Such alliances are increasing in incidence and will be prominent through the second decade of the 2000s as a way to operate in global markets. Examples are as follows: Boeing joined with the Japanese companies Mitsubishi, Fuji, and Kawasaki Heavy Industries to develop, manufacture, and market a small jet aircraft; AT&T, KDD of Japan, Singapore

	Equity commitments	Non-equity commitments
Dyadic relationships	Joint ventures with two partners Equity block ownership	Licensing Franchising Supplier agreements Outsourcing R&D partnership Marketing partnership
Multiple relationships	Joint ventures with multiple partnerships	Networks Community of firms

Figure 9.5 Types of strategic alliance

Source: Adapted from Culpan, 2009, p. 8.

Telecom, and other Asian telephone carriers formed World Partners; British Telecom and MCI Communications formed Concert, which has distribution agreements with Norwegian Telecom, Tele Danmark, Telecom Finland, and Nippon Information & Communication; Korea's Samsung is acquiring technology from Japanese companies such as Fujitsu, Toshiba, and NEC. IBM and Germany's Siemens are sharing technology with Toshiba in its development of advanced, new generation semiconductors. As these examples show, alliances are formed between companies that can complement each other as well as companies that are competing in certain products, markets, or both. Such alliances are a necessity. There are so many different technologies changing the basis of competition in numerous industries, and changes occur rapidly, that no country, much less any single company is self-sufficient any more. Hence there is a recognition that sharing costs and resources has become a necessity and that marketing and distribution partnerships can be very attractive under the right conditions. Indeed, licensing and joint venture have been around for a long time. It is the label 'strategic alliance' that is relatively new.

There are many definitions of strategic alliance. Some examples are as follows:

- A business arrangement in which two or more firms choose to cooperate for their mutual benefit (Akoorie and Scott-Kennel, 2005, p. 379).
- Collaborations between firms in various countries to exchange or share some value-creating activities (de Búrca *et al.*, 2004, p. 240).
- Linkages between companies from different countries to jointly pursue a common goal that have the following characteristics: independence of participants, shared benefits, and ongoing contributions in technology, products and other key strategic areas (Keegan and Green, 2000, p. 324).

A fundamental purpose of an international, or global, strategic alliance is to enhance the long-run competitiveness of the strategic partners. Such an alliance is founded on a belief that each party has something unique to contribute, for example technology, managerial know-how, market access. This requires that power and control be shared in the interest of mutual benefit. For example, in 2003 the British oil company BP and the Russian conglomerate TNK formed a joint venture, TNK-BP, which became one of the largest oil companies operating in Russia. BP offered its market power in the world and technological know-how, while TNK had vast oil reserves in Siberia (Ekin and King, 2009).

Very broadly, the following advantages from interfirm agreements such as strategic alliances have been identified by Gugler (1992, p. 91):

- sharing of the large investments needed for specific activities such as in R&D;
- access to complementary resources such as technologies;
- accelerating return on investment through a more rapid turnover on the firm's assets;
- spreading of risks;
- efficiency creation through economies of scale, specialization and/or rationalization;
- coopting competition.

Any strategic alliance has certain core dimensions. If any of these are lacking, problems can arise and there can be conflict between individual company goals and alliance goals. These interrelated core dimensions are as follows (Spekman and Sawhney, 1990, pp. 6–9):

- *Goal compatibility*: each party's goals must be compatible to the extent that both alliance and individual party goals can be achieved.
- *Strategic advantage*: there must be a perceived benefit.
- *Interdependence*: each partner will be dependent upon the other and the relationship must be managed such that conflict is held to a minimum while cooperation emerges victorious.
- *Commitment*: trust is crucial to the long-run viability of an alliance and is vital to the pledge of relational continuity between partners that underlies commitment.
- *Communication and conflict resolution*: partners need to communicate with each other and there is a need to have a mechanism, other than legal, to resolve conflicts that inevitably will arise.
- *Coordination of work*: it is clear that work among the partners be coordinated without a bureaucracy and costs of ownership.
- *Planning*: the first things to plan are the structure and processes of exchange; then the substance of exchange can be tackled.

Other principles for success are illustrated in Exhibit 9.4, which looks at the auto industry in Asia. A key issue in partner selection is the degree of possible fit to the other partner's profile. The ideal partner for, say, a UK company may very well differ from that for a medium-sized Chinese company, or a small US high-technology company. The dimensions of fit are *strategic* (Murray and Kotabe, 2005), *resources*, *organizational* including management styles, and national and corporate *culture* (Dong and Glaister, 2007). Holmberg and Cummings (2009) discuss partner fit in service-business alliances. The discussion presents a strategic management-based industry and partner selection process, and a dynamic partner selection tool for evaluating target industries and specific firms, which is applicable to multiple alliance and industry contexts.

There is a wide range in complexity of strategic alliance relationships. On the one side there are the relatively 'simple' alliance structures as illustrated by the Star Alliance of United Airlines, Lufthansa, SAS, Thai and other airlines, where they coordinate schedules (including flight code sharing), marketing, joint facilities, and other amenities for passengers. At the other extreme are very complex networks involving many partners such as the alliances the large Dutch electrical and electronics company Philips had in the early 1990s with 36 foreign companies. Entire industries may be affected by strategic alliances such as

Exhibit 9.4 How to succeed in a joint venture/strategic alliance

There have been many international joint ventures in the automobile industry. Often they did not make much profit. Because of that, and for other reasons as well, there have been dissolutions of the venture.

There is a major exception: Ford–Mazda. Their more than 30-year collaboration has weathered disagreements about specific projects, trade disputes between Japan and the United States, and allegations that Mazda and other Japanese companies engaged in dumping practices for mini-vans exported to the United States.

Ford and Mazda cooperate on new vehicles and exchange valuable expertise – Ford in international marketing and finance, Mazda in manufacturing and product development. For Ford, the payoff has been partly in the form of sales. But the alliance also taught Ford some practical lessons that it applied elsewhere in its business.

A major question is, why was this alliance the success it was? According to the presidents of the two companies there are seven principles that have been followed (*Businessweek*, 1992):

1. **Top management must be continually involved:** Top management must set a tone for the relationship. If not, lower-level managers will resist sharing control of a project with a partner.
2. **Meet frequently, and often informally:** Meetings should occur at all levels and should include time for socializing. This is essential for building trust.
3. **Use a matchmaker:** A third party can mediate disputes, suggest new ways of approaching the partner, and be an independent 'listener.'
4. **Maintain independence:** Independence helps both partners to sharpen the areas of expertise that made them desirable partners in the first place.
5. **Allow no 'sacrifice' deals:** Every project must be viable for each partner. It is top management's responsibility to ensure that an overall balance is maintained.
6. **Have a monitor:** Someone must have the primary responsibility for monitoring all aspects of the alliance.
7. **Anticipate cultural differences:** They may be corporate or national. All parties should be flexible, and should try to place culturally sensitive managers in key posts.

The principles really are quite simple!

that for the semiconductor industry, and the telecommunications industry. Another example is the airline industry. In 2002 there were five alliances in operation: Wings (including KLM and Northwest), Qualiflyer, Star, Skyteam and Oneworld. By 2009 there were only three left: Skyteam, Star, and Oneworld (de Man *et al.*, 2010). As of 2016 the most significant alliances are Star alliance, SkyTeam, Oneworld, Etihad Airways Partners, and the world's first low cost airlines alliance U-Fly. The managing of strategic alliance portfolios by multinational companies is discussed by Vapola *et al.* (2010). These researchers show that portfolios of such companies differ significantly with respect to partner integration and partner heterogeneity. Moreover, the choice regarding the management of alliance portfolios depends on the multinational company's international strategy.

Strategic alliances are not static. They can be changing all the time. For example, the joint venture between Ford and Volkswagen established in the 1980s to service the Brazil and Argentina markets was dissolved in the mid-1990s. Another example comes from the global telecommunications industry. Telefónica de España, the largest communications provider in Latin America, and AT&T have both left an alliance with smaller European telecoms known as Unisource to pursue other interests. The major problem with telecommunications alliances has been that partners are wary of integrating operations and sharing competitive information. Companies do not want to give up control of resources. Sometimes alliances are changed due to pressures from stockholders, customers, government policy, and other 'outside' pressures. In 1996 PepsiCo severed all ties with its Burmese (Myanmar) bottler and all production and distribution of its products ended. The company stated that it took this action in recognition of US policy toward Burma and in deference to the desires of many shareholders and customers. In other instances alliances fail due to slow sales growth. For example, in March 2003 Starbucks Corp. ended a joint venture in Switzerland and Austria by buying out its partners. In a very few years the BP/TNK joint venture became unstable, primarily because of the differences in economic motives and cultural orientations of the partners (Ekin and King, 2009). In 2008 this instability led to a change in management and a restructuring of governance.

Licensing

In the broadest sense, licensing is a method of foreign market operation where a company in one country (the licensor) enters into a contractual agreement with a company or person in another country (the licensee) whereby the licensee is given the right to use something owned by the licensor. A license usually involves one or more of the following:

- technology, know-how, manufacturing processes (patented and nonpatented);
- trademark, brand name, logos;
- product and/or facility design;
- marketing knowledge and processes;
- other types of knowledge and trade secrets.

The French designer, Pierre Cardin, has licensed his name to more than 800 products, from clothing to luggage to socks and even pens.

In his research monograph, Contractor (1985) recommends to corporate planners and strategists that they view a license as a strategic wedge where technology can be the centerpiece around which other modes of business can be built. He suggests that a broader package might include, in addition to a technology license, any of the following elements: turnkey plant, supply of components to the licensee, contract assembly or production for third countries, guaranteed 'buy-back' in lieu of cash, management service, and so forth.

Where a branded or named product or service is involved, the licensee is responsible for marketing in a defined market area. Along with this responsibility go all the profits and risks associated with the venture. In exchange, the licensee pays the licensor royalties or fees, which are the licensor's main source of income from its licensing operations, and which usually include the following: *Initial payment, annual minimum, annual percentage fee, and at times additional fees*.

A license agreement may also be one of *cross-licensing* wherein there is a mutual exchange of knowledge and/or patents. In cross-licensing there may or may not be a cash payment involved.

Licensing is a cross between exporting and direct investment and involves a little of each. The licensor exports whatever the agreement is concerned with, but this export is in effect an investment.

A special type of licensing should be distinguished – *franchising*. Franchising is really incomplete licensing. In licensing, the licensor allows a foreign company to manufacture a complete product whereas in a franchise agreement the franchisor usually supplies an important ingredient (part, material, and so on) for the finished product. Franchise agreements are perhaps best known in the nonalcoholic beverage and retail fast food industries. For example, Coca-Cola has a worldwide network of franchised bottlers and supplies them with the syrup needed to produce its product. In the fast food field McDonald's golden arches are to be found throughout the world, including Russia and China. Similarly, Kentucky Fried Chicken (KFC) and Pizza Hut are found worldwide. Starbucks appears in many countries, including China. In many countries franchising will be combined with a joint venture. The situation is not static. What is happening in China is a good example of this. McDonald's has now opened more than 2,500 restaurants in China; KFC and Pizza Hut have expanded their menus (Einhorn and Cheng, 2010). Yum Brands is the parent company of Taco Bell, Pizza Hut, and KFC in China. The plans of Yum Brands to open more than 700 new stores across China have been hit by the meat scandal. A supplier of meat sold expired meat to the fast food giant. While not a major supplier to Yum foods, perception is everything, and building trust is crucial in the Chinese market after a series of scandals.

Objectives and evaluation

Most companies have one or more of the following basic objectives in mind when they negotiate a license agreement and use licensing as a method of penetrating foreign markets:

- Obtaining revenue from company-owned patents, trademarks, and accumulated know-how.
- Gaining some tactical or strategic advantage in marketing its products in foreign markets.
- Acquiring reciprocal know-how and research developments from foreign companies.
- Gaining a foothold in the market to be used at a later date for a move into other types of foreign-market-based marketing activity.
- Entering a market per se, or remaining in a market when conditions (including government action) make export undesirable or impossible.
- The company wants to have a foreign-market production presence but does not want, or may not be able, to make a capital investment.
- Contributing to economic development where needed.

Licensing offers many potential benefits to the licensor; at the same time, though, there are significant potential drawbacks. Probably the basic advantage in licensing as contrasted to other approaches is the ease and low cost of entering a foreign market. Large capital outlays are avoided as well as the expense of tying up personnel and production at home to satisfy unstable foreign markets. The licensor, in effect, uses the licensee's management, capital equipment, and knowledge (of the market and working environment) to exploit whatever markets are served by the licenses; royalty income can then be viewed virtually as a return of the technology alone. Thus, this method is particularly well suited to a small-sized manufacturer and others with limited financial and labor resources. For example, one of the reasons that Gerber Products Company, a manufacturer of baby food, entered the Japanese market through licensing when it did was that the company had a staffing problem; the company did not have enough bilingual people to operate a foreign subsidiary. Licensing is also advantageous in that it can be used to test a foreign market without the risk of capital loss should the market not be receptive to the manufacturer's product.

On the other hand, the greatest disadvantages to the licensor are that a potential competitor is set up, there is a lack of control over production and marketing, there may be incomplete market exploration, and there could be a loss in flexibility since it is often difficult to coordinate a licensee into a worldwide marketing plan. There are, of course, methods that a licensor can use to minimize the chances that a licensee will become a potential competitor. In the first place, if the arrangement is very profitable to the licensee, he or she will probably want things to remain as they are. Second, an option to buy into the licensee's company can be beneficial, and often rewarding if the operation is highly successful. This allows the licensor to become a partner, and the licensee is less likely to want to dissolve the agreement. Finally, probably the best way to maintain control and keep the arrangement intact is through marketing, particularly through innovation and product development. A somewhat different view of power and control in franchising is shown in Exhibit 9.5. That is, the best way to keep a licensee happy and under control is to provide him with a continuing flow of innovations and product features or know-how that surpass what he could do personally. In this way the licensee receives something valuable on a continuing basis in return for the royalty that must be paid. In addition, allowing the licensee to try his or her own innovations may be beneficial to both parties. As an illustration, when McDonald's opened its first location in Egypt in the mid-1990s, its local licensee suggested adding delivery after noticing that other fast food chains did so. Today, almost all of McDonald's restaurants around Cairo deliver. Delivery service has been introduced to more than 20 additional cities in the world including Taipei, Shanghai, Manila, and Montevideo (Arndt, 2007).

The importance of viewing a licensing agreement in the light of its short- and long-term implications to a company both at home and abroad cannot be overemphasized. To illustrate, consider the experience of one US company that initially exported to foreign markets. As the markets grew, local competition appeared. To combat this competition, the US company entered into a licensing arrangement with a leading European manufacturer. Extensive provisions for transmitting know-how were incorporated in the agreement.

Exhibit 9.5 Power and control in international franchising

There are different sources of power in a franchise arrangement and different ways to exercise control. In the traditional view power is exerted through either the contract between franchisor and franchisee or through support provided for the franchisee by the franchisor. However, there is organizational power and relationship power as well. Many of the complications and lack of control that can arise from managing too many partners in one country or region, such as in international retail franchising, can be avoided by use of master or area franchising. The nature of power and control in international franchising in retailing is discussed by Doherty and Alexander (2006).

As foreign markets for the product became larger than the domestic market, the US company found itself blocked in planning any overseas expansion by its agreement to share design and production developments with what would be its European competitor. Furthermore, the European licensee had lower production costs than its licensor. The final blow came when the licensee set up its own marketing outlets in the United States and began to compete in the home market of the very company that had supplied it with know-how in the first place.

One final comment. All licensing agreements must have provisions for handling disputes between licensor and licensee, perhaps even allowing for arbitration. In addition, the conditions under which the licensor or the licensee can terminate the agreement must be specified, including what happens to any trademarks, patents, sublicenses, or other forms of intellectual property.

Contracting

In addition to licensing and franchising agreements, other contractual entry modes are *contract manufacturing* and *management contracting*. We discuss each briefly.

Contract manufacturing

This approach to foreign market entry is a cross between licensing and direct investment. A company contracts for the manufacture or assembly of its product(s) by manufacturers established in foreign markets, either targeted for sales there or elsewhere while still retaining the responsibility for marketing and distributing its products. Often the contract will call for a transfer of technology and provide for technical assistance to the foreign-market-based manufacturer. Despite any transfers, this method of foreign market entry is purely a sourcing activity. In the personal computer industry in mid-1996, for example, Taiwan's Acer delivered a large number of its products to other computer makers such as Apple, which were sold under the buyer's brand names. With the exception of Dell Computers, most of the world's personal computer manufacturing is handled by six Asian contractors (Malik, 2003). On a broader scale, the largest electronics manufacturer in the world, Taiwan's Hon Hai Precision Instrument Co., is a contract manufacturer, with sales in 2008 totaling US$59.4 billion. Hon Hai manufactures such products as Apple's iPod and iPhone, Sony's PlayStation, Nintendo's Wii, Hewlett-Packard printers and PCs, and thousands of other electronic gadgets (Einhorn, 2007).

As with all methods of serving foreign markets, contract manufacturing has its advantages and disadvantages. Although the disadvantages appear to be quite formidable, for many companies they are far outweighed by the advantages. Some of the major advantages are as follows:

It requires minimum investment of cash, time, and executive talent – particularly desirable where the market is risky – and permits rapid entry into a new market.

- It gives control over marketing and after-sales service and protects a trademark.
- It avoids currency risks and financing problems.
- It is particularly desirable where a local production base is needed (that is, inside tight controls or high tariff barriers, or where the government requires local manufacture) but the size of the market does not warrant an investment.

- It allows labeling a product as 'locally made,' which is beneficial where nationalistic feelings are strong.
- It avoids intracorporate pricing problems that can arise with a subsidiary, foreign branch, or joint venture.

There are some potential drawbacks that must be acknowledged. First, the profit from manufacturing is transferred to the contractor. Second, like licensing, it trains a potential competitor that will have the know-how to manufacture a high-quality product. This is especially true when the agreement calls for exchange of research and know-how (which may sometimes benefit both companies). One answer is to develop better products constantly so that the contract manufacturer will not want to compete with only the old products and will extend the relationship. Third, it is often difficult to find a satisfactory manufacturer, and even then a transfer of technology may be required. Fourth, again as with licensing, there is little control of manufacturing quality, other than refusing to accept products that do not meet specifications. Finally, since many contract operations are done in developing countries, critics claim that workers are being exploited by low wages, poor working conditions, and no benefits. In China, where there is abundant cheap labor, plenty of engineers and good infrastructure, the charge has been made that subcontractors use prison labor, or that workers in other cases are mistreated by employers. In short, claims are made that so-called 'sweat shops' are being used. Often such claims are made by persons using a self-reference criterion and applying the employment situation in their own, usually a developed, country as a baseline. Companies such as Walmart, Adidas-Solomon, Disney, Mattel, and Reebok have been singled out. While such claims may have validity in some instances, in others it has been shown that workers are better off than those working for domestic employers not doing contract manufacturing. Still, those companies using Asian contract manufacturers have developed codes of conduct for their suppliers and have developed monitoring systems from self-policing to hiring outsiders (*Businessweek*, 2000b; *The Economist*, 1999).

This method allows a company to have foreign-based sourcing without making a final commitment to establish both complete manufacturing and selling operations; yet the way is kept open for implementing a long-term foreign development policy when the time is right. These considerations are perhaps most important to the company with limited resources or wanting to measure more accurately the long-run profit potential of various foreign markets. Contract manufacturing allows a company to at least gain a beachhead with minimum risk when foreign markets are being more thoroughly evaluated. Thus, if it decides to enter a market permanently where it has previously contracted manufacturing, a company can do so with less difficulty and cost because competitive products would not be as firmly entrenched as they could be in the absence of such a contract arrangement.

Many firms that manufacture for other companies will ultimately develop and manage their own brands. The success of own-brand management is affected by learning from the key buyer, learning from the key subsidiary, and the firm's cultural heritage identity. A study by Horng and Chen (2008) found a positive relationship between own-brand management performance and learning from the key subsidiary and one's own cultural heritage identity. Interestingly, there was a negative moderating effect of identity on the relationship between learning from the key buyer and own-brand performance.

Companies within the same industry do not always follow the same strategy regarding production. The retail clothing industry is a good example. Sweden's Hennes & Mauritz (H&M) outsources its production to suppliers in Europe and Asia, the US's Gap outsources all production, but Spain's Zara has the bulk of its production handled by the company's own manufacturing facilities in Spain.

Outsourcing/offshoring

Contract manufacturing is a form of outsourcing or offshoring. The major country for outsourcing in the first decade of the 2000s has been India, particularly for services. China has been the world's top location for contracting-out manufacturing, and services outsourcing to China has also been growing rapidly (*The Economist*, 2006). During the period that services outsourcing to China has been growing, its advantages as a source for manufacturing outsourcing have been eroding. Labor and currency costs have contributed to this situation (Engardio, 2009).

By the year 2010 the United States had become a major site for services outsourcing of workers to provide tech support, software programming, and other services. On a broader scale, outsourcing has become a global phenomenon as Western countries are spreading their offshore/outsource business in many places, including Central and Eastern Europe. Table 9.3 shows rankings of different countries, based on attractiveness for outsourcing. As shown, cost (financial attractiveness) has been a major factor for a company in selecting where to outsource. Surveys conducted by the Outsourcing Institute have consistently shown that the five most important criteria used by companies in choosing a vendor abroad are (in order): price; commitment to quality; flexible contract terms; references/reputation; scope of resources (www._outsourcinginstitute.com/oiindex/keyfactors.html, accessed 6 July 2010). What is a favorite outsourcing spot today may not be so tomorrow. An example, of course, is China's moving up on India in services, and China's moving down in manufacturing. Vietnam may be next in moving up (Balfour, 2006).

Companies are increasingly viewing outsourcing within the context of lean production and global supply chains. Companies practicing lean production, often called just-in-time production, emphasize elimination of waste and improvement of quality (Mefford, 2010, p. 304). The apparel and footwear industries (and others as well) provide good examples. The normal practice in these industries is to use outsourcing vendors in other countries that offer the lowest price, while meeting minimal quality and delivery requirements. As costs and exchange rates change, frequent switching of suppliers occurs. Such a supply chain strategy is performed by multinational companies in so-called simple manufactures, such as the previously mentioned apparel and footwear industries as well as toys and small appliances (Mefford, 2010, p. 305). Often the suppliers, who typically are subcontractors, have sweatshop conditions in their factories including using child labor, low wages, long hours without overtime pay, etc. Exhibit 9.6 discusses sweatshops in the United States in services outsourcing.

The interest in, and importance of, outsourcing can be illustrated by the recent research that has been reported on various facets of the practice. For example, entire issues of journals (*Journal of International Management*, June 2009, 15(2)) or major sections of issues (*Journal of International Business Studies*, August 2009, 40(6); *Industrial Marketing Management*, 2009, 38(4)) have been devoted to this topic. A study has examined the

Table 9.3 A. T. Kearney Global Services Index

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total
1	India	3.13	2.48	1.30	6.91
2	China	2.59	2.33	1.37	6.29
3	Malaysia	2.76	1.24	1.97	5.98
4	Thailand	3.05	1.30	1.41	5.77
5	Indonesia	3.23	1.47	0.99	5.69
6	Egypt	3.07	1.20	1.37	5.64
7	Philippines	3.19	1.17	1.24	5.60
8	Chile	2.41	1.20	1.89	5.50
9	Jordan	2.99	0.91	1.59	5.49
10	Vietnam	3.21	1.02	1.24	5.47
11	Mexico	2.48	1.50	1.45	5.43
12	Brazil	2.18	1.83	1.37	5.39
13	Bulgaria	2.83	0.89	1.62	5.34
14	United States	0.47	2.71	2.15	5.33
15	Ghana	3.26	0.70	1.36	5.32
16	Sri Lanka	3.13	0.95	1.17	5.25
17	Tunisia	2.86	0.91	1.45	5.22
18	Estonia	2.06	0.93	2.20	5.19
19	Romania	2.63	0.91	1.58	5.12
20	Pakistan	3.12	1.08	0.91	5.11
21	Lithuania	2.31	0.81	1.99	5.11
22	Latvia	2.28	0.86	1.96	5.10
23	Costa Rica	2.67	0.89	1.50	5.07
24	Jamaica	2.77	0.79	1.49	5.06
25	Mauritius	2.32	0.95	1.77	5.04
26	Senegal	3.06	0.88	1.08	5.03
27	Argentina	2.47	1.34	1.21	5.02
28	Canada	0.54	2.10	2.38	5.02
29	United Arab Emirates	2.10	0.84	2.04	4.98
30	Morocco	2.62	0.93	1.42	4.97
31	United Kingdom	0.43	2.13	2.39	4.94
32	Czech Republic	1.74	1.14	2.07	4.94
33	Russia	2.39	1.45	1.08	4.92
34	Germany	0.42	2.10	2.40	4.91
35	Singapore	0.72	1.55	2.62	4.90
36	Uruguay	2.46	1.00	1.43	4.89
37	Hungary	1.95	1.01	1.92	4.88
38	Poland	1.82	1.22	1.73	4.77
39	South Africa	2.28	1.02	1.44	4.74
40	Slovakia	2.05	0.94	1.75	4.73
41	France	0.40	2.03	2.29	4.72

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total
42	Ukraine	2.63	0.97	0.99	4.58
43	Panama	2.48	0.70	1.40	4.58
44	Turkey	2.01	1.23	1.29	4.54
45	Spain	0.57	1.90	2.00	4.47
46	New Zealand	1.12	1.18	2.15	4.45
47	Australia	0.42	1.62	2.22	4.26
48	Ireland	0.27	1.56	2.26	4.09
49	Israel	0.85	1.39	1.78	4.02
50	Portugal	1.00	1.00	1.97	3.98

Note: The weight distribution for the three categories is 40:30:30. Financial attractiveness is rated on a scale of 0 to 4, and the categories for people skills and availability, and business environment are on a scale of 0 to 3.
Source: The Global Services Location Index, A. T. Kearny, copyright 2009, p. 2.

Exhibit 9.6 Inside the sweatshops

Unfortunately, not all outsourcers are honest. There are companies that recruit workers from abroad to provide tech support, software programming, and other services. This has been increasing in the United States, for example, where some tech services companies operate a type of sweatshop (Hamm and Herbst, 2009). Following are some of the ways that workers from abroad are hurt, and how some tech service outsource companies violate United States work-visa regulations.

Inside the sweatshops

Pay-to-play recruiting

Workers from abroad need companies to sponsor them for the visas necessary to come to the US. So some tech services companies take advantage by demanding exorbitant fees in exchange for sponsorship. Such fees, which can be as high as $15,000, are illegal.

Résumé inflation

Tech companies also pressure workers to make inflated claims about their education and on-the-job experience. That makes it easier for workers to get visas reserved for the highly skilled, and it allows the companies to charge corporate clients higher fees for their service.

Payroll running

In some cases, tech companies that can't find legitimate jobs for visa holders force them to seek employment on their own. Then the companies, which hold the workers' visa documents, use that leverage to extract a cut of their wages – which also is illegal.

'Benching' without pay

When guest workers are between assignments to clients, or 'on the bench,' their visa sponsors are required by law to keep paying them. But some don't. Workers on the bench are often forced to hunt for assignments themselves and live off their savings.

How the system works

The worker

Indian software programmer Prasad Nair moved to the US in 2008 on a work visa. He claims he was offered a job in Michigan at a salary of $60,000, plus medical insurance and travel expenses.

The sponsor

United Business Technologies in Troy, Mich., sponsored Nair's visa, but, he claims, forced him to sign a new contract requiring him to pay visa and travel costs. UBT denies any wrongdoing.

The staffing agency

UBT sent Nair to a tech services outfit, Larsen & Toubro Infotech, to find him a job. Larsen & Toubro, which is not accused of any wrongdoing, declined to comment for this story.

The client

Larsen & Toubro placed Nair in a job in the San Diego offices of tech giant Qualcomm. He claims UBT, his official employer, paid him less than the prevailing wage. UBT has countersued Nair for failure to give proper notice when he quit and for defamation. Qualcomm and Larsen & Toubro are not accused of any wrongdoing.

Source: Adapted from America's high-tech sweatshops, *Businessweek*, 12 October, pp. 34-9 (Hamm, S. and Herbst, M. 2009), Bloomberg, Reprinted from 12 October 2009 issue of Bloomberg Businessweek by special permission, copyright © 2009 by Bloomberg L.P.

research and practice of outsourcing during the past 30 and more years, and indicates what the future may hold (Hätönen and Eriksson, 2009).

Management contracting

In management contracting the international marketer operates a company in a foreign market for a local investor of the country in which the company is located. The local investor provides the capital for the enterprise, while the international marketer provides the necessary know-how to manage the company. The agreement between the two parties may give the international marketer an option to buy all or a part of the newly created company. A good illustration of this type of arrangement is the Hilton hotel system. Hilton manages hotels throughout the world.

A specialized form of management contract is the *turnkey operation*. Such an operation typically calls for the construction of a plant, training of personnel, and the initial operation of the plant for a local investor. The client, in essence, acquires a complete operational system together with the skills and abilities to operate the system following its completion and initial operating experience.

For the 'outside' firm the use of management contracts as a mode of entering foreign markets offers a low-risk way into a foreign market, if used with some type of purchase option. It allows a company to manage, and in many ways control (in a functional sense), another company without equity control or legal responsibility. There is a 'guaranteed' minimum income from a joint operation, and unlike other types of joint foreign operations the return is quick. Also, exchange or other types of remittance controls are often avoided. Finally, a management contract arrangement establishes clarity in administration and decision-making. By so doing, it tends to minimize the disputes that can arise between the partners in a joint operation, which can be a major problem in other forms of joint foreign operations. Thus the need for arbitration is lessened, which is a real advantage, since arbitration is usually very costly for all concerned, causes bad feelings among the parties involved, and seldom satisfies either side.

From the point of view of the international marketer, there are some important drawbacks to using management contracts. In the first place, the contract itself is a complex, expensive legal document, which must differ for each case. Because it is complex, many potential problem areas cannot possibly be foreseen in advance and these may lead to disputes and legal questions at a later time. More importantly, a management contract arrangement can limit future management and investment decisions depending upon the terms of the contract and the possibility of a conflict of interest arising. The international marketer is bound by the contract, which may not allow it to set up its own operations for a period of time, if at all. Finally, since the international marketer has to supply personnel to operate the local company, this can hinder the firm's other operations if there is a shortage of qualified management personnel available.

There is a resource investment involved – time, personnel, and managerial know-how. All of these are scarce. Consequently, a proposal for management contracting must be evaluated in light of the overall long-term objectives of the firm. This is of especial importance to an international marketer with a long-term interest in a particular foreign market. If there is no purchase option, or if it appears that the company should not exercise its option when one exists, then a potential formidable competitor has been set up. When the company finally decides to enter the market in its own way, the difficulty and cost of doing so will be that much greater.

Joint venture

As a way of engaging in international marketing by foreign production, joint ventures are quite popular. In some foreign markets this may be the only way to enter, except under very special circumstances. Joint ventures are favored by developing countries in general, but are widely used in developed countries as well.

There is a problem in defining just what is meant by joint venture. Certainly, the basic concept in the joint venture is that of partnership, which has two sides – *technical* and *emotional*. On the technical side, there is a joining of contributions; on the emotional side, there is a feeling of cooperative effort.

In the widest sense, any form of association that implies collaboration or cooperation for more than a very transitory period comprises a joint venture. For the purposes of this book at this time, we include only those ventures that involve the sharing of ownership and control in an economic enterprise. Moreover, it will be recalled that earlier in this chapter we defined a joint venture as occurring when companies from at least two different countries, generally one being local, form a *new company* to manufacture/produce products or provide a service on a joint basis. Excluded are other types of shared ownership, especially those involving an acquisition by one company of most or only a part of another company. Much of what was said about shared ownership is applicable to joint ventures as well. Furthermore, many of the advantages of the other types of strategic alliances are applicable, as are drawbacks and limitations.

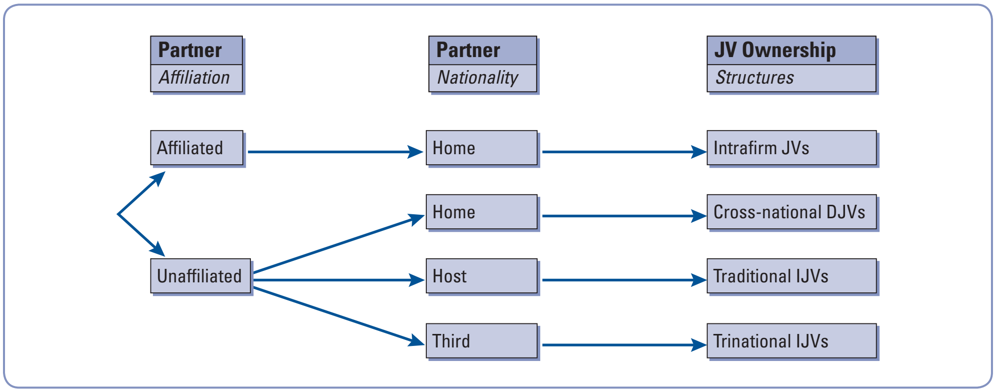

Figure 9.6 **Joint venture ownership structure options**

Source: Makino and Beamish (1998), p. 801.

One approach to identifying the ownership structure of international joint ventures (IJVs) is proposed by Makino and Beamish (1998). Using partnership nationality and partner affiliation, four distinct types of joint ventures are shown in Figure 9.6.

In this schema, home country refers to the foreign company and host country refers to the country where the joint venture is to be located and operated. The traditional IJV is where a foreign company joins with a local company in the market, and the two companies are not affiliated in any other way. This is a useful schema as it identifies joint ventures in a foreign market where neither of the partners are local (cross-national domestic joint ventures (DJVs) and trinational IJVs). There has been limited empirical research done on so-called nonresident-firm-based joint ventures.

Joint ventures may be either specialized ventures or shared value-added ventures. Specialization ventures are generally organized around functions such as marketing or manufacturing. Each partner adds something unique that adds value – for example, one partner designs products while the other produces them. In shared-value ventures, partners equally engage in value-adding activities. Often, joint ventures are created so that one company can acquire marketing know-how from its foreign partner. This knowledge transfer can be affected by certain organizational factors: (1) international joint venture management characteristics such as management commitment and teamwork, and (2) matching factors which bind the partners in an international joint venture, including relationship strength and cultural distance between the partners (Evangelista and Hau, 2009).

Every potential joint venture must be evaluated on its own merits. No categorical statement can be made concerning whether an international marketer should adhere to a policy of engaging in joint ventures. However, certain general comments can be made, which can point out possible conditions that should be considered by a firm in evaluating proposed projects.

Joint ventures are sometimes the best way to get started in an overseas market because they allow a company with limited capital and labor resources to enter more overseas markets than would be possible if the company established subsidiaries. Because of the resource savings and the potential ability to enter more markets, business risks can be minimized. Risk is also minimized because management skills and experience from a local partner allow easier adaptation to the particular dangers of an unfamiliar business environment.

Moreover, risks are reduced because the project is generally less subject to the danger of adverse action by the host government. Sales and profits of the joint venture may be greater than those of a subsidiary, because the operation is looked upon with more favor by nationalist-oriented consumers than would be the case if it were considered a foreign operation.

While there are significant potential advantages associated with using joint ventures, there are potential limitations as well. The profit potential may be less, because all profits must be shared. Also, there are many things that can lead to disagreements between the partners, such as a dispute over dividend policies or differences in management philosophies. In short, many international joint ventures fail due to so-called mismatches between strategic motives and rationales among the partners. Strategic motives have been viewed as being of two types: (1) *exploit*, which is concerned with increasing productivity through standardization, cost reduction and improvement of existing technology and capabilities, and (2) *explore*, which is associated with new opportunities for gain by innovation, etc. A mismatch occurs when one partner wants to exploit while the other wants to explore (Nielsen, 2002, 2010). These can be resolved, however, if the partners can work together. For example, on the surface one might have concluded that the joint venture between Toyota and General Motors which created New United Motor Manufacturing, Inc. in the United States in 1984 could not succeed because of obvious differences in handling of profits and styles of management decision-making. But the joint venture was a success until 2009 when General Motors withdrew from the alliance because each gained what it really wanted from the alliance. Toyota wanted to learn about marketing in the United States whereas General Motors wanted to learn how to make a good small car efficiently.

Being party to a joint venture can also affect operations in other markets. For example, problems can arise if the international marketer wants to create a new venture in a third market in which the joint venture has been selling. By creating such a new enterprise, the international marketer becomes a competitor while still being a partner. Competing with oneself is a policy that many companies in foreign countries have not yet accepted.

Regardless of policies, agreements, and so on, the real success of every joint venture is dependent upon the cooperation and communication between the partners. The extent to which such cooperation is forthcoming from each local partner depends upon the characteristics of each partner. Thus the selection of a local partner is *perhaps the single most important activity* involved in establishing a joint venture. Since it is extremely difficult to find compatible partners the situation can be eased somewhat if the partners attempt to anticipate all possible areas of disagreement and if they include specific phrases dealing with them in the joint venture agreement. In other words, the agreement should assist the partners in becoming, and remaining, compatible. Ricks (1999, p. 110) reports that one of the major reasons why Dow Chemical Company's joint venture in Korea failed was *poor communication*. Misunderstandings were everywhere and communication seemed to get nowhere. Dow made a mistake when it went public with complaints about its partner as Asians tend to keep problems very private. The Korean partner felt it had no choice but to withdraw from the venture to avoid further loss of face.

The process involved in designing and implementing international joint ventures can be complex and time-consuming. One approach to the process consists of four phases: (1) solution–opportunity identification, (2) evaluation of the basic proposal for the international joint venture, (3) design of the IJV, and (4) implementation and results of operating the IJV. Each of the four phases can take one or more years. Using this process as a model, Woodside *et al*. (1991) analyzed retail joint ventures in Hungary. The decision process resulting in the first McDonald's fast food store in Hungary, with Babolna Agricultural Cooperative, involved a five-year time period. Similarly, the process involved in the Swedish company IKEA joining forces with the Hungarian company Butarker also took five years from first contact until the opening of a store in Budapest.

Often a joint venture agreement has a provision that the foreign partner buy out the local partner at some point in time. In short, the local partner has an option to sell at a fixed price. At the time the agreement is signed this may appear to be sound. But experience shows that the worst that could happen does, on occasion, happen. For example, in late 2001 AOL Time Warner had to pay its partner Germany's Bertelsmann US$6.75 billion for its half-share of AOL Europe. By April 2003 the value of the half-share was one-quarter the amount paid for it. To avoid this type of situation, and it may not always be possible to do so as it is hard to predict the world of business, agreements should be more flexible and spread the risk in the event of a breakup.

Other types of strategic alliances

In addition to licensing, contracting, and joint ventures there are other types of strategic alliance arrangements. These include marketing distribution agreements. Marketing agreements are best illustrated by the international airline industry. Among the many agreements (some of which involve an equity stake) is the Star Alliance mentioned earlier.

Alliances linked to R&D and technology are illustrated by the sharing of engineers between Mitsubishi of Japan and Daimler of Germany. Boeing and three Japanese partners in the 777 aircraft project created a trans-Pacific telecommunications system to link their design operations.

A distribution agreement existed in the late 1990s between Laura Ashley and Business Logistics Services (BLS), a subsidiary of Federal Express. BLS took over, in its entirety, Laura Ashley's global distribution operation. The agreement was designed to restructure, improve, and manage every aspect of the flow of goods and information within the Laura Ashley supply chain.

A *consortium* including Asea Brown Boveri (ABB) and Daimler Transportation received a contract in 1996 to build Singapore's first light-rail commuter line. On a broader scale, consortia have been created by European companies as a means of responding to international competition in general as well as competition from Japanese *keiretsus* and South Korean *chaebols*.

Yet another type of alliance is the *vertical alliance*, or supply chain alliance. Companies forming these are seeking a long-term relationship with compatible partners. Volkswagen's assembly operation in Brazil, discussed earlier in the chapter, has many of the characteristics of this type of alliance.

Choosing between alternatives

As we stated in Chapter 7, the decision about what specific international marketing channel to use, including the phase of foreign market entry (or the channel between nations), is not a simple one for the international marketer. There are many factors that influence what

Exhibit 9.7 Competitors from the same country approach Europe differently

Often assumptions are made that companies from the same country that produce and sell the same type(s) of products do the same things when entering foreign markets. There are statements made such as 'The Japanese do this,' 'The Germans have done that,' and so forth. Such behavior does not always hold in reality. As an example we can look at the three largest South Korean consumer electronics companies and their experiences in Europe in the 1990s. The companies – Daewoo, Goldstar, and Samsung – all tried assembly plants for TVs, VCRs, and microwave ovens as a way to overcome foreign market barriers. Even then, market share only got as high as about 5%.

Then, these Korean companies thought they had the answer. Starting in the early and mid-1990s the companies launched an all-out effort to become 'local players,' including direct investment and joint ventures. They thereby implemented origin management (including remedying a relatively poor country image and avoiding foreign-origin biases (we will elaborate on these issues in Chapter 10).

Faced with high labor costs, increasing interest rates, and low-cost competition from Southeast Asian countries, Korean companies had seen their exports to Europe go flat. It appeared that a minimum share in each country was needed to remain a force in the market. The Korean products lacked clear brand identity and, as one Korean government official has stated, 'the image of Korea was of cheap, low-quality products.'

The new approach to Europe forced Korean companies to drop their nationalistic approach to foreign sales. 'Go European' was the theme for Daewoo Electronics Co. The company built a US$150 million, integrated color TV plant in France. The TVs were designed in France, and most of the components are European made.

In a key move, in mid-1992 Samsung announced it would buy Werk für Fernsehelektronik, a former East German picture tube maker. Samsung spent US$120 million to upgrade the plant, which could produce 1.2 million TV sets a year. The company negotiated to buy an even larger German TV maker, RFT. For more efficiency, Samsung has moved its Portuguese and Spanish color TV plants to Billingham, England, and its VCR plant from England to Spain. The company will use the Portuguese plant to make parts for all its European plants.

Goldstar focused on alliances to widen its market share. Its Italian venture, Goldstar-Iberna Italy, is a good example. Goldstar, Italy's Iberna, and Germany's Gepi collaborated to produce a refrigerator that was designed by Goldstar's Ireland facility and manufactured in Italy with parts and components supplied by Gepi. And Goldstar's color TV plant in Italy uses picture tubes made by Finland's Nokia.

As shown above, the three companies have taken different approaches to break away from production in Korea and export. One company made a greenfield investment, another company took the acquisition route, while the third emphasized strategic alliances.

might be the best choice for a company in a foreign market at a specific time. These factors also apply to choosing a nonexport entry mode from among manufacturing, assembly, and strategic alliance. It is clear that companies competing with each other directly in the same foreign markets do not make the same choice. As shown in Exhibit 9.7, this may be the situation even for competitors with the same home country.

Often, a company may use multiple entry modes and/or channels of distribution within a nation. A study of sales channels used in the European Union market for personal computers concluded that multiple channels, especially hybrid ones where the manufacturer and the channel intermediary (or partner) share the marketing functions performed, may be an optimal solution for expanding sales volumes (Gabrielsson *et al.*, 2002).

Summary

In this chapter we examined nonexport modes of entry into foreign markets. The use of direct investment, particularly in manufacturing, assembly operations, and strategic alliances was examined in enough depth to show how these represent viable alternatives for the international marketer. One thing is clear. There are no easy answers to which mode of entry is 'best' when a decision has been made to have a production presence in a foreign market area.

Questions for discussion

9.1 What are the major nonexport modes of entry into foreign markets? How does strategic focus relate to such market entry modes?

9.2 What are the major considerations taken into account by the international marketer in a decision to engage in some form of foreign area production?

9.3 If a company were contemplating establishing a manufacturing facility in a foreign market, why might it decide to wholly own the facility rather than partially own it? Similarly, why might it prefer partial ownership?

9.4 When developing manufacturing operations in foreign markets, is it better for the international marketer to seek out merger/acquisition possibilities or start from scratch (a greenfield investment)? Explain.

9.5 Why might an international marketer that is involved in foreign production still have problems concerning channel control and cooperation? Would such a marketer handle channel conflict differently than the international marketer that exports?

9.6 What is a strategic alliance? Why are these alliances so popular and who benefits?

9.7 What are the key essentials for a strategic alliance to be a success?

9.8 'Licensing seems to be a fairly safe way for a manufacturer to produce in a foreign market for the first time.' Comment.

9.9 Although licensing and contracting may appear desirable, they have drawbacks. What are the drawbacks?

9.10 Why might a company not choose outsourcing even when production costs are significantly lower? Explain.

9.11 Why might an international marketer prefer a joint venture to a licensing arrangement?

9.12 'In running a jointly owned facility in a foreign market (including a joint venture), it is not necessary to own more than 50% to maintain operational and management control.' Discuss.

9.13 Does cultural and/or psychic distance between countries have an effect upon the type of nonexport market entry mode used by a company? Explain your answer.

9.14 Why are management style, and any cultural differences that exist in styles, important in all types of market entry modes involving partners?

9.15 Select a company that has chosen direct investment in a foreign market and a company that has established a strategic alliance abroad and analyze why each company made the decision it did. Explain why you would or would not agree with that decision.

9.16 Choose a company that has made both a direct investment in a foreign country and has become part of a strategic alliance in that same, or another, country and analyze why the company chose those particular modes of entry.

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CASE STUDY 9.1

GG Farm Machinery Company

GG Farm Machinery Company is a French manufacturer of a specialized piece of machinery. Marcel Ger, the managing director of GG, was convinced there was a market in Australia for his machine and he wanted to explore in more depth how his company might do business there. Since GG was a relatively small company with less than 50 employees and an annual turnover in 2010 of approximately e45 million, the company did not have people available to make an appraisal. In addition, Marcel himself had little spare time for such an endeavor.

An international marketing consultant firm, Bonjoir Consulting Company, was hired to make an assessment of the Australian market for GG's machinery. Market entry mode was also to be examined and Bonjoir was to recommend whether an export or a licensing strategy would be the best approach to use in developing the market.

As part of the research effort, the project director assigned by Bonjoir to the GG project traveled to Australia where a number of potential distributors, licensees, and end users were visited. While in Australia, the project director discussed the issue of tariff and nontariff barriers with Australian Customs officials.

The findings reported to Mr Ger by the consultant are summarized in Table 9.4.

Based on these findings, a decision was made by Mr Ger to enter into a licensing agreement with an Australian manufacturer.

Questions

1. Do you agree with the decision made by Marcel Ger? Explain your answer.
2. What other modes of market entry into the Australian market might GG have considered? Why are these viable alternatives?

Table 9.4 Consultant's report to GG Farm Machinery

		Strategy favored	
Factor	**Finding**	**Licensing**	**Export**
Product's Australian market potential	Excellent	Either	
Service requirements	Minimal		Yes
Transportation costs	High and difficult to reduce	Yes	
Strength of French franc	Moderately strong	Yes	
Import duties	Exist for some products	If duties are significant	In short run, no duties favor export
Patent protection	Exporter holds strong French and Australian patents	Yes	
Capabilities and interests of potential representatives	Best candidate wanted to become a licensee, not a distributor	Yes	
Price competitiveness	Price was sensitive issue: any duties would seriously damage export efforts	Yes	

CASE STUDY 9.2

VW in China

(This case study was written by Min Zhao, University of Paris 1 Pantheon-Sorbonne, and Mitsuko Saito Duerr, San Francisco State University.)

In 2009, after four decades of rapid growth, China surpassed the US to become the world's largest car market in number of vehicles sold (Waldmeir, 2010a).

China is currently the largest single market for Volkswagen AG, the largest automobile manufacturer in Germany (Schafer, 2010). The company has been very successful in China, becoming the market leader there in 1985 and holding that position until at least 2009. Operations in China have been a major contributor to VW's profits over the years. It has benefited greatly from its early entry into automobile manufacturing in China as the Chinese market began to open to foreigners; its effective adaptation to the business, political, and legal environments; the strength of its commitment; its development of management and employee training programs for local personnel; and changes in its product line as competitive conditions have changed. These policies are discussed in more detail later in this case study.

The company continues to increase both production and sales in China. However, its market share has continued to decline, from 58% of the market in 1997 to 18% in 2007 (Chozick and Fairclough, 2007) and under 12% in 2009. This decline in market share resulted from additional foreign companies beginning to manufacture there, and existing competitors expanding capacity, to meet the increasing demands of the rapidly growing market. Entrants have included General Motors, Nissan, Hyundai, Daimler, Toyota, BMW, and a number of others in joint ventures with Chinese companies. In 2010, Germany's BMW made a major share of its profits from operations in China as the demand there for luxury cars, while still comparatively small, is growing rapidly. Chinese companies, in addition to joint ventures with foreign companies, are also directly acquiring technologies from foreign companies in order to develop their own models. Examples include Shanghai Auto acquiring vehicle platforms from the UK's Rover to develop a new line of cars of their own, Beijing Automotive Industry Corp. acquiring vehicle platforms and other technologies from Saab (Dyer, 2010) and China's Greely buying Volvo outright (Waldmeir, 2010b). In the long run, Chinese automobile companies without foreign partners can be expected to increase their market share as they develop vehicles of their own, and bring their quality up to international levels. The Chinese government hopes that it can force consolidation among its approximately 25 domestic carmakers to enable one of them to achieve 'global power status within a decade' (Waldmeir 2010a).

Volkswagen initially entered the Chinese market as it began to open to foreigners. They first exported vehicles from Europe to China and then, in 1985, began manufacturing in China through a joint venture with Shanghai Automotive Industry Company (SAIC). It quickly became the market leader in the country.

Details of the changing business and governmental environments in China, and Volkswagen's strategies to meet these changes are given below.

Among the many foreign and domestic companies that have entered the Chinese market, General Motors presents a particularly strong challenge to VW. General Motors was another early entrant to marketing in China. It added to its manufacturing capacity when, with a Chinese partner, it purchased bankrupt Daewoo's Chinese factory in 2004. Continuing to add to its manufacturing capacity, General Motors began to challenge VW for market leadership in 2007.

While Volkswagen was still the market leader in 2009, in 2010 General Motors announced that it will sell over 2 million cars in China during the year (Coy, 2010). If it does so, it would claim market leadership with over 12% of China's estimated sales of 16.5 million units. VW's lower target is to reach sales of 2 million by 2018 (Schafer, 2010).

This case discusses: (1) the changing government policies and regulations within which Chinese vehicle production was initially developed; (2) the rapid economic growth of the economy and the automobile industry, as the country opened up to foreign investment; (3) the strategies Volkswagen used in entering the Chinese market; and (4) the responses of the company to increasing competition, including but not limited to that of General Motors.

Government policies and regulations

A motor vehicle industry was started in China in 1955, primarily to produce trucks and military vehicles. After government policies changed in 1978, the economic growth rate increased and production of automobiles expanded. In 1985 the government declared the automotive industry a 'pillar' of industry, targeting it for financial and developmental assistance. The automobile industry was among the first Chinese industries to be backed by a formal state industrial policy. This policy was first formulated in 1987 and modified in 1994 with emphasis on three points: (1) shift the product mix of the industry from commercial vehicles to passenger cars; (2) increase economies of scale by restructuring the industry to bring about greater concentration; and (3) obtain technology from abroad by inviting the participation of multinational enterprises (MNEs).

A number of regulations were established in order to ensure the Chinese government's continuing overall control, encourage domestic production, and prevent possible abuses. The most important limitations on trade were high tariff and nontariff barriers on imports. Government approval of investments is required at central and/or local levels, there are limits on foreign investments, and there are local content requirements.

The limit on the percentage of foreign ownership allowed in a company depends upon the categories, types, and models of vehicles or components to be produced, and the size of the investment. Foreign companies planning to build a complete car or any of the three key components of a vehicle (motors, air bags, and ABS) were limited to a maximum of 50% of equity.

Foreign investments of over $30 million or involving key car components required approval at the national level by both the State Planning Commission and the Ministry of Foreign Trade and Economic Cooperation. Smaller investments not involving production of key components can be approved at the provincial level. Even with approved projects, barriers may still be encountered at the local level. Remittance of profits may still be difficult. In all arrangements, with companies as well as with government officials, time must be taken to develop personal relationships and show the advantages to all groups involved.

In order to encourage local production and protect local industry, China had very high tariff barriers, particularly on goods that were viewed as luxuries (such as automobiles). The tariff rate on automobiles was set at 180–220% before 1986. The import taxes were as high as 100% on complete vehicles and 60% for parts before 2000. Purchase prices of imported cars were therefore 250–300% higher than comparable prices abroad. China also has restrictions regarding the obtaining of licenses to import motor vehicles and parts. Thanks to government market-opening measures, tariffs for automobiles were reduced to 25% by 2006. The tariff rate on other vehicles depends upon the cylinder capacity and ignition features of the vehicle. Import license restrictions and quotas were phased out by 2005.

The government sets the duty rates on locally assembled vehicles according to the percentage of the value of locally made parts. In order to cut down on the nation's pollution problems, China's authorities give foreign car makers more favorable treatment if they bring in cars with advanced ecological technologies, such as catalytic converters, electronic fuel injection, and computer-controlled ignitions.

Economic growth and the development of the automobile industry

The overall Chinese economy began to expand after it opened up to foreign companies in the early 1980s, with growth averaging 7% per year during that decade.

China joined the WTO in 2001. This resulted in the gradual liberalizing of trade and phased increases in the rights of foreign corporations regarding investment limits, property rights, and the ability to engage in distribution, finance, etc. For the first time carmakers could set prices and introduce new models without obtaining formal government approval. Since then, foreign investment, exports, and GDP have grown even more rapidly, making China's GDP growth rate the highest in the world. China has become one of the world's largest investment destinations, and the automobile industry has become one of the largest beneficiaries of that investment.

Automobile sales to private parties have been rising faster than per capita income. This is partly due to a growth in the number of people in the middle and upper classes, and the recognition of the convenience, usefulness, and status conveyed by owning an automobile. In 1990, sales of automobiles and trucks together totaled less than half a million. By 2009, the number had increased to 13.6 million (Nissan Production in China to Rise, 2010).

The boom in the Chinese automobile market has attracted investment from almost all of the world's automobile manufacturers. With sales stagnant or growing only slowly in their home markets, China has been viewed as a major source of growth. The latecomers to the market, including Toyota, Nissan, Hyundai, and BMW now plan to make major additional investments in China. Seven of the world's ten largest parts suppliers have also established operations in China. There is a danger that the flood of investment may result in excess capacity. Automobile prices have already been declining as competition increases.

The automotive industry in China remains fragmented with over 3,000 parts suppliers and many final assemblers. The Chinese government has designated seven companies as 'key firms' targeted for expansion.

It encouraged these firms to pursue alliances with foreign original equipment manufacturers (OEMs), while limiting small new investments. The automobile industry is still dominated by joint ventures of foreign and Chinese companies.

One of the Chinese government's objectives is to have at least one of its Chinese companies become a world-class manufacturer capable of exporting large numbers of vehicles.

Changing strategies, VW and GM

In spite of the high duty rates and other restrictions on imports, there was an increase in the demand for foreign automobiles in the growing market for vehicles in the 1980s. It was apparent, however, that importing would continue to be restricted. Thus achieving substantial sales in China would require an investment in manufacturing, at least in the assembly of vehicles, in China. The impediments and risks seemed high as government attitudes, policies and regulations were not always clear and could be changed abruptly. The division of authority and responsibility between the national, regional, and local governments was evolving, and not always transparent. Continued growth of the market was not assured.

Volkswagen had been able to export some automobiles to China and felt confident that they could sell enough of their least expensive models to justify undertaking local manufacturing. Because of the limits on foreign ownership on substantial investments, VW needed to find a domestic partner. The first step in the process was to develop relationships with government officials at all levels and with a potential partner. The Chinese emphasis on first developing trust, and the necessity of understanding the nontransparent but critically important informal relationships that influence both government and business actions, required both time and patience.

Volkswagen's first joint venture was with the General Corporation of Automobiles and Tractors of Shanghai, now the Shanghai Automobile Industrial Co. (SAIC). The joint venture, Shanghai VW (SVW), was formed in 1984 and started production in 1985. SAIC was the second-largest vehicle manufacturer in China, one of the 'key firms' targeted by the national government for growth, and under the control of the local government. Its location in Shanghai put it in the main industrial and business center of the country. SAIC had an excellent industrial network for supplying parts. SVW invited the Bank of China to join the joint venture to ensure the ability to make foreign currency payments. The Chinese National Automobile Industry Co. (CNAIC), a firm controlled by the national government, became the fourth partner due to the importance of tangible and intangible support from the central government.

Zhu Rongji, the mayor of Shanghai from 1988 to 1991, set up a taxi company for the municipality that would be equipped with Volkswagen Santanas. VW moved its assembly lines for Santanas from South Africa to Shanghai. The efforts were mutually beneficial as sales rose for Shanghai VW, the local government encouraged foreign parts suppliers to establish joint ventures in China, more industrial workers were employed in the area, and SVW achieved an 85% local content rate by 1993.

Volkswagen's second joint venture was with First Automobile Work Group (FAW), forming FAW VW in 1991. FAW is under the direct control of the central government. The FAW VW joint venture was formed to produce the VW Jetta and the Audi.

The increasing competition in car production in China, and China's entry into the WTO, have caused Volkswagen to modify some of the strategies it adopted when it first began manufacturing in China. These include changes in manufacturing, changes in the product line and model introductions, and changes in marketing management.

Foreign automobile manufacturers entering China typically began by assembling cars from a set of imported components, with little or no use of locally made parts. They sometimes continued this policy for a number of years. Shanghai VW, with assistance from the local government, quickly adopted a program to increase the percentage of parts made locally. By 2004 Volkswagen had initiated the establishment of 160 joint ventures between foreign and Chinese suppliers of parts, approximately 100 license and know-how agreements, and 250 toll and equipment agreements.

VW modernized its production line and began to make its Passat model vehicle at the Shanghai facility in 2000, maintaining the same technical standard as that used in Europe (including processes such as laser welding). In 2002, the company successfully launched its Polo model car in Shanghai.

Productivity was improved by employee training programs from the beginning of the joint ventures, and by demonstrating to local employees that there were opportunities for advancement. In 1998 VW instituted a three-year program in which 40 key people from all sectors, including the factory lines, were sent to Germany. Since then, more than 1,000 others have left Shanghai for various types of training in Germany. The joint venture is working hard to keep up with growing demand. Of the three production lines in Shanghai, two are on a double shift and one is on three shifts. The company has also spent $120 million on a new technology center.

The rate of introduction of new models was greatly increased. For the first ten years of SVW in China, it produced only one model, the Santana. In 1995, the more modern Santana 2000 was launched. Two other models, the Jetta and the Audi, were put into production at FAW VW plants. As the time of entry to the WTO approached, VW began production of Passats at its Shanghai plant. Since then, Volkswagen has introduced a number of new models. Most of them have appeared on the Chinese markets within a few months of their European and US launches. The choice of color combinations has also been expanded.

While Volkswagen's main focus in China remains on manufacturing locally, it still imports specialized models that cannot be sold in sufficient numbers to justify local production. Examples include Volkswagen's super luxury Phantom and a Chinese version of its luxury SUV, the Touareg, introduced at the Volkswagen Forum Beijing in 2004.

Marketing is another area where changes have been made. In the 1980s, with market demand uncertain and Volkswagen desiring to concentrate on manufacturing, the joint venture agreement stated that the sales of assembled cars would be the responsibility of SAIC. With the expansion of the market VW has developed its own sales network under its control. VW has introduced a version of an incentive system for dealers that it uses in Europe. The system uses a computerized network that allows call-center managers to monitor how dealers follow up on customer inquiries. Volkswagen is considering entering into car-purchase financing.

The company is also increasingly engaged in promotional activities. In 2004 it sponsored a four-week Volkswagen Forum Beijing including a Volkswagen Masters–China golf tournament; a Women's Day Celebration; activities featuring German and Chinese artists, musicians and actors; and a Tree Planting Day.

At the Beijing Auto Show that opened in April, 2010, Volkswagen became the first automobile company ever to sponsor a whole pavilion.

The foremost challenge to Volkswagen's market leadership has come from General Motors. GM was also an early entrant to the Chinese market. It successfully established Buick as a luxury brand, including such features as control of the audio system from the back seat since owners of luxury vehicles had drivers who would not be expected to control the radio or CDs. It added productive capacity by purchasing, with a Chinese partner, the Chinese factory of bankrupt Daewoo. GM introduced lower-priced cars and made continuing improvements in productivity. In 2010, GM announced that it would sell over 2 million cars during the year (Waldmeir, 2010a). That would put it in first place, ahead of Volkswagen that had not planned to increase sales to that level until 2018 (Schafer, 2010).

On March 7, 2010, Volkswagen responded to the latest challenges by increasing its budget for investment in China by $2.1 billion. Most of the additional money will be used to build two new plants. This will bring its total investment fund for China to $7.8 billion for the coming six years (Schafer, 2010).

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Questions

1. Evaluate Volkswagen's strategies with regard to marketing.
2. What choices did Volkswagen have in market entry strategy, and did it make a wise choice?
3. Should Volkswagen make a strong effort to maintain market share?
4. Could selling the Phantom in China be useful for Volkswagen even if it does not make money there?
5. What benefits can Volkswagen expect from its promotional activities?

CASE STUDY 9.3

Sonya Madden

(Adapted from 'Designer Rapt with HK's Advantages,' *Hong Kong Trader*, 1 May 2007, www.hktrader.net. Reprinted with permission of the Hong Kong Trade Development Council and Sonya Madden.)

If not for Hong Kong, Sonya Madden believes she could never have made the quantum leap from investment banker to international fashion designer.

Basing her business close to the supplies enabled the celebrated Canadian accessories designer to produce small runs – enhancing her eponymous brand's exclusivity – and provide the fickle world of fashion with a fast turnaround. Famous for her luxurious, cashmere cardi-wraps that are now sold internationally, Ms. Madden says Hong Kong's favorable business environment is another reason why the city helps turn entrepreneurial dreams into reality.

Ending up as an investment banker, Ms. Madden spent seven years working in London, Hong Kong and New York before realizing design was her passion. She left banking in 2000, returned to Hong Kong, and after taking some design classes set up her own business.

Close to the source

'I'd always loved Hong Kong, but the decision to base my business here was taken for much more pragmatic and practical reasons,' Ms. Madden explained. 'It made sense to be close to so many manufacturers and suppliers, and I'd also made some strong connections with people I knew would support me.'

'The wonderful thing about Hong Kong is that it's next to China, the factory of the world. All of the major manufacturers have offices in Hong Kong, and there is no other place in the world where you would be able to source, for example, yarn from Italy, fur from Canada, and beads from India, all in one day.'

'The other advantage is access to factories. I am only half a day away from my factory (in the Chinese mainland) which is important in the fashion business, where lead times are shorter and on-time delivery critical.'

'I'm also in Hong Kong for the same reason so many large corporates are headquartered here: the legal, technical, financial and administrative infrastructure gives one a confidence that you wouldn't get in any other Asian city. The favorable tax environment is a huge plus, and it's very conducive to doing business in general. Any time I ask for support, the knee-jerk reaction is yes, I can do that; yes, we want to do business with you. For a start-up, this is incredibly compelling. A lot of other, more mature parts of the world don't have that eagerness.'

Celebrity clientele

Within four years of starting her business, Sonya Madden's wraps were being sold in all Kate Spade boutiques, and US department stores Saks Fifth Avenue, Henri Bendel and Nieman Marcus. Hollywood celebrities picked up on the trend, with Catherine Zeta-Jones reported to own a dozen of the brand's luxurious, made-in-China cardi-wraps. And it's all largely through word of mouth.

Having reintroduced the wrap as fashion's must have, Ms. Madden continues to build her brand and is planning offices in New York and Los Angeles. She believes the wrap is here to stay.

'When I was first designing, I called my wraps security blankets for adults,' said Ms. Madden, who was inspired by the pure pleasure of cocooning oneself in luxurious yarns.

'With today's lifestyles, versatility is so important and the beauty of the wrap is that you can wear it during the day, evening or weekend. A wrap gives the ability to accessorize an outfit in a way you can't with a coat or jacket.'

Question

Evaluate Sonya Madden's decision to locate her business close to where she has her products produced.

CASE STUDY 9.4

Wah Shing Toys

(Adapted from 'Eco-friendly toys firmly on the Horizon,' *Hong Kong Trader*, 3 September 2007, www.hktrader.net. Reprinted with permission of the Hong Kong Trade Development Council and Wah Shing Toys Co. Ltd.)

Hong Kong's Wah Shing Toys, one of the world's largest toy manufacturers, has teamed up with Horizon Fuel Cell Technologies, a Singaporean developer of fuel-cell products, to lead the charge for eco-friendly toys for global markets.

Both parties met at the 2007 Nuremburg Toys Fair in Germany. A strategic alliance and exclusive manufacturing agreement was signed recently to produce environmentally friendly, fuel-cell-powered toys (a fuel cell being an energy-conversion device designed to replace combustion engines and batteries).

Richard Ellert, Wah Shing's Managing Director who personally tries to reduce his carbon footprint by driving an energy saving Prius hybrid car, said the partnership with Horizon will be big for the toy industry in Hong Kong as both companies are reaching out to make toys greener.

No batteries required

'Today's more popular toys can use in excess of 500 million disposable alkaline batteries per year. It never hurts to go in the direction of doing the right thing and eco-friendly toys are definitely the toys of the future. Fuel-cell technology is not a new thing but what Horizon has done is to take it to the level where everyone can understand and afford it," explained Mr Ellert.

He said Hong Kong companies can no longer survive purely as original equipment manufacturers (OEM) in the fast changing toy landscape. Wah Shing is 90% OEM but is rapidly expanding its R&D team to move up the value chain to original design manufacturing (ODM), a move adopted by the majority of the city's toy companies to maintain competitive edge.

Taras Wankewycz, the co-founder and vice president of Horizon Fuel Cell Technologies, said their company needed to associate with an expert manufacturer to scale up the production of toys that integrate the fuel-cell technology.

'We chose Wah Shing since the company is in our opinion the most advanced in the production and design of high-tech toys with expertise in robotics, electronics and toy design. Wah Shing is also one of the world's largest toy producers, with over 60 million toy products delivered to six of the world's top ten toy brands.'

An added advantage is Wah Shing's large scale production – it has five manufacturing sites in southern China. This means that the toys are produced at 'unbeatable cost levels' and with the highest production and quality standards.

'This is an essential point as our innovative technology cannot do without quality, starting at the design stage and through every step of manufacturing,' said Mr Wankewycz.

Indeed, Horizon, a three-year-old company managed by an international team based in Singapore and Shanghai with a trading base in Hong Kong, has brought fuel-cell technology out of the laboratory where it has been for decades and into the marketplace in a viable form. Their best known product is the H-racer miniature hydrogen fuel-cell car which has won a slew of accolades. *2.0 Magazine* called it one of the '11 Coolest Products on the Planet,' *Businessweek* named it 'One of the Best Product Designs of 2007,' and *Time Magazine* 'One of the Best Inventions of 2006.'

Aiming high

The H-racer is an eco-friendly toy for an increasingly eco-conscious public that does not need disposable or rechargeable batteries to operate. 'The product is basically a miniature version of a real zero emissions car that runs on power generated from sun and water. It is refuelable, fun to operate and learn about,' explained Mr Wankewycz. 'In fact, since introduction, it has amazed scientists, business people, and the general public alike.'

Horizon is coming up with many other fuel-cell products in different industry sectors and working with major companies around the world to launch commercial applications with the technology.

'The first products are fun and educational, but as we say, we are working on toy cars to real cars and everything in between. We also have customers in the aerospace market, which is very different from toys, but the technology is somewhat the same basic concept,' added Mr Wankewycz.

Together, both companies aim to be the leading name in eco-friendly manufacturing – a vision very timely in today's renewable energy based global economy.

Questions

1. Is this an 'alliance that cannot miss?' Discuss.
2. Would the venture be better if Wah Shing had acquired Horizon Fuel Cell Technologies or vice versa? Why or why not?

CHAPTER 10

Product decisions

Learning outcomes

In Chapter 10, we discuss:

- the product:
  - as the sum of all physical and psychological satisfactions that a user receives
  - includes the physical core, packaging, and auxiliary services
- the decision of standardization or adaptation
- product planning and development
- product mix decisions: breadth and length of product mix; evaluating product portfolio
- packaging
- brand image: one brand or many
  - trademark and brand protection
- international consumer behavior and origin
- product origin image
- destination imagery and image
- origin biases

The cases at the end of the chapter focus on the challenges of making product decisions. Case 10.1 deals with the purchase South Korea's Daewoo Corporation by India's Tata Motors. General Motors, GM Daewoo, and Hyundai, Case 10.2, considers General Motors' possible rebranding some of the vehicles produced by its South Korean unit. In Case 10.3, the direct selling company The Pampered Chef has a unique approach to new product development for the global market. Case 10.4 discusses the challenges in the internationalization of Chinese brands, and examines possible models for overcoming them. Case 10.5 discusses the development and use of outside specialists to help with simplicity by Royal Philips Electronics. The Boeing Company, the second-largest commercial aircraft company in the world, produces more than commercial aircraft. Case 10.6 discusses Boeing's drive to have a cohesive brand identity.

Introduction

The product is at the heart of the marketing mix. If the product fails to satisfy the end-user or the consumer in his/her needs, no additional efforts on any of the other ingredients of the marketing mix will improve the product performance in the marketplace. A cellular telephone that fails to perform satisfactorily will not become more attractive to the buyer just because large sums have been spent on an international marketing campaign extolling the virtue of the telephone in question.

For a firm operating in multiple foreign markets, the problems of product planning and policies are extremely complex. Customers from different countries have varying requirements, and multinational decisions on product characteristics and containers or packages for products are necessarily quite complex. But there are market segments or niches that occur throughout the world. To illustrate, there is a growing health conscious market that is concerned about obesity and diabetes. Nestlé is continually working on new products that alter the body's absorption of sugar, reduce fatty acids in the bloodstream, and step up the burning of carbohydrates digestion. In 2005, Nestlé launched a cereal bar in Asia, Nutren Balance, with a fiber additive that tamps down surges in blood sugar levels after eating (Matlack, 2006). The cereal bar was ultimately introduced worldwide. Unilever and Danone have products designed to have similar effects to that of Nestlé's product.

Product policy

Product policy for international/export marketing has two major interrelated dimensions: (1) product planning and development, and (2) product strategy. These are applicable to both a single product itself and the total product mix. The product mix refers to the set (or assortment) of products that a company offers to customers. This assortment may consist of one or more product lines as well as individual products not part of a product line. Product lines are groups of products that are similar or have something in common – used together, sold to the same customer, handled through the same distribution channels; or are different versions (models) of the same thing. The important product policy questions facing the international marketer are as follows:

- Should the company keep a commitment to its existing product mix as the products reach maturity?
- How strongly should the firm follow a strategy of new product acquisition/innovation?
- What are the organizational requirements for following each of the above approaches?

In the case of international export marketing, product strategy translates into policy regarding product adaptation or standardization (globalization). This is the extent to which the international marketing company adapts (or customizes) its products to foreign markets. Product strategy together with market selection define the company's export (international) marketing strategy and can be shown in the framework of a product/market matrix.

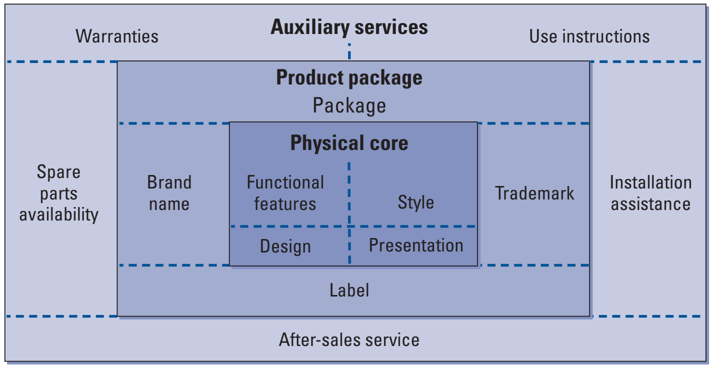

Figure 10.1 Dimensions of a product

We define a product as everything that the consumer or industrial purchaser/user receives when making the purchase or using the product. More formally, a product (or service) is:

> the sum of all the physical and psychological satisfactions that the buyer (or user) receives as a result of the purchase and/or use of a product.

Since a product includes everything that the buyer or user perceives as being part of the product, it can be viewed as having the following three major components:

1. the physical product core;
2. the product package;
3. auxiliary services.

Specific dimensions of each of these components are illustrated in Figure 10.1. In addition, price can also be regarded as part of a product, since buyers will view a product priced at €10 as being different from the same product (core, package, and auxiliary services) priced at €17. However, since price is important in its own right as an element of the export (international) marketing mix it is discussed separately in Chapter 11.

Product planning and development

In international/export marketing there are four major forms of product development:

1. new product development or addition;
2. changes in existing products;
3. finding new uses for existing products;
4. product elimination.

All of these decision areas are important to the success of managing the product mix, although primary attention is frequently given to the problem of developing, adding, and modifying new products. Since any product may be at different stages in its life cycle in different national markets, concern for potential new uses and product elimination is as necessary as concern for the other facets of product development if a company is to operate effectively in foreign markets.

New products

There are many ways in which a company may add products to its product mix for marketing in foreign markets by exporting. The most obvious approach is to *export domestic products*. This strategy is easy to implement, at least initially, and may represent a relatively low-cost approach.

Another relatively easy way, though certainly not the most economical, is to *acquire a firm* or some operations of a firm that has products for which there are potential or existing overseas markets. The acquired firm may be a foreign firm whose products are designed for its home market and perhaps third markets, or it may be a company in the same country as the firm doing the acquiring. In the 1980s, and to an extent in the late 1990s, a great merger and acquisition movement spread throughout Europe which was aimed at creating companies that, among other things, would be large enough to engage in expensive product innovation programs. Such mergers included ones resulting in either greater market power in an industry or diversification. For example, Unilever and Nestlé created a joint venture for frozen foods, Dunlop and Pirelli's merger resulted in a stronger tire company for developing a market in the United States, and Ciba and Geigy merged to form a large chemical pharmaceutical company. More recently most of the mergers were more defensive, meaning that they were initiated in part because the company involved was under threat. Sometimes there was a change in the size or the nature of a particular market, such as major buyers cutting purchases. Occasionally the threat lay in globalization, and its concomitant demand for greater scale.

Many acquisitions have cost a great deal of money, which seems to suggest that acquiring companies consider that it is cheaper in the long run to pay high prices for established brands than to invest in building new ones. For example, Ford Motor Co. expanded its Premier Automotive Group by acquiring Europe's Jaguar, Land-Rover, Aston Martin, and Volvo (Kerwin, 2004). Volvo has since been sold off. Although these examples are of very large companies, the acquisition approach is viable for any company that has the means to handle the acquisition. To illustrate, in early 2010 the Swedish automobile company Saab, which was owned by General Motors, was acquired by the Dutch boutique car maker Spyker Cars. Spyker cars hand-builds about 40 automobiles each year, selling them for a minimum price of US$219,000 (Welch and Kinnander, 2010). During General Motors' ownership the value of the brand Saab was diluted and brand consciousness was lost.

There is a resurgence in global merger activity taking place now. The merger boom is broader-based than in the past in terms of industry and geography. Regarding industry, there is interest in financial services, metals and mining, power generation, property, and consumer goods. For geography, Europe as well as the United States is home to mergers, as such mergers are increasingly cross-border.

A company can also add products to its offerings by *copying products* developed successfully by others. Many firms seem to follow this approach with varying degrees of success, although it is obviously not the approach used by a market leader.

Finally, a company can obtain its new products by *internal product development*. The process of internal product development can be viewed as an evolutionary process consisting of a number of stages. This is shown in Figure 10.2. As the process progresses from idea

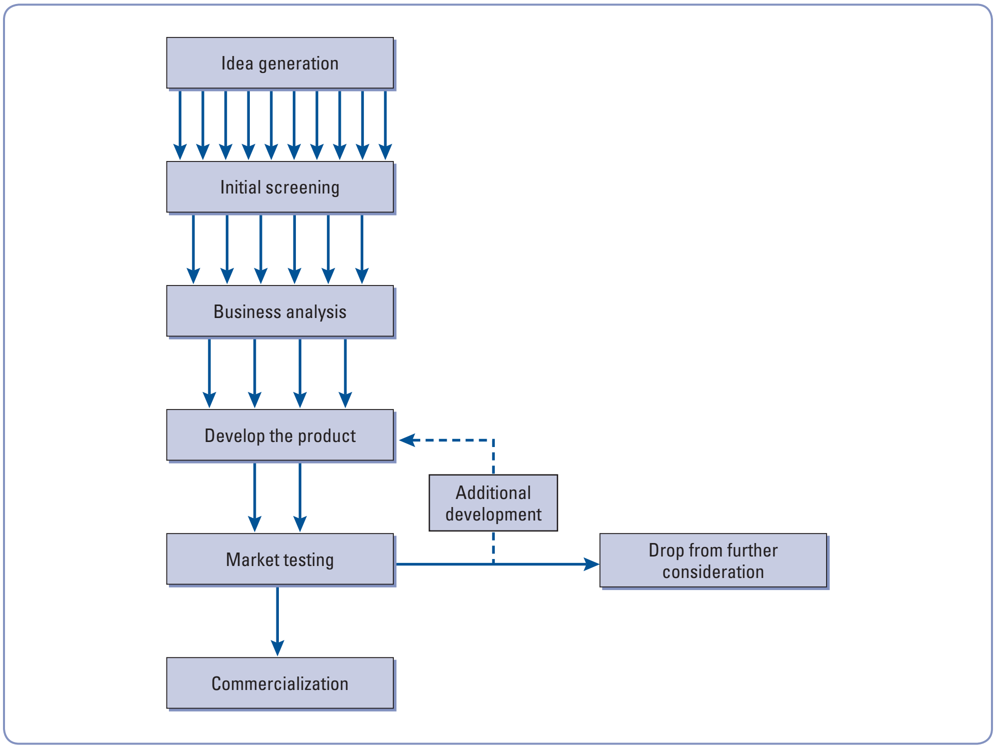

Figure 10.2 New product decision process

generation to evaluation to development to commercialization or introduction, each stage becomes progressively more expensive as measured in terms of both time and money. This is particularly the case for the development of drugs, where the time period of the discovery phase to the stage of realized sale often takes ten to 15 years. The cost of making a wrong decision increases progressively from stage to stage. For example, it has been estimated by Yun Jong Yong, chief executive of the Korean multinational Samsung Electronics Co., that as much as 80% of cost and quality is determined in the initial stages of product development (Ihlwan, 2006, p. 47). One characteristic of the process is the existence of a so-called decay curve of new product ideas whereby there is progressive rejection of ideas or projects at each stage. Similarly, in Figure 10.2 the number of arrows leaving each stage is less than that of the preceding stage. The invention of the micro compact car, the *smart*, a cross-border joint venture between Mercedes-Benz and SMH (Swatch) is shown in Exhibit 10.1.

Four additional issues that are relevant to the internal development of new products merit brief discussion:

1. location of R&D facilities of firms;
2. the process of screening new product ideas;
3. the **diffusion of new product** innovations;
4. quality management.

Exhibit 10.1 Inventing the *smart*: the micro compact car

The whole adventure of the company MCC (Micro Compact Car) started in 1994 when Mercedes-Benz and SMH (Société Suisse de Microélectronique et d'Horlogerie SA) agreed on a rather unconventional cross-border joint venture in the automobile industry. Mercedes-Benz initially held 51% of the capital and SMH 49%. SMH was the company that made the world famous 'Swatch' line of products. The headquarters of MCC were located in Biel, Switzerland; the development premises in Renningen, Germany; and the production plant in Hambach, France. The marketing, sales, finance, and control functions were centralized in Biel. MCC Renningen started developing the car in March 1994, the site for the plant was selected in early 1995 and the plant received FF450 million in subsidies from the European Union as recognition for: (1) its environment-friendly production system, (2) creating a new market segment, and (3) inventiveness of the concept. Volume production was scheduled for July 1998. '*smart*' was the name chosen for the new car, where *S* stands for Swatch, *M* for Mercedes, and *ART* to highlight the inventiveness of the total concept. Micro Compact Car was the name chosen for the company to evoke the revolutionary notion of a small city car. The joint venture was given extremely limited resources to carry out this experimental, yet rather ambitious, project.

The *smart* concept

Two major developments triggered the search for a new car concept. First, in Germany, consumers had since the early 1980s become increasingly sensitive to the societal costs of individual transportation, for example air pollution, energy, and material consumption. Second, individual car use was on the increase and the total number of registered cars as well as the average number of kilometers driven per capita had risen to alarming levels. In particular, the highly concentrated car use in urban areas was held responsible for negative effects on the quality of life, for example, daily traffic jams, air pollution, shortage of parking space, and of course noise levels. Under strong pressure from consumer and environmentalist lobbies, governments were considering measures to restrict car pollution, control emissions and increase taxation on fuels.

What kind of car would people buy and how could you make money out of a venture such as this? These were the key questions for MCC. Since 1990, the Mercedes-Benz strategic design and car concept department had been working on a new concept to address these growing consumer concerns. The objective was to create a car with the following features: small size, yet maintaining a high level of passenger comfort and safety; low fuel consumption, using nontoxic, easy-to-recycle materials, and an environmentally friendly production process. However, further market research pointed out that consumers were not ready to acquire such a city car unless it offered additional qualitative and emotional utility. Therefore the car needed to provide the customer enhanced total driving experience to attract attention, a 'navigation system,' and customized design. To deliver distinct qualitative advantage the engineers were pushed to focus on three concepts: 'the pleasure to drive,' the 'mobility concept,' and the concept of a customized design.

The *smart* resulted in a significant departure from the usual product offerings from Mercedes-Benz, which traditionally focused on luxury cars. The car was supposed to create its own new market in the city car segment niche. It was revolutionary in its technological innovations and the way it was designed and produced. Only 2.50 m in length, 1.51 m in width, but 1.53 m high, the car was definitely designed to attract attention. The car had only two seats and customers could choose between two engines. To be on the market by October 1998, with a price tag ranging from DM16,000 to DM20,000, the *smart* would first be distributed in Austria, Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, and Switzerland.

The *smart* was a tiny passenger car and safety was an even more important factor. MCC wanted it to be superior to other cars of this size. Its engineers were able to use the Tridion-frame technology invented by Mercedes-Benz, a steel-faced body for the car, around which the entire vehicle was designed. They also came up with the 'sandwich' design where the engine is located in the rear underneath the passenger compartment. The engine and the gearbox were designed as an integrated power unit decoupled from the passenger compartment. In the event of an accident the power unit would absorb the likely return shocks to which small cars are particularly prone. A crash box was installed in the front and in the back of the car and was able to fully absorb crashes at speeds of up to 15 kilometers per hour. Another key feature of the *smart*, likely to make it a market success, was its customized design and its 'mobility box' concept. The strategic design and car concept department aggressively pushed for shorter development time to allow for faster customer feedback and championed a 'modular' design that would allow complete customization. The customer, for instance, would walk into a *smart* dealership or visit the *smart* home page and custom design his or her own vehicle. He or she could independently choose from four colors for the body panels, two colors for the Tridion frame, or select one of the special colors and many other options. In addition, he or she could at any time after the purchase change any of these features very quickly and at low cost. The 'mobility box' offers individualized 'mobility' packages to include car navigation services, such as help functions, traffic information and assistance, and a mobile phone.

Today, the company is named Smart GmbH and is 100% owned by Daimler AG. All management is in Boblingen, Germany. Smart is part of the Mercedes Car Group. By 2015 the car was available in 46 countries throughout the world.

Location of R&D

Research and development are major activities of the product development process. In general, one important issue facing the international operating company is to consider whether or not to locate R&D facilities abroad. Table 10.1 presents important criteria for considering overseas R&D locations. An important dimension in the evaluation process is the market orientation of the international company. Three possible 'market orientations' are considered: home market, host market, and world market. 'Home market' firms are primarily concerned with investing abroad for the purpose of serving their domestic market. This is a case of inverting for sourcing rather than market entry. The foreign affiliate of the 'host' firms are oriented to the markets of the place where they are located. This is the orientation of United States-based Urban Outfitters in their designed-for-Europe strategy. 'World market' firms are those foreign affiliates that are integrated to serve a standardized international market. These firms are typically organized to achieve economies of scale based upon high technology and a high degree of worldwide product standardization.

A study of subsidiary managers in seven European countries examined the degree to which commonly cited location advantages actually influence the incidence and level of subsidiary R&D (Davis and Meyer, 2004). Four aspects of the local environment were investigated: competitive conditions, supply conditions, scientific institutions, and government support. Major findings are: (1) only the presence of scientific institutions has a consistent, positive effect on the incidence and level of subsidiary R&D; (2) government support has a positive effect on the incidence of subsidiary R&D, but not its level; and (3) highly competitive environments have a negative effect, at least in small countries.

Table 10.1 Important criteria for considering overseas R&D locations

	Home market firms	Host market firms	Worldwide market firms
Important criteria for considering an overseas R&D location	**1.** Proximity to operations **2.** Availability of universities	**1.** Proximity to markets **2.** Concept of overseas operations as full-scale business entities	**1.** Availability of pockets of skills in particular technical areas **2.** Access to foreign scientific and technical communities **3.** Availability of adequate infrastructure and universities
Important criteria for not considering overseas R&D locations	**1.** Products sold in the developing countries are not sophisticated **2.** Lack of qualified scientists and engineers **3.** Economics of centralized R&D	**1.** Increasing costs of doing R&D overseas **2.** Economics of centralized R&D	**1.** Economics of centralized R&D **2.** Difficulties in assembling R&D teams

Source: Behrman and Fisher, 1980.

How is technology to be handled in terms of product and process? The two extremes seem to be 'incremental improvements' versus 'breakthroughs.' Many European and US companies tend to favor the latter and continually seek the technological breakthrough that will revolutionize things. In contrast, Japanese companies have tended to stress incremental and continuous improvements, called 'Kaizen.' Japanese companies seem to operate on the premise that technological leadership means gradual, perceived improvement (by consumers) throughout a product's life, while manufacturing processes are improved. Obviously, there are exceptions. For example, Sony had its blockbuster breakthrough with its Walkman. But Sony has also been able to refine repeatedly the original product that allows it to fend off the many imitators.

As we move into the second decade of the 2000s there is an even greater need for product and process R&D people to work as a team. By adapting a team approach to new product development, including design and manufacturing engineering, companies such as General Motors and NCR report that development time on new products is cut dramatically (Chiesa, 1995). Some companies even include marketing and sales personnel on such new product teams. By the early 1990s Ford Motor Company was using so-called '**centers of excellence**' in the United Kingdom, United States, and Japan to develop common platforms for automobile models sold in different countries. Not all companies have been able to use the team approach effectively.

An integral part of research and development is product design. Often, companies establish design centers away from the home country, either to be market oriented or to have access to top product designers. For example, the Korean automobile manufacturer Hyundai opened a design studio in Fountain Valley, California in the United States in 1991. Increasingly, the company is moving its design process to the United States. In addition, Chinese designers are working on new products such as automobiles, appliances, and electronic devices for export markets. These designers typically have worked on color and form, while conceptual work is done in Europe or the United States. With an increasing number of design graduates from its own schools and graduate programs abroad, China is moving toward a situation where 'Made in China' will be joined by 'Designed in China.'

What has been occurring is the globalization of design. The late Gianni Versace had this to say about the globalization of the fashion business (source and date unknown):

> Fashion is more and more global. It doesn't belong anymore to the French. Or even to the Italians. I'm a global person: I spend two months in Como [in the Italian Alps], one month in Milan, two months in Miami. I just don't think any longer in terms of nationality. Calvin Klein is American, [but he] makes things in Italy. The French houses all have English designers now, and women are going global.

The globalization of design goes beyond that of the fashion clothing industry. In 2005, Sony opened a design center for the MP3 player in Shanghai, China. Other companies also have design centers in China to create products for the Chinese domestic market – Nokia, Motorola, and General Motors are just a few (Rocks, 2005). Sony also has a design center in the United States which works on products that in the past were reserved for headquarters, such as creating high-margin products from Internet TV devices to stereo systems. However, Japan remains the center of Sony's creative efforts with more than 80% of its designers based there (Edwards and Hall, 2007). Toyota has technical and design centers in Europe, the United States, Australia, and Thailand.

Screening ideas

Since the cost of performing each stage in the product development process increases as an idea progresses from an idea to a product, careful attention must be paid to the screening of ideas. At this stage, the company should establish a system that is designed for either minimizing the chance that a 'bad' idea will be evaluated further, or minimizing the likelihood that a 'good' idea will be dropped. Exhibit 10.2 discusses alternative strategies for idea generation and development.

Before any screening can occur, management must decide upon a set of criteria against which every idea can be judged and a model for applying the criteria. Such models as *ranking* ideas relative to each other or *scoring* each idea and seeing how each relates to a cut-off score are very useful in this stage of the product-development process. Other models such as profitability indices or optimization models are better suited for the business analysis stage.

Management must be very careful in selecting screening criteria. Not every product type should be judged by exactly the same criteria. For companies that export products in diversified industries this means that multiple sets of criteria must be established. Or it may mean that a single master set of criteria may be developed and only selected criteria are used and/or are modeled differently, depending upon product type. Alternative approaches to modeling include the following:

- *Conjunctive model*, which uses all evaluative criteria. The product, in order to proceed for further consideration, must meet or exceed a minimum value for each of the criteria used.
- *Disjunctive model*, which is based on accepting a product that exceeds specified levels on one or a few key criteria, regardless of its score on the others.
- *Lexicographic model*, which is based on ranking the evaluation criteria in terms of their perceived importance. New product ideas are compared criterion by criterion

Exhibit 10.2 Strategies for idea generation and development

There are two strategies that a company can follow when developing new products or services (Hall, 2006):

1. create ideas based on listening to the 'voice of the customer'; or
2. come up with ideas that customers are not necessarily asking for.

Most business experts would argue for listening to customers and doing what they want. This is the essence of a market-driven approach, and is one similar to that used by the Korean multinational company Samsung Electronics (Ihlwan, 2006). Samsung creates teams of engineers, designers, and planners from throughout the company who brainstorm until a product is developed, at least in concept. Samsung's development of the Bordeaux flat-screen LCD TV illustrates this process. The initial thinking was for a product that was sleek, functional with good picture and sound quality, and would beat what Sharp Corp., the leader in LCD TVs, had to offer. But customer surveys indicated that shoppers buy a flat-screen TV as much for its look as a piece of furniture as for its technological features. So, the group cut back on function in favor of form.

The first strategy is *reactive or responsive.* The second strategy is *proactive* and is based on innovation. In order to truly innovate, Hall (2006) offers the following suggestions:

1. Ask the right questions—for example how can we help customers anticipate developments in their markets? How can we discover additional needs of which customers are unaware?
2. Stop asking current customers for ideas.
3. Exceed customers' expressed needs.
4. Anticipate the future.

In concept, a proactive strategy is substantially more strongly related to new product success than is a responsive strategy. Both strategies are approaches to market orientation; proactive is based on latent or unknown consumer needs and responsive is based on expressed needs. A more recent study of marketing and export managers in Thailand found that product design adaptation strategy was positively associated with performance, but that the relationship between product adaptation and performance was stronger for companies that had lower levels of market orientation (Tantong *et al*., 2010). Interestingly, the companies with larger market orientation had an overall higher level of product adaptation and performance.

A survey of innovation managers in South Korean and Japanese companies examined the role of customer orientation, cross-functional integration, and new product team proficiency as contributors to new product advantage (Nakata *et al*., 2006). New product advantage is the degree to which a new product is perceived as superior to competitive products. Findings were that cross-functional integration and new product team proficiency contribute significantly to advantage in South Korea, while customer orientation and new product team proficiency play positive roles in Japan.

until there is a superior idea. This may occur after the first criterion or after many criteria.

- *Linear compensatory model*, which assigns differential importance weights to each criterion and then determines a summated evaluation score for each product. Further analysis is conducted either on all products exceeding a minimum score or the one product scoring highest. This is perhaps the most widely used approach.

Innovation and diffusion of products

Some companies, particularly multinational companies, often do not develop a product for their domestic market, but do so in response to opportunities in world markets. Consequently the company must select a strategy for the diffusion of the product from point of development to the market. The innovation and diffusion process is one of the most complex of all organizational processes. Past research has suggested a generic stages model that views the innovation process as consisting of sequential but also interaction subprocesses of sensing, response, and implementation. Nohria and Ghoshal (1997) have developed a typology of innovation processes of multinational enterprises that reveals four different patterns in terms of the location of sensing, response and implementation:

1. *The center-for-global innovation process*. Center-for-global innovations are those where the center – the parent company or a central facility such as the corporate R&D laboratory – creates a new product for worldwide use. Most instances of center-for-global innovations are technological innovations. Most involve no participation of the national subsidiaries except for the routine tasks such as marketing support at the implementation stage. The process by which L. M. Ericsson, the Swedish manufacturer of telecommunications switching and terminal equipment, created the AXE digital switch is one example of a center-for-global innovation. Impetus for the AXE digital switch came from an early sensing of both shifting market needs and emerging technological changes. The loss of an expected order from the Australian Post Office, combined with the excitement of a new digital switch developed by CIT-Alcatel (a French competitor), set in motion a formal review process within Ericsson's headquarters. The review resulted in a proposal for developing a radically new switching system. The new product was estimated to cost US$50 million, to require 2,000 worker-years of development effort, and to take five years before it could be introduced to the market. The development was carried out entirely in Sweden. In 1976, the company had the first AXE switch in operation. By 1984, the system was installed in 59 countries around the world.
2. *The local-for-local innovation process*. Local-for-local innovations are created and implemented by a national subsidiary entirely at the local level. The sensing, response, and implementation tasks are all carried out within the subsidiary. Most of these innovations tend to be market-led rather than technology-driven and usually involve minor modifications of an existing technology, product, or administrative system.

   The ability of local subsidiaries to sense and respond in innovative ways to local needs and opportunities has been an important corporate asset for Unilever, for example. Advanced laundry detergents, a major product line of the company, were not appropriate for markets such as India where much of the laundry was done by hand in neighboring streams rather than at home in washing machines. A local adaptation that allowed synthetic detergents to be compressed into solid tablet form gave Unilever's local subsidiary a product that could capture a significant share of the traditional bar soap market. Similarly, in Turkey, where the company's margarine products did not sell well, an innovative application of Unilever's expertise in edible fats allowed the local subsidiary to develop a product from vegetable oils that competed with the traditional local clarified-butter product, *ghee*.
3. *The local-for-global innovation process*. Local-for-global innovations are those that emerge as local-for-local innovations, are subsequently found to be applicable in multiple

locations, and are diffused to other organizational units within the multinational corporation. In other words, the initial sensing, response, and implementation tasks are undertaken by a single subsidiary, but then other subsidiaries participate in subsequent implementations as the innovation is diffused within the company.

Such was the case when Philips' British subsidiary reorganized the structure of its consumer electronics marketing division based on an analysis of changes in its product line and a growing concentration in its distribution channels. The United Kingdom subsidiary abolished its uniform structure and organized the marketing department into three groups: an advanced-system group for technologically sophisticated, high-margin products (Laservisison and compact disk players); a mainstay group for high-volume mature products (color TVs and VCRs); and a mass-merchandizing group for older, declining products (i.e., portable cassette players). The new model for the marketing organization developed by the British subsidiary was clearly appropriate for other subsidiaries in Europe, and despite initial resistance the innovation was soon transferred to most other national organizations.

4. *The global-for-global innovation process.* Instead of finding individual local solutions or imposing a central solution on different subsidiaries, global-for-global innovations are created by pooling the resources and capabilities of many different organizational units of the MNC to arrive at a jointly developed general solution to an emerging global opportunity.

   One of the best examples of this mode of innovation was the way in which Procter & Gamble (P&G) developed a global liquid detergent. Despite the success of liquid laundry detergents in the United States, all attempts to create a heavy-duty liquid detergent category in Europe had failed due to different washing practices and the superior performance of European powder detergents, which contained enzymes, bleach, and phosphates at levels not permitted in the United States. But P&G's European scientists were convinced that the liquid detergent's performance could be enhanced to match local powders. After seven years of work they developed a bleach substitute as well as a means to give enzymes stability in liquid form. Meanwhile, researchers in the United States were working on a new liquid better able to deal with the high clay soil content in dirty clothes in the United States, and the company's International Technology Coordination Group was working with P&G scientists in Japan to develop a more robust surfactant (the ingredient that removes greasy stains) to make the liquid more effective in the cold-water washes common in Japan. Joint effort on the part of all groups ultimately led to the launch of Liquid Tide in the United States, Liquid Cheer in Japan, and Liquid Ariel in Europe. Each product incorporated the best developments created in response to European, US, and Japanese market needs.

The Boston Consulting Group compiles an annual listing of the world's most innovative companies. Table 10.2 presents results for most of the companies in the top 50 for the year 2015. It is interesting to note that 10 of the top 50 are Asian, and for the first time since the rankings began in 2005, there were more companies based outside the United States than there were based inside the United States. As of 2015 this trend has continued.

The other side of the issue – non-adoption – is equally important. Figure 10.3 shows an integrative model derived from previous research in which innovation diffusion is affected by technological, social, and learning conditions while operating in the contextual domain

Table 10.2 The most innovative companies in 2015

2015 Rank	Company name	HQ country
1	Apple	USA
2	Google	USA
3	Tesla Motors	USA
4	Microsoft Corp.	USA
5	Samsung	South Korea
6	Toyota Motors	Japan
7	BMW	Germany
8	Gilead Sciences	UK
9	Amazon	USA
10	Daimler	Germany
11	Bayer	Germany
12	Tencent	People's Republic of China
13	IBM	USA
14	SoftBank	Japan
15	Fast Retailing	Japan
16	Yahoo!	USA
17	Biogen	USA
18	The Walt Disney Company	USA
19	Marriott International	USA
20	Johnson & Johnson	USA
21	Netflix	USA
22	AXA	France
23	Hewlett-Packard	USA
24	Amgen	USA
25	Allianz	USA
26	Tata Motors	India
27	General Electric	USA
28	Facebook	USA
29	BASF	Germany
30	Siemens	Germany
31	Cisco Systems	USA
32	Dow Chemical Company	USA
33	Renault	France
34	Fidelity Investments	USA
35	Volkswagen	Germany
36	Visa	USA
37	DuPont	USA
38	Hitachi	Japan
39	Roche	Switzerland
40	3M	USA

2015 Rank	Company name	HQ country
41	NEC	Japan
42	Medtronic	USA
43	JPMorgan Chase	USA
44	Pfizer	USA
45	Huawei	People's Republic of China
46	Nike	USA
47	BT Group	UK
48	MasterCard	USA
49	Salesforce.com	USA
50	Lenovo	People's Republic of China

Source: Adapted from The Most Innovative Companies 2015 – Innovation in 2015, Michael Ringel, Andrew Taylor, and Hadi Zablit, BCG Perspectives, The Boston Consulting Group 2015.

<table>
<tr><th colspan="3" rowspan="2">New technology fails to replace older (or no use of) technology when:</th><th colspan="3">In the domain of the:</th></tr>
<tr><th>Individual user</th><th>Community of users</th><th>Market/industry</th></tr>
<tr><td rowspan="9">Given the effect of conditions relating to:</td><td rowspan="3">Technology</td><td>Utility...</td><td colspan="2">is perceived to be less then the older technology</td><td>fails to exceed the older technology's measurable specifications</td></tr>
<tr><td>Complexity...</td><td colspan="2">focuses attention on overall effectiveness not newest features</td><td>renders really new innovations less frequent</td></tr>
<tr><td>Complementarity...</td><td colspan="2">of older technology results in higher total utility</td><td>does not lead to a dominant design</td></tr>
<tr><td rowspan="3">Social structure</td><td>Context...</td><td>creates material limits to access</td><td>supports social divisions to access</td><td>restricts access on behalf of proprietors/the state</td></tr>
<tr><td>Orientations...</td><td>toward its use are negative</td><td>are towards the older technology</td><td></td></tr>
<tr><td>Contagion...</td><td colspan="2">is not strong enough to displace existing community norms</td><td>is not dispersed due to poor marketing and/or operations functionality</td></tr>
<tr><td rowspan="3">Learning</td><td>Capacity...</td><td>or cognitive ability limits learning</td><td>to access education is limited</td><td>of resources/guidance is inadequate</td></tr>
<tr><td>Capability...</td><td>generated by older product use does not assist in new technology use</td><td>of users has not created a community of expertise</td><td>to experience the product is diminished</td></tr>
<tr><td>Costs...</td><td colspan="2">related to switching are high</td><td>of learning determined by the product are prohibitive</td></tr>
</table>

Note: the dark blue box indicates that, historically, a competitive market/industry has usually been oriented towards innovation diffusion.

Figure 10.3 An integrative model of factors limiting innovation

Source: Adapted from MacVaugh and Schiavone, 2010, p. 208.

of the individual, community (of users), or market/industry. This model has been designed to explain limits to adoption of innovation and non-adoption of new technologies. While not developed within the context of international marketers, it nevertheless applies to them. It may be more difficult within the international company and community as cultural differences may have an effect on non-adoption.

Positioning products

To a certain extent, how successfully a new product is diffused to an export market will be influenced by the product *positioning strategy* followed in a foreign market. Positioning is a communication strategy based on the notion of mental 'map.' Positioning refers to the act of locating a branded product in the customers' minds over and against other brands in the same product category in terms of product attributes and benefits that the branded product does or does not offer.

The conceptual foundation of international positioning is that a set of products can be viewed as different collections of attributes that can provide benefits to the buyer/user. When targeting specific market segments the marketer tries to develop those product attributes that generate the benefits matching the requirements of a targeted segment. This is a product design issue involving the product core, the package, and auxiliary services: the task is one of product positioning. Since it is the buyer/user perception of benefit-generating attributes that is important, product positioning is the activity that creates for a product a desired position in the buyer/user's mind. Whether a company is effective in positioning an export product where it wants depends heavily upon the extent to which any country-of-origin stereotype enters into the importing country's buyers' evaluation process. The effect of country stereotype is to shift the position of a product in the perceptual space of buyers and thus alter the evaluation of its merits.

Quality management

Total quality management (TQM) became a major concern in the 1990s, and it will continue to be important. Company after company is finding out that managing for quality means more than just fine-tuning production controls. Total quality management is being used as a strategic weapon and companies are wanting to produce products of high quality at costs lower than competitors'. Japanese companies, for example, tend to use a preventive TQM approach that overhauls procedures in every function from R&D to marketing and service to avoid errors, while cutting costs anywhere from 10% to 50%. The idea is to get products to a market faster, with fewer defects, and at a lower cost. Companies adopting TQM often see dramatic results. For example, in the early 1990s the Swedish appliance manufacturer Electrolux reduced field-service repairs by 40% as a result of changes in design methods and other work processes.

In order to succeed in the international marketplace, particularly in the European Union, it is becoming necessary that companies adopt minimum standards set and administered by the International Organization for Standardization (ISO), known as ISO 9000. ISO 9000 specifies design, manufacturing, logistics, and other controls associated with producing quality products and services. ISO develops and administers standards; it does not register or certify companies. A company is issued a certificate of registration to, say, ISO 9001 by a registration/certification body, which is accredited by an accreditation body such as the Dutch Council for Accreditation (RvA) or the United Kingdom's National Accreditation Council for Certification Bodies (NACCB). The European Committee for Standardization adopted it as the means of harmonizing the varying technical norms among European Union member states. As shown in Exhibit 10.3 there exist five standards that collectively make up ISO 9000.

In short, ISO 9000 is primarily concerned with quality management, or what an organization does to fulfil the following:

- the customer's quality requirements;
- applicable regulatory requirements, while aiming to
- enhance customer satisfaction;
- achieve continual improvement of its performance in pursuit of these objectives.

Exhibit 10.3 The five standards of ISO 9000

The five standards that collectively make up the ISO 9000 are as follows:

- *ISO 9000*. This is the road map for the series. It is the overall term covering the other four standards in the series: 9001, 9002, 9003, and 9004.
- *ISO 9001*. This is the most comprehensive of the standards. It is a quality assurance that requires the demonstration of a supplier's capability to fulfil the requirements during all phases of operation: design, development, production, installation, and servicing.
- *ISO 9002*. This standard is a subset of ISO 9001 with the areas of design and development of the product removed. The standard is sometimes used as an interim standard before expanding to the more comprehensive ISO 9001. It is also the most common standard used by service companies. The quality guidelines are used to ensure that the service is provided using a consistent process that is described in the quality documents.
- *ISO 9003*. This standard provides a standard of quality assurance for firms only involved in final inspection and testing of products. Firms using this standard are basically performing the inspection function of the product that would normally be done by the customer when the product is received.
- *ISO 9004*. This standard provides a set of guidelines by which the management of a company can implement and develop an effective quality management system. There is heavy emphasis on meeting company and customer needs.

A discussion of the current status of ISO 9000 and its components is found in an interview of two consultants conducted by *Quality Digest* magazine (Robitaille and West, 2006). A discussion specifically of ISO 9001 is given by Robitaille (2005).

Closely related to ISO 9000 as it affects product development is ISO 14000, which is a 'family' of standards concerned with environmental management. This is what an organization does to achieve the following:

- minimize harmful effects on the environment caused by its activities, and
- continual improvement of its environmental performance.

It covers environmental management systems, environmental auditing, eco-labeling, life cycle assessment, environmental aspects in product standards, and environmental performance evaluation (www.14000.org). ISO 14001 is the standard against which organizations are assessed and it applies to any organization producing any product or service anywhere in the world. It pertains to environmental management systems and is the standard under which companies are registered by a third party.

In many ways, quality is pretty much the same wherever one goes. It can be measured differently, for example customer satisfaction or money saved or earned. But, depending upon where in the world a product is manufactured or a service is delivered, one component may be more important than others.

There is wide divergence throughout the world in the number of companies registered to ISO 9001 and ISO 14001. For ISO 9001 the number of companies registered range from over 10,000 (India) to more than 130,000 (China). In contrast, far fewer companies are registered to ISO 14001. In 2007 the range of ISO 14001 certificates for the top ten countries was under 3,500 for France to more than 30,000 for China (Eves and Hack, 2008, p. 33).

Even with concern for quality, bad quality can emerge. As an illustration, China experienced a series of events in 2007 that led to safety scares in other countries (the United States, Panama, even Hong Kong): tainted pet food; toxic toothpaste, toys and seafood; faulty tires (*Businessweek*, 2007). Fisher-Price, a manufacturer of toys and a subsidiary of Mattel, Inc., in early August 2007 announced a recall in the United States of 83 types of toys made by a Chinese vendor because the paint contained an excessive amount of lead (D'innocenzio and Metzler, 2007). So-called shoddy manufacturing is not new to China. But, it appears that the Chinese government is starting to do something about it. For example, in the first six months of 2007, 180 food factories were shut down. The food and toy recalls have created an image problem for other Chinese exporters such that 'Made in China' hurts many other brands from there (Roberts, 2007). The supply chain in China has forces operating that have an effect upon product safety such as cost pressures and quality fade and the cleverness of the Chinese at evading detection (Berman and Swani, 2010). To best counteract these forces, companies which outsource products from China need a well-defined strategy to improve product safety. Exhibit 10.4 shows a simple product safety audit form.

Exhibit 10.4 Product safety when dealing with outsourcers

Although product safety is a concern in many developing countries, it is China that has had the worst experience in the past few years. Because of this it is suggested that firms outsourcing in China conduct a product safety audit, which can be conducted by a product safety coordinator, a product safety committee, or an independent consultant (Berman and Swani, 2010). Below is an example of a product safety audit list (Berman and Swani, 2010, p. 47).

- Are references of potential subcontractors carefully checked?
- Have we investigated the subcontractor's finance and insurance status?
- Has the subcontractor's litigation and claims history been verified?
- Does the subcontractor have a positive sales history with major firms?
- Do subcontractors have a legal presence in the United States?
- Do subcontractors have product liability insurance?
- Do subcontractors have an **import-export** license?
- Is the subcontractor certified by ISO 9000 of Underwriters Laboratories?
- Has our firm developed a detailed vendor manual that includes a listing of approved ingredients, banned substances, and allowable levels of quality variation?
- Do we use different testing procedures for low- versus high-risk groups?
- Do we inspect outsourcers' books and records to verify the source of raw materials and the outsourcers' further use of outsourcing?
- Do we test goods on a pre-production basis?
- Do we test goods during production?
- Do we test goods on a post-production basis?
- Do we employ multiple independent testers to verify compliance with safety issues?
- Do we use suppliers that employ security labels to reduce the use of counterfeit supplies?
- Do we require subcontractors to employ lot coding?
- Do we maintain proper records to limit recalls to affected batches?

More recently, Toyota Motor recalled 8 million cars due to mechanical failures linked to 51 deaths in the United States. Runaway acceleration was causing crashes (Ohnsman *et al.*, 2010). Earlier in the decade Toyota had problems with its Camry model. The company's focus on cost reduction during that time period was viewed as the underlying cause.

A good example of a company that has a clear policy on quality and product safety is the LEGO Group from Denmark. Since its inception the company has focused on quality, which to the company means product quality and ethical values of a high standard. The LEGO Group's policy on quality can be summarized as follows (www.lego.com/eng/info/default.asp?page+safety, accessed 28 June 2010):

> Our aim at the LEGO Group is to exceed customer expectations with regard to our products, service and their experience of the LEGO brand
>
> Quality is firmly rooted in our fundamental beliefs, our mission statement, our strategic goals and our values
>
> As a world leader in the field of quality experience, service and products, we focus on the customer's perception of quality
>
> Quality procedures are specified in our global quality management system
>
> We view the implementation of this policy as the shared responsibility of all LEGO employees

Many other companies believe in these principles even though they may not have formalized them to the extent LEGO has.

We now move from discussing innovation to discussing changes that can be made to existing products in the firm's product portfolio.

Changes in existing products

Often a product that is in trouble or is in the market maturity or decline stages of its life cycle (discussed later in this chapter) can have its life extended by making modifications. Such modifications may be in the physical product core, the package, and/or auxiliary services. To an extent this may involve making a decision related to the broader issue of standardization or adaptation, an issue that we discuss later in this chapter. However, the need for considering modifying the product may arise independently of this broader question.

Product modification, particularly at the outset of export to foreign markets, may involve changing the product from that marketed in the domestic market. Unfortunately this is not done too often. At the present time foreign buyers are in a position to choose from a wide assortment of offerings from many sellers in many countries. Consequently they do not have to accept products that may represent offerings resulting from a company's surplus capacity, relative to its domestic market, or which may represent an outdated generation of a technology-based product. For the export marketer this means that products must be designed as specifically as economic and environmental considerations will allow for each specific overseas market being considered. For example, US, Swedish, and German automobiles exported to the United Kingdom, Australia, New Zealand, and Japan should be right-hand drive even though the home and other export markets are left-hand drive countries. Similarly, Japanese automobiles exported to Western Europe (other than the United Kingdom) must be left-hand drive.

Often a company will need to continually change and improve its product(s) in order to maintain, and hopefully increase, its market share/position vis-à-vis competitors. This is the approach used by Sony for its Walkman personal stereo. Sony's ability to gain back market share it lost to other Japanese companies producing similar products is due to bringing out a stream of new and better models. It continually introduces new features to meet changing tastes.

New uses for existing products

Finding new uses for existing products can be an important approach to extending the life cycle for a product. For example, a home garden tractor marketed in an industrialized country such as the United States can be used commercially in a less developed country where farms are smaller and incomes lower.

Finding new uses for products may be difficult in foreign markets because of the distances between markets and the product planning and development activity of a company. Such distances can be great for the smaller company and for the company that relies primarily, if not solely, on exports. Also, a new use may also require some modification in the product. New uses may arise out of product research, consumer research, or chance. Regardless of the method by which new uses may arise, certain guidelines can be suggested, as follows:

- Is there a related application (e.g., an insecticide for ants may be used for bees in Latin America)?
- A product sold to women may be sold to men and vice versa (such as deodorants).
- Can the product be used differently when used with another product (e.g., an after-shave lotion used as a pre-shave lotion with an electric razor)?
- Consumer products may have an industrial market and vice versa (such as garden tractors).
- Does the nature of attributes and/or ingredients suggest new uses (e.g., the light weight and strength of balsa wood)?

Although chance can often play a meaningful role in success, it must be recognized that products are not always used in foreign markets for their intended purpose.

Product elimination

While primary attention is often given to the other forms of product planning and development, less emphasis is usually placed on deleting 'old' or weak products. This is unfortunate since keeping weak products can add substantially to overhead costs. In addition, company resources are often diverted from more profitable uses. One manifestation of carrying weak products in the product line is the **disproportionality phenomenon** in which a certain percentage of products in the product mix and product lines brings in a disproportionately greater or lesser percentage of sales and profits. This phenomenon is more popularly known as the 80–20 principle, although research evidence suggests that the empirical relationship is different. One study found that one-third of the products accounted for about three-quarters of sales and profits. The existence of this phenomenon alone does not necessarily mean that any given product should be deleted. For example, a company may decide to keep a weak product because it helps sell other products. Some buyers may prefer to buy their products from a single supplier. There may be a valid reason that a product is not presently contributing as it should and it may contribute meaningfully in the future.

The existing product mix should be continually evaluated or monitored. For some export/international operations this can put a tremendous burden on the communication and information system of the firm. Nevertheless, monitoring of products should be done to examine their relevancy and contribution in the light of changing customer needs, competitive products, and environmental conditions. This is particularly important to the firm active in international markets because often the breadth and depth of the worldwide product line is greater than in the domestic market and the rate of change in international market conditions can be more rapid.

There is a need, then, for a procedure for the systematic review of products. As in screening new product ideas, criteria have to be established and a model developed for applying the criteria. For example, normal sales and cost analysis can provide the background data needed about a product. Then it can be evaluated by rating it along dimensions such as its future market potential, possible gain by modification of product and/or marketing strategy, alternative opportunities available to the company, its contribution to the sale of other products, and so on. Some type of rating value, weighted or unweighted, can then be used to guide the decision about elimination.

Once a product has been evaluated as being weak, thus becoming a candidate for elimination, decisions must be made as to *when* to withdraw it from foreign markets and, further, when to eliminate it from the company's product line. This again poses a number of issues concerning the uniformity of the worldwide product line. One approach is to withdraw products in potentially weak markets while retaining them in profitable markets. Alternatively, one could consider the withdrawal of the product from all markets. The appropriate approach depends on opportunity and other costs associated with carrying the product in a limited number of countries, and the autonomy of product management decisions in relation to other export marketing decisions.

There are times when the export/international marketer may find it desirable to replace a withdrawn product with a new one. The set of strategies for the synchronization of old product deletion with entry of a new product is known as *product phasing*. When a new product replaces an old one there is a choice in the element of the product/marketing mix that can be continued or discontinued. As shown in Figure 10.4, discontinuity increases from the 'No change' corner (upper left) to 'Innovation' (lower right).

There are many phasing strategies that can be used to implement the replacement of an old product. These include the basic *butt-on* approach where the replacement product is made available immediately after the old product is deleted, the *low season switch* where replacement occurs while demand is low, the *high season switch*, and *fudging*, where, in order to reduce discontinuity, overlapping occurs and there is no special market announcement about the replacement and replaced products.

Product mix decisions

Determining the export product mix involves making decisions with regard to the *breadth and length* of the product mix sold in a company's foreign market areas. Our major concern in this section is with those factors that affect such breadth and length. When these factors

Marketing \ Product	No change	Modified	Technology change
No change	**No change** • No change	**Face lift** • Appearance • Costs	**Inconspicuous substitution** • Technology • Materials • Manufacturing
Re-mix	**Remerchandizing** • Name • Promotion • Price • Distribution	**Relaunch** • Costs • Promotion • Price • Distribution	**Conspicuous substitution** • Technology • Materials • Manufacturing • Name • Appearance • Promotion • Price • Distribution
New market	**Brand repositioning** • Name • Promotion • Price • Distribution • Target • Competitors	**Product repositioning** • Name • Appearance • Costs • Promotion • Price • Distribution • Target • Competition	**Innovation** • Technology • Materials • Manufacturing • Promotion • Price • Target markets • Competition

Figure 10.4 The phasing continuity matrix

Source: Adapted from Saunders (n.d.), p. 25.

are used in product mix determination the analysis should be individual product-market situational. That is, they often act as limits to the expansion of a product line or the total mix, in one or more foreign markets. It must be remembered that these factors will help answer the question: 'Can a product be sold in a way that objectives are met?' Exhibit 10.5 discusses some major issues regarding managing consumer products in the international marketplace.

We discuss now an analytical approach to determining product line and then the specific considerations that go into determining the product mix.

Analytical approaches

Product portfolio

One approach that has been suggested for achieving an optimal export product mix, both within and across countries, is the *product portfolio* approach (Grewel and Levy, 2010, pp. 49–52). The major assumptions of this approach are as follows:

- The two most relevant characteristics of a product portfolio are its expected return and its riskiness.
- Managers will choose to hold efficient portfolios that are defined as either maximizing expected returns for a given risk or minimizing risk for a given expected return.
- It is theoretically and operationally possible to identify efficient portfolios by a systematic analysis of information for each of *n* products.

Exhibit 10.5 Managing a line of consumer products

The cost of operating in the world market for consumer goods has increased greatly, and more companies are choosing to drop out. The cost now goes far beyond advertising budgets. It includes research to understand shifts in consumer attitudes; intertwined manufacturing and logistics networks providing superior retail service at lower cost; retaining information processing capability; and product discovery and development geared to speed new products.

The large companies in consumer goods categories amortize capabilities across related businesses and continually look to expand the definition of their categories. These companies apply a consistent set of principles, as follows:

- *Focus* resources on a broadly defined category across all core markets.
- *Acquire* products to fill out the line.
- *Adapt* the world brand to local tastes.
- *Conduct* deep and thorough consumer research to understand all the possible segmentation dimensions and furiously hurl product at the most promising targets.
- *Control* the retail shelf and promotional program with value-added category management.
- *Recognize* profitable market share gain as a critical performance measure.
- *Behave* as if the category 'belongs' to them.

Only a few companies are rigorously applying the above principles.

Clout will come from focusing on winning categories, margin dollars that fund investment in behavior tracking, in-store activities, new product launches, new promotional schemes, and acquisitions that further consolidation. Companies will steadily expand their volume through brand development, clever consumer promotion, a stream of new products that respond to new and existing consumer needs, and products that deliver superior performance.

The analytical procedures used in portfolio analysis can range from simple graphs to the use of calculus or complex mathematical programming. Given international management's preference for a trade-off between expected return and risk, the end result of the analysis could be a suggested proportion of the total product mix that should be allocated to each product and market in order to achieve efficiency.

In Chapter 5 we discussed the use of product portfolio approaches for market selection. Of particular note was the Boston Consulting Group approach in which products are classified as stars, question marks, cash cows, or dogs on the basis of relative market share and market growth rate, as illustrated in Figure 10.5. Relative market share, which is a surrogate measure of competitive strength within an industry, is computed by dividing a company's (or business unit, or brand) absolute market share by that of the leading competitor in an industry. Cash is generated via market share and is used to respond to market growth. In order to survive in the long run a company needs a balanced portfolio where cash cows generate sufficient funds to support question marks and stars, which hopefully will become cash generators themselves at a later point in time.

The BCG portfolio approach has been criticized intensively, because it is not equally useful in all circumstances. In particular, for small and medium-sized companies involved in exporting (the largest group in terms of numbers of companies) the BCG approach will

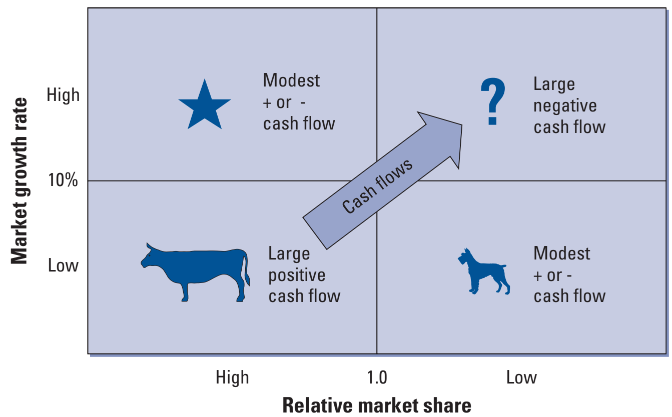

Figure 10.5 BCG portfolio matrix

often lead to inappropriate and misleading applications. First, the basic assumptions concerning the experience curve mechanism, that is, the links between market share and profitability, and the product life cycle as the driving force of market evaluation, are violated. Second, the measurements are questionable. How much market segmentation? Which level of geography? Should the definition of the product market be broad or narrow? These questions are important for measuring the relative market share and market growth rate, and so are the interpretations of the strategic bases for resource allocation.

Other issues relevant to the use of portfolio analysis by small and medium-sized exporters include the following:

- Do such companies even have a portfolio of strategic product/market combinations?
- Do these exporters have the environmental information needed to apply the approach, including strategically relevant information related to actual and future rate of market growth, market size, and market share?
- The key factors determining the success of these types of exporters are not necessarily based on costs, prices, and market shares (and therefore on economies of scale and **experience-curve effects**) but very often on other things such as quality, service, innovation capabilities, and a specific technology.

Since it is very difficult to implement the product portfolio approach, its major immediate value would seem to be in suggesting a framework for evaluating alternative product and/or market mixes. In effect, the BCG analytical approach is more of a diagnostic tool rather than a guide for making strategy prescriptions.

Decision theory

Another approach involves the use of *statistical decision theory*, which provides a framework for improving not only the clarity of thought that is employed in the analytical process, but also a vehicle for quantifying certain aspects of the process (Moore and Thomas, 1976; Wright, 1984). Although this approach usually requires the use of probabilities and payoffs, and poor estimates are likely to lead to poor decisions, it could be argued that the method has some merit:

- It serves to focus attention on critical issues.
- It forces one to be explicit about alternative courses of action and their consequences.
- It provides a systematic procedure for quantifying and evaluating the consequences of alternative courses of action.

The really distinctive feature of the above approach is the subjective interpretation and use of probability notions. Unfortunately, it is more difficult to utilize statistical decision theory in international and export product decisions than in domestic decisions; the degree of subjectivity is greater due to a greater lack of knowledge of the necessary probabilities. However, the framework for thought (if not analysis) is just as relevant to export decisions.

Internal determinants

The internal determinants of the breadth and length of the export product mix are those factors that emerge from the firm itself. These are collectively concerned with company objectives and resources, and potential profitability. Of concern are answers to such questions as the following. What are the firm's objectives in export marketing: For example, growth, market share, reduction of risks, exporting products with surplus production capacity, and so forth? Does the product line make the best use of company resources and differential advantages, for example superior technology or management and marketing skills? Related to this is the philosophy of management regarding how serious they are about international/export marketing. Is permanence a desire of management? This question is analogous to making a distinction between sales and marketing. A sales approach would involve selling a product of which there is an excess in the hope that it can be found useful overseas. In contrast, the marketing approach dictates that a company assesses the needs of an overseas market and then attempts to find the product that best satisfies those needs.

The other elements of the export marketing mix can have an effect upon, and be affected by, product mix decisions. The mode of export entry abroad can be used as an illustration. If indirect export channels are to be used, a company may be able to concentrate on a limited number of the most profitable products. On the other hand, offering a broad range of products may be necessary for the profitable operation of direct export, for example for an overseas sales subsidiary. Similar concerns arise for nonexport market entry modes. For example, with licensing, only selected products from the overall product mix will be involved, and usually only a small number of them.

External determinants

External factors are those deriving from outside the company that affect product line decisions. We now take a look at some of these factors.

Customer influences

The nature of customer needs and wants in each relevant market affects the effectiveness of any marketing effort. Certainly, looking at these together with customer characteristics and interests provides the basis for determining which products should be, in the first place, considered and, second, which products should constitute the product mix. However, different assortments and quantities of products may be desired and purchased in various countries.

One factor that often causes such differences is patterns of use, which may vary among market areas. For example, in the United States a bicycle is used primarily for recreation while in various parts of Europe and Asia the bicycle is used primarily for nonrecreational transportation.

Cultural and social values that underlie market behavior can explain why some products can be marketed profitably in some foreign markets, but not in others. Values influence a wide range of behavior, including product purchase and use, because they are central to people's lives. For example, as we discussed in Chapter 5, one approach to examining values uses the List of Values (LOV), which includes the following eight values: self-respect, sense of accomplishment, being well respected, security, warm relationships with others, sense of belonging, fun and enjoyment in life, and self-fulfillment. LOV is potentially useful in new product development as well as international market segmentation (Kahle *et al*., 1987). The LOV has been used in consumer and management research settings in a variety of countries, including Japan, Scandinavian countries, the United States, the former USSR, Israel, Venezuela, Australia, PRC, Hong Kong, the Philippines, and Vietnam (Kahle *et al*., 1999; Albaum *et al*., 2004).

Competition

Of concern are answers to questions such as the following. What is the type and range of products offered by competitors in the target market countries? Has the demand for a given product already been satisfied by competitors? If competition is strong the cost of market penetration for a given product may be very high, perhaps so high that it would not be worth the effort of trying to penetrate the market.

To a large extent competition can be overcome by marketing specific products to selected segments of the market. Even here, though, the segment(s) may not be large enough nor have enough growth to sustain a new entrant into a market already dominated by competitive firms. CPC learned this lesson the hard way when it tried to market a successful European product, dry Knorr soup, in the United States. Not only was Campbell the dominant company (with Heinz a distant second), but the expected growth in the segment that used dehydrated packaged soups never materialized.

Product's stage in the life cycle

In Chapter 2 we discussed the product life cycle (PLC) as a theory to help explain and predict export trade. We now look at the concept at a more micro level, and see how it might affect a company's export product mix.

The product life cycle guides the development of product programs; it can be used in the strategy of both existing and new products and can be involved in both product addition and elimination decisions. The life cycle can be a useful planning device, and is an essential methodological element of strategic international marketing. The development of products in various countries can be phased to the product cycle and growth of demand. Four distinct stages of the cycle can be delineated, as shown in Figure 10.6. In foreign markets, the time span for a product to pass through a stage may differ among the markets, and perhaps be longer than in the country of origin. In addition, a given product may be in a different stage in different countries. This is illustrated in Figure 10.6 by the product being in the market maturity stage in the home market, the introduction stage in country A, and the growth stage in country B.

A useful feature of the life-cycle concept is its emphasis on impending *change*. The PLC indicates quite clearly that the future will differ from the past and the present, although there may be some similarities. Another feature is that it alerts management to the strategic importance of timing, as the right strategy for one phase may not be appropriate for

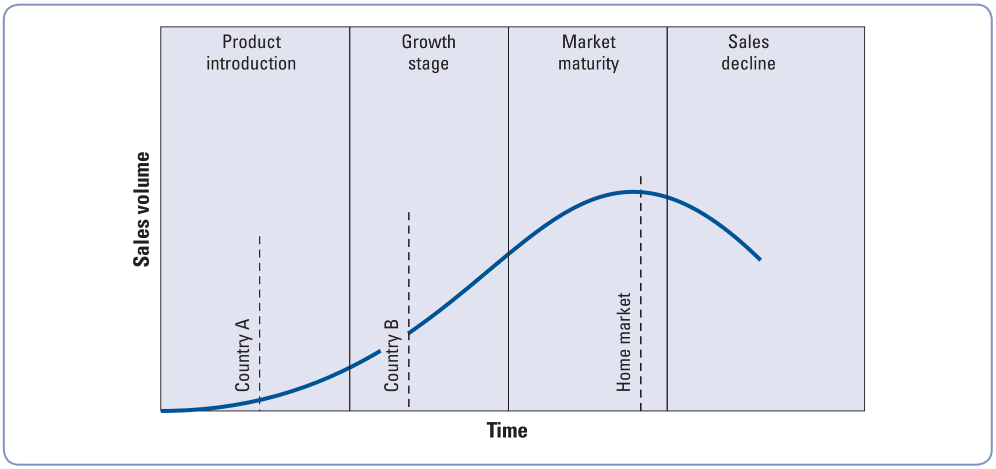

Figure 10.6 Product life cycle

another phase. The product life cycle can also be used across markets. One approach would be to view markets as leader and follower countries. Figure 10.7 shows how leader and follower strategies vary by stage in the PLC. It is interesting to note that as the product enters stages 3 and 4 there are pressures to establish production facilities abroad, although the nature of countries differs for each strategy.

In both strategies company location is important. While there is a tendency for companies to introduce new products first in their home countries, such is not always the case. For example, Japanese color television producers exported to the United States before marketing them in Japan. Similarly, Hitachi exported video disks to the United States before selling them at home.

Depending upon its organization, a company may find it difficult to operate in more than one or two of the stages of the life cycle at any one time for any given product. Thus, *where* a product is in its life cycle in a foreign market can affect its inclusion in the product line being offered in that market. The differing characteristics of the PLC stages – for example advertising needs, competition, pricing behavior – illustrate why it would be difficult to operate in more than two stages at any one time.

Advanced planning should be directed at extending the life of the product. This means that export management should be thinking of later actions that may be necessary in the cycle even before a product is introduced into a foreign market. One or more of the following may be used to expand sales:

- Promote more frequent use among current users.
- Develop more varied use among current users.
- Create new users.
- Find new uses for the product.
- Make changes to the product.
- Introduction of a product that is designed to be short-lived.

Exhibit 10.6 gives an example of a product introduced solely for the purpose of creating interest in the company's other products.

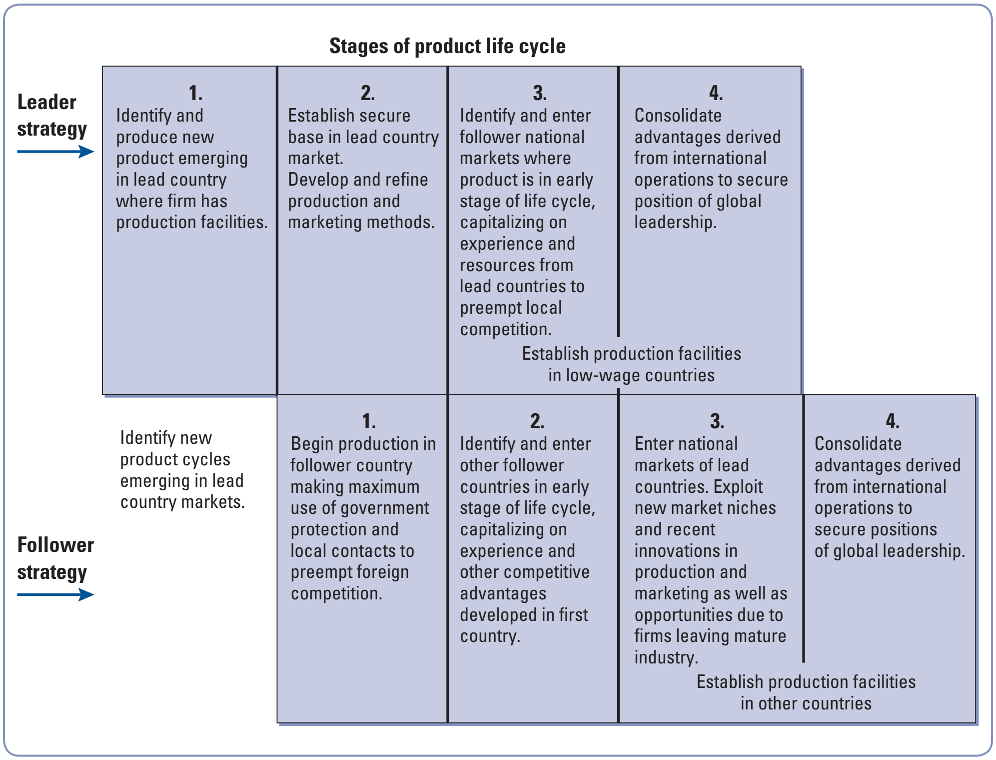

Figure 10.7 Leader and follower strategies across the product life cycle

Exhibit 10.6 Fad marketing

In June 2007, PepsiCo introduced a new drink product, Ice Cucumber, in Japan. More than two years of development work was spent by Pepsi and its Japanese bottler and distributor Suntory. After being on the shelves of convenience stores for about two weeks, all 4.8 million bottles of Ice Cucumber had sold out. Pepsi brand managers then discontinued the drink.

The introduction of this product was largely a marketing stunt designed to generate interest in the Pepsi brand. Pepsi and Suntory expressly wanted to create a short-lived fad. Pepsi hopes that the Ice Cucumber experience will lead to a longer-term benefit, and that it will have a positive effect on its sales of other products in Japan (Hall, 2007).

Other external factors

A variety of other external factors may affect the breadth and length of the international product mix. Included among these are the following:

- the existing marketing structure of distribution, including facilitating agencies;
- government regulations on product content or packaging;
- import regulations including tariffs and nontariff barriers;
- climatic and other physical conditions;
- the level of economic development in markets.

Standardization versus adaptation

A central challenge in international marketing is the decision whether to standardize or adapt. An overview and review of the literature of the broad issue of standardization of marketing programs, including the product dimension, is given by Birnik and Bowman (2007). Standardization or adaptation can occur for the physical product core (e.g., size, function, color), package, and auxiliary services. At one extreme a company will standardize by offering only one version of a product and this may be essentially the same product as that marketed in the domestic market. This approach is the essence of what is called a *global* product strategy.

A so-called global product is one designed to meet one of two standards: (1) the preferences of consumers in the domestic home market, or (2) the lowest common denominator of the export markets. At the other extreme, adaptation can be carried to the point of individualization whereby a company customizes products or services to meet the unique needs of individual buyers or groups of buyers in foreign markets. It has been suggested by Japanese officials, for example, that in order to exploit their market properly, companies should sell products that have been specially tailored to Japanese requirements. Examples of companies that have done this include Ore-Ida with frozen potatoes in smaller packages and with low salt content, and Triumph International producing women's underwear to fit Japanese women, who are smaller than Europeans.

The issue does not usually involve one extreme or the other. Rather, it is a matter of degree. That is, there are reasons for adaptation and reasons for standardization such that companies can be placed on a continuum (Vrontis *et al.*, 2009). Figure 10.8 summarizes these reasons as they might affect marketing tactical behavior. Market development,

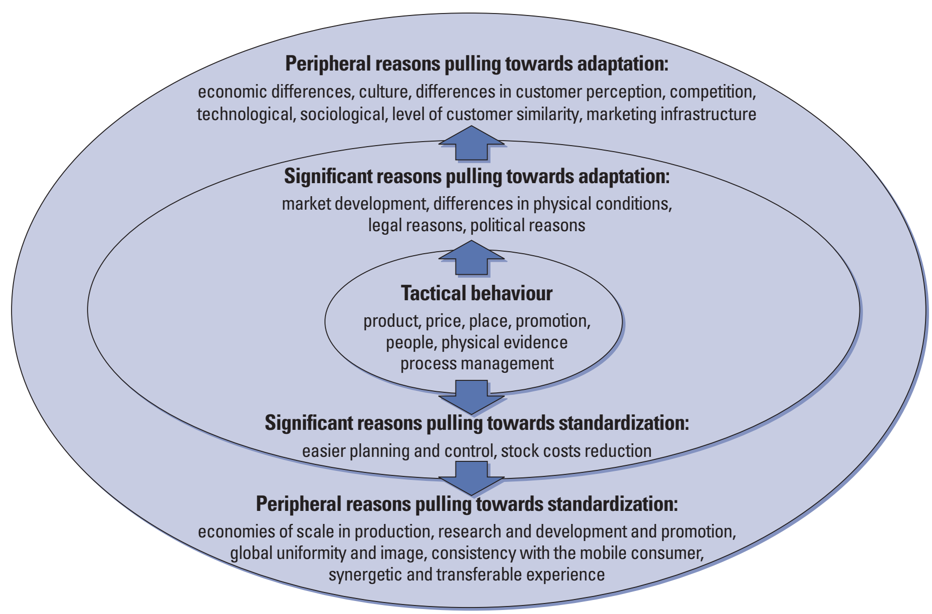

Figure 10.8 Reasons for standardization or adaptation (research produced)

Source: Vrontis *et al.*, 2009, p. 492.

differences in physical conditions, legal reasons and political reasons are the major reasons that move a company toward adaptation. In contrast, easier planning and control and stock cost reductions are significant reasons for standardization.

Of course, standardization is common for certain agricultural products, raw materials, and processed commodities sold to industry. Likewise individualization of products or services is common for certain kinds of buildings, plants, and equipment, as well as for certain services. But, although a policy may be primarily one of standardization or individualization, export product decisions usually have to be a compromise between these extremes. Adaptation can be *mandatory* or *voluntary*. Mandatory adaptation may be required because of such things as language differences, differing electrical systems, differing measurement systems and product specifications, and government requirements. Voluntary adaptation occurs when the exporter decides solely by itself to modify one or more products. For example, Switzerland-based Nestlé SA offers its popular instant coffee brand Nescafé with 200 variations – more variations than the number of countries that Nestlé sells coffee to.

Should an exporter try to globalize or standardize its products? It is not clear that there is a definite answer to this question, nor even that it is possible to completely standardize. Certainly it is possible to standardize a product concept such as fast food, convenience in use, state-of-the-art electronics, and so on. In general, however, some type of mandatory adaptation may have to be made or a voluntary change (minor or major) may be beneficial. Examples of global products are Coca-Cola, Sony television, McDonald's restaurants, Levi jeans, and Kentucky Fried Chicken. In fact each of these has required some adaptation to foreign market conditions:

Product	***Adaptation***
Sony TV	Voltage, broadcast standard
McDonald's	Menu, décor of restaurant
Levi jeans	Size mix, fabric, cut
Coca-Cola	Brand name (China), package
Kentucky Fried Chicken	Menu

From a buyer's standpoint a product should not be almost what the buyer wants, it should be exactly what he or she wants. This suggests a policy of individualization of products. However, from a seller's standpoint it is often possible to reduce costs by standardization. The key question then becomes: to what degree can the interests of producers in cutting costs be reconciled with the interests of buyers in having individualized products? Significant cost savings can come about from product design by offering the same basic product in several markets; often, however, with minor differences. Nestlé found it could reduce product variations in its KitKat line of chocolate bars worldwide when product testing showed that KitKat's particular combination of milk chocolate and wafers went over well across cultures. The differences were mainly in the raw materials, which are often purchased locally, and the packaging sizes.

Cost savings can also come from packaging, as illustrated by a food processing firm selling prepared soups throughout Europe, which standardized packaging from the 11 different packages previously used. Another example, also from the packaged food industry, is Kellogg, which lowers packaging costs by using a multilanguage package for its individual-sized cereal packages in Europe.

While there are definitely production cost savings to be obtained from standardization, whether this should be viewed as one piece of evidence of the eventual emergence of global markets that consume and use global products is debatable. First, the cost of production is only one, and often not the critical, component in determining the total cost. In addition, there is no evidence supporting two other critical assumptions underlying the growing emergence of a standardization strategy:

1. Homogeneity of world tastes and wants, and an increase in the number of global market segments.
2. People are willing to sacrifice specific preferences in product features, functions, design, and so on for lower prices at higher quality.

The degree to which standardization is acceptable to the market – or to which individualization is necessary – depends in part on the kind of product involved. Figure 10.9 arranges a sample of products along two dimensions. The horizontal dimension, the consumer's preferred product, classifies products along a continuum from standardized to customized. The vertical dimension, rate of change of product, covers a spectrum from slow to fast.

For example industrial goods, such as steel and petrochemicals, may be homogeneous throughout the world. Certain consumer durables may be fairly well standardized except for technical characteristics such as different kinds of electrical plugs or internal components to handle different voltages. Consumer nondurables often require greater individualization due to more widely varying tastes, habits, attitudes or shopping behavior.

One of the most difficult products to standardize is food. Food is a difficult product class because food habits are deeply and emotionally ingrained in the culture of a people. And there are substantial differences not only regionally and internationally, but even from one

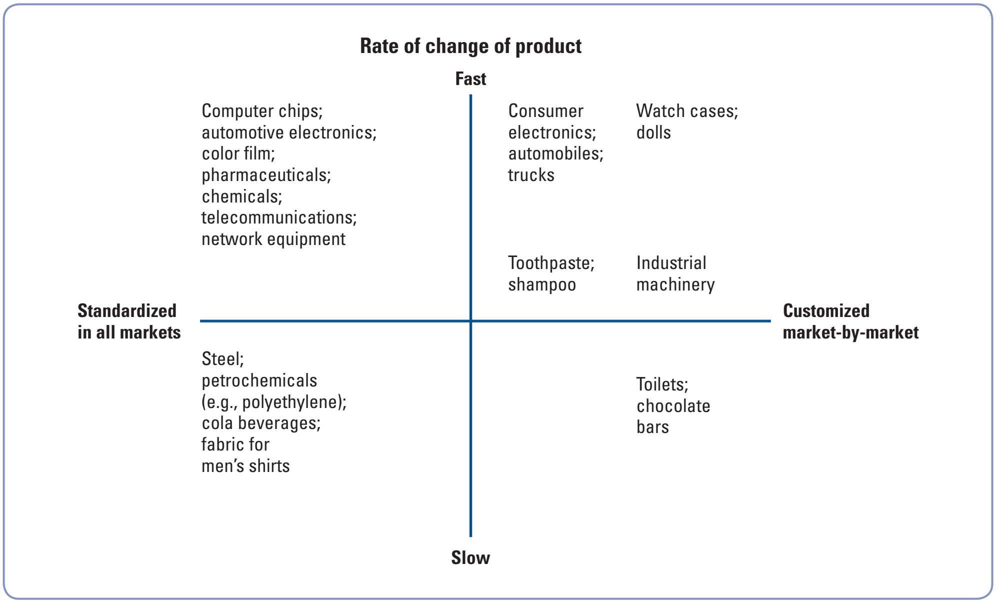

Figure 10.9 Market requirements and product characteristics

community to the next. Often overlooked by food processors and packagers is that the key ingredient for a cook might be ritual. Therefore, convenience-based foods might not be readily accepted.

On the other hand, product policies on certain durable goods or industrial products are relatively easy to formulate. Perhaps the only change that needs to be made in the domestic model is to adapt the wiring for differences in electric current, or to change the size of the product. Automobiles may be designed in one country, exported, and meet fairly well the needs of drivers in another country. However, varying styling tastes, driving conditions (left or right side of road), as well as road and climate conditions, increasingly require some individualization.

Products requiring art work or creative designs ordinarily are relatively good candidates for standardization. Some forms of art and styles – such as are required by furniture, silverware, or china manufacturers – tend to be universal, with certain market segments in numerous countries. For example, Rosenthal-Porzellan AG, the large German china and glass producer, has stressed leadership through design. The company employs artists and designers from dozens of countries and lets them loose to produce their best work. They turn out products that meet both a high international level of taste and all the variations of taste within that level. Other types of artistic/creative products, especially for the consumer market, may be individualized, as shown in Figures 10.10 and 10.11.

Figure 10.10 Designing pottery in Malaysia

Figure 10.11 Jewelry making in Bali, Indonesia

For many products the world is not divided into national or regional markets. Rather it is divided into segments that transcend political or geographical boundaries of many countries. Therefore it sometimes is not necessary to adapt products to national markets. A good example is music. It can be argued that the musical tastes of teenagers in Rio de Janeiro or Melbourne are more similar to the tastes of teenagers in London or Rome than they are to the tastes of their parents. There are products that have a small share of any given national market, but are successful in world markets, for example, Scotch whisky and quality cameras. This could involve being a niche marketer (see Exhibit 10.7).

Niche Ltd-type companies seem to have a simpler challenge – to survive! These are small, highly flexible companies that tend to specialize. Some specialize in luxury markets which have a demand structure that is so elastic it tends to be insensitive to price. In such markets the economies of scale of Megacorps have no effect. Other Niche companies operate in specialized industries with such high market barriers that Megacorp companies are not interested. A Niche Ltd company is always *defending* its market as it is concerned with a takeover, a decline in its market, or a chance discovery by a Megacorp that would make its product obsolete.

Government regulations, taxes, and political conditions can also be a factor. When Orange Fanta was introduced around the world it was found that there were many different legal requirements on the percentage of real orange juice that food products must contain if the word 'orange' is used. The differing regulations by the respective ministries of health required that Orange Fanta vary either the product formula, the name of the product, or the advertising messages. Likewise, the horsepower of automobile engines tends to be lower in countries where cars are taxed according to engine power. Also, pharmaceutical companies frequently encounter varying legal requirements of purity or tests of efficiency before a product can be introduced to a market.

Exhibit 10.7 Megacorp, Inc. versus Niche Ltd

As we moved through the 1990s, two categories of market-oriented companies seem to have emerged from the marketing 'wars' of the 1980s – *Megacorp, Inc.* and *Niche Ltd* (*The Economist*, 1989). These types of companies continue to flourish in the 2000s. In most instances these companies are involved in the marketing of 'packaged consumer goods.' But the concepts underlying these companies can apply to firms producing and marketing any type of product where multiple branding is feasible.

Megacorp's approach is to sell a wide variety of brands throughout the global marketplace and, as such, is concerned with the global aspects of marketing. There are obvious economic benefits in producing the same product worldwide, then marketing it in the same way everywhere. This is the essence of having a *global product*. But such companies have found that if they wanted to sell their branded goods they need to be adapted somewhat to local markets. Very few exceptions exist – Coca-Cola and Marlboro are two examples.

As a result, the marketing managers of Megacorp companies put emphasis on *thinking global, but acting local*. In some instances this can mean altering the product's image. For example, Schweppes tonic water was advertised as a mixer for alcoholic drinks in the United Kingdom, but as a soft drink (such as Coca-Cola) in France. In other situations it is the product itself that is changed. Unilever's shampoo Timotei was marketed with the same image throughout the global marketplace, but the product was changed to suit the different ways that people in different cultures and nations wash their hair. In a similar manner, Procter & Gamble tried to develop products with a technology that could be applied globally but in forms suited to local needs. For example, its Japanese sanitary pad, Whisper, was lighter than its US product, Always.

There seem to be numerous conditions under which a policy of either standardization or individualization is desirable (see Table 10.3). But there seems to be no way to truly generalize on this matter except that the desirability of the policy depends on analysis of the market, buyer behavior, competition, government or legal regulations, and the numerous other factors in the relevant economic, social, and political environment. However, since modern transportation and communication media have made people in various countries more aware of the tastes of those from other areas, market segments with similar needs and wants tend to develop. This circumstance tends to make a policy of standardization feasible. At the same time, as local economies and citizens become more affluent, they demand greater variety. Thus the problem of meeting diverse needs and wants tends to intensify somewhat. These trends and countertrends, and the forces behind them, suggest that making good export product decisions is becoming increasingly difficult.

It is possible for individual companies to do both more standardization and greater individualization of products going to foreign markets. This seeming contradiction is explained as follows:

1. A policy of market segmentation can be followed to serve market segments that are similar in many nations and at the same time large enough in number to permit a simultaneous policy of standardization among such market segments.
2. Manufacturers from many countries increasingly have the ability to handle short production runs economically; to 'custom-make' goods to meet the increasingly individualized demands of markets as they become more affluent.

Table 10.3 Factors to consider for global product strategy

	Globalize when:	Adapt when:
Competitive factors		
Strength of competition	Weak	Strong
Market position	Dominant	Nondominant
Market factors		
Homogeneity of consumer preferences	Homogeneous	Heterogeneous
Potential for growth of currently small segments	Low	High
Consumer purchasing power	Uniform	Varied
Willingness of consumers to pay for differentiated products	Low	High
Need satisfied by product in markets served	Shared	Individual
Conditions of use	Uniform	Varied
Product factors		
Importance of scale economies in manufacturing	High	Low
Opportunities to learn from small-scale production of innovative products	Low	High
Type of product	Industrial	Consumer
Codes and restrictions	Uniform	Varied
Companies factors		
Scope of international involvement	Many or large markets	Few or small markets
Company resources (financial, personnel, production)	Limited	Abundant

Source: Rosen, 1986.

Despite the potential benefit of standardization, there are and will continue to be some important obstacles arising from such sources as the physical environment (e.g., climate), stage of economic development (e.g., income levels), culture, competition, stage of product life cycle, availability of distribution outlets, legal restrictions, and even differences in consumer use.

An approach to determining standardization

How does an exporter determine the extent to which a product should be standardized across foreign markets? An approach that involves a certain amount of subjective judgment on the part of the decision maker is to select one country or market area as a 'benchmark' country and then evaluate all other markets in relation to it. Usually the benchmark will be the home country of the exporter, but it could very well be the country where success has been the greatest. A 10-point numerical rating scale, with 0 representing no hope for standardization and 10 indicating that standardization is quite feasible, can be used. The benchmark country is assigned the value of 10. If a manager decided that any point on the scale higher than 6 indicates that standardization should be considered seriously, then the profiles can reveal quickly which markets would warrant a closer look.

Table 10.4 Product-communications strategy alternatives

Strategy	Product function or need satisfied	Conditions of product use	Ability to buy product	Recommended product strategy	Recommended communications strategy	Relative cost of adjustments	Product examples
1	Same	Same	Yes	Extension	Extension	Low	Soft drinks
2	Different	Same	Yes	Extension	Adaptation	Medium	Bicycles
3	Same	Different	Yes	Adaptation	Extension	Low	Gasoline
4	Different	Different	Yes	Adaptation	Adaptation	Medium	Cards
5	Same	–	No	Invention	New	High	Hand-powered washing machine communications

To illustrate, a United Kingdom company is examining a number of markets. It decides to use its home market as the benchmark. The following ratings are made: Canada (8), France (8), Brazil (5), United States (10), Belgium (7), and Mexico (3). Using a cut-off value of 6, this example indicates that a similar product might be appropriate for Canada, France, Belgium, and the United States. This general approach can be used for the other marketing elements. As such, this approach can be useful in formulating market segmentation strategies.

Effect of other marketing variables

The issue of product standardization versus adaptation often cannot be resolved in isolation. Rather, product decisions of this type are often likely to be made with decisions regarding other export marketing variables (Birnik and Bowman, 2007). To illustrate, consider product and promotion policies. Five alternative strategies that can be identified are summarized in Table 10.4 (Keegan and Green, 2003, Ch. 11).

Packaging

Packaging is probably the cheapest, quickest, and easiest way to adapt a product to make it more suitable for foreign markets. Such adaptation goes beyond the matter of language and involves the question of altering appeals. The issues relevant to marketing revolve around the relative importance of the package's dual roles of *protection* and *promotion*. While protection is important, a package's promotional power cannot be ignored. Since the same product sells in different countries often for different reasons, package design can do much to express and present a product in a way that is preferred by customers in each market. The package must be convenient and easy for buyers to use. In addition, it should help sell the product by attracting the buyer's attention, identifying the product, and providing a reason to buy. Another way of looking at this is to apply the VIEW test in each market:

V – *Visibility*: the package must be easily distinguished from the visual competition.

I – *Information*: the package must quickly communicate the nature of its contents.

E – *Emotional impact*: the design must create favorable impressions in the mind of the consumer.

W – *Workability*: the package must function as protection and must also be efficient in home use.

Some amount of standardization is desirable, particularly for consumer goods that may be sold by self-service. Language may or may not be a problem. In various parts of Europe, such as Denmark, it is not uncommon to find products from English-speaking countries packaged using English. However, in some countries (e.g., Germany and the United States) you may need to use the country's language if you really want to tap the full potential of the market. The Canadian market requires bilingual packaging: English and French. In still other areas a company can export to selective markets using its own language because it is similar to that of the market. For example Danish, Swedish and Norwegian companies can use their own language in the other two markets.

Multilanguage packaging is becoming more and more prevalent for consumer goods. As previously cited, Kellogg's Corn Flakes, produced in Germany and distributed throughout Europe, in the past used 14 languages on a small individual package to convey contents and serving instructions. For its package of 3.5-inch diskettes, 3M shows opening instructions in five languages. A Danish company, Scandinavian Marzipan Factory A/S, uses French, English, and German on its Denmark brand of cookies, even those sold in Denmark. The French-made EKS model 38 diet and kitchen scale uses nine languages – Swedish, English, German, Finnish, Portuguese, Dutch, French, Italian, and Spanish – for showing capacity and other information about the product (Figure 10.12). The Austrian company Swarovski includes a short promotional piece in seven languages with its crystal products. A final example is that of the Norwegian outdoor clothing company Helly Hansen. Attached to each garment are tags with further information about the company and its products in multiple languages. Figure 10.13a shows the tag with emphasis on the product whereas Figure 10.13b points out some things about the company. However, multilanguage packaging can also

Figure 10.12 EKS diet and kitchen scale package

Figure 10.13a Helly Hansen tag about the product

bear risks for the producing company. For example, Italian-based Barilla used various languages on the packaging of its pasta sauces, each piece of information written in letters almost too small to read. This issue raised criticism from consumers who saw transgression of consumer laws (minimum font size) and discrimination against older consumers.

Using standardized dimensions for packages leads to reductions in cost and generates some benefits. Some of these are as follows:

- Reduction of dimensions to a few standard sizes facilitates the machine packing of merchandise.
- Standardized package sizes reduce inventory investment in packaging materials, and facilitate mass production of the fewer types of packages and shipping boxes.
- Standardization permits full utilization of storage space at the factory and all levels of distribution.
- Uniform package dimensions permit a balanced format for display and for self-service selling.
- Standardized sizes simplify, expedite, and cut the cost of handling and shipping.

Figure 10.13b Helly Hansen tag about the company

Standardization may be advantageous from the point of view of facilitating consumer convenience in purchasing, and possibly disadvantageous in terms of consumers' abilities to evaluate the characteristics of products of different producers, when such products come in identical package sizes. While products such as textiles lend themselves relatively readily to standardization, other products may cause problems. If cost savings are real, an exporter may be able to lower prices of the exported product(s), thus becoming more competitive and more appealing to consumers. For example, Fuji film, a Japanese company, uses its 'green box' identity for its film worldwide. The goal is to be able to communicate multilingually and position itself against Kodak with its 'yellow box' identity worldwide.

A potential problem is that countries may differ in their preferences for different packaging materials. The relative role of paper, plastic, glass, wood, and metal can vary in foreign markets. Unit size and internal packaging may also differ. In the United States food products such as crackers are sold with multiple paper-wrapped packages inside a box whereas in other parts of the world the tendency is to use bulk packages within the box. In the European Union all products sold within its borders must be labeled and specified only in metric measurement. Nonmetric measurements cannot be used in product advertising, catalogs, technical manuals, user instructions, and packaging design. Dual measurements on product labels – such as listing both ounces and liters on a soda bottle – are also prohibited.

A study in the early 2000s of US multinational companies doing business in India concluded that packaging standardization is more often used in the early stages of entry into the market, when the firm's level of commitment is relatively low (Griffith *et al*., 2002). This suggests that desire for cost efficiencies in packaging drives companies when first entering the market. Over time, however, companies may find that they are better able to achieve a competitive advantage by adapting packaging, and other forms of promotion as well, to more closely match consumer tastes in the local market.

Another issue regarding packaging arises through ecological problems. This has an impact on materials to be used and how they are used. Environmental policies are paramount in the European Union and in other countries such as the United States. The European Union has a directive on packaging and packaging waste. This directive aims to harmonize national measures concerning the management of packaging and packaging waste in order to reduce their impact on the environment. Within a few years after the directive has been implemented in the member states, the European Union countries must ban packaging that is neither reusable nor recyclable and part of an established return channel. All packaging placed on the market in the community is included in this perspective: sales packaging (primary), grouping packaging (secondary), and transport packaging (tertiary). All reusable and recoverable packaging must bear the appropriate marking(s) either on the packaging itself or on the label. Packaging material can also be a significant cost in some countries as companies are obliged to pay extra for the recycling of the packaging material. For example, it may be cheaper to avoid plastic packaging for tomatoes in one country while in another a company may be able to use plastic without having to pay an extra fee.

An issue related to packaging is *labeling*. A label is a means whereby information about the product (e.g., brand name and trademark, company name, etc.) is communicated to potential buyers and consumers. Throughout the world there is growing concern about the impact of products on the environment. This has led some companies to engage in so-called *green marketing* – that is matching the environmental performance of products and production processes to the current and future environmental concerns of consumers and other stakeholders. **Eco-labeling** has emerged. An eco-label can be defined as any symbol appearing on product packaging that seeks to inform consumers that a particular product is in some way less harmful to the environment than purchase alternatives (Tang *et al*., 2004, p. 87). In broader terms, an eco-label is a label which identifies overall environmental preference of a product or service within a product category based on life cycle identification. An eco-label is awarded by an impartial third party to products that meet established environmental leadership criteria (Global Ecolabelling Network, 2004, p. 1). Thus, an eco-label is meant to convey information to consumers about the environmental implications of purchasing the product, so that consumers who care about such effects can express their desires in the market. All eco-label designs use a visual logo, but only a few of them include a verbal message within the label to state the main reason why the label is granted. Some representative eco-labeling programs are shown in Figure 10.14. Eco-labeling schemes exist in the European Union, Canada, the United States, Japan, Hong Kong, and elsewhere, and may be administered by public sector (Europe) or private sector (United States) organizations. The end result for a company interested in identifying their more environmentally friendly products is that they have a recognized accreditation for a particular product. By meeting specified criteria, a label or seal can be attached to the package indicating this. This is closely related to the Green Dot program in Germany for recycling packaging and packing materials (discussed in Chapter 14).

The eco-label	The program objective	Government involvement	Written Content	Classification
Germany	The eco-label aims at not only environmental protection but also those of consumer protection. Certification is for those products and services which from a holistic point of view that are particularly environmentally friendly and at the same time up to high standards of industrial safety, health protection and serviceability.	Government is heavily involved, together with an independent decision-making body called Environmental Label Jury representing various interests.	'Environmental Label' is written at the top while space is reserved at the bottom for writing the most important environmental feature, alter the word 'because.'	Visual plus Verbal
European Union	Empowerment of the individual through consumer choice is a central principle of the scheme. By setting strict ecological criteria for product groups, the scheme enables consumers to make reliable and informed decisions.	Each member state is required to designate a Competent Body to administer the scheme at a national level. The Competent Bodies must be independent and neutral but with no restriction on level of government involvement.	No written content other than the letter 'e.'	Visual only
U.S.A	To achieve *a* more sustainable world by promoting environmentally responsible production, purchasing, and products.	Operates under a non-government independent non-profit organization.	Only the name 'Green Seal' is written, however, accompany text that spells out the environmental attribute of the product can be written beneath the seal or anywhere on the packaging.	Visual only, with verbal nearby
Canada	• Encourage the efficient management of renewable resources to ensure their availability to future generations; • Promote the efficient use of non-renewable resources, including fossil fuels; • Facilitate the reduction, reuse and recycling of Industrial, commercial and consumer waste; • Encourage the protection of ecosystems and species diversity; • Encourage the proper management of chemicals in products.	Run by the government with the main services outsourced to a private sector company.	Only the name of the label 'Environmental Choice' is written, no verbal explanation on why the label is given.	Visual only
Australia	To contribute to the growth of the environmental consumer market in Australia and add commercial value to companies and businesses which are preferable on environmental grounds.	Run by a non-profit organization with little government involvement.	Only generic words 'Environmental Choice' and 'Australia' are written, text that specifies product category and license number can also be printed anywhere nearby.	Visual only, with verbal for non-enviro. info. nearby
China	To assist the general public to become more environmentally responsible in their everyday life's by raising the awareness of green consumerism and to assist enterprises not to be wasteful in using resources and non-renewable energy, and to encourage the development and production of green products which are friendly to the environment and not harmful to human.	Totally run by state organizations.	Only generic words 'China Environmental Labeling' are written in both English and Chinese, no verbal mentioning about environmental attribute.	Visual only
Japan	To disseminate information on the environmental aspects of products and to encourage consumers to choose environmentally sound products.	Run by the government with collaboration from various interest groups.	At the top, 'Friendly to the earth' is written in Japanese; at the bottom the most important benefit for environmental protection is written.	Visual plus Verbal

Figure 10.14 Summary of some eco-labeling programs

Source: Tang, Fryxell, and Chow, 2004, p. 88

In addition to the environment there is concern for safety requirements. A case in point is the European Union, where New Approach Directives are replacing national regulations. If a product falls within any of the EU's New Approach Directives it must have **CE marking** if it is to move freely throughout the European Union (Brooks, 2002). CE marking on a product is a manufacturer's assertion that the product complies with the essential safety requirements of relevant European regulations for each country in which the manufacturer intends to market the product. There are CE marking directives for such diverse products as toys, machinery, medical devices and lifts.

Brand image

A brand is anything that identifies a seller's goods or services and distinguishes them from others. A brand can be a word, letter, group of words, symbol, design, or some combination of these. A brand name is the spoken form of the brand. A trademark is a brand, or part of a brand, which is protected (in that others may not use it) by law. There are millions of names registered as trademarks in countries throughout the world, and the number increases every year.

Many companies have more than one trademark for their products, often having multiple trademarks for the same product. Figure 10.15 shows the many trademarks used by the Danish company LEGO.

The primary function of a brand is to identify the output of the owner of the brand – a manufacturer, exporter, agent, wholesaler, or retailer – so that buyers can distinguish it from other comparable merchandise. A brand indicates the origin of the product; it carries the assurance of quality; it serves as a warranty; it permits consumers to buy those products that satisfy their needs well and to avoid those that do not. A brand permits the manufacturer or seller or exporter to tell the market about the product and it helps purchasers to obtain what they want. In short, branding is necessary from the standpoint of both seller and buyer.

Figure 10.15 LEGO of Denmark uses many trademarks for its products (Used by courtesy of the LEGO Group)

Table 10.5 Flunking brand geography

Brand	Country of origin	% Who answered correctly	Most common answer
Nokia	Finland	4.4	Japan (53.6)
LEGO	Denmark	8.4	US (61.1)
Samsung	South Korea	9.8	Japan (57.8)
Ericsson	Sweden	9.9	US (30.3)
Adidas	Germany	12.2	US (48.5)

Source: Woyke (2007).

Branding is important to other elements in the marketing mix. Importers, wholesalers, and retailers in the importing country order by brand and promote brands in conjunction with their advertising and selling activities. Branding is one of the essentials that makes much advertising and selling not only desirable, but feasible. Without branding, manufacturers and exporters would find far fewer opportunities to advertise profitably. Without such opportunity undoubtedly some products would not even be introduced to the market. Manufacturers find that branding permits pricing policies, which assist both the price setter and the consumer in determining the appropriate price/value relationship. Although this discussion has been in the context of consumer goods, branding may also be important to the export of industrial products.

Branding is also important in that a brand can identify the company owning it and is a source of country-of-origin effect. A company should do all it can to ensure that its brands are attributed to it, and that a situation similar to what exists among some university undergraduate students in the United States does not continue to exist. Table 10.5 shows the results of a study in the United States wherein undergraduate students widely misperceived the country of origin of five major global brands.

Brand image is defined by the American Marketing Association as of 2015 'The perception of a brand in the minds of persons. The brand image is a mirror reflection (though perhaps inaccurate) of the brand personality or product being. It is what people believe about a brand – their thoughts, feelings, expectations.' As such, it is critical for firms to manage the image that consumers hold of their brand. However, companies can only make an image proposition (also labeled the brand identity). This is what the firm wants the brand to be and be perceived as. Consumers, for example, also have an image of universities, and universities are interested in ranking as highly as possible on university rankings. EDUNIVERSAL, Texas Rankings, and the ARWU Shanghai Rankings are some of the best known rankings.

Brand equity

A brand's reputation, together with its country of origin, contribute to its brand equity. Brand equity or brand value can be viewed as a measure of the strength of consumers' attachment to a brand and as a description of the associations and beliefs the consumer has about the brand (Wright *et al.*, 2007, p. 143). Brand equity also means brand description or brand strength, often referred to as 'consumer brand equity.' Table 10.6 shows the top 25 brands worldwide from the rankings of the top 100 brands for 2013 by *Interbrand Corporation*. Value is calculated as the net present value of the earnings that the brand is expected to generate. To qualify for the list each brand must derive at least one-third of its earnings outside its home country. The most valuable brand as of 2014 are: 1. Apple, 2. Google, 3. Coca-Cola, 4. IBM, 5. Microsoft, 6. GE, 7. Samsung, 8. Toyota, 9. McDonald's, and 10. Mercedes-Benz.

Table 10.6 Brand worth of the top 25 brands worldwide in 2013 calculated by Interbrand Corp

Rank 2013	Rank 2012		Brand Value $Millions	Percent Change from 2012	Country of Ownership
1	2	Apple	98,316	28%	US
2	3	Google	93,291	34%	US
3	1	Coca-Cola	79,213	2%	US
4	3	IMB	78,808	4%	US
5	5	Microsoft	59,546	3%	US
6	6	GE	46,947	7%	US
7	7	McDonald's	41,992	5%	US
8	9	Samsung	39,610	20%	South Korea
9	8	Intel	37,257	–5%	US
10	10	Toyota	35,346	17%	Japan
11	11	Mercedes-Benz	31,904	6%	Germany
12	12	BMW	31,839	10%	Germany
13	14	Cisco	29,053	7%	US
14	13	Disney	28,147	3%	US
15	15	Hewlett-Packard	25,843	–1%	US
16	16	Gillette	25,105	1%	US
17	17	Louis Vuitton	24,893	6%	US
18	18	Oracle	24,088	9%	US
19	20	amazon	23,620	27%	US
20	21	Honda	18,490	7%	Japan
21	23	H&M	18,168	10%	Sweden
22	22	Pepsi	17,892	8%	US
23	24	American Express	17,646	12%	US
24	26	Nike	17,085	13%	US
25	25	SAP	16,676	7%	Germany

Source: Interbrand. Best Global Brands 2013. 2013: http://interbrand.com/best-brands/best-global-brands/2013/ranking/.

Country of origin also contributes to the value of a brand. Country brand equity is defined as the value added by the association of a product or brand with a given country, as perceived by the individual consumer (Zeugner-Roth *et al*., 2008, p. 594). Results from a study showed that country brand equity was an important intervening variable between country of origin and consumers' product preferences. Country brand equity is thus one of the ways by which a country's image influences perceptions of a country's products, and as such is an important driver of brand equity (Zeugner-Roth *et al*., 2008).

Brand protection

Brand protection is offered first at the national level, second at the regional level, and third at the international level. Virtually all countries, even those among the lesser developed in Africa, Asia, and Latin America, have some form of system for registering and protecting trademarks for foreign, as well as domestic brands. The European Union has a directive that allows community trademarks.

The nature of the protection afforded to brands depends on the national legislation of each country. Most countries are 'code law' countries and follow the 'priority in registration' doctrine. In such countries the date of registration rather than prior use (with certain exceptions) determines who shall have the rights to use the brand. However, an increasing number of countries with such laws require continued use for a trademark to maintain protection. Included among the many countries following this doctrine are Bolivia, France, and Germany.

Some countries, however, protect brands even though they are not registered as a trademark. These countries, even though they may have codified their trademark law, have retained the 'priority in use' doctrine of the English common law tradition. Thus the rights to a trademark (with certain exceptions) depend upon priority in use. This approach is found in Canada, Taiwan, the Philippines, the United States, and other countries. In some countries a 'compromise' approach may be used. For example, in Israel either the first applicant or prior user will be entitled to registration, whichever is earlier. In Japan, although the first applicant is entitled to registration, another company that has been widely using the mark prior to the application can continue to use it. Also, even though France and Germany are 'first applicant' countries, exceptions are made for marks that are already well known as belonging to someone else.

There are a number of international, as well as bilateral, agreements that amplify and extend national legislation so as to provide protection for foreigners. The most important agreement is the International Convention for the Protection of Industrial Property (Paris Union) to which more than 170 countries adhere, including all major western European countries and the United States (see World Intellectual Property Organization www.wipo.int.) Under this convention each country is required to extend national treatment to businesses of the other member countries. Another convention is the Madrid Agreement for International Registration of Trademarks. Under this agreement, the owner of a trademark registration in one of the signatory countries can have it filed and registered in the others. There is also the Agreement on Trade-related Aspects of Intellectual Property (TRIPS Agreement) of the World Trade Organization, which requires governments to create an effective deterrent against counterfeiting. More generally, it sets down minimum standards for many forms of intellectual property regulation. There are also regional conventions, such as InterAmerican conventions for western hemisphere countries.

Information on most of the trademark laws of the world is generally available to a firm from its national government, particularly in the industrialized nations. However, the many complexities in international trademark protection suggest that export marketers should consult legal counsel at an early stage when they plan to sell products abroad. In fact it has become routine among many large concerns to register trademarks abroad at the same time as they are registered in the home country. Smaller companies also should consider such a practice. If a company does register a trademark in foreign countries, it must not forget that the registration will be cancelled if the mark is not used within a specified period of time, which varies among countries. Also, use must be continuous.

Although every marketer would like its brand name and trademark to become a 'household word' this could lead to loss of the use of the trademark if it became *generic*. When a trademark becomes generic the trademark owners lose the exclusive right to use the mark in association with its products, because a court has found that the word, symbol, logo, or design no longer indicates to the public the source of the owner's goods. Instead, the mark now describes a *type* of goods. Examples of once famous trademarks that are now generic names are aspirin (in the United States, but interestingly not in its origin country Germany), cellophane, escalator, octane, yo-yo, nylon, corn flakes, and thermos. There are some things that can be done to protect trademarks from this happening, discussed by Retsky (2001).

Owners of trademarks must be on the continual lookout for imitation or even outright piracy of brands that are exported to foreign countries. This is the growing problem of **counterfeit trade**, which is the practice of attaching brand names or trademarks to 'bogus' products or services, thereby deceiving customers into believing that they are purchasing the legitimate brand name or product of the owner of the trademark. Discussions of the global counterfeit business are given by Staake *et al*. (2009), Berman (2008), and Nill and Schultz (2009). As shown in Figures 10.16 and 10.17, at first glance it is often difficult to distinguish the copy from

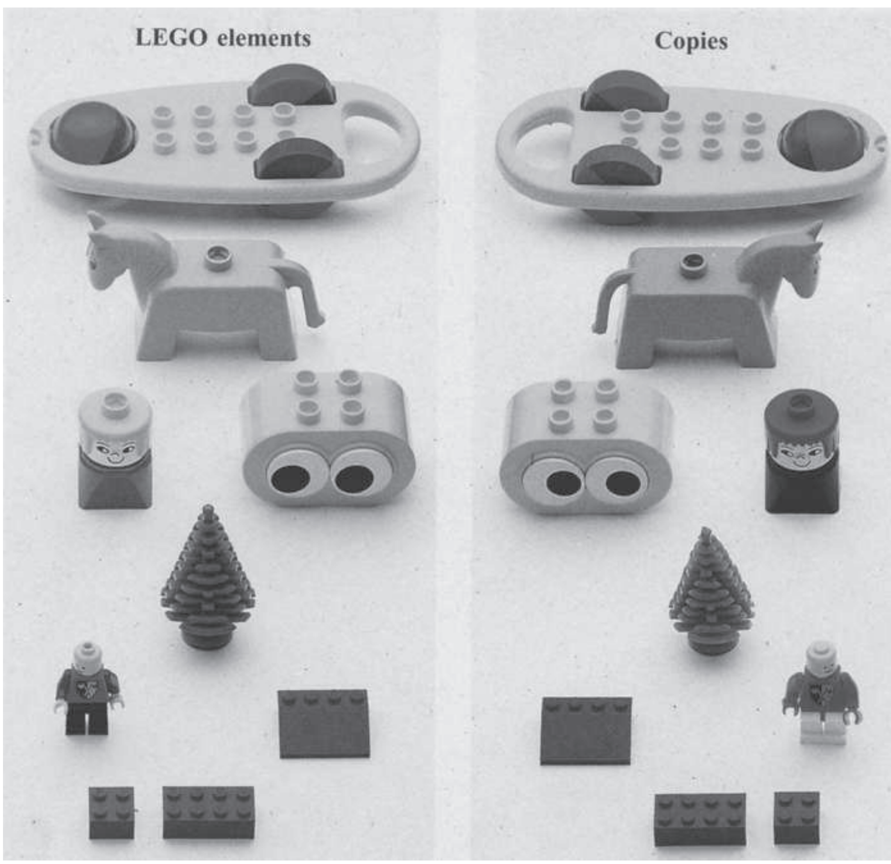

Figure 10.16 Counterfeit products often do not meet the quality and safety standards of the genuine product, and this can lead to consumer confusion and dissatisfaction. These examples are from the Danish company LEGO. (Used by courtesy of the LEGO Group)

Figure 10.17 Louis Vuitton real and fake handbags
Source: Balfour, 2005, p. 60. Used by courtesy of *Businessweek*.

the 'real' product. The range of products for which this occurs is wide, as is the range of countries from which the products are exported. That is, while China is a major source of counterfeit goods, it is by no means the only source. For example, the European Commission indicated in a report that in 2007 other major sources were Turkey, Georgia, Switzerland, India, and the United Arab Emirates (Hong Kong Trade Development Council, 2008). National governments are concerned with this problem, but it is difficult to resolve. To a large extent the exporter itself will have to 'police' its foreign markets in order to detect counterfeiting of its products. Then government can step in. Some companies are starting to incorporate high-technology items in their products as a means of distinguishing the real from the fake. Tags, advanced barcodes, magnetic filament, and other such devices are being used (Schine, 2007).

Brand piracy refers to violation of intellectual property rights. Particularly vulnerable are industries such as publishing and computer software. Various countries in Asia, such as China, Vietnam, and Indonesia, are known to be centers of this illegal activity. Often the existence of such activity affects relations between nations; for example, computer software piracy, particularly CD-ROM, has been an issue in the past in China's annual application to the United States for Most Favored Nation (MFN) status. China has been making concerted efforts to solve this problem, but it is not that easy to do. Tens of thousands of counterfeiters are at work in China today. They operate at all levels, from low-end products such as soap and shampoo through midrange (batteries, film), high-end (motorcycles), and top of the market.

Lack of legislation is not the problem. China, Vietnam, and Indonesia all have laws covering intellectual property. All too often these laws are not enforced, or are enforced inconsistently.

Branding decisions

Branding and trademark problems can be grouped into two major categories: (1) selecting a good brand, and (2) determining how many brands should be in the company's product line. Branding policies are important, since they may be used to accomplish a variety of important objectives. For example:

1. A single brand, or family brand, may be helpful in convincing consumers that each product is of the same quality or meets certain standards. Or, when the language of two or

more countries is the same, a single brand may be used to make advertising more efficient. For example, a single brand may be useful for Austria and Germany, particularly when advertising crosses the border.

2. Individual (local) brands may be used in different national markets to meet unique market needs. For example, the New Zealand Dairy Board, a large exporter of dairy foods, uses the following brand names for its milk powder: Anchor and Fernleaf (Malaysia), Fernleaf (the Caribbean area), Magnolia (Singapore and the Philippines), and Mainland (Australia). Similarly, in Malaysia the Board uses the brand name Fern for its butter, although the name Anchor is its flagship brand. The reason that Anchor is not used for butter and is not promoted for milk powder in Malaysia is that the same name is used by a widely advertised local beer. Housewives in the predominantly Muslim country are not inclined to buy their children dairy products that they subconsciously associate with an alcoholic beverage. Another example is the Dutch brewer Heineken, which operates in 170 countries and uses multiple brands throughout its markets. For example, in 2003 the number of brands used by Heineken within a country varied as follows:

The Netherlands	5	United States	4
China	2	Singapore	2
France	4	Germany	3
Italy	3	Poland, Panama, and Nigeria	2

The flagship brand, Heineken, is used in six of the countries listed above. Another brand, Amstel, is also used in six of the countries.

3. Multiple brands may be used as part of a policy of market segmentation: to sell essentially the same physical product to different market segments within a national market. Turning again to the New Zealand Dairy Board we find that more than one milk powder brand is used in Taiwan to meet the requirements of a highly segmented market where more than 30 brands compete.
4. Multiple brands may be used to distinguish between products of varying quality or with different characteristics.

In short, branding can be an integral aspect of the standardization versus adaptation decision. Even if the product core is not standardized, the brand may be used to satisfy export management's desire to achieve consistency with customers. There can be great cost savings in creating a unified brand across national borders. Such a brand eliminates duplication of design and art work, production, distribution, communications, and other related issues.

A company has the option of using the same brand in most or all foreign markets or in using individual, 'local' brands. There are certain cost and marketing advantages to using the same brand. However, local brands may also have advantages as well. The factors bearing on this choice include the following:

- customer needs;
- distribution and promotion methods to be used;
- competitive market structure;

- economies of scale in production and distribution;
- legal constraints;
- operational structures.

Despite the problems of piracy, companies still like using global branding, and thus engage in brand extensions. However, the products and/or markets should be related for maximum effectiveness. Sara Lee, a broad-base consumer goods company, extended a successful brand name to related products. Dim, a leading hosiery brand in France, has been extended to men's underwear and T-shirts. Gerber products uses the company's brand name in three product categories: food and formula (where it started), baby-care products, and clothing. The link between the three branded product categories is that all three are aimed at children under the age of four.

Selection of a brand or trademark for use in multiple countries involves essentially the same considerations as when selecting a brand for use in a domestic market. Many companies today are taking a global perspective in selecting brands. Such a perspective requires a careful search among languages for unexpected meanings of words or phrases. In the past, companies with well-established brands have sometimes found it necessary to change their brand because of an unfortunate meaning in another language. For example, Vick's Chemical Company changed to Wick's in Germany because the company name sounds like an obscene word in the German language. Chinese exporters have tried to market to the West such products as Fang Fang lipstick, White Elephant batteries, and Pansy underwear for men. Situations such as these occur when the exporter tries to use its domestic brand. When a company has a name that is somewhat descriptive of the product there can still be translation problems. A company marketed a piece of equipment under the name Grab Bucket. In Germany this was translated as 'cemetery plot flowers.'

The so-called 'global brand' is typically positioned the same way in every market. For example, Carlsberg beer is positioned around the world as a premium beer. The Carlsberg brand is the global premium beer, with the specific objective of creating growth on a worldwide basis through a more widespread distribution supported by increased resources for communication and general market cultivation. Regional brands such as Tuborg are developed in the relevant regions around the world, whereas strong local brands such as Tetley's Super bock, Okocim, Falcon, or Koff create the basis for strong local business systems in close contact with local consumer preferences. Similarly, Gucci bags are positioned as premium-priced bags. Benetton does similar positioning, but goes further by segmenting on the basis of age. Thus, within age group segments Benetton positions itself the same everywhere. A global brand is also marketed the same way in all markets, including following the same strategic principles, although the specific marketing mix may be modified to fit local market conditions – both consumer and competition.

There is no real agreement on what is a global brand. One definition is 'a brand that is marketed under the same name in multiple countries with similar and centrally coordinated marketing strategies' (Johansson and Ronkainen, 2004, p. 46). There are some global brands that do not have the same name, but share some marketing program elements. A global brand does not just appear, but is created by international marketers, and should be 'driven' by consumer considerations, not business convenience. On balance it is easier, and perhaps safer as well, to create a global brand from scratch than it is to reposition and rename an existing national brand. A good discussion of consumer preference for global brand is given by Steenkamp *et al*. (2003).

Research has shown that there is a connection between global brands and the emotional connection between consumers and a brand (Pitta and Franzak, 2008). Many marketers, both international and domestic, want to create products (and brands) and promotional campaigns that will 'win the hearts of the customer.' It is believed that 'share of heart,' a measure of so-called brand love, will lead to market share. Share of heart represents a degree of consumer commitment and emotional bonds that underlie a relationship with a product or brand. Techniques for building share of heart are discussed by Pitta and Franzak (2008).

Choosing a brand name involves both legal and creative issues. In many countries there are specialist companies that can handle each of these aspects, such as advertising agencies to work on the creation of names.

International consumer behavior and origin

The origin or place of products and firms may be more important than ever for consumers when choosing products for purchase and consumption. Traditionally in international marketing textbooks the consumer behavior that the international marketer needed to be familiar with was largely similar to what the domestic marketer needed to understand. Mostly the same theories and models were used with increased cultural and geographical distance. However, increasingly international consumer behavior is a field of study in its own right. The core theories and models that are unique to international consumer behavior are outlined in this section. Specifically, in this section, the central ways in which place or origin information influences consumer behavior will be discussed.

Origin image

Earlier in this chapter we discussed country stereotypes in the context of positioning. Now we turn to so-called 'built-in' images that reflect the tendency for people to associate certain quality and products with certain countries (e.g., Swedish steel, French wines, German and Danish beer, US airplanes, English textiles, and Japanese consumer electronics). This has traditionally been known as the **country-of-origin** (COO) *effect* (Josiassen and Harzing 2008), which refers to the extent to which the origin of products influences consumers' product evaluations, including consumer perceptions of product quality. Although the effect traditionally has been referred to as the COO effect, the geographic area of interest is not limited to the country but may, for example, be the city or region. As such, newer research refers to this effect as an *origin effect* rather than a country of origin effect (e.g., Josiassen *et al.*, 2013).

A product's origin is used by consumers as an product attribute, and has an influence on consumers' product evaluations. In an extensive review of the research done on COO effects through the late 1990s, it was proposed that the country of origin concept should constitute a major dimension of the marketing mix, along with the product itself, its price, promotion, and distribution (Al-Sulaiti and Baker, 1998). The origin of products acts as a signal to the consumer about the product quality. The signal is used by the consumer as extrinsic information about the product. In order to guide their feelings, thoughts, or actions regarding the purchase and consumption of particular products the consumers draw on a related origin image.

The image stored in the consumer's memory may be the result of a halo or summary cognitive processing (Han, 1989; Josiassen *et al*., 2008). Halo processing takes place when the consumer considers a specific product category, and infers the product quality from knowledge which does not relate specifically to that product category. For example, a consumer considering binoculars might rate highly a Swiss origin despite not having any experience or knowledge about Swiss binoculars. However, the halo from other similar Swiss products makes the consumer infer that 'if they can make other similar products, surely they can make excellent binoculars.' Summary processing, on the other hand, takes place when the consumer has experience with products in the particular category which he or she is looking for. In this case the image is a result of, or the summary of, the combined experiences with and knowledge about these products.

Origin facets

One complicating factor relates to the increasing complexity with which multinational (or global or transnational) companies are expanding their international operations. Many companies are now using multi-country input to the design, sourcing, and manufacturing of a single product (Josiassen *et al*., 2008; Chao, 2001). It becomes difficult to assess just what the country of origin is for a given product. For example, if a product is financed in Japan, designed in Italy, and assembled in Mexico using components designed in the United States and fabricated in Japan, what is the country of origin? Many companies often market products that have such a background.

So-called global outsourcing – buying products, components, materials, services, and so on, in foreign countries – is a contributing factor to the dilemma over country of origin. Major reasons that companies have increased purchasing from foreign sources include lower price, better quality, more advanced technology, more consistent attitude, and more cooperative delivery than domestic sources. Outsourcing has become a political issue and a matter of national concern in some countries, for example the United States, where it is claimed, to cause the export of jobs. In some cases the foreign source may be the only one available or it is done to fulfil a countertrade agreement. Another practice that can confuse matters is that of 'outward processing.' This occurs when a company exports components and parts for construction, and then reimports the constructed product for finishing.

A related effect is derived from ownership changes. Many companies, and their products, are still perceived to have an origin in their country of 'birth' even though they may be foreign owned. For example:

- Jaguar cars (UK) is US owned.
- Arrow shirts (US) is French owned.
- Godiva chocolate (Belgian) is a US company.

We are interested in understanding how origin image affects consumer behavior. It is therefore important to figure out how to measure origin image. The origin facets could complicate this effort. Recent research, Josiassen & Harzing 2008, however, has identified one facet as the central facet which consumers rely on when making decisions about products. This facet is the origin of association. The origin of association is the origin which consumers in general associate the product with. Examples could be Apple which is seen as an American product despite having Chinese origin facets.

Origin image effect under varying circumstances

The degree to which origin image is applied and the prominence given in the evaluation of the product varies. This is, consumer sensitivity to the origin image differs from one country to another (Papadopoulos *et al*., 1987), may be hierarchical by country, and varies by the level of consumer knowledge and involvement (Josiassen *et al*., 2008). Finally, the congruency among origin facets also influences the prominence of origin image in terms of affecting product evaluations and intentions. The more congruent consumers' evaluations of each origin facet, the more weight consumers' attach to the origin image attribute in their consumer decision-making.

Origin image across geographical entities

Typically, origin image has been defined in terms of a country. But, for some products it may be that other geographical entities influences perceptions of and preferences for specific products (van Ittersum *et al*., 2003). A good example is wine. There are differences in images of French wine from the Bordeaux and Burgundy regions. Similarly, Australian wines from the Barossa Valley and Hunter Valley regions conjure up images and preferences that are different to other regions in Australia. In the United States, wines from the Napa and Sonoma areas have distinct images in the minds of potential purchasers. This is the sub-national region image. Similarly, the street or super-national region may be the relevant geographical entity.

The BPC model

The BPC model (also known as the halo model of origin images) argues that three origin images are sequentially related in a causal chain (Josiassen *et al*., 2013): The basic origin image (BOI), the product origin image (POI), and the category origin image (COI). The basic origin image refers to the image that individuals have of the origin in general; for example, its resources, weather, and people. The product origin image relates to the image that individuals have of the products originating from the origin and the product-making ability of the origin. Finally, the category origin image relates to the image held by individuals about products in a particular category, and the abilities of the country in terms of making such products.

The most specific and concrete image is the COI, and the most general and overall image is the BOI. Consumers tend to use as concrete and specific an image as possible. If a consumer is considering a toaster made in Germany, but does not know anything about German toasters, he or she may use the POI. Drawing on the POI, the consumer would rely on Germany's general product-making ability; the general quality of German products, and characteristics of German manufacturers such as precision, and quality control. In the unlikely event that the consumer did not know much about Germany's ability to make products or German products in general, the consumer would instead rely on the BOI. Consider the image that most people would have of the three images in relation to Cuban cigars. The POI might be quite low or negative, while the COI might be quite positive. This demonstrates that in order to understand the effect of origin one should. make use of as concrete an image as possible among the three. The BPC model also includes the motion that the relevant origin varies. The relevant origin might be the country, the state, the city or another area. In the Cuban example the most relevant image would be the Category Country Image. For more in-depth introduction to the BPC model see Josiassen *et al*. (2013).

Stakeholders

Several levels of stakeholders have a keen interest in the image strength, favorability, and uniqueness of the origin. Society as such is interested in their place of origin being associated with a good image. This is important as a source of pride and self-identity. Financially, origin images can be a large part of the determinants which explain the socio-economic level of the geographical entity. Research shows that consumers are willing to pay thousands of dollars more for the same generic car when made in Germany rather than a country with a lesser country image (Jaffe and Nebenzahl, 2006).

Origin Mimicry

Origin mimicry takes place when a firm uses origin branding deceptively. One form of origin mimicry branding is extralocal origin branding. Extralocal origin branding takes place when a firm wishes to enter a market characterized with a local bias. In order to overcome such bias the firm may use origin branding measures to allude to a local origin. For example, by using a local name, or a local spokesperson. However, marketers may also communicate the wrong third-country origin for a product. For example, if origin B has a stronger origin image among the target segment than origin C, a retailer in country A may wish to allude to country B as the origin even if the actual origin is origin C. A firm making shampoo or perfume might wish to relate the product to Paris or France despite not being actually associated with France. Thus, many such products carry French-sounding names. This type of origin mimicry is labeled third-country origin mimicry.

Final thoughts

What can an international marketer do to overcome any bias or predisposition which is due to such 'built-in' images? Promotion may be used to overcome some bias, but predispositions are difficult to change by such means. Another possibility would be to use price as a means of overcoming the effect of such attitudes. The effect of any existing origin-of-product bias on the selection between similar goods from different countries may be offset by manipulating **price differentials**. However, the exporter must be careful not to go too far as such a strategy could backfire if the exporter misreads the price/quality beliefs held by consumers.

Destination imagery and image

Related concepts to origin image are destination imagery–image. The destination imagery–image duality model was first introduced by Josiassen *et al*. (2015). Destination imagery (DY) refers to the total set of perceptions and impressions a person has about a potential tourist destination. Destination image (DI) refers to the overall evaluative representation of the destination. As such, a potential tourist would draw on the DY when forming the DI. For example, a tourist may have a very positive image of Spain as a destination. This image will be formed from all the available information in the individual's DY with some aspects or pieces of information weighing more or less than other aspects. Please refer to Josiassen *et al*. (2015) for a thorough discussion of destination imagery and image.

Consumer country biases and the consumer attraction–repulsion matrix

Consumers infer product quality from specific country images that they associate with the product. Although it is intuitive that, for example, consumers judge cars from Germany more positively than cars from Spain, this perspective is at best incomplete to understand international consumer behavior because perceived quality may be only one factor that consumers consider when they evaluate the origin of a product. A growing literature in marketing investigates consumers' preference for or avoidance of domestic or foreign products because of reasons other than perceived product quality. That is, consumers may hold positive or negative predispositions toward countries that influence their buying behavior even though these predispositions are not used to infer product quality. As Herche (1992) notes, a consumer can be convinced by the high quality of French wine (since France is a renowned wine-producing country) but still refuses to buy it because of a negative predisposition toward France and French products in general. Literature refers to such consumer predispositions that drive consumer behavior beyond mere quality perceptions as *country biases* (Josiassen, 2011).

Research documents four distinct types of country biases that explain consumers' attraction, respectively repulsion of products from the own or a particular foreign country. In the example regarding French wine, the consumer may be Australian and is repulsed by French products because of the nuclear tests by France in the South Pacific. Such incidents can be approached with the construct of **animosity** (Klein *et al.*, 1998). Analogously, consumers may also feel attracted toward a specific foreign country. The construct of **consumer affinity** targets such incidents (Oberecker *et al.*, 2008). In addition, some consumers may feel a moral obligation to buy products originating from their home country in order to support their own economy and secure workplaces. This attraction toward consumers' own country's products is explained and measured by **consumer ethnocentrism** (Shimp and Sharma, 1987). While ethnocentric consumers are positively biased toward the products from the country in which they live, other consumers may deliberately avoid these domestic products. This behavior can stem from a motivation of distancing oneself from the typical domestic consumer, reflected by the construct of **consumer disidentification** (Josiassen, 2011).

A useful way to understand and structure the four consumer country biases toward the products of the domestic country or a foreign country is the **Consumer Attraction–Repulsion Matrix** (Josiassen, 2011). This matrix (Figure 18) consists of four quadrants, capturing the four country biases that have been identified in international marketing as being not entirely related to product quality expectations. The matrix delimits the conceptual domain of the four biases and can guide an understanding on which bias is relevant in which context. The biases are structured along the dimensions of attraction/repulsion and domestic/foreign country. The matrix is theoretically grounded on the view of psychologists and sociologists who document that an individual's attraction to or repulsion of a group can be conceptualized in terms of the similarity–attraction model and the dissimilarity–repulsion model (Byrne, 1971; Newcomb, 1956). Research indicates that attraction and repulsion is a positive, respectively negative function of the extent to which an individual assumes to share similarities, respectively dissimilarities with a psychological object (Chen and Kenrick, 2002; Rosenbaum, 1986).

The Consumer Attraction–Repulsion Matrix consists of four quadrants that reflect consumers' attraction to domestic products (consumer ethnocentrism), consumers' repulsion of domestic products (consumer disidentification), consumers' attraction to products of a particular foreign country (consumer affinity) and consumers' repulsion from products of a particular foreign country (animosity). Each of these four country biases rests on its own conceptual core and is measureable among individuals in order to predict biased consumer behavior beyond mere product quality judgments that consumers link with a particular origin

Consumer ethnocentrism

The concept which has received the most attention in the marketing literature is consumer ethnocentrism (Shimp and Sharma, 1987) which measures the attraction of consumers toward domestic products. The construct is conceptualized as a domain-specific subset of the more general concept of ethnocentrism, which was first introduced by Sumner (1906) and reflects a perspective in which the own group is the center of everything, superior and virtuous. As such, ethnocentrism is associated with discriminatory behaviors that include cooperative relations with the own group (i.e., the in-group) and the absence of cooperative relations with out-groups (LeVine and Campbell, 1972). Individuals associate themselves with and favor the in-group in order to maximize the benefits for this group (Brewer, 1999). However, the conceptualization of this general kind of ethnocentrism is not appropriate to understand the positive bias individuals may have in a consumption context. Drawing on the existing ethnocentrism literature, Shimp and Sharma (1987) introduced consumer ethnocentrism, representing 'the beliefs held by [...] consumers about the appropriateness, indeed morality, of purchasing foreign made products' (Shimp and Sharma, 1987, p. 280).

Ethnocentric consumers who are attracted to their domestic country, are patriotic and consider the purchase of imported products as wrong because it hurts the domestic economy and destroys jobs (Shimp and Sharma, 1987). Consumer ethnocentrism is grounded on both socio-normative and economic aspects. The socio-normative aspects are reflected by consumers' felt moral and ethical obligation to behave patriotically. The economic aspects are based on a perceived concern for the domestic market and potentially harmful effects

	Attraction	Repulsion
Domestic	Consumer Ethnocentrism Shimp and Sharma (1987)	Consumer Disidentification Josiassen (2011)
Foreign	Consumer Affinity Oberecker et al. (2008)	Consumer Animosity Klein et al. (1998)

Figure 10.18 The Attraction-Repulsion Matrix

that imports may have on the own country's economy. Both moral and economic concerns can motivate a consumer to support the own economy by buying domestic products. That means, ethnocentric consumers have a propensity to buy domestic products, although they do not necessarily consider them to be superior (Josiassen, 2011). Similarly, ethnocentric consumers tend to prioritize the own nation's goals over individual goals, and thus may buy domestic products even if these products are of lower quality or more expensive than the foreign alternative (Shimp and Sharma, 1987).

Since the introduction of consumer ethnocentrism, many studies have successfully validated and applied the measure of consumer ethnocentrism, the CETSCALE (Shimp and Sharma, 1987), to explain consumers' positive bias toward purchasing domestic products in various contexts (e.g., Dimofte *et al*., 2008; Kaynak and Kara, 2002; Steenkamp *et al*., 1999). The CETSCALE, which is one of the most referenced scales in international marketing, was originally developed to measure the ethnocentric bias of US–American consumers and used items such as 'We should purchase products manufactured in America instead of letting other countries get rich off us,' or 'American consumers who purchase products made in other countries are responsible for putting their fellow Americans out of work.' Whereas researchers agree that consumer ethnocentrism can reliably explain consumers' willingness to buy domestic products (Shankarmahesh, 2006), its usefulness to predict the purchase of foreign products is controversial (Balabanis and Diamantopoulos, 2004; Nebenzahl, 2001).

Sources of consumer ethnocentrism can be socio-psychological predispositions such as collectivism, nationalism, or patriotism as well as the own country's stage of economic development (Balabanis *et al*., 2002; Good and Huddleston, 1995; Sharma *et al*., 1995). Further, older consumers tend to be more ethnocentric than younger consumers, female consumers show higher ethnocentric orientations than male consumers (Josiassen *et al*., 2011) and more educated people are, on average, less ethnocentric than less educated people (Klein and Ettenson, 1999). Marketers can use this insight of demographic sources of consumer ethnocentrism and market their products accordingly. For example, a company may benefit from communicating the domestic origin of its products to older consumers but should not rely on this strategy when targeting younger and well-educated consumers.

Consumer disidentification

Sociologists indicate that people can hold oppositional positions toward the country in which they reside, and label it national disidentification (Verkuyten and Yildiz, 2007). Drawing on this research, Josiassen (2011) developed the construct of consumer disidentification, reflecting 'consumer's active rejection of and distancing from the perceived typical domestic consumer' (p.125). Disidentifying consumers do not see themselves as members of the majority national group and avoid domestic products in order to create a symbolic distance between them and the typical domestic consumer. That is, consumer disidentification reflects the repulsion of domestic products and negatively affects the willingness to buy them. In the original study by Josiassen (2011), the construct of consumer disidentification has been developed in the context of second-generation immigrants living in the Netherlands. Among these immigrants, those who scored high on consumer disidentification showed an oppositional position toward buying domestic products in order to distance themselves from the Dutch majority group. However, it is also worth noting that consumer disidentification and thus repulsion of domestic products may not only be present among immigrants but can be applied to other consumer groups as well that may seek disidentification from the typical domestic consumer. In addition to immigrants, these may also be youth movements or marginalized social milieus who cultivate an own identity or subculture.

Investigating the sources of consumer disidentification, Josiassen (2011) found that acculturated consumers who speak the domestic language or use mainstream media, exhibit lower level of consumer disidentification. In contrast, consumers who strongly identified with their ethnic origin and maintained traits from their original culture showed higher level of this bias against domestic products. Consumer disidentification is also distinct from consumer ethnocentrism (Shimp and Sharma, 1987). While both constructs reflect consumers' biases toward domestic products, consumer disidentification is a negative bias against domestic products whereas consumer ethnocentrism measures a positive bias toward these products. Accordingly, the absence of ethnocentrism is no indicator for the presence of disidentification, and likewise, consumers who do not disidentify with the majority national group are not necessarily ethnocentric (Josiassen, 2011). To fully understand consumers' bias toward domestic products, both the construct of consumer ethnocentrism, as well as consumer disidentification have to be taken into consideration.

The insights consumer disidentification provides for managers are useful in multicultural markets where consumer groups such as immigrants or subcultures have a strong identification with their ethnic or cultural origin. Among these consumers, some may also have high levels of consumer disidentification and thus are repulsed by domestic products. Facing such incidents, marketers should not offensively promote the domestic origin of their products in such respective markets. While high ethnocentrism in a market may help to protect the domestic firm from competition posed by foreign products, the strategy of promoting the domestic origin may backfire when consumer identification is prevalent in a market (Josiassen, 2011).

Animosity

History provides countless examples of hostility and tensions among nations, such as the Cold War between the US and Russia, the Middle East conflict or the territory dispute in Kashmir between India and Pakistan. The construct of animosity captures such atrocities between countries and has significantly contributed to understand the impact of such bilateral disputes on consumers' behavior toward products from the offending nation. Animosity was introduced by Klein *et al*. (1998) and is defined as 'the remnants of antipathy related to previous or ongoing military, political, or economic events' (p. 90). That is, animosity does not only refer to people's beliefs and negative feelings about armed conflicts but it is also associated with economic or diplomatic disputes. Although animosity is often a serious manifestation, also relatively benign rivalry between two countries (e.g., between Germany and Austria) is covered by this construct.

In their pioneering study, Klein *et al*. (1998) measure war and economic animosity toward Japan among Chinese consumers. In particular, the historical event of the Nanjing massacre (committed by Japanese soldiers in China during the Second World War) is found an important source of still-persisting war animosity among Chinese today. Economic animosity also exists toward Japan among Chinese consumers and is reflected by perceptions of economic dominance and exploitation by Japan. The authors show that consumers who harbor higher levels of animosity toward China have a lower willingness to buy Chinese products. A key tenet of the study is that although consumers have high animosity toward a specific country, they may still acknowledge the quality of products coming from this country. That is, animosity decreases the propensity of buying products from the offending country, but not necessarily along with a denigration of these products (Klein, 2002; Klein *et al.*, 1998). For example, a Chinese consumer may be convinced by the high quality of a Japanese camera, but at the same time still refuses to buy it due to high animosity toward Japan. Thus, animosity significantly enhances the existing research on country-of-origin (e.g., Bilkey and Nes, 1982; Eroglu and Machleit, 1989) as it shows that consumer behavior may be unaffected by quality perceptions.

Animosity is particularly useful to explain consumers' repulsion against products from a specific origin and also enlightens boycott intentions. Consumer behavior such as the boycott of Danish products in the Muslim world as a response to the Mohammed caricatures in Danish newspapers can be understood from a new angle by using the animosity construct. Several studies have investigated animosity and found its negative effect on consumer behavior in various contexts, such as Dutch consumers' willingness to buy German products (Nijssen and Douglas, 2004) or US consumers' remnants toward Russia (Harmeling *et al.*, 2015). However, animosity is not limited to between-country conflicts or rivalry but can also exist within national borders. For example, Shoham *et al.* (2006) investigate the animosity between Jewish and Arab Israelis and find that Jewish Israelis avoid products that have an Arab-Israeli origin. This behavior reflects the existing animosity stemming from the ongoing conflicts between Jews and Arabs in the country, and the Gaza and West Bank region in particular. This view on *regional* animosity (Shimp *et al.*, 2004) is particularly interesting as many recent conflicts nowadays do not exist between countries but rather between national groups, such as in Ireland or Spain.

Exporting firms are advised to be aware of potential animosity in the target country in order to avoid potential failure. For example, the Israeli company SodaStream experienced a growing boycott as a consumers' response to Israel's occupation of Palestinian territories. In such cases, downplaying national ties may be an option to mitigate consequences of animosity.

Consumer affinity

Similar to animosity, affinity captures an individual's bias toward a specific foreign country. The construct of consumer affinity (Oberecker *et al.*, 2008) is a feeling of liking, sympathy, and even attachment. It therefore describes a positive emotional bond the individual has with a particular foreign country. Feelings of affinity toward a country may be the result of an individual's direct personal experience. For example, spending the holiday in a particular country or studying and meeting new friends there may be sources of affinity feelings. In addition to such personal experiences, affinity may also stem from events occurring on country-level. That is, the sharing of collective memories between two nations or a particularly strong cultural or economic relationship may also elicit affinity on the individual level. Accordingly, the cultural, political or economic similarity of two countries may have an effect on the level of affinity. Two countries that have cultural similarities, such as speaking the same language or sharing the same religion, may have higher levels of affinity among their nationals than countries that are highly dissimilar.

Consumer affinity is conceptualized as a host of positive feelings individuals harbor toward a specific foreign country (Oberecker and Diamantopoulos, 2011). The authors locate the roots of consumer affinity in social identity theory (Tajfel, 1982) that posits a distinction between the own group (the in-group) and out-groups. Following this view, individuals harboring affinity feelings toward a specific country may consider this focal foreign country a part of their own group. Affinity comprises two groups of feelings (Oberecker *et al.*, 2008). The first dimension captures rather moderate feelings of sympathy whereas the second dimension comprises intense feelings of love and attachment toward the affinity country. Consumer affinity follows the notion that feelings are likely to influence subsequent behavior. This view is anchored in emotional attachment theory (Bowlby, 1977) suggesting that feelings toward a specific object (like a country) determine how an individual interacts with that object. It follows that feeling positively toward a particular country is likely to induce favorable behavioral intentions. Likewise, an individual that feels sympathy or even attachment toward a particular affinity country may also show a higher willingness to buy products from that country or visit it. In contrast, products that originate from countries the individual has no emotional link with are rather unlikely to elicit such positive behavioral intentions, holding everything else constant. Further, affinity can also reduce consumers' perceived risk of products from the affinity country. If, for example, Italy is the affinity country of a consumer, he may consider purchasing Italian products to be less risky and more certain than products from other countries.

Consumer affinity is also distinct from a related construct in international marketing, namely the construct of consumer cosmopolitanism (Riefler and Diamantopoulos, 2009). Whereas affinity captures a consumers' attraction toward a specific foreign country, cosmopolitan individuals have a transnational mindset and are unaffected by origins in general. Whereby affinity reflects a strong bias in favor of a particular country, cosmopolitanism reflects an unbiased orientation among consumers who choose from domestic or foreign products.

By connecting their products with an affinity country, companies may be able to benefit from consumers' affinity feelings. For example, leveraging positive feelings and emphasizing an Italian nature may appeal to consumers who harbor affinity toward Italy. Similarly, international companies attempt to exploit such affinity feelings by developing Italian-like brands such as *Nescafe Dolce Gusto* (Nestle), *Miracoli* (Mars) or *Viennetta* (Unilever).

Summary

In this chapter we have discussed the broad area of product decisions. Of concern to international marketers/exporters are planning and developing of products for foreign markets and the strategies followed. Product strategy concentrates on policies regarding standardization or adaptation.

A product is defined as everything that the consumer or industrial purchaser/user receives when making the purchase or using the product. Relevant decision areas for product development were identified as new products, changes in existing products, new uses for existing products, and product elimination. Each of these was discussed, with emphasis given to new product considerations.

We next turned to product mix decisions and our concern was for those external and internal determinants affecting the breadth and length of a company's export product mix. Some discussion was denoted to analytical techniques, especially the product portfolio analysis.

A central issue facing all exporters that do business in many foreign markets is whether to standardize a product for these markets or adapt it. There are no ready answers to this question. In reality, a company may have to compromise between the extremes. Sometimes adaptation is mandatory while at other times it is voluntary. A key question that arises is to what degree the interests of producers and exporters in cutting costs (by standardizing or globalizing) can be reconciled with the interests of buyers in having individualized products. In a way, market segmentation allows a company to do both. A final consideration is that the question often cannot be resolved in isolation since other export marketing variables interact with the product.

The next sections of the chapter dealt with packaging and branding issues. The matter of standardization or adaptation is also relevant for these two decision areas. Regarding packaging, there is also the issue of environmental impact, and this was discussed briefly in the context of what has been happening in Europe. Next, the problems associated with counterfeit products were addressed briefly.

The final half of the chapter focused on the importance of the destination or place information in consumers' decision-making. Specifically, destination image, origin image, and the four country biases were addressed.

Questions for discussion

10.1 Explain the major product policy questions facing the exporting company. In what ways, if any, does size of company affect the relative importance of the question?

10.2 Is there a best way for a company to acquire new products for its export product mix? If so, what is it? If not, why not?

10.3 What is the relationship between a company's product development policies and its implementing a product positioning strategy?

10.4 Can an exporter realistically follow the strategy of product phasing when replacing a product in the product mix being exported to a foreign market? Explain.

10.5 Evaluate an exporter's use of the product portfolio approach in decisions about its product mix.

10.6 Is standardization or adaptation of individual products the most desirable policy for an exporter? Why or why not?

10.7 For export packaging and branding considerations, discuss how language may be significant, particularly to the multimarket exporters.

10.8 Discuss the importance of using 'ecologically correct' packaging materials and the main impact of the packaging policy. Is eco-labeling necessary? Why?

10.9 What can an individual exporter do about counterfeit products being sold as its own? Will this really be effective over time?

10.10 Find a company exporting its product under the same brand name in all (or most) countries and a company that uses a variety of brands. How do these companies differ and are these the reasons for different branding policies? Explain.

10.11 Is there really such a thing as a global brand? If so, describe it and give examples. If not, explain why this is so.

10.12 Is global branding limited to certain products, product classes, and/or companies, or can any company selling any product pursue global branding? Explain.

10.13 Discuss the relationship between brand equity, brand value and share of heart. How can a company use these concepts in practice?

10.14 Which is more influential for consumers, COI or BOI?

10.15 Who are the key stakeholders for Bayonne Ham, Feta Cheese, and Champagne?

10.16 What are the differences and similarities between origin image and the origin biases?

10.17 In your domestic country of origin what are some reasons that consumers might have to disidentify with their country?

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CASE STUDY 10.1

Tata Motors and Tata Daewoo

(This case study was written by Mitsuko Saito Duerr.)

India's Tata Motors, the nation's largest vehicle maker, purchased bankrupt Daewoo Commercial Vehicles in 2004 in order to gain entry into the South Korean market and access to Daewoo's technology. It renamed the company Tata Daewoo. Tata Group, of which Tata Motors is a key member, is one of India's four largest conglomerates. Tata Group has been recognized by *Bloomberg Businessweek* as number 13 in the list of the world's 50 most innovative companies. It has developed an 'Innometer' to stress and measure creative goals and accomplishments against global or domestic benchmarks (Arndt and Einhorn, 2010). Tata Motors itself was earlier recognized as one of India's top corporate innovators for developing an ultra-low-cost passenger car and a more effective method of distribution for it (Kripalani, 2005).

Tata Motors is the world's fourth largest manufacturer of medium- and heavy-duty commercial vehicles. It has two in-house engineering centers and India's only Certified Crash Test Facility. A joint venture with Cummings Engine Company of the US in 1992 introduced advanced emission control and testing. It has upgraded its entire range of 4- and 6-cylinder engines to meet international emission standards, using the improved engines in all of the Indian market and over 70% of its export markets (limited only by the requirements of its customers) (www.tata-motors.com and associated websites).

Tata Motors sells very roughly equal numbers of passenger cars and trucks, with two-thirds of its earnings coming from the truck and commercial vehicle business. In spite of the importance of its trucks, except for emission controls their design had been changed little over the years while trucks produced in the more developed nations were being improved. In the early 2000s, Tata Motors recognized that India's rapid development and the upgrading of some of India's roads provided an opportunity for more powerful and more comfortable trucks to be driven greater distances than Tata's traditional offerings. Tata Motors also faced a competitive threat from the higher quality, heavier duty, more comfortable trucks made by Daimler and Volvo that are becoming increasingly familiar on Indian roads.

In cooperation with its new acquisition, Tata Daewoo, the parent Tata Motors developed a new line of heavy trucks branded Prima. They carry the same payload but have larger engines and are more comfortable to drive, allowing drivers to cover up to twice the distance they do in the older Tata trucks. They are thus in a position to compete in the market entered by Volvo and Daimler. However, the narrowness, poor maintenance, and crowded conditions of most of India's roads, and the higher cost of the Prima line, indicate that Tata's cheaper vehicles are likely to maintain a large share of the Indian market in the near future. The new trucks were also seen to have a potential market in Korea. The Prima line was introduced in India in mid-2009, selling 50 in the final six months of the year, and introduced in South Korea in September, 2009, selling 400 there in the final three months of the year (Leahy, 2010). In 2014 Tata introduced the first truck racing championship in India called the T1 Prima. In 2014 the managing director Karl Slym died in Bangkok, Thailand after a fall from the 22nd floor of the Shangri-la hotel.

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Questions

1. Does the purchase of Daewoo Commercial Vehicles seem to have been a wise decision for Tata Motors. Why?
2. Do the initial sales of the Prima line in India seem to justify the decision to market it there? Why?

CASE STUDY 10.2

General Motors, GM Daewoo, and Hyundai

(This case study was written by Mitsuko Saito Duerr.)

In 2010, General Motors was considering rebranding some of the vehicles produced by its Korean unit (Song, 2010). GM had purchased a controlling interest in Daewoo Motor Company, the car-making subsidiary of bankrupt Daewoo Corporation, for $400 million in 2002. It renamed the company GM Daewoo Auto and Technology, and its Korean unit GM Daewoo. GM made a major injection of cash in upgrades as it introduced its production system, quality control, and information systems technology. Relations with the workers, happy to be employed after the layoffs as Daewoo Motors collapsed, were generally cooperative. However, GM Daewoo felt it had to give the workers large wage increases, resulting in higher labor costs (Moon *et al.*, 2004).

GM Daewoo made substantial profits for GM for several years after its acquisition. While Korea's home auto market had contracted by 30% in late 2002 through early 2004, GM Daewoo enjoyed rapid growth through exporting. In the first ten months of 2004, it exported almost two-thirds of a million cars, up 90% from the first ten months of the preceding year.

GM Daewoo became GM's main producer of small cars for sales worldwide as other ventures proved unprofitable. In 2010, GM withdrew from NUMMI, its 20-year joint venture in making small cars in California with Toyota. Throughout the 20 years of the joint venture, GM had experienced disappointing US sales of GM-branded automobiles from NUMMI. This was in spite of the fact that Toyota-branded vehicles produced from the same production line by the same people sold well. The difference resulted from poor consumer views regarding GM small cars. GM also closed Saturn, its small car-producing subsidiary. In spite of high productivity, high quality, and excellent customer acceptance of the Saturn-branded automobiles, the subsidiary had never made a profit. This was a result of a combination of factors. GM never provided funding to the subsidiary to enable it to expand its line into the larger size vehicles many satisfied customers wanted as they moved up economically. At times the parent company also failed to provide adequate capital for model changes and/or adequate advertising.

The GM Daewoo-produced cars are sold in many countries in Asia and Europe, with exports accounting for about 90% of its output. Initially, most were sold under the Daewoo brand. This was changed to using the Chevrolet brand in Europe and most of Asia from January 2005. The change was made because of adverse publicity surrounding the Daewoo name which resulted from the closing of an unrelated company in France named Daewoo Electronics. The Daewoo name was also used by other non-automobile companies in parts of eastern Europe and GM felt that possible problems with them might further damage the brand name (Griffiths, 2004).

Within South Korea, GM Daewoo continued to use the Daewoo brand name because of the country's strong nationalist sentiment. Producing cars with two or more different brand names, and even with differences in design, on the same production line is not a problem. (While the Japanese were pioneers in doing this, companies in many countries now do so.)

In 2008, a combination of the global economic downturn and the loss of domestic market share in Korea resulted in a 34% fall in sales and a loss of $775 million. At its height, Daewoo Motor Company had a 33% share of the Korean market. By 2008, this had slipped to 7.9% as Hyundai Motor and affiliate Kia Motors captured over 70% of the Korean domestic market (Song, 2010). It is also significant that GM Daewoo's parent, most other American and European manufacturers, and even some Japanese manufacturers lost US market share to Hyundai in 2009. While GM's US sales including its small cars declined in 2009, Hyundai actually sold more cars. In 2010, Hyundai continued to increase sales in China, India and the US (Song and Betts, 2010). Hyundai had been achieving sales growth for several years as they greatly improved the quality of their automobiles, and emphasized their faith in the product by providing warranties that were longer than those offered by other manufacturers. At the same time, Hyundai kept prices lower than those of similarly sized and equipped cars produced by other companies.

In looking for ways to increase sales and market share, GM Daewoo is continuously introducing new models. In 2011 when Daewoo was fully acquired by GM, the Daewoo name was discontinued and replaced by Chevrolet.

GM Daewoo's general manager was targeting a major increase in sales for 2010, which seems optimistic considering the company was already over two months into the year when he indicated the target. The introduction of three new models may help, as major manufacturers have often achieved increased sales when doing so and lagged in sales when few new models are introduced.

However, having more new models will only be effective if they are well designed, of high quality, and competitively priced. The fact that GM Daewoo has lost market share to Hyundai, and its American parent has also lost market share to Hyundai in the US, should be a matter of concern.

One of General Motors problems was that for many years the company continued to base its plans on assumptions that they would attain a larger market share and sales, while the opposite continued to occur. Honda and Toyota continued to gain market share as they simply provided cars that were generally of higher quality and lower price. It may well be that GM Daewoo's current problems include issues of quality, labor productivity, and price as well as the design of its cars.

The proposal to change its brand name in Korea seems to be counterproductive. The country's consumers show a preference for domestic products when available, and a change in name would make it seem more foreign. It would also likely be unpopular with the workers who don't want to be seen as employees of a foreign firm.

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Questions

1. Should GM Daewoo go ahead with their plans to introduce three new models when sales have already fallen. Why?
2. Should GM Daewoo change the brand name used on their cars sold in Korea from GM Daewoo to Chevrolet? Why?
3. Should GM Daewoo examine other factors such as the comparative prices, quality, design, and perhaps labor cost with respect to Hyundai? Why?

CASE STUDY 10.3

The Pampered Chef

(Adapted from Erin Casey, 'Bringing families together', *Direct Selling News*, September 2006, pp. 16–20. Reprinted with permission of *Direct Selling News*, www._directsellingnews._com)

Three things set The Pampered Chef, a direct selling company, apart from its competition in the housewares industry: a passion for providing unique, quality products, a dedication to ensuring customers know how to make the most of the products they purchase, and a mission to bring friends and family together through sharing meals.

Chief Executive Officer Marla Gottschalk says all three elements come together at The Pampered Chef's trademark Cooking Shows. 'Our consultants offer customers a unique advantage that they will not be able to find anywhere else,' she says. 'Retailers can't show every customer how to use the products they sell or allow them to try them out before they buy them. At a Cooking Show, our customers are encouraged to do exactly that. And they get to do it in a relaxed, friendly atmosphere.'

The Pampered Chef would not be the successful company it is today were it not for its unique, interactive approach to sharing its products at Cooking Shows. Consultants teach customers how simple it can be to use the tools in their own kitchens. A by-product of that education is consultants and customers learn to enjoy cooking.

In addition to new products and ideas, consultants share new recipes at Cooking Shows. The company has a team of home economists, food scientists and culinary professionals who work in the company's six test kitchens to test products and develop new recipes. Whether customers are looking for healthy and nutritious meals, impressive appetizers or scrumptious sweets, they'll always find a tasty selection of goodies on the menu at a Pampered Chef Cooking Show.

A look back

The Pampered Chef has a history of offering consultants the resources and support they need to create a life of their choosing along with an opportunity that encourages family interaction, especially at mealtime.

That's what Doris Christopher was trying to do for her family when she began the business more than 25 years ago. Christopher and her husband, Jay, worked together, brainstorming about business options that would suit their family's lifestyle.

As a former home economist and educator, Christopher was able to draw on her experience to create a business that fit her life and would, in time, fit the lives of thousands of men and women around the world. By the fall of 1980, Christopher decided a home-based party plan was the right business mode. Christopher headed to Chicago's famed Merchandise Mart to find the tools she would offer her customers. They borrowed $3,000 from Jay's life insurance policy for inventory and set up an office in their basement.

Since that humble beginning, the company has expanded from the basement of the Christopher's suburban home to a 780,000-square-foot headquarters near Chicago. With nearly 1,000 employees and tens of thousands of independent consultants in the United States, Canada, and Germany, the company has expanded its reach and touches the lives of men and women from every economic level. The firm was also in the UK, but is expected to close UK offices in 2015–16.

Christopher had no intention of building a multimillion-dollar business. But through the company's growth from a one-woman shop to a successful international business, the company's mission of bringing families together has remained constant.

Quality makes the difference

When Christopher began the business, she recognized the need for quality kitchen tools – items that would stand the test of time and deliver the desired results consistently. The professional-quality tools she became familiar with in her career as a home economist weren't available to the general public. Today, while stores carry a variety of kitchen utensils, the quality, durability and performance of The Pampered Chef's products continue to exceed customer expectations. 'People come back to The Pampered Chef because they love it,' says Independent Advanced Director Yolanda Easton, 'not because they have to keep replacing their products.'

What makes The Pampered Chef's tools and cookware special? Since 1980, when Christopher first searched the Chicago Merchandise Mart for the perfect tools for her business, The Pampered Chef has looked for kitchenware that meets the company's strict standards. 'Superior functionality and quality are our key criteria – that's what makes a Pampered Chef product unique,' says Lisa Flynn, Vice President of Product Development. 'Our Product Development Team is composed of experienced specialists who have their finger on the pulse of the marketplace, and are trained to identify emerging trends and new opportunities,' she says. 'We add new products to our line based on the needs of our customers and our ability to improve upon what's currently in the marketplace. And we constantly re-evaluate existing products to determine which need to be updated with improved features and technology.'

Test, test and retest

Once the team determines a product's specifications, they work with a manufacturer to re-develop a prototype. 'The prototypes are tested in our own test kitchens,' Flynn says. 'Here, they're used and reused in an actual home environment – in the dishwasher, microwave, freezer and oven. That way, we can accurately assess how they will hold up to normal daily use and whether they will perform the way we want them to.'" Staffed with home economists and culinary professionals – individuals as demanding of the products as their customers – the test kitchens are busy places. 'We often go through several rounds of prototype development before a product meets our standards,' Flynn says.

The company also submits products to abuse testing to determine potential breakdown points and how the product can be made more durable. 'Every test that's done provides learning that enables us to make the product easier to use, and more functional and durable than what's available on the market,' says Fran Coursey, Director of Product Development.

Along with in-house testing, the company's Quality Assurance Team sends some products, such as cutlery and cookware, to a third party for a more extensive and scientific testing. 'We send out anything that requires a high level of repetitive testing, for example to test the quality of steel in our cutlery and its ability to maintain sharpness,' Flynn says.

Thorough testing, continuous evaluation and a highly collaborative relationship between the company and its vendors are critical elements in the product-development process, as are the opinions of the company's consultants. 'Our consultants are another important source of information and inspiration,' Coursey says. 'They are our front line, so to speak, because they're out there every day talking to customers, hearing what their needs are. We encourage our consultants to share their product ideas with us. They often give us feedback on new products they would like added to the line, as well as suggested improvements for existing products.'

Dishing out cooking skills in a fun way

With so many women entering the work force full time in the late 70s and early 80s, Christopher knew that, in addition to offering quality kitchen tools, educating her customers about using them would be important. 'What I considered simple, basic, essential tools were things others didn't have in their kitchens, much less know how to use,' she says. Cooking Shows continue to provide customers with tools and resources that help them save time in their kitchens. Retail stores simply can't compete with this fun, hands-on approach. For many consultants, the knowledge that they're helping customers by offering them a valuable service is extremely rewarding.

'I'm teaching my hosts and guests something that allows to decrease the stress around family mealtime by giving them the tools to make cooking so much easier,' Independent Director Deb Skrzynecki says. 'I love seeing their faces light up and hearing them say, "Hey, I can do that!"'

Consultants learn not only about tools through The Pampered Chef, but about ingredients and meal preparation. That education gives consultants the confidence to put their own twists on Cooking Shows. Theme shows are one way consultants share their enthusiasm for particular culinary tastes. From 'death by chocolate' shows and Italian feasts, to Cooking Shows focusing on health-conscious cooking, consultants can express their creativity while sharing some of their favorite tips. Some consultants enjoy putting on a performance, while others keep the presentation simple, making a point to encourage guest participation. Regardless of the consultant's style, guests enjoy spending time with friends, learning about the products and easy food-preparation techniques and tasting new recipes.

Global appeal

The Pampered Chef's business model serves up rewarding careers to tens of thousands in the United States, Canada, the United Kingdom and Germany. They are drawn to the company's unique service, innovative products and powerful earnings opportunity. 'When it comes to meal preparation, people want three things: They want to spend less time in the kitchen, they want to enjoy the time they spend there, and they want what they prepare to be easy to make yet spectacular to look at and wonderful to taste,' says Rick Voke, Executive Vice President, Global Operations and Strategy with The Pampered Chef. 'This is true whether you live in Kansas City, Mo.; Toronto; or Birmingham, England. Our products are so simple to use, and our recipes so creative and easy to make, their appeal transcends borders.'

The Pampered Chef creates recipes specifically for every taste. 'We have food professionals who specialize in the taste preferences and cooking styles for each of our markets,' Voke says. And, to make sure customers get consistent results, recipes destined for the United Kingdom and Germany are tested in a kitchen styled after a typical European kitchen. The success of The Pampered Chef in Canada, the United Kingdom and Germany shows that people everywhere love the products and the business opportunity. 'We have large, independent sales forces in Canada and in the United Kingdom, and we have a growing sales force in Germany,' Voke says. 'Obviously this model has tremendous global appeal.' That global appeal has been evident since The Pampered Chef opened its doors in Toronto in 1996. 'We made the decision to expand into Canada because, as the company grew in the United States, there was quite a demand for our product on the Canadian side of the border,' Voke says. 'The business took off right from the start.' The company enjoys success in all Canadian provinces. In July the company celebrated its 10-year anniversary in Canada. After a successful launch in Canada, The Pampered Chef researched European markets and determined the United Kingdom would be a good fit for its products and business opportunity. 'We started in the UK in 1999, and it is currently our fastest-growing operation,' Voke says. With continued record growth the company has independent consultants in Scotland, Northern Ireland and across Great Britain. The most recent international expansion was in Germany in 2000, where the company continues to experience growth in its independent force and sales.

Preparing for the future

Doris Christopher set out to create a business that would meet her family's financial goals and the needs of a changing society. The Pampered Chef's phenomenal growth and stronghold in the marketplace persuaded Christopher that her business would continue to thrive, regardless of her position in the company.

'A business leader has a responsibility to her stockholders, employees, vendors and customers, to assure them that their future is intact,' Christopher says. 'Over the years, Jay and I have seen a lot of good people hurt because they worked for, or did business with, a company that did not have a succession plan in place.' With concern, and respect, for the company's consultants, co-workers and vendors, the Christophers established a company succession plan. In October 2002, The Pampered Chef was acquired by Warren Buffett's holding company, Berkshire Hathaway.

While the decision wasn't simple, it was solid. Buffett's management style allows The Pampered Chef to operate as it always has on a daily basis. At the same time, the ownership transfer, coupled with The Pampered Chef's solid team of professional management, offers the company a stable and secure future [. . .].

Wisdom and sincerity are words that come to mind when Doris Christopher's name is mentioned. From the beginning, her leadership set the foundation for a company whose mission to bring families together is as relevant today as it was 25 years ago, when the first Cooking Show was held.

Question

1. Evaluate Pampered Chef's approach to new product development for the global market.

CASE STUDY 10.4

The internationalization of Chinese brands

(Adapted from a presentation made by Andrew Papadimos, Australian Catholic University, at the International Business and Economy Conference, Honolulu, Hawaii, January 5–8, 2006.)

China's entrance into the World Trade Organization in December 2001 meant the opening of China's domestic market to foreign competition. However, it also opened the doors of other member countries to Chinese competition. When Western and Japanese multinational corporations enter foreign markets, they also carry with them their own brands, capital and technology. Can Chinese corporations do the same? Chinese companies like TCL and Haier have taken the first successful steps in the internationalization of Chinese enterprises, and have demonstrated that Chinese corporations do have limited success overseas. Their experiences have also become templates for the increasing number of Chinese enterprises that are stepping out into the international market. However, there are still many problems facing Chinese companies on their path to internationalization, as the famous Chinese wool manufacturer Hengyuanxiang discovered when it ventured abroad. While Hengyuanxiang has great brand recognition at home, its name is meaningless internationally. Also, the names of other famous Chinese companies such as Lebaidi and Yangzi die out once management has been handed over to international corporations.

For Chinese brands to survive, therefore, they must develop, but to develop they need to internationalize. Brand internationalization for enterprises from developing nations faces all sorts of challenges, and this piece will examine the problems and issues surrounding Chinese companies in their journey toward brand internationalization.

Changing the name

Chinese brand names originate with the Chinese enterprise, and all copyrights are owned by that enterprise. They are registered as Chinese characters at startup, and, as in the West, the company tries to make the name catchy, sometimes even including geographic and personal names. Chinese brand names may also be registered using Pinyin Romanization, eg. = Changhong = Rainbow. Chinese brand names have two major flaws:

1. Because international recognition of Chinese brand names is low, Chinese companies are unable to enter host markets in the same way as globally recognized US brands such as IBM, DELL or Coca-Cola.
2. Even if Chinese brands do have a Romanized version, Westerners will still have difficulty pronouncing it because of linguistic differences. This issue alone can mean the death of Chinese products in foreign markets.

The basic principles of brand name development are that brands should be easy to recognize, easy to remember and easy to pronounce. Chinese brands meet none of these requirements when they enter international markets.

All of the internationally successful Chinese brands changed their names long ago. [ ] has become Haier; (Haixin) has become Hisense; TCL (simply no Chinese name); (Meide) has become Midea, etc. The first step for internationalizing Chinese companies, therefore, is to make their brand more globally recognizable.

During the 1970s and 1980s, Japanese companies were faced with similar problems when they first entered the international market. When Matushita arrived in the United States, it changed its name to Panasonic; became Canon; and in an attempt to hide its Japanese trace, was renamed Konica. Adapting Chinese brand names to the linguistic styles and customs of the local country is at the core of Chinese brand internationalization.

This certainly does not mean, though, that all Chinese brands must change their names when going abroad. For example, Chinese companies which trade on their products' unique Chinese qualities and characteristics would be foolish to change names. Examples include the company Tongren Temple, which is a maker of Chinese medicine or Chinese restaurants. In these instances, Chinese characters and Pinyin Romanization become a distinct marketing advantage in the sale of such products to Western consumers.

Establishing international brand recognition

After many years of competitive low prices, an impression has been created that Chinese goods are inferior to those produced by other countries, especially in Europe, the United States and Australia. As a consequence, even more barriers to the internationalization of Chinese brands are created. But where are the greatest difficulties? It is in establishing brand recognition, for without brand recognition and prestige value, a brand has no value at all.

How can Chinese companies establish brand prestige overseas? One method is to proceed gradually, and first establish market prestige and brand consciousness in developing nations and regions. For example, if Konka opens a factory in India and TCL opens one in Vietnam, and their operations slowly take root, brand prestige will establish itself gradually. But there are still some serious flaws in this method: although establishing brand recognition in developing countries' markets is easier and quicker than in developed markets, establishing brand prestige always needs to follow a course of moving from the unfamiliar to the familiar, and from initial suspicion to trust. Opening up a market in an undeveloped country, then a developing country, and finally a developed country is time-consuming and strenuous. Moreover, the easier the access to a country or area, the more is its capacity to be limited. While the company may have established prestige in the undeveloped country, it cannot translate this experience to other countries in the region. For example, establishing brand prestige in Vietnam does not help brand recognition in the Malaysian or Thai markets, and the so-called easy markets may actually not be that easy to enter. They may possibly be already crammed full of other multinational corporation's products (such as in the case of Vietnam), or be politically or economically unstable (such as Afghanistan).

Therefore, starting with the seemingly easy markets, and moving on to more difficult ones to establish international prestige is usually time-consuming and ineffective. This is also a major reason why Chinese enterprises give up on exporting their brands in favor of producing OEMs.

If we hark back to the experience of Japanese companies, we can then see that the only way to really achieve brand internationalization is through the process of starting with the difficult markets, and then moving on to the easier ones. It took Sony a decade of hard work before it first entered the American market in the 1950s, and then found it easier to expand to other parts of the world. Japan's domestic electrical appliance and automobile industries soon followed the same pattern.

Brand internationalization is therefore best achieved by companies taking the difficult road before the easy. For example, the reason Haier entered the international market was not because it had entered the Southeast Asian and South American markets first, but because it had come to a standstill in the US market. Matushita, Sony, Toyota also captured the American market first, and then moved on to the European, Latin American and African markets. Moreover, Hisense entered the South African market after it discovered a blank spot, and rapidly expanded across other borders. Why did it do this? Because South Africa is the most developed country on the African continent and is where competition is at its most intense. Acceptance of a brand name in the South African market meant acceptance throughout Africa. But Hisense's success in Africa did not help its success in developing the European and American markets. Haier, however, had a different experience. Success in the American market was akin to global approval of its quality and good standing, and helped it establish markets in more than 100 countries in a very short time frame. A market may therefore seem impenetrable at first, but once a niche market has been found in a country, further breakthroughs become easier and market expansion continues.

Is Chinese brand internationalization exportation or localization?

Another issue regarding Chinese brand internationalization is whether products should be domestically produced with a view for sales overseas, or whether Chinese companies should carry out production overseas. There are currently two opposing views in regard to this issue. The first view is firmly opposed to establishing factories overseas. It sees China's large population and cheap labor as the chief reason for its cheap manufacturing costs. It is also why China has become the world's production processing base for electrical appliances, clothing and electronic products. The argument goes that while Europe, the US, Japan and other developed countries are moving their production bases to China, if China sets up factories in these countries, it will sacrifice its cost superiority. Therefore, proponents of this view approve the internationalization of Chinese brands, but also place Chinese labels on Chinese products that are being sold overseas, thus being a form of localization.

Another viewpoint suggests that, while Chinese companies should exploit the cost superiority of domestic production, when the time is ripe, and the Chinese market has reached its capacity, China must internationalize its production base and establish factories overseas. What are the advantages of this? On the one hand overseas market information can be better understood, and faster market responses made. On the other hand, it relays a message to the customer that Chinese corporations are ready to solve problems as necessary, and meet the needs of overseas customers.

The latter opinion is the more convincing. The internationalization of Chinese brands is not an urgent demand, but rather one that is more of a long-term strategy. China possesses cost superiority today, but, in ten or twenty years, this advantage may vanish. Brand names need to live much longer. Therefore, it is inevitable that Chinese brands will internationalize, and this demands both overseas managed factories *and* internationalization. Even in the short term, Chinese corporations must leave China. What can Chinese corporations learn from Western MNCs? All MNCs have their antennas in the global market, and are extremely aware of market conditions. They possess brand superiority, and their brands (such as Coca-Cola, Sony etc.) have taken root in consumers' minds. Compared with Chinese corporations, they also have vast superiority in research and development, and are able to design products that meet the needs of the international market. China's only advantage is its low production costs. But now that Western and Japanese MNCs are using Chinese OEMs (original equipment manufacturers) on a large scale, and taking away this cost advantage from local companies, how can Chinese enterprises compete?

Chinese brand internationalization must do the opposite of what Western and Japanese MNCs have done in the past. Western and Japanese MNCs have entered China, and so Chinese MNCs must venture out so that they too can have an equally keen market antenna and reaction capacity. Hisense has said that nobody can understand local people more than local people. Just as important is the low international confidence level in Chinese brands. In order to express the determination and sincerity of Chinese corporations, China must establish manufacturing bases and retail networks overseas and gradually establish local consumers' confidence and trust. In summary, Chinese brand internationalization must continue, and go along the road to overseas factories sooner or later. If it doesn't, it will be impossible for Chinese companies to internationalize their brands' images and international prestige.

To OEM or not to OEM?

At present China's manufactured goods, especially consumables, are mostly exported as rebadged products. This is the case with Changhong, Midea, Gree Airconditioning, Shinco, and Galanz, who rebadge for companies such as Sanyo, Mitsubishi, Carrier, etc. In an article entitled 'The two sides of Galanz' in the March 2002 edition of *Sino-Foreign Management*, Galanz's Vice President Yu Yao Chang stated 'What are brands? Brands are gold stacks.' He then asked himself, 'How many stacks of gold do we have?' His meaning was that China does not have the money nor resources to internationalize its brands, and is only capable of manufacturing OEMs. With this in mind, Galanz has positioned itself to be one of the world's largest production workshops, and allows multinational corporations to manage the marketing networks. Galanz, therefore, makes brands to order.

China's largest DVD manufacturer, Shinco, is also doing the same. Midea's President, He Xiangjian, clearly said in an interview for the same article, 'I have yet to see one Chinese factory that has been set up overseas become successful in selling its own products under its own brand, including Haier. While it may be true that TCL's operations in Vietnam posted a profit at the end of 2002, this one instance to date is hardly sufficient to give Chinese enterprises sufficient courage to enter the international market.

Certainly there is another viewpoint which believes that producing OEMs is a way of better understanding the needs of the international market, and is a way of preparing Chinese organizations for the eventual internationalization of their own brands. There is a lot of validity to this argument. Manufacturing OEMs can enable Chinese companies to grasp the product's production technology, enhance the enterprise's management level, and allow it to understand what types of product foreign markets are seeking. But, after all, the manufacturing process and marketing networks are in the hands of the foreign corporation, and consumers purchase not only the product, but the brand. Ultimately, it is the owner of the brand that is responsible for the consumer. Most consumers recognize a brand more than a product.

Also, once a multinational corporation finds a better production base, it will move there. Even though rebadging raises the management levels and technical abilities of Chinese corporations, they will always be behind with those of the multinational corporation. The Secretary-General of China's Electrical Appliances Association, Mr. Jiang Feng, has frankly stated that OEM products are popularist and mainly used for mid- to low-grade products. The Vice President of Siemens (China) responsible for sales of electrical appliances, Dong Quanxin, also indicated that, because it will be very difficult for Chinese producers of electrical appliances to reach Siemens' technical standards within the next 3–5 years, Chinese producers will not be manufacturing high-end products for Siemens. Obviously, therefore, it is highly unlikely that producing OEMs will greatly enhance the technical ability of Chinese enterprises, and is also unlikely to bridge the gap in technical disparities between them and foreign multinational corporations.

It is impossible for Chinese enterprises to truly understand the international market by producing OEMs. International markets are constantly changing, and, by only producing OEMs, Chinese corporations are closing themselves off by staying in their workshops and passively responding to orders from outside. An understanding of global markets and economic fluctuations is vital to the success of international corporations. Chinese companies therefore have to try and break the cultural and linguistic constraints and venture forth into the open world.

Therefore, by producing only OEMs, it will be impossible for China to attain the technical support abilities, the HR skills and the 'combat readiness' that is needed for the internationalization of Chinese brands. Only the *products* made in China will be for sale in international markets. But brand internationalization and product internationalization are two completely different concepts.

Product internationalization occurs when your products are available for sale in many countries, but consumers don't care where they are made. They only care about the prestige and quality guarantees that are manifested through the brand name. OEMs cannot influence the internationalization of Chinese brands, and so Chinese companies must persist in exporting their own local brand names.

Conclusion

In conclusion, there are huge hurdles facing the internationalization of Chinese brands. The time line is long and the costs will be enormous. But in order to create truly international brands on the scale of Coca-Cola, McDonald's, Toyota, Sony, Phillips, or the like, China's entrepreneurs cannot base their decisions on the poor short-term results for one specific time period at one location, such as the case with Haier to date. Establishing a brand name and brand prestige needs patience and a lot of money. But the payback for China in terms of economic profits, and indeed its national dignity, is potentially enormous.

Questions

1. Evaluate the process followed by Chinese companies to gain brand-name recognition internationally.
2. Is the experience of Japanese companies in the 1950s and later really applicable to Chinese companies today? Explain.
3. Can Chinese SMEs internationalize their brands or is this only possible for larger firms? Why or why not?

CASE STUDY 10.5

Royal Philips Electronics

(This case is adapted from Capell, K. (2006). Thinking Simple at Philips. Reprinted from December 11 2006 issue of *Bloomberg Businessweek*, p. 50, by special permission, copyright © 2006 by Bloomberg L.P. and from the Philips website www.philips.com, accessed 23 June 2010.)

In late 2004, British fashion designer Sara Berman received an unexpected telephone call from Andrea Ragnetti, chief marketing officer for Royal Philips Electronics. Figuring the Dutch company wanted her to design some sort of wearable technology, she was prepared to politely decline the proposal. Instead, she spent an hour engaged in a freewheeling discussion on the meaning of simplicity, and by the end of the chat she had accepted Ragnetti's invitation to join Philips' Simplicity Advisory Board, a new panel of outside experts.

What does a fashion designer know about technology? Not much. But that's the point. To drive change following a radical restructuring, Philips reckoned it needed a fresh perspective from creative types with no ties to the company. So it formed the simplicity board, a group of specialists in health care, fashion, design, and architecture. 'Philips was too inward-looking,' Ragnetti says. 'To really embed simplicity into the company's DNA, we needed an element of vision.'

Change agents

The five-member board's mission is to help Philips focus on 'sense and simplicity,' which is what the company called a new branding initiative to underpin its transformation from a high-volume electronics maker into a design-led company concentrating on health, lifestyle, and technology.

Each member of the Simplicity Advisory Board comes from a different cultural and professional background. While the board members bring a mix of experience and cultures, they all share the company's passion for simplicity. Berman, who heads a successful clothing label, is helping the company explore new opportunities in consumer products. Dr. Peggy J. Fritzsche, a radiology professor in California, advises Philips on its $8 billion medical-equipment business. Gary Chang, a leading architect in China, serves as a brand ambassador in the mainland. John Maeda, a graphic designer and professor at Massachusetts Institute of Technology, is working to fine-tune the emotional appeal of the company's wares. Ken Okuyama is active in automotive and transportation design and is a professor at the Art Center College of Design in the United States.

On a practical level, the board is helping Philips rethink what its customers want. For two years, members met for several days every month or two in cities such as Rome, Paris, or New York. Today they no longer meet as a group, but each is on call to help Philips create intuitive, easy-to-use products that meet specific needs. 'In the past, companies just developed the technology and hoped someone would buy it,' says Ragnetti. 'Now we are starting from the point of discovering what exactly consumers want a product to do.'

'Mind-opening'

Philips has given the board members free rein to kick the tires. When the consumer electronics unit was ready to launch its Wireless Audio Center, a system for listening to different tunes in multiple rooms around the house, Maeda gave it a whirl. His verdict: Too much computer jargon such as 'booting up, please wait.' 'His suggestions were mind-opening,' says Geert van Kuyck, Philips' senior vice president of global marketing. Maeda's input 'made us ask questions we hadn't asked before.'

The outside perspective came in handy when assessing Philips' fast-growing medical business. As a practicing radiologist, Fritzsche noted that medical equipment is often too complex. Although the quality of images has grown dramatically, Fritzsche says the greater detail and quantity have increased the burden on radiologists. Offering so much data led to information overload instead of better diagnoses. With Fritzsche's insights, Philips is working to make its gear more intuitive, allowing doctors to spend more time with patients and less grappling with technology.

For Philips, the promise of simplicity isn't just about making products that are easier to use. The bigger challenge is rewiring the entire organization. The board's primary contribution, says Berman, is 'using creative chaos to affect lasting change.' That's trickier than it might sound. 'Simplicity,' says Maeda, 'is actually a very complex topic.'

In practical terms, the board acts as a think tank and sounding board for Philips, providing counsel and guidance on a number of projects and issues in the healthcare, lifestyle, and technology areas.

Questions

1. Evaluate the use of the Simplicity Advisory Board by Philips. Is this really a good idea for such a company? Explain your answer.
2. Could other types of companies find value in creating similar boards? If so, what types of companies?
3. Is the use of advisory boards limited to one on the desire for simplicity or could other types of advisory boards be valuable giving advice on such matters as cost savings, market penetration, etc.? Explain your answer.

CASE STUDY 10.6

The Boeing Company

(Reprinted with permission from *Marketing News*, published by the American Marketing Association, Elizabeth A. Sullivan, 'Building a better brand,' 15 September 2009, pp. 14–17.)

Boeing, the Chicago-based aerospace giant, is known for its commercial aircraft. The 93-year-old company is the no. 2 manufacturer in the world of such planes, behind Blagnac, France-based Airbus. But Boeing produces much more than just commercial jets. It also makes military aircraft, integrated defense systems, missiles, satellites and communications systems. It's the no. 2 contractor for the Pentagon, second only to Lockheed Martin Corp. It works with NASA to help operate the space shuttle and International Space Station, and with the US Army as a systems integrator. Boeing employs more than 158,000 people in the United States and 70 other countries, has customers in more than 90 countries and is one of the United States' largest exporters.

In short, Boeing is a multifaceted B-to-B behemoth. But while the Boeing brand might be familiar to the marketplace, until recently the company lacked a cohesive brand identity or communications strategy to unify its disparate enterprises. A few years ago, Boeing set out to integrate its various businesses into one company, one visual identity and one brand. And in early 2008, Boeing launched the One campaign, a comprehensive internal and external branding effort to drive a 'one brand' culture and unify how the company connects with the outside world.

Boeing execs understand that, regardless of its size, a company needs to present a cohesive identity to clearly define where the company stands within the marketplace and how it intends to serve its customers. In other words, every company needs to leverage the power of 'One.'

'One brand'

For a B-to-B brand whose power and legacy already resonate within the marketplace, a comprehensive brand overhaul, many years in the making, might seem unnecessary. But 'the choice for the company is a house of brands versus a branded house. Boeing chose the branded house.' A strong, cohesive brand lends instant recognition to new products, positions a company well against competition and withstands any negative impacts within the marketplace. And probably one of the most important [benefits of a unified brand] is internally, it makes us more cohesive.

Many years ago, Boeing's visual identity was all over the map. Boeing grew over the years through a series of mergers and acquisitions, and although every business segment shared the Boeing label, each had its own marketing material, signage, color palette, you name it. There were more than 200 different styles of letterhead and business cards.

Over the years, Boeing execs have worked to create a cohesive communication style. And with the 'current brand refresh,' as company calls it, Boeing is taking hold of the aforementioned rope to tie the company's visual dements, culture and outwardly facing brand together.

'One look'

The aerospace industry's as whole is becoming more sophisticated in how it approaches the marketplace. So in 2006 and 2007, Boeing conducted a series of audits of all communication materials to see how it was measuring up. The company found that cohesion was sorely lacking, and marketing materials appeared dated and disjointed.

In early 2008, Boeing execs put together a cross-departmental, 'super-unwieldy' team of employees from communications, creative services, customer relations, marketing, sales, HR and other 'internal organs' to hash out what the Boeing brand's visual identity should be. They called in assistance from the company's ad agency, Chicago-based Draftfcb; Seattle-based corporate design firm Methodologie Inc.; and Paul Haverly, an aviation design consultant. They all set out to cut through Boeing's visual clutter, create a unified brand, reduce costs and drive efficiency by promoting consistent design principles.

The team researched the brand's personality, promise and mission. Team members understood that to create an authentic sense of 'oneness,' they had to identify which characteristics Boeing's many enterprises have in common.

The first phase of the process concluded with 'the initial distillation of all of [the gathered information] into the brand DNA,' says Dale Hart, Methodologie's partner and creative director. The team came up with a triple helix; enterprising spirit, or why Boeing does what it does; precision performance, or how Boeing gets things done; and defining the future, or what Boeing achieves as a company.

Using that simply stated but carefully honed framework, the team created a design roadmap for the Boeing brand called the brand visualizer. Methodologie, which had experience building brand mapping systems for other clients, assembled the brand visualizer to guide all design decisions – creating a company color palette, pinpointing one company typeface, defining the company's voice and communications style, and determining how photos and images should be used.

'In a company the size of Boeing … they have many, many agencies articulating their brand, as well as many people on the staff articulating the brand,' says Janet DeDonato, Methodologie's founding partner and strategic director. 'It had to be a really broad and encompassing system … It's hard to figure out a system that will work for everybody.'

For example, one employee who worked with military customers said the design was trending toward a light, ephemeral typography that wouldn't correctly convey who Boeing is to his customers. He said the company needed something with enough weight to suit both commercial and military enterprises. The team then spent five days doing type studies to find a font with some edge and eventually chose Helvetica, Newcomb says.

The resulting system is structured enough to keep everyone on the same page from a branding and design perspective, but flexible enough to accommodate products 'from zero elevation up to 30,000 feet and beyond,' Hart says.

Of course, it's all well and good to create a comprehensive system like this, but the true test of a company's success is employee buy-in. For that, the brand visualizer's simplicity is key, says Sandy Kolkey, executive vice president and group management director at Draftfcb and manager of the Boeing account. 'It's like the difference between getting a 400-page PowerPoint deck and getting the executive summary. No one reads the 400-page deck.'

'The main thing is getting people to understand the concept … That's the hard part,' Newcomb adds. Once employees understand the reason behind the branding strategy and design, they can implement the guidelines, tools and best practices correctly, he says. Employee training is underway and the company has held design and branding workshops. Every employee in the company has access to the brand map and to a company brand network online, whether or not his job description requires it, for one simple reason: 'Everyone should be managing the brand.'

'One company'

Over the past few years, Boeing has leveraged its brand's silo-busting power wherever and however possible, extending that thickly threaded rope throughout the company to create a sense of camaraderie and shared purpose among the disparate enterprises.

Even before embarking on the brand refresh project, the company began working to bond its employees together through internal communications. A set of newsletters, for example, are sent out to managers and employees to keep them up to speed on the company's daily goings-on. And the company has been working on a series of internal motivational videos featuring Boeing employees taking about their jobs and achievements.

'In 2007, Boeing parlayed the internal motivational video effort into an external B-to-B-to-C advertising effort known as the 'That's Why We're Here' campaign. Like the motivational videos, the ads feature real Boeing employees from a diverse range of business segments talking about what Boeing does and what the Boeing brand stands for.

The campaign has been a huge hit with Boeing employees, which has served to strengthen the 'One company' strategy. In a company survey, seven out of ten respondents said that the campaign 'expresses the way I feel about Boeing' and nine out of ten found the campaign appealing. 'It was a 65% increase over the previous campaign.'

Prepare for Takeon

Richard Aboulafia, vice president of analysis at Teal Group Corp., a Fairfax, VA-based aerospace and defense industry research group, says Boeing has an 'extremely strong' brand, but he's wary of giving an all-out endorsement for the external manifestations of the 'One brand, One company' strategy.

'Is branding important? Sure. Is creating a unified company and making it look like you're one company? Sure,' he says. 'On balance, I think it's good' to have a cohesive brand. But if Boeing's brand is intrinsically unified, negative occurrences in one area of the company can reflect poorly on other areas as well. For example, issues that occur in the construction of Boeing's much-anticipated and much-delayed 787 Dreamliner aircraft also could reflect poorly on Boeing's military or information systems businesses, Aboulafia surmises.

The flipside of that coin is that a cohesive, well-executed brand can create more favorable perceptions of the company and can act as a buffer for the company's image, says Richard Ford, executive creative director of the New York office of Landor Associates, a global branding firm. 'It's more about keeping stock prices high and about making sure that Boeing has some kind of halo around it … a positive impression of the brand that would protect the brand from damage, should it occur," says Ford, an expert in aviation branding. 'I think they're on the right track, at least as far as the [brand] clean-up goes,' he says. 'But I think there's a lot more for Boeing in the future and this is just the beginning.'

A global, multipronged business, Boeing is making strides in branding itself as one company versus a conglomerate of smaller businesses, banking on the power of internal branding and a cohesive marketing communications strategy to put it ahead of its competitors. And as mentioned earlier, when it comes to branding, a true measure of success is employee buy-in. If the Boeing brand rings true to the people who represent it, and those people want to take care in representing it well, then the brand is well-positioned to succeed.

Questions

1. Evaluate Boeing's strategy for 'Becoming One.'
2. Is the approach used by Boeing suitable for other companies, including B-to-C companies? Discuss.
3. What did Boeing's team on brand identity come up with as the three elements they thought should be considered as making up 'the company's DNA?' Do you agree with their list?
4. Why did Boeing go to three outside groups (ad agency, design firm, aviation design consultant) to assist in developing 'one brand'?
5. In very brief summary, what methods did the company use to get people to understand the branding strategy?
6. Do you think that it is really possible for a brand to help create a sense of camaraderie and shared purpose among employees? Why or why not?
7. What has been the reaction of the employees to the program?
8. Discuss any potential downside to such broad and strong branding.

CHAPTER 11

Pricing decisions

Learning outcomes

In Chapter 11 we look at:

- fundamental export pricing strategies and relationships to domestic price policies
- factors that must be considered in determining an export price: costs, competition, legal/political considerations, company policies
- the effects of the Internet and World Wide Web, and other advances in communications, on pricing as:
  — a threat to prices and brands
  — an opportunity for balancing demand over time, and
  — a means of improving economic growth and social welfare
- problems from changing exchange rates, the choice of currency to be used, and hedging possibilities
- price quotations, terms, and calculations
- transfer pricing

Three cases are provided at the end of the chapter. Case 11.1, RAP Engineering and Equipment Company, requires the student to develop two different price calculations and to explain the implications regarding responsibilities for arrangements and liabilities for each. Case 11.2, Capitool Company, explores the issue of transfer pricing policies. Case 11.3, Strato Designs, involves questions regarding the possible use of hedging.

Introduction

The management of prices and price policies in export marketing is somewhat more complex than in domestic marketing. Due to increasing complexity of markets, price decisions are becoming more critical than ever. All markets are becoming more segmented, which results in firms having to broaden their product lines with different products aimed at different types of customer. Gone are the days when Coca-Cola could offer a single brand to everyone; today it has Coke, Diet Coke, Caffeine Free Coke, Cherry Coke, etc. Successful B2B marketing is similarly shifting from commodity selling to speciality products. Of concern to the export marketing manager are the following:

- pricing decisions for products that are produced wholly or in part in one country and marketed in another (exports);
- pricing decisions that are made on products produced or marketed locally but with some centralized influence, from outside the country in which the products are produced or marketed;
- the effect of pricing decisions in one market on the company's operations in other countries.

The philosophy and practice of establishing an export price is fundamentally no different to establishing a price for the domestic market. The customer must feel that he or she has received full value for their money. At the same time the export marketing manager must seek profits, either short-run or long-run, depending upon the company's overall objectives and the specific decision situation at hand.

Broadly speaking, pricing decisions include setting the initial price as well as changing the established price of products from time to time. Changing a price may involve a discount or allowance or anything that represents a deviation from the so-called base price. Price decisions must be made for different classes of purchasers, that is, prices must be set for sales to the following:

- consumers or industrial users;
- wholesalers, distributors, or other importing agencies;
- partners in strategic alliances;
- licensees (when parts or components are exported);
- one's own subsidiaries or joint ventures, whether minority or majority interest or wholly owned subsidiaries.

Pricing for the last type of purchaser involves the use of transfer prices. Other pricing decisions include the following:

- determining the relationships between prices of individual products in a product line and between products in the product mix;
- whether to offer **bundle pricing** or price by individual product or component;
- deciding, in larger companies, on the type and amount of central control to be exercised to ensure that the price to ultimate consumers and users is maintained at a certain level;
- establishing a geographic pricing policy, for example whether or not to quote uniform delivered prices, or free on board (FOB) factory prices.

The issue of differential pricing is important with regard to most of these decisions, especially the differential between export prices and domestic prices. Decisions must be made on the relationships between the prices of products sold in multiple national markets, that is, whether the price to customers in one foreign market should be the same, lower, or higher than in other foreign markets or in the domestic market.

There are five distinct facets to the pricing problem facing the export manager, at least three of which are unique to exporting. These five facets, each of which will be discussed in the following pages, are as follows:

- fundamental pricing strategy;
- relation of foreign price policy to domestic policy;
- currency issues;
- elements in the price quotation;
- transfer pricing.

We will now discuss the fundamental export pricing objectives and strategies.

Fundamental export pricing objectives and strategies

All too frequently export marketing managers rely entirely on costs as a basis for establishing foreign market price policy. In some instances they attempt to cover full costs at all times even though such a policy may result in substantially less than optimum sales volume or may encourage competitors to enter and steal the market. In other instances a rough approximation of marginal (direct) cost pricing is utilized. In this situation the price is based primarily on the variable, or direct, costs of production with only a minimum part of fixed costs added. Such a technique assumes that profits will be made on domestic sales and that they will be larger than otherwise because of the utilization of fixed equipment and labor for a larger volume of production, thus reducing fixed costs per unit. Foreign markets may be used to dispose of surplus production (or use excess capacity) priced at no more than the direct costs. Unfortunately, such strategy may prove short sighted since it gives rise to the frequent international complaint of dumping, which may result in foreign governments imposing arbitrary restrictions on the import of the commodity. In addition, there is a chance that the strategy may be viewed as predatory pricing, which might be a violation of the foreign country's antitrust law.

The relationship between cost and volume is critical to an approach to pricing known as *experience-curve pricing*. Based on the Boston Consulting Group's work, unit costs are expected to decline as accumulated volume (i.e., total units produced of a product) increases. The decline in costs is attributed to changes in production efficiency. Initially, prices are set below unit cost so as to gain a price advantage over competitors. Efficiency increases through market share increase, leading to a reduction in cost, and these lower costs then exceed price reductions. The essence of the cyclical nature of experience-curve pricing is illustrated in Figure 11.1.

Strategies of basing prices on costs, whether full cost or marginal cost, oversimplify the pricing process in export marketing. There are a number of different pricing strategies that may be used effectively in export markets. Pricing is not the simple problem of establishing a selling price somewhere between cost and the maximum that the traffic (market, customers, or consumers) will bear. It is not one of mathematical precision, but one of statistical probabilities. The problem of the pricing executive is much like that of the player in a card game. His or her play is determined by the moves and countermoves of opponents. This anticipating and reacting to opponents or competitors is known as strategy and is as important in pricing as in card games.

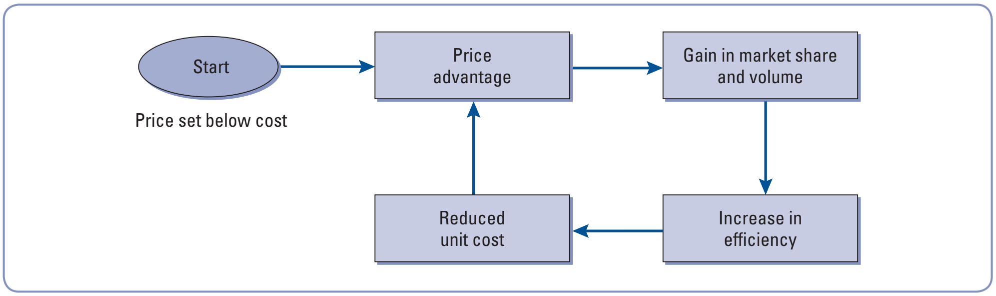


Figure 11.1 Experience-curve pricing

It is the gap between cost and value that makes it possible to have a pricing strategy. Which strategy is appropriate for a company depends upon the objective underlying strategy choice. That is, just what is it that export management wants to achieve by using price as a marketing tool? There are many objectives in pricing (see Table 11.1) and as many strategies. For example, in a recent study of international pricing practice that was based on a series of 45 qualitative interviews with seasoned international business executives from five different countries, the author concludes that the respondent exporting firms did not employ separate objectives for pricing decisions. Interestingly, the responding firms stated either financial or nonfinancial goals as key objectives for their international business. More explicitly, maintaining market share or increasing international market coverage ranked first. Only one-third of the firms in the sample were using financial goals to measure performance. What seemed in particular to influence the price goals were the company's experience in exporting and the distribution system in which the company was operating internationally.

The following sections present the two main export price strategies (skimming and penetration) as well as several alternative price strategies that can be used effectively in export markets.

Skimming the market

A simple objective might be to make the largest profit possible. This involves the strategy of getting the highest possible price out of a product's distinctiveness. A high price is set until the small market at that price is exhausted. The price may then be lowered to tap a second successive market or income level. This strategy may be used either because the company

Table 11.1 Alternative pricing objectives

- Satisfactory return on investment
- Maintaining market share
- Meeting a specified profit goal
- Largest possible market share
- Meeting a specific sales goal
- Profit maximization
- Pricing at the high end of the price range
- Highest return on investment
- Prices are set at a high level and then lowered after a certain period has elapsed
- Meeting competition

feels that there is no permanent future for the product in a foreign market; that its costs are high and a competitor may come in and take the market away; or because production capacity is limited; or because it enjoys a temporary and erodible competitive advantage.

Penetration pricing

This strategy involves establishing a price sufficiently low to rapidly create a mass market. Emphasis is placed on value rather than cost in setting the price. Penetration pricing involves the assumption that if the price is set to bring in a mass market, the effect of this volume will be to lower costs sufficiently to make the price yield a profit. In an industry of rapidly decreasing costs, penetration pricing can accelerate the process. The strategy also involves the assumption that demand is highly elastic or that foreign purchasers buy primarily on a price basis. This strategy may be more appropriate than skimming for multinational companies facing the demand conditions of the less-developed countries.

An extreme form of penetration pricing is *expansionistic* pricing. This is the same as penetration pricing except that it goes much lower in order to get a larger percentage of the customers who are potential buyers at very low prices. This strategy assumes: (1) a high degree of price elasticity of demand and (2) costs extremely susceptible to reduction with volume output. This may be based on experience-curve pricing.

Sliding down the demand curve

This strategy is a variation of the skimming strategy and in this case the company reduces prices faster and further than it would be forced to do in view of potential competition. A company pursuing this strategy has the objective to become established in foreign markets as an efficient producer at optimum volume before foreign or domestic competitors can get entrenched. This is primarily used by companies introducing product innovations. Here the strategy involves starting out with almost the entire emphasis on pricing on the basis of what the market will bear and moving from this point toward cost pricing at a measured pace. The pace must be slow enough to pick up profits but fast enough to discourage competitors from entering the market. Companies following this strategy are seeking to recover development costs as they become an established entity in the market.

Preemptive pricing

Setting prices so low as to discourage competition is the objective of preemptive pricing. The price will be close to total unit costs for this reason. As lower costs result from increased volume, still lower prices will be quoted to buyers. If necessary to discourage potential competition prices may even be set temporarily below total cost. The assumption is that profits will be made in the long run through market dominance. This approach, too, may utilize experience curves.

Extinction pricing

The purpose of extinction pricing is to eliminate existing competitors from international markets. It may be adopted by large, low-cost producers as a conscious means of driving weaker, marginal producers out of the industry. Since it may prove highly demoralizing, especially for small firms and those in newly developing countries, it can slow down economic advancement and thus retard the development of otherwise potentially substantial markets.

Preemptive and extinction pricing strategies are both closely associated with 'dumping' in international markets. Actually, they are merely variations of the dumping process, depending upon the domestic or 'home' market price. Although they may serve to capture initially a foreign market and may keep out, or drive out, competitors, they should be used only with extreme caution. There is the ever-present danger that foreign governments will impose arbitrary restrictions on the import and sales of the product, consequently closing the market completely to the producer. More important, once customers have become used to buying at low prices it may prove difficult, if not impossible, to raise them subsequently to profitable levels.

Exhibit 11.1 provides examples of some pricing strategies used, and the results achieved.

Exhibit 11.1 Some pricing strategies and results achieved

- *Successfully using premium prices.* Louis Vuitton has opened its 46th store in Japan, where the combination of its status-symbol name and high prices appeal to a growing market segment of young, educated single women still living with their parents. They splurge on products with cachet while cutting costs on other items. Louis Vuitton sells more than twice as many handbags in Japan as in all of Europe. Maintaining high prices that support their positions as status symbols Vuitton, Chanel and Hermes do well while the overall market for luxury goods in Japan has been falling since 1996 (Katz, 2003).
- *Pricing to capture an additional market segment.* An ongoing recession in 2009 caused a 17% drop in worldwide sales of Rolls-Royce automobiles, one of BMW's brands. In December of 2009, the company launched a new smaller Rolls-Royce model, the Ghost, selling for about $250,000. BMW hopes it will broaden its appeal to a younger clientele than the four models of its existing Phantom model, which sell for about $380,000 to $450,000 each. In the first five months of 2010, the company sold 678 cars, a rise of 146% from 2009. The number Rolls-Royce sold has been steadily increasing since 2005.
- *A problem in failing to meet price competition.* In the mid-2000s with the weak dollar failing to adequately cover high euro prices for labor and parts in Germany, Volkswagen AG adopted a strategy of reducing discounts on cars being sold in the United States. Their US sales fell 30% in the first two months of 2004, and VW then resumed offering competitive discounts (White, 2004). In recent years, the dollar has been much stronger and European producers are benefiting. In 2015, however, VW was faced with a major problem after it was discovered that software had been installed to make it seem in tests like the cars were more environmentally friendly than they actually are.
- *Two successes in using low-price strategies.* (1) Southwest Airlines of the United States has been very successful providing low-cost scheduled air services at prices below those charged by major airlines. They have done this by maintaining substantially lower cost structures for personnel (made easier by cutbacks in service by many major carriers) and lower overhead than traditional international airlines. They also avoid routes on which they cannot attain high load factors for the aircraft they use, while major carriers need to provide service on some of these routes. (2) Walmart has been highly successful in some countries, such as the United States, using very low prices to attract a large number of customers. It was able to do this by developing a very efficient distribution system, operating large stores attracting a high volume of customers, and obtaining low prices from suppliers. It is notable that it was not successful with this strategy in Germany where competitive conditions and customer preferences were different.

- *Pricing to prevent piracy.* Microsoft was frustrated that 95% of the installations of its Office software in China were pirated. In a 10-month trial in China it lowered its price to $29. Sales increased more than 800%.
- *An experiment in pricing.* Procter & Gamble has traditionally focused on in-house development of new products, setting initial prices at a high level to cover development costs and advertising, and then cutting prices as competitors move in. But in January 2001 they took a new approach in acquiring a low-cost battery-powered toothbrush from outside entrepreneurs, who they also hired to assist in marketing. Focus groups and the prior experience of the entrepreneurs in selling the electric toothbrush to selected retailers indicated that, with a toothbrush design that would appeal to children and with proper packaging, advertising would not be necessary for the product launch. The price was set at $5, far below the prices of $50 or more for most electric toothbrushes and one-fourth the cost of a recently introduced low-priced electric toothbrush. The SpinBrush was a great success and, in P&G's quickest global rollout ever, posted global sales of over $200 million in 2001 (Berner, 2002). Over time, competitors such as Colgate developed their own low-priced battery-powered toothbrushes, taking away P&G's initial advantage.
- *Changing competition, changing strategies.* Toys 'Я' Us grew rapidly in the United States and overseas based on a low-price strategy. It was able to do this through high volume that allowed them to obtain low prices from manufacturers. Now, faced with growing competition from Walmart in the United States, they are closing US stores, emphasizing some different product lines including video games, and increasing their operations in smaller overseas markets that do not have extremely large competitors such as Walmart.
- *Changing type of payments accepted, and services provided.* Costco is a chain originally designed to provide small business owners, particularly restaurants and food service organizations, with groceries and other products. It charges a membership fee and is able to offer very low prices because it sells in bulk in wholesale or near-wholesale quantities, and accepts payment only by debit cards or cash. It expanded to include selling to individuals willing to buy in large quantities, customers generally economically 'upscale' from those buying at Walmart. It continued to do well in the recession, but decided to see if additional customers could be attracted by accepting government-provided food stamps in payment for goods. These 'stamps,' now available to recipients as a value on a card that can be used like a bank debit card at a checkout stand, are given to lower-income families and individuals in the United States (Costco, 2009). The change substantially increased sales, with 13% of new members indicating that this change had caused them to join. In one overseas market it was not successful until it offered a 'refund with no questions asked' policy. This was an innovation in the country which, after seeing that the company really did this, resulted in the attraction of many new customers.
- *A disaster in pricing.* In 1997 McDonald's Holdings Co. (Japan) was the market leader in hamburger chains, a position it had held since entering the market. The chairman of the company came up with a plan to increase that share by offering a burger for the extraordinarily low price of ¥59, far below that of any competitor. He was able to do this because he had contracted for a large amount of beef priced in dollars shortly before a substantial increase in the value of the yen. He expected to be able to continue to get beef at a very low price. The company enjoyed initial success as greatly increased volume raised profits in spite of the drop in prices. However, the temporary advantages gained from lower prices disappeared under a combination of price cuts by competitors, a drop-off in customers as the novelty wore off, and an inability to gain long-term cost advantages in using forward purchases of foreign exchange. McDonald's subsequently raised prices to a point part-way between the original prices and the lowest prices, but profits suffered. In 2003 McDonald's Japan had its first loss in 30 years and the chairman resigned (Tanaka, 2003).

- *Success in using an incentive.* In the US market, Toyota has been able to increase its market share for automobiles and small pickups without using the large incentives frequently offered by GM, Ford and Chrysler. In 2006, Toyota began manufacturing the Tundra full-size pickup truck in a large new facility in Texas, hoping to gain a sizeable share of the market for this type of vehicle (Kurasawa, 2007). American buyers of full-size pickup trucks are very brand-loyal, and sales of the Tundra were initially substantially lower than desired. In June 2007, Toyota began offering incentives, including no-interest loans, valued at $5,083 per vehicle. Sales for the Tundra more than doubled in June, putting sales back on track, while sales of trucks by GM, Ford and Chrysler all fell sharply (Tierney, 2007).
- *Different prices for different sharks.* When the entrepreneurs in 2014 on the popular TV-show 'Shark tank' were presented with the idea of "Elephant chat' they did not agree on the optimal pricing strategy. After hearing the Adams family pitch the idea, sharks seemed to agree that the price of $69.00 was way too high for a stuffed elephant that would otherwise be bought for a couple of dollars. Each shark explained the necessity of starting low in order to achieve sales. Mark Cuban, however, disagreed with the other sharks, and proposed that the product was too inexpensive and should be specifically targeted to marriage counsellors. In the end, none of the sharks invested in the Adams family and their product.

Summary

In the final analysis there are different approaches to pricing strategy; and there is no one master policy or procedure that should be used under all circumstances or in all foreign markets. Pricing strategy is a matter of having as much information as possible about costs and the value of a product to various classes of consumers in different markets. With this information and intelligent application the danger of an exporting company pricing itself out of potentially profitable markets is considerably reduced. Given the importance firms attach to international pricing, however, it is a wonder that most exporting companies do not apply more systematic approaches to price-related issues. In a study on international price practices the overall impression of how industrial exporters deal with international pricing issues was as follows: anchored around the strategic price position, managers set a certain, implicit price level. This price level serves as a guideline and overall benchmark. For setting prices, firms choose either a fixed or a flexible cost-plus approach. The calculation approach and the goals that are set are a matter of international experience. The size and the design of the firms' international distribution systems will mediate the final solution. The price decision is most likely taken centrally under the supervision of top management. Furthermore, the study concludes that the importance of pricing compared with other marketing decisions was at least highlighted by the responding exporting firms.

Determinants of an export price

No other marketing tool has such a powerful and immediate effect on a firm's sales and profitability record as pricing. The consequences of price changes are more direct and immediate than those of any other of the elements of the marketing mix, as they result in subsequent customer and, in most cases, competitor reactions. Given their power, pricing issues have attracted surprisingly little research interest compared with other marketing tools. What applies to a single market-setting holds even more true for the global marketplace, because additional context factors increase complexity.

In order to understand the structure of a price we need first to examine those basic factors that influence the setting of an export price. These factors include the following:

- costs;
- market conditions and customer behavior (demand or value);
- competition;
- legal and political issues;
- general company policies, including policies on financial matters, production, organization structure; and on marketing activities such as the planning and development of products, the product mix, marketing channels, sales promotion, advertising, and selling.

Costs

Costs are often a major factor in price determination and there are a number of reasons to have detailed information on costs. Costs are useful in setting a price *floor*. In the short run, when a company has excess capacity, the price floor may be *out-of-pocket* costs, that is, such direct costs as labor, raw materials, and shipping. However, in the long run *full costs* for all products must be recovered, although not necessarily full costs for each individual product. The actual cost floor, therefore, may often be somewhere *between* direct cost and full cost.

Some years ago a large chemical company sometimes sold products abroad on an incremental cost basis whenever excess domestic capacity existed. The company's price floor was direct cost, since every unit sold at a price in excess of direct cost would contribute to net profit. This company illustrates a technique known as *marginal* pricing, based on the accounting concept of contribution margin. *Direct costs* are those that are incurred by the decision that is made. When used in export pricing, this technique suggests that only those costs that are necessary to produce export revenues are relevant and should be matched against export revenues when assessing profitability. In addition to excess capacity, marginal or incremental pricing may be used for the purposes of entering an export market on a competitive level, or retaining an existing competitive position. Other reasons for pricing exports at less than full costs include: to assist dealer organization growth; to keep a group of employees working together; to sell a special product outside the usual export line; to supply a manufacturing prototype to a subsidiary or licensee; orders for large volumes; the product sold in the domestic market at less than full cost; the export customer provides his or her own installation and services; and significant incremental sales may result.

Costs are also helpful in estimating how rivals will react to setting a specific price, assuming that knowledge of one's own costs helps to assess the reactions of one's competitors. Costs may help in estimating a price that will keep out or discourage new competitors from entering an industry. Internationally, however, costs are often somewhat less helpful for this purpose than in the domestic market, since they may vary over a wider range from country to country.

The developments of e-commerce, e-trade, etc. seem to lower the price differentials between countries. Economic theory might suggest the Internet would reduce price competition. Prices becoming more transparent, consumers and competitors having fuller information at a very low cost are all factors conducive to industry cooperation.

However, what makes price competition rather more than less likely is the lowering of barriers to entry. New entrants do not need to invest in expensive stores or international channels of distribution. This could increase the number of firms and the differences among them, making high prices more difficult to sustain. New entrants with no brand name will find it necessary to compete on price to get a toehold in the market. Further, the reduction in search costs and the ease with which consumers can compare prices on the Internet will encourage consumers to switch to lower price suppliers. Search and switching costs may be so low that negotiated prices become the norm. It may be much easier for customers to play suppliers off against each other, obtaining price quotes through e-mail and making offers and counteroffers among a large number of sellers.

The Internet challenges price quotations and strategies for most exporting companies due to what economists call price and cost transparency, a situation made possible by the abundance of free, easily obtained information on the Internet. All that information has a way of making a seller's prices and costs more transparent to buyers – in other words, it lets them see through those costs and determine whether they are in line with the prices being charged (see Exhibit 11.2).

Exhibit 11.2 The Net's threat to prices and brands

The most prevalent form of information available on the Internet is about prices. Consumers know that they can often find lower prices for books, CDs, computers, and airfares by clicking online rather than by standing offline. But they can do much more than compare the prices of an Internet store against those of a traditional retailer. They can log on to price-comparison sites such as Pricescan.com and shopping agents such as Bottomdollar.com to compare the prices and features of more than 10,000 products available on the Web. Every time a customer takes advantage of a cheaper price from an online discounter such as Buy.com or Onsale.com, she unlearns her long-held rules of thumb about how price and cost are related for the product she has just purchased.

Therefore, the Internet represents a threat thus far to a company's ability to extract price premiums from buyers, to brand its products, and generate high profit margins. Everyone knows that the Web makes price comparisons much easier. The Web is increasing price and cost transparency in several ways:

- *The Internet makes a buyer's search much more efficient.* Anyone can use Web-based shopping agents or bots to research products quickly. With a few clicks of the mouse a consumer can find out, say, who's selling washing machines, at what prices, with what features, and what kind of warranty. Thus an online shopper can know in a matter of minutes what the best deal is.
- *The Internet encourages highly rational shopping.* The Internet presents a very different shopping experience, one that appeals to people's cognitive facilities instead of affective behavior. It encourages dispassionate comparisons of prices and features. It also puts shoppers in control – it is up to them to consciously navigate through the net's maze of pages and links. The information-rich nature of Web shopping will encourage people to make decisions based on reason rather than emotion.
- *The Internet encourages buyer-led pricing and reverse auctions.* Buyer-led pricing and reverse auctions allow consumers to see the 'price floor' more easily than they can with traditional shopping. Thanks to sites such as Priceline._com and eBay, consumers have started to believe that the prices of even the best-known brands are open to negotiation.

Priceline requires that buyers name the price they are willing to pay for hotel rooms, air tickets, home financing, cars, etc. It then lets companies decide if they want to meet the quoted price. A buyer whose price is accepted may be motivated to bid even lower the next time. Sooner or later, she will come to know the price floor – the lowest price for which the company is willing to sell a product or service.

- *The Internet erodes 'risk premiums' experienced by the buyers.* Through the Web people can, in effect, always find an expert to provide information about a product or service. In the past, buyers had relatively few sources of information about a brand's quality or about variations in quality from brand to brand vis-à-vis the price of the product.

A growing number of sites maintained by individuals and organizations offer reliable and independent information about products and services, as well as stories about them from consumers around the world. For example, people who need medical treatment can research their ailments on the Internet. Moreover, health care consumers can even find out if the charges being levied by their health maintenance organization are in line with prevailing rates. Such easy access to information helps prospective buyers – whether of digital cameras or surgery – to see through a risk premium and make better decisions about the premium's justification.

Source: Adapted by permission of *Harvard Business Review* from 'Cost transparency; The Net's real threat to prices and brands' by I. Sinha in *Harvard Business Review*, March–April 2000.

In the new reality of price and cost transparency the seller or manufacturer can take several steps to mitigate the effects brought about by the Internet's trove of information; however, companies won't be able to avoid it. First, companies can pursue price options that go beyond just cutting their prices. One strategy involves 'price lining.' This is a well-known practice of offering different products or services at various price points to meet different customers' need. For example, the US telephone operator ANC offers many plans at different prices and rates for its customers worldwide according to the level of subscriber usage.

Second, companies may implement *dynamic pricing*, in which the prices they charge vary from one market to another, depending on the market conditions, differences in costs, and variations in the way consumers value the offering. By forcing the customers to enter their zip codes before they can view prices, companies can earn higher profits than those that have only one price for every market they serve. However, the companies should tread carefully when thinking about dynamic pricing. Because the Internet allows customers to share information with one another easily, dynamic pricing is likely to create widespread perceptions of unfairness that may prove devastating to business in the long run. Consumers will be unhappy if they believe they have paid more for a product than someone who was more persistent, more adept at bargaining, or just plain lucky.

As a third and better solution, companies should look toward innovating and improving the benefits that their products or services offer. Bundling – packaging a product with other goods and services – can make it difficult for buyers to see through the costs of any single item within the bundle. It focuses buyers on the benefits of the overall package rather than the cost of each piece. Also consumers will reward makers of new and distinctive products that improve their lives.

The Internet and World Wide Web do not only provide problems for exporters/suppliers. They give them a tool that can help them in smoothing out demand over time. Increased communications capabilities can also be advantageous to companies in responding to shifts in purchasers' preferences between models and other characteristics of products, colors, for example (see Exhibit 11.3).

The basic categories of cost incurred to serve domestic and export customers are the same, for example labor, raw materials, component parts, selling, shipping, overheads. But their relative importance as a determinant of price may differ greatly. For example, the cost of marketing a product in a thin market thousands of miles from the production plant may be relatively high. Such items as the cost of sales people, ocean freight, marine insurance, modified packaging, specially adapted advertising, and so forth may raise the price floor. Also, the location of foreign customers affects either the time needed to ship products or the need for maintaining local inventories, thus influencing either the cost of transportation – for example relatively expensive shipments by air cargo – or the costs of carrying and financing local inventories. Special legal requirements may influence production costs; for

Exhibit 11.3 Using the Internet to smooth out demand

The Internet and the World Wide Web, coupled with appropriate software programs, provide suppliers/sellers in some industries with a tool to deal effectively with short-run as well as longer-range fluctuations in demand. All components of the travel industry, including airlines, hotels, restaurants, etc., experience periods of low demand and excess demand from both domestic and international customers. Airlines and hotels in particular attempt to smooth out longer-range fluctuations by having different prices for low, mid-, and high seasons, and may even have exceptionally high rates for periods of peak demand (New Years' Eve, Mardi Gras, national or international events). Airlines and restaurants often have different prices for different times of the day (e.g., for airlines in some countries, the lowest-cost flights are early in the morning when they have business travelers going on short flights from one city to another, but still have difficulty filling all of the seats). Some airlines have set up Web pages on which it is very easy to find the lowest price combinations of days and times for flights between cities.

With the increasing number of customers who are making purchases online, airlines can now make real-time determinations of demand by dates and times, and adjust prices in real time accordingly. Hotels may do the same by date. The authors have observed a price increase of over $100 for an e-ticket purchase, for a given flight on a given date and time, during a five minute interval.

Independent companies that offer discount online bookings, such as Expedia, Hotels.com, and Priceline, will search for the lowest price among all (or most) hotels and airlines for potential customers. Making purchases through these companies will often provide lower prices. However, offered prices may vary between booking companies, may not actually turn out to be the lowest, and may sometimes not include certain add-on prices (fuel surcharges, hold baggage, etc.).

With the improved communications and logistics now available, and advanced software for tracking sales to final customers, importers and their suppliers can use quick response time as a competitive weapon. A modified version of just-in-time can be applied, particularly where air freight is justified by the mix of value, transportation cost, and importance of timing to sales. Examples would include changes in demand for clothing of a new design or in new colors, and for different versions of electronic components or final products that can be produced by the same factory. While only 2% of world trade by volume goes by air, 40% of the value of trade moves by air (Byrnes, 2007).

example automobile safety requirements or legislation affecting food and drugs. To illustrate, in 2000 a right-hand drive model of a Jeep Cherokee vehicle produced in the United States and destined for Japan needed to have adjustments made to adapt it to Japanese regulations. Chrysler, the manufacturer, needed to show compliance with 238 regulations. It is no wonder that costs can easily mount up.

Any consideration of costs requires knowledge of volume. The allocation of nonescapable costs on a per unit basis varies in accordance with the number of units sold. Thus if volume is increased in a situation where nonescapable costs are a substantial proportion of total costs, the cost floor will drop relatively rapidly. On the other hand, if direct costs are high, say 80% or 85% of total costs – a realistic figure for a broad range of products – a substantial increase in volume is necessary before the amount of nonescapable cost allocated to each unit will be reduced appreciably. Thus, since for most products a high percentage of costs are direct, the cost floor is often influenced primarily by direct costs.

Mobile phones have also been used to improve market efficiency in areas where Internet access is limited by availability, cost, or the capabilities of prospective users. Exhibit 11.4

Exhibit 11.4 Using mobile phones to improve market efficiency and economic growth

While the primary emphasis in this text is on individuals and companies that are or can be involved in international activities, improved communications can also help both sellers and buyers in local markets. This can eventually lead to an improvement in their economic conditions and/or organization that allows participation in wider markets. An article in *The Economist* (Economic focus, 2010) cites a study showing that access to mobile phones by fishermen and local markets in southern India resulted in fishermen increasing their profits while consumer prices fell. This resulted from the fishermen being able to take their catches to the local markets that were short on fish that day and avoid markets where there was a surplus. This allowed them to avoid wasting their catches while increasing the supply and decreasing the prices for consumers in the local markets where there was a shortage that day. It also cites another study involving a large Indian company that established Internet kiosks to improve its purchasing from intermediaries who purchased from farmers. The kiosks posted minimum and maximum prices being paid at each. The result was that the profits of farmers increased by one-third, while output also increased as production became more attractive. Studies by others, including an author of this text, showed that Japan in much earlier years had been able to greatly increase rice production and provide more equal income distribution by providing stable and higher prices to farmers. This enabled them to purchase more fertilizer and gave them an incentive to bring more land under cultivation.

The number of mobile phones in use in Africa has expanded dramatically. With backing from Britain's Department for International Development, Vodafone and a local partner developed M-Pesa, a mobile banking and savings system that now has over 6.5 million customers. Other groups and banks are entering the market (Lapper, 2010). Some estimates indicate that improvements in communications in Africa are contributing a percentage point growth to GDP each year, and changing attitudes toward business (Wallis and Burgis, 2010). The article in *The Economist* also notes that an advantage in using mobile phones, at least initially, is that they are cheaper and easier to obtain and use than access to the Internet may be in some areas.

Many international organizations, and a number of international companies interested in social responsibility issues, actively support efforts to improve opportunities and assist local companies.

provides an example of using mobile phones as well as the Internet to improve market efficiency and welfare in underdeveloped areas.

Market conditions (demand)

The nature of the market determines the upper limit for prices. The utility, or *value*, placed on the product by purchasers sets the price *ceiling*. When a manager attempts to establish the value of a product in an export market, the manager in essence is attempting to establish a demand schedule for the product. Values should be measured in terms of product utility, translated into monetary terms. Thus pricing can be viewed as a continuous process of adjusting the price of the export product to the fluctuating utility of the last prospective buyer so as to make him a customer. In June 1988 Isuzu Motors Limited of Japan increased its base price in the United States for its sports utility vehicles and pickup trucks. Although the company claimed that the price increase was due to the currency exchange situation caused by continuing pressure of the Japanese yen on the US dollar, the facts were that the dollar/yen exchange rate was the same as it had been six months earlier and the trend seemed to be for the dollar putting pressure on the yen. What did justify higher prices was a higher demand. Purchases of Isuzu vehicles were more than 6% above those a year earlier, while purchases of Japanese-produced competing products all declined. Since US consumers seemed to prefer Isuzu over competitors' products, it can be argued that the company made a good decision in raising the price to take advantage of that preference. In effect this amounted to assessing customers' price sensitivity or price elasticity. Although techniques such as conjoint analysis can be used to estimate elasticities, it has been suggested that a simple starting point is to examine the important factors that affect sensitivity, as shown in Table 11.2.

When estimating a demand schedule the market can be stratified, which involves estimating the number of customers who will buy at several levels of price. The exporter can then select the strata of interest, which gives the last prospect an amount of utility equal to the price charged while all other buyers will have surplus utility in that they would be willing to pay a higher price. Value may be determined by *asking* people, by some type of *barter* experiment, by *test market pricing*, by *comparison to substitute products*, or by *statistical analysis* of historical price/volume relationships.

A special type of market is discussed in Exhibit 11.5.

Table 11.2 Factors affecting price sensitivity

Customer economics:
- Will the decision maker pay for the product himself?
- Is the cost of the item a substantial percentage of the total expenditure?
- Is the buyer the end user? If not, will the buyer be competing on price in the end-user market?
- In this market, does a higher price signal higher quality?

Customer search and usage:
- Is it costly for the buyer to shop around?
- Is the time of the purchase or the delivery significant to the buyer?
- Is the buyer able to compare the price and performance of alternatives?
- Is the buyer free to switch suppliers without incurring substantive costs?

Competition:
- How is the offering different from competitors' offerings?
- Is the company's reputation a consideration? Are there other intangibles affecting the buyer's decision?

Source: Adapted from Dolan, 1995, p. 178.

Exhibit 11.5 A special case: Comics and heroes

Ever since the first Superman comics, kids around the world have been fascinated with the heroic deeds of super-heroes. As these kids have grown up, the super-hero comics have become bearers of social, cultural, and personal meaning. Today, super-hero comics is one of the most internationally liquid collectible markets. Other examples include coins, sports memorabilia, and stamps.

Action Comics no. 1 – sold for $3,207,852 in 2014

In 2014, a copy of the first appearance of Superman, Action Comics 1, was put for sale on eBay. As the auction progressed over several days thousands of users were following the price as the bids came in. Another copy of Action Comics no. 1 was owned by actor Nicolas Cage, but was sold when he had to sell most of his belongings after a tax issue. But how was the price of more than $3 million determined? What determines the price of a super-hero comic?

The price of a comic book reflects the significance of the event that takes place in the issue, as well as the state of preservation of the comics. The latter is graded on an incremental scale from 'poor' to 'mint.' In between there are further grades such as fair, good, very good, fine, very fine, and near mint. At times these increments are put on a scale from 0 to 10 with 10 being 'mint.'

A further price determinant is the significance of the comic book. Action Comics 1 is the most expensive comic book (in equal grade) because it is the first appearance of arguably the most important super-hero in the world. Apart from the *first appearance*, comics with the *first origin*, and comics with the *first appearance in own title* are the three most sought after events by comic book collectors (in order of importance). This trinity of events can be identified for each super-hero or super-hero team or group. However, at times more than one of these events happens in the same issue. For example, the first appearance of Spawn was in the first appearance in own title, Spawn 1. The trinity events (appearance, origin, and title) for 20 selected super-heroes are as follows:

	First Appearance	First Origin	First in own title
Superman	Action Comics 1	Action Comics 1	Superman 1
Batman	Detective Comics 27	Batman 47	Batman 1
Spider-man	Amazing Fantasy 15	Amazing Fantasy 15	Amazing Spiderman 1
Wolverine	The Incredible Hulk 181	X-men 98	Wolverine 1
Captain America	Captain America Comics 1	Captain America Comics 11	Captain America Comics 1
Thor	Journey into Mystery 83	Thor 159	Thor 126
The Hulk	The Incredible Hulk 1	The Incredible Hulk 1	The Incredible Hulk 1
Fantastic Four	Fantastic Four 1	Fantastic Four 1	Fantastic Four 1
Justice League of America	Brave and the Bold 28	Justice League of America 9	Justice League of America 1
Iron-man	Tales of Suspense 39	Tales of Suspense 39	Iron-man 1
The Flash	Flash Comics 1	Flash Comics 1	Flash Comics 1
Wonder Woman	All Star Comics 8	All Star Comics 8	Wonder Woman 1

	First Appearance	First Origin	First in own title
Green Lantern	All American Comics 16	Ail-American Comics 16	Green Lantern 1 (1941)
Deadpool	New Mutants 98	Deadpool 1	Deadpool 1
The Thing	Fantastic Four 1	Fantastic Four 1	The Thing 1
Doctor Strange	Strange Tales 110	Strange Tales 115	Doctor Strange 169
Punisher	Amazing Spider-man 129	Marvel Preview 2	Punisher 1 (miniseries)
Atom	Showcase 34	Showcase 34	Atom 1
Spawn	Spawn 1	Spawn 1	Spawn 1

Sometimes the creators of the stories allow for interpretation in regards to which issue the trinity event actually took place. For example, the origin of the Wolverine is not completely clear-cut. Wolverine is a mutant and not half wolverine and half human or some other being. Therefore, discovering his mutant origin in X-men 98 is crucial to our understanding of Wolverine. X-men 98 is also the first time we learn that Wolverine's claws are not merely gloves, and it is arguably the first time we see Wolverine without his mask on. Marvel comics presents 72 on the other hand reveals how adamantium was later inserted into his body. Another example relates to the first origin and first appearance of the Teen Titans. The first time we hear about a group of teenage super-heroes called the Teen Titans is in The Brave and the Bold no. 60. In this issue we learn that the group had four founding members, and was founded after the bout with Mr Twister. Seemingly, the team was founded before no. 60, and first appeared in no. 60 as the Teen Titans. The prequel to this appearance takes place in Brave and the Bold no. 54. In no. 54 three teenage friends join forces to battle Mr Twister. As such, we learn how at least three of the teens who would later form the Teen Titans met. However, contrary to real life, it is rare in comics that the origin takes place before the first appearance, and thus there is still no real agreement among comic book collectors on whether no. 54 is not only the origin, but also the first appearance of the team.

First appearance of the origin is defined as *the first time we learn who the super-hero really is (for teams/groups: who the members are and how they meet) and the origin of his/her super-powers*. In the early Thor stories we were told that Thor was an earthling who found Thor's hammer in a cave. This, however, turned out to be a false origin story, and we first learned of Thor's actual origin in Thor 159. Both super-heroes and groups are represented in Table 11.3. However, also super-hero teams (sustained team-up of two super-heroes) have trinity events. For example, the first appearance and origin of 'Atom and Hawkman' takes place in Atom no. 7, and their first appearance in own title is Atom and Hawkman no. 1. First appearance is usually more attractive and commands higher prices than first origin, and first in own title.

A separate collecting category relates to the *cross-over event*. A cross-over is an important event in comics. A cross-over event may become the origin of a future team or group of super-heroes, or it may be the beginning of a recurring rivalry. Among the most important cross-overs in comic book history are Superman no. 76, Top Notch Comics no. 5, and Marvel Mystery Comics 8.

Apart from trinity events, cross-overs events, and grade, the *popularity* of the super-hero, team, or group also influences the value of the comic. The *supply* of each issue is also a very important price determinant, and one of the reasons why Action Comics no. 1 fetched more than $3 million in grade 9.0 (near mint).

Table 11.3 Cost figures of a consumer product

	Domestic market	Export market
Factory price	$10.00	
Domestic freight	1.00	1.00
	$11.00	$11.00
Export documentation		0.75
		$11.75
Ocean freight and insurance		2.25
		$14.00
Import duty (10% of landed cost)		1.40
		$15.40
Wholesaler markup (15% on cost)	1.65	
	$12.65	
Importer/distributor markup (25% on cost)		3.85
		$19.25
Retail markup (50% on cost)	6.32	9.62
Final consumer price	$18.97	$28.87

Source: Terpstra 1988.

The basic factors that determine how the market will evaluate a product in foreign markets include demographic factors, customs and traditions, and economic considerations, all of which are related to customer acceptance and use of a product. However, the nature of demand as expressed in terms of price elasticity, income elasticity, and so forth, often varies widely from country to country. Diverse religions, differences in the cost of borrowing, varying attitudes on family formation and living habits, to mention just a few factors, create wide differences in the willingness and ability of customers to pay a given price.

Often a critical determinant to estimating demand is the availability of information. The obtaining of such information can be extremely difficult and costly in many countries, particularly developing countries. The lack of published statistics and the lack of competent local marketing research agencies in some countries, added to the cost of conducting marketing research in distant markets, may make it relatively difficult to determine how the market will respond to different levels of export pricing.

Competition

While costs and demand conditions circumscribe the price floor and ceiling, competitive conditions help to determine where within the two extremes the actual price should be set. Reaction of competitors is often the crucial consideration imposing practical limitations on export pricing alternatives. Prices of competitive products ('substitute' products) have an impact on the sales volume attainable by an exporter. The decision is whether to price above, at the same level as, or below competition.

In addition to present competitors, potential competitors must be considered. Of relevance is the extent and importance of the barriers to entry and competition – how easy and cheap it is to get into the business and compete effectively. Barriers that an exporter can use to provide 'shelter' from competition include having a *product distinctiveness*, a *brand prominence with high brand equity*, and a *well-established channel of distribution* both between countries and within a country that can provide greater dealer strength. Obviously, the more significant the barriers, the more pricing freedom there is.

Under conditions approximating *pure competition*, price is set in the marketplace. Price tends to be just enough above costs to keep marginal producers in business. Thus, from the point of view of the price setter, the most important factor is costs. If a producer's cost floor is below the prevailing market price, the product will be produced and sold. Since the exporter in such a market has little discretion over price, the pricing problem is essentially whether or not to sell at the market price.

Under conditions of *monopolistic* or *imperfect competition* the seller has some discretion to vary the product quality, promotional efforts, and channel policies in order to adapt the price of the 'total product' to serve preselected market segments. For most branded products and even for some commodities (when the export marketer and its reputation for service, dependability, and delivery are known) exporters have some range of discretion over price. Nevertheless, they are still limited by what their competitors charge; any price differentials from competitors must be justified in the minds of customers on the basis of differential utility, that is, perceived value. The closer the substitutability of products, the more nearly identical the prices must be, and the greater the influence of costs in determining prices (assuming a large enough number of buyers and sellers so that conditions of oligopoly do not exist).

There are times when an exporter in such a competitive structure ignores competitive prices. To illustrate, a few years ago one manufacturer of capital equipment for mining and earth-moving operations sold primarily on a cost-plus 'fair profit' basis. The company sold in foreign markets at domestic factory list prices plus costs of exporting. The company paid little attention to the utility of the equipment and to competitors' prices, mainly because foreign products were not good substitutes. However, many branded industrial products must also be priced competitively (e.g., electronic data processing equipment, machine tools, and road-building equipment) since purchasers are often keenly aware of the comparative cost/value relationship among feasible product alternatives.

Under conditions of *oligopoly*, without sufficient product differentiation to give a seller a monopoly position, the point between the cost floor and price ceiling at which products will be priced depends upon the assessment of each oligopolist of the others' reactions to his decisions. If there is price leadership, conscious parallel action, or collusion, the price will probably be somewhat above the cost floor, and competition is likely to be based to a great extent on product variations, quality, services, and promotional activities.

A good illustration of the effect of competition on prices is the reaction of Eastman Kodak to competition by Japan's Fuji in the US film market. In 1994 Fuji was priced such that Kodak's main product, Kodak Gold, was priced at 17% above Fuji. Since Fuji could easily, and would, match any price cut, Kodak chose to introduce a new low-priced product, Funtime Film, in larger package sizes and limited quantities. On a per-roll basis Kodak was priced lower than Fuji. Fuji continued using price as a competitive tool, but in 1997 it cut prices in the United States by as much as 50% on multiple-roll packs of color film. Kodak lost market share. Kodak's problems were aggravated by the loss of exclusive rights to parts of Walmart's photo-developing business and problems with its film-developing agreements with Walgreen Co., the US's largest drugstore chain (Bandler, 2004). Kodak's film sales through these outlets has been hurt by its diminished visibility. In 2004 Kodak announced that it would cease selling traditional film-using cameras in its move into digital cameras, and the effect that this may have on its film sales is unknown. Sales of all brands of film have been declining for several years, but it is still a major market that Kodak cannot afford to lose.

Within the limits of costs, market conditions, and competition, there are still alternative ways of pricing related products. Some companies are challenging traditional models. For a number of international giants, new software products are being used to determine more optimal prices, to determine when and where to have sales, and to enable them to respond more rapidly to requests for quotations (see Exhibit 11.6).

Exhibit 11.6 New approaches to pricing: alternative strategies and Web-based systems

An alternative strategy

The model of 'companion pricing,' in which a basic device is sold cheaply and money made by selling replacement or complimentary parts, is being challenged. Rolls-Royce and General Electric both sell jet engines worldwide at low prices, and then make much of their profits by selling spare parts and services at high prices. Pratt & Whitney is challenging this marketing model by selling parts for the GE/Snecma engine, used on the Boeing 737, at a lower price than GE/Snecma itself does. Hewlett-Packard, and several other producers of printers, sell their printers at low prices and replacement ink cartridges at a high price. Kodak is now offering a relatively high-priced Kodak Easyshare printer for which the replacement cartridges cost relatively little (Gapper, 2007).

Software for improving pricing

SAP AG and Oracle Corp., as well as startups such as DemandTec Inc., ProfitLogic and others, have developed programs that can analyze massive amounts of data for the purposes of determining more optimum pricing for products, timing of sales and discounts, and speeding up quotations. Two very simple examples will give an idea of what the systems do. For one company, an analysis of customer buying decisions indicated that cutting the price on a mid-priced model of a drill, while leaving the prices of the least expensive and most expensive models the same, would result in greater sales overall and greater profits. It did (Bergstein, 2007). A major electronics retailer found that there was a greater sensitivity to the price of its batteries in Boston than in Dallas. Prices were adjusted accordingly with a resulting increase in total sales and profits (**San Francisco Chronicle**, 2007). The systems being used by giant internationals are sometimes referred to as Web-based since they depend upon the analysis of vast amounts of data fed in, usually on a real-time basis, from multiple locations. Companies using these systems include GE Lighting, DHL, Hewlett-Packard, 7-Eleven Inc., Walmart, and approximately 150 retailers worldwide (Keenan, 2003; Bergstein, 2007).

A new system for providing computing services

Cloud computing is the Internet-based provision of computing services to companies that no longer need to have all of their own physical infrastructure. Covered services, such as for computing, data storage, etc. are provided on-demand as needed by contracting organizations, paid for based on usage, and provided by outside organizations ('servers') such as Amazon, Google and Microsoft and others that operate worldwide. The model is somewhat analogous to that of the electricity grid with power companies providing the electricity when needed by their customers, and charging their customers based on usage. The customers thus do not have to have physical facilities designed for maximum need with the attendant higher costs for plant and maintenance.

Legal/political influence

The manager charged with determining prices must consider the legal and political situations as they exist and as they differ from country to country. Legal and political factors act primarily to restrict the freedom of a company to set prices strictly on the basis of economic considerations.

Today it is widely recognized that sovereign nations have the right and obligation to take action that protects and fosters the prosperity and wellbeing of their citizens. Although there is often disagreement as to whether specific types of governmental actions are proper (whether or not they advance the long-run interests of their citizens), managers with pricing responsibility nevertheless must usually accept the situation as it exists, taking account of antidumping legislation, tariffs, import restrictions, and so forth.

Officials of some countries will not issue import licenses if they feel that the price is too high or too low. One company in Brazil needed a product that Brazilian manufacturers were unable to supply due to lack of capacity. Brazilian authorities, presumably to foster local production, would not permit importation of the product from Japan or the United States because it was available from these countries at a lower price than ordinarily charged by Brazilian manufacturers.

Sometimes foreign officials use pricing guidelines as a criterion for granting foreign exchange to the buyer of foreign merchandise. In some countries the government is concerned with the relationship between the amount paid and the social benefits of the purchase. Even though the customer may be willing to pay a high price, the government may refuse to grant adequate foreign exchange for what it considers to be nonessential imports.

Most industrialized countries have antidumping legislation. Dumping is the practice of selling in foreign markets at prices below those in the domestic market. Antidumping legislation is ordinarily enacted in nations that wish to protect certain industries from temporary or abnormal price fluctuations that would disrupt local production. Thus, antidumping legislation sets a price floor. It should be noted that antidumping legislation is particularly relevant for firms from less-developed countries wherein a Catch-22 situation often arises. Competitive advantage for firms from less-developed countries centers on their low-cost base; firms run the risk of being reported in export markets for 'unfair' pricing and dumping. While promoting exports is essential to less-developed countries improving their economic performance, in some cases they may be prevented from utilizing their competitive advantages in the most effective way. The fact that sales are made at lower prices for export does not mean that antidumping action will be initiated in a foreign market. Under the laws of most countries, no dumping occurs if the exporter's price is above that of the country's current market price, even if the exporter's price to that country is lower than its selling price in its domestic market. Exhibit 11.7 gives some recent examples of antidumping actions.

Exhibit 11.7 Examples of antidumping actions

The United States, European nations, and Canada have a long history of imposing antidumping penalties on products from both developing nations and other industrialized nations. More recently, India and China have become active in levying antidumping duties on both the United States and members of the EU. The steel industries and chemicals industries in various countries often charge their counterparts in other nations with dumping. This is due to their typically high fixed costs and low marginal (variable, direct) costs that enable them to make additional profits by selling below total costs when they have unused capacity. However, companies from many industries file actions.

While the duties are usually imposed immediately on imports when the importer's country finds the prices charged by exporters constitute dumping, the government of the exporter's country may appeal the decision to the government of the importers country, and if that fails, appeal to the World Trade Organization. The WTO rules state that the legitimacy of charges of dumping must be determined on the basis of conclusions drawn from fair comparisons of the export price and the domestic price in the exporting country. While the WTO has no means of enforcing its decisions, it provides a moral/legal basis for the imposition of retaliatory tariffs by the exporter's country on products from the importer's country. In 2005, the WTO ruled on a complaint by Brazil that US subsidies to cotton farmers violated fair trade rules by depressing world prices and breaching WTO subsidy limits. The ruling was a moral victory for millions of farmers in less-developed countries. Though Brazil initiated action to impose offsetting high duties on a number of American products, it eventually backed down. This was probably due to the realization that the United States was politically unable to reduce the subsidies and Brazil did not want to enter into a possible series of trade disputes.

Examples of some of the many antidumping duty cases in recent years are:

- The EU in 2010 extended duties on footwear from China and Vietnam: 16% and 10% respectively. The duties caused some of the countries that just buy shoes to oppose those that make shoes within the EU (Chaffin, 2009).
- Russia has proposed imposing duties of 28.9% to 39.1% on Chinese nickel-containing stainless steel from different companies
- China, which is involved in a number of trade disputes with the United States, has proposed duties on US chicken exports, with different rates for different parts of the chicken (chicken feet are an item of particular interest: they are virtually worthless in the United States but bring good prices in China, where they are a delicacy)
- In 2010 the US imposed new duties on steel pipes used in oil and gas wells, with rates of 29.94% to 99.14% depending upon the company exporting. (The executive director of the US Consuming Industries Trade Action Coalition has complained that this will hurt United States industries by raising their costs and making supplies uncertain.)
- The EU has put duties on screws and bolts made in China

A very small sample of earlier actions includes the following. In 2003 the United States imposed antidumping duties ranging from 44.66% to 63.88% on catfish from Vietnam, and tariffs of up to 44.71% on computer chips from South Korea (the amount varying according to the particular company producing the chips) (*The Japan Times*, 2003). In 2004 antidumping investigations were being held on shrimp exported from Vietnam. In some earlier examples, Canada imposed antidumping tariffs on carbon steel plate suppliers in seven European countries and Brazil. Canada also imposed antidumping duties on US exporters of cold-rolled steel in retaliation for the filing of antidumping petitions by US steel producers against Canadian steel exporters (and exporters in 18 other countries) (Mercado *et al*., 2001).

Another area of potential concern is how to handle rebates, discounts, allowances, and even price escalation or guarantee against price decline clauses in contracts. An importer may ask for, and the exporter may give, one of these price concessions. By themselves such concessions are not illegal, but they may become so in the exporter's and/or the importer's country if they are not disclosed to the appropriate governmental agency (Johnson, 1994, p. 82).

Since tariff levels vary from country to country there is an incentive for exporters to vary the price somewhat from country to country. The incentive changes, depending on the nature of demand in each market and how much customers are willing to pay (i.e., the price elasticity of demand). Thus, in some countries with high Customs duties and high price elasticity, the base price may have to be lower than in other countries if the product is to achieve satisfactory volume in these markets. Consequently the profitability of the product will be reduced. On the other hand, if demand is quite inelastic, the price may be set at a high level, with little loss of volume, unless competitors are selling at lower prices.

Import tariffs can influence decisions on sourcing, thereby influencing costs and prices. If import duties in a country are high on finished products, relative to duties on materials or component parts, from a total cost standpoint it may be desirable to import materials or components for local manufacturing or assembly.

When the government intervenes in currency markets the competitive situation may change. If a government devalues its currency, exporters to that market might have to lower prices in order to compete with domestic producers. At the same time the country's exporters would find themselves able to do better in export markets as their prices become lower. An exporter in such a situation might find itself able to improve its competitive position in selected foreign markets.

Company policies and marketing mix

Export pricing is influenced by past and current corporate philosophy, organization, and managerial policies. Ideally, all long-run and short-run decisions should be recognized as interrelated and interdependent, but as a practical matter some decisions must be made first and must serve as a basis for making subsequent decisions. For example, the company organizational structure must be established and maintained for a period of time. During this period other activities must be conducted within the constraints of the structure.

Pricing cannot be divorced from product considerations. Management must take the customer's point of view and evaluate a product in terms of its quality and other characteristics relative to its price. Decisions on the nature of the product, package, quality, varieties or styles available, and so forth influence not only the cost, but what customers are willing to pay, as well as the degree to which competitors' products are considered acceptable substitutes. For example, there are numerous manufacturers of such products as industrial machines, tools, and equipment, which are able to export at higher prices than foreign competitors because of a design advantage.

So-called national stereotypes and buyer attitudes toward particular countries of origin (as discussed in Chapter 10) can affect the way in which export prices are interpreted in foreign markets. Customer reactions to price and the judgements that customers make will be conditioned by their perceptions and attitudes toward the country of origin of imported goods. For example, if the image of the exporting country held by buyers is favorable and the price of a product from there is low, it will be viewed as 'good value for the money.' If the price was high, a product from there would be perceived as 'high quality.' With an unfavorable country image the perceptions would be 'low quality' and 'poor value for the money,' respectively. Such perceptions are thought to be more true the less the market knows about the products themselves and the suppliers. In short, this situation is most likely to face the new exporter as well as the smaller company with a limited market reputation.

The channel of distribution utilized also affects price. Certain channels such as export merchants may require a higher operating margin than a manufacturer's export agent, depending, of course, on the nature of the product, the markets served, and the cost of performing the required functions. Thus, if dual channels are used and if the price to marketing intermediaries is uniform, the price to ultimate users will probably vary. However, if the prices to intermediaries are varied in approximate proportion to their different costs of operations (or operating gross margin), it would be possible to achieve some degree of uniformity in prices to ultimate consumers or users. But such a price structure would be complex and difficult to implement and maintain.

Utility of a product depends not only on its physical characteristics but also on how it is sold and serviced. For example, a manufacturer of a diversified line of electrical control products and other electrical equipment once found that a price disadvantage (vis-à-vis foreign competitors) can often be overcome by the following:

- careful appointment and training of technical representatives;
- continued analysis and comparison of product features with competitors' products and exploitation of design advantages by demonstrating to customers superior performance characteristics, ease and low cost of maintenance, long life, and ease of installation;
- prompt delivery, which is in some cases facilitated by maintaining inventories abroad.

Thus such factors as the type of channels selected, the relations with foreign representatives or dealers, the distinctiveness of the product, and the services provided determine the price that customers are willing to pay.

Promotional policies are also interrelated with pricing. Communication activities (e.g., advertising, personal selling, and sales promotion) should be designed to provide customers with appropriate information and persuasive appeals. The cost of preparing and conducting international promotional activities helps to set the price floor; such costs also contribute to the utility of the product and thereby influence the price ceiling.

Summary

We now summarize what has been said in this section of the chapter. The value of a product to the last prospective customer fixes the ceiling on price while cost sets the floor. However, there are two cost floors: one set by direct or relevant costs (the lowest floor) and one set by full costs. In any export price decision the appropriate cost floor depends upon the company's goals or objective in pricing. Between the cost floor and demand ceiling is a gap. Where in this gap to set the price depends upon such factors as the nature and type of competition, the legal/political situation, and the overall export marketing program.

Relation of export to domestic price policies

The second aspect of price policy for the export marketing manager is the relation of export price policy to the company's domestic policy or policies. The manager must decide whether to price at higher levels, the same level, or lower levels than domestic prices. There are arguments for and against each of these alternatives.

Export prices lower than domestic

One argument for export prices lower than domestic prices is that the manufacturer's product is probably less well known in foreign markets than domestic. To secure market acceptance and initial purchase the lowest possible price should be quoted. Furthermore, as part of securing market acceptance the manufacturer should be willing to absorb any additional expenses such as transportation, marine insurance, and on occasion even the foreign import duties.

Others believe that export prices should be lower because foreign competitors can manufacture more cheaply due to lower labor costs, government subsidies, or other advantages that they are said to enjoy. Still another argument advanced in favor of lower export prices is the lure of increased sales volume in order to assist in absorbing manufacturing and overhead costs. A further argument is that the manufacturer has incurred certain necessary expenses in initiating its business that have been disbursed and cannot be escaped. Therefore, any export business is in a sense plus business and should not be charged with this burden.

It may be that the export price turns out to be lower than the domestic price simply because the manufacturer feels that domestic customers are nationalistic and will pay a higher price for a domestic product. For example, cars in Germany in some cases are more expensive (before taxes) than in neighbouring Denmark.

A potential problem that may arise by following this policy is that the exporter may be considered to be dumping. Consequently, the exporter should watch for 'local' government reaction in export markets.

Export prices higher than domestic

One of the arguments most frequently advanced in favor of higher export prices is that the increased initial cost of equipping an organization to enter the export field is considerable. The probability is that selling expense may be higher than in the domestic market due to the complexities of procedure, difficulties in language, differing commercial customs, and varying legal needs and tastes of customers in export markets (Exhibit 11.8). There is frequently extra investment and added expense in preparation of special documents and forms in packing, preparation, and alteration of the products. Some believe that the cost of extending credit to and financing foreign accounts means a slower turnover of invested capital and higher expense. Some manufacturers and producers feel that there is added risk in doing business abroad due to unsettled economic and political conditions, and that this risk should be compensated for in the form of a higher price.

Exhibit 11.8 Price escalation

Price escalation in exporting is a phenomenon that occurs all too often. If the exporting firm does not pay conscious attention to the conditions that lead to price escalation it may find itself in a situation where it prices itself out of a foreign market. In general, it is the physical and economic distance between the initial manufacturer and the consumer (or user for industrial products) that provides the environment for price escalation to emerge. These distances may mean that a longer channel of distribution with more intermediaries is needed than in the domestic market. In addition, there are other costs involved such as documentation and import duties.

Export price escalation occurs when there is a significant increase in the price of a product as it goes from the exporting manufacturer to the industrial user or ultimate consumer. Since usually exporting is more complex (in terms of stages) than is domestic marketing and each stage has a fixed cost, the final price in export markets can be much greater than in the exporter's domestic market. For example, in 1995 a Jeep Cherokee vehicle produced in the United States at a factory cost of US$19,100 had a retail price in Japan of US$31,372. A comparable model was priced in the United States at US$20,698 (WuDunn, 1995).

A short example illustrates this point. In Table 11.3 we show relative illustrative cost figures for a domestic sale and an export sale of a consumer product. The various markups and so on are not unusual. It is quite clear that there can be an escalation in the export price such that it ends up more than 50% higher than the comparable price in the domestic market. Obviously, there are situations where escalation will be less than that shown in the example; there may also be situations where it is greater.

Whenever there is escalation such as that illustrated, the exporter is almost bound to price higher than in the domestic market. In trying to overcome the problems that arise with this phenomenon, Terpstra (1988, p. 138) has indicated that the exporter can consider at least four possible strategies, as follows:

1. shipping modified or unassembled products that might lower transportation costs and duties;
2. lowering its export price at the factory, thus reducing the multiplier effect of all the markups;
3. getting its freight and/or duty classifications changed for a possible lowering of these costs;
4. producing within the export market to eliminate the extra steps.

The last option amounts to sourcing for the foreign market within the market itself by making a direct investment in manufacturing facilities, or by forming a strategic alliance through licensing, joint venture or contract manufacturing.

Export prices on a par with domestic prices

The policy of carrying the domestic price into the export market has much to commend it, particularly to the manufacturer or producer who is entering export for the first time and who has not yet explored all the varieties of conditions that may be found later in the foreign markets. There are several arguments in favor of this policy. It enables the manufacturer to fix export prices that costs and experience in the domestic market have indicated are necessary and fair. It gives the manufacturer a feeling of safety upon entering the export market when the opportunity for marketing research, knowledge of competitive conditions, and previous experience are still lacking. It dispels any fear the manufacturer may have of becoming involved in antidumping regulations that exist in many foreign countries. It is a policy that can be easily altered when the manufacturer gains experience and acquires a more comprehensive knowledge of export markets.

This approach is easy to implement but may not be suitable if the domestic price is low because of unusual circumstances, such as intense competition. Before following this approach, or pricing lower than domestic price for that matter, the export manager should be certain that the domestic price is, in fact, the usual or 'normal' price. Exports priced the same as domestic assumes that objectives are similar. It should be recognized, however, that company objectives and market conditions may not be the same across markets.

Differential pricing

Since the market and competitive conditions and other environmental factors vary from one foreign market to another, possibilities arise for setting a different export price to each market. However, in a study of pricing practices of US multinational corporations (Samli and Jacobs, 1994), the findings indicate that 70% of US firms standardized their prices in most markets. Much has been said and written in conventional international economics textbooks about the conditions under which price differentials occur among foreign markets. The most important conditions are: (1) differential elasticities of demand, and (2) effective separation of markets.

Differential elasticities of demand are necessary if there is to be a profit incentive for the exporter to set a higher price in one market than another. High price elasticity suggests low prices; price inelasticity suggests high prices.

Another necessary condition for differential pricing is that the relevant markets must be separated effectively. Unless tariffs, transportation costs, or reexporting costs are higher than the price differential, or unless other restrictions on the free transfer of goods across political boundaries exist, products sold in a low-price market may find their way into a high-price market. In the case where export prices are higher than domestic prices, the exporter must guard against setting the differential so high that foreign customers or their representatives find it attractive to enter the domestic market and perform the exporting functions for themselves. Within the European Union, prices of automobiles vary by country. For example, in 2000 the price for a Volkswagen Golf (made in Germany) varied from a low of US$8290 in Finland to a high of US$13,040 in the United Kingdom. In Germany, the price was US$11,040 (*Businessweek*, 2000). In some instances the differential was greater than differences in taxes, etc. This has been called 'pricing to the market.' In addition, there have been reports that the manufacturers have been 'encouraging' dealers not to sell to people in other countries. Currency differences even arise in the European Union, where not all countries have adopted the euro. The euro is supposed to equalize prices, but they may vary as much as 30% from country to country for the same model of automobile. In 1999 the price of a BMW 318i was priced in the United Kingdom in pounds at 30% more than the euro-denominated price, converted to pounds, in the Netherlands. The higher price in the United Kingdom was partly due to the pound's appreciation against the euro.

This is the issue of the price of goods obtained through parallel imports or the so-called *gray market*, which was discussed earlier in Chapter 8. If buyers in one country are able to purchase at a lower price than in another country, there will be an incentive for customers in the lower price market to divert goods to the higher price market in order to make a profit. Obviously the exporter's distributor and dealers in the higher price country will complain about such unauthorized imports since they represent a loss in sales to them. The laws of many countries including those in the European Union and Japan *encourage* such parallel imports as a means of stimulating competition and forcing the authorized distributor to reduce its price. In the European Union, any attempts to prohibit a distributor from selling outside its country, but within the European Union, can be a violation of law.

European pharmaceutical companies are particularly concerned over gray markets. Each country within the EU sets its own prices on what it will pay for prescription drugs, with substantial differences between countries. Thus the drug companies face different sales prices in different countries within the eurozone, making parallel trade attractive to importers and exporters. Countries outside of the eurozone at least have different, and in some cases variable, exchange rates. Germany is the largest importer of parallel pharmaceuticals in Europe, with the UK and the Netherlands tied and others including Sweden, Denmark, Ireland and Norway accounting for smaller shares.

North Korea has used the gray market to get around sanctions imposed by the United Nations. British American Tobacco Company had shipped at least 15,000 cases of State Express 555 branded cigarettes, worth $6.3 million, to North Korea. Made in Singapore, the cigarettes were worth at least $6.3 million. North Korea diverted or reexported them to Vietnam, the Philippines, and China where they commanded a higher price. This supplied North Korea with additional foreign currency, much needed because of international sanctions imposed upon the country. While tobacco companies dislike gray market or parallel exports, Customs officials are generally more concerned with counterfeits rather than simple diversions of genuine products.

Smuggling, however, is a crime. In 2001 the European Union accused several large US tobacco companies of complicity in cigarette smuggling by selling oversupplies to neighboring non-European Union countries. At the same time smuggling of cheap imitations of Philip Morris's Marlboro cigarettes made in China, South America, and eastern Europe were causing approximately $100 million in lost profits to Philip Morris International. It was estimated that smuggling costs the European Union $1 billion annually in lost taxes. In 2004 Philip Morris agreed to a settlement with the European Union in which the company will work with the European Union to fight smuggling, and will pay the European Union $1 billion over a period of 12 years. Part of the money will be used to hire and train more Customs officers and buy equipment and technology (Geitner, 2004). If RFID (Radio Frequency Identification) equipment is used it should be relatively easy to determine if checked cross-border shipments of cigarettes are actually legal, and if cigarettes delivered through legitimate distributors are authorized.

The tobacco giant Altria, makers of Marlboro brand cigarettes, has hired undercover agents to hunt for fake Marlboros and ones that do not have genuine tax markings in New York State and New Jersey. Marlboro has a direct interest in stopping the flow of counterfeit cigarettes made in China. Genuine Marlboros are also illegally transported across state borders in the United States because some states, for example, New York, charge much higher sales taxes on cigarettes than others do. This makes it profitable for professional crooks and some other people to smuggle the cigarettes across the state line from lower-tax jurisdictions. Marlboro is also interested in preventing cross-border evasion of taxes because it feels this indirectly affects its sales. Altria has no legal standing to take direct action about fakes or tax evasion, but passes the evidence to law enforcement officials. Altria's brand integrity unit also works for other companies trying to stop smuggling (Byrnes, 2010).

The exporter considering differential pricing must also look at other factors, including local competition in each market, the company's products' fixed-cost/variable-cost ratio, the stability of demand in the domestic market, and the overall marketing strategy to be employed.

Reasons for following a policy of differential pricing often arise because the marketing strategy varies from market to market. For example, in one country a policy of intensive distribution coupled with heavy advertising may go hand in hand with a low price to serve a mass market. In another country a direct marketing channel with little advertising may call for a high unit price to serve a small number of high-income persons.

Product line considerations may also contribute to the desirability of differential pricing. For example, so-called full-line considerations can be important. If customers expect to buy certain products from a common source the exporter that does not have all of the expected items in the product mix is likely to have difficulty selling any of the mix. The buyer might reason: 'Why should I split my orders among two or more suppliers when I can order all of my requirements from one supplier at one time, thus saving both time and effort?' Under these conditions it may be necessary for a seller to include an item in the product mix that cannot be sold at as high a price as in other markets; thus the price of the item must vary from country to country.

Product line pricing in another sense may also contribute to the desirability of differential pricing of certain items in the line. The products in a line often must be priced so that there is a reasonable relationship between them. For example, tractors of varying sizes and specifications may, to some degree, be substituted for each other. But the degree to which they are not substitutes, that is, the evaluation by customers as to the degree to which one product is better or more suitable than another, should correspond approximately to the price differential. Since groups of customers in diverse markets may evaluate products differently, the appropriate differences in the prices of items in the line will vary; thus it may be desirable for prices of identical products to vary from country to country.

A policy of differential pricing may also be desirable on an occasional basis. In industries that require heavy fixed investment it may be expedient, when there is periodic overcapacity due to short-term fluctuations in demand, to lower prices in foreign markets if such sales make some contribution to fixed costs.

Although the selection and exploration of nonhomogeneous marketing targets require varying marketing strategies, there is the possibility that a firm may try to select similar market targets from within the varying segments in each country. For example a manufacturer may make a product that appeals to persons of a certain economic or social position, regardless of nationality. National markets may be segmented on the basis of income, education, family size, leisure time, and so forth, and such segments of the markets of Canada, Denmark, France, Germany, Australia, Japan, and other nations may have similar motivations or needs, which a standardized product and marketing strategy can satisfy. Customer requirements in certain market segments for such products as household furniture, airline service, or automobiles may be quite similar in many respects. Likewise the marketing strategy, including price, may be similar.

On the other hand, the greatest opportunities for growth often exist in new or developing market segments that have not been reached or served adequately in the past. In fact, one of the frequently stated objectives of differential prices is to enter 'new markets' or attract a new class of buyer. This objective can sometimes be achieved by selecting an additional marketing channel, which may provide a different mix of functions and reach additional segments of the market. Such a channel is likely to have a cost structure different from other channels and thus will require a different operating margin. The operating margin required by marketing channels may vary for many reasons, including costs of market development (e.g., the need for heavy advertising in some areas, light in others), labor costs, or margins offered to marketing agencies by competitors. Either the manufacturer's price or the marketing intermediary's price, or both, should differ from prices in the previously established normal channel. In view of the great diversity among foreign markets and foreign marketing channels, therefore, a policy of differential pricing is often logical.

The size of an exporter and its share of market also has a bearing on the desirability of following a policy of differential pricing. A small exporter is likely to feel that there is greater flexibility since the company may have a relatively minor share of the total world market. If customers are small and scattered widely, customer pressures for equal prices may be minimal.

However, a large exporter, depending on large customers for a significant percentage of volume, may find that customer pressures call for uniform prices in order to avoid customer discontent. Also, in the cases where markets are not effectively separated by transportation costs, tariffs, or other barriers to trade, large customers are likely to make purchases in low-price countries. Or, if the product is important in a market, perhaps marketing intermediaries will purchase the product in the low-price market and sell it in the high-price market under the price umbrella provided by a manufacturer that sells at inordinately large price differentials.

Differential pricing may also be advisable seasonally or cyclically. For example, if a product has a seasonal sales pattern in the northern hemisphere it may have just the opposite pattern in the southern hemisphere. Thus a manufacturer in the north may find South American markets during the domestic slack season. It may be that price variations seasonally may contribute to the proper exploitation of both markets.

Exchange rate changes, currency issues, and hedging

Changes in exchange rates

Exchange rates between the currencies of most countries often change significantly in the short run, and more greatly in the long run. Obviously there are no changes between countries within the eurozone, but the euro's value changes with respect to the Japanese yen, the US dollar, and many other currencies. Some smaller countries actually use the US dollar as their currencies (Equador, El Salvador, East Timor, and others), several other countries allow people to freely exchange their local currencies to dollars on a one-to-one basis, and finally there are some countries that peg their currency to the US dollar. In the latter case, they may use some type of exchange controls to maintain that rate. This can be done by requiring exporters to turn all foreign currencies into the national bank, and requiring all importers to purchase foreign exchange from that bank. This is likely to lead to violations of the law and other problems as people try to get around the exchange controls.

Some typical examples of changes are the following. In a shorter run, the amount of dollars required to buy one euro went from a little less than 1.3 in April 2009 to more than 1.5 in late 2009 (an increase of over 15%), and back down to 1.37 early in 2010 (Garnham, 2010). In the longer run, the euro bought 160 yen at one point in 1995, 120 at one point in 1998, 200 at one point in 2000, and 105 at one point in 2008 (Whipp and Garnham, 2009).

Significant changes in exchange rates between countries often lead to increased or decreased competitiveness and/or increases or decreases in profits, as discussed in Exhibit 11.8. Countries may attempt to bring about changes in exchange rates by buying or selling large amounts of their own currency in financial markets. This seldom has a strong and lasting effect.

People making decisions regarding international trade or investment need to understand what drives these changes, as well as the options and costs of hedging against them. At one time exchange rates were determined largely (or almost entirely) by how much the countries exported compared to how much they imported. In an over simplified version, if a country began to import more than it was exporting, there would be as a lack of demand for its currency relative to other currencies. The value of its currency would then fall. For many countries this is still the case, but for most countries in the short run and some in the long run, other factors become more important.

The opening of financial markets has resulted in flows of short-term investment funds of over 2,000 trillion dollars per day, many times greater than the value of international investments and trade combined (Johnson, 2010). This has led to funds moving, and exchange rates changing, due to motives other than trade and long-term investment. Some of these factors are briefly noted below, in no particular order since the importance of any particular one may be greater or smaller at any given time.

The relative strength of the US dollar, while greater or smaller at any given time, continues in spite of several decades of a negative balance of payments. It is viewed as a 'haven' or place of relative safety during crises. In 2010, the dollar surged to a seven-month high (on a trade-weighted basis) because of concerns over Greece's budget and its possible effects on the euro, and because of the fall of global equity markets (Garnham, 2010). It has also surged because of a 'haven' demand when threats of a major armed conflict have arisen, even when the United States is expected to be a major participant.

Additionally, US government debt is the most widely held asset in the foreign exchange reserves of many countries including China and Japan, reflecting years of willingness to purchase debt of a major customer. While China stopped adding dollars and increased addition of euros to its foreign exchange reserves when the dollar was weak in 2009, it resumed adding dollars in 2010.

In 2009, the Japanese yen hit a 13-and-a-half year high against the dollar, a 7-year high against the euro, and a record high against the British pound because the yen was seen as a haven in a time of recession and nervous global markets (Whipp and Garnham, 2009). In 2014, the yen has fallen steadily for years and is trading above the 120 per dollar ratio (*Money Morning*, 2014). Another factor is the prospect of higher rates of return in a particular country if its economy is expected to grow rapidly.

One more factor is relative interest rates. It is possible for large foreign companies to borrow yen in Japan at Japan's very low interest rates (kept low by the government for reasons connected to its domestic economy). They can then sell the yen for dollars (or euros or pounds or whatever) and invest them at higher rates of interest in their own countries). Known as the yen 'carry trade,' this tends to drive down the price of the yen (as they sell) or raises the price as they buy to pay off the loans, as has happened more recently.

Currency issues

If it is possible for an exporter to specify what currency should be used in a particular transaction, the decision is of great importance. The importer may require that its own currency be used. Otherwise, the exporter can choose his own currency, the buyer's currency, or some 'third party' currency. To a large extent, which of these should be used will be dependent upon a number of factors including buyer preferences, exchange rates per se, and whether they are floating or fixed, freedom of exchange, the availability of currencies in the importer's country, and government policies. If they are floating rates then their stability becomes a concern. Exhibit 11.9 shows the potential effects of changes in currency valuations. Another consideration is whether the exporter needs a particular currency. For example, exporters in developing countries often need foreign currency in order to purchase capital equipment that enables them to remain in business in the first place.

Exhibit 11.9 The effects of changes in currency valuations

Changes in currency valuations affect the ability of exporters to maintain competitiveness in foreign markets. In 2010, the weak euro resulted in increasing demand from overseas and manufacturers in the eurozone expanding production at the highest rate in a decade (Atkins, 2010). In 2007, a sharp rise in the value of the yen caused great concern by Japanese exporters. Every 1 yen rise in the value of the Japanese currency against the US dollar was estimated to reduce the operating profit of export-sensitive Toyota by 35 billion yen (approximately US$ 318 million) (*The Nikkei Weekly,* 2007). Exporters in the eurozone have been concerned about their competitiveness as the euro has risen to record highs against the dollar, and United Kingdom exporters have been worried about the climb of the British pound against both the euro and the dollar. Japan, the United Kingdom, the eurozone countries, and the United States have all felt that the Chinese currency was undervalued, giving Chinese exporters an unfair advantage in their rapid penetration of world markets.

Exporters from countries with more highly valued currencies do face a dilemma. If they raise prices in foreign countries to maintain profits they may lose market share (or lose out in some markets altogether). If they do not raise prices they may lose profits and may even be unable to cover their costs. The exporters from countries with lowered currency valuations will find that they can lower prices to increase market share, or maintain prices and reap more profits, as long as the currency imbalance remains. In 2004 the continuing high value of the euro resulted in European automobile companies increasing the prices they charged in the United States, in turn leading to reduced exports. At the same time wine exports from California to Europe surged, with California displacing Italy as the third largest exporter to the United Kingdom (Emert, 2004).

Currency **devaluation** does not always result in increased exports, as was illustrated by the Asian financial crisis of 1997. Exporters in some countries whose currencies had fallen sharply were unable to obtain export financing because of the financial crises within their countries, and their exports actually fell. The financial crisis and banking system problems in Argentina in 2003–4 also resulted in some companies being unable to obtain bank financing for exports.

A currency crisis in one country may spread to others. This was a problem that occurred in the Asian financial crisis. Macroeconomic similarities may spread a crisis as countries similar to the one under crisis could face problems generated largely by expectations rather than concrete phenomena. Short-term investors may pull money out of similarly situated countries, resulting in devaluation in those countries. Trade is another possible channel through which a crisis may spread, as countries that have not devalued find exports falling and their economy suffers.

There is a strong tendency for devaluation of a currency to lead to inflation as raw materials cost more. It should be noted, however, that the value of a freely convertible currency is determined by other factors besides trade. Short-term investment flows, driven by interest rates or concerns over safety and other factors, are many times larger than trade and long-term investment flows. Thus currency levels do not necessarily follow trade balances even over fairly long periods of time.

The currency in which the price of a product or service is quoted can have a great effect upon company performance in a foreign market. Exchange rate changes between the time of the price quotation in foreign currencies and receipt of funds can also affect profitability in the short run unless some form of hedging is undertaken.

In the first half of 2010, McDonald's hamburgers profits rose in Europe (in euros), but showed as a decline when converted into dollars in the financial reports of the company's US headquarters. The weaker euro, as compared to the dollar, accounted for the difference.

If avoidance of any foreign exchange risks were critical then exporters would prefer to receive their own currency and importers would prefer to pay with their currency. If, however, either party had to accept the other's (or a third country's) currency it could protect itself against exchange loss by entering the forward exchange market and hedge its open position.

Hedging

In July of 2007, Sony was concerned about the possible effects on its profits if the yen were to appreciate substantially. The company had owed about 40% of its net profits the previous quarter to the weaker-than-expected yen, with the result that the inflow of dollars from its overseas operations was worth more in its home currency (yen). However, in the weeks before the end of July the yen had appreciated sharply against the dollar. Worried that this would impact its profits during a period of economic problems for the company, Sony had entered the forward exchange market to hedge 80% of expected incoming dollar funds against the risk of an overvalued yen for the next quarter. Of course, if the yen were to drop in value rather than rise, Sony would miss a windfall profit. The company had not hedged for the quarter following the next since it felt that its other economic problems would be solved by then (Pilling, 2007).

It should be noted that it is also possible to assure in advance that certain inputs can be obtained at set price. This is done by purchasing options to buy the required amounts of needed commodities at set prices at set times or within set time frames, often far in the future. Some airlines have been doing this for jet fuel for a long time. In the third quarter of 2005, Southwest Airlines saved $87 million in fuel costs because of its hedging. It had also made deals to purchase more than half its fuel needs through 2007 at prices that turned out to be far below market prices during the period. A number of other airlines also hedged varying amounts of their expected future fuel needs (*San Francisco Chronicle,* 2005).

In 2009, EasyJet lost half of its profits after the company had hedged its jet fuel prices at a higher level than what the spot market turned out to be (O'Doherty, 2009). Three other large US airlines lost money on their hedges by paying more for jet fuel prices than they would have paid on the spot market (Baer, 2009). With options rather than straight futures contracts, they would not have needed to exercise the options if fuel prices had dropped rather than risen. But they still would have been out by the cost of purchasing the options.

Not all companies believe that hedging is a good practice, even though a company can lose money in the short run. The reason why companies such as Exxon, Kodak, and 3M do little, if any, hedging is that currency fluctuations can help profits as often as they hurt them. Large companies can usually ride out negative currency moves without having to cut back on plans. In addition, hedging can be costly (*Businessweek*, 1998). Another way to lessen risk is to extend credit for a shorter period of time, if credit has been extended. This limits the extent of risk.

It cannot be said categorically which currency is best under all conditions. It should be noted, however, that if necessary, price can be used to an extent to compensate for potential exchange losses. This is one situation where a price escalation provision may be used.

The price quotation

A third phase of export pricing should be based upon some examination of the elements included in the price quotation. Such a determination should be made by the exporter in conjunction with the customer abroad.

Export prices are quoted in various ways. The two major systems available for use in quoting prices are known as *trade terms*. The use of such terms as FOB, FAS, C&F, and CIF (see pages discussed below) is important with regard to specifying not only where the exporter's responsibility and liability end (and the buyer's responsibility and liability begin), but they determine the costs that the exporter will bear. Thus it is customary in the calculation of a price quotation to add the appropriate costs to the basic price.

There are two systems of definition that are used by exporters throughout the world – INCOTERMS 2010 (developed by the International Chamber of Commerce) and Revised American Foreign Trade Definitions – 1941 (originally developed by the Chamber of Commerce of the United States and two other trade organizations).

Trade term definitions generally have no status at law unless there is specific legislation providing for them, or unless they are confirmed by court decisions. If sellers and buyers agree to their acceptance as part of the contract of sale, the definitions become legally binding on the parties to the sale. In Europe, while the application of INCOTERMS 2010 is voluntary, courts and arbitration bodies tend to apply them even if not explicitly stipulated.

INCOTERMS 2010 is the eighth (and latest) revision of INCOTERMS since they were first issued in 1936. The latest changes reflect the increased number of free trade zones, the increased use of electronic communications, greater concerns about security, and other developments in trade since the previous 2000 version.

Comparison of terms

The Revised American Foreign Trade Definitions – 1941 and INCOTERMS 2010 are shown in Table 11.4. As a means of comparing the different sets of terms as well as the different terms within a set, Figure 11.2 shows for each term the point at which the exporter's liability, costs, and responsibilities cease.

Although the detail is beyond the scope of this book, below we present a brief description of the major general trade terms. More detailed information about INCOTERMS and the American Foreign Trade Definitions may be obtained from the International Chamber of Commerce, Paris, France, 38 Cours Albert 1 er, 75008 Paris, France, and Chambers of Commerce in the United States and other nations.

Foreign Freight Forwarders and Customs House Brokers can also provide information about terms and conditions as well as information about costs involved. The exporter and importer, however, need to have a basic understanding of what the terms mean and the rights and responsibilities of the parties under the terms agreed upon.

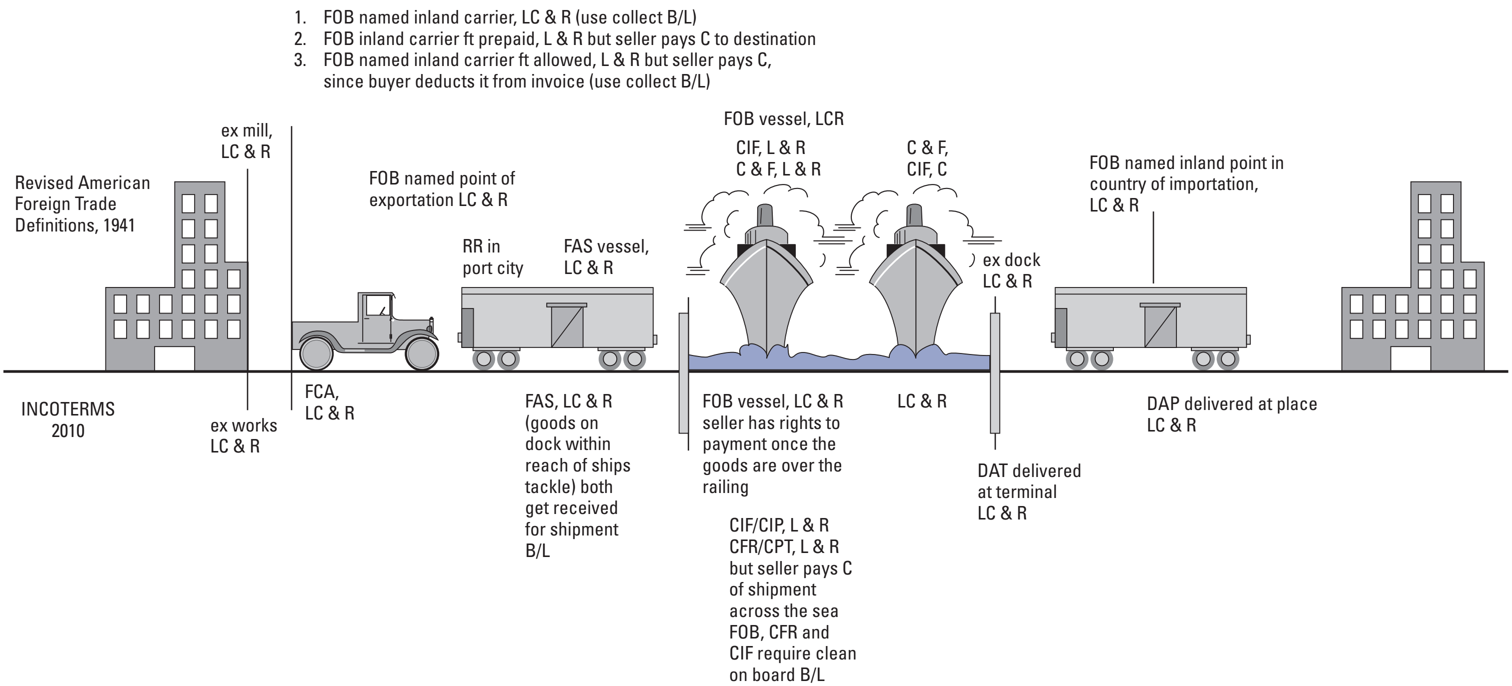
Other terms are for any mode of transport (sea, inland waterway, road, air, rail, etc.)

1. **Ex** (point of origin). This term is referred to as ex factory, ex mill, ex mine, ex works, ex warehouse, and so on (point of origin). The seller's responsibility and costs end at this point in his home country.
2. **Free on board** (FOB). In general, FOB means free on board a transportation carrier at some named point. There are a wide range of FOB terms, all but one of which specify a named point in the country of exportation. The comparable INCOTERM designation is FCA (free carrier) and is used for rail or air transport. The seller's responsibility and cost end in most cases when the goods are loaded on the appropriate carrier and a clean bill of lading has been issued. A clean shipping document **bill of lading** is one that bears

Table 11.4 Comparison of trade terms

INCOTERMS 2010	Revised American Foreign Trade Definitions – 1941
EXW (ex works)	Ex (point of origin) or ex mill
FCA (free carrier), named place	FOB (named inland carrier) Free on board at named point of departure
	FOB (named inland carrier – freight prepaid)
	FOB (named inland carrier – freight allowed)
	FOB (named inland carrier at named point of exportation)
FAS*	FAS (Free alongside) vessel
FOB*	FOB vessel
CFR (Cost and freight)*	C&F (**Cost and freight**)
CIF*	CIF (**Cost, insurance and freight**)
CPT (Carriage paid to)	
CIP (Carriage and insurance paid to)	
DAT (Delivered at Terminal)	
DAP (Delivered at Place)	**Ex dock**
DDP (Delivered duty paid)	FOB (named inland point in country of importation)

*Sea and inland waterway transport only.



L = Liability of exporter: legal.
C = Cost of exporter.
R = Responsibility of exporter: what he or she must do; obtain marine insurance, proper documentation and licenses, certificate of origin, consular invoice, etc.

Figure 11.2 Point of expiration of exporter's liability, costs, and responsibilities no superimposed clause or notation that expressly declares a defective condition of the goods and/or the packaging. The one exception to this is when the named point is inland in the country of importation. In this case the seller is responsible until the goods arrive on a carrier at the appropriate place in the overseas market. For INCOTERMS this would involve use of DDU or DDP.

3. **Free alongside** (FAS). Under this term the seller must provide for delivery of the goods free alongside, but not on board, the transportation carrier (usually an ocean vessel) at the port of shipment and export. Thus this term differs from that of FOB since the time and cost of loading are not included in the FAS term.
4. **Cost and freight** (C&F). The C&F (or CFR, CPT) term means that delivery costs are extended beyond the country of export. Although the seller's liability ends when the goods are loaded on board a carrier or are in the custody of the carrier at the port of exportation, she is responsible for providing and paying for transportation to the overseas port of discharge. However, the buyer must still provide for the necessary insurance.
5. **Cost, insurance, and freight** (CIF). This trade term is identical to C&F except that the seller must also provide the necessary insurance.
6. **Ex dock**. The ex dock (and DAT, DAP) term goes one step beyond CIF and requires the seller to be responsible for the cost of the goods and all other costs necessary to place the goods on the dock at the named overseas port, with the appropriate import duty paid.

Selection of trade terms

In deciding when to use each term, exporters should consider the following factors:

- Whether shipment will be made on domestic or foreign carriers.
- Availability of insurance coverage.
- Availability of information on costs.
- Exporter's need for cash (reason against C&F and CFR/CPT).
- Needs of importers to have quotes from several suppliers that can be readily compared (reason for CIF and CIP).
- Currency convertibility problems. FOB vessel is often desirable so that the buyer pays freight in his own currency. Of course, the carrier still has the convertibility problem, unless it is from the buyer's country.
- Requirements of the government of the importing nation. For example, some developing nations require FOB point of exportation as a condition for receiving an import license. This allows them to foster their own developing merchant marine and insurance companies since the importer has the responsibility to arrange for insurance and transportation, and he may find it convenient (or required) to use certain facilities. Many importers request CIF (or CIP) terms so that they may compare alternative prices, and then they place the order in FOB point of exportation terms.

Price quotations can be a meaningful part of export marketing strategy. Ideally, the price quote should be in a form that customers find suitable, and at least as convenient for the customer as those offered by competitors. Often this requires a CIF or CIP quote since it is the only quote (among those commonly used) that permits the buyer to compare prices easily from alternatively located suppliers.

CIF quotations

Only one of these quotations represents any considerable difficulty in reaching an accurate figure: CIF. This is one of the most commonly used quotations in export trade. It indicates that the terms of the quotation include the cost of the merchandise delivered on board the vessel, plus the cost of the insurance to destination, plus the freight charges to the named destination. A CIF quotation indicates that no other charges will accrue to the account of the buyer before the shipment arrives at the port of destination.

The reason that the CIF quotation is more difficult to figure accurately is that it is customary in the export business to add a fixed percentage, usually 10%, to the insured value to take care of extra expenses and losses not covered by the simple CIF value. Therefore the insured CIF value is the sum of the cost, the freight to destination, and the insurance premium on 110% of the CIF value. Inasmuch as the premium is figured on the entire CIF value, the difficulty presents itself in figuring the *I*.

There are two methods of ascertaining insured value when the total C&F value has been determined in a CIF calculation. A widely practiced method is the approximation or estimate method. The other is the formula method.

The estimate method

The exporter employing the estimate method simply adds 10% (or some other percentage) to the C&F value. Then, if the insurance rate is X%, he takes X% of the C&F value and adds it to the 10%. The resulting amount is then added to the C&F value.

The formula method

The most accurate method of computing a CIF quotation involves the use of a formula. The formula, which in this case is used for calculating the CIF price when 10% is added to the C&F value, is as follows:

$$\text{CIF} = \frac{\text{C\&F}}{N(1 - 0.011\,R)}$$

where

C = FAS value
F = total freight charges
N = total weight to be shipped (or other unit of measure, e.g., volume, pieces)
R = insurance rate (per \$100).

To obtain the insured value the following formula is applied (assuming a 10% addition):

$$\text{Insured value} = \frac{110(\text{C\&F})}{100 - 1.1\,R}$$

There is no reason that only 10% should be added for insurance purposes, except that this is the general custom. Many firms add 15%, in which case 15% may be substituted in the above formula for 10%. As a matter of fact, any percentage that the exporter decides upon may be added and the formula changed accordingly. An example of a CIF calculation is shown in Exhibit 11.10.

Exhibit 11.10 CIF calculation

An apple packer located in the Okanagan valley in British Columbia, Canada, received an inquiry from a potential buyer in France for 4,000 boxes of apples, five-tier, 175/215s, combination of extrafancy and fancy. The request asked for a firm price, CIF, Le Havre, France.

The apple packer proceeds by examining relevant costs (in Canadian currency) as follows:

	$
Current price FOB, Penticton	7.50 per box
Rail freight to Vancouver	1.00 per box
Wharfage and handling	0.25 per box
Ocean freight (Vancouver to Le Havre)	4.80 per box
Marine insurance (coverage of cargo in refrigerated space)	0.20 per $100.00
French consular invoice fee	10.00 per invoice

To determine the CIF price, the packer wants to insure the shipment for a value that is the CIF price plus 10%.

The formula for calculating the CIF price is as follows:

$$\text{CIF} = \frac{\text{C\&F}}{N(1 - 0.011\,R)}$$

where C = FAS value, determined as

	$
FOB	= 30,000.00
Rail freight	= 4,000.00
Wharfage, etc.	= 1,000.00
Consular fee	= 10.00
FAS	= 35,010.00
F = ocean freight	= 19,200.00
R = insurance rate	= 0.20 (per $100)
N = total number of boxes	= 4,000

Now, we determine the CIF, Le Havre price per box to be:

$$\text{CIF} = \frac{35{,}010.00 + 19{,}200.00}{4{,}000(1 - 0.011 \times 0.20)}$$

$$= \$13.58 \text{ per box}$$

Computation of ocean freight

In general, ocean freight is calculated either on the weight or on the measurement of the shipment, carrier's option. The standard unit is the long ton, which weighs 2,240 lb and measures 40 cubic feet. In quoting a price, care should be taken to distinguish between terms that seem to be the same but may be different. For example, the ton may be a short ton

(2,000 lb), a long ton (2,240 lb), or a metric ton (2,204.62 lb); a gallon may be a US gallon or an imperial gallon, which is five US quarts. A British hundredweight is equal to 112 lb US weight.

Transfer pricing

Prices must be set not only on products sold to independent customers, but also on products transferred to foreign subsidiaries or transferred to foreign operations in which the seller has part ownership. For our purposes, prices to wholly or partially owned operations are defined as transfer prices.

The problem of establishing international transfer pricing policies is in a broad sense essentially the same as the problem of establishing domestic transfer pricing policies. However, upon close examination it can be observed that not only are the details of international transfer pricing more complex than domestic transfer pricing, but additional factors influence the decision-making process.

Decentralization and profit centers

At the outset it must be made clear that the need for transfer pricing arises only when a company decentralizes managerial authority and responsibility, making each unit responsible for operating profitably. The reasons for such decentralization may be both legal and managerial. Laws relating to corporate organization, taxation, and other matters may make it desirable for certain units or divisions of a company to be incorporated separately. Under such conditions the financial records of the unit must be kept in such a way that the company appears to operate as a profit center, if for no other reason than to satisfy foreign and domestic tax authorities.

Indeed, transfer pricing has been viewed by many primarily as a means for controlling divisional performances and coordinating cash and income flows from foreign subsidiaries. However, there is strong evidence that transfer pricing, including export transfer pricing, can be used for marketing decisions. Transfer pricing has great potential for helping marketing managers achieve strategic objectives in changing international environments.

Transfer pricing to wholly owned foreign subsidiaries

For a company with wholly owned foreign subsidiaries such factors as distance, expense of communicating, and decentralization of authority to the local level complicate the process of setting export transfer prices. Also, a complex set of taxes, tariffs, and governmental regulations affect the decision. Since competitive and market conditions vary from country to country, it is difficult to develop a policy that can be applied uniformly.

In the case where 100% ownership is held, a company has complete freedom to decide who will control the establishment of transfer prices, for example company management, the selling units, competitors (by the market price), the buying unit, or some combination. The determination of who should set the transfer price, and the method to be used, depends in part on the needs of the company for cost and profit information. Typically this information is used for such decisions as whether to 'make or buy,' determining the price of the end product, deciding whether to add or drop products, and determining the budget for capital expenditure.

The problem of transfer pricing has two dimensions: (1) how (by what method) should transfer prices be set, and (2) who should establish transfer pricing policies and set specific transfer prices? These questions are interrelated, since whoever sets the price will have some influence on deciding which factors to consider and the relative weight to give each factor.

How should transfer prices be set?

A number of methods of setting transfer prices have been tried and tested by companies of various sizes and product lines. Out of this experience have come a number of guidelines. Nevertheless, as yet, there is no general agreement as to which method of setting transfer prices has the most merit. No one method is best for all circumstances since the 'best' method for a company depends on the characteristics of the company and the purpose of the transfer price.

The factors that influence transfer prices fall into three general categories:

1. **competitive market prices**, including competitor's list prices or bids;
2. **costs**, including production costs, physical distribution costs, foreign and domestic tariffs, and corporate income taxes;
3. **legal restrictions**, including political policies, governmental controls, and foreign laws against practices such as price discrimination and dumping.

If the purpose of transfer pricing is to provide profitability data, then it is necessary that an accurate profitability figure be obtained. Such decisions must be made on the basis of alternative rates of return on investment, in the short run as well as in the long run; opportunity costs also must be considered. Thus it may seem desirable to base the transfer price on the competitive market price, or the best estimate of a market price, and to require the purchasing unit to buy internally. Under this policy, if the selling unit has unduly high costs, its profits will suffer, and the divisional manager will soon have to correct the situation or face corporate management with a poor profit record.

If the purpose of the transfer price is to assist management in setting the cost floor for prices of the end product, or if the purpose is to shift profits to the foreign operation, the use of costs is desirable as a means of determining the transfer price. There are different relevant cost concepts to consider. In the short run, marginal costs may be the relevant minimum, since any amount over such costs would result in a direct contribution to net profit. In the long run, full costs or standard costs may be closer to the ideal minimum that will help management to determine whether or not the resources of the corporation are being used to maximize profits, and if not, how to correct the situation.

The views of foreign Customs officials (for purposes of valuation of goods and assessment of duties) are also important. To minimize Customs duties, it is often desirable to set the price as close to cost as possible. However, some countries require that the Customs duty valuation be the 'fair market value,' or some concept of value related to the market price of the item in the country of exportation.

Domestic and foreign tax regulations and enforcement of those regulations also influence whether or not cost can be used as the basis for prices. Tax rates vary from country to country. When the home country corporate income tax is higher than the tax rate in the country in which the subsidiary is located, the recommended procedure is to set transfer

Exhibit 11.11 Legal problems in transfer pricing

A number of countries have become increasingly concerned about losses in tax revenues caused by the transfer pricing policies of subsidiaries of foreign companies. It is possible for international companies to shift profits from their wholly owned foreign subsidiaries to their home countries by inflating the prices of parts, services, or intellectual property supplied from the home country, and/or by charging below market prices on products sold to subsidiaries in third countries with lower taxes. In 2004, Nissan paid 37 million pounds to the UK tax authority to settle a tax dispute over shifting profits out of the country. Nissan's factory in the United Kingdom had been rated as having the highest productivity of any automobile plant in Europe, but had not shown a profit in several years of operation. Honda was also under investigation over alleged selling of UK-made motorcycles to its Brazilian subsidiary at artificially low prices (Mackintosh, 2004).

In the United States, GlaxoSmithKline paid $3.4 billion in 2006 to the IRS to settle a case of allegedly inflating prices the American unit paid to its British parent (Matthews and Whalen, 2006). Merck & Co. paid $2.3 billion to the United States to settle a dispute related to payments made for the use of patents that had been transferred to a Bermuda-based subsidiary. Merck was also in a tax dispute with Canadian tax authorities. The IRS also had victories in disputes over the use of tax shelters by General Electric Co., Black and Decker Corporation, and Coltec Industries Inc. (Drucker, 2007).

prices as close to costs as permissible. Income tax authorities, however, may object to using taxes as a criterion for setting transfer prices.

Legal problems can arise because of transfer prices used (see Exhibit 11.11).

Cost-plus transfer pricing has disadvantages beyond not being able to set a price that assures maximized profits, if that is the objective. Prices set in this way may not provide sufficient incentive for the producing unit to reduce costs to the absolute minimum. However, standard costs may be satisfactory as a basis for cost-plus transfer prices if the standards are proper.

A transfer pricing method that uses both costs and competitive market prices may permit the accomplishment of desired objectives without incurring the disadvantages of either method when it is used alone. For example, a system might be set up whereby the transfer price is set at cost, but the selling unit is credited with a certain percentage of the net profit that results from any further processing and the ultimate sale. Such a system could be used to minimize taxes and tariffs and at the same time generate profitability data.

It is desirable that some degree of flexibility in the process of formulating transfer prices be maintained. If flexibility is to be maintained, and if the interests of the buying and selling units as well as the corporate entity are to be considered, a system of *negotiation* or bargaining is required.

Negotiation also has some disadvantages. Discussions can be long and tedious and they may erupt into unharmonious interdivisional squabbles. Even though the negotiations and agreements must be reviewed periodically, the amount of time spent in negotiation can be kept within acceptable limits. Perhaps the greatest disadvantage of negotiation, on the other hand, is the occurrence of disputes. If the dispute is resolved on the basis of strength of personality or power position within the company, healthy, cooperative intracompany relations may be destroyed. If transfer prices are imposed on managers, this may also hamper morale and the profit incentive.

The desirability of each type of transfer pricing system is related to the characteristics of a company and the products it sells. A relatively small company with only a few foreign operating units, staffed by managers who are well acquainted with each other, can often operate on a somewhat more flexible basis than a large company. The size of the company is also related to the number and types of products in the company's product mix. Since the transfer price of different products should sometimes be set by different methods, the situation faced by large companies is complex.

Generally, most authorities on transfer pricing feel that if profitability data from profit centers are used to accomplish management purposes, the pricing policy must be aimed at setting 'competitive' transfer prices. Another reason for using competitive transfer prices is that tax laws are often written to prevent the arbitrary shifting of income among taxable units of companies in order to evade taxes. A key test seems to be whether a transfer price is *reasonable* rather than arbitrary. One of the strongest pieces of evidence that a price is fair and reasonable is that the price is not only at the market value, but that it was established by dealing at 'arm's length.' The arm's length requirement is also a strong argument in favor of permitting the price to be set by bargaining between the selling and buying units, with the buying unit free to buy outside if it desires.

Since competitive prices may differ from market to market, a company that bases transfer prices on competitive conditions in each market may have to set a different price for each market. Not only would such a pricing schedule be complex and costly to administer, but disagreements may arise among company units. Moreover, tariff authorities may object if they feel that valuation should be based on the price in the seller's home market. Last, but certainly not least, foreign and domestic income tax authorities may object if they feel that differential transfer prices may operate to shift profits from one nation to another and thereby affect taxable income.

The so-called *business purpose* test requires that there be a demonstrable managerial purpose for the adoption of a particular method of transfer pricing. Where different but equally satisfactory methods of transfer pricing are available, a business firm is not precluded from choosing the method that is to its advantage tax-wise. However, in general, the business purpose must be paramount. Thus it seems that transfer pricing methods would be acceptable to governments if the method meets either the arm's length or the business purpose test and is not for the purpose of avoiding payment of taxes.

Who should set transfer prices?

The power to set the transfer price can be retained by company management or delegated to the selling or buying unit. A compromise may be to permit the selling unit to set the price, but to permit the buying unit to buy outside if it desires. Or, management may prefer that the buying and selling divisions negotiate the transfer price. When this is the policy, corporate management enters into the negotiations only if a dispute arises.

Transfer pricing to partially owned foreign enterprises

It is relatively common for companies to have only a part interest in a foreign operation in partnership with either a foreign concern or with another firm domiciled in the same home country. When only a partial interest is held, or in the case of a joint venture, the seller cannot dictate prices to the same degree as if it were an internal transfer. The independent nature of the buyer requires that the price be set so as to take account of the interests of the other owners or partners in the venture.

Setting transfer prices to foreign operations that are not wholly owned involves some considerations in addition to those that are relevant for pricing to wholly owned subsidiaries. There is little reason to set the transfer price as close to cost as possible since the 'shifting' of profits abroad would mean that the foreign partner would share in them. Likewise, it would not be reasonable for transfers to be made at prices higher than the competitive market price. In fact, there may be pressures on the part of the foreign partner to reduce the transfer price below the 'outside' price. The transfer pricing process under such circumstances is similar to the process of pricing to third parties. The normal practice is likely to be arm's length negotiation, with the buyer having the freedom to buy outside.

However, if a joint venture has been formed for some special purpose, perhaps to produce an item not available elsewhere, the transfer price may be set on the basis of factors in addition to those already discussed. For example, suppose a joint venture is entered into by two noncompeting German firms to produce abroad a component that both of them need in their foreign products. Equal amounts of capital funds for the establishment of the foreign plant may be contributed by both parties. Thus, any profit that the firm would earn would be either paid out equally to the two stockholders or retained in the business. As long as each partner also takes exactly 50% of the output of the joint venture, both firms are benefiting equally from it. Under such conditions, in order to minimize income taxes on any profits that the joint venture might earn, it may be well to operate the plant on a break-even basis. Prices charged to its two customers by the joint venture might be set just high enough to cover costs. But, if one of the partners takes a disproportionate share of the output of the joint venture, one partner will benefit more from the joint venture than the other partner.

If the joint venture's product requires components that are produced by one of the partners, the situation is even more complex. Generally, under this circumstance, the partner selling the component to the joint venture would want to set a high price for it. The other partner would desire a low price.

Summary

This chapter has examined pricing for export. The major issues covered include the determinants of price, pricing objectives, pricing strategy, how foreign prices are related to domestic prices, the elements of the price quotation, and transfer pricing. Although export pricing issues are in many ways similar to domestic price considerations, there are elements that are unique to export marketing. The issues facing an exporter become more complex when a number of often quite diverse export markets are to be served.

In the future, export pricing is likely to gain rather than lose importance. As most markets reach saturation, companies will find it increasingly difficult to achieve higher sales without actively using pricing as a competitive tool. At the same time, communication technologies such as the Internet lead to more transparency, rendering it more difficult for firms to establish and maintain price differentials across markets. Disappearing retail price maintenance and shortening product life cycles add pressure for more sophisticated pricing practices to achieve quicker payback times. Finally, trade liberalization and growing economic integration render traditional market-per-market pricing obsolete and require improved pricing strategies.

Questions for discussion

11.1 What is the meaning of the 'anatomy of a price' as it refers to an export price?

11.2 Explain why export prices should or should not be established using the same methods and according to the same criteria as prices set in the domestic market.

11.3 Discuss the relationship between objective and strategy in pricing.

11.4 What alternative pricing strategies are available to the exporter and what objective(s) does each seek to achieve? Is any one more desirable than the others? Explain.

11.5 Can a small exporter use experience-curve pricing? If so, how? If not, why not?

11.6 Under what conditions might an exporter establish a policy of differential pricing for foreign markets?

11.7 'Since all trade terms are basically the same, there is no need for using them in export sales contracts.' Discuss.

11.8 Under what conditions might an exporter prefer to use INCOTERMS for a price quotation and under what conditions might this exporter prefer to use Revised American Foreign Trade Definitions – 1941? Does an exporter always have the choice of which trade term schema to use?

11.9 What factors must the exporter consider when making a decision on price quotation?

11.10 From the perspective of the 'parent' company, is it better to use a low export transfer price or a high price? What effect does extent of ownership of the importing unit have on your answer? Explain fully.

11.11 How does the nature of the product involved affect what might be a desirable transfer pricing policy?

11.12 Discuss what you consider to be the ideal approach for establishing an export transfer price.

11.13 Explain when the export firm should no longer be concerned about the pricing of its products.

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CASE STUDY 11.1

RAP Engineering and Equipment Company

This company, located in Seattle, Washington, in the United States, is a distributor of engineering equipment and machine tools. The company receives an order from the Matens Company in Portugal for ten light earth-moving machines. Since the company does not normally carry this number in stock, the export manager, Mr Green, places an option on ten machines with the CPPC Manufacturing Company in Akron, Ohio, and requests a firm price quotation to be held in force for 90 days. The CPPC Company agrees to this and quotes a price of US$4500 ex warehouse, Akron, Ohio, for each machine.

Mr Green checks with his traffic manager and is told that railroad freight from Akron to Seattle for these machines will average approximately US$750 per machine. Other costs are as follows:

	US$
Trucking and handling	5.00 per short ton
Export packing	70.00 per machine
Shipping to pier	4.20 per short ton
Wharfage and handling	3.30 per 40 cubic feet (cf)
Heavy lift charges: (applicable to items weighing over 5000 lb)	17.00 per 2000 lb
Ocean freight: Seattle to Lisbon	142.50 per 2000 lb or 40 cubic feet, weight/measure
Marine insurance:	
shipped under deck	1.70 per $100
shipped above deck	2.50 per $100

	US$
Portugal **consular invoice** fee	20.00 per invoice
Seattle Engineering & Equipment Company markup	20% of machine cost
Weights and measurements	
10 crates containing chassis, each	6400 lb, 180 cf
10 boxes containing rails, chains, and parts, each	6000 lb, 50 cf
10 bundles containing wheels and tires, each	240 lb, 20 cf

Questions

1. Calculate the C&F Lisbon price per machine and the CIF Lisbon price per machine.
2. At what point in time, or place, will RAP's responsibilities for arrangements of the shipment end? When does RAP's legal liability end and when does it acquire the right to payment?
3. How would your answer to question 2 change if the terms of sale were FOB vessel (FOB) or ex dock (DEQ)?

CASE STUDY 11.2

The Capitool Company

(This is an abridged version of a Capitool case study, originally written by Gordon E. Miracle, Michigan State University. All monetary figures have been adjusted to disguise the actual values. For the most part, the relationships between numbers were maintained.)

The Capitool Company, with headquarters and main manufacturing plant in Racine, Wisconsin, in the United States, produces a line of capital equipment for use in a variety of industries, especially for automobiles, trucks, farm equipment, and construction equipment. The company was founded over 70 years ago, with sales (turnover) growing slowly to about US$60 million by the end of World War II, and since then more rapidly to more than US$3.5 billion at present. After-tax profits have grown correspondingly, usually amounting to about 3–4% of turnover.

Capitool has been a leader in offering an advanced line of products. Heavy research and product development expenditures coupled with customer orientation have enabled the company to achieve a dominant position in the US market.

In order to continue to grow rapidly and profitably Capitool decided in the mid-1950s to move into foreign markets. The company had exported a number of products for many years, but increasing foreign demand made it not only feasible, but desirable, to establish manufacturing facilities abroad. Within a 10-year period Capitool had wholly owned manufacturing plants in New Zealand, England, and Germany; joint ventures in Germany and Italy; and licensees in England, Argentina, and Turkey.

In addition to manufacturing facilities, Capitool has sales branches in England, Argentina, and Turkey to handle the marketing of the products of licensees in those countries. Since the licensees take only a part of their output of the licensed products for use in their own end products, the remainder is marketed to third parties by the Capitool sales branches.

In areas of the world not served by Capitool manufacturing or licensing affiliates, Capitool Exports Ltd, a wholly owned subsidiary incorporated in Bermuda, functions as an 'offshore' trading company. Capitool Exports Ltd has 20 regional offices located strategically to serve about 100 independent distributors who act as sales and service outlets in more than 100 countries.

The German subsidiary company

The Capitool Company GmbH, a wholly owned manufacturing subsidiary in Germany, is responsible for the operation of two factories, one in Duisburg and one in Düsseldorf.

The Düsseldorf plant manufactures components for various items of capital equipment, and has customers throughout Europe. Sales are concentrated in Germany, with a large proportion going to a joint venture with a large US automobile manufacturer; the joint venture is incorporated under the name Genforsler-Capitool GmbH.

The Duisburg plant manufactures a piece of equipment that is a mainstay in the Capitool line in the United States and worldwide. The prices of this piece of equipment range from US$90 to US$700, depending on the size and performance characteristics of the item. The Duisburg plant and three major German competitors account for over 95% of sales of the piece of equipment in Germany.

The fact that the Duisburg and Düsseldorf plants are part of the same company permits a 'tax loss carry forward' from the Duisburg plant to be used to minimize the total German tax obligation. By itself, the Düsseldorf plant is quite profitable. Recently the Duisburg plant has also become profitable. The 'tax loss carry forward' is expected to be depleted within the next three or four years.

The total Capitool investment in the Duisburg plant since the mid-1950s has been US$10,500,000. The plant has an area exceeding 221,000 square feet and employs over 1100 people currently. Capacity to produce exceeds demand by about 20%. Within three years demand is expected to exceed capacity, and expansion will be required.

The output of the Duisburg plant is sold throughout the European continent, England, Canada, and Mexico. Annual sales of the Duisburg plant exceed US$10 million.

Although the Duisburg plant is a manufacturing operation, only 35% of the contents of the product are actually manufactured at the Duisburg plant or in Düsseldorf. Local German suppliers furnish about 30% of the finished components, and the remaining 35% are imported from one of Capitool's divisions in the United States. Components are purchased from the United States when one or more of the following conditions apply to a specific component:

- technically adequate manufactured components are not available in Germany;
- the total of the US transfer price (as defined below) plus freight, insurance, and duty is less than the purchase price in Germany;
- delivery from the United States is faster than from the German supplier, and the need warrants use of the fastest source.

Transfer pricing policies

Corporate policy on transfer pricing is as follows:

- If there is a market price for the item, the basis for establishing the transfer price will be the market price.
- If the product is available elsewhere but there is no market price, the basis is negotiation between the selling and buying division. Negotiation is guided by (a) costs, and (b) outside competitive bids, if realistic bids are available. If not available, an estimate of a realistic outside quote is made.
- If the product is not available elsewhere, that is, if it is a unique part which is made only by Capitool, the basis for establishing the transfer price is negotiation based on: (a) costs, (b) anticipated volume, and (c) an 'equitable' markup.

The policy with regard to 'international' transfer pricing is basically the same, but with some additional complications. A major additional consideration is to minimize unnecessary Customs duties and taxes. In addition, the policy depends in part on the types of overseas operations, for example:

1. If the transfer price is to a subsidiary that is 100% owned, the policy would be to price as near to cost as possible. The policy is designed to accomplish two objectives: (a) to minimize Customs duties, and (b) to let the maximum amount of profit be taken by the subsidiary so as to minimize taxes, while at the same time satisfying the US Internal Revenue Service authorities that there is no intent to avoid legitimate taxes by shifting profits abroad.
2. In the case where products are sold to a 50–50 joint venture, the policy is to set the price as high as possible, but to keep it competitive (since the joint venture could buy outside). This policy permits the profits to be earned by the Capitool Company rather than shifting it to the joint venture so that the foreign partner shares it. The joint venture is in this way limited to the profits that are properly earned as a result of its operations and efficiency.

   A limiting factor is the trade-off in taxes or in duties. For example, if the duty is exceedingly high, the Capitool Company share of joint venture profits might be enough to make a low transfer price more profitable than a high transfer price.

   In some cases, the transfer prices are covered in the joint venture contract; that is, an upper limit may be set. When there is a specific price ceiling it is renegotiable periodically.

   However, in the special case of the Genforsler-Capitool joint venture (special because Genforsler-Capitool produces machines for sales only to Genforsler and to Capitool) the philosophy is for Genforsler-Capitool to develop a high-volume operation by operating just above the break-even point, and charging both Genforsler and Capitool as low a price as possible while earning enough profit to satisfy German tax authorities.

In the case of a joint venture in which the transfer price has not been specified, the policy is to take as much of the profit as possible in the transfer price.

Since the company goal is to maximize corporate profits rather than divisional profits, there inevitably arise situations where a domestic division must take a reduced profit (by lowering the transfer price) in order that the International Division may capitalize on a favorable tax or Customs duty situation, or vice versa. Usually, the division that must give up the profits sees the reason clearly, and there is no friction. However, in complex situations, transfer price negotiations between divisions can result in disputes. When such an occasion arises, and when the dispute cannot be resolved satisfactorily, it is referred to the Control Committee. This committee consists of the financial vice president of the corporation (the chairman of the committee), the corporate controller, the controller of the domestic division that is involved, and the International Division controller.

Company officials are reviewing their transfer pricing policy on components shipped to the Duisburg plant. When the original policy was established, the following considerations were evaluated in determining the transfer price:

- At what price would corporate profits be greatest? Capitool GmbH is in a 'tax loss carry forward' position.
- What price would be most advantageous for computing shipping insurance, freight, and duty? These costs are estimated at 40% of the FOB US price.
- What transfer price would the US Internal Revenue Service consider adequate for determining taxable income for the Capitool Company?
- What transfer price would the German authorities consider adequate for determining the taxable income of Capitool GmbH?
- What transfer price would the German authorities consider adequate for determining a duty base?
- Should the company encourage Capitool GmbH to seek maximum indigenous content through high transfer prices?
- What is the relative quality of German-sourced components versus US components?
- What transfer price is necessary to keep the landed cost of components at a level that will allow Capitool GmbH to price their machines competitively and obtain a satisfactory gross margin?

Currently the FOB US transfer price on components shipped from the US plant to the Duisburg plant is the sum of:

- actual direct material;
- actual direct labor;
- full manufacturing expense;
- 14.2% markup on cost.

This formula has been reviewed and approved by the United States Internal Revenue Service and the German Income Tax and Customs Authorities as the lowest acceptable basis for determining: (a) taxable profits at each location and (b) the value to be used in assessing Customs duty payments.

Company officials have been concerned about the meaning and usefulness of transfer prices. In the past the policy has been one of decentralization of authority to managers that head profit centers. Profit centers have been used both as a managerial incentive (so that a manager can see the profits for which he can take credit), and as a method of measuring the performance of executives. Under such a system, whenever there are intracompany transfers of products, a 'transfer price' must be established. Company officials are concerned that there are inequities in the system, since maximum corporate profit may not be achieved simply by letting divisions maximize profits individually.

One company official went so far as to suggest that perhaps it would be better to determine all transfer prices at headquarters; and that the 'profit' centers should be changed to 'cost' centers. The general manager of each cost center would have no control over centrally administered transfer prices; he or she would simply be forced to accept them as they are set by headquarters. Under this arrangement managers would be evaluated not on profits but according to other measures, for example, share of market, sales increases, cost reductions, and so forth. The company's tax counsel pointed out that this policy would cause problems with tax and Customs authorities.

Another company official expressed the view that managers of cost (or profit) centers should be permitted to buy wherever landed cost is lowest, except when the corporate interest is served by 'buying' internally, for example: (1) when there is excess capacity (probably there would be no difficulty in this regard if the 'selling' division were willing to set the price as near to marginal cost as necessary to be competitive), or (2) when tax or duty factors make it desirable to transfer at a 'higher than competitive' price.

Questions

1. What should be Capitool's general policy on the formulation of international transfer prices?
2. What methods should be used to set Capitool's transfer prices and who should be involved in the process?
3. Should Capitool have a system of multiple transfer prices: (a) for different products, (b) to different countries, or (c) to different classes of customers?

CASE STUDY 11.3

Strato Designs

Exchange rate fluctuations between the Japanese yen, the euro, and the US dollar have posed serious problems for Strato Designs (the name of the company is disguised). The California company produces graphics components for nine of the top ten PC makers, other specialty logic chips for PCs, and modems. Approximately 35% of its sales are to Japanese companies, and approximately 10% to European companies.

Japanese customers require that prices be quoted in yen, and many European customers are now requiring that prices be quoted in euros. Payments in foreign currencies could, of course, be converted to dollars at the spot (current) exchange rate when received. However, when the yen or euro has increased in value between the time of price quotation and the receipt of payment, it means a windfall profit for Strato Designs. A decrease in the value of the yen or euro means an exchange loss that might exceed the margin on the sale, resulting in a loss on the sale.

The fluctuations in exchange rates over the past ten years have been substantial and unpredictable. From its launch in January 1999, the euro lost over 30% of its value relative to the dollar by October 2000. It rallied, fell again, and then greatly increased. At one point in 2007, the euro stood at 1.35 per dollar, an increase of over 55% from its low. The British pound has increased in value against the euro as well as against the dollar. During the 1999–2007 period, the yen moved up and down in a range of about 25% relative to the dollar. Daily fluctuations were sometimes substantial. Short-term changes in the value of the yen were dampened somewhat by massive Japanese government interventions in the foreign exchange market.

Overall margins in the industry are not high enough to allow Strato Designs to make quotations to cover possible losses due to a weakening of a foreign currency. Even windfall profits from a strengthening foreign currency could be a problem for the company. Foreign customers who contracted for products when their currencies were weak, and subsequently paid when their currencies were strong, would realize that they were paying high prices in dollars. They might ask for rebates if Strato Designs' competitors were offering products at lower prices based on revised exchange rates.

Company officials discussed the problem with their bank, and with other companies facing similar problems, using the yen as an example. At least six strategies are available:

1. The company could enter into a forward exchange contract to sell the yen for dollars at a specified date in the future for a specified price. The date for sale of the yen (purchase of dollars) would be set for the time when the yen would be received from the Japanese importer of the goods. Such a contract, available at a relatively low price and usually with a rate very near to the spot rate, would lock in the profit. But it would also prevent Strato Designs from benefiting from a windfall profit. Further, it would not solve the potential problem of having a dissatisfied customer if the yen became stronger during the period between the sales contract and the time of payment.
2. The company could purchase an option to sell the yen (buy dollars) at a specified rate at the date when the yen are due to be received. With an option, Strato Designs would not have to sell the yen to the option provider. It could do so if the yen had become weaker, or it could simply not exercise the option and instead sell the yen at the spot rate (current rate) if the yen had become stronger. The disadvantage of this method is that options are relatively expensive to purchase.
3. Strato Designs might be able to arrange a swap of currencies at a predetermined rate with a US-based

exporter who will need to pay yen at the time that Strato Designs will receive yen.

4. Depending upon Strato Designs' need for parts or other goods from Japan, it might be able to partially or totally offset potential exchange losses/gains from export sales with balancing gains/losses from import purchases at the same time.
5. Strato Designs could make contracts or purchase options only when it believes that the yen will become weaker. When it believes that the yen will become stronger, it could simply wait to sell the yen when received, thereby making an additional profit.
6. Strato Designs could simply not take any advance action, accepting exchange losses or gains as they might occur.

From these possible models, Strato Designs has to decide upon a specific system to use.

Questions

1. Are the Japanese customers of Strato Designs likely to be willing to accept price quotations in dollars? Discuss.
2. What should be the company's objective in managing the exchange rate situation?
3. What model or system would you recommend that Strato Designs use? Defend your choice!
4. Is your choice in Question 3 something that the company should do for all the foreign currencies that it might have to manage or only for the Japanese yen? Explain.

CHAPTER 12

Financing and methods of payment

Learning outcomes

Chapter 12 covers financing and methods of payment. It specifically covers areas related to:

- export financing issues:
  - legal actions may be difficult, costly, and subject to differences in laws
  - return of goods may be very difficult or impossible
- credit insurance
- countertrade arrangements

Two cases are provided at the end of the chapter. Case 12.1, Tainan Glass Manufacturing, discusses how special arrangements had to be made in order for an exporter to obtain a letter of credit (L/C) from a Nigerian importer. Case 12.2 involves a South Korean exporter who is considering changing the method of payment he requires from Canadian importers.

Introduction

Financing and payments are issues directly tied to export pricing. Export prices are not set in isolation but are set in consideration of when and how payment is to be made. The financial procedures that have been developed, although rather complicated, provide export marketers with the services and tools essential to control payment for internationally traded merchandise. Although banks engage in international finance for the purpose of making profits, the services they furnish are indispensable aids to the export manager. In the following pages the methods, procedures, and tools of export financing and methods of payment, including some of the services offered by banks, will be described. In addition, various types of countertrade arrangements, which may or may not involve a monetary payment, are discussed. Necessarily, however, these descriptions will be brief. For more detail see the publications by Bank of America (2004) or similar publications by banks with international banking departments.

Advances in electronic communications have had a substantial impact on both bank interfaces with customers and inter-bank operations. Some customers still fill out paper application forms for letters of credit and other financial transactions. However, most companies now conduct much of their business online, sending EDI (electronic data interchange) and/or other files, using Web-based application forms, etc. These forms, for international as well as domestic transactions, are usually in the language and format of the country in which the bank is located. In the past, letters of credit and other forms were sent internationally in full-language text in hard copy or electronically. Differences in formats and the meanings of terms sometimes resulted in delays or confusion in translating the forms into the language and format used in the receiving country. This procedure has been changed by the development of SWIFT (Society for Worldwide Inter-bank Transfers).

Over 90% of inter-bank financial transfers are now made through SWIFT, a proprietary electronic network owned by banks. It is also used for inquiries, settlements of various types of transactions, and commercial payments. For the various forms commonly used, messages are sent in a structured format that has all of the necessary information in standard locations. The cost of sending a letter of credit using the structured message is less than one-fifth of the cost of sending a full-text message, and greatly reduces the potential for misunderstanding. In the world of satellite and other means of wireless communications, banks have various methods for conducting other types of transactions.

While the personal relationships of customers and their banks continue to be of great importance, routine transactions are often done online (Scanlan D., 2010, personal communication).

Export financing terms of payment

Financing methods are determined to a large extent by the degree of control that the exporter desires to retain over the merchandise, the willingness of the importer to accept the terms, and the time limit that has been placed upon the extension of credit.

In exporting, there are seven different ways in which credit can be extended and payments made. These are discussed more or less in ascending order from the least secure to the most secure – from the seller's/exporter's point of view – regarding risk of nonpayment. This ordering also corresponds to ascending costs to the importer from least expensive to most expensive. Generally, the exporter would prefer the most secure method, while the importer would prefer the least expensive. Since the extremes for each are on opposite ends of the ordering, it is obvious that some form of compromise may be needed.

Consignment

When this method is used, demand for payment is usually made by means of a **clean draft** (no documents attached), drawn on the consignee/importer by the exporter. Payment typically occurs after the products have been resold by the buyer/importer. The timing and procedures for payment will depend on the prior arrangements made between the buyer and seller. The seller may draw a clean draft (no documents attached) on the buyer for the value of a particular shipment or shipments. Alternatively, the buyer may simply make periodic payments, such as monthly, with or without receiving a clean draft, on the balance owed. Actual remittance (payment) is made by check, bank draft, or electronic transfer. Consignment business, in many countries, can be dangerous for three reasons: first, the laws are not always clear on the ownership of the consigned merchandise; second, it is difficult for the seller to keep a watchful eye on the consigned merchandise when it is physically in a far country; and third, exchange controls may preclude payment by the consignee. For these reasons, this method is rarely used.

Open account

Business done in export trade on open account is handled by the same procedure and methods as in domestic trade. An exporter would normally be willing to use this method only when he has confidence in the creditworthiness of the buyer.

Another method for financing open account sales is to obtain export credit insurance, and then obtain financing from your own bank. Depending upon the country in which the exporter is located, export insurance may be obtained that covers political risk, nonconvertability of currency, and even commercial risk. Where this method can be used it may be less expensive than factoring (Figure 12.1).

Documentary collections

Exporters may obtain a greater measure of assurance of payment, beyond that of open account, by ensuring that the importer cannot obtain the shipment until he/she agrees to pay by a certain time (**documents against acceptance D/A**), or until payment is actually

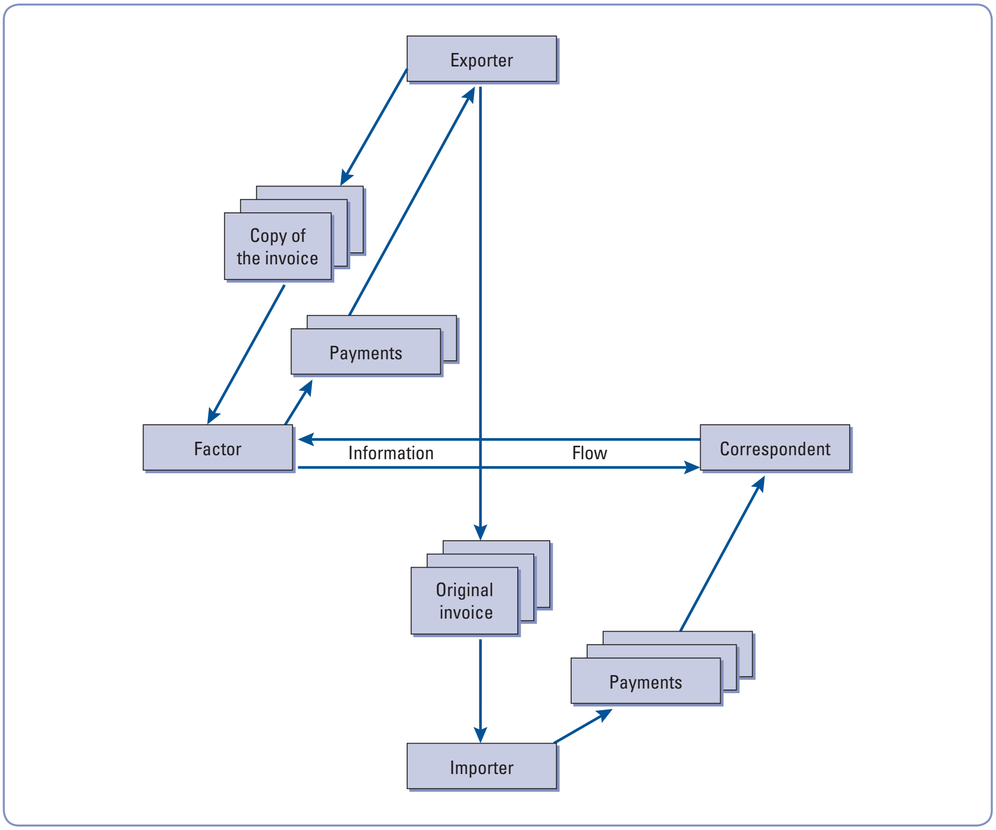

Figure 12.1 Exporter's use of factoring

made by the importer (documents against payment D/P). The exporter does this by sending the documents the importer needs in order to get the shipment to a third party, almost always a bank or collecting agency, along with a draft demanding payment. The bank is instructed to deliver the documents to the importer only when the payment conditions are met.

Drafts may be sent to the importer's bank for collection, without the bank itself having provided any guarantee of payment. A greater level of security for the exporter is provided if the importer has arranged a letter of credit providing the exporter's bank's guarantee of payment as discussed on page 736. For some cases the importer may be unwilling or unable to arrange for a letter of credit from his/her bank because of cost or other reasons.

Documents against acceptance

When a draft is drawn to be paid at a future date (i.e., it is not a *sight draft*), credit is extended to the importer (buyer) on the basis of his acceptance of the draft. (This is known as documents against payment, D/A, as noted on the previous page.) The bank or other party holding the documents the importer needs to obtain the merchandise from the shipping company is obligated not to release the documents until the importer 'accepts' the draft. The importer does this by writing 'Accepted' on the draft, signing it, and giving it back to the bank or other party holding the documents. The bank or other party then gives the documents to the importer, and the buyer thus is able to obtain the merchandise before paying. Once the importer 'accepts' the draft, he or she is obligated to pay the face value of the draft on the maturity date.

The specified time for payment may expressed as a certain number of days after sight (the first time the draft is presented to the importer's bank or other responsible party). This is known as a *time draft*. Alternately, the specified time may be expressed as a certain number of days after date (*date draft*), which means that the date on which the draft is drawn serves as the beginning day of tenor (i.e., length of time before payment is due) of the draft. Date drafts are generally preferred to time drafts because they indicate the exact date of maturity of the draft.

If a seller uses a draft not issued under a letter of credit, whether D/A or D/P he or she faces the risk that the buyer may fail to accept the draft. While this would leave the title of the goods with the seller, the goods would already be in a foreign country. Obtaining return or sale of the goods may be difficult and/or expensive. Legal action across international boundaries is also often difficult and/or expensive.

There is also a risk that the buyer will not or cannot honor (pay) the draft at maturity.

Collections by banks are now handled in accordance with the ICC (International Chamber of Commerce) Publication 52.

Documents against payment

Here the buyer (importer) must make payment for the face value of the draft before receiving the documents conveying title to the merchandise. This occurs when the buyer first sees the draft. Sometimes, with instructions from the drawer, the buyer may be given a certain limited period within which to make payment. In the meantime, the merchandise remains in the name of and in the hands of the bank or other responsible party. It should not be assumed, however, that the drawee must make immediate payment. It is the custom, in most foreign countries, for the drawee of the draft (importer) to make credit arrangements with his own bank, at point of destination, to advance the funds with which to pay the full face of the draft.

In some countries it is also customary that the drawee defers payment until the arrival of the goods.

In some countries also, no drafts are used in the case of sight transactions where payment is actually made upon delivery of the goods. Drafts are not really necessary when collections are made by the transportation company.

Export credit insurance

Export credit insurance is available to most exporters through governmental export credit agencies or through private insurers. Such insurance can usually be obtained to cover political risk and nonconvertability of currency. It may even be available to cover commercial risks associated with nonpayment by buyers. Export credit insurance is based on three basic principles (Ghose, 1993):

1. *Co-sharing of risks:* The insurers provide about 80–95% cover against commercial and political risks, leaving the rest to be borne by the exporters.
2. *Spread of risk:* Like any other insurance, export credit insurance is based on the law of averages so that risk is widely diversified. Hence, exporters are usually required to insure their entire export portfolios rather than only the riskier ones. This type of cover is known as 'whole turnover' or 'comprehensive' policies. However, the insurers may exclude particular buyers or countries, at their discretion. Spread of risk is also necessary to provide cover at a reasonable cost.
3. *Reduction of risk:* By keeping an ongoing and current credit rating portfolio of overseas buyers, credit risk can be substantially reduced. However, it is beyond the capacity of individual exporters or even financial institutions to achieve this objective effectively. On the other hand, export credit insurance agencies are in a far better position to gather and exchange updated credit information through the central 'clearing house' of the International Union of Credit and Investment Insurers (the **Berne Union**).

Exporters may be able to use credit insurance to enable them to grant more liberal credit terms or to encourage their banks to grant them financing against their export receivables. In fact, the principal advantage of this type of insurance is that it encourages exporters to diversify and extend competitive credit terms at minimal commercial and political risks.

The costs of such insurance are often quite low in many markets, ranging from one-half of 1% to less than 2% of the value of the transaction. Specialized insurance brokers handle such insurance.

There are some disadvantages associated with credit insurance. Exporters still have to assume part of the credit and political risks. Claims may take a long time to be settled. There are restrictions that are attached to coverage. For example, for medium- and long-term commitments ceilings are often put on total exposure in a particular importing country. Coverage can be suspended in specific situations such as the Gulf War and the Bosnian crisis.

Countertrade

Countertrade techniques are used as a means of financing exports in both the industrialized and developing countries of the world. Countertrade is a generic term used to describe a variety of trade agreements in which a seller provides a buyer with products (commodities, goods, services, technology) and agrees to a reciprocal purchasing obligation with the buyer in terms of an agreed-upon percentage (full or partial) of the original sales value. In short, what is involved are parallel business transactions that link a sales contract to a purchase contract in addition to, or in place of, financial settlements. This means that each party is both a buyer and a seller at the same time. Such techniques are appealing to buyers in countries that lack sufficient foreign hard currencies to pay directly for exports. But, as shown in Table 12.1, there are many other objectives that buyers may seek to achieve (other than conserve hard currencies) and there are objectives that sellers have in engaging in countertrade. Often such agreements are made by governments rather than private companies. For example, at the end of the year 2000, in an attempt to export rice through state-owned trading houses, the Indian government asked its embassies to find out if government-to-government exports were possible. It was ready to exchange rice for other commodities, preferably oil. Indonesia and the Philippines, two large Asian importers of rice, were obvious potential markets (Bose, 2000). In some situations governments may 'mandate' that

Table 12.1 Seller's and buyer's objective in international countertrade

Seller's objective	Buyer's objective
Increase profits	Generate goodwill
Capitalize on strong bargaining power	Acquire badly needed products and technology
Help countertrade partner conceal a price cut	Help conceal price cut
Signal a high quality product	Secure access to critical sources of supply
Increase sales volume and market share	Free blocked funds
Establish long-term relationships with new trading partners	Make purchases without deteriorating the balance of trade
Secure government contracts	Conserve hard currencies
Gain entry into new or difficult markets	Reduce heavy debt burdens
Fuller use of production capacity	Bypass trade restrictions
Generate customer goodwill	Establish long-term relationships with new trading partners
Dispose of surplus, obsolete, or perishable products	Circumvent an overvalued currency
Gain access to marketing networks and expertise	Secure low cost sources of production or raw materials
	Collection of existing debts

Source: Adapted from Paun and Albaum, 1993.

countertrade be part of a transaction or it may be 'voluntary' on the part of the contracting parties.

Some so-called voluntary countertrade, for example, is the result of a government creating conditions (such as restrictions on foreign exchange or on repatriation of funds) that stimulate firms to use countertrade. In contrast, other firms may voluntarily use countertrade for commercial reasons such as tax avoidance, developing relationships, disposing of excess inventory, and so forth.

A type of tradeoff not falling within the traditional definition of countertrade, but that can be of importance in international transactions, is one in which a price or other economic consideration is given for a non-economic advantage. The government of the Ukraine has received a 30% discount on the price of imports of natural gas from Russia in return for allowing Russia's Black Sea fleet to continue to use Ukraine's port of Sevastopol until 2047 (Olearchyk, 2010). Another example, told to one of the authors by a senior manager at a major Japanese airline, is an off-the-record statement by a government official of a European country that the airline's request for landing rights at a particular airport would be considered if the airline began to order aircraft from Airbus.

It is difficult to measure accurately the total of all types of countertrade in overall world trade, due to the lack of or inconsistencies in reporting systems. Estimates range from 5% to 40% upwards.

Exhibit 12.1 More on countertrade

It may well be that some countries or organizations using countertrade do not want to have their actions publicized because they believe it might imply a lack of traditional financing or other problems of the participants. In any case, here is some additional information about countertrade and some organizations involved. No endorsement is made or implied.

An entry on the subject in Wikipedia, dated 30 June 2010, did discuss an 'oil for wheat' deal between India and Iraq in 2000, but did not appear to have other references later than 1992. It indicated that more than 80 countries regularly use countertrade exchanges but did not list them. It provided estimates of countertrade as a percentage of world trade at from 5% to 30%. It also provided an official US statement that 'The US government generally views countertrade . . . as not in the interest of the US business community' but will not oppose US companies' participation 'unless it could have a negative impact on national security' (US Office of Management and Budget, December 1985) http://en.wikipedia.org/wiki/Counter-trade.

The homepage of the Global Offset and Countertrade Association indicates that it has, as members, over 100 globally based companies engaged in countertrade and offset activities. The organization sponsors semi-annual meetings in North America and Europe, often in cooperation with other professional organizations. This provides member companies with an opportunity to network (http://www.globaloffset.org/).

There is an Asia Pacific Countertrade Association Pte. Ltd. whose mailing address is Novena PO Box 200, Singapore 913019, Republic of Singapore.

The Web address http://www.barter.com belongs to an organization stating that it provides 'contacts, strategies & techniques.'

Pure barter

This involves a simple direct exchange in that the exporter agrees to accept products from the importer as payment for the original export transaction. For example, in 2002 Daimler-Chrysler joined General Motors and Toyota in accepting grain in payment for automobiles in Argentina. Problems in the banking system there made payment in cash very difficult for consumers, but grain collected could be sold by the automobile companies to farm-commodity exporter Louis Dreyfus Group at current market prices (*The Wall Street Journal*, 2002). In another case, PepsiCo had an agreement with the former Soviet Union to supply Pepsi-Cola syrup from its British subsidiary for bottling and sale in the USSR. For the syrup, for training and supervising Soviet workers, and for use of its trademarks, PepsiCo agreed to take Stolichnaya vodka as payment. In another transaction, General Motors agreed to supply the USSR with US$100 million worth of earth-moving equipment in exchange for timber.

Sometimes the barter process can become complicated. In the early 1990s SGD International, a US-based bartering company, supplied latex rubber to a Czech company in exchange for 10,000 yards of finished carpeting. SGD then traded the carpeting to a hotel for room credits. The rooms were then traded to a Japanese company for electronic equipment that was then bartered away for convention space. The 'cycle' ended when SGD traded the convention space for advertising space. Similarly, in the mid-1990s, the Paris-based Barter International Group (BIG) in France exchanged engines for advertising, then sent the engines to eastern Europe in return for cars, then exchanged the cars in Africa for cotton and sugar.

A number of so-called corporate barter companies operate throughout the world to assist companies that have no need for the product offered by potential buyers in a barter transaction. These companies buy the unwanted product (i.e., they take actual title to the goods), and in exchange provide such things as advertising media space and time, air travel, hotel rooms, sales meetings, air freight, car rentals, and similar services. Operating in this manner, corporate barter companies help manufacturers to sell goods and services in foreign markets, even when a country does not have the hard currency with which to pay for the goods or services.

Technology is finding its way into barter. Online barter through 400 regional exchanges on the Internet is already available in the United States. It would seem that a next logical step is to globalize such exchanges. At the very least such an international exchange could be used as a focal point for information about barter opportunities.

Clearing arrangements

This system of barter occurs where two countries agree to exchange a number of products, some generally not easily sold on the open market, during a specified time period. The parties agree on the quantities and values to be exchanged, and the final settlement date when any surpluses must be cleared up, either by accepting more goods or by paying a penalty. When the transactions are between governments, any balances are known as 'clearing accounts,' whereas when the transactions have been between organizations they are known as 'evidence accounts.' In 1974, Russia and Morocco negotiated an agreement in which Russia agreed to build a phosphate plant in return for long-term phosphate supplies. Tied to this agreement was a commitment by Morocco to import petroleum products, timber, and industrial equipment, in exchange for Russia taking citrus fruit.

Counter purchase

This approach involves two separate exchanges: (1) an exporter sells its products to an importer for cash or credit, and (2) the exporter agrees to purchase (with the cash or credit) and market products from the importer or other companies in the importer's country. Often the products 'purchased' are not related to the original exporter's product line. As an example, in the late 1970s Volkswagen agreed to buy coal, oil, and machines from East Germany in return for selling 10,000 automobiles.

A US producer of mine-safety equipment agreed to sell some units of a compact breathing apparatus to a Polish manufacturing and distributing firm in exchange for metal components that it could use in its US assembly operations (Reade, 1990). The Polish company obtained units for which it could not pay hard currency, and the US company obtained parts at a low cost while also penetrating a new market. In 1990 the US company's sales expanded rapidly as the Polish company began distributing the product to other eastern European and Third World countries.

Switch trading

Often, one party to a barter or counterpurchase arrangement has goods that the other does not want. If this is the case, then switch trading can be used, often with the help of a switch specialist. The original transaction can be completed and a firm will accept payment in the form of clearing currency units. These clearing currency units represent a bookkeeping unit that is universally accepted for the accounting of trade between countries and parties whose commercial relationship is based on bilateral agreements. When the unwanted goods are sold by the switch trader, the company with clearing currency units receives its hard currency payment. Or, it may be that the switch specialist buys the clearing units at a discount before reselling the goods. As an illustration of this system, consider the following hypothetical example.

A German firm agrees to trade machine tools worth €1 million to Brazil in exchange for coffee with an equivalent open market value. The equipment is shipped to São Paulo, and the coffee is ready for shipment to Hamburg. But the German firm does not really want the coffee. So, with the help of a switch specialist, the coffee is sold to a Canadian company for €925,000. The German company gets its hard currency, less a commission paid to the switch specialist. Since the German company would know in advance that the coffee would have to be sold at a discount, it could build this into its price for the equipment.

Buy-back

In the buy-back, or **compensation agreement**, a company agrees to supply technical knowledge to build a plant, or actually builds the plant or licenses the use of a trademark, in exchange for the production output of the plant. For example, Levi Strauss had such an agreement with Hungary; Levi's took part of the output of jeans produced in Hungary and exported them to western Europe. Another example of this type of countertrade is provided by three European companies that had jointly agreed to build two petrochemical plants in the former Soviet Union. Their payment was to be in petrochemicals that they would sell on the world market. In the late 1980s an Australian company undertook the rehabilitation of outdated coal washeries in Vietnam. Payment was made by Vietnam's National Coal Export–Import and Material Supply Corporation in anthracite coal.

Offsets

This involves an arrangement whereby the seller is required either to assist in or to arrange for the marketing of products produced by the buyer. When governments make large purchases from foreign companies they may insist that the purchase be offset in some way by the seller. The seller is expected to source some of the production locally, increase its imports from that country, and/or transfer technology. It is mainly used in defense-related and commercial aircraft sales. For example, McDonnell Douglas, subsequently acquired by Boeing, agreed to buy airframe components and other goods from Canadian companies in exchange for a US$2.4 billion commitment from Canada to buy fighter jet planes. In 2006, Boeing formed a joint venture with Russia's VSMPO-Avisma in which the Russian company will supply titanium products and engineering services to Boeing and it is expected that Aeroflot, Russia's national airline, will purchase over twenty 787s from Boeing (Kirchgaessner and Ostrovsky, 2006). In 2007, Airbus agreed that it would give design and production of some parts for the A350 to Russia's United Aircraft Corporation and Aeroflot would purchase 22 of the aircraft (Wiesmann, 2007).

Non-Western nations buying equipment from Western aerospace and defense companies are demanding more offsets as part of the purchase agreements. Some past offset agreements have failed to generate the job creation or other benefits expected. Because of this, more purchasers are requiring more specific commitments in agreements regarding job creation, technology transfers, or other benefits. The benefits that can be obtained in an offset agreement frequently determine whether or not an export sale can be made. They are thus of great importance but may also be very expensive so careful calculations must be made. Boeing currently has outstanding obligations, some lasting to 2024, of almost 11 billion dollars. The UK's BAE Systems has obligations in 17 countries amounting to several billion pounds (Pfeifer, 2010a).

A type of 'opaque offset' is one in which a government purchaser requires a supplier to actively assist in generating exports for the purchasing nation. A case study of the Czech Republic's government leasing 14 Gripen fighter jets from Sweden in return for the company agreeing to commit to actively assist in the generation of a specific amount of Czech exports was given in the *Financial Times* in 2010 (Pfeifer, 2010b).

Although some offset transactions are similar to counterpurchase, they are viewed as an offset because of the industry and parties involved. Moreover, offset transactions often involve the 'seller's' purchase of components from the 'buyer' to be used in producing the seller's product(s).

In addition to formal offset agreements connected to specific purchases, companies may enter into procurement arrangements designed to influence sales in a potential market. In an informal arrangement, Boeing has done some sourcing of components in Japan for a number of years. It has enjoyed an advantage there with both Japan Airlines, formerly partially owned by the Japanese government, and independent All Nippon Airlines purchasing almost all of their aircraft from Boeing. In a mix of formal

Exhibit 12.2 Two additional topics of interest

There are two additional topics in finance which are of interest to individuals involved in corporate finance, particularly those in multinationals that have direct investments overseas and/or earn a substantial percentage of their profits abroad. They may not be of direct interest to most people concerned primarily with financing of export shipments, but they should be aware of both. These are offshore financial centers and Sharia financing.

Offshore financial centers (OFCs) are typically small countries or semi-autonomous areas with their own tax jurisdictions. They provide advantages to foreign businesses in having low taxes, business-friendly regulations, and a stable political environment. A large corporation with its headquarters in one country (Country A: Canada, the Netherlands, the UK, the US, etc.), that earns money in another country (Country B), has to pay taxes on its earnings when it brings them into its home country (A). This will be true even if it intends to invest all or part of those funds in some third country. An attractive alternative may be to have a separate legal entity (subsidiary) and bank account in an OFC. It can then bring the earnings into the OFC without having to pay much (or any) income tax. Thus it can have the use of all of its transferred money without 'losing' some of it to home-country taxes until it brings the earnings into its home country. The higher the tax rate in the home country, the greater the incentive for companies to save profits abroad. (In 2004, the US government allowed a one-time reduction in corporate tax rate from 35% to 5% and American companies brought in almost $350 billion in profits from overseas [*The Economist*, 2007].)

Sharia financing is the use of financial instruments that comply with Islamic law. To receive approval as Sharia-compliant the instrument must not pay interest, and must not generate wealth from improper means such as alcohol, tobacco or gambling (*The Economist*, 2006).

and informal agreements, both Boeing and Airbus are expanding their procurement of components from overseas. The American company is outsourcing over 90% of its parts for the 787, primarily to companies in nations that are potentially major purchasers of its aircraft. In some of the agreements with companies in Japan, Italy, and elsewhere the supplying partners will bear some of the costs and risks of development and design work as well as doing manufacturing (Cameron, 2007; *Financial Times*, 2007). Airbus is increasing outsourcing with about 50% of the aero structure work to be done in low-cost regions. Airbus has a tougher problem in doing more outsourcing with Germany threatening to cancel defense contracts with its parent EADS if production problems are shifted out of Germany (Atkins, 2007) and France is also anxious to protect domestic jobs.

Concluding comment

Countertrade agreements are used for two general purposes. Barter contracts are used to avoid using money or to avoid setting a money price. Offset, buy-back, and counterpurchase agreements are used to impose reciprocal commitments.

Needless to say, barter/countertrade can become quite complex. The larger companies can often handle such transactions by establishing in-house organizational units for this purpose. The smaller, infrequent exporter will most likely find it more economically feasible to use independent barter/switch companies. Such firms act as agent intermediaries in much the same way as happens with regular exporting.

Summary

This chapter covered export financing and methods of payment. For the most part the discussion involved describing methods, instruments used, and alternatives available. Primary emphasis was placed on letters of credit (which do not involve exporter financing) and drafts or bills of exchange (which often involve exporter financing). These are summarized in Table 12.2. The chapter concluded with a brief discussion of the major techniques of international countertrade.

Table 12.2 Outline of payment procedures

I. Letter of credit
- A. Regular or ordinary letter of credit
    1. Revocable: transferable, nontransferable
    2. Irrevocable (Figure 12.2)
        - a confirmed transferable
        - b unconfirmed nontransferable
- B. Revolving letters of credit
    1. Revocable
        - a transferable
        - b nontransferable
    2. Irrevocable
        - a confirmed transferable
        - b unconfirmed nontransferable
    3. Cumulative, noncumulative

II. **Drafts (bills of exchange)**
- A. Payer of draft
    1. Bank draft, payable on presentation to the branch or correspondent of issuing bank (similar to a cashier's check)
    2. Letter-of-credit draft, drawn under the authority of issuing bank's letter of credit and so indicated on the face of the draft (Figure 12.3)
    3. Commercial draft (trade bill)
- B. **Documentary drafts**
    1. Documents against acceptance
        - a Time drafts, payable a specified time after sight
        - b Time drafts, payable a specified number of days after a date drawn (also called date drafts)
    2. Documents against payment
        - a Sight drafts, payment due on presentation
        - b Time drafts, payment due on a specific date
        - c. Clean drafts
    1. Sight drafts
    2. Time drafts

ABN♦AMRO

International Trade Services
200 W. Monroe Street, Suite 1100
Chicago, Illinois 60606-5002
(312) 904-8462 fax (312) 904-6303

L/C no. ____________________
(For Bank Use)

APPLICATION FOR IRREVOCABLE COMMERCIAL LETTER OF CREDIT

Subject to our Master Letter of Credit Agreement with yourselves, please issue an irrevocable Commercial Letter of Credit (L/C) substantially as set forth below, and
☐ send the original L/C directly to the Beneficiary
☐ send the L/C to the Advising Bank indicated or your chosen correspondent, as applicable (for delivery to the Beneficiary)
by ☐ airmail. ☐ courier. ☐ cable (SWIFT/telex/cablegram). ☐ other: ____________________.

Advising Bank (optional)	Applicant (name & address)
Beneficiary of L/C (name & address expected to appear on invoices)	Amount (U.S. dollars unless otherwise indicated) up to: plus or minus ____%
	Expiry Date of L/C (month in words, day, year) in the country of the Beneficiary unless otherwise indicated

Please make the L/C subject to the Uniform Customs and Practice for Documentary Credits (UCP) currently in effect.
Documents must be presented within ________ days after shipment (21 days if not otherwise specified) but, in any case, within the validity of the credit.
Draft(s) must be drawn at (specify "sight" or other tenor)____________________ for ______% (100% unless otherwise specified) of Commercial Invoice value drawn on you or (specify other drawee)____________________ and accompanied by the following documents:

☐ Original and ____ copy(ies) of Commercial Invoice covering (describe goods as in the Beneficiary's proforma invoice but only in generic terms, omitting details as to grade, quality, etc.): ____________________
☐ EXW (Ex Works, Ex Factory At) ____________________ (place)
☐ FCA (Free Carrier At) ____________________ (place)
☐ CPT (Carriage Paid To) ____________________ (place)
☐ CIP (Carriage & Insurance Paid To) ____________________ (place)
☐ FOB (Free On Board At) ____________________ (port of loading) (for port-to-port ocean shipments only; otherwise use FCA)
☐ CFR (Cost & Freight Paid To) ____________________ (port of discharge) (for port-to-port ocean shipments only; otherwise use CPT)
☐ CIF (Cost, Insurance & Freight Paid To)____________________ (port of discharge) (for port-to-port ocean shipments only; otherwise use CIP)
☐ Other terms____________________

☐ Marine Cargo Insurance Policy or Certificate (for CIP and CIF shipments) in negotiable form for at least ________% (110% unless otherwise specified) of Commercial Invoice value, endorsed in blank and covering the following risks:
☐ All risks warehouse-to-warehouse
☐ All risks warehouse-to-warehouse including war risks and strikes, riots and civil commotions
☐ Other (specify)____________________
☐ Copy of a cable or fax message addressed to the Applicant giving date and means of shipment and description and value of the goods shipped, bearing the Beneficiary's original signed certification that "This is a true and accurate copy of a message sent as addressed within two days of shipment of the described goods" (for insurance purposes on EXW, FCA, CPT, FOB, and CFR shipments).

☐ Full set of Multimodal Transport (Door-to-Door) Bills of Lading showing place of receipt as ____________________ and place of delivery or final destination as ____________________ consigned to the order of the shipper, endorsed in blank.
☐ Full set of Port-to-Port Bills of Lading showing port of loading as ____________________ and port of discharge as ____________________, consigned to order of shipper, endorsed in blank.
☐ Transshipment prohibited (only applies to Port-to-Port Bills of Lading).
☐ Original Shipper's Copy of Air Waybill, showing airport of departure as ____________________ and airport of destination as ____________________, consigned to ____________________.
☐ Beneficiary's certificate that "one extra set of documents is accompanying the air shipment" (not applicable to ocean shipments).
The above Bills of Lading, Air Waybill or other transport documents are to be marked and evidence:
Freight: ☐ Collect ☐ Prepaid Notify Party: ____________________
Partial shipments: ☐ Allowed ☐ Not allowed Shipment not later than: ____________________
☐ Forwarder's Cargo Receipt issued by ____________________ showing merchandise received no later than ____________________, consigned to or held at the disposal of the Applicant.

☐ Original and _____ copy(ies) of Packing List.

☐ Original and _____ copy(ies) of Certificate of Origin.

☐ Original and _____copy(ies) of ____________________.

SPECIAL CONDITIONS/INSTRUCTIONS
☐ Please make the L/C transferable in full or in parts by any bank.
☐ All bank charges other than those of the Issuing Bank are for the account of the Beneficiary. ☐ All bank charges are for the account of the Applicant.
☐ Discount charges, if any (applicable only to drafts other than "sight"), are for the account of the ☐ Beneficiary. ☐ Applicant.
☐ All documents are to be sent to you in one lot by ☐ Courier. ☐ Airmail.
☐ Other conditions/instructions: ____________________

____
Account Party name (if different from Applicant name above)

____
Authorized signature date phone number fax number

FORM NO: TF3263

Figure 12.2 Application for irrevocable letter of credit

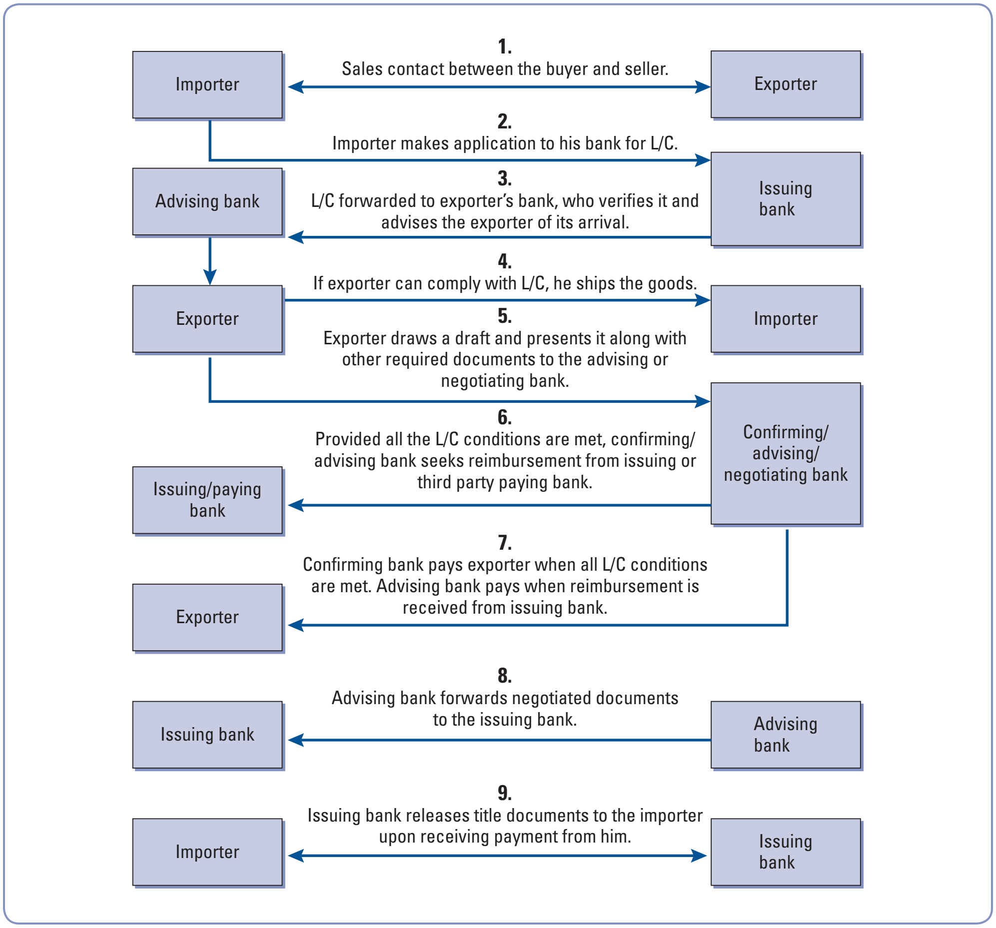

Figure 12.3 How a letter of credit operates

Source: Adapted from Seafirst Bank, 1988, p. 10.

While this chapter deals primarily with export financing for products and services, individuals can benefit from some advance knowledge about transferring and exchanging money in foreign countries, as illustrated in Exhibit 12.3.

Exhibit 12.3 Money transfer and exchange rates for individuals

The number of business people, students, and tourists traveling and living abroad is increasing every year. In their travel and temporary residence abroad, many individuals have encountered two problems. First, depending on the channel used, transferring small amounts of money can involve high percentage charges and may involve lengthy delays. A small check denominated in a foreign currency may cost more to negotiate through the bank than the value of the check itself. Government regulations may place restrictions on the transfer of funds. Second, depending upon the country and the channel used, the exchange rates on currency or travelers' checks may vary widely. The rates given by banks, money changers, and retail establishments are often quite different.

The spread of international retail banking with credit and ATM/debit cards has made it possible to avoid high costs on many exchange transactions, and has facilitated the transfer of funds. In most countries, credit cards are accepted in many establishments. Most major/well-known credit cards will use the bank exchange rate with a surcharge of 1% to 3% depending upon the issuing bank's policy. Local currency, for use in taxis, for tips, and at vendors that do not accept credit cards, can be obtained from ATM machines using a major ATM/debit card. The rates charged are usually the bank exchange rate plus a 3% surcharge, and perhaps an additional charge by the local bank whose machine you use. In any event, the total costs for the transaction will usually be lower than those offered by money changers. For individuals who will be spending some time in a foreign country, such as students and business people, it is often advantageous to open a local bank account. The cost of electronic transfers into and out of the account normally will be very low. Of course, local banking laws and regulations, as well as those of your own country, must be determined and followed.

Questions for discussion

12.1 Compare and contrast the seven methods of financing exports that are presented in this chapter.

12.2 Explain how factoring can enable an exporter to use open account when making payment arrangements with buyers. How does this differ from forfaiting?

12.3 What are the major differences between using letters of credit and bills of exchange (drafts) as a procedure for financing exports and receiving payment?

12.4 'An exporter gets the same protection from using a **bill of exchange** as from using a letter of credit.' Discuss.

12.5 Is there one best type of letter of credit? Explain.

12.6 When draft or bill-of-exchange methods are used, is it better to have the terms 'documents against acceptance' or 'documents against payment'? Defend your position.

12.7 'With export credit insurance the exporter can eliminate all risks of nonpayment by foreign buyers.' Discuss.

12.8 Compare and contrast the alternative techniques for countertrade. Is there one best form for a seller and one best form for a buyer? Explain.

12.9 To what extent are the objectives of sellers and buyers in countertrade transactions in conflict with each other and to what extent are they in harmony with each other?

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Further reading

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CASE STUDY 12.1

Tainan Glass Manufacturing Company

(This case study was written by Mitsuko Saito Duerr, San Francisco State University.)

The Tainan Glass Manufacturing Company of Taiwan (the name of the company is disguised) produces large glass sheets for windows, display cases, and industrial uses. It is one of two manufacturers in Taiwan.

Odd-sized pieces left over from cutting sheets to order are made into glass louvers for use in jalousies. Jalousies, which are windows or doors made of slats that can be rotated open to allow air to flow through or closed to keep wind and rain out, are very popular in a number of countries with hot climates.

Unless made into louvers, the odd-sized pieces are scrap of no value. In effect, this makes the raw material free, and the only additional cost of making the louvers is the cost of cutting to exact size and polishing the edges. When demand for louvers is exceptionally high, however, full-size sheets are sometimes cut into louvers. This requires the use of full-cost raw material as well as labor, and the sales prices of the louvers normally reflect total cost for glass as well as labor.

For a number of years Tainan's major customers for the louvered glass had been several importers in Nigeria. However, three years ago economic problems in that African country had made it impossible for importers to arrange for foreign exchange to pay for the glass imports, unless the importers had special arrangements with the Nigerian government. None of the glass importers had been successful in making such arrangements, so Tainan has had to suspend exports to Nigeria. Unfortunately, except for some small buyers in the state of Hawaii in the United States, no other potential customers appeared. Tainan continued to make the louvers from scrap, rather than waste the odd-sized pieces of glass. They accumulated a large inventory of glass louvers.

Recently Tainan received an order for 200 container loads of louvers from a trading company in Nigeria. (Tainan ships the glass in ocean-going 20-feet long containers. Use of larger containers is not economical since it is the weight of glass rather than its volume that determines how much can be put in a container. Even a 20-feet container cannot be filled to its volumetric capacity.) The order was so large that it would not only use up the inventory, but also require some production from full-sized sheets.

Prolonged negotiations ensued, with the Nigerian company indicating that they could not provide a letter of credit because of government regulations, and Tainan arguing that without an L/C they would be running too large a risk of not receiving payment in US dollars. Tainan was very anxious for the sale to be made because of their large inventory, but did not let the Nigerian company know this. Tainan's bargaining position improved when representatives from some other Nigerian trading companies arrived and offered to buy smaller amounts (two or three container loads) for cash, US dollars paid in advance in Taiwan. This led Tainan to believe that there was a strong demand for the louvers in Nigeria.

The large Nigerian customer finally agreed to provide an L/C drawn in US dollars on a Hong Kong bank. The buyers did require that the invoice be undervalued because they said the duty in Nigeria was very high. Since the Nigerian government required that an independent firm certify the value of the shipment, Tainan had to pay an additional fee to that firm in order that they would certify the value which the Nigerian importer wanted.

The letter of credit did not arrive until two days before the shipment was due to be made, but it did arrive, the sale was completed, and payment received.

Questions

1. Why did the Nigerian company arrange for payment from a Hong Kong bank rather than a Nigerian bank?
2. In what ways may the Nigerian company have obtained hard currency?

CASE STUDY 12.2

Arion Exports

Arion Exports, a South Korean company that specializes in producing automative replacement parts, had decided to enter the Canadian market. Raymond Lee, the general manager, turned his attention initially to specific arrangements for finance and shipment.

Arion's intention originally was to have the customers of its Canadian agent, the Peterson Trading Company, finance shipments by letters of credit. On the first order received from Peterson, the letter of credit was delayed. Lee had wanted to make prompt shipment to show the Peterson organization and its customers the fast service and deliveries they could expect from Arion. For this reason he did not wait for the technicalities involved with the letter-of-credit delay to be resolved but proceeded with the shipment, using a 'to order' bill of lading to retain title and control of the merchandise.

As matters turned out, the shipment arrived in Canada before the letter of credit was received in South Korea. When it did arrive, Arion presented it and shipping documents to the South Korean bank involved. The bank promptly made payments in won and airmailed the documents and clearances to its correspondent bank in Canada, where they were relayed to the customer.

Lee had quoted the lowest export prices possible on the order and had advised the Peterson Trading Company of its commission percentages as agent, and the terms of sale: letter of credit from the local customer. Since Lee had discovered that Peterson's customers would buy on a delivered-price basis, Arion had to give its new agent a fairly accurate basis for estimating CIF charges on each of the lines. On some of the early quotations following the first order, Peterson's CIF estimates were too low, and its customer's letter of credit did not cover all costs; Peterson's account was charged for the balance. Conversely, when the estimate from Peterson Company's account was too liberal for CIF charges, the difference was credited to its account. By trial and error, Peterson improved its CIF quotations and, after several shipments, they corresponded closely to the exact shipping charges.

After a series of orders had been received from the Peterson Company, the financial delays showed clearly that wholesalers in Canada were having considerable trouble getting letters of credit (Figures 12.4–12.6). The reason was

DATE: DECEMBER 15, 2003

ADVICE OF IRREVOCABLE DOCUMENTARY CREDIT

ISSUING BANK'S NUMBER: 3ALLH205788-0822
OUR REFERENCE NUMBER: XXXXXXX

SEND TO	ISSUING BANK
BANK OF AMERICA, TRADE FINANCE 800 FIFTH AVE. WA1-501-31-01 31 FLOOR SEATTLE, WA 98104	GOOD CORRESPONDENT BK 325 CHUNG HSIAO E. ROAD SEC 4, FL 3 FOREIGN CITY, FX COUNTRY
BENEFICIARY	**APPLICANT**
VALUED EXPORT INC ANY USA STREET ANYCITY USA 97290	GOOD IMPORTER CORPORATION 113 CHUNG SHAN N. RD., SEC.2 FOREIGN CITY, FX COUNTRY
	AMOUNT
	USD 15,400.00 FIFTEEN THOUSAND FOUR HUNDRED AND 00/100'S US DOLLARS
	EXPIRATION
	FEBRUARY 10, 2004 U.S.A.

AT THE REQUEST OF OUR CORRESPONDENT, WE HEREBY ADVISE THE FOLLOWING LETTER OF CREDIT DETAILS:

QUOTE:

```
:27  : SEQUENCE OF TOTAL
:    : 1/1
:    :
:40A: FORM OF DOCUMENTARY CREDIT
:    : IRREVOCABLE
:    :
:20  : DOCUMENTARY CREDIT NUMBER
:    :
:31C: DATE OF ISSUE
:    : 031215
: :
:31D: DATE AND PLACE OF EXPIRY
:    : 040210USA
:    :
:50  : APPLICANT
:    : GOOD IMPORTER CORPORATION
:    : 113, CHUNG SHAN N. RD., SEC.2
:    : FOREIGN CITY, FX COUNTRY
:    :
:59  : BENEFICIARY
```

Figure 12.4 Correspondent bank's notification of opening a letter of credit

Source: Bank of America, 2003.

```
                                                                  PAGE:  2
THIS IS AN INTEGRAL PART OF ADVICE NUMBER: XXXXXXX

:    : VALUED EXPORT INC
:    :  ANY USA STREET
:    :  ANYCITY USA 97290
:    :
:32B: CURRENCY CODE, AMOUNT
:    : USD15400,00
: :
:41D:  AVAILABLE WITH ... BY ...
:     : ANY BANK        IN USA
:     : BY NEGOTIATION
:     :
:42C : DRAFTS AT ...
:     : SIGHT
:     :
:42A : DRAWEE
 :     : TACBTWTP
:      :
:43P :  PARTIAL SHIPMENTS
:      :  ALLOWED
:      :
:43T  : TRANSHIPMENT
:       : PROHIBITED
:       :
:44A  : LOADING ON BOARD/DISPATCH/TAKING IN CHARGE AT/FROM ...
:       : U.S. PORT
:       :
:44B  : FOR TRANSPORTATION TO ...
:       : KAOHSIUNG
:       :
:44C  : LATEST DATE OF SHIPMENT
:       : 040131
:       :
:45A  : DESCRIPTION OF GOODS AND/OR SERVICES
:       : 110 MTS OF WASTE PAPER
:       : KRAFT MULTIWALL BAG WITH POLYETHYLENE POLY
:       : COATED AND/OR ASPHALT INTERLEAF CONTENT 20PCT
:       : MAX., OUTTHROWS INCLUDING WET STRENGTH
:       : PAPER 5PCT MAX.,MOISTURE 13PCT MAX, COATED
:        : BAGS/SHEETS/CUTTINGS 25PCT MAX.
:        : USD140.00/MT
:        : CFR KAOHSIUNG (INCLUDING DESTINATION T.H.C.)
:        :
:46A   : DOCUMENTS REQUIRED
:        : +MANUALLY SIGNED COMMERCIAL INVOICE IN SEXTUPLICATE
:         : INDICATING NUMBER OF THIS CREDIT.
:         :
:         : +FULL SET OF CLEAN ON BOARD OCEAN BILLS OF
:         : LADING MADE OUT TO THE ORDER OF SHIPPER BLANK ENDORSED,
:         : NOTIFYING APPLICANT WITH FULL ADDRESS
:         : AND MARKED " FREIGHT PREPAID"

:         : +PACKING LIST IN SEXTUPLICATE.
```

Figure 12.4 (*continued*)

PAGE: 3

THIS IS AN INTEGRAL PART OF ADVICE NUMBER: XXXXXXX

: : +BENEFICIARY'S CERTIFICATE STATING THAT
: : ONE COMPLETE SET OF NON-NEGOTIABLE DOCUMENTS
: : HAVE BEEN SENT DIRECTLY TO THE APPLICANT BY REGISTERED AIRMAIL
: : WITHIN 5 DAYS AFTER SHIPMENT.
: :
:47A: ADDITIONAL CONDITIONS
: : +ALL DOCUMENTS AND DRAFT(S) MUST BEAR THIS CREDIT NUMBER.
: : +DOCUMENTS PRESENTED FOR NEGOTIATION LATER THAN 21 DAYS AFTER
: : THE DATE OF SHIPMENT BUT WITHIN THE VALIDITY OF THIS CREDIT
: : ARE ACCEPTABLE.
: : +SHIPMENT EFFECTED PRIOR TO THE ISSUING DATE OF THIS CREDIT
: :
:71B : CHARGES
: : ALL BANKING CHARGES, INCLUDING
: : REIMBURSEMENT COMMISSION, OUTSIDE
: : FX COUNTRY ARE FOR BENEFICIARY'S A/C.
: :
:49 : CONFIRMATION INSTRUCTIONS
: : WITHOUT
: :
:78 : INSTRUCTIONS TO THE PAYING/ACCEPTING/NEGOTIATING BANK
: : +DOCUMENTS UNDER THIS CREDIT MUST BE SENT BY COURIER SERVICE
: : +A DISCREPANCY FEE OF USDXX SHOULD BE DEDUCTED FROM NEGO
: : AMT FOR EACH PRESENTATION IF DOCS DO NOT COMPLY WITH.
: : +UPON RECEIPT OF DOCUMENTS ALONG WITH DRAFT(S) STRICTLY
: : COMPLYING WITH TERMS OF THIS CREDIT WE WILL REMIT THE PROCEEDS
: : TO YOU AS INSTRUCTED.
: : +ONE FOLD OF NON-NEGOTIABLE B/L IS REQUIRED FOR OUR FILE.
: :

UNQUOTE

THIS CREDIT IS NOT CONFIRMED BY US AND THEREFORE CARRIES NO ENGAGEMENT ON OUR PART.

DRAFTS MUST BE DRAWN ON GOOD CORRESPONDENT BK TAIWAN COOPERATIVE BANK, FOREIGN CITY, FX COUNTRY

THIS LETTER OF CREDIT IS SUBJECT TO THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993 REVISION). INTERNATIONAL CHAMBER OF COMMERCE PUBLICATION NO. 500.

DRAFT (IF REQUIRED) TOGETHER WITH THE DOCUMENTS SHOULD BE PRESENTED TO BANK OF AMERICA, TRADE FINANCE, 800 FIFTH AVE. WA1-501-31-01, 31 FLOOR, SEATTLE,

Figure 12.4 (*continued*)

WA 98104

PAGE: 4

THIS IS AN INTEGRAL PART OF ADVICE NUMBER: XXXXXXX

DOCUMENTS RECEIVED AFTER 3:00 PM LOCAL TIME WILL BE CONSIDERED AS PRESENTED ON THE NEXT BANKING DAY.

THE ORIGINAL LETTER OF CREDIT (OPERATIVE CREDIT INSTRUMENT) MUST BE SUBMITTED WITH EACH PRESENTATION OF DOCUMENTS. ALSO, PLEASE PROVIDE ONE COPY OF EACH DOCUMENT FOR OUR FILES.

SHOULD PAYMENT BE EFFECTED BY WIRE TRANSFER OR CHECK, A USD 35.00 HANDLING FEE WILL BE DEDUCTED FROM PROCEEDS. THIS FEE DOES NOT APPLY WHEN YOU MAINTAIN AN ACCOUNT WITH US AND PAYMENT IS CREDITED TO THIS ACCOUNT.

PRESENTATION OF DOCUMENTS(S) THAT ARE NOT IN COMPLIANCE WITH THE APPLICABLE ANTIBOYCOTT, ANTI-TERRORISM, ANTI-MONEY LAUNDERING, AND SANCTIONS LAWS AND REGULATIONS IS NOT ACCEPTABLE. APPLICABLE LAWS VARY DEPENDING ON THE TRANSACTION AND MAY INCLUDE UNITED NATIONS, UNITED STATES AND/OR LOCAL LAWS.
SHOULD ANY OF THE TERMS OF THE CREDIT BE UNACCEPTABLE TO YOU, PLEASE CONTACT YOUR CUSTOMER SO THEY CAN INSTRUCT THE ISSUING BANK TO AMEND THE CREDIT.

IF YOU REQUIRE ANY ASSISTANCE OR HAVE ANY QUESTIONS REGARDING THIS TRANSACTION, PLEASE CALL 206-358-7411 .

AUTHORIZED SIGNATURE

Figure 12.4 (*continued*)

PAGE: 1

DATE: MARCH 10, 2004

IRREVOCABLE DOCUMENTARY CREDIT NUMBER: XXXXXX

BENEFICIARY
PACIFIC BENEFICIARY
2050 ANY STREET
ANYTOWN, CA 92507

APPLICANT
VALUED CUSTOMER
1278 GLORIOUS ST. NO.1200
SWEET TOWN, CA 92651

ISSUING BANK
BANK OF AMERICA, N.A.

AMOUNT
NOT EXCEEDING USD 49,541.10
NOT EXCEEDING FORTY NINE THOUSAND FIVE HUNDRED FORTY ONE AND 10/100 US DOLLARS

EXPIRATION
APRIL 5, 2004 AT OUR COUNTER

WE HEREBY ISSUE THIS IRREVOCABLE DOCUMENTARY CREDIT AVAILABLE WITH BANK OF AMERICA N.A. BY PAYMENT AGAINST PRESENTATION OF THE ORIGINAL OF THIS LETTER OF CREDIT AND YOUR DRAFTS AT SIGHT DRAWN ON BANK OF AMERICA, N.A., LOS ANGELES, CA FOR 100 PERCENT OF INVOICE VALUE, BEARING THE CLAUSE "DRAWN UNDER BANK OF AMERICA N.A., LETTER OF CREDIT NUMBER XXXXXXX", AND ACCOMPANIED BY THE DOCUMENTS DETAILED BELOW:

MERCHANDISE DESCRIPTION:

50,000 COMPUTERS PER PO NO. ABC, CFR LOS ANGELES PORT

DOCUMENTS REQUIRED:

+ ORIGINAL AND 2 COPIES OF COMMERCIAL INVOICE.

+ ORIGINAL AND 2 COPIES OF CERTIFICATE OF ORIGIN.

+ ORIGINAL CERTIFICATE OF INSPECTION DATED PRIOR TO SHIPMENT DATE, PURPORTEDLY SIGNED BY A REPRESENTATIVE OF TRUSTED THIRD PARTY INC, STATING THAT MERCHANDISE HAS BEEN INSPECTED AND IS ACCEPTABLE.

+ BENEFICIARY'S SIGNED STATEMENT CERTIFYING THAT ONE SET OF COPIES OF ALL DOCUMENTS HAS BEEN FAXED TO VALUED CUSTOMER AT FAX NO. 800-XXX-XXXX.

+ ORIGINAL AND 2 COPIES OF PACKING LIST.

+ FULL SET OF ORIGINAL OCEAN BILL OF LADING CONSIGNED TO THE ORDER OF SHIPPER, BLANK ENDORSED MARKED FREIGHT PREPAID NOTIFY VALUED CUSTOMER FORWARDERS AT ANY TOWN ANYWHERE, USA.

Figure 12.5 Opening bank's letter of credit notification

Source: Bank of America, 2004.

THIS IS AN INTEGRAL PART OF LETTER OF CREDIT NUMBER: XXXXXX

PARTIAL SHIPMENTS NOT ALLOWED

TRANSHIPMENTS ALLOWED

ADDITIONAL CONDITIONS:

INSURANCE TO BE EFFECTED BY THE APPLICANT.

THIS LETTER OF CREDIT IS TRANSFERABLE, TRANSFER OF THIS CREDIT IS SUBJECT TO THE PAYMENT OF OUR USUAL TRANSFER COMMISSION ACCOMPANIED BY BENEFICIARY'S INSTRUCTIONS SATISFACTORY TO US ON THE ATTACHED FORM.

AS A MATTER OF U. S. LAW, PLEASE BE AWARE THAT U. S. BANKS CANNOT PAY LETTERS OF CREDIT IN FAVOR OF OR TRANSFERRED TO PARTIES LOCATED IN, ANY COUNTRY SUBJECT TO THE FOREIGN ASSET CONTROL REGULATIONS OF THE U. S. DEPARTMENT OF THE TREASURY. NEITHER MAY ANY PARTY BE IN THE UNITED STATES AND SUBJECT TO A DENIAL OF EXPORT PRIVILEGES PURSUANT TO SANCTIONS ISSUED BY THE U. S. DEPARTMENT OF COMMERCE. WE ARE OBLIGATED TO CHECK THE NAME OF THE SECOND BENEFICIARY AT THE TIME WE RECEIVE BENEFICIARY'S REQUEST TO TRANSFER THIS CREDIT.

ALL BANK CHARGES, OTHER THAN THOSE OF THE ISSUING BANK, ARE FOR THE ACCOUNT OF THE BENEFICIARY.

DOCUMENTS TO BE PRESENTED AT PLACE OF EXPIRY WITHIN 15 DAYS AFTER SHIPMENT BUT WITHIN VALIDITY OF CREDIT.

DOCUMENTS MUST BE FORWARDED TO BANK OF AMERICA, N.A. 333 SOUTH BEAUDRY AVENUE 19TH FLOOR, CA9-703-19-13 LOS ANGELES, CA 90017 ATTN TRADE BANK SECTION IN ONE LOT BY COURIER.

THIS LETTER OF CREDIT IS SUBJECT TO THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993 REVISION), INTERNATIONAL CHAMBER OF COMMERCE PUBLICATION NO. 500.

AN ADDITIONAL HANDLING FEE OF USD XX.00 WILL BE DEDUCTED FROM PROCEEDS FOR EACH SET OF DOCUMENTS PRESENTED WITH DISCREPANCIES. IF DISCREPANT DOCUMENTS ARE PRESENTED TO US, AND IF THE APPLICANT WAIVES THE DISCREPANCIES AND WE ACCEPT THAT WAIVER, THEN, NOTWITHSTANDING OUR NOTICE OF REFUSAL TO THE PRESENTER AND NOTWITHSTANDING THE PROVISIONS UCP500 SUB-ARTICLE 14(D), WE RESERVE THE RIGHT TO RELEASE THE DOCUMENTS TO THE APPLICANT AND MAKE PAYMENT TO THE PRESENTER, WITHOUT FURTHER NOTICE TO THE PRESENTER, UNLESS, PRIOR TO OUR FINAL ACCEPTANCE OF THE WAIVER, WE RECEIVE CONTRARY INSTRUCTIONS BY AUTHENTICATED TELETRANSMISSION OR A SIGNED LETTER FROM THE PRESENTER. ANY SUCH RELEASE OF DOCUMENTS TO THE APPLICANT PRIOR TO OUR RECEIPT OF CONTRARY INSTRUCTIONS FROM THE PRESENTER SHALL NOT CONSTITUTE A FAILURE ON OUR PART TO HOLD THE DOCUMENTS AT THE PRESENTER'S DISPOSAL, AND WE WILL HAVE NO LIABILITY TO THE PRESENTER OR ANY OTHER PARTY IN RESPECT OF SUCH RELEASE.

SHOULD PAYMENT BE EFFECTED BY WIRE TRANSFER OR CHECK, A USD 45.00 HANDLING FEE WILL BE DEDUCTED FROM PROCEEDS. THIS FEE DOES NOT APPLY WHEN YOU MAINTAIN AN ACCOUNT WITH US AND PAYMENT IS CREDITED TO THIS ACCOUNT.

IF YOU REQUIRE ANY ASSISTANCE OR HAVE ANY QUESTIONS REGARDING THIS TRANSACTION, PLEASE CALL 213-345-6614.

Figure 12.5 (*continued*)

PAGE: 1

DATE: FEBRUARY 10, 2000

IRREVOCABLE STANDBY LETTER OF CREDIT NUMBER: XXXXXXX

BENEFICIARY
ANY TOWN FOREST SERVICE
14931 BROAD RIVER ROAD
ANY TOWN USA

APPLICANT
VALUED CUSTOMER, INC.
P.O. BOX 791230
35740 NEW ROAD, SUITE B25
ANY TOWN USA

AMOUNT
USD 46,000.00
FORTY SIX THOUSAND AND 00/100'S
US DOLLARS

EXPIRATION
APRIL 20, 2004 AT OUR COUNTERS

WE HEREBY ESTABLISH IN YOUR FAVOR OUR IRREVOCABLE STANDBY LETTER OF CREDIT NUMBER XXXXXXX WHICH IS AVAILABLE WITH BANK OF AMERICA, N.A. BY PAYMENT AGAINST PRESENTATION OF THE ORIGINAL OF THIS LETTER OF CREDIT AND YOUR DRAFTS AT SIGHT DRAWN ON BANK OF AMERICA, N.A., ACCOMPANIED BY THE DOCUMENTS DETAILED BELOW:

A WRITTEN STATEMENT FROM THE BENEFICIARY THAT FOOTHILLS FOREST PRODUCTS, INC. HAS FAILED TO COMPLY WITH THE TERMS OF CONTRACT NO ABCDEFG AND INDICATING THEY ARE DRAWING UNDER THIS LETTER OF CREDIT BY REFERENCING THIS LETTER OF CREDIT NUMBER XXXXXXX.

THIS LETTER OF CREDIT IS SUBJECT TO THE INTERNATIONAL STANDBY PRACTICES 1998, ICC PUBLICATION NO. 590.

IF YOU REQUIRE ANY ASSISTANCE OR HAVE ANY QUESTIONS REGARDING THIS TRANSACTION, PLEASE CALL 213-345-6632.

AUTHORIZED SIGNATURE

AUTHORIZED SIGNATURE

THIS DOCUMENT CONSISTS OF 1 PAGE(S).

Figure 12.6 Irrevocable standby letter of credit

Source: Bank of America, 2000.

that the importer had to make a full deposit of the amount with the local banks before they would open letters of credit. Since a period of about 90 days was required – after the credit was opened, and the order placed – before the goods were received in Canada, a severe strain was being placed on the working capital of the auto-parts importers.

In view of this, Lee believed that, if practical, other financial arrangements should be made to replace the particular letter-of-credit procedure being used (Figures 12.7–12.10). The delays in opening letters of credit might have to be accepted as a necessary evil – a condition of doing business in Canada. On the other hand, it might be possible to effect other terms of payment.

Questions

1. What other financial and payment methods might Arion use in exporting to the Canadian market?
2. Which one of these would you suggest be used by Arion? Explain.
3. Should Mr Lee necessarily drop using the letter-of-credit procedure? Why or why not?

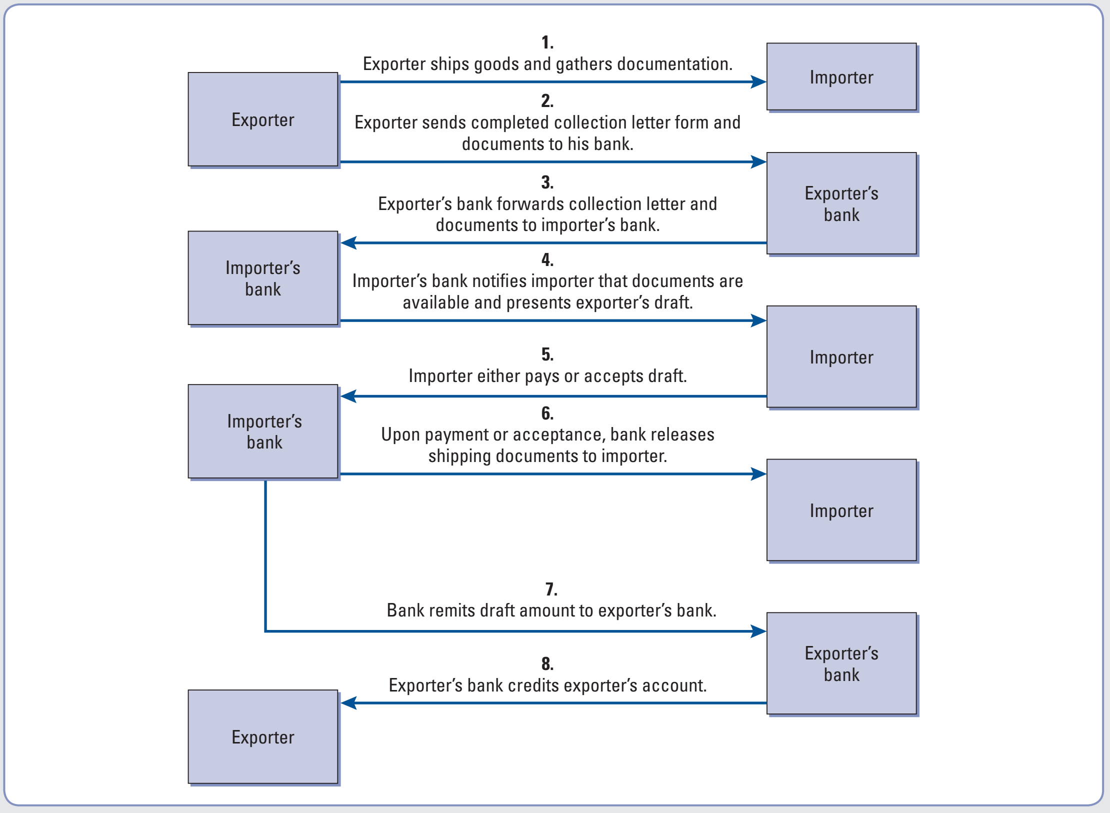


Figure 12.7 The process of foreign collections

Bank of America
National Trust and Savings Association

International Collection; Instructions and Receipt (Must be completed by customer)

TO: Trade Operations Center
Collections Department #4992
333 S. Beaudry Avenue
Los Angeles, CA 90017

DATE: March 4, XXXX

WE ENCLOSE THE DESCRIBED ITEM(S) FOR COLLECTION *(Check boxes where appropriate)*:

DRAFT/CHECK NUMBER: 1250

DRAWN ON:
East Africa Suppliers, Ltd
P.O. Box 60032
Nairobi, Kenya

TENOR: Sight
AMOUNT: USD $7,600.00

- PAYABLE AT SIGHT
- PAYABLE ON — DATE
- OTHER

INSTRUCT YOUR COLLECTING BANK TO

ADVISE NONACCEPTANCE AND/OR NONPAYMENT BY	ADVISE PAYMENT BY	REMIT FUNDS BY
X CABLE	X CABLE	X CABLE TRANSFER
AIRMAIL	AIRMAIL	AIRMAIL

DISPOSITION OF FUNDS

- CREDIT OUR (MY) COMMERCIAL ACCOUNT AT — OFFICE
- CHECKING — SAVINGS — ACCOUNT NUMBER
- X MAIL YOUR CHECK TO US (ME)
- OTHER

FURTHER INSTRUCTIONS

- X FORWARD TO YOUR CORRESPONDENT
- FORWARD TO
- X DELIVER DOCUMENTS AGAINST PAYMENT
- DELIVER DOCUMENTS AGAINST ACCEPTANCE
- X DO NOT PROTEST
- PROTEST FOR
  - NONPAYMENT
  - NONACCEPTANCE
- COLLECT INTEREST FROM DRAWEE(S) AT % P.A.
- TERMS
- X YOUR CORRESPONDENT'S CHARGES ARE TO BE PAID BY DRAWEE(S)
- X YOUR CHARGES ARE TO BE PAID BY DRAWEE(S)
- ALL CHARGES ARE TO BE PAID BY US
- X WAIVE ALL CHARGES IF REFUSED BY THE DRAWEE(S) AND CHARGE THEM TO US
- DO NOT WAIVE CHARGES
- IF NECESSARY CONTACT

SPECIAL INSTRUCTIONS

SPECIMEN

DOCUMENT	BILL OF LADING	INSURANCE	CONSULAR INVOICE	CERTIFICATE OF ORIGIN	INVOICE	INSPECTION CERTIFICATE	QUALITY CERTIFICATE	WEIGHT CERTIFICATE	SANITARY CERTIFICATE	PARCEL POST	OTHER DOCUMENTS
ORIGINALS	3/3	3			4						Draft – 1
DUPLICATES											

COVERING SHIPMENT OF: Agricultural Tools — VIA: S.S. Eventide — B/L NO. 3767

If required by exchange regulations, release documents against provisional payment in local currency and drawee's written undertaking to remain responsible for any exchange fluctuation. Surrender draft when dollar remittance effected.
If immediate credit has been given for the drafts described hereon, it is understood that such credit is conditional and is subject to collection and receipt by you of the requisite number of dollars, in the absence of such receipt and collection by you, the undersigned will, upon your demand, reimburse you for the amount so advanced plus the agreed rate of interest for the time outstanding.
If the collection is returned unpaid, documents are to be returned by regular mail to the address below.
In receiving items for collection, the Bank acts only as depositor's collection agent and assumes no responsibility beyond the exercise of due care. All items are credited subject to final payment in cash or solvent credits. This Bank will not be liable for default or negligence of its duly selected correspondents nor for losses in transit, and each correspondent so selected shall not be liable except for its own negligence. This Bank or its correspondents may send items directly or indirectly to any Bank, including the payor, and accept its draft or credit as conditional payment in lieu of cash; it may charge back any item at any time before final payment, whether returned or not, also any item drawn on this Bank not good at close of business on day deposited. Unless otherwise specified, this collection is subject to the Uniform Rules for the Collection of Commercial Paper, International Chamber of Commerce, Brochure Number 322.
I (we) agree to pay for all out of pocket charges for phone and/or cable tracers requested by me (us). I (we) also agree to wait at least thirty days from today before requesting you to trace.

BANK USE ONLY		
TO BRANCH SUPPORT CENTER NO.	COLLECTION REFERENCE NUMBER	
TELLER'S INITIALS	BRANCH NAME	NUMBER
AUTHORIZED OFFICER'S SIGNATURE		
OFFICER'S NAME *(Printed or Typed)*	PHONE NUMBER	

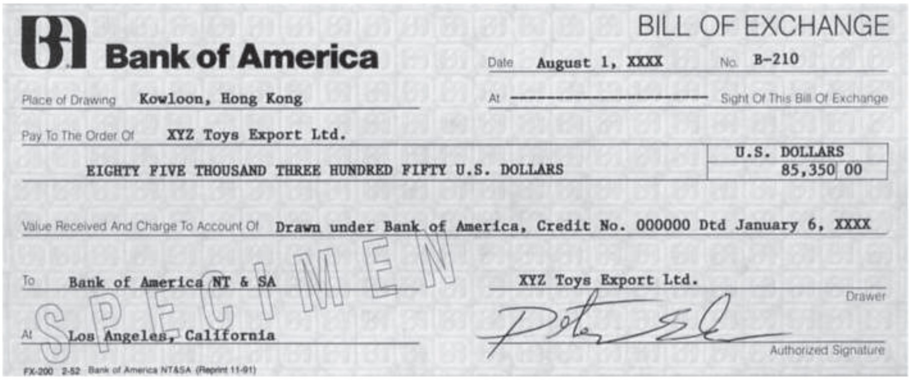
CUSTOMER'S SIGNATURE: David Michaels
CUSTOMER'S NAME *(Printed or Typed)*: Transglobe Mfg. Company Inc.
STREET ADDRESS: 333 Van Ness Avenue
CITY, STATE, AND ZIP CODE: San Francisco, CA 94127

C-162 10-87 (Reprint 5-88)

ORIGINAL

Figure 12.8 International collection instructions and receipt

Source: Bank of America, 1994, p. 34.



Bank of America

BILL OF EXCHANGE

Date August 1, XXXX No. B-210

Place of Drawing Kowloon, Hong Kong

At ---------------------- Sight Of This Bill Of Exchange

Pay To The Order Of XYZ Toys Export Ltd.

U.S. DOLLARS 85,350 00

EIGHTY FIVE THOUSAND THREE HUNDRED FIFTY U.S. DOLLARS

Value Received And Charge To Account Of Drawn under Bank of America, Credit No. 000000 Dtd January 6, XXXX

To Bank of America NT & SA

At Los Angeles, California

XYZ Toys Export Ltd.

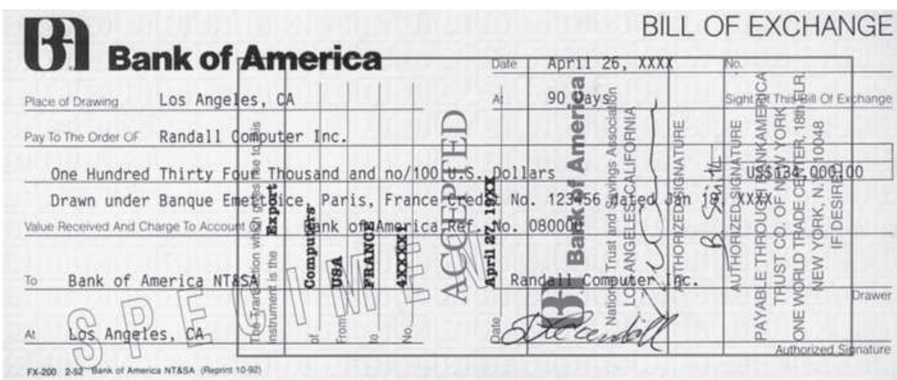
Drawer

Authorized Signature

SPECIMEN

FX-200 2-52 Bank of America NT&SA (Reprint 11-91)

(a) Sight draft



Bank of America

BILL OF EXCHANGE

Date April 26, XXXX No.

Place of Drawing Los Angeles, CA

At 90 Days Sight Of This Bill Of Exchange

Pay To The Order Of Randall Computer Inc.

One Hundred Thirty Four Thousand and no/100 U.S. Dollars US$134,000.00

Drawn under Banque Emettrice, Paris, France Credit No. 123456 dated Jan 18, XXXX

Value Received And Charge To Account Of Bank of America Ref. No. 080000

To Bank of America NT&SA

At Los Angeles, CA

Randall Computer Inc.

Drawer

Authorized Signature

ACCEPTED

April 27, 19XX

Bank of America

National Trust and Savings Association

LOS ANGELES, CALIFORNIA

AUTHORIZED SIGNATURE

PAYABLE THROUGH BANKAMERICA TRUST CO. OF NEW YORK

ONE WORLD TRADE CENTER, 18th FLR

NEW YORK, N.Y. 10048

IF DESIRED

The Transaction which gives rise to this instrument is the Export of Computers from USA to FRANCE No. 4XXXXX

SPECIMEN

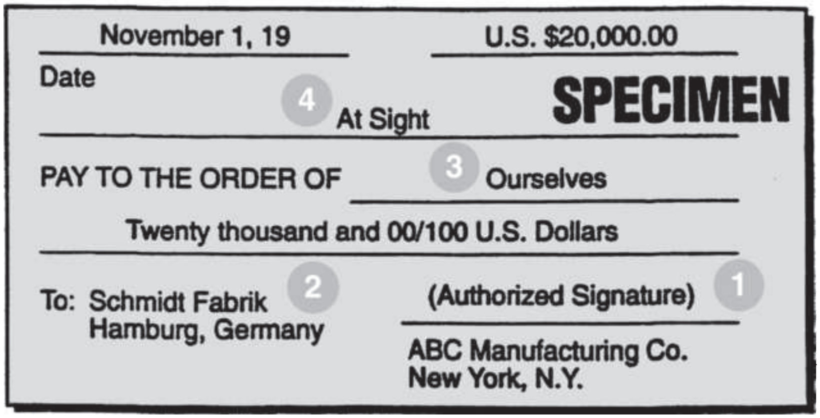
FX-200 2-52 Bank of America NT&SA (Reprint 10-92)

(b) Time draft accepted for payment (becomes a banker's acceptance)

Figure 12.9 Drafts drawn under letter of credit

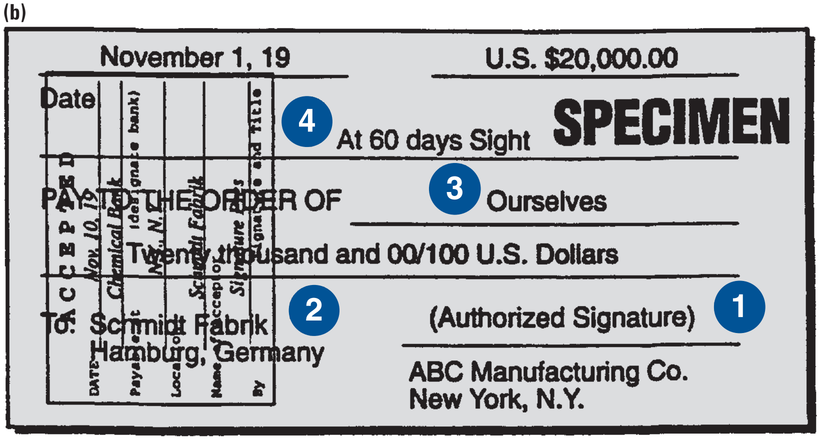
Source: Bank of America, 1994, p. 24.

(a)



1 Seller/Drawer Principal
2 Buyer/Drawee
3 Payee
4 Tenor

(b)



1 Seller/Drawer Principal
2 Buyer/Drawee
3 Payee
4 Tenor

Figure 12.10 Sight and time drafts. (a) Sight draft. (b) Time draft accepted for payment (becomes a trade acceptance)

Source: Chemical Bank, 1987, p. 48.

CHAPTER 13

Promotion and marketing communication

Learning outcomes

In Chapter 13, we discuss:

- export marketing promotion and communications decisions
- alternative methods of promotion:
  - personal selling
  - the many types of sales promotion
  - publicity
  - the many types of advertising
- developing promotional programs and strategies
- standardization or adaptation of marketing communication
- advertising transference and management issues

There are four cases at the end of the chapter. In Case 13.1, Christa Clothing International already markets in North America and Europe, and is considering entering Asian markets. In Case 13.2, Hong Kong manufacturer Nove Ltd is adding a new line of dry shavers and has done research with the objective of developing effective advertising programs and pricing. Case 13.3, Eli's Cheesecake Company, discusses marketing and sales organization, product promotion, and use of the Internet and World Wide Web. Case 13.4, Kraft Foods, discusses the strategy of targeting a small number of brands in the product line for disproportionate use of resources in advertising and promotion and R&D.

Introduction

Communication is a major part of international marketing activities. It is not enough to produce and make available a product or service; it is also necessary to provide information that buyers can use in their purchasing decisions. International marketing communication is cross-cultural communication; that is, communication between a person or persons in one culture and a person or persons in another culture. In addition it is possible that, insofar as cultural differences occur within a single nation, advertising within that nation might also be cross-cultural in varying degrees. For example, many major languages are spoken in India, and, since language is an important part of the culture, cross-cultural communication can occur within the political boundaries of a single nation.

It is also possible for certain segments of markets in different nations to be culturally similar. Thus certain similar socio-economic market segments in Europe might have very similar personal characteristics and habits that might permit an advertiser to regard them as essentially a homogeneous market. For example, youthful motorcyclists in a number of different European cultures may be influenced to purchase motorcycle accessories by essentially identical advertising appeals, copy, illustrations, and layout. Or, farmers in several European countries, who use tractors for the same purposes and under the same conditions, may be influenced by nearly identical advertisements.

The nature of the communication task and some of the potential problems facing promotion by export marketers are illustrated in Figure 13.1. Although we will discuss these barriers in varying degrees throughout this chapter, some comments are in order at this point.

These barriers (problems) may interact with each other as well as have independent effects. For example, there are some countries where government regulations prohibit the use of a foreign language in promotion activities. There may be exceptions. For instance, in Germany an advertisement can be run in English for a raincoat made in the United Kingdom, but not for one made in Germany. Other regulations may affect production of promotional materials. International Playtex, Inc. moved to an approach of global advertising (discussed later in this chapter) in order to sell its Wow bra in 12 countries. The single advertisement was developed in one of the markets, Australia, because of a regulation that no imported film could be used there except when a full Australian crew has taken part in the production: in short, at the time Australian television would only run commercials produced there. Similarly, in the United Kingdom a national crew had to be present at a filming (and be paid), but was not required to do the filming. Other regulations may affect the type of promotion that can be done. In South Korea, for example, comparing two different products in advertising is illegal. In addition, an increasing number of countries are prohibiting the promotion of tobacco products at sporting events. In India provisions of the Cable and Television Networks Act state that no advertisement will be allowed which derides any race, caste, color, creed, and nationality. Moreover, women cannot be portrayed in a manner that emphasizes passive, submissive qualities and encourages them to play a subordinate, secondary role in the family and society. In the United Kingdom, the government regulators of television advertising in 2006 banned the use of the word 'bloody' in the Tourism Australia campaign using the slogan-where the bloody hell are you? China, in 2006, instituted a ban on sending e-mail for advertising purposes to people without their permission, and all advertising e-mail must be titled 'advertising' or 'AD.'

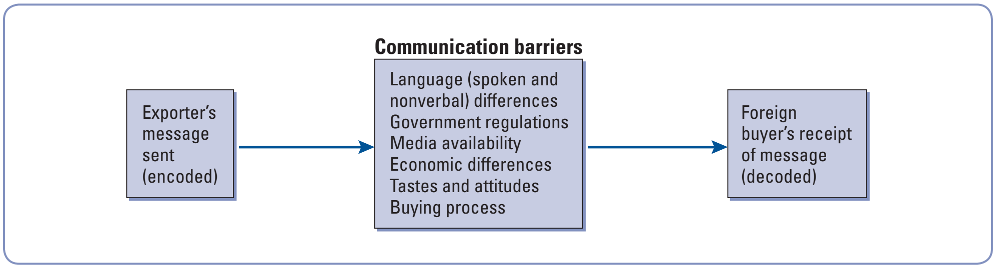


Figure 13.1 Some barriers to export marketing promotion

The nature and theme of the advertisement itself may be subject to government scrutiny. So-called 'attack ads' (or comparative advertising) in which a company 'attacks' a competitor's product or the company itself are banned in some countries in Europe and Asia. In some of these ads a competitor is not named, but the wording is such that a knowledgeable consumer/buyer knows what company is being singled out. Attack ads are part of the broader advertising practice of comparative advertising. As worldwide competition gets stronger, an increased use of comparative advertising, where it is legal, will emerge. Use of comparative advertising has been regulated by national governments and by regional groups such as the European Union. For example, the European Union allows indirect comparisons that do not name competitors, and also allows direct comparisons between named products, but under tight controls (Nye *et al*., 2008, p. 851). Increasingly, national and regional regulations are being bypassed with the use of international media. In a study conducted in three countries – France, United States, and the Netherlands – the researchers argued that the effectiveness of comparison advertising varies with consumers' experience with this approach, and depends in large measure on both the market position of the brand being advertised and the type of comparison information contained in the ad (Nye *et al*., 2008). Results were such that comparative advertising can be effective for brands that are established in the marketplace. However, when introducing new brands, comparative advertising is not a particularly effective strategy.

Other regulatory barriers relate to market segments. For example, there has been concern about advertising aimed at children, particularly in Europe. In the United Kingdom, in contrast, there has been self-regulation within the advertising community. The British Independent Television Commission states that ads targeting children must not take advantage of their natural credulity, lead them to believe they will be inferior if they do not have the advertised product, harm children, or force them to pester their parents. In some countries there has been a ban on advertising directly to children less than 12 years of age. In other countries, any advertising that may harm children's and juveniles' physical, moral, or intellectual development is not allowed.

Promotion and communication by exporters and other international marketers is tied intimately to consumer and buyer behavior. But not all cultures will necessarily respond to marketing promotion in the same way, following the same sequence with respect to hierarchy of effects in the dimensions of attitude and behavior – cognitive (*learn*), affective (*feel*), connative (*do*). Four basic sequences by which advertising influences consumers are shown as follows:

Hierarchy	**Sequence**
Traditional learning	Learn – Feel – Do
Low involvement	Learn – Do – Feel
Dissonance attribution	Do – Feel – Learn
Dependency	Feel – Do – Learn

For the most part, the first three seem to be characteristic of western cultures. The *feel – do – learn* sequence appears to be appropriate for Japan and other Asian countries. This might explain, for example, why successful Japanese advertising campaigns are usually based on 'subtle sell' and not 'hard sell.' A recent study of Japanese and United States consumers indicates that in both countries soft-sell appeals are accepted as are hard-sell appeals (Okazaki *et al*., 2010). The study concludes that both types of appeals have the potential to be used as part of a global consumer cultural positioning strategy in the two countries, and perhaps in other countries.

Export marketing promotion and communication decisions

The promotion decisions faced by export marketing management can be reduced to the following:

- What messages?
- What communications media?
- How much effort or money to spend?

These decision areas are interrelated. Export marketing promotion takes various forms:

- *Personal selling:* sales people are used to communicate primarily face-to-face with prospective customers.
- *Advertising:* a nonpersonal presentation of sales messages through various 'mass' media, paid for by the advertiser.
- *Sales promotion:* all sales activities, which supplement and strengthen personal selling and advertising. Activities usually are nonrecurrent and have a relatively short-run 'life.'
- *Publicity:* any kind of news about a company or its products that is reported by some media, and is not paid for by the company.

Even though the discussion is presented in the context of export marketing, the general principles, concepts, and practices apply to other international market entry modes (such as strategic alliance or direct foreign investment operations), as appropriate.

Although much of the discussion in this chapter, and many of the examples given, will refer directly to advertising, the reader is cautioned to keep in mind two points: (1) general principles are applicable to all communication activities, including personal selling by an exporter's salesperson or the marketing intermediary in the export channel, and (2) advertising is viewed as only one of several components in the broader communication or promotional mix. There are many alternatives to straightforward advertising, including many marketing and communication services, some of which are called 'below-the-line' advertising (*The Economist*, 2004, p. 69). These include public relations, direct mail, consumer promotions (such as coupons), in-store displays, business-to-business promotions (e.g., paying a retailer for shelf space), telemarketing, sponsoring events such as the World Cup (Coca-Cola, Yahoo!, McDonald's), product placements, and exhibitions such as the Chinese Export Commodities Fair for sourcing from China, which is held in Guangzhou twice a year (www.cecf.gz.com), the Paris Intersélection trade fair for women's and men's clothing and accessories (tpwebapp.tdctrade.com), and the Hong Kong Electronics Fair (tpwebapp.tdctrade.com) and more. Many exhibitions and trade fairs are held in Hong Kong each year for electronics, gifts, housewares, and toys.

We must also keep in mind that, in a broad sense, the question of what mix of promotion activities to employ is the question of whether to emphasize a 'push' or a 'pull' strategy. A *pull* strategy is defined as preselling the product so that buyers seek it out or ask for it at the point of purchase. A *push* strategy is defined as working with resellers or assisting them in selling the product at the point of sale; when a push strategy is required, buyers are not presold and they depend on the advice or guidance of the salesperson.

In the extreme case of a pull strategy a buyer would be firmly presold on a product before he or she reaches the place of purchase. In the extreme case of a push strategy a buyer would have no previous knowledge of a product and would make up his or her mind entirely at the point of sale. Obviously, most situations fall somewhere between these two extremes. Where an exporter finds itself with regard to emphasizing push or pull will affect the relative importance and desirability of the several methods of communicating marketing information to the target market.

The export/international marketer needs to have guidelines for selecting which promotion activities to use and in which combinations. There are a number of factors that will influence the decision regarding the mix of promotion activities. These include the availability of funds for promotion, the cost of promotion activities, how much and how intense the competition to be faced, the type of product involved and its seasonality, the product's price, mode of market entry, the nature of the market, the size of the market, sizes of relevant segments, company resources other than funds that are available, and availability of various media.

Export marketing promotion as communication

Earlier in this chapter export marketing promotion was discussed in the context of communication wherein the exporter sends messages to the target market to *inform* prospective buyers (including intermediaries) about a product, to *persuade* people to become buyers, to develop *positive attitudes*, and to cause other *changes* in people's thinking and behavior that will be beneficial to the exporter. As suggested by Figure 13.1, there are obstacles to effective promotion and these can be formidable when attempting to communicate with people in foreign countries whose values, attitudes, and behavior patterns have been developed from different cultural backgrounds.

Communication problems are not limited to promotion that is *verbal* (spoken or written) in nature. *Nonverbal* communication problems can also arise. As we mentioned in Chapter 3, nonverbal communication exists in many forms; some kinds supplement verbal communication while others are used when verbal communication is not possible (see Table 13.1 and Figure 13.2 which illustrates 5 ways to say *no* in different cultures). Any one of these forms of nonverbal communication may lead to different interpretations and responses in different cultures (Gesteland, 2002, Ch. 7). This results in different messages being received. For example, sloppy attire (appearance) may be more offensive in some countries

Table 13.1 Nonverbal communication

Appearance:	includes physical attire and grooming
Chronemics:	the timing of verbal exchanges
Haptics:	the use of touch while conversing
Kinesics:	the movement of part of the body to communicate
Oculesics:	the use (or avoidance) of eye contact
Olfaction:	the action of smelling
Orientation:	the angles at which people position themselves in relation to each other
Paralinguistics:	the nonverbal aspects of speech (such as accents)
Posture:	the many bodily positions of standing, sitting, lying, and so on
Proxemics:	the use of space in communication

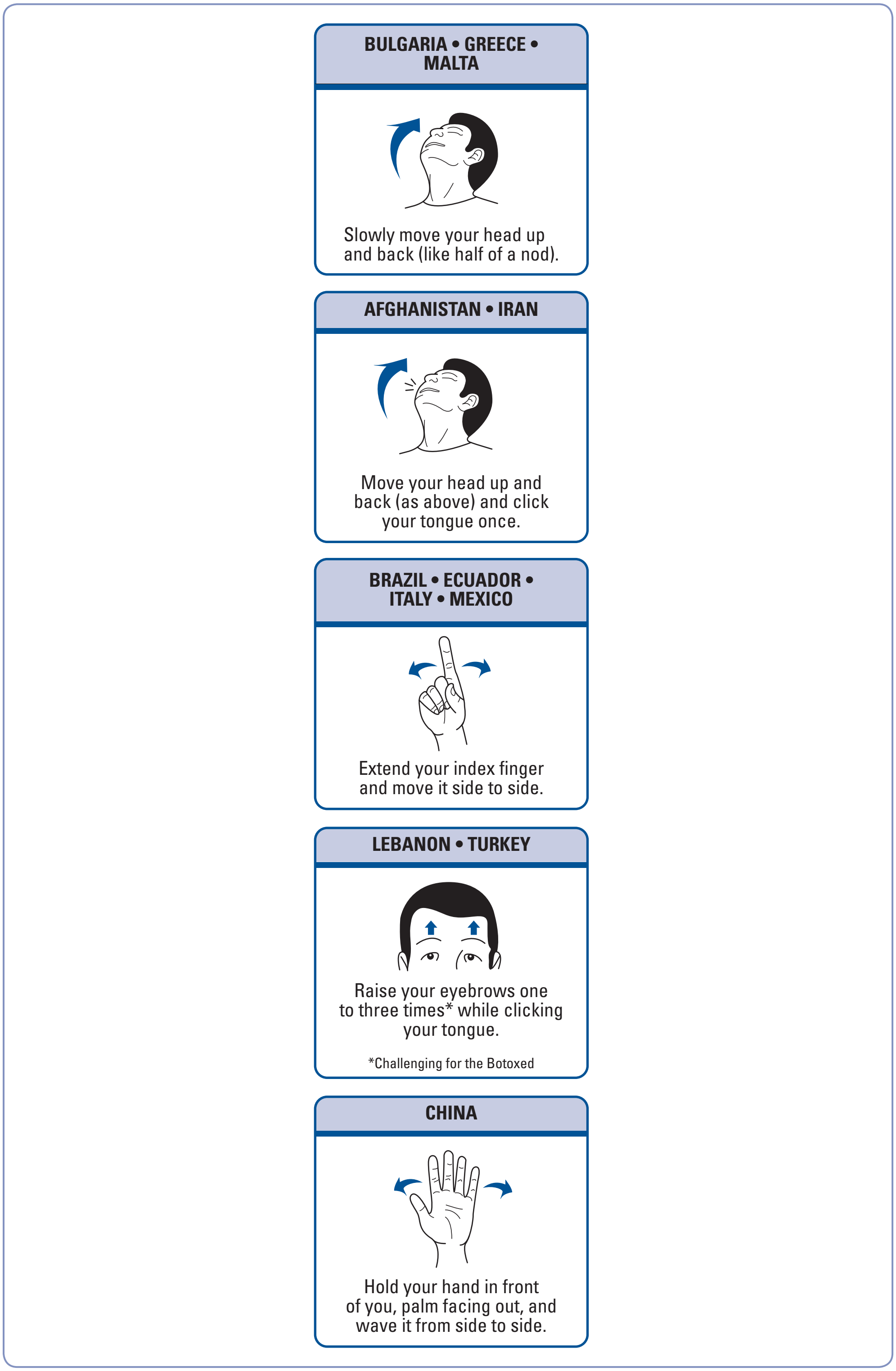


Figure 13.2 From Body language basics, *Budget Travel*, May, p. 28 (Berger, T., Lee, J. 2010), Courtesy of Budget Travel

than in others. French and Italian people use their hands (kinesics) more than Americans do. South Americans and Greeks feel more comfortable when standing or sitting closer to others (proxemics) than do people from other cultures and nationalities.

In export marketing and promotion the communicator must learn about the audience, define the market as precisely as possible, and study background and motivational influences before beginning preparation of a promotion strategy and campaign. There are many who believe that the appeals, illustrations, and other features of advertising and other forms of promotion need not be changed from market to market. They have observed that, in many respects, consumers in diverse markets are similar and that human nature is basically the same in most societies. People everywhere require satisfaction of physiological and psychological needs. These people favor standardization of advertising programs. Standardization and adaptation are discussed later in this chapter.

However, it can be argued that a communicator should rightly take cognizance of the differences between consumers in his or her own country and those in other countries. They not only may speak another language, but they adhere to other religions, philosophies, and traditions; they differ with regard to family patterns, childhood training, and the role of members in the family. The occupational hierarchy varies among nations; climate and geography and other aspects of consumers' physical environment are diverse; consumers engage in a wide variety of sports, hobbies, and other forms of amusement and entertainment. These environmental differences play an important part in shaping the demand for specific types of goods and services and in determining which promotional appeals are best. Consequently, adaptation or individualization of advertising programs may be needed.

Another barrier to communication is social or class structure. In societies where social status attitudes are quite rigid, a salesperson from the middle class is usually not effective if the job requires selling to upper-class factory owners, since he will not know how to behave in the new social environment.

One conclusion that can be drawn from this discussion is that appeals, illustrations, and other advertising and promotion features often must differ from market to market. We discuss this issue later in the chapter in the context of standardization versus adaptation (the globalization) of export marketing promotion.

Another aspect of communication/promotion concerns the use of foreign settings, actors/characters, and written language in advertising in specific markets. The extent to which foreign elements are used varies across countries. In Japan, they find widespread use. In contrast, relatively few foreign elements are present in US advertising while their use in South Korea seems to be associated with features of the country's history, culture, and economic development (Taylor and Miracle, 1996). The feasibility of using foreign elements in advertising in a country has direct implications for standardization and/or transference of advertising campaigns or parts of campaigns.

In some markets the use of athletes in their original home country market is effective. A notable example is the Chinese-born Yao Ming, a player on the Houston Rockets of the professional US National Basketball Association. He is 'spokesman' for US brands selling in China – McDonald's, Pepsi, and Reebock (Roberts, 2004).

If Exporter A wishes to communicate effectively with Buyer X, they must somehow put themselves in each other's shoes. This involves the process of *empathy*. Effective communication requires that they have a common set of meanings and definitions. Such a common set of meanings derives not only from the language, but refers more broadly to the pattern of beliefs, codes, and feelings on the basis of which people learn to live with their environment.

According to Dr Sharon Livingston, president of the Livingston Group in Marketing, Inc., 'create an emotional connection with the consumer and you establish a positive brand image which increases the opportunity for affinity and loyalty' (cited in Levy, 2009, p. 6). One of marketing's most recognizable emotion-centric campaigns is NY-based MasterCard, Inc.'s Priceless. As of mid-2009 this has been included in ads in 105 countries over 12 years. The campaign focuses on the emotional benefits one can get with MasterCard credit (Levy, 2009).

Although the firm may focus on emotional consumer benefits, the marketing communications approach of the most successful companies often starts with science. For example, specifically tailored to a fast-paced world of social media, Heineken has formulated a communication strategy based on three Ss (Marketo, 2015). The first 'S' stands for science. Heineken starts from collecting and understanding what knowledge can be gathered from marketing science. Next is the story. How can Heineken use those scientific insights to its advantage, and which story can help facilitate this? Finally, how quickly (speed) can the message be spread to the target consumers? For example, the campaign 'Best-tasting light' reached 37 million people in only three days using only digital media.

Symbols

The successful communicator depends upon symbols as a means of establishing empathy with another person. Thus, the export marketer must choose with care the symbols used in promotion for a foreign market. Color is one type of visual symbol that possesses emotional and psychological properties. It is important that the exporter remember that specific colors may not have the same meaning and significance among cultures. In China, for example, light and bright colors are chosen by young people, and plainer and deeper colors by their elders. Yellow has always been the imperial color; originally its use by the masses was prohibited, and it is still not used extensively except for religious purposes; it suggests grandeur and mystery. Purple is a noble color in Japan, but in Myanmar (Burma) and in some Latin American countries it represents death. The color of mourning in Japan is black and in Iran it is blue; thus these colors are not likely to be well received in marketing promotion in these countries. Green symbolizes nationalism in Egypt and this color should be used only with great care by the exporter to that country.

The effects of culture on the meaning associated with marketing cues such as color are critical for international marketing managers. If the meaning associated with a color or combination of colors is different across cultures, markets may benefit from pursuing a customized strategy with respect to the color associated with the brand, package, and so on. In contrast, when color meanings are similar across preference, a standardized strategy is more viable.

Because of these differences in traditions, customs, religions, and related cultural features of a society, extreme care must be exercised in selecting symbols that can convey the intended message and that do not offend the sensibilities of the audience. For example, comparing people to animals, or utilizing animals in cartoon advertisements to portray human beings, may be quite unacceptable to Buddhists, who believe in reincarnation. An advertisement comparing people to animals also runs the risk of being offensive to an Arab. ('A beast is a beast and a man is a man. Allah says so.') Thus the use of animals to illustrate human behavior may not be attractive, even though understandable.

In a similar manner, the advertiser must be careful about the use of animal symbols and company logos in advertising illustrations (Ricks, 1999, pp. 58–9). These, too, can be misinterpreted and 'mistranslated.' For example, in Brazil a US company used a large deer as a sign of masculinity. The word 'deer' turned out to be a Brazilian 'street name' for a homosexual. Another company used an owl in promotion to India. To an Indian, the owl is a symbol for bad luck. The company was not successful.

Regarding layout of advertising, it is obvious that it should match the reading patterns of the target market. A laundry detergent company marketing in the Middle East had all of its advertisements structured with pictures of soiled clothes on the left, soap in the middle, and clean clothes on the right. Since people in that part of the world read from right to left many potential customers interpreted the message to indicate that the soap actually soiled the clothes.

The exporter should also be sure that the symbols to be used are accurate and up to date. A number of years ago McDonnell Douglas Corporation had an unexpected reaction to a brochure sent to potential aircraft customers in India. An old photo was used that depicted turbaned men who turned out to be Pakistani men, not Indians.

When using an object (including a person) as a type of symbol the export promoter must be sure that the symbol means something to the target audience. Ricks (1999, pp. 51–4) provides two excellent illustrations of this. In Japan, a cosmetics company tried to sell its lipstick through a television advertisement that depicted Nero coming to life just as a pretty woman wearing the lipstick walked by. Unfortunately for the advertiser, many Japanese women had no real idea who Nero was. In the past, Marlboro cigarette advertisements were popular and successful in the United States and Europe, where the Marlboro man projected a strong masculine image. This approach was not successful in Hong Kong, where the urban people did not identify with horseback riding in the countryside. The advertising was changed to reflect a Hong Kong-style Marlboro man; a virile cowboy who is younger, better dressed, and owns a truck and the land he is on.

These examples illustrate the need to be more 'local' oriented in using symbols, including using locally known historical figures. Other examples are shown in Exhibit 13.1.

Going a step further, multinational corporations are increasingly directing advertising toward various parts of the world, which is being tailored more and more to specific differentiated audiences and markets. This, of course, is consistent with a philosophy that an increasing number of companies seem to believe in – 'think global, but act local.' The Dutch company Heineken typically tailors its beer advertising to each market. In France and Italy, for example, which are traditional wine cultures, Heineken is marketed as a drink for all occasions. It has been successful there. Farther east, Heineken targets young professionals, promoting its products as a taste of refined European culture. In the United States, Heineken is promoted as a status symbol, an upscale European beer.

How a symbol is used (the context in which it is shown) can vary among countries. For example, Americans tend to show something including a product in action if at all possible. In contrast, the French are relatively more likely to look for an idea or symbol per se.

Cultural differences also may vary considerably over very short distances. For example, one might expect considerable homogeneity in language, traditions, and customs in Germany. But there are marked differences between Germans from different regions. Villagers from Schleswig-Holstein and Bavaria have great difficulty in communicating with each other in their native dialects, although both are German. Even in small countries like Denmark and Norway, with only about 5 million inhabitants, cultural differences occur. For example, Danish people from the western part of the country, Jutland, often have difficulty in communicating with people from Copenhagen and its surrounding area.

Exhibit 13.1 Promotion blunders are no joke

It is not difficult for a company doing business in foreign markets to make mistakes in promoting its products, including its use of advertising. Sometimes these errors result from applying concepts that worked in the home market. Even though errors are made, the blunder will not necessarily cause a company to lose out. Using the analogy of a race, the company can have a bad start and still win the race.

A case in point is Nike, the large US athletic shoe company (Cone, 1990), which was chasing the long-time leader Adidas in the very lucrative European sports footwear market.

Nike's blunder was its US$21 million European advertising campaign in 1990 which centered on US gridiron football and baseball star Bo Jackson. While the advertisement spots were deservedly popular in the United States – where Jackson was a superstar and the tag line from an earlier advertisement 'Bo knows . . .' had become a pop culture reference – they did not go over well in Europe.

The problem was simple: a joke with a punch line that has to be explained is never funny, and Jackson was relatively unknown in Europe. One evening in 1990 at a crowded Paris cinema only one man – evidently the only American in the building – laughed as a slickly produced Jackson advertisement was shown to the French audience. Printed advertisements featured the muscular athlete with a note telling readers exactly who he is.

In February 2000, Adidas was hitting back at arch-rival Nike's campaign, which was launched a week before (*Marketing*, London, February 2000). Nike's ad was styled on a video game featuring Nike stars Andre Agassi, Michael Jordan, and Ronaldo alongside cyberbabe Lara Croft. The Adidas campaign employed humor to make its brand image more colorful for the youth market. Rugby star Jonah Lomu, tennis player Anna Kournikova and athlete Ato Boldon were shown performing successfully in their sports wearing Adidas clothing and footwear. The ads were intended as a tongue-in-cheek dig at products that claim to change people's lives. Adidas's television and poster campaign was shown across Europe, Latin America and Asia simultaneously.

As with earlier examples of concepts that worked at home but flopped when transferred to other countries Nike's mistake did not prove fatal. Other notable translation errors included the Parker Pen theme 'Won't leak in your pocket and embarrass you' which, when translated into Spanish, came out as 'Won't leak in your pocket and impregnate you,' General Motors 'Body by Fischer' translated in Belgium as 'Corpse by Fischer,' KFC's 'Finger licking good' in Chinese was 'Eat your fingers off,' and Coors Brewing Company's 'Turn it loose' when translated into Spanish, came out as 'Let loose bowels.'

A wide variety of companies in many different countries have made promotional advertising mistakes for a wide variety of reasons.

A concluding comment

Communication with buyers in export markets may not be effective for a number of reasons. Of particular importance to export marketing communication are the following:

- *The message may not get through to the intended recipient.* Either the medium may not reach the recipient, or the message may not be perceived for some reason, perhaps because the person is not interested in the message at the moment, or other distractions may take the intended recipient's attention away from the message. Such difficulties may be due to lack of knowledge about which media are appropriate to reach foreign target audiences, and lack of knowledge about when to reach them (e.g., scheduling difficulties).

- *The message may not be understood in the way intended by the sender.* Because of lack of knowledge of the factors that influence how persons from different cultures will interpret messages, it is possible for a message to be perceived and interpreted incorrectly.
- *The message may not induce the recipient to take the action desired by the sender.* Although a message may be perceived correctly, lack of knowledge about foreign cultural factors that influence attitude formation, purchasing behavior, and so forth, may cause communication to fail in producing the desired effect. Such failure may be due to lack of knowledge on such matters as consumer motives, reference group influence, or consumers' economic circumstances.

Alternative techniques of promotion

Earlier in this chapter we briefly defined the various major forms of export promotion; personal selling, advertising, sales promotion, and publicity. In this section we discuss each of these activities further.

Personal selling

The objective of any export marketing operation in the final analysis is only achieved through people. It is the *personal aspect of marketing* that can least readily be duplicated by competition. An enterprise must rely for survival and progress on the personal qualification of those who make up its personnel and direct its destinies.

Personal selling is person-to-person communication between a company representative and a prospective buyer. The seller's communication effort is focused on informing and persuading the prospect with the goal of making a sale. The salesperson's job is to understand the buyer's needs correctly, attach those needs to the company's product(s), and then persuade the customer to buy.

A well-selected, well-trained, well-compensated, and well-supported salesperson can, and in most instances will, make the difference between successful and unsuccessful foreign sales volume. For example, a key aspect in the Japanese approach to selling products is their reliance upon support materials and data. Sales representatives carry well-designed brochures, big notebooks of data, micro photographs, and other material. This allows them to respond quickly to questions with substantive answers. Sales promotion, including advertising, will arouse interest in the company or the product. But the final sale will not be closed until the actual purchasing decision is made, and personal contact is usually essential for this.

There is little difference in kind between managing export and domestic marketing sales people; they have to be recruited, hired, trained, organized, compensated, supervised, motivated, and controlled (see Hollensen, 2011, pp. 602–5). In global selling it is absolutely essential for a salesperson to understand cultural norms and proper protocol. Therefore a common theme in sales training is the notion of active listening; naturally, in global sales verbal and nonverbal communication, barriers of the type presented in Table 13.1 may arise. As we discussed in Chapter 8, there are three basic functions that all sales people operating in foreign markets must perform:

1. **The actual selling activity.** The communication of product information to customers, and obtaining orders.
2. **Customer relations.** The salesperson must at all times be concerned with maintaining and improving the company's position with customers and the general public.
3. **Information gathering and communicating.** The salesperson is often able to provide information that might be useful in planning advertising and trade promotion programs.

The personal selling process is typically divided into several stages: prospecting, pre-approach, problem solving, approaching, presenting, handling objections, closing the sale, and follow-up. It is important to realize that the relative importance of each stage can vary by country or region.

For example, an experienced Danish company operating with its own sales force in the United States knows that persistence in personal sales is often very important in that country compared with sales in the home market. Therefore, 'Don't take "no" for an answer' in the US market; in Denmark, however, 'A "no" means mostly a "no".'

Patience is also required if a global industrial marketing effort is to succeed; in some countries this means a willingness to patiently invest months or years before the effort results in an actual sale. For example, a company wishing to enter the Japanese market must be prepared for negotiations to take place over several years. This also is true for China. Cross-cultural sales negotiations are discussed thoroughly by Hollensen (2011, Chap. 18).

Personal selling is a popular communication tool in countries with restrictions on advertising and in countries where low wage rates allow large local forces to be hired. In such countries it may be the only way to communicate effectively with potential buyers.

Sales promotion

Earlier we defined sales promotion as including all sales activities that supplement and strengthen personal selling and advertising. For the most part sales promotion activities are of a relatively short-run duration that add tangible value to the product or brand. The tangible value created by the sales promotion may come in various forms, such as price reduction or a 'buy one, get one free' offer. The purpose of a sales promotion may be to stimulate nonusers to sample a product or to increase overall consumer demand. Also, sales promotions are designed to increase product availability in distribution channels.

Of the wide variety of activities classed as sales promotion devices, the exporter must choose those best adapted to the company's products, the markets that are to be developed, and what the company can afford. Some devices that have lost their pulling power and have become worn out in the domestic market or some foreign markets may be effective in other foreign markets. However, sales promotion in Europe is highly regulated, although most popular in some countries, for example the Nordic countries. Promotions such as cash backs, free draws, lottery, and in-pack premiums are permitted in some countries but not in others. Regulation occurs primarily at the retail level in the domestic market, and has been designed to protect small retailers.

Differences in promotional packages can be considerable in a European setting. Even in cases where there are no language problems, differences in promotional packages can be useful in order to elicit a strong regional response from consumers. If, as expected, such regulations are relaxed as an internal market develops in the European Union and regulations are harmonized, companies may be able to roll out pan-European promotion programs.

For example, in Scotland promotional campaigns are often different from those used elsewhere in the United Kingdom. This can be illustrated by the Brooke Bond tea promotional policies. In most of the United Kingdom Brooke Bond PG Tips is marketed; in Scotland this product is called Scottish Blend. Although similar promotional tactics are used there are significant differences, including a distinctive Scottish-oriented advertising package.

In the vast array of devices, six should be discussed because of special factors significant for foreign market development. They are the foreign catalog, samples, the export house organ, the motion picture/video or slide film, trade fairs and exhibitions, and point-of-purchase materials. For the most part these activities are used for export to business firms rather than to the ultimate consumer. However, there are types of sales promotion materials designed for ultimate consumers that the export/international marketer must be concerned about, such as point-of-purchase materials, samples, and new direct promotion techniques such as coupons, contests, and so on.

Foreign catalogs

The foreign catalog is the ever-present, silent, accurate, all-knowing sales tool. The customer in a foreign market may be located quite a distance from the closest sales office. When prepared with this in mind, the foreign catalog can be extremely effective. It must be able to close the gap between buyer and seller. Independent of personal selling, it must attract attention, arouse interest, impel action, and make that action easy by supplying all the needed information from sizes, colors, and quantities to packing, approximate shipping time, terms, forms of payment acceptable, and, if feasible, duties. Prices, too, must be clearly stated, whether FOB, FAS vessel, or CIF port of destination.

Therefore, the purposes of the foreign catalog are as follows:

- *Create interest and attract readership.* A colorful cover, as much color as possible in the body of the catalog, and a well-printed and easily read text are 'musts.'
- *Mirror the personality of the manufacturer or exporter.* An introduction giving years in business, the array of products, number of plants and their locations, the company's status in the industry, and similar information is invaluable to the buyer. To supplement this impression, the catalog must also be well bound, logically arranged, and attractive.
- *Carry the reputation of the manufacturer or exporter into world markets.* Often this includes a statement regarding trademarks, for the exporting manufacturer must realize that domestic product names are often unknown abroad.
- *Make buying easy.* The foreign catalog must answer all questions that a buyer might want answered about the product, terms, and so on. It should make ordering easier for the foreign dealer.
- *Create the desire for ownership.* This can be achieved through action-packed illustrations or ultraclear photographs of the product in use.
- *Supply all the facts that a salesperson would present in person.* These include the features of the product that make it desirable to the consumer and the salesperson's arguments, and how complaints and later questions are to be handled.

The foreign catalog has the potential to be even more convincing than a salesperson. Nothing speaks more loudly or more effectively than the printed word, for dealers in other countries know that what a dependable company puts in print is apt to be true and is often more reliable than a salesperson's claims.

Preparation of this type of catalog is, of course, not an easy task. A foreign catalog cannot be merely a domestic catalog put into another language. The text must be completely edited for world markets, and all idioms, colloquialisms, and trade nomenclature used must be understandable in the target market. The products' qualities and qualifications must be clearly stated, and the best selling points presented. Adaptation to a specific foreign market is greater for consumer catalogs than B2B catalogs (Robles and Akhter, 1997).

In addition to catalogs, other types of literature may be good sales tools. *Brochures* of various types are especially useful for sales people, distributors, dealers, and agents. Since sending printed sales aids to export markets can be very expensive, the exporter should carefully assess the needs of marketing intermediaries *before* sending vast quantities of such materials. The language will depend upon product and target markets. Translations (from the language of the domestic market) should be done in cooperation with overseas agents and/or distributors. The most effective brochures are those that are informative and which are written for a reader who knows nothing about the exporter's product(s).

Samples

A sample can give the potential foreign buyer an idea of form and quality that cannot be attained by even the most graphic picture. Foreign customers are often situated a long distance from where a product is manufactured and consequently any mistakes in ordering or misunderstandings over styles, sizes, models, and so on, are apt to prove serious and costly. Samples, as many successful foreign sales people recognize, are a means of avoiding such difficulties.

The use of samples will, of course, vary with the product and the markets involved. The most common is *direct sampling* by mail, express or courier, by which means the export marketer sends a specimen of its product(s) to the distant individual buyer or even the ultimate consumer. Second, and steadily growing in importance, is the use of samples by *residential agents*, *branch office managers*, and *traveling sales people*. Then there is the use of samples at sample *fairs*, import fairs, and similar demonstrational and promotional enterprises for buyers. In some places sample fairs take the form of a permanent display of manufacturers for buyers to look at the available offerings.

Direct sampling, preferably by mail, is usually practical only in the case of small or relatively inexpensive articles such as food products, medical preparations, toilet articles, and so on, where the size can be kept down so that the expense involved is not formidable, and where the samples can be tried out by the recipient under normal conditions of consumption. In the case of articles where the value can be measured only by the services rendered rather than by their appearance, such as various mechanical devices, samples are not satisfactory. Manufacturers of bulky objects such as furniture, ranges, and refrigerators are, however, able to use samples by putting them in permanent trade exhibits at commercial centers.

When planning to use samples, or any sales promotion material, direct to consumers the international marketer should look at national regulations. Laws pertaining to sales promotion activities differ greatly across countries. These laws govern both the types of promotion that are allowed and the manner of presentation. For example, in Malaysia a contest may be used, but it must involve a game of skill and not chance. In Germany, only full-value coupons may be used in a consumer promotion; in the Netherlands and Switzerland, although they are legal, major retailers refuse to accept coupons.

House organ and company-published magazines

Also important in sales promotion is the house organ, either offline or online. Such publications can serve as an effective means to provide company, distributor, or agent personnel with knowledge of the success of other distributors or agents. House organs may be a vehicle for promotional ideas, company news, the results of contests, employee commendation, and so forth, and may be an important device to stimulate enthusiasm and effective sales performance abroad. Unlike the catalog, this type of publication is not limited to an accurate description of the product, but can cover almost any phase of the business. Its articles can be so written as to convey information to the foreign customer. An exporter's house organ is especially suited to goodwill building and institutional advertising. It should endeavor to sell the entire organization as well as its merchandise.

Most companies prepare, edit, and produce house organs in the home country, but a few companies with well-established export operations may have separate foreign editions, prepared and produced locally, with only a minimum of central direction and control of content. Of these, probably the most successful are those in which there is a systematic or planned sharing of information and interchange of ideas among the various foreign editions.

As access to and use of the Internet has spread, house organs have been transformed into company websites.

Films, slides, and personal computers

One of the potentially best sales aids in foreign markets is the motion picture, video tape, and DVD. Though expensive, particularly the motion picture, such aids perform the essential task of telling the manufacturer's entire sales story to the foreign customer who may never have seen the products or factory, and may never have been to the manufacturer's country. The motion picture/video/DVD combines the illustration with the spoken word, but its effectiveness is dependent on the skill with which it has been made and used, and the extent to which it is adapted to the company's purpose. Films can show selected audiences of potential customers a comprehensive story of the exporter's product, organization, or even the manufacturing process.

A motion picture/video tape/DVD has many advantages. This method of presentation is still relatively new and unusual in many markets, some of them major ones, and buyers are often willing to take the time to watch, when they would not be willing to spend the same amount of time listening to a conventional sales talk. It adds novelty to the presentation of the company's message. The sales message is told in exactly the language that the exporter wishes to use and stresses exactly those points that it wishes to stress. The story is completely told, and no valuable points are inadvertently omitted. It serves to refresh the memory of the distributor and/or agent, aiding the intermediary to keep in mind the major points of manufacture. It supplies the marketing intermediary with a sales medium that saves energy for the all-important closing of the sale, attracts attention from clientele, and helps greatly in creating a desire for possession.

Slide films, though much less expensive to produce than films and videos, have definite limitations by comparison. Where cost is a major factor they do present a solution, for they can be more economically produced, easily presented, and readily transported. The opportunities for their use and the inherent problems are, however, similar to films, video tapes and DVDs.

Due to the technological revolution, the personal computer can be used in a manner similar to films and slides. Laptop, notebook and netbook computers are easily carried by sales-personnel and distributors, and companies can develop the appropriate software to present their promotion and sales message. The Internet has expanded the potential uses of the personal computer. In addition to sales promotion, it is increasingly becoming a basic advertising medium. Similarly, the fax machine is also being used for promotion purposes.

Trade fairs and exhibitions

As mentioned earlier in this chapter, trade fairs and exhibitions are a medium that is extremely important for some industries and some countries. Often a trade fair is the first communicative step in the process of export development of the small and medium-sized company. A trade fair is a concentrated exhibition of the products of many manufacturers/exporters. They are of two general types: (1) the broad, general-type, well-established annual affairs and (2) the specialized type, for products in specialized groups or industries. An example of the general fair, the largest of its kind, is the annual Hanover Fair in Germany, which attracts thousands of exhibitors in 20 major industry categories. Similarly, China hosts the China International Maternity and Baby Industry Exposition. The second exposition was held in Hangzhou in 2007. Close to 200 Chinese and foreign companies participated. Seven major categories of products were represented, including food, toys, and educational products, feeding supplies, clothing, bedding, travel goods, and services (tdctrade.com, 2007).

A much broader and larger trade fair is the 17th edition of the East China Fair, which was held in 2007 in Shanghai. This fair was jointly organized by the provinces and cities of Shanghai, Jiangsu, Zhejiang, Onhiou, Fujian, Jiangxi, Shandong, Nanjing, and Ningbo. The fair is designed to provide opportunities for negotiations on processing trade, equity and contractual joint ventures, and other forms of economic cooperation between Chinese and foreign companies. A total of 3,522 Chinese companies and 144 foreign companies exhibited, including companies from the United States, Canada, the United Kingdom, Australia, France, Italy, Japan, South Korea, Singapore, Hong Kong, and Taiwan. There were 18,500 visitors from 117 countries as well as 70 buying missions from 22 countries and regions. Total export orders received amounted to US $3.5 billion. An illustration of the more specialized fair is the annual Paris Air Show.

Trade fairs have become a big part of the selling process for many companies and industries. Although selling at a trade fair requires the same skills and knowledge as other selling, there are some elements of the process that are unique: (1) gathering names; (2) demonstrations; (3) prizes; and (4) client promotions. Gathering names of a trade fair's attendees makes up a list of potential buyers. A product demonstration not only involves a prospect with the product but also gives the exporting firm the opportunity to engage the potential buyer in a conversation about his or her needs and objectives. Prizes and client promotions are means that might generate a tremendous amount of traffic, but at the same time could make it almost impossible for the booth, or the one next to it, to conduct any business.

Trade fairs are used to buy and sell products, sign contracts, and arrange for international distributorships and agent relationships. Trade fairs can be valuable not only to well-established firms – for purposes of prestige, public image, introducing new products – but also to new firms that might have no other readily available way of getting their products displayed before the right audience, at low cost.

Sometimes trade fair participation is by invitation only. Such is the case for the semi-annual Chinese Export Commodities Fair held in Guangzhou, China, in which the invitation is for overseas business people. When participating in such a fair, advance preparation is crucial, including contact initiation and translation of materials into the language of the host country. Advance planning for trade fair participation and what to do during the fair are discussed by Wells and Dulat (1996, pp. 143–50) and Smith (1998).

A different type of fair is the annual month-long Christmas Market in Aachen, Germany. It is a consumer market that attracts about 1 million visitors from Europe and as far away as the United States. Figure 13.3 shows an exhibition of replicas of German cathedrals, castles and other buildings. Many of these items are designed in Aachen, custom-made in Lithuania, and sold in the Christmas Market.

Point-of-purchase materials

Manufacturers and exporters of packaged consumer goods such as cosmetics, paper-tissue products, or proprietary pharmaceuticals sometimes find it useful to provide point-of-purchase (POP) literature and displays to sale subsidiaries, agents, distributors, and retail dealers. Successful POP merchandising ideas in one country can often be applied, directly or in modified form, in another country. Local POP materials can sometimes also be tied in with advertisements run in local media. Such materials may also contribute to, and be in harmony with, a uniform worldwide image that a manufacturer/exporter may want to achieve. Some companies prepare POP materials domestically in rough form for shipment abroad. Local foreign representatives usually handle production and printing. In the rare event that the POP materials are produced in the home country, the copy would most likely be left blank so that the local distributor or agent can silk-screen or overprint the copy in the local language.

Consumer promotion materials

Throughout the world international marketers of consumer goods, either through their subsidiaries, affiliates, partners, distributors, or dealers, are increasingly using various types of sales

Figure 13.3 An exhibit at the Christmas Market, Aachen, Germany

promotion devices to stimulate sales. This is particularly so for companies in the packaged consumer goods product categories such as Unilever, Procter & Gamble, and Nestlé. For the most part the larger companies have left sales promotion in the hands of local managers since it does deal with motivating local consumers and members of the trade to act – try the product, repurchase, buy more, switch brands, and so on. However, there will be differences among countries due to differing levels of economic development and market maturity, culture-based consumer and trade perceptions of promotional incentives, regulations, and trade structures.

Recent studies in developing countries have shown that free samples and demonstrations are by far the most widely used consumer promotion tool. In contrast coupons, which are widely used in the developed countries, are rarely used. Even in Japan coupons do not have widespread use. Coupons are distributed differently in various countries. In the United States freestanding inserts account for the major share of coupon distribution while in-ad couponing (e.g., coupons within a grocery retailer advertisement) is the favorite in Canada. Newspapers and magazines are the most popular means in the United Kingdom while Spain and Italy utilize in/on-pack promotions for their coupon distribution. In some European markets coupons are distributed door to door.

The international/export marketer needs to address many issues concerning its relationship to local management of promotion activities. Headquarters should be concerned with how to help improve local practices; to upgrade local performance in terms of their overall impact, productivity, and, where needed, contribution to the building of an international brand franchise. What is needed will depend to an extent on whether the brands involved are local and do not need international coordination (e.g., Nestlé's Excella coffee in Japan), global with a widespread international presence and a high degree of uniformity in worldwide brand promotion (e.g., Swatch, Benetton, and Coca-Cola), or are regional using regional uniformity in promotion (e.g., Polaroid's Image System used in Europe). Obviously the major coordination task is for regional and global brands.

Publicity

Publicity, which is any form of nonpaid significant news or editorial comment about a company, its practices, its personnel, or its products, is a major component of the *public relations* activities of a company. Public relations is the marketing communications function that carries out programs designed to earn public understanding and acceptance: it should be viewed as an integral part of the export marketing effort. There are, of course, some exceptions but the trend is toward closer coordination of public relations activities, which are designed to accomplish marketing objectives.

The marketing purpose of public relations activities is to achieve objectives that cannot be achieved by other means or achieved as cheaply by other means. For example, if a company wants to gain recognition as one with social responsibilities in foreign locations, this objective may often be accomplished much more effectively by a carefully planned campaign to receive favorable editorial mention than by using paid advertisements. The context and source of the message may play an important role in how it is perceived and interpreted and whether or not it has the desired impact on attitudes of consumers, government officials, or other persons with whom a company wants to have a favorable reputation.

Among the most widely used tools of public relations are press releases and prepared editorial material. Such material is often prepared for new products, the opening of new plants, the achievements of the company, the activities of company personnel in community or governmental activities of locally recognized merit, the favorable impact of the company on the local economy, the role of the company as a local employer, or the contribution that a company makes to the country.

In many companies public relations materials for international use originate from the domestic operation. A few, however, attempt to solicit ideas and materials from foreign operations. For example, a clipping service may be maintained to demonstrate the success of local public relations activities. Or a story may be written on the successful application by a foreign customer of the company's product; in such cases pictures may be taken, and the material offered to an appropriate trade journal as editorial content. Reprints of such material may then be utilized by sales people in other export markets.

It should be remembered that publicity is not an export promotion activity in the same way as the others are. Although an exporter can attempt to influence the reporting of news about itself and its activities, the decision to carry out such reporting is out of the hands of the exporters. As companies become more involved in global marketing and the globalization of industries continues, it is important that a company recognizes the value of international publicity.

Public relations practices in specific countries can be affected by cultural norms, social and political contexts, and economic environments. Often there are large differences in such practices. In the developing countries the best way to communicate might be through the market square, or the chief's court. In most of the industrialized countries local, regional, and national newpapers, television, and so on, are the traditional mass media for public relations. The technology-driven communication revolution that has ushered in the information age, however, makes public relations a profession with truly global reach in the future. Faxes, satellites, high-speed modems, and the Internet allow public relations professionals to be in contact with media virtually anywhere in the world.

Advertising

Advertising may be defined as any paid message placed in a medium. International or global advertising is the use of the same advertising appeals, messages, art copy, stories, and so forth, in multiple country markets.

There seem to be several reasons for the growing popularity of international advertising. International campaigns attest to management's conviction that unified themes not only spur short-term sales but also help build long-term product identities and offer significant savings in production costs of a campaign. Regional trading areas such as the European Union are experiencing an influx of internationalized brands. Second, the potential for effective global advertising also increases as companies recognize that some market segments can be defined on the basis of global demography – youth culture, life styles, and so on, rather than ethnic or national culture. Global advertising also offers companies economies of scale in advertising as well as improved access to distribution channels. For example, a study investigating advertising appeals and cultural values in television advertising from newly emerging markets in sub-Saharan Africa – Ghana, Nigeria, and South Africa – included among its findings one suggesting that advertisers can safely use the beauty appeal as a global advertising appeal (Oyedele *et al*., 2009).

It is a rare exporter who does not use advertising of some type, even if it is no more than being listed in an export directory, such as Europages, a European business directory. In various countries government regulations may limit the type of advertising and the media to be used. But most foreign markets are open for advertising of some type. Even in the People's Republic of China the doors are increasingly open to advertising by exporters. However, advertising there must be deeply rooted in Chinese cultural values and social and economic practices that the government considers nonthreatening. Consumer advertisers, for example, are focusing on the younger population segments that have greater spending power (Zhou and Meng, 1997). In 1999 an agreement was made between the government-run broadcaster Chinese Central Television (CCTV) and an Australian company, Bo Long International, which opened the door for Australian companies to advertise on Chinese television. Australian advertisers were offered ad slots in and around a program called *World Sports*, which started airing in early 2000. The program focuses on Australian sports. Prior to this arrangement only advertising campaigns initiated in China or by Chinese agencies were allowed on CCTV.

An interesting form of advertising is through sponsorship of sports and sports teams. Regarding the latter, European soccer (football) teams in the various national leagues in Europe have been sponsored for years by multinational companies such as Philips Electronics and Siemens. The Chinese mobile phone manufacturer China Kejian Co. sponsored Everton, a team in the English Premier League, and China's Yanjing Beer, through its US distributor Harbrew Imports, has a sponsorship arrangement with the US National Basketball Association team the Houston Rockets. A key player on the Houston team is China's Yao Ming. On a larger scale in China, Adidas-Salomon sponsors the national soccer team, Coca-Cola sponsors the national basketball team, Siemens backs the first division soccer league, and Philips Electronics sponsors the national women's soccer team and the university soccer league (Balfour, 2003). Other multinationals are sponsoring other sports activities in China: Pepsi sponsors teen soccer; Adidas funds camps dedicated to the sport; and Nike has started a high school basketball league. Adidas, in addition to its sponsorship deals with the FIFA global soccer league and its six top teams, sponsored the entire World Cup soccer tournament held in South Africa in 2010 and one-third of the teams (Townsend and Elfes, 2010).

Exhibit 13.2 discusses what is happening in Japan, especially for younger consumers.

Exhibit 13.2 Advertising to the young and engagement

In Japan companies are targeting younger people. The automobile industry, including Nissan and Toyota in particular, is targeting young women. For example, they are adding cute features to appeal to women. There is a lesson for non-Japanese consumer product firms as well if they are to succeed in the Japanese market. In Japan, young women are extremely powerful in setting trends, and the culture of cute is so widespread that adult men are not embarrassed about having little mascots dangle from their cell phones.

Japanese consumers frequently use personal products to show off who they are, often buying designer-brand products to make a statement. Product image is far more important for Japanese consumers than American consumers, for example. The Japanese put a greater emphasis on personal identity and advertising needs to address this aspect of the consumers.

One Japanese advertising agency, Hakuhodo, Inc., is approaching what it does by working on generating consumers' engagement with the brand – that is how engaging or involving is the brand and the brand messaging to the customers. This is a change from the past when, particularly in the West, concern was with engagement with the media or media form. Engagement with the brand works better as a pull communication program wherein the consumer makes a brand decision first and then chooses the medium by which to obtain more information.

Source: Adapted from Kageyama (2007) and Schultz (2007).

Climate for advertising

To a large extent the potential viability and effectiveness of export advertising depends upon the *climate* for that advertising in the foreign markets of concern. The climate for advertising is the result of a set of factors operating within a socio-economic and cultural system that determines if the system views advertising as a desirable activity, and reacts accordingly, or if it views advertising as a threat or a waste, and reacts negatively (Exhibit 13.3).

Exhibit 13.3 Dimensions of the climate for advertising

The climate for advertising is evaluated best through a review of underlying economic, social, and cultural conditions, popular attitudes, and legislation related to advertising.

The underlying economic, social, and cultural factors

- *Economic system.* A liberal economic system based on a market economy is more favorable to advertising than a centrally planned economic system. However, even a centrally planned system may, once in a while, use advertising to adjust demand to planned production.
- *Social structure.* Modern social structures tend to accept advertising because it fits within their dynamic outlook of the future; traditionally oriented societies do not accept advertising easily because it is viewed as a dangerous change agent, upsetting the status quo.
- *Cultural background.* Among modern societies the acceptance of advertising is not the same everywhere; some countries have a cultural background that fosters individualism while others are more prone to foster gregariousness. There is no evidence that advertising is more successful in one surrounding than another, but it seems that people in relatively individualistic societies are likely to view advertising as an invasion of privacy and tend to be more vocal in their criticism of advertising.
- *Religious climate.* Countries that are dominated by very dogmatic religious groups (and for that matter by dogmatic groups of any kind) tend to feel more negative toward advertising than those where a climate of benign tolerance exists (dogmatic groups tend to be found in traditionally oriented societies).

The underlying legal and political factors

- *State monopoly.* Certain countries own and operate all or part of the mass media, especially broadcast media.
- *Censorship.* The practice of controlling the content of mass media is widespread, especially in socialist countries, dictatorships, and in most of the developing countries. Censorship affects the media in terms of reach, program content, and cost structure.
- *Restrictions on advertising.* Restrictions may be total or partial and may affect all mass media, or only selected ones. Restrictions may affect certain product categories and not others. For example, in the early 1990s all tobacco advertising (including sports sponsorship) and most liquor advertising (except for most wines) were banned in France. Similar laws exist in other countries. Prior to its sovereignty change, Hong Kong passed legislation that banned tobacco advertising at sports events, and because print and display advertisements cannot be used, this ban effectively stops tobacco sponsorship of

major sporting events there. Some countries permit radio advertising but restrict television advertising. Other countries restrict the advertising of certain products, for example alcoholic beverages and cigarettes, on television. Furthermore, other countries restrict advertising by taxing it or by putting a ceiling on advertising deductions for income tax purposes. Still another form of restricting advertising is the practice of limiting the number of advertisements broadcast per day over certain media, for example television. Some Latin American countries have legislation discriminating on the basis of the origin of advertising copy. Other countries such as Germany restrict severely the techniques that can be used in advertising, such as prohibition of the use of superlatives or comparisons. Almost all countries have some legislation dealing with the truth of advertising claims. In Saudi Arabia business executives have endorsed the regulation of advertising aimed at children or dealing with products potentially harmful to the public, whereas the Singapore government in the mid-1990s banned all advertising that included gifts, special discounts, and incentives for credit card holders. Within the European Union, Sweden is the first country to introduce a ban on advertising to children under the age of 12. Similarly, the Flemish region of Belgium bans advertising aimed at children for five minutes before and five minutes after children's programs. Greece bans television advertising of toys.

The number, type, and characteristics of media vary considerably from country to country. There are two broad categories of media of interest to the export marketer: (1) *international* media – those media that circulate, or are heard or seen, in two or more nations, and (2) *foreign* media – local, domestic media. For contiguous countries, such as Germany/Austria or Canada/United States, local media from one country may be heard or seen in the other.

International media

The term 'international media' is often used in reference to business and consumer magazines and newspapers that circulate in many countries. International media attract a relatively minor share of the advertising expenditure of exporters; the great bulk is spent in local, foreign media. Nevertheless international media are important for some companies.

International print media originate from a number of countries, primarily in Europe and North America. For example, *Time* and *National Geographic* magazines and *The Wall Street Journal* newspaper have a US home base, while the *International Herald Tribune* is published in Europe and elsewhere, but is owned by US companies. *The Wall Street Journal* also has a regional version, *The Asian Wall Street Journal*, published in Hong Kong. The *Financial Times* and *The Economist*, in contrast, come from the United Kingdom.

Technical business publications are also of great importance in certain industries such as agriculture, automobiles, construction, farm equipment, electronics, frozen foods, medical and pharmaceutical products, metalworking, petroleum, paper and pulp, plastics, and transportation. Technical publications aimed at engineers and scientists sometimes cut across a number of industries.

International print media are often published in several languages. Thus regional or country 'buys' are frequently available. They sometimes have surprisingly high readership as well as an excellent reputation as a source of information on foreign products.

Television is no longer only a local medium as in the 1980s, because technology and satellite transmission have created the potential for expanded use of television as international media. In Europe, pan-European television stations exist nearly everywhere, for instance in the United Kingdom, Germany, France, Italy, and the Netherlands. Their coverage extends beyond the European Union to include eastern Europe, and the western part of Russia. Reception is obtained through cable television, either CATV (Cable Television available from commercial companies covering sections or all of a community) or MATV (Master Antenna Television, which is localized cable in apartment houses or hotels). Obviously satellite television has led to many changes regarding availability of television in countries that prohibit the use of this medium for advertising or which limit the times, days, and when during a program advertising can be used. In Chapter 9 we identified the media empire of News Corp., which includes satellite and cable television channels throughout the world.

As we shall discuss later in this chapter, advertising on the Internet is growing throughout the world. In addition, advertising on websites appearing on mobile phones is growing. Although global numbers are hard to obtain, many of the obstacles that have held mobile advertising back, such as hardware, are going away (*The Economist*, 2008a).

Foreign media

The availability and suitability of local advertising media vary considerably from country to country. But, with the exception of broadcast media, major types exist in virtually all markets. Some of the lesser developed countries have no television at all; and in some developed countries television and radio are not available for commercial advertising of branded products. This situation is changing rapidly, however, as regulations are being liberalized, especially in Europe.

Media patterns differ from country to country because of cultural, sociological, economic, and even psychological differences between countries. We will discuss here, briefly and generally, each of the major media categories. It should be recognized that within a country there will always be some overlap between the audiences of the available media.

There is a great deal of variety in the types of *newspapers* and the reading habits of people from country to country. In countries where literacy is high, such as Canada, the United States, and the developed countries of Europe, the great majority of the population reads a daily newspaper. In other countries – those characterized by low educational levels, a low rate of literacy, and low consumer incomes – coverage of consumer markets by the press is very poor. Readership of the press may be limited to small portions of the market in the middle and upper socio-economic groups. Some countries have national daily newspapers whereas in other countries newspapers are local.

When using newspapers in a foreign country, or any print medium for that matter, the advertiser should make sure that the readership class matches the appropriate target market. Some time ago a New Zealand company using a national newspaper in the United Kingdom (the *Daily Telegraph*) ran a mail order campaign similar to one done in their home market. The campaign was not successful because they should have been appealing to readers of the *Daily Mirror* and the *Sun*.

Foreign *magazines* are often a difficult medium for export advertisers to use. In Europe, for example, there are literally hundreds of consumer magazines, each with a very limited circulation compared to, say, the national magazines in the United States. Technical and business magazines, which are often considered an important part of the media mix for industrial advertising in such countries as Canada, the United Kingdom, Germany, and the United States, do not exist in many markets. Often either the lack of periodicals or the excessive number of small circulation periodicals forces export advertisers to rely less heavily on these media than they would otherwise prefer. Yet there are exceptions.

A recent study of advertising in a global magazine across seven countries (Brazil, China, France, India, South Korea, Thailand, and the United States) reported some interesting findings (Nelson and Paek, 2007). The magazine studied, *Cosmopolitan*, offers 110 editions in 28 languages with a readership of close to 40 million. Key findings include:

1. local editions deliver more multinational than domestic product advertisements across all countries except India;
2. overall, multinational products advertisements use standardized strategies and tactics – to be discussed later in this chapter – more than domestic product advertisements, although this varies across countries;
3. beauty products are more likely to use standardized approaches than are other products.

Posters, *signs*, and *car cards* (forms of outdoor and transportation media) are used quite frequently in low income countries, such as those in Latin America. In European countries posters are quite popular, especially on kiosks or the sides of buildings. Large billboards, which are particularly appropriate for viewing by a motorized populace, are not common in most countries, except for use near main traffic arteries in major metropolitan centers. Much outdoor advertising is designed for viewing by pedestrians or those who use public transportation. Buses and streetcars are major means of transportation and reach large, important audiences. Posters are usually intended to be read by people who are going somewhere and are preoccupied with other matters; they are designed to attract attention to, or to serve as a reminder of, the product.

Dandy, a large Danish confectionery company specializing in chewing gum, focuses its advertising in Russia on outdoor advertising primarily with billboard posters of their chewing gum brand, Dirol. In Russia, Dandy is one of the dominant confectionery competitors with high market share. Colgate Palmolive, on the other hand, started its toothpaste advertising in Russia by placing ads on buses. The Colgate advertisements were part of a strategy to develop increased awareness of its products among consumers and dentists. As illustrated in Figure 13.4, Vodafone uses buses to promote its company in Sydney, Australia. Figure 13.5 shows Club Monaco advertising on a tram in Hong Kong. Finally, Figure 13.6 shows a semi-truck for Pepsi decorated to look like its sides are missing. This truck was the winner of the 2005 Rhino Rolling Advertising Awards competition in Germany.

The *cinema* is an important advertising medium in some countries (e.g., Italy and Denmark), especially in those without top quality press or broadcast advertising facilities. However, the importance of this medium is decreasing. Many cinemas, especially in small countries, sell commercial time. And, since attendance is often very high, even in poor countries, cinema advertising can be used to reach a high percentage of urban audiences. An attractive feature of cinema advertising is that an accurate estimate of the audience exposed to the commercial (attendance) can usually be obtained either from government tax records or from the files of theatrical film distributors. Cinema advertising can be useful to introduce new products requiring demonstration, or when color is important. It has a captive audience, which is not distracted by competing messages or other ongoing activities. Generally the impact can be considered high.

Figure 13.4 Big Mac advertisement on a tram in Helsinki, Finland.

Figure 13.5 Advertising on tram in Hong Kong

Figure 13.6 Truck art in Germany

Source: Winner of the Rhino Rolling Advertising Award 2005, title: Getränkekistan light, reproduced with permission of Transmarketing.

Radio can be an important advertising medium for products with a broad market. Radio tends to be used more widely in Latin America than in Europe. In Europe, the radio medium seems to be of greater interest in local and/or regional markets. Also, the medium is of special value when the literacy rate is low. It penetrates to the lowest socio-economic levels, reaching at reasonable cost otherwise inaccessible potential market segments.

Television is well developed as an advertising medium in an increasing number of countries. The greatest progress has been in the relatively affluent countries that permit commercial television to operate with a minimum of restriction. Some countries in which television is government owned permit television advertising, but restrictions are usually severe and have limited effectiveness. For example, in some countries commercials are bunched together and shown only at certain times. In other countries advertising may not be shown after a certain time in the evening and may not be shown on certain days or on holidays. In still other countries some products such as alcoholic beverages, tobacco, and pharmaceuticals may not be advertised by this medium.

The markets reached by television in many countries are relatively small and include primarily the privileged few. Television advertising is especially useful for packaged consumer goods and widely used consumer durables in which rapid technological developments and changing fashions or tastes play an important role in successful marketing. Television is especially helpful in demonstrating product benefits or to show the product in use. The number of major commercial television channels in Europe, for example, continues to grow.

The growth of new forms of mass communication, by satellite television and the integration of telecommunications and computer systems, will in the future not only create new 'buying systems' but will also increase the potential for the encouragement of a new cultural setting, which will reformulate the company's use of the television media. For example, in 2003 Honda had developed an unusual television commercial, a two-minute film called *Cog*, that it released on the Internet. This commercial shows 86 distinct parts from a Honda Accord dancing around using a roll, pirouette, and flying along the floor. Honda United Kingdom tested *Cog* on BSkyB's fledgling interactive television system in England. A relatively small number of people saw the film. However, more than 10,000 viewers requested additional information on the car. To obtain this kind of response through regular direct mail, Honda would have had to spend close to US$1 million. On BSkyB it spent about US$32,000 (Battelle, 2003).

Direct marketing can often be a useful part of a sales and advertising program. It can be useful as a direct action vehicle, to solicit orders directly, or in a supporting capacity; it can be useful to members of the export marketing channel, as a dealer or agent stimulator or aid, or to reach ultimate consumers. Direct marketing can take many forms – mail, letters, catalogs, technical literature, telephone, fax, Internet – and it can serve as a vehicle for the distribution of samples or premiums. A major problem in the effective use of direct marketing is the preparation of a suitable contact list or database. At the household level, for example, it should be recognized that there are big differences between countries in the levels/volume of direct marketing contacts, even within as developed an area as the European Union. Consequently, response rates and effectiveness of direct marketing campaigns will differ between countries.

Users of direct mail in a direct marketing campaign aimed at households have to contend with regulations regarding acquisition and use of information about people and households. This concerns the purchase and sale of 'mailing lists.' Increasingly, governments are concerned over privacy rights of individuals. The European Commission, for example, is attempting to devise common guidelines on data use and protection across the countries of the European Union. There is a directive stipulating that consumers should be told, at the time of collection or the first opportunity thereafter, about all possible uses of their personal details. The use of these data must be compatible with the need for the data. In addition, the consumer must have the express opportunity to be excluded from any such list.

Ordinarily direct mail and telephone/telemarketing can be handled best by local foreign distributors, or agents. The objectives of such campaigns are usually local objectives, for example to provide samples, to tell customers where they can get the product, or to announce a special sale. At the same time, however, direct mail and telemarketing can be a major tool for the exporter to use in reaching potential overseas customers and distributors, as can fax and the Internet.

Online advertising

Advertising on the World Wide Web is generally acknowledged to take place when an advertiser pays to place advertising content on another website. It can be contended that each website is in itself an advertisement since it can inform, persuade, and remind customers about the company or its products and services. However, a company website is not strictly an advertisement in the conventional sense since money is not exchanged to place the content of the website on a medium owned by a third party.

Advertisements placed on sites usually take the form of **banner advertisements**. These are so called because they are usually placed across the top of the website. The power of banner advertisements is that they can be targeted at a particular audience. Companies will pay for banner advertisements for two main reasons: (a) in the hope that the customer will click on the advertisement and then will be exposed to more detailed brand information on the company's website and (b) all visitors to a page will see an advertisement, either noting it consciously or viewing it subconsciously. This may help to establish or reinforce a brand image. The effectiveness of banner advertising in terms of attitudes toward such advertising and intention to click on banner ads varies along cultural dimensions (Möller and Eisend, 2010). Using Hofstede's (2001) dimensions, consumers from individualistic countries show less acceptance of this type of advertising than those from collectivist countries. Overall, acceptance of banner advertising is influenced more by national-level cultural characteristics than individual-level characteristics.

Banner advertising is often thought of simply in terms of its function in driving traffic to the website. There are, however, several outcomes that the international marketing manager may be looking to achieve through a banner advertising campaign. Cartellierie *et al*. (1997) identify the following objectives:

- *Delivering content.* This is the typical case where a click on a banner advertisement leads to a corporate site giving more detailed information on an offer.
- *Enabling transaction.* This is the case if a click-through leads direct to a sale.
- *Shaping attitudes.* An advertisement that is consistent with a company brand can help build brand awareness.
- *Soliciting response.* An advertisement may be intended to identify new leads or as a start for two-way communication. In these cases an interactive advertisement may encourage a user to type in an e-mail address. The use of interactive banners is increasing and might for example include entering the amount of loan required to give an indication of its costs or entering the destination of a flight to show the cheapest fare available.
- *Encouraging retention.* The advertisement may be placed as a reminder about the company and its service.

Advertising on the Web (the Internet) is a growing business. About one-half of the expenditures will be involved in arrangements where advertisers pay by the click; every time a person anywhere in the world clicks on the advertisement, the advertiser is charged. One potential problem is that so-called click-through rates have been declining. The novelty of Web ads seems to be wearing off as online marketing has become a form of mainstream marketing (Holahan and Hof, 2007).

The declining click rates seems to be fostering the emergence of a new approach to online advertising – *behavioral targeting* (*The Economist*, 2008b; *The Economist Technology Quarterly*, 2008). Companies such as Phorm, a European-based global personalization technology company, have devised software for use by Internet-service providers which allows the development of profiles – demographic and interests – of Web surfers that are useful to advertisers in targeting advertisements more accurately. A value of this to advertisers is that they can target their ads to those consumers who are potentially more interested in the offer. This means that websites will be able to charge more for their advertising slots (*The Economist*, 2008b). This approach to targeting online advertisements is not without its critics and has caused some concern by governments regarding possible violation of privacy laws.

Internet advertising can also be paid for according to the number of Web users who view the web page and the advertisement on it. These are the 'ad impressions.' Cost is typically calculated as CPM or cost per thousand (*mille*) ad impressions. More expensive sites are likely to have a more specialist audience with a higher disposable income or to be related to specific keywords, as in the case of Yahoo! and Google.

The exporting company can place its banner advertisements through **advertising networks**. Advertising networks are collections of independent websites from different companies and media networks, each of which has an arrangement with an advertising broker to place banners. For example, one of the best-known advertising networks is DoubleClick, which operates in the United States and through worldwide franchises. The network offers advertisements in a range of different areas such as automobiles, finance, health, and entertainment.

In contrast to advertising networks, an **affiliate network** is a collection of websites that link to an online retailer in exchange for commission on purchases made from the retailer. The Amazon Bookshop is the best exponent of this online marketing technique. Amazon's affiliates offer small banner advertisements on their websites that when clicked on will take the user of their site to the Amazon site. The network includes many major portals, for example Yahoo! Each partner earns up to 15% commission every time a customer clicks on the advertisement and then buys a book or other item at Amazon. Links to Amazon also occur on search engines such as AltaVista, where links to Amazon are given according to the kind of keywords typed in.

Many international advertisers such as Kraft, Heinz, Coca-Cola, and Unilever that have prospered by advertising in traditional media are concerned as to how they can exploit online advertising. An innovative approach to online advertising was used by the Italian clothing company 55DSL as shown in Exhibit 13.4. Lately, several consumer goods

Exhibit 13.4 An innovative use of Internet advertising

In a crowded market for high-end denim goods aimed at a fickle audience of well-heeled teenagers and stylish twenty-somethings, the relatively little-known brand 55DSL raised its profile with an edgy campaign that demanded little from its target consumers and committed to even less. And it worked.

'We're telling everyone to take a stand and live 55 seconds a day,' meaning life shouldn't always be taken too seriously, says Kristian Kristiansen, international head of marketing at 55DSL. 'We tell everyone else to do it, so why don't we do it? We wanted to do something that personified what we have been saying.'

Launched by the international denim and sportswear label Diesel in 1994, 55DSL remained a Diesel sub-brand until the larger company spun it off in 1999. It is still based in the same town – Molvena, Italy – as Diesel. 55DSL had nearly six dozen branded retail stores worldwide, but all were in Europe and Asia until recently when the brand opened its first dedicated retail store in the United States. Previously, the 55DSL line had been sold almost exclusively through retail outlets such as boutique stores.

Regardless of the brand's popularity elsewhere, the United States remains the ultimate target market because of the sheer volume of spending by 55DSL's 15- to 25-year-olds on clothing and accessories.

So 55DSL turned to Portland, Oregon-based marketing agency TAOW Productions LLC, which had worked with Diesel on a store opening in Portland.

TAOW's idea was to create an Internet-based campaign and establish a relationship between the 55DSL brand and its target market through a 17-stop trip around the world by two customers. They would document the trip through Web log postings and short video clips that reflect the brand's tag line.

Yet the below-the-radar brand faced several challenges: a limited budget (about 3% of the company's European advertising budget), a short timeframe (six weeks from hiring TAOW to the project launch) and a 55-day worldwide itinerary.

The Junior Lucky Bastard World Tour was conceived.

TAOW contacted corporate partners it had worked with in the past, such as Red Bull, Nokia (which donated new phones), Mini Cooper (which donated cars at the 17 stops) and Airtreks (a San Francisco-based travel company that offered discounted airfare to the winners).

To publicize the campaign, TAOW solicited applications for what it called 'the best job in the world' for two 'junior lucky bastards' – as the job 'titles' read – to experience. The contest attracted 900 applicants from more than 100 countries who submitted videos that best illustrated the brand's tag line ('live at least 55 seconds a day'). The 'job' was advertised on posters, in classified ads and on Monster.com.

The campaign sought applications from creative, young recent graduates. The winners – two twenty-somethings from the United Kingdom and France – were a freelance graphic designer and amateur filmmaker.

The two guys posted an online video of how they were 'living at least 55 seconds each day' on each leg of the trip in August and September 2006. The campaign began to generate local buzz along the way, and soon the winners were being interviewed by local media. They began to meet and socialize with local residents, giving 55DSL unlimited (albeit difficult-to-track) exposure.

TAOW helped develop ways to maximize the exposure of the campaign by assisting with PR strategy, designing Internet content and leveraging media interest.

'These guys went around the world with two cameras and a laptop,' Kristiansen says, and they produced the videos entirely, from filming and editing to uploading the content. They also posted photos of their travels on a photo-sharing site and supplemented their video diaries with Web log postings. 'We let two strangers take over our brand and our website,' Kristiansen adds.

For Taylor, although he can't point to a direct effect on the brand's sales figures, the results speak for themselves: 480 million impressions (including television coverage, Web log coverage and unique video views), 135 print articles worldwide, nearly 400,000 unique visitors with more than 2 million page views to the 'Junior Lucky Bastard' page on the 55DSL Internet site, and 300,000 links to Web logs.

Taylor advises marketers to establish partnerships with an eye to the future rather than expecting an immediate return. Kristiansen agrees: 'All these partners were brought in, in a short period of time, but if you have the right idea and the right people working on it, anything can be done. Any company could have done (something similar) if they had the idea and believed in it and took the risk.'

Source: Adapted from Fielding (2007). Reprinted with permission from *Marketing News*, published by the American Marketing Association.

companies have created online communities on the World Wide Web for their brands, and are thereby building new relationships with their customers that enable consumers to communicate with each other. Many famous brands have developed online communities through bulletin boards, forums, and chat rooms, such as Disney (http://family.go.com/boards), the Shell International Petroleum forums (www.shell.com), CNN (http://community.cnn.com), and Bosch tools forum on www.boschtools.com. Heineken (www.heineken.com) allows individuals to establish their own virtual bars, where, as bartender, they can chat with other visitors or meet their friends.

In traditional brand relationships, communication flows between the marketer and the consumer. Lately, brand-based online communities have demonstrated the potential benefits of dialogue flowing between consumers via two utilities: real-time 'chat' taking place in 'chat rooms' and discussions that play out over days, weeks, and even months in discussion forums or bulletin boards. Brand-based online communities have a distinctive focus. The audiences may be geographically dispersed in time, but they share common interests that are perhaps difficult to serve profitably through other international media. The online sites thrive because they offer their participants the following:

- a forum for exchange of common interests;
- a sense of place with codes of behavior;
- a meeting place for specialists;
- the development of stimulating dialogues leading to relationships based on trust;
- encouragement for active participation by more than an exclusive few.

The popularity of interactive communication gives the brand website an abundance of 'free' content from the consumer community. Consumers benefit from their ability to recognize in each other 'people like me' and to form genuine relationships with like-minded people. Both the content and possibility of forming relationships with other buyers and with the brand's managers act as a magnet, drawing consumers back to the site on a frequent and regular basis. This enables further commercial opportunities for the brand owners and legitimizes the investment in website development and maintenance. In this respect, connecting the brand site and the social aptitude of community participants potentially creates a new marketing tool.

By making sure that consumers can interact freely with each other and build a friendly online community, marketers can follow consumers' perceptions about and feelings toward the brand in real time. The value lies precisely in the volume of communication and interaction generated between consumers. The more communication and interaction, the stronger the community, and the better the feedback. Interactive online media will enable marketers to sense market forces with unprecedented accuracy and efficiency, overcoming the limitations of today's one-way research methods.

Any brand can develop an online community. However, not all brands allow for much customer involvement. Some brands enjoy a natural focus by virtue of their high-involvement product offerings. For example, Bosch, a German manufacturer of power tools, hosts a forum for trades people and do-it-yourself enthusiasts to swap information and suggestions, including prices, which brand of power tool to buy, and how to fix cracks between walls and ceilings (www.boschtools.com).

Other large consumer companies have built popular communities around associated interests. On its family.com site, Disney operates one of the liveliest bulletin boards targeted at mothers. Its discussion topics deal with parenting, marriage, health, food, education, holidays, and many other issues. CNN hosts many discussion forums and chat sites, generated in part from viewers of its broadcasts and in part from its regular audience that seeks out CNN when traveling. Not surprisingly, CNN has an active community of business travelers who share tips about packing, rate worldwide restaurants, and debate the hand luggage policies of various airlines (community.cnn.com).

As mentioned earlier in this chapter, the advertising on mobile phones is increasing as the technology – both hardware and software – advances. The generation of Smartphones such as Apple's iPhone, Google's G1, and the BlackBerry Storm have a touch screen that is large enough to display the web page and advertisements properly (*The Economist*, 2008a). Marketers are working on which types of advertising work on mobile phones. While simple text messages and banner ads are the most widely used, a newer approach is to use several channels. Advertising on mobile phones presents both risk and opportunity. The risk is that it can appear to be intrusive as it appears in a personal context, but that is also what makes it attractive to advertisers, depending upon their ability to target their audience without seeming to be intrusive (*The Economist*, 2008a).

There is a potential problem with online advertising that can cost advertisers a great deal of money. This is known as *click fraud*, which Grow and Elgin (2006, p. 48) define as:

> clicking on advertising solely to generate illegitimate revenue for the website carrying the ads; those doing the clicking typically also get paid.

Another practice is use of the *parked website*, which is a site typically having little or no content except for lists of Internet ads, often supplied by Google or Yahoo!. Many of these are the source of false clicks. A third practice is creating a *paid-to-read (PTR)* site, which pays members to look at other websites and offers from marketers. PTR sites are also often used to generate false clicks on parked websites. When the advertiser pays by the click, it becomes apparent that costs from fraudulent clicks can be high.

Media mix

In terms of general effectiveness in accomplishing advertising objectives (see Exhibit 13.5), the capabilities of media in various countries are similar. Newspapers are a good medium to indicate where and at what price a product is available; magazines are suitable for reaching specialized audiences or for promoting products that require considerable explanation or perhaps display in color; outdoor or transportation advertising is good for brief visual

Exhibit 13.5 Media objectives

Media are often evaluated in terms of the following:

- *reach* (the number of individuals or households reached);
- *frequency* (the number of times a message is delivered to target audiences);
- *continuity* (the pattern of message delivery);
- *size* (the space or time unit employed);
- *availability* (the extent to which a medium can be used and how it can be used).

Selection of media on the basis of whether or not they accomplish the objectives of desired reach, frequency, continuity, size, or availability is a somewhat mechanistic approach. Also to be sought are measures of the qualitative characteristics, for example the credibility and reputation of the medium, and general impact of messages that are carried by the medium. Some media are better suited to demonstration of a product in use while others are better suited to portray the color or other physical characteristics of a product. Thus different media may assist an advertiser with different communication objectives. Finally, there is the matter of costs. The media plan must be feasible within the limits imposed by the budget.

messages; television and cinema are appropriate to demonstrate a product in use, especially when it is mechanical or when a demonstration is desirable. The potential of the Internet and mobile phones has been barely scratched.

International print or broadcast media are often useful as part of a corporate advertising program, designed essentially to accomplish broad objectives relating to the reputation and nature of the company as a well-known, responsible producer of certain products or as a respected member of the business community, serving the needs of society and the economy. International media audiences are often relatively influential, either as members of the middle and upper socio-economic groups or as specialized professionals in a given industry. Therefore international media may be used to enhance a company's reputation or prestige, or to reach opinion leaders, high-level government officials, foreign corporate executives, scientists, and others who may be in a position to influence the climate for the company's products or services.

International media may also be useful in reaching markets in which local foreign media are unavailable or, if available, are not sufficiently developed or suitable to provide coverage of and impact on the relevant persons in a market. For example, farm equipment manufacturers may advertise in international print media that are read by farm equipment dealers.

International media may also be useful to develop a uniform or at least a harmonious image in a number of relevant foreign markets. For example, an automobile manufacturer, an airline, an oil company, or a tire manufacturer – in view of the fact that significant segments of their markets frequently travel from country to country – may wish to advertise in international media in order to develop a uniform reputation throughout foreign markets.

Although international media can be used to accomplish specific promotional objectives, it does not follow that they can often be used to the exclusion of foreign media. In fact, companies are coming to depend more and more on foreign media, while continuing to refine their knowledge of the particular role that international media can play as a part of the total promotional program.

A concluding comment

Each of the forms of export (or international marketing) promotion discussed in this section has special strengths, but each also has significant weaknesses. For the most part these characteristics should be viewed as *relative* rather than necessarily absolute.

Personal selling can often be the most effective form of promotion in the context that the ratio of sales made to number of prospects contacted is usually higher than in nonpersonal promotion. In contrast, the major disadvantage of personal selling is its high cost per sales contact as compared to other forms of export promotion. Export sales people often travel great distances and remain away from home for long periods of time. Expenses 'on the road' are quite high.

It is difficult to generalize about sales promotion because it takes so many forms. Many techniques (sales aids, displays, training, and so on) are used to improve the sales performance of channel members or personal sales people. Participation in trade fairs and exhibitions is frequently successful for export marketers because it combines, in one place and in a short time period, personal contacts by company representatives with a large number of potential buyers. Sales promotion activities may also coordinate advertising and personal selling by helping both company sales people and channel members (e.g., distributors and agents).

A major advantage of publicity is its credibility. People who do not believe advertising claims about a product or company often believe the same claims when they are exposed to them as a news item.

In contrast to personal selling, advertising has the advantage of reaching many potential buyers at a relatively low cost for each contact. It is the form of promotion best suited for mass promotion. For example, *sponsorship of events* – sporting, cultural, and so on – has been successful for many companies. It is difficult to attend a major international sporting or cultural event in Asia without being aware of the presence of large tobacco companies such as Philip Morris (motor sports and the arts), RJR (tennis and rock concerts), and BAT (track and field, and the arts). Because of increasing government regulation tobacco sponsorship is on the decline. Other sponsorship activities include European schoolroom campaigns targeting children beyond traditional television as follows (Stewart-Allen, 1999):

- Procter & Gamble sponsors 3-on-3 basketball as a way of keeping fit on its European Sunny Delight bottles.
- News International and Walkers potato chips sponsor books for schools, where schools collect coupons from News International newspapers and the chip packets in exchange for books.
- Unilever's Stork margarine has its 'Make it, Bake it' program to promote baking in home economics classes.
- Earlier in this chapter we mentioned that Pepsi, Adidas and Nike are sponsoring youth sports in China.

A major limitation of advertising is its all-too-frequent failure to convince a significantly large share of the people exposed to it to buy the advertiser's product. In all fairness to advertising, it should be recognized that certain approaches are designed to have a longer-run impact and, as such, advertising's impact may be cumulative.

Also, sometimes the objective of advertising may be one of communication only, such as creating awareness. Finally, it is difficult to measure the true impact of advertising on sales because the individual main effects of all marketing variables cannot be separated.

Advertising as mass promotion is used most with the export of consumer goods to create brand/product acceptance in a broad target market. Industrial advertising uses specialized media to contact relatively smaller numbers of prospects. Often its main purpose is simply to 'open the door' for personal selling.

Promotional programs and strategy

Although the export (international marketing) promotional program is an integral part of the export (international marketing) marketing mix, it can be visualized separately as a subsystem (a collection of interrelated activities) that we will call the promotional mix or a promotional program. A promotional program is a planned, coordinated, integrated series of efforts built around a single major theme or idea designed to achieve predetermined communication objectives. A promotional program may include such activities as consumer product advertising, corporate advertising, personal selling, sales aids, and a wide variety of sales promotional activities. Promotional programs may be geared to either *prototype standardization*, in which minor modifications are made to some basic strategy, or *pattern standardization*, whereby a strategy is designed from the start to accept modification to fit local conditions, yet still keeping sufficient common elements to minimize the drain on resources and management time.

An example of globalizing the brand image of Unilever's ice cream business in the late 1990s is shown in Exhibit 13.6.

At times a company whose identity, though strong at home, is relatively unknown in foreign markets finds it advantageous to attach its company identity to a known, respected entity in its targeted foreign market(s). This would involve what is called **co-promotion**.

Exhibit 13.6 Globalizing the brand image of Unilever's ice cream business

Unilever, world market leader in the ice cream business in the late 1990s was competing globally with a multidomestic strategy. At the beginning of 1997 the company considered globalizing its ice cream operations in the 130 countries where its products were marketed. In Europe there was a separate Business Group for ice cream and frozen foods. In North America ice cream was handled by a Business Group that was in charge of all Unilever's food products categories. In the rest of the world the Business Groups responsible for ice cream were also responsible for all other corporate products, including cleaning and personal grooming articles.

Reasons for changing Unilever's international image

There were four main reasons why Unilever started thinking about changing its ice cream brand image: market trends, new consumers, life styles, and individual brand images in different countries.

The ice cream market had undergone significant changes through the 1990s. Competitors were going global, placing more emphasis on their global brand name than on local brands. Unilever was not benefiting from this globalization (i.e., tourism and overspill media) due to the use of different brand names and logotypes in different countries.

Furthermore, production was becoming increasingly highly concentrated. The industry's largest groups were unifying their production centers and reducing the number of suppliers to one or two for each ingredient.

In a situation such as this advertising was becoming tremendously important in the ice cream industry. The value of brand name products was becoming far greater than the value of local products.

Market studies carried out in various European countries revealed the weak points of Unilever's different ice cream brands. Among the shortcomings reported were the following:

- The brands had a seasonal image and were largely associated with summer.
- Customers perceived the brand images as somewhat out of date.
- The logotypes of the various brands were perceived as less than dynamic and somewhat old.

Market studies further revealed that although consumers were familiar with Unilever's different brands they did not associate them with the parent company.

'The best provider of the best ice cream product'

After carefully studying the situation, the group's management team thought it was time to radically change the different brand images. Their aims were to:

- shape a more up-to-date image that would strengthen Unilever Group's position as a market leader;
- transmit a more dynamic, natural, and fresh image;
- reduce costs through synergies attained;
- give the image an international identity.

There were many different options, given that the group manufactured in 80 countries and distributed its products in an additional 50. There were doubts about how many countries should be affected by the change in image, how the new image should be focused, whether one of the existing brands could be extended to other markets or whether an entirely new brand should be created. There were also doubts about whether a single image would be globally accepted, the different sorts of impact this image would have in individual countries and the consequences and implications of any major change.

The Unilever decision: a new global brand image and local brand names

A new logotype was introduced in 1998 as the house brand of Unilever's ice cream products throughout the world. But this logotype was to be combined with each subsidiary's local brand name, so the high awareness of each local brand in its corresponding market would not be lost. This decision aimed to gain most of the benefits of using a global brand and avoid some of the drawbacks. Unilever was attempting to place stronger emphasis on the logotype, as Nike does with its 'swoosh.'

An implementation plan with different stages was designed. It was decided to change to the new global image in different stages: the countries in the northern hemisphere were to use the new global image starting in February–March 1998, the countries of the southern hemisphere had to adopt the new image as of September–October 1998. The exception was those countries in which a local subsidiary had been recently acquired.

By mid-1998 market research studies were conducted to measure consumer acceptance of the new logotype. The results were quite positive: the new logotype was regarded as dynamic, modern, distinctive, innovative, etc. It was reported that the new image had problems in two places: some Arab countries and the Basque country (in Spain). In some Arab countries the new logotype has a certain resemblance to the graphic writing of 'Allah' and was therefore rejected. In the Basque country the rejection of the logotype was for political reasons. The red and yellow colors used are the same as the colors of the Spanish flag. Using a different Pantone color closer to orange than to yellow solved this problem.

In all, the new general global logotype was successfully introduced. Some awareness studies conducted in Europe after the campaign revealed that brand awareness in most countries was similar to what it had been before the introduction.

For example, when the US-based FedEx wanted to increase its name recognition in Europe, the company teamed up with Benetton, an established name there. FedEx sponsored one of Benetton's Formula One racing cars in Europe. In dual sponsorships, companies need to join with an overseas partner that has a common objective with them. FedEx joined with Benetton's racing team because their image fit with its brand, which connotes the image of speed and high technology. Another example is shown in Figure 13.7.

a b

Figure 13.7a and b Co-promotions are beneficial when both parties deem their products or services suit each other, as in these examples of LEGO joining with Kellogg's and McDonald's (used by courtesy of the LEGO Group)

Planning export promotional strategy involves the following:

- setting promotional objectives;
- deciding on the types of advertising and promotional messages;
- selecting media;
- determining how much time, effort, and money to spend.

The possible objectives of promotional efforts are indeed large in number. For example, they might include not only creating an awareness and interest in a company's products, but also creating a favorable name and reputation in the minds of customers, distributors, suppliers, or even foreign governmental officials or regulatory agencies. Usually it is best to establish specific attainable goals. While it may sound fine to support the marketing of a product around the world, it is much better to try to accomplish specific objectives such as these:

- to convince buyers of the durability of a product;
- to illustrate the effectiveness of the product in satisfying a particular want;
- to create an image of the company as a dependable supplier.

Preliminary steps in the planning of an export promotional program include an assessment of the size and extent of markets, customer behavior and buying habits, and competitive circumstances. Consideration must be given to the channel(s) of distribution that a company uses (including original entry strategy) both between nations and within each foreign market; a promotional program may vary according to whether a company sells direct or through wholesalers; or it may vary according to the type of retail channels utilized, especially regarding the cooperation to be expected from channels. The nature of the product line, brand policies, the price of the product, and other aspects of the overall marketing effort must also be considered.

With the appropriate information at hand on markets, competition, channels, product characteristics, and price, a company can formulate its general promotional strategy. For example, the company can decide whether to depend mainly on consumer advertising to presell the product and pull it through the channel of distribution, or to depend mainly on distributors, agents, or dealers to give the product satisfactory push to help customers make up their minds at the point of sale. Then the company can decide on the advertising platform and the timing of the several stages of the campaign; and the company can make decisions on specific advertisements and media. Finally, the company can add up probable costs to arrive at the total cost of the program: a proposed budget. Then, the budget can be examined to be sure that it is within general company guidelines. If not, it will have to be justified to the satisfaction of management, or the promotional campaign will have to be revised.

Since advertising is the dominant form of sales promotion, we discuss in the remainder of this chapter two major issues facing export marketers in planning advertising strategy and tactics: (1) whether to standardize across markets and (2) transference of a successful campaign from one market to another.

Standardization or adaptation?

An overriding issue facing export marketers is whether standardized advertising can be used across countries or whether each market is so unique that it needs to have advertising developed solely for it (individual market adaptation). There has been a great deal of discussion and research about the issue, but no consensus for an answer.

In a review of the, at the time, nearly 40-year debate on standardization or adaptation in international advertising, Agrawal (1995) concluded that practitioners alternated between the adaptation approach and the standardization approach. A preference for localization in the 1950s, due to a lack of familiarity with international consumers and markets, shifted toward standardization in the 1960s as knowledge of international markets improved. This was followed by a reversal toward greater adaptation in the 1970s as a result of the rising nationalistic forces and some well-publicized advertising blunders that occurred during the 1960s. Then there was the second reversal toward standardization in the 1980s, which witnessed the rise of multinational advertising agencies. In the last decade of the 20th century the trend was more diffuse, however; the few surveys on multinationals report the use of a combination strategy or adoption of a more localized strategy (Yin, 1999). A study of wholly owned subsidiaries of US, European, and Japanese multinational corporations in China, Hong Kong, Singapore, and Taiwan found that patterns of advertising standardization varied based on national origins of the MNCs (Samiee *et al.*, 2003). The subsidiaries of US-based companies are likely to pursue a standardized advertising approach, whereas the Japanese are least likely to standardize.

A more recent study (Okazaki *et al.*, 2007) examined the relationship between market convergence and standardization of advertising campaigns in the European Union. Results of this study of Japanese and United States companies operating in the EU suggest that companies that believe the EU is converging are more likely to use standardized advertising strategies. In addition, companies that seek to create a uniform brand image such as Unilever (see Exhibit 13.6) are more likely to standardize their advertising program. Another

Table 13.2 VALS categories

Need-driven groups (poverty-stricken people with no real economy and unhappy with life)
1. Survivors: tend to remain depressed
2. Sustainers: continue to struggle to get ahead

Outer-directed groups (oriented toward others and the environment)
3. Belongers: conservative, traditional, family oriented, and happy with life
4. Achievers: successful, self-reliant, and happy; they have arrived!
5. Emulators: striving to be as successful as achievers, but have difficulty reaching this goal, are low in self-confidence, and dissatisfied with life

Inner-directed groups (internally motivated)
6. 'I-am-me's': in transition and tend to be young, active, and innovative
7. Experientials: seek direct, vivid experiences, tend to be experimental, self-reliant, and happy
8. Societally conscious: concerned with social issues and living in harmony with nature

Combined inner–outer-directed group
9. The integrated: psychologically mature and tolerant

study looked at advertising campaigns in fast-moving consumer goods companies from small and open economies and the impact of the internationalization/globalization phase of the company (Gabrielsson *et al*., 2008). Results show that during internationalization often within the home continent, companies increasingly adapt advertising campaigns to different countries. In contrast, globalization to other continents leads to increased standardization across countries.

There are different schools of thought regarding the standardization versus adaptation issue. At one extreme is the belief that basic human needs, wants, and expectations today transcend geographical, national, and cultural boundaries. Consequently, any differences between countries are viewed as being of degree, not of direction. The values and lifestyles of people in different countries may be similar. One approach to measuring this is the Values and Life Styles (VALS) methodology developed by Mitchell (1983). Nine distinct VALS categories of people have been identified and these represent market segments based on lifestyle variables, values, and demographics as shown in Table 13.2.

At the other extreme is the view that even though human nature is the same everywhere a Dane will always remain a Dane, and an Australian will always remain an Australian. In the view of this group, different cultures create different needs, although there may still be similar *basic* needs. This means that people may not be satisfied with similar products and communication appeals and approaches. For example, Polish people have been reported as being irrational, sensitive, and emotional, so in advertising to them these qualities have to be appealed to. Similarly, Asian countries have been characterized as each country being an 'individual minefield of social factors.' Strategies appropriate for Indonesia will not work in South Korea. A number of successes by companies following each extreme indicates that the approach to use is largely situation specific, particularly among product type. In some ways each person in the world is the same, and yet no two people are exactly the same.

Thus, each person is a cultural *communicator* and a cultural perceptor. When export advertising is being done the advertiser's cultural background affects message form whereas the recipient's cultural background determines message perception (Hornik, 1980). Another possible confounding aspect may be whether the respective cultures differ in context. Differences between low-context and high-context cultures have major implications for the export advertiser.

In high-context cultures (e.g., much of the Middle East, Asia, and Africa), the meaning of a message cannot be understood without its context. In contrast, in low-context cultures (North America and much of western Europe) the meaning of a message can be separated from the context of use and understood by itself. Such differences suggest that advertising messages developed for low-context cultures may not be effective in high-context cultures and vice versa.

The appeal of standardized export advertising is that it provides a number of opportunities to the company doing the advertising:

- *Present a worldwide company/product/brand image.* In the early 1990s the Italian apparel firm Benetton created a very controversial worldwide advertising campaign. This campaign replaced the 50 different campaigns that the company had in 50 different countries. The advertising was to create a message directly from the company without showing a product. This campaign included ads showing people of different races laughing, hugging, and kissing; and photos of an oil-coated bird, a newborn child with the umbilical cord still attached, and a man dying of AIDS. According to Luciano Benetton, chairman of the company, these ads were a consequence of the company seeing the world as a whole. It wanted to touch themes that were common to countries worldwide. This advertising has been both award-winning and banned (Lynch, 1993).
- *Lower costs of preparing advertisements and implementing an advertising program.* In the mid-1990s Colgate Palmolive, a large US-based packaged consumer goods firm, saved a lot of money when it replaced 20 separate local advertising campaigns for laundry detergent with a series of successful commercials developed in France. This single campaign ran in 30 countries (*Businessweek*, 1996).
- *Reduce message confusion in areas where there is media overlap* (e.g., Canada/United States, Germany/Austria, Denmark/Germany) *or country-to-country consumer mobility* (e.g., throughout western Europe).

These opportunities may still be possible without adherence to a strict interpretation of standardized advertising.

One reason, perhaps even the major reason, that there is such controversy regarding standardization, and no consensus in research evidence, is that the concept of standardized advertising has been used too simplistically. It has been suggested that a more realistic approach to defining standardization would be to recognize that it has two versions, as mentioned briefly previously in this chapter (Onkvisit and Shaw, 1999). One version is *prototype standardization*, in which the same advertisement(s) or campaign(s) are used in multiple export markets with the only difference being language translation, and perhaps even a few idiomatic changes (see Exhibit 13.7). Even if prototype standardization is the goal of management, differences in product line, size of market, and media availability may influence the actual degree of standardization used.

In contrast to prototype standardization is *pattern standardization*, which is more planned and flexible. Under pattern standardization the export advertising campaign, including its overall theme and individual components, is designed at the outset for use in multiple markets and is developed to provide a uniformity in direction, but not necessarily in specific detail. Thus pattern standardization need not differ significantly from a policy of individual market adaptation. In 1992 Colgate Palmolive was extremely successful (the product sold out in the country in two weeks) in adapting a global television commercial for Ajax all-in-one cleanser for use in Poland during the product's initial launch there. In late

Exhibit 13.7 Wow goes global

Some years ago, Grey Advertising, Inc., a large advertising agency located in the United States, was involved in the development of an advertising campaign to help market the Wow bra in 12 countries. Wow was a product of International Playtex, Inc. The idea was to create a standardized campaign that would work in all the countries. That is, Grey wanted to develop a global advertising campaign based on a single commercial that could be used with minor changes wherever the product is sold. Such a campaign can save an advertiser a large amount of money in the production of advertising. At one time in the past Playtex had 43 different versions of advertisements being used throughout the world.

Major problems in creating a global advertisement include logistical problems and management resentment. Managers responsible for operations in individual countries may resent having an advertising plan and campaign imposed on them. In addition, government regulations and varying industry standards in different countries make sound logistics management critical. All this means that it is, in many ways, more complicated to develop a global advertisement than to produce advertisements in different languages.

It is essential that the advertising be based on the idea that specific versions of the product vary in their appeal. For example, lacy bras were the preference of French women whereas Americans favored plainer, opaque styles. The appropriate product version could then be inserted into the advertisements for each market. Although the style of the product varied for each market, the advertising message was the same. A single product feature was emphasized, which it was felt had universal appeal – extra support and shape without the use of underwires.

Included among the major changes for individual markets were that in some markets (e.g., the United States and South Africa) fully clothed women showed the product rather than modeled it directly. Also, some of the television advertisements were 20 seconds in length while others were 30 seconds.

This global campaign allowed Playtex to present one unified message in the markets of concern. At the same time the company was able to save money. The total cost of the single global advertisement was US$250,000. In the past, the cost of producing a single advertisement for the US market was US$100,000.

The start of versions run in Britain, Germany, and Spain had minor differences. There were subtle differences in the nonverbal communication (via positioning) of the three models in each version. Yet all versions covered the three basic hair-colors (red, blonde, brunette) and the dresses worn were the same and were appropriate for the models' hair color.

2003 McDonald's launched a new global advertising campaign in more than 100 countries that is designed to increase business with a younger image and a new slogan – 'I'm lovin' it.'

A number of different aspects of international advertising are subject to standardizing, including the following components:

- target markets;
- product positioning;
- campaign objectives, campaign themes;
- media objectives;
- basic media mix, media schedules;
- creative execution – visual and copy.

Appeals

Export advertising appeals must be in accordance with tastes, wants, values, and attitudes; in short, in harmony with the prevailing mentality of the market.

For example, the health appeal varies in effectiveness from country to country. Belgians are hard-working, earn a good living, and spend freely. They appreciate the good things in life. They desire comfort in clothing, heating, and home facilities. They are fun loving and appreciate radio, television, beer, wine, and other products that add to the enjoyment of life. To a Belgian, 'good for you' means pleasurable. He or she will buy if the taste pleases, even if it is bad for their health. Likewise, in France, the suggestion that the use of a certain toothpaste will help prevent dental caries is likely to be less effective than in the United States, since the French are not as inclined as Americans to be concerned about the numbers of cavities in their teeth.

In the Netherlands health attitudes are quite different. The Dutch show greater concern about their health than the French. To the Dutch the vitamin content and energy value of some foods are more important than taste. At the same time, however, vitamin content and energy value have the connotation of health food, for example sprouts, alfalfa, and muesli. Very stolid eaters, the Dutch like fresh, traditional foods such as farm products, for example, ready-scrubbed new potatoes, where freshness and presentation are very important. Some may question whether strong coffee, spirits, high-fat meats, cheese, and potatoes – all favorite foods of the Dutch – constitute a very healthy diet. What this can suggest, however, is that the effectiveness of an appeal in a foreign market may vary within the country and product class.

Sex appeal in advertising has been widely used in most countries. Obviously, consumer response to such an appeal is influenced by culture. In a study of Australian, Chinese, and United States consumers, each exposed to the same advertisements, results showed that while there are differences in attitudes toward the ads among the three groups of consumers, consumer buying intentions toward the advertised brand were not significantly different (Liu *et al*., 2009). An unexpected finding was that Chinese consumers had similar attitudes toward sex appeal ads as did US consumers. The Australian consumers had the least favorable attitudes toward this type of advertising. Product involvement was found to have an effect on attitudes and buying intentions.

For products that are identical physically but which are used differently from one market to the next – for example corn starch, cake mixes, instant coffee, margarine, and many other food products – the advertising message may have to be adapted for each market segment. However, a number of years ago Campbell Soup, in order to show active people on the move around the world and at the same time to underscore the universal appeal of Campbell Soup, commissioned the filming of a 60-second film spot that included a high-speed train in Japan, a market scene in Singapore, and a children's playground in Puerto Rico. It was dubbed into a number of languages, including Cantonese, Spanish, and Creole, for cinema presentation in 20 countries.

It is obvious that culture has a strong effect on what appeals would work best. In a study of North American and Chinese consumers, the interactive effects of appeals, arguments, and competition in advertising were examined (Teng and Laroche, 2006). Not surprisingly, the findings indicated that a culturally congruent appeal and a strong argument embedded in an advertisement may create more favorable responses when competing advertisements contain culturally incongruent appeals and neutral arguments than when competing advertisements contain culturally congruent appeals and neutral arguments. Advertising must be matched with the distinctive cultural values of the target consumers. That is, export/international marketers should always take cultural variables into account in their advertising (Teng and Laroche, 2006, p. 125). As an example, an individualistic appeal works in North America whereas a collectivistic appeal works best in China.

Illustrations and layout

Illustrations and layout are perhaps more likely to be universal than other features of advertisements. Certain types of illustrations can be used in several nations. For example, many years ago advertisements for what was then known as Canadian Pacific Airlines that were created in Mexico City appeared not only in US and Canadian publications but also in newspapers in such places as Tokyo and Hong Kong. The advertisements were originally planned for people in cities along the company's Latin American routes, but the airline found much of the work also suitable for worldwide use. A company spokesman said: 'It's one of the best campaigns we've got going. It's too good to limit it to Latin America. A slight change in copy, and we find it does the job as well for us in Vancouver or Hong Kong.'

The campaign to which the Canadian Pacific Airline spokesman referred had several features that may account, at least in part, for its wide suitability. The advertisements displayed large attention-grabbing photographs, usually with no more than 20% of the space used for copy. For example, a picture of a Canada goose, a symbol of the airline, was captioned, 'He knows the best routes south, so does Canadian Pacific.' Short and simple copy with the same message, of course, can be written for other routes. More recently, a three-minute television advertisement for Chivas Regal whisky was created by an advertising agency in Thailand and shot in western locations, for example in jazz clubs. The actors were Eurasian who looked western and therefore glamorous but were also eastern and therefore familiar. Since the Eurasians are not really identifiable as Thai, Chinese, or Malay, a pan-regional approach was used in running the ad in Thailand, Hong Kong, Taiwan, and Singapore. In the previously mentioned campaign of Benetton in the early 1990s, the same controversial pictures were used throughout the world.

Perhaps some forms of artwork are understood universally, and hence sometimes the same illustrations may be appropriate in different markets. Playtex used the same illustration of three models at the start of its commercial in the United Kingdom, Germany, and Spain, changing only the brand name Wow, shown in the background, to fit the language (see Exhibit 13.7).

On the other hand cultural influences may dictate that illustrations for the same product must differ from country to country. In German and Danish magazines an advertisement for cheese might show a large foaming glass of beer with the cheese, which would whet the appetite of a Bavarian and a Dane. But in France an advertisement for cheese would more appropriately substitute a glass of red wine for the beer.

Sometimes an advertisement – or a campaign – may use a celebrity as an illustration. Sports figures and actors are often used. As previously mentioned, the professional basketball player Yao Ming appears in advertising in China. The British soccer (football) player David Beckham appears in advertising in the United States and elsewhere.

Copy

There is considerable diversity of opinion with regard to the translation of copy from one language to another. On the one side are those who warn against translations. They point out that while mistakes can be made in any language, even by local copywriters, it is more likely that they will be made if advertisements are prepared in one country, translated, and inserted in international or foreign media without review by competent local linguists. Procter & Gamble attempted to market Pampers disposable nappies (diapers) in Thailand by stressing their convenience. This was a direct translation of the campaign developed in the United States. After some research it was discovered that Thai women worried that using the product might identify them as bad mothers, interested more in their own comfort than that of their babies. The campaign was changed to emphasize night-time use of Pampers, and that the disposable nappy would stay drier than cloth ones, resulting in babies being more comfortable at night. This approach was successful in getting Thai women to buy Pampers.

With regard to whether to prepare new copy for a foreign market or to translate the domestic copy, it seems reasonable to conclude that an advertiser must consider whether the translated message can be received and comprehended by the foreign audience to which it is directed. Anyone with a knowledge of foreign languages realizes that it is usually necessary to be able to think in that language in order to communicate accurately. One must understand the connotations of words, phrases, and sentence structures, as well as their translated meaning, in order to be fully aware of whether the message will be received and how it will be understood. The same principle applies to advertising, perhaps to an even greater degree. Difficulty of communication in advertising is compounded, because it is essentially one-way communication, with no provision for immediate feedback. The most effective appeals, organization of ideas, and the specific language, especially colloquialisms and idioms, are those developed by a copywriter who thinks in the language and understands the consumer at whom the advertisement is directed. Thinking in a foreign language involves thinking in terms of the foreigner's habits, tastes, abilities, and prejudices; one must assimilate not only words but customs and beliefs.

There are things that the export marketer can do in trying to avoid translation errors (Ricks, 1999, pp. 154–9). First, even if a company has a good translator nearby, it is desirable that a local person also be hired as a supplementary translator, one familiar with the local slang and unusual idioms. Second, use the technique of back-translation when developing advertising messages. Its value is illustrated by the situation faced by an Australian soft drink company entering the Hong Kong market. The company had its successful slogan 'Baby, it's cold inside' translated into Chinese. When back-translated into English, the message read 'Small mosquito, on the inside it is very cold.' 'Small mosquito' was a local colloquial expression for a small child, but it did not convey the intended English slang word 'baby' to refer to 'woman.' Third, under certain conditions it may be possible to use the language of the exporter. For example, in Denmark one finds much cinema advertising presented in English. Obviously, a significant proportion of the target market must understand the exporter's language.

Some generalizations

Generally speaking most advertising people would agree that it is unlikely that standardization can be successful for all products, for all countries, and in all export markets. Thus the critical question is: when will this approach be successful and when not; and what criteria can be used to make a judgement on this question?

The factors that will influence the appropriateness of standardized advertising for various export markets and market segments include the following:

- *The type of product.* There are certain universal selling points for some products – for example razor blades, electric irons, automobile tires, ballpoint pens – that are sold primarily on the basis of objective physical characteristics.
- *The homogeneity or heterogeneity of markets.* When aggregate characteristics such as income, education, and occupation are alike, individual consumer characteristics such as needs, attitudes, and customs may also be alike, thus suggesting that the advertiser use the same selling points.
- *The characteristics and availability of media.* For example, if specific media are available in one country but not in another, certain messages and materials may not be usable.
- *The types of advertising agency service available in each market segment.* For example, if in some markets only poor service is available, a firm may be forced to rely on centralized control of advertising.
- *Government restrictions on the nature of advertising.* For example, some governments prohibit certain types of messages.
- *Government tariffs on artwork or printed matter*, which might offset a cost advantage of centralization.
- *Company organization.* If a company is organized to conduct business on a multinational basis, and if personnel are available, the standardized approach to advertising may be feasible; for example, if a company has subsidiaries it can often control advertising better than if it relies on independent licensees.
- *Availability and quality of advertising agencies.* Every major city has ad agencies. But, one of the 'hottest' cities is Amsterdam, where agencies are relatively small, but do innovative global work for companies such as Coca-Cola, Adidas, Sony, IKEA, Sam's Club, and others (Ewing, 2006).

People the world over have the same needs – such as food, safety, and love. But they sometimes differ in the ways in which they satisfy their needs. Just as it is important to provide physical variations in products to meet the varying demands of diverse market segments, it is also important to tailor advertisements to meet the requirements of each market segment. But it is the demands of the market segments that are diverse, not the approach to planning and preparing marketing programs. It is only the specific methods, techniques, and symbols that sometimes must be varied to take account of diverse environmental conditions. Therefore international advertisers may be well advised to export their approach to planning and preparing export advertising; but before making final decisions on copy or media they should be sure to consult personnel who know the foreign market intimately.

Advertising transference

Closely related to the issue of standardization is that of *transferability* (or extension) of a successful campaign from one market (domestic or export) to another market. Whereas standardization occurs when a marketing activity is conducted the same way, or a marketing strategy is the same, in all (or a set of) foreign markets, it does not refer to *how* the commonality was achieved. Transference, which refers to how a marketing activity or strategy 'arrived' in a foreign market, can be defined as the extent to which a marketing activity or strategy is performed the same in a foreign market compared to the market from which it came, usually the home market. Three factors have been identified as having a bearing on whether transfer is a viable alternative (Sheth, 1978). These factors are as follows:

1. The expectations and criteria that people use to evaluate a product class in various countries. In other words, what benefits do people expect to get from the purchase and consumption of a product class? This factor influences *appeals*.
2. The mechanics of encoding and decoding symbolic communications. This represents both the production and consumption of advertising and is reflected by: (a) media availability differences, (b) differing laws and regulations that affect advertising, and (c) cross-cultural differences in receptivity and acceptance of advertising.
3. The 'silent languages' of each country. These affect the background settings for the message to be conveyed.

A simple model of transference assumes that two countries are either the same or different for each of these factors, and this leads to eight different types of extension–adjustment combinations. These strategies are defined as follows:

- *Complete extension.* Under this strategy a successful advertising effort is transferred to other countries without any modification either in content or in media choice. We do find the strategy of complete extension operating in clusters of countries, among Scandinavian countries, for example, and in North American countries.
- *Symbolic extension.* Successful advertising is extended to other countries with modifications only in the background situations. Only minimal modification must be made, since both the appeal and the medium remain the same. A good example of symbolic extension is the substitution of a boy for a girl in the Vicks VapoRub commercials when extended to Arab countries, where boys are more the object of parental affection.
- *Literal extension.* This strategy is most common when buyer expectations and silent languages are the same but encoding/decoding processes are different. In this strategy different media may be used or the same medium may be used differently in the foreign country. This strategy is usually developed in response to differing legal restrictions. For example, cinema houses are a common medium for advertising in Scandinavia but seldom used in the United States.
- *Symbolic and literal extension.* It is probably more common to see both symbolic and literal extensions than either of them alone when a company is marketing a universal product to developing countries. A company such as Coca-Cola, IBM, or Unilever can conceivably create a worldwide advertising effort with the use of this strategy.
- *Simple adjustment.* In this strategy the medium and the background of advertising remain the same while the product is promoted on a different appeal. There are a number of instances in export marketing in which the same product is promoted on widely different appeals. For example, the bicycle is promoted as a commuting vehicle in developing countries as well as in Scandinavia, whereas in the United States it is promoted primarily as a leisure or sports item.

- *Symbolic adjustment.* Under this strategy both content elements, appeals, and background are modified. We find numerous examples of this type of transfer of advertising in most developing countries. For example, a number of prepared or processed foods (such as instant coffee) are advertised on the basis of being modern rather than convenient.
- *Literal adjustment.* This strategy calls for the appeals themselves to be changed and different media chosen to convey them. To illustrate, in the past the advertising appeals used by Gillette in Sweden were directed to compete against dry shaving, whereas they were directed toward encouraging self-shaving in Greece and toward superiority of Gillette compared to other blades in the United States.
- *Complete adjustment.* This strategy suggests a completely fresh approach in a foreign country. Blue Diamond Growers has a practice that even if a commercial or campaign promoting its almonds is a tremendous success in the home market (the United States), it is not used in any other country. Messages are tailored for each of the 94 foreign countries to which it sells and local people are used to direct advertising.

The United States brewer Anheuser-Busch in 2004 introduced its 'Ants' campaign – not seen in the United States since the late 1990s – into China, where it was a hit. Busch's former US campaigns are also being used in Great Britain, Ireland, and Canada. These campaigns are modified to fit each country's cultural tastes.

Management issues

Control over planning promotion strategy and selecting media for advertising depends on such considerations as the objectives of the promotional program, the availability of information on the relevant possible promotion forms including media selections, the knowledge and experience of company personnel, and the degree to which promotion, particularly advertising, must be supervised locally to insure proper performance.

For example, objectives that are company-based in nature, rather than local, suggest that control is likely to be centralized at the company level. Or, if relevant detailed information on certain media is available only on the local level, decisions are more likely to be made on that level. Similarly, if local media must be monitored closely to insure proper performance, company representatives and any cooperating organizations (e.g., an advertising agency) at the local level are more likely to be involved in both planning and control of media strategy.

The situations described above often vary from one part of the world to another, from time to time, from company to company, and from product to product. Thus it is only reasonable to expect that generalizations on the proper control policies should vary accordingly. And the question of centralized versus decentralized control has no universally applicable solution. Regarding media, however, we can identify types for which certain kinds of control are frequently desirable. International media are often used for company advertising and may be used for product advertising to reach markets not adequately served by the local media or in markets in which the exporter does not have representatives to handle local media advertising. For these reasons programs using international media are often planned and controlled at the company level, rather than locally. Also, international media provide extensive information regarding their publications, the markets they reach, circulation breakdowns, and so forth; therefore it is possible for personnel at a central location not only to develop expertise, but to maintain it.

In contrast, the original selection of foreign media is usually left to local personnel. Since media conditions differ greatly between countries, any centralized direction concentrates on policy guidelines on the use of, and criteria for the evaluation of, foreign media.

The basic reasons that those on the local level can do the media selection job better are as follows:

- They know the market better and which media will influence it effectively.
- They know the true costs, fee structures available to local advertisers, and local taxes that apply.
- They know at once whether an advertisement is running at the right time and place and can make necessary corrections without costly delay.
- They can get an advertisement into media with limited time or space, which can be extremely important. In the case of television, time is severely restricted in some countries.

On the other hand, centralized selection of media facilitates utilization of the latest and most sophisticated media selection techniques (if they can be used with the limited data available), coordination of regional or worldwide campaigns, and effective use of information on competitors' activities throughout the world as a base for appropriate counter strategies. Company, product, and brand image as it relates to country of origin is of increasing concern.

The availability of resources, especially technically competent marketing promotion personnel, make it desirable for some degree of centralization in order to be able to integrate and coordinate the major elements in export marketing promotion programs. The emergence of large international advertising agencies with offices throughout the world has facilitated this centralization. Perhaps the idea that a company exporting to many markets should aim for would be the following:

1. centralized strategic planning and policy making, based on information provided by foreign personnel as well as knowledge of company objectives;
2. decentralized planning and execution of advertising and promotional campaigns, with the guidance and assistance of central personnel or successful experience and ideas from other countries.

Summary

In this chapter we have looked at communication and promotion as major activities in export (international) marketing. We started with general comments about communication per se and then looked at export promotion as a form of communication.

Next we looked at the alternative techniques available for export promotion. Specifically we covered personal selling, sales promotion techniques (catalogs, trade fairs, and so on), publicity, and advertising. Most of our attention was devoted to advertising

since it is the form of export promotion that is most likely to be used in one way or another by all exporters. The climate for advertising and media types was discussed in some depth.

A short general discussion of promotional strategy was presented and this led to an examination of the one advertising issue that faces all companies exporting to two or more markets – standardization or adaptation – and the presentation of one model of the advertising transference phenomenon. We concluded the chapter by briefly examining some management issues relating to centralization or decentralization of promotion planning and control.

Questions for discussion

13.1 What is your interpretation of the term 'climate for advertising'? What factors cause the climate for advertising to differ among countries? Select one foreign country and explain how the climate for advertising in that country is important to an exporter.

13.2 From an exporter's standpoint, what kinds of objectives should promotional messages be designed to accomplish?

13.3 It can be argued that sometimes export marketing promotion activities appropriate for one foreign market are also appropriate in other foreign markets. Do you agree or disagree? Explain.

13.4 Explain how culture can influence the effectiveness of comparative advertising. Is there a stronger influence on 'attack ads'? Discuss. Choose a country representing a western culture and one representing an eastern culture. Would the same type of comparative advertising work in each? Why or why not?

13.5 Which type of media can be most effective: international or foreign? Explain.

13.6 Explain why individual sales promotion activities might be more effective in some markets than in others.

13.7 In what ways does culture affect export marketing promotion and communications?

13.8 As an export marketer becomes more or less 'permanent' in doing business in multiforeign markets, it almost inevitably faces the issue of standardization versus adaptation of its advertising program. Discuss what you consider to be the best approach for an exporter to use.

13.9 Discuss the main issues involved in deciding whether to centralize or decentralize the planning, developing, and controlling of export promotion strategy and tactics.

13.10 Go to the library and search out print media (i.e., magazine and newspaper) advertising by a company, or one of its products or brands in different countries. Does this company use standardized or individualized advertising? Explain.

13.11 What do you see as the 'future' for the Internet as a basic advertising medium and/or a means for implementing sales promotion in foreign markets?

13.12 Go to a European company's website, an Asian/Pacific company's website, and a US or Canadian company's website and evaluate each in terms of its use for marketing communications about the company's product(s). What can you conclude about the promotion strategies of the websites?

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CASE STUDY 13.1

Christa Clothing International

(This case study is adapted from the case Kleider International Clothing, written by Gordon Miracle, Michigan State University.)

Company history

Christa Clothing International is a well-known international company headquartered in Blusen City, North Carolina in the United States. Christa specializes in fashion clothing for men and women.

In 1991 two 30-year-old former university classmates founded an importing business. They purchased cheap fabrics from Indonesia and the Philippines and sold them to garment makers in the United States. These two men, Frank Carmino and Saul Green, built their importing business rapidly and profitably. They soon decided to expand into the fashion business. In 1992 Christa launched two new brands of its own, 'Bluse' for women and 'Jacke' for men. In 1993 they merged the two into an international brand, Blujac. The brand change was made in anticipation of entering European markets.

Christa's success in the United States provided a firm foundation for expansion into Belgium, Germany, and the Netherlands in 1995; followed by Sweden, Finland, Canada, and France in 1996; Denmark, the United Kingdom, Switzerland, and Norway in 1997; Austria in 1998; Spain and Italy in 1999; and Portugal in 2000.

In 2009 company sales (turnover) were more than US$600 million in the North American and European markets. This level of sales was almost 400% greater than sales in 1994, indicating that company growth had been rapid.

Potential expansion

Christa is contemplating Asian markets as a source of future growth, especially Hong Kong, Singapore, Thailand, Malaysia, Japan, and Korea. Recently Mr Carmino visited Korea as a tourist. He was not sure that Korea was necessarily the best choice to enter first, but he had a favorable impression from his visit and from the general characteristics of the Korean market, which he felt had great potential. The economy seemed to be growing vigorously, and competition for fashion did not appear to be as strong as in the relatively more mature markets of Japan and Australia. It seemed to be the right time to move into this growing market.

Before doing any further planning, Mr Carmino felt he needed further information. He knew that the World Bank had reported population and the purchasing power parity measure of gross national income per capita in these countries in 2008 to be approximately (www.worldbank.org/data):

	Population (million)	GNI per capita (US$)
Hong Kong	7.0	31,420
Singapore	4.8	34,760
Thailand	67.4	3,670
Malaysia	27.0	7,250
Japan	127.7	38,130
Korea	48.6	21,530

Mr Carmino ascertained that the Korean market was open to foreign products, and that several large, well-known international advertising agencies had branch offices or joint ventures with Korean agencies in Seoul. Korea has well-developed mass media and more than 1% of gross national product is spent on advertising. Korean GNI per capita continues to rise as recovery from the Asian crisis continues. Its population in 2008 was 48.6 million and 50.4 million by 2014.

Mr Green, who had headed the European expansion, was a little concerned that the Korean cultural, economic, legal, political, and social conditions were somewhat different from those with which he was familiar. For example, he was aware of the following somewhat different cultural, legal, and political conditions: (1) Korea has experienced somewhat peaceful changes in government through what some were willing to recognize as democratic elections and (2) the Korean culture differed from the US culture with respect to language patterns, religions, the level of individualism versus collectivism, the desire for harmony versus confrontational behavior, and so forth. Mr Green had some experience with these kinds of differences and similarities in Europe, but knew he would need specialized help to enter Korea and other Asian markets.

In addition to population, income, and age statistics, market potential in each country depends on many other factors such as local habits and customs of consumers regarding purchasing and use of clothing, availability and consumer use of mass media, and the role of clothing as symbols of the lifestyles of young people.

Recently, Mr Green met Cathy Peters, a young vice president of a New York advertising agency. She was born in Germany, has a degree in economics from the University of London, and had lived for several years in Japan as a teenager (where her father headed a US–Japanese joint venture advertising agency). She had several years' experience working as an account executive for US products sold in Korea and had been to Korea several times in a coordinating capacity. Her agency has had a joint venture arrangement in Seoul with a Korean agency for some years. Mr Green and Mr Carmino felt that Ms Peters' multicultural background and Asian experience were such that she would be an ideal person to head Christa's expansion into Asian markets.

Ms Peters was hired and given a mandate to study the situation and prepare recommendations to proceed. She began a broad program of desk research to make use of available published statistics and other information available from published sources. She was aware that some companies had tried 'global' branding, advertising, and marketing, and that some had failed while others had succeeded. She was determined to think carefully about the conditions under which advertising objectives, strategies, and executions should or should not be standardized, transferred (or extended) from existing markets to new markets in Asia, and controlled from headquarters or controlled in local markets (see Table 13.3).

The fashion business

The fashion business is complex. There are many suppliers. Brands emerge and vanish rapidly. The average fashion brand life cycle is normally a maximum of seven years. Market offerings consist of manufacturer brands, fake brands (counterfeit labeled products), private brands, and unbranded products.

Distribution tends to be broad, varying somewhat from country to country, but often including shops (which can vary from cheap, shabby-looking outlets to high-fashion stores or boutiques), chain stores, street markets, mail order, and even selling from the back of a car.

Transactions between traders and retailers are still often made in cash. This fact, combined with the diversity of brands and manufacturers, makes accurate tracking studies of fashion sales, such as Nielsens's, difficult indeed.

Company organization and functions

Christa Clothing is organized to facilitate centralized control of coordination and planning functions. Local offices translate international guidelines and strategies into local strategies and tactics. Headquarters is responsible for:

1. corporate objectives, policies, planning, organization, and finance;
2. design and styling;
3. coordination of production and distribution;
4. marketing and advertising services.

The Christa subsidiary in Manila, the Philippines is responsible for production, quality control, physical distribution, and coordinating production in Indonesia and the Philippines.

There are two main types of country offices in Europe: (1) Christa wholly owned subsidiaries and (2) Locally owned distributors, such as agents or traders that deal with fashion products. Christa prefers wholly owned subsidiaries in larger markets, using locally owned distributors, especially to get started, in new markets.

Local country offices, both subsidiaries and distributors, have the following local responsibilities: sales, physical distribution, pricing, and coordination of advertising and other marketing communication.

Table 13.3 Dimensions of international advertising to be considered for standardization/localization

I.	*Advertising objectives*
	Communication tasks
	Defined target audience
	Specified periods of time
II.	*Advertising message strategies*
	Theme
	Appeals
	Positive vs negative approach
	Benefits or product/service attributes
	Information amount and types
	Image vs product attributes
	Comparisons vs no comparisons
	Spokesperson vs voice-over, color mix, etc.
III.	*Advertising media strategies*
	Choice of media categories and vehicles
	Size and length of advertising materials
	Scheduling patterns: continuity, flighting, pulsing
IV.	*Advertising budgets*
	Heavy, medium, or lightweight
	By product
	By market area
	By customer classification
	By selected media
	For selected creative or message approaches
	Match or not-match competitors
	Contra-cyclical or not
V.	*Advertising decision processes*

Products and market segments

Christa offers fashion collections of casual wear that are coordinated with respect to design. Target groups are teenagers and young adults, mainly 'followers.' These target groups consist of those who are urbane, outgoing, and cosmopolitan. They shop for garments that fit their lifestyle, which is one of an attitude of fun, freedom, and individuality. With Christa, people buy a 'way of life.' It is a reflection of people's need and desire to be different. Therefore Christa emphasizes people's personalities with expressions of freedom, personal responsibility, and individuality. Christa fashion casual wear is leisurewear for young, dynamic, colorful, daring, and internationally oriented people.

Christa has not advertised in the mass media for over a year. The company felt its brands were well known and could depend on the support of retailers. However, brand awareness, liking, and preference have weakened compared to competitors. Christa may have to consider relaunching its brand or replacing it. Further, there is increasing demand for high quality in fashion, and Christa feels its relatively low quality image may put the company at a competitive disadvantage.

The planning cycle is critical to Christa's success. In the fashion industry it is common practice for retailers to buy the next year's collections approximately six months in advance. Thus the manufacturer knows what has to be produced. The advantage is that there is no inventory problem. Everything produced has already been sold. The only problem is to get the goods delivered on time, as promised. One or two weeks' delay can be disastrous. Often delayed shipments are refused by the retailer. Because of the efficiency of its planning cycle, Christa has a delivery guarantee of 95% while other brands in the market often do not reach 70%.

For fashion casual wear, designs and styles change every few months. Christa offers a broad range of products from basics (simple trousers, shirts, and sweaters) to more stylish and extrovert clothing. They are not really 'designed' products, but, more accurately, are the commercial translations of top designers. The company originally targeted its collections at 15–25-year- olds but recently split its primary target markets as follows: 20–30-year-old women and men, and 10–19-year-old girls and boys.

Seasonality

The fashion business is based on four seasons: Spring; High summer-transition; Fall; and Holiday, early spring. Spring and Fall are the major seasons, contributing approximately 80% of total sales.

Physical distribution

International distribution is handled by the Manila office. The local country offices, in turn, distribute the goods to local retailers. In general, Christa casual wear is available in regular shops and large chain stores; often the latter have a shop-in-shop. This means that a special counter or corner is reserved for a particular brand with a selection of its products, providing the opportunity to dress or merchandise the corner in the brand's style. Additionally, large countries (in terms of sales volume) have one or two pilot shops, which stock the entire Christa collection. In addition they offer the opportunity for both retailers and consumers to see, experience, and enjoy the Christa lifestyle.

Pricing

In most countries the Christa collections are moderately priced; not really expensive, not really cheap. Although there is a fixed price the local subsidiary or distributor can adapt prices to the local situation, as long as the unit operates within headquarters' profitability guidelines.

Communication

Christa Clothing International starts with catalogs of the available collection and distributes them to retailers. In 1996 Christa started advertising in Europe and the campaign proved successful. The creative theme was 'Streetlife,' which portrayed young people in the hectic atmosphere of big cities of the world. They are young people who are happy to meet each other and kiss. But the kissing does not denote a love relationship. It is more of a friendly kiss. The fashion is adventurous and extrovert. Christa's expenditure on advertising during the period 2011–14 are shown in Table 13.4.

Competition

Competition is fierce, with many brands and manufacturers competing in the marketplace. Companies (and brands) competing with Christa include:

1. *Ciao*, a well-established, Italian brand. Ciao advertising is well known: 'United colors of the world.' Usually two completely different young people are shown next to each other, dressed in the Ciao style. Ciao's primary advertising media are magazines and outdoor.
2. *Derci*, the second brand of the Ciao company. It is small but has a distinctive image and lifestyle. Derci's use of media was striking, though expensive. It used the last five or six pages in magazines and turned its advertisements upside down, thus giving the impression that Derci had a magazine of its own. Derci used only magazines.
3. *Eureka*, a well-known US (California-based) brand. The company's collection is targeted at women in all age brackets. It is one of the largest companies in this segment. Eureka advertising campaigns show beautiful, attractive people and radiate a kind of purity. The main media are magazines and outdoor.
4. *Mode/Statique*: Mode for women, Statique for men. This is a Danish company, mainly European oriented. Its products are middle-of-the-road, not extrovert. The creative aspects of its advertising campaigns have differed greatly over the last few years. The main media have been magazines.
5. *New Male*, a French company. This line is male oriented and comparable to Statique. Media expenditures have been low.
6. *Canonel*, a recently established Italian company, which uses an approach similar to Ciao. However, its products are somewhat more daring. Advertising expenditure is low but includes television.

Ciao, Derci, and Eureka have advertised consistently over the years. The others, including Christa, have been less consistent. Other competition consists mainly of many local brands.

The future

Christa expects to continue international expansion and to become a truly global company. The general preference is for standardization of product design, production, brand image, advertising, and other promotional efforts. In developed countries competition has been fierce, with many brands competing in each market. With the expansion of the European Union internal market in 2004 competition intensified.

Although Christa has utilized local advertising agencies in each market in the past, it is possible that global advertising may require a global advertising agency. However, one of the big unknowns is how similar consumer-purchasing behavior and product desires are in non-European and non-North American markets. On the one hand, certain brands of jeans sell well worldwide. On the other hand, there is great diversity in cultures with respect to the naming of colors, preferences for particular styles, standards of modesty (or immodesty), types of leisure activities, climate, hair and skin colors, what is considered attractive, and so forth.

Table 13.4 **Christa Clothing International total advertising expenditure (US$000)**

	2011	2012	2013	2014
TV	500	500	1,000	1,000
Magazines	2,100	3,900	4,100	4,900
Newspapers		2,000*	400	700
Cinema		400	600	1,000
Outdoor	200	200	300	400
Total	2,800	7,000	6,400	8,000

*In 2007 a large newspaper campaign was used to achieve brand awareness.

Questions

1. Should Christa Clothing International enter Asian markets? If so, in which countries, and in what order? If not, why not?
2. Assuming Christa decided to enter one or more of the Asian markets, what should be the company's advertising objectives, message strategies, media strategy, and budget?
3. Can the company standardize its advertising or must it individualize? Can the company transfer advertising from other markets? Defend your answer.

CASE STUDY 13.2

Nove Ltd

Nove Ltd is a large concern located in Hong Kong that manufactures a line of household appliances in which sales expansion in the past has been very rapid. Actual manufacturing takes place in mainland China. Since Hong Kong is a Special Administrative Region (SAR) of China, the export takes place from Hong Kong while the country of origin of the products exported is China. For certain new products the increase in sales has been so fast that production capacity could not keep up with demand. For one of the new products – electric (dry) shavers – management foresaw and provided for more than normal commercial expansion. Production capacity for these articles has been enlarged to the extent that even in the face of a rapid sales growth, a sufficient number of dry shavers could be manufactured. In view of the enlarged production facilities, more effective sales effort became necessary. Total 2009 sales amounted to 8 million shavers. The 2010 sales target was set at 8.5 million pieces.

In order to put the planning indicated above into effect, a more intensive marketing communication campaign was considered desirable. In Countries A, B, and C (countries so designated for purposes of disguise) particularly favorable results were expected from a stepped-up advertising campaign. The approved advertising budget for these countries was therefore separated from the normal sales budget and determined individually. The company's advertising manager felt that for the most effective results, the advertising budget should at least be doubled. In view of the enormous amounts planned for advertising, the management suggested a preliminary investigation in the countries concerned to ascertain why dry shavers in general, and the company's own brand, 'Nover,' in particular, were purchased. Nove intended to obtain arguments that might best be used in its advertising and get some tips for sales promotion.

Consumer investigation

Before the investigation, Nover enjoyed a strong market position in the three countries. Otex was its largest competitor while Porde accounted for an insignificant market share.

Shaving habits

From the answers about shaving habits it appeared that in Country A approximately 100% of the men shaved themselves, while in Country C an important number (23%) went to the barber shop for a shave. The portion of men who shaved themselves daily varied from 13% in Country C to 77% in Country A. The majority of dry shavers were found among the men who shaved themselves daily. To stimulate sales it might thus be useful to promote the habit of shaving daily.

Following a request to indicate the advantages of dry shaving, the most frequent reactions were: ease, speed, and absence of skin irritation. All wet shavers were asked why they had not yet switched to dry shaving. Between 40% and 50% replied that dry shavers were too expensive.

Characteristics of the dry shaver

Table 13.5 indicates, in percentages of total dry shavers, replies made to the question: 'Why do you shave electrically?'

How did users obtain their dry shavers?

It appeared from the market research that an important part of the dry shaver owners had received the shaver as a gift – in Country A, 52%; in Country B, 40%; and in Country C, 40%.

The greater part of those receiving gifts (approximately 65%) had expressed the desire for a shaver themselves. Usually it was a gift from a wife or fiancée (in approximately 60% of the cases). It was also important to determine the place of purchase. Most dry shavers (75% to 80%) were bought in radio shops and electrical appliance stores. An entirely different situation, however, appeared to exist in Country A. There, radio shops and electrical appliance stores accounted for only 30% of sales. Most dry shavers in this country were bought in barber shops and department stores.

Table 13.5 Reasons for shaving electrically

Arguments	Country A	Country B	Country C
Ease	52	84	80
Speed	38	52	50
Absence of skin irritation	24	52	30
Other arguments	76	64	30
Total	190	252	190

Choice of brand

In the process of buying, it is important to know what portion of future buyers has gained information in advance about various brands. It appears that more than 50% of the buyers had in fact formed an opinion in advance about the brand to be selected and intended to ask for additional information. Factors that favored the purchase of a certain brand are expressed in Table 13.6 in percentages of the total answers recorded.

Further investigation of brand choice was based on brand distribution among the shavers in use. The brands in use in each country are shown in Table 13.7.

Familiarity with the three brands is shown in Table 13.8. Replies to a question about the best brand generally favored Otex, rather than Nover.

Results indicated that brand loyalty is very important. In the case of Otex, this loyalty seems to be somewhat stronger than for Nover. In Country C, however, a larger percentage of Nover users seem to be willing to switch brands than among Otex users. Relating the findings about brand switching to the results concerning the best brand (as expressed by wet and dry shavers), it can be concluded that there is a greater preference for Otex than for Nover by the wet shavers. This last observation could be an important aspect in attacking the potential market. Subsequently, the question was raised: 'Which brand are you likely to buy?' Reactions are expressed in Table 13.9 in a percentage of those intending to buy and who at the same time mentioned a brand name.

Factors that favor the purchase of a certain brand

Seen in shop and advertisements

It is known that advertising and sales promotion are important influencing factors. The extent to which this has affected dry shavers, however, has not yet been determined. The number of men, both wet and dry shavers, who have noticed advertising for dry shavers, is expressed in percentages of the group in Table 13.10. It thus seems that dry shavers are more quickly aware of dry shaving advertising than wet shavers. This could be explained by the concentration of shaver owners in the higher income brackets. This group reads more, and consequently is confronted with more publicity and advertising matter than the lower-income classes. In view of the high percentage of shaver owners remembering publicity, it is probable that shaver owners in general have an active interest in dry shaving publicity. Of the replies to the question, 'Where, or in which media have you noticed dry shaving advertising?' those favoring Nover were divided among publicity media, as presented in Table 13.11.

Table 13.6 Factors favoring brands

Motive	Country A	Country B	Country C
Seen in shop and advertisement	28	22	18
Advice of acquaintances	23	26	20
Price of shaver	13	12	10
Advice from shopkeeper	10	11	10
Other reasons	26	29	42
Total	100	100	100

Table 13.7 Brands in use

Brand	Country A	Country B	Country C
Nover	24	64	50
Otex	33	8	30
Porde	1	1	2
Miscellaneous	42	27	18

Table 13.8 Brand familiarity

Brand	Country A	Country B	Country C
Nover	67	88	79
Otex	80	33	60
Porde	4	2	15

Table 13.9 Brands most likely to purchase

Brand	Country A	Country B	Country C
Nover	14	55	44
Otex	57	22	34
Porde	1	1	11

Table 13.10 Who notices advertising

Brand	Country A	Country B	Country C
Wet shavers	60	48	28
Dry shavers	67	58	39
Both groups	62	51	30

Table 13.11 Advertising media used by those preferring Nover

Brand	Country A	Country B	Country C
Newspaper	62	67	29
Weekly magazine	44	39	54
Shop	26	39	46
Posters	3	25	8
Movie	–	8	8
Folders, etc.	3	6	3

Price of shaver

Wet shavers generally regard price as an objection to buying a dry shaver. However, the influence of price in brand selection was not unfavorable for Nover, compared with other brands. In percentages of total Nover shaver owners, price was important in their selection of Nover to 12% in Country A, 17% in Country B, and 12% in Country C. This factor plays an important role in the gift market, where traditionally the cheaper brands are favored.

Questions

1. Explain why Nove Ltd can or cannot standardize its advertising in Countries A, B, and C.
2. If advertising can be standardized, what would the advertising program be?
3. If advertising cannot be standardized, what advertising programs should be developed in each country?

CASE STUDY 13.3

Eli's Cheesecake Company

(This case study was written by Mitsuko Duerr and Edwin Duerr, both of San Francisco State University.)

In mid-2004 the president of Eli's Cheesecake Company, Mr Marc Schulman, was reviewing the policies that had guided the international expansion of the firm. In the 1990s the company had recognized the potential for increasing international sales provided by the Internet and the improvements in logistics. The company had moved quickly to exploit that potential.

Eli's opened its first website in 1995. This helped support the company's policy, 'follow your customer,' by making it easier to continually provide up-to-date information to existing and potential customers, and to facilitate ordering and service processes. It resulted in accelerated growth, both domestically and internationally, and Eli's now exports its products to over 20 countries. In 2003 the state of Illinois gave Eli's its 'Exporter of the Year Award.' In 2004, annual sales passed US$35 million. In addition to its primary business of selling 50,000 cheesecakes per day in over 100 flavors and sizes, the company also offers tie-in products such as sweatshirts that help to spread the company name.

Mr Schulman was now planning to expand into additional overseas markets. This raised questions about selecting the countries into which to expand, possible changes in customer selection procedures, and the possibility of using additional marketing channels or entry modes. Whatever he did, he wanted to be sure that it would be consistent with the original vision for the company and the policies that had resulted in their success to date. In order to assist in the effort, Mr Schulman had asked their former US Sales Manager, Walter Babian, to come back from retirement to be Senior Vice President of International Sales. Mr Babian was living in Arizona and continues to reside there, an option made feasible by the Internet and fax. While he spends a substantial amount of time traveling overseas to develop and maintain relationships, and some time at the Chicago headquarters, his home can be anywhere.

Company background

Marc Schulman had founded Eli's Cheesecake Company on 4 July 1980, in part to fulfill a dream of his father, Eli Schulman. The senior Schulman was a 48-year veteran of the restaurant business, who had eventually opened a fine restaurant in Chicago, 'Eli's the Place for Steak.' In addition to operating the restaurant, Eli Schulman took a great interest in civic affairs. He participated in and sponsored civic events, provided appropriate (and legal) gifts to organizations and dignitaries, and was host to and photographed with a wide range of important individuals including presidents of the United States. His activities and personality resulted in widespread recognition of, and a great deal of favorable publicity for, his restaurant.

At the restaurant, Eli developed an exceptionally rich and creamy cheesecake that customers began referring to as 'Chicago's Finest.' He had a vision of selling something outside of his restaurant that would carry his name, and his signature cheesecake seemed to be the appropriate product. Eli's vision became a reality when his son, Marc, founded Eli's Cheesecake Company.

The new venture grew steadily through the 1980s following four principles: Always provide high-quality food. Always give great service. Always maintain good relationships with customers and employees. Develop new products, varieties, flavors, and sizes to meet expressed and possible changes in consumer tastes.

The company uses all natural products and is able to avoid the use of preservatives because it can ship by refrigerated containers. As fast and reliable cargo service has become available to more places, Eli's potential market has grown. They now ship primarily by United Airlines cargo, and also enjoy other relationships with the carrier as noted below.

As a small company with 220 employees, Marc Schulman believes that family owned Eli's Cheesecake Company is big enough to have the resources to do things, and small enough to be nimble. At a speech at Crain's Small Business Forum in 2000 he indicated that a small business must have focus and passion. The owners are on the hook financially and personally and have a commitment to making it work with a longer-term perspective.

Marketing and sales organization

The company has three people in the marketing department, including the senior vice president, Mr Babian, plus seven in sales. The senior vice president spends all of his time on international accounts, reflecting Mr Schulman's objective of increasing sales in overseas markets. Mr Babian is assisted by a representative in England.

Domestic sales presently account for 85% and international sales account for 15% of total sales. International sales, however, are growing at approximately twice the rate of domestic sales. Domestically, 60% of sales are for foodservice operations and 40% are for eventual sale at retail.

Within the United States, the company uses 50 brokers as well as selling directly to some very large customers and selling directly to the public. Internationally, 70% of sales are for foodservice operations and only 30% for eventual sale at retail. Sales through retail outlets in some countries abroad have been limited because of costs and problems in meeting multiple labeling requirements for the relatively small markets. In each of the European countries, they need to have different packaging for their products that will be sold through retail outlets. Internationally, brokers are used in some areas but not in other areas, depending upon conditions and the market structure. Eli's does not generally need to modify their ingredients or recipe by country since they already offer a wide variety of cheesecakes. They have had testing done in France for GMO-free certification (product free from genetically modified ingredients).

Sales in Asia are growing rapidly with the increasing demand for premium American products. Europe is a large overseas market for Eli's Cheesecake. The company is working on a major project with a Japanese company. In spite of conflicts in the Middle East, sales in some areas are continuing. A market has been developed in Iceland.

Overall sales are affected, to some degree, by the level of tourism, and the destruction of the twin towers in New York in 2001 decreased both international and domestic travel. Total attendance at food product and service trade shows has decreased, but the increasing globalization of business has resulted in attendance at most major shows by representatives from companies in many countries. The continuing consolidation of food companies is also providing additional marketing opportunities for medium-sized producers such as Eli's.

Mr Schulman sees expansion of international sales as requiring a serious commitment of time and effort. Without such a commitment there is a tendency to fail to respond to the inquiries from abroad because they entail additional attention and effort beyond that involved with domestic orders. This also means that a company must be careful in its international expansion. Because there are so many things going on at the same time, including dealing with many new regulations, developing new packaging for each market that requires it, and possibly developing new channels for sales and shipping, there is a high cost in time, effort, and managerial attention. In efforts to expand overseas the company must not only find customers who want their product, but must communicate effectively and get the product there when promised and in perfect condition. While Eli's takes great pride in the quality of its products and in its service, it has found that overseas customers – particularly in Japan, Hong Kong, and other Asian countries – are very demanding in all respects. The Eli brand name, and what it has come to represent, is what gives the company the advantage over others.

Personal relationships are of particular importance in international dealings. Eli's objective is to meet with each major customer four times per year, visiting each of them twice and having them visit Eli's twice. Both internationally and domestically, Mr Schulman feels that it is essential never to lose the focus on the customer, and face-to-face meetings cannot be replaced by telecommunications alone. Location in Chicago is an advantage for the company since many trade shows are held there. Most major food product distributors and food service companies send representatives to attend shows in Chicago at least once per year.

Product promotion

While Marc Schulman credits the Internet and improved logistics for his company's rapid growth since 1995, it is apparent that the company's policies and his skills in promotion were what made it possible for the company to take advantage of these advances. Mr Schulman has commented that traditionally, bakers are not very marketing oriented, but that he comes from a foodservice background where marketing is extremely important.

A major method by which Eli's attracts customers is through participation in trade shows. In addition, Eli's frequently has exhibits at both candy and food product expositions in Europe. They also attend some trade shows in Asia. The US government, and some state governments, have effective programs to assist small and medium-size companies to export. As a part of these programs, companies can obtain places in the US pavilions at many international trade shows. Eli's has had such places at a number of shows, and has found this very useful. Retailers and food service companies that visit their exhibits contact their importers or make direct inquiries to Eli's.

The company does not pay for advertising, except for printing brochures and mini-catalogs, and using its web page. However, it has been extremely effective in gaining recognition through its promotional activities as well as through the quality of its cheesecakes.

Major promotional activities include producing special cakes for special events and for celebrities. It provided Eli's Cheesecake at the 1985 Superbowl. In 1987, it provided a 1,000-pound cheesecake for Chicago's 150th birthday celebrations, and subsequently provided big cakes for Crain's 20th, the *Chicago Tribune*'s 15th, Chicago's 153rd, Steppenwolf's birthday, DePaul University's 150th anniversary, and many others. In March 1992, then Governor Clinton and Hillary Clinton visited in connection with a program to help associates earn General Education Diplomas. (People working at Eli's are referred to as 'associates' rather than employees.) Eli's provided Inaugural Birthday Cheesecakes in Washington in 1993 and 1997, in Chicago for Hillary's 50th birthday, and at the White House in 1999. A visit to the company's bakery by President Clinton led to a cover story in the *New York Times* and an appearance on *Face the Nation*. The company produced an event for the Gore-Liberman campaign in 2000. Other Eli's Cheesecake fans noted in the company's website include Jay Leno, The Backstreet Boys, the Italian design team of Dolce and Gabbana, Donna Karan, and Bonnie Hunt. The company participates in various civic activities in Chicago, and provides the use of its parking lot for Chicago's Farmers' Market during the summers. It has partnerships with Wright College, Chicago High School for Agricultural Sciences, Norman Bridge School, New Horizon's Center, and the Chicago Public Library.

Eli's has expanded its partnership with Wright College, one of the community colleges of Chicago, to provide training opportunities for its people. Classes include sales training, database management, regulatory and costing issues and communications through a new City of Chicago Program called TIF Works that funds training through a portion of the real estate taxes paid.

United Airlines (Eli's primary carrier, as mentioned above) has featured Eli's cheesecakes on many of its flights, and an article about the company appeared in the United Airlines publication, *Hemispheres*, in September 2000. In the year 2000 alone, additional articles about Eli's appeared in *eCommerce Business*, *Modern Baking*, *Bon Appetit*, *Chicago Tribune*, and *eCFO*. Excellent reviews have appeared in *Parade*, *The New York Times*, *Chicago Sun-Times*, *News City*, and *Cooks Magazine*.

Eli's also provides a tour of its bakery in Chicago, including a slice of cheesecake, for $3 per person (price in 2001), and will provide luncheons for groups. It has tie-ins with the restaurant, Eli's the Place for Steak, and there is even an Eli's Cheesecake Fan Club that people may join. All of these promotional activities have provided a foundation for exploiting the Internet and modern information technology.

Using the Internet and the World Wide Web

Since Eli's Cheesecake established their first web page in 1995 they have frequently updated it to make it more 'user friendly' and effective as a marketing tool.

The company's web page, http://www.elicheesecake.com, provides three basic services:

- information about the product, answers to questions most frequently asked by customers and potential customers, the story of Eli Schulman (in keeping with one of the original purposes of forming the company), the company's history, company activities in the greater community, and reviews and comments about the company and its products;
- a way for retail customers to order online and telephone numbers for customers who prefer to call;
- a way for existing Foodservice Partners to access the company's communications network regarding new products, merchandising, recipes, and promotions; a way for potential Foodservice Partners to obtain a username and password to the network.

The material is colorful and attractive, complete without being wordy, and easy to navigate. The *Direct Hit Search Engine*, which analyzes the sites that millions of Internet searchers have visited, gives the Eli website the highest of its five ratings for relevance and satisfying searchers' requests.

The use of the Internet and commercial software for information and planning purposes has also improved Eli's Cheesecake's efficiency and effectiveness. In 1998, there had been only one Eli employee who knew how to work with their Microsoft Access database, and he had been overwhelmed with requests for reports. Then the company went to an Online Analytical Processing (OLAP) system that lets businesspeople query databases without knowing much about their underlying architecture. This allowed Mr Schulman and several other key users to obtain information and spot trends more easily (Liebs, 2000). This was a step forward in improving the flow of information, reducing the need to make multiple entries, and tying the ordering, producing, warehousing, shipping, and billing functions together. These advances facilitated the accommodation of additional international and domestic customers and sales information and processing. It still did not do the whole job and it was seen that additional steps would be needed. Now the company uses Cognos, a multidimensional data warehouse system for keeping track of sales and sales opportunities that provide a basis for future planning. All of their efforts are aimed at developing and maintaining ever closer contacts and relationships with customers and potential customers.

In the overall strategy of increasing international sales, Mr Schulman will be looking at criteria for selecting additional markets, customers, and distribution channels.

References

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http://www.elicheesecake.com

Liebs, S. (2000): 'Store and deliver,' *eCFO*, October.

Questions

1. What factors/actions/characteristics of Eli's have made its Web initiative so effective?
2. Evaluate the company's use of promotion versus traditional advertising in light of the type of business it is in. Would another mix of promotion and advertising more efficiently or effectively meet its objectives?
3. Are the apparent objectives of Eli's Cheesecake the same as those you would expect to find in a large conglomerate?
4. What appears to be the emphasis on short-term versus long-term objectives?
5. What channels should Eli's consider in its international expansion?
6. How should Eli's go about identifying potential new markets?
7. How should Eli's go about finding potential new distributors or large customers?
8. Should Eli's consider other methods of market entry such as joint ventures or establishing production facilities abroad?
9. Will the present web page be adequate for the next several years? Why or why not?
10. Should Eli's consider expanding its product line? If so, what additional products might it consider? What would be the advantages and disadvantages of its doing so?

CASE STUDY 13.4

Kraft Foods

(Adapted from D.D. Stanford (2010), 'Tang gets a Second Rocket Ride'. Reprinted from 26 April–2 May issue of *Bloomsberg Businessweek*, pp. 32, 34 by special permission, copyright © by Bloomberg L.P.)

In the United States, Tang has been around for half a century, and the powdered, tangerine-flavored drink was the chosen beverage for some of the early NASA space flights. For example, in 1962 astronaut John Glenn drank Tang on board the space shuttle. 'Tang makes water more exciting.' Now the Chinese are drinking it up – literally.

Kraft Foods saw sales of Tang in developing markets soar 30% in recent years, to more than $950 million, powered by Asia, Latin America, and Eastern Europe.

The resurgence of Tang is one payoff from Kraft's strategy of boosting overseas sales by targeting 10 so-called power brands – products the company identified in 2008 as being under-marketed and having the highest potential profit margins.

Also on the list are household names like Oreo cookies and Philadelphia cream cheese. 'These 10 get a disproportionate amount of talent, R&D resource, as well as advertising and promotion,' says Sanjay Khosla, who oversees Kraft's developing markets.

The two-year-old strategy is credited with raising revenues from developing markets to 21% of Kraft's $42.2 billion total in 2009, excluding currency fluctuation, divestitures, and acquisitions.

Kraft relied on market research to help refresh Tang's image overseas, where sales growth had stagnated. In China, where the brand was introduced 22 years ago, surveys showed that mothers believed their children needed about six glasses of water a day to be properly hydrated, says Shawn Warren, Kraft's vice president for marketing for the Asia-Pacific region. Children, however, saw water as 'boring' and 'bland,' he said. That led to a new marketing plan built around the 'Tang makes water more exciting' tagline.

From its research, Kraft also learned that the Chinese prefer powdered drinks by the glass rather than by the pitcher – likely a by-product of the country's one-child policy. So the US company developed a box of single-serve powder sticks in place of pitcher packs, which had also been too expensive for some Chinese consumers.

Kraft's country managers were also encouraged to experiment with new flavor combinations aimed at local palates. That gave rise to mango concoctions in the Philippines; *tuna* – a type of cactus fruit – and tamarind in Mexico; and *maracuja,* also known as passion fruit, in Brazil.

To introduce the new Tang flavors, Kraft distributed 27 million samples in 2009, up from 300,000 in 2008. Sales of Tang in Latin America jumped 42% in 2009, while sales in Asia Pacific grew 25%, says Khosla. That's a huge improvement over the previous year, when Tang averaged just a 4% sales increase across developing markets.

Even with the added investment in packaging and marketing, Kraft managed to keep Tang's profit margins at a sweet 37.2%. Powdered drinks are one of the most profitable products that Kraft has.

In the middle of the success, former astronaut Buzz Aldrin stated 'Tang sucks.'

Questions

1. Evaluate Kraft's strategy of targeting so-called 'power brands' for overseas markets. Is this something that is unique to Kraft's situation or can other consumer goods companies be as successful? Discuss.
2. Is the success of following a strategy of targeting brands limited to developing countries in Asia-Pacific and Latin America, or can it be applied with success in other areas such as Western Europe? Discuss.
3. Is it desirable to devote a disproportionate amount of talent, R&D resources, and advertising and promotion to a small number of brands in a company's product line? What about the other products (brands)? Wouldn't sales of these necessarily be less than what they might be with proper support? Explain.

CHAPTER 14

Supply chain management and handling export orders

Learning outcomes

Chapter 14 discusses:

- how to handle the export order
- logistics/supply chain management
- the basic structure of international physical distribution

There are three cases at the end of the chapter. Case 14.1, Jaguar Electronics, asks where components should be assembled into final products. Case 14.2, Primex Marketing, Inc., concerns the marketing, organization, logistics and manufacturing of a niche marketer. EFI Logistics, in Case 14.3, is a Customs House broker targeting a niche market.

Introduction

This chapter covers information requirements for the development of international marketing in:

- companies (and individuals) that are new to exporting;
- firms that have established exporting and importing operations;
- the growing number of companies for which logistics/supply chain management has become a critical factor in success.

The success or failure of the export business of a firm depends entirely upon securing orders from buyers, delivering products in good condition at the correct time, and, most important, receiving payment. This depends upon the correct handling of export procedures. All documents and procedures must be carefully followed in order to avoid violations of the laws of the countries involved and/or refusal of the financial organizations to honor demands for payment. Errors in paperwork (documentation) in export transactions can cause major delays or losses.

Successful handling of the export order and physical distribution depends upon much more than the filling out of paperwork. Decisions must be made regarding the management of all steps and processes in the supply chain that are under the control of the exporter. This, in turn, requires extensive knowledge of the characteristics and costs of alternative methods of packing, transportation, storage, and processing in order for management to make appropriate decisions.

Logistics and the systems concept, on pages 868–76, addresses the increasing importance of the broader aspects of physical distribution, including the location of production, storage and distribution facilities, the place of international strategic alliances, and their overall effects on costs and responsiveness. Exporting, importing, and international marketing have all been directly affected by these developments.

The final section of the chapter covers the structure of international physical distribution including modes of transportation, facilitating organizations and services, and documents required. The availability, costs, and benefits of using facilitating organizations such as foreign freight forwarders and custom-house brokers are discussed. The steps in the overall export procedure are illustrated in Figure 14.1.

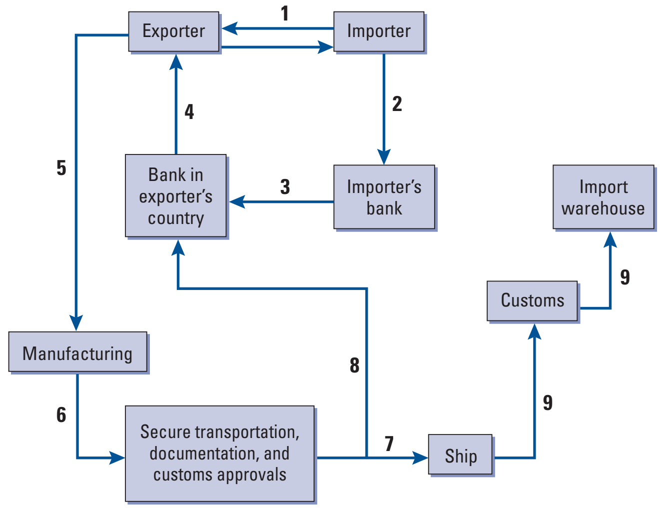
Two disparate trends are affecting the costs and speed of international physical distribution. The first is the continuing advance in systems and equipment that is making physical distribution faster, easier, and more efficient. There are continuing improvements in ports, handling equipment, and transportation equipment. There are also improved communications systems and technology including the evolving Radio Frequency Identification Equipment (RFID) systems, and global positioning systems (GPS), discussed later in this chapter. They are basically designed to identify the contents of shipments, identify potential problems, and provide real-time tracking of the locations of carriers and containers. Goods, like information, are moving around the world with increasing speed, and the modern supply chain is sometimes called 'the physical Internet' (*The Economist*, 2006).

The second is the increased concern over security and the prevention of terrorist acts. Most countries now have in place new requirements for documentation and additional inspection of both imports and exports. The United States has particularly strong controls, as discussed in Exhibit 14.1, though some nations like China have controls that

Exhibit 14.1 Example of US controls on imports and exports

Exports from the United States are controlled through the Automated Export Control System (AES). The producer and exporter or their agents/forwarders are required to submit shipment information to Customs no later than 24 hours prior to vessel/aircraft loading. Customs then issues an AES number that the exporter must provide to the carrier before they will load the cargo. Export licenses are also required for some products and for certain products to certain countries. Goods may be prohibited on the basis of public policy, national security, boycott, nuclear proliferation and dual-use items (that could be used for peaceful purposes but that could also be used for military purposes). However, 98% of exports are classified as NLR (no license required) and a statement to this effect must be included on the documents provided to Customs and the carrier where this is the case.

For imports into the United States a similar procedure, the Importer Security Filing (ISF) is required. The US government now has US Customs officers stationed in key ports overseas, with the permissions of the host governments. The manifest documents must be submitted to the carrier and, by extension to US Customs, at least 24 hours in advance of loading abroad. When approved, an ISF number is issued. Where foreign country Customs requirements are in effect, they must also be met.



1. The Sale
   Importer makes inquiry from potential supplier.
   Exporter sends catalogs and price list.

   Importer requests samples.

   Importer requests pro forma invoice (price quote).

   Exporter sends pro forma invoice.
   Importer sends purchase order.

   Exporter receives purchase order.

2. Importer arranges financing through his bank.

3. Importer's bank sends letter of credit (most frequently used form of payment).

   Note: for alternative options for payment see Chapter 11.

4. Exporter's bank notifies exporter that letter of credit is received.

5. Exporter produces or acquires goods.

6. Exporter arranges transportation and documentation (obtained by exporter or through freight forwarding company).

   Space reserved on ship or aircraft.

   Documents acquired or produced, as required:

   (a) Exporter's licence
   (b) Shipper's export declaration
   (c) Commercial invoice
   (d) Bills of lading
   (e) Marine insurance certificate
   (f) Consular invoice
   (g) Certificate of origin
   (h) Inspection certificates
   (i) Dock receipts

7. Exporter ships goods to importer.

8. Exporter presents documents to bank for payment.

9. Importer has goods cleared through Customs and delivered to his warehouse.

Figure 14.1 **The export procedure**

are even more stringent. More sophisticated inspection equipment has been installed at some seaports, including gamma-ray detectors to spot nuclear materials and other equipment designed to detect particular chemicals and other products inside containers. The eventual objective is to have all containers screened before they leave port or while in transit.

Both exporters and importers must take into consideration that deliveries may be delayed as agencies of various governments increase their scrutiny of cargo and choose to inspect more containers (Fitzgerald, 2010).

A discussion of interesting problems affecting transportation of goods, including economic changes, piracy, and inadequate infrastructure are discussed in Exhibit 14.5 in the section on Modes of Transportation. The overall process of handling export orders is portrayed in Figure 14.1.

Handling the export order

The inquiry and response

The initial inquiry or order for goods from a prospective foreign buyer may be unsolicited, or may come from the efforts of an export management company, agents, or a company's own efforts. No matter in what form it may be received, every inquiry should be handled seriously with the expectation that it may lead to a profitable sale. A leading business executive in one of the largest South American countries made it a practice to make regular tours of inspection of his various activities. When he was advised of the need for a piece of machinery, for additional raw materials, or other items, he would rapidly scribble a letter of inquiry on a blank page of a pad of paper he carried with him, slip it into an envelope, and have it mailed. There was no letterhead or other means of identification other than the return address on the envelope. More than one exporter receiving one of these hastily scribbled letters in the writer's own language, sometimes even with smudged fingerprints on it, would promptly throw it away as having been written by some irresponsible person and not worthy of an answer. Those firms that carefully observed the fundamental rule that all inquiries should be answered seriously made considerable profitable sales.

The response to the inquiry should normally be in polite, business-like letter format. If the request for information is general, the response should include catalogs and price lists, and/or an offer to have a sales person or representative call. If the prospective order is a very large one the inquiry may serve primarily to open the way for negotiations. Major transactions often require some face-to-face communications, and business people in a number of cultures place less value on contracts and more value on personal relationships.

The order

Order received directly from prospective importer

There is no such thing as a standard order form. Some companies merely use a letterhead; others have regularly printed forms with spaces provided for all necessary information. As long as the order contains the essential facts concerning the desired merchandise and how it is to be shipped, no special form or procedure is necessary.

When the actual order is received, the exporter will normally send a *confirmation of receipt*, followed by a commitment to fill the order if the exporter finds all of the terms and the payment arrangements acceptable. If there are any problems the exporter should not agree to the sale until the problems have been resolved.

It should be noted that the acceptance of an order without modification creates a contract that is binding upon both parties. If, however, the manufacturer or exporter (or for that matter any seller) indicates to the prospective buyer that he or she wishes to make some modification in the terms of the order, there is no contract. But if the prospective buyer then confirms and accepts the proposed modification, a contract is created.

A *pro forma invoice*, as illustrated in Figure 14.2, may be prepared by the exporter to indicate the terms that have been agreed upon (or are proposed). The pro forma invoice normally shows the type and amount of merchandise, unit costs and extensions, expected weights and measures, and terms of sale and payment (INCOTERMS). If accepted by the prospective buyer, it may serve as a contract.

Order received from branch or representative overseas

Where the exporter has an overseas representative who visits the prospective customer the representative may use a combination order form and sales contract. When the sales representative has received approval from the exporter to accept the order the form is completed and signed by both the seller and the buyer. All the terms of the contract are printed on the reverse side of the form and may be considered legally binding unless changed by prior agreement.

An order received by an exporter based on a contract of sale negotiated between the final purchaser and an overseas-based branch office or distributor of the exporter is referred to in international trade as an *indent order*.

Performance of a contract

In the export business generally it is difficult to enforce performance of a contract. At the very least litigation between the nationals of two countries is so expensive as to make it virtually prohibitive. Both buyers and sellers, therefore, are likely to disregard a breach of contract if no monetary obligation has been created or if no considerable damages have been created or inflicted. But, and this is of grave consequence in export trade, if a contract has been created between a buyer and a seller, both parties are honor bound to perform.

Commercial disputes are often hard to avoid in exporting. When such disputes do occur, their resolution is often complicated by the great distance between exporter and buyer and by the differing business customs and laws that exist in their respective countries. One approach to settling disputes is commercial arbitration. The usual arbitration procedure is for the parties involved to choose a disinterested and informed person or persons as a type of referee to determine the merits of the case and make a judgement that both parties agree to honor. It is desirable that a contract include an *arbitration clause* specifying that arbitration is to be used when there is a dispute between exporter and buyer.

Most international arbitration is done under the auspices of a formal arbitration organization. For example, in the western hemisphere there are the Inter-American Commercial Arbitration Commission (handling disputes between the businesses in more than 20 North and South American republics) and the Canadian–American Arbitration Commission for Canadian and United States businesses. In the United Kingdom, the London Court of Arbitration is limited to situations that can be legally arbitrated in the United Kingdom. Finally, the American Arbitration Association and the International Chamber of Commerce deal with disputes on a worldwide basis.

Questions sometimes arise concerning whether awards made in one country are enforceable in others. More than 60 countries have signed a United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This convention provides for legal enforcement in a signatory country of private arbitral awards granted in other countries that are parties to the convention. However, some large countries are still not signatories of the convention.

XYZ Manufacturing
22 Canton Road
Hong Kong

ABC Importers
San Jose, CA
USA

Purchase Order Date:
Invoice Date:
Invoice Ref. No.: PRO FORMA 0001

Terms of payment:Confirmed
Irrevocable Letter of Credit
Payable in US dollars

Invoice To:
Ship To:
Forwarding Agent:

via: Country of Origin: China

QUANTITY	DESCRIPTION	PRICE EACH	TOTAL PRICE
1,000	Male shirts	$15.00	US$15,000.00

Inland freight, export packing & forwarding fees $300.00

$15,300.00

Free alongside (FAS) Hong Kong
Estimated ocean freight $1,000.00
Estimated marine insurance $150.00

US$16,450.00

CIF San Francisco
Packed in 5 boxes, 100 cubic feet
Gross weight 1,000 lbs.
Net weight 900 lbs.
Payment terms: Irrevocable letter of creit confirmed by a Hong Kong bank. Shipment to be made (2) weeks after receipt of firm order.
We certify this pro forma invoice is true and correct.

Woo Yuk Shee
President

Figure 14.2 Illustration of pro forma invoice

Export licenses

The need for export licenses, using the United States as an example, was given in the Introduction. For potential exporters in every country, no contract to supply goods or services should be accepted until the potential exporter ascertains that the material can be legally exported. Export regulations are presently in a state of flux with changes occurring frequently. Individual countries have their own export laws, and may control the export of products to specific countries for reasons of national security, foreign policy, short supply, preservation of cultural property, assisting of industries using domestic products, and revenue purposes.

The potential exporter must contact the appropriate government offices in order to assure that the goods can be exported. Then the proper license must be obtained before the goods are actually shipped. Foreign freight forwarders (discussed later in the chapter) can provide valuable information and assistance in this area.

To avoid potential problems for the importer, the potential exporter could also check that the goods can be legally imported into the country of destination, though this may be difficult and is often not done.

Financing/payment and other terms of sale

A key element for the exporter in any transaction is assuring that payment will be made by the importer. With the difficulties of international litigation, collection of overdue international accounts may simply become impossible. In Chapter 12 we discussed the options for obtaining payment.

The importer and exporter must agree on the dates when the items are to be shipped, whether all the goods must be sent in one shipment or if partial shipments are allowed, and so on. These terms are usually specified in the letter of credit if that approach is used for payment.

The importer, or the exporter in some instances, will also normally specify which party is to be responsible for making the following arrangements:

1. getting the merchandise from the exporter's plant to the port;
2. getting the merchandise through outbound Customs;
3. getting the merchandise aboard ship (or other mode of transport);
4. paying for the freight;
5. paying for insurance.

These are aspects of the trade terms discussed previously in Chapter 11. It should be remembered that the trade term agreed upon also indicates when and where legal title to the goods changes.

Physical distribution

Having received the order, ensured that the terms of sale and payment are satisfactory, and then accepted the order, there is the need to arrange for shipping, insurance, and preparation of the multitude of required documents. In short, the physical distribution (i.e., supply chain management or logistics) of the product must be attended to. From the standpoint of the individual exporting company, physical distribution (and its management) can be viewed as encompassing the movement and handling of products outward to points of consumption or use. To a large extent physical distribution activities associated with shipments to foreign markets are much the same as those for shipment to domestic markets. But the processes, procedures, and documents required in export shipments are relatively more complex because of the following three factors:

1. the passage of goods across national boundaries, with attendant legal requirements;
2. shipment by ocean-going vessels or international airlines, with attendant security needs and specific documentary requirements;
3. the time and distance required to complete the transaction, with attendant needs for ensuring payment.

Importance to management

There are many reasons that export marketing managers should be concerned with the physical distribution of their companies' products.

The price that the ultimate user in foreign markets has to pay is strongly influenced by the way in which the product is physically moved from the manufacturer/exporter. That is, in distributing the product to the place where the user wants it and at the time it is wanted, certain costs are incurred that ultimately are borne by the user. Included are inventory holding costs, warehouse costs, transportation and handling costs, and order processing costs. Thus, *the cost of physical distribution can constitute a significant portion of the selling price*. In an export shipment, for example, additional packing or crating beyond the standard pack used for domestic shipments may be necessary. In addition, there may be added costs because of the need to utilize the services of freight forwarders or other specialized organizations to avoid complex export problems such as documentation. Another example of an additional cost item is the need for special transportation insurance if full protection is to be had.

Another reason that physical distribution deserves the diligent attention of managers is that it is an aspect of export marketing where *increased profits can be generated directly* – through either reduced costs or increased sales. The information systems used and technologies employed have direct effects on both costs and meeting customer requirements. Two examples are given in Exhibit 14.2. One describes the use of automation at a port to

Exhibit 14.2 Technology facilitates physical distribution

Some ports have automated systems for controlling internal operations, and a number have developed systems for handling external interactions.

Internal operations control

The Port of Hamburg in Germany has the most highly automated container terminal in the world. Container operations are controlled from a central tower overlooking the handling facilities. The containers are removed from the ship by semi-automated gantry cranes. The containers, each with its unique identification code, are placed on unmanned automated guided vehicles (AGVs). These vehicles move the containers along electronic tracks in the floor of the container yard to the designated storage locations where they are lifted into the specified position. There each container is lifted into its designated position by an IT-controlled storage crane. The operator in the control tower specifies the start and finish position for each container and the IT system does the rest. If something does go wrong and two vehicles begin to approach each other on a collision course, sensors in the vehicles cause both vehicles to stop and notify the operator in the control tower. The controller then takes corrective action.

The port can discharge and load up to 10,000 containers – 20-foot trailer equivalent units (TEUs) – in two days. The Port of Hamburg also handles large volumes of grabbable cargo (iron ore, coal, etc.) and suction cargo (liquids, grains, etc.). It has a large freeport, processing and manufacturing capabilities, capacity for doing major work on containers, warehousing, and trans-shipment capabilities. (see http://hafen-hanburg.de/index.php?lang=en and http://en.wikipedia.org/wiki/Port_of_Hamburg.)

The port also has a videotape that shows its system in operation.

Interactions with others

Electronic data interchange systems have been set up by a number of ports in cooperation with the ocean and railroad carriers, shippers, Customs authorities, and brokers/forwarders interacting with the port. They provide a virtually paperless system using single entries to replace the need for multiple entries, and instantaneously inform all participants of the actions, status and movement of orders. One EDI system may connect with ports in more than one country, along with the associated members of each port (companies, etc.). These systems operate on the Internet but separately from the Internet. They typically have special security systems and software to support them.

increase speed and accuracy while reducing handling costs. The second concerns the use of an Electronic Data Interchange (EID) network to improve information flow and reduce both costs and paperwork among a cooperating group of producers, carriers, and customers.

Physical distribution can have a positive effect on a company's sales volume through the service provided. Service encompasses many things such as the following:

- the speed with which a product can be provided to a customer;
- the reliability with which the average speed of service is achieved;
- the degree of immediate availability of the product;
- the arrival of the product in good condition.

Thus an exporter may be able to make a specific sale only because the physical distribution method it uses gets the product to the buyer when and where it is wanted and at a reasonable cost, relative to other alternatives available to the buyer.

How a company structures its physical distribution system can determine whether it succeeds or even survives. For companies operating in Europe, for example, the protocols or directives of the European Union internal market have caused changes in the 'ground rules' of transportation, warehousing, and production and the role of logistics (supply chain management) will be even more crucial to success.

A final major reason that export marketing managers should pay particular attention to physical distribution is that *national governments exert pressures that can affect the manner in which certain physical distribution activities are carried out*. These pressures emanate from the implementation by national governments of policies to stimulate national industrial development and achieve full and stabilized employment or the pressures may be due to political relations between governments. The result is that a company engaged in export marketing may find itself constrained and limited in its attempts to manage the availability and flow of materials, products, services, facilities, and other resources. For example, national government controls over exports and imports through the use of licenses, quotas, and tariffs can influence the planning and control of a manufacturer's inventory. Moreover, national governments can affect inventories and movements of goods within and between nations through their buying practices – in many markets they are a major (if not the largest) customer. National government policies can affect the means of transportation used to move a product from a seller to a buyer by requiring that importing business firms must use land, sea, and air transportation companies owned by 'local' firms, as well as harbor facilities belonging to the importer's government. Finally, the political relationship between the exporter's and importer's countries may have an effect. Using the year 1996 as an example, there was a lot of indirect trade between companies in China and Taiwan. However, the Taiwanese government prohibited containers of the Chinese Ocean Shipping Company (COSCO) from entering the island (Engbarth, 1996). As a result, goods destined for Taiwan had to be removed from their Chinese containers in Hong Kong and repacked in containers belonging to non-Chinese shipping companies before being reexported to Taiwan. One estimate of the added cost per container was HK$4,650 (US$600). This is no longer true for all shipments between China and Taiwan as there is limited direct service between Xiamen in Fujian province in China and Kaohsiung in Taiwan, with increased trade probable in the near future.

Decision areas

As suggested above, physical distribution embraces many specific activities concerned with product movement, storage, and related activities. We comment briefly on each of the major activities.

Nature of the shipment

To be decided are such things as the minimum size of the unit pack, the quantities to be shipped, the type and method of packing to be used to protect the product from damage in transit (i.e., its protective packaging rather than the immediate package in which the product is sold), the identification markings to be placed on the outside packing container, and so forth.

Transportation

The basic concern is with the external movement of the product, which usually involves choosing the route that the shipment is to follow, selecting the mode(s) of transportation, and providing adequate insurance coverage to protect the shipment while it is in transit, especially marine or air insurance for products in transit between countries.

Warehousing

This activity involves more than just storage. In addition to storing products in anticipation of consumer demand, warehousing encompasses a broad range of other activities, such as assembling, breaking bulk shipments into smaller sizes to meet customer needs, and preparing products for reshipment. Of importance to export marketing management is the need to determine: (1) the number and type of warehousing facilities to employ and (2) their spatial arrangement.

Materials handling

Provision must be made for the internal movement of products within plant and warehouse facilities.

Carrying inventory

There are many different cost elements involved in managing an inventory – storage, interest on capital tied up, taxes, lost sales, materials handling, and so forth. Since these costs may sometimes be sizable, management must be concerned about inventory control. This involves determining the proper level of inventory to hold so that a balance is maintained between customer service and inventory cost.

Order processing and documentation

Procedures must be established to process orders in as routine a manner as possible. Correct documentation is essential to the successful physical movement of a shipment. Many overseas shipments have been delayed due to errors in documentation. Davies (1984, p. 66) has summarized the so-called 'problem of documentation' as consisting of five main components. These are as follows:

1. **Complexity:** numbers of documents and correspondents.
2. **Culture:** language, currency, law.
3. **Change:** changes in requirements.
4. **Cost:** costs of preparation.
5. **Error:** consequential costs of error and cost of correction.

In addition to the usual documents used in a business transaction, such as a **commercial invoice** and bill of lading, there are other special documents – for example, consular invoice, **certificate of origin**, **export declaration**, and Customs declaration – that may be necessary in selling to a foreign country. The complex and rather technical nature of documentation requirements and procedures necessary to obtain permission for a shipment to cross national boundaries has fostered the emergence and growth of two special types of international marketing intermediaries: the foreign freight forwarder (for the exporter) and the custom-house broker (for the importer). In most countries the laws allow companies to perform both types of services.

Within the European Union, documentation requirements have been greatly simplified for shipments from one country to another. Since the mid-1990s most border stations have been closed, and all countries ultimately will be using the same single document covering shipments that cross national borders.

Logistics and the systems concept

Logistics, also called supply chain management, is concerned with the study and management of the activities, relationships, and decision-making processes in the overall production/storage/distribution system. The systems approach emphasizes the necessity of considering all of the elements in the supply chain as a group when making evaluations.

That is, one cannot look simply at all of the direct and indirect costs of every step in the supply chain, but must also consider the effects of each decision on the costs of other processes in the chain, and also on product attractiveness and customer satisfaction. With the growing internationalization of business and increased competition, export and international marketing managers need to have a broad view of their own functions as an integral part of the overall system.

The importance of supply chain management/logistics has been recognized by many international companies. Three examples are:

- In 2009, Unilever appointed its first Chief Global Supply Chain Officer, bringing in a highly qualified individual from outside the company. Unilever expects to strengthen its operations and keep its costs competitive through an increasingly fast and flexible supply chain. Its specific objectives include speeding up launches of global rollouts, ensuring that their products are always on the shelves, and reducing overall stock levels (Unilever, 2009).
- The UK's GlaxoSmithKline pharmaceutical company has a global logistics team managing all aspects of its supply chain, supported by global IT systems. It has 6,000 people working in logistics at its sites and markets around the world (GSK, 2010).
- HP is the world leader in PC sales. In the company's 2009 Annual Report, the CEO letter states that the company has gained tremendous leverage in the world marketplace by rationalizing the operating model of its PC supply chain (HP, 2009).

A combination of five developments have led to new advances in logistics:

- A recognition that proper supply chain design and management can add value and provide a company with a competitive advantage through:
  - an increased ability to more accurately determine what consumers want in styles, features, and/or services;
  - an increased ability to supply more accurately what consumers want at the time and place they want it;
  - greater flexibility in production and delivery systems;
  - reduced time to market.
- Improvements in management systems, including just-in-time, MRP, and ERP approaches.
- Improvements in communications technologies.
- Improvements in physical facilities.
- Software to support improvements in every part of the supply chain.

Exhibit 14.3 provides examples of improvements in logistics that have provided specific companies with competitive advantages.

The present approach to supply chain management does build upon the ideas and analyses used earlier in models designed to minimize costs, including the total-cost approach and least-cost models. It expands them to include methods developed to improve flexibility and control through other approaches such as the just-in-time approach, material requirements planning (MRP1), manufacturing resource planning (MRP2), and enterprise requirements planning (ERP1 and ERP2).

Exhibit 14.3 Examples of value added/cost reduction through improved logistics

- Nokia's efficient and effective supply chain management, with closely linked manufacturing, distribution and marketing, has given the company a big advantage in China and India (Ewing, 2007).
- BMW installed a built-to-order system that enables customers to custom-design automobiles. It thus provided more options to potential buyers, cut delivery times by one-third, and reduced the costs of carrying overstock.
- Sony Pictures Imageworks was having problems in meeting the scheduled release date for **Lord of the Rings: The Two Towers**. Failure to meet the targeted date would have meant the loss of several million dollars in already-contracted-for promotional events and advertisements. The company set up a website that connected people working in 20 different time zones with the three key coordinators, enabling the company to meet the required deadline.
- Spain's Inditex, parent of Zeta, a retailer of cheap and chic clothing, uses its tight supply management system to rapidly meet demands for its short-life-cycle clothing, providing growth and profits. The company is able to move new fashions from in-house design to stores in two weeks.
- Shiseido built a Web-based communications network linking factories with 16,000 outlets, cutting inventory by 30% and reducing the percentage of unsold and returned products.
- Sega Software, Inc. is a $1 billion company selling software to help businesses run more efficiently and effectively. It does not own or lease space for a headquarters. Its eight-member executive team members live in various cities widely scattered around the United States, and hold their monthly meetings at the Hyatt at the Dallas Fort Worth airport. Support services for the company are outsourced (Byrnes, 2007).
- Nike developed a Web-based just-in-time system that reduced development time and improved accuracy in determining designs and amounts of shoes to be ordered from suppliers, increasing its gross margins.
- Apple Computers switched from an EDI system to a Web-based system provided by Web Methods Integration Platform. The new system provides real-time interfaces for Apple with both suppliers and customers, including placing orders and exchanging documents via the Internet. Exchange of commercial information now takes place in seconds rather than hours. The company has indicated that they have 100% visibility of inventory of every product they have at the manufacturer at any given time.

Before discussing some of the basic models that are often incorporated in IT-supported systems, it should be noted that there are many uncertainties and risks involved in international supply chains that are not found in strictly domestic systems. Manuj and Mentzer wrote an article based on in-depth interviews with senior supply chain executives and other research, providing a guide to choosing risk management strategies in global management chains (Manuj and Mentzer, 2008).

The just-in-time approach is widely used throughout the world, and is discussed after we review the total-cost approach.

MRP and ERP systems were originally basically designed to work backwards from output requirements to determine input requirements. The objectives of MRP1 were to:

1. ensure that inputs for production and delivery were available when needed to meet customer needs;
2. minimize inventory;
3. plan manufacturing activities, delivery schedules, and purchasing activities.

MRP2 was designed to include information about financials. Though these systems can theoretically be developed and run manually, in practice they run on computer software. Basic information and references to additional sources of information about the ERP and MRP systems is available on Wikipedia®, 'the free encyclopedia' (http://en.wikipedia.org/wiki).

The cost approach

In addition to *direct* physical distribution costs – such as the costs of transporting, warehousing, carrying inventory, packaging, packing, and insurance – there is another group of costs that can have a pronounced effect on profits. These can be classified as *hidden* or *distribution-related* costs, and include such cost categories as lost sales, distributor–customer dissatisfactions, cost of time in transit, inventory losses, foreign warehousing, losses from not being fully insured and delays due to Customs/security issues. Although the total-cost approach may sound simple and easy to implement, this is not necessarily the case. The nature of the various cost elements that have been identified suggests that even a relatively simple problem in physical distribution system development can involve great quantities of information that interact in an even greater number of ways. Fortunately, analytical techniques such as mathematical programming and simulation are available to handle this information and such complex interrelationships.

There are many instances in which relatively simple analytical techniques provide operational solutions to physical distribution analysis problems. One such technique is break-even analysis. To use break-even analysis (which is a *least-cost* model) one need know only the total fixed cost and average variable cost associated with each alternative system. For each alternative, such costs are assumed to be constant over the range of possible amounts of the product to be moved to an overseas market area. Given this information, it is relatively easy to determine the volume at which one is indifferent as to which alternative to use. For all volumes up to the point of indifference, one system has a lower total cost, while for all volumes beyond this point the other system is the least costly. The analysis can be easily expanded to include any number of alternative systems of physical distribution for specific overseas markets. An alternative system must not have both a higher fixed cost and higher average variable cost than the other alternatives. If this situation exists, there can be no point of indifference. An illustration of the application of this approach is summarized by Figure 14.3, which presents a graphical analysis of four alternative systems. The heavy line represents the minimum cost curve at any volume level. Because of its simplicity, this approach is easy to use. Also, it allows one to plan in advance for possible system changes. That is, the export marketer will know that as volume to a given market approaches a certain point, making a change in the system being used must be considered if minimizing cost is the objective. Referring to Figure 14.3, as volume approaches 2,500 units the exporter should prepare to change from distribution system I to system II.

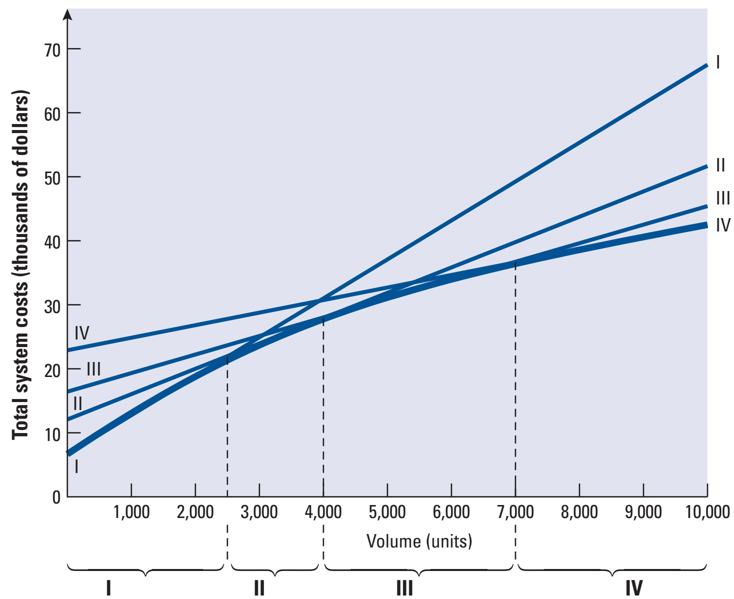


Figure 14.3 Total-cost analysis for multiple distribution alternatives

The total-cost approach is not limited to minimizing costs. Performance, or customer service, must also be considered. One objective may be to *maximize service* provided to a foreign market area. This may be accomplished by minimizing the time involved in order processing and delivery. As discussed above, advances in logistics and IT-supported systems may enable companies to both reduce time in order processing and reduce costs. However, using the fastest methods in transportation (e.g., air vs surface) or some other functions will still usually be more costly.

Finally, the system may try to *maximize competitive advantage*. With this policy, management is interested in creating competitive cost advantages such that revenue will be positively affected.

It should be obvious that the objectives stated above are not consistent. For example, how can service be maximized and at the same time cost minimized? Also, how can costs be reduced and yet the system still provide maximum information feedback? The answer lies in recognizing that there is still another possible objective, to *maximize profits*. This policy involves optimizing service and costs to arrive at the best balance among them. In short, what is involved is a process of cost and service trade-offs.

Systems and innovations supporting modern logistics

Present logistics/supply chain management systems are highly dependent upon modern broadband communications and computer software programs. They also benefit from the use of models like the just-in-time (JIT) planning and control systems, flexible manufacturing, and technological advances such as RFID. These three topics are discussed in this section, but we will first look at earlier models of production planning.

Manufacturing systems

In the design of manufacturing systems, operations using general-purpose machines have the greatest flexibility and are the least costly for making small numbers of any given item. For making many units of a particular item, the purchase of more specialized equipment requiring greater investment produced lower per-unit costs. The ultimate in traditional manufacturing systems was the assembly line dedicated to making one product with synchronized production stages and included transfer machines. These were very expensive, and relatively inflexible, but resulted in the lowest cost per unit when large numbers of units were produced. The development of computer-controlled machines and rapid change-over methods have made it possible to develop more flexible assembly lines. It is thus possible to set up assembly lines to produce smaller runs of products at costs only somewhat higher than lines dedicated to long runs of one product.

Production planning

In traditional production planning models, economic lot size models were used to determine the lowest cost combination of ordering–shipping costs plus storage costs. Inventories of three types were maintained:

- Raw material inventories were needed to assure adequate supplies of raw materials to meet surges in demand or interruptions in supply.
- Work-in-process inventories were needed to even-out variations in production rates between steps in the process, and assure that, in the event of a slowdown or breakdown in any one step in the process, the downstream operations would not have to be interrupted for a lack of parts to be worked on.
- Finished goods inventories were needed to assure that the company could accommodate surges in demand and continue to run the production line if there was a drop in demand.

The JIT system was originally developed by Toyota Motor Company but is now used worldwide, and has been very effective in reducing costs and improving quality and productivity. The system, as fully developed, is based on five main ideas:

1. The extensive use of inventories is wasteful in several ways. It is expensive because of the cost of money tied up in the materials, the requirements for warehouse and in-factory space to house the inventories, and the cost of additional materials handling at every stage. It is also wasteful in that, if defective parts begin to be produced at any stage in the process, the problem might not be discovered until many of the items have been produced for in-process storage.
2. At every stage in the production process, the parts required should arrive at the work station just in time to be installed.
3. Flexibility can be built in to the production system to allow more than one product, or design of product, to be made on one production line.
4. The highest level of quality can be attained if each individual worker is responsible for assuring that the product/part arriving at his or her work station is of the proper quality, that their job is done properly, and that the product/part leaving their workstation is of the proper quality. In order for the individual worker to really be responsible, he or she must be able to control the process.
5. Relationships with suppliers must be stable, provide for small shipments at frequent intervals, and shipments must be received just in time to be used.

An example of the use of JIT was that of the Toyota–General Motors joint venture in California, the New United Motors Manufacturing (NUMMI) plant in Fremont, California. While some inventories were required because a number of parts were received from overseas and from other plants far from the NUMMI plant, overall the inventories were very low. The plant was flexible, producing both Toyotas and GM cars in several models on the same assembly line. A perfect example of just-in-time arrival was that of seats for the automobiles. At the time when each individual automobile chassis was placed on the assembly line at NUMMI, an order was sent to the nearby supplier, who then sent the seats of the proper design and color to the plant.

To ensure that each worker had the ability as well as the responsibility for assuring proper quality at each step in the process, every assembly line worker had immediate access to a cord that would shut down the assembly line if a quality problem or emergency occurred. The NUMMI plant enjoyed high productivity, high quality, and good labor relations.

A much more complete explanation of the use of JIT at NUMMI is given in Case study 1.2.

Radio frequency identification systems and global positioning systems

Radio frequency identification systems use sensors (tags) that can be installed on containers, pallet loads, or even individual items. The simplest (passive) tags can provide information about what is in the container, or even what a single item is. The more complex (active) tags may provide information on the condition and location of containers as well as on its contents. They are different to the barcode systems that use optical scanners. The use of optical scanners requires that there be a line of sight between the tag and the scanner. RFID systems use radio waves and thus do not require a line of sight. The RFID tags are of two types: relatively simple passive tags, and active tags that may be much more complex.

The passive tags do not contain batteries. When the radio waves from the reader (transceiver) hit them, the radio waves pick up the information about the contents of the containers and bounce it back to the reader. In addition to identifying the contents of shipments, they can be used in many other applications such as reading e-pass tags on automobiles using bridges or roadways.

The active tags contain batteries and can transmit information on their own power. In addition to providing information on the contents of shipments the more complex active sensors may be enabled to: (1) provide long-distance communication, over the user's network via satellite, regarding the physical condition of the container and its contents (temperature and other factors), as well as what the contents are, and (2) track real-time location of the containers in ocean freight and land shipments (All About RFID, 2009). One system is presently tracking about 25,000 containers a day.

In supply chains, depending upon the type of RFID system, users can determine the location of products, stock levels, and point of sale information. This has the potential for reducing both costs of carrying inventory and out-of-stock costs. Using RFID tags can also help to protect against counterfeit products that may not have such tags because of the cost of programming them. The active tags can also be programmed to detect shock, vibration and tampering (Dusharme, 2006).

They are also being used by some retailers. Walmart launched a pilot project RFID system in 2005 with its top 100 suppliers nationwide and its stores in Texas taking part. It had 600 suppliers participating in the system in 2007. It has five of its distribution centers and 1,000 of its US stores included (Birchall, 2007). There have been some problems with the system so far. Since most manufacturers do not yet use the system, the intermediaries in the supply chain have to purchase the necessary equipment – readers, transponders, antennas – and put on the tags by hand at their warehouses. This has raised their costs. The type of chip Walmart is using cost $0.15 each compared with a fraction of a penny for barcodes.

Until 2010, Walmart used the smart tags only on pallets or cases of merchandise. They are now going to have individual tags put on men's clothing including jeans, underwear and socks. Though they can be removed from the garments, they will remain readable, even in the garbage. Some people have expressed concerns about privacy. Walmart says they will be used only to keep track of inventory, enabling a clerk to identify what and how many it has in stock of an item (D'Innocenzio, 2010).

This may give a boost for RFID systems. The initial enthusiasm for RFID systems had declined somewhat after 2005 because it appeared to be less widely applicable than originally hoped (McWilliams, 2007). In any event, it does have a place and can be expected to grow, though not at the rate originally envisioned.

Increasing use of these systems is inhibited by the costs of the equipment required and the sensors, as well as by a lack of uniform standards resulting from the wide variation in objectives targeted.

The GPS is a widely used aid to navigation, and also provides assisted GPS for mobile phones. The system operates 24 to 32 satellites in medium earth orbit. Originally developed for military use by the US Air Force, it is now an open system, free and available to everyone worldwide who wants to use it. GPS has increasing use worldwide, and not only by companies. Most automobile owners in Europe, the United States, Canada, and a number of other countries now own GPS receivers.

Structure of international physical distribution

To facilitate the flow of products across national boundaries there has evolved a complex structure of specialized marketing institutions, organizations, and services.

Modes of transportation

When faced with the decision of selecting a mode of transportation, the exporter has five basic types available from which to choose, depending, of course, upon the geographical proximity of the countries of export and import: ocean, air, rail, truck, and inland water. A sixth alternative is pipeline, which transports very specialized products. The choice between available methods of transportation is usually determined by a combination of cost, time, and security.

Ocean transportation is the dominant mode of international transportation. The significance of the other basic types of international transportation varies depending upon the countries involved. For example, rail and truck shipments do not constitute a significant portion of the export transactions of the United States, except perhaps for those that involve buyers in Canada and Mexico. In contrast, these transport modes carry large amounts of export goods among the countries of Europe. Similarly, inland waterways typically are not important carriers of goods between countries except in Europe where waterways such as the Rhine and Danube rivers carry large amounts of goods among the countries through

Figure 14.4 A container vessel that is not fully loaded

which they flow. Often the use of these relatively less important modes of transport depends upon the nature of specific products in unique geographic situations. The use of trucks to haul fresh produce from northern Mexico to the United States illustrates this practice.

Ocean transportation is widely used because it is a relatively low-cost way to transport goods, and it can easily handle large shipments. In addition, certain geographic conditions may make it impossible to use overland transportation to some foreign markets and infeasible to use it to others. Figure 14.4 shows a container vessel that is not fully loaded. Exhibit 14.4 discusses characteristics of some of the major ports of the world, and Table 14.1 shows the changing rankings of the 10 largest container ports in the world as trading patterns change.

Exhibit 14.4 The major container ports of the world

Table 14.1 shows the rankings of the world's 10 largest container ports as measured by TEU (20-foot container equivalent units) handled per year. The major changes in the rankings from 2000 to 2005 to 2007 to 2014 are due to the reshaping of ocean transportation logistics by China's becoming a major producer of manufactured goods for the world.

The present competitive positions of the individual ports are also influenced by the particular types of functions they serve.

- The 2014 top 10 list (Forbes, 2014) of the busiest ports in the world is completely dominated by Chinese ports. The new busiest port in the world is Shanghai port, handling 33.62 TEUs in 2013. Next on the list are Singapore, Shenzhen (China), Hong Kong, and Busan (South Korea). Number 6 Ningbo-Zhoushan Port handled 17.33 TEUs in 2013. Next are Qingdao (China), Guangzhou Harbor (China), Jebel Ali Port (Dubai), and Tianjin (China). Some of the ports that were in the top 10 recently, but not on the new list are: Hamburg, Germany; Kahoshing, Taiwan; and Rotterdam, the Netherlands.
- Singapore is a trans-shipment hub with an estimated 80% of the containers entering the port by ship also leaving the port by ship. The port is located at the bottom of the Straits of Malacca and almost everything moving between East Asia and Europe passes through these Straits. Though continuing to grow and still number one in the rankings, its share of total trade is now diminishing as more ships have full cargos going directly from China to a European port without need for sorting at an intermediate port.

- Hong Kong, while it continued to grow slowly during the period, has dropped sharply in relation to Singapore and Chinese ports between 2000 and 2007. Two Chinese ports and Dubai have joined the top 10 since 2000. Located at the mouth of the Pearl River delta, Hong Kong was a traditional entrepôt, a commercial center linking overseas trade with a large manufacturing region. Most containers go to and from the delta area by truck and from the port overseas by ship.

Table 14.1 The top 10 container ports in the world, selected years

Port	Country	Rank	Rank order of top 10 in		
		2014	2007	2005	2000
Shanghai	China	1	2	3	6
Singapore	Singapore	2	1	1	2
Shenzhen	China	3	4	4	-
Hong Kong	Hong Kong	4	3	2	1
Busan	South Korea	5	5	5	3
Ningbo-Zhoushan	China	6	-	-	-
Qingdao	China	7	10	10	-
Guangzhou	China	8	-	-	-
Jebel Ali	Dubai	9	-	-	-
Tianjin	China	10	-	-	-

There is continuing pressure to reduce the costs of ocean transportation, and to meet changing logistics requirements. Container ships have traditionally been limited in size to allow passage through the Panama Canal. Now the traffic on the Asia–US route has grown so that there is no need for some ships to be able to transit the Canal. Much larger ships that carry more than 8,000 20-foot-long containers have entered service and even larger ships are being built. Over 250 million containers are in service around the world and 65% of them carry trade between China, India, America, and Europe (*The Economist*, 2007).

Many diverse types of products are being transported to foreign markets by air in large volume: computers, office machines, electrical and electronic equipment, automobile parts, television sets, pharmaceuticals, certain metal manufactures, and clothing, to name but a few. Thus, even with existing technology, it is evident that air cargo movements are no longer confined to fast shipments of emergency supplies, goods of high value (e.g., jewelry), and perishable products (e.g., fresh-cut flowers), although it is widely used for such products.

Time in transit is but one of the so-called *hidden costs* that may be relevant. For example, Seagate Technology, which has an unpredictable global demand, uses air transportation to ship its computer disk drives from its plants in Singapore and Thailand to customers throughout the world in a very short time period. Thus, inventory-carrying costs are reduced and the company is able to predict better and with greater confidence when a buyer's order will arrive.

Exporters may send small shipments by international parcel post, air parcel post, or air courier service (such as FedEx, UPS, and DHL) rather than pay the higher minimum bill of lading charges for ocean freight or air shipments. Most large shipments of goods are sent by sea and are charged on a per container basis, with a maximum weight allowed per container. Less-than-container loads will be charged on the basis of weight or measurement, whichever is greater. Very small shipments are charged a set fee because of the costs involved in documentation and handling. Bulk shipments of petroleum, grain, coal, etc. are carried in specialized vessels and may be charged per voyage.

Internet technology may make things easier for shippers of smaller shipments. For example, there is a website in the United States (www.intershipper.com) that offers a service for helping a US exporter compare rates among eight carriers (FedEx, Air Net, DHL, Airborne Express, BAX, UPS, Emery Worldwide, and the US Postal Service). A company can enter the size or weight specifications of a package and the site analyzes all shipping options and guaranteed delivery times and dates. The site also helps choose the best rate, call for a package pickup or locate a drop-off location, track shipments automatically, or notify the exporter or the recipient when the package is delivered, or if it is delayed. At present, the service is free. Similar sites may appear elsewhere in the world.

There are times when a combination of transportation methods are used. One commonly used arrangement is air–sea, wherein cargo is transferred between air and ocean carriers, usually without the same intermodal container. Containers used by each of these types of carriers have characteristics that are incompatible with the other. The intent in using such an intermodal combination is to take advantage of the speed and cost efficiencies of each. Although there are different routes where this combination is used, major ones include the Far East (Asia-Pacific). For example, one route is to ship from Southeast Asia by ocean to Singapore and the Persian Gulf. From there, air is used to Europe. Products that are particularly well suited for the air–sea arrangement are higher value, larger volume consumer electronics, automated office equipment, and high-technology components that are less time sensitive than other products using air freight.

A land–sea combination is often used in the United States. For example, fresh California grapes destined for Europe may be shipped by truck or rail to the East Coast, then loaded aboard ocean vessels bound for Europe. This combination greatly reduces the transit time compared to shipment by all-water service.

The method of transportation is usually selected by the importer. The route selected for the export shipment may be determined either by the exporter or the importer. Exhibit 14.5 discusses factors affecting costs and effectiveness regarding international transit.

Exhibit 14.5 Factors affecting costs and effectiveness of international transportation

Ocean transportation

The ocean transportation system itself has been greatly affected by three factors.

The first is the growth of China as a major exporter of manufactured products and a major importer of raw materials. This has resulted in major changes in international trade routes and volumes, causing serious delays at some ports and for some inland carriers.

The second was the global recession that began in 2008, and its aftermath. The initial sharp drop in volume of trade caused most carriers to suffer significant losses, and several carriers required government financing in order to continue operations. A number of carriers took ships out of service, reduced schedules, and operated their vessels at slower speeds (slow steaming) to save on fuel costs. As trade began to recover in 2010, there were some serious shortages of containers on certain routes as volume increased more rapidly than expected and too few containers had been ordered. Denmark's Maersk Line, the world leader, has ordered more containers, is leasing others, and has reactivated high-speed ships to take empty containers from Europe and the Americas to Asia. They are needed there to handle outgoing shipments to Europe and the Americas during the busy season in late summer and early autumn (Wright, 2010).

A third is that piracy has become an increasingly serious problem. Attacking of mostly smaller vessels in the Straits of Malacca, and in some other spots around the world, has been a problem for many years. More recently, there have been many seizures of large ocean carriers that have then been held for ransom. These attacks are being carried out by increasingly well organized groups from Somalia operating in the Gulf of Aden. These groups support the pirate operations and divide the proceeds among the various participants according to their contributions to the attacks. The very weak Somali government is unable to prevent the attacks, and the income from ransom payments has become the major source of income for many people in the country. The seizures of ships resulted in very steep increases in insurance premiums, and the rerouting of some vessels to avoid the most dangerous area. This, in turn, resulted in great increases in time required and costs in using the much longer routes. As foreign governments began to send naval vessels to patrol the areas nearest the Somali coast, the pirates began to use mother ships that could support the smaller attack vessels further from Somalia. In November 2008 a Somali pirate ship 450 miles from Mombasa, Kenya captured a Saudi Arabian tanker carrying 2 million barrels of oil. That was the farthest out to sea for such an attack to that date (*Financial Times*, 2008).

In 2009, attacks by pirates increased sharply to 406 cases worldwide, more than half of which were by Somali pirates. The response by foreign governments has been to send even more naval vessels and aircraft patrols to the region. Still, pirate attacks continued to increase through 2010.

Supporting infrastructure

Many countries do not have adequate infrastructure to enable them to economically get potential exports to ports, or to deliver potential imports to places they are needed. In some cases, the ports themselves are not adequate to handle desired volumes of goods.

India doesn't have enough ports, roads or railroads to transport food products, 'leading to shortages and higher prices in many cities' (Einhorn and Thomas, 2010).

Brazil is the world's largest exporter of a number of agricultural products, but the competitiveness of some farmers is hurt by poor highways, underdeveloped waterways, and a lack of rail transport. It costs farmers in the Mato Grosso five times as much to get their soybeans to ports as it does US farmers, with inland transportation accounting for 30% of the value at the port (Wheatly, 2010).

Facilitating organizations and services

In addition to the transportation carriers, other types of organizations providing service to the exporter are freight forwarders and public warehouses. Most companies can benefit at one time or another from utilizing the services of such facilitating organizations. This is particularly true for those companies whose export marketing operations are small or irregular, and for the firm located away from the main exit or entry ports of its country. Functioning as integral parts of an export marketer's physical distribution system, these facilitating organizations can often be powerful marketing tools in that their existence in a system can make the difference in whether a particular transaction is consummated.

Freight forwarders

Foreign (export) freight forwarders or **consolidators**, now designated in the United States as *ocean transportation intermediaries* under the US Shipping Act of 1998, have two principal classes of function. One group is concerned with the forwarding of an export shipment from the point of origin to the ultimate destination in some foreign market; the other is concerned with the engaging of space on transportation carriers.

The services that foreign freight forwarders perform in carrying out these basic functions are many. Although a forwarder can usually perform every necessary physical distribution service from the time that an order is placed until the shipment is delivered at the foreign destination, perhaps a forwarder's major contribution lies in the taking over of traffic (arranging for shipping to the port, booking space on the carrier, and arranging insurance), documentation work on international freight movements and preparing and filing export Customs paperwork. In addition, by being able to consolidate small shipments into larger ones, the forwarder is in a position to secure lower transportation rates than any single shipper could get directly from the carriers. Such savings in freight charges can then be passed on to the shipper. Some freight forwarders may also offer advice on markets, government regulations, and potential problems. The forwarder can track the movement of goods, warehouse inventory, and process Customs documentation electronically.

More recently, forwarders have expanded their activities to include production planning, inventory management, parts assembly, distribution warehousing, real-time tracking, wheels-up clearance, and electronic reporting. For example, in its center in the Netherlands, Air Express International (AEI) has its personnel perform simple repairs to electronic assemblies. AEI views this not as a concession to a customer but as a logical extension of being a forwarder. In Malaysia, AEI manages the entire inventory and distribution of Intel's plant, saving Intel millions of dollars and halving the delivery time of microchips.

Forwarders can function as nonvessel operating common carriers (NVOCC), though in the United States these are now officially designated simply as another type of *ocean transportation intermediary*. To the exporter an NVOCC is a transport carrier and to a carrier it is a shipper. The NVOCC issues a bill of lading to the exporter and is the responsible party to the exporter. The carrier, on the other hand, issues a bill of lading to the NVOCC. Air freight consolidators work in a manner similar to the ocean freight NVOCC.

The relationship between the exporter, the foreign freight forwarder, and the carrier may vary. The forwarder may perform some of the functions of an export house, particularly for companies fairly new in exporting. Sometimes more experienced exporters may choose to take over some of the forwarder's usual duties, especially documentation. The degree to which exporters take on some of the traditional forwarder's duties seems to be related to the export effort of the company, as measured by the number of orders or consignments rather than export volume or value.

In addition to exporters taking on forwarding activities, transportation companies themselves have done likewise. For example, DFDS, a Danish sea transport company, views itself as a total transport company operating multimodes of transport that are concerned with logistics management. It handles all the physical distribution for a number of companies, small, medium, and large. Thus DFDS has absorbed freight-forwarding activities. The company has created a network in Europe based on strategic alliances formed in Germany and France. The company has allocated Europe among itself and its two partners as follows:

- DFDS Home (Scandinavia, Benelux, United Kingdom, Portugal);
- DFDS/THL Germany (Germany, Switzerland, Spain);
- French partner (France, Austria, Italy, Greece).

There is clearly a trend toward consolidation between carriers and freight forwarders to offer companies a total logistics and transport package. By forming long-term alliances with airlines and shipping companies, and by making the necessary investment and accepting the risks that go with it, forwarders can take on overall responsibility for the entire transport chain. This seems to be more viable than simply forming larger and larger forwarders.

Although all foreign freight forwarders will handle shipments by air transportation as a routine service, some specialize in air cargo. In the same way as regular forwarders, these special air freight forwarders provide complete services from point of origin to point of destination.

A special type of forwarder is the *shippers' agent*. This type of facilitating organization handles inland movement of international freight. As intermodal experts they offer valuable assistance to exporters, importers, ocean transport companies, railroads, and trucking companies. They aim to put together a cost-effective (through lower inland rates), quality intermodal transportation package.

Warehousing

When it is necessary and profitable for an exporter to maintain an inventory in foreign markets, a storage or warehousing branch can be established. Such facilities may be part of a foreign sales branch. If so connected, the buyer is afforded greater convenience and a potentially powerful marketing tool is created in that a greater volume of business may be generated than would be the case if storage facilities were absent. The same situation occurs when the warehousing branch is a separate entity, set up to fill orders made by overseas distributors or agents.

As an alternative to establishing branch warehouses in foreign markets, the exporter can utilize the services of public warehouses. A branch warehouse may not be practical because of irregular demand for warehouse space or, if such demand is regular, its magnitude is not large enough to support the investment required and the regular operating costs incurred. Many public warehouses are being established in the various free areas of the world.

International public warehouses provide all the usual services of warehousing: unloading, storing, packing, and so on. Such warehouses in many foreign markets may offer other services, as illustrated by a company in the Netherlands that offers customer freight forwarding, packaging, insurance, and transportation service to all of Europe and the Middle East. For at least one customer it has coordinated promotional material. In addition, many such warehouses are designated as **Customs-bonded warehouses**, which means that goods from abroad may be stored there, and certain manipulations performed on the goods, without payment of duty until such time as they are released from storage and delivered to a buyer. The manipulations may include manufacturing activities, although such activities may be allowed only if the finished products are exported. The activities carried on in bonded warehouses are under strict supervision of Customs authorities.

It is not necessary that a foreign storage or warehousing operation provide stocks for a single market area. In fact, many exporters, as they increasingly apply the total-cost concept to their physical distribution or logistics problems, are establishing such branches as central distribution centers to serve a wide area. For example, in the early 1990s a housewares company sourcing from the United States consolidated its seven European warehouses to two, while a computer manufacturer with a plant in Ireland stopped carrying inventory in each national market and shifted to direct delivery from the plant. Freight forwarders handled local distribution. Where several market areas are to be served by a single storage or warehousing branch, it may be best for these facilities to be located in a free port or trade zone such as Hong Kong, New York, or Colon. By locating in a free area, it is relatively easy for a manufacturer to serve many markets since the usual Customs procedures and regulations of the country where the free area is physically located do not apply. In addition to free areas, an exporter doing business in Europe might have one or more warehouses to serve the entire European Union. These could be located in any member country.

Two additional types of facility need to be identified – Distriparks and Districenters. *Distriparks*, which are located in the major ports of the world such as Rotterdam and Singapore, provide a place where the supplier/exporter/shipper can lease warehouse space in the port area and assemble, process, and label products with a meaningful savings in cost. More comprehensive, in terms of what is done in them, are the *Districenters*. In effect, a Districenter offers the complete logistics system and effectively is a process whereby the manufacturer/exporter/supplier contracts out of distribution and transport. The operator of the center handles the complete management of the flow of goods and information and provides additional services such as invoicing, packing, sorting, and inventory control. An early user of the concept was Nedlloyd Flowmaster in Europe. A new Districenter opened in Panyu, Guangdong Province, China in late 1997. It serves as an entry point into China. Tenants are allowed to buy, sell, and manufacture. The center offers one-stop-shop services, including licenses for distribution in Panyu, free business consultation, banking and transportation, business registration and help in hiring personnel (Tang, 1998). Since manufacturers can display products, Chinese wholesalers and retailers can meet with the manufacturers for immediate cash-and-carry sales. The Panyu Districenter represents a new concept for distribution into China and has circumvented laws regulating such distribution. Interestingly, the center allows foreign buyers to bypass intermediaries, and if the concept catches on in China may reduce Hong Kong's role as an entrepôt for reexport of Chinese goods.

Free areas

Two distinct types of free areas can be found throughout the world. They are similar in that all are considered to be outside the Customs area of a country. Products may be brought into and exported from such areas easily. In addition, other activities may be allowed, such as repacking and manufacturing.

As we showed in Chapter 4, a *free trade zone* is basically an enclosed, policed area without resident population in, adjacent to, or near a port of entry, into which foreign goods not otherwise prohibited may be brought without formal Customs entry. The Barrenquilla Free Zone in Colombia, Shannon in Ireland, and Honolulu in the United States are examples. Sometimes the zone may be only one company's plant or warehouse. E. R. Squibb & Sons, a global manufacturer of pharmaceuticals and healthcare products with 29 plants in 27 countries, has its New Brunswick, NJ, plant designated as such a zone.

With such status Squibb will lower its costs significantly through tariff payment deferral, elimination of duties on waste products and reexports and by paying lower tariffs for finished products than it would pay for new materials. In a similar manner, 'free warehouses' in Denmark, operated by the Danish government in Copenhagen and other cities, function like a free zone. These are a variation of Customs-bonded warehouses that can be found in such European cities as Antwerp and Rotterdam. Exhibit 14.6 illustrates potential benefits from using a free zone.

Exhibit 14.6 How companies can benefit from a free trade zone

A reason that many companies use a free trade zone (FTZ) facility is for cash flow savings. Realized savings can be accrued on lower cost items as well as high cost products. To show how savings can be significant, a hypothetical situation is depicted in the table below:

Activities in the FTZ	Examples of savings	
Duty is deferred on imported goods admitted to zone	*Constant inventory savings*	
For storage, manipulation such as packaging, marking, labeling, repackaging, etc. or for assembly/ manufacturing. Cash flow is improved.	Amount of average durable inventory	$40,000,000
	Average duty rate	10%
Zone user pays duty only when goods leave the zone and enter the market.	Duty deferred on permanent basis	$4,000,000
	Cost of money (est.)	13%
Zone user improves cash flow position by shortening the time between payment of duties, and receipt of income from sale of goods.	Annual savings (est.)	$520,000
Zone user achieves a major reduction in its capital requirements for financing.		
No duty is assessed when reexporting from zone	*Export savings*	
Goods imported duty free into zone may be processed several ways: inspected, assembled into finished products, repackaged, or warehoused, then exported to markets outside the country with no assessed duties.	Amount of imports exported annually from the zone	$20,000,000
	Average duty rate (est.)	6%
	Annual savings (est.)	$1,200,000
Processing goods within the zone can eliminate or lower tariffs	*Manufacturing/ assembly/processing savings*	
A company that imports parts into the zone and assembles them into finished products can reduce or eliminate tariffs by shipping finished products from the zone.	Annual duty that would have been paid on imported components/ materials, etc.	$750,000
	Duty on finished goods due to lower rate on duty thereon	450,000
	Annual savings (est.)	$300,000

Activities in the FTZ	Examples of savings	
Duties can be avoided on defective damaged goods by inspecting and testing imported goods within a zone	*Defective/damaged/ waste/obsolete savings*	
Segregate rejects for return to shipper or other duty-free disposition.	Total dutiable imported goods	$20,000,000
	Percentage of defective material	15%
And no duty is due for any accountable losses including evaporation, seepage, spoilage, impurities, damage, defects, or obsolescence.	Value of dutiable goods that became defective, etc.	$3,000,000
	Average duty rate (est.)	8%
	Annual savings (est.)	$240,000
Savings of 10% to 25% have been realized in total transport insurance from foreign shipper's plant to importer in a zone vs importer outside a zone.	*Fire and theft insurance*	
	Average annual value of duty-paid inventory	$44,000,000
In addition to fire and theft insurance savings, which depend upon shipment method, air/ocean, containerized/noncontainerized, nature of goods, etc.	*Fire and theft insurance (7c per $100)*	$30,800

Source: Adapted from (1991) Foreign trade advantage: an innovative way to trim costs, *Via Port of NY–NJ*, 43(1), pp. 12–15.

Both BMW of North America and Mazda utilize a free trade zone in the United States to benefit from duty deferral on imported automobiles admitted into the zone. These companies use the zone to process their vehicles with domestic-status accessories and they are able to store them on site. Another example is Magnavox, which uses a free trade zone in the United States to store a marine navigation system product, a Navigator, which is manufactured in Denmark. This zone serves as an inventory center for sales made in the United States and abroad as well.

A *free port* encompasses a port or entire city isolated from the rest of the country for Customs purposes. Important free ports still operating as such are Hong Kong and Singapore. These areas exist primarily to facilitate reexporting and thus can be central distribution centers. A variation is the *free perimeter*, which is generally confined to a remote underdeveloped region of a country. At many points along its border with the United States, for example, Mexico has established such areas.

A related type of area is an *export processing zone* (EPZ), which is an area where foreign manufacturers enjoy favored treatment on the import of intermediate goods, taxes, provision of infrastructure, and freedom from industrial regulations applying elsewhere in the country. Developing countries use these areas as a means of stimulating exports as a route to industrial development. In order to be successful, such zones should have adequate physical infrastructure and be close to good transport and commercial support services. Since the mid-1960s EPZs have spread rapidly throughout much of East and South Asia, the Caribbean, and Central America. Some western European countries, including France and the United Kingdom, have also accepted the idea.

Transportation insurance

One of the more important risks involved in an export transaction is that of loss or damage to goods during their physical movement from seller to buyer. In most instances full protection from this risk can be provided through special transportation insurance, such as *marine insurance*. Protection can be provided to cover all transport risks from the time the goods leave the seller's warehouse or factory – whether located inland or at a port of exit from the exporter's country – until they reach the final destination stipulated by the foreign buyer. In its most basic form such insurance provides the means to reimburse the owners of goods being transported to overseas markets for any losses or damages incurred for which the carriers cannot legally be called upon to make payment. In addition to legal owners, non-owners often have an interest in seeing that a shipment is adequately protected.

From the point of view of the parties involved in an international marketing transaction – the seller and buyer – a deciding factor in the question of who needs transportation insurance, and when to insure, is *insurable interest*. Generally speaking, insurable interest depends upon whether a company will benefit from the safe arrival of the carrier and its cargo or whether the firm will be injured by its loss, damage, or detention. This covers a wide range of situations in that not only do the owners of the carrier and cargo have such an interest, but so may certain non-owners. For instance, in some situations the seller can have an insurable interest as a non-owner even though the buyer has already become the legal owner of the goods.

The liability of the transportation carrier in international trade is severely limited. Additionally, the owner of cargo on board a vessel is a participant in a 'joint venture' and may become subject to a *general average* claim which is liability for loss or destruction of merchandise of other persons which is sacrificed to save the vessel (see Exhibit 14.7).

Exhibit 14.7 Marine insurance coverage

When acquiring marine insurance there are a number of perils that the exporter wants to insure against. Major perils include fire, perils of the sea (weather, waves, damage by sea water, etc.), jettison (throwing items overboard), assailing thieves (forcible taking), and barratry (willful misconduct of captain or crew, including theft). In addition, the exporter can obtain insurance coverage for other perils and hazards, including theft by other than crew.

The perils specified govern the nature of the loss and damage recoverable under the insurance. The *average* terms cover the extent of coverage. As used in insurance, average refers to 'loss less than total.' A *particular average* loss is one that affects specific interests only, whereas a *general average* loss is one affecting all cargo interests on a particular vessel plus the vessel itself.

The narrowest form of coverage is 'free of particular average' (FPA) which means that in addition to total losses, partial losses from perils of the sea are recoverable, but only if the carrying vessel has stranded, sunk, burnt, been on fire, or been in a collision. Under English conditions (FPA-EC), any one of these conditions must have occurred but it is not necessary to show that it actually caused the loss. In contrast, under American conditions (FPA-AC), the event must have caused the loss.

A more inclusive coverage is 'with average.' Partial damage is recoverable, sometimes with a deductible being applied depending upon the specific event that occurred. The most inclusive coverage would be 'all risks.' At times the all-risk coverage may exclude specific types of damage to specific products.

Therefore, shipments on ocean-going vessels are invariably covered by marine insurance. Most frequently coverage is secured by the shipper or exporter; however, importers customarily also maintain coverage to provide protection if for any reason it is not provided by the exporter. So universally is marine insurance necessary that most firms engaged regularly in export business maintain an open policy with a reliable marine insurance company.

When a CIF price is quoted to a buyer the exporter must furnish marine insurance. If no special coverages are requested by the buyer, the exporter provides that which is customary and which has been found necessary or desirable for that particular type of shipment.

Shippers by air may obtain insurance coverage for their shipments from the initial air carrier or through the shipper's insurance broker. Airlines provide a limited amount of insurance coverage on shipments of selected products. If insurance coverage is made by the airline concerned, it should be noted that the insurance company usually imposes a maximum limit upon the value of merchandise that may be carried on any one flight. This fact sometimes accounts for the refusal of an airline to carry some physically small, but highly valuable shipment.

Insurance is also furnished by the air freight forwarder. Merchandise, therefore, may be covered from the time of pick up to the time of delivery at the airport.

The regular form of open or floating policy used for marine insurance is also used for insurance of air cargo, but air insurance requires a special rider, which is attached to the open policy. If the exporter makes regular shipments by air, it is to his or her advantage to obtain an open policy covering all shipments. Such a policy can be arranged to cover door-to-door shipments from exporter to importer.

Export packing

Distinct from packaging is the activity of packing. Sound export packing is not just the operation of putting a piece of merchandise into a container so that it will arrive at its destination in good condition. Additional objectives are to economize shipping space, to save expense by employing economical packing materials, to prevent pilferage, and to insure the lowest assessable Customs duties.

The type of packing that will deliver the commodity in good condition to the foreign customer will vary with the product concerned, the port of destination, length of journey, climate of the place of delivery, and the heat and moisture conditions to which the goods may be subjected en route. Only experience and experimentation can determine the type of container or packing best suited to the particular conditions of a given shipment. A US company, Ekkwill Tropical Fish Farm, Inc., annually exports a few million live fish. Air transportation is used to service Canada, Mexico, and markets in Europe, Asia, South America, and the West Indies. Special shipping and packing precautions are needed for such a perishable product. Thus the company uses the latest technology including tranquilizers and top-quality water. Proper packing for export has a great impact on this company's reputation in diverse world markets.

Transportation space is expensive, and unless care is taken to use this space most efficiently, the cost to the exporter may quickly mount. Sound packing methods involve the use of economical packing materials. This is not synonymous with the use of either heavy or first-class packing materials. One exporter used heavy paper cartons to ship electric refrigerators with enamel exteriors to the west coast of South America. This is virtually a contradiction of every rule of sound packing, but it was successful because the amount saved in packing materials and in shipping space far outweighed the losses that occurred due to the fragility of the packing.

Another consideration is environment based. Throughout the markets of the world there is increasing interest in recycling packages and packing materials. In Germany, for example, there is the Green Dot program that covers recycling of packaging and packing materials. This program, or something similar, is very likely to become the norm in the European Union. The German law underlying this program is that all links in the distribution chain must take back and reduce or recycle used transport, sales, and secondary packaging. Since all packaging materials must be recyclable, only the following materials are allowed: paper, cardboard, wood, foils, packaging strips, stryrofoam, glass, tinplate, laminate board, and aluminum. Material used in packing export shipments is covered by this program.

Closely identified with packing is the marking and labeling of shipments being exported. In this matter there are three interested parties: transportation companies, Customs authorities, and importers. The requirements of these interested parties differ. Consequently, the manufacturer/exporter should be aware of the requirements for each individual export shipment. Careless marking and labeling can be a great stimulus to pilferage. Proper labeling conceals the contents of the shipment to outside parties and, at the same time, makes the contents identifiable to those who must know. Labels should also show the country of origin, number of packages contained in each case, destination and any special handling instructions.

Documents required

It should be noted that customs and practices differ from country to country, and even to some extent in different parts of the same country. A consular invoice (discussed below) is required by some countries but not by others. **Dock receipts** (discussed below) are used in the United Kingdom and on the United States East Coast, but are not used on the West Coast of the United States. Shipping conferences and rate agreements (sometimes called discussion agreements), designed to control rates and schedules on particular trade routes, are organized, become stronger or weaker, and may be disbanded in certain areas or at certain times. Inbound and outbound freight between the same two ports of the same type or classification of merchandise may pay widely differing rates. Changes in government regulations may have substantial effects on procedures and costs in distribution.

Table 14.2 describes briefly nine of the most common documents used in export shipments. One of the major documents required is the *bill of lading*, which is discussed in the next section. The other important documents are discussed now. At the present time there is a great amount of paperwork needed to complete an export transaction. Figure 14.5 illustrates the complexity of documentation as it identifies the main lines of communication in international trade. Each contact between the exporter/forwarder involves one or more documents. There is a great deal of work being done to standardize and simplify documentation, including development of EDI systems and networks.

Export license and export declaration

In addition to any required export license, the shipper may be required to complete a *shipper's export declaration*. Most countries require that shipments abroad be accompanied by such a declaration. This document is prepared by the exporter, given to the shipping company, and then filed with Customs officials at the port of export. In some countries, for

Table 14.2 Common export documents

Transportation documents:

- *Bill of lading.* A receipt for the cargo and a contract for transportation between a shipper and a transport carrier. It may also be used as an instrument of ownership.
- *Dock receipt.* This is the document acknowledging receipt of the cargo by an ocean carrier.
- *Insurance certificate.* Evidence that insurance is provided to cover loss or damage to the cargo while in transit.

Banking documents:

- *Letter of credit.* A financial document issued by a bank at the request of the importer guaranteeing payment to the exporter if certain terms and conditions surrounding a transaction are met.
- *Draft.* A demand for payment from the exporter to the importer or his or her bank.

Commercial documents:

- *Commercial invoice.* This is a bill for the products from the exporter to the buyer.

Government documents:

- *Export declaration.* Includes complete information about the shipment.
- *Consular invoice.* This is a document signed by a consul of the importing country that is used to control and identify goods shipped there.
- *Certificate of origin.* A document certifying the origin of products being exported so that the buying country knows in which country the products were produced.

example the United States, the document can be filed electronically with the proper government agency by the exporter or forwarder. The export declaration lists the descriptions, quantities, and values of the various types of merchandise in the shipment. It also lists the name of the shipper, the name of the agent of the shipper, and the destination and consignee. It is a basic document used in the collection of statistical data on exports and is also used by governments for control over exports. It is now an essential document for security purposes.

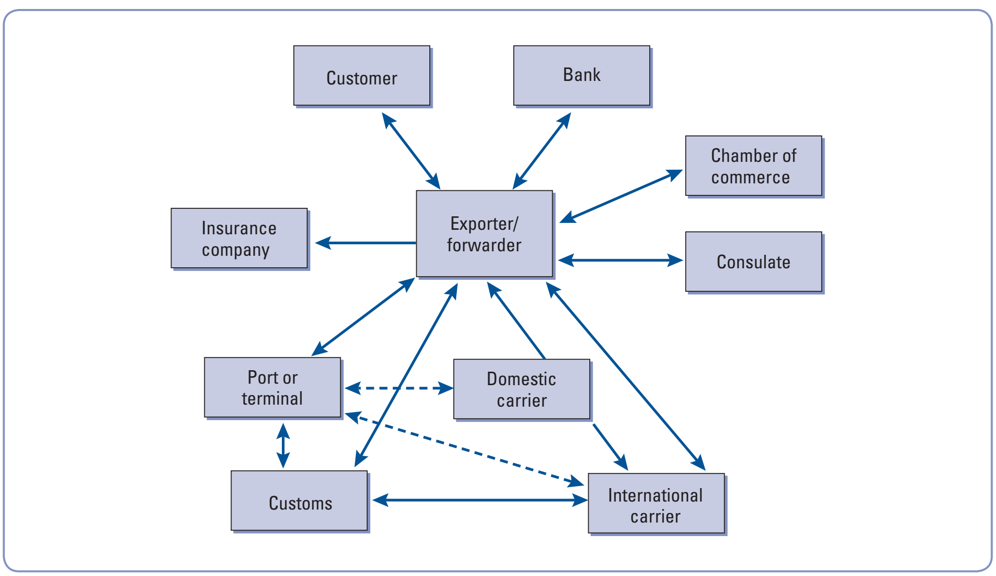


Figure 14.5 Main lines of communication in trade

Commercial invoice

In exporting, the bill that the exporter or consignor sends to the importer or consignee is called a *commercial invoice*. This invoice lists full particulars of the shipment. The marks, the number of packages, an accurate packing list, and a full description of the merchandise should appear on the commercial invoice. It should state the name of the ship (if ocean transportation is used), the name and address of the consignee, the contract number, the code word for the contract if one is used, the price per unit of the merchandise, and the total price of the shipment. The commercial invoice should also show the nature of the price quotation – whether the merchandise is sold FOB factory, FAS vessel, or CIF port of destination – and the terms of payment (i.e., letter of credit, sight draft, 60 or 120 days after sight, documents against acceptance or documents against payment, or other terms).

Various countries differ widely in the number of copies of the commercial invoice required with each shipment. The general practice is to send at least two copies to the bank with the other shipping documents and with the draft drawn either against letters of credit or filed with the bank for collection (drawn directly on the buyer). Many exporters send at least two copies of the commercial invoice direct to the consignee by separate mails. Other copies of the commercial invoice in large quantities are frequently required by consular officers of the importer's country.

In those countries that use common law, the commercial invoice generally carries no legal title to the merchandise and is, therefore, not a negotiable instrument. At best, it is evidence of the intentions of the parties and is a notification to the consignee of all the facts and the amount to be paid. In those countries where **civil law** is used, however, the commercial invoice is of much greater importance in determining the passage of title. In such countries, it may even become evidence of the fact that title has passed.

The commercial invoice is also important in connection with insurance claims and is frequently filed with underwriters and surveyors when claims for damages are made.

Consular invoice/special Customs invoice/factura

Another essential shipping document for shipments to some countries, but not all, is the *consular invoice*, 'special Customs invoice,' or *factura* (as it is called in some Spanish-speaking countries). This is a document obtained by the exporter in the home country from the governmental representative of the importer's country. Thus, the exporter must prepare and have certified before the foreign consul or representative a document containing all essential details of the sale. After certification the document is forwarded to the buyer for presentation to Customs with the Customs declaration, ostensibly for use in determining the amount of tariff to be levied. Figure 14.6 is an example of a consular invoice that has been used by the Republic of Haiti. Although specific formats will vary by country, this example shows the type of information that is requested.

The fees charged to certify the document by the consul of the foreign government vary widely from country to country. Some fees are nominal, but a few countries, particularly some of the less developed nations, have found that the consular invoice can be a good source of revenue.

Where they are required, consular invoices must be filled out with meticulous care. Some countries will not accept a form containing erasures or corrections of errors. When errors

FACTURE CONSULAIRE

CONSULAT DE LA REPUBLIQUE D'HAITI

CONSULAR INVOICE

B. L. No.

Marks (Marques) and Country of Origin

Merchandise Shipped on the S. S.: ______ on ______
Marchandises expédiées sur le SS. (Nationality - Name (nom)) le (Date of Sailing)

Sailing from the Port of ______ for ______, Haiti
Partant du port de ______ Pour

Name and Address of Shipper
Nom et adresse de l'expéditeur

Consigned to order of ______ of ______
Consignées à l'ordre de

Notify ______ of ______, Haiti
Notifier ______ de

Numbers Numéros	Number of pieces Nombre de colis	Nature of Packing Nature de l'emballage	Denomination and Details of Each Article (Quantity, Quality, Measure, Yardage, etc.) in Terms of the Haitian Tariff. Dénomination et détails de chaque article (quantité, qualité, mesure, yardage, etc.) dans les termes du Tarif Haïtien.	Weights in / Poids en: Gross Brut	Weights in / Poids en: Net Net	Values in U.S. Currency Valeur en Monnaie des E.U.

We affirm that this invoice is a correct and faithful expression of the truth, that it corresponds in every particular with our books, and that neither the usual designation, nor the weights, nor the quantity or quality, nor the value and origin named therein are in any way altered, and are thereof exactly the same than those appeared on our Export Declaration No. of (date) submitted to the U. S. Custom House.

J'affirme que cette facture est l'expression sincère et fidèle de la vérité, qu'elle est en tout conforme à mes livres, qu'aucune dénomination usuelle, ni le poids, ni la quantité ou la qualité, ni la valeur, ni l'origine des articles qui y sont portés, n'ont été altérés et sont, en conséquence, les mêmes que ceux accusés sur ma déclaration No. du soumise à la Douane des Etats-Unis.

______ Date ______ 19 ______

______ For Account of
Name of forwarding agent, broker or commissioner, etc.

Shippers
Expéditeurs ______

Per: ______
Signature

NOTE:—In all cases where the merchandise is taxed at net weight, the weight to be taxed of said merchandise will include all interior or immediate packing, including the paste board boxes or objects made of paste board, not subject to a higher tax. (Article 29, Law of July 26, 1926.)

Dans tous les cas où les marchandises sont taxées au poids net, le poids imposable des dites marchandises comprendra tous les emballages antérieurs ou immédiats, y compris les cartons ou objets en carton, non soumis à un droit plus élevé (Article 29, loi du 26 Juillet, 1926.)

ARRANGEMENT OF DOCUMENTS:

3 Consular Invoices and 3 Original Bills of lading clipped or stapled together, the invoice on top.

To each of the remaining Consular invoices a copy of signed B/L must be stapled and the whole set clipped together.

Value of merchandise Valeur des marchandises		
Packing (if not included in the value of the merchandise) Emballage (s'il n'est pas compris dans la valeur des marchandises)		
Inland Freight. Bill of Lading, Wharfage and Trucking Charges Frêt et frais du connaissement, embarquement et camionnage.		
Total F. O. B. Value		
Brokerage fees Commission d'achat		
Interest Intérêts		
Export Duties paid at Port of Origin Droits d'exportation acquittés au port d'origine		
Ocean Freight and Bill of Lading Expenses (including embarking and disembarking) Frêt et frais du connaissement, embarquement et débarquement compris		
Insurance Assurance		
Consular fees: / Droits consulaires: *2% of F O B value $		
Stamp on Inv. ($1.20)		
B/L visa ($2.00)		
Stamp on B/L ($1.20)		
Other expenses Autres frais		
Total amount of invoice Montant total de la facture		

CONSULAR INVOICE FEES

*For any merchandise being shipped by boat to Haiti and whose value FOB is inferior to $200.00 — the fee is $3.00 plus B/L visa and Stamps —— 7.40
Over $200.00 — the fee is 2% on the value FOB plus B/L visa and Stamps
Visa for Certificate of Origin $2.00 plus Stamps $1.20 —— 3.20
Visa for Commercial Invoice if requested $2.00 plus Stamp $1.20 —— 3.20
ADDITIONAL FEES:
Visa on Consular Invoice requested after 4 p. m. —— 2.00*
Visa on Consular Invoice requested on holidays —— 4.00*

Figure 14.6 Consular invoice for the Republic of Haiti are detected by Customs officials a substantial fine may be levied, or the shipment may be subject to confiscation.

Packing list

The packing list is sometimes shown on the commercial invoice, or it may be a separate document, depending on the number of packages and the complexity of the list. It should contain, item by item, the contents of cases or containers in a shipment. The items should be listed separately with their weight and description set forth so as to make a complete check of the contents of each package possible upon arrival at the port of destination or the Customs office. This information is also useful for the consignee. Any variation in description from the commercial invoice or consular invoice usually subjects the consignee to large fines, which are then passed on to the exporter.

Certification and other documents

There are a number of other documents that may be necessary for a complete set of shipping papers. Among the most important are certificates of origin and special certificates.

Certificates of origin are documents certifying the place of origin of the merchandise. Figure 14.7 is an example of a general certificate of origin for the United States. Although specific formats may vary, this certificate is representative of those used by most countries. All ask for essentially the same types of information. They are required by some countries for all products and by other countries for only certain types of product or only for products originating in certain countries. In addition to such general certificates, special certificates may be required for shipments between countries with special arrangements. For example, there is a separate certificate for US shipments to Israel that are covered by the US–Israel Free Trade Area Agreement.

In some countries, the certificate of origin is the only special document required. In other countries, a combined consular invoice and certificate of origin is required. In still others, a separate certificate of origin is required in addition to the consular invoice.

The certificate of origin is not treated, generally, with anything like the formality of the consular invoice. The form is generally filled out by the consignor or an agent, and is then certified by officers of a local commercial organization, not consular officials. In some cases a consular official has to authorize the signature of the local commercial organization person.

Special certificates include a wide variety of special inspection certificates issued by various authorities and may be required by the importer to meet his own or government requirements. These documents certify as to purity and absence of disease, and are issued to cover food products, plants, seeds, and live animals. Frequently, they must be visaed or legalized by the consular representative of the importing country. Food products are those for which sanitary certificates are most often required.

Special certificates are also issued for certain types of merchandise, to certify a required composition or the existence of specific ingredients. Some types of steel, for example, are sold on analysis. Certain chemical mixtures must be analyzed and certified with respect to the presence of desired constituents.

The importer can be expected to specify what special certificates may be required, and the exporter must provide them. All required certificates should be attached to the commercial invoice and forwarded to the importer together with the other shipping documents.

CERTIFICATE OF ORIGIN

The undersigned ....
(Owner or Agent, & c)

for .... declares
(Name and Address of Shipper, etc.)

that the following mentioned goods shipped on S/S ....
(Name of Ship)

on the date of .... consigned to ....

.... are the product of the United States of America.

MARKS AND NUMBERS	NO. OF PKGS., BOXES OR CASES	WEIGHT IN KILOS GROSS	NET	DESCRIPTION

Sworn to before me

Dated at .... on the .... day of .... 19 ....

this .... day of . ..... 19 ....

....

....
Signature of Owner or Agent

The ...., a recognized Chamber of Commerce under the laws of the State of ...., has examined the manufacturer's invoice or shipper's affidavit concerning the origin of the merchandise and, according to the best of its knowledge and belief, finds that the products named originated in the United States of North America.

Secretary ....

Figure 14.7 Certificate of origin from the United States

Source: Form 10–900P Certificate of Origin. Reproduced with permission of Unz & New Providence, NJ 07974.

Ocean transportation and bills of lading

The ocean bill of lading

The bill of lading used in ocean transportation is a document that serves three distinct purposes:

1. It is the contract of carriage between the shipper and the transportation company.
2. It is a receipt for the goods issued by the steamship company.
3. It is evidence of title to the merchandise.

Different types of bills of lading are described in some detail in Exhibit 14.8. An example is shown in Figure 14.8.

Exhibit 14.8 Types of bills of lading

Bills of lading (B/Ls) may be classified on several bases relating to title to the goods and the type of receipt.

Signed and unsigned B/Ls

Bills of lading are frequently prepared in as many as 25 copies. Sometimes even more may be required. Only those signed by the master of the vessel or his authorized agent are legally binding documents. In the case of a to-order bill of lading (discussed below), each of the signed copies carries with it the title to the shipment. Any one may be used by the shipper, the consignee, or his agent, or by some person or persons to whom the merchandise has been conveyed for claiming ownership and taking delivery. However, when any of the signed copies is presented the others automatically become void (only one copy can be presented to the carrier to claim the shipment). Signed nonnegotiable copies, issued in the case of straight bills of lading (discussed below), are used as proof of shipment.

Unsigned copies of the bill of lading have no legal status, yet they are essential. Several are needed for the files of the shipper and the consignee; a number are used by the steamship company for recording and billing purposes; and others may be necessary for purposes such as preparing and settling insurance claims, and by banks participating in the financing or collection process.

Straight and order B/Ls, and datafreight receipts/seaway bills

Ocean bills of lading may be either *straight* or *order*. A straight bill of lading is made out to a specifically named consignee at the destination, who is the only person authorized to take delivery. An order bill of lading may be made out to the order of the shipper, a bank, an agent, or merely 'to order.' Whoever legally holds the document may take delivery of the shipment.

The straight bill of lading is nonnegotiable. By its provisions, the transportation company accepts receipt of the freight and contracts to move it from the point of shipment to the point of delivery. Anyone who holds the arrival notice of a shipment and can establish the fact that he or she is the consignee, or represents the consignee, may obtain possession of the merchandise. This could be a bank, a custom-house broker, or an agent.

An order bill of lading is a negotiable instrument, and the surrender of the original, properly endorsed, is required for delivery of the merchandise. Title remains with the person to whose order it is made out – if made out 'to order,' title remains with the shipper – until it is endorsed. The ultimate recipient is usually shown as the person or organization to be notified of arrival at the destination by the carrier.

Documents generally called datafreight receipts in most European countries and seaway bills in the United States and Asia are often used in place of straight bills of lading. Under this system no original bills of lading are issued. The arrival information is simply forwarded to the carrier's agent at the port of discharge.

Received-for-shipment and on-board B/Ls

Unless the bill of lading specifically shows on the face that the cargo has been loaded on board the vessel, it is no more than a *received-for-shipment bill of lading*. This may be done when space on the vessel has not been reserved in advance and the carrier agrees to load it only if space should be available. Received-for-shipment bills of lading are only used when there is no urgency in delivery of the shipment to its destination and when other than letter-of-credit or draft financing is used.

On-board bills of lading carry with them the legal guarantee by the master of the vessel, acting as agent for the carrier, that the goods have actually been loaded on the vessel.

Clean or foul B/Ls

Cargo checkers inspect shipments carefully when they are delivered to the pier and when they are loaded on board the vessel. If any damage is observed or if the quantity is less than that specified when the goods are delivered to the pier, a notation is entered on the dock receipt, and the shipper is usually given the opportunity to make repairs or complete the quantity. If any exception to the apparent good order of the cargo is noted when the cargo is loaded on the vessel a notation is made on the bill of lading, which then becomes a *foul bill of lading*. If, however, the merchandise is in apparent good order and there are thus no notations, it is referred to as a ***clean bill of lading***.

Special types of B/Ls

A special type of bill of lading, used more frequently than generally supposed, is the *accommodation bill of lading*. If the shipper is well (and favorably) known to the steamship company and wants a bill of lading dated on a certain day and the merchandise has not yet been delivered at the pier, the shipper may be issued a bill of lading in the regular form and properly signed by the company. This is an accommodation bill of lading. There is, however, no evidence on the face of it to indicate its character. The shipper might want the bill of lading in order to meet the expiry date in a letter of credit and may be willing to give such guarantees as the steamship company may require.

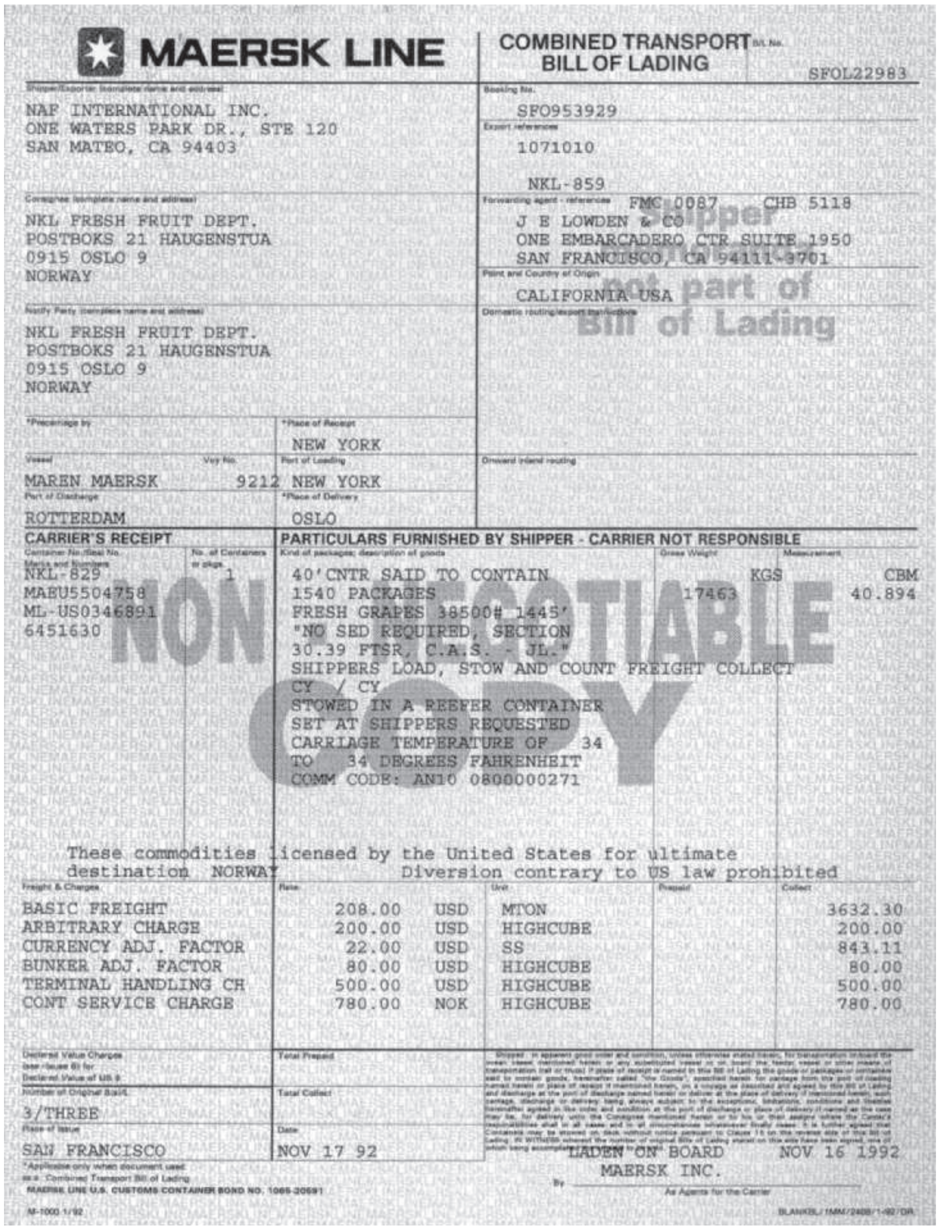
Forwarder's and NVOCC B/Ls

Another form of bill of lading that is sometimes used is the *forwarder's bill of lading*. The reason for the use of this particular form is the fact that most steamship companies have a minimum bill-of-lading fee. This imposes a heavy charge on the shipper who wishes to send a single box, crate, or small lot of merchandise. The export freight forwarder can combine several small shipments from individual shippers and send the lot under one bill of lading to a destination. At the destination, the forwarder's branch office or correspondent breaks out the shipment and delivers the individual pieces to the several consignees. At the time of shipment, the foreign freight forwarder delivers a forwarder's bill of lading to each of the original exporters.

This consolidation function is often performed by the ocean transportation intermediary formerly known as a nonvessel ocean common carrier. The NVOCC is authorized to issue regular bills of lading. The development of the NVOCC arose largely because of containerization that makes consolidation into much larger amounts desirable from the standpoints of cost, ease of handling, and security.

Uniform through export B/L

Use of this special form of bill of lading simplifies matters for inland manufacturers and exporters. This type of bill of lading replaces two documents: the railroad (or truck) bill of lading and the steamship bill of lading. In this case, the ocean carrier assumes responsibility for both modes of transportation.



MAERSK LINE

COMBINED TRANSPORT BILL OF LADING

B/L No. SFOL22983

Shipper/Exporter (complete name and address)
NAF INTERNATIONAL INC.
ONE WATERS PARK DR., STE 120
SAN MATEO, CA 94403

Booking No.
SFO953929

Export references
1071010

NKL-859

Consignee (complete name and address)
NKL FRESH FRUIT DEPT.
POSTBOKS 21 HAUGENSTUA
0915 OSLO 9
NORWAY

Forwarding agent - references FMC 0087 CHB 5118
J E LOWDEN & CO
ONE EMBARCADERO CTR SUITE 1950
SAN FRANCISCO, CA 94111-3701

Point and Country of Origin
CALIFORNIA USA

Shipper memo not part of Bill of Lading

Notify Party (complete name and address)
NKL FRESH FRUIT DEPT.
POSTBOKS 21 HAUGENSTUA
0915 OSLO 9
NORWAY

Domestic routing/export instructions

*Precarriage by

*Place of Receipt
NEW YORK

Vessel MAREN MAERSK Voy No. 9212

Port of Loading NEW YORK

Onward inland routing

Port of Discharge ROTTERDAM

*Place of Delivery OSLO

CARRIER'S RECEIPT

PARTICULARS FURNISHED BY SHIPPER - CARRIER NOT RESPONSIBLE

NON NEGOTIABLE COPY

Container No./Seal No. Marks and Numbers	No. of Containers or pkgs.	Kind of packages; description of goods	Gross Weight	Measurement
NKL-829 MAEU5504758 ML-US0346891 6451630	1	40' CNTR SAID TO CONTAIN 1540 PACKAGES FRESH GRAPES 38500# 1445' "NO SED REQUIRED, SECTION 30.39 FTSR, C.A.S. - JL." SHIPPERS LOAD, STOW AND COUNT FREIGHT COLLECT CY / CY STOWED IN A REEFER CONTAINER SET AT SHIPPERS REQUESTED CARRIAGE TEMPERATURE OF 34 TO 34 DEGREES FAHRENHEIT COMM CODE: AN10 0800000271	KGS 17463	CBM 40.894

These commodities licensed by the United States for ultimate destination NORWAY Diversion contrary to US law prohibited

Freight & Charges	Rate		Unit	Prepaid	Collect
BASIC FREIGHT	208.00	USD	MTON		3632.30
ARBITRARY CHARGE	200.00	USD	HIGHCUBE		200.00
CURRENCY ADJ. FACTOR	22.00	USD	SS		843.11
BUNKER ADJ. FACTOR	80.00	USD	HIGHCUBE		80.00
TERMINAL HANDLING CH	500.00	USD	HIGHCUBE		500.00
CONT SERVICE CHARGE	780.00	NOK	HIGHCUBE		780.00

Declared Value Charges (see clause 6) for Declared Value of US $

Total Prepaid

Number of Original B(s)/L
3/THREE

Total Collect

Place of Issue
SAN FRANCISCO

Date
NOV 17 92

LADEN ON BOARD NOV 16 1992

MAERSK INC.

By As Agents for the Carrier

*Applicable only when document used as a Combined Transport Bill of Lading

MAERSK LINE U.S. CUSTOMS CONTAINER BOND NO. 1066-20691

Figure 14.8 Ocean/combined transport bill of lading

Source: Reproduced with permission of Maersk Line and J. E. Lowden & Co.

The conditions under which the ocean carrier company accepts goods for conveyance are stated on the ocean bill of lading. Although the contract between the ocean carrier and the shipper of the merchandise is set forth in great detail, it is rare indeed that the shipper reads all of its conditions. Every sentence has been interpreted in courts, and a great body of law now surrounds and interprets this contract. The shipper's rights are fully protected.

As a result of these years of litigation, ocean carriers are almost completely exempt from the responsibility of loss of the shipment through theft or by pilferage, or its damage by breakage, water, or fire. The only responsibility ordinarily assumed by ocean carriers is the damage arising out of their own or their employees' negligence or for failure to make sure that the vessel is seaworthy before it leaves port.

Selecting the route and getting the merchandise to the port

The exporter should keep two major factors in mind when selecting the route of an ocean shipment. These are: (1) the route that will bring the shipment to its port of destination in the shortest possible time and (2) the route that will be most economical. Frequently the quickest route is not the most economical.

Frequency of sailings from a given port is more important than the actual duration of the voyage. When a shipment just misses one sailing and has to be held over for the next, several days or weeks later, demurrage (charges for the use of the freight car or container in which sent) and storage charges may accumulate. This is one of the reasons that, in spite of possible higher port costs for individual shipments, major ports are usually the best to use for shipment.

When the products to be exported are delivered to a railroad (or trucking company) at an inland point, either a railroad (trucking) bill of lading or a through bill of lading is issued. If just a railroad (trucking) bill of lading is issued, a second bill of lading will have to be issued at the port for the ocean portion of the shipment. Upon arrival of the merchandise at the port, a notice referred to as an *arrival notice* is sent by the railroad to the domestic consignee at port of shipment. The representative of the exporter then accepts the merchandise from the rail (trucking) carrier and makes delivery to the ocean carrier. The representative of the shipper then becomes responsible for all details connected with starting the merchandise on its ocean journey.

Freight rates and space reservations

Ocean freight rates may be obtained directly from shipping lines or through the foreign freight forwarder. In some countries the shipper is faced with the question of whether to use independent carriers or ocean carriers belonging to a conference or rate agreement. Referred to briefly earlier, shipping conferences are associations of ocean transportation companies. They are organized by formal agreement, with governmental sanction, primarily to set freight rates and sailing schedules over specified routes. A shipper may make an annual contract with the conference to ship all of the company's cargo to places served by the conference on vessels operated by conference companies. By signing such a contract the shipper gets a lower rate than shippers who do not have a contract. Independent carriers may also offer discounted rates for shippers that are willing to sign annual contracts. While both conference carriers and independent carriers have government-approved schedules of rates (tariffs) by which they must abide, the independent carrier's rates are often lower. The lower rates must be balanced against the possibly less frequent sailings available from one or a few independent carriers as compared with the often greater number of conference members. A third type of carrier, which often offers the lowest rates, is the so-called *tramp vessel*. Used largely in carrying bulk cargos, this type of carrier does not follow an established schedule. Rather, it operates on a charter basis.

Whether the carriers involved are members of a conference or independent, outbound and inbound rates between two points for the same product are often not the same. To illustrate, in the mid-1990s for sporting goods going through base ports in continental Europe the rate per ton of outbound cargo was 70% higher than that for inbound cargo.

Once the decision is reached as to the particular ocean transportation company to use, the next task is to secure a freight space reservation on a particular ship. An inland shipper may secure space by contacting the line or its agent. However, as sailing schedules to the destination are usually not known, it may prove better to contact a foreign freight forwarder, who will make the space reservation at no cost to the exporter.

Container shipment

Some years ago many commodities were shipped 'break bulk,' that is, in individual packages individually handled. Now most merchandise that is not handled in bulk, such as petroleum or wheat, is packed in large, standard-sized containers. Figure 14.9a shows an example of a container facility in a major port and Figure 14.9b shows a vessel being loaded with containers. Containers may be filled on the dock before loading on the vessel, or they may be filled at the exporter's plant. Some ocean transport companies will provide containers to producers within a reasonable distance at a lower charge than usual inland freight rates.

Figure 14.9a A modern container facility, Auckland, New Zealand

Figure 14.9b A container vessel being loaded in Melbourne, Australia

Dock receipt

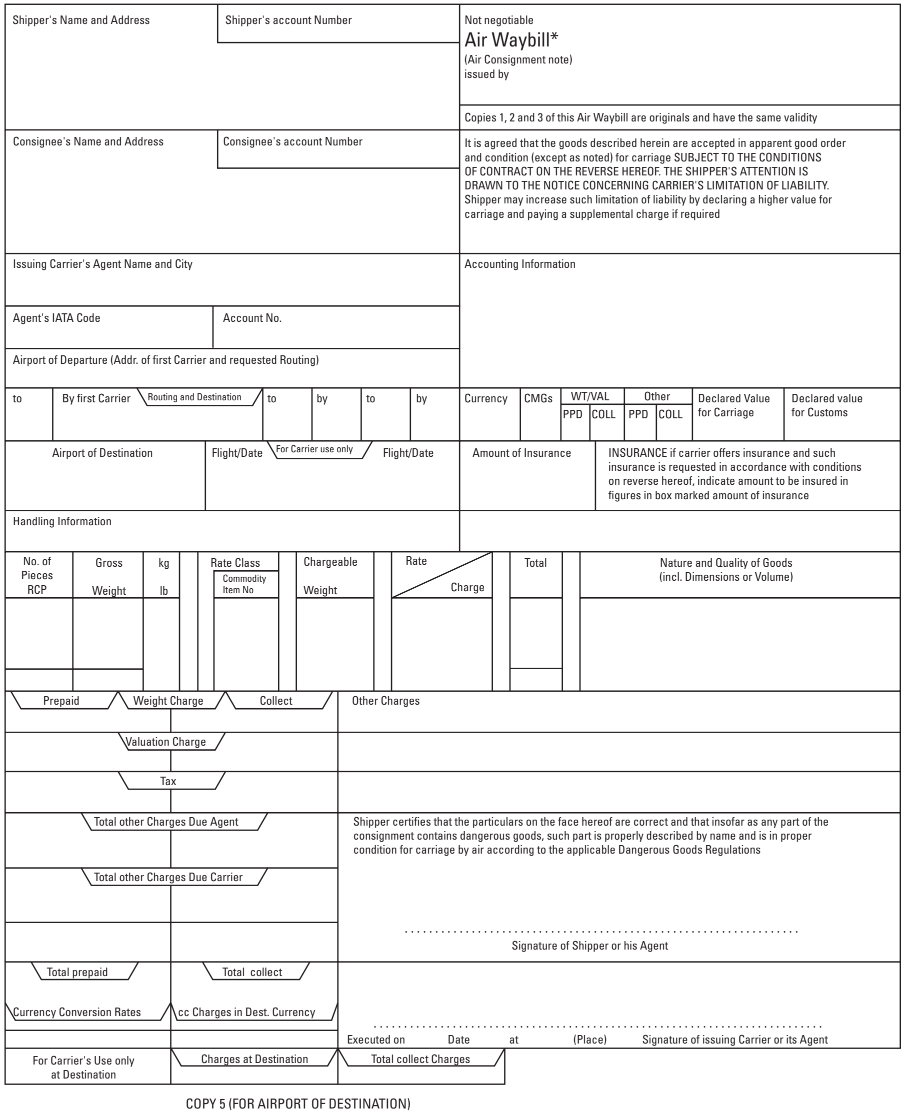
In some places, when the shipment has been delivered to the pier the receiving clerk signs a dock receipt. At the time that the shipment is checked at the pier, the packages are examined to determine whether they are all in good condition. Any that are not are noted on the dock receipt. If any such notices appear on the dock receipt, it is then described as a 'foul dock receipt' and these notes will, if not eliminated by the required repairs, appear later on the bill of lading. Dock receipts for full containers show only the condition of the container, which is not opened for inspection of contents.

Air shipments and air waybills

With the rapid expansion of international air freight, an ever-growing number of shippers are utilizing this means. Moreover, considering savings in inland freight, packing, inventories, and working capital investment, some shippers are finding that movement by air is actually cheaper even though air freight rates are somewhat higher. In short, following a total-cost approach to physical distribution may lead an exporter to use air transport.

Up to the point of overseas movement, the procedures for an ocean shipment and an air shipment are usually similar. One difference that may prove significant is that some international air carriers, such as Lufthansa and KLM, serve inland points; hence, no trans-shipment at an export point is necessary.

The major difference in procedure arises at the time that the shipment is turned over to the international air carrier. International airlines have been able to eliminate some of



Shipper's Name and Address | Shipper's account Number

Not negotiable
Air Waybill*
(Air Consignment note)
issued by

Copies 1, 2 and 3 of this Air Waybill are originals and have the same validity

Consignee's Name and Address | Consignee's account Number

It is agreed that the goods described herein are accepted in apparent good order and condition (except as noted) for carriage SUBJECT TO THE CONDITIONS OF CONTRACT ON THE REVERSE HEREOF. THE SHIPPER'S ATTENTION IS DRAWN TO THE NOTICE CONCERNING CARRIER'S LIMITATION OF LIABILITY. Shipper may increase such limitation of liability by declaring a higher value for carriage and paying a supplemental charge if required

Issuing Carrier's Agent Name and City

Accounting Information

Agent's IATA Code | Account No.

Airport of Departure (Addr. of first Carrier and requested Routing)

to | By first Carrier | Routing and Destination | to | by | to | by | Currency | CMGs | WT/VAL PPD COLL | Other PPD COLL | Declared Value for Carriage | Declared value for Customs

Airport of Destination | Flight/Date | For Carrier use only | Flight/Date | Amount of Insurance | INSURANCE if carrier offers insurance and such insurance is requested in accordance with conditions on reverse hereof, indicate amount to be insured in figures in box marked amount of insurance

Handling Information

No. of Pieces RCP | Gross Weight | kg lb | Rate Class Commodity Item No | Chargeable Weight | Rate Charge | Total | Nature and Quality of Goods (incl. Dimensions or Volume)

Prepaid | Weight Charge | Collect | Other Charges

Valuation Charge

Tax

Total other Charges Due Agent

Shipper certifies that the particulars on the face hereof are correct and that insofar as any part of the consignment contains dangerous goods, such part is properly described by name and is in proper condition for carriage by air according to the applicable Dangerous Goods Regulations

Total other Charges Due Carrier

Signature of Shipper or his Agent

Total prepaid | Total collect

Currency Conversion Rates | cc Charges in Dest. Currency

Executed on Date at (Place) Signature of issuing Carrier or its Agent

For Carrier's Use only at Destination | Charges at Destination | Total collect Charges

COPY 5 (FOR AIRPORT OF DESTINATION)

Figure 14.10 Air waybill

the routine of export procedure required of ocean carriers. Most important, an *air waybill* (variously designated as an 'air waybill,' 'airway bill,' 'international airwaybill,' or 'air consignment note') is used rather than a standard bill of lading (see Figure 14.10). In some cases the air waybill may also replace the commercial invoice, the consular invoice, the certificate of origin, and the insurance certificate. These simplified procedures have been devised and promoted by the International Air Transport Association (IATA), which has brought about a high degree of uniformity in the international use of the air waybill.

The application and use of the air waybill differs in different countries. Usually the abbreviated procedure applies only to shipments of small value. In some countries consular invoices and certificates of origin are still required, whereas in others they are not. In certain cases the shipper may elect to use his or her regular marine insurance coverage, especially where warehouse-to-warehouse protection is desired; in other cases insurance provided by the airlines is sufficient.

When foreign freight forwarders prepare the air waybill for the shipper from information furnished to them, the information usually includes a description of the merchandise conforming to the export declaration and any other shipping documents, and whether or not insurance coverage is desired. The shipper must also make a statement of value for carriage and Customs purposes.

The value for carriage serves three purposes:

1. It may be required for computing the transportation rates when a special commodity rate is based on value.
2. It is the limit of liability of the carrier for loss or damage to the shipment.
3. It is the amount on which the carrier's valuation charge and insurance premium will be computed.

As a general rule, the shipper uses as the value for carriage the amount declared as value for Customs, plus shipping charges, plus 10%. Although the shipper may declare any value, the carrier's maximum liability may be limited to the actual value plus 10%.

The air waybill is not negotiable. It is not, therefore, a complete substitute for an ocean bill of lading. The air waybill serves as a shipping contract and receipt to the shipper, providing evidence that the airline has accepted the goods, as listed, and agrees to carry the consignment to the airport of destination. International shipments made by air cannot be financed in exactly the same way as the majority of shipments made by surface carriers; modifications must be made. The elapsed time between dispatch and delivery is so short that financing during the transportation period is normally unnecessary. Generally, airlines will not deliver or change consignment without the original or shipper's copy of the air waybill. Finally, consignees always have the privilege of specifying that the air waybill shall be acceptable as the document against which payment will be made.

Since most airlines provide **cash on delivery (COD)** facilities as a service to shippers, this method may be utilized if the shipper requires quick reimbursement. Also, arrangements can usually be made for electronic notification of collection to the home office of the airline which can then issue a check immediately to the shipper.

If the importer has a satisfactory reputation and it is desirable to extend credit, a clean time or acceptance draft can be used. When used, the draft would be forwarded for collection in the usual manner.

These methods, however, can only be used in sales to countries in which there are no foreign exchange restrictions. For those countries in which exchange controls are still in effect, the letter of credit would still have to be used with necessary modifications in document specifications so as to permit utilization of the nonnegotiable air waybill.

If the shipper believes that credit protection is necessary, the merchandise may be consigned to a bank, an agent, or a foreign freight forwarder with instructions regarding conditions of delivery to the buyer. This method is similar to that used for surface shipments to those countries that do not permit the use of the order bill of lading.

A concluding comment

The ramifications of international marketing described in the preceding chapters and of export procedure and physical distribution described in this chapter may seem to be quite involved and somewhat complicated for the business firm considering foreign sales. Actually, export marketing management is not significantly more cumbersome than good domestic business management; and each particular function and institution fills a well-recognized need. Each individual document also covers some specific function in long-established export procedure. Once thoroughly learned, tasks and responsibilities become simple and routine.

Nevertheless, the omission of any management function or the omission of any document in the actual export procedure may create problems for either the seller or buyer, if not both. Wise business people frequently review both management responsibilities and procedures and, even more important, they keep up to date with changes in today's dynamic international business world, such as developments in Internet and other technology.

Questions for discussion

14.1 What are the main issues that are of concern to the exporter regarding inquiries and orders?

14.2 Why might the cheapest form of transportation not be the most economical?

14.3 Discuss the various ways in which a company might minimize its export marketing costs by paying proper attention to physical distribution matters.

14.4 Explain the meaning of the 'total-cost concept,' and illustrate how break-even analysis might be used to solve an export physical distribution analysis problem.

14.5 Why does an exporter often need the services of a foreign freight forwarder?

14.6 A typical export shipment requires many documents. Identify those that are generally required for all shipments and those that may be required only for specific shipments.

14.7 Why is the bill of lading an important document in an export transaction?

14.8 Distinguish between the alternative types of free areas that are potentially available for use by an exporter and/or importer. Is any one type better than the others? Explain.

14.9 How has the rapidly changing technology of the late 1990s and the early 2000s affected the physical distribution of products from one country to another?

14.10 How have security concerns affected physical distribution?

14.11 How did NUMMI give workers some control over the production line? (Also see Case 1.2.)

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Further reading

Detailed information on aspects of exporting and shipping may be found on a number of websites, some of them country-specific, as well as articles. Examples are:

http://www.export911.com

http://www.exporthelp.co.za

http://www.intershippers.net

http://www.schednet.com/home/index.asp

http://www.tradeport.org

http://www.fita.worldbid.com

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CASE STUDY 14.1

Jaguar Electronics, Inc.

(This case study is derived from one written by Frank C. Burinsky and Michael A. McGinnis, Shippensburg University. The company name, product and component names, overseas locations for selling the products, and shipping costs have been changed to protect the actual company name and reflect changes in trade agreements and shipping practices.)

Jaguar Electronics, Inc. is a specialized electronics firm located in Charleston, South Carolina in the United States. The company was founded in 1965 and has enjoyed success and modest growth as a supplier of components to large manufacturers of specialty electronic-mechanical devices. Recently the company's management has decided to begin manufacturing and marketing a product called the 'Airflow.' The Airflow is manufactured by assembling two component parts: (1) mechanical assemblies (MA), which are purchased from a company in Belgium and (2) electronic assemblies (EC) manufactured by Jaguar Electronics at its Charleston facility.

Jaguar Electronics has manufactured and supplied the electronic assemblies to several national manufacturers of products similar to the Airflow for several years. Most of the consumer demand for the final products comes from areas enjoying a relatively warm climate throughout the year. Accordingly, the manufacturers of those products have sold their goods with great success throughout the southern and southwestern United States. The population and economic growth in these areas have contributed greatly to the success of this type of consumer product.

The man largely responsible for Jaguar Electronics' proposed move into manufacturing and marketing Airflow is the company president, Mr Smith. He has spent his entire career in the electronics industry and was with Jaguar Electronics for several years before becoming its president. His reign as president has been very successful. However, he has viewed the impressive sales growth of EC units with mixed feelings. As a supplier of EC components, Jaguar Electronics has prospered from the growth in sales of products such as Airflow. However, Smith has always felt that his company was not reaping all of the benefits available in sales to the consumers. At the same time he felt that Jaguar Electronics did not have the resources to compete successfully with the large firms that dominate the US market.

Smith employed a consultant to determine where increasing consumer demand for Airflow-type products would approach a level sufficiently high to justify entering these smaller markets. After reviewing the consultant's recommendations, Smith decided that Jaguar Electronics should target two of the higher-income countries in Latin America, Country 1 and Country 2. These nations, because of the income levels in particular cities, had the potential to be lucrative markets for Airflow. The consultant estimated the potential demand for Airflow to be 20,000 units per year in Country 1, and 40,000 units per year in Country 2.

The consultant had also recommended four options available to Jaguar Electronics as to how the widgets could be produced and distributed to these markets:

1. Assemble the widgets in Charleston and distribute them from that point.
2. Assemble them in a free trade zone in Country 1, and distribute them from that point.
3. Assemble them in Country 2 (which had no free trade zone).
4. Assemble them in a free trade zone in another country, Country 3, which had no significant potential domestic market for Airflow, but a lower labor cost.

Smith held a meeting to brief his production manager, Daphne R. Feldblum, and his distribution manager, Karl Q. Winklepleck, on the proposed Airflow venture and the consultant's recommendations. Both had been with the company for several years.

After briefing the two managers, Smith asked: 'What course of action would you recommend?' Feldblum replied: 'We should probably assemble them where the labor cost would be lowest.' Winklepleck commented: 'We should also consider transportation rates, insurance rates, import duties, and free trade zones.' Smith decided that Feldblum and Winklepleck should work together to compile the information necessary for making the best possible decision.

Two weeks later the information shown in Tables 14.3 and 14.4 had been compiled.

With the data available, Smith had a meeting with Feldblum, Winklepleck, and a member of the corporate legal staff to discuss what should be done. The meeting went poorly. Feldblum still believed that the company should locate assembly in the place with the lowest labor cost. Winklepleck realized that he should have provided a spreadsheet indicating total costs associated

Table 14.3 Cost, demand, weight, and tariff data

Annual demand in Country 1	20,000 units
Annual demand in Country 2	40,000 units
Labor costs for assembly	
in Charleston	$5.00/unit
in Country 1 free trade zone	$4.50/unit
in Country 2	$4.00/unit
in Country 3 free trade zone	$3.75/unit
Cost of components	
MA, FOB Brussels (Belgium)	$25.00/unit
EC, FOB Charleston	$30.00/unit
Product weight	
MA	60 lb/unit
EC	40 lb/unit
Airflow	100 lb/unit
Import duties as a percentage of price paid (excluding transportation and insurance costs from port of embarkation to port of entry)	
United States	5%
Country 1	10%
Country 2	10%
Country 3	25%

Table 14.4 Combined rates for transportation and insurance between respective points

(*Note:* Projected sales volumes would justify shipping by container load. Though shipping rates would actually be charged per container load, for ease of calculation the rates below are shown as dollar costs per hundred pounds ($/cwt). If products were shipped in less-than-container loads, rates would be much higher.)

From	To	Rate, $/cwt
Belgium	US	1.65
Belgium	Country 1	3.50
Belgium	Country 2	3.00
Belgium	Country 3	3.75
US	Country 1	2.50
US	Country 2	2.25
US	Country 3	3.00
Country 1	Country 2	1.25
Country 2	Country 1	1.25
Country 3	Country 1 or 2	2.00

Footnote by Winklepleck: Ocean freight shipments from Belgium to Country 3 are very infrequent.

with each approach. In order to avoid having the meeting end in confusion, he decided to show on the conference room whiteboard how the calculations should be made.

He gave the following figures for assembly in Charleston and shipping to Country 1:

$25.00	Cost of MA
0.99	Trans. + Ins., MA to Charleston (1.65 $/cwt × 0.60 cwt = $0.99)
1.25	Duty (5% of $25. Check to see if US government will rebate when finished goods are exported)
30.00	Cost of EC
5.00	Assembly
2.50	Trans. + Ins., US to Country 1 (2.50 $/cwt × 1.0 cwt = $ 2.50)
6.22	Duty in Country 1: 10% × $(25.99 + 30.00 + 5.00 + 1.25)
$70.96	Total landed cost in Country 1

The corresponding figures for assembly in Country 3 and shipping to Country 1:

$25.00	Cost of MA
2.25	Trans. + Ins., MA to Country 3 (3.75 $/cwt × 0.6 cwt = $ 2.25)
–	No duty in free zone on goods to be exported
30.00	Cost of EC
1.20	Trans. × Ins., EC to Country 3 (3.00 $/cwt × 0.4 cwt = $ 1.20)
3.75	Assembly in Country 3
2.00	Trans. + Ins., Country 3 to Country 1 (2.00 $/cwt × 1.0 = $2.00)
6.42	10% duty on all costs to Country 3 and Assembly in Country 3
$70.62	Total landed cost in Country 1

Winklepleck hoped that his quick calculations did not contain any errors. The total-cost figures for assembling in Charleston and Country 3 appeared to be very close. If it was possible to obtain some type of free trade area in Charleston, or if the US government could refund duty on the component MA when the finished product was exported, Charleston would actually be less expensive. In any event, figures for all of the combinations should be carefully calculated.

Winklepleck also had some questions in his mind that he wondered if he should raise. They seemed to be important, but the president might not be pleased to have them brought up. If assembly were to be done overseas, how would quality be controlled? Should the company consider making a product for export that it thought it couldn't market successfully in the United States? Did the company have the resources needed and was it prepared to make the effort required to begin marketing internationally: establishing marketing channels, product promotion, etc. How long would it take to reach the projected sales overseas, and what would be needed to promote the product? How sure could they be that they could ever sell the expected number of units in each of the two overseas markets?

Questions

1. Calculate the costs if the Airflow is assembled in Country 1 and if it is assembled in Country 2. Note that Country 1 has a free trade zone and Country 2 does not. Note also that calculations should be done for total sales to the two countries rather than on a per-unit basis since the costs will differ depending upon destination as well as assembly point.
2. Is Jaguar Electronics likely to be able to compete overseas with a new product that it feels will not be competitive in its home market? Why or why not?
3. Should Winklepleck bring up the questions that are bothering him? If so, when?
4. What do you recommend?

CASE STUDY 14.2

Primex Marketing, Inc.

(This case study was written by Edwin C. Duerr and Mitsuko Saito Duerr, San Francisco State University.)

Primex Marketing, Inc., formed in 1982, is an international niche marketer of Roleez® wheels and a limited line of products using the wheels. The patented wheels use very low pressure, soft, wide, and pliable tires mounted on flanged hubs to disperse the weight of a load over a wide surface area. This permits carts, dollies and wheelchairs equipped with the wheels to be moved easily over sandy beaches and soft soil where regular wheels sink into the ground. The wheels also offer a level of protection to muddy turf and environmentally sensitive terrain.

Most of Primex's wheels are sold to other manufacturers for use in making sports, recreation, industrial, construction, and health assistance equipment. In addition to the Roleez® wheels Primex manufactures and markets a limited line of products using its wheels. These include push carts, sports caddies, four- and six-wheel dollies for moving jet skis, and two-wheel carts and totes for canoes and kayaks using its wheels. The company also sells winch kits, hitch kits, and low-pressure tire gauges.

Resorts, and companies that supply products to them, are an important market for Primex. The resorts use large numbers of carts and dollies that must be operated over beaches and rough terrain in providing services to guests. Wheelchair manufacturers are another growing market, and additional uses in the industrial and construction sectors offer great potential.

In addition to continuing to provide quality products and service, on time and economically, the company has four additional marketing objectives. In order to continue to grow and to increase profitability, it is working to: (1) locate additional customers for its present products in current types of use; (2) find additional applications for its products; (3) develop modifications and innovations of present products for existing and new customers; and (4) extend its line of end products.

Mr Peter J. U. Reich, the president of Primex and the related company, Roleez® Wheels, Inc., is an entrepreneur with a global view of all functions including marketing, manufacturing and distribution. Brought up and educated in what was then East Germany, he moved to West Germany. Working for companies there, then in Canada, and finally in the United States, he developed personal contacts in a number of countries. He also began to explore new business opportunities.

In the mid-1980s Mr Reich became interested in windsurfing and recognized a business opportunity. Becoming increasingly involved in the sport, he eventually served on the board of the US Windsurfing Association. In addition to the demand for masts, booms and sails, the Association recognized the need for two additional products for surfers: helmets, and carts to make the transport of surf boards and other gear easier. These products did not bring the anticipated sales among surfers.

The carts did appeal to kayak/canoe enthusiasts and, in 1992, L.L. Bean™ approached Primex about providing a large number of carts. In 1997–8, as the Primex kayak/canoe carts became more widely used, the company received comments about the wheels sinking in the sand. Primex tried many types of wheels, but none of them were completely satisfactory. Then one of its customers said it should try Roleez® wheels.

At the end of 1998 Mr Reich contacted the inventor of the Roleez® wheels, a dentist in Virginia. The inventor was having problems in manufacturing and other areas of his business, and was open to developing a cooperative agreement with Primex. Mr Reich flew out to Virginia and they developed a two-page letter of intent. This was subsequently turned into a carefully worded 28-page agreement by their lawyers. Under the agreement, Mr Reich took over the manufacturing, marketing, and other functions of Roleez® wheels under the Primex Marketing, Inc. umbrella.

In looking for a new manufacturing base, Mr Reich spent some time in Thailand, but decided that it was not ideal for what Primex needed for Roleez. A German friend in Thailand suggested that he talk to one of his contacts in Taiwan. This was not a problem since Primex had already been doing business in Taiwan for many years. The Taiwan contact then suggested that he talk to an individual in Hong Kong. Eventually, through additional contacts in the United States, Taiwan, Hong Kong and China, he located the Chinese companies that now work for Primex.

Marketing

The company employs several approaches in making itself and its products visible, and providing information to potential customers. By attending trade shows, it finds potential customers, and gains information about products that might use Roleez® wheels. Trade shows of particular interest include those concerned with travel and leisure, equipment for medical and rehabilitation use, and materials-handling equipment. Potential customers include a wide range of manufacturers and service providers. An Italian firm providing equipment for resorts worldwide is interested in carts for use outside, including beach access. A Japanese company uses the Roleez® wheels in its wheelchair designs. Those designs are licensed back to another US manufacturer for marketing. Several other small manufacturers are also using Roleez® wheels on newly designed wheelchairs. A US company dominates the worldwide market for service carts, and is a potential customer.

Primex uses the Internet both to identify companies throughout the world that might be potential customers for its products, and to provide information on its products to present and potential customers. Potential customers are contacted, usually by e-mail, referred to the Roleez website, sent literature as appropriate, and contacted further by e-mail as appropriate. In some cases a meeting at a trade show or a visit by a company representative is arranged, or prospective customers are invited to the company main office or its Shanghai office.

The Roleez website was set up by a provider in Sacramento in consultation with Mr Reich. It is kept completely up to date by an outside support person in southern California. It provides information, including specifications, pictures, and costs for the company's products. Additionally, it provides information for ordering and for becoming a dealer.

The Roleez website provides cross-links to a wide number of other sites of companies that handle its products and/or offer products for which Roleez® wheels would be advantageous. The company also makes arrangements to be on the websites of other companies and in catalogs as appropriate. For example, it is on the website of a provider of castor wheels.

Public relations and promotion are important elements in the overall marketing plan. In the Summer 2003 issue of *Access Today*, a publication of the National Center on Accessibility, a front page photograph showed four kinds of wheelchairs for use on beaches, all of which use Roleez® wheels. Primex is working with an outside company to prepare a press release targeting wheel-using markets where terrain requires Roleez balloon tires.

Cards, brochures, and instructions are printed in China. Advertising, except in areas of special interest, appears to be too expensive to be justified.

The company's present customer base includes over 400 companies worldwide. Mr Reich's marketing efforts are concentrated on extending this base, as well as selling more to existing customers.

Organization, logistics, and manufacturing

Primex is making maximum use of outsourcing, advances in communications and logistics, and working with others. This is serving to maintain flexibility, keep costs low, assure effectiveness, and minimize financial risk. The company has only five people at its main location in Benicia, California: the president (who spends much of his time traveling); a sales manager; a person handling order processing; an office manager (with responsibilities for accounting service and computers); and one person for warehousing and shipping. The company has both FedEx and UPS terminals in their office.

The company has a sixth employee, located at its Shanghai office, who handles arrangements there. The Benicia office, however, does the invoicing, handles collections/receivables from customers, and makes payments to suppliers in China. Primex has issued import and distribution rights for their products to Off The Road Wheel Systems, NL, for the Netherlands, Belgium, and Luxembourg. The company currently relies on importers in Australia, Germany, Japan, South Africa, and the United States. Companies in other countries are being contacted.

Customers overseas send their orders, including advance payment, directly to Primex's bank in the United States, either by electronic transfer or by credit card. The bank forwards the order to Primex after it has verified payment. If the payment is by credit card, the bank charges a fee, but the simplicity and assurance of payment is considered to be worth the cost. Payroll and tax services are contracted out.

The originally Roleez company in Virginia used polyvinylchloride (PVC) in making the tires, but testing indicated that polyurethane was a better raw material. Primex Marketing, Inc. changed to the polyurethane. The type required by Primex is produced at only one plant in the world, a Bayer facility in Marysville, West Virginia. Primex buys the raw material from Bayer through an agent, and has it sent directly from the West Virginia plant to a factory in China. The tires are then made in China at one of three companies, each of which is located in a different area of China. When the factory in China completes the order it sends the product directly to the customer who ordered it. Depending on the size of the order, the wheels are sent by 40-foot or 20-foot container, or by the pallet load. The latter substantially increases the shipping cost per wheel. At each stage of exporting and importing, required documentation is handled by foreign freight forwarders or custom-house brokers for the local companies involved.

Mr Reich personally visits each of the factories frequently, working directly with each company's management regarding quality control, payment issues, and in some cases, product development. The meetings are conducted in English, and while most of the managers do speak English, it is easy for misunderstandings to arise. Mr Reich has found it useful to carefully watch the eyes of the people with whom he is speaking to see if they seem to understand, or if he is talking too quickly or is unclear.

Through the careful development of relations with his providers of products, Mr Reich has been able to arrange with all of them to accept payment after the products have been shipped. He thus does not have to prepay or arrange letters of credit.

Innovation and product development

It is the very low tire pressure in the Roleez® wheels (0.069 bar or psi, as compared to 20 to 35 psi for many pneumatic tires), and the wide surface coming in contact with the ground, that allow them to move over soft ground without sinking in. This also allows them to move easily over rough terrain and curbs. The largest wheel presently in production has a tire 49 cm (19.3 inches) in diameter with a tire width of 15 cm (5.9 inches) mounted on a 25.4 mm axle. In addition to the axle-mounted wheels, castor-type wheels, both rigid and swivel models, are made. Most of the Roleez® wheels currently being produced are used on carts and dollies, but the wheelchair market has great potential.

Additional development work needs to be done to expand the market for wheelchairs. The wide tread of the Roleez® wheels makes standard wheelchairs too wide to go through standard residence doors. Though the soft tires enable wheelchairs to be used at the beach, some assistance must be provided to the wheelchair occupant by another person. To meet the desire for greater independence by those in wheelchairs, there is a need to develop a motorized wheelchair to be used with these tires. The same concern does not arise with the use of carts and dollies since these all require human or motorized assistance in any event. Various new applications in industry will require other adaptations.

Research and development is an ongoing activity at the company, drawing on ideas from within Primex, from outside inventors, and from users and potential users of the products. Five small companies are designing wheelchairs specifically for Roleez® wheels. One of these companies is already building some, but the costs are high because each is made individually. Larger-scale production will be needed to bring the costs down. An inventor from outside of the company is looking at the feasibility of developing an adapter to allow Roleez® wheels to be used on standard-width wheelchairs.

Mr Reich is continually developing ideas of his own, which he writes down on anything handy, from pads of paper to napkins. He has found that the Chinese companies from which he buys wheels have very good product development people. Though he did employ an engineer as a product development person in his Benicia office for a year, he has now developed a synergistic relationship with the Chinese companies that is more satisfactory. His ideas, and those from others that may be appropriately handled in China, are sent there for development.

The company has patent protection in all major markets. Though obtaining patent protection is expensive and time-consuming, it is necessary for a product that can be relatively easily imitated. As Roleez develops new products, the company needs to assure itself that these also are covered by patent protection.

Looking to the future

Meeting all of the opportunities and challenges facing Primex and Roleez at this time can be expected to continue to place a heavy burden on Mr Reich's time and abilities. The company's future success will remain heavily dependent upon his knowledge of markets and needs, his selection of key employees and partners, his capacities for planning and coordination, and his ability to gain cooperation and useful input for all of those with whom he interacts.

Questions

1. Do the methods used to locate, contact, and work with prospective customers appear to be appropriate? What other actions might be undertaken?
2. What are the advantages and disadvantages in Primex's requirement for having payment in advance, and for having a bank handle incoming payments?
3. What are the advantages and disadvantages of contracting out services such as payroll (including handing of required taxes) and web page updating?
4. What are the advantages and disadvantages of having others make international shipping arrangements?
5. What problems can the companies expect to face as they grow in size and expand product lines?

CASE STUDY 14.3

EFI Logistics

EFI Logistics, headquartered in San Francisco, is a company providing a wide range of services to exporters and importers. In addition to performing the traditional foreign freight-forwarding and custom-house broker functions, it can provide information to potential exporters and importers and assist them in developing contacts and establishing relationships abroad.

The company was established in 2004 by Jim Fitzgerald and Dave Enberg, each of whom had over 30 years of experience with their former employer, J. E. Lowden & Company. The mission of the company is to provide the highest quality of international logistics services to agricultural importers and exporters on the west coast of the United States. It is meeting its mission by using new technologies and procedures in what is a traditionally based industry. The founders of the company believed that it would have been difficult or impossible to make the technological advances within the constraints of an existing company.

The company had a challenging, and sometimes frustrating, initial two years. In order for a company to provide a full range of international logistics services, it must have two licenses. One is required in order to provide foreign freight-forwarding services for American exporters and must be obtained from the Federal Maritime Commission. The other is required in order to provide Customs House services for importers and must be obtained from the US Customs Service. EFI Logistics was able to quickly obtain the license to function as a foreign freight forwarder.

The problem arose in obtaining the Customs House License. This was a direct result of US government organizational and procedural changes following the attack on the World Trade Center on September 11, 2001. When the Department of Homeland Security was created after that disaster, the US Customs Service was integrated into that department. New procedures resulted in the time required to obtain a Customs House License increasing from three weeks to 13 months.

The result was that, when EFI Logistics began operations, it was only able to operate its foreign freight-forwarding department. Trying to maintain and expand its initial customer base while being unable to provide importing services proved to be quite a challenge. Once both licenses had been obtained, however, the company grew rapidly and now employs 22 people.

The company does have people in England and Germany to represent them, and maintains contacts with other Customs House brokers and foreign freight-forwarders abroad.

As a small, niche company, EFI Logistics distinguishes itself from potential competitors by providing custom-designed services for each client. It is able to provide superior service because it has been able to attract key staff members who are experienced and very knowledgeable about the singularities in growing, packing and shipping agricultural products. This sets them apart from general commodity logistics providers and larger providers of services to a wide range of customers. It makes EFI's services particularly attractive to farmers in the field.

The services they provide include:

- negotiating rates with international shipping companies, truckers, and warehouse operators;
- serving as an NVOCC (non-vessel-owning common carrier) that consolidates shipments;
- arranging and coordinating all transportation, including surface, airfreight, and ocean schedules and interfaces;
- arranging cargo insurance;
- preparing and filing all necessary customs paperwork;
- preparing and distributing shipping documents;
- preparing and presenting documents to banks.

Marketing

New customers are found primarily through referrals in the form of recommendations from current customers and from transportation companies, primarily ocean carriers. Both existing customers and potential customers are primarily concerned with the quality and speed of service. The company owners indicated that some of the larger firms have tried hiring salespersons, but that most did not keep them for more than three months. Charges for basic services do not differ sufficiently from one company to another. It is thus difficult for a sales pitch on cost to be effective, and it is hard for a salesperson to convincingly argue that one company is faster or provides better service than another if the potential new customer is not really dissatisfied with its current provider. The test is in the experience.

Mr Fitzgerald stated that, 'The key is to not lose the customers you have, and this means responding to each call quickly and knowledgeably, and then providing excellent service.' Excellent service means making all of the arrangements and preparing all of the paperwork quickly and accurately, and following through to ensure that everything goes as scheduled.

The company's web page is short and simple. Page 1 states simply that

We are a full service provider of ocean freight and airfreight transportation including:

Freight Forwarding

Custom House Brokerage

NVOCC

Airfreight

Cargo Insurance

and then provides basic telephone, fax, and e-mail information for contacting the company.

There are only two more pages, and they provide the names and direct telephone numbers and e-mail addresses of the individuals responsible for each of the seven departments: Ocean Exports, Perishable Exports, Dried Fruits & Nuts, LCL/FCL – NVOCC, Air exports, Ocean Imports, and Air Imports. It is thus possible for customers to deal directly with the person in charge of each area without going through an intervening switchboard or general operator.

Questions

1. Do EFI's marketing strategies appear to be appropriate?
2. Do the organization's structure and stated objectives appear to be appropriate given the existing and potential customer base?
3. What would be the advantages and disadvantages of attempting to expand into other geographical areas or into providing similar services for other lines of business?

Glossary

absolute advantage The case where one country or firm has a cost advantage in one product or service, and another country or firm has a cost advantage in another product or service.

acceptance Time draft that has been accepted for payment.

adaptation A company offers different versions of the marketing program or individual elements of the program (such as a product) to each foreign market.

advertising Nonpersonal presentation of sales messages through mass media, paid for by the advertiser.

advertising network Collection of independent websites from different companies and media networks.

affiliate network Collection of websites that link to an online retailer in exchange for commission on purchases made from the retailer.

agent Independent marketing organization that represents the exporter when making a sale, and is paid a commission. May be foreign-based or home-country-based.

air waybill Bill of lading used in air transport; it is a nonnegotiable document.

Andean Common Market A common market in South America that includes Bolivia, Colombia, Ecuador, Peru, and Venezuela.

antidumping duties Taxes imposed on an import that is being sold at a price lower than its cost of production or lower than the price at which it is sold in its home market.

antitrust regulation Government regulation of business behavior that is concerned with concentration of economic resources and possible monopoly power.

apps, app An abbreviation for 'applications' but with a specific meaning that it is a piece of software that can be run on the Internet or electronic device. (Having a number of apps for a particular electronic device adds to its value so international marketers develop and/or encourage others to develop apps for their particular cell phone, note pad, etc.)

arbitration An approach to settling disputes in which a third, disinterested party acts as a type of referee to determine the merits of the case and make a judgment that both parties agree to honor.

ASEAN (Association of Southeast Asian Nations) A regional economic integration scheme that includes the countries of Brunei, Cambodia, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, Myanmar and Laos.

assembly operations A foreign-market-based facility that uses mostly imported components and parts to put together a final product.

auxiliary services When applied to a product, this includes warranties, use instructions, installation help, after-sales service, and spare parts availability.

banner advertisements Advertising placed on websites.

barter A form of countertrade that involves a direct exchange of goods or services between two parties, which may be business firms or governments.

bases of segmentation Variables (criteria) used to segment a foreign market into specific components.

BEMs Big emerging markets. A small number of countries in central Europe, Latin America, and Asia that experienced rapid economic growth during the 1990s.

Berne Union The global coordinator of national credit and investment insurers from more than 30 countries. Formally known as the International Union of Credit and Investment Insurers.

bill of exchange Draft drawn on an importer. See *draft*.

bill of lading A document that is the contract of carriage between the shipper and the transportation carrier, a receipt for the goods issued by the carrier, and/or evidence of title to the goods.

border tax Used primarily in Europe, this tax was imposed on imports in addition to any tariffs and is designed to place a tax burden on imports equivalent to that borne by similar domestic products.

brand Anything that identifies a seller's goods or services and distinguishes them from others.

BRICs The four-largest economies outside the Organization for Economic Development. This group of emerging economies consists of Brazil, Russia, India, and China.

broker A home-country-based agent whose chief function is to bring a buyer and seller together. May act as the agent for either party.

brownfield investment A foreign acquisition in which resources and capabilities are provided by the investor, replacing most resources and capabilities of the acquired firm.

built-in export department A company unit consisting of an export sales manager with some clerical help, and most of the export marketing (except sales) is done by the regular domestic marketing company units.

bundle pricing Pricing for all components, and/or products in a group, together.

Business Environment Risk Index (BERI) An index that measures the discrimination of foreigners compared with nationals as well as the general quality of a country's business climate.

business model The combination of products and/or services, the marketing methods used, and supporting management and control systems.

buyback A form of countertrade where a company agrees to supply technical knowledge to build a plant, or actually builds the plant or licenses the use of a trademark, in exchange for a portion of the production output of the plant.

Caribbean Community and Common Market (CARICOM) Common market within the Caribbean area consisting of Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago.

cartel An association of producers formed with the objectives of coordinating and controlling the production and marketing of a product and improving profits.

cash on delivery (COD) Payment is to be made in cash when the shipment is delivered to the buyer.

CE marking Used in the European Union to indicate that a product meets essential safety requirements of those countries where it will be marketed. It is required for products that fall within any of the EU's New Approach Directives.

center of excellence A technical-based center within a multinational or global company in which development of products or components of products is centralized for the entire company. Also known as competence center.

Central American Common Market (CACM) A common market that consists of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

Central American Integration System (SICA) The economic, cultural and political organization of the Central American countries of Belize, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

centralization Organization pattern where decision making and control for international operations are concentrated at headquarters.

certificate of origin A document that certifies the country of origin of products being exported.

change agent A government or private organization that promotes export activities of business firms.

civil-law (Roman Law) country A country in which the legal system is based on the codes that are considered to be the completely comprehensive, all-inclusive source of authority that 'regulates' behavior.

clean bill of lading Bill of lading that has no notation of damage to the goods indicated.

clean draft A draft with no documents attached.

clearing arrangements Type of barter where surpluses are cleared up either by accepting more goods or by one party paying a penalty.

climate for advertising Views about advertising in general held by people and institutions in a socioeconomic, cultural, and political system.

Cloud computing Internet-based computing where central resources of software and information are provided to users on demand, as in an electricity grid.

commercial invoice A bill from the exporter to the importer for the product(s) that is (are) being exported.

common-law country A country in which the legal system relies on past judicial decisions, or cases, to resolve disputes or 'regulate' behavior.

common market A group of countries that has formed an integration scheme in which internal barriers to trade are eliminated, external barriers are common, and free movement of factors of production internally is allowed.

comparative advantage The case where one country or firm has absolute cost advantages in the production of all products and services compared with another country or firm, but has a greater cost advantage in some products or services than in others.

compensation agreement See *buyback*.

confirming house An agent who assists the overseas buyer by confirming, as a principal, orders already placed.

consignment The exporter ships to the buyer who pays after the products have been resold.

consolidator See *foreign freight forwarder*.

consular invoice A document signed by the consul of the importing country that is used to control and identify products shipped there.

Consumer affinity A consumer's attraction towards a certain (often foreign) outgroup.

Consumer animosity A consumer's rejection of a certain (often foreign) outgroup.

Consumer ethnocentrism A consumer's attraction to the domestic in-group including interest in the well-being and preservation of this group.

Consumer disidentification A consumer's rejection of being seen as a member of the domestic group.

contract manufacturing A form of strategic alliance where a company contracts for the manufacture/assembly of its product(s) by manufacturers established in foreign markets, while still retaining responsibility for marketing and distributing these products.

contractible market selection Systematic screening of all potential markets leading to elimination of the least promising and further investigation of the most promising.

cooperative exporter A manufacturer with its own export organization that is retained by other manufacturers to sell in some or all foreign markets.

coopetition Simultaneous competition and cooperation between two or more rival companies competing in global markets.

co-promotion Joint promotions of two products that are compatible.

cost and freight (C&F) Trade term indicating that price includes costs for the goods to be on board a carrier plus the freight costs to a named foreign port.

cost, insurance, and freight (CIF) Trade term that includes the costs of C&F plus transportation insurance.

counterfeit trade The practice of attaching brand names or trademarks to bogus products or services, thereby deceiving the customer into believing that they are purchasing products/services of the owner of the trademark or brand name.

counter purchase A form of countertrade where an exporter sells its products to an importer for cash or credit and agrees to purchase (with the cash or credit) and market products from the original importer's country.

countertrade Parallel business transactions that link a sales contract to a purchase contract in addition to, or in place of, financial settlements. A seller provides a buyer with products/services/technology and agrees to a reciprocal purchasing obligation with the buyer.

countervailing duty Tax (a tariff surcharge) imposed on an import that is designed to offset some special advantage given to the exporter by the exporter's government.

country-of-origin image Views of foreign products held by consumers (users) in an importing country based on their perceptions of the country of export.

cross-cultural communication Communication between a person in one culture and a person or persons in another culture.

cross-licensing Mutual exchange of knowledge, processes, and/or patents between companies in different countries.

cultural distance See *psychic/psychological distance*.

cultural empathy The capacity of a person for understanding cultural differences to an extent that allows the person to see a situation from the standpoint of those in the other culture.

culture The sum of the knowledge, values, beliefs, and attitudes that are shared by a particular society or group of people.

customs-bonded warehouse A warehouse in which goods from foreign countries can be stored, and certain manipulations performed on the goods, without payment of duty until the goods are released from storage and delivered to the buyer.

customs union A group of countries that have abolished tariffs among themselves and have adopted common external tariffs.

danwei The basic work unit in China where a joint venture is responsible for providing all the services needed by employees of the company – homes, stores, schools.

data equivalence Data that have, as far as possible, the same meaning or interpretation, and the same level of accuracy, precision of measurement, or reliability, in all countries and cultures.

date draft A draft where payment is due a specified number of days after a specific date.

decentralization Organization pattern where decision making and control for international operations are delegated away from headquarters to subdivisions of the organization, often to local management.

del credere An extra commission paid to a manufacturer's export agent who either guarantees payment for all orders sent to the exporter or finances the transaction.

desk jobber A type of export merchant who does not ever physically possess the product sold in a foreign market. Also known as a drop shipper or a cable merchant.

devaluation of currency The price of a national currency in terms of another is lowered either by market forces or by government decision.

differential pricing Relationship of prices for products in a product line. Also used for relationship of prices for a single product in different markets.

diffusion of product Movement of a product from the point of development to the market.

direct export(ing) Selling directly to an importer or buyer located in a foreign market area.

direct marketing Marketing by mail, letters, catalogs, telephone, fax, and the Internet.

disproportionality phenomenon A certain percentage of products in the product mix and/or product lines brings in a proportionately greater or lesser percentage of sales and profits.

distinctive competence An ability or quality that gives an organization a unique advantage over its competitors.

distributor Independent merchant marketing organization that buys from the exporter and resells to other marketing organizations. May be foreign-based or home-country-based.

dock receipt A document given to the shipper by the transport company indicating that goods have been received for shipment.

documentary credit See *letter of credit*.

documentary draft Draft accompanied by the relevant documents that are needed to complete a transaction.

documents against acceptance (D/A) A term used with a draft to indicate that the documents attached to the draft are to be given to the importer upon his or her acceptance of the draft for payment within a specified time.

documents against payment (D/P) A type of draft where documents are given to the importer when he or she pays the amount specified on the draft.

draft Type of check drawn on the importer by the exporter specifying that a sum of money is to be paid to the exporter. When used with a letter of credit the draft is drawn on a bank.

dumping The selling of a product or service by an exporter in a foreign market at below its production cost, or below its price in the domestic market.

duty See *tariff*.

e-business (e-commerce) Sale, purchase, or exchange of goods, services, or information over the Internet or other telecommunications networks.

eco-labeling Identification of products that cause less harm to the environment than others in their category: A seal or label indicating this is issued by a recognized national accrediting organization.

economic advantage Classical trade theory stating that countries tend to specialize in those products in which they have an advantage (e.g., lower cost of production).

economic environment Economic dimensions of the market environment, including population, income and wealth, extent of economic development, and so forth.

economic integration The unification in some way of separate individual national economies into a larger single (or internal) market.

economic union A group of countries that have eliminated tariffs among themselves, established common external barriers, allow free flow of factors of production, and coordinate and harmonize economic and social policy within the union.

emic Human behavior that is culture-bound (specific).

empathy Process of a person looking at something from the point of view of another person. See *cultural empathy*.

entry strategy A company's strategy for how foreign markets are to be entered, and the plan for the marketing program to be used for a given product/market. Also known as international marketing channel strategy.

equal advantage A situation where one country or company has equal relative cost advantages over another country or company in all products and services.

etic Human behavior that is culture free.

ethical behavior Behavior that most people in a society or group view as being moral, good, or right.

ethnocentrism A buyer's preference for domestic (i.e., local) products and services, and bias against imported goods.

euro The common currency used in most countries of the European Union. See *European Monetary Union*.

European Economic Area (EEA) Free trade area encompassing the EU and EFTA countries.

European Monetary Union (EMU) A union of the members of the European Union – excluding Denmark, Sweden, the United Kingdom – that have adopted a single currency, the euro, to replace their national currencies.

European Free Trade Association (EFTA) Free trade area consisting of Iceland, Liechtenstein, Norway, and Switzerland.

European Union (EU) Economic union consisting of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, Bulgaria, and Romania.

ex dock Trade term that includes CIF plus all costs to place the goods on the dock at the port of import, including payment of duty.

exchange controls Government limitations on the ability of companies or persons to obtain foreign currencies, or import or export currency.

exogenous variables Factors outside the control of the company, such as culture and laws.

expansive market selection An approach to selecting foreign markets that starts with the home market or existing market core as a base and expands from there on a market-by-market basis.

experience-curve pricing Pricing based on the relationship between cost and volume of production/sales as production/sales increase.

exporting The sale of products/services to foreign markets.

export commission house An agent representative of foreign buyers who resides in the exporter's home country. Also known as an export buying agent. See *resident buyer*.

export controls Restrictions by the exporter's government over the export of products.

export credit insurance Insurance from a government or private insurer that covers nonpayment by importers due to political risk, nonconvertibility of currency, and commercial risk.

export declaration Document required by an exporter's government showing complete information about a shipment. Used for statistical data and control over exports.

export development Process by which a company advances from not exporting to being a committed exporter.

export license Government document allowing a product to be exported. See *export controls*.

export management company (EMC) An international sales specialist that functions as the exclusive export department for several allied but noncompeting manufacturers.

export market direction Decision of company whether to build, hold, divest, or abandon its position in a foreign market.

export market selection (expansion) The process or opportunity evaluation leading to the selection of foreign markets in which to compete.

export merchant A company that engages in export and buys and sells on its own account.

export processing zone A free area in which foreign manufacturers are provided with incentives for investment, which will produce products for export.

export sales subsidiary A separate company unit located in the home country that operates as a quasi-independent firm.

export subsidy Direct or indirect financial contribution to the exporter by its government.

exporting agent An intermediary that does not take title to the products to be sold in a foreign market.

exporting combination A cooperative organization that is a more or less formal association of independent and competitive business firms, with membership being voluntary, organized for purposes of selling to foreign markets.

extinction pricing Price is set very low (close to direct cost) in order to eliminate existing competitors from foreign markets.

facilitating payment A type of gratuity or 'bribe' that is a commercial requirement in some countries in order to get things done.

facilitating/service organizations Institutions or agencies that are not members of the marketing channel, but provide useful and necessary services to the international marketer. Examples are banks, transport companies, and advertising agencies.

factor proportions theory A nation will export that product for which a large amount of the relative abundant (cheap) input is used and it will import that product in the production of which the relatively scarce (expensive) input is used.

factoring The purchase of a company's accounts receivable by a financial institution.

factura Consular invoice used in some Spanish-speaking countries.

first-mover advantages Benefits that accrue to the firm that is first in the industry to enact certain behavior in a foreign market, such as setting up a production facility.

foreign direct investment (FDI) Investment in ownership in firms in foreign countries with the object of gaining some degree of control.

foreign freight forwarder An independent firm specializing in arranging for the physical movement (forwarding) of an export shipment to a foreign market, and/or arranging for space on transportation carriers. Also known as a consolidator.

foreign media Advertising media that are unique to a single country. Also known as local, domestic media.

foreign representative agreement Defines the conditions upon which the relationship between the exporter and its foreign-based representative (distributor, agent) rests.

foreign sales branch An office located in a foreign market that handles all the distribution and promotional work in a designated market area and sells primarily to marketing organizations and industrial users.

foreign sales subsidiary A foreign-market-based separate company operating as a quasi-independent firm.

forfait financing Transfer of a term debt obligation from an export sale by an exporter to a third party.

foul bill of lading Bill of lading making note that there is damage to the goods, or the packing container of the goods, that have been loaded on a transport carrier.

franchising Type of licensing where the company giving the right to use something supplies an important ingredient (parts, materials, and so on) for the finished product.

free alongside (FAS) Trade term indicating that goods are delivered free alongside, but not on board, a transportation carrier.

free area An area within a country considered to be outside the customs area of the country.

free on board (FOB) Trade term indicating that goods are free on board a transportation carrier at some named point.

free perimeter A type of free area generally found in a remote underdeveloped region of a country, often along a border.

free port Customs-free area that encompasses a port or entire city.

free trade area An economic integration schema whereby member countries abolish tariffs between themselves, but each maintains its own tariffs for nonmember countries.

free trade zone Enclosed, policed area, without resident population, in, adjacent to, or near a port of entry, into which foreign goods not otherwise prohibited may be brought without formal customs entry.

functional export department See *built-in export department* and *separate export department*.

General Agreement on Tariffs and Trade (GATT) See *World Trade Organization*.

general average A type of loss during shipment on an ocean carrier affecting all shippers on a particular vessel plus the vessel itself.

generic brand Trademark that has become the description of a type of goods and where the original owner no longer has the exclusive right to use the mark.

geographic organization Company structure organized regionally on a market or area basis.

global advertising Use of the same advertising appeals, messages, art copy, stories, etc., in multiple country markets. See *standardization*.

global corporation A company operating with such consistency across its markets or areas of operation that it appears to treat the world, or major regions within the world, as a single market.

global marketers Companies that are using an integrated worldwide marketing strategy based on consistent brand selling for their product(s), making only minor changes required by differing markets.

global outlook Viewing the world, or relevant parts of the world, as a single market consisting of a number of segments defined by the product(s) to be sold.

globalization Process of moving from individualized marketing programs for specific foreign markets to development of programs to market products/services on a worldwide basis.

governance environment The mechanisms that an investor uses to control and protect his or her investment in a foreign country.

Government Environment Index An index developed by researchers to measure the governance environment in a country. The index is the extent to which a country is rule-based in its governance.

gravity promotion policy A policy of nonpromotion. The international marketer sells to an intermediary and lets the product find its own way to consumers and users.

gray market export channel A marketing channel that is not authorized by the exporter for a particular foreign market. Also known as parallel importation.

greenfield investment Foreign direct investment in a manufacturing facility that 'starts from scratch.'

guanxi Personal relationships and connections, or a network, among people in China.

Hanover Fair General trade fair held annually in Hanover, Germany, covering at least 20 major industry categories.

hedging Use of techniques involving buying and selling currencies at about the same time to reduce exchange rate exposure by ensuring that the loss of one currency position is offset by a corresponding gain in some other currency position.

Herfindahl Index A measure of the degree of export market concentration of a company.

heterarchical organization structure Multinational structure that is characterized by many centers of different kinds, different strategic roles for foreign subsidiaries, coalitions with other companies, and a problem orientation behavior that tends to be radical.

high-context culture A culture in which the meaning of a message or behavior is dependent upon the situation or context in the message or behavior performed rather than on the words or acts themselves.

host country The foreign country within which a company operates.

house organ A company's in-house publication that presents promotional ideas, company news, employee commendations, and so forth.

importing The buying of products from a foreign area.

INCOTERMS System of trade terms developed by the International Chamber of Commerce.

indent order An order received by an exporter based on a sales contract negotiated between a purchaser and an overseas-based branch office or distributor.

Index of Business Environment An index prepared by *The Economist* that ranks countries on the attractiveness as a business location. Eighty-two countries are ranked.

Index of Operational Risk An index prepared by *The Economist* for 150 markets indicating the relative risk of doing business in each market.

indirect export(ing) Using the services of independent marketing organizations, or cooperative organizations, located within the home country in exporting.

internal product development An evolutionary process consisting of a number of stages starting with idea generation and ending with commercialization.

international division Organization structure in which all international marketing activities are separated from domestic business operations and placed in a single division.

international marketing Marketing of goods and services across political boundaries.

international marketing channel The system composed of marketing organizations that connect a manufacturer to the final users in a foreign market.

international marketing strategy The sum of the basic marketing decisions regarding product and market selection, entry mode, and other marketing activities.

international media Advertising media that circulate, or are heard or seen, in two or more countries.

internationalization A process, end result, and way of thinking whereby a company becomes more involved in and committed to serving markets outside its home country.

Internet marketing See *e-business*.

inward internationalization Foreign-area sourcing.

irrevocable letter of credit Letter of credit that cannot be unilaterally cancelled by the importer or the opening bank.

ISO 14001 A standard set by the International Organization for Standardization (ISO) that sets criteria for a company's internal environmental management system (EMS).

ISO 9000 Minimum standards set by the International Organization for Standardization (ISO) that specifies design, manufacturing, logistics, and other controls associated with producing quality products and services.

joint venture Type of strategic alliance in which companies from at least two countries, generally one being local, form a new company to produce products/services on a joint basis.

Josiassen's matrix A matrix displaying the four main consumer predispositions towards the in-group and out-groups.

Latin American Integration Association Common market that includes Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. See also *Andean Group* and *Mercosur*.

letter of credit Commercial credit established through a bank by the buyer that specifies the conditions under which payment is to be made to the beneficiary (the exporter). It is a type of credit with the backing of a bank or banks.

licensing A strategic alliance in which a company in one country gives the right to use something it owns (technology, trademark, etc.) to a company or person in another country.

List of Values (LOV) A set of nine value dimensions that characterize people.

Little Dragons Asian areas of Korea, Taiwan, Hong Kong, and Singapore.

location-specific advantages Advantages to a company that result from the specific location of its business activity.

logistics Management of relationships, decisions, and activities among production, storage, and physical distribution.

low-context culture A culture in which the meaning of a message or behavior resides primarily in the words or behavior themselves, rather than in the setting or context.

management contracting Strategic alliance where a foreign-based company operates a company in a local market for a local investor.

management style Pattern of decision making that exists in a company and/or country. It is also viewed as a recurring set of characteristics associated with the process of making decisions.

manufacturer's export agent A representative of a manufacturer who functions as a salesperson and is paid a commission.

Maquiladora A factory, mainly in Mexico but also elsewhere in Latin America, that imports materials and equipment on a duty-free and tariff-free basis for assembly or manufacturing and then re-exports the completed product, usually back to the originating country.

marginal pricing Pricing based on contribution margin wherein the only relevant costs are direct costs.

marine insurance Insurance for the protection of risk of damage to goods during their physical movement from exporter to buyer.

market concentration Market selection strategy involving a slow and gradual rate of growth in the number of foreign markets served by a company.

market demand The total volume of a product/ service that would be bought by a defined customer group in a defined geographical area in a defined time period in a defined marketing environment under a defined marketing program.

market-driven firm A company that is customer oriented and is concerned with what the customer will buy that can be made profitably.

market entry mode The means that a company uses to penetrate (enter) a foreign target country. See *international marketing channel*.

market forecast Expected market demand.

market potential The amount of a product (or service) that the market could absorb over some indefinite time period under optimum conditions of market development.

market segmentation Process of identifying and categorizing groups of customers and countries according to common characteristics.

market spreading Market selection strategy characterized by a fast rate of growth in the number of foreign markets served by a company at the early stages of expansion.

marketing mix (program) The planned and coordinated combination of marketing methods or tools used by a company to achieve a predetermined goal.

marketing organizations Independent companies that directly participate in the transactions and physical flows in an international marketing channel.

marketing research The systematic and objective search for, and analysis of, information relevant to the identification and solution of any problem relevant to the firm's marketing activity. See *research process*.

matrix organization A mixed structure that combines two or more competencies on a worldwide basis.

mechanics of export The practical, everyday details of an export transaction and shipment.

media mix Combination of different advertising media used by a company.

MENA (Middle East and North Africa) A region consisting of 24 Arab countries and territories having a population of almost 500 million.

merchant exporter An intermediary who takes title to the products to be sold in a foreign market.

Mercosur A common market including Argentina, Brazil, Paraguay, and Uruguay. Venezuela is awaiting ratification of its membership.

mobile marketing (m-marketing) The application of marketing to the mobile environment of smart phones, mobile phones, personal digital assistants (PDA) and telematics.

multinational corporation (MNC) A company that operates in a number of countries and adjusts its products and practices to each country or group of countries.

multinational marketing Companies treat each foreign market as separate and distinct, developing differentiated products and marketing strategies specifically for each market. See *international marketing*.

NAFTA (North American Free Trade Area) Free trade area consisting of the United States, Canada, and Mexico.

nationalism The influence of collective forces in the form of national spirit or attitude.

nearest neighbor Type of clustering or grouping of foreign markets based on geographic proximity.

network model Approach to B2B marketing whereby a company is engaged in networks of business relationships comprising a number of different firms.

niche marketer International marketer who markets primarily to a generally small and specialized segment of the overall market.

nontariff barriers Government regulations on trade that are other than duty or tariffs on imports.

nontransferable letter of credit Letter of credit that may not be transferred by the beneficiary to another party.

nonvessel operating common carrier (NVOCC) Designation given to foreign freight forwarders that issue a bill of lading to the exporter, and which are the responsible party to the exporter.

offset A type of countertrade where the seller is required to either assist in or arrange for the marketing of products being produced or sold by the buyer.

offshore plant A plant owned by a company in one country but located in another country whose principal mission is to produce products to be exported to the home market.

offshoring Outsourcing that involves movement of white-collar jobs to low-wage countries. This can refer to the situation when a company relocates an activity to another country, but ensures that it remains under the control of the company doing the relocating. See also *outsourcing*.

open account Payment is to be made to the exporter either on a specific date or within a specified number of days after a date indicated on the export invoice.

opening bank Bank in the importer's country that opens a letter of credit for an importer.

outdoor media Advertising posters, signs, and car cards that are placed on the sides of buildings, public transportation vehicles, and stand-alone sites.

outsourcing Occurs when a company extends a portion of its operation to a third party in a foreign country, in contrast to buying already produced goods or components from a supplier. See also *offshoring*.

packing list Contains, item by item, the contents of cases or containers in a shipment.

Paris Union The International Convention for the Protection of Industrial Property in which signatory countries extend national treatment to the business of other member countries in the protection of trademarks, patents, and so on.

particular average A loss during ocean shipment that affects specific shippers only.

pattern standardization Promotion strategy that is designed from the start to accept modification to fit local national-market conditions, yet still keeping some common elements across all foreign markets.

penetration pricing A strategy where a price is established that is sufficiently low to rapidly create a mass market.

personal selling Person-to-person marketing communication between a company representative and a prospective buyer.

physical core of product Functional features, style, presentation, and design.

physical distribution The movement and handling of products outward from the exporting country to points of consumption or use. See *logistics*.

piggyback marketing One manufacturer uses its foreign distribution facilities to sell another company's products alongside its own.

point-of-purchase materials Sales promotion materials by manufacturers and exporters of packaged consumer goods used at the point of purchase to appeal to consumers.

political risk Application of host government policies that constrain the business operations of a given foreign investment. Includes risk based on transfer, operations, ownership control, and general instability.

positioning A strategy of marketing communications to a foreign market whereby the attempt is made to locate a brand in the customers' minds over and against other products in terms of product attributes and benefits that the brand does and does not offer.

preemptive pricing Price is set low (close to total cost) to discourage competition.

price escalation The tendency for the price of a product to increase significantly as it moves from the exporting manufacturer to the user or consumer.

price sensitivity Consumers' (buyers') reactions to price changes. Also known as price elasticity.

primary data Data collected through original research pertaining to the particular research question asked.

primary information sources Collection of information by observation, controlled experiments, surveys, and other techniques to obtain information directly from those on whom one desires such information.

Primary Message Systems (PMS) The means by which cultures communicate to their members and to other cultures.

priority-in-registration doctrine Concept of law granting the rights to use a trademark to the firm or person who first registers it with the proper agency.

priority-in-use doctrine Concept of law granting the rights to use a trademark to the firm or person that has first used it.

proactive behavior Aggressive behavior based on a company's interest in exploiting unique competence or market possibilities.

product Sum of all the physical and psychological satisfactions that the buyer or user receives as a result of the purchase and/or use of a product.

product differentiation Perceived uniqueness of a product.

product-driven firm A company that is guided in its decision making by technology and product concerns.

product life cycle The stages followed by a product from its birth (product introduction) to its abandonment (sales decline).

product life-cycle theory Theory explaining stages where an innovator country of a new product is initially an exporter, then loses its competitive advantage vis-à-vis its trading partners, and may eventually become an importer of the product some years later.

product line Group of products that are similar or have something in common.

product mix The set (assortment) of products that a company offers to customers.

product organization Company structure organized on a product basis where product divisions have global responsibility.

product package Includes package itself, trademark, brand name, and label.

product phasing Set of strategies for the synchronization of old product deletion with entry of a new product.

pro forma invoice A preliminary invoice prepared by the exporter that shows the terms of a transaction agreed upon, or being proposed.

promotion mix Combination of different marketing promotion activities used by the export/international marketer.

promotion program Planned, coordinated, integrated series of efforts built around a single major theme or idea designed to achieve predetermined communication objectives.

prototype standardization Promotion strategy in which the same advertisement(s) or campaign(s) are used in multiple foreign markets with language being modified for the local markets.

psychic/psychological distance Applied to countries, this is distance between countries as assessed by looking at culture, stage of economic development, history, etc.

psychographic segmentation Segmentation of a market on the basis of psychographic variables, such as lifestyle and personality.

publicity Any kind of news about a company or its products that is reported by some media, and is not paid for by the company.

public relations Marketing communications designed to gain public understanding and acceptance of a company and its business activities.

pull promotion policy/strategy Consumer demand is established by promoting directly to the consumer who will then 'pull' the product through the channel by demanding it from intermediaries.

push promotion policy/strategy Promotion through the marketing channel. Channel members promote a product to other channel members at lower levels.

quotas Legal restrictions limiting the amount of a product that can be imported from a particular country.

Radio Frequency Identification Systems (RFID) A system of tags containing tiny radio frequency transmitters, used with readers, that are used to track locations and other information about merchandise.

reactive behavior A company responds to internal and external pressures and acts passively.

regulatory-supportive activities Regulatory-type activities used by a government to promote international marketing by local business firms.

relationship marketing Marketing by a country based on lasting relationships with buyers. See *network model*.

research process A process of obtaining information that starts with 'problem definition' and ends with the completed report and ultimate integration of findings into management decision making. See *marketing research*.

resident buyer An agent representing foreign buyers domiciled in the exporter's home market. See also *export commission house*.

Revised American Foreign Trade Definitions – 1941 System of trade terms originally developed by the Chamber of Commerce of the United States and two other organizations.

revocable letter of credit Letter of credit that can be cancelled at any time by the importer or the opening bank.

RFID See *Radio Frequency Identification Systems.*

Rules of Origin Established by regional economic integration schemes to specify the amount of content that must be region-based for a product to be exported/imported between countries in the region without tariff.

sales forecast The expected level of sales of a company based on the marketing plan to be implemented and some assumed external environment.

sales promotion All sales activities that supplement and strengthen personal selling and advertising.

sales response function Relationship between expenditure on marketing efforts and the sales response in a foreign market.

secondary data Data available from secondary information sources.

secondary information source Any source of published information and information previously collected for purposes other than the present need.

self-reference criterion (SRC) Judging a foreign market's cultural traits, habits, and norms on the basis of the cultural traits, habits, and norms of the home society.

separate export department A self-contained and largely self-sufficient company unit in which most of the export activities are handled within the department itself.

shippers' agent A facilitating organization that handles the inland movement of international freight.

shipper's export declaration See *export declaration*.

shipping conference Association of ocean transportation companies providing service on specific routes.

sight draft A draft indicating that payment must be made when the buyer first sees the draft and it is presented for payment.

silent language Nonverbal communication, including time, space, relationships, and other aspects of culture.

skimming the market Pricing strategy where a high price is charged until the market at that price is exhausted; the price may then be lowered and/or the company sold.

sliding down the demand curve Pricing strategy where a high price is set and then reduced in anticipation of competition so the company can become established in foreign markets.

socio-cultural characteristics Factors that influence the buying decision process and include material culture, language, education, aesthetics, values and attitudes, social organization, and political-legal structure and philosophy.

sogo shosha Large Japanese general trading companies engaged in a wide range of commercial and financial activities in addition to trade and distribution.

standardization A company offers one version of the marketing program or individual elements of a program (such as a product) to all foreign markets. Also known as globalization.

state trading Government engagement in commercial, business operations, either directly or through agencies under its control.

strategic alliances Long-term agreements for collaboration and/or cooperation in specific areas of international marketing activity between companies from two or more countries.

structure of distribution All of the intermediary marketing agencies or institutions in a foreign market that are in use by all companies at any given time, and their geographic coverage.

subculture A culture within a broader culture that may be based on nationality, religion, race, or geographical area.

supply chain management See *logistics*.

support-the-strong strategy A strategy for allocating marketing effort when introducing new products into multi-markets that distributes effort proportional to the number of adopters in the market, at least up to a certain market coverage.

support-the-weak strategy A company invests its marketing efforts proportional to the remaining market potential.

switch trading A type of countertrade to dispose of goods used when one party to a barter or counterpurchase transaction does not want what the other party is offering.

targeting Process of evaluating market segments and focusing marketing efforts on a country, region, or group of people.

tariff A tax (duty) on imports. A schedule of rates and terms for transportation of goods is also called a tariff.

tariff surcharge Temporary tariff placed on a product to discourage its importation. See *countervailing duty*.

technology-driven firm See Two Jabberwockies sa.

time draft Draft where payment is due a specified number of days after sight.

total quality management (TQM) Managing for quality in which companies strive to get products to a market faster, with fewer defects, and at a lower cost.

trade fair Concentrated exhibition of the products of many manufacturers/exporters.

trademark A brand, or part of a brand, that is protected by law.

trade mission Government- or industry-sponsored activity where a group of business people go to a foreign market for the purpose of making sales and/or establishing relationships.

trade terms System for quoting export prices, indicating exporter's and buyer's liability, costs, and responsibility.

trading company A type of export/import merchant.

transfer price Price quoted to wholly or partially owned foreign subsidiaries.

transferable letter of credit Allows the transfer of all or part of the letter of credit to some other party.

transference of advertising The process of moving an advertising campaign, or some of its components, from one market (domestic or foreign) to another market.

traveling salesperson Salesperson for an exporter who resides in one country (often the home country) and travels to foreign markets to perform sales duties.

turnkey operation A management contract calling for the construction of a plant, training of personnel, and the initial operation of the plant for a local investor.

unconfirmed letter of credit Letter of credit where a bank in the exporter's country does not take on a legal obligation to pay (honor) drafts drawn under the letter of credit.

uniform strategy A strategy for allocating marketing efforts when introducing new products into multi-markets that distributes the efforts evenly among its markets regardless of market development.

usance letter of credit Letter of credit where delivery of documents is made against acceptance of the documents rather than against payment.

Values and Lifestyles (VALS) A system for representing the values and lifestyles of people in a country or culture.

VIEW test A way to assess the effectiveness of packaging by examining visibility, information, emotional impact, and workability.

voluntary export restraint (VER) Agreement, typically unilateral, by a company or a country to limit its exports of a specific product, or product class, to a particular foreign market.

whole channel concept An integrated system with the manufacturer on one end and the final user or buyer on the other end. Basic components are the headquarters organization of the international marketer, the channel between nations, and the channel within a nation.

World Trade Organization (WTO) A multinational, supranational organization providing a forum for negotiating, at national government level, issues affecting international business. Includes a mechanism for resolving disputes.

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