Beyond Exporting - FOREIGN DIRECT INVESTMENT

World Trade Practices
Chapter 23

FDI
- Most risky of market entry strategies
- May be necessary to overcome:
  - Barriers to successful exporting strategies
  - Need for more control and feedback
  - Access to foreign resources

Barriers to export success
- Transportation costs
- Import barriers
  - Tariff
  - Non-tariff

Preferences given to in-country companies
Increased Control/Feedback

- Pressure for manufacturers to become more involved in market region
- Once initial success with sales, desire for faster growth and more profitability
- Enhance customer service requirements
- Develop long-term buyer-seller relationships
- Due to more competition, exports stagnate and renewed efforts may require more direct involvement

Scale of Entry

- Large scale entry
  - Strategic Commitments: a decision that has a long-term impact and is difficult to reverse
  - May cause rivals to rethink market entry
  - May lead to indigenous competitive response
- Small scale entry
  - Time to learn about market
  - Reduces exposure risk

Entry Modes

- Exporting
- Turnkey Projects
- Licensing
- Franchising
- Joint Ventures
- Wholly Owned Subsidiaries
Exporting

Advantages:
- Avoids cost of establishing manufacturing operations.
- May help achieve experience curve and location economies.

Disadvantages:
- May compete with low-cost location manufacturers.
- Possible high transportation costs.
- Tariff barriers.
- Possible lack of control over marketing reps.

Turnkey Projects

Advantages:
- Can earn a return on knowledge asset.
- Less risky than conventional FDI.

Disadvantages:
- No long-term interest in the foreign country.
- May create a competitor.
- Selling process technology may be selling competitive advantage as well.

Licensing

Advantages:
- Reduces costs and risks of establishing enterprise.
- Overcomes restrictive investment barriers.
- Others can develop business applications of intangible property.

Disadvantages:
- Lack of control.
- Cross-border licensing may be difficult.
- Creating a competitor.
Franchising

Advantages:
- Reduces costs and risk of establishing enterprise.

Disadvantages:
- May prohibit movement of profits from one country to support operations in another country.
- Quality control.

Joint Ventures

Advantages:
- Benefit from local partner's knowledge.
- Shared costs/risks with partner.
- Reduced political risk.

Disadvantages:
- Risk giving control of technology to partner.
- May not realize experience curve or location economies.
- Shared ownership can lead to conflict.

Wholly Owned Subsidiary

Advantages:
- No risk of losing technical competence to a competitor.
- Tight control of operations.
- Realize learning curve and location economies.

Disadvantages:
- Bear full cost and risk.
Strategic Alliances
- Cooperative agreements between potential or actual competitors.

Advantages:
- Facilitate entry into market.
- Share fixed costs.
- Bring together skills and assets that neither company has or can develop.
- Establish industry technology standards.

Disadvantage:
- Competitors get low cost route to technology and markets.

Alliances Are Popular
- High cost of technology development;
- Company may not have skill, money or people to go it alone;
- Good way to learn;
- Good way to secure access to foreign markets;
- Host country may require some local ownership.

Global Alliances, however, are different
- Companies join to attain world leadership;
- Each partner has significant strength to bring to the alliance;
- A true global vision;
- Relationship is horizontal not vertical;
- When competing in markets not part of the alliance, they retain their own identity.
Partner Selection

- Get as much information as possible on the potential partner.
- Collect data from informed third parties:
  - former partners
  - investment bankers
  - former employees
- Get to know the potential partner before committing.

4 Cs to partner selection

- Complementary skills
- Cooperative cultures
- Compatible goals
- Commensurate levels of risk

Structuring the Alliance to Reduce Opportunism

Opportunism by partner reduced by:

- Seeking credible commitments
- Agreeing to swap valuable skills and technologies
- Establishing contractual safeguards
- Walling off critical technology
Characteristics of a Global Alliance

- Players are independent prior to the creating of the alliance
- Players share:
  - benefits of the alliance
  - control over operations
- Players continue to contribute:
  - technology
  - products

Characteristics of a Strategic Alliance

- Independence of Participants
- Shared Benefits
- Technology and Products
- Markets
- Ongoing Contributions

Problems with Strategic Alliances

- Have to give up some authority/control
- Could be strengthening a future competitor
  - Technology transfer
  - Management practices
  - Operating procedures
Range of Options
(Foley’s View)

- Overseas salesperson
- Overseas sales office
- Overseas marketing office
- Overseas customer support, training, warranty repair
- Overseas joint venture
- Overseas product finishing (labeling, packaging)
- Overseas assembly
- Overseas manufacturing joint venture
- Overseas manufacturing, wholly owned facility

Investment Considerations

- Location
- Facility size
- Staffing
  - Levels
  - Locals or expats
- Market perception
- Taxes/accounting
- Reporting and control