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 faster growth-more profitability
- Enhance customer service requirements
- Develop long-term buyer-seller relationships
  - B2B
- Due to more competition-exports stagnate and renewed efforts may require more direct involvement

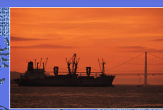
Scale of Entry

- 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.
- **Disadvantage:**
  - Bear full cost and risk.

Strategic Alliances

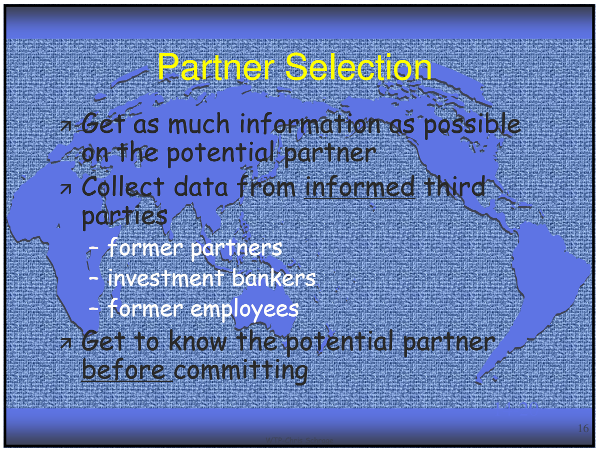
- Cooperative agreements between potential or actual competitors.
- **Advantages:**
  - Facilitate entry into market.
  - Share fixed costs.
  - Bring together skills and assets that neither company has or can develop.
  - Establish industry technology standards.
- **Disadvantage:**
  - Competitors get low cost route to technology and markets.

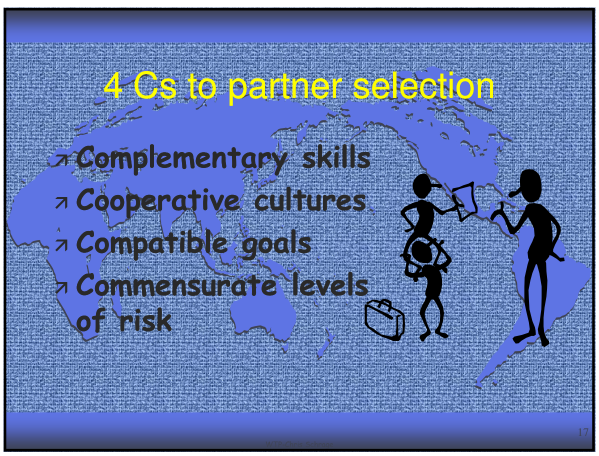
Alliances Are Popular

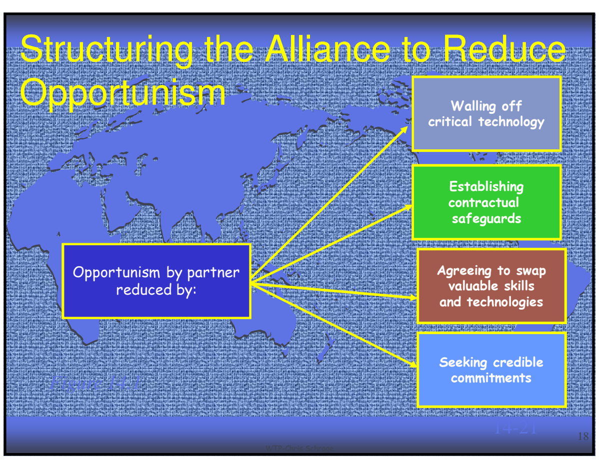
- High cost of technology development
- Company may not have skill, money or people to go it alone
- Good way to learn
- Good way to secure access to foreign markets
- Host country may require some local ownership

Global Alliances, however, are different

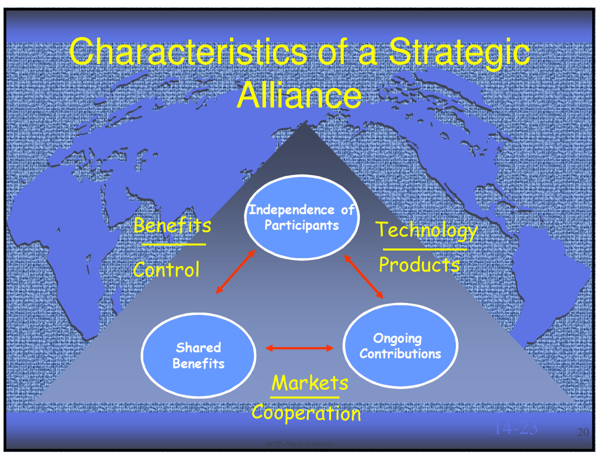
- Companies join to attain world leadership
- Each partner has significant strength to bring to the alliance
- A true global vision
- Relationship is horizontal not vertical
- When competing in markets not part of alliance, they retain their own identity


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

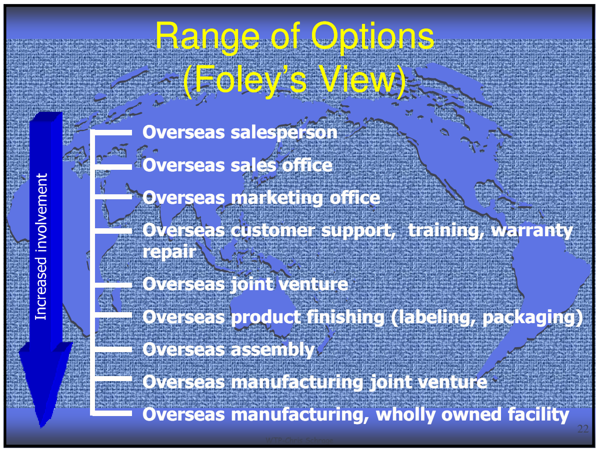

4 Cs to partner selection
Complementary skills
Cooperative cultures
Compatible goals
Commensurate levels of risk


Structuring the Alliance to Reduce Opportunism
Opportunism by partner reduced by:
Walling off critical technology
Establishing contractual safeguards
Agreeing to swap valuable skills and technologies
Seeking credible commitments


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
Benefits
Control
Technology
Products
Shared Benefits
Ongoing Contributions
Markets
Cooperation


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)
Increased involvement
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
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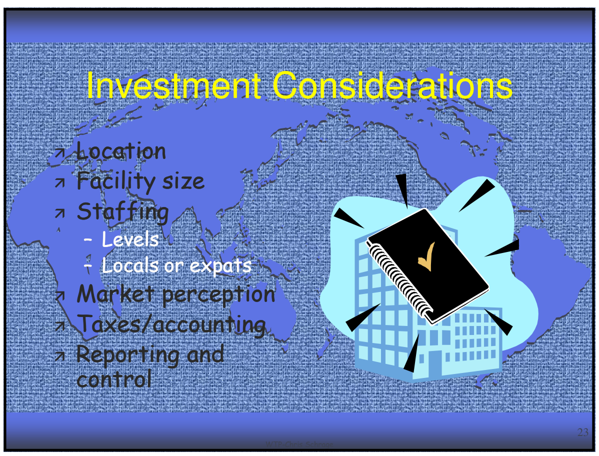
Investment Considerations
Location
Facility size
Staffing
- Levels
- Locals or expats
Market perception
Taxes/accounting
Reporting and control
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