2

Initiation of internationalization

Contents

Learning objectives

After studying this chapter you should be able to do the following:

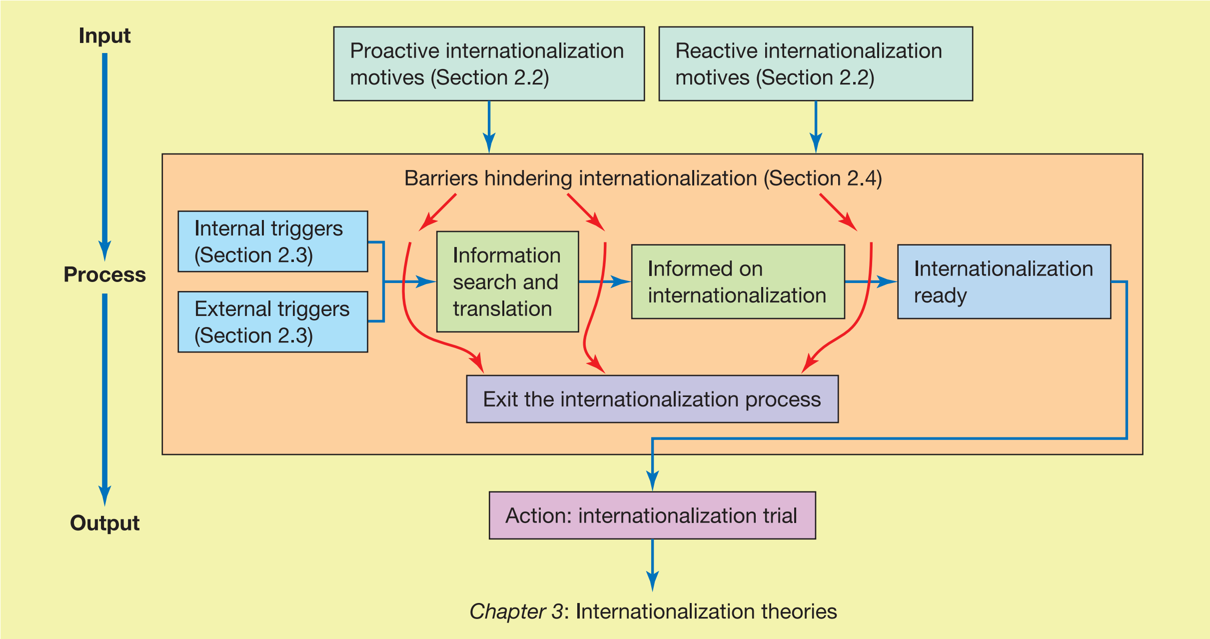
- **Discuss the reason (motives) why firms go international.**
- **Explain the difference between proactive and reactive motives.**
- **Analyse the triggers of export initiation.**
- **Explain the difference between internal and external triggers of export initiation.**
- **Describe different factors hindering export initiation.**
- **Discuss the critical barriers in the process of exporting.**

2.1 Introduction

Internationalization occurs when the firm expands its R&D, production, selling and other business activities into international markets. In many larger firms internationalization may occur in a relatively continuous fashion, with the firm undertaking various internationalization stages on various foreign expansion projects simultaneously, in incremental steps, over a period of time. However, for SMEs, internationalization is often a relatively discrete process; that is, one in which management regards each internationalization venture as distinct and individual.

In the pre-internationalization stages, SME managers use information to achieve enough relevant knowledge to initiate internationalization (Freeman, 2002). Figure 2.1 illustrates the different stages in pre-internationalization, and the rest of this chapter refers to the stages in this figure.

Figure 2.1 Pre-internationalization: initiation of SME internationalization



2.2 Internationalization motives

The fundamental reason for exporting, in most firms, is to make money. But, as in most business activities, one factor alone rarely accounts for any given action. Usually a mixture of factors results in firms taking steps in a given direction.

Internationalization motives
The fundamental reasons – proactive and reactive – for internationalization.

Table 2.1 provides an overview of the major **internationalization motives**. They are differentiated into proactive and reactive motives. *Proactive* motives represent stimuli to attempt strategy change, based on the firm's interest in exploiting unique competences (e.g. a special technological knowledge) or market possibilities. *Reactive* motives indicate that the firm reacts to pressures or threats in its home market or in foreign markets and adjusts passively to them by changing its activities over time.

Let us take a closer look at each export motive.

Table 2.1 Major motives for starting export

Proactive motives	Reactive motives
● Profit and growth goals	● Competitive pressures
● Managerial urge	● Domestic market: small and saturated
● Technology competence/unique product	● Overproduction/excess capacity
● Foreign market opportunities/market information	● Unsolicited foreign orders
● Economies of scale	● Extend sales of seasonal products
● Tax benefits	● Proximity to international customers/psychological distance

Source: adapted from Albaum *et al.*, 1994, p. 31.

Proactive motives

Profit and growth goals

The desire for short-term profit is especially important to SMEs that are at a stage of initial interest in exporting. The motivation for growth may also be of particular importance for the firm's export start.

Over time, the firm's attitude towards growth will be influenced by the type of feedback received from past efforts. For example, the profitability of exporting may determine management's attitude towards it. Of course the perceived profitability, when planning to enter international markets, is often quite different from profitability actually attained. Initial profitability may be quite low, particularly in international start-up operations. The gap between perception and reality may be particularly large when the firm has not previously engaged in international market activities. Despite thorough planning, sudden influences often shift the profit picture substantially. For example, a sudden shift in exchange rates may drastically alter profit forecasts even though they were based on careful market evaluation.

The stronger the firm's motivation to grow, the greater will be the activities it generates, including search activity for new possibilities, in order to find means of fulfilling growth and profit ambitions.

Managerial urge

Managerial urge
Managers' motivation that reflects the desire and enthusiasm to drive internationalization forward.

Managerial urge is a motivation that reflects the desire, drive and enthusiasm of management towards global marketing activities. This enthusiasm can exist simply because managers like to be part of a firm that operates internationally. Further, it can often provide a good reason for international travel. Often, however, the managerial urge to internationalize is simply a reflection of general entrepreneurial motivation – of a desire for continuous growth and market expansion.

Managerial attitudes play a critical role in determining the exporting activities of the firm. In SMEs export decisions may be the province of a single decision maker; in LSEs they can be made by a decision-making unit. Irrespective of the number of people involved in the export decision-making process, the choice of a foreign market entry strategy is still dependent on the decision maker's perceptions of foreign markets, expectations concerning these markets and the company's capability of entering them.

The internationalization process may also be encouraged by the cultural socialization of the managers. Managers who either were born or have the experience of living or travelling abroad may be expected to be more internationally minded than other managers. Prior occupation in exporting companies, or membership in trade and professional associations, may also reinforce key decision makers' perceptions and evaluations of foreign environments.

Technology competence/unique product

A firm may produce goods or services that are not widely available from international competitors or may have made technological advances in a specialized field. Again, real and perceived advantages should be differentiated. Many firms believe that theirs are unique products or services, even though this may not be the case in the international market. If products or technology are unique, however, they can certainly provide a sustainable competitive edge and result in major business success abroad. One issue to consider is how long such a technological or product advantage will continue.

Historically, a firm with a competitive edge could count on being the sole supplier to foreign markets for years to come. This type of advantage, however, has shrunk dramatically because of competing technologies and a frequent lack of international patent protection.

However, a firm producing superior products is more likely to receive enquiries from foreign markets because of the perceived competence of its offerings. Several dimensions in the product offering affect the probability that a potential buyer will be exposed to export stimuli. Furthermore, if a company has developed unique competences in its domestic market, the possibilities of spreading unique assets to overseas markets may be very high because the opportunity costs of exploiting these assets in other markets will be very low.

Foreign market opportunities/market information

It is evident that market opportunities act as stimuli only if the firm has or is capable of securing those resources 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.

From time to time certain overseas markets grow spectacularly, providing tempting opportunities for expansion-minded firms. The attraction of the south-east Asian markets is based on their economic successes, while the attraction of the eastern European markets is rooted in their new-found political freedoms and desire to develop trade and economic relationships with countries in western Europe, North America and Japan. Other countries that are likely to increase in market attractiveness as key internal changes occur include the People's Republic of China and South Africa.

Specialized marketing knowledge or access to information can distinguish an exporting firm from its competitors. This includes knowledge about foreign customers, marketplaces or market situations that is not widely shared by other firms. Such specialized knowledge may result from particular insights based on a firm's international research, special contacts a firm may have, or simply being in the right place at the right time (e.g. recognizing a good business situation during a vacation trip). Past marketing success can be a strong motivator for future marketing behaviour. Competence in one or more of the major marketing activities will often be a sufficient catalyst for a company to begin or expand exports.

Economies of scale – learning curve

Becoming a participant in global marketing activities may enable the firm to increase its output and therefore climb more rapidly on the learning curve. Ever since the Boston Consulting Group showed that a doubling of output can reduce production costs by up to 30 per cent this effect has been very much sought. Increased production for the international market can therefore also help in reducing the cost of production for domestic sales and make the firm more competitive domestically as well. This effect often results in seeking market share as a primary objective of firms. (See Exhibits 1.2 and 2.1 as examples of this.) At an initial level of internationalization it may mean an increased search for export markets; later on it can result in opening foreign subsidiaries and foreign production facilities.

Exhibit 2.1 Global marketing and economics of scale in Japanese firms

Japanese firms exploit foreign market opportunities by using a penetration pricing strategy – a low-entry price to build up market share and establish a long-term dominant market position. They do accept losses in the early years, as they view it as an investment in long-term market development. This can be achieved because much of Japanese industry (especially the *keiretsu* type of organization) is supported or owned by banks or other financial institutions with a much lower cost of capital.

Furthermore, because of the lifetime employment system, labour cost is regarded as a fixed expense, not a variable as it is in the West. Since all marginal labour cost will be at the entry salary level, raising volume is the only way to increase productivity rapidly. As a result market share, not profitability, is the primary concept in Japanese firms, where scale of operation and experience allow economies of scale, which also help to reduce distribution costs. The international trading companies typically take care of international sales and marketing, allowing the Japanese firm to concentrate on economies of scale, resulting in lower cost per unit.

Source: Genestre *et al.*, 1995.

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 foreign markets to the fullest extent is the possibility of standardizing the marketing mix internationally. For others, however, standardized marketing is not necessary for scale economies.

Tax benefits

Tax benefits can also play a major motivating role. In the United States a tax mechanism called the Foreign Sales Corporation (FSC) has been instituted to assist exporters. It is in conformity with international agreements and provides firms with certain tax deferrals. Tax benefits allow the firm either to offer its products at a lower cost in foreign markets or to accumulate a higher profit. This may therefore tie in closely with the profit motivation.

However, antidumping laws enforced by the WTO (the World Trade Organization) punish foreign producers for selling their products on local markets at very low prices, in order to protect local producers. This is the law that every country that has signed the WTO agreement (and most countries have signed) must abide by.

Reactive motives

Competitive pressures

A prime form of reactive motivation is reaction to competitive pressures. A firm may fear losing domestic market share to competing firms that have benefited from economies of scale gained by global marketing activities. Further, it may fear losing foreign markets permanently to domestic competitors that decide to focus on these markets, knowing that market share is most easily retained by the firm that obtains it initially. Quick entry may result in similarly quick withdrawal once the firm recognizes that its preparations have been insufficient. In addition to this, knowing that other firms, particularly competitors, are internationalizing provides a strong incentive to internationalize. Competitors are an important external factor stimulating internationalization. Coca-Cola became international much earlier than Pepsi did, but there is no doubt whatever that Coca-Cola's move into overseas markets influenced Pepsi to move in the same direction.

Domestic market: small and saturated

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 behaviour 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.

A saturated domestic market, whether measured in sales volume or market share, has a similar motivating effect. Products marketed domestically by the firm may be at the declining stage of the product life cycle. Instead of attempting a push-back of the life cycle process, or in addition to such an effort, firms may opt to prolong the product life cycle by expanding the market. In the past such efforts were often met with success as customers in many developing countries only gradually reached a level of need and sophistication already attained by customers in industrialized nations. Some developing nations are still often in need of products for which the demand in the industrialized world is already on the decline. In this way firms can use the international market to prolong the life cycle of their product. (See also Chapter 11 for further discussion.)

Many US appliance and car manufacturers initially entered international markets because of what they viewed as near-saturated domestic markets. US producers of asbestos products found the domestic market legally closed to them, but because some overseas markets had more lenient consumer protection laws they continued to produce for overseas markets.

Another perspective on market saturation is also 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 can provide those knowledge resources required for collecting, interpreting and using market information.

Overproduction/excess capacity

If a firm's domestic sales of a product are below expectation the inventory can be above desired levels. This situation can be the trigger for starting export sales via short-term price cuts on inventory products. As soon as the domestic market demand returns to previous levels global marketing activities are curtailed or even terminated. Firms that have used such a strategy may encounter difficulties when trying to employ it again because many foreign customers are not interested in temporary or sporadic business relationships. This reaction from abroad may well lead to a decrease in the importance of this motivation over time.

In some situations, however, excess capacity can be a powerful motivation. If equipment for production is not fully utilized firms may see expansion into the international market as an ideal possibility for achieving broader distribution of fixed costs. Alternatively, if all fixed costs are assigned to domestic production, the firm can penetrate international markets with a pricing scheme that focuses mainly on variable costs. Although such a strategy may be useful in the short term it may result in the offering of products abroad at a lower cost than at home, which in turn may stimulate parallel importing. In the long run, fixed costs have to be recovered to ensure replacement of production equipment. A market penetration strategy based on variable cost alone is therefore not feasible over the long term.

Sometimes excess production capacity arises because of changing demand in the domestic market. As domestic markets switch to new and substitute products companies making older product versions develop excess capacity and look for overseas market opportunities.

Unsolicited foreign orders

Many small companies have become aware of opportunities in export markets because their products generated enquiries from overseas. These enquiries can result from advertising in trade journals that have a worldwide circulation, through exhibitions and by other means. As a result a large percentage of exporting firms' initial orders were unsolicited.

Extend sales of seasonal products

Seasonality in demand conditions may be different in the domestic market from other international markets. This can act as a persistent stimulus for foreign market exploration that may result in a more stable demand over the year.

A producer of agricultural machinery in Europe had demand from its domestic market primarily in the spring months of the year. In an attempt to achieve a more stable demand over the year it directed its market orientation towards the southern hemisphere (e.g. Australia, South Africa), where it is summer when the northern hemisphere is winter and vice versa.

Proximity to international customers/psychological distance

Physical and psychological closeness to the international market can often play a major role in the export activities of a firm. For example, German firms established near the Austrian border may not even perceive their market activities in Austria as global marketing. Rather, they are simply an extension of domestic activities, without any particular attention being paid to the fact that some of the products go abroad.

Unlike US firms, most European firms automatically become international marketers simply because their neighbours are so close. As an example, a European firm operating in Belgium needs to go only 100 kilometres to be in multiple foreign markets. Geographic closeness to foreign markets may not necessarily translate into real or perceived closeness to the foreign customer. Sometimes cultural variables, legal factors and other societal norms make a foreign market that is geographically close seem psychologically distant. For example, research has shown that US firms perceive Canada as psychologically much closer than Mexico. Even England, mainly because of similarity in language, is perceived by many US firms as much closer than Mexico or other Latin American countries, despite the geographic distances. The recent extensive expansion of many Greek firms (especially banks) into the Balkans is another example of proximity to international customers.

In a study of small UK firms' motives for going abroad, Westhead *et al.* (2002) found the following main reasons for starting exporting of firms' products/services:

- being contacted by foreign customers that place orders;
- one-off order (no continuous exporting);
- the availability of foreign market information;
- part of growth objective of the firm;
- export markets actively targeted by key founder/owner/manager.

The results in the Westhead *et al.* (2002) study also showed that the bigger the firm the more likely that it would have cited *proactive* stimuli/motives.

Exhibit 2.2 Internationalization of Haier – proactive and reactive motives

China, consumer goods production, Haier

The Chinese manufacturer of home appliances (e.g. refrigerators), Haier Group, was near bankruptcy when Mr Zhang Ruimin was appointed plant director in 1984, the fourth one that year. It is Zhang Ruimin who has led the company to stand up and grow to the world's sixth largest home appliance manufacturer.

Proactive motives

Zhang Ruimin had an internationalization mindset for the initial stage of Haier's development. In 1984, soon after having joined the plant, he introduced technology and equipment from Liebherr, a German company, to produce several popular refrigerator brands in China. At the same time he actively expanded cooperation with Liebherr by manufacturing refrigerators based on its standards which were then sold to Liebherr, as a way of entering the German market. In 1986 the value of Haier's exports reached US$3 million for the first time. Zhang Ruimin later commented on this strategy: 'Exporting to earn foreign exchange was necessary at that time.'

When Haier invested in a plant in the United States, Zhang Ruimin thought it gained location advantage by setting up plants overseas to avoid tariffs and reduce transportation costs. Internalization advantage had been attained through controlling services and marketing/distribution, and ownership advantage had been achieved by developing design and R&D capabilities through utilizing high-quality local human resources.

Reactive motives

The entry of global home appliance manufacturers into the Chinese market forced Haier to seek international expansion. In particular, since China joined the WTO almost every international competitor has invested in China, establishing wholly-owned companies. The best defensive strategy for Haier would be to have a presence in its competitors' home markets.

The saturation of the Chinese home appliance market, with intensifying competition, has been a major motive. After the mid-1990s price wars broke out one after another in various categories of the market. At the end of 2000, Haier's market shares in China of refrigerators, freezers, air conditioners and washing machines had reached 33, 42, 31 and 31 per cent, respectively. The potential for further development in the domestic market was therefore limited.

One of the important external triggers for the internationalization of Haier has been the Chinese government. Being an international player, Haier gained some special conditions that other Chinese companies could not obtain. For instance, Haier had already been approved to establish a financial company, to be the majority shareholder of a regional commercial bank, and to form a joint venture with a US insurance company. Without its active pursuit of internationalization, as well as a dominant position in home appliance sectors, it would normally be impossible for a manufacturer to get approval to enter the financial sector.

Source: adapted from Liu and Li, 2002.

The results of Suárez-Ortega and Alamo-Vera (2005) suggest that the main driving forces motivating internationalization are found within the firm, and therefore they are based on the management's strengths and weaknesses. They conclude that it is not the external environment that mainly influence the internationalization activities, but the pool of resources and capabilities within the firm that might be appropriately combined to succeed in international markets. Consequently, the speed and intensity of internationalization can be emphasized through programmes aimed at enhancing managers' skills and capabilities. Also export promotion programmes aiming to get more non-exporters to become interested in exporting should emphasize activities that increase managers' awareness of export advantages.

2.3 Triggers of export initiation (change agents)

Internationalization triggers
Internal or external events taking place to initiate internationalization

For internationalization to take place someone or something within or outside the firm (so-called change agents) must initiate the process and carry it through to implementation (see Table 2.2). These are known as **internationalization triggers**. One conclusion from the research done in this area is that it is rare that an isolated factor will trigger the firm's internationalization process. In most cases it is a combination of factors that initiates the internationalization process (Rundh, 2007).

Internal triggers

Perceptive management

Perceptive managers gain early awareness of developing opportunities in overseas markets. They make it their business to become knowledgeable about these markets, and maintain a sense of open-mindedness about where and when their companies should expand overseas. Perceptive managers include many cosmopolitans in their ranks.

A trigger factor is frequently foreign travel, during which new business opportunities are discovered or information received which makes management believe that such opportunities exist. Managers who have lived abroad, have learned foreign languages or are particularly interested in foreign cultures are likely, sooner rather than later, to investigate whether global marketing opportunities would be appropriate for their firm.

Often managers enter a firm having already had some global marketing experience in previous jobs and try to use this experience to further the business activities of their new firm. In developing their goals in the new job managers frequently consider an entirely new set of options, one of which may be global marketing activities.

Specific internal event

A significant event can be another major change agent. A new employee who firmly believes that the firm should undertake global marketing may find ways to motivate management. Overproduction or a reduction in domestic market size can serve as such an event, as can the receipt of new information about current product uses. For instance, a company's research activity may develop a by-product suitable for sale overseas, as happened with a food-processing firm that discovered a low-cost protein ideal for helping to relieve food shortages in some parts of Africa.

Research has shown that in SMEs the initial decision to export is usually made by the chief executive, with substantial input provided by the marketing department. The

Table 2.2 Triggers of export initiation

Internal triggers	External triggers
• Perceptive management • Specific internal event • Importing as inward internationalization	• Market demand • Competing firms • Trade associations • Outside experts

carrying out of the decision – that is, the initiation of actual global marketing activities and the implementation of these activities – is then primarily the responsibility of marketing personnel. Only in the final decision stage of evaluating global marketing activities does the major emphasis rest again with the chief executive of the firm. In order to influence a firm internally, it therefore appears that the major emphasis should be placed first on convincing the chief executive to enter the international marketplace and then on convincing the marketing department that global marketing is an important activity. Conversely, the marketing department is a good place to be if one wants to become active in international business.

In a recent study of internationalization behaviour in Finnish SMEs, Forsman *et al.* (2002) found that the three most important triggers for starting up operations internationally were as follows:

1 management's interest in internationalization;
2 foreign enquiries about the company's products/services;
3 inadequate demand in the home market.

In this study it is interesting to note that companies do not regard contacts from Chambers of Commerce or other support organizations as important for getting their international activities going. However, Chambers of Commerce are often used for obtaining further information about a foreign country after an initial trigger has led to the consideration of going international.

Inward/outward internationalization

Internationalization has traditionally been regarded as an outward flow and most internationalization models have not dealt explicitly with how earlier inward activities, and thereby gained knowledge, can influence later outward activities. A natural way of internationalizing would be first to get involved in inward activities (imports) and thereafter in outward activities (exports). Relationships and knowledge gathered from import activities could thus be used when the firm engages in export activities (Welch *et al.*, 2001).

Inward internationalization
Imports as a preceding activity for the later market entries in foreign markets.

Outward internationalization
Imports as a preceding activity for the later market entries in foreign markets.

Welch and Loustarinen (1993) claim that **inward internationalization** (importing) may precede and influence **outward internationalization** (international market entry and marketing activities) – see Figure 2.2.

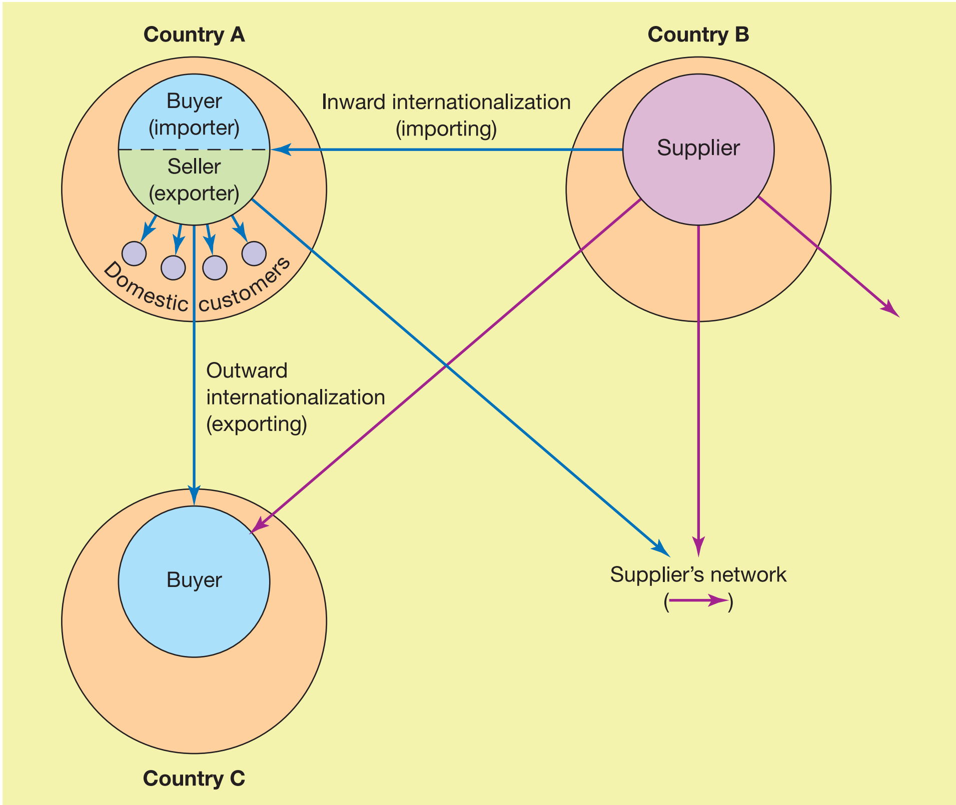
A direct relationship exists between inward and outward internationalization in the way that effective inward activities can determine the success of outward activities, especially in the early stages of internationalization. The inward internationalization may be initiated by one of the following:

- *the buyer*: active international search of different foreign sources (buyer initiative = reverse marketing); or
- *the seller*: initiation by the foreign supplier (traditional seller perspective).

During the process from inward to outward internationalization the buyer's role (in country A) shifts to that of seller, both to domestic customers (in country A) and to foreign customers. Through interaction with the foreign supplier the buyer (importer) gets access to the network of the supplier, so that at some later time there may be an outward export to members of this network.

Inward international operations thus usually cover a variety of different forms used to strengthen a firm's resources. Of course inward flows imply importing products needed for the production process, such as raw materials and machinery. But inward operations can also include finances and technology through different operational forms, such as franchising, direct investments and alliances (Forsman *et al.*, 2002). In some cases inward foreign licensing may be followed by outward technology sales.

Figure 2.2 Inward/outward internationalization: a network example



According to Fletcher (2001) and Freeman (2002), inward and outward activities and the links between them can develop in different ways. The links are most tangible in counter-trade arrangements (where the focal firm initiates exporting to the same market from which importing takes place), but they can also be found in the networks of relationships between subunits within a multinational enterprise and in strategic alliances.

External triggers

Market demand

Growth in international markets also causes the demand for the products of some companies also to grow, pushing the makers of these products into internationalization. Many pharmaceutical companies entered international markets when growth in the international demand for their products was first getting under way. The US-based company Squibb entered the Turkish market before it was large enough to be profitable; but the market was growing rapidly, which encouraged Squibb to internationalize further.

Competing firms

Information that an executive in a competing firm considers certain international markets to be valuable and worthwhile developing captures the attention of management. Such statements not only have source credibility but are also viewed with a certain amount of fear because the competitor may eventually infringe on the firm's business.

Trade associations

Formal and informal meetings among managers from different firms at trade association meetings, conventions or business round tables often serve as a major change agent. It has even been suggested that the decision to export may be made by small firms on the basis of the collective experience of the group of firms to which they belong.

Outside experts

Several outside experts encourage internationalization. Among them are export agents, governments, Chambers of Commerce and banks.

- *Export agents* Export agents as well as export trading companies and export management firms generally qualify as experts in global marketing. They are already dealing internationally with other products, have overseas contacts and are set up to handle other exportable products. Many of these trade intermediaries approach prospective exporters directly if they think that their products have potential markets overseas.
- *Governments* In nearly all countries governments try to stimulate international business through providing global marketing expertise (export assistance programmes). 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.
- *Chambers of Commerce* Chambers of Commerce and similar export production organizations are interested in stimulating international business, both exports and imports. These organizations seek to motivate individual companies to get involved in global marketing and provide incentives for them to do so. These incentives include putting the prospective exporter or importer in touch with overseas business, providing overseas market information, and referring the prospective exporter or importer to financial institutions capable of financing global marketing activity.
- *Banks* Banks and other financial institutions are often instrumental in getting companies to internationalize. They alert their domestic clients to international opportunities and help them to capitalize on these opportunities. Of course, they look forward to their services being used more extensively as domestic clients expand internationally.

Information search and translation

Of all resources, information and knowledge are perhaps the most critical factor in the initiation of the internationalization process in the SME (see also Figure 2.1 earlier).

Because each international opportunity constitutes a potential innovation for the SME its management must acquire appropriate information. This is especially important to SMEs that typically lack the resources to internationalize in the manner of LSEs. Consequently management launches an *information search* and aquires relevant information from a number of sources, such as internal written reports, government agencies, trade associations, personal contacts or the Internet, relevant to the intended internationalization project. In the *information translation* stage the internationalization information is transformed by managers into knowledge within the firm. It is through the information search and translation into knowledge that management becomes informed on internationalization. At this stage the firm has entered a cycle of continuous search and translation into internationalization knowledge. This cycle continues until management is satisfied that it has sufficiently reduced the uncertainty associated with the internationalization project to ensure a relatively high probability of success. Once sufficient information has been acquired and translated into usable knowledge the firm leaves the cycle, becoming *internationalization ready*. It is here that the firm proceeds to action, that is, *internationalization trial*. 'Action' refers to behaviours and activities that management executes based on the knowledge that it has acquired. At this stage the firm could be said to have an embedded internationalization culture, where even the most challenging foreign markets can be overcome, leading to further internationalization and 'storage' of actual internationalization knowledge in the heads of the managers. The above description represents the firm more or less in isolation. However, the network theory recognizes the importance of the firm's membership in a constellation of firms and organizations. By interacting within such a constellation the firm derives advantages well beyond what it could obtain in isolation.

At the most fine-grained level, knowledge is created by individuals. Individuals acquire explicit knowledge via specific means and tacit knowledge through 'hands-on' experience (experiential learning).

The nature of the pre-internationalization process (illustrated in Figure 2.1) will be unique in each firm because of several factors at the organization and individual levels within the firm (Knight and Liesch, 2002). For example, for SMEs it seems that the managers' personal networks tend to speed up the pre-internationalization process. These personal networks are used for creating cross-border alliances with suppliers, distributors and other international partners (Freeman *et al.*, 2006).

Throughout the process depicted in Figure 2.1 the firm may exit from the pre-internationalization process at any time, as a result of the barriers hindering internationalization. The manager may decide to 'do nothing', an outcome that implies exiting from pre-internationalization.

2.4 Internationalization barriers/risks

A wide variety of barriers to successful export operations can be identified. Some problems mainly affect the export start; others are encountered in the process of exporting.

Barriers hindering internationalization initiation

Critical factors hindering *internationalization initiation* include the following (mainly internal) barriers:

- insufficient finances;
- insufficient knowledge;
- lack of foreign market connections;
- lack of export commitment;
- lack of capital to finance expansion into foreign markets;
- lack of productive capacity to dedicate to foreign markets;
- lack of foreign channels of distribution;
- management emphasis on developing domestic markets;
- cost escalation due to high export manufacturing, distribution and financing expenditures.

Inadequate information on potential foreign customers, competition and foreign business practices are key barriers facing active and prospective exporters. Obtaining adequate representation for overseas distribution and service, ensuring payment, import tariffs and quotas, and difficulties in communicating with foreign distributors and customers are also major concerns. Serious problems can also arise from production disruptions resulting from a requirement for non-standard export products. This will increase the cost of manufacturing and distribution.

In a study of craft micro-enterprises (less than ten employees) in the United Kingdom and Ireland, Fillis (2002) found that having sufficient business in the domestic market was the major factor in the decision not to export. Other reasons of above-average importance were: lack of export inquiries, relating to the reactive approach to business; complicated exporting procedures; poor levels of exporting assistance; and limited government incentives. Similar results were supported by a study by Westhead *et al.* (2002), who found that for small firms 'focus on local market' was the main reason for not exporting any of their products.

The internationalization process can also go in another direction than expected – see Exhibit 2.3.

Exhibit 2.3 De-internationalization at British Telecommunications (BT)

BT started its internationalization from the mid-1990s. Over the the next years BT built a global strategy seeking to position itself as a leading supplier of telecommunication services to multinational companies in different countries. However the percentage increase in international activities has slowed down over the years. In 1994 less than 1 per cent of total turnover came from international activities. In 2002 this increased to 11 per cent, and in 2007 it increased to 15 per cent of its £20 billion turnover. So though BT overall has experienced a sharp increase in turnover from international activities it has also experienced some setbacks in the internationalization process, especially in the beginning, as indicated in Figure 2.3.

In the beginning of the internationalization process BT built its international strategy around three guiding principles:

1. Not over-committing itself by building its own infrastructure based on uncertatain traffic flows.
2. Achieving quick and reliable access to targeted marketplaces by entering distribution partnerships and equity joint ventures. This strategy involved relatively low risk and allowed speedy access into marketplaces with partners who had intimate knowledge of local market conditions.
3. Ensuring that the strategy gave BT sufficient strategic flexibility to be able to adjust rapidly to changing market conditions

At its height in 1999, BT had 25 equity joint ventures and 44 distribution partnerships. Within the equity joint ventures, BT took a minority stake with the stated intention to gradually upgrade this stake to a controlling investment over time. BT would also often take a stake in its distribution partners as a means of giving them incentives to sell the BT products.

Figure 2.3 Illustration of BT's internationalization 1994–2007

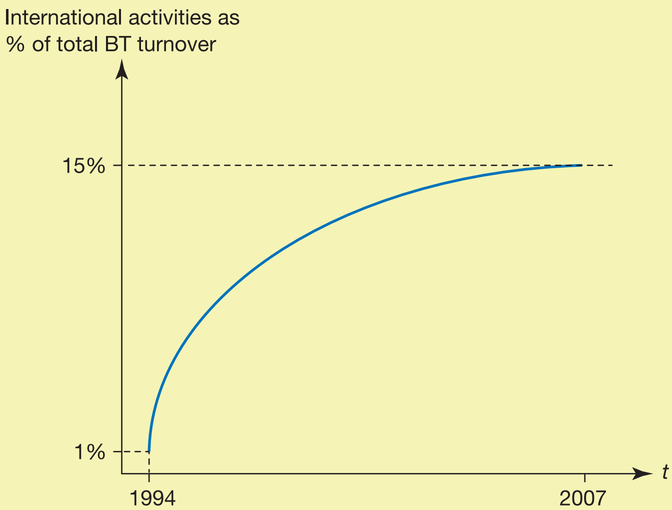


Exhibit 2.3 continued

De-internationalization at BT

In 2002, BT launched a new corporate strategy that was considerably more defensive than its predecessor. There were mainly two problems with the series of joint ventures and partnerships:

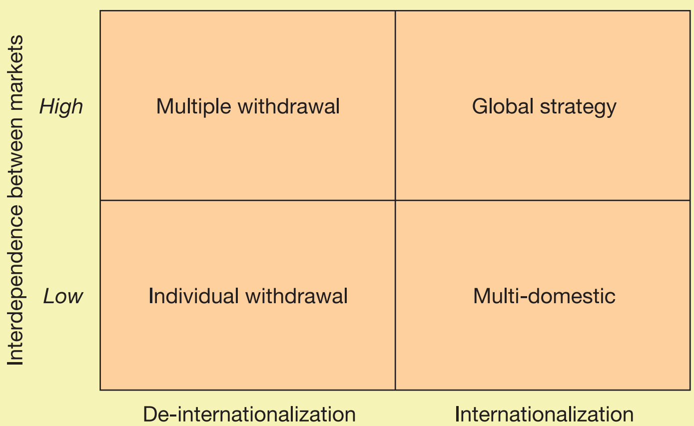
1 BT needed different skills and competences for different partners. This made coordination of activities between partners very complex. As a consequence, BT found itself on a steep learning curve with this large number of partners.
2 The strategy of only taking a minority stake in the joint ventures rebounded on BT. Furthermore, there was little imperative by partners to fully support the roll out of BT products especially where they were in competition with their own offerings. When BT attempted to increase its financial stake within the partnership, it often found that the other shareholders had exactly the same intent.

Subsequently, BT made divestments, both in North America and in Asia.

What can we learn from the BT case?

BT's de-internationalization was driven by the financial situation, where the high cost of market entry combined with falling prices (driven by excess capacity in the telecommunication sector) led to declining profits throughout the 1990s. Consequently, the new defensive strategy represented a process of de-internationalization as BT retreated from the US and Asian markets ('Multiple withdrawal' in Figure 2.4). BT's new international strategy is based on the European market where there are interdependencies with the core UK business. This means that BT tries to own and control all aspects of the delivery mechanism within the European market.

Figure 2.4 Global strategy options



This BT case demonstrates that the future development of the global marketing strategy can work in both directions. If the globalization of markets goes well in a company, the interdependence and synergies between markets can be further utilized to strengthen the global strategy (upper-right corner in Figure 2.4). However the case also shows that divestment in individual locations cannot occur in isolation without damaging the firm's global value proposition. Therefore, BT's de-internationalization also means (because of the high dependence of markets) that it had to make multiple market withdrawals.

If we talk about SMEs (that is not the case with BT!) we will often experience a low interdependence between markets, and in that case we will talk about a 'multi-domestic' strategy if we increase internationalization (lower-right corner in Figure 2.4) and individual withdrawal if we decrease internationalization (lower-left corner in Figure 2.4).

Source: Adapted from Turner and Gardiner, 2007; BT Financial Report 2007.

Barriers hindering the further process of internationalization

Critical barriers in the *process of internationalization* may generally be divided into three groups: general market risks, commercial risks and political risks.

General market risks

General market risks include the following:

- comparative market distance;
- competition from other firms in foreign markets;
- differences in product usage in foreign markets;
- language and cultural differences;
- difficulties in finding the right distributor in the foreign market;
- differences in product specifications in foreign markets;
- complexity of shipping services to overseas buyers.

Commercial risks

The following fall into the commercial risks group:

- exchange rate fluctuations when contracts are made in a foreign currency;
- failure of export customers to pay due to contract dispute, bankruptcy, refusal to accept the product or fraud;
- delays and/or damage in the export shipment and distribution process;
- difficulties in obtaining export financing.

Political risks

Among the political risks resulting from intervention by home and host country governments are the following:

- foreign government restrictions;
- national export policy;
- foreign exchange controls imposed by host governments that limit the opportunities for foreign customers to make payment;
- lack of governmental assistance in overcoming export barriers;
- lack of tax incentives for companies that export;
- high value of the domestic currency relative to those in export markets;
- high foreign tariffs on imported products;
- confusing foreign import regulations and procedures;
- complexity of trade documentation;
- enforcement of national legal codes regulating exports;
- civil strife, revolution and wars disrupting foreign markets.

The importance of these risks must not be overemphasised, and various risk-management strategies are open to exporters. These include the following:

- Avoid exporting to high-risk markets.
- Diversify overseas markets and ensure that the firm is not overdependent on any single country.
- Insure risks when possible. Government schemes are particularly attractive.
- Structure export business so that the buyer bears most of the risk. For example, price in a hard currency and demand cash in advance.

In Fillis (2002) over one-third of the exporting craft firms indicated that they encountered problems once they entered export markets. The most common problem was connected with the choice of a reliable distributor, followed by difficulties in promoting the product and matching competitors' prices.

2.5 Summary

This chapter has provided an overview of the pre-internationalization process. The chapter opened with the major motives for firms to internationalize. These were differentiated into proactive and reactive motives. Proactive motives represent internal stimuli to attempt strategy change, based on the firm's interest in exploiting unique competences or market possibilities. Reactive motives indicate that the firm reacts to pressures or threats in its home market or in foreign markets and adjusts passively to them.

For internationalization to take place someone or something ('triggers') inside or outside the firm must initiate it and carry it through. To succeed in global marketing the firm has to overcome export barriers. Some barriers mainly affect the export initiation and others are encountered in the process of exporting.

CASE STUDY 2.1

Elvis Presley Enterprises Inc. (EPE): Internationalization of a 'cult icon'

Even more than 25 years after his death Elvis Presley has one of the most lucrative entertainment franchises in the world. Despite the sorry state of his affairs in 1977 the empire of Elvis has thrived due in large part to the efforts of the people who handled his estate after his grandmother died in 1980, including his ex-wife Priscilla Beaulieu Presley, his daughter Lisa Marie and Jack Soden, the CEO of Elvis Presley Enterprises Inc. (www.elvis.com), the company that handles all the official Elvis properties.

Priscilla Presley was involved in the master-stroke decision to open Elvis's mansion, Graceland, to the public in 1982. Graceland gets more than 600,000 visitors per year, according to EPE's website. Over half of Graceland's visitors are under the age of 35. While visitors come from all parts of the world the majority still come from different parts of the United States. The Graceland tour costs US$25, which means that EPE makes US$15 million on those tickets alone, plus what it receives from photographs, hotel guests, meals and souvenirs.

EPE's other revenue streams include a theme restaurant called Elvis Presley's Memphis; a hotel, down at the end of Lonely Street, called Heartbreak Hotel; licensing of Elvis-related products, the development of Elvis-related music, film, video, TV and stage productions; and more.

© Used by permission, Elvis Presley Enterprises, Inc.

Ironically, EPE gets very little money from Elvis's actual songs, thanks to a deal Elvis's infamous former manager, Colonel Tom Parker, made with RCA in 1973, whereby Elvis traded the rights for all future royalties from the songs he had recorded up to that point for a measly $5.4 million – half of which he had to give to Parker.

In 2000, the 25th anniversary was an international spectacle. A remix of the 1968 Elvis song 'A little less conversation' became a global hit single. Furthermore the CD 'Elvis: 30 #1 Hits' went triple platinum.

In mid-2004, to commemorate the 50th anniversary of Presley's first professional recording, 'That's All Right' was re-released, and made the charts around the world, including the top three in the United Kingdom and top 40 in Australia.

In mid-October 2005, *Variety* named the top 100 entertainment icons of the twentieth century, with Presley landing in the top ten, along with the Beatles, Marilyn Monroe, Lucille Ball, Marlon Brando, Humphrey Bogart, Louis Armstrong, Charlie Chaplin, James Dean and Mickey Mouse.

By the end of October 2005, *Forbes* magazine named Elvis Presley, for the fifth straight year, the top-earning dead celebrity, grossing US$45 million for the Elvis Presley Estate during the period from October 2004 to October 2005.

Source: money.cnn.com/2002/08/15/news/elvis.

Questions

1 What are the main motives for the internationalization of EPE?

2 What can EPE do to maintain a steady income stream from abroad?

3 What are the most obvious assets for further internationalization of EPE?

For further exercises and cases, see this book's website at www.pearsoned.co.uk/hollensen

Questions for discussion

1 Export motives can be classified as reactive or proactive. Give examples of each group of export motives. How would you prioritize these motives? Can you think of motives other than those mentioned in the chapter? What are they?

2 What is meant by 'change agents' in global marketing? Give examples of different types of change agent.

3 Discuss the most critical barriers to the process of exporting.

4 What were the most important change agents in the internationalization of Haier (Exhibit 2.2)?

5 What were the most important export motives in Japanese firms (Exhibit 2.1)?

References

Albaum, G., Strandskov, J., Duerr, E. and Dowd, L. (1994) *International Marketing and Export Management* (2nd edn), Addison-Wesley, Reading, MA.

Fillis, I. (2002) 'Barriers to internationalization: an investigation of the craft microenterprises', *European Journal of Marketing*, (7–8), pp. 912–927.

Fletcher, R. (2001) 'A holistic approach to internationalization', *International Business Review*, 10, pp. 25–49.

Forsman, M., Hinttu, S. and Kock, S. (2002) 'Internationalization from an SME perspective', Paper presented at the *18th Annual IMP Conference*, September, Lyon, pp. 1–12.

Freeman, S. (2002) 'A comprehensive model of the process of small firm internationalization: a network perspective', Paper presented at the *18th Annual IMP Conference*, September, Dijon, pp. 1–22.

Freeman, S., Edwards, R. and Schroder, B. (2006) 'How smaller Born-Globals Firms use Networks and Alliances to Overcome Constraints to Rapid Internationalization', *Journal of International Marketing*, Vol. 14, No. 3, pp. 33–63.

Genestre, A., Herbig, D. and Shao, A.T. (1995) 'What does marketing really mean to the Japanese?', *Marketing Intelligence and Planning*, 13(9), pp. 16–27.

Knight, G.A. and Liesch, P.W. (2002) 'Information internalization in internationalizing the firm', *Journal of Business Research*, 55, pp. 981–995.

Liu, H. and Li, K. (2002) 'Strategic implications of emerging Chinese multinationals: the Haier case study', *European Management Journal*, 20(6), pp. 699–706.

Rundh, B. (2007) 'International Marketing Behaviour Amongst Exporting Firms', *European Journal of Marketing*, Vol. 41, No. 1/2, pp. 181–198.

Suárez-Ortega, S.M. and Àlamo-Vera, F.R. (2005) 'SMES' internationalization: firms and managerial factors', *International Journal of Entrepreneurial Behavior & Research*, 11(4), pp. 258–279.

Turner, C. and Gardiner, P.D. (2007) 'De-internationalisation and global strategy: the case of British Telecommunications (BT)', *Journal of Business & Industrial Marketing*, Vol. 22, No. 7, pp. 489–497.

Welch, L.S., Benito, G.R.G., Silseth, P.R. and Karlsen, T. (2001) 'Exploring inward–outward linkages in firms' internationalization: a knowledge and network perspective', Paper presented at the *17th Annual IMP Conference*, September, Oslo, pp. 1–26.

Welch, L.S. and Loustarinen, R.K. (1993) 'Inward–outward connections in internationalization', *Journal of International Marketing*, 1(1), pp. 44–56.

Westhead, P., Wright, M. and Ucbasaran, D. (2002) 'International market selection strategies selected by "micro" and "small" firms', *Omega – The International Journal of Management Science*, 30, pp. 51–68.