10.1 Introduction

Recent studies of subcontracting and competitiveness have emphasized the importance of outsourcing: moving functions or activities out of an organization. Outsourcing is often more efficient, except in the case of the firm’s core competences, which are considered central to its success. Thus the issue is whether an organization should perform certain functions itself (‘make’) or source (‘buy’) these activities from outside. If LSEs outsource an increasing number of value chain functions this provides business opportunities for SMEs as subcontractors to LSEs (main contractors).

A subcontractor can be defined as a person or a firm that agrees to provide semi-finished products or services needed by another party (main contractor) to perform
Figure 10.1 Subcontractor’s position in the vertical chain

![Diagram of vertical production chain]

Source: Adapted from Lehtinen, 1991, p. 22.

another contract to which the subcontractor is not a party. According to this definition, the characteristics of subcontractors that distinguish them from other SMEs are as follows:

- Subcontractors’ products are usually part of the end product, not the complete end product itself.
- Subcontractors do not have direct contact with the end customers, because the main contractor is usually responsible to the customer.

The position of subcontractors in the vertical production chain is shown in Figure 10.1.

In the OEM contract (where OEM stands for original equipment manufacturer), the contractor is called the OEM or ‘sourcer’, whereas the parts suppliers are regarded as ‘manufacturers’ of OEM products (= subcontractors = subsuppliers). Typically the OEM contracts are different from other buyer–seller relationships because the OEMs (contractors) often have much stronger bargaining power than the subcontractors. However, in a partner-based buyer–seller relationship the power balance will be more equal. There are cases where a subcontractor improved its bargaining position and went on to become a major force in the market (Cho and Chu, 1994).

The internationalization of the supply chains adds considerable complexity to the coordination tasks performed by the subsuppliers (Andersen and Christensen, 2005). The structure of the remainder of this chapter is shown in Figure 10.2.

10.2 Reasons for international sourcing

More and more international firms are buying their parts, semi-finished components or system solutions from international subcontractors. In most multinational companies there is a tendency to outsource more and more of the upstream activities to subsuppliers,
who will then take over more complex coordination tasks, leaving firms to concentrate on their core competences. This will create more business for subsuppliers, but at the same time there is a tendency to decrease the number of subsuppliers (system suppliers) (see the first layer of Figure 10.1) in the vertical chain. This means that there is fierce competition among existing subsuppliers for staying at the first layer level. In this consolidation process, those firms who cannot stay at the first layer level will have to move to the second layer, maybe concentrating on production of more simple components, which will then be sold and handed over to the system suppliers (first layer).

In general, creating competitiveness through the subcontractor is based on the understanding that the supplier could be essential to the buyer (contractor) for a number of reasons.

Concentration on in-house core competences

A contractor wishes to concentrate management time and effort on those core business activities that make the best use of in-house skills and resources. There may also be special difficulties in obtaining suitably skilled labour in-house.

Lower product/production costs

In this respect there are two underlying reasons for outsourcing:

1 Economies of scale. In many cases the subcontractor produces similar components for other customers, and by use of the experience curve the subcontractor can obtain lower production costs per unit.

2 Lower wage costs. The labour costs involved in the domestic country can make the in-house operation uneconomic and motivate international sourcing. For example, 80 per cent of the labour cost of clothing manufacture is in the sewing stage. Short production runs of different sizes of clothes permit only a low degree of mechanization. Moreover, adjusting the tooling for each run is relatively labour intensive (Hibbert, 1993). Therefore a large part of labour-intensive clothing production is moved to low-wage countries in eastern Europe and the Far East.
General cost efficiency

If a firm plans to be more cost efficient than its competitors it has to minimize the total costs towards the end (ultimate) customer. Figure 10.3 shows a model of the different cost elements, from the basic price of materials to the ultimate customer cost.

Each element of the supply chain is a potential candidate for outsourcing. Quality costs, inventory costs (not explicitly mentioned in Figure 10.3) and buyer–supplier transaction costs are examples of costs that should be included in every calculation. However, some of these costs are difficult to estimate and are consequently easily overlooked when evaluating a subcontractor.

For example, the quality of a subcontractor’s product or service is essential to the buyer’s quality. However, it is not only a question of the quality of the product or service. The quality of the delivery processes also has a major impact on the buyer’s performance. Uncertainties, as far as lead times are concerned, have an impact on the buyer’s inventory investments and cost efficiency, and they may cause delays in the buyer’s own delivery processes. Thus the buyer’s own delivery times towards the end customers are determined by the subcontractors and their delivery. Another important fact is that the cost of components and parts is to a large extent already determined at the design stage. Thus, close cooperation between buyer and seller at this stage can give rise to considerable cost advantages in production and distribution.
Increased potential for innovation

Ideas for innovation can be generated by the subcontractor due to its more in-depth understanding of the component. New ideas can also be transferred from other customers of the subcontractor.

Fluctuating demand

If the main contractor is confronted with fluctuating demand levels, external uncertainty and short product life cycles, it may transfer some risk and stock management to the subcontractor, leading to better cost and budget control.

Finally, it should be mentioned that, when buying from international sources, fluctuations in exchange rates become particularly important, especially when there is a lag from the time the contract is signed to when payment is made. When the currency in the country of the main contractor is very strong against a particular country this can be an incentive for the main contractor to buy from this country.

In summary, price is a very important reason for (international) outsourcing, but the main contractors increasingly regard cooperation with critical subcontractors as advantageous to the buying firm’s competitiveness and profitability.

A typology of subcontracting

Traditionally, a subcontractor has been defined as a firm carrying out day-to-day production based on the specifications of another firm (the main contractor). The variety of subcontracting relationships that are appearing indicates a need for a more differentiated typology.

Figure 10.4 displays a typology of subcontractors based on differences in the contractor–subcontractor relationship. The typology displays the interplay between the degree of coordination needed and the complexity of the tasks to be solved.

Figure 10.4 Typology of subcontracting

Source: adapted from Blenker and Christensen, 1994.
Part III  Market entry strategies

- **Standard subcontracting.** Economies of scale often operate in the global market with standardized products, in which case no adaptation to specific customers is needed.
- **Simple subcontracting.** Information exchange is simple since the contractor specifies criteria for contribution. The contractor’s in-house capacity is often a major competitor.
- **Expanded subcontracting.** There is some mutual specialization between the two parties and exit costs are higher for both parties. Therefore single sourcing (one supplier for a product/component) may replace multisourcing (more suppliers for a product/component).
- **Strategic development subcontracting.** This is very important to the contractor. Subcontractors possess a critical competence of value to the contractor. They are involved in the contractor’s long-term planning, and activities are coordinated by dialogue.
- **Partnership-based subcontracting.** This is a relationship based on a strong mutual strategic value and dependency. The subcontractor is highly involved in the R&D activities of the contractor.

There is a certain overlap between the different types of subcontractor and in a specific relationship it can be very difficult to place a subcontractor in a certain typology. Depending primarily on the task complexity, a main contractor may have both standard subcontractors and partnership-based subcontractors. Also a subcontractor may play more than one role in Figure 10.4, but only one at a time.

### 10.4 Buyer-seller interaction

Traditionally, subcontracting has been defined as the production activities that one firm carries out on the day-to-day specification of another firm. Outsourced activities increasingly include R&D, design and other functions in the value chain. Thus what starts with simple transactions (so-called episodes) may, if repeated over time, evolve into a relationship between buyer and seller.

Interaction theory was developed by the Swedes but spread into France, the United Kingdom, Italy and Germany when a group of like-minded researchers formed what became known as the IMP Group, basing their research on the interaction model (Figure 10.5).

The interaction model has four basic elements:

1. The interaction process, which expresses the exchanges between the two organizations along with their progress and evolution throughout time.
2. The participants in the interaction process, meaning the characteristics of the supplier and the customer involved in the interaction process.
3. The atmosphere affecting and being affected by the interaction.
4. The environment within which interaction takes place.

**Interaction process**

The interaction process can be analysed in both a short-term and a long-term perspective. Over time the relationship is developed by a sequence of episodes and events that tends to institutionalize or destabilize it, depending on the evaluations made by the two firms in the interaction. These episodes may vary in terms of types of exchange: commercial transactions, periods of crisis caused by delivery, price disputes, new product development stages, etc.
Chapter 10  International buyer–seller relationships

Through social exchange with the supplier the customer attempts to reduce decision-making uncertainty. Over time and with mutual adaptation a relationship-specific mode of operation emerges and may act as a ‘shock absorber’ in case of crisis. This mode of operation can take the form of special procedures, mutual developments, communication style between individuals, and more or less implicit rules. These rules are modified through past exchanges and form the framework for future exchanges.

Interacting parties

The participants’ characteristics strongly influence the way they interact. Three analytical perspectives of buyer and seller, at different levels, may be taken into account.

1 The social system perspective

Dimensions such as culture – languages, values and practices – and the operating modes of the firm influence the distance between actors that will limit or encourage collaboration.

2 The organizational perspective

The relationship between buyer and seller is influenced by three organizational dimensions:

1 The characteristics of each firm’s technology (i.e. products and production technology) strongly influence the nature of the interaction between the two organizations.

2 The complexity of products sold, for example, conditions the very nature and the density of the interaction between supplier and customer.

3 Relationship characteristics: a supplier can choose to develop a stable relationship with a customer, or the supplier can regard the relationship as a pure transaction-based exchange where the supplier typically makes ‘one-shot’ business with a customer purely to increase sales volume and with no further involvement.

Figure 10.5 The buyer–seller interaction

3 The individual perspective

The individuals’ characteristics, their objectives and their experience will influence the way social exchanges and social contacts take place, and subsequently the development of supplier–customer interaction.

Atmosphere of the relationship

The atmosphere is the ‘climate’ that has developed between the two firms. This atmosphere can be described in terms of power–dependence, cooperation–conflict and trust–opportunism, and in terms of understanding and social distance. The atmosphere concept is central to the understanding of the supplier–customer relationship. In the case of key account management, atmosphere plays a particularly important role. As buyer and seller approach each other the marketing exchanges are changing from single transactions to a relationship. The further characteristics of these two situations are described in Table 10.1 and Figure 10.6.

Table 10.1 Marketing exchange understanding

<table>
<thead>
<tr>
<th>Objective</th>
<th>Transaction</th>
<th>Relationship</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer needs satisfaction</td>
<td>To make a sale (sale is end result and measure of success). Customer buys values.</td>
<td>To create a customer (sale is beginning of relationship). Customer integration (interactive value generation).</td>
</tr>
<tr>
<td>Marketers’ task and performance criteria</td>
<td>Assessment on the basis of products and prices. Focus on gaining new customers.</td>
<td>Assessment on the basis of problem-solving competence. Focus on value enhancing of existing customers.</td>
</tr>
</tbody>
</table>


Figure 10.6 Market exchange understanding

Chapter 10  International buyer–seller relationships

Interaction environment

Supplier–customer relationships evolve in a general macroenvironment that can influence their very nature. The following analytical dimensions are traditionally considered: political and economic context, cultural and social context, market structure, market internationalization and market dynamism (growth, innovation rate).

10.5 Development of a relationship

A relationship between two firms begins, grows and develops – or fails – in ways similar to relationships between people. The development of a relationship has been mapped out in a five-phase model: awareness, exploration, expansion, commitment and dissolution. The five phases are shown in Figure 10.7.

Figure 10.7 shows, the initial psychic distance 1 between a buyer and a seller (both from different countries and cultures) and it is influenced by the psychological characteristics of the buyer and the seller, the firm’s organizational culture, and the national and industry culture to which the firm belongs. Figure 10.7 also shows that the initial psychic distance 1 at the beginning of the relationship is reduced to physical distance 2 through the interaction process of the two partners. However, relationships do not always last forever. The partners may ‘move from each other’ and the psychic may increase to distance 3. If the problems in the relationship are not solved, it may result in a ‘divorce’.

Within such a framework one might easily characterize a marketing relationship as a marriage between a seller and a buyer (the dissolution phase being a ‘divorce’). The use of the marriage metaphor indicates that business relationships involve inter-organizational relationships, but certainly also inter-personal relationships (Mouzas et al., 2007).

Dwyer et al. (1987) call the first phase in a relationship awareness, which means that the partners recognize each other as potential partners. In other words, in their model the decisions made about cooperating and choosing the partner are combined. Both types of decision making can exist at the beginning of cooperation, but it is difficult to state any definite chronological order between them.

In SMEs it is likely that the decision-making process is reactive, in the way that the SME probably first realizes the existence of a potential partner (maybe ‘love at first sight’) and then decides to cooperate. The selection process may, however, be better if companies look for three key criteria (Kanter, 1994):

1. **Self-analysis.** Relationships get off to a good start when partners know themselves and their industry, when they have assessed changing industry conditions and decided to seek an alliance. It also helps if executives have experience in evaluating potential partners. They will not be easily attracted by the first good-looking prospect that comes along.

2. **Chemistry.** To highlight the personal side of business relationships is not to deny the importance of sound financial and strategic analysis. But successful relations often depend on the creation and maintenance of a comfortable personal relationship between senior executives. This will include personal and social interests. Signs of managers’ interests, commitment and respect are especially important in high-context countries. In China, as well as in Chinese-dominated businesses throughout Asia, the top manager of the western company should show honour and respect to the potential partner’s decision by investing his or her personal time.
3 Compatibility. The courtship period tests compatibility on broad historical, philosophical and strategic grounds: common experiences, values and principles, and hopes for the future. While analysts examine financial viability, managers can assess the less tangible aspects of compatibility. What starts out as personal rapport, philosophical and strategic compatibility, and shared vision between two companies’ top executives must eventually be institutionalized and made public (“getting engaged”). Other stakeholders get involved, and the relationship begins to become depersonalized. But success in the engagement phase of a new alliance still depends on maintaining a careful balance between the personal and the institutional.
In the exploration phase of Figure 10.7 trial purchases may take place and the exchange outcomes provide a test of the other’s ability and willingness to deliver satisfaction. In addition, electronic data interchange can be used to reduce the costly paperwork associated with purchase orders, production schedule releases, invoices and so on.

At the end of the exploration phase it is time to ‘meet the family’. The relations between a handful of leaders from the two firms must be supplemented with approval, formal or informal, by other people in the firms and by stakeholders. Each partner has other outside relationships that may need to approve the new relationship.

When a party (as is the case in the expansion phase) fulfils perceived exchange obligations in an exemplary fashion, the party’s attractiveness to the other increases. Hence motivation to maintain the relationship increases, especially because high-level outcomes reduce the number of alternatives that an exchange partner might use as a replacement.

The romance of courtship quickly gives way to day-to-day reality as the partners begin to live together (‘setting up house’). In the commitment phase the two partners can achieve a level of satisfaction from the exchange process that actually precludes other primary exchange partners (suppliers) that could provide similar benefits. The buyer has not ceased attending other alternative suppliers, but maintains awareness of alternatives without constant and frequent testing. In a buyer–seller relationship with a high conflict potential (e.g. caused by two very different partners) the partners tend to a more close monitoring of the relationship because each partner is afraid that its interests are not fully taken into account. However, the relationship is able to sustain its structure and remain an efficient mechanism for interfirm transactions between buyer and seller, as long as partners’ economic benefits exceed potential costs in managing the alliance (Wahyuni et al., 2007).

During the description of the relationship development, the possibility of a withdrawal has been implicit. The dissolution phase may be caused by the following problems:

- Operational and cultural differences emerge after collaboration is under way. They often come as a surprise to those who created the alliance. Differences in authority, reporting and decision-making styles become noticeable at this stage.
- People in other positions may not experience the same attraction as the chief executives. The executives spend a lot of time together both informally and formally. Other employees have not been in touch with one another, however, and in some cases have to be pushed to work with their overseas counterparts.
- Employees at other levels in the organization may be less visionary and cosmopolitan than top managers and less experienced in working with people from different cultures. They may lack knowledge of the strategic context in which the relationship makes sense and see only the operational ways in which it does not.
- People just one or two tiers from the top might oppose the relationship and fight to undermine it. This is especially true in organizations that have strong independent business units.
- Termination of personal relationships, because managers leave their positions in the companies, is a potential danger to the partnership.

Firms have to be aware of these potential problems before they go into a relationship, because only in that way can they take action to prevent the dissolution phase. By jointly analysing the extent and importance of the attenuating factors, the partners will become more aware of the reasons for continuing the relationship, in spite of the trouble they are already in. Moreover, this awareness increases the parties’ willingness to engage in restorative actions, thus trying to save the relationship from dissolution (Tähtinen and Vaaland, 2006).
10.6 Reverse marketing: from seller to buyer initiative

Reverse marketing describes how purchasing actively identifies potential subcontractors and offers suitable partners a proposal for long-term cooperation. Similar terms are proactive procurement and buyer initiative (Ottesen, 1995). In recent years the buyer–seller relationship has changed considerably. The traditional relationship, in which a seller takes the initiative by offering a product, is increasingly being replaced by one in which the buyer actively searches for a supplier that is able to fulfil its needs.

Today, many changes are taking place in the utilization of the purchasing function:

- Reduction in the number of subcontractors.
- Shorter product life cycles, which increase the pressure to reduce the time to market (just in time).
- Upgraded demands on subcontractors (zero defects). In addition, firms are demanding that their suppliers become certified. Those that do not comply may be removed from the approved supplier list.
- Purchasing that no longer just serves the purpose of getting lower prices. The traditional arm's-length relationships are increasingly being replaced by long-term partnerships with mutual trust, interdependence and mutual benefits.

Implementing a reverse marketing strategy starts with fundamental market research and with an evaluation of reverse marketing options (i.e. possible suppliers). Before choosing suppliers the firm may include both present and potential suppliers in the analysis as well as current and desired activities (Figure 10.8).

Based on this analysis the firm may select a number of suitable partners as suppliers and rank them in order of preference.

Figure 10.8 Supplier development strategies

<table>
<thead>
<tr>
<th></th>
<th>Current activities</th>
<th>New activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing suppliers</td>
<td>Intensify current activities</td>
<td>Develop and add new activities</td>
</tr>
<tr>
<td>New potential suppliers</td>
<td>Replace existing suppliers Add suppliers: secure deliveries</td>
<td>Develop new activities not covered by existing suppliers</td>
</tr>
</tbody>
</table>

10.7 Internationalization of subcontractors

In Chapter 3 the internationalization process was described as a learning process (the Uppsala school). Generally speaking it is something that can be described as a gradual internationalization. According to this view the international development of the firm
is accompanied by an accumulation of knowledge in the hands of management and by growing capabilities and propensities to manage international affairs. The main consequence of this way of thinking is that firms tend to increase their commitment towards foreign markets as their experience grows. The number of adherents to this theory has grown, but there has also been much criticism of it.

The main problem with the model is that it seems to suggest the presence of a deterministic and mechanistic path that firms implementing their internationalization strategy must follow. Sometimes it happens that firms leapfrog one or more stages in the establishment chain; at other times firms stop their internationalization altogether (Welch and Luostarinen, 1988).

Concerning internationalization among contractors and subcontractors, there is a central difference. The internationalization of subcontractors is closely related to their customers. The concept of subcontractor indicates that the strategies of such a firm, including its internationalization strategy, cannot be seen in isolation from the strategies of its partner, the contractor.

Systems supplies result in the development of a new layer of subcontractors (second-tier subcontractors). Through the interaction between a system supplier and a domestic main contractor the system supplier can get access to the network of a global contractor (the dotted line in Figure 10.9) because of the network/contract between the contractor and the global contractor. For example, a Japanese car seat supplier supplies the Japanese Toyota factory (domestic main contractor). This can eventually give the supplier access to other Toyota factories around the world (global contractors) and their global networks.

In many cases the collaboration between the subcontractors will be characterized by exchange of tacit, not easily transferable, knowledge. The reason for this is that the complete subsystem is frequently based on several fields of competence, which have to be coordinated by use of tacit knowledge and communication. In the case of the Japanese car seat supplier, the system supplier should have a tight relationship with the subcontractors (suppliers of leather head rest, etc.) in order to adapt the car seat to the individual car models. (See also Exhibit 10.1.)

Figure 10.9 Possible internationalization of system suppliers
Exhibit 10.1 An example of Japanese network sourcing: the Mazda seat-sourcing case

Mazda adopts a policy of splitting its seat purchases between two suppliers, Delta Kogyo and the Toyo Seat Company. The present division is approximately 60 per cent to Delta and 40 per cent to Toyo. Each of these companies is responsible for different models of seats. Note that each individual item, such as a seat for the Mazda 626, is single sourced for the product life cycle of typically three to five years, but seat production in general is, in effect, dual sourced.

Both Delta Kogyo and the Toyo Seat Company are informally assured of a certain percentage of the Mazda seat business at any one time. This percentage is approximately one-third of the total Mazda seat purchases for each of them. Thus each firm has an assured long-term share of Mazda’s seat business. The last third of the Mazda seat business was available to whichever of the suppliers had performed the best over the life cycle of previous car models.

The two seat makers rely on Mazda for a very high percentage of their business. In the case of Delta Kogyo, Mazda business represents around two-thirds of its total sales. In addition, both suppliers are members of Mazda’s keiretsu (network) and hence come into direct contact with each other on a regular basis. Additionally, since they are direct competitors for only a third of Mazda’s seat business, there is a significant degree of openness between the two firms. This openness in some instances takes the form of cooperation in solving mutual or individual problems, because the other seat supplier is often in a better position to give advice than Mazda itself.

However, competition for the remaining third of the Mazda seat business is very intense, since both firms know that they have only one chance to gain the orders for a new car model every three to five years. Either firm can obtain new business as long as the other does not fall below 33 per cent of Mazda’s total seat purchases. A situation has been created in which there is creative tension between cooperation and competition.

Indeed, when one of the suppliers approaches the lower limit of its 33 per cent supply Mazda typically uses its own engineers, and possibly those of the supply competitor, to help the weaker supplier in terms of a joint value analysis/value engineering programme. Because neither supplier wants to be forced into this situation both will work diligently to avoid this fate – and at the same time to enhance their own competitiveness.

Mazda is careful to ensure that neither supplier is forced into a situation of unprofitability, since this would obviously mean that Mazda would suffer in the long term. This is not to say that either supplier is allowed to make excessive profits. Indeed profit as a percentage of sales is roughly equalized throughout the supply network, including the Mazda organization itself. During recessionary periods Mazda and its network of suppliers would make no more than about 2 per cent profit on sales. Thus members of the supply network stand or fall together, increasing the shared bonds and the willingness to help any member of the network.


10.8 Project export (turnkey contracts)

This chapter has dealt mainly with sourcing (subcontracting) in the industrial market. Although marketing of subsupplies to international projects has a number of similarities with subsupplies in the industrial market in general, it also has the characteristics of the special marketing situation in the project market: for example, the long and often very bureaucratic selection of subsuppliers for ad hoc supplies.

The subsupplier market in project export, however, is also very internationalized, and the main part of marketing should be conducted in those centres or countries where the main contractor is domiciled. For example, London is the domicile of a number of building contracting businesses, which work in those countries that used to be in the British Empire.
Chapter 10  International buyer–seller relationships

Project export is a very complex international activity, involving many market players. The preconditions for project export are a technology gap between the exporting and importing countries and that the exporter possesses the specific product and technology know-how that is being demanded in the importing country.

Project export involves supplies or deliveries that contain a combination of hardware and software. When the delivery is concluded it will constitute an integrated system that is able to produce the products and/or the services, which the buyer requires. An example of this type of project is the construction of a dairy in a developing country.

**Hardware** is the blanket term for the tangible, material or physical contribution of the project supply. Hardware is composed of buildings, machines, inventory, transport equipment, etc., and is specified in the quotation and contract between buyer and seller in the form of drawings, unit lists, descriptions and so on.

**Software** is the blanket term for the intangible contributions in a project supply. Software includes know-how and service. There are three types of know-how:

1. **technology know-how**, comprising product, process and hardware know-how;
2. **project know-how**, comprising project management, assembly and environmental know-how;
3. **management know-how**, which in general terms involves tactical and operational management, and specifically includes marketing and administrative systems.

Service includes advisory services and assistance in connection with various applications and approvals (environmental approval, financing of the project, planning permission, etc.).

The marketing of projects is different from the marketing of products in the following respects:

- Decision of purchase, apart from local business interests, often involves decision processes in national and international development organizations. This implies the participation of a large number of people and a heavily bureaucratic system.
- The product is designed and created during the negotiation process, where the requirements are put forward.
- It often takes years from the disclosure of needs to the purchase decision being taken. Therefore total marketing costs are very large.
- When the project is taken over by the project buyer, the buyer–seller relations cease. However, by cultivating these relations before, during and after the project, a ‘sleeping’ relationship can be woken again in connection with a new project (Hadjikhani, 1996).

Financing a project is a key problem for the seller as well as the buyer. The project’s size and the time used for planning and implementation result in financial demands that make it necessary to use external sources of finance. In this connection the following main segments can be distinguished. The segments arise from differences in the source of financing for the projects:

- Projects where **multilateral organizations**, such as the World Bank or regional development banks, are a primary source of finance.
- Projects where **bilateral organizations** are a primary or essential source of finance.
- Projects where a **government institution** acts as buyer. This was normal in the command economies, where government companies acted as buyers. However, it can also be found in liberal economies: for example, in connection with the development of social infrastructure or the building of a bridge.
- Projects where a **private person or firm** acts as buyer, as when Unilever builds a factory in Vietnam for the production of ice cream.
For large-scale projects, like a new airport, there may be many partners forming a consortium, where we will have the concept of a 'leader firm', but each partner would undertake financing, organization, supervision and/or construction etc., of a part of the project on the basis of their specific expertise.

Organizing export projects involves establishing an interaction between different firms from the West on the one side, and firms and authorities typically from developing countries on the other. Creating or adapting an organization that is able to function under these conditions is a precondition of project marketing.

### Table 10.2 Advantages and disadvantages of buyer–seller relationships for contractor and subcontractor

<table>
<thead>
<tr>
<th>Contractor (buyer)</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The contractor is flexible by not investing in manufacturing facilities.</td>
<td>The availability of suitable manufacturers (subcontractors) cannot be assumed.</td>
</tr>
<tr>
<td></td>
<td>The subcontractor can source the products more cheaply (because of e.g. cheaper labour costs) than by own production.</td>
<td>Outsourcing tends to be relatively less stable than in-house operations.</td>
</tr>
<tr>
<td></td>
<td>The contractor can concentrate on in-house core competences.</td>
<td>The contractor has less control over the activities of the subcontractor.</td>
</tr>
<tr>
<td></td>
<td>Complement of the contractor’s product range.</td>
<td>Subcontractors can develop into competitors.</td>
</tr>
<tr>
<td></td>
<td>New ideas for product innovation can be carried over from the subcontractor.</td>
<td>Quality problems of outsourced products can harm the business of the contractor.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assistance to the subcontractor may increase the costs of the whole operation.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Subcontractor (seller)</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Access to new export markets because of the internationalization of the contractor (especially relevant for the so-called late starters).</td>
<td>Risk of becoming dependent on the contractor because of expanding production capacity and concurrent overseas expansion of sales and marketing activities in order to meet the demands of the contractor.</td>
</tr>
<tr>
<td></td>
<td>Exploits scale economies (lower cost per unit) through better capacity utilization.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Learns product technology of the contractor.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Learns marketing practices of the contractor.</td>
<td></td>
</tr>
</tbody>
</table>

### 10.9 Summary

This chapter has analysed the buyer–seller relationship from different angles in the internationalized environment. The advantages and disadvantages for the contractor and subcontractor of going into a relationship are summarized in Table 10.2.

The project export situation differs from the ‘normal’ buyer–seller relationship in the following ways:

- The buying decision process often involves national and international development organizations. This often results in very bureaucratic selection of subcontractors.
- Financing of the project is a key problem.
Chapter 10  International buyer–seller relationships

YouTube: Can YouTube get too many marketing partners?

‘The marketing guys love YouTube and the legal guys hate it’.

(Jones and Leamonth, 2007)

YouTube ([www.youtube.com](http://www.youtube.com)) is a video sharing website where users can upload, view and share video clips. YouTube was founded in a garage in February 2005 by three former PayPal employees – Chad Hurley, Steve Chen and Jawed Karim – in the city of San Mateo, California, USA and it was officially launched in December of the same year.

YouTube officially accepts uploaded videos in .WMV, .AVI, .MOV, MPEG and .MP4 formats and converts videos into .FLV (Adobe Flash Video) format after uploading. The extension is then stripped from the file. The different files are stored in obscurely named subdomains. YouTube also converts content to other formats so that it can be viewed outside the website.

Unregistered users can watch most videos on the site, while registered users are permitted to upload an unlimited number of videos. Some videos (e.g. videos containing potentially offensive content) are available only to users aged 18 plus. The uploading of pornography or videos containing nudity is prohibited. Related videos, determined by title and tags, appear on screen to the right of a given video.

In October 2006, Google Inc. announced that it had reached a deal to acquire the company for US$1.65 billion in Google stock. The deal closed on 13 November 2006. The working arrangement is that Google will focus on the search engine technology and the YouTube team will focus on the video content. Google has helped to make YouTube videos more searchable, including tighter integration into Google’s video search product. As cameras become more and more powerful, YouTube video resolution will need to keep pace by encoding videos at higher and multiple bitrates – this is where Google’s infrastructure advantages come into play.

A few notable statistics on YouTube at the time of its acquisition by Google are as follows:

- it is the fastest growing website in Internet history;
- on average 100 million videos are streamed every day;
- 65,000 new video clips are uploaded every day;

Soon after, it became an instant hit among its users. Adobe Flash technology is the preferred choice to play back a wide variety of video content, including movie clips, TV clips and music videos, as well as amateur content such as video blogging and short original videos, thus providing a huge store on the net for keeping video clips and files safe. This is a standard format supported by most browsers, including Internet Explorer, Firefox, Safari and Opera. Videos can be played on some mobile devices and even on the Nintendo Wii game system.

YouTube’s video playback technology is based on Macromedia’s Flash Player. This technology allows the site to display videos with quality comparable to more established video playback technologies (such as Windows Media Player, QuickTime and RealPlayer) that generally require the user to download and install a web browser plug-in in order to view video. Flash also requires a plug-in, but Adobe considers the Flash 7 plug-in to be present on approximately 90 per cent of online computers.

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A few notable statistics on YouTube at the time of its acquisition by Google are as follows:

- it is the fastest growing website in Internet history;
- on average 100 million videos are streamed every day;
- 65,000 new video clips are uploaded every day;
there are more than 13 million unique visitors per month;
- an average user spends 30 minutes on YouTube and most uploaders are repeat visitors themselves;
- 58 per cent of Internet videos are watched on YouTube;
- 20–30 per cent of traffic volume is from the United States;
- while there is a wide range of user demographics, the largest segment of users are 18–35 year-olds.

The ability to embed the external player on any web page turned the tide for YouTube. Once MySpace.com users started adopting YouTube en masse, MySpace.com blocked video links to YouTube. However, MySpace caved under pressure from MySpace users and reinstated access to YouTube content.

The other key driver to YouTube’s user acquisition was the frequency at which popular video content was distributed in a viral manner. Once traffic picked up, roughly every two weeks or so a video would become wildly popular. Soon the time between these super-hit videos started shrinking. The site took off at a scorching pace. Video footage of the South-east Asian tsunami resulted in one of the largest traffic spikes. Other popular clips included Jon Stewart on Crossfire and the infamous Janet Jackson Super Bowl video.

YouTube remains an interesting study in marketing a consumer internet service. While initial responses to the site were tepid, the June 2005 site revamp resulted in viral growth.

Before being purchased by Google, YouTube declared that its business model was advertisement-based, making 15 million dollars per month. Some industry commentators have speculated that YouTube’s running costs – specifically the bandwidth required – may be as high as US$5–6 million per month, thereby fuelling criticisms that the company, like many Internet start-ups, did not have a viably implemented business model. Advertisements were launched on the site beginning in March 2006 (Mikew, 2007).

The copyright balance

YouTube presents perhaps the best example of the fine line video-sharing companies must walk in regard to copyright materials. Besides displaying a fascination with amateur-made videos, YouTube fans have shown they want slicker, professionally crafted content as well. People often upload TV shows or movie clips on YouTube without authorization.

At present, most user-generated sites remove copyrighted materials once notified by the owner. YouTube, which does not pre-screen any of its videos, is very quick to pull videos once it has confirmed that the rightful owner did not authorize the material to be posted on the site.

Marketing partnerships

As YouTube started in late 2005, NBC Universal was demanding that clips of its shows be removed from YouTube. Since then, NBC seems to have changed its mind. In June 2006, NBC and YouTube signed a strategic marketing partnership. NBC would upload promotional video clips of some of its TV shows on YouTube, including Saturday Night Live and The Tonight Show with Jay Leno. In return NBC would also advertise on YouTube and promote the site on some of its TV shows. The companies also launched a contest where viewers of The Office could create and submit their own 20-second promo videos and post them on YouTube.

What NBC was doing was acknowledging the power of YouTube as a marketing vehicle. At the same time, NBC has a vested interest in controlling the marketing message on YouTube.

However, in March 2007, News Corp. and NBC announced that they would create an online video site that would rival the popular YouTube. The site will contain user-generated videos but the emphasis here is on the premium content, showing whole shows and not only video clips as with YouTube. In August 2007, the two companies were finally revealing key details about the joint venture: the site’s name is Hulu.

Such deals do not necessarily mean that YouTube and other video-sharing sites will still not run into legal troubles. Also YouTube needs partnerships with professional media companies (entertainment companies) so it can get high-quality content on the site in a legitimate way.

Since June 2006 YouTube has gone into several partnerships (in Europe alone there are now more than 150 YouTube partners), including with the BBC.

BBC content now appears legitimately on YouTube. Whereas shows such as Top Gear, for example, were often to be found on the site, content will now appear legitimately. Under the terms of the deal, there will be three officially BBC-branded channels on YouTube featuring promo, entertainment and news content.

There will be no full length episodes online, however. Under the non-exclusive partnership, the BBC channels will only contain ‘short-form videos’.
On the News channel, around 30 news clips a day are available, providing ‘up-to-the-minute news and analysis from around the world’, in the words of the BBC. These advertising-funded clips, however, have only been available to users outside the UK.

**Internationalization**
Localized versions of YouTube are available in a number of countries (see Table 1).

**Competitors**
YouTube now competes with a range of domestic competitors, such as RuTube and Mail.ru in Russia, MyVideo (owned by Pro7Sat.1 media group), Sevenload and RTL’s Clipfish in Germany, DailyMotion in France, Tudou in China (see below), Hispavista’s Tu.tv, Libero Video in Italy, Brazil’s Videolog, French-based Dailymotion, Dutch video sharing sites Filmpjes and 123video.nl, and many others.

**Tudou (www.tudou.com)**
Tudou is the largest video sharing website in China, where users can upload, view and share video clips. Tudou went live on 15 April 2005 and by September 2007 used the world’s largest CDN to serve over 55 million videos each day.

Tudou was founded by Gary Wang and Dutchman Marc van der Chijs, whom Wang met while at Bertelsmann Media Group in China. Like many technology start-ups, Tudou began on a shoestring with a raw technology team, practically in a garage. The name Tudou is Chinese Pinyin (Romanized Chinese) for potato. It was previously known as Toodou.com, and changed its domain name to Tudou.com in August 2006 when that domain became available. According to CEO Wang, the name comes from the English idiom ‘couch potato’.

Tudou states it is one of the world’s largest bandwidth users, moving more than 1 petabyte per day to 7 million users. YouTube serves more videos per day, but Tudou’s content is much longer on average, so its total delivered video is much larger: about 15 billion minutes versus 3 billion for YouTube.

The Shanghai-based service uses Adobe Flash technology to publish more than 20,000 new videos each day, including amateur content such as videoblogging and original videos, movie and TV clips, and music videos. Unregistered users can watch videos on the site, while registered users are permitted to upload an unlimited number of videos, using online and Windows-based upload tools.

**Sources:**

### Table 1 Localization of YouTube (in chronological order)

<table>
<thead>
<tr>
<th>Country</th>
<th>URL</th>
<th>Languages</th>
<th>Launch date</th>
</tr>
</thead>
<tbody>
<tr>
<td>World (USA)</td>
<td><a href="http://www.youtube.com/">http://www.youtube.com/</a></td>
<td>American English</td>
<td>15 February 2005</td>
</tr>
<tr>
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<td><a href="http://nl.youtube.com/">http://nl.youtube.com/</a></td>
<td>Dutch</td>
<td>19 June 2007</td>
</tr>
<tr>
<td>France</td>
<td><a href="http://fr.youtube.com/">http://fr.youtube.com/</a></td>
<td>French</td>
<td>19 June 2007</td>
</tr>
<tr>
<td>Spain</td>
<td><a href="http://es.youtube.com/">http://es.youtube.com/</a></td>
<td>Spanish</td>
<td>19 June 2007</td>
</tr>
<tr>
<td>United Kingdom</td>
<td><a href="http://uk.youtube.com/">http://uk.youtube.com/</a></td>
<td>British English</td>
<td>19 June 2007</td>
</tr>
<tr>
<td>Ireland</td>
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<td>Italian</td>
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<td>Brazil</td>
<td><a href="http://br.youtube.com/">http://br.youtube.com/</a></td>
<td>Brazilian Portuguese</td>
<td>19 June 2007</td>
</tr>
<tr>
<td>Hong Kong</td>
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<td>Traditional Chinese</td>
<td>17 October 2007</td>
</tr>
<tr>
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<td>Traditional Chinese</td>
<td>18 October 2007</td>
</tr>
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<td>Australia</td>
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<td>German</td>
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<td><a href="http://in.youtube.com/">http://in.youtube.com/</a></td>
<td></td>
<td>7 May 2008</td>
</tr>
</tbody>
</table>
Questions
You have just received your BA degree in International Marketing and are just starting your first job at YouTube in the Marketing Department. The YouTube Marketing Manager has given you the task of delivering a report within a week containing answers to the following questions:

1. Should YouTube also try to penetrate the Chinese market? If so, how?
2. How would you characterize the relationship between YouTube and its marketing partners?
3. How should YouTube select future marketing partners?

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

Questions for discussion

1. What are the reasons for the increasing level of outsourcing to international subcontractors?
2. Describe the typology of subcontractors based on the differences in the contractor/subcontractor relationship.
3. Explain the shift from seller to buyer initiative in subcontracting.
4. Explain the main differences between the US and the Japanese subsupplier systems.
5. How are project exports/turnkey projects different from general subcontracting in the industrial market?
6. Project export is often characterized by a complex and time-consuming decision-making process. What are the marketing implications of this for the potential subcontractor?

References


Chapter 10  International buyer–seller relationships


At the beginning of 2007 Ingvar Kamprad, founder of the Swedish furniture retailing giant IKEA, is concerned 'his' firm may be growing too quickly. He used to be in favour of rapid expansion, but he has now become worried that the firm may be forced to close stores in the event of a sustained economic downturn.

Although IKEA is one of Sweden’s best-known exports, it has not in a strict legal sense been Swedish since the early 1980s. The store has made its name by supplying Scandinavian designs at Asian prices. It has managed its international expansion without stumbling. Indeed, its brand – which stands for clean, green and attractive design and value for money – is as potent today as it has been at any time in more than 50 years in business.

The parent of all IKEA companies – the operator of 207 of the 235 worldwide IKEA stores – is Ingka Holding, a private Dutch-registered company. Ingka Holding (which is named after the first and last name of the founder) belongs entirely to Stichting Ingka Foundation. This is a Dutch-registered, tax-exempt, non-profit-making legal entity, which was given the shares of Ingvar Kamprad in 1982. Stichtingen, or foundations, are the most common form of not-for-profit organization in the Netherlands; tens of thousands of them are registered.

Most Dutch stichtingen are tiny, but if Stichting Ingka Foundation were listed it would be one of the Netherlands’ ten largest companies by market value. Its main asset is the Ingka Holding group, which is conservatively financed and highly profitable.

Valuing the Ingka Holding Group is awkward, because IKEA has no direct competitors that operate globally. Shares in Target, a large, successful chain of stores in the United States that makes a fifth of its sales from home furnishings, are priced at 20 times the store’s latest full-year earnings. Using that price/earnings ratio, the Ingka Holding Group is worth €28 billion ($36 billion).

Now Ingvar Kamprad has heard that the top management of the IKEA Group plans to make a further international expansion, into South America, because of the growth opportunities there. Kamprad is very sceptical about these plans and his personal assistant has asked you, as an international marketing specialist, to get an expert opinion about the plans . . .
1969  The first IKEA store in Denmark opens.
1973  The first store outside Scandinavia is opened in Spreitenbach, Switzerland.
1974  The first IKEA store opens in Germany, in Munich.
1975  The first IKEA store in Australia.
1976  The first IKEA store in Canada.
1977  The first IKEA store in Austria.
1978  The first IKEA store in Singapore.
1979  The first IKEA store in the Netherlands.
1980  The first IKEA store in the Canary Islands.
1981  The first IKEA stores in France and Iceland.
1983  The first IKEA store in Saudi Arabia.
1984  The first IKEA stores in Belgium and Kuwait.
1985  The first IKEA store in the United States.
1987  The first IKEA stores in the United Kingdom and Hong Kong.
1989  The first IKEA store in Italy.
1990  The first IKEA stores in Hungary and Poland.
1991  The first IKEA stores in the Czech Republic and the United Arab Emirates.
1992  The first IKEA stores in Mallorca and Slovakia.
1994  The first IKEA store in Taiwan.
1996  The first IKEA stores in Finland, Malaysia and mainland Spain.
1997  IKEA appears on the Internet with the World Wide Living Room website.
1998  The first IKEA store in mainland China.
2000  First IKEA store opens in Russia (Moscow).
2001  First stores in Israel (Netanya) and Greece (Thessaloniki).
2004  First stores in Portugal (Lisbon).
2005  First stores in Turkey (Istanbul).
2006  First stores in Ireland (Dublin).
2007  First stores in Romania (Bucharest).

About corporate IKEA
IKEA has grown into the world’s largest furniture retailer, with 237 stores in 35 countries (2007) and a workforce of some 90,000 people since its first outlet opened in Älmhult in 1958. The firm is noted for its rapid international expansion and has recently set up stores in Eastern Europe and Russia.

IKEA’s success in the retail industry can be attributed to its vast experience in the retail market, product differentiation and cost leadership. The company is one of the world’s most successful multinational retailing firms, operating as a global organization, with its unique concept that its furniture is sold in kits that are assembled by the customer at home. The firm, which remains in private ownership, racked up sales of nearly €15 billion in 2002.

There are about 12,000 products in the total IKEA product range. Each store carries a selection of these 12,000 products depending on store size. The core range is the same worldwide. IKEA accounts for just 5 per cent to 10 per cent of the furniture market in each country in which it operates. More important is that the awareness of the IKEA brand is much bigger than the size of the company because IKEA is far more than a furniture merchant. It sells a Scandinavian lifestyle that customers around the world embrace.

The IKEA business idea is to offer a wide range of home furnishing items of good design and function, excellent quality and durability, at prices so low that the majority of people can afford them. The company targets the customer who is looking for value and is willing to do a little bit of work serving themselves, transporting the items home and assembling the furniture. The typical IKEA customer is a young low-to-middle-income family.

As mentioned, IKEA’s retailing, is based on a franchise system. Inter IKEA Systems B.V., located in Delft (the Netherlands), is the owner and franchisor of the IKEA concept. The IKEA Group is a private group of companies owned by a charitable foundation in the Netherlands. It is active in developing, purchasing, distributing and selling IKEA products. The IKEA experience is more than just products, however, it is a retail concept. For the concept to work all aspects must be in place. IKEA products are therefore sold only in IKEA stores franchised by Inter IKEA Systems B.V. However, most of the global product policy (including product development) and the global marketing is centralized to the Swedish part of the company, IKEA of Sweden.

Product development
The team behind each product consists of designers, product developers and purchasers who get together to discuss design, materials and suitable suppliers. Everyone contributes with their specialist knowledge. Purchasers, for example, use their contacts with suppliers all over the world via IKEA Trading Service Offices. Who can make this product of the best quality for the right price at the right time? Products are often developed in close cooperation with suppliers and often only one supplier is appointed to supply all the stores around the world.

IKEA does not have its own manufacturing facilities but uses subcontracted manufacturers all over the world. In order to keep costs low, IKEA shoppers are producers – half producers and half consumers. In other words, they have to assemble the products themselves. To facilitate shopping, IKEA provides catalogues, tape measures, shopping lists and an internet website to help the consumer with fitting the furniture into the room. Car roof racks are available for purchase at cost and
Part III Market entry strategies

IKEA pick-up vans/mini-trucks are available to rent. IKEA’s success is based on the relatively simple idea of keeping the cost between manufacturers and customers down. Costs are kept under control starting at the design level of the value-added chain. IKEA also keeps costs down by packing items compactly in flat standardized packaging and stacking them as high as possible to reduce storage space during and after distribution.

Effective marketing through catalogues is what usually attracts the customer first; what keeps customers coming back is good service. IKEA believes that a strong in-stock position, in which the most popular style and design trends are correctly anticipated, is crucial to keep customers satisfied. For that IKEA depends on leading-edge technology and the company has developed its own global distribution network. By utilizing control points in the distribution cycle the firm is able to insure timely delivery of products to retail stores all over the world.

IKEA thinks that consumer tastes are merging globally. To take one example, IKEA, which has been exporting the ‘streamlined and contemporary Scandinavian style’ to the United States since 1985, found several opportunities to export US style to Europe, as Europeans picked up on some US furnishing concepts. To respond to this new demand IKEA now markets ‘American-style’ furnishings in Europe.

Bureaucracy is fought at all levels in the organization. Kamprad believes that simplicity and common sense should characterize planning and strategic direction. In addition, the culture emphasizes efficiency and low cost, which is not to be achieved at the expense of quality or service. Symbolic policies, such as only flying economy class and stay at economical hotels, employing young executives and sponsoring university programmes, have been integrated into the corporate culture and have further inspired the spirit of entrepreneurship in the organization. For instance, all design teams enjoy complete autonomy in their work, but are expected to design new and appealing products regularly.

IKEA has improved its value chain by a cooperative focus on suppliers and customers. The firm emphasizes centralized control and standardization of the product mix.

In order to maintain cost leadership in the market, internal production efficiencies must be greater than those of competitors. Under IKEA’s global strategy suppliers are usually located in low-cost nations, with close proximity to raw materials and reliable access to distribution channels. These suppliers produce highly standardized products intended for the global market, which size provides the firm with the opportunity to take advantage of economies of scale. IKEA’s role is not only to globally integrate operations and centrally design products, but also to find an effective combination of low cost, standardization, technology and quality.

In the case of IKEA, a standardized product strategy does not mean complete cultural insensitivity. The company is, rather, responding to globally emerging consumer tastes and preferences. Retail outlets all over the world carry the basic product range, which is universally accepted, but also place great emphasis on the product lines that appeal to local customer preferences.

IKEA has modified the value chain approach by integrating the customer into the process and introducing a two-way value system between customers, suppliers and IKEA’s headquarters. In this global sourcing strategy the customer is a supplier of time, labour, information, knowledge and transport. On the other hand, the suppliers are customers, receiving technical assistance from IKEA’s corporate technical headquarters through various business services. The company wants customers to understand that their role is not to consume value, but rather to create it.

IKEA’s role in the value chain is to mobilize suppliers and customers to help them further add value to the system. Customers are clearly informed in the catalogues of what the firm’s business systems provide, and what they are expected to add to the final process.

In order to furnish the customer with good quality products at a low cost, the firm must be able to find suppliers that can deliver high-quality items at low cost per unit. The company’s headquarters provides carefully selected suppliers with technical assistance, leased equipment and the necessary skills needed to produce high-quality items. This long-term supplier relationship not only produces superior products, but also adds internal value to the suppliers. In addition, this value chain modification differentiates IKEA from its competitors.

Directly linked to its mission statement, IKEA has built its cost leadership position on these processes. It furnishes the customer with a quality product with components derived from all over the world utilizing multilevel competitive advantages, low cost logistics, and large simple retail outlets in suburban areas. Furthermore, cost leadership has been effectively incorporated into the organization’s culture through symbols and efficient processes. In return for high sales volumes IKEA accepts low profit margins. In addition, IKEA’s marketing emphasis on budget prices and good value clearly communicates cost leadership to customers. IKEA’s strategy demonstrates that the perception that cost leadership equals poor quality in products and services is incorrect. High quality is associated with input and process variables. Cost reduction, on the other hand, does not mean reducing the quality of these variables, but rather doing things better, and more efficiently. Cost leadership is a part of the management process and culture.
From this discussion it is possible to conclude that IKEA effectively aligns its cost leadership platform, focusing on the needs of its target market segment. Differentiation, as indicated in the modification of the value chain, also focuses on this particular segment.

The internationalization of IKEA
IKEA has applied a conservative policy to internationalization. As a general rule, the firm does not enter a new potential market by opening a retail outlet. Instead, a supplier link with the host nation is established. This is a strategic, risk-reducing approach in which local suppliers can provide valuable input on political and legal, cultural, financial and other issues that provide opportunities and/or threats to the IKEA concept. In the 1970s and 1980s IKEA concentrated its international expansion in Europe and in North America mainly through company-owned subsidiaries. On the other hand, over the past 20 years franchising has been extensively utilized in expanding to other areas of the world.

Expansion by franchising
IKEA approaches unknown, relatively small and high risk markets by franchising. Franchises are granted by Inter IKEA Systems B.V. as part of a detailed international expansion plan. Serious applicants are carefully researched and evaluated and franchises are granted only to companies and/or individuals with strong financial backing and a proven record in retail. Franchisees have to carry basic items, but have the freedom to design the rest of the product mix to fit local market needs. The basic core items number approximately 12,000 simple and functional products. The centralized head office is actively involved in the selection processes and provides advice. In addition, all products have to be purchased from IKEA’s product lines. In order to maintain service, quality and logistic standards, individual franchisees are periodically audited and compared to overall corporate performance. Extensive training and operational support is provided from headquarters. All franchisees pay franchise fees to IKEA Holdings. All catalogues and promotional advertising is the responsibility of headquarters. Franchising has been used as a vehicle for the company’s generic focus strategy.

Balance of autonomy and strategic direction
As IKEA continues to expand overseas the significance of centralized strategic direction will increase. Naturally rapid internationalization will trigger a range of challenges imposed on the headquarters, such as the following:

- The complexity of the logistics system will increase.
- It will be more difficult to respond to national needs and cultural sensitivity issues.
- Franchisees may demand more control over operations.
- Emerging demographic trends will force the organization to broaden its focus strategy to respond to varying nation-level consumer groups.

With all these challenges emerging it might be very difficult to maintain a central organizational structure. The best way to meet these challenges is to find the proper balance between country level autonomy and centralized intervention. With reference to IKEA's long-term relationship and control over its suppliers in exchange for quality assurance, technology transfers and economies of scale factors may trigger potential suppliers to integrate forward and produce competitive products for IKEA's local competitors. With logistics complications and long lead times IKEA is forced to maintain high control levels over its suppliers. For instance, if the supplier responsible for the screws component to a table cannot deliver on time, the supplier of the table-top has to adapt its production to the new scenario. Without IKEA's centralized logistics system this example could lead to severe store shortages, leading to losses in sales.

The Brazilian market for furniture
According to the Brazilian Association of Furniture Manufacturers (ABIMOVEI), the Brazilian furniture market was estimated at approximately $3.6 billion in 2000, of which about $111 million were imports. The market can be broken down into three main categories: residential (60 per cent), office (25 per cent), and institutional organizations, such as schools, hospitals and hotels (15 per cent).

Brazil has 4.6 million hectares of planted forests, almost all of which is located in the south of the country. Wood from such forests is mainly used in the production of furniture, pulp and paper. The main furniture production centres, as well as the most important markets, are also located in southern Brazil.

The production of particleboard, which was 494,000 m³ in 1990, jumped to 1.3 million m³ in 1998, an annual growth rate of 13 per cent. This pattern is expected to continue in the near future. Approximately 80 per cent of Brazil’s particleboard production is consumed by the furniture sector. A smaller volume is marketed by resellers and destined for small furniture manufacturers.

As the Brazilian furniture market continues to reap more and more of its profits from exports, production is increasingly tailored to satisfy market niches that demand differentiated products. To meet this need the Brazilian industry is investing more in design and development, although investments are smaller in comparison to investments made in the United States, Italy and Germany. Brazil is also importing state-of-the-art equipment to address quality issues mandated by
foreign markets, e.g. the US, Italian and German ones. Today the segment requires import of equipment such as wood-drying machinery, finishing machinery and tools.

According to the Brazilian Furniture Association there are approximately 13,500 Brazilian furniture manufacturers, most of which are small. These firms are typically family-owned companies whose capital is exclusively Brazilian. Historically, the greater proportion of Brazilian manufacturers have been concentrated in areas of large population density in southern Brazil.

The process of trade liberalization initiated in 1990 introduced significant changes in Brazil’s trade regime, resulting in a more open and competitive economy.

The Brazilian economy was deeply affected by the crises in the Asian and Russian markets. As a consequence the currency suffered deeply from the devaluation in January 1999. Brazilian imports of furniture were also seriously affected by this devaluation, and the industry is currently suffering from the unfavourable (for Brazilians) real-dollar exchange rate.

US exports of furniture to Brazil reached $43 million in 2000 (39 per cent of total Brazilian furniture imports) and are expected to decrease to $36 million in 2001. US exports to Brazil were particularly strong in the area of seats, new-design office furniture, and high-end, high-value-added residential furniture. Market analysts estimate that in the next three to four years imports of institutional furniture, such as that used in hospitals and hotels, will increase considerably, mainly imports from the United States.

**Imports**

Brazilian furniture imports totalled $111 million in 2000, and decreased to $96 million in 2001. This represents 3 per cent of the total furniture market in Brazil. The USA holds 39 per cent of the imported furniture market, followed by Germany with 36 per cent, Italy with 10 per cent, and other countries with 15 per cent.

**End-user analysis**

Different industry segments, such as automotive, aviation and furniture (residential, commercial and institutional) make up the Brazilian market. Each of those areas has its own purchasing approach. For example, the automotive industry may import directly from its headquarters and, in the case of the furniture industry, the end user might be an importer or a store chain.

It is important to mention that there are no major distributor chains in Brazil. Most furniture imports are made through direct importers and, in a smaller proportion, local manufacturers wishing to complement their product line.

High-end furniture and mattresses are commonly imported into Brazil by direct importers or furniture stores. Interior decorators and architects are also considered decision makers, since they are the ones who recommend brands and styles to their final clients.

**Import climate**

Brazil has a tariff-based import system and has simplified the process for obtaining import licences. Import tariffs are levied ad valorem on the CIF value of the imports. Import tax (IPI – See below) for furniture varies from 5–15 per cent.

The industrial products tax (IPI) is a federal tax levied on most domestic and imported manufactured products. It is assessed at the point of sale by the manufacturer or processor in the case of domestically produced goods, and at the point of customs clearance in the case of imports. The tax rate varies by product and is based on the product’s CIF value plus duties.

Interest rates in Brazil are high (estimated at 18.3 per cent per year in June 2001) and discourage demand for bank loans. The few sources of funds available for long-term financing are provided by the National Bank for Economic and Social Development (BNDES), through leasing operations and by foreign government export agencies.

**Distribution and business practices**

Major end users of furniture will only purchase from well-known and reliable suppliers. Although large end users may import directly from foreign suppliers, they are always concerned with after-sales service. Technical assistance and availability of replacement parts are considered important factors in the purchasing decision. In some segments, such as commercial and institutional, this factor may determine from whom the end user will purchase. A physical presence in the market, either through an agent or a manufacturing plant, increases the end user’s trust in the supplier’s commitment to this market and facilitates the sale.

**The retail scene in Brazil**

For many years the popular wisdom in Brazil was that shopping malls were only for rich people. The 1984 opening of Center Norte mall in São Paulo changed all that. It is strategically placed next to a subway and a bus terminal. Proximity to mass transit is essential, since many low-income consumers do not own cars. Center Norte was followed by other shopping malls in other cities, such as Rio de Janeiro and Belo Horizonte.

Economic instability, difficulties in obtaining financing at reasonable interest rates and customs barriers for certain imports have slowed down the the entry of foreign retailers to Brazil. Among the international chains that have been attracted by Brazil’s 80 million consumers are JC Penney, Zara and the Dutch chain.
C&A, that leads the fashion sector in Brazil. International franchisors such as Benetton, Lacoste, Hugo Boss, Polo Ralph Lauren and McDonald’s operate in Brazilian shopping centres, some on a large scale.

Those who have set up shops in Brazil have varied results directly related to their ability to adapt to local conditions. Sears, for example, had extremely negative results, due to the centralization of decision making in Chicago. Similarly, Zara tried to bring to Brazil its European management policy and market approach and is now facing poor financial results. The contrast is the excellent performance of C&A, whose policies and procedures were defined in Brazil for the local market. JC Penney acquired a local chain (Renner) and accelerated its expansion with good results (ICSC Worldwide Commission, 2000).


Questions

1 Until now IKEA international marketing strategy has been tightly and centrally controlled by corporate headquarters. However, high local pressures emerging due to demographic and cultural differences might force the local IKEA shops to take strategic initiatives to respond to local market needs. In this connection discuss the regional headquarters and transnational organization (presented in Chapter 9) as hierarchical ‘entry mode’ alternatives to the very centralized strategy emanating from IKEA’s headquarters.

2 IKEA has not yet explored joint venture and strategic alliances strategies. Evaluate the pros and cons regarding these two entry strategies versus the traditional IKEA entry mode of franchising.

3 Should IKEA penetrate the South American market by establishing a shop in Brazil?

4 In the light of the political and economic situation in South America, outline the sourcing concept that should be implemented in the South American market.
**Chief executive officer of Autoliv Inc., Lars Westerberg, is in the middle of a board of directors’ meeting in Stockholm in September 2006, discussing how it is possible to further globalize Autoliv. He takes out a situation report for the business area of air bags. As there are a couple of new members on the board Lars takes the opportunity to give a broader introduction to the business area than he usually does. The following is Lars Westerberg’s status report.**

**Situation report for the business area of air bags**

**Business concept**

Autoliv Inc., which is a Fortune 500 company, is the world’s largest automotive safety supplier with sales to all the leading car manufacturers in the world. Autoliv’s shares are listed on the New York Stock Exchange and on the Stockholm Stock Exchange. The company develops, markets and manufactures airbags, seat belts, safety electronics, steering wheels, anti-whiplash systems, seat components and child seats. Autoliv has 80 subsidiaries (production plants) and joint ventures in 30 vehicle-producing countries, with over 40,000 employees. In addition, Autoliv has technical centres in nine countries with 20 crash test tracks – more than any other automotive safety supplier.

Autoliv aims to develop, manufacture and market systems and components worldwide for personal safety in automobiles. This includes the mitigation of injuries to automobile occupants and pedestrians and the avoidance of accidents. In this aspect, Autoliv wants to be the systems supplier and the development partner to car producers that satisfy all the needs in the area of personal safety. To fulfil its business concept Autoliv has strong product lines:

- frontal and side-impact airbags (including all key components such as inflators with initiators, textile cushions, electronics with sensors and software, steel and plastic parts);
- seat belts (including all key components such as webbing, retractors and buckles);
- seat belt features (including pretensioners, load limiters, height adjusters and belt grabbers);
- seat SubSystems (including anti-whiplash systems);
- steering wheels (including integrated driver airbags);
- roll-over protection (including sensors, pretensioners and airbag curtains).

In 2006 the penetration rate of curtain airbags in new cars was 50 per cent in Europe, 35 per cent in North America, 20 per cent in Japan and 10 per cent in the rest of the world.

The following concentrates on the business area of air bags.

**Production strategy**

Autoliv has final assembly of restraint systems, located close to major customers’ plants for just-in-time supply (see Figure 1). Most of the component production (textiles and stamped metal components, etc.) has been outsourced during the past five years.

Since major automobile manufacturers are continually expanding production into more countries, it is also Autoliv’s strategy to have manufacturing capacity where the major vehicle manufacturers have or are likely to set up production facilities. As a consequence Autoliv has more plants for automotive safety products in more countries than any other supplier.
**The product: the air bag**

Even the best belt designs cannot prevent all head and chest injuries in serious head-on crashes. This is where air bags help, by creating an energy-absorbing cushion between an occupant’s upper body and the steering wheel, instrument panel or windshield. Independent research has shown that driver deaths in head-on crashes are about 20 per cent lower in cars with frontal air bags than in similar cars with belts only. In all kinds of crash deaths are down by about 15 per cent over and above lives already being saved by belts.

Although air bags may seem complicated they are in fact relatively simple. In moderate and severe head-on crashes sensors signal inflators to fill the bags with harmless gas. The bags fill in a fraction of a second and begin deflating the instant they contact people, but in the United States a few occupants have died of broken necks. Peak inflation is in less than 1/4th of a second, faster than the blink of an eye. The speed and force of air bag inflation may occasionally cause injuries, mostly minor abrasions or bruises, but in the United States some occupants have died of broken necks caused by air bags that inflated with great force. Those at the greatest risk of injury caused by an air bag are those who drive or ride unbelted, small children, short or obese adults, and certain disabled people.

Injury risk from the bag itself can be reduced by choosing a driving or passenger position that does not put your face or chest close to the steering wheel or instrument panel. The combination of seat belt and air bag provides maximum protection in all kinds of crash.

Together with Volvo Autoliv has also developed the first side air bags to protect drivers and front-seat passengers in side-impact crashes. These bags are typically smaller than frontal air bags and they inflate more quickly. Volvo was the first manufacturer to offer side air bags in its 850 model in 1994. Volvo’s bag is mounted on the outside of driver and front-seat passenger seat backs. Since 1996 side bags have been standard in all Volvo models.

The history of air bags goes back to the early 1950s. The product idea was patented in 1951 by Walter Linderer from Munich. It was in the United States, however, that the concept came into existence, driven by the North Americans’ reluctance to use seat belts and hindered by the car manufacturers, which initially ridiculed the idea. In 1981 only 2,636 air bag systems were produced.

However, in late 1989 automatic restraint systems became compulsory in all passenger cars in the United States on the driver’s side and, while this included automatically fastening seat belts, it seemed that the air bag had at last arrived. By 1992, 10 million air-bag-equipped cars had been delivered to the United States. In 1993 came the requirement that all new light vehicles of model year 1999 produced in the United States had to be fitted with frontal air bags for the driver and the front-seat occupant. The next stage will be the compulsory fitting of air bags to both the driver and front passenger sides.

Autoliv introduced its first air bag system in 1990. It was designed to meet US requirements, where not all states have laws on wearing seat belts. The air bag therefore had to be relatively large. Autoliv has developed a special system (the Eurobag system) for markets where wearing a seat belt is compulsory. In this system the air bags have less volume (but they are still effective) and therefore the price can be kept at a lower level than some of the competitors. In the Eurobag system the air bags are 30–45 litres on the driver’s side and 60–100 litres on the passenger’s side. Furthermore, the Eurobag system is lighter and less bulky.

An air bag system consists of an electronic control unit and an air bag module. The electronic control unit contains (among other things) a sensor, while the module essentially consists of a gas generator, a nylon bag and a cover for the steering wheel centre or the instrument panel, depending on where the air bag module is placed. Autoliv typically supplies entire systems adapted to individual car models.

**Organization**

In France, Germany, Spain, Sweden, the United Kingdom and the United States, local management is regionally responsible for Autoliv’s operations in countries other than their own. As a result the main customers have the advantage of dealing with Autoliv both in their home market and when they have or are going to establish production in other markets. Together with two regional coordination offices this organization contributes to low corporate overheads and short response times for the customers. (Autoliv’s global headquarters has only 40 employees.) Autoliv’s business directors and their organizations coordinate all activities with major customers on a global basis.

**The world market for air bags**

With its successful growth strategy, Autoliv has become the global leader in the $20 billion automobile occupant restraint market. Airbags account for just over 50 per cent of that market, seat belts for almost 30 per cent and electronics for nearly 20 per cent.

The global steering wheel market, which Autoliv entered in 1995 to promote the integration of driver air bags into steering wheels, amounts to over $1.5 billion.

The world market for air bags was an area of spectacular growth during the 1990s. In 2005 the number of frontal air bag units was almost 125 million and the number of side-impact air bags nearly 50 million.
In the United States frontal air bags – both on the driver and the passenger side – are compulsory under federal law in all new light vehicles sold after 1 September 1998. The US market for frontal air bags therefore fluctuates with the car production cycle, but sales of side air bags are now about to take off. Their penetration rate was less than 20 per cent among new US light vehicles in 2001. Both Ford and General Motors have announced aggressive plans for curtain side air bags such as Autoliv’s Inflatable Curtain. In addition, new regulations in the United States will require vehicle manufacturers to phase in more valuable ‘advanced air bags’ during a three-year period starting on 1 September 2003.

In Europe, Autoliv estimates that more or less all new vehicles have dual airbags. Installations of side impact air bags began in 1994, but in 2001 two-thirds of all new vehicles in Europe had such systems for chest protection. In addition, 25 per cent had a separate side impact air bag for head protection (such as the inflatable curtain).

In Japan, where development started later than in Europe, penetration rates for frontal air bags are nearly as high as in Europe, while the penetration rate for side air bags is clearly below the level in Europe.

In the rest of the world, penetration rates vary greatly from country to country, but the average is still less than 50 per cent for both driver and passenger air bags (see Table 1). Installations of side air bags has just started.

The potential market for side air bags is difficult to assess. This is because side impact air bags will be optional accessories in many cars – at least initially – until the car producers have had time to evaluate the reaction from the market.

Autoliv estimates that it currently has approximately one-third of the global market for car occupant restraint products and that it has a somewhat larger global market share for air bags than for seat belts. For side air bags, which were invented by Autoliv and introduced in 1994, Autoliv’s global market share is still more than 40 per cent (see also Table 2). For other recent safety improvements, such as seat belt pretensioners and load limiters, Autoliv’s global market position is strong.

In North America, Autoliv estimates that in 2001 it accounted for a little less than one-third the air bag products market and the same for the seat belt market compared with just over 10 per cent in 1999. (Autoliv did not sell seat belts in the United States until 1993.) Autoliv made its big entry into the North American market in 1996 when it acquired

<table>
<thead>
<tr>
<th>Table 1 The world market for frontal air bags (2005)</th>
</tr>
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<tbody>
<tr>
<td>Production of light vehicles (millions)</td>
</tr>
<tr>
<td>Europe</td>
</tr>
<tr>
<td>West</td>
</tr>
<tr>
<td>USA</td>
</tr>
<tr>
<td>Asia</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>China</td>
</tr>
<tr>
<td>South Korea</td>
</tr>
<tr>
<td>Others</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Morton Automotive Safety Products, which at that time was North America’s largest air bag producer. The air bag business has given Autoliv an opportunity to expand its seat belt business now as complete systems sourcing takes place. In 2000 Autoliv acquired the North American seat belt business of NSK. Autoliv’s market share for seat belts also increased as a result of new contracts, and the increasing number of new United States vehicles with seat belt pretensioners. Steering wheel sales in the United States commenced in 1998. Based on orders received so far, Autoliv expects its steering wheel market share to approach 10 per cent in just a couple of years.

In Europe, Autoliv estimates its market share to be about 50 per cent with a somewhat higher market share for seat belts than for air bags. The market share for steering wheels is approximately 15 per cent. In Asia, Autoliv’s market share is not more than approximately 10 per cent for frontal air bags.

In Japan, Autoliv has a strong position in the air bag inflator market and rapidly growing sales of air bag modules. Local assembly of air bag modules began in 1998. In 2000 Autoliv acquired the second largest Japanese steering wheel company with a market share exceeding 20 per cent, and 40 per cent of NSK’s Asian seat belt operations with the option to acquire the remaining shares in two steps in 2002 and 2003. Including NSK’s sales, Autoliv accounts for approximately a fifth of the Japanese seat belt market.

In other countries, such as Argentina, Australia, China, India, Malaysia, New Zealand, South Africa and Turkey, where Autoliv established production early, the company has achieved strong market positions in several places.

**Competitors**

In the late 1990s the number of major suppliers of occupant restraint systems was reduced from nine to four. As a result of the consolidation among producers of light vehicles the new entities that have been formed require suppliers to be cost efficient and have the capability to deliver the same products to all the companies’ plants worldwide.

The four leading car occupant restraint suppliers now account for approximately 80 per cent of the world market (worth $16 billion) as opposed to 50 per cent five years ago. During this period Autoliv has increased its share to slightly more than 30 per cent and has replaced TRW (a US publically traded company) as the market leader. Another important auto safety supplier is Takata (a privately owned Japanese company). Both TRW and Takata have about 25 per cent market share. Delphi (the world’s largest automotive components supplier) and Key Safety Systems, formerly Breed (a US company that in 2000 emerged from bankruptcy) have less than 5 per cent each.

**Customers**

Several of the world’s largest car producers are among Autoliv’s customers (see Table 3). Autoliv typically accounts for between 25 and 75 per cent of customers’ purchases of seat belts and air bags. Autoliv supplies all major car makers in the world and most car brands. In the development of a new car model, a process that takes several years, Autoliv in many cases functions as a development partner for the car manufacturer. This typically means that Autoliv gives advice on new safety-enhancing products and assists in adaptation and conduct testing (including full-scale crash tests with the vehicle) of the safety systems.

No customer accounts for more than 21 per cent of Autoliv’s sales. Most of these car makers can be characterized as Autoliv’s global accounts (GAs) – see also Chapter 20. The contracts are generally divided among a car maker’s different car models, with each contract usually running for the life of the car model. No contract accounts for more than 5 per cent of consolidated sales. Of the 2005 total sales in Table 4, Europe accounts for 54 per cent, North America 26 per cent, Japan 9 per cent and the rest of the world 11 per cent.

**Table 2** Autoliv’s global market shares (%) in main product categories, 2005

<table>
<thead>
<tr>
<th>Product</th>
<th>North America</th>
<th>Europe</th>
<th>Japan</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seat belts</td>
<td>28</td>
<td>62</td>
<td>19</td>
<td>41</td>
</tr>
<tr>
<td>Frontal airbags</td>
<td>28</td>
<td>42</td>
<td>11</td>
<td>28</td>
</tr>
<tr>
<td>Side airbags</td>
<td>41</td>
<td>52</td>
<td>32</td>
<td>41</td>
</tr>
</tbody>
</table>

**Table 3** Autoliv’s customer mix (2005)

<table>
<thead>
<tr>
<th>Car manufacturer</th>
<th>Share of global vehicle production (70 million vehicles) (%)</th>
<th>Share of Autoliv’s total sales ($6.2 billion) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Motors</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>Renault/Nissan</td>
<td>9</td>
<td>14</td>
</tr>
<tr>
<td>Ford</td>
<td>12</td>
<td>21</td>
</tr>
<tr>
<td>Daimler/Chrysler</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>PSA (Citroën and Peugeot)</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>VW</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Toyota</td>
<td>15</td>
<td>7</td>
</tr>
<tr>
<td>BMW</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Hyundai</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Honda</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Others</td>
<td>15</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
Part III  Market entry strategies

Table 4  Three years of economic development at Autoliv Inc.

<table>
<thead>
<tr>
<th>Key figures</th>
<th>2005</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales ($million)</td>
<td>6,205</td>
<td>6,144</td>
<td>5,301</td>
</tr>
<tr>
<td>Pre-tax profit ($million)</td>
<td>293</td>
<td>326</td>
<td>268</td>
</tr>
</tbody>
</table>

The total number of employees (whole Autoliv Group, including subsidiaries) in December 2005 was about 400,000.

With this positive news Lars Westerberg finishes his presentation of Autoliv’s position in the air bags market. He would like a discussion of the following, to which you are asked to contribute.

Questions

1. Describe Autoliv’s role as a subsupplier for large auto manufacturers in a market that is characterized by consolidation.
2. Which car manufacturer should Autoliv target to strengthen its global competitive position?
3. What strategic alternative does Autoliv have to strengthen its competitive position outside Europe?