Rai Technology University

ENGINEERING MINDS

International Marketing

Subject: INTERNATIONAL MARKETING **Credits: 4**

SYLLABUS

Introduction to International Marketing
Strategic concept of Marketing, Market needs and wants, guiding principles of the Marketing Company.

Global Marketing Environment
Introduction, Economic Environment-The World economy, International Trade Theory, Legal Environment, Social and cultural Environment.

Targeting Global Opportunities
Global market Segmentation, Targeting and global product Positioning,

Global Marketing Strategy
Entry and Expansion Strategies- Marketing and sourcing, Planning process and entry strategies, Cooperative strategies and global strategic partnerships, Competitive analysis and strategy, Strategic Positioning and Intent,

Global Marketing Programs
Product decisions, International product strategies, Moving toward world product.

Branding
Branding and packaging decisions, marketing industrial products, International marketing of services, Basic pricing concepts.

Advertising
Global promotion, Channels of Distribution, Physical distribution and documentation.

Suggested Readings:

1. International Marketing, Warren Keegan, Pearson Education Asia Ltd and Tsinghua University Press.
2. Strategic Planning for Export Marketing, Franklin R Root Scranton, International Textbook Co.
3. International Trade and Investment, Franklin R Root Scranton, International Textbook Co.
4. International Marketing Management, Philip Kotler Prentice-Hall International, Inc Prentice-Hall International, Inc
5. International Marketing, Philip R Cateora and John L Graham Irwin/McGraw-Hill, Boston
6. International Marketing (Analysis and strategy): Sak Onkvisit & John J Shaw, Pearson Education Asia Ltd and Tsinghua University Press.
7. International Marketing, Vern Terpstra and Ravi Sarathy New York Holt, Rinehart and Winston Inc

COURSE OVERVIEW

Today the corporate world cannot survive with restricting themselves within the domestic boundaries. As the consumers across countries become more universal in nature, the need to look at the whole world as a market is growing. The aim of this unit is to introduce the students to International Marketing, which explains how International Markets operate in an International Environment. An elementary approach is used in the module, which emphasizes the reasons for undertaking International Market analysis and their interpretation. An international perspective is maintained throughout the text. The objective of the problems is to enhance the student's understanding of analytical techniques- more emphasis on policy and managerial implications of International Marketing. The module focuses on International skills required to be an effective manager. It will develop the student's ability to identify and appreciate effective ways of getting the objective fulfilled. It also develops practical applications ability and knowledge and how these can be used in the decision-making process.

Reference Books

1. International Marketing: Warren Keegan
2. Strategic Planning for Export Marketing: Warnklin R. Root
3. International Trade And Investment: Framklin R. Root
4. International Marketing Management: Philip Kotler
5. International Marketing: Philip R.Cateora & John L. Graham
6. International Marketing, Analysis & Strategy: Sak Onkvisit & John J. Shaw
7. International Marketing: Vern Terpstra & Ravi Sarathy

INTERNATIONAL MARKETING

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LESSON 1:
INTRODUCTION TO INTERNATIONAL MARKETING

Learning Objectives from the lesson:

1. Understanding of international marketing.
2. Distinguish between international and domestic marketing.
3. The various management orientations.
4. Why is international marketing required?
5. Benefits of international marketing.

We live in a global marketplace. As you read this chapter, you may be sitting in a chair imported from Brazil or at a desk imported from Denmark. You may have purchased these items form IKEA, the Swedish global furniture retailer. The computer on your desk could be a sleek new IBM ThinkPad designed and marketed worldwide by IBM and manufactured in Taiwan by Acer, Inc., or perhaps a Macintosh designed and marketed worldwide by Apple and manufactured in Ireland. Your shoes are likely to be from Italy, and the coffee you are sipping is form Latin America or Africa.

Marketing: A Universal Discipline

The foundation for a successful global marketing program is a sound understating of the marketing discipline. Marketing is the process of focusing the resources and objectives of an organization on environmental opportunities and needs. The first and most fundamental fact about marketing is that it is universal discipline. Marketing is a set of concepts, tools, theories, practices and procedures, and experience. Together, these elements constitute a teachable and learnable body of knowledge. Although marketing is universal, marketing practice, of course, varies form country to country. Each person is unique, and each country is unique. This reality of differences means that we cannot always directly apply experience form one country to another. If the customers, competitors, channels of distribution, and available media are different, it may be necessary to change our marketing plan.

The Strategic Concept of Marketing

By the 1990s, it was clear that the "new" concept of marketing was outdated and that the times demanded a strategic concept the strategic concept of marketing, a major evolution in the history of marketing thought, shifted the focus of marketing from the customer or the product to the customer in the context of the broader external environment. Knowing everything there is to know about the customer is not enough. To succeed, marketers must know the customer in a contact including the competition, government policy and regulation, and the broader economic, social, and political macro forces that shape the evolution of markets. In global marketing this may mean working closely with home –country government trade negotiators and other officials and industry competitors to gain access to a target country market.

A revolutionary development in the shift to the strategic concept of marketing is in the marketing objective : from profit to stakeholder benefits. Stakeholders are individuals or groups who have an interest in the activity of a company. They include the employees and management, customers, society, and government, to mention only the most prominent. There is a growing recognition that profits are a reward for performance (defined as satisfying customers in a socially responsible or acceptable way). To compete in today's market, it is necessary to have an employee team committed to continuing innovation and to producing quality products. In other words, marketing must focus on the customer in context and deliver value by creating stakeholder benefits for both customers in context and deliver value by creating stakeholder benefits for both customers and employees. This change is a revolutionary idea that is accepted today by a vanguard minority of marketing practitioners.

Profitability is not forgotten in the strategic concept. Indeed, it is a critical means to the end of creating stakeholder benefits. The means of the strategic marketing concept is strategic management, which integrates marketing with the other management functions. One of the tasks of strategic management is to make a profit, which can be a source of funds for investing in the business and for rewarding shareholders and management. Thus, profit is still a critical objective and measure of marketing success, but it is not an end in itself. The aim of marketing is to create value for stakeholders and the key stakeholder is the customer. If your customer can get greater value for stakeholders, and the key stakeholder is the customer. If your customer can get greater value form your competitor because your competitor is willing to accept a lower level of profit reward for investors and management, the customer will choose your competitor, and you will be out of business. The spectacular inroads of the " clones" into IBM's PC market illustrate that even the largest and most powerful companies can be challenged by competitors who are more efficient or who are willing to accept lower profit returns.

Finally, the strategic concept of marketing has shifted the focus of marketing form a microeconomics maximization paradigm to a focus of managing strategic partnerships and positioning the firm between vendors and customers in the value chain with the aim and purpose of creating value foe customers. This expanded concept of marketing was termed boundary less marketing by Jack Welch, chairperson and chief executive officer (CEO) of General Electric. Marketing, in addition to being a concept and philosophy is a set of activities and a business process. The marketing activities are called the four Ps; product, price, place (distribution), and promotion (or communications). These four Ps can be expanded to five Ps by adding probe (research). The marketing management process is the task of focusing the resources and objectives of the organization on opportunities in the environment. The three basic principles that underlie marketing are discussed next.

The Three Principles of Marketing

The essence of marketing can be summarized in three great principles. The first identifies the purpose and task of marketing, the second the completive reality of marketing, and the third the principal for achieving the first two.

a. Customer Value And The Value Equation

The task of marketing to create customer value that is greater than the value created by competitors. Expanding or improving product and / or service benefits, by reducing the price, or by a combination of these elements, can increase value for the customer. Companies with a cost advantage can use price as a competitive weapon. Knowledge of the customer combined with innovation and creativity can lead to a total offering that offers superior customer value. If the benefits are strong enough and valued enough by customers, a company does not need to be the low-price competitor to win customer.

b. Competitive or Differential Advantage

The second great principle of marketing is competitive advantage. A competitive advantage is a total offer, vis-à-vis relevant competition that is more attractive to customers. The advantage can exist in any element of the company's offer; the product, the where

V= value

B= perceived benefits – perceived costs (for example, switching costs)

P= price

Price, the advertising and point of sale promotion, or the distribution of the product. One of the most powerful strategies for penetrating a new national market is to offer a superior product at a lower price. The price advantage will get immediate customer attention, and, of those customers who purchase the product, the superior quality will make an impression.

c. Focus

The third marketing principle is focus, or the concentration of attention. Focus is required to succeed in the task of creating customer value at a competitive advantage. All great enterprise, large and small, is successful because they have understood and applied this great principle. IBM succeeded and became a great company because it was more clearly focused on customer needs and wants than any other company in the emerging data-processing industry.

One of the reasons IBM found itself in crisis in the early 1990s was that its competitors had become much more clearly focused on customer needs and wants. Dell and Compaq, for example, focused on giving customers computing power at low prices; IBM was offering the same computing power at higher prices.

A clear focus on customer needs and wants and on the competitive offer is required to mobilize the effort needed to maintain a differential advantage. This can be accomplished only by focusing or concentrating resources and efforts on customer needs and wants and on how to deliver a product that will meet those needs and wants.

Global Marketing: What It is and What It is Not

The foundation for a successful global marketing program is a sound understanding of the marketing discipline. Marketing is the process of focusing the resources and objectives of an organization on environmental opportunities and needs. The first and most fundamental fact about marketing is that it is a universal discipline. Marketing is a set of concepts, tools, theories, practices and procedures, and experience. Together these elements constitute a teachable and learnable body of knowledge.

Although the marketing discipline is universal, markets and customers are quite differentiated. This means that marketing practice must vary from country to country. Each person in unique, and each country are unique. This reality of differences means that we cannot always directly apply experience form one country to another. If the customers, competitors, channels of distribution, and available media are different, it may be necessary to change our marketing plan.

Companies who don't appreciate this fact will soon learn about it if they transfer irrelevant experience form one country or region to another. Nestle, for example, sought to transfer its great success with a four – flavor coffee line from Europe to the United States. Its U.S competitors were delighted. The transfer led to a decline of 1 percent in U.S. market share! An important task in global marketing is learning to recognize the extent to which marketing plans and programs can be extended worldwide, as well as the extent to which they must be adapted.

Much of the controversy about marketing dates to professor Theodore Levitt's 1983 seminal article in the Harvard Business Review, " The Globalization of Markets." Professor Levitt argued that marketers were confronted with a "homogenous global village." Levitt advised organizations to develop standardized, high-quality world products and market them around the globe using standardized advertising, pricing, and distribution. Some well-publicized failures by parker pen and other companies seeking to follow Levitt's advice brought his proposals into question. The business press frequently quoted industry observers who disputed Levitt's views. For example, Carl Spielvogel, chairman and CEO of the Backer spiel Vogel Bates Worldwide advertising agency, tale The wall street Journal, "Theodore Levitt's comment about the world becoming homogenized is bunk. There are about two products that lend themselves to global marketing—and one of them is Coca-Cola."

Indeed, it was global marketing that made Coke a worldwide success. However, that success was not based on a total standardization of marketing mix elements. In his book, The Borderless world, kenichi Ohmae explains that Coke's success in Japan could be achieved only by spending a great deal of time and money becoming an insider. That is, the company built a complete local infrastructure with its sales force and vending machine operations. Coke's success in Japan, according to Ohmae, was a function of its ability to achieve "global localization," the ability to be as much of an insider as local company nut still reaping the benefits that result form world-scale operations.

What does the phrase global localization really mean? In a nutshell, it means a successful global marketer must have the ability to "think globally and act locally." As we will see many times in this book, " global" marketing may include a combination of standard (e.g., the actual product itself) and nonstandard (e.g., distribution or packaging) approaches. A "global product" may be " the same" product everywhere and yet " different." Global marketing requires marketers to behave in a way that is global and local at the same time by responding to similarities and differences in world markets.

As the Coca-Cola Company has demonstrated, the ability to think globally and act locally can be a source of competitive advantage. By adapting sales promotion, distribution, and customer service efforts to local needs. Coke established such strong brand preference that the company claims a 78 percent share of the soft drink market in Japan. At first, Coca Cola managers did not understand the Japanese distribution system. However, with considerable investment of time and money, they succeeded in establishing a sales force that was as effective in Japan is it was in the United States. To complement Coke sales, the Japanese unit has created products such as Georgia – brand canned coffee and Lactia, a lactic, no carbonated soft drink that promotes healthy digestion and quick refreshment expressly for the Japanese market.

Coke is a product embodying marketing mix elements that are both global and local in nature. In this book, we do not propose that global marketing is a "knee-jerk" attempt to impose a totally standardized approach to marketing around the world. A central issue in global marketing is how tailors the global marketing concept to fit a particular product or business. Finally it is necessary to understand that global marketing does not mean entering every country in the world. Global marketing does mean widening business horizons to encompass the worlds when scanning for opportunity and threat. The decision to enter markets outside the home country depends on a company's resources, managerial mind –set, and the nature of opportunity and threat. The Coca-Cola Company's soft-drink products are distributed in almost 200 countries in fact, the theme vice." Coke is the best known, strongest brand in the world its enviable global position has resulted in part form the Coca-cola symbol is available globally, the company also produces over 200 other nonalcoholic beverages to suit local beverage preferences.

A number of other companies have successfully pursued global marketing by creating strong global brands. Philip Morris, for example, has example, has made Marlboro the number one cigarette brand in the world. In automobiles, Daimler Chrysler has gained global recognition for its Mercedes nameplate BMM automobiles and motorcycles.

Global marketing strategies can also be based on product or system design, product positioning, packaging, distribution, customer service, and sourcing considerations. For example, Mc Donald's has designed a restaurant system that can be set up virtually anywhere in the world. Like Coca-cola, McDonald's also customizes its menu offerings in accordance with local eating customs. In Jakarta. Indonesia, for example, McDonald's is upscale dinning. It is the place to be and to be seen in Jakarta. Cisco systems, which makes local area network routers that allow computers to communicate with each other, designs new products that can be programmed to operate under virtually any conditions in the world.

Unilever uses a teddy bear in various world markets to communicate the benefits of the company's fabric softener. Harley-Davidson's motorcycles are positioned around the world as the all –American bike. Gillette uses the same packaging for its flagship sensor razor everywhere in the world. Italy's Benetton utilizes a sophisticated distribution system to quickly deliver the latest fashions to its worldwide network of stores.

The backbone of Caterpillar's global success is a network of dealers that supports a promise of "24 hour parts and service" anywhere in the world. The success of Honda and Toyota in world markets was initially based on exporting cars form factories in Japan. Now, both companies have invested in manufacturing facilities in the United States and other countries form, which they export. In 1994, Honda earned the distinction of being the number one exporter of cars form the United States by shipping more than 100,000 accords and civics to Japan and 35 other countries. Gap focuses its marketing effort on

TABLE 1.1 Examples of Global Marketing

Global Marketing Strategy	Company/ Home Country
Brand Name	Coca-Cola (U.S.), Philip Morris (U.S.), Daimler Chrysler (Germany) McDonald's (U.S), Toyota (Japan), Ford (U.S.), Cisco systems (U.S.)
Product Design	Unilever (Great Britain / Netherlands), Harley-Davidson (U.S) Gillette (U.S.)
Product positioning	Benetton (Italy) Caterpillar (U.S.) Toyota (Japan), Honda (Japan), Gap (U.S.)
Packaging	
Distribution	
Customer service	
Sourcing	

The United States but relies on apparel factories in low-wage countries to supply most of its clothing.

The particular approach to global marketing that a company adopts will depend on industry conditions and its source or source or sources of competitive advantage. Should Harley Davidson start manufacturing motorcycles in a low –wage country such as Mexico or china? Will U.S. consumers continue to snap up U.S. –built Toyotas? The answer to these questions is " it all depends," because Harley's competitive advantage is based in part on its "made in the U.S.A." positioning, shifting production outside the united states is not advisable at this time. Toyota's success in the United States is partly attributable to its ability to transfer world –class-manufacturing skills to the united states while using advertising to stress that its Camry is built by American, with many components purchased in the united states.

Toyota has positioned itself as a global brand independent of any country of origin link. A Toyota wherever it is made. The same thing is true for thousands of companies that have successfully positioned their brand independent of country of origin. A Harley- Davidson motorcycle made China would shock Harley buyers; the brand at this stage of its development is linked to a single country of origin, the United States.

The Process of Internationalization

For certain firms, they may have started at the outset as international firms in the sense that their mission is to be involved in international business activities. For many others, however they may have begun as domestic firms concentrating on their own domestic markets before shifting or expanding the focus to also cover international markets. It is thus useful to investigate the stages of internationalization.

Based on his review of a number of the internationalization models, which specify the various stages of internationalization models, which specify the various stages of internationalization, Andersen has proposed his own U – model which ahs received mixed empirical support. According to this model, there are four stages: (1) no regular export activities, (2) Export via independent representatives (agent) (3) establishment of an overseas sales subsidiary, and (4) overseas production/ manufacturing. The development is supposed to take place first within a specific country before being repeated across countries.

Another study found evidence to support the hypothesis that there are four identifiable stages in a firm's internationalization. The four stages are: (1) nonexporters, (2) export intenders. (3) Sporadic exporters, and (4) regular exporters. The process shows how firm were initially constrained by resource limitations and a lack of expert commitment and how they can become more and more internationalized as more resources are allocated to international activity.

At present, there is no conclusive evidence to show that domestic firms have generally indeed progressed from one stage to another as prescribed on their way to become more internationally oriented. Likewise, no empirical evidence has been provided so far to support a competing hypothesis that some firms are "born global" in the sense that their mission from the outset is to become MNCs.

Management Orientations

The form and substance of a company's response to global market opportunities depend greatly on management's assumptions or beliefs— both conscious and unconscious— about the nature of the world. The worldview of a company's personnel can be described as ethnocentric, polycentric, egocentric, and geocentric. Management at a company with a prevailing ethnocentric orientation may consciously make a decision to move in the direction of geocentricism. The orientations are collectively known as the EPRG framework.

a. Ethnocentric Orientation

A person who assumes his or her home country is superior compared to the rest of the world is said to have an ethnocentric orientation. The ethnocentric orientation means company personnel see only similarities in markets and assume the products and practices that succeeded in the home country will, due to their demonstrated superiority, be successful anywhere. At some companies, the ethnocentric orientation means that opportunities outside the home country are ignored. Such companies are sometimes called domestic companies. Ethnocentric companies that do conduct business outside the home country can be described as international companies; they adhere to the notion that the products that succeed in the home country are superior and, therefore, can be sold everywhere without adaptation.

In the ethnocentric international company, foreign operations are viewed as being secondary or subordinate to domestic ones. An ethnocentric company operates under the assumption that "tried and true" headquarters' knowledge and organizational capabilities can be applied in other parts of the world. Although this can sometimes work to a company's advantage, valuable managerial knowledge and experience in local markets may go unnoticed. For a manufacturing firm, ethnocentrism means foreign markets are viewed as a means of disposing of surplus domestic production. Plans for overseas markets are developed utilizing policies and procedures identical to those employed at home. No systematic marketing research is conducted outside the home country, and no major modifications are made to products. Even if consumer needs or wants in international markets differ form these in the home country, those differences are ignored at headquarters.

Nissan's ethnocentric orientation was quite apparent during its first few years of exporting cars and trucks to the united state. Designed for mild Japanese winters, the vehicles were difficult to start in many parts of the United States during the cold winter cars. Nissan's assumption was that Americans would do the same thing. Until the 1980s, Eli Lilly and company operated as an ethnocentric company in which activity outside the United States was tightly controlled by headquarters and focused on selling products originally developed for the U.S market.

Fifty years ago, most business enterprise- and specially those located in a large country such as the United States could operate quite successfully with an ethnocentric orientation. Today, however, ethnocentrism is one of the biggest internal threats a company faces.

b. Polycentric Orientation

The polycentric orientation is the opposite of ethnocentrism. The term polycentric describes management's often-unconscious belief or assumption that each country in which a company does business is unique. This assumption lays the ground work for each subsidiary to develop its own unique business and marketing strategies in order to subsidiary to develop its own unique business and marketing strategies in order to succeed; the term multinational company is often used to describe such a structure. Until recently, Citicorp's financial services around the world operated on a polycentric basis. James Bailey, a Citicorp executive, offered this description of the company; " we were like a medieval state. There was the king and his court and they were in charge, right? No. It was the land barons went and did their thing. Realizing that the financial services industry is global zing; CEO John Reed is attempting to achieve a higher degree of integration between Citicorp's operating units. Like Jack Welch at GE, Reed is moving to instill a geocentric orientation throughout his company.

c. Regiocentric and Geocentric Orintatons

In a company with a regiocentric orientation, management views regions as unique and seeks to deep an integrated strategy. For example, a U.S. company that focuses on the countries included in the North American Free Trade Agreement

(NAFTA)—the United States, Canada, and Mexico — has a regiocentric orientation. Similarly, a European company that focuses its attention on the EU or Europe is regiocentric. A company with a geocentric orientation views the entire world as a potential market and strives to develop integrated world market strategies. A company whose management has a regiocentric or geocentric orientation is sometimes known as a global or transnational company.

Philips and Matsushita: How Global Companies Win

Until recently, Philips Electronics, headquartered in Eindhoven, the Netherlands, was a classic example of a company with a polycentric orientation. Philips relied on relatively autonomous national organizations (called Nos in company parlance) in each country. Each No developed its own strategy. This approach worked quite well until Philips faced competition form matsushita and other Japanese consumer electronics companies in which management's orientation was geocentric. The difference in competitive advantage between Philips and its Japanese competition was dramatic.

For example, Matsushita adopted global strategy that focused its resources on serving a world market for home entertainment products. In television receivers, matsushita offered European customers tow models based on a single chassis. In contrast, Philips's European cos offered customers seven different models based on four different chassis. If customers had demanded this variety, Philips would have been the stronger competitor. Unfortunately, the product designs created by the Nos were not based on customer preferences. Customers wanted value in the form of quality, features, design –and price. Philips's decision to offer greater design variety was based not on what customers were asking for but, rather, on Philips's structure and strategy. Watch major country organization had its won engineering and manufacturing group. Each country unit had its own design and manufacturing operations. This polycentric, multinational approach was part of Phillips's heritage and was attractive to Nos that had grown accustomed to functioning independently. However, the polycentric orientation was irrelevant to consumers, who were looking for value. They were getting more value from matsushita's global strategy than from Philips's multinational strategy. Why? Matsushita's global strategy created value for consumers by lowering costs and, in turn, prices.

As a multinational company, Philips squandered resources in a duplication of effort that led to greater product variety. Variety entailed higher costs, which were passed on to consumer with no offsetting increase in consumer benefit. It is easy to understand how the right strategy resulted in matsushita's success in the global consumer electronics industry. Because the matsushita strategy offered greater customer value, Philips executives consciously abandoned the polycentric multinational approach and adopted a more geocentric orientation. A first step in this is direction was to create industry groups in the Netherlands responsible for developing global strategies for research and development (R&D), marketing, and manufacturing.

The geocentric orientation represents a synthesis of ethnocentrism and polycentrism; it is a "worldview" that sees similarities and differences in markets and countries and seeks to create a global strategy that is fully responsive to local needs and wants. A regiocentric manager might be said to have a worldview on a regional scale; the world outside the region of interest will be viewed with an ethnocentric or a polycentric orientation, or a combination of the two. Jack Welch's quote at the beginning of this chapter that "globalization must be taken for granted" implies that at least some company managers must have a geocentric orientation. However, some research suggests that many companies are seeking to strengthen their regional competitiveness rather than moving directly to develop global responses to changes in the competitive environment.

The ethnocentric company is centralized in its marketing management, the polycentric company is decentralized, and the regiocentric and geocentric companies are integrated on a regional and global scale, respectively. A crucial difference between the orientations is the underlying assumption for each. The ethnocentric orientation is based on a belief in home country superiority. The underlying assumption of the polycentric approach is that there are so many differences in cultural, economic, and marketing conditions in the world that it is impossible and futile to attempt to transfer experience across national boundaries.

Benefits of International Marketing

International marketing daily affects consumers in many ways, though its importance is neither well understood nor appreciated. Government officials and other observers seem always to point to the negative aspects of international business. Many of their charges are more imaginary than real. The benefits of international marketing must be explicitly discussed in order to dispel such notions.

Survival

Because most countries are not as fortunate as the United States in terms of market size, resources, and opportunities, they must trade with others to survive. Hong Kong has historically underscored this point well, for without food and water form China proper, and The British colony would not have survived long. The countries of Europe have had similar experience, since most European nations are relatively small in size. Without foreign markets, European firms would not have sufficient economies of scale to allow them to be competitive with U.S. firms. Nestle mentions in one of its advertisements that its own country, Switzerland, lacks natural resources, forcing it to depend on trade and adopt the geocentric perspective.

International competition may not be a matter of choice when survival is at stake. A study of five medical – sector industries found that international expansion was necessary when foreign firms entered a domestic market. However, only firms with previously substantial market share and international experience could expand successfully. Moreover firms that retrenched after an international expansion disappeared.

Growth of Overseas Markets

Developing countries, in spite of economic and marketing problems, are excellent markets. According to a report prepared for U.S. Congress by the U.S. Trade Representative. Latin America and Asia / Pacific are experiencing the strongest economic growth.

The conference Board is a business information service that assists senior executives and other leaders in arriving at sound

decisions, and more than 3,000 organizations in over fifty nations participate as Associates. The conference Board's study of some 1500 companies found that U.S manufactures with factories or sales subsidiaries overseas outperformed their domestic counterparts during the 1980s in terms of growth in nineteen out of twenty major industry groups and higher earnings in seventeen out of twenty groups.

American marketers cannot ignore the vast potential of international markets. The world market is more than four times larger than the U.S market. In the case of Amway Corp, a privately held U.S manufactures of cosmetics, soaps, and vitamins, Japan represents a larger market than the United States.

A slowing of the growth of the U.S population and changing lifestyles explain why the growth of other markets should be viewed with a critical eye. The fitness craze has contributed mightily to the leveling of U.S. sales of cigarettes and liquor. However, sales of cigarettes in the former Soviet Union are still going strong. Some 575 billion cigarettes were sold there in 1994 as compared to 490 billion cigarettes sold in the United States. Russian smokers apparently show no concern about the health risks. Not surprisingly, international giants Philip Morris Co., R.J. Reynolds tobacco international SA, And British – American Tobacco Co. have entered the market aggressively. Without outside markets, executives of U.S. distillers and tobacco firms probably would be driven to drink and smoke to forget their troubles.

Sales and Profits

Foreign markets constitute a large share of the total business of many firms that have wisely cultivated markets abroad. Many large U.S companies have done very well because of other overseas customers. IBM and Compaq, for example, sell more computers abroad than at home. According to the U.S Department of Commerce, foreign profit of American firms rose at a compound annual rate of 10.8 percent between 1982 and 1991, almost twice as fast as domestic profits of the same companies.

The case of Coca – Cola clearly emphasizes the importance of overseas markets and (marketing strategy 1 – 2) international sales account for more than 80 percent of the firms operating profits. In terms of operating profit margins, they are less than 15 percent at home but twice that amount overseas. For every gallon of soda that Coca – Cola sells, it earns thirty – seven cents in Japan – a market difference form the mere seven cents per gallon earned in the United States. The Japanese market contributes about $ 350 million in operating income to Coca – Cola (vs. $324 million in the U.S. market). Making Japan the company's most profitable market. With consumption of Coca – Cola's soft drinks averaging 296 eight – ounce servings per person per year in the United States, the U.S market is clearly saturated. Non U.S. consumption, on the other hand, averages only about forty servings and offers great potential for future growth.

Diversification

Demand for most products is affected by such cyclical factors as recession and such seasonal factors as climate. The unfortunate consequence of these variables is sales fluctuations, which can frequently be substantial enough to cause layoffs of personnel. One way to diversify a company's risk is to consider foreign markets as a solution for variable demand. Such markets even out fluctuations by providing outlets for excess production capacity. Cold weather, for instance, may depress soft drink consumption. Yet not all countries enter the winter season at same time, and some countries are relatively warm year round. Bird, USA Inc., a Nebraska manufacturer of go – carts and minicars for promotional purpose, has found that global selling has enabled the company to have year round production. "It may be winter in Nebraska but it's summer in the Southern Hemisphere" – somewhere there's a demand and that stabilizes our business.

A similar situation pertains to business cycle: Europe's business cycle often lags behind that of the United States. That domestic and foreign sales operate in differing economic cycles works in the favor of General Motors and Ford because overseas operations help smooth out the business cycles of the North American market.

Marketing Strategy 1-2

The Real Thing vs. The Pepsi Generation

A global market can balance good market with bad ones while there is no question that the U.S cola market is the biggest one in the world, it is a highly mature market, and the profit potential is limited, cola has shrunk form 63.3 percent of soft – drink sales in the United state in 1984 to 58.8 percent in 1993 – a loss of $2.4 billion in potential retail sales. The united states leads the world in coca – cola consumption. Averaging 296 eight ounce serving per person per year. The comparable figures for other markets are: Mexico (275 servings), Germany (189), Canada (169), Japan (124), Great Britain (89), France (56) Egypt (18) Russia (2) and china (1) in the case of India's 890 million people, each person only consumes an average of three servings in a year, well below the levels found in Pakistan (9) and Thailand (75). In addition to being the world's most populous nations, china and India are two of the world's fastest growing economies, and Japanese, European, and American firms are all quite excited about doing business with and in china and India.

Undoubtedly, china and India have plenty of room to grow as a market. If the Chinese and Indians can be persuaded to drink just one more serving per person a year, coca –cola and Pepsi can derive additional sales of more than two billion cans. Coca –cola has been particularly aggressive in East Europe, Asia, and South America. It has opened plant in Romania, Norway, and India while planning several more in china, Hungary, Lithuania, and Thailand. When the Soviet Union Collapsed, PepsiCo held on to its network of state run bottlers so as to utilize their ties to old-line management. Coca cola on the other hand, quickly got rid of the government link and spent more than $ 1.5 billion in former East bloc countries to build a new business form scratch. As a result, Pepsi's lead due to its early distribution deals evaporated. Coke now leads in market share in every Eastern European country. In addition it also has a wide lead in Latin America.

Inflation and Price Moderation

The benefits of export are readily self – evident. Imports can also be highly beneficial to a country because they constitute reserve capacity for the local economy. Without imports (or with severely restricted imports), there is no incentive for domestic firms to moderate their prices. The lack of imported product alternatives forces consumers to pay more, resulting in inflation and excessive profits for local firms. This development usually acts as a prelude to workers demand for higher wages, further exacerbating the problem of inflation. Import quotas imposed on Japanese automobiles in the 1980 saved 46200 U.S production jobs but at a cost of $ 160,000 per job per year. This huge cost was a result of the addition of $400 to the prices of U.S cars and $1000 to the prices of Japanese imports. This windfall for Detroit resulted in record – high profits for U.S automakers.

The short-term gain derived from artificial controls on the supply of imports can in the long run return to haunt domestic firms. Not only do trade restrictions depress prices competition in the short run, but also they can also adversely affect demand for years to come. In Europe, when prices of orange juice were driven upward, consumers switched to apple juice and other fruit drinks. Likewise, Florida orange growers found to their dismay that sharply higher prices turned consumers to other products. After the 1962 freeze, it took the citrus industry ten years to win back these consumers. United states orange growers finally learned to live with imports because they found that imported Brazilian juice, by minimizing price increases, is able to keep consumers.

Employment

Trade restrictions, such as the high tariffs caused by the 1930 Smoot –Hawley Bill, which forced the average tariff rates across the board to climb above 60 percent, contributed significantly to the greater Depression and have the potential to cause wide – spread unemployment again. Unrestricted trade. On the other hand, improves the world's GNP and enhances employment generally for all nations.

Importing products and foreign ownership can provide benefits to a nation. According to the institute for International Economics – a private, nonprofit research institute – the growth of foreign ownership has not resulted in a loss of jobs for Americans, and foreign firms have paid their American workers the same, as have domestic firms.

Business week found that, unlike those who are employed in the import competing and domestic sectors. Those working in an exporting industry are more likely to be college educated to earn higher wages, and to be in a good position to benefit form worldwide growth.

U.S. Trade Facts

The United States is the world's largest economy and the largest market. In 1995 the United States retained its position as the world's largest exporter.

Goods Trade

United states two-way trade totaled $ 1324.3 billion in 1995 with exports of $ 574.9 billion ad imports of $749.4 billion.

The 1995 U.S. merchandise trade deficit was $ 174.6 billion larger than in 1994.

U.S. goods exports increased to 8.0 percent of the nation's gross domestic product in 1995, up form 7.3 percent in 1994. That compares with 1994 shares of GDP for Germany of 24.2 percent and for Japan of 8.6 percent.

In 1995 the United States accounted for an estimated 11.6 percent of world's goods exports.

Total U.S. goods imports in 1995 were comprised of 84 percent manufactured goods; 8 percent mineral fuels; and 8 percent agricultural and other goods.

In 1995 jobs supported by goods and services experts reached a record 11million. On average, the wages of workers in jobs supported by goods experts are 13 percent higher than the national average.

From 1891 through 1970, the United States had an unbroken string of trade surpluses. After 1970, it had deficits in every year except 1973 and 1975.

Canada was the United States, leading foreign market for export in 1995. followed by Japan, Mexico, the United Kingdom, South Korea, and Germany, Canada was also the United States leading supplier followed by Japan, Mexico, China, and Germany.

Capital goods, including aircraft, are the largest category of U.S. exports, followed by industrial supplies and materials, than non-automotive consumer goods, automotive products, and – collectively – goods, feeds, and beverages.

The commerce department estimates that over 37000 U.S. manufacturing companies exports, slightly more than one – third of the approximately 104600 U.S. companies that export.

Approximately two thirds of U.S. goods exports are by U.S. owned multinational corporations, with over one – third of these exports by the U.S. parent corporation shipped to foreign affiliates.

Business Services Exports

Exports of U.S. services are over one third as large as U.S. exports of goods.

Exports and imports of services totaled $ 208.8 billion and $ 145.8 billion, respectively in 1995.

In 1995 U.S. exports of services accounted for about 3.1 percent of the nation's GDP. Travel service receipts and passenger fares accounted for over 38 percent of the total.

The United States is the world's largest exporter of business services by far, with 16.5 percent of the world's total in 1994. France was second with 8.3 percent.

Unfortunately there is no question that globalization is bound to hurt some workers whose employers are not cost competitive. Some employers may also have to move certain jobs overseas so as to reduce costs. As a consequence, some workers will inevitably by unemployed. As in the case of the state of Connecticut, some 200000 jobs were lost, while United Technologies Corp. (the state's largest employer) has reduced the number of jobs from 51,000 to fewer than 32,000. It is extremely difficult to explain to those who must bear the brunt of unemployment due to trade that there is a net benefit for the country.

Standards of Living

Trade affords countries and their citizen's higher standards of living than otherwise possible. Without trade, product shortages force people to pay more for less. Products taken for granted. such as coffee and bananas, may become unavailable overnight. Life in most countries would be much more difficult were it not for the many strategic metals that must be imported. Trade also makes it easier for industries to specialize and gain access to raw materials. While at the same time fostering competition and efficiency. A diffusion of innovations across national boundaries is a useful by – product of international trade. A lack of such trade would inhibit the flow of innovative ideas.

Understanding of Marketing Process

International marketing should not be considered a subject or special case of domestic marketing. As commented by the chairman of the supervisory board of N.V. Philip's Gloeilampen – fabrieken.

"American managers should really understand, not just say they understand, that there are other parts of the world beside the United States. If Americans started doing business with other countries, they would develop greater understanding as well as more trade. And that is the most important thing. After all – that society be open to each other. To close yourself off is the worth thing that can happen."

Marketing Strategy 1 –3

It is OK to Be Un-American

The Economist is a news and business weekly publication. Wanting American readers to subscribe to its publication, It makes the following points:

The Japanese drink more U.S. bourbon than American. New York City is merely the world third largest urban center an only two American cities rank among the top twenty.

When it comes to foreign aid, Denmark is the most generous nation on earth : Nearly seven times as giving as America.

Read only the U.S. press and your might end up with a wholly one sided dangerously inaccurate – view of the entire world. Because it's un – American, the Economist is so popular among the ranks of those in the know. The economist is the news and business weekly whose beat is the whole world – including America's prominent place in it.

When an executive is required to observe marketing in other cultures, the benefit derived is not so much the understanding of a foreign culture. Instead, the real benefit is that the executive actually develops a better understanding of a foreign culture. Instead, the real benefit is that the executive actually develops a better understanding of marketing in one's own culture. For example, Coca – Cola Co. has applied the lessons learned in Japan to U.S. and European markets. The study of international marketing thus can prove to be valuable in providing insights for the understanding of behavioral patterns often taken for granted at home. Ultimately, marketing as a discipline of study is more effectively studied.

LESSON 2:
INTRODUCTION TO INTERNATIONAL MARKETING-2

Driving and Restraining Forces Affecting Global Integration and Global Marketing

The remarkable growth of the global economy over the past 50 years has been shaped by the dynamic interplay of various driving and restraining forces. During most of those decades, companies from different parts of the world in different industries achieved great success by pursuing international, multinational, or global strategies. During the 1990s, changes in the business. Today, the growing importance of global marketing stems form the fact that driving farces have more momentum than the restraining forces.

Driving Forces

Converging market needs and wants, technology advances, pressure to cut costs, pressure to improve quality, improve quality, improvements in communication and transportation technology, global economic growth, and opportunities for leverage all represent important driving forces; any industry subject to these forces is a candidate for globalization.

Technology

Technology is a universal factor that crosses national and cultural boundaries. Technology is truly "stateless", there are no cultural boundaries limiting its application. Once a technology is developed, it soon becomes available everywhere in the world. This phenomenon support Levitt's prediction concerning the emergence of global markets for standardized products. In his landmark Harvard Business Review article, Levitt anticipated the communication revolution that has, in fact, become driving force behind global marketing. Satellite dishes. Globe-spanning television networks such as CNN and MTV, and the Internet are just a few of the technological factors underlying the emergence of a true global village. In regional markets such as Europe, the increasing overlap of advertising across national boundaries and the mobility of consumers have created opportunities for marketers to pursue pan- European product positioning.

Regional Economic Agreements

A number of multilateral trade agreements have accelerated the pace of global integration. NAFTA is already expanding trade among the United States, Canada, and Mexico. The General Agreement on Tariffs and Trade (GATT), which was ratified by more than 120 nations in 1994, has been replaced by the world Trade Organization to promote and protect free trade, but it has come under attack by developing countries. In Europe, the expanding membership of the European Union is lowering barriers to trade within the region.

Market Needs and Wants

A person studying markets around the world will discover cultural universals as well as cultural differences. The common elements in human nature provide an underlying basis for the opportunity to create and serve global markets. The word *create* is deliberate. Most global markets do not exist in nature: They must be created by marketing effort. For example, no one needs soft drinks, and yet today in some countries per capita soft drink consumption exceeds the consumption' of water. Marketing has driven this change in, behavior, and today the soft-drink industry is a truly global one. Evidence is mounting that consumer needs and wants around the world are converging today as never before. This creates an opportunity for global marketing. Multinational companies pursuing strategies of product adaptation run the risk of being overtaken by global competitors that have recognized opportunities to serve global customers.

Marlboro is an example of a successful global brand. Targeted at urban smokers around the world, the brand appeals to the spirit of freedom, independence, and open space symbolized by the image of the cowboy in beautiful, open western settings. The need addressed by Marlboro is universal, and, therefore, the basic appeal and execution of its advertising and positioning are global. Philip Morris, which markets Marlboro, is a global company that discovered years ago how the same basic market need can be met with a global approach.

Transportation and Communication Improvements

The time and cost barriers associated with distance have fallen tremendously over the past 100 years. The jet airplane revolutionized "communication by making it possible for people to travel around the world in less than 48 hours. Tourism enables people from many countries to see and experience the newest products being sold abroad. One essential characteristic of the effective global business is face-to-face communication among employees and between the company and its customers. Without modern jet travel, such communication would be difficult to sustain. In the 1990s, new communication technologies such as e-mail, fax, and teleconferencing and videoconferencing allowed managers, executives, and customers to link up electronically from virtually any part of the world for a fraction of the cost of air travel.

A similar revolution has occurred in transportation technology. Physical distribution has declined in terms of cost; the time required for shipment has been greatly reduced as well. A letter from China to New York is now delivered in eight days faster than domestic mail is delivered within many countries. The per-unit cost of shipping automobiles from Japan and Korea to the United States by specially designed auto-transport ships is less than the cost of overland shipping from Detroit to either U.S. coast.

Product Development Costs

The pressure for globalization is intense when new products require major investments and long periods of development time. The pharmaceuticals industry provides a striking illustration of this driving force. According to the Pharmaceutical

Manufacturers Association (PMA), the cost of developing a new drug in 1976 was $54 million; by 1982, the cost had increased to $87 million. By 1993, the cost of developing a new drug had reached $359 million.13 Such costs must be recovered in. the global marketplace, as no single national market is likely to be -large enough to support investments of this size. As noted earlier, global marketing does not necessarily mean operating everywhere; in the $200 billion pharmaceutical industry, for example, seven countries account for 75Percent of sales.

Quality

Global marketing strategies can generate greater revenue and greater operating margins, which, in turn, support design and manufacturing quality. A global and a domestic company may each spend 5 percent of sales on research and development, but the global company. May have many. Times the total revenue of the domestic because it serves the world market. It is easy to understand how Nissan, Matsushita, Caterpillar, and other global companies can achieve world-class quality. Global companies 'raise the bar" for all competitors in an industry. When a global company establishes a benchmark in quality, competitors must quickly make their own improvements and come up to par. Global competition has forced all companies to improve quality. For truly global products, uniformity can drive down research, engineering, design, and production costs across business functions. Quality, uniformity, and cost reduction were all driving forces behind Ford's development of its "World Car," which is sold in the United States as the Ford Contour and Mercury Mystique and in Europe as the Mondeo.

World Economic Trends

There are three reasons why economic growth has been a driving force in the expansion of the international economy and the growth of global marketing. First, growth has created market opportunities that provide a major incentive for companies to expand globally. At the same time, slow growth in a company's domestic market can signal the need to look abroad for opportunities in nations or regions with high rates of growth.

Second, economic growth has reduced resistance that might otherwise have developed in response to the entry of foreign firms into domestic economies. When a country is growing rapidly, policy makers are likely to look favorably on outsiders. A growing country means growing markets; there is often plenty of opportunity for everyone. It is possible for a "foreign" company to enter a domestic economy and to establish itself without taking business away from local firms. Without economic growth, global enterprises may take business away from domestic ones. Domestic businesses are more likely to seek governmental intervention to protect their local position if markets are not growing. Predictably, the worldwide recession of the ea.r1y 1990s created pressure in most countries. to limit access by foreigners to domestic markets.

The worldwide movement toward deregulation and privatization is another driving force. The trend toward privatization is opening up formerly closed markets significantly; tremendous opportunities are being created as a result. For example, when a nation's telephone company is a state monopoly, it is much easier to require it to buy only from national companies. An independent, private company will be more inclined to look-for the best offer, regardless of the nationality of the supplier. Privatization of telephone systems around the world is creating opportunities and threats for every company in the industry.

Leverage

A global company possesses the unique opportunity to develop leverage. Leverage is simply some type of advantage that a company enjoys by virtue of the fact that it conducts business in more than one country. Four important types of leverage are experience transfers, scale economies, resource utilization, and global strategy.

Experience Transfers

A global company can leverage its experience in any market in the world. It can draw on management practices, strategies, products, advertising appeals, or sales or promotional ideas that have been tested in actual markets and apply them in other comparable markets.

For example, Asea Brown Boveri (ABB), a company with 1,300 operating subsidiaries in 140 countries, has considerable experience with a well-tested management model that it transfers across national boundaries. The Zurich-based company knows that a company's headquarters can be run with a lean staff. When ABB acquired a Furnish company, it reduced the headquarters staff from 880 to 2S'between 1986 and 1989. Headquarters staff at a German unit was reduced from 1,600 to 100 between 1988 and 1989; after acquiring Combustion Engineering (a U.S. company producing power plant boilers), ABB knew from experience that the headquarters staff of8oo could be drastically reduced, in spite of the fact that Combustion Engineering. had a justification for every one *of* the headquarters staff positions.

Scale Economies

The global company can take advantage *of* its greater manufacturing volume to obtain traditional scale advantages within a single factory. Also, finished products can be produced by combining components manufactured in scale-efficient plants in different countries. Japan's giant Matsushita Electric Company is a classic example of global marketing; it achieved scale economies by exporting videocassette recorders (VCRs), televisions, and other consumer electronics products throughout the world from world-scale factories in Japan. The importance of manufacturing scale has diminished somewhat as companies implement flexible manufacturing techniques and invest in factories outside the home country. However, scale economies were a cornerstone of Japanese success in the 19708 and 1980s.

Leverage from scale economies is not limited to manufacturing. Just as a domestic company can achieve economies in staffing by eliminating duplicate positions after an acquisition, a global company can achieve the same economies on a global scale by centralizing functional activities. The larger scale of the global company also creates opportunities to improve corporate staff competence and quality.

Resource Utilization

A major strength of the global company is its ability to scan the entire world to identify people, money, and raw materials that will enable it to compete most effectively in world markets. This is equally true for established companies and start-ups. For example, British Biotechnology Group, founded in 1986, raised $60 million from investors in the United States, Japan, and Great Britain. For a global company, it is not problematic if the value of the "home" currency rises or falls dramatically, because for this company there really is no such thing as a home currency. The world is full of currencies, and a global company seeks financial resources on the best available terms. In turn, it uses them where there is the greatest opportunity to serve a need at a profit.

Global Strategy

The global company's greatest single advantage can be its global strategy. A global' strategy's built on an information system that scans the world business environment *to* identify opportunities, trends, threats, and resources. When opportunities are identified, the global company adheres *to* the three principles identified earlier: It leverages its skills and *focuses* its resources to create superior perceived value for' customers and achieve competitive advantage. The global strategy is a design *to* create a winning offering on a global scale. This takes great discipline, much creativity, and constant effort. The reward is not just success-it is survival.

The Global/Transnational Corporation

The Global/transnational Corporation, or any business enterprise that pursues global business objectives by linking world resources to world market opportunity, is the organization that has responded to the driving, restraining, and underlying forces in the world. Within the international financial framework and under the umbrella of global peace, the global corporation has taken advantage of the expanding communications technologies to pursue market opportunities and serve needs and wants on a global scale. The global enterprise has both responded to market opportunity and competitive threat by going global and at the same time has been one of the forces driving the world toward greater globalization.

Restraining Forces

Despite the impact of the driving forces identified earlier, several restraining forces may' slow a company's efforts to engage in global marketing. Three important restraining forces are management myopia, organizational culture, and national controls. As we have noted, however, in today's world the driving forces predominate. over the *re*straining forces. That is why the importance of global marketing is steadily growing.

Management Myopia and Organizational Culture

In many cases, management simply ignores opportunities to pursue global marketing. A company that is "nearsighted" and ethnocentric will not expand geographically. Myopia is also a recipe for market disaster .if headquarters attempts to dictate when it should listen. Global marketing does not work without a strong local term that can provide information about local market conditions. Executives at Parker Pen once attempted to implement a top-down marketing strategy that ignored experience gained by local market representatives. Costly market failures resulted in Parker's buyout by managers of the former U.K. subsidiaries eventually: the. Gillette Company. Acquired Parker.

In companies in which subsidiary management "knows it all," there is no room for vision from the top. In companies in which headquarters management is all knowing, there is no room for local initiative or an in-depth knowledge of local needs and conditions. Executives and managers at successful global companies have learned how to integrate global vision and perspective with local market initiative and input A striking theme emerged during interviews conducted by the author with executives of successful global companies. That theme was the respect for local initiative and input by headquarters executives, and the corresponding respect for headquarters' vision by local executives. .

National Controls and Barriers

Every' country protects local enterprise and interests by maintaining control over market access and entry in both low-and high-tech-tech industries and advertising. Such control ranges from a monopoly controlling access to tobacco markets to national government control of broadcast, equipment transmission markets. Today, tariff barriers have been largely removed in the high-income countries, thanks to the World Trade Organization WTO) NAFTA, and other economic agreements. However, non tariff barriers (NTBs) still make it more difficult for outside companies to succeed in foreign markets. The only way Global companies -can overcome these barriers is to become "insiders" in every country in which they do business. For example, utility companies in France are notorious for accepting bids from foreign equipment suppliers but in the end, favoring national suppliers when awarding contracts. When a global company such as ABB acquires or establishes a subsidiary in France, it can receive the same treatment as other local companies. It becomes an "insider."

Global advertising and promotion are also hampered by government regulations. It is illegal in some countries to use comparative advertising. In some countries, such as

Germany, premiums and sweepstakes are illegal. Also working against global advertising is the use of different technical standards around the world. Videotape players in the Americans and Japan use the NTSC standard, whereas in Europe (except for France, which uses SECAM), the PAL system is uses.

Arizona Sunray, Inc.

Buy American or Look Abroad?

Jeffrey A. Fadiman

San Jose State University

Arizona Sunray is one of the pioneering companies in solar energy within that state. Its founding generation consisted of third-generation Arizonans, descendants of the state's earliest pioneers. The founders took great pride in that pioneering heritage, often boasting that the family's rise to relative prosperity was a result of "thinking Arizona." To them, the phrase meant a ceaseless search for business opportunities within the state.

In the late I 950s, one member of this generation emerged as a new type of pioneer-one of a cluster of scientists and businessmen who hoped to develop the first practical applications of solar energy on a scale available to home owners. In the early 1960s, he pioneered the use of solar energy in offices and homes, incorporating, with other members of his family, into what proved to be a surprisingly successful firm, eventually named Arizona Sunray. After some experimentation, the firm chose the slogan "Follow the Sun: It's Arizona's Way." Reasoning that the way to acquire new business was to follow the sun, the firm expanded into every area of Arizona, and then into Nevada and New Mexico.

The next generation took control of the business in 1965. As a result, a decision was made to redirect expansion away from the relatively unpopulated states of the Southwest and move due, west into the larger urban population centers of coastal California. The Los Angeles/Orange County area was considered particularly favorable for potential expansion, with relatively affluent target populations that might show considerable interest in the use of solar energy within their homes. Several aspects of the marketing program were reshaped to appeal more directly to coastal Californians, including a change in the firm's slogan, which became "Catch the Rays: It's California's Way." The concept proved quite successful, and the firm continued to expand.

By 1995 members of the next generation were just beginning to reach positions of influence and authority within the firm. Their relative affluence, however, had permitted them to acquire both travel experience and education abroad. As a consequence, they proposed a further expansion, seeking to "follow the sun" on a scale undreamed of by their elders. They argued that Arizona Sunray should spread around the entire Pacific Rim, taking appropriate advantage of new techniques in miniaturization to fulfill an entire range of solar-powered needs-from solar-powered calculators to rural solar cookers-permitting Arizona Sunray (to be renamed Pacific Sunray) to take maximum advantage of both current opportunity and long-range planning for expansion.

Surviving members of the founding generation instantly rejected the proposal, refusing to contemplate such radical ideas. "Why even bother?" the firm's first president asked. "We're doing fine right in America. We know our product, we know our clientele, and we know the West. This market's huge! We're making steady profits. Every member of this family and every worker in this firm is doing fine. Why would we want to dissipate our capital in marketing to places we know next to nothing about? The money's in America; why look abroad?"

Members of all three generations met to thrash out the issue. The oldest, though now retired held considerable influence. The youngest, though lacking power, felt they held a wider and more flexible perspective. The middle generation, though holding formal decision-making powers, felt pulled both ways and wondered if there might be ways to satisfy both sides.

Questions

1. As a member of the youngest generation, present your case. What advantages could Arizona Sunray derive from an attempt to expand its goods and services abroad?
2. As a member of the oldest generation, present your case. Why should the firm remain within America? What hard questions could you ask of members of the youngest generation that' might suggest weaknesses in their proposal?
3. As a member of the middle generation, what compromise can you propose that might prove acceptable to both sides?

Can Mac Fight Back?

LEAD STORY-DATELINE: Marketing, 17 October 2002. McDonald's is the world's biggest restaurant chain, and according to Interbrand, the 8th most valuable brand. It seems everyone recognizes the golden arches. The company is extremely successful despite being a symbol of American imperialism, and being hated by animal rights activists, groups promoting healthy diets, and anti-capitalists. There are signs that McDonald's is having difficulty keeping up with the trends in the restaurant industry, maintaining its positive brand image, and getting the message out about its products. The company's share price stands at a seven-year low, and in September 2002; Salomon Smith Barney forecasted McDonald's stock would under perform.

McDonald's is experimenting with new restaurant designs, diversifying its menu offerings to include healthier choices or touches of cuisines favored in the local area, and lowering prices on various items to try to appeal to more people, keep its image fresh, and increase sales. Yet Mark Kalinowski of Salomon Smith Barney says those things do not make up for rude McDonald's workers, order mistakes, or sluggish service. And Kalinowski is not the only one to have noticed. Many people around the world are questioning McDonald's ability to meet its commitment of quality and service in its restaurants. Even the role of Ronald McDonald in the company's communications may be faltering. Leaked internal memos suggest company executives are questioning his relevance for today's children.

The company's commercials in the UK have taken a turn for the worse lately, lacking a cohesive message. The company has been beleaguered by bad press - vegetarians suing over eating its beef-based cooking oil, teenagers accusing the restaurant of making them fat, popular books criticizing the fast food industry, and fears of mad cow disease. The company seems to be responding by supporting more community programs and increasing its sponsorship of charitable causes, such as funding Unicef's World Children's Day. Whether McDonald's strategy to stay ahead of the competition will be effective remains to be seen.

Questions

1. In general, where do you think McDonald's stands on the range from standardization to adaptation in terms of its global marketing?
2. What are some of the issues in having a mascot like Ronald McDonald in another culture besides the U.S.? How can it be effective in other national settings?
3. The text discussion refers primarily to manufactured products. However, do you think that it applies to the problems that McDonald's has in the restaurant business?

Reasons for Global Marketing

- Growth
  - Access to new markets
  - Access to resources
- Survival
  - Against competitors with lower costs (due to increased access to resources)

Global Marketing Vs. Marketing

- Marketing is the process of planning and executing the conception, pricing, promotion, and distribution of goods, ideas, and services to create exchanges that satisfy individual and organizational goals.
- Global marketing focuses on global market opportunities and threats.

Globalization

- *Globalization is the inexorable integration of markets, nation-states, and technologies to a degree never witnessed before - in a way that is enabling individuals, corporations, and nation-states to reach around the world farther, faster, deeper and cheaper than ever before, and in a way that is enabling the world to reach into individuals, corporations, and nation-states farther, faster, deeper, and cheaper than ever before.*
  - » Thomas Friedman

What is a Global Industry?

- An industry is global to the extent that a company's industry position in one country is interdependent with its industry position in another country
- Indicators of globalization:
  - Ratio of cross-border trade to total worldwide production
  - Ratio of cross-border investment to total capital investment
  - Proportion of industry revenue generated by companies that compete in key world regions

Globalization or Global Localization?

- Globalization
  - Developing standardized products marketed worldwide with a standardized marketing mix
  - Essence of mass marketing
- Global localization
  - Mixing standardization and customization in a way that minimizes costs while maximizing satisfaction
  - Essence of segmentation
  - Think globally, act locally

Keegan and Green, Chapter 1 11

Examples of Global Marketers

• Coca-Cola	• USA
• Philip Morris	• USA
• Daimler-Chrysler	• Germany
• McDonald's	• USA
• Toyota	• Japan
• Ford	• USA
• Unilever	• UK/ Netherlands
• Gillette	• USA
• IBM	• USA

Keegan and Green, Chapter 1 13

The 18 Guiding Principles of The Marketing Company

What is the marketing company? As you will soon explore the characters of the company in the following pages, it is not just a marketing-oriented company. The Marketing Company is an organization that adopts the 18 Guiding Principles of the Marketing Company as its credo-as its guiding values, its principles to compete in the new marketplace. It endures external and internal change drivers, more demanding customers, and even fiercer competitors. After all, a new competition needs a different kind of rules and principles to survive and win the race. Be ready to rewrite your credo or your company will die.

Principle no. 1: The principle of the company: Marketing is a strategic business concept.

Principle no. 2: The principle of the community: Marketing is everyone's business

Principle no. 3: The principle of competition: Marketing war is about value war

Principle no. 4: The principle of retention: Concentrate on loyalty, not just on satisfaction

Principle no. 5: The principle of integration: Concentrate on differences, not just on averages

Principle no. 6: The principle of anticipation: Concentrate on proactivity, not just on reactivity

Principle no. 7: The principle of brand: Avoid the commodity-like trap

Principle no. 8: The principle of service: Avoid the business-category trap

Principle no. 9: The principle of process: Avoid the function-orientation trap

Principle no. 10: The principle of segmentation: View your market creatively

Principle no. 11: The principle of targeting: Allocate your resources effectively

Principle no. 12: The principle of positioning: Lead your customers credibly

Principle no. 13: The principle of differentiation: Integrate your content, context and infrastructure

Principle no. 14: The principle of marketing mix: Integrate your offer, logistics and communications

Principle no. 15: The principle of selling: Integrate your company, customers and relationships

Principle no. 16: The principle of totality: Balance your strategy, tactics and value

Principle no. 17: The principle of agility: Integrate your what, why and how

Principle no. 18: The principle of utility: Integrate your present, future and gap

LESSON 3:
ECONOMIC ENVIRONMENT-THE WORLD ECONOMY

The macro dimensions of "the environment is economic, social and cultural, political and legal and technological". Each is important, but perhaps the single most immortal characteristic of the global market environment is the economic dimension. With money, all things (well, almost all!) are possible. Without money, many things are impossible for the marketer. Luxury products, for example, cannot be sold to low-income consumers. Hypermarkets for food, furniture, or durables require a large base of consumers with the ability to make large purchases of goods and the ability to drive away with those purchases. Sophisticated industrial products require sophisticated industries as buyers.

Today, in contrast to any previous time in the history of the world, there is global economic growth. For the first time in the history of global marketing, markets in every region of the world are potential targets for almost every company from high tech to low tech, across the spectrum of products from basic to luxury. Indeed, the fastest-growing markets, as we shall see, are in countries at earlier stages of development. The economic dimensions of this world market environment are of vital importance. This chapter examines the characteristics of the world economic environment from a marketing perspective

The global marketer is fortunate in having a substantial body of data available that charts the nature of the environment on a country-by-country basis. Each country has national accounts data, indicating estimates of gross national product, gross domestic product, consumption, investment, government expenditures, and price levels. Also available on a global basis are demographic data indicating the number of people, their distribution by age category, and rates of population growth. National accounts and demographic data do not exhaust the types of economic data available.

The World Economy-An Overview

The world economy has changed profoundly since World War II. Perhaps the most fundamental change is the emergence of global markets; responding to new opportunities, global competitors. have steadily displaced local ones. Concurrently, the integration of the world economy has increased significantly. Economic integration stood at 10 percent at the beginning of the 20th century; today, it is approximately 50 percent. Integration is particularly striking in two regions, the European Union (formerly the European Community) and the North American Free Trade Area.

Within the past decade, there have been several remarkable changes in the" world economy that hold important implications for business. The likelihood of business success is much greater when plans and strategies are based on the new reality of the changed world economy:

- Capital movements rather than trade have become the driving force of the world economy.
- Production has become "uncoupled" from employment.
- The world economy dominates the scene. The macroeconomics of individual countries no longer control economic outcomes.
- The growth of commerce via the Internet diminishes the importance of national

Barriers. The first change : is the increased volume of capital movements. The dollar value of world trade is greater than ever before. Trade in goods and services is running at roughly $4 trillion per year, but the London Eurodollar market turns over $400 billion each working day. That totals to $100 trillion per year-25 times the dollar value of world trade. In addition, foreign exchange transactions are running at approximately $1 trillion per day worldwide, which is $250 trillion per year-40 times the volume of world trade in goods and services. There is an inescapable conclusion in these data: Global capital movements far exceed the volume of global merchandise and services trade. This explains the bizarre combination of U.S. trade deficits and a continually rising dollar during the first half *pf* the 1980s. Previously, when a country ran a deficit on its trade accounts, its currency would depreciate in value. Today, it is capital movements and trade that determine currency value.

The second change : concerns the relationship between productivity and employment. Although employment in manufacturing remains steady or has declined, productivity continues to grow. The pattern is especially clear in American agriculture, where fewer farm employees' produce more output. In the United States, manufacturing holds a steady 23 to 24 percent of gross national product (GNP). This is true of all the other major industrial economies as well. Manufacturing is not in decline-it is employment in manufacturing that is in decline. Countries such as the United Kingdom, which have tried to maintain blue-collar employment in manufacturing, have lost both production and jobs for their efforts.

The third major change : is the emergence of the world economy as the dominant economic unit. Company executives and national leaders who recognize this have the greatest chance of success. Those who do not recognize this fact will suffer decline and bankruptcy (in business) or overthrow (in politics). The real secret of the economic success of Germany and Japan is the fact that business leaders and policy makers focus on the world economy and world markets; a top priority for government and business in both Japan and Germany has been their competitive position in the world. In contrast, many other countries, including the United States, have focused on domestic objectives and priorities to the exclusion of their global competitive position.

In the 1990s the greatest economic change was the end of the Cold War. The success of the capitalist market system had caused the overthrow of communism as an economic and

political system. The overwhelmingly superior performance of the world's market economies has led socialist countries to renounce their ideology. A key policy change in such countries has been the abandonment of futile attempts to manage national economies with a sentential plan. The different types of economic systems are contrasted in the next section.

Economic Systems

There are three types of economic systems capitalist, socialist, and mixed. This classification is based on the dominant method of resource allocation market allocation, command or central plan allocation, and mixed allocation, respectively.

a. Market Allocation

A market allocation system is one that relies on consumers to allocate resources. Consumers "write" the economic plan by deciding what will be produced by whom. The market system is an economic democracy—citizens have the right to vote with their pocketbooks for the goods of their choice. The role of the state in a market economy is to promote competition and ensure consumer protection. The United States, most Western European countries, and Japan-the triad countries that account for three quarters of gross world product-are examples of predominantly market economies. The clear superiority of the market allocation system in delivering the goods and services that people need and want has led to its adoption in many formerly social.

b. Command Allocation

In a command allocation system, the state has broad powers to serve the public interest. These include deciding which products to make and how to make them. Consumers are free to spend their money on what is available, but decisions about what is produced and, therefore, what is available are made' by state planners. Because demand exceeds supply, the elements of the marketing mix are not used as strategic variables. There is little reliance on product differentiation, advertising, and promotion; distribution is handled by the government to cut out "exploitation" by intermediaries. Three of the most populous countries in the world-China, the former USSR, and India-relied on command allocation systems for decades. All three countries are now engaged in economic reforms directed at shifting to market allocation system.

By contrast, Cuba stands as one of the last bastions of the command allocation approach.

c. Mixed System

There are, in reality, no pure market or command allocation systems among the world's economies. All market systems have a command sector, 'and all command systems have a market sector; in other words, they are "mixed." In a market economy, the command allocation sector is the proportion of gross domestic product (GDP) that is taxed and spent by government. For the 24 member countries of the Organization for Economic Cooperation and Development (OECD), this proportion ranges from 32.percent of GDP in the United States to 64 percent in Sweden.3 In Sweden, therefore, where 64 percent of all expenditures are controlled by government, the economic system is more "command" than "market." The reverse is true in the United States. Similarly, farmers in most socialist countries were traditionally permitted to offer part of their production in a free market. China has given considerable freedom to businesses and individuals in the Guangdong province to operate within a market system. Still, China's private sector constitutes only 1 to 2 percent of national output.

Global country markets are at different stages of development. GNP per capita provides a very useful way of grouping these countries. Using GNP as a base, we have divided global markets into four categories. Although the income definition for each of the stages is arbitrary, countries in each of the four categories have similar characteristics. Thus, the stages provide a useful basis for global market segmentation and target market

Stages of Market Development

a. Low-Income Countries

Low-income countries, also known as preindustrial countries, are those with incomes of less than $786 per capita. They constitute 37 percent of the world population but less than 3 percent of world GNP. The following characteristics are shared by countries at this -income level:

1. Limited industrialization and a high percentage of the population engaged in agriculture and subsistence farming
2. High birthrates
3. Low literacy rates
4. Heavy reliance on foreign aid
5. Political instability and unrest
6. Concentration in Africa, south of the Sahara

In general, these countries represent limited markets for all products and are not significant locations for competitive threats. Still, there are exceptions; for example, in Bangladesh, where GNP per capita is $366, a growing garment industry has enjoyed burgeoning exports.

b. Lower-middle-income Countries

Lower-middle-income countries (also known as less developed countries or LDCs) are those with a GNP per capita of more than $786 and less than' $3,125. These countries constitute 39 **percent** *of* the world population but only 11 percent of world GNP. These countries are at the early stages of industrialization. Factories supply a growing domestic market with such items as clothing, batteries, tires, building materials, and package foods. These countries are also locations *for* the production of standardized or mature products such as clothing for export markets.

Income Group by per capita GNP	*2000 GNP ($ millions)*	*2000 GNP per capita ($)*	*% of world GNP*	*2000 population (million)*
High income countries (GNP per capita >$ 9,656)	24,259	24,755	81	981
Upper-middle-income countries (GNP per capita >$ 3,126 but <$9,655)	2,031	4,503	7	451
Lower- middle income countries (GNP per capita >$785 but <$ 3.125)	3,148	1,302	10	2,418
Low income countries GNP per capita >$ 785)	812	356	3	2,284

Consumer markets in these countries are expanding. LDCs represent an increasingly) competitive threat as they mobilize their relatively cheap-and often highly motivated labor to serve target markets in the rest of the world. LDCs have a' major competitive advantage in mature, standardized, labor-intensive products such as athletic shoes. Indonesia, the largest country in Southeast Asia, is a good example of an LDC on the move: Despite political problems GNP per capita has risen *from* $250 in 1985 to $1,176 in 2000. Several factories there produce athletic shoes under contract for Nike.

c. Upper-middle-income Countries

Upper middle-income countries, also known as industrializing countries, are those with GNP per capita between $3,126 and $9,6$5. These countries account for 7 percent of world population and almost 7 percent of world GNP In these countries, the percentage of population engage4 in agriculture drops sharply as people move to the industrial sector and the degree of urbanization increases. Many of the 'Countries in this stage-Malaysia, *for* example-are rapidly industrializing. They have rising wages and high rates of literacy and advanced education, but they still have significantly lower wage costs than the advanced countries. Countries hi this stage of development

Frequently become formidable competitors and experience rapid, export-driven economic growth.

d. High-income Countries

High countries, also known as advanced, industrialized, postindustrial, or Fire world countries, are those with GNP per capita above $9,655. With the exception of a few oil-rich nations, the countries in this category reached their present income level through a process of sustained economic growth. These countries account for only 16 percent of world population but 82 percent of world GNP.

The phrase postindustrial countries was first used by Daniel Bell of Harvard to describe the United States, Sweden, and Japan and other advanced, high-income societies. Bell suggests that there is a difference between the industrial and the postindustrial societies that goes beyond mere measures of income. Bell's thesis is that the sources of innovation in postindustrial societies are derived increasingly from the codification of theoretical knowledge rather than from "random" inventions. Other characteristics are the importance of the service sector (more than 50 percent of GNP); the crucial importance of information processing and exchange; and the ascendancy of knowledge over capital as the key strategic resource, of intellectual technology over machine technology, and of scientists and professionals over engineers and semi-skilled workers. Other aspects of the postindustrial society are an orientation toward the future and the importance of interpersonal relationships in the functioning of society.

Product and market opportunities in a postindustrial society are more heavily dependent on new products and innovations than in industrial societies. Ownership levels for basic products are extremely high in most households. Organizations seeking to grow often face a difficult task if they attempt to expand share of existing markets. Alternatively, they can endeavor to create new markets. For example, in the 1990s, global companies in a range of communication-related industries were seeking create new markets for multimedia, interactive forms of electronic communication.

e. Basket Cases

A basket case is a country with economic, social, and political problems that are so serious they make the country unattractive for investment and operations. Some basket cases are low-income, no-growth countries, such as Ethiopia and Mozambique, that lurch' from one disaster to the next. Others are once growing and successful countries that have become divided by political struggles. The result is civil strife, declining income, and, often, considerable danger to residents. Basket cases embroiled in civil wars are dangerous areas; most companies find it prudent to avoid these countries during active conflict. most marketers tend to stay away from these countries or do business on a limited basis.

The Stages of Economic Development

The stages of market development based on GNP per capita correspond with the stages of economic developments. Low and lower-middle income countries are also referred to as less developed countries or LDCs. The upper middle-income countries. are also called industrializing countries, and high-income countries are referred to as advanced, industrialized, and postindustrial. Note that the shares of world GNP and the GNP per capita data. Are based on income in national currency translated into U.S dollars at year-end exchange rates. They do not reflect the actual purchasing power and standard of living in the different countries.

Income and Purchasing Power Parity Around The Golbe

When a company charts a plan for global market expansion, it often finds that, for most products, income is the single most valuable economic variable. After all, a market can be defined as a group of people willing and able to buy a particular product. For some products, particularly those that have a very low unit cost—cigarettes, for example population is a more valuable predictor of market potential than income. Nevertheless, for the vast range of industrial and consumer products in international markets today, the single most valuable and important indicator of potential is income.

Ideally, GNP and other measures of national income converted to U.S. dollars should be calculated on the basis of purchasing power parities (i.e., what the currency will buy il1 the country of issue) or through direct comparisons of actual prices for a given product. This would provide an actual comparison of the standards of living in the countries of the world. Unfortunately, these data are not available ill regular statistical reports.

The reader must remember that exchange rates equate, at best, the prices of internationally traded goods and services. They often bear little relationship to the prices of those goods and services not traded internationally, which form the bulk of the national product in most countries.

The per capita GNP for Brazil and Chile are similar, $4,986 and $5,822, respectively. However, the PPP per capita GNP is quite different, $5,536 and *$12,035,* respectively. The typical" consumer in Chile has more than twice the purchasing power than the Brazilian consumer.

Top 10 nations ranked by per capita income and purchasing power parity

2000 GNP Per Capita Income		2000 GNP Income Adjusted for Purchasing Power Parity (PPP)	
1. Luxembourg	$38,587	1.Luxembourg	$35,708
2. Norway	38,010	2.United States	29,953
3. Singapore	36,484	3.Singapore	28,648
4. Switzerland	36,479	4. Norway	25,807
5. Kuwait	35,242	5. Hong Kong	24,602
6. Japan	34,796	6. Switzerland	24,222
7. Denmark	33,894	7. Denmark'	23,555
8. United States	20,953	8. Japan	23,353
9. Hong Kong	27,463	9. Belgium	22,765
10. Austria	25,854	10. Austria	21,787

A visit to a mud house in Tanzania will reveal many of the things that money can buy: radios, an iron bed frame, a corrugated metal roof, beer and soft drinks, bicycles; shoes, photographs, and razor blades. What Tanzania's per capita income of $244 does not-reflect is the fact that instead of utility bills, Tanzanians pave the local well and the sun. Instead of nursing homes, tradition and custom ensure that families will take care of the elderly at home. Instead of expensive doctors and hospitals, villagers can turn to witch doctors and healers. In industrialized countries, a significant portion of national income is generated by taking goods and services that would be free in a poor country and putting a price on them. Thus, the standard of1iving in many countries is often higher than income data might suggest.

One researcher has calculated that India, one of the poorest countries in the world, could reach U.S. income levels by growing at an average rate of 5 to 6 percent in real terms for 40 to 50 years. This is no more than the lifetime of an average Indian, and about half the lifetime of an average American. Japan was' the first country with a non-European heritage to achieve high-income status. This' was the result of sustained high growth and the ability to acquire knowledge and know-how, first by making copies of products and then by making improvements. As Japan has dramatically demonstrated, this is a potent formula for catching up and achieving. economic leadership.

Today, much more than was true 1,000 years ago, wealth and income are concentrated regionally, nationally, and within nations. The implications of this reality. are crucial for the global marketer. A company that decides to diversify geographically can accomplish this objective by establishing operations in a handful of national markets.

The Location of Population

We have already noted the concentration of 72 percent of world income in the Triad(North America, the EU, and Japan) but only 13 percent of the world population. As shown in the table below, in 2000, the 10 most populous countries in the world accounted for 59 percent of world income, and the 5 largest accounted for 48 percent. The concentration of income in the high-income and large-population countries means that a company can be global-derive a significant proportion of its income from countries at different stages of development-while operating in 10 or fewer countries.

For products whose price is low enough, population is a more important variable than income in determining market potential. Although population' is not s concentrated as income, there is, in terms of size of nations, a pattern of considerable concentration. The 10 most populous countries in the world account for roughly 0 percent of the world's population today.

The 10 most populous countries in the world accounted for

TABLE 2.7 The 10 most populous countries: 2000 with projection to 2020

Global income and Population	2000 Population (Thousands)	%of World Population	Projected Population 2020	2000 GNP (Millions)	Per Capita. GNP	%01 World GNP
World Total	6;134,466	100.0	8,504,642	30,578,246	-	100.0
1. China	1,268,121	20.7	1,609,796	1,179,345	930	3.9
2 India	1,15,287	16.6	1,464,902	430,09	424	1.4
3. United States	275,746	4.5	326,601	8,259,358	29,953	27.3
4. Indonesia	210,785	3.4	286,706	247,846	1,176	0.7
5, Brazil	170,661	2.8	232,130	850,852	5,535	2.8
6. Russian federation	146,866	2.4	157,495	342,008	2,329	1.1
7. Pakistan	138,334	2.3	242,669	66,219	479	0.2
8. Bangladesh	129,663	2.1	190,792	47,489	1,501	0.2
9. Nigeria	128,454	2.1	255,338	38,416	299	0.1
10. Japan	127,229	2.1	137,804	4,427,104	34,796	14.6

People have inhabited the earth for over 2.5 million years. The number of human beings has been small during most of this period. In Christ's lifetime. There were approximately 300 million people on earth, or roughly one quarter of the number of people on mainland China today. World population increased tremendously during the 18th and 19th centuries, reaching 1 billion by 1850. Between 1850 and 1925, global population had doubled, to 2 billion, and from 1925 to 1960 it had increased to 3 billion. World population is now over 6 billion; at the present rate of growth it will reach 10 billion by the middle of this century. Projections on whether this growth rate will continue or not will have has a dramatic effect on the total future population. Also to consider is that the population is not expanding equally across the globe. Developing countries are expanding much faster than developed countries but the birthrate even in developing countries can vary widely as attitudes toward the number of children, economic development, and diseases change. Simply put, global population will probably double during the lifetime of many students using this textbook.

Generally, there is a negative correlation- between population growth rate and income per capita. The lower the income per capita, the higher the rate of population growth and vice versa. In countries such as the United States, Germany, and Japan, the growth rate from 1990 to 1996 was 1 percent or under. Recently, however, some countries in the low-middle and lower-income categories have negative rates of population. These are concentrated in the former republics of the Soviet Union.

Marketing and Economic Development

An important concern in marketing is whether it has any relevance to the process of economic development. Some people believe the field of marketing is relevant only to the conditions that apply in affluent, industrialized countries where the major problem is one of directing society's resources into ever-changing output or production to satisfy a dynamic marketplace. In the less developed country, the argument goes, the major problem is the allocation of scarce resources toward obvious production needs. Efforts should focus on production and how to increase output, not on customer needs and wants.

Conversely, it can be argued that the marketing process of focusing an organization's resources on environmental opportunities is a process of universal relevance. The role of marketing-to identify people'8 needs and wants, and to focus individual and organizational efforts to respond to these needs and wants : is the same in both low : and high-income countries.

Economic Risk

Economic development does not always follow a straight upward path. Even in countries with established governments, radical political change often goes hand in hand with drastic economic change. This has a tremendous effect on consumer purchases and how marketers adapt their efforts in these countries. Depending on the gravity of the economic disorder, stagflation to depression, consumers buy fewer, less expensive but more functional products. This is a signal to marketers to adjust pricing and product design 'accordingly. Recent examples of cases in which marketers had to implement such changes are the countries affected by the Asian Flu. In Southeast Asia in the late 1990s, the Indonesian rupiah fell more than 70 percent against the U.S. dollar, the Thai .baht and Korean won depreciated by 40 to 50 percent, the Malaysian ringgit and Philippine peso lost 40 percent of their value, and the currency in Singapore and Taiwan lost 20 percent as. well. Global market in the region had to adapt their marketing strategies on a country-by-country basis.

Balance of Payments

The balance of payments. is a record of all of the economic transactions between residents of a country and the rest of the world.

The balance of payments is divided into a so-called "current" and "capital" account. The current account is a record of all of the recurring trade in merchandise and service, private gifts, and public aid transactions between countries. The capital account is a record of all long-term direct investment, portfolio investment, and other short- and long-term capital flows. The minus signs signify outflows of cash; for example, in Table 2-8, line A2 shows an outflow of $877 billion that represents payment for U.S. merchandise imports. In general, a country accumulates reserves when the net of its current and capital account transactions shows a surplus; it gives up reserves when the net shows a deficit. The important fact to recognize about the overall balance of payments is that it is always in Balance. Imbalances occur in subsets of the overall balance.

U.S.balance of Payments(1994-1997)

	1994	1995	1996	1997
A. Current Account	-123.21	-115.22	-135.44	-155.38
1. Goods: Exports FOB	504.45	577.69	613.89	681.27
2. Goods: Imports FOB	-668.59	-749.57	-803.32	-877.28
3. Balance on Goods	-164.14	-171.88	-189.43	-196.01
4. Services: Credit	199.25	217.80	236.71	256.06
5. Services: Debit	-132.45	-141.98	-152.00	-166.09
6. Balance on Goods and Services	-97.34	-96.06	-104.72	-106.04
B. Capital Account	-.60	.10	.52	.16
Total A + B	-123.81	-115.12	-134.91	-155.22

Source: *Adapted from* Balance of Payments Statistics Yearbook *(Washington, DC: The International Monetary Fund, 1998), p. 852.*

Japan Balance of Payments (1994-1997)

	1994	1995	1996	1997
A. Current Account	131.64	111.04	65.88	94.35
1. Goods: Exports FOB	385.70	428.72	400.28	409.24
2. Goods: Imports FOB	-241.51	-296.93	-316.72	-307.64
3. Balance on Goods	144.19	131.79	83.56	101.60
4. Services: Credit	58.30	65.27	67.72	69.30
5. Services: Debit	-106.36	-122.63	-129.96	-123.45
6. Balance on goods and Services	96.13	74.43	21.32	47.45
B. Capital Account	-1.85	-2.23	-3.29	-4.05
Total A + B	128.41	108.82	62.59	90.30

Source: *Adapted from* Balance of Payments Statistics Yearbook *(Washington, DC: The International Monetary Fund, 1998), p. 405.*

Trade Patterns

Since the end of World War II, world merchandise trade has grown faster than world production. In other words, import and export growth has outpaced the rate of increase in GNP. Moreover, since 1983, foreign direct investment has grown five times faster than world trade and 10 times faster than GNP.

The importance of Europe and Central Eurasia-is quite pronounced: They accounted for approximately 60 percent of world exports and imports. Industrialized nations have increased their share of world trade by trading more among themselves and less with the rest of the World.

a. Merchandise Trade

In 1994, the dollar value of world trade was approximately $4.1 trillion. Seventy-five percent of world exports were generated by industrialized countries, and 25 percent by developing countries. The European Union accounted for 40 percent, the United States and Canada for 18 percent, and Japan for 9 percent. If the EU were considered a single country, its share of world export would be slightly less than that of the United States. Trade growth outside industrialized countries has been slow.

Key U.S. Trade Information

1998 $ Volume		Exports: $ Billion		Imports: $ 912 Billion
Partners	Canada	22%	Canada	19%
	Western Europe	21%	Western Europe	18%
	Japan	10%	Japan	14%
	Mexico	10%	Mexico	10%
			China	7%
	Total	63%	Total	68%
Commodities	Capital goods Automobiles Industrial supplies Consumer goods Agricultural products		Oil and petroleum products Machinery Automobiles Consumer goods Industrial raw materials Food and beverages	

b. Servicestrade

Probably the fastest-growing sector of world trade is trade in services. Services include trade and entertainment; education; business services such as engineering, accounting, and legal services; and payments of royalties and license fees. Unfortunately, the statistics and data on trade in services are not as comprehensive as those for merchandise trade. For example, many countries (especially low-income countries) are lax in enforcing international copyrights, protecting intellectual property, and patent laws. As a result, countries that export service products such as software and Video entertainment suffer a loss of service. According to the software publishers association, annual worldwide losses due to software piracy amount to$8 billion. In china and the countries of the former Soviet Union, more than 95 percent of the personal computer software in use in believed to be pirated.

20 Leading Exporters and Importers in World Merchandise Trade-1997

	Percent Change			Percent Change	
Leading Exporters	1997	'97/'96	Leading Importers	1997	'97/'96
1. United States	762.8	9.0	1. United States	867.0	8.9
2. Germany	482.4	-2.2	2. Germany	438.9	-1.6
3. Japan	464.4	3.6	3. Japan	304.9	-3.1
4. China, P. R	287.6	12.9	4. United Kingdom	297.5	6.7
5. France	280.9	-1.0	5. France	270.4	3.5
6. United Kingdom	265.2	6.3	6. Netherlands	204.7	2.5
7. Italy	222.4	-1.8	7. Canada	195.2	13.0
8. Canada	220.1	5.8	8. Italy	190.4	3.8
9. Netherlands	171.3	-.005	9. Hong Kong	186.6	11.0
10.Belgium-Luxembourg	143.3	1.1	10. China, P. R.	164.6	5.2
11. Taiwan	135.2	3.6	11. Belgium-Luxembourg	155.2	0.2
12. South Korea	125.0	7.5	12. South Korea	123.2	-4.0
13. Malaysia	115.0	24.0	13. Spain	119.9	3.5
14. Mexico	108.7	16.2	14. Taiwan	103.9	11.3
15. Spain	99.5	3.9	15. Mexico	92.5	25.8
16. Singapore	98.9	1.8	16. Switzerland	87.9	-2.7
17. Switzerland	90.8	-3.9	17. Malaysia	79.3	4.6
18. Sweden	79.1	-1.5	18. Russia	63.6	9.6
19. Russia	82.9	-2.7	19. Brazil	61.2	15.0
20. Saudi Arabia:	67.2	7.3	20. Austria	60.6	-3.5
Source: Adapted from International Monetary Fund, Direction afTrade Statistics (Washington, DC: IMF, 1998), pp. 2-3.					

Since World War II, there has been a tremendous interest among nations in economic cooperation. This interest has been stimulated by the success of the European Community, which was itself inspired by the U.S. economy. There are many degrees of economic cooperation, ranging from agreement between two or more nations to reductions of barriers to trade, to the full-scale economic integration of two or more national economies. The best-known preferential arrangement of the early 20th century was the British Commonwealth preference system. This system provided a foundation for trade among the United Kingdom, Canada, Australia, New Zealand, India, and Certain other former British colonies in Africa, Asia, and the Middle East. The decision by the United Kingdom to join the European Economic Community resulted in the demise of this system and illustrates the constantly evolving nature of international economic cooperation.

The marketing implications of trade alliances may include harmonization of business requirements such as packaging requirements, a common currency that allows consumers to more easily compare pricing across countries, and economic development that leads to more consumers who can afford to buy more products

LESSON 4:
ECONOMIC ENVIRONMENT- FOREIGN ECONOMIES

Measuring The Russian Economy

In today's Russia, average citizens are not the only ones struggling to keep pace with rapid and revolutionary economic change; government statisticians cannot even keep up. The result is that economic information and statistics coming form Russia are inaccurate, inadequate, distorted, and biased.

Russia's main source of economic statistics is an agency called Goskomstat, or the Russian state statistical committee. The inherent problem with the statistics generated by Goskomstat is one of original intent; Historically, Goskomstat measured the state economy of the soviet union the purpose of the statistics that are still used for economic measurement today does not exist anymore because of the change form a planned economy to a market economy.

Goskomstat continues to collect data and measure production in the least productive sectors, namely, industries that have not been privatized and farms still owned by the state. If those statistics were somewhat balanced by equivalent numbers from the private sector, Russian GNP might not be so severely underestimated. However, Goskomstat is not at all aggressive about counting the growing private sector in the Russian economy. The growth in Russian joint ventures, retail and service trade, and private banking has been well documented in the press but not by Goskomstat.

The problem of gathering data form start up businesses in the emerging private sector is compounded by the fact that those enterprises are reluctant to be included because of potential tax implications. Also, because of inadequate survey techniques, thousands of sole proprietorships, entrepreneurial and barter trade enterprises, as well as informal, black and gray markets are all outside to inflate production numbers to reach goals set by state planners.

Even the data generated from the fading state sector are inadequate because organizations on the government dole are not motivated to report any increased production. That enterprise could stand to lose government subsidies if production goes up. Ironically, in the soviet era, managers of state owned businesses were inclined to inflate production numbers to reach goals set by state planners.

So what is the impact of the skewed numbers put forth by Goskomstat? The faulty numbers create a ripple effect worldwide. Other agencies that rely on this imperfect source for economic data include the world bank, international monetary fund, US. Department of commerce, the central intelligence Agency (CIA), plus countless banks and 8ndustrial and investment analysis. At the very least, statistics severely understate production, especially in the growing private economy. The estimated amount of underreported production ranges from 25 percent to 60 prevent, with most experts estimating a 45 prevent undercount to be closest to reality. One consequence for the Russian economy is slowed growth because nervous investors may be reluctant to enter a market depicted by such bleak numbers.

Degrees of Economic Cooperation

There are four degrees of economic cooperation and integration, as illustrated in table below

Free Trade Area

A free trade area (FTA) is a group of countries that have agreed to abolish all internal barriers to trade among themselves. Countries that belong to a free trade area can and do trade policies with third countries. A system of certificates of origin is used to avoid trade diversion in favor of low tariff members. The system discourages importing goods in the member country with the lowest tariff for shipment to countries within the area with higher external tariffs. Customs inspectors police the borders between members. The European Economic Area is an *FTA* that includes the 15nation European Union and Norway, Liechtenstein, and Iceland. The Canada-U.S. Free Trade Area formally came into existence in 1989. In 1992, representatives from the United States, Canada, and Mexico' concluded negotiations for the North American Free trade Agreement (NAFTA). The agreement approved by both houses of the U.S. Congress and became effective on January 1, 1994.

In the 1960s, the Latin Americans responded to European integration moves by forming regional groupings of their own. In Central America, they formed the Central American Common Market; in South America, they formed the Latin American Free Trade Area; the Andean countries broke away from LAFTA to form the Andean Common Market. Unfortunately, none of these groups has made rapid progress. In the early 1990s, the Southern Cone countries (Argentina, Brazil, Paraguay, Uruguay) formed .Mercosur, which has made rapid progress. It is now the most successful and promising regional grouping apart from the EU.

During the Vietnam War, a: number of; Southeast Asian nations formed ASEAN (Association of Southeast Asian Nations). ASEAN had political overtones as well as economic goals, but it made only modest progress at economic integration over the next two decades. In 1998, however, the leaders reaffirmed their commitment to achieve an Asian Free Trade Area (AFT A) by 2003. The Asian troubles may affect this. The United States is a member of two free-trade areas, one with Israel and one with Canada and Mexico in *NAFTA*. NAFTA is very important because it creates a free-trade area of 360 million consumers-as large as the EU-EFTA grouping. As with any regional grouping, NAFTA has encountered some rough spots, but its importance can be seen in the fact that the three member countries are each other's largest customers and suppliers.

There was discussion during the Clinton administration of forming a free trade area of all the Americas, North and South.

Though there is interest from most countries in the Americas, it is still just an idea on the horizon.

Stage of integration	Abolition of Tariffs and Quotas	Common Tariff and Quota System	Removal of Restrictions on Factor Movements	Harmonization of Economic, Social, and Regulatory Policies
Free trade area	Yes	No	No	No
Customer union	Yes	Yes	No	No
Common market	Yes	Yes	Yes	No
Economic union	Yes	Yes	Yes	Yes

Customs Union

Though similar -to a free-trade area in that it has no tariffs on trade among members, a customs union has the more ambitious requirement that members also have a uniform tariff on trade with nonmembers. Thus, a customs union is like a single nation, not only in internal trade, but also in presenting a united front to the rest of the world with its common external tariff. A customs union is more difficult to achieve than a free-trade area because each member must yield its sovereignty in commercial policy matters, not just with member nations but also with the whole world. Its advantage lies in making the economic integration stronger and avoiding the administrative problems of a free-trade area. For example; in a free-trade area, imports of a particular good would always enter the member country with the lowest tariff on that good, regardless of the country of destination. To avoid this perversion of trade patterns, special regulations are necessary.

The leading example of a customs union is the EU. Although the EU is often referred to as the Common Market, it is more accurately described as a customs union. In July 1968, the EU achieved a full customs union, a goal toward which member nations had been working since January 1, 1958. Though this is a slower timetable than that of EFTA, it represents a much more ambitious endeavor because it includes not only a free-trade area among members but also a common external tariff. In addition, it covers agricultural products, which were omitted by EFTA.

A customs union represents the logical evolution of an FTA. In addition to eliminating the internal barriers to trade, members of a customs. union agree to the establishment 'of common external barriers. The Central American Common Market, Southern Cone Common Market (Mercosur), and the Andean Group are all examples of customs unions.

Common Market

A common market goes beyond the removal of internal barriers to trade and the establishment of common external barriers to the important next stage of eliminating the barriers to the flow of factors (labor and capital) within the market. A common area builds on the elimination of the internal tariff barriers and the establishment of common external barriers. It seeks to coordinate economic and social policy within the market to allow free flow of capital and labor from country to country. Thus, a common market creates an open market not only for goods but also for services and capital.

A true common market includes a customs union but goes significantly beyond it because it seeks to standardize or harmonize all government regulations affecting trade. These include all aspects of government policy that pertain to business-for example, corporation and excise taxes, labor laws, fringe benefits and social security programs, incorporation laws, and antitrust laws. In such an economic union, business and trade decisions would be unaffected by the national laws of different members because they would be uniform. The United States is the closest example of a common market. Even here, however, the example is not perfect, because different states do have different laws and taxes pertaining to business. U.S. business decisions, therefore, are solve what influenced by differing state laws.

The EU is the best contemporary example of a common market in formation. It always had the goal of achieving such status, but what it achieved earlier was actually a customs union with a few extra dimensions. What was exciting about 1992 was the member states undertaking 300 new directives to reach a true common market by harmonizing the different national regulations in 12 member countries. Even though this goal was not reached fully by 1992, great strides. toward market integration were made. The fact that 300 directives were still necessary 30 years after forming the EU shows how difficult and complex it is to form a true common market.

The Single Market continues in Europe with two major new steps. One is the monetary union with the Euro as the new single currency for most member countries. The second is the coming addition of five new members front Central Europe. However, given the fact that the EU members have multiple languages, as well as diverse cultures, histories, and legal systems, it is not surprising that they continue to have trouble emulating common market environment of the much more homogeneous United States.

Economic Union

The full evolution of an economic union would involve the creation of a unified central bank; the use of a single currency; and common policies on agriculture, social services and welfare, regional development, transport, taxation, competition and mergers, construction and building, and so on. A fully developed economic union requires extensive political unity, which makes it similar to a nation. The further integration of nations that were members of fully developed economic unions would be the formation of a central government that would bring together independent political states into a single political framework.

The European Union (EU) is approaching its target of completing most of the steps required to create a full economic union, but major hurdles remain.

The World Trade Organization and Gatt

The year 1997 marked the 50th anniversary of the GAIT, a treaty among 123 nations whose governments agreed, at least in principle, to promote trade among members. GAIT was intended to be a multilateral, global initiative, and GAIT negotiators did, indeed, succeed in liberalizing world merchandise trade. It "was also an organization that had handled 300 trade disputes-many involving food - during its half century of

existence. GAIT itself had no enforcement power (the losing party in a dispute was entitled to ignore the ruling), and the process of dealing with disputes sometime stretched on for years. Little wonder, then, that some critics referred to GATT as the " general agreement to talk and talk."

The successor to GATT, the World Trade Organization (WTO), came into existence on January 1,1995. From its base in Geneva, the WTO provides a forum for trade-related negotiations. The WTO's staff of neutral trade experts will also serve as mediators in global trade disputes. The WTO had a Dispute Settlement Body (DSB) that mediates complaints about unfair trade barriers and other issues between WTO member countries. During a 60-day consultation period, parties to a complaint are expected to engage in good-faith negotiations and reach an amicable resolution. Failing that, the complainant can ask the DSB to appoint a three-member panel of trade experts to hear the case behind closed doors. After convening, the panel has 9 months within which to issue its ruling. The DSB is empowered to action the panel's recommendations. The losing party has the option of turning to a seven-member appellate body. If, after due process, trade policies are found to violate WTO rules, the country is expected to change those policies if changes are not forthcoming, the WTO can authorize trade sanctions against the loser.

One of the WTO's first major tasks was hosting negotiations-on the General Agreement on Trade in Services, in which 76 signatories made binding market access commitments in banking, securities, and insurance. The WTO faced its first real test when representatives from the United States and Japan met in 1995 to try to resolve a dispute over Washington's claims that Japan engaged in unfair trade practices that limited imports of U.S. car parts. The Clinton administration was responding to the fact that one third of the U.S. merchandise trade deficit-$66 billion in 1994 alone-is with Japan. Moreover, cars and auto parts accounted for approximately two thirds of that $66 billion. In the spring of 1995, the United States threatened to slap 100 percent tariffs on 13 models of cars imported from Japan. Japan formally filed a complaint with the WTO to object to the tariffs; although a trade war was narrowly averted at the last moment, trade-related tensions between- the two countries continue to simmer. Trade tensions flared up again in 1"998 as the United States threatened to slap 100 percent tariffs on European imports such as Italian hams and bed linens. The United States was acting in response to Europe's banana import quota system."

Still, it remains to be seen whether the WTO will live up to expectations regarding additional major policy initiatives on such issues as competition of foreign investment. One problem IS that politicians in many countries are resisting the WTO's plans to move swiftly in removing trade barriers. A Norwegian trade group told reporters that the WTO's motto should be, "If you can decide it tomorrow, why decide it today?" Still, as Director General Renato Ruggiero said recently, "Free trade is a process that cannot be stopped."

Regional Economic Organizations

In addition to the multilateral initiatives of the World Trade Organization (WTO), countries in each of the world's regions are seeking to lower barriers to trade within their regions. The following section describes the major regional economic cooperation agreements. The trade groups listed next are divided geographically into the European, North American, Asian, South and Latin American, and African and Middle Eastern trade groups.

1. European Trade Groups

The European Union (formerly known as the European Community [EC]) was established by the Treaty of Rame in 1958. The six original members were Belgium, France, Holland, Italy, Luxembourg, and West Germany. In 1973, Britain, Denmark, and Ireland were admitted, followed by Greece in 1981 and' Spain and Portugal in 1986. The three newest members, Finland, Sweden, and Austria joined in 1995. (In 1994, voters in Norway rejected a membership proposal.) today, the 15 nations of the EU represent 378 million people, a combined GNP of $8.3 trillion, and 28 percent of world GNP.

Beginning in 1987, the 12 countries that were EC members at that time set about the difficult task of creating a genuine single market in goods, services, and capital. Completing the single-market program by year-end 1992 was a major EC achievement; the Council of Ministers adopted 282 pieces of legislation and regulations to make the single market a reality. Now, citizens of the 15 countries are able to freely cross borders within the EU.

How have companies responded to the movement in the EU toward a single market? In a series of surveys carried out in 1973,1983, and 1993, Boddewyn and Grosse found that there was a growing standardization of marketing policies by U.S. firms in the EU from its inception in 1958 to the early 1980s followed by a return to greater adaptation. The obstacles to standardization mentioned by respondents include differences in tastes and habits and national government regulations for consumer products, as well as nationalistic feelings and government regulations for industrial goods. These findings suggest that the EU effort to achieve greater harmonization has some distance to go.

Under provisions of the Maastricht Treaty, the EU is working to create an economic and monetary union (EMU) that will include a European Central Bank and a single European currency. Implementation of the EMU will require working out the extent to which countries sharing a currency need to coordinate taxes and budgets. A single currency would eliminate costs associated with currency conversion and exchange rate uncertainty. It would also make it easier for consumers in the various participating countries to compare pricing of goods and services. Member countries recognize that the use of multiple currencies in the EU is a source, of economic "drag" on their economy, but they also realize that the adoption, of a single currency would expose the member countries to economic risks that the countries do not face when operating with separate currencies. There is also the realization that having a currency is a key element of national control and in the end is what distinguishes a nation from a sub national unit of political organization. Countries have currencies, and states or provinces do not. Since the EU members adopted a single currency, they no longer can control the inflation and interest rates, the two key levers of monetary policy, which are key tools of any

sovereign for controlling its economic destiny. Britain, Denmark, Greece, and Sweden, are not currently participating in the single currency, which will not assume a cash form until 2002.

Further EU enlargement has become a major issue with 12 countries having been accepted as applicants. The list of applicants is divided into several categories. The Economist estimates that Hungary, Poland, and Cyprus may become full members by 2003; Estonia, Malta, Czech Republic, and Latvia in 2004; Slovenia, Lithuania, and Slovakia in 2005; Bulgaria and Romania in 2008; and Turkey in 2011.16 In theory, economic development should be the main criteria for entry; however, many political issues are also involved in making the decision for admission into the EU.

The Lome Convention

The EU maintains an accord with 70 countries in Africa, the Caribbean, and the Pacific (ACP). The Lome Convention was designed to promote trade and provide poor countries with financial assistance from the European Development Fund. Recently, budget pressures at home have prompted some EU nations to push for cuts in Lome aid.

European Economic Area

In 1991, after 14 months of negotiations, the European Economic Community and the seven nations European free Trade Association (EFTA) reached agreement on the creation of the European Economic Area (EEA) beginning January 1993. Although the goal was to achieve the free movement of goods, services, capital, and labor between the two groups, the EEA is a free trade area, not a customs union with common external tariffs. With Austria, Finland, and Sweden now members of the EU, Norway, Iceland, and Liechtenstein are the sole remnants of the EFTA that are not EU members (Switzerland voted-not to be part of the EEA). The EEA is the world's largest trading bloc, with 383 million consumers and $8.5 trillion combined GNP.)

Central European Free Trade Association

The transition in Central and Eastern Europe from command to market economies led

To the demise, in 1991, of the Council for Mutual Economic Assistance. COMECON (or CMEA, -as it was also known) was a group of communist bloc countries allied with the Soviet Union.

In 1992, Hungary, Poland and Czechoslovakia signed an agreement creating the Central European Free Trade Association (CEFTA). The signatories, pledged cooperation in a number of areas, including infrastructure and telecommunications, sub regional projects, interenterprise cooperation, and tourism and retail trade.17 Romania, Slovenia, and the two countries created by the division of Czechoslovakia- Czech Republic and Slovakia –are also CEFTA members.

Meanwhile, within the Commonwealth of Independent States, formal economic integration between the former Soviet republics is proceeding slowly. In 1995, the governments of Russia and Belarus agreed to form a customs union and remove border posts between their two countries.

2. North American Trade Group

North American, Free Trade Agreement

In 1988, the United States signed a free trade agreement with Canada (U.S.-Canada

Free Trade Agreement, or *CFTA),* the scope of which was enlarged in 1993 to include Mexico. The resulting free trade area had a 2000 population of 406.7 million and a gross

National product of $9.3 trillion.

All three governments will promote economic growth through expanded trade and investment. The benefits of continental free trade will enable all three countries to meet the economic challenges of the decades to come. The gradual elimination of barriers to the flow of goods, services, and investment, coupled with strong intellectual property rights protection (patents, trademarks, and copyrights), will benefit businesses, workers, farmers, and consumer.

3. Asian Trade Groups

Asia -Pacific Economic Cooperation

Each member of each year representatives of 18 countries that border on the Pacific Ocean meet formally to discuss prospects for liberalizing trade. Collectively, the countries that make up the Asia-Pacific Economic Cooperation (APEC) forum account for 38 percent of world population and 52 percent of world GNP. APEC provides a chance for annual discussions by people at various levels: academics and business executives, ministers, and heads of state.

Much debate among APEC members has centered on whether all trade barriers in Asia can be eliminated, without exception, by the year 2020. In 1997, the APEC meeting in Vancouver, British Columbia, faced a surprising challenge: the so-called Asian Flu financial crisis that began in Thailand and quickly spread to Malaysia, Indonesia, Korea, and even Japan. This crisis, caused by careless lending and borrowing practices in the private sectors of these countries, led to a crisis in investor confidence in security values, which led to a collapse in prices in equity markets, a major decline in currency values, and a massive increase in exports from countries in the region to the United States. The entire world was caught off guard by this crisis, which underlined the fact that lending and banking practices in the region had become quite "loose" and sloppy. The world realized that the Asian "miracle" had some major deficiencies that needed to be repaired. These repairs presented a challenge to the world economy: how to fix the problems in Asia without spreading the "flu" to the rest of the world. It was clear to economists that as long as the economic leaders of the high-income countries of the world did not allow aggregate demand in their markets to collapse or trade barriers to be imposed it would be possible for the countries in the Asian region to clean house. This would require ending the traditional close relationship that had existed in many countries between business and government and the establishment of a more rigorous system of private sector responsibility for investment decision.

Association of Southeast Asian Nations

The Association of Southeast Asian Nations (ASEAN) is an organization for economic, political, social, and cultural cooperation among its 10 member countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, MyaI1mar, the Philippines, Singapore, Thailand, and Vietnam. ASEAN (pronounced OZZIE-on) was established in 1967 with the signing of the Bangkok Declaration. Vietnam became the first communist nation in the group when it was admitted in 1995. Cambodia - and Laos were admitted to ASEAN in Myanmar joined in 1998.The countries have agreed to eliminate most tariffs by *2010).* The ASEAN group has 495 million people and a GNP of $700 billion. A constant problem is the strict need for Consensus among all members before proceeding with any form of cooperative effort. Although the 10 countries of ASEAN are geographically close, they have historically been divided in many respects.

4. South And Central American Trade Groups

Andean Group

The Andean Group was formed in 1969 to accelerate development of its member states-Bolivia, Colombia, Ecuador, Peru, and Venezuela-through economic and social integration. Members agreed to lower tariffs on intragroup trade and work together to decide what products each country should produce. At the same time, foreign goods and companies were kept out as much as possible.

In 1988, the group members decided to get a fresh start. Beginning in 1992, the Andean Pact signatories agreed to form Latin America's first operating sub regional free trade zone. More than 100 million consumers would be affected by the pact, which abolished all foreign exchange, financial and fiscal incentives, and export subsidies at the end of 1992. Common external tariffs were established, marking the transition to a true customs union. A high-level commission was created to look into any alleged unfair trade practices among countries.

Southern Cone Common Market

Argentina, Brazil, Paraguay, and Uruguay (Figure 2-8)-with a combined population of 32 million people, a GNP of $1,332 billion or a per capita GNP of $5,741 in 2000 : agreed in 1991 to form a customs union known as the Southern Cone Common Market (in Spanish, Mercado del Sur, or Mercosur). In 1996, while became an associate member. Chile chose not to become a full member because it already had lower external tariffs than the rest of Mercosur; full membership would have required raising them. Presently, Chile has been negotiating for membership in NAFTA.

Caribbean Community and Common Market

The Caribbean Community and Common Market (CARICOM) were formed in 1973 as a movement toward unity in the Caribbean. It replaced the Caribbean Free Trade association (CARIFTA) founded in 1965. The members are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Monterrey, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Surinam, and Trinidad and Tobago. The population of the entire IS-member Caribbean Community is 14 million. The total population is 112,000 and has a GNP of $209 million or per capita GNP of $1,866.

The Caribbean Community's main activity is economic integration by means of a Caribbean Common Market. CARlCOM has created a customs union with common tariffs on imports from third countries, cross-listed stocks on the various changes, created a Caribbean Court of Justice to deal with economic issues and trade disputes, and is working toward a common currency.

Central American Integration System (SICA)

Central America is trying to revive its common market, which was set up in the 1960s. It collapsed in 1969 when war broke out between Honduras and EI Salvador after a riot at a soccer match betweet1 teams from the two countries. The five members-EI Salvador, Honduras, Guatemala, Nicaragua, and Costa Rica-decided in 1991 to reestablish the common market by 1994. Efforts to improve regional integration gained momentum with the granting of observer status to Panama. In 1997, with Panama as a member, the group's name was changed to Central American Integration System.

Free Trade Area of the Americas

One of the biggest issues pertaining to trade in the Western Hemisphere is the Free Trade Area of the Americas (FTAA). The idea was formally proposed in 1994 by U.S. President Bill Clinton during a summit of heads of state in Miami. Meeting in Brazil in May 1997, trade ministers from the 34 participating countries agreed to create "preparatory committees" in anticipation of formal talks that would begin in 1998. The Clinton administration was keen to open the region's fast-growing big emerging markets (BEM) countries to U.S. companies. In particular, the president wanted talks to focus immediately on tariffs and "early harvest" agreements on individual industry sectors, such as information technology.

When the second Summit of the Americas was held in Santiago, Chile, in April 1998, the FTAA was formally launched. However, it was also clear that fast track authority would be essential to successfully concluding the negotiations. Mean. While, Mercosur, CARlCOM, SICA, and the Andean Community intend to pursue further integration among themselves, as well as with Europe.

5. African and Middle Eastern Trade Groups

The Treaty of Lagos establishing the Economic Community of West African States {ECOWAS) was signed in May 1975 by 16 states, with the object of promoting trade, cooperation, and self-reliance in West Africa. The members are Benin, Burkina Faso, Cape Verde, the Gambia, Ghana, Guinea, Guinea-Bissau, the Ivory' Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo. The total population of ECOWAS is 300 million and total GNP is $254 million for a per capita GNP of $846.

In 1980, the member countries agreed to establish a free trade area for unprocessed agricultural products and handicrafts. Tariffs on industrial goods were also to be abolished; however, there were implementation delays. By January 1990, tariffs on 25 items manufactured in ECOWAS member states had been eliminated. The organization installed a computer system to

process customs and trade statistics and to calculate the loss of revenue resulting from the liberalization of intercommunity trade. In a move to a common currency, which is unlikely before 2005, an ECOWAS traveler's check was initiated in 1999 for purchase by citizens of the member countries.

East African Cooperation Treaty

During the 1960s and 1970s, efforts to organize the countries of East Africa failed for several reasons. Given the trend toward gloating, a new attempt has been made and the result is that Kenya, Tanzania, and Uganda have signed an agreement forming the East African Cooperation Treaty. Modeled after the EU, it already has a common passport and is working toward a common currency, a regional stock market, and harmonization of laws.

The south African Development Coordination Conference (SADCC) was set up in 1980 by the region's black-ruled states to promote trade and cooperation. The members are Angola, Botswana, Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. The real impediment to trade has been SADCC's poverty. The World Bank indicates that combined 2000 gross national product (GNP) for the 14 member nations amounted to $174 million, a figure that is even lower than the GNP of Denmark. The total population of SADCC is 216 million for a per capita GNP of $805.

Cooperation Council for the Arab States of the Gulf

The organization generally known as the Gulf Cooperation Council (GCC) was established in 1981 by six Arab states-Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. It is difficult **to** provide GNP numbers for the GCC as economic data are not provided for several of the countries.

The organization provides" a means of realizing coordination, integration, and cooperation in all economic, social, and cultural affairs. Gulf finance ministers drew up an economic cooperation agreement covering investment, petroleum, the abolition of customs duties, harmonization of banking regulations, and financial and monetary coordination. GCC committees coordinate trade development in the region, industrial strategy, agricultural policy, and uniform petroleum policies and prices.

Arab Maghreb Union and Arab Cooperation Council

In 1989, two other organizations were established. Today, the Arab Maghreb Union '(AMU) consists of Morocco, Algeria, Mauritania, Tunisia, and Libya, and the Arab Cooperation Council (ACC) consists of Egypt, Iraq, Jordan, and Yemen. Many Arabs see their regional groups-the GCC, ACC, and AMU-as embryonic economic communities that will foster the development of inter-Arab trade and investment. The newer organizations are more promising than the Arab League, which consists of 21 member states and a constitution that requires unanimous decisions.

AFTA *(ASEAN Free Trade Area): ASEAN members*

Andean Group (the Cartagena Agreement): Bolivia, Colombia, Ecuador, Peru, and Venezuela

ANZCERTA *(Australia-New Zealand Closer Economic Relations Trade Agreement): Australia and New Zealand*

APEC *(Asia Pacific Economic Cooperation): Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia; Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, Chinese Taipei (Taiwan), Thailand, and the United States Arab Middle East Arab Common Market: UAR, Iraq, Jordan, Sudan, Syria, and Yemen*

ASEAN *(Association of Southeast Asian Nations): Brunei, Indonesia, Malaysia, the*

Philippines, Singapore, Thailand, and Vietnam. Benelux Customs Union: Belgium, the Netherlands, and Luxembourg

CAEMC *(Central African Economic and Monetary Community): Cameroon, the Cen-tral African Republic, Chad, the Congo, Equatorial Guinea, and Gabon*

CARICOM *(Caribbean Common Market): Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Christopher-Nevis,*

. Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago

Central American Community: Costa Rica, EI Salvador, Guatemala, Honduras, Nicaragua, and Panama.

CFA *Franc Zone: the Comoros, members of the WAEMU, and members of the CAEMC*

CIS *(Commonwealth of Independent States): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kirgizstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and*

Uzbekistan East Africa Customs Union: Ethiopia, Kenya, Zimbabwe, Sudan, Tanzania, and Uganda

ECOWAS *(Economic Community of West African States): Benin, Cape Verde, Da-homey, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierrg Leone, Togo, and Upper Volta*

EU *(European Union): Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom*

EEA *(European Economic Area): Iceland, Norway, and EU members*

EFTA ***(****European Free Trade Association): Austria, Finland, Iceland, Liechtenstein, Nor-way, Sweden, and Switzerland Group of Three: Colombia, Mexico, and Venezuela*

LAIA *(Latin American Integration Association): Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela*

Mahgreb Economic Community: Algeria, Libya, Tunisia, and Morocco

Mercosur (Southern Common Market): Argentina, Brazil, Paraguay, and Uruguay NAFTA (North American Free Trade Agreement): Canada, Mexico, and the United States

OECD *(Organization for Economic Cooperation and Development): EU members, Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, Turkey, and the United States.*

RCD *(Regional Cooperation for Development): Iran, Pakistan, and Turkey*

SICA*: EI Salvador, Guatemala, Honduras, and Nicaragua*

WAEMU *(West African Economic and Monetary Union): Benin, Burkina Faso, Ivory Coast, Mali, Niger, Senegal, and Togo.*

LESSON 5:
INTERNATIONAL TRADE THEORY

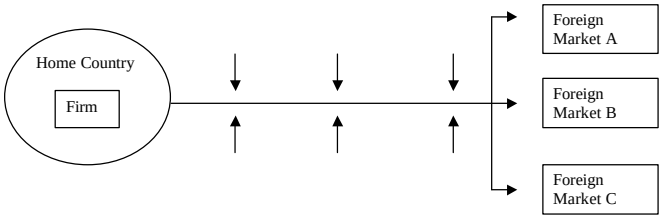
The learning objective of this lesson are:

1. An overview of the world trade
2. Usefulness of data on balance of payments.
3. International monetary financial systems.

Nation Trades With Nation

Although our primary concern is international marketing rather than international trade, a brief survey of international trade will prove useful. Trading between groups has been going on since the beginning of recorded history. Much early trade was economically motivated and conducted through barter or commercial transactions. However, a large part of the exchange of goods historically occurred through military conquest: " To the victor belong the spoils." The predominant pattern of international trade is the voluntary exchange of goods and services.

The International Environment of Marketing



International Trade Theory

In domestic marketing, much emphasis is placed on the analysis of buyer behavior and motivation. For the international marketer, knowledge of the basic causes and nature of international trade is important. It is easier for a firm to work with the underlying economic forces than against them. To work with them, however, the firm must understand them.

Essentially, international trade theory seeks the answers to a few basic questions: Why do nations trade? What goods do they trade? Nations trade for economic, political, and cultural reasons, but the principal economic basis for international trade is difference in price; that is, a nation can buy some goods more cheaply from other nations than it can make them itself. In a sense, the nation faces .the same "make or buy" decision, as does the firm. Just as most firms do not go for complete vertical integration but buy many materials and supplies from outside firms, so most nations decide against complete self-sufficiency (or autarky) in favor of buying cheaper goods from other countries.

An example given by Adam Smith helps illustrate this: In discussing the advantages to England in trading manufactured goods for Portugal's wine, he noted that grapes could be grown "under glass" (in greenhouses) in England but that to do so would lead to England's having both less wine and fewer manufacturers than if it specialized in manufacturers. In fact, Smith's major conclusion was that the wealth of nations derived from the division of labor and specialization. Applied to the international picture, this means trade rather than self-sufficiency.

Comparative Advantage

It has been said that price differences are the immediate basis of international trade. The firm that decides whether to make or buy also considers price as a principal variable. But why do nations have different prices on goods? Prices differ because countries producing these goods have different costs. And why do countries have different costs? The Swedish economist Bertil Ohlin came up with an explanation generally held to be valid: Different countries have dissimilar prices and costs on goods because different goods require a different mix of factors in their production and because countries differ in their supply of these factors. Thus, in Smith's example, Portugal's wine would be cheaper than wine made in England because Portugal has a relatively better endowment of winemaking factors (for example, land and climate) than does England.

What we have been discussing is the principle of comparative advantage, namely, that a country tends to produce and export those goods in which it has the greater comparative advantage (or the least comparative disadvantage) and import those goods in which it has the least comparative advantage (or the greatest comparative disadvantage). On this basis, it is possible to predict what goods a nation will export and import. As Smith suggested, the nation maximizes its supply of goods by concentrating production where it is most efficient, and trading some of these products for imported products where it is least efficient. An examination of the exports and imports of most nations tends to support this theory.

Product Life Cycle

A recent refinement in trade theory is related to the product life cycle, which in marketing refers to the consumption pattern for a product. When applied to international trade theory, it refers primarily to international trade and production patterns. According to this concept, many products go through a trade cycle wherein one nation is initially an exporter, then loses its export markets, and finally may become an importer of the product. Empirical studies have demonstrated the validity of the model for some kinds of manufactured goods.

Outlined below are the four phases in the production and trade cycle, with the United States as an example. We'll assume a U.S. firm has come up with a high-tech product.

Phase 1. U.S. export strength is evident.

Phase 2. Foreign production starts.

Phase 3. Foreign production becomes competitive in export markets.

Phase 4.Import competition begins.
In Phase 1, product innovation is likely to be related to the needs of the home market. The firm usually serves its home market first. The new product is produce in the home market because, as the firm moves' down the production learning curve, it needs to communicate with both suppliers and customers. As it begins to fill home-market needs, the firm begins to export the new product, seizing on its first-mover advantages. (We assume the U.S. firm is exporting to Europe.)

In Phase 2, importing countries gain familiarity with the new product. Gradually, producers in wealthy countries begin producing the product for their own markets. (Most product innovations begin in one rich country and then move to other: rich countries.) Foreign production will reduce the exports of the innovating firm. (We assume that the U.S. firm's exports to Europe are replaced by production within, Europe.)

In Phase 3, foreign firms gain production experience and move down the cost curve. If they have lower costs than the innovating firm, which is frequently the case, they export to third-country markets, replacing the innovator's exports there. (We assume that European firms are now exporting to Latin America, taking away the U.S. firm's export markets there.)

In Phase 4, the foreign producers now have sufficient production experience and economies of scale to allow them to export back to the innovator's home country. (We will assume the European producers have now taken away the home market of the original U.S. innovator.)

In Phase 1 the product is "new." In Phase 2 it is "maturing." In Phases 3 and 4 it is "standardized." The product may become so standardized by Phase 4 that it almost becomes commodity. Textiles in general are an example of a product in Phase 4. Products. in Phase 4 may be produced in less developed countries for export to the developed countries. This modification of the theory of comparative advantage provides further insight into patterns of international trade and production and helps the international company plan logistics, such as when it will need to produce—or source – abroad.

Balance of Payments

In the study of international trade, the principal source of information is the balance of-payments statement of the trading nations. These are summary statements of all the economic transactions between one country and all other countries over a period of time, usually one year.

In governmental reporting, the balance of payments is often broken down into a current account and one or more capital accounts. The current account is a record of all the goods and services the nation exchanged with other nations. The capital account includes international financial transactions, such as private foreign investment and government borrowing, lending, or payments. The international marketer usually is more interested in the details of current account transactions, that is, the nature of the goods being traded and their origin and destination.

Marketing Decisions

The balance of payments is an indicator of the international economic health of a country. Its data help government policymakers plan monetary, fiscal, foreign exchange, and commercial policies. Such data can also provide information for decisions in international marketing. Two important decisions for a firm are the choice of location of supply for foreign markets and the selection of markets to sell to. Balance-of-payments analysis can show which nations are importers and exporters of the products in question. The firm can thus identify its own best import and export targets that are, countries to sell to and countries to supply from. Longitudinal analysis of the balance of payments can help to track the international product life cycle.

When the firm is considering foreign market opportunities, it finds a country's import statistics for its products to be a preliminary indicator of market potential. Furthermore, the firm can get an indication of the competition in these countries by noting the nations supplying the products in question. The statistics sometimes even permit identification of low-price supplying nations and high-price (high- /quality?) suppliers. Please note, though, that the use of balance- of-payments data requires that a period of several years be considered to get an idea of trends.

Financial Considerations

Up to now, we have considered primarily the current account in the balance of payments, especially the movement of goods reflected in that account. A look at the capital account is also useful. A nation's international solvency can be evaluated by checking its capital account over several years. If the nation is steadily losing its gold and foreign exchange reserves, there is a strong-likelihood of a currency devaluation or some kind of exchange control, meaning that the government - restricts the amount of money sent out of the country as well as the uses to which it can be, put. With exchange 'Control, the firm may have difficulty getting foreign exchange to repatriate profits-'or even to import its products. If the firm is importing products that are not considered necessary, the scarce foreign exchange will go instead to goods on which the nation places a higher priority.

The firm's pricing policies, too, are affected by the balance of-payments problems of the host country. If the firm cannot repatriate profits from a country, it tries to use its transfer pricing to minimize the profits earned in that country, gaining its profits elsewhere where it can repatriate them. If the exporting firm fears devaluation of a currency, it hesitates to quote prices in that currency, preferring to give terms in its home currency or another "safe" currency. Thus, for both international marketing and international finance, the balance of payments is an important information source.

Commercial Policy

One reason international trade is different from domestic trade is that it is carried on between different political units, each one a sovereign nation exercising control over its own trade. Although all nations control their foreign trade, they vary in the degree of such control each nation invariably establishes laws that favor its nationals and discriminate against traders from other countries. This means, for example, that a U.S. firm trying to sell in the French market faces certain handicaps deriving from the French government's control over its trade. These handicaps to the U.S. firm are in addition to any disadvantages

resulting from distance or cultural differences. By the same token, the French firm trying to sell in the United States faces similar restrictions when competing with U.S. firms selling in their home market.

Commercial policy is the term used to refer to government regulations bearing on foreign trade. The principal tools of commercial policy are tariffs, quotas, exchange control, and administrative regulation (the "invisible tariff "). Each of these will be discussed in turn as it relates to the task of the international marketer.

Tariffs

A tariff is a tax on products imported from other countries. The tax may be levied on the quantity-such as 1 0 cents per pound, gallon, or yard-or on the value of the imported goods-such as 1 0 or 20 percent *ad valorem.* A tariff levied on quantity is called a *specific duty* and is used especially for primary commodities. Ad valorem duties are generally levied on manufactured products.

Governments may have two purposes in imposing tariffs: They may wish to earn revenue and/or make foreign goods more expensive in order to protect national producers. When the United States was a new nation, most government revenues came from tariffs. Many less developed countries today earn a large amount of their revenue from tariffs because they are among the easiest taxes to collect. Today, however, the protective purpose generally prevails. One could argue that with a tariff, a country penalizes its consumers by making them pay higher prices on imported goods; it' penalizes its producers that import raw materials or components. The rationale is that a policy that is too liberal with imports may hurt employment in that countries own industries.

Tariffs affect pricing, product, and distribution policies of the international marketer as well, as foreign investment decisions. If the firm is supplying a market -by -exports, the tariff increases the price of its product and reduces competitiveness in that market. This necessitates a price structure that minimizes the tariff barrier. A greater emphasis on marginal cost pricing could result. This examination of price is accompanied by a review of other aspects of the firm's approach to the market. The product may be modified or stripped down to lower that price or to get a more favorable tariff classification. For example, watches could be taxed either as time- pieces at one rate or as jewelry at a higher rate. The manufacturer might be able to adapt its product to meet the lower tariff.

Another way the manufacturer can minimize their tariff burden is to ship products completely knocked down (CKD) for assembly in the local market. The tariff on unassembled products or ingredients is usually lower than that on completely finished goods. The importing country employs a tariff differential to promote local employment. This establishment of local assembly operations is a form of the phenomenon known as a tariff factory; the term used when the primary reason a local plant exists is to get behind the tariff barrier to protect markets that a firm can no longer serve with direct exports. Taken to the extreme, the phenomenon would result in complete local production rather than just assembly.

In some circumstances, the firm may seek to turn the tariff to its own advantage. Assume that the host country is exerting pressure for local manufacture that will be noncompetitive with existing sources. The firm might acquiesce on the condition that the plant it sets up be protected by tariffs imposed against more efficient outside suppliers. It would seek this protection as an "infant industry" against mature companies abroad. Thus, if the firm becomes a local con1pany it may benefit from the tariff protection.

Quotas

Quantitative restrictions, or quotas, are barriers to imports. They set absolute limits on the amount of goods that may enter the country. An import quota can be a more serious restriction than a tariff because the firm has less flexibility in responding to it. Price or product modifications do not get around quotas the way they might get around tariffs. The government's goal in establishing quotas on imports is obviously not revenue. It gets none. Its goal is rather the conservation of scarce foreign exchange and/or the protection of local production in the product lines affected. About the only response the firm can take to a quota is to assure itself a share of the quota or to set up local production if the market size warrants it. Since the latter is in accord with the wishes of government the firm might be regarded favorably for taking such action.

The Japanese auto companies in the United States illustrate problems firms have with quotas. For many years, the United States had a "voluntary" quota on Japanese car imports. Japanese producers responded in two ways: ((1) They exported more expensive cars with higher margins, thereby earning high profits. (2) They also built assembly plants in the United States as the long-run solution to, quota constraints.

In 1989, the U.S. Customs Service ruled that the Suzuki Samurai and most small vans would be classified as "trucks" subject to a 25 percent tariff rather than as "cars," subject to a 2.5 percent duty. The positive side of the ruling was that this would allow more "car" imports by the Japanese (to replace the vehicles reclassified as trucks). American auto firms applauded the decision but the Japanese (and European) producers complained.

Exchange Control

The most complete tool for regulation of foreign trade is exchange control, a government monopoly of all dealings in foreign exchange. Exchange control means that foreign exchange is scarce and that the government is rationing it out according to its own priorities. A national company earning foreign exchange from its exports must sell this foreign exchange to the control agency, usually the central bank. In turn, a company wishing to buy goods from abroad must buy its foreign exchange from the control agency.

Firms in the country have to be on the government's favored list to get ex-change for imported supplies. Alternatively, they may try to develop local suppliers, running the risk of higher costs and indifferent quality control. The firms exporting to that nation must also be on the government's favored list. Otherwise they will lose their market if importers can get no foreign

exchange to pay them. Generally, exchange-control countries favor the import of capital goods and necessary consumer goods but not luxuries. While the definition of "luxuries" varies from country to country, it usually includes cars, appliances, and cosmetics. If the exporter does lose its market through exchange control, about the only option is to produce within the country if the market is large enough for this to be profitable.

Another implication for the firm when foreign exchange is limited is that the government is unlikely to give priority to a company's profit remittances as a way of using the country's scarce foreign earnings. In this situation, the firm tries to use transfer pricing to get earnings out of the host country or to avoid accumulating earnings there. It accomplishes this by charging high transfer prices on supplies sold to the subsidiary and low transfer prices on goods sold by that subsidiary to affiliates of the company in other markets. The firm's ability to do this depends on the plan's acceptance by tax officials of the country.

For international executives in exchange-control countries, dealing with the government exchange authorities is a major preoccupation and problem-and never n10re so than in Venezuela, where, in 1989, the government issued arrest warrants for 47 executives of multinational companies for abuses in dealing with the government foreign exchange office. All charged professed innocence, and many left the country.

Invisible Tariff and Other Government Barriers

There are other government barriers to international trade that are hard to classify-for example, administrative protection, the invisible tariff, or no tariff barriers (NTBs). As traditional trade barriers have declined since World War II, the NTBs have taken on added significance. They include such things as customs documentation requirements, marks of origin, food and drug laws, labeling laws, anti-dumping laws, "buy national" policies, and so on. Because these barriers are so diverse, their impact cannot be covered in a brief discussion.

Other Dimensions and Institutions in the World Economy

UNCTAD

Although GATT-WTO has been an important force in world-trade expansion, benefits have not been distributed equally. The less developed countries have been dissatisfied with trade arrangements because their share of world trade has been declining, and the prices of their raw material exports compare unfavorably with the prices of their manufactured goods imports. Though In any of these countries are members of WTO, they felt that GATT did more to further trade in goods of industrialized nations than it did to promote their own primary products. It is true that tariff reductions have been far more important to manufactured goods than to primary products. The result of these countries' dissatisfaction was the formation of the United Nations. Conference on Trade and Development (UNCTAD)- in 1964. UNCTAD is a permanent organ of the United Nations General Assen1bly and counts over 160 member countries. The goal of UNCTAD is-to furthers the development of emerging nations-by trade as well as by other means. Under GATT trade expanded, especially in manufactured goods, creating a growing trade gap between industrial and developing countries. UNCTAD seeks to improve the prices of primary goods exports through commodity agreements. If the commodity-producing countries could get together to control supply, this would mean higher prices and higher returns.

UNCTAD also worked to establish a tariff preference system favoring the export of manufactured goods from less developed countries. Since these countries have not been able to export commodities in a quantity sufficient to maintain their share of trade, they want to expand in the growth area of world trade: industrial exports. They believe they might achieve this if manufactured goods coming from developing countries faced lower tariffs than the same goods coming from developed countries.

UNCTAD has made modest progress. One achievement is its own formation, a new club for world trade matters that is a lobbying group for developing-country interests. Tanzanian leader Julius Nyerere called it "the labor union of the developing countries." Through UNCTAD, developing countries have also received preferential tariff treatment from the EU, Japan, and the United States, as they requested. Overall, UNCTAD has focused world attention on the trade needs of developing countries and has given them a more coherent voice. UNCTAD's committees and studies have also made for a more informed dialog.

WTO, UNCTAD, and the Firm

WTO's success in reducing barriers to trade has meant that a firm's global logistics can be more efficient. Further the firm, through its subsidiaries in various markets, can help protect its 'interest in trade matters through discussions with governments in advance -of trade negotiations. In the United States, for example, a committee holds hearings at which business representatives can present their international trading problems. These problems are noted for consideration in WHO negotiations. Firms in the EU usually work with trade associations that channel industry views to the EU negotiators. Brazil also looks to trade associations for industry views.

UNCTAD can have a more direct impact on the firm than WTO. International firms can playa major role relating to the tariff preferences granted by the industrialized nations. Developing countries have limited experience in exporting manufactured goods. Elimination of tariffs by itself is not sufficient to help them. Here the multinational firm can be a decisive factor. If the firm combines its know-how and resources with those of the host country, it could offer competitive exports. Included in the firm's resources is its global distribution network, which could be the critical factor in gaining foreign market access. Also, the firm supplies the foreign marketing know-how lacked by most developing-country producers. For example, if Ford had the choice of importing engines from its plant in Britain or its plant in Brazil, it might choose Brazil if engines from Brazil had a zero tariff and engines from Europe faced a 15 percent duty.

A complementarity of interest may exist between the less developed countries and international firms in the question of

preferences. On the one hand, the marriage of these interests could help nations achieve their industrialization and balance-of-payments goals; on the other, multinational companies could expand their international markets and participate more actively in the group of the less developed nations, which have a majority of the world's population.

The Big Emerging Markets (BEMs)

The U.S. government' has traditionally focused its international economic policy on Europe and Japan. These industrial nations will probably continue to be the largest U.S. exports markets for the next few decades. About three-quarters of all world trade *growth* in the next two decades, however, is expected to come from the developing countries. In fact, 10 markets are expected to account for 30 percent of total world imports over the next 20 years.

These so-called "Big Emerging Markets-" are Argentina, ASEAN, Brazil, Chinese Economic Area (China, Hong Kong, Taiwan), India, Mexico, Poland, South Africa, South Korea, and Turkey.

Given the perceived importance of the BEMs, the U.S. government is realigning its export strategy to deal with these opportunities, just as the BISNIS program has been established for Eastern Europe. For every BEM, the government wants to develop a bilateral forum to discuss trade cooperation and to build a U.S. Commercial Center. Cabinet and sub-Cabinet officials are traveling to the BEMs to develop stronger commercial ties. The government has also identified an initial list of strategic industries for special consideration for U.S. exporters. They are environmental technologies; information technologies, health technologies, transportation technologies (including space, automotive, and transportation infrastructure), and energy technologies.

International Financial System

A major goal of business is to make a profit, so firms pay close attention to financial matters. International companies must be even more concerned with financial matters than national firms are because they must deal with many currencies and many national financial markets where conditions differ from one to the other. Marketing across national boundaries involves financial considerations, which we will discuss here.

Exchange Rate Instability

The international payments system is the financial side of international trade. A special dimension is the fact that transactions occur in many different currencies. Dealing with multiple currencies is not a serious problem in itself. The difficulty arises because currencies frequently challenge in value vis-à-vis each other, and in unpredictable ways. Since 1973 the major currencies have been floating, often in a volatile manner.

The exchange rate is the domestic price of a foreign currency. For the United States, this means that there is a dollar rate, or price, for the British pound, the Swiss franc, and the Brazilian real, as well as every other currency. If one country changes the value of its currency, firms selling to or from that country may find that the altered exchange rate is sufficient to wipe out their profit, or, on the brighter side, give them a windfall gain. In any case, they must be alert for currency variations in order to optimize their financial performance.

In the days of the gold standard, exchange rates did not change in value. The stability and certainty of the international gold standard came to an end, however, with the advent of World War 1. The international financial system of the 1930s had no certainty, stability, or accepted rules. Instead, there were frequent and arbitrary changes in exchange rates. This chaotic and uncertain situation contributed to the decline in international trade during that period. The world wide Depression of the 30s was reinforced by the added risks in international finance. In 1944, some of the allied nations met at Bretton Woods to design a better international economic system for the postwar world. One element of this system dealt with international trade and left us with WTO. Another element, concerned with the need for international capital, led to the formation of the World Bank. A third aspect involving the international monetary system resulted in the establishment of the International Monetary Fund (IMF).

International Monetary Fund (lMF)

The Bretton Woods international monetary system was an attempt to avoid the uncertainty of the 1930s and to regain some of the stability of exchange rates that existed under the gold standard. Countries that joined the International Monetary Fund (IMF) were required to establish a par value for their currency (in terms of the U.S. dollar) and maintain it within plus or minus 1 percent of that value. Up to 1970, the Bretton Woods system of stable "pegged" rates worked reasonably well, although numerous devaluations occurred during that period. The increased confidence in the international monetary system contributed to the great surge in international trade since World War II.

In the late 1960s and early 1970s, there existed very large funds in the hands of corporations, banks, and others with international dealings. This made it increasingly difficult for central banks to defend the par value of their currency. The holders of funds tended to move them out of currencies they considered weak, and into currencies they considered strong.

Those who were moving funds called the action prudent management because they were protecting their assets. Others called the same activity speculation. In any case, the results were the same. Central banks had fewer resources than those who were moving funds and had to give up the struggle to maintain the par value of their currencies. As a result, since 1973, the major industrialized countries have let their currencies "float," that is, fluctuate daily according to the forces of supply and demand. Thus, the international marketer today must contend with exchange rates that are continually moving targets, a complication for international pricing and logistics.

The Bretton Woods system of pegged exchange rates is dead. However, the IMF did not die, nor did it fade away. It now has a more nebulous role, however, in a world of floating exchange rates. Even so, the IMF is a help to international marketing. It still lends money to countries with problems, enabling them to continue their international trade-and making them better customers. The IMF also continues to provide a forum for international monetary cooperation that lessens the chances of

nations taking arbitrary actions against others, as occurred in the 1930s. More recently, the IMF played a critical role in solving Mexico's problems in 1994, and in the Asian and Russian crises of the late 1990s.

World Bank

The International Bank for Reconstruction and Development (IBRD or World Bank) is another institution conceived at Bretton Woods. It also has an impact on the world economy in which international business operates. Whereas the IMF is concerned with the provision of short-term liquidity, the World Bank supplies long term capital to aid economic development. The World Bank is parent to the International Development Ass9ciation (IDA), created for the purpose of giving "soft" loans to the least developed countries, that is, long-term loans at very low interest rates. Lending by these two groups supports all aspects of development, including infrastructure, industrial, agricultural, educational, tourist, and population-control projects.

World Bank activities have improved the international economic environment and aided international business. The supply of capital has meant a higher level of economic activity and, therefore, better markets. For example, many firms are suppliers to projects in developing countries for which the World Bank and IDA lend billions of dollars. This often opens up new import markets that might have been impossible to enter had the World Bank not given assistance to the country. Many firms find profitable contracts in projects financed by the World Bank.

LESSON 6:
POLITICAL ENVIRONMENT

While governing in many countries are studying environmental issues, particularly recycling, Germany already has a packing ordinance that has shifted the cost burden for waste material disposal onto industry. The German government hopes the law, known as *verpackungerordung,* will create a " closed loop economy," the goal is to force manufacturers to eliminate nonessential materials that cannot be recycled and adopt other innovative approaches to producing and packaging products. Despite the costs associated with compliance, industry appears to be making significant progress toward creating the closed loop economy. Companies are developing new packaging that uses less material and includes more recycled content. More than 1,900 non- German companies are currently participating in the program.

The German packaging law is one example of the impact that political, legal, and regulatory environments can have on marketing activities. Each of the world's national governments regulates trade and commerce with other countries and attempts to control the access of outside enterprises to national resources every country has its own unique legal and regulatory system that impacts the operations and activities of the global enterprise, including the global marketer's ability to address market opportunities. Laws and regulations constrain the cross border movement of products, services, people, money, and know how. The global marketer must attempt to comply with each set of national—and in some instances, regional —— constraints. These efforts are hampered by the fact that laws and regulations are frequently ambiguous and continually changing.

The Political Environment

Global marketing activities take place within the political environmental of governmental institutions, political parties, and organisations through which a country's people and rulers exercise power. Any company doing business outside its home country should carefully study the government structure in the target country and analyze salient issues arising from the political environment. These include the governing party's attitude toward sovereignty, political risk, the threat of equity dilution, and expropriation.

National – States and Sovereignty

Sovereignty can be defined as supreme and independent political authority. A century ago, U.s. supreme court chief Justice fuller said" every sovereign state is bound to respect the independence of every other sovereign state, and the courts in one country will not sit in judgment on the acts of government of another done within its territory," more recently, Richard Stanley offered the following concise description.

A sovereign state was considered free and independent. It regulated trade, managed the flow of people into and out of its boundaries, and exercised undivided jurisdiction over all persons and property within its territory. It has the right, authority, and ability to conduct its domestic affairs without outside interference and to use it international power and influence with full discretion.[1]

Government actions taken in the name of sovereignty occur in the context of two important criteria a country's state of development and the political and economic system in place in the country.

Many governments in developing countries exercise control over their nations' economic development by passing protectionist laws and regulations. Their objective is to encourage economic development by protecting emerging or strategic industries. Conversely, when many nations reach advanced stages of economic development, their governments declare that (in theory, at least) any practice or policy that restrains free trade is illegal. Antitrust laws and regulations are established to promote fair competition. Advanced country laws often define and preserve a nation's social order; laws may extend to political, cultural, and even intellectual activities and social conduct. In France, for example, laws forbid the use of foreign words such as i.e marketing in official documents.

Political risk – the risk of a change in government policy that would adversely impact a company's ability to operate effectively and profitably—can deter a company from investing abroad. When the perceived level of political risk is lower, a country is more likely to attract investment. The level of political risk is inversely proportional to a country's stage of economic development all other things being equal, the less developed a country, the greater the political risk. The political risk of the triad countries, for example, is quite limited as compared to a country in an earlier stage of development in Africa, Latin America, or Asia.

National Controls Create Bariers for Global Marketing

Many countries attempt to exercise control over the transfers of goods, services, money, people technology, and rights across their borders. Historically and important control motive was economic. The goal was to generate revenue by levying tariffs and duties. Today, policymakers have additional motives for controlling cross border flows, including protection of local industry and fostering the development of local enterprise. Such policies are known as protectionism or economic nationalism.

Differing economic and political goals and different value systems are the primary reasons for protectionism. The barriers that exist between the United States and Cuba, for example exist because of major differences between the values and objectives of the two countries. Many barriers based and different political systems have come down with the end of the cold war. However, barriers based on different value systems continue. The world's farmers—be they Japanese, European, or American – are committed to getting as much protection as possible form their respective governments. Because of the political influence of the farm lobby in every country, and in spite of the efforts of trade negotiators to open up

agricultural markets, controls on trade in agricultural products continue to distort economic efficiency. Such controls work against the driving forces of economic integration.

The price of protection can be very high for two basic reasons. The first is the cost to consumers: when foreign producers are present4ed with barriers rather than free access to a market, the result is higher prices for domestic consumers and a reduction in their standard of living. The second cost is the impact on the competitive ness for domestic companies. Companies that are procreated and sustain world class competitive advantage. One of the greatest stimuli to competitiveness is the open market. When a company faces world competition, it must figure out how to serve a cliché market better than any company in the world, or it must figure out how to compete in face to face competition.

Taxes

It is not uncommon for accompany to be incorporated in one place, do business in another, and maintain its corporate headquarters in a third. This type of diverse geographical activity requires special attention to tax laws. Many companies make efforts to minimize their tax liability by shifting the location of income. For example, it has been estimated that tax avoidance by foreign companies doing business in the United States costs the US government several billion dollars each year in lost revenue. In one approach, called earning stripping, foreign companies reduce earnings by making loans to us. Affiliates rather than using direct investment to finance US activities. The U.S subsidiary can deduct the interest it pays on such loans. There by reducing it tax burden.

There are no universal international laws governing the levy of taxes on companies that do business across national boundaries. To provide fair treatment, many governments have negotiated bilateral tax treaties to provide tax credits for taxes paid abroad. The United States has dozens of such agreements in place. Un 1977, the organisation for economic cooperation and Development (OECD) passed the model Double taxation convention of income and capital to help guide countries in bilateral negotiations. Generally, foreign companies are taxed by the host nation up to the level imposed in the home country, an approach that does not increase the total tax burden to the company.

Dilution of Equity Control

Political pressure for national control of foreign owned companies is a part of the environment of global business in lower- income countries. The foremost goal of national governance is to protect the right of national sovereignty, especially in all aspects of domestic business activity. Host nation governments sometimes attempt to control ownership of foreign owned companies operating within their borders. In underdeveloped countries, political pressures frequently cause companies to take in local partners.

1. First, look at the range of possibilities. There is no single best solution, and each company should look at itself and tat the country situation to decide on strategy.
2. Companies should use the law to achieve their own objectives. The experiences of many companies demonstrate that by satisfying government demands, it is possible to take advantage of government concessions, subsidies, and market protection.
3. Anticipate government policy changes. Create a win-win situation. Companies that take initiatives are prepared to act when the opportunity arises. It takes time to implement changes; the sooner a company identifies possible government directions and initiatives, the sooner it will be in a position to propose its own plan to help the country achieve its objectives.
4. Listen to country managers. Country managers should be encouraged to anticipate government initiative and to propose company strategy for taking advantage of opportunities created by the government policy. Local mangers often have the best understanding of the political environment. Experience suggests that they are in the best position to know when issues are arising and how to turn potential adversity into opportunity through creative responses.

Expropriation

The ultimate threat a government can pose toward a company is expropriation. Expropriation refers to governmental action to dispossess a company or investor. Compensation is generally provided to foreign investors, although not often in the " prompt, effective, and adequate" manner provided for by international standard. Nationalization occurs if ownership of the property for by international standard. Nationalization occurs if ownership of the property or assets in question is referred to as confiscation.

Short of outright expropriation or nationalization, the phrase creeping expropriation has been applied to severe limitations on economic activities of foreign forms in certain developing countries. These have included limitations on repatriation of profits, arrangements. Other issues are increased local content requirements, quotas for hiring local nationals, price controls, and other restrictions affecting return on investment. Global companies have also suffered discriminatory tariffs and no tariff barriers that limit market entry of certain industrial and consumer goods, as well as discriminatory laws on patents and trademarks. Intellectual property restrictions have had the practical effect of eliminating or drastically reducing protection of pharmaceutical products.

Types of Government: Political Systems

A knowledge of the form governments' can take can be useful in appraising the political climate. One way to classify governments is to consider them as either parliamentary (open) or absolutist (-closed). Parliamentary governments consult with citizens from time to time for the purpose of learning about opinions and preferences. Government policies are thus intended to reflect the desire of the majority segment of the society. Most industrialized nations and all democratic nations can be classified as parliamentary.

At the other end of the spectrum are absolutist governments, which include monarchies and dictatorships. In an absolutist system, the ruling regime dictates government policy without considering citizens' needs or opinion. Frequently, absolutist countries are newly formed nations o—nose undergoing some

kind of political transition. Absolute monarchies are now relatively rare. The United Kingdom is a good example of a constitutional hereditary monarchy; despite the monarch, the' government is classified as parliamentary.

Many countries' political systems do not fall neatly into one of these two categories. Some monarchies and dictatorships (e.g., Saudi Arabia and North Korea) have parliamentary; elections. The former Soviet Union had elections and mandatory voting but was not classified as parliamentary because the ruling party never allowed an alternative on the ballot. Countries such as the Philippines under Marcos and Nicoragua under somoza held elections, but the results were suspect because of government involvement in voting fraud.

Another way to classify governments is by number of political parties. This classification results in four types of governments: two-party, multiparty, single-party, and dominated one-party. In a two-party system, there are typically two strong parties that take turns controlling the government, although other parties are allowed. The United States and the United Kingdom are prime examples. The two parties generally have different philosophies, resulting in a change in government policy when one party succeeds the other. In the United States, the Republican party is often viewed as representing business interests, whereas the Democratic party is often viewed as representing labor interests, as well as the poor and disaffected.

In a multiparty system, there are several political parties, none of which is strong enough to gain control of the government. Even though some parties may be large, their elected representatives ran smart of a majority. A government must then be formed through coalitions between the various parties, each of which wants to protect its own interests. The longevity of the coalition depends largely on the cooperation of party partners. Usually, the coalition is continuously challenged by various opposing parties. A change in a few votes may be sufficient to bring the coalition government down. If the government does not survive a vote of no confidence (i.e., does not have the support of the majority of the representatives), the government is disbanded and a new election is called. Countries operating with this system include Germany, France, and Israel. In the 1991 elections in Poland, twenty-nine parties (including the Polish Beer Lovers' Party) won seats, and no party got more than 13 percent of the vote.

In a single-party system, there may be several parties, but one party is so dominant that there is little- opportunity for others to elect representatives to govern the country. Egypt has operated under single-party rule for more than three decades. This form of government is often used by countries in the early stages of the development of a true parliamentary system. Because the ruling party holds support from the - vast majority, the system is not necessarily a poor one, especially when it can provide the stability and continuity necessary for rapid growth. But when serious economic problems persist, citizens" dissatisfaction~ and frustration may create an explosive situation. For example, Mexico has been ruled since its revolution by the Institutional Revolutionary Party (PRI), but economic problems caused dissatisfaction with the PRI in the 1980s. The National Action Party (PAN), Mexico's main opposition party, began gaining strength, possibly foreshadowing a transition away from a single-party system.

In a dominated one-party system, the dominant party does not allow any opposition, resulting in no alternative for the people. In contrast, a single-party system does a How some opposition party. The former Soviet Union, Cuba, and Libya are good examples of dominated one-party systems. Such a system may easily transform itself into a dictatorship. The party, to maintain its power, is prepared to use force or any necessary means to eliminate the introduction and growth of other parties. For example the Soviet Union had repeatedly shown a willingness to quell any opposition within its satellite countries.

One should not be hasty in making generalizations about the ideal form of government in terms of political stability. It may be tempting to believe that stability is a function of economic development in the sense that a more developed nation should also have more political stability. South Africa, a developed nation, has been beset with internal and external problems. Italy is another politically unstable developed country. Its political atmosphere is marred by a weak economy, recurring labor unrest, and internal dissension. In contrast, it can be argued that Vietnam, despite being a developing economy, is politically more stable than Italy. This stability is due in part to Vietnam's relatively closed society.

It may be just as tempting to conclude that a democratic political system is a prerequisite for political stability. India, the largest democracy in the world, possesses a solid political infrastructure and political institutions that have with stood many crises over time. The democratic system is strongly established in India, and it is most inconceivable that the Indians would choose any other system. Yet India's political stability is hampered by regional, ethnic, language, religious, and economic problems. Unlike such other democratic nations as Australia, where such problems have largely been resolved, India's difficulties remain. These geographic, ideological, and ethnic problems inhibit the government's ability to respond to one sector's demands without alienating others.

Dictatorial systems, monarchies, and oligarchies may be able to provide great stability for a country, especially one with a relatively closed society, high exists in many communist countries and Arab nations. If a country's ruler and military are strong, any instability that may occur can be kept under control. The problem, however, is that such systems frequently exist in a divided society where dissident groups are waiting for an opportunity to challenge the regime. When a ruler suddenly dies, the risk of widespread disruption and revolution can be quite high.

Political Risks

There are a number of political risks with which marketers must contend. Hazards based on a host government's actions include confiscation, expropriation, nationalization, domestication, and creeping expropriation. Such actions are more likely to be levied against foreign investments, though local firms' properties are not totally immune. Charles de Gaulle, for example, nationalized France's three largest banks in 1945, and more nationalization occurred in 1982 under the French Socialists.

1. Confiscation is the process of a government's taking ownership of a property without compensation. An example of confiscation is the Chinese government's seizure of American property after the Chinese Communists took power in 1949. A more recent example involves Occidental Petroleum, which wanted the United States to review Venezuela's GSP eligibility after the country confiscated the firm's assets without compensation.

2. Expropriation differs somewhat from confiscation in that there is some compensation, though not necessarily just compensation. More often than not, a company whose property is being expropriated agrees to sell its operations-not by choice but rather because of some explicit or implied coercion.

After property has been confiscated or expropriated, ii can be either nationalized or domesticated. Nationalization involves government ownership, and it is the government that operates the business being taken over. Burma's foreign trade, for example, is completely nationalized. Generally, this action affects a whole industry rather than just a single company. For example, when Mexico attempted to control its debt problem; President Jose Lopez Portillo nationalized the country's banking system. In another case of nationalization, Libya's Colonel Gadhafi's vision of Islamic socialism led him to nationalize all private business in 1981. Unlike Communists in Hungary and Poland, Czech Communists nationalized 100 percent of their economy. As a result, rebuilding private markets in Czechoslovakia will be both slow and difficult.

In the case of domestication, foreign companies relinquish control and ownership, either completely or partially, to the nationals. The result is that private entities are/allowed to operate the confiscated or expropriated property. The French government, after finding out that the state was not sufficiently proficient to run the banking business, developed a plan to sell thirty-six French banks.

Domestication may sometimes be a voluntary act that takes place in the absence of confiscation or nationalization. Usually, the causes of this action are either poor economic performance or social pressures. When situations worsened in South Africa and political pressures mounted at home, Pepsi sold its South African bottling operation to local investors, and Coca-Cola signaled that it would give control to a local company. General Motors followed suit by selling its operations to local South African management in 1986. Shortly thereafter, Barclays Bank made similar moves.

Another classification system of political risks is the one used by Root IS Based on this classification, four sets of political risks can be identified: general instability risk, ownership/control risk, operation risk, and transfer risk.

3. **General instability risk** is related to the uncertainty absolute future viability of a host country's political system. The Iranian revolution that overthrew the Shah is an example of this kind of risk. In contrast, ownership/control risk is related to the possibility that a host government might take actions (e.g, expropriation) to restrict an investor's ownership and control of a subsidiary in that host country.

4. Operation risk proceeds from the uncertainty that a host government might constrain the investor's business operations in all areas, including production, marketing, and finance. Finally, transfer risk applies to any future acts by a host government that ,might constrain the ability of a subsidiary transfer payments, capital, or profit out of the host country back to the parent firm

Although the threat of direct confiscation or expropriation has become remote, and of threat has appeared. MNCs have generally been concerned with coups, revolutions, and confiscation, but they now have to pay attention to so-called creeping expropriation. The Overseas Private Investment Corporation (OPIC) defines creeping expropriation as "a set of actions whose cumulative effect is to deprive investors of their fundamental rights in the investment." Laws that affect corporate ownership, control, profit, and reinvestment (e.g., currency inconvertibility *or* cancellation of import license) can be easily enacted. Because countries can change the rules in the middle of the game, companies must adopt adequate safeguards. Various defensive and protective measures will be discussed later.

Indicators of Political Instability

To assess a potential marketing environment, *a* company should identify and, evaluate the relevant indicators of political difficulty. Potential sources of political complication include social unrest, the attitudes of nationals, and the policies of the host government.

Social Unrest

Social disorder is caused by such underlying conditions as economic hardship, internal dissension and insurgency, and ideological, religious, racial, and cultural differences. Lebanon has experienced conflict among the Christians, Muslims, and other religious groups. The Hindu-Muslim conflict in India continues unabated. A company may not be directly involved in local disputes, but its business can still be severely disrupted by such conflicts.

The breakup of the Soviet Union should not come as a surprise. Human nature involves monastery (the urge to stand alone) as well as systems (the urge to stand together), and the two concepts provide alternative ways of utilizing resources to meet a society's needs. Monastery encourages competition, but systems emphasizes cooperation. As explained by Alderson, "a cooperative society tends to be a closed society. Closure is essential if the group is in some sense to act as one." Not surprisingly China, although wanting to modernize its economy, does not fully embrace an open economy, which is likely to encourage dissension among the various groups. For the sake of its own survival, a cooperative society may have to obstruct the dissemination of new ideas and neutralize an external group that poses a threat. China apparent has learned a lesson from the Soviet Union's experience.

Attitudes of Nationals

An assessment of the political climate is not complete without an investigation of the attitudes of the citizens and government of the host country. The nationals' attitude toward foreign enterprises and citizens can be quite inhospitable.

Nationals are often concerned with foreigners' intentions in regard to exploitation and colonialism, and these concerns are often linked to concerns over foreign governments' actions that may be seen as improper. Such attitudes may arise out of local socialist or nationalist philosophies, which may be in conflict with the policy of the company's home country government.

Policies of the Host Government

Unlike citizens' inherent hostility, a government's attitude toward foreigners is often relatively short-lived. The mood can change either with time or change in leadership, and it can change for either the better or the worse. The impact of a change in mood can be quite dramatic, especially in the short run. Government policy formulation can affect business operations either internally or externally. The effect is internal when the policy regulates the firm's operations within the home country. The effect is external when the policy regulates the firm's activities in another county.

Marketing Strategy 4-1

A Primer on Privatization

After the 1989 Velvet Revolution which began the tran-sition to democratic rule, the Czech and Slovak Re-publics faced a policy dilemma. There were numerous problems. First, they had to quickly privatize over some 7,000 medium- and large-scale enterprises, but they did not know what these enterprises might be worth. Sec-ond, the former Czechoslovakia was one of the most extreme cases of a centrally planned economy because the state controlled 98 percent of property. The pri-vate sector was responsible for less than one percent of production. Third, this formerly communist country had low household savings rates, and there were no domestic capitalists who could buy these enterprises. To simply auction assets might result in foreigners' cheap acquisitions while failing to cultivate a "culture of capitalism" among citizens. If you were a policy-maker, what would you do?

Conventional privatization methods include: restitution to original owners; small-scale privatization through public auctions; transfer of state property to municipalities; transformation of cooperatives; and us-ing direct sales, public tenders, joint ventures and mass privatization to privatize medium- and large-scale en-terprises. These methods were used when they would result in a rapid transfer of ownership.

For the vast majority of medium- and large-scale firms, the conventional methods were not feasible be-cause they would have resulted in long delays while benefiting only foreigners or a few rich nationals. The Republics thus came up with a very innovative, albeit controversial, solution: mass privatization. They took care of the absence of domestic savings by giving away shares to citizens. All citizens over the age of eighteen received "coupons" which could be used to bid for shares in enterprises. Govern-ment officials solved the valuation problem by using a system of sequential auc-tions which generate information about enterprises market values.

Measures to Minimize Political Risk

Political risk, though impossible to eliminate, can at the very least be minimized. there are several measures that MNCs can implement in order to discourage a host country from taking control of MNC assets.

Stimulation of the Local Economy

One defensive investment strategy calls for a company to link its business activities with the host country's national economic interests. Brazil expelled Mellon Bank be cause of the bank's refusal to cooperate in renegotiating the country's massive foreign debt.

A local economy can be stimulate in a number of different ways. One strategy may involve the company's porches local products and raw material for its production and operations. By assisting local firms, it can develop local allies who can provide valuable political contacts. A modification of this strategy would be to use subcontractors. For example, some military tank manufacturers tried to secure tank contracts from the Netherlands by agreeing to subcontract part of the work on the new tanks to Dutch companies.

Sometimes local sourcing is compulsory. Governments may require products to contain locally manufactured components because local content improves the economy in two ways: (1) it stimulates demand for domestic components; and (2) it saves the necessity of a foreign exchange transaction. Further invest-ment in local production facilities by the company will please the government that much more. IBM is, the only foreign company allowed to sell switchboards in France because the firm's PBXs are made there.

Employment of Nationals

Frequently, foreigners make the simple but costly mistake of assuming that citizens of LDCs are poor by choice. It serves no, useful purpose for a company to assume, that local people are lazy, unintelligent, unmotivated, or uneducated. Such an attitude may become a self-fulfilling prophecy. Thus, the hiring of local workers should go beyond the filling of labor posi-tions. United Brand's policy, for example, is to hire only locals as managers

Sharing Ownership

Instead of keeping complete ownership for itself, a company should try to share ownership with others, especially with local companies. One method is to convert from a private company to a public one or from a foreign company to a local one. Dragon' Airline, claiming that it is a real Chinese company, charged that Cathay Pacific Airways' Hong Kong landing rights should be curtailed because Cathay Pacific was more British than Chinese. The threat forced Cathay Pacific to sell a new public issue to allow Chinese investors to have minority interests in the company. The move was made to convince Hong Kong and china that the company had Chinese roots.

Being Civic Minded

MNCs whose home country is the United States often encoun-ter the "ugly American" label abroad, and this image should be avoided. It is not sufficient that the company simply does business in a foreign country; it should also be a good corporate citizen there. To shed the undesirable perception, multinationals should combine investment projects with civic projects. Corporations rarely undertake civic projects out of total generosity, but such projects make economic sense in the long run. It is highly desirable to provide basic assistance because many civic entities exist in areas with slight or nonexistent

municipal infrastructures that would normally provide these facilities. A good idea is to assist in building schools, hospitals, roads, and water systems because such projects benefit the host country as well as company, especially in terms of the valuable goodwill generated in the long run.

Political Neutrality

For the best long-term interests of the company, it is not wise to become involved in political disputes among local groups or between countries. A company should clearly but discretely state that it is not in the political business and that its primary concerns are economic in nature. Brazilian fins employ this strategy and keep a low profile in. matters related to Central American revolutions and Cuban troops in foreign countries. Brazilian arms are thus attractive to the Third World because those arms are free of ideological ties. In such a case, a purchasing country does not feel obligated to become politically aligned with a seller, as when buying from the United States or China.

Behind-the-Scenes Lobby

Much like the variables affecting business, political risks can be reasonably managed. Companies as well as special interest groups have varying interest, and each party will want to make its own opinion- known. When the U.S. mushroom industry asked for a quota against imports from China, Pizza Hut came to China's rescue by claiming that most domestic and other foreign suppliers could not meet its specifications. Pizza Hut has a great deal at stake because it is one of China's largest customers as well as a user of half of some nine million pounds of mushrooms for pizzas-not to mention the desires of Pepsi Co, its parent, to open a factory in southern China. Subsequently, the petition of the U.S. mushroom industry was dented.

Even though a firm's operation is affected by the political environment, the direction the influence does not have to flow in one direction only. Lobbying activities can be undertaken, and it is wise to lobby quietly behind the scenes in order not to cause unnecessary political clamor. In explaining the intensity of foreign corporate representation in Washington, the level of U.S. imports from the home country of the MNC is the most important variable, as it outranks U.S. exports to the home country and foreign direct investment in the United States from the home country.

Importers must let their government know why imports are critical to them and their consumers. For example, many U.S. clothing retailers complained vigorously when trade barriers were erected against the importation of clothes. U.S. computer makers, likewise, voiced their objection to. a government action designed to protect the prices of U.S.-made semiconductors because those firms would have to absorb any price increase.

Companies may not only have to lop by in their own country, but they also may, have to lobby in the host country. Companies may want to do the lobbying themselves, or they may let their government do it on their behalf. Their government can be requested to apply pressure against foreign government.

Observation of Political Mood and Reduction of Exposure

Marketers should be sensitive to changes in political mood. A contingency plan should he in readiness. When the political climate turns hostile, when measures are necessary to reduce exposure. Some major banks arid MNCs. took measures to reduce their exposure in France in response to a fear that a Socialist: Communist coalition might gain control of the legislature in the elections of 1978. Their concern was understandable, as-most of these companies were on the left's nationalization list. Their defensive strategy occluded the outflow of capital, the transfer of patents and other assets to foreign subsidiaries, and the sale of equity holdings at foreigners and French nationals living abroad. Such activities once concluded made it difficult for the Socialist government to nationalize the companies' properties. Prudence enquired that these transactions be kept quiet so as to avoid reprisals. As events developed, the fears were partially realized. Although the coalition did win, the new government was pragmatic and did not actively pursue expropriation in a broad sense. Nevertheless, in a time of uncertainty and under such circumstances, what these companies did was local.

Other Measures

There are a few other steps that MNCs can undertake to minimize political risk. One strategy could involve keeping a low profile because it is difficult to please all the people all the time, it may be desirable for company to be relatively inconspicuous. For example, in the 1980s Texas Instruments removed identifying logos and signs in EI Salvador.

Another tactic could involve -trying to adopt a local personality. A practical approach may require that the company blend in with the environment. There is not much to be grainy a company being ethnocentric and trying to westernize the host country's citizen

Multinational firms, due to their presence in a large number of countries, must be mindful of terrorist threats. A survey of U.S.-based MNCs found that less than 50 percent had formal programs to deal with a terrorist attack. Most of the MNCs with antiterrorist programs focus on security equipment rather than on training executives and their families. Some of the activities included in antiterrorist training are: defensive driving, self-defense, kidnapping avoidance, behavior after/during kidnapping, negotiating skills, weapon handling, collecting information from local sources on terrorists, and protection of assets.

Big Brother

Supercomputers are the fastest computers which are used mainly by scientists. A supercomputer can cost upward of $30 million. Cray Research Inc. is the undisputed leader in this market segment, and it has 67 percent of the world market. Fujitsu Ltd., in second place, holds 20 percent. The third-place NEC Corp. has 6 percent.In 1987, the Massachusetts Institute of Technology (M.I.T.) planned to buy or rent a supercomputer and solicited bids former $7.5 million contract. Among those submitting proposals were Cray Research, IBM, E.T.A. System, Amdahl (46 percent owned by Fujitsu), and Honeywell-NEC (SO percent-owned b} Nippon Electric

Corp.).Learning of M.I.T.'s preference for Japanese-made machines, the U.S. government intervened. The acting Secretary of Commerce formally informed M.I.T.'s president that "imported products may be subject to U.s. antidumping duty proceedings informally, despite a denial of the Commerce Department of the government's threat, it was made clear to M.I.T. that, in light of Japan's barriers preventing U.S. supercomputer firms from entering the Japanese market, it would not be in the interest of the United States to purchase Japanese units.M.I.T reacted to the U.S. government's intervention by canceling its procurement and announcing that it planned to apply for federal funds for a research center- that would use 'several U.S.-made supercomputers.The 1990 supercomputer trade accord has helped Cray Research to increase its market share in commercial installation is in Japan to 25 percent. However, Cray Research has been unable to further penetrate the public sector, and its market share-in this sector remains at 8per cent. The public sector includes government funded universities and research labs. Although Japanese firms have long been Cray's customers. The Japanese government (Japan's 'biggest buyer) has never bought from Cray.As an example of how difficult it is to penetrate Japan's public sector, the National Institute for Fusion Research chose to lease NEC's SX-3 system for $625,000 a month. However, according to four pages of benchmark test results, Cray's C90 system surpassed all but one of the Fusion Institute's speed requirements. Still Japanese officials insisted that the extra power available from Cray's machine was irrelevant since the fusion scientists did not need it. Furthermore, they pointed out that the bid required the machine to work with specialized storage devices. Cray, on the other hand, argued that the requirement in question was bogus since it was included solely to favor NEC's machine.-Washington, while accusing Japan of being unfair, has done exactly the same thing. The U.S. government has done its best to discourage sales of Japanese supercomputers in the United State. U.S. government labs, the biggest supercomputer users in the world, have not yet bought a Japanese machine. Whenever an American university or government agency ha5 expressed an interest in buying a Japanese unit, Cray has quietly but effectively lobbied to block the move.In 1991, due to political pressure, Fujitsu was prevented from donating a $17 million supercomputer to a Colorado consortium of environmental scientists. Congressional critics did not like the idea of a Japanese giveaway. They did not object, however, when Cray donated in the same year an X-MP system to the Energy Department in support of a national high-school supercomputer program.

Questions

1. Is it appropriate for the U.S. government to pressure M.I.T. to reject Japanese supercomputers in spite of lower prices? Note that the M. I.T. research projects that would use the supercomputers were federally funded.
2. Did MI.T. React properly in canceling its procurement plan?
3. Is it appropriate for the United States to try to close off its supercomputer market to Japan while, at the same time, trying to pressure the Japanese government to purchase American supercomputers?

BRIBERY

A Matter of National Perspective

JEFFREY A. FADIMAN

San Jose State University

U.S. executives may feel unsure, for example, of how to cope with foreign payoffs, especially when requests for "gifts" take on a form that most Americans consider bribes. Although payoffs obviously exist in the United States, they are detested in our culture. In consequence, this type of solicitation may suggest to even the most overseas-oriented executives that U.S. business values are morally superior to those used abroad. This conviction, if sensed by foreign colleagues, can shatter the most carefully planned-commercial venture. My own initial experience with Third World forms of bribery may serve as an example. It occurred in East Africa during the I 970s and began with this request "Oh, and, Bwana I would ,like [a sum of currency was specified] as Zawadi, my gift. And, as we are now friends, for Chai, -my tea; an eight band-radio, to bring to my home when you visit."Both *Chai* (tea) and *Zawadi* (gift) can be Swahili terms for bribe. These particular suggestions were delivered in, tones of respect. They came almost as an, afterthought at the conclusion of negotiations in which details of a projected business venture had been sided one by one by one. I had looked forward to buying my counterpart a final drink to symbolically complete the deal in" American fashion. Instead, after every commercial aspect had been settled, he expected money.The amount he suggested seemed huge at the time, but it was his specific request for a radio that angered me. Somehow, it added Insult to my injury. Outwardly, I simply kept smiling. Inside, my stomach boiled. I was being asked for a bribe, a request my own culture would condemn. I didn't do it and didn't expect it of others. Beyond that, like most Americas, I expect all monetary discussion to precede the signing of contracts. In this instance, although negotiations were complete, I had been asked to pay once more Once? How often? What were the rules? Where would it stop? My reaction took only moments to formulate. I am American," I declared. "I don't pay bribes." Then, I walked away.That walk was not the longest in my life. It was, however, one of the least commercially productive. For in deciding to conduct international business by American rules, I terminated more than a commercial venture. I also closed a gate that opened into a foreign culture. Beyond it lay the opportunity to do business in a wholly local fashion, as well as an interpersonal relationship that could have' anchored my commercial prospects in that region for years to come.

Questions

1. Do you agree with the author's rejection of the request for "gifts"?
2. If you were in a similar situation, how would you handle the situation while considering-your own business needs?

LESSON 7:
LEGAL ENVIRONMENT

Legal Systems

To understand and appreciate the varying legal philosophies among countries, it is useful to distinguish between the two major legal systems: common law and statute law.

There are some twenty-five common law or British law countries. A common law system is a legal system that relies heavily on precedents and conventions. Judges' decisions are guided not so much by statutes as by previous court decisions and interpretations of what certain laws are or should be. As a result, these countries' laws are tradition-oriented. Countries with such a system include the United States, Great Britain, Canada, India, and other British colonies.

Countries employing a statute law system, also known as code or civil law, include most continental European countries and Japan. Most countries over seventy are guided by a statute law legal system. As the name implies, the main rules of the law are embodied in legislative codes. Every circumstance is clearly spelled out to indicate what is legal and what is not. There is also a strict and literal interpretation of the law under this system.

International law may be defined as the rules and principles that nation-states consider binding upon themselves. There are to categories of international law; public law, or the law of nations; and international commercial law, which is evolving. International law pertains to trade and other areas that have traditionally been under the jurisdiction of individual nations.

Early international law was concerned with waging war, establishing peace, and other political issues such as diplomatic recognition of new national entities and governments. Elaborate international rules gradually emerged covering, for example, the status of neutral nations. The creation of laws governing commerce developed on a state by state basis, evolving into what is termed the law of the merchant. International law still has the function of upholding order, although in a boarder sense than dealing with problems arising from war. At first international law as essentially an amalgam of treaties, covenants, codes, and agreements. As trade grew among nations, order in commercial affairs assumed increasing importance. Whereas the law had originally dealt only with nations as entities, a entities, a growing body of law rejected the idea that only states can be subject to international law.

Common Versus Code Law

Private international law is the body of law that applies to interpretations of and disputes arising from commercial transactions between companies of different nations. As noted, laws governing commerce emerged gradually.

Today, the majority of countries have legal systems based on civil code traditions, although an increasing number of countries are blending concepts, and hybrid systems are merging. Despite the differences in systems, three distinct forms of laws are common to all nations. Statutory law is codified at the national, federal, or state level; administrative law originates in regulatory bodies and local communities; and case law is the product of the court system.

Under civil or code law, the judicial system is divided into civil, commercial, and criminal law. Thus, commercial law has its own administrative structure. Property rights, for example, are established by a formal registration of the property in commercial courts. Code law uses codified, written norms, which are complemented by court decisions. Common law, on the other hand, is established by tradition and precedents, which are rulings from previous cases; until recently, commercial law was not recognized as a special entity.

In code law counties, intellectual property rights must be registered, whereas in common law counties, some : such as trade marks but not patents : are established by prior use.

The host country's legal system : that is, common or civil law : directly affects the form a legal business entity will take. In common law countries, companies are formed by contract between two or more parties who are fully liable for the actions of the company.

Corruption: In the Eye of the Beholder?

On January 25, 1992, the *Economist* reviewed a paper by Prakash Reddy, an Indian social anthropologist who, reversing the common pattern of Western scholars going to study developing countries' social behavior, obtained a research grant to study a village in Denmark. He spent a few months in this village and registered his impressions of the relations among its inhabitants. Professor Reddy was amazed to observe that the villagers hardly knew one another. They rarely exchanged visits and had few other social contacts. They had little information on what other villagers, including their neighbors, were doing and apparently little interest in finding out. According to Professor Reddy, even relationships between parents and children were not very close. When the children reached adulthood, they moved out, and after that, they visited their parents only occasionally.Professor Reddy contrasted this behavior with that prevailing in a typical Indian village of comparable size. In the latter, daily house visits would be common. . Everyone would be interested and involved in the business of the others. Family contacts would be very frequent and the members of the extended families would support one another in many ways: Relations with neighbors would also be close.This story has implications for the concept of arm's-length and, in turn, for the role of corruption. Arm's-length relationships in economic exchanges would be much more likely to prevail in the Danish village than in the Indian village. In the latter, the concept of arm strength relationships would seem strange and alien. It would even seem immoral. The idea that, economically speaking, one should treat relatives and friends in the same way

as strangers - would appear bizarre. Relatives-and friends would simply expect preferential treatment whether- they were dealing with- individuals in the private or public sector.If a government were established in each of the two villages, with each having a bureaucracy charged with carrying out its functions through the instruments described earlier, it would be far easier for the Danish bureaucrats to approximate in their behavior the Weber Ian ideal than for the Indian bureaucrats. In the lndian village, the attempt to create an impersonal bureaucracy that would operate according to principles in which there is no place for personalize, cronyism, etc., would conflict -with the accepted social norm that family and friends come first. In this society, the government employee, just like any other individual, would be expected to help relatives and friends with special treatment or favors even if, occasionally, this behavior might require bending, or even breaking, administrative rules and departing from universal principles. The person who refused to provide this help would be seen as breaking the prevailing moral code and would be ostracized.The Indian and Danish villages represent polar or extreme cases of how individuals may interact within a community. Whether Professor Reddy's description of them is accurate or not, they provide convenient polar cases. Most societies probably fall somewhere between these two extremes, with Northern . European and Anglo-Saxon countries closer to the Danish-village-model, and many other countries closer to the Indian village model. The Anglo-Saxon concept of privacy is probably just a manifestation of arm's length relationships. Many developing countries would probably be clos9r to the model represented by the Indian village. Sadly, the very features that make a country a less cold and indifferent-place are the same ones that increase the difficulty of enforcing arm's-length rules that a-re so essential for modern, efficient markets and governments.

Sidestepping Legal Problems : Important Business Issues

Clearly, the global legal environment is very dynamic and complex. Therefore, the best course to follow is to get legal help. However, the astute, proactive marketer can do a great deal to prevent conflicts from arising in the first place, especially concerning issues such as establishment, jurisdiction, patents and trademarks, antitrust, licensing and trade secrets, and bribery.

The services of counsel are essential for addressing these and other legal issues. The importance of international law firms is growing as national firms realize that to properly serve their clients, they must have a presence in overseas jurisdictions.

Establishment

Under what conditions can trade be established? To transact business, citizens of one country must be assured that they will be treated fairly in another country. In western Europe, for example, the creation of the single market now assures that citizens from member nations get fair treatment with regard to business and economic activities carried out within the Common Market. The formulation of the governance rules for trade, business, and economic activities in the EU will provide additional substance to international law.

Jurisdiction

Company personnel working abroad should understand the extent to which they are subject to the jurisdiction of host-country courts. Employees of foreign companies working in the United States must understand that courts have jurisdiction to the extent that the company can be demonstrated to be "doing business" in the state in which the court sits. The court may examine whether the foreign company maintains an office, solicits business, maintains bank accounts or other property, or has agents or other employees in the state in question.

Normally, all economic activity within a nation is governed by that nation's laws. When transaction crosses boundaries, which nation's laws apply? If the national laws of country Q pertaining to a simple export transaction differ from those of country P, which country's laws apply to the export contract? Which apply to the letter of credit opened to finance the export transaction? The parties involved must reach agreement on such issues, and the nation whose laws apply should be specified in a jurisdictional clause. There are several alternatives from which to choose: the laws of the domicile or principal place of business's of one of the parties, the place where the contract was entered, or the

The Multilateral Agreement on Investment

In 1995, the GECD began talks on a new initiative known as the Multilateral Agreement on Investment (MAI) that will set rules for foreign investment and provide a forum for dispute settlement. In some countries, so-called per-formance requirements favor local investors over for-eigners. For example, foreign companies may be required to obtain some goods and services from local companies rather than the home office Performance requirements can also take the form of stipulations that a certain number of senior managers must be local nationals or that the foreign company must export a set percentage of its production:

The existence of the MAI negotiations remained largely unknown to the general public until a Canadian consumer rights group obtained the text of MAI and posted it on the Internet. In fact, a large number of consumer and environmentalist action groups have joined in opposition to the agreement. As Mark A. Vallianatos, an international policy analyst at Friends of the Earth, explained:

Our fear is that MAI will give multinational corporations the opportunity to treat the whole world as their raw pool of natural resources and labor and consumer markets. It may allow them to do everything based on profit motives with-out environmental considerations providing sensible limits on how they operate. MAI gives new rights to corporations without addressing their responsibilities to workers and the environment. . An MAI that is worth doing should deal with how investments will affect sustainable development, how they will affect workers' rights, and how they will affect excessive resource extraction-those kinds of issues.

Some industry experts downplay MAI's potential to contribute to environmental degradation. R. Garrity Baker, senior director at the Chemical Manufacturers Association, says, "When foreign companies that have better It environmental performance come in and invest in a market bring that know-how with them, then over time '" that know-how kind of trickles down to other companies. Foreign companies set an example that others can learn from." MAI supporters also point out that the agreement If(allows countries to adopt any measure deemed appropriate

to ensure investment is undertaken in a manner that reflects sensitivity to environmental issues. As of mid- 1998, prospects for MAI approval in the United States were clouded. by disagreements between key Washington agencies that might be affected by the agreement's provi-sions. The U.S. State Department and Commerce Department are generally supportive, but the Environmental Protection Agency, the U.S. Agency for International Development, and the Justice Department are concerned that MAI will lead to a rash of lawsuits against the United States. At the state level, a number of governors felt that MAI would impinge on state sovereignty.

place of performance of the contract. If a dispute arises under such a contract, it must be heard and determined by a neutral party such as a court or an arbitration panel. If the parties fail to specify which nation's laws apply, a fairly complex set of rules governing the "conflict of laws" will be applied by the court or arbitration tribunal. Sometimes, the result will be determined with the help the scales of justice," with each party's criteria stacked on different sides of the scale.

Intellectual Property: Patents and Trademarks

Patents and trademarks that are protected in one country are not necessarily protected in another; so global marketers must ensure that patents and trademarks are registered in each country where business is conducted. In the United States, where patents, trademarks, and copyrights are registered with the Federal Patent Office, the patent holder retains all rights for the life of the patent even if the product is not produced or sold. Patent and trademark protection in the United States is very good and American law relies on the precedent of previously decided court cases for guidance.

Companies sometimes find ways to exploit loopholes or other unique opportunities offered by patent and trademark laws in individual nations.

Trademark and copyright infringement is a critical problem in global marketing and one that can take a variety of forms. Counterfeiting is the unauthorized copying and production of a product. An associative counterfeit, or imitation, uses a product name that differs slightly from a well-known brand but is close enough that consumers will associate it with the genuine product. A third type of counterfeiting is piracy, the unauthorized publication or reproduction of copyrighted work. Piracy is particularly damaging to the entertainment and software industries; computer Programs, videotapes, cassettes, and compact discs are particularly easy to duplicate illegally.

Individuals and firms have the freedom to own and control the rights to- intellectual property (i.e., inventions and creative works). The terms patent, trademark, copy right, and trade secret are often use~ interchangeably.

A trademark is a symbol, word, or thing used to identify a product made or marketed by a particular firm. It becomes a registered trademark when the mark is accepted for registration by the Trademark Office.

A copyright, which is the responsibility of the Copyright Office, offers protection against unauthorized copying by others to an author or artist for his or her literary, musical, dramatic, and artistic works. A copyright protects the form of expression rather than the object matter. A copyright bas now been extended to computer software as well.

A patent protects an invention of a scientific or technical nature. It is a statutory t from the government (the Patent Office) to an inventor in exchange for public disclosure giving the patent holder exclusive right to the functional and design inventions patented and excluding others from using those inventions for a certain period of time.

The term trade secret refers to know-how (e.g., manufacturing methods, for mulas, plans, and so on) that is kept secret within a particular business. This know how generally unknown in the industry, may offer the firm a competitive advantage.

Infringement occurs when there is commercial use (i.e., copying or imitating) without owner's consent, with the intent of confusing or deceiving the public.

Counterfeiting

Counterfeiting is the practice of unauthorized and illegal copying of a product. In essence, it involves an infringement on a patent or trademark or both. According to the U.S. Lanham Act, a counterfeit trademark is a " spurious trademark which is identical with, or substantially indistinguishable from, a registered trademark." Section 42 of the U.S. Trademark Act prohibits imports of counterfeit goods into the United States.

Counterfeiting is a serious business problem. In addition to the direct monetary loss, companies face indirect losses as well. Counterfeit goods injure the reputation of companies whose brand names are placed on low quality products.

A true counterfeit product uses the name and design of the original so as to look exactly like the original. On the other hand, some counterfeit partially duplicate the original's design and/or trademark in order to mislead or confuse buyers.

Products affected by counterfeiting cover a wide range. At one end of the spectrum are prestigious and highly advertised consumer products, such as Hennessy brandy, Dior and Pierre Cardin fashion apparel, Samsomite luggage, Levi's jeans and Cartier watches. At the other end of the spectrum are industrial products, such as Pfizer animal feed supplement, medical vaccines, heart pacemakers, and helicopter parts. Counterfeits include such fashionable products as Gucci and Louis Vuitton handbags, as well as such mundane products as Farm oil Filters and caterpillar tractor parts. Although faces are more likely to be premium priced consumer products, low init value predicts have not escaped the attention of the counterfeiter. Even Coke is not always the "real thing" as it very easy for counterfeiters in LDCs to put something else that looks and tastes like Coke into genuine Coke bottles.

Controlling the counterfeit trade is difficult is part because counterfeiting is a low- risk, high profit venture. It is difficult and time consuming to obtain a search warrant. Low prosecution rates and minimal penalties in terms of jail terms and fines do not make a good deterrent. Walt Disney and Microsoft, in winning two trademark infringement cases in china, were awarded only $91 and $2,600 respectively. More over, there are many small –time counterfeiters who could just pack up and go to a new location to escape police.

Just as critical, if not more so, is the attitude of law enforcement agencies and consumers. Many consumers understand neither the seriousness of the violation nor the need to respect trademark rights. Law enforcement agencies often believe that the crime does not warrant special effort. The problem is severe in Taiwan, because so many local manufacturers pay no attention to copyrights and patents. The strong export potential for bogus merchandise makes the: government there look the other way. In Mexico, one counterfeiter openly operated several "Cartier" stores in American owned hotels. After many years in Mexican courts and at least forty-nine legal decisions against the retailer, Cartier was still unable to gain the cooperation of Mexican officials to close down the counterfeit.

It is not sufficient for a company to fight counterfeiting' only in its home country. The battle must be carried to the counterfeiters' own country and to other major markets. Apple has filed suits against imitators in Taiwan, Hong Kong, and New Zealand and has planned further legal action in Singapore, Japan, Australia, and Western Europe. The overall idea is to prevent bogus goods from entering the industrialized nations that make up the major markets. To make the tactic effective, it is necessary to go after the distributors and importers in addition to the manufacturers of counterfeit goods.

Finally, the company must invest in and establish its own monitoring. system. Its best defense is to strike back rather than relying solely on government enforcement. One computer firm in Taiwan allows consumers to bring in fakes that it then exchanges for the purchase of genuine computers at a discount.

When the cost of surveillance is high, it may be more desirable to form an association for the purpose of gathering information and evidence. Apple, Lotus, Ashton-Tate, Microsoft, AutoDesk, and Word Perfect formed the Business Software Association as an investigative team. The team was successful in providing information to authorities for the arrest of pirates. This strategy reduces costs while increasing cooperation and effectiveness.

Definitions

1. Intellectual Property is a general term that describes Inventions or other discoveries that have been registered with government authorities for the sale 'or use by their owner. Such terms as patent, trademark, copyright, or unfair competition fall into the category of intellectual property.
2. A patent is a government grant of certain rights given to an inventor for a limited time in exchange for the disclosure of the invention. The most important of these rights is" the one under which the patented invention tan" be made, used, or sold only with the authorization of the patent owner.
3. A trademark relates to any work, name, or symbol which is used in trade to distinguish a product from other similar goods (e.g., "Coke"). Trademark laws are used to prevent others from making a produced with a confusingly similar mark. Similar rights may be acquired in marks used in the sale of advertising of services (service marks).
4. A copyright protects the writings of an author against copying literary, dramatic, musical, and artistic-and more recently computer software-works are included within the protection of copyright laws.
5. A mask work is a new type of intellectual property, protected by the Semiconductor Chip Protection Act of 1984. It is, in essence, the design of an electrical circuit, the pattern of which is transferred and fixed in a 'semiconductor chip during the manufacturing process.
6. Unfair competition is a very broad term defining legal standards of business conduct. It provides protection against such things as simulation of trade packaging, using similar corporate and professional names, misappropriation of trade secrets, and palming off one person's goods as those of another.

Antitrust

Antitrust laws are designed to combat restrictive business practices and to encourage competition. American antitrust laws are a legacy of the 19th-century U.S. "Trust-busting" era and are intended to maintain free competition by limiting the concentration of economic power. The Sherman Act of 1890 prohibits certain restrictive business practices, including fixing prices, limiting production, allocating markets, or any other scheme designed to limit or avoid competition. The law applies to foreign companies conducting business in the United States and extends to the activities of U.S. Companies outside U.S. Boundaries as well if the company conduct is deemed to have an effect on US. Commerce contrary to law similar laws are taking on increasing importance outside the United States as well.

The European Commission prohibits agreements 'and practices that prevent, restrict, and distort competition.

In some instances, individual country laws Europe apply to specific marketing mix elements. For example, some countries permit selective or exclusive product distribution. However, community law can take precedence.

Licensing and Trade Secrets

Licensing is a contractual agreement, in which a licensor allows a licensee to use patents, trademarks, trade secrets, technology, or other intangible assets in return for royalty payments or other forms of compensation (see Chapter 8 for a discussion of licensing as a marketing strategy). In the United States, laws do not regulate the licensing process per se as do technology transfer laws in the EU, Australia, Japan, and many developing countries. The duration of the licensing agreement and the amount of royalties a company can receive are considered a matter of commercial negotiation between licensor and licensee, and there are no government restrictions on remittances of royalties abroad. In many countries, these elements of licensing are regulated by government agencies.

Important considerations in licensing include analysis of what assets a firm may offer for license, how to price the assets, whether to grant only the right to "make" the product or to grant the rights to "use" and to "sell" the product as well. The right to sublicense is another important issue. As with distribution agreements, decisions must also be made regarding exclusive or nonexclusive arrangements and the size of the licensee's territory.

To prevent the licensee from using the licensed technology to compete directly with the licensor, the hitter may try to limit the licensee to selling only in its home country. The licensor may also seek to contractually bind the licensee to discontinue use of the technology after the contract has expired. In practice, host government laws, including U.S. and EU antitrust laws, may make such agreements impossible to obtain. Licensing is a potentially dangerous action: It may be instrumental in creating a competitor. Therefore, licensors should be careful to ensure that their own competitive position remains advantageous. This requires constant innovation. There is a simple rule: If you are licensing technology and know-how that are going to remain unchanged, it is only a matter of time before your licensee will become your competitor not merely with your technology and know-how but with improvements on that technology and know-how. When this happens, you are history.

Branch Versus Subsidiary

One legal decision that an MNC must make is whether to use branches or subsidiaries to carry out its plans and to manage 'its operations in a foreign country. A branch is the company's extension or outpost at another location. Although physically detached, it is not legally separated from its parent. A subsidiary, in contrast, is both physically and legally independent. It is considered a separate legal entity in spite of its ownership by another corporation.

A subsidiary may be either wholly owned (i.e., 100 percent owned) or partially owned. GE receives some $1 billion in revenues from its wholly owned and partially owned subsidiaries in Europe. The usual practice of Pillsbury, Coca-Cola, and IBM is to have wholly owned subsidiaries. Although a parent company has total control when its subsidiary is wholly owned, it is difficult to generalize about the superiority of one approach over the other.

As a rule, multinationals prefer subsidiaries to branches. Fiat has 432 subsidiaries and" minority interests within 130 companies in sixty countries. The question that must be asked is why Fiat, like other MNCs, would go -through the trouble and, expense of forming hundreds of foreign companies elsewhere. When compared to the use of branches, the use of subsidiaries adds complexity to the corporate structure. They are also expensive, requiring substantial sales volume to justify their expense.

There are several reasons why a subsidiary is the preferred structure. One reason has to do with *recruitment of management.* Titles mean a great deal in virtually all parts of the world. A top administrator of an overseas operation wants a prestigious title of president chief executive, or managing director rather than being merely, a branch manager."

Gray Market

Gray market exists when a manufacturer ends up with an unintended channel of distribution that performs activities similar to the planned channel-hence the term parallel distribution. Through this extra channel, gray market goods move, internationally as well as domestically. In an international, context, a gray market product is one imported by an unauthorized party. Products notably affected by this method of operation include watches, cameras, automobiles, perfumes, and electronic goods. The problem is particularly acute for Seiko, because one out of every four Seiko watches imported into the U.S. market is unauthorized.

A gray marketer can acquire goods in two principal ways. One method is to place an order directly with a manufacture by going through an intermediary, in order, to conceal identity and purpose. Another method is to buy the merchandise for immediate shipment on the open market overseas. Asian countries in general and Hong Kong in particular are favorite targets because the wholesale prices there are usually much lower than elsewhere. The importance of the gray market even gets some countries to specialize in handling such goods for the third country, primarily the United States.

Gray marketing of a product within a market often takes place because of the channel structure and margins. A manufacturer who wants to eliminate the potentially profitable gray marketing activity should restructure its pricing and discount policies. Parallel importation of trademarked products occurs for several reasons: (1) gray marketers can easily locate sources of supply because many trademarked products are available in markets throughout the world, (2) price differences among these sources of supply are great enough, and (3) the legal and other barriers to moving goods are low.

Although there are several causes, price differential is the only true reason for the gray market to exist. There is no justification for the existence of the gray market unless prices in at least two domestic markets differ to the extent that even with extra transportation costs reasonable profits can be -made. This is a good example of the economic force" at work. Gray market goods can be purchased, imported, and resold by an unauthorized distributor at prices lower than those charged by manufacturer-authorized importers/distributors. As a result, identical items can carry two different retail prices.

At one time, whether gray market goods are illegal or not could not be answered with a great degree of certainty. Unlike the black market, which is clearly illegal the gray market, as its name implies, is neither black nor white-legality is in doubt.

At one time, certain exclusive sales territories were supported by nontariff barriers between member states of the European Union. However, the EU's elimination of non-tariff barriers and border controls has made it possible for parallel imports to move freely across the EU, resulting in price competition. Under the ED concept of parallel imports, suppliers and distributors of products in one member state cannot use exclusive sales arrangements to conspire to block parallel imports of identical products from dealers in other member states. Such actions are a violation of EU antitrust laws.

To manufacturers and authorized dealers, parallel distributors are nothing but freeloaders or parasites who take advantage of the legitimate owners' investment and goodwill. Manufacturers also feel that these discounters deceive buyers by implying that gray market have the same quality and warranties as items sold through authorized channels.

Gray marketers naturally see the situation differently. They feel that manufacturers try to have it both ways tolerating gray marketing when they need to get rid of surplus merchandise

and condemning gray marketers when that need subsides. Gray marketers also accuse manufacturers of not wanting to be price competitive and view manufacturers distribution restrictions as a smokescreen for absolute price control. Parallel distributors claim to align themselves more with consumers by providing an alternative and legal means of distribution, a means capable of delivering the same goods to consumers at a lower but fair price under the free enterprise system. Some parallel distributors have even sued Mercedes-Benz for restraint of trade, which is a violation of the Sherman and Clayton Acts. As pointed out by them; trademarks are designed to counter fraud rather than limit distribution.

With regard to the charge that gray market goods are inferior, manufacturers and authorized dealers refuse to service such goods by pointing out that gray market good are not for U.S. consumption. Therefore, such goods are adulterated, second-rate, or discontinued articles, and consumers may be misled into believing that they receive identical products with U.S. warranties. Gray marketers, however, do not buy this argument. According to them, there is really no proof that the products they handle are inferior. It is inconceivable that a manufacturer would stop a production line just to make another product version for the non U.S. market. As such, gray market goods are genuine products subject to the same stringent product control. Concerning the inferior warranty and the manufacturer's refusal to service gray market goods under warranty terms, parallel distributors show no concern because they have their own warranty service centers that can provide the same, if not better, service. Their service offers are often closer to the market being served. Gray marketers also point out that they would not survive in the long run if they did not provide service and quality assurance.

The arguments used by both sides are legitimate and nave merits. Only one thing is certain: authorized suppliers are adversely affected by parallel distribution. They lose market. share as well as control over price. They may have to service goods sold by parallel competitors, and the loss of goodwill follows when consumers are unable to get proper repair.

Manufacturers and authorized suppliers definitely see the need to discourage gray marketing. There are several strategies for this purpose, and each strategy has both merits and problems. Although tracking down offenders' costs money, disen-franchisement of offenders is a stock response. This move sends loud signals of commitment to distributors who abide by the terms of the franchise agreement.' A one price-for-all policy can eliminate an important source of arbitrage, but it ignores transaction costs and forecloses valid price discrimination opportunities among classes of customers who are buying very different benefits in the same product. Another strategy is to add distributors (perhaps former gray market distributors to the network, but this approach may create disputes among current distributors.

Conflict Resolution, Dispute Settlement, And Litigation

Countries vary in their approach toward conflict resolution. The United states ha more lawyers than any other country in the world and is arguably the most litigious nation on worth. In part, this is a refection of the low context nature of American culture, a spirit of confrontational competitiveness, and the absence of tone important principle of code law the loser pays all court costs for all parties. The degree of legal cooperation and harmony in the EU is unique and stems in part form the existence of code law as a common bond. Other regional organisations have made for less progress toward harmonization.

Conflicts will inevitably arise in business anywhere, especially when different cultures come together to buy, sell, establish joint ventures, compete, and cooperate in global markets for American companies, the dispute with a foreign party is frequently in the home country jurisdiction. The issue can be litigated in the united states, where a company and its attorneys might be said to enjoy " home court" advantage. Litigation in foreign courts, however, becomes vastly more complex. This is due in part to differences in language, legal systems, currencies, and traditional business customs and patterns. In addition,

Country	Lawyers per 100,000 people
United states	290
Australia	242
United kingdom	141
France	80
Germany	79
Hungary	79
Japan	11
Korea	3

Problems arise from differences in procedures relating to discovery. In essence, discovery is the process of obtaining evidence to prove claims and determining which evidence may be admissible in which countries under which conditions. A further complication is the fact that judgments handed down in courts in another country may not be enforceable in the home country. For all these reasons, many companies prefer to pursue arbitration before proceeding to litigate.

The World Trade Organisation and Its Role in International Trade

In 1948 when 23 countries underlined in the General Agreement on Tariffs and Trade (GATT) their determination to reduce import tariffs, this was considered a milestone n international trade relations. GATT is based on three principles. The first concerns nondiscrimination, each member country must treat the trade of all other member countries equally. The second principle is open markets, which are encouraged by the GATT through a prohibition of all forms of protection except customs tariff air trade is the third principle, which prohibits export subsidies on manufactured products and limits the third principle, which prohibits export subsidies on manufactured products and limits the use of export subsidies on primary products. In reality, none of these principles is fully realized as yet, although much progress as made during the Uruguay Round on issues such as no tariff barriers, protection of intellectual property rights, and government subsidies.

Italy GreeceFinlandSwedenNetherlands Bans all forms of tobacco advertising Bans all advertising of toysBans speed as a feature in car advertisingBans television advertising directed at children under age 12Bans claims about automobile fuel consumption

Another major breakthrough at the Uruguay Round was the establishment of the world Trade Organisation (WTO) in 1995, which replaced GATT. In contrast to GATT, which was more loosely organised, WTO as a permanent institution is endowed with much more decision making power in undecided cases. These extended competencies have become manifest in visible consequences. During its 50 years of existence, only 300 complaints in international trade disputes were filed with GATT, since its installation in 1995, the WTO has already dealt with 200 cases.

Ethical Issues

Ethics, just as the legal environment, vary around the world. What is acceptable in one country may be considered unethical in another. In addition to the obvious moral questions, companies may suffer when negative publicity is generated. A case in point it the use of child labor or allegations of its use. Nike is well aware of this problem. Nike sources its goods in countries with low wages and poor labor regulations. Although Nike does not directly employ children in its overseas manufacturing the sourcing agent may. A program has been established by Nike to monitor its suppliers but it is difficult when some locals may argue in favor of child labor. Regarding child labor in Pakistan, " trade bands on goods produced by child labor could have the unintended effect of forcing the children into other paid work at a lower wage" and/ or prostitution. The US Department of Labor has many publications on this specific issue.

In order to "do the right thing" but also generate good publicity, companies can take an active approach to ethical issues. Reebok and Levi Strauss have done this by establishing standards that their contractors must follow, and they actively monitor results to ensure that standards are met.

An increasing number of companies are addressing ethical issues. A recent survey of companies in 22 countries found that 78 percent of boards of directors were establishing ethical standards. This is up significantly from 21 percent in 1987. The study also warns that regional differences can hinder effective implementation of any efforts.

U.s. Laws and Exports

Assistance or Hindrance?

The United States has many laws that have made exports difficult. These laws have been a contributing factor to the trade deficit of the United States.

Nuclear Nonproliferation Treaty

Section 378.1 of the U.S. Export Administration Regulations applies to nuclear weapons and explosive devices. A concern over the use of nuclear weapons prompts the United States to limit exports of nuclear reactors and material to any countries that may produce a nuclear bomb. Israel, despite refusing to sign the Nuclear Nonproliferation Treaty, is able to substantially secure much of what it needs anyway. India, on the other hand, is unable to get the needed materials and technology from the United States in spite of its willingness to sign the treaty. Critics of the law believe that if a country wants nuclear materials it will find a source, and it is naive to believe that leaders would not consider using nuclear weapons just because a treaty has been signed. It is difficult to believe that a country would prefer to lose a war with dignity rather than "winning ugly." What is most bothersome to many Third World critics is the idea that only the superpowers or developed nations know how to use nuclear weapons' "responsibly."

Human Rights Policy

The human rights policy of the United States at times interferes with America firms' business activities. For protection of human rights, there are regulations for export of crime control and detection instruments and data to all countries except NATO members, Japan, Australia and new Zealand. The strictest adherence to this policy occurred during the carter years, which led to severe restrictions on trade with countries that violated the human rights code. Loans were withheld from South Africa, Uruguay, EI Salvador, and Chile.

Critics charge that the United States has been arbitrary in the application of its sanctions. While criticizing in the rights abuses in Cuba. Czechoslovakia Nicaragua and the former Soviet Union, the- United States as at times ignored or tolerated similar abuses in Haiti, {Honduras, Kenya, South Africa, and Turkey. According to two private groups (Human Rights Watch and the Lawyers Committee for Human Rights), the Reagan administration "[applied] human rights standards inconsistently between perceived allies and foes."

Other questions related to the restrictions involve whether the end justifies the means and whether the restrictions are effective. Repeated pressures on EI Salvador, for example; yielded few concrete results. Even when the sanctions are effective, they may not result in the accomplishment of the desired goal. There was overwhelming evidence of human rights violations in Iran and Nicaragua during the administrations of the Shah and President Somoza, respectively. Yet it has been widely debatable whether the new regimes, after overthrowing those dictators, have provided desirable alternatives. Nevertheless, the U.S. human rights policy has served a useful purpose in some instances.

Antiboycott Regulations

The U.S. Export Administration Act of 1977 has anti boycott provisions that establish a U.S. policy of opposing restrictive trade practices imposed by foreign countries against other countries friendly to the United States. The purpose of the law is not to challenge any country's sovereign right to boycott products from another nation, but rather to prevent U.S. citizens from being used as tools of another nation's foreign policy. American firms are urged to refuse any request to support such boycotts and are required to report such' a request to the Office of Ant boycott Compliance (OAC). which administers-the law.

The anti boycotts provisions specially prohibit U.S. persons from :

"Refusing to do business with black listed firms and boycotted countries friendly to the United States pursuant to foreign boycott demands.

Discriminating' against other U.S. persons on the basis of race, religion, sex, or national origin to comply with a foreign boycott.Furnishing information about another person's race, religion sex or national origin where such information is sought for boycott enforcement purposes.

Furnishing information about their business relationships with boycotted countries or blacklisted companies."

In response to the Arab nations' boycott of Israeli-made goods, the United States has adopted anti-Arab boycott rules, which require U.S. exporters to forego Arab contracts that prohibit the inclusion of goods from Israel. Safeway Stores Inc. provides technical and management assistance to Arab-owned stores in Saudi Arabia and Kuwait, which refused to do business with companies on the anti-Israeli blacklist. As a result, Safeway managers told customers and suppliers not to do business with Israel or with blacklisted companies. Safeway also furnisher information about its dealings with Israel to the Israel Boycott Office of Kuwait. To settle the charges that Safeway had illegally complied with the Arab boycott, Safeway paid the Department of Commerce $995,000. The previous largest ant boycott penalty was a $323,000 fine paid, by- Citicorp.

Foreign Corrupt Practicess Act (FCPA)

This act greatly limits corporate payments of fees to obtain a foreign contract, and a violation-of the act is punishable by fines and jail terms. But the law is ambiguous. And it increases delays as well as the cost of doing-business. For example, a person associated with a company must certify that there is no bribe of immoral act practically every time business is transacted. The company's agent must get an expense account validated by the American consular authority before receiving a payment for expenses as routine as a taxicab ride.

Health, Safety And Environmental Regulations

These regulations are based on the assumption that what is good for the United States is good for other nations. The health, safety, and environment rules thus enforce strict U.S. standards over American firms' overseas operations. The problem that some businesses see is that U.S. standards may make certain products either unavailable or too expensive for foreign consumers. Critics of the regulations contend that the United States should not make health, safety, and environmental decisions for citizens of other countries.

Antitrust Laws

U.S. antitrust regulations result in a reluctance on the part of American firms to form joint trading companies or to bid jointly on major overseas projects. In the 1980s, with a trend toward mega mergers, the antitrust restrictions appeared to be relaxing. A 1982 Jaw- allowed exporters to form export trading companies so that they could pool resources under antitrust exemptions. Despite new rules, exporters must deal with varying-definitions and-interpretations of- the law among the Treasury, Commerce, and Justice departments.

The U.S. laws cited above, in one way or another, impede U.S. exports. Although these laws '"may have been enacted with good intentions, their appropriation's depends on the criteria used to judge them. They may make sense-from the standpoint of foreign policy. The trade is the criterion, h9wever, these laws are -clearly disadvantageous to American firms. Do you agree with the rationale of these laws from the perspectives of national security, foreign policies, and trade?

LESSON 8:
SOCIAL & CULTURAL ENVIRONMENT

Marketing has always been recognized as an economic activity involving the exchange of goods and services. Only in recent years, however, have sociocultural influences been identified as determinants of marketing behaviour, revealing marketing as a cultural as well as economic phenomenon. Because our understanding of marketing is culture bound, we must acquire a knowledge of diverse cultural environments in order to achieve successful international marketing. We must, so to speak, remove our culturally tinted glasses to study foreign markets.

The growing use of anthropology, sociology and psychology in marketing is explicit recognition of the noneconomic bases of marketing behaviour. We now know that it is not enough to say that consumption is a function of income. Consumption is a function of many other cultural influences as well. Furthermore, only non economic factors can explain the different patterns of consumption of two individuals with identical incomes-or by analogy, of two different countries with similar per capita incomes.

A review of consumer durables ownership in EU countries with similar income levels shows the importance of nonincome factors in determining consumption behaviour. For automatic washing machines the range is from 72 percent in Sweden to 96 percent in Italy; for dishwashers, from 11 percent in the Netherlands and Spain to 34 percent in Germany; for clothes dryers, from 5 percent in Spain to 39 percent in Belgium; for microwave ovens, from 6 percent in Italy to 37 percent in Sweden; for vacuum cleaners, from 56 percent in Italy to 98 percent in the Netherlands. It is remarkable that the same countries(Italy, Netherlands, Sweden) can be at the high-penetration level for some appliances and at the low-penetration level for others. Only cultural difference can account for these variables.

Basic Aspects of Society and Culture

Anthropologists and sociologists define culture as "Ways of Living ", built up by a group of human beings, which are transmitted from one generation to another. A culture acts out its ways of living in the context of social institutions, including family, educational, religious, governmental, and business institutions. Culture includes both conscious and unconscious values, ideas, attitudes, and symbols that shape human behavior *and that are transmitted from one generation to the next.* **In** this sense, culture does not include one-time solutions to unique problems, or passing fads and styles. As defined by organizational anthropologist Geert Hofstede, culture is "the collective programming of the mind that distinguishes the members of one category of people from those of another".

In addition to agreeing that culture is learned, not innate, most anthropologists share two additional views. First, all facets of culture are interrelated: Influence or change one aspect of a culture and everything else is affected. Second, because it is shared by the members of a group, culture defines the boundaries between different groups.

Culture consists of learned responses to recurring situations. The earlier these responses, are learned, the more difficult they are to change. Taste and preferences for food and drink, for example, represent learned responses that are highly variable from culture to culture and can have a major impact on consumer behavior. Preference for color is culturally influenced as well. For example, although green is a highly regarded color in Moslem countries, it is associated with disease in some Asian countries. White, usually associated with purity and cleanliness in the West, can signify death in Asian countries. Red is a popular color in most parts of the world (often associated with full flavor, passion, or virility); however, it is poorly received in some African countries. Of course, there is no inherent attribute to any color of the spectrum; all associations and perceptions regarding color arise from culture.

Culture and Its Characteristics

1. Culture is prescriptive. It prescribes the kinds of behaviour considered acceptable in the society. The prescriptive characteristics of culture simplifies a consumer's decision-making process by limiting product choices to those which are socially acceptable.
2. Culture is socially shared. Culture, out of necessity, must be based on social interaction and creation. It cannot exist by itself. It must be shared by members of a society, thus acting to reinforce culture's prescriptive nature.
3. Culture facilitates communication. One useful function provided by culture is to facilitate communication. Culture usually imposes common habits of thought and feeling among people. Thus, within a given group culture makes it easier for people to communicate with one another. But culture may also impede communication across groups because of a lack of shared common cultural values.
4. Culture is learned. Culture is not inherited genetically-it must be learned and acquired. Socialization or enculturation occurs when a person absorbs or learns the culture in which he or she is raised. In contrast, if a person learns the culture of a society other than the one in which he or she was raised, the process of acculturation occurs. The ability to learn culture makes it possible to absorb new cultural trends.
5. Culture is subjective. People in different cultures often have different ideas about the same object. What is acceptable in one culture may not necessarily be so in another. In this regard, culture is both unique and arbitrary.
6. Culture is enduring. Because culture is shared and passed along from generation to generation, it is relatively stable and somewhat permanent. Old habits are hard to break, and people tend to maintain its own heritage in spite of a continuously changing world. This explains why India and

China, despite severe overcrowding, have a great difficulty with birth control. The Chinese view a large family as a blessing and assume that children will take care of parents when growth old.

7. Culture is cumulative. Culture is based on hundreds or even thousands of years of accumulated circumstances. Each generation adds something of its own to the culture before passing the heritage on to the next generation.
8. Culture is dynamic. Culture is passed along from generation to generation, but one should not assume that culture is static and immune to change. Far from being the case, culture is constantly changing-it adapts itself to new situations and new sources of knowledge.

Cultural Dimension-1

Meaning of Time

The work week in many Middle Eastern regions runs from Saturday to Thursday. In many countries, it is customary to have lunch hours of two to four hours. Culture also affects attitudes toward punctuality. Latin Americans have a relaxed attitude toward time. In Guatemala, a person may choose to arrive anytime from ten minutes to forty-five minutes late for a luncheon appointment. On the other hand, Romanians, Germans, and Japanese are very punctual. However, punctuality is a function of occasion. Although it is rude for a Japanese to be late for a business meeting, it is acceptable(and perhaps even fashionable) to be late for a social occasion.

The Language of Friendship

In India, it is an honor to be invited to have dinner at a private home-a sign of real friendship. Thus, any business discussion at dinner would be inappropriate. In Italy, Egypt and China, dinner is a social event in itself, making it an all-evening affair, as exemplified by the ten-course meal in China. In the United States, people finish their meals in a hurry, as if eating were a mere necessity, and then quickly get on to the purpose or objective for having had the dinner.

Pillsbury is one company that owes its success in Japan to an ability to adjust to the radically different style of doing business there. The Oriental values of old friends, long courtship, trust, and sincerity were all understood by Pillsbury's management, and those values were kept in mind when Pillsbury decided to conduct business in Japan. Pillsbury saw its joint venture as like a marriage in a society where a divorce is frowned upon, and thus took great pains to learn the accepted way of doing business there.

Cultural Dimension-2

The Language Of Religion

A government itself can also make a religious mistake. As soon as Indonesia announced its plan to introduce state lottery, the controversy erupted. Religious leaders and students called the lottery immoral and corrupt. After weeks of growing Muslim demonstrations, the government decided to drop the lottery idea.

Muslims launched a protest because Yokohama Rubber Co automobile tires had a tread pattern resembling the Arabic word for Allah. The tread was designed by computer to maximize driving safety. The company soon stopped making these tires and offered to replace the tires free of charge. The tire maker apologized for its lack of knowledge of Islam and stated that the tread was not meant to blaspheme Allah.

The Art Of Gift Giving

Businesspeople need to understand customs of gift giving. In certain countries, it is offensive to offer a gift. Exchanging gifts is rare and inappropriate in Germany. Gift giving is also not a normal custom in Belgium or Britain, but flowers are a suitable gift when invited to someone's home.

In some countries, it is insulting when gifts are not presented since they are expected. Businesspeople should attempt to find out how to present gifts. When should it be presented-on the initial visit or afterwards? Where should a gift be presented-in public or private? What is the type of gift to give, what should its color be, and how many people should receive gifts? In Japan, gift giving is an important part of doing business, and gifts are usually exchanged at the first meeting.

The Search For Cultural Universals

An important quest for the global marketer is to discover cultural universals. A universal is a mode of behavior existing in all cultures. Universal aspects of the cultural environment represent opportunities for global marketers to standardize some or all elements of a marketing program. A partial list of cultural universals, taken from cultural anthropologist George P. Murdock's classic study, includes the following: athletic sports, body adornment, cooking, courtship, dancing, decorative art, education, ethics, etiquette, family feasting, food taboos, language, marriage, mealtime, medicine, mourning, music, property rights, religious rituals, residence rules, status differentiation, and trade.The astute global marketer often discovers that much of the apparent cultural diversity in the world turns out to be different ways of accomplishing the same thing.

Music provides one example of how these universals apply to marketing. Music is part of all cultures, accepted as a form of artistic expression and source of entertainment. However, music is also an art form characterized by widely varying styles. Therefore, al. though background music can be used effectively in broadcast commercials, the type of music appropriate for a commercial in one part of the world may not be acceptable or effective in another part. A jingle might utilize a bossa nova rhythm for Latin America, a rock rhythm for North America, and "high life" for Africa. Music, then, is a cultural universal that global marketers can adapt to cultural preferences in different countries or regions.

TRUE EUROPEANS

Consumer demands vary widely from one European country to another. The French cook their food at high temperatures and thus splatter grease onto oven walls. Understandably, most French consumers want self-cleaning ovens. The Germans, in contrast, do their cooking at lower temperatures and do not have much demand for this feature.

After acquiring Phillips's European appliance business. Whirlpool moved to transform sales and distribution systems in thirteen countries into two pan-European operations. On the manufacturing side, Whirlpool cut costs

by standardizing parts and materials which account for 55 percent of an appliance's total cost. Before the move, the washing machine made in Germany and the one made in Italy did not contain any common parts; they did not even share one screw.

It has long been argued that national tastes dictate the kind of washing machine to be sold in a certain market. As a result, French consumers would not accept front loaders because French kitchens have only enough space for the narrow, top-loading machines. Whirlpool Corp however, found that many of the differences in countries had less to do with consumer tastes but more to do with the fact that French manufacturers have always made only top loaders.

Whirlpool's study of laundry habits revealed that consumers across Europe want a washing machine that get clothes clean, is easy to use and trouble free, and does not use too much electricity, water, or detergent. If a machine can meet these significant criteria, consumer taste can change because such features as where the machine opens and its size are less important. Therefore, Whirlpool has treated Germans, British and Italians like true Europeans due to their similarities, which overshadow their differences.

The global marketers in the business are always alert toward the potential of extending a successful act across national boundaries. For example, the success of Robyn, a Swedish vocalist who sings in English, first in Sweden and northern Europe established her potential to go beyond these markets. Kadja Nin, a vocalist from Burundi who sings in Swahili and French, has been positioned as a new sound, sensous, and international.Many feel that she has great potential for global markets.

Increasing travel and improving communications mean that many national attitudes toward style in clothing, color, music, food and drink are converging. The globalization of culture has been capitalized upon, and even significantly accelerated, by companies that have seized opportunities to find customers around the world. Coca-Cola, Pepsi, Levi Strauss, McDonald's, IBM, Heineken and BMG Entertainment are some of the companies breaking down cultural barriers as they expand into new markets with their products. Similarly, new laws and changing attitudes toward the use of credit are providing huge global opportunities for financial service providers such as American Express, Visa and Master Card International. According to one estimate, the volume of global credit card sales surpassed $2 trillion in the year 2000. the credit card companies and on-line marketers has to chose communication efforts to persuade large numbers of people to use the cards. There is great variation in the world in the use of credit and debit cards and cash. Japan is a cash and debit card culture, Europe is more of a check and debit card culture, and the United States is a credit card culture.

Culture Shapes Foreign Marketing

International marketers all have stories to tell of their adventures-and misadventures-in foreign market cultures. These cultural constraints can affect all aspects of the marketing program. A couple of examples:

1. Cosmetics : *Maybelline and Max Factor add brighter colors to their lipstick and makeup for Latin America. Vidal Sassiin adds more conditioner and a pine aroma to some shampoos in the Far East. Amway's skin care line in Japan has less lather and Amway removes the pork proteins found in some of its products for Muslim markets, such as Malaysia.*

2. Promotion : *Hollywood has found the best way to promote its movies in Asia is to use popular local musicians. When Warner Bros released "Lethal Weapon 4" in Hong Kong, its major promotion was a music video with a very popular heavy-metal band. Though music didn't relate to the film, scenes from the film were interspersed on the video. The song became the movie's "Asian theme song".*

In Taiwan, a leading female singer made a music video based on "The English Patient". The studios usually don't even have to pay the local artists because both parties benefit.

Elements of Culture

The anthropologist studying culture as a science must investigate every aspect of a culture is an accurate, total picture is to emerge. To implement this goal, there has evolved a culture scheme that defines the parts of culture. For the marketer, the same thoroughness is necessary if the marketing consequences of cultural differences within foreign market are to be accurately assessed.

Culture includes every part of life. The scope of the term culture to the anthropologist is illustrated by the elements included within the meaning of the term. They are:

Material Culture : Technology, Economics

Material Culture is divided into two parts, technology and economics. Technology includes the techniques used in the creation of material goods; it is the technical know-how possessed by the people of a society. For example, the vast majority of U.S. citizens understand the simple concepts involved in reading gauges, but in many countries of the world this seemingly simple concept is not part of their common culture and is, therefore, a major technical limitation.

Economics is the manner in which people employ their capabilities and the resulting benefits. Included in the subject of economics is the production of goods and services, their distribution, consumption, means of exchange, and the income derived from the creation of utilities.

Material culture affects the level of demand, the quality and types of products demanded, and their functional features, as well as the means of production of these goods and their distribution. The marketing implications of the material culture of a country are many. For example, electrical appliances sell in England and France but have few buyers in countries where less than 1 percent of the homes have electricity. Even with electrification, economic characteristics represented by the level and distribution of income may limit the desirability of products. Electric can openers and electric juicers are acceptable in the United States, but in less-affluent countries not only are they unattainable and probably unwanted, they would be a spectacular waste because disposable income could be spent more meaningfully on better houses, clothing or food.

Social Institutions : Social organizations, Education, Political Structures

Social Institutions include social organization, education, and political structures that are concerned with the ways in which people relate to one another, organize their activities to live in

harmony with one another, teach acceptable behaviour to succeeding generations, and govern themselves. The positions of men and women in society, the family, social classes, group behaviour, age groups and how societies define decency and civility are interpreted differently within every culture. In cultures where the social organizations result in close-knit family units, for example, it is more effective to aim a promotion campaign at the family unit than at individual family members. Travel advertising in culturally divided Canada pictures a wife alone for the English audience but a man and wife together for the French segments of the population because the French are traditionally more closely bound by family ties.

Education, one of the most important social institutions, affects all aspects of the culture from economic development to consumer behaviour. The literacy rate of a country is a potent force in economic development. Numerous studies indicate a direct link between the literacy rate of a country and its ability for rapid economic growth. According to the World Bank no country has been successful economically with less than 50 percent literacy, but when countries have invested in education the economic rewards have been substantial. Literacy has a profound affect on marketing. It is much easier to communicate with a literate market than to one where the marketer has to depend on symbols and pictures to communicate. Each of the social institutions has an effect on marketing because each influences behaviour, values and the overall patterns of life.

Humans and the Universe-belief Systems

Within this category are religion (belief systems), superstitions, and their related power structures. The impact of religion on the value systems of a society and the effect of value systems on marketing must not be underestimated. Religion impacts people's habits, their outlook on life, the products they buy, the way they buy them, even the newspapers they read.

Acceptance of certain types of food, clothing, and behaviour are frequently affected by religion, and such influence can extend to the acceptance or rejection of promotional messages as well. In some countries, focusing too much attention on bodily functions in advertisements would be judged immoral or improper and the products would be rejected. What might seem innocent and acceptable in one culture could be considered too personal or vulgar in another. Such was the case when Saudi Arabian customs officials impounded a shipment of French perfume because the bottle stopper was in the shape of a nude female. Religion is one of the most sensitive elements of a culture. When the marketer has little or no understanding of a religion, it is easy to offend, albeit unintentionally.

Superstition plays a much larger role in a society's belief system in some parts of the world than it does in the United States. What an American might consider as mere superstition can be a critical aspect of a belief system in another culture. For example, in parts of Asia, ghosts, fortune telling, palmistry, head-bump reading, phases of the moon, demons, and soothsayers are all integral parts of certain cultures. Astrologers are routinely called on in Thailand to determine the best location.

Aesthetics : Graphic and Plastic Arts, Folklore, Music, Drama and Dance

Closely interwoven with the effect of people and the universe on a culture are its aesthetics, that is, its arts, folklore, music, drama, and dance. Aesthetics are of particular interest to the marketer because of their role in interpreting the symbolic meanings of various methods of artistic expression, color, and standards of beauty in each culture. Customers everywhere respond to images, myths, and metaphors that help them define their personal and national identities and relationships within a context of culture and product benefits. The uniqueness of a culture can be spotted quickly in symbols having distinct meanings.

Without a culturally correct interpretation of a country's aesthetic values, a whole host of marketing problems can arise. Product styling must be aesthetically pleasing to be successful, as must advertisements and package designs. Insensitivity to aesthetic values can offend, create a negative impression, and, in general, render marketing efforts ineffective. Strong symbolic meanings may be overlooked if one is not familiar with a culture's aesthetic values. The Japanese, for example, revere the crane as being very lucky for it is said to live a thousand years, however, the use of the number four should be avoided completely because the word four, shi, is also the Japanese word for death.

Language

The importance of understanding the language of a country cannot be overestimated. The successful marketer must achieve expert communication, and this requires a thorough understanding of the language as well as the ability to speak it. Advertising copywriters should be concerned less with obvious differences between languages and more with the idiomatic meanings expressed. It is not sufficient to say you want to translate into Spanish, for instance, because, in Spanish-speaking Latin America the language vocabulary varies widely. Tambo, for example, means a roadside inn in Bolivia, Colombia, Ecuador, and Peru; in Argentina and Uruguay, it means a dairy farm; and in Chile, a tambo is a brothel. If that gives you a problem, consider communicating with the people of Papua, New Guinea. Some 750 languages, each distinct and mutually unintelligible, are spoken there.

Carelessly translated advertising statements not only lose their intended meaning but can suggest something very different, obscene, offensive, or just plain ridiculous. Language may be one of the most difficult cultural elements to master, but it is the most important to study in an effort to acquire some degree of empathy. Many believe that to appreciate the true meaning of a language it is necessary to live with the language for years. Whether or not this is the case, foreign marketers should never take it for granted that they are communicating effectively in another language. Until a marketer can master the vernacular, the aid of a national within the foreign country should be enlisted; even then, the problem of effective communications may still exist. One authority suggests that we look for a cultural translator, that is, a person who translates not only among languages but also among different ways of thinking and among different cultures.

It's Not The Gift That Counts, But How You Present It

Giving a gift in another country requires careful attention if it to be done properly. Here are a few suggestions:

Japan

Do not open gift in front of a Japanese counterpart unless asked and do not expect the Japanese to open your gift.

Avoid ribbons and bows as part of gift-wrapping. Bows as we know them are considered unattractive and ribbon colors can have different meanings. Do not offer a gift depicting a fox or badger. The fox is the symbol of fertility, the badger, cunning.

Europe

Avoid red roses and white flowers, even numbers, and the number 13. Do not wrap flowers in paper. Do not risk the impression of bribery by spending too much on a gift.

Arab World

Do not give a gift when you first meet someone. It may be interpreted as a bribe. Do not let it appear that you contrived to present the gift when the recipient is alone. It looks bad unless you know the person well. Give the gift in front of others in less personal relationships.

Latin America

Do not give a gift until after a somewhat personal relationship has developed unless it is given to express appreciation for hospitality. Gifts should be given during social encounters, not in the course of business. Avoid the colors black and purple; both are associated with the Catholic Lenten season.

China

Never make an issue of a gift presentation-publicly or privately. Gifts should be presented privately, with the exception of collective ceremonial gifts at banquets.

Analytical Approaches to Cultural Factors

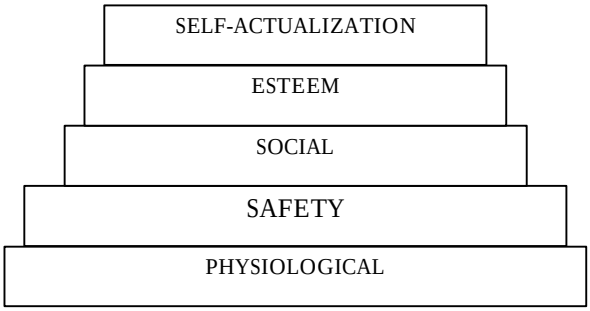
The reason cultural factors are a challenge to global marketers is that they are hidden from view. Because culture is learned behaviour passed on from generation to generation, it is difficult for the inexperienced or untrained outsider to fathom. Becoming a global manager means learning how to let go of cultural assumptions. Failure to do so will hinder accurate understanding of the meaning and significance of the statements and behaviours of business associates from a different culture.

For example, a person from a culture that encourages responsibility and initiative could experience misunderstandings with a client or boss from a culture that encourages bosses to remain in personal control of all activities. Such a boss would expect to be kept advised of a subordinate's actions; the subordinate might be taking initiative on the mistaken assumption that the boss would appreciate a willingness to assume responsibility.

Maslow's Hierarchy of Needs

The late A. H. Maslow developed an extremely useful theory of human motivation that helps explain cultural universals. He hypothesized that people's desires can be arranged into a hierarchy of five needs. As an individual fulfills needs at each level, he or she progresses to higher levels. Once physiological, safety, and social needs have been satisfied, two higher needs become dominant. First is a need for esteem. This is the desire for self-respect, self-esteem, and the esteem of others and is a power-ful drive creating demand for status-improving goods.

The final stage in the need hierarchy is self-actualization. When all the needs for food, safety, security, friendship, and the esteem of others are satisfied, discontent and restlessness will develop unless one is doing what one is fit for. A musician must make music, an artist must create, a poet must write, a builder must build, and so on. Maslow's hierarchy of needs is, of course, a simplification of complex human behavior. Other researchers have shown that a person's needs do not progress neatly from one stage of a hierarchy to another. For example, an irony of modern times is the emergence of the need for safety in the United States, one of the richest countries in the world. Indeed, the high incidence of violence in the United States may leave Americans with a lower level of satisfaction of this need than in many so-called "poor" countries. Nevertheless, the hierarchy does suggest a way for relating consumption patterns and levels to basic human need-fulfilling behavior. Maslow's model implies that, as countries progress through the stages of economic development, more and more members of society operate at the esteem need level and higher, having satisfied physiological, safety, and social needs. It appears that self-actualization needs begin to affect consumer behavior as well.

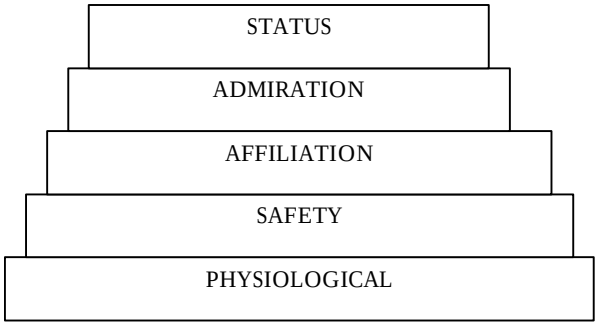


Maslow's Hierarchy of Needs

For example, there is a tendency among some consumers in high-income countries to reject material objects as status symbols. The automobile is not quite the classic American status symbol it once was, and some consumers are turning away from material possessions. This trend toward rejection of materialism is not, of course, limited to high-income countries. In India, for example, there is a long tradition of the pursuit of consciousness or self-actualization as a first rather than a final goal in life. And yet, each culture is different. For example, in Germany today, the automobile remains a supreme status symbol. Germans give their automobiles loving care, even going so far as to travel to distant locations on weekends to wash their cars in pure spring water.

Helmut Schutte has proposed a modified hierarchy to explain the needs and wants of Asian consumers. While the two lower-level needs are the same as in the traditional hierarchy, the three highest levels emphasize the intricacy and importance of social needs. Affiliation needs are satisfied when an individual in Asia has been accepted by a group. Conformity with group norms becomes a driving force of consumer behavior. For example,

when Tamagotchis and other brands of electronic pets were the "in" toy in Japan, every teenager who wanted to fit in bought one (or more). Knowing this, Japanese companies develop local products specifically designed to appeal to teens. The next level is admiration, a higher-level need that can be satisfied through acts within a group that command respect. At the top of the Asian hierarchy is status, the esteem of society as a whole. In part, attainment of high status is character driven. However, the quest for status also leads to luxury badging, a phrase that describes consumers who engage in conspicuous consumption and buy products and brands that others will notice. Support for Schutte's contention that status is the highest-ranking need in the Asian hierarchy can be seen in the geographic breakdown of the $35 billion global luxury goods market. Fully 20 percent of industry sales are to Japan alone, with another 22 percent of sales occurring in the rest of the Asia-Pacific region. Nearly half of all sales revenues of Italy's Gucci Group are generated in Asia.



Maslow's Hierarchy: The Asian Equivalent

The Self-refernce Criterion And Perception

As we have shown, a person's perception of market needs is framed by his or her own cultural experience. A framework for systematically reducing perceptual blockage and distortion was developed by James Lee. Lee termed the unconscious reference to one's own cultural values the self-reference criterion, or SRC. To address this problem and eliminate or reduce cultural myopia, he proposed a systematic four-step framework.

Step 1: Define the problem or goal in terms of home-country cultural traits, habits and norms.

Step 2: Define the problem or goal in terms of the host culture, traits, habits and norms. Make no value judgments.

Step 3: Isolate the SRC influence and examine it carefully to see how it complicates the problem.

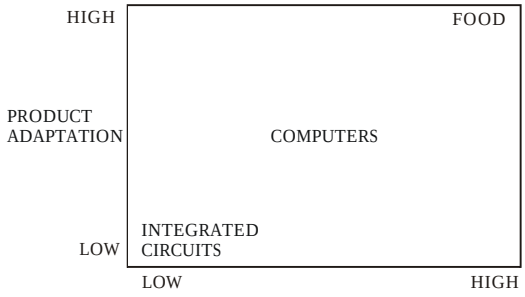
Step 4: Redefine the problem without the SRC influence and solve for the host-country market situation.

The lesson that SRC teaches is that a vital, critical skill of the global marketer is unbiased perception, the ability to see what is so in a culture. Although this skill is as valuable at home as it is abroad, it is critical to the global marketer because of the widespread tendency toward ethnocentrism and use of the self-reference criterion. The SRC can be a powerfully negative force in global business and forgetting to check for it can lead to misunderstanding and failure. While planning Euro Disney, chairman Michael Eisner and other company executives were blindsided by a lethal combination of their own prior success and ethnocentrism. Avoiding the SRC requires a person to suspend assumptions based on prior experience and success and be prepared to acquire new knowledge about human behaviour and motivation.

Environmental Sensitivity

Environmental Sensitivity is the extent to which products must be adapted to the culture-specific needs of different national markets. A useful approach is to view products on a continuum of environment sensitivity. At one end of the continuum are environmentally insensitive products that do not require significant adaptation to the environments of various world markets. At the other end of the continuum are products that are highly sensitive to different environmental factors. A company with environmentally insensitive products will spend relatively less time determining the specific and unique conditions of local markets because the product is basically universal. The greater a product's environmental sensitivity, the greater the need for managers to address country-specific economic, regulatory, technological, social and cultural environmental conditions.

The sensitivity of products can be represented on a two-dimensional scale as shown in the figure. The horizontal axis shows environmental sensitivity, the vertical axis the degree for product adaptation needed. Any product exhibiting low levels of environmental sensitivity-highly technical products, for example-belongs in the lower left of the figure. Intel was sold over 100 million microprocessors, because a chip is a chip anywhere around the world. Moving to the right on the horizontal axis, the level of sensitivity increases, as does the amount of adaptation. Computers are characterized by low levels of environmental sensitivity but variations in country voltage requirements require some adaptation. In addition, the computer's software documentation should be in the local language. At the upper right of the figure are products with high environmental sensitivity. Food, especially food consumed in the home, falls into the category because it is sensitive to climate and culture. McDonald's has achieved great success outside the United States by adapting its menu items to local tastes. Particular food items such as chocolate, however must be modified for various differences in taste and climate. The consumers in some countries prefer a milk chocolate; others prefer a darker chocolate while other countries in the Tropics have to adjust the formula for their chocolate products to with stand high temperatures.



Environmental Sensitivity

Influence of Culture on Consumption

Consumption patterns, living styles, and the priority of needs are all dictated by culture. Culture prescribes the manner in which people satisfy their desires. Not surprisingly, consumption habits vary greatly. The consumption of beef provides a good illustration. Some Thai and Chinese do not consume beef at all, believing that it is improper to eat cattle that work on farms, thus helping to provide foods such as rice and vegetables. In Japan, the per capita annual consumption of beef has increased to eleven pounds, still a very small amount when compared to the more than 100 pounds consumed per capita in the United States and Argentina.

The eating habits of many people seem exotic to Americans. The Chinese eat such things as fish stomachs and bird's nest soup(made from bird's saliva). The Japanese eat uncooked seafood, and the Iraqis eat dried, salted locusts as snacks while drinking. Although such eating habits may seem repulsive to Americans and Europeans, consumption habits in the West are just as strange to foreigners. The French eat snails. Americans and Europeans use honey (bee expectorate, or bee spit) and blue cheese or Roquefort salad dressing, which is made with a strong cheese with bluish mold. No society has a monopoly on unusual eating habits when comparisons are made among various societies.

Food preparation methods are also dictated by culture preferences. Asian consumers prefer their chicken broiled or boiled rather than fried. Consequently, the Chinese in Hong Kong found American-style fried chicken foreign and distasteful.

Not only does culture influence what is to be consumed, but it also affects what should not be purchased. Muslims do not purchase chickens unless they have been halalled, and like Jews, no consumption of pork is allowed. They also do not smoke or use alcoholic beverages, a habit shared by some strict Protestants. Although these restrictions exist in Islamic countries, the situation is not entirely without market possibilities. The marketing challenge is to create a product that fits the needs of a particular culture. Moussy, a nonalcoholic beer from Switzerland, is a product that was seen as being able to overcome the religious restriction of consuming alcoholic beverages. By conforming to the religious beliefs of Islam, Moussy has become so successful in Saudi Arabia that half of its worldwide sales are accounted for in that country.

Influence of Culture on Thinking Processes

In addition to consumption habits, thinking processes are also affected y culture. When traveling overseas, it is virtually impossible for a person to observe foreign cultures without making references, perhaps unconsciously, back to personal cultural values. This phenomenon is known as the self-reference criterion. Because of the effect of the SRC, the individual tends to be bound by his or her own cultural assumptions. It is thus important for the traveler to recognize how perception of overseas events can be distorted by the effects of the SRC.

Influence of Culture on Communication Processes

A country may be classified as either a high-context culture or a low-context culture. The context of a culture is either high or low in terms of in-depth background information. This classification provides an understanding of various cultural orientations and explains how communication is conveyed and perceived. North America and northern Europe(e.g. Germany, Switzerland and Scandinavian countries) are examples of low-context cultures. In these types of society, messages are explicit and clear in the sense that actual words are used to convey the main part of information in communication. The words and their meanings, being independent entities, can be separated from the context in which they occur. What is important, then, is what is said, not how it is said and not the environment within which it is said.

Japan, France, Spain, Italy, Asia, Africa and the Middle Eastern Arab nations in contrast, are high-context culture. In such cultures, the communication may be indirect, and expressive manner in which the message is delivered becomes critical. Because the verbal part(i.e. words) does not carry most of the information, much of the information is contained in the non verbal part of the message to be communicated. The context of communication is high because it includes a great deal of additional information, such as the message sender's values, position, background, and associations in the society. As such, the message cannot be understood without its context. One's individual environment(i.e. physical setting and social circumstances) determines what one says and how one is interpreted by others. This type of communication emphasizes one's character and words as determinants of one's integrity, making it possible for businesspersons to come to terms without detailed legal paperwork.

Cultures also vary in the manner by which information processing occurs. Some cultures handle information in a direct, linear fashion and are thus monochromic in nature. Schedules, punctuality, and a sense that time forms a purposeful straight line are indicators of such cultures. Being monochromic, however, is a matter of degree. Although the Germans, Swiss and Americans are all monochromic cultures, the Americans are generally more monochromic than most other societies, and their fast tempo and demand for instant responses are often viewed as pushy and impatient.

Other cultures are relatively polychronic in the sense that people work on several fronts simultaneously instead of pursuing a single task. Both Japanese and Hispanic cultures are good examples of a polychronic culture. The Japanese are often misunderstood and accused by Westerners of not volunteering detailed information. The truth of the matter is that the Japanese do not want to be too direct because by saying things directly they may be perceived as being insensitive and offensive. The Japanese are also not comfortable in getting right down to substantive business without first becoming familiar with the other business party. For them it is premature to discuss business matters seriously without first establishing a personal relationship. Furthermore, American businesspersons consider the failure of the Japanese to make eye contact as a sign of rudeness, whereas the Japanese do not want to look each other in the eye because eye contact is an act of confrontation and aggression.

The cultural context and the manner in which the processing of information occurs can be combined to develop a more precise description of how communication takes place in a particular country. Germany, for example, is a monochromic and low context culture. France, in comparison, is a polychronic and high context culture. A low context German may insult a high context French counterpart by giving too much information about what is already known. Or a low context German becomes upset when he feels that he does not get enough details from the high context Frenchman.

Subculture

Because of differing cultures, worldwide consumer homogeneity does not exist. Neither does it exist in the United States. Differences in consumer groups are everywhere. There are white, black, Jewish, Catholic, farmer, truckdriver, young, old, eastern, and western consumers, among other numerous groups. Communication problems between speakers of different languages are apparent to all, but people who presumably speak the same language may also encounter serious communication problems. Subgroups within societies utilize specialized vocabularies.

In order to understand these diverse groups of consumers, particular cultures must be examined. As the focus is on a subgroup within a society, the more appropriate area for investigation is not culture itself but rather subculture, culture on a smaller and more specific level.

A subculture is a distinct and identifiable cultural group that has values in common with the overall society but also has certain characteristics that are unique to itself. Thus, subcultures are groups of people within a larger society. Although the various subcultures share some basic traits of the wider culture, they also preserve their own customs and lifestyles, making them significantly different from other groups within the larger culture of which they are a part. Indonesia, for instance, has more than 300 ethnic groups, with lifestyles and cultures that seem thousands of years apart.

There are many different ways to classify subcultures. Although race or ethnic origin is one obvious way, it is not the only one. Other demographic and social variables can be just as suitable for establishing subcultures within a nation.

The degree of intracountry homogeneity varies from one country to another. In the case of Japan, the society as a whole is remarkably homogenous. Although some found, the differentials are not pronounced. There are several reasons why Japan is a relatively homogenous country. It is a small country in terms of area, making its population geographically concentrated. National pride and management philosophy also help to forge a high degree of unity. As a result, people work hard together harmoniously to achieve the same common goals. The need to work hard together was initially fostered by the need to repair the economy after World War II, and the lessons learned from this experience have not been forgotten.

Canada, in contrast, is a large country in terms of geography. Its population, though much smaller than that of Japan, is much more geographically dispersed, and regional differences exist among the provinces, each having its own unique characteristics. Furthermore, ethnic differences are clearly visible to anyone who travels across Canada.

Given the fact that each subcultural group is a part of the larger culture while possessing its own unique cultural, demographic, and consumption characteristics, a marketing question is the language that should be used so as to effectively appeal to a particular subculture. According to one study, Spanish language advertising positively affected Hispanic consumers in the United States by signaling solidarity with the Hispanic community. However, exclusive use of Spanish in advertising also had a negative effect since it appeared to arouse Hispanic insecurities about language usage. Therefore, language choice requires more research.

Culture Values

Underlying the cultural diversity that exists among countries are fundamental differences in cultural values. The most useful information on how cultural values influence various types of business and market behaviour comes from a seminal work by Geert Hofstede. Studying over 90,000 people in 66 countries, he found that the cultures of the nations studied differed along four primary dimensions and that various business and consumer behaviour patterns can be closely linked to these four primary dimensions. Hofstede's approach has been widely and successfully applied to international marketing and research by others has reaffirmed these linkages. Research evidence indicates that the four cultural dimensions can be used to classify countries into groups that will respond in a similar way in business and market contexts. The four dimensions are:

1. The Individualism/Collective Index(IDV), which focuses on self-orientation.
2. The Power Distance Index(PDI), which focuses on authority orientation.
3. The Uncertainty Avoidance Index(UAI), which focuses on risk orientation.
4. The Masculinity/Femininity Index(MAS), which focuses on achievement orientation.

Individualism/Collective Index(IDV)

The Individualism/Collective Index refers to the preference of behaviour that promotes one' self-interest. Cultures that are high in IDV reflect an "I"mentality and tend to reward and accept individual initiative, while those low in individualism reflect a "we" mentality and generally subjugate the individual to the group. This does not mean that individuals fail to identify with groups when a culture scores high on IDV, but rather that personal initiative is accepted and endorsed. Individualism pertains to societies in which the ties between individuals are loose; everyone is expected to look after himself or herself and his or her immediate family. Collectivism as its opposite pertains to societies in which people from birth onward are integrated into strong, cohesive groups, which throughout people's lifetime continue to protect them in exchange for unquestioning loyalty.

Power Distance Index(PDI)

The power distance index measures the tolerance of social inequality, that is, power inequality between superiors and subordinates within a social system. Cultures with high PDI

scores tend to be hierarchical, with members citing force, manipulation and inheritance as sources of power. Those with low scores, on the other hand, tend to value equality and cite knowledge and respect as sources of power. Thus, cultures with high PDI scores are more apt to have a general distrust of others since power is seen to rest with individuals and is coercive rather than legitimate. High power scores tend to indicate a perception of differences between superior and subordinate and a belief that those who hold power are entitled to privileges. A low score reflects the opposite attitude.

Uncertainty Avoidance Index(UAI)

The uncertainty avoidance index explains the intolerance of ambiguity and uncertainty among members of a society. Cultures with high UAI scores are highly intolerant of ambiguity, and as a result tend to be distrustful of new ideas or behaviours. They tend to have a high level of anxiety and stress and a concern with security and rule following. Accordingly, they dogmatically stick to historically tested patterns of behaviour, which in the extreme become inviolable rules. Those with very high level of UAI thus accord a high level of authority to rules as a means of avoiding risk. Cultures scoring low in uncertainty avoidance are associated with a low level of anxiety and stress, a tolerance of deviance and dissent, and a willingness to take risks. Thus, those cultures low in UAI take a more empirical approach to understanding and knowledge while those high in UAI seek a more "absolute truth".

Masculinity/Femininity (MAS)

The masculinity/femininity index refers to one's desire for achievement and entrepreneurial tendencies, and the extent to which the dominant values in society are "masculine". Assertiveness, the acquisition of money and not caring for others, and the quality of life or people are all cultural traits in countries with high MAS scores. Low-scoring cultures are associated with fluid sex roles, equality between the sexes, and an emphasis on service, interdependence, and people. Some cultures allow men and women to take on many different roles, while others make sharp divisions between what men should do and what women should do. In societies that make a sharp division, men are supposed to have dominant, assertive roles and women more service-oriented, caring roles. An interesting study showed that tipping appeared to be less prevalent in countries with feminine values (low MAS scores) that emphasized social relationships compared with countries with masculine values (high MAS scores) that emphasized achievement and economic relationships.

LESSON 9:
BUSINESS CUSTOMS IN GLOBAL MARKETING

Business customs are as much a cultural element of a society as is the language. Culture not only establishes the criteria for day-to-day business behavior but also forms general patterns of attitude and motivation. Executives are to some extent captives of their cultural heritages and cannot totally escape language, heritage, political and family ties, or religious backgrounds. One report notes that Japanese culture, permeated by Shinto precepts, is not something apart from business but determines its very essence. Although international business managers *may* take on the trappings and appearances of the business behavior of another country, their basic frame of references is most likely to be that of their own people.

In the United States, for example, the historical perspective of individualism and "winning the West" seems to be manifest in individual wealth or corporate profit being dominant measures of success. Japan's lack of frontiers and natural resources and its dependence on trade have focused individual and corporate success criteria on uniformity, subordination to the group, and society's ability to maintain high levels of employment. The feudal background of southern Europe tends to emphasize maintenance of both individual and corporate power and authority while blending those feudal traits with paternalistic 'concern for minimal welfare for workers and other members of society. Various studies identify North Americans as individualists, Japanese as consensus-oriented and committed to the group, and central and southern Europeans as elitists and rank conscious. While these descriptions are stereotypical, they illustrate cultural differences that are often manifest in business behavior and practices.

A lack of empathy for and knowledge of foreign business practices can create insurmountable barriers to successful business relations. Some businesses plot their strategies with the idea that counterparts of other business cultures are similar to their own and are moved by similar interests, motivations, and goals-that they are "just like us." Even though they *may* be just like us in some respects, enough differences exist to cause frustration, miscommunication, and, ultimately, failed business opportunities if they are not understood and responded to properly.

Knowledge of the business culture, management attitudes, and business methods existing in a country and a willingness to accommodate the differences are important to success in an international market. Unless marketers remain flexible in their own attitudes by accepting differences in basic patterns of thinking, local business tempo, religious practices, political structure, and family loyalty, they are hampered, if not prevented, from reaching satisfactory conclusions to business transactions. In such situations, obstacles take many forms, but it is not unusual to have one negotiator's business proposition accepted over another's simply because "that one understands us."

This chapter focuses on matters specifically related to the business'-environment. Besides an analysis of the need for adaptation, it will review the structural elements, attitudes, and behavior of international business processes, concluding with a discussion of ethics and socially responsible decisions.

Required Adaptation

Adaptation is a key concept in international marketing and willingness to adapt is a crucial attitude. Adaptation, or at least accommodation, is required on small matters as well as large ones. In fact, the small, seemingly insignificant situations are often the most crucial. More than tolerance of an alien culture is required. There is a need for affirmative acceptance, that is, open tolerance of the concept "different but equal" Through such affirmative acceptance, adaptation becomes easier because empathy for another's point of view naturally leads to ideas for meeting cultural differences.

As a guide to adaptation, there are ten basic criteria that all who wish to deal with individuals, firms, or authorities in foreign countries should be able to meet. They are: (1) open tolerance, (2) flexibility, (3) humility, (4) justice/fairness, (5) ability to adjust to varying tempos, (6) curiosity/interest, (7) knowledge of the country, (8) liking for others, (9) ability to command respect, and (10) ability to integrate oneself into the environment. In short, add the quality of adaptability to the qualities of a good executive for a composite of the perfect international marketer. It is difficult to argue with these ten items. As one critic commented, "They border on the 12 Boy Scout laws." However, as we complete this chapter we see that it is the obvious that we sometimes overlook.

Degree of Adaptation

Adaptation does not require business executives to forsake their ways and change to conform to local customs; rather, executives must be aware of local customs and be willing to accommodate those differences that can cause misunderstanding. Essential to effective adaptation is awareness of one's own culture and the recognition that differences in others can cause anxiety, frustration, and misunderstanding of the host's intentions. The self-reference criterion (SRC) is especially operative in business customs. If we do not understand our foreign counterpart's customs, we are more likely to evaluate that person's behavior in terms of what is acceptable to us.

The key to adaptation is to remain American but to develop an understanding and willingness to accommodate differences that exist. A successful marketer knows that in China it is important to make points without winning arguments; criticism, even if asked for, can cause a host to "lose face." In Germany, it is considered discourteous to use first names unless specifically invited to do so; always address a person as Hen; Frau, or Fraulein with the last name. In Brazil, do not be offended by the Brazilian inclination to touch during conversation. Such a

custom is not a violation of your personal space but rather the Brazilian way of greeting, emphasizing a point or as a gesture of goodwill and friendship.

A Chinese, German, or Brazilian does not expect you to act like one of them. After all, you are not Chinese, German, or Brazilian, but American, and it would be foolish for an American to give up the ways that have contributed so notably to American success. It would be equally foolish for others to give up their ways. When different cultures meet, open tolerance and a willingness to accommodate each other's differences are necessary. Once a marketer is aware of the possibility of cultural differences and the probable consequences of failure to adapt or accommodate, the seemingly endless variety of customs must be assessed. Where does one begin? Which customs should be absolutely adhered to? Which others can be ignored? Fortunately, among the many obvious differences that exist between cultures, only a few are troubling.

Imperatives, Adiaphora and Exclusives

Business customs can be grouped into *imperatives*, customs that must be recognized and accommodated; *adiaphora*, customs to which adaptation is optional; and *exclusives*, customs in which an outsider must not participate. An international marketer must appreciate the nuances of cultural imperatives, cultural adiaphora, and cultural exclusives.

Cultural Imperatives

Cultural imperatives refer to the business customs and expectations that must be met and conformed to or avoided if relationships are to be successful. Successful businesspeople know the Chinese word guan-xi, the Japanese ningen kankei, or the Latin American compadre. All refer to friendship, human relations, or at taining a level of trust. They also know there is no substitute for establishing friendship in some cultures before effective business negotiations can begin.

Informal discussions, entertaining, mutual friends, contacts, and just spending time with others are ways guan-xi, ningen kankei, compadre, and other trusting relationships are developed. In those cultures where friendships are a key to success, the businessperson should not slight the time required for their development. Friendship motivates local agents to make more sales and friendship helps establish the right relationship with end users, leading to more sales over a longer period. Naturally, after-sales service, price, and the product must be competitive, but the marketer who has established guan-xi, ningen kankei, or compadre has the edge. Establishing friendship is an imperative in many cultures.3 If friendship is not established, the marketer risks not earning trust and acceptance, the basic cultural prerequisites for developing and retaining effective business relationships.

In some cultures a person's demeanor is more critical than in other cultures. For example, it is probably never acceptable to lose your patience, raise your voice, or correct someone in public however frustrating the situation. In some cultures such behavior would only cast you as boorish, but in others it could end a business deal. In China, Japan, and other Asian cultures it is imperative to avoid causing your counterpart to "lose face." In China to raise your voice, to shout at a Chinese person in public, or to correct them in front of their peers will cause them to lose face.

A complicating factor in cultural awareness is that what may be an imperative to avoid in one culture is an imperative to do in another. For example, in Japan prolonged eye contact is considered offensive and it is imperative that it be avoid. However, with Arab and Latin American executives it is important to make strong eye contact or you run the risk of being seen as evasive and untrustworthy.

Cultural Adiaphora

Cultural adiaphora relates to areas of behavior or to customs that cultural aliens may wish to conform to or participate in but that are not required; in other words, it is not particularly important but permissible to follow the custom in question. The majority of customs fit into this category. One need not greet another man with a kiss (a custom in some countries), eat foods that disagree with the digestive system (so long as the refusal is gracious), or drink alcoholic beverages (if for health, personal, or religious reasons). On the other hand, a symbolic attempt to participate in adiaphora is not only acceptable but also may help to establish rapport. It demonstrates that the marketer has studied the culture. Japanese do not expect a Westerner to bow and to understand the ritual of bowing among Japanese, yet a symbolic bow indicates interest and some sensitivity to their culture that is acknowledged as a gesture of goodwill. It may help pave the way to a strong, trusting relationship.

For the most part adiaphora are customs that are optional, although adiaphora in one culture may be perceived as imperative in another. In some cultures one can accept or tactfully and politely reject an offer of a beverage, while in other cases the offer of a beverage is a ritual and not to accept is to insult. In the Czech Republic an aperitif or other liqueur offered at the beginning of a business meeting, even in the morning, is a way to establish good will and trust. It is a sign that you are being welcomed as a friend. It is imperative that you accept unless you make it clear to your Czech counterpart that the refusal is because of health or religion.7 Chinese business negotiations often include banquets at which large quantities of alcohol are consumed in an endless series of toasts. It is imperative that you participate in the toasts with a raised glass of the offered beverage but to drink is optional. Your Arab business associates will offer coffee as part of the important ritual of establishing a level of friendship and trust; you should accept even if you only take a ceremonial sip.S Cultural adiaphora are the most visibly different customs and thus more obvious. Often, it is compliance with the less obvious imperatives and exclusives that is more critical.

Cultural Exclusives

Cultural exclusives are those customs or behavior patterns reserved exclusively for the locals and from which the foreigner is excluded. For example, a Christian attempting to act like a Muslim would be repugnant to a follower of Mohammed. Equally offensive is a foreigner criticizing a country's politics, mores, and peculiarities (that is, peculiar to the foreigner) even though locals may, among themselves, criticize such issues. There is truth in the old adage, "I'll curse my brother but, if

you curse him, you'll have a fight." There are few cultural traits reserved exclusively for locals, but a foreigner must carefully refrain from participating in those that are reserved.

Foreign managers need to be perceptive enough to know when they are dealing with an imperative, an adiaphora, or an exclusive and have the adaptability to respond to each. There are not many imperatives or exclusives, but most offensive behavior results from not recognizing them. It is not necessary to obsess over committing a faux pas. Most sensible businesspeople will make allowances for the occasional misstep. But the fewer you make the smoother the relationship will be, When in doubt, rely on good manners and respect for those with whom you are associating.

Crossing Borders 1

Jokes Don't Travel Well

Cross-cultural humor has its pitfalls. What is funny to you may not be funny to others. Humor is culturally specific and thus rooted in people's shared experiences. Here are examples:

President Jimmy Carter was in Mexico to build bridges and mend fences. On live television President Carter and President Jose Lopez Portillo were giving speeches. In response to a comment by President Portillo, Carter said, "We both have beautiful and interesting wives, and we both run several kilometers every day. In fact, I first acquired my habit of running here in Mexico City. My first running course was from the Palace of Fine Arts to the Majestic Hotel where my family and I were staying. In the midst of the Folklorico performance) I discovered that I was afflicted with Montezuma's Re-venge; Among Americans this may have been an amusing comment but it was not funny to the Mexican. Editorials in Mexico and U.S. newspapers commented on the in- appropriateness of the remark.

'Most jokes; even though well intended, don't *translate well. Sometimes a translator can help you out. One speaker, in describing his experience, said,"1 began my speech with a joke that took me about, two minutes to tell. Then my interpreter translated my story. About thirty second later the Japanese, audience laughed loudly. I continued with my talk which seemed' well received," he said, "but at the end, just to make sure, I asked the, interpreter, 'How did you translate my joke so quickly?' The interpreter replied, 'Oh I did not translate your story at all. I did not understand it. I simply said our foreign speaker has just told a joke so would you all please laugh. "*

Who can say with certainty that anything is funny? Laughter, more often than not, symbolizes embarrassment, nervousness, or even scorn. Hold your humor until you are comfortable with the culture.

Methods of Doing Business

Because of the diverse structures, management attitudes, and behaviors encountered in international business, there is considerable latitude in ways business is conducted. No matter how thoroughly prepared a marketer may be when approaching a foreign market, a certain amount of cultural shock occurs when differences in contact level, communications emphasis, tempo, and formality of foreign businesses are encountered. Ethical standards are likely to differ, as will the negotiation emphasis. In most countries, the foreign trader is also likely to encounter a fairly high degree of government involvement. Among the four dimensions of Hofstede's cultural values discussed in Chapter 4 Individualism/Collectivism (IDV) and Power Distance (PDI) are especially relevant in examining methods of doing business among countries.

Sources and Level of Authority

Business size, ownership, public accountability, and cultural values that determine the prominence of status and position (PDI) combine to influence the authority structure of business. In high PDI countries like Mexico and Malaysia, understanding the rank and status of clients and business partners is much-more important than in more egalitarian (low PDI) societies like Denmark and Israel. In high PDI countries subordinates are not likely to contradict bosses, but in low PDI countries they often do. Although the international businessperson is confronted with a variety of authority patterns, most are a variation of three typical patterns: top-level management decisions; decentralized decisions; and committee or group decisions.

Top-level management decision making is generally found in those situations where family or close ownership gives absolute control to owners and where businesses are small enough to make such centralized decision making possible. In many European businesses, such as in France, decision-making authority is guarded jealously by a few at the top who exercise tight control. In other countries, such as Mexico and Venezuela, where a semi-feudal, land-equals-power heritage exists, management styles are characterized as autocratic and paternalistic. Decision-making participation by middle management tends to be de-emphasized; dominant family members make decisions that tend to please the family members more than to increase productivity. This is also true for government-owned companies where professional managers have to follow decisions made by politicians, who generally lack any working knowledge about management. In Middle Eastern countries, the top man makes all decisions and prefers to deal only with other executives with decision-making powers. There, one always does business with an individual per se rather than an office or title.

Crossing Borders 2

Meishi— Presenting Business Card in Japan

In Japan the business card, or Meishi, *is the executive's trademark. It is both a mini re-sume and a friendly deity that draws people together. No matter how many times you have talked with a businessperson by phone before you actually meet, business cannot really begin until you formally exchange cards.*

The value of a Meishi *cannot be overemphasized; up to 12 million are exchanged daily and a staggering'4. 4 billion annually. For a businessperson to make a call or re-ceive a visitor without and is like a Samurai going off to battle without his sword. There are a variety of ways to present a card, depending on the giver's personality and style:*

Crab style : Held out between the index and middle fingers.

Pincer : Clamped between the thumb and index finger.

Pointer : Offered with the index finger pressed along the edge.

Upside down : The name is facing away from the recipient

Platter fashion : Served in the palm of the hand.

The card should be presented during the earliest stages of introduction, so the Japanese recipient will be able to determine your position and rank and know how to respond to you. The normal procedure is for the Japanese to hand you their name card and accept yours at the same time. They read your card and then formally greet you either by bowing of shaking hands or both.

Not only is there a way to present a card, there is also a way of received a car. It makes a good impression to receive a card in both hands, especially when the other party is senior in age or status. Do not put the card away before reading or your will insult the other person, and write on a person's card in their presence as this may cause offenses.

As businesses grow and professional management develops, there is a shift toward decentralized management decision making. Decentralized decision making allows executives at different levels of management authority over their own functions. This is typical of large-scale businesses with highly developed management systems such as those found in the United States. A trader in the United States is likely to be dealing with middle management, and title or position generally takes precedence over the individual holding the job.

Committee decision making is by group or consensus. Committees may operate on a centralized or decentralized basis, but the concept of committee management implies something quite different from the individualized functioning of the top management and decentralized decision-making arrangements just discussed. Because Asian cultures and religions tend to emphasize harmony and collectivism, it is not surprising that group decision-making predominates there. Despite the emphasis on rank and hierarchy in Japanese social structure, business emphasizes group participation, group harmony, and group decision making-but at top management level.

The demands of these three types of authority systems on a marketer's ingenuity and adaptability are evident. In the case of the authoritative and delegated societies, the chief problem would be to identify the individual with authority. In the committee decision setup, it is necessary that every committee member be convinced of the merits of the proposition or product in question. The marketing approach to each of these situations differs.

Crossing Borders 3

The Engle : An Exclusive in Mexico

According to legend, the site of the Aztec city of tenochtitlan, now Mexico city, was revealed to its founders by an eagle bearing a snake in its claws and alighting on a cactus. This image is now the official seal of the country and appears on its flag. Thus, Mexican authorities were furious to discover their beloved eagle splattered with catsup by an interloper from north of the border: McDonald's.

To commemorate Mexico's Flag Day, two golden Arches outlets in Mexico City papered their trays with placemats embossed with a representation of the national emblem. Eagle eyed government agents swooped down and confiscated the disrespectful placemats. A senior partner in McDonald's of Mexico explained, "Our intention was never to give offense. It was to help Mexicans learn about their culture. "

It is not always clear what symbols or what behavior patterns in a country are reserved exclusively for locals. In McDonalds's case there is no question that the use of the eagle was considered among. Mexicans as an exclusive for Mexicans only.

Management Objectives and Aspirations

The training and background (i.e., cultural environment) of managers significantly affect their personal and business outlooks. Society as a whole establishes the social rank or status of management, and cultural background dictates patterns of aspirations and objectives among businesspeople. These cultural influences affect the attitude of managers toward innovation, new products, and conducting business with foreigners. To fully understand another's management style, one must appreciate an individual's objectives and aspirations that are usually reflected in the goals of the business organization and in the practices that prevail within the company. In dealing with foreign business, a marketer must be particularly aware of the varying objectives and aspirations of management.

Personal Goals

In the United States, we emphasize profit or high wages while in other countries security, good personal life, acceptance, status, advancement, or power may be emphasized. Individual goals are highly personal in any country, so it is hard to generalize to the extent of saying that managers in anyone country always have a specific orientation. For example, studies have shown that Kuwaiti managers are more likely than American managers to make business decisions consistent with their own personal goals. Swedish managers were found to express little reluctance in bypassing the hierarchical line, while Italian managers believed that bypassing the hierarchical line was a serious offense.

Security and Mobility

Personal security and job mobility relate directly to basic human motivation and therefore have widespread economic and social implications. The word *security* is somewhat ambiguous and this very ambiguity provides some clues to managerial variation. To some, security means good wages and the training and ability required for moving from company to company within the business hierarchy; for others, it means the security of lifetime positions with their companies; to still others, it means adequate retirement plans and other welfare benefits. In European companies, particularly in the countries late in industrializing such as France and Italy, there is a strong paternalistic orientation, and it is assumed that individuals will work for one company for the majority of their lives. For example, in Britain managers place great importance on individual achievement and autonomy, whereas French managers place great importance on competent supervision, sound company policies, fringe benefits, security, and comfortable working conditions. There is much less mobility among French managers than British.

Personal Life

For many individuals, a good personal life takes priority over profit, security, or any other goal. In his worldwide study of

individual aspirations, David McClelland discovered that the culture of some countries stressed the virtue of a good personal life as being far more important than profit or achievement. The hedonistic outlook of ancient Greece explicitly included work as an undesirable factor that got in the way of the search for pleasure or a good personal life. Perhaps at least part of the standard of living that we enjoy in the United States today can be attributed to the hardworking Protestant ethic from which we derive much of our business heritage.

To the Japanese, personal life is company life. Many Japanese workers regard their work as the most important part of their overall lives. Metaphorically speaking, such workers may even find themselves "working in a dream." The Japanese work ethic maintenance of a sense of purpose-derives from company loyalty and frequently results in the Japanese employee maintaining identity with the corporation.

Social Acceptance

In some countries, acceptance by neighbors and fellow workers appears to be a predominant goal within business. The Asian outlook is reflected in the group decision-making so important in Japan, and the Japanese place high importance on fitting in with their group. Group identification is so strong in Japan that when a worker is asked what he does for a living, he generally answers by telling you he works for Sumitomo or Mitsubishi or Matsushita, rather than that he is a chauffeur, an engineer, or a chemist.

Power

Although there is some power-seeking by business managers throughout the world, power-seems to be a more important motivating force in South American countries. In these countries, many business leaders are not only profit-oriented but also use their business positions to become social and political leaders.

Crossing Borders 4

Business : Protocol in a Unified Europe

Now that 1992 has come and gone and the European community is now a single market, does it mean that all differences have been wiped away? For some of the legal differences, yes! For cultural differences, not!

There is always the issue of language and meaning even when you both speak English. English and American English are often miles apart. If you tell someone his presentation was "quite good". An American will beam with pleasure. A brat will ask you what was working with it your have just told him politely that he barely scraped by. Then there is the matter of humor. The anecdote you open a meeting with may fly well with your American audience; however, the French will smile the Belgians will laugh, the Dutch will be Puzzled, and the Germans will take you literally. Humor doesn't travel well.

And then there are the French, Who are very attentive to hierarchy and ceremony. When first meeting with a French speaking business person. Stick with monsieur, Madame, or mademoiselle; the use of first names is disrespectful to the French. If you don't speak French fluently, apologize. Such apology shows general respect for the language and dismisses any stigma of American arrogance.

The formality of dress can vary with each county also. The Brit and the Dutchman will take off their jackets and literally roll up their sleeves; they mean to get down to business. The Spaniard will loosen his tie. While the German disapproves – he thinks they look sloppy and un-business like and he keeps his coat on throughout the meeting. So does the Italian, but that was because he dressed especially for the look of the meeting.

With all that, did the meeting decide anything? It was, after all a first meeting. The Brits were just exploring the terrain, checking out the broad perimeters and all that. The French were assessing the other payers' strength and weaknesses and deciding what position to take at the next meting. The Italian also won't have taken it too seriously. For them it was a meeting to arrange the meeting agenda for the real meeting. Only the Germans will have assumed it was what it seemed and be surprised when the next meeting starts open ended.

Communications Emphasis

Probably no language readily translates into another because the meanings of words differ widely among languages. Even though it is the basic communication tool of marketers trading in foreign lands, managers, particularly from the United States, often fail to develop even a basic understanding of a foreign language, much less master the linguistic nuances that reveal unspoken attitudes and information. One writer comments "even a good interpreter doesn't solve the language problem." Seemingly similar business terms in English and Japanese often have different meanings. In fact, the Japanese language is so inherently vague that even the well educated have difficulty communicating clearly among them-selves. A communications authority on the Japanese language estimates that the Japanese are able to fully understand each other only about 85 percent of the time. The Japanese often prefer English-language contracts where words have specific meanings.

The translation and interpretation of clearly worded statements and common usage is difficult enough, but when slang is added the task is almost impossible. In an exchange between an American and a Chinese official, the American answered affirmatively to a Chinese proposal with, "It's a great idea, Mr. Li, but who's going to put wheels on it?" The interpreter, not wanting to lose face but not understanding, turned to the Chinese official and said, "And now the American has made a proposal regarding the automobile industry"; the entire conversation was disrupted by a misunderstanding of a slang expression.

The best policy when dealing in other languages, even with a skilled interpreter, is to stick to formal language patterns. The use of slang phrases puts the interpreter in the uncomfortable position of guessing at meanings. Foreign language skills are critical in all negotiations, so it is imperative to seek the best possible personnel. Even then, especially in translations involving Asian languages, misunderstandings occur.

Linguistic communication, no matter how imprecise, is explicit, but much business communication depends on implicit messages that are not verbalized. E. T. Hall, professor of anthropology and, for decades, consultant to business and government on intercultural relations, says, "In some cultures, messages are explicit; the words carry most of the information.

In other cultures . . . less information is contained in the verbal part of the message since more is in the context."

Hall divides cultures into high-context and low-context cultures. Communication in a high-context culture depends heavily on the context or nonverbal aspects of communication, whereas the low-context culture depends more on explicit, verbally expressed Communications.

Recent studies have identified' a strong relationship between Hall's high/low context and Hofstede's individualism/collectivism (IDY) and power distance (PDI) indices. For example, low context American culture scores relatively low on power distance and –high on individuaIisnr,-while-high;context:Arab-cultures-scoreirigh-on:power distance and low on individualism. Managers in general probably function best at a low context level because they are accustomed to reports, contracts, and other written communications.

In a low-context culture one-gets down to business quickly. In a high-context culture it takes considerably longer to conduct business because of the need to know more about a businessperson before a relationship develops. High-context businesspeople simply do not know how to handle a low-context relationship with other people. Hall suggests that, "in the Middle East, if you aren't willing to take the time to sit down and have coffee with people, you have a problem. You must learn to wait and not be too eager to talk business. You can ask about the family or ask, 'How are you feeling?' but avoid too many personal questions about wives because people are apt to get suspicious. Learn to make what we call chitchat. If you don't, you can't go to the next step. It's a little bit like a courtship." Even in low-context cultures, our communication is heavily dependent on our cultural context. Most of us are not aware of how dependent we are on the context, and, as Hall suggests, "Since much of our culture operates outside our awareness, frequently we don't even know what we know. "

As an example of this phenomenon, one study discusses hinting, a common trait among Chinese, which the researcher describes as "somewhere between verbal and nonverbal communications." In China, comments such as, "I agree," might mean "I agree with 15 percent of what you say"; "we might be able to" could mean "not a chance"; or "we will consider" might really mean "we will, but the real decision maker will not. The Chinese speaker often feels that such statements are very blunt with a clear hint; unfortunately, the U.S. listener often does not get the point at all. Prior experience, the context within which a statement is made, and who is making the comment are all - important in modifying meaning.

Probably every businessperson from America or other relatively low-context countries who has had dealings with counterparts in high-context countries can tell stories about the confusion on both sides because of the different perceptual frameworks of the communication process. It is not enough to master the basic language of a country; the astute marketer must have a mastery over the language of business and the silent languages of nuance and implication. Communication mastery, then, is *not* only the mastery of a language but also a mastery of customs and culture. Such mastery develops only through long association.

Crossing Borders 5

You Don't Have to be a Hollywood Star to Wear Dark Glasses

Arabs may watch the pupils of your eyes to judge your responses to different topics.

A psychologist at the university of Chicago discovered that the pupil is a very sensitive indicator of how people responds to a situation. When you are interested in some thing, your pupils dilate; if your hear something your don't like, your eyes tend to contract, the Arabs have known about the pupil response for hundreds if not thousand s of years, and because people can't controls the response of their eyes, many Arabs wear dark glasses, even indoors.

These are people reading the personal interaction on a second to second basis. By watching the pupils, they can respond rapidly to mood changes, that one of the reasons why they use a close conversations distance than Americans do. At about five feet, the normal distance between two Americans who are talking, we have a hard time following, eye movement. But if your use an Arab distance, about two feet, you can watch the pupil of the eye.

Direct eye contact for an American is difficult to achieve because we are taught in the United States not to star, not to look at the eyes that carefully. If you stare at some one, it is too intense, too sexy, or too hostile. It also may mean that we are not totally tuned in to the situation. May be we should all wear dark glasses.

Formality and Tempo

The breezy informality and haste that seem *to* characterize the American business relationship appear to be American exclusives that businesspeople from other countries not only fail *to* share but also fail *to* appreciate. This apparent informality, however, does *not* indicate a lack of commitment to the job. Comparing British and American business managers, an English executive commented about the American manager's compelling involvement in business, "At a cocktail party or a dinner, the American is still on duty."

Even though Northern Europeans seem to have picked up some American attitudes in recent years, do not count on them being "Americanized." As one writer says, "While using first names in business encounters is regarded as an American vice in many countries, nowhere is it found more offensive than in France," where formality still reigns. Those who work side by side for years still address one another with formal pronouns. France ranks fairly high on the power distance value orientation (PDI) scale while the United States ranks much lower, and such differences can lead to cultural misunderstandings. For-example, the-formalities-of-French-business practices as opposed to Americans' casual manners are symbols of the French need to show rank and Americans' tendency to downplay it. Thus, the French are dubbed snobbish by Americans, while the French consider Americans Philistines.

Haste and impatience are probably the most common mistakes of North Americans attempting to trade in the Middle East. Most Arabs do not like to embark on serious business discussions until after two or three opportunities to meet the individual they are dealing with; negotiations are likely to be

prolonged. Arabs may make rapid decisions once they are prepared to do so, but they do not like to be rushed and they do not like deadlines. The managing partner of the Kuwait office of KMPG Peat Marwick LLP says of the "flying-visit" approach of many American businesspeople, "What in the West might be regarded as dynamic activity-the 'I've only got a day here' approach-may well be regarded here as merely rude."

Crossing Borders 6

You Say You Speak English?

The English speak English and North Americans speak English, but can the two com-municate? It is difficult unless you understand that in England:

Newspapers are sold at bookstalls.

The ground floor is the main floor, while the first floor is what we call the second, and so on up the building.

An apartment house is a block of flats.

You will be putting your clothes not in a closet, but in a cupboard.

A closet usually refers to the W.C. or water closet, which is the toilet.

When one of your British friends says she is going to "spend a penny," she is going to the ladies' room.

A bathing dress or bathing costume is what the British call a bathing suit, and for those who want to, go shopping, it is essential to know that a tunic is a blouse; a stud is a collar button, nothing more; and garters are suspenders.

Suspenders are braces;

If you want to buy a sweater, you should ask for a jumper or a jersey as the recognizable item will be marked in British clothing stores.

A ladder is not used for climbing but refers to a run in a stocking.

If you called up someone, it means to-your British-friend1hatyou have drafted the person—probably for military service. To ring someone up is to telephone them.

You put your packages in the boot of your car not the trunk.

When you table something, you mean you want to discuss it, not postpone it as in the United States.

Any reference by you to an M.D. will probably not bring a doctor. The term means mental deficient in Britain.

When the desk clerk asks what time you want to be knocked up in the morning, he is only referring to your wake up call.

A billion means a million (1000000000000) and not a thousand millions as in the United States.

Marketers who expect maximum success have to deal with foreign executives in ways that are acceptable to the foreigner. Latin Americans depend greatly on friendships but establish these friendships only in the South American way: slowly, over a considerable period of time. A typical Latin American is highly formal until a genuine relationship of respect and friendship is established. Even then the Latin American is slow to get down to business and will not be pushed. In keeping with the culture, manana (tomorrow) is good enough. How people perceive time helps to explain some of the differences between U.S. managers and those from other cultures.

P-Time Versus M-Time

North Americans are a more time-bound culture than Middle Eastern and Latin cultures. Our stereotype of those cultures is "they are always late," and their view of us is "you are always prompt." Neither statement is completely true though both contain some truth. What is true, however, is that we are a very time-oriented society-time is money to us-whereas in other cultures time is to be savored, not spent.

Edward Hall defines two time systems in the world: mono-chromic and polyphonic time. M-time, or monochromic time, typifies most North Americans, Swiss, Germans, and Scandinavians. These Western cultures tend to concentrate on one thing at a time. They divide time into small units and are concerned with promptness. M-time is used in a linear way and it is experienced as being almost tangible in that we save time, waste time, bide time, spend time, and lose time. Most low-context cultures operate on M-time. P-time, or polychronic time, is more dominant in high-context cultures where the completion of a human transaction is emphasized more than holding to schedules. P-time is characterized by the simultaneous occurrence of many things and by "a great involvement with people." P-time allows for relationships to build and context to be absorbed as parts of high-context cultures.

One study comparing perceptions of punctuality in the United States and Brazil found that Brazilian timepieces were less reliable and public clocks less available than in the United States. Researchers also found that Brazilians more often described themselves as late arrivers, allowed greater flexibility in defining early and late, were less concerned about being late, and were more likely to blame external factors for their lateness than were Americans.

The American desire to get straight to the point, to get down to business, and other indications of directness are all manifestations of M-time cultures. The P-time system gives rise to looser time schedules, deeper involvement with individuals, and a wait-and see-what-develops attitude. For example, two Latins conversing would likely opt to be late for their next appointments rather than abruptly terminate the conversation before it came to a natural conclusion. P-time is characterized by a much looser notion of on time or late. Interruptions are routine; delays to be expected. It is not so much putting things off until manana but the concept that human activity is not expected to proceed like clockwork.

Most cultures offer a mix of P-time and M-time behavior, but have a tendency to be either more P-time or M-time in regard to the role time plays. Some are similar to Japan, where appointments are adhered to with the greatest M-time precision but P-time is followed once a meeting begins. The Japanese see U.S. businesspeople as too time bound and driven by schedules and deadlines, which thwart the easy development of friendships. The differences between M-time and P-time are reflected in a variety of ways throughout a culture.

When businesspeople from M-time and P-time meet, adjustments need to be made for a harmonious relationship. Often

clarity can be gained by specifying tactfully, for example, whether a meeting is to be on Mexican time or American time. An American who has been working successfully with the Saudis for many years says he has learned to take plenty of things to do when he travels. Others schedule appointments in their offices so they can work until their P-time friend arrives. The important thing for the U.S. manager to learn is adjustment to P-time in order to avoid the anxiety and frustration that comes from being out of synchronization with local time. As global markets expand, however, more businesspeople from P-time cultures are adapting to M-time.

Crossing Borders 7

When Yes Means No, or May be or I Don't Know, or?

Once my youngest child asked if we could go to the circus and my reply was, "may be." My older child asked the younger sibling, "what did he say?" The prompt reply, " he said NO!'

All cultures have ways to avoid saying no when they really mean no. After all, arguments can be avoided. Hurt feelings postponed, and so on. In some cultures, saying "no" is to be avoided at all costs – to say no is rude, offensive, and disrupts harmony. When the maintenance of long lasting stable personal relationships is of utmost importance, as in Japan to say no is to be avoided because of the possible damage to a relationship. As a result the Japanese have developed numerous euphemisms and paralinguistic behavior to express negation. To the unknowing American, who has been taught not to take no for an answer, the unwillingness tosay no is often misinterpreted to mean that there is hope – the right argument or more forceful persuasions is all that is needed to get a yes. But don't be misled – the Japanese listen politely and , when the American if finished, respond with hai. Literally it means yes, but usually it only means, "I hear you." When a Japanese avoids saying yes of no clearly, it most likely means that he or she wishes to say no. one example at the highest levels of government occurred in negotiations between the Prime Minister of Japan and the President of the United States. The prime minister responded with, "we'll deal with it," to a request by the president. It was only later that the U.S. side discovered that such a response generally means no – to the frustration of all concerned. Other euphemistic, decorative no's sometimes used by Japanese: " it's very difficult." We will think about it." "I'm not sure." We'll give this some more thought." Or they leave the room with an apology.

Americans generally respond directly with a yes or no and then give their reasons why. The Japanese tend to embark on long explanation first, and then leave the conclusion extremely ambiguous, Etiquette dictates that Japanese may tell you what you want to hear, may not respond at all, or are evasive. This ambiguity often leads to misunderstanding and cultural friction.

Negotiations Emphasis

All the just-discussed differences in business customs and culture come into play more frequently and are more obvious in the negotiating process than any other aspect of business. The basic elements of business negotiations are the same in any country; they relate to the product, its price and terms, services associated with the product, and finally, friendship between vendors and customers. But it is important to remember that the negotiating process is complicated and the risk of misunderstanding increases when negotiating with someone from another culture. This is especially true if the cultures score differently on Hofstede's PDI and IDV value dimensions.

Attitudes brought to the negotiating table by each individual are affected by many cultural factors and customs often unknown to the other individuals and perhaps unrecognized by the individuals themselves. Each negotiator's understanding and interpretation of what transpires in negotiating sessions is conditioned by his or her cultural background the possibility of offending one another or misinterpreting each other's motives is especially high when one's SRC is the basis for assessing a situation. One standard rule in negotiating is "know thyself' first, and second, "know your opponent." The SRCs of both parties can come into play here if care is not taken.

Gender Bias in International Business

The gender bias toward women managers that exists in many countries creates hesitancy among U.S. multinational companies to offer women international assignments. Questions such as, Are there opportunities for women in international business? And should women represent U.S. firms abroad? Frequently arise as U.S. companies become more international. As women move up in domestic management ranks and seek career-related international assignments, companies need to examine their positions on women managers in international business.

In many cultures-Asian, Arab, Latin American, and even some European women are not typically found in upper levels of management. Traditional roles in male-dominated societies often are translated into minimal business opportunities for women. This cultural bias raises questions about the effectiveness of women in establishing successful relationships with host country associates. An often-asked question is whether it is appropriate to send women to conduct business with foreign customers. To some it appears logical that if women are not accepted in managerial roles within their own cultures, a foreign woman will not be any more acceptable. This is but one of the myths used to support decisions to exclude women from foreign assignments.

It is a fact that men and women are treated very differently in some cultures. In Saudi Arabia, for example, women are segregated, expected to wear veils, and forbidden even to drive. Evidence suggests, however, that prejudice toward foreign women executives may be exaggerated and that the treatment local women receive in their own cultures is not necessarily an indicator of how a foreign businesswoman is treated.

When a company gives management responsibility and authority to someone, a large measure of the respect initially shown that person is the result of respect for the firm. When a woman manager receives training and the strong backing of her firm, she usually receives the respect commensurate with the position she holds and the firm she represents. Thus, resistance to her as a female either does not materialize or is less severe than anticipated. Even in those cultures where a female would not ordinarily be a manager, foreign female executives benefit, at least initially, from the status, respect, and importance attributed to the firms they represent. In Japan, where Japanese women rarely achieve even lower-level management positions, represen-

tatives of U.S. firms are seen first as Americans, second as representatives of firms, and then as males or females.

Similarly, women in China are seen as foreigners first and women second. Being foreign is such a major difference that being a woman is relatively minor. As one researcher notes, in China "businesswomen from the West are almost like 'honorary men' Once business negotiations begin, the willingness of a business host to engage in business transactions and the respect shown to a foreign businessperson grow or diminish depending on the business skills he or she demonstrates, regardless of gender. As world markets become more international and as international competition intensifies, U.S. companies need to be represented by the most capable personnel available; it seems shortsighted to limit the talent pool simply because of gender.

LESSON 10:
BUSINESS ETHICS AND BRIBERY

Business Ethics

The moral question of what is right and/or appropriate poses many dilemmas for domestic marketers. Even within a country, ethical standards are frequently not defined or always clear. The problem of business ethics is infinitely more complex in the international marketplace because value judgments differ widely among culturally diverse groups. What is commonly accepted, as right in one country may be completely unacceptable in another Giving business gifts of high value, for example, is generally condemned in the United States, but in many countries of the world gifts are not only accepted but also expected.

For U.S. businesses, bribery became a national issue during the mid-1970s with public disclosure of political payoffs to foreign recipients by U.S. firms. At the time, there were no U.S. laws against paying bribes in foreign countries, but for publicly held corporations the Securities and Exchange Commission's (SEC) rules required accurate public reporting of all expenditures. Because the payoffs were not properly disclosed, many executives were faced with charges of violating SEC regulations.

The issue took on proportions greater than that of nondisclosure because it focused national attention on the basic question of ethics. The business community's defense was that payoffs were a way of life throughout the world: if you didn't pay bribes, you didn't do business. Consider this situation: Suppose your company makes large, high-priced generators for power plants and a foreign official promises you a big order if you slip a million dollars into his Swiss bank account. If you are an American and you agree, you have committed a felony and face up to five years in prison. If you are German, Dutch, French, or Japanese, among others, you have merely booked another corporate tax deduction-the value of the bribe-and you have the contract as well. In fact, French tax authorities actually have a sliding scale of acceptable "commissions" paid to win business in different countries. The Asian deduction is 15 percent, although that drops to between 8 percent and 11 percent in India, where apparently it costs less to buy officials. It is important to note that bribes usually violate the laws in the countries where the bribery takes place, and that in countries where bribes can be deducted as a business expense the laws clearly state they apply only to transactions outside that country.

The decision to pay a bribe creates a major conflict between what is ethical and proper and what is profitable and sometimes necessary for business. Payoffs are perceived by many global competitors as a necessary means of accomplishing business goals. A major complaint of U.S. businesses is that other countries do not have legislation as restrictive as does the United States. The United States advocacy of global ant bribery laws has led to an accord by the 29 member nations of the Organization for Economic Cooperation and Development (OECD) to force their companies to follow rules similar to those that bind U.S. firms. It may be some time before the accord becomes binding, however, since each of the member countries will have to ratify the treaty individually.

In Latin America, the-organization-of American States (OAS) has -taken a global lead in being the first to ratify an agreement against corruption. Long considered almost a way of business life, bribery and other forms of-corruption now have been criminalized. Leaders of the region realize that democracy depends on the confidence the people have in the integrity of their government, and that corruption undermines economic liberalization. The actions of the GAS coupled with those of the GECD will obligate a majority of the world's trading nations to maintain a higher standard of ethical behavior than has existed before. Unfortunately, India, China, and other Asian and African countries are not members of either organization.

Exhibit 5-2 Transparency Intemational1997 Corruption Perception Index* (Selected Countries 1997 & 1996)

Country	CPI 1997	CPI 1996	Country	CPI 1997	CPI1996
Denmark (1)	9.94:1:	9.33	Italy (30)	5.03	3.42
Finland (2)	9.48	9.05	S Korea (34)	4.29	2.96
Norway (7)	8.92	8.87	Brazil (36)	3.56	2.96
Singapore (9)	8.66	8.80	China (41)	2.88	2.43
Switzerland (11)	8.61	8.76	India (45)	2.75	2.63
U.S. A(16)	7.61	7.66	Mexico (47)	2.66	550
France (20)	6.66	6.96	Russia (49)	2.27	2.58
Czech Rep. (27)	5.20	5.37	Nigeria (52)	1.76	0.69

The actions of the GECD and GAS also reflect the growing concern among most trading countries of the need to bring corruption under control. International businesspeople often justify their actions in paying bribes and corrupting officials as necessary because "corruption is part of their culture," failing to appreciate that it takes "two to tango" -a bribe giver and a bribe taker.

Since 1993 an international organization called Transparency International (TI) has been dedicated to "curb[ing] corruption through international and national coalition encouraging governments to establish and implement effective laws, policies and anti-corruption programmes." Among its various activities, TI conducts an international survey of businesspeople, political analysts, and the general public to determine their perception of corruption in various countries. In the 1997 Corruption Perception Index (CPI), shown in Exhibit 5-2, Denmark, with a score of 9.94 out of a maximum of 1-0, was perceived to be the least corrupt and Nigeria, with a score of 1.76, as the most corrupt. TI is very emphatic that its intent is not to expose villains and cast blame, but to raise public awareness that will lead to constructive action. As one would expect, those countries receiving low scores are not pleased; however, the

effect has been to raise public ire and debates in parliaments around the world-exactly the goal of TI.

Bribery: Variations on a Theme

While bribery is a legal issue, it is also important to see bribery in a cultural context in order to understand different attitudes toward bribery. Culturally, attitudes are significantly different among different peoples. Some cultures seem to be more open about taking bribes, while others, like the United States, are publicly contemptuous of such practices but are far from virtuous. Regardless of where the line of acceptable conduct is drawn, there is no country where the people consider it proper for those in position of political power to enrich themselves through illicit agreements at the expense of the best interests of the nation. A first step in understanding the culture of bribery is to appreciate the limitless variations that are often grouped under the word bribery. The activities under this umbrella term range from extortion through subornation to lubrication.

Bribery and Extortion : The distinction between bribery and extortion depends on whether the activity resulted from an offer or from a demand for payment. Voluntarily offered payments by someone seeking unlawful advantage is *bribery*. For example, it is bribery if an executive of a company offers a government official payment if the official will incorrectly classify imported goods so the shipment will be taxed at a lower rate than correct classification would require. On the other hand, it is *extortion* if payments are extracted under duress by someone in authority from a person seeking only what they are lawfully entitled to. An example of extortion would be a finance minister of a country demanding heavy payments under the threat that a contract for millions of dollars would be voided.

On the surface, extortion may seem to be less morally wrong because the excuse can be made that "if we don't pay we don't get the contract" or "the official (devil) made me do it." But even if it is not legally wrong, it is morally wrong-and in the United States it is legally *and* morally wrong.

Subornation and Lubrication : Another variation of bribery is the difference between lubrication and subornation.37 *Lubrication* involves a relatively small sum of cash, a gift, or a service given to a low-ranking official in a country where such offerings are not prohibited by law. The purpose of such a gift is to facilitate or expedite the normal, lawful performance of a duty by that official. This is a practice common in many countries of the world. A small payment made to dock workers to speed up their pace so un-loading a truck take few-hours rather than all day is an example of lubrication.

Subornation, on the other hand, generally involves giving large sums of money, frequently not properly accounted for, designed to entice an official to commit an illegal act on behalf of the one offering the bribe. Lubrication payments accompany requests for a person to do a job more rapidly or more efficiently; subornation is a request for officials to turn their heads, to do their jobs more quickly, to not do their jobs, or to break the law.

A third type of payment that can appear to be a bribe but may not be is an agent's fee. When a businessperson) is uncertain of a country's rules and regulations, an agent may be hired to represent the company in that country. For example, an attorney may be hired to file an appeal for a variance in a building code on the basis that the attorney will do a more efficient and thorough job than someone unfamiliar with such procedures. While this is often a legal and useful procedure, if a part of that agent's fees is used to pay bribes, the intermediary's fees are being used unlawfully. Under U.s. law, an official who knows of an agent's intention to bribe may risk penalties of up to five years in jail. The Foreign Corrupt Practices Act (FCPA) prohibits U.S. businesses from paying bribes openly or using middlemen as conduits for a bribe when the U.S. official knows that part of the middleman's payment will be used as a bribe. There are many middlemen (attorneys, agents, distributors, and so forth) who function simply as conduits for illegal payments. The process is further complicated by legal codes that vary from country to country; what is illegal in one country may be winked at in another and legal in a third.

The answer to the question of bribery is not an unqualified one. It is easy to generalize about the ethics of political payoffs and other types of payments; it is much more difficult to make the decision to withhold payment of money when the consequences of not making the payment may affect the company's ability to do business profitably or at all. With the variety of ethical standards and levels of morality that exist in different cultures, the dilemma of ethics and pragmatism that faces international business cannot be resolved until the anticorruption accords among the OECD and OAS members are fully implemented and multinational businesses refuse to pay extortion or offer bribes.

The Foreign Corrupt Practices Act has had a positive effect. The Secretary of Commerce has stated that bribery and corruption cost U.S. firms $64 billion in lost business in just one year, the implication being that had there been no FCPA there would have been no lost business.39 Even though there are numerous reports indicating a definite reduction in U.S. firms paying bribes, however, the lure of contracts is too strong for some companies. Lockheed Corporation made $22 million in questionable foreign payments during the 1970s. For example, the company pled guilty in 1995 to paying $1.8 million in bribes to Dr. Leila Takla, a member of the Egyptian national parliament, in exchange for Dr. Takla to lobby successfully for three air cargo planes worth $79 million to be sold to the military. Lockheed was caught, fined $25 million, and cargo plane exports by the company were banned for three years. Lockheed's actions during the 1970s were a major influence on the passing of the FCPA. The company now maintains one of the most comprehensive ethics and legal training programs of any major corporation in the United States.

It would be naive to assume that laws and the resulting penalties alone will put an end to corruption. Change will come only from more ethically and socially responsible decisions by both buyers and sellers and governments willing to take a stand.

Crossing Borders 9

Time : A Many Cultured Thing

Time is cultural, subjective, and variable. One of the most serious causes of frustration and friction in cross cultural business dealings occurs when counterparts are out of sync with each other. Differences often appear with respect to the pace of time, its perceived nature, and its function. Insights into a culture's view of time may be found in its sayings and proverbs. For example:

"Time is money. " United States

"Those who rush arrive first at the grave." Spain

"the clock did not invent man." Nigeria

"if you wait ling enough, even an egg will walk." Ethiopia

"Before the time, it is not yet the time; after the time, it's too late." France

The precision of clocks also tells a lot about a culture. In a study on how cultures keep time, the researcher found:

Clock are slow of fast by an average of just 19 seconds in Switzerland.

When a man in brazil was queried about the time, he was more than three hours off when he said it was "exactly 2:14."

When the researcher ask the time in Jakarta, he was told by a postal employees in the central post office that he didn't know the time but to go outside and ask a street vendor.

Ethical and Socially Responsible Decisions

To behave in an ethically and socially responsible way should be the hallmark of every businessperson's behavior, domestic or international. It requires little thought for most of us to know the socially responsible or ethically correct response to questions about knowingly breaking the law, harming the environment, denying someone his or her rights, taking unfair advantage, or behaving in a manner that would bring bodily harm or damage. Unfortunately, the difficult issues are not the obvious and simple right or wrong ones. In many countries- the international marketer faces the dilemma of responding to sundry situations where-there is no local law, where local practices appear to-condone a certain-behavior, or where the company willing to "do what is necessary" is favored over the company that refuses to engage in certain practices. In short, being socially responsible and ethically correct is not a simple task for the international marketer operating in countries whose cultural and social values, and/or economic needs are different from those of the marketer.

In normal business operations there are five broad areas where difficulties arise in making decisions, establishing policies, and engaging in business operations: (1) employment practices and policies; (2) consumer protection; (3) environmental protection; (4) political payments and involvement in political affairs of the country; and (5) basic human rights and fundamental freedoms. In many countries, the law may help define the borders of minimum ethical or social responsibility, but the law is only the floor above which one's social and personal morality is tested. The statement that "there is no controlling legal authority" may mean that the behavior is not illegal but it does not mean that the behavior is morally correct or ethical. "Ethical business conduct should normally exist at a level well above the minimum required by law" or "controlling legal authority." In fact, laws are the markers of past behavior that society has deemed unethical or socially irresponsible.

There are three ethical principles that provide a framework to help the marketer distinguish between right and wrong, determine what ought to be done, and properly justify his or her actions. Simply stated they are:

Principle	Question
Utilitarian ethics	Does the action optimize the "common good" or benefits of all constituencies?
Rights of the parties	Does the action respect the rights of the individuals involved?
Justice or fairness	Does the action respect the canons of justice or fairness to all parties involved?

Answers to these questions can help the marketer ascertain the degree to which decisions are beneficial or harmful, right or wrong, or whether the consequences of actions are ethical or socially responsible. Perhaps the best framework to work within is defined by asking: Is it legal? Is it right? Can it withstand disclosure to stockholders, to company officials, to the public?

One researcher suggests that regardless how corrupt a society might be there are core human values that serve as the underpinning of life, no matter where a person lives. Participants in 43 countries and more than 50 faiths were given 17 values and asked to rate each as a core value. Five values-compassion, fairness, honesty, responsibility, and respect for others-were the most often selected regardless of cuIture.49 The researcher suggests that an action should only be taken if the answer is no to the question, "Is the action a violation of a core human value?" When people are clear about their own values and can identify the principles and core values that make up ethical behavior, they have the tools for looking at potential decisions and deciding whether or not a decision is ethical.

Cultural Considerations In International Marketing:

A Classroom Simulation

James B. Stull

San Jose state University

With the constant increase of multinational companies (MNCs), foreign investments, and international negotiations, the need for smooth interpersonal transactions and business strategies also grows. Practices taken for granted in one country face varying degrees of probability of achieving desirable results in another. For example, if a Saudi Arabian host offers an American visitor a cup of coffee, the American stands a better chance of preserving friendly relations if he accepts the Saudi's offer. Politely refusing-a cup of coffee may be acceptable behavior in the United. States, but to a Saudi it may be an insult, as the offer of a cup of coffee is an expression of Saudi hospitality and a symbol of one's honor. An American visiting a Latin American country may arrive at his host executive's office for a 10 A.M. appointment at 9:55 A.M. However, the host may not appear until 11 A.M. While the American may be fuming at having to wait over an hour, his host may feel no need to apologize to the American as this is normal practice in this

host's business environment. .This simulation' is designed to illustrate how the sensitive businessperson may be the' one who approaches another culture by attempting to adopt the viewpoint of that particular culture.

Components Of Culture

Culture is a complex pattern of consistent behaviors which can be broken into components for the purposes this exercise, let's consider those proposed by Vern Terpstra in his first edition of the cultural entities and values, social organization, education, technology, political systems, and legal systems.

Language

Language reflects the philosophy and lifestyle of a group of people. It also conditions people to think and behave in certain ways. Eskimos have more than twenty five words for " snow" but no word for " war." Arabs have over 6,000 words for camel, its parts and equipment. The Arabic word for "citizen" translates roughly as "one who performs Allah's will." Nearly one-half of English is made up of scientific and technological terms. A clock "runs" in the United States, while it "walks" in some Spanish-speaking countries. People who study languages learn much more about other people than merely how they speak. Language may be the most reliable indicators of other components of a culture; it can tell us a great deal about how other people live and think as well.

Religion

If religion provides people with a sense of why they are on this earth, it may consciously and subconsciously dictate how they conduct their lives. Attitudes, values, and behavior can often be traced to religious philosophies. Although numerous religions existent of the world fits into six basic religious categories: animism (primitive religions), Hinduism, Buddhism, Islam and Christianity. Judaism is found primarily in Israel.

Attitudes and Values

A people's attitudes and values about certain topic are important to that society's economic development and its people's behavior. Of particular concern are attitudes and values about time, work-and achievement, wealth and material gain. Religions plays major role in their development. The tenets and canons followed by most religions often contain prescriptions and proscriptions about greed and the attainment of wealth and material items.

Social Organisation

People organize activities and role relationships consistent with other cultural values and expectations. Important considerations include a culture's origin and history, family relationships, friendships, class structure, governmental powers, social and reference groups (including labor unions,) gender roles, supervisor subordinate relationships, and more.

Education

Educational systems are culture-specific, promulgating norms as a vein of cultural existence. Studies show a high correlation between educational enrollments in secondary and higher levels of education and a country's economic development. Diffusion of innovations into a culture depends heavily on literacy, which typically leads to better communication systems, new ideas, new ways to solve problems, increased technological development, improved labor forces, and more.

Technology

The artifacts, material symbols, problem-solving techniques, quantitative systems, managerial styles, and other intellectual tools reflect the educational and technological development of a culture. Studies show high positive relationships between per capita incomes and per capita energy' consumption; high gross domestic products and manufacturing; and low gross domestic products and agriculture. Also characteristic of technologically developed cultures are more urban dwellers; high per capita expenditures on education; more cars, radios, televisions, and telephones; more scientists, engineers, and, technicians; and higher expenditures for research and development. Technology determines how a country uses its land, labor, capital, and education. It also leads to further technologic innovation.

Political Systems

Political-environments both within and between countries are major considerations when conducting international business. Politicians exercise controls over resources and how people use them. Religious groups, labor unions, and multinational companies are also clearly political. Multinational corporations (MNCs) are always at risk politically when they enter a foreign arena to conduct business. The MNC may be forced to take severe action because of sudden changes in a host country's environment, including competing political philosophies, social unrest, lobbying independence, war, and new international alliances

Legal Systems

Laws are rules of a culture established by authority, society, or custom. They reflect the attitudes of the culture; they may be written or unwritten. Most of the world fits into one of the following legal systems: common, civil, communism, Islam, or indigenous. Some of the legalities an MNC must consider include location, structure, finances, money, taxes, property, antitrust, and transportation. Additional considerations might involve controls over importing, exporting, patents, trademarks, competition, and controls over the host country imposed by still other nations.

Economic forces such as employment, income, gross national product, foreign exchange risk, balance of payments, and commodity agreements also affect international business. One must also look at the country's population, climate, geography, natural resources, ecological systems, and plant and animal life. You may wish to add these variables to the simulation, but they are not discussed in detail here.

Simulating International Business

This simulation was originally designed for a fifteen-week, two seventy-five-minute sessions-per week marketing class, with approximately forty students per section. It can easily be adapted to fit the needs of any group.

Simulation are a popular, widely used method of teaching and training people in the development of various skills. Discoveries about aircraft in flight have been made in wind tunnels. Astronauts train for space flight through simulations. Airplane pilots and automobile drivers learn on simulators. Law

students experience trial conditions through moot courts. First aid personnel practice cardiopulmonary resuscitation on inflatable dummies. Security, safety, and medical personnel train to deal with various hazards and obstacles through fire, lifeboat, and air raid drills, disaster training, and other forms of simulation. Simulations are also used widely in management training machine and interpersonal simulations have given trainees ideas about what to expect and how to react to probable leadership situations.

A simulation is an operating model of real life in which participants a can experience much of what would happen without suffering many of the negative consequences.

Here is one way to successfully experience the benefits of this simulation.

Week 1 : you will be assigned to a research group to find out as much as you can about one of the following variables: language, religion, attitudes and values, social organization, education, technology, political systems, and legal systems. An excellent source of information for this phase of the simulation is Vern Terpstra, The Cultural Environment Of international Business, Cincinnati: South-Western, 1978.

Weeks 1-5: Your group should pace itself and prepare to present your research findings to the class sometime during weeks six through nine. You should develop ways for your audience to actually *experience* your concept or component as it is experienced in other cultures.

Weeks 6- 9: Your group will present your findings daringness class period. Plan for one concept to be presented each class period. Be sure to take notes and participate in this phase, as the information will be used during the next module, weeks 10-1 5.

Weeks 10-15: On the first day of this phase you will be assigned to a new group. One-member from each of the research groups from the first nine weeks will be assigned to a culture group, so that each culture group and an expert on each of the separate - components making up that culture. Each new group will function as a business organization representing one-of the following five -cultures: Bwana, Feliz, Leung, Koran, and Dharma.

Bwana : This African republic is slowly beginning to trade with the rest of the world. Its level of technology is far-behind countries such as Japan, Germany, Great Britain, and the United States. Bwana is rich with gems, ivory, and precious metals, but its primary language is Swahili, although some English is spoken in the capital city, Zulu. Organised religion has made little impact on this tiny nation. Most of the people are animistic, believing that spirits inhabit everything; people worship volcanoes, the moon, rubber trees, and waterfalls. A very traditional slowly emerging country, Bwana still relies on tribal laws that have been handed down through generations. Children can get a formal education in ht capital city, but most of the people live in rural villages where tribal leaders determine what needs to be learned.

Feliz : This Central American country is constantly in the world news. Guerrilla warfare leaves

Feliz politically unstable : Although the official language is Spanish, dozens of pre-Columbian dialects are spoken in rural villages. Catholicism is the primary religion: however, some pre-Catholic animism still exists as the local brufo or shaman is frequently seen waving incense pots and chanting at village churches. Some technological advancements have been made in the capital and two other large cities. Exports include rum, sugar, rice, lumber, and motor vehicles. Tourism is strong on the Caribbean coast, where fishing is extremely popular and politics seem not to exist. In the cities, many children complete their secondary education. Village children typically receive no formal education. Civil law is followed in Feliz.

Leung : Leung is located in Asia. Cantonese is spoken throughout the country. The Lounges people revere education and encourage their children to learn as much as they can, but the country's economy makes it, virtually impossible for the education to be put to use. Most of the children receive a solid education, but formal training is limited to trade schools and technology centers. The average citizens believes in the country, but many lounges leave to seek opportunities elsewhere; A significant number of those who have been educated and trained in Western countries are beginning to return to help develop their native land. Leung exports rice, wheat, corn, cotton, and textiles. It produces steel, iron; coal, and some machinery. Recent ventures have resulted in foreign-owned high technology computer assembly plants being set up and operated near the port cities. The people follow the teachings of Confucius, Buddha, and Tao Communism has been the main form of government since the 1920s, but the younger generation want to see change soon. Some free trade zones have, emerged in the past few years allowing merchants to experience other coun tries' ways of doing business.

Koran : Koran is situated in the middle east, in a very dry desert region. The country has produc4ed and exported oil since 1938, and is also abundant with fertilizer, petrochemicals, and cement. Koran enjoys a strong' fishing industry. Desalinization plants have helped Koran provide water for agriculture and industry. Because of its success with oil the per capita income is one of the highest in the world. However, other levels of technology are low. Some areas of the country are run down and the people are extremely poor. Koran imports a great deal from the rest of the world. The primary language is Arabic. Islam is the only religion with Muslims following the word from the holy book, The Koran. The oil industry has modernized part of the country, but Islam dictates that Muslims adhere to tradition.

Dharma: Dharma, a former British colony, is located on the Indian subcontinent. The people speak Hindi, through some 200 different dialects may be heard. Most Dharmese practice Hinduism. Education is very important to the Dharmese people, and they make great sacrifices to be sure that their children go to school. The economy is historically poor. The main exports are rice, legumes, tea, and tapioca. Children often leave Dharma to study in England, Canada, or the United States, and they tend not to return to their homelands except to visit their families. The government is primarily socialist, with strong ties to the English common law system.

Although these cultures are, obviously fictitious, they are intentionally similar to real cultures so that you can make

reasonable inferences that will help you succeed in this simulation.

Procedure for Weeks 10-15 You will need to go through the following steps to complete the phase of the simulation:

1. Each culture must consult, its own specialists to develop a clear understanding of its own identity regarding each component. Focus on developing specific verbal and nonverbal language norms which will be observed during negotiations with other cultures. This may take a few class days.
2. Study the other cultures to gain some familiarity with their cultural components. Research real cultures that you perceive as similar so that you can make reasonable inferences about life in the fictitious culture.
3. Your overall goal is to market a product, product line, service, or idea to the other culture. Your success will depend on how well you know the other culture and how well you adapt your business and marketing strategies to each.
4. You must identify a product, service, or idea that you believe is compatible with your own culture and that you could market successfully to the other culture. You don't have to invent something.
5. Develop business and marketing strategies that you believe will be sensitive to the idiosyncrasies of each, other culture.
6. You will negotiate with each other culture persisting-until a contract has been settled or until you perceive that a stalemate has been reached.
7. Discuss the simulation, focusing on bow you felt and what you learned while you were simulating international business.
8. Your instructor may modify this simulation to meet the-needs of your particular class.

Nissan Micra, Denmark

Deborah Fain

New York University

Introduction

In 1992 the Micro, Nissan's smallest car, cost $20,000 U.S. dollars in Denmark. That made it the most expensive car in its class. The price of the new model was up 20 percent from one year ago. Historically, only *35.4* percent of Micra owners buy another Micra. The reason usually given is price.

Moreover, due to the continuing recession, car sales in Denmark were at their lowest level in thirty years. Only 9,000 small cars are sold each year, in a good year, in Denmark.

To make the problem even more difficult, marketing costs had increased by at least 10 percent in each of the past five years.

Nissan Denmark addressed this situation by developing and executing a truly innovative database marketing program. They were able to do this because they had very little to lose and much to gain:

"First given the economic situation described above, no one inside or outside the company expected success, so a loss would not cause great concern.

Second, even a small success would be greeted with great satisfaction.

Third, management was willing to take a chance on a really bold program because the situation was becoming quite critical."

Working with their advertising agency, management decided that the only way to reverse the trend was to develop and execute an ongoing relationship building campaign, specifically targeting currently satisfied customers.

This new program was in addition to the ongoing print campaign, the objective of which had been awareness of the Nissan Micra product. This campaign had been running in Denmark for several years. The advertising agency brought in a research firm and a direct marketing agency to assist in development and execution of the new relationship-building campaign.

Objectives

Nissan Denmark had several objectives, some short-term and others long-term. The key was using a test drive to motivate previous or current Micra owners to purchase a new Micra.

Short-Term Objectives

The first short-term objective was to sell 200 Nissan Micras through a test drive program. The second was to reduce the average marketing cost below the current $400 per car.- Obviously, both of these objectives were important to demonstrate that the Micra remained a practical choice for Danes purchasing a new car. However, Nissan Denmark and the agency were also looking ahead to the, longer term, since any innovative program was certain to be expensive relative to staying with the current program. The long-term objectives were set to guarantee Nissan Micra's future, and even Nissan's overall future, in Denmark.

Long Term objectives

The first long-term objective was to develop an ongoing communications/ relationship maintenance program for current micro owners. The second was to develop ongoing methodology to target the highest sales potential customers.

By accomplishing these long term objectives, Nissan could develop targeted mailings to get potential buyers to test drive a new Micra, or other Nissan models, as part of an ongoing promotional program.

Nissan actually accomplished all of its objectives, both short and long term, by the following steps, which were carefully organized and managed.

Organising The Team

By hiring both a direct marketing agency and a respected market research firm, Nissan and its general advertising agency ensured that whatever program was developed would be based on a higher level of expertise than the ad agency alone would have been able to provide to the client.Together all four team members-client, general agency, direct marketing agency and research firm-developed marketing questions hypotheses, and an initial approach to the problem.

Assignments

1. Generate list of marketing questions and hypotheses
2. Develop a strategy outline and a mailing plan.
3. Prioritize the mailing and develop a data-driven plan.

This case was prepared as a basis for classroom discussion rather than to illustrate effective or ineffective handling of a business situation.

Beneath Hijab

Marketing to the Veiled Women of Iran

Jeffrey A. Fadiman

San Jose state University

Hijab means modest dress, and that is how Muslim women cover themselves. To Muslim women wearing *hijab,* one of the most annoying questions asked by Western women is; "Why?

"In defense of the practice, Mahjubah: The Magazine for Moslem, Women (an English-language journal published in Iran for foreign distribution) ran an article examining hijab from the perspective of Muslim women. According to the article, men and women are physically and psychologically different. Muslim women are equal to men but not the same as men. Each sex has its own rights and place in society. Women wear hijab to because they weak but because of the high status given to them by Allah and because of their desire to adhere to Islamic morality such, 'hijab' means more than an outer garment; the heart must be modest as well.

Muslim women, on the other hand, often-wonder why Western women wear skimpy, skin-tight dresses that are impractical arid uncomfortable. Why must western women be slaves to appearance, forever listening to the media about how to be glamorous? Why must they have to look beautiful for strangers to ogle them in public places? Why do western feminist groups want to turn women into men? Muslim women wonder whether such questioning of gender roles is a sign of strength or actually a sign of weakness.

Questions

Assume that Iran's new leaders now welcome U.S. businesses, requiring only that the members of each firm respect the religious, ethical, and moral beliefs of the nations. Consider that before the Ayatollah Khomeini's revolution, Iran's respect revolution, Iran's women showed enormous and increasing interest in a wide range of U.S. goods often wearing them "beneath the *hijab,*" in deference to the opinions of Iranian men. Then came Khomeini, labeling the United States "the Great Satan." As a consequence, Western goods became equated with religious evil. Now the market has opened once more, after a drought of years.

How can you reawaken that demand? How can you stimulate the demand for Western goods (or. services) among Iranian women without generating anxiety on the part of Iran's (all male) religious and secular authorities?

Your, responses to this question should take the form of an essay, suggesting a number of specific measures that might be taken. The essay should include your responses to the following:

1. Product selection : What type of product (goods or service) could you, as marketing director of a small U.S. firm, attempt to test, market to the female population of Iran's Describe in detail. Justify your choice of product.
2. Segment market : Which segment of the market should you target as an initial clientele describe in detail, including sex, age, social class, residential pattern (rural, suburban, urban), and so on. Justify your choice of segment.
3. Product modification : In what ways should the product (or service) be modified to stimulate demand by women, particularly those who continue to wear the black 'chadur, thereby conforming to hijab either by preference or in deference to male authority? Justify your modifications.
4. Product image : In what ways must the product image be modified to conform to Iranian religious, ethical, and moral norms, considering that these are entirely imposed by men. Justify your modifications (note: although upper- and middle – class women often do their own shopping, lower class and more traditional middle class women do not. Their husbands, fathers, and other men shop for them, and the man involved selects what seems appropriate to him. The problem is how to market products or services that entice women, without thereby alienating their men.) Also consider media selection, potential distribution outlets, point-of-purchase strategies, and so on.
5. On-site project head : Considering both the legacy-of hostility that Iranians feel toward America and their long-range fascination with' Western goods, what type of individual would you select to launch this first-time effort within the country? Assume his or her professional qualifications to be adequate, but describe those personal characteristics (sex, age, appearance, temperament, language potential, special skills, etc.) that the ideal candidate should possess to deal with Iranians. Once you have described your ideal candidates, consider this question: based on the data available to you at this moment, who among your classmates would appear to be the best selection Justify your choice.

As you write your essay, you should consider specifics about Iranian distribution out lets. Iran's cities, like many in the Middle East, can be described as three communities in one:

Modern core Department stores, specialty shops; luxury goods (pre-Khomeini) elitist, Western oriented -clientele; also patronized by middle class.

Traditional core Middle Eastern marketing patterns : open bazaars, with separate sections for specialists (e.g., street of the silversmiths, etc.), family go-downs, (small general stores) clustered along tiny street; lower-middle-class, "traditional," and urban worker clientele.

Worker zones Concentric circles around both cores, each less wealthy than its predecessor, extending outward until they blef1d into the rural villages, from which the cities draw their food.

TUTORIAL A

The second dimension of the economic environment of international marketing *includes* the domestic economy of every nation in which the firm is selling. Thus, the international marketer faces the traditional task of economic analysis, but in a context that may include 100 countries or more. This chapter addresses the economic dimensions of individual world markets. The investigation will, be di-rected toward answering two broad questions: (1) How big is the market? and (2) What is the market like? Answers to the first question help determine the firm's market potential and priorities abroad. Answers to the second question help deter-mine the nature of the market-ing task.

Size of The Market

The firm's concern in examining world markets is the potential they offer for its products. The international marketer must determine market size not only for present markets but also for potential markets. This helps allocate effort among present markets and determine which markets to enter next. Market size for any given product is a function of particular variables, and its determination requires an ad hoc analysis. However, certain general indicators are relevant for many goods. We will see how world markets are described by the following general indicator (1) population growth rates and distribute and (2) income-distribution, Income per casita, and gross national product.

Possible markets are numerous. The *United Nations Statistical Yearbook* lists data for over 200 political entities. Of course, many of these are very small. UN mem-bership itself counts about 185 countries. On a more practical level, the World Bank counts 133 countries with a population of over 1 million. The number of these nations that are worthwhile markets varies according to the firm's situation. However, many companies sell in over 100 markets. Singer and Komatsu, for exam-ple, sell in over 150 countries.

Population

It takes people to make a market and, other things being equal, the larger the pop-ulation in a country, the better the market. Of course, other things are never equal, so population figures in himself or herself are not usually a sufficient guide to market size. Nevertheless, the consumption of many products is correlated with population fig-ures. For many "necessary" goods, such as ethical drugs, health care items, some food products, and educational supplies, population figures may be a good first indicator of market potential. For other products that are low in price or meet particular needs, population also may be a useful market indicator. Products in these latter categories include soft drinks, ballpoint pens, bicycles, and sewing machines.

Population figures are one of the first considerations in analyzing foreign economies. One striking fact is the tremen-dous differences in size of the nations of the world. The largest nation in the world has about 10,000 times the population of the smallest countries. Well over half the people of the world live in the ten coun-tries that have populations of more than 100 million. On the other hand, two-thirds of the countries have populations of less than 10 million, and about 60 have fewer than 1 million people.

The marketer concerned primarily with individual markets, but regional pat-terns can also be important for regional logistics. For example, Asia contains six of the ten most populous markets. By contrast, Africa, the Middle East, and Latin America are rather thinly populated. Nigeria is the only populous African nation, with 115 million people. Turkey is the largest market with 63 million people. Latin America has only two relatively populous countries: Brazil with 161 million and Mex-ico with 93 million. Europe, much smaller in land area but more densely populated, has four countries with populations over 57 million.

Population Growth Rates

The international marketer must be concerned with population trends as well as the current population in a market. This is because many marketing decisions will be af-fected by future developments. Although most countries experience some population many countries. in Western Europe have reached a stationary population.

The World Bank projects the high-income countries' popula-tion will grow at 0 y .3 percent annually to 2010. At the other extreme, the low-income countries are expected to grow at 2.2 percent yearly. China and India are expected to grow at a slower rate but will still add over 300 million to their combined populations. Of a total world population of about~ billion in 2010, the high-income countries will account for less than 1 billion's.

Distribution of Population

Understanding population figures involves more than counting heads. It makes a lot of difference what kind of heads one is counting. The population figures should be classified-by age group, sex, education or occupation, for example-in ways that show the relevant segments of the market.

a. Age- People in different stages of life have different needs and present different marketing opportunities. In the U.S. market, many firms recognize different mar-ket segments related to age groupings. Each country has a somewhat different pro-file as to age groupings. Generally, however, there are two major patterns, one for the developing countries and one for the industrialized countries.

The developing countries are experiencing population growth and have relatively short life ex-pectancies. This means that about 40 percent of their population is in the in active, dependent 0-14 age group adjust over half in the productive 15-64 age group. Contrast that with the rich industrialized countries, which have only 20 percent in the dependent 0-14

group versus two-thirds in the 15-64 groups and over one-eighth in the over-65 category. This "senior" category is a very important market in the high-income countries, but also in China, which has well over 100 million citi-zens in that *group.*

b. Density. The concentration population is important to the marketer in evaluat-ing distribution and communication problems. The United States, for example, had a population density of 29 persons per square kilometer in 1998. This is only about one-fifteenth of the population density of the Netherlands. Even with a mod-ern transportation network, distribution costs in the United States are likely to be higher than in the Netherlands. Promotion is also facilitated where population is concentrated.

Other things being equal, the marketer prefers to operate in markets with con-centrated populations. There is a great difference in population density among na-tions and regions of the world. On a regional basis, population densities range, from less than reasons per square kilometer in Oceania to about 120 per square kilometer in Asia.

Income

Markets require not only people but also people with money. Therefore, it is necessary to examine various income measures in a country to go along with a population analysis. We will look at three aspects of income in foreign markets: the distribu-tion of income among the population, the usefulness of per capita income figures, and gross national product.

Distribution of Income

Some way of understanding the size of a market is to look at the distribution of in-come within it. Per capita income figures are averages and are meaningful, espe-cially. if most people of the country are near the average. Frequently, however, this is not the case. Few nations have a very equal distribution of income among their people, but the high-income economies are somewhat better than the other coun-try categories. In the United States, of course, marketers are very attentive to dif-ferences in income levels if their product is at all income sensitive:

Per Capita Income

The statistic most frequently used to describe a country economically is its per capita income. This figure is used as a shorthand expression for a country's level of economic development. Partial justification for using this figure in evaluating a for-eign economy lies in the fact that it is com-monly available and widely accepted. A more pertinent justification is that it is, in fact, a good indicator of the size or qual-ity of a market.

The per capita income figures vary widely among the countries of the world. Figures for 1998 show Mozambique at $90 per capita and Switzerland at $44,320 as the extreme cases. The World Bank finds over50 percent of the world's popula-tion living in countries with an average per capita income of only $490. That is less than 2 percent of the $25,870 average for the high-income countries. If mar-kets are people with money, these figures show a grim picture of many world mar-kets. Five-sixths of-the world's population has less than one-fourth of the world's GNP.

The bank reports provide a good starting point for foreign market studies. Because per capita income figures are relied on so ex-tensively, however, the following words of caution are in order.

1. **Purchasing Power Not Reflected**. Per capita income comparisons are expressed in a common currency-usually U.S. dollars-through an exchange-rate conversion. The dollar figure for a country is derived by dividing its per capita income figure in national currency by its rate of exchange against the dollar. The resulting dollar statistic for a country's per capita income is accurate only if the exchange rate re-flects the relative domestic purchasing power of the two currencies. There is often reason for doubting that it does.

   The **exchange rate** is the price of one currency in terms of another. The supply and demand determinants of that price are the demand for and supply of foreign exchange, or a country's imports and exports plus speculative demand. A coun-try's external supply and demand have quite a different character from supply and demand within the country. Thus, it is not surprising that the external value of a currency (the exchange rate) may be different from the domestic value of that cur-rency. Furthermore, speculation can further pull a currency away form its "true" value.

2 **Lack of Comparability.** Another limitation to the use of per capita income figures is that there is a twofold lack of comparability. First, many goods entering into the national income totals of the developed economies are only partially in the money economy in less developed countries. A large part of a North American's budget, for example, goes for food, clothing, and shelter. In many less developed nations, these items may be largely self-provided and therefore not reflected in national in-come totals.

   Second, many goods that figure in the national income of developed nations does not figure in the national incomes of poorer countries. For example, a signifi-cant amount of U.S. national income is derived from such items as snow removal, heating buildings and homes, pollution control, military and space expenditures, agricultural support programs, and winter-vacations in Florida or other warmer states.

3. **Sales Not Related to Per Capita Income.** A third limitation to using per capita income figures to indicate market potential is that the sales of many goods show little correlation with per capita income. Many consumer goods sales correlate more closely with population or household figures than with per capita income. Some examples might be Coca-Cola, ballpoint pens, bicycles, sewing machines, and tran-sistor radios. Industrial goods and capital equipment sales generally correlate bet-ter with the industrial structure or total national income than with per capita income.

4. **Uneven Income Distribution.** Finally, per capita figures are less meaningful if there is great unevenness of income distribution in the country.

Gross National Product (GNP)

Another useful way to evaluate foreign markets is to compare their gross national products. Gross national product (GNP)

measures the total domestic and foreign value added claimed by residents. Gross domestic product (GDP) is GNP less net factor income from abroad. For certain goods, total GNP is a better indicator of market potential than is per capita income. Where this is true, it is useful to rank countries by GNP.

Nature of The Economy

In addition to their size and market potential, foreign economies have other characteristics that affect a marketing program, including those produced by the nation's physical endowment, the nature of its economic activity, its infrastructure, and its degree of urbanization.

Physical Endowment

Natural Resources

A nation's natural resources include its actual and potential forms of wealth sup-plied by nature-for example, minerals and waterpower-as well as its land area, topography, and climate. The international marketer needs to understand the eco-nomic geography of a nation in relation to the marketing task there. Land area as such is not very important, except as it figures in population density and distribution -problems. However, local natural resources can be important to the international marketer in evaluating a country as a source of raw materials for local production.

Topography

The surface features of a country's land, including rivers, lakes, forests, deserts, and mountains are its topography. These features interest the international marketer for they indicate possible physical distribution problems.

Flat country generally means easy transportation by road or rail. Mountains are always a barrier that raises transportation costs. Mountains also may divide a nation into two or more distinct markets. For example, the Andes Mountains divide many South American countries into entirely separate areas. Although these areas are united politically, the marketer often finds that culturally and economically they are separate markets. Deserts and tropical forests also separate markets and make transportation difficult. The international marketer analyzes the topography, population and transportation situation to anticipate marketing and logistical problems.

Climate

Another dimension of a nation's physical endowment is its **climate,** which includes riot only the temperature range, but also wind, rain, snow, dryness, and humidity. The United States is very large and has great climatic variations within its borders. Most nations are smaller and have more uniform climatic patterns. Climate is an important determinant of the firm's product offerings. An obvious example is the heater or air conditioner in an automobile. However, climate also affects a whole range of consumer goods from food to clothing and from hous-ing to recreational supplies. Even medical needs in the tropics are different from those in temperate zones.

Nature of Economic Activity

Rostow's View

The stages of economic growth described by economist Walt Rostow provide a use-ful description of foreign economies.[5] According to Rostow, all the nations of the world are in one of the following levels of economic development: (1) the traditional society, (2) the preconditions for takeoff, (3) the takeoff, (4) the drive to maturity, and (5) the age of high mass consumption. Each level represents a dif-ferent type of economy, that is, differing production and marketing systems. The marketing opportunities and problems encountered by the International firm vary according to the host country's stage of economic growth.

Farm or Factory?

One way to determine the kind of market a country offers is to look at the origin of its national product. Is the economy agricultural or industrial? What is the na-ture of its agricultural, manufacturing, and service industries? Such an analysis is especially useful to industrial marketers. However, even consumer goods marketers find that consumer demands and mentality are related to the nature of economic activities in the country. For example, there are invariably differences in the consumption patterns of the farmer compared with those of a factory worker.

Input-Output Tables

If the firm can construct **input-output tables** for its industry for relevant mar-kets, it can gain a better idea of how its supplies or equipment fit in with the indus-trial structure in given markets. Such tables are often used in U.S. marketing, and their use is increasing in international marketing. Although their construction can be difficult; the technique is worth mastering. As our data improve, economic analysis through input-output tables is becoming more common.

Infrastructure of the Nation

A manufacturing firm generally divides its activities into two major categories: production and marketing. These operations depend on supporting facilities and services outside the firm. These external facilities and services are called the infrastructure of an economy. They include paved roads, railroads, energy supplies, and other communication and transport services. The commercial and financial infrastructure includes such things as advertising agencies and media, distributive organizations, marketing research companies, and credit and bank-ing facilities. The more adequate these services in a country, the better the firm can perform its production and marketing tasks there. Where these facilities and services are not adequate, the firm must adapt its operations, or perhaps avoid the market altogether.

Energy

The statistics on energy production per capita serve as a guide to both market po-tential and the adequacy of the local infrastructure. Marketers of electrical ma-chinery and equipment and consumer durables are concerned about the extent of electrification throughout the market. In. countries with low energy consump-tion, the marketer will find that power is available only in the cities, not in the villages or countryside, where most of the population may live. Energy production is also closely inflated to the overall industrialization of an economy and thus is cor-related to the market for industrial goods there. Finally,

energy production per capita is probable best single indicator as to the adequacy of a country's over-all infrastructure.

Transportation

The importance of transportation for business operations needs no elaboration. Transportation capabilities, infrastructure, and modes vary significantly from coun-try to country depending on the topography and level of economic development. The share of road, rail, river, and air transport varies by country but the World Bank has no good comparable data. For information here the firm needs local sources in the market. It can also consult with transportation companies. One good example is given in " Global Marketing" Avon in the Amazon."

Communications

In addition to being able to move its goods, a firm must be able to communicate with its various audiences, especially workers, suppliers and customers. Communi-cations with those outside the firm depend on the communications infrastructure of the country. Intra company communications between subsidiaries or with head-quarters depend equally on local facilities.

Commercial Infrastructure

Equally as important to the firm as the transportation, communication, and energy- capabilities of a nation is its commercial infrastructure. By this is meant the avail-ability and quality of such supporting services as banks and financial institutions, advertising agencies, distribution channels, and marketing research organizations. Firms accustomed to strong supporting services at home often find great differ-ences in foreign markets. Wherever the commercial infrastructure is weak, the firm must make adjustments in its operations, which affect costs and effectiveness.

Urbanization

One of the most significant characteristics of an economy is the extent to which it is Urbanized the degree of urbanization. Numerous cultural and economic differences exist between people in cities and those in villages or rural areas. These differences are reflected in the attitudes of the people. Modern transportation and communica-tion have greatly reduced the differences between urban and rural populations in the United States, but in much of the world the urban-rural differences persist. Because these differences are important determinants of consumer behavior, the international marketer needs to be aware of the situation particular to each market.

Other Characteristics of Foreign Economies

Our survey or foreign economies has been introductory rather than exhaustive. It should be helpful, in giving the market analyst a feel for the relevant dimensions of national economies. Before concluding this chapter, we look briefly at a few other characteristics of foreign economics that can be important in operations there.

Inflation

Each country has its own monetary system and monetary policy—except for the 11 European countries in the Euro group. The result is differing financial environments and rates of inflation among countries. Of all the nations analyzed by the world Bank, less than one half had single – digit annual inflation rates for the period 1990- 1996. That means the others had more serious challenges with double-or triple- digit rates, or worse.

Role of Government

The business environment and the nature of business operations in an economy are very dependent on the role government plays in that economy. If government has strong Socialist leanings, it may restrict the sectors of the economy where private companies may be engaged. Where international companies are allowed to operate, governments have regulations restricting their operations.

In a number of countries, international companies may have the government as a partner in a joint venture. This is especially true in less developed countries that lack a strong private sector to provide the capital. Such a partnership provides its own constraints on the international company.

Foreign Investment in the Economy

When contemplating operations in a foreign economy, the international marketer is interested to know what other international firms are operating there. This information gives clues as to the government's attitude toward foreign companies. It helps to determine something about the competitive environment the firm will encounter.

That a country has few or no international companies operating in it could indicate a good opportunity for one to enter-or it could indicate that the environment is inhospitable. Conversely, an economy that has many international companies operating in it indicates an open market but one that may be very competitive. A distinction must be made, of course, between extractive industries and manufacturing or marketing subsidiaries. Extractive industries go into a country for raw-material supply rather than for marketing reasons.

TUTORIAL B:
TRADE DISTORTIONS AND MARKETING BARRIERS

Free trade makes a great deal of sense theoretically because it increases efficiency and economic welfare for all involved nations and their citizens. South Korea's trade barriers, however, do not represent an insolated case. In practice, free trade is woefully ignored by virtually all countries. Despite the advantages, nations are inclined to discourage free trade.

The National Estimate Report on Foreign Trade Barriers, issued by the U.S. Trade Representative, defines trade barriers as " government laws, regulations, policies, or proactive that either protect domestic producers from foreign competition or artificially stimulate exports of particular domestic products. Restrictive businesses practices and government regulations designed to protect public health and national security are not considered as trade barriers. The report classifies the trade barriers into eight categories. (1) Import policies (e.g., tariffs, quotas, licensing, and customs barriers); (2) standards, testing, labeling, and certification; (3) government procurement; (4) export subsidies; (5) lack of intellectual property protection; (6) services barriers (e.g., restrictions on the use of foreign data processing); (7) investment barriers; and (8) other barriers.

Protection of Local Industries

Why do nations impede free trade when the inhibition is irrational? One reason why governments interfere with free marketing is to protect local industries, often at the expense of local consumers as well as consumers worldwide. Regulations are created to keep out or hamper the entry of foreign made products. Arguments for the protection of local industries usually take one of the following forms: (1) keeping money at home, (2) reducing unemployment, (3) equalizing cost and price, (4) enhancing national security, and (5) protecting infant industry.

Keeping money at Home

Trade unions and protectionists often argue that international trade will lead to an outflow of money, making foreigners richer and local people poorer this argument is based on the fallacy of regarding money as the sole indicator of wealth. Other assets, even products, can also be indicators of wealth.

Reducing Unemployment

It is a standard practice for trade unions and politicians to attack imports and international trade in the name of job protection.

The argument is based on the assumption that import reduction will create more demand for local product and subsequently create more jobs.

Another problem with protectionism is that it may lead to inflation. Instead of using protective relief to gain or regain market share and for competitive investment, local manufactures often cannot resist the temptation of increasing their prices for quick profits.

Equalizing Cost and Price

Some protectionists attempt to justify their actions by invoking economic theory. They argue that foreign goods have lower prices because of lower production costs. Therefore, trade barriers are needed to make prices of imported products less competitive and local items more competitive. This argument is not persuasive to most analysts for several reasons. First, to determine the cause of price differential is unusually difficult. Is it caused by labor, raw materials, efficiency, or subsidy? Furthermore, costs and objectives vary greatly among countries, making it impossible to determine just what cost need to be equalized.

Second, even if the causes of price differentials can be isolated and determined, it is hard to understand why price and cost have to be artificially equalized in the first place. Trade between nations takes place because of price differentials; otherwise, there is no incentive to trade at all.

Enhancing National Security

Protectionists often present themselves as patriots. They usually claim that a nation should be self sufficient and willing to pay for inefficiency in order to enhance national security.

Opponents of protectionism dismiss appeals to national security. A nation can never be completely self - sufficient because raw materials are not found in the same proportion in all areas of the world.

Protecting Infant Industry

The necessity to protect an infant industry is perhaps the most credible argument for protectionist measures. Some industries need to be protected until they become viable. South Korea serves as a good example. It has performed well by selectively protecting infant industries for export purpose.

In practice it is not an easy task to protect industries. First, the government must identify deserving industries. Next, appropriate incentives must be created to encourage productivity. Finally, the government has to make sure that the resultant protection is only temporary.[2] there is a question of how long an " infant " needs to grow up to bean " adult " .

Marketing Barriers Tariffs

Tariff, derived from a French word-meaning rate, price, or list of charges, is a customs duty or a tax on products that move across borders. Tariffs can be classified in several ways. The classification scheme used here is based on direction, purpose, length, rate, and distributions point. These classifications are not necessarily mutually exclusive.

1. Direction: import and Export Tariffs

   Tariffs are often imposed on the basis of the direction of product movement that is, on imports or exports or exports, with the latter being the less common one. When export tariffs are levied, they usually apply to an exporting country's scarce resources or raw materials (rather than finished manufactured products.)

2. Purpose: protective and Revenue Tariffs

   Tariffs can be classified as protective tariffs and revenue tariffs. The distinction is based on purpose. The purpose of a protective tariff is to protect home industry, agriculture, and labor against foreign competitors by trying to keep foreign goods out of the country. The South American markets, for instance, have high import duties that hinder the import of fully built cars. Brazil has a 50 percent import tax on imported " flyaway " plans.

   The purpose of a revenue tariff, in contrast, is to generate tax revenues for the government. Compared to a protective tariff, a revenue tariff is relatively low. When Japanese and other foreign cars are imported into the United States, there is a 3 percent duty. On the other hand, American cars exported to Japan are subject to variety of import taxes.

3. Length: Tariff Surcharge versus Countervailing Duty

   Protective tariffs can be further classified according to length of time. A tariff surcharge is a temporary action, whereas a countervailing duty is permanent surcharge. When Harley Davidson claimed that it needed time to adjust to Japanese imports. President Reagan felt that it was in the national interest to provide import relief. To protect the local industry, a tariff surcharge was used. The tariff on heavy motorcycles jumped from 4.4 percent to 45 percent for one year and then declined to 35 percent, 20 percent, 15 percent, and finally 10 percent in subsequent years.

   Countervailing duties are imposed on certain imports when foreign governments subsidize products. These duties are thus assessed to offset a special advantage or discount allowed by an exporters government. Usually, a government provides an export subsidy by rebating certain taxes if goods are exported.

4. Rates: specific, ad Valorem, and Combined

   How are tax rates applied? To understand the computation, three kinds of tax rates must be distinguished specific, ad valorem, and combined.

   Specific duties are a fixed or specified amount of money per unit of weight, gauge, or other measure of quantity. Based on a standard physical unit of a product, they are specific rates of so many dollars or cents for a given unit of measure (e.g., $1/ gallon, 25¢/ square yard, $2/ton, etc.) product casts or prices are irrelevant in this case. Because the duties are constant for low- and high priced products of the same kind, this method is discriminatory and effective for protection against cheap products because of their lower unit value.

   Ad valorem duties are duties "according to value" They are stated as a fixed percentage of the invoice value and are applied as a percentage to the dutiable value of the imported goods. Japan's ad valorem tariffs on beef and processed cheese are 25 percent and 35 percent, respectively.

   Based on this method, there is a direct relationship between the total duties collected and the prices of products. That is, the absolute amount of total duties collected will increase or decrease with the prices of imported products.

   Combined rates (or compound duty) are a combination of the specific and ad valorem duties on a single product. They are duties based on both the specific rate and the ad valorem rate that are applied to an imported product. For example, the tariff may be 10¢ per pound plus 5 percent ad valorem. Under this system, both rates are used together, though in some countries only the rate producing more revenue may apply.

5. Distribution point: Distribution and consumption taxes

   Some taxes are collected at a particular point of distribution or when purchases and consumption occur. These indirect taxes, frequently adjusted at the border, are of four kinds: single stage, value added, cascade, and excise.

   Single stage sales tax is a tax only at one point in the manufacturing and distribution chain.

   A value added tax (VAT) Is a multistage, noncullative tax on consumption. It is a national sales tax levied at each stage of the production and distribution system, though only on the value added at that stage. In other words, each time a product changes hands, even between middlemen, a tax must be paid. But the tax collected at that point. Sellers in the chain collect the VAT from a buyer, deduct the amount of VAT they have already paid on their purchase of the product, and remit the balance to the government.

Cascade taxes are collected at each point in the manufacturing and distribution chain and are levied on the total value of a product, including taxes borne by the product at earlier stages.

An excise tax is a one time charge levied on the sales of specified products. Alcoholic beverages and cigarettes are good examples. In lower process of exports. Prices of imports are raised by charging imported goods with (in addition to customs duties) a tax usually borne by domestic products. For exported products, their export prices become more competitive (i.e., lower) when such products are relieved of the same tax that they are subject to when produced, sold, and consumed domestically. The rebate of this tax when the goods are exported, in effect, lowers their export prices.

Many countries have a **turnover or equalization tax.** This tax is intended to compensate for similar taxes levied on domestic products. Any critical examination of this would demonstrate that the tax does not domestic products; any critical examination of this would demonstrate that the tax rate is applied to the imported and domestic products, the effect is uneven. There is a greater impact on the import because the tax is usually levied on the full CIF, duty-paid value, rather than on the invoice value alone.

Marketing Barriers: Nontariff Barriers

Tariffs, though generally undesirable, are at least straightforward and obvious. Non-tariff barriers, in comparison, are more elusive or nontransparent. Tariffs have declined in importance, while no tariff barriers have become more prominent. Often disguised, the impact of no tariff barriers can be just as devastating, if not more, as the impact of tariffs.

Government Participation in Trade

The degree of government involvement in trade varies form passive to active. The types of participation include administrative guidance, state trading, and subsidies.

1. **Administrative Guidance** many governments routinely provide trade consultation to private companies. Japan has been doing this on a regular basis to help implement its industrial policies. This systematic cooperation between the government and business is labeled "Japan, Inc." to get private firms to conform to the Japanese government 2& #1& s guidance, the government uses a carrot and stick approach by exerting the influence through regulations, recommendations, encouragement, discouragement, or prohibition. Japan's government agencies' administrative councils are influential enough to make importers restrict their purchases to an amount not exceeding a certain percentage of local demand.
2. **Government procurement and state trading** state trading is the ultimate in government participation, because the government itself is now the customer or buyer who determines what, when where, how and how much to buy. In this practice the state engages in commercial operations, either directly or indirectly, through the agencies under its control, such business activities are either in place of or in addition to private firms.
3. **Subsidies** According to GATT, "subsidy is a "financial contribution " provided directly or indirectly by a government and which confers a benefit " subsidies can take many forms- including cash, interest rate, value added tax, corporate income tax, sales tax, freight, insurance, and budgetary subsidies are among the various subsidy policies of several Asian countries.

Customs and Entry Procedures

Customs and entry procedures can be employed as no tariff barriers. These restrictions involve classification, valuation, documentation, license, inspection, and health and safety regulations.

1. **Classification-** How a product is classified can be arbitrary and inconsistent and is often based on a customs officer 2& #1& s judgment, at least at the time of entry. The U.S customs reclassified Nissan 2& #1& s imported truck cabs and chassis from " parts " with 4 percent duty to " assembled vehicles " subject to 25 levies instead.
2. **Valuation- Regardless** of how products are classified, each product must still be valued. The value affects the amount of tariffs levied. A customs appraiser is the one who determines the value. The process can be highly subjective, and the valuation of a product can be interpreted in different ways, depending on what value is used (e.g., foreign, export, import, or manufacturing costs) and how this value is constructed.
3. **Documentation -** Documentation can another problem at entry because many documents and forms are often necessary, and the documents required can be complicated.

   Documentation requirements vary from country to country. Usually, the following shipping documents are either required or requested commercial invoice, Performa invoice, certificate of origin, bill of landing, pacing list, incurrence certificate, import license, and shippers export declarations. Without proper documentation, goods may not be cleared through customs. At the very least, such complicated and lengthy documents serve to slow down product clearance.
4. **License or permit** not all products can be freely imported; controlled imports require licenses or permits. For example, importations of distilled spirits, wines, malt beverages, arms, ammunition, and explosives into the United States require a license issued by the Bureau of Alcohol, Tobacco, and Firearms. India requires license fro all imported goods.[18] an article is considered prohibited if not accompanied by license. It is not always easy to obtain an import license, since many c untried will issue one only if goods can be certified as being necessary.
5. **Inspection** is an integral part of product clearance. Goods must be examined to determine quality and quantity. This step is highly related to other customs and entry procedures. First, inspection classifies and values products for tariff purposes. Second, inspection reveals whether imported items are consistent with those specified in the accompanying documents and whether such items require any licenses. Third, inspection determines whether products meet health and safety regulations in order to make certain that food products are fit for human consumption or that the products can be operated safely. Fourth, inspection prevents the importation of prohibited articles.

   Marketers should be careful in stating the amount and quality of products, a from the United states, for instance, have a potential for selling very will in the Japanese market. But a major obstacle is that every single bat must carry a stamp of consumer safety, and this must be " ascertained " only after expensive on dock inspection, more delay, and more expenses.
6. **Health & Safety Regulations -** many products are subject to health and safety regulations, which are necessary to protect the public health and environment. Health and safety regulations are not restricted to agricultural products. The regulations also apply to TV receivers, microwave ovens, X-ray devices, cosmetics, chemical substances, and wearing apparel.

Product Requirements

For goods to enter a country, product requirements set by that country must be met. Requirements may apply to product standards and product specifications as well as to packaging, labeling, and marketing.

1. **Product standards** each country determines its own product standards to protect the health and safety of its consumers. Such standards may also be erected as barriers to prevent or to slow down importation of foreign goods.
2. **Packaging, Labeling, and marking** packaging, labeling, and marketing are considered together because they are highly interrelated. Many products must be packaged in a certain way for safety and other reasons.
3. **Product Testing** Many products must be tested to determine their safety and suitability before they can be marketed. This is another area in which the United States has some troubles in Japan. Although products may have won approval everywhere else for safety and effectiveness, such

products as medical equipment and pharmaceuticals must go through elaborate standards testing that can take a few years 2& #1& just long enough for Japanese companies to develop competing products.

4. **Product specifications -**product specifications, though appearing to be an innocent process, can wreak havoc on imports. Specifications can be written in such a way as to favor local bidders and to keep out foreign suppliers. For example, specifications can be extremely detailed, or they can be written to closely resemble domestic products. Thus, they can be used against foreign suppliers who cannot satisfy the specifications without expensive or lengthy modification.

Quotas

1. **Quotas** are a quantity control on imported goods. Generally, they are specific provisions limiting the amount of foreign products imported in order to protect local firms and to conserve foreign currency. Quotas can be used for export control as well. An export quota is sometimes required by national planning to preserve scarce resources. From policy standpoint, a quota is not as desirable as a tariff since a quota generates no revenues for a country. There are three kinds of quotas: absolute, tariff, and voluntary.
2. **Absolute Quotas-** An **absolute quota** is the most restrictive of all. It limits in absolute terms the amount imported during a quota period. Once filled, further entries are prohibited. Some quotas are global, but others are allocated to specific foreign countries.
3. **Tariff Quotas- A tariff quota** permits the entry of a limited quantity of the quota product at a reduced rate of duty. Quantities in excess of the quota can be imported but are subject to a higher duty rate. Through the use of tariff quotas, a combination of tariffs and quotas is applied with the primary purpose of importing what is needed and discouraging excessive quantities through higher tariffs.
4. **Voluntary Quotas- a voluntary quota** differs from the other two kinds of quotas, which are unilaterally imposed. A voluntary quota is a formal agreement between nations or between a nation and an industry. This agreement usually specifies the limit of supply by product, country, and volume.

Financial Control

Financial regulations can also function to restrict international trade. These restrictive monetary policies are designed to control flow so that currencies can be defended or imports controlled. For example, to defend the weal Italian lira, Italy imposed a 7 percent tax on the purchase of foreign currencies. There are several forms that financial restrictions can take.

1. Exchange control -An exchange control is a technique that limits the amount of the currency that can be taken abroad. The reason exchange controls are usually applied is that the local currency is overvalued, thus causing imports to be paid for in smaller amounts of currency. Purchasers then try to use the relatively cheap foreign exchange to obtain items either unavailable or more expensive in the local currency. Exchange controls also limit the length of time and amount of money an exporter can hold for the goods sold.
2. Multiple exchange Rates multiple rates a form of exchange regulation or barrier. The objectives of multiple exchange rates are twofold: to encourage exports and imports of certain goods and to discourage exports and imports of certain goods and to discourage exports and imports of others. This means that there is no single rate for all products or industries. But with the application of multiple exchange rates, some products and industries will benefit and some will not.
3. Prior import Deposits and credit Restrictions. Financial barriers can also include specific limitations or import restraints, such as prior import deposits and credit restrictions. Both of these barriers operate by imposing certain financial restrictions on importers. A government can require prior import deposits (forced deposits) that make imports difficult by tying up an importer 2& #1& s capital. In effect the importer is paying interest for money borrowed without being able to use the money or get interest earnings on the money from the government.

   Credit restrictions apply only to imports; that is, exporters may be able to get loans from the government, usually at very favorable rates, but importers will not be able to receive any credit or financing from the government. Importers must look for loans in the private sector-=- very likely at significantly higher rates, if such loans are available at all.
4. Profit Remittance Restrictions another form of exchange barrier is the profit remittance restriction. ASEAN countries share a common philosophy in allowing unrestricted repatriation of profits earned by foreign companies. Singapore, in particular, allows the unrestricted movement of capital. But many countries regulate the remittance of profits earned in local operations and sent to a parent organisation located abroad.

Partner or Enemy?

By Philip R. Agress And Krysten B. Jenci

Office of *Japan Trade Policy U.S. Department* of Commerce

There is no telling how different our streets and high-ways would look had Japanese car companies not been able to sell their cars in the U.S. market when they first came to the United States in the 1960s and 1970s. Since the days of the ultra-compact Honda Civics which could barely make it up the hilly roads in California, U.S. consumers have had the opportunity to choose from a wide variety of high-quality Japanese cars and parts. In fact, in the last twenty-five years, Japan has sent 40 million cars to the United States.

This competition from Japan has helped ensure that U.S. auto and auto parts companies remain top-notch, world-class competitors. Is the U.S. auto and auto parts company's fierce competitors in the United States, they also compete aggressively all over the world.

In Japan the U.S. companies have taken specific steps to tailor their products specifically to Japanese consumers. Today, American auto manufacturers sell 101 products in the Japanese

market, sixty of which are right-hand drive vehicles. These include the Jeep Cherokee, Ford Probe and Mondeo, and GM Opel. More are, on the way. But in .the last/twenty-five years, the United States has only shipped 400,000 cars to Japan.

In the recently concluded automobile negotia-tions with Japan, all the United States asked was that Japan provides the same free access to its market that we provide to their companies here. Denial of this ac-cess has cost substantial loss bf jobs and business op-portunities in the. United States and other countries.

Ford, GM, Chrysler, and U.S. parts manufactur-ers have had great success in markets all over the world from Europe to other Asian markets. But when they have tried to sell their products in Japan, they con-fronted a web of unnecessary and burdensome regu-lations, informal and artificial barriers, and business practices that made it extremely difficult to sell their products in Japan.

After a significant investment of time and re-sources trying to crack the Japanese market, these companies turned to the U.S. Government for help in trying to weed through some of the burdensome reg-ulations, break up some of the exclusive business re-lationships, and create an environment which would al-low them to sell their autos and auto parts in Japan.

The Clinton Administration was eager to take on the challenge. After all, autos and auto parts represent nearly 60 percent of our trade deficit with Japan. These industries support about 2.5 million U.S. jobs in sec-tors from semiconductors to rubber and glass.

The Agreement

After twenty-two months of intensive negotiations with Japan, a negotiating team led by Under Secretary, of Commerce for International Trade Jeffrey E. Garten, and Ambassador Ira Shapiro from USTR, reached an historic, market-opening agreement on autos and auto parts on June 28, 1995.

This agreement will increase access to Japanese dealerships for U.S. auto manufacturers, help deregu-late Japan's repair parts market, and lead to increased Japanese purchases of U.S. parts both here and in Japan. Accomplishments in these three areas should go a long way in helping U.S. auto and auto parts companies substan-tially increase their sales to Japanese companies.

Dealerships

One key problem for U.S. auto companies trying to sell their products in Japan is that they were effectively blocked from getting their cars to Japanese show-rooms. This was because Japanese dealers were afraid that their primary Japanese suppliers would retaliate against them if they entered into independent franchise agreements with foreign vehicle manufac-turers. As a result of the agreement, the Japanese Government has promised to vigorously enforce its antitrust laws, and to take actions to assure Japanese dealers that they are free to carry foreign cars, without risking business re-lationships with their primary suppliers.

As a result of this agreement, we expect U.S. auto companies to open an additional 200 outlets in Japan by 1996, and 1,000 new outlets by the year 2000.

Deregulation of Aftermarket For Parts

U.S. parts suppliers also faced great difficulties trying to sell their replacement parts in the Japanese aftermar-ket. To deal with this problem, the United States sought to substantially reduce the number of Japanese regulations that greatly constrain consumer choice and the ability of foreign suppliers to have their products reach the 'end-user. The multi-billion-dollar Japanese market for replacement auto parts is restricted by a complex system of regulations that go well beyond what is needed for safety or environmental protection. These regulations involve a complex car inspection system that forces Japanese consumers to have their cars repaired in "certified" garage_ that tend to only carry Japanese parts. The regulations also stipulate that any repair to "critical" parts must be done at special garages, and that any modifications made to cars must be reinspected.

One American expert on this system recently said in a *Japan Digest* article, "It's a no-brainer to say that $1 U.S.-made spark plugs should have long since captured 100 percent of a market in which Japanese plugs sell for $8 apiece. They haven't because inspection laws com-pel drivers to use 'authorized' parts. Toyotas can only use pure Toyota parts, Nissans pure Nissan parts, etc.

Spark plugs are just one example. Because of Japan's closed market and the lack of competition, prices for auto parts far exceed prices in the United States. An alternator which sells for $120 in the United States sells for $600 in Japan. Shock absorbers that sell in the United States for $228 sell for $605 in Japan. As a result of the automotive agreement, Japanese con-sumers should now be able to save over $300 when they need new shocks for their cars by purchasing high- quality U.S. products.

The agreement cuts through some of the bur-densome aftermarket regulations, and allows market forces a greater chance to work properly in ensuring that the best quality and lowest-priced products reach the Japanese consumer. The agreement specifically re-duces the number of parts on the "critical parts" list, reduces the number of modifications subject to in-spection, and makes it easier to establish garages that can sell foreign auto parts.

Original Equipment Parts Purchases

In the area of original equipment parts sales to Japan-ese manufacturers in Japan as well as the. United States, the U.S. addressed a very real problem: the: closed "keiretsu" purchasing relationships between Japanese manufacturers and their key suppliers. Despite the world-class competitiveness and strong price advan-tages of U.S. parts suppliers, Japanese manufactur-ers have simply not been responding to market forces.

To help address this situation, the five major Japanese auto manufacturers have released business plans which will lead to increased parts purchases by Japanese transplants in the United States, increased auto production in the United States, and increased im-ports of foreign auto parts into Japan. We expect that the transplants wilt purchase $6.75 billion more in parts from U.S. suppliers by 1998, Japanese car makers will increase auto production in the U.S. to 2.65 million in 1998, and Japan will import $6 billion worth of foreign parts by 1997.

Many agencies in the U.S. Government con-tributed to bringing about an agreement in this sector so critical to our nation's economy. The Commerce De-partment, which played a key role throughout the nearly 2 years of talks, succeeded in working with other gov-ernmental agencies and industry groups to avoid a seri-ous trade conflict with Japan, and in reaching a mean-ingful agreement. International Economic Policy's Office of Japan led die negotiations within the Department, along with Trade Development's Office of Automotive Affairs. Ambassador Mickey Kantor, the United States Trade Representative, acknowledged this fact when he stressed in a recent letter to Senator Bob Dole, " . . . the Commerce Department provides essential analytic sup-port and in-depth knowledge of foreign trade practices that have been invaluable to USTR and other agencies involved in negotiation and implementing trade agree-ments . . . the Commerce Department's detailed knowledge or-the 'Japanese automotive sector has been *e*ssential to our efforts to open the Japanese auto and auto parts markets to foreign competition."

Of course, an international trade agreement is only as good as its implementation. The Commerce Department will be responsible for carefully monitoring and implementing this agreement. Martina Bradford, Vice President for government affairs at A T& T Corp., recently said in a *Washington Post* article, "trade agree-ments only yield results through vigorous monitoring, enforcement and measurement of results." The De-partment of Commerce will implement this agreement with the vigor and energy it demonstrated in helping to negotiate it.

As former Secretary of Commerce Ron Brown noted, "The Commerce Department is proud to have played such a critical role in negotiating an agreement which deals with many of the very real and specific problems U.S. businesses face in trying to penetrate the Japanese market." The level of cooperation demon-strated by the Department of Commerce, USTR, and the U.S. auto and auto parts industries in developing an agreement which deals with such complex and tech-nical barriers and regulations in Japan should set a new standard for future negotiations in other areas.

U.S.-Japan Auto and Auto Parts Agreement Fact Sheet

The United States and Japan on June 28 reached an his-toric agreement, which will result in significantly in-creased market access for autos and auto parts, and structural change in the Japanese automotive sector.

This is the sixteenth trade agreement the Clin-ton Administration has completed with Japan in the past twenty-eight months-an unprecedented rate of success. These agreements have opened major trade sectors.

The missing piece has been the autos and auto parts sector. This area represents $37 billion of our $66 billion trade deficit with Japan, nearly 60 percent of our Japan deficit and 25 percent of our overall trade deficit.

Since auto negotiations began in October 1993, the Administration has emphasized three overriding goals for opening the auto and auto parts sector. This agreement meets our goals in' each area:

- **Deregulation of the Replacement Parts Mar-ket in Japan**: A thicket of bureaucratic regulations have blocked competitive U.s. auto parts from Japan's multibillion-dollar market for replacement parts. This agreement clears away layers of need-less regulations, introducing new competition and opening a market previously reserved for Japanese suppliers.
- **Access to Dealerships:** This agreement will give U.s. auto companies increased access to Japanese dealership networks. U.S. auto companies will be able to sell through more dealerships in Japan. Japanese consumers will have the option to buy our reasonably priced, high-quality cars. We expect U.S. auto companies to open an additional 200 outlets by 1996 and 1,000 new outlets by 2000, to support the U.S. industry's objective of exporting 300,000 vehicles by the year 2000.
- **Increased Purchases of Original Equipment Parts**: In Japanese companies, the original equip-ment auto parts market is dominated by "keiretsu"-unique, interlocking relationships be-tween manufacturers, suppliers, distributors, and fi-nancial institutions. The keiretsu act unfairly to block foreign access to the market

Japan's five largest auto companies are an-nouncing plans to increase their parts purchases in North America, including diversification into high-value components such as transmissions and engines; to increase their vehicle production in North America by $6.7 billion; and to purchase $6 billion of foreign parts by 1998 for production use in Japan.

Questions

1. Does Japan's trade success owe more to its man-ufacturing superiority or to its mercantilistic trad-ing philosophy (i.e. import barriers)? Does the Japanese government use non-tariff barriers unrea-sonably to restrict imports?
2. Given the huge trade deficit the United States has with Japan, should the United States continue to trade with Japan?
3. Some claim that U.S. trade deficits are caused by U.S. adoption of a free-trade philosophy. Do you think that the United States has fewer import bar-riers than its trading partners?
4. Will protectionist measures adopted by the U.S. government be effective in increasing employment in the United States? Do you think that the U.S. government's use of OMAs against Japanese auto imports benefits the United States?
5. What can U.S. firms (including auto makers) do to overcome Japanese trade barriers and improve their performance?

CASE 1:
SELLING U.S. ICE CREAM IN KOREA

Effect of Controllable and Uncontrollable Factors

The call from Hong Kong was intriguing: Go to South Korea and be the franchisee of an American premium ice cream to capitalize on the Koreans' new disposable income and their growing appetite for Western fast-food products.

Within six months of my application, the government granted me permission to bring the ice cream, Hobson's, to Seoul with only two non-tariff trade conditions: Make my ice cream in Korea after a year of operation and at the same time take on a Korean partner who had at least a 25 percent stake in the company.

I agreed, and chose Itaewon for my site, figuring that between the Korean bar girls and the U.S. Army up the road it would give me a good cross-section of East and West.

The Early Years-Getting Started. Almost a half-year after start-up, I still thought it was a timely idea but it certainly hadn't been easy pickings. The Korean bar girls, for instance, thought my ice cream was too expensive, and Koreans in general are highly suspicious of new products. Government red tape has always been horrendous and foreigners are not welcome.

But because internationalization and economic progress are hard to separate, Seoul had been coming to accept foreigners and their products as a necessary ingredient for their own growth.

The irony, however, is that Korean intransigence was not the only problem a Yankee entrepreneur faced here: Washington trade- bashing can take its toll as well. In the mid-1990s the U.S. govern-ment had been pressuring this country to raise the value of the won, to make Korean exports more expensive and U.S. imports less. On top of this was Congress's omnibus trade bill, which forces Korea to open its markets or face punitive sanctions on its own exports to the United States. Although these efforts were de-signed to help American traders like me, I have seen all too often how the best-laid political plans can actually make it more diffi-cult for us to maintain a foothold in these countries.

In fairness, it also must be said that some American companies often bring this on themselves. Evidence indicates that American companies are badly outclassed by their failure to take Asian mar-kets seriously and a tendency to follow the laws of least resistance by concentrating on selling within the borders of the United States.

American companies have tried to cheat by getting Congress to force not only Korea, but also Japan, Hong Kong, Singapore, and other countries to raise the value of their currency. Those forces drove the won to a value of 590 to 600 won for one dollar by the end of 1994, when just two years earlier $1 would buy 890 won. I thus found myself importing more dollars just to stay even with my original projections when it was 800 won to the dollar. In other words, it cost me 16 percent more dollars just to get started operating, and that was the margin I was hoping I could apply to- ward profits. Any price increase to recoup losses risked pricing my ice cream out of the Korean market.

Another result of exchange rate jiggling was inflation. This was a by-product of the won's strengthening against the dollar, re-flected in the many outside investment dollars trying to find a home in Korea's currency and stock market.

Consequently, everything came with a price tag that equaled or exceeded what one could buy in the United States. On top of this were import taxes, tariffs, and non-tariff barriers on imported capi-tal goods and, in my case, finished ice cream. Duties, for example, ranged from 20-38 percent additional money.

U.S. trade bullying also fans the flames of anti-Americanism here, and American business pays for that. Even though Washing-ton had some legitimate gripes about closed Korean markets, Ko-reans felt that they were being pushed around and that the United States didn't recognize the great strides they had made. For me this resentment translated into vandalism of my storefront prop-erty, such as knocked-down signs, broken patio tables and chairs, pane-glass windows smeared with soda and dirt, and even human feces left on my doorstep. It also mani-fested itself by Koreans staying away from buying my ice cream.

The Korean bureaucracy seemed to share the suspicion of for-eigners trying to do business here. When I made arrangements for the arrival of my first ice cream shipment into Pusan a month be-fore the scheduled opening of my store, the authorities informed me that they couldn't care less about my ice cream and that I was illegally in the country. The upshot was my lawyers spent three weeks trying to persuade some second-echelon bureaucrat that I was here under valid reasons, to no avail. Desperate, and a day away from packing my bags and buying a one-way ticket to Cali-fornia, I called the one friend I had in the government. By a one--in-a-thousand chance, he knew the second-echelon bureaucrat and was able to clear away his "mental block" about me.

But this was a fluke. I have no doubt that the mental block was the Korean dairy farmers complaining about foreign imports of ice cream, which in turn was part of the bigger picture of pressure that Korean agriculture was receiving from U.S. trade negotiators to open its market.

Finally, coinciding with the Olympic games in Seoul the Ko-rean economy really began to take off. By the mid-1990s South Koreans were buying more products from all over the world. The efforts of our trade negotiators and trade policies appar-ently were finally having some effect. A few American companies like mine were at last enjoying moderate successes in South Korea, but some were still not.

The question was whether all American companies could take advantage of the "much broader access" into the Korean

market. Some Korean business leaders criticized the level of effort of some American managers. Woo Choong Kim, founder of the Dae-woo business empire, said: "In the old days, Americans worked hard to challenge new frontiers. But as their economy got mature, they became more interested in nice houses, jogging, and having a good time than in doing business. How can you compete without dedication? It is not the management system that is not working in American companies, it is the people not working hard."

Indeed, one U.S. Commerce Secretary lamented at the time that although Americans are great at coming up with new inventions, they "are not good at getting them into products to be sold."

Establishing a Beachhead. For example, in the early 1990s Korean executives were almost throwing machine-tool and welding-machine orders at American companies-with the U.S. con-cerns dropping the ball almost every time. The reasons given by Koreans were various: inflexibility about the terms of a contract, poor service, or just plain not trying hard enough (e.g., not work-ing on Saturdays). The one American company that did measure up was Varian Associates. Its management team had projected that the bulk of world manufacturing would be done in Asia in the next few decades and that U.S. companies were missing out on Asia's rush to outfit the factories building more and more of the world's cars, computers, and fast-food plants.

Varian installed 18 Korean nationals and several expatriates in a Seoul office to market its equipment and match Japanese service. Unlike many other American companies, Varian had ac-commodated the Korean culture and way of doing business by establishing a beachhead presence in one of the world's fastest- growing markets.

Surviving the New Disasters. For almost 10 years now the business partnership in South Korea has been rewarding. Yes, there have been ups and downs, but I myself have learned that it is important to be here and to learn their ways. In doing so, we have helped each other. The Korean company I chose to do business with, for example, is learning from me an ice cream-making tech-nology and formula that enhances its competitiveness in that in-dustry at home and abroad. I, in turn, am learning from my partner how to be competitive in Korea.

Despite what we have gained from our South Korean adventure two new problems challenge us now. First is the meltdown of the Korean won during the winter of 1997-98. In that time period the won's, value halved from 860 to the dollar to 1710 to the dol-lar. This has proven to be a disaster for our imports of ice cream, and for our fellow American competitors as well. We are some-what more competitive because part of our production is local, thank goodness. But the general consumers' reaction against im-ports in a time of financial crisis has made the whole ice cream category less appealing.

Then throw on top of that the contamination scare and our sales really tanked. This last problem got started in October 1997 when E. coil bacteria were discovered on the surface of some imported American beef here in South Korea. When Hong Kong authorities found bacteria contaminating American ice cream shipments there, Korean authorities began to check here as well. Sure enough, they found a different form of dangerous bac-teria in one American brand. Now all brands are receiving more scrutiny from government health officials and concerned con-sumers alike.

Questions

1. Identify each of the domestic and foreign uncontrollable elements that this U.S. ice cream franchisee encountered in Korea.
2. Describe how problems encountered with each uncontrollable element may have been avoided or compensated for had the element been recognized in the planning stage.
3. Identify other problems the franchisee may encounter in the future.

CASE 2 :
UNILEVER AND NESTLE-AN ANALYSIS

While Unilever and Nestle have engaged in international market-ing their entire corporate existence, they are very different compa-nies in their approaches to international marketing and corporate philosophies. Both companies maintain very extensive Web sites. Your challenge in this case is to visit both Web sites, carefully read the information presented, and write a report comparing the two companies on the points that follow.

1. Philosophies on international marketing.
2. Corporate objectives.
3. Global coverage, that is, number of countries in which they do business.
4. Production facilities.
5. Number of product categories and number of brands within each category.
6. Number of standardized versus global brands for each.
7. Product categories and brands where the two companies compete.
8. Brands that are standardized, that is, what is standardized in each brand and what are localized in each brand.
9. Product research centers.
10. Organization.
11. Environmental concerns.
12. Research and development.

After completing your analysis, write a brief statement about the area(s) where Uni-lever is stronger than Nestle and vice versa, and where Uni-lever is weaker than Nestle and vice versa.

CASE 3:
NESTLE-THE INFANT FORMULA INCIDENT

Nestle Alimentana of Vevey, Switzerland, one of the world's largest food-processing companies with worldwide sales of over $8 billion, has been the subject of an international boycott. For over 20 years, beginning with a Pan American Health Organiza-tion allegation, Nestle has been directly or indirectly charged with involvement in the death of Third World infants. The charges re-volve around the sale of infant feeding formula, which allegedly is the cause for mass deaths of babies in the Third World.

In 1974 a British journalist published a report that suggested that powdered-formula manufacturers contributed to the death of Third World infants by hard-selling their products to people inca-pable of using them properly. The 28-page report accused the industry of encouraging mothers to give up breast-feeding and use powdered milk formulas. The report was later pub-lished by the Third World Working Group a lobby in support of less-developed countries. The pamphlet was entitled, "Nestle Kills Babies," and accused Nestle of unethical and immoral behavior.

Although there are several companies that market infant baby formula internationally, Nestle received most of the attention. This incident raises several issues important to all multinational com-panies. Before addressing these issues, let's look more closely at the charges by the Infant Formula Action Coalition (INFACT) and others and the defense by Nestle.

The Charges. Most of the charges against infant formulas fo-cus on the issue of whether advertising and marketing of such products have discouraged breast feeding among Third World mothers and have led to misuse of the products, thus contrib-uting to infant malnutrition and death. Following are some of the charges made:

- A Peruvian nurse reported that formula had found its way to Amazon tribes deep in the jungles of northern Peru. There, where the only water comes from a highly contaminated river-that also serves as the local laundry and toilet -formula-fed babies came down with recurring attacks of diarrhea and vomiting.
- Throughout the Third World, many parents dilute the formula to stretch their supply. Some even believe the bottle itself has nutrient qualities and merely fill it with water. The result is extreme malnutrition.
- One doctor reported that in a rural area, one newborn male weighed 7 pounds. At four months of age, he weighed 5 pounds. His sister, aged 18 months, weighed 12 pounds, what one would expect a 4-month-old baby to weigh. She later weighed only 8 pounds. The children had never been breast-fed, and since birth their diets were basically bottle-feeding. For a four-month baby, one tin of formula should have lasted just under three days. The mother said that one tin lasted two weeks to feed both children.
- In rural Mexico, the Philippines, Central America, and the whole of Africa, there has been a dramatic decrease in the incidence of breast feeding. Critics blame the decline largely on the intensive advertising and promotion of infant formula. Clever radio jingles extol the wonders of the "white man's powder that will make baby grow and glow." "Milk nurses" visit nursing mothers in hospitals and their homes and provide samples of formula. These activities encourage mothers to give up breast feeding and resort to bottle feeding because it is "the fashionable thing to do or because people are putting it to them that this is the thing to do."

The Defense. The following points are made in defense of the marketing of baby formula in Third World countries:

- First, Nestle argues that the company has never advocated bottle-feeding instead of breast-feeding. All its products carry a statement that breast-feeding is best. The company states that it "believes that breast milk is the best food for infants and encourages breast feeding around the world as it has done for decades." The company offers as support of this statement one of Nestle's oldest educational booklets on "Infant Feeding and Hygiene," which dates from 1913 and encourages breast feeding.
- However, the company does believe that infant formula has a vital role in proper infant nutrition as (1) a supplement, when the infant needs nutritionally adequate and appropriate foods in addition to breast milk and, (2) a substitute for breast milk when a mother cannot or chooses not to breast feed. One doctor reports, "Economically deprived and thus dietarily deprived mothers who give their children only breast milk are raising infants whose growth rates begin to slow noticeably at about the age of three months. These mothers then turn to supplemental feedings that are often harmful to children. These include herbal teas and concoctions of rice water or corn water and sweetened, condensed milk. These feedings can also be prepared with contaminated water and are served in unsanitary conditions."
- Mothers in developing nations often have dietary deficiencies. In the Philippines, a mother in a poor family who is nursing a child produces about a pint of milk daily. Mothers in the United States usually produce about a quart of milk each day. For both the Philippine and U.S. mothers, the milk produced is equally nutritious. The problem is that there is less of it for the Philippine baby. If the Philippine mother doesn't augment the child's diet, malnutrition develops.
- Many poor women in the Third World bottle-feed because their work schedules in fields or factories will not permit breast-feeding. The infant feeding controversy has largely to do with the gradual introduction of weaning foods during the period between three months and two years. The average

well-nourished Western woman, weighing 20 to 30 pounds more than most women in less-developed countries, cannot feed only breast milk beyond five or six months. The claim that Third World women can breast feed exclusively for one or two years and have healthy, well-developed children is outrageous. Thus, all children beyond the ages of five to six months require supplemental feeding.

- Weaning foods can be classified as either native cereal gruels of millet or rice, or commercial manufactured milk formula. Traditional native weaning foods are usually made by mixing maize, rice, or millet flours with water and then cooking the mixture. Other weaning foods found in use are crushed crackers, sugar and water, and mashed bananas.

There are two basic dangers to the use of native weaning foods. First, the nutritional quality of the native gruels is low. Second, microbiological contamination of the traditional weaning foods is a certainty in many Third World settings. The millet or the flour is likely to be contaminated, the water used in cooking will most certainly be contaminated, the cooking containers will be contaminated, and therefore, the native gruel, even after it is cooked, is frequently contaminated with colon bacilli, staph, and other dangerous bacteria. Moreover, large batches of gruel are often made and allowed to sit, inviting further contamination.

- Scientists recently compared the microbiological contamination of a local native gruel with ordinary reconstituted milk formula prepared under primitive conditions. They found both were contaminated to similar dangerous levels.
- The real nutritional problem in the Third World is not whether to give infant's breast milk or formula; it is how to supplement mothers' milk with nutritionally adequate foods when they are needed. Finding adequate locally produced, nutritionally sound supplements to mothers' milk and teaching people how to prepare and use them safely is the issue. Only effective nutrition education along with improved sanitation and good food that people can afford will win the fight against dietary deficiencies in the Third World.

The Resolution. In 1974, Nestle, aware of changing social pat-terns in the developing world and the increased access to radio and television there, reviewed its marketing practices on a region--by-region basis. As a result, mass media advertising of infant for-mula began to be phased out immediately in certain markets and, by 1978, was banned worldwide by the company. Nestle then un-dertook to carry out more comprehensive health education pro-grams to ensure that an understanding of the proper use of their products reached mothers, particularly in rural areas.

"Nestle fully supports the WHO (World Health Organization) Code. Nestle will continue to promote breast-feeding and ensure that its marketing practices do not discourage breast-feeding any-where. Our company intends to maintain a constructive dialogue with governments and health professionals in all the countries it serves with the sole purpose of servicing mothers and the health of babies." -this quote is from Nestle Discusses the Recom-mended WHO Infant Formula Code.

In 1977, the Interfaith Center on Corporate Responsibility in New York compiled a case against formula feeding in developing nations, and the Third World Institute launched a boycott against many Nestle products. Its aim was to halt promotion of infant for-mulas in the Third World. The Infant Formula Action Coalition (IN-FACT, successor to the Third World Institute), along with several other world organizations, successfully lobbied the World Health Organization (WHO) to draft a code to regulate the advertising and marketing of infant formula in the Third World. In 1981, by a vote of 114-1 (three countries abstained and the United States was the only dissenting vote), 118-member nations of WHO endorsed a vol-untary code? The eight-page code urged a worldwide ban on promo-tion and advertising of baby formula and called for a halt to distrib-ution of free product samples and/or gifts to physicians who pro-moted the use of the formula as a substitute for breast milk.

In May 1981 Nestle announced it would support the code and waited for individual countries to pass national codes that would then be put into effect. Unfortunately, very few such codes were forthcoming. By the end of 1983, only 25 of the 157 member na-tions of 'the WHO had established national codes.

Accordingly, Nestle management determined it would have to apply the code in the absence of national legislation, and in Febru-ary 1982 issued instructions to marketing personnel, delineating the company's best understanding of the code and what would have to be done to follow it.

In addition, in May 1982 Nestle formed the Nestle Infant For-mula Audit Commission (NIFAC), chaired by former Senator Ed-mund J. Muskie, and asked the commission to review the com-pany's instructions to field personnel to determine if they could be improved to better implement the code. At the same time, Nestle continued its meetings with WHO and UNICEF (United Nations Children's Fund) to try to obtain the most accurate interpretation of the code.

NIFAC recommended several clarifications for the instructions that it believed would better interpret ambiguous - areas of the code; in October 1982, Nestle accepted those recommendations and issued revised instructions to field personnel.

Other issues within the code, such as the question of a warning statement, were still open to debate. Nestle consulted exten-sively with WHO before issuing its label warning statement in October 1983, but there was still not universal agreement with it. Acting on WHO recommendations, Nestle consulted with firms experienced and expert in developing and field-testing educational materials, so that it could ensure that those materials met the code.

When the International Nestle Boycott Committee (INBC) listed its four points of difference with Nestle, it again became a matter of interpretation of the requirements of the code. Here, meetings held by UNICEF proved invaluable, in that -UNICEF agreed to define areas of differing interpretation-in some cases providing definitions contrary to both Nestle's and INBC's inter-pretations.

It was the meetings with UNICEF in early 1984 that finally led to a joint statement by Nestle and INBC on January 25. At that time, INBC announced its suspension of boycott activities, and Nestle pledged its continued support of the WHO code.

Nestle Supports WHO Code. The company has a strong record of progress and support in implementing the WHO Code, including:

- Immediate support for the WHO Code, May 1981; and testimony to this effect before the U.S. Congress, June 1981.
- Issuance of instructions to all employees, agents, and distributors in February 1982 to implement the code in all Third World countries where Nestle markets infant formula.
- Establishment of an audit commission, in accordance with Article 11.3 of the WHO Code, to ensure the company's compliance with the code. The commission, headed by Edmund S. Muskie, was composed of eminent clergy and scientists.
- Willingness to meet with concerned church leaders, international bodies, and organization leaders seriously concerned with Nestle's application of the code.
- Issuance of revised instructions to Nestle personnel, October 1982, as recommended by the Muskie committee to clarify and give further effect to the code.
- Consultation with WHO, UNICEF, and NIFAC on how to interpret the code and how best to implement specific provisions including clarification by WHO/UNICEF of the definition of children who need to be fed breast milk substitutes, to aid in determining the need for supplies in hospitals.

Nestle Policies. In the early 1970s Nestle began to review its infant formula marketing practices on a region-by-region basis. By 1978 the company had stopped all consumer advertising and direct sampling to mothers. Instructions to the field issued in Feb-ruary 1982 and clarified in the revised instructions of October 1982 to adopt articles of the WHO Code as Nestle policy include:

- No advertising to the general public.
- No sampling to mothers.
- No mother-craft workers.
- No use of commission/bonus for sales.
- No use of infant pictures on labels.
- No point-of-sale advertising.
- No financial or material inducements to promote products.
- No samples to physicians except in three specific situations:
- A new product, a new product formulation, or a new graduate physician; limited to one or two cans of product.
- Limitation of supplies to those requested in writing and fulfilling genuine needs for breast milk substitutes.
- A statement of the superiority of breast-feeding on all labels/materials.
- Labels and educational materials clearly stating the hazards involved in incorrect usage of infant formula, developed in consultation with WHO/UNICEF.

Even though Nestle stopped consumer advertising, it was able to maintain its share of the Third World infant formula market. By 1988 a call to resume the seven-year boycott was called for by a group of consumer activist members of the Action for Corporate Accountability. The group claimed that Nestle was distributing free formula through maternity wards as a promotional tactic that undermines the practice of breast-feeding. The group claims that Nestle and others including American Home Products, have continued to dump formula in hospitals and maternity wards and that, as a result, "babies are dying as the companies are violating the WHO resolution. As late as 1997 the Interagency Group on Breastfeeding Monitoring (IGBM) claims Nestle continues to sys-tematically violate the WHO code. Nestle's response to these ac-cusations is included on their Web site (see www.nestHi.com for details).

The boycott focus is Taster's Choice Instant Coffee, Coffee-mate Nondairy Coffee Creamer, Anacin aspirin, and Advil.

Representatives of Nestle and American Home Products re-jected the accusations and said they were complying with World Health Organization and individual national codes on the subject.

The New Twist. A new environmental factor has made the entire case more complex: Circa 1998 it was believed that some 3.8 million children around the world have contracted HIV at their mothers' breasts. In affluent countries mothers can be told to bottle feed their children. However, 90 percent of the child infections occur in developing countries. There the problems of bottle-feed-ing remain. Further, in even the most infected areas, 70 percent of the mothers do not carry the virus, and breast-feeding is by far the best option. And the vast majority of pregnant women in the de-veloping countries have no idea whether they are infected or not. One concern is that large numbers of healthy women will switch to the bottle just to be safe. Alternatively, if bottle-feeding be-comes a badge of HIV infection, mothers may continue breast-feeding just to avoid being stigmatized. In Thailand, pregnant women are offered testing, and if found HIV positive, are given free milk powder. But in some African countries where women get pregnant at three times the Thai rate and HIV infection rates are 25 percent compared to the 2 percent in Thailand, that solution is much less feasible.

The Issues. Many issues are raised by this incident and the ongoing swirl of cultural change. How can a company deal with a worldwide boycott of its products? Why did the United States de-cide not to support the WHO Code? Who is correct, WHO or Nestle? A more important issue concerns the responsibility of MNC marketing in developing nations. Setting aside the issues for a moment, consider the notion that, whether intentional or not, Nestle's marketing activities have had an impact on the behavior of many people. In other words, Nestle is a cultural change agent. And, when it or any other company successfully introduces new ideas into a culture, the culture changes and those changes can be functional or dysfunctional to established patterns of behavior. The key issue is what responsibility does the MNC have to the culture when, as a result of its marketing activities, it causes change in that culture? Finally, how might Nestle now participate in the battle against the spread of MV and AIDS in developing countries?

Questions

1. What are the responsibilities of companies in this or similar situations?

2. What could Nestle have done to have avoided the accusations of "killing Third World babies" and still market its product?
3. After Nestle's experience, how do you suggest it, or any other company, can protect itself in the future?
4. Assume you are the one who had to make the final decision on whether or not to promote and market Nestle's baby formula in Third World countries. Read the section titled "Ethical and Socially Responsible Decisions" in Chapter 5 (pp. 138-39) as a guide to examine the social responsibility and ethical issues with the marketing approach and the promotion used. Were the decisions socially responsible? Were they ethical?
5. What advice would you give to Nestle now in light of the new problem of HIV infection being spread via mothers' milk?

EURO DISNEY(A)

Michael Eisner, chairperson of Walt Disney Company, was sitting in his Los Angeles office. It was New Year's Eve 1993, and Eisner had one meeting left before he could go home to celebrate a quiet holiday. The meeting was with yet another group of high-powered consultants from one of the 'world's most prestigious general management and strategy consulting companies. The consultants had assembled a multidisciplinary team include financial, marketing, and strategic planning experts from the New York and Paris of-fices. The meeting couldn't wait until after the holidays -the topic, what to do about Euro Disney, was that critical. The consultants were asked by the consortium of bank lenders to provide an additional perspective on the prob-lems of Euro Disney and to make recommendations to Eisner and Disney management on what should be done.

In the 10 years since Eisner and his senior manage-ment team had arrived, they had turned Disney into a com-pany with annual revenues of $8.5 billion, compared with $1 billion in 1984. For Eisner, his track record was impec-cable. "From the time they came in, they had never made a single misstep, never a mistake, never a failure," according to a former Disney executive. "There was a tendency to be-lieve that everything they touched would be perfect." Eisner was particularly proud of the success of the im-mensely profitable Tokyo Disneyland, which had more vis-itors in 1993 than even the two parks in California and Florida. Based on the company's success in the United States and Japan, Eisner had vowed to make Euro Disney, located outside of Paris, the most lavish project that Disney had ever built. Eisner was obsessed with maintaining Disney's reputation for quality and he listened carefully to the designers who convinced them that Euro Disney would have to brim with detail to compete with the great monu-ments and cathedrals of Europe. Eisner believed that Euro-peans, unlike the Japanese, would not accept carbon copies. Construction of the park alone (excluding the hotels) was approaching $2.8 billion. In developing Euro Disney, Eisner had learned from some of the mistakes made on other pro-jects. For example, in Southern California, Disney let other companies build the hotels to house visitors and in Japan; Disney merely collected royalties from the park rather than having an equity ownership stake.

In preparing for the meeting with the consultants, Eisner was shuffling through some of the papers on his desk. An article in that week's French news magazine *Le Point* quoted Eisner as saying that Euro Disney might be shut down if Disney failed to reach an agreement with its creditor banks on a financial rescue plan by March 31. The company's annual report for 1993 said that Euro Disney was the company's " first real financial disappointment" since Eisner had taken over in 1984. Eisner's defense had been to publicly blame the performance on external factors including the severe European recession, high interest rates, and the strong French franc. Eisner picked up the financials from the comparable periods from the initial two years' operations of Euro Disney (Exhibit 1) and then quickly, after reviewing the numbers, put them down. The situation was deteriorating quickly, he thought. Eisner then turned to the attendance figures, which were also trending downward (Exhibit 2).

Review Of Projections/The Initial Plan

Eisner walked to his bookshelf from which he took down a bound copy of the initial 30-year business plan for Euro Disney. The plan was done in the typical detailed and methodical Disney fashion. The table of contents was exhaustive, appearing to cover virtually every detail. Over 200 locations in Europe were examined before selecting the site just outside Paris, with Paris being Europe's biggest magnet for tourism. A huge potential population could get to Euro Disney quickly (see Exhibit 3).

European vacation habits were also studied. Whereas Americans' average 2 to 3 weeks' vacation, French and Ger-mans typically have 5 weeks' vacation. Longer vacations.

1992-1993

Six Months Ending Sept 30

EXHIBIT 1	**1993**	**1992**
Revenues (Frencll francs)	1.8 billion	3.1 billion
Profit/(Loss)	(1.1 billion)	0.7 billion

Years Ending April

(Initial Opening in April 1991)

EXHIBIT 2	**1993**	**1992**
Attendance	9.5 million	10.5 million

EXHIBIT 3 European population proximity to euro Disney

Population (Mil/ions)	**Time .to Euro Disney**
17	2-hour drive
41	4-hour drive
109	6-hour drive
310	**2-hour flights**

should translate into being able to spend more time at Euro Disney.

The French government was spending hundreds of millions of dollars to provide rail access and other infra-structure improvements. Within 35 minutes, potential visi-tors could get to the

park from downtown Paris. The opening of the Channel Tunnels in 1993 would make the trip from London 3 hours and 10 minutes.

While the weather in France was not as warm as that in California or Florida, waiting areas and moving side-walks would be covered to protect visitors from wind, rain, and cold. Tokyo Disney had been built in a climate similar to Euro Disney and the company had learned a lot about how to build and run a park in a climate that was colder and wetter than those of Florida and California.

The attractions themselves would be similar to those found in the American parks, with some modifications to increase their appeal to Europeans. Discoveryland, for ex-ample, would have attractions based on Frenchman Jules Verne's science fiction; a theater with a 360-degree screen would feature a movie on European history. The park would have two official languages, English and French; a multilingual staff would be on hand to assist Dutch, German, Italian, and Spanish visitors. Basically, however, Euro Disney's strategy was to transplant the American park. Robert Fitzpatrick, a U.S. citizen with extensive ties to France and the chairperson of Euro Disney, felt "it would have been silly to take Mickey Mouse and try to do surgery to create a transmogrified hybrid, half French and half American."

Other aspects of the American parks would also be transferred to France. These include Main Street U.S.A. and Frontier land, as well as Michael Jackson's Captain EO 3-D movie. Like the American parks, wine and other alco-holic beverages would not be served.

Fitzpatrick's greatest fear was that we will be too successful" and that too many people would come at peak times, forcing the park to shut its gates.

Eisner turned to the financing plan, which had been prepared by chief financial officer (CFO) Gary Wilson, a man known as a tough negotiator with a knack for creating complex, highly leveraged financing packages that placed the risk for many projects outside of Disney while keeping Much of the upside potential for the company Wilson had subsequently left Disney to become chief executive officer (CEO) of the parent company of Northwest Airlines.

The plan had set up a finance company to own the park and lease it back to an operating company. Under the plan, Disney held a 17 percent stake in the company, which was to provide tax losses and borrow capital at relatively low rates. Disney was to manage the resort for large fees and royalties, while owning 49 percent of the equity in the oper-ating company, Euro Disney SCA. The remaining shares were sold to the public, largely to small individual European investors. A total of $3.5 billion in construction loans was raised from dozens of banks eager to finance the project.

Euro Disney was just the cornerstone of a huge real estate development planned by Disney in the area. Ini-tially, the area was to have 5,200 hotel rooms, more than are available in the entire city of Cannes. The number of rooms was expected to triple after a second theme park opened in the area. Subsequent phases of the plan also included office space that would rival the size of France's largest office complex, La Defense, in Paris. Other plans showed shopping malls, golf courses, apartments, and vacation homes. Key to the plan's financial success was that Euro Disney would tightly control the design and build almost everything itself and then sell off the completed properties at a large profit.

The Japanese Experience

Eisner put the book down and picked up another file that contained an assessment of the incredible success of Tokyo Disneyland. Seeking to determine if there were any paral-lels between the Japanese and European experiences, he had commissioned a study of why the Japanese venture was doing so well.

Tokyo Disneyland had been open about 11 years and had been drawing larger crowds than the U.S. parks. Located less than 10 miles from Tokyo, the park drew over 16 million visitors from throughout Asia in 1993. Tokyo Disneyland is a near replica of the American original. Most of the signs are in English, with only occasional Japanese; the Japanese flag is never seen but variations on the Stars and Stripes appear throughout the park. In the file, Eisner found a study writ-ten by Masako Notoji, a Tokyo University professor, who studied the hold that Tokyo Disneyland has over Japanese people. Notoji wrote that the "Japanese who visit Tokyo Dis-neyland are enjoying their own Japanese dream, not the American dream. In part, this is because the, park is so san-itized and precise in how it depicts an unthreatening, fantasy America that it has become totally Japanese, just the way that Japanese want it to be." It has been compared to the Japanese garden, which is a controlled and confined version of nature that becomes more satisfying and perfect than nature itself. The Japanese Disneyland, some say, outdoes the American parks because it is probably cleaner due to the Japanese obsession with cleanliness.

Notoji's report also noted that Tokyo Disneyland opened in 1983. a period in which the Japanese economy was especially strong. During that time period, the United States was perceived as a model of an affluent society. At the same time, as a result of its growing affluenc,e, Japan was starting to feel part of world culture. Tokyo Disneyland became a symbol for many people of Japan's entry into world culture.

In commenting on the differences between Tokyo and France, Notoji's research hypothesized that ". . . the fake-ness of (Tokyo) Disneyland is not evident because (the Japanese) only had fantasy images of these things before" while "Europeans see the fakeness because they have their own real castles and many of the Disney characters come from European folk tales."

Eisner's secretary announced that the consulting team had arrived and that the meeting would be held in his con-ference room. The meeting started with Eisner explaining the assign-ment and the short time frames in which solu-tions had to be developed.

Euro Disney Problems

In early February, a team of consultants returned to Eisner's office with the first phase of their study com-pleted. Given the size and complexity of the problems that they expected to find, the study had been divided into three phases. The first phase was a top-level assessment of the problems that they had

uncovered in the initial month of the study, without any recommendations as to what should be, done. The second phase was to identify the most critical problems that needed to be addressed immediately and to develop, action plans. The third phase was to identify the re-maining, less critical problems, and develop recommended plans of action.

The consultants' report identified six critical major problem areas that they felt had contributed to the prob-lems. The team felt that, even though not all of the problems could be rectified, it was critical that Disney management understand the funda-mental problems so that they could fix the problems at Euro Disney and not repeat the same mistakes again should they expand to other countries. The six critical problem areas were

1. Management hubris
2. Cultural differences
3. Environmental and location factors
4. French labor issues
5. Financing and the initial business plan
6. Competition from U.S. Disney parks

Management Hubris

The first issue addressing the way in which Disney man-agement had approached the development of the project and tactical errors made by members of the management team was the most sensitive. Because of the sensitivity of this subject, the consulting firm had brought in the head of their European practice, based in Paris, to analyze the problem and make the presentation, Extensive interviews had been conduced with members of the Disney manage-ment teams, both in the United States; and in France: aca-demicians who have studied French and American culture; and executives of the European banks that had made many of the construction loans as well as workers at the park.

"The initial premise of Euro Disney in the mid-1980s was that there was no limit to the European public's appetite for American imports given the success of Big Macs, Coke, and Hollywood movies," the presentation started off. That initial assumption totally failed to take into consideration the fact that "the French flatter themselves that they are more resistant to American cultural imperialism." The "her-metically scaled world of the theme park did not give the French an ability to put their own mark on the park. Disney was exporting the Am6rican management system, experi-ence and values with a manage-ment style that was brash. Frequently insensitive, and often overbearing," The Ameri-cans were overly ambitious and always sure that it would work because they were Disney, and it had always worked in the past. By 'starting off on this premise, Euro Disney quickly became known as a "cultural Chernobyl" and it cre-ated hostility from the French people. The initial arrogance of American management further demoralized the work-force, creating a spiraling effect that cut down on the number of French visitors.

Much of this arrogance, the report continued, created tension and hostility among the management team, The first general manager, Robert Fitzpatrick, an American, spoke French and was married to a French woman; how-ever, he was distrusted by some American as well as French executives. Management, unfamiliar with the French con-struction industry, had made a number of critical mistakes including selecting the wrong local contractors, some of whom went bankrupt. Fortunately, Fitzpatrick had already been replaced with a French native.

Cultural Differences/Marketing Issues

The firm's senior marketing strategist presented the second part of the 'report, which focused on cultural and marketing differences between the U.S. and European markets.

The first phase of the analysis had uncovered a number of obvious problems, some of which had already been recti-fied. The purpose in identifying these problems, the consul-tants said, was to be able to be sensitive and to identify other, possibly more subtle cultural and marketing problems.

While attendance was initially strong at the park, the length of the average stay was considerably different than at the U.S. parks. European,s stayed in Euro Disney an average of 2 days and 1 night, arri ving early in the morning of the first day and checking out early the next day. By comparison, the average length of the visit in the United States was 4 days. In large part, this was because the American parks in Florida and California had multiple parks in the immediate areas while there was only one park at Euro Disney.

Attendance at the park was also highly seasonal, with peaks during the summer months when European children had school vacations and troughs during non-vacation pe-riods, Unlike American parents who would take their chil-dren out of school for vacations, European parents were reluctant to do this. Europeans were also accustomed to taking one or more longer vacations, while Americans fa-vored short mini-vacations.

Revenues from food were also significantly lower at Euro Disney compared with the other parks, the report found. Three of the reasons that had been identified just after the park had opened were related to misunderstand-ings about European lifestyles. The initial thinking was that Europeans did not generally eat a big breakfast and, as a result, restaurants were planned to seat only a small number of breakfast guests. This proved incorrect, with large num-bers of people showing up for fairly substantial breakfasts. This problem was corrected by changing the menus as well as providing expanded seating for breakfast through the expansion of cafeteria facilities. While the park offered fast-food meals, they were priced too high, restraining the demand. This problem, too, had been taken care of by re-ducing the prices at the fast-food restaurants. At the U.S. parks, alcohol was not served, in keeping with the family oriented values. The decision not to serve alcohol at Euro Disney failed to account for the fact that alcohol is viewed as a normal part of daily life and a regular beverage with meals. This error, too, was rectified after it was discovered.

Revenues from souvenir shop sales were also consid-erably below those in the other parks, particularly Tokyo Disneyland. In Japan, great value was placed on purchas-ing a souvenir from the park and giving the souvenir as a gift to friends and family upon one's return home. Euro-peans were far less interested in purchasing souvenirs.

In the initial design of the project, it was assumed that Europeans would be like Americans in terms of transportation around the park and from the hotels to the park attractions. In the United States, a variety of trains, boats, and tramways carried visitors from the hotels to the park. Although it was possible to walk, most Americans chose to ride. Europeans, on the other hand, chose to walk rather than ride, leaving the vehicles significantly underutilized. While not directly affecting revenue, the capital as well as ongoing costs for this transportation were considerable.

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It was also assumed, given the automobile ownership statistics in Europe, that the majority of visitors would drive their own cars to Euro Disney and that a relatively small number of tourists would arrive by bus. Parking facilities were built accordingly, as were facilities for bus drivers who would transport passengers to the park. Once again, the ini-tial planning vastly underestimated the proportion of visi-tors who would arrive by bus as part of school, community, or other groups. Facilities for bus drivers to park their buses and rest were also inadequate. This, too, was a problem that was initially solved.

The consultant concluded this portion of the presen-tation by saying that these were just a few examples of problems that resulted from a misunderstanding of the difference between the U.S. and Japanese parks that had al-ready been identified. Most likely, he said, there were a number of other similar problems that needed to be iden-tified and fixed.

Environmental and Location Factors

Next to speak was a team that included experts from an environmental planning firm. This presentation would be brief, since the problems that they identified were virtually impossible to correct at this stage in the project.

They initially noted that given the location in middle to northern Europe and the fact that there were only about six months of temperate weather when it was truly pleas-ant to be outside, the park was clearly sited in a location that did not encourage visitors on a year-round basis. Al-though accommodations were made (including the covered sidewalks), the fact that off-season visits had to be heavily discounted and promoted to groups to get even reasonable attendance still represented a major problem that needed to be corrected. Whether through pricing changes or the de-velopment of other attractions or other marketing and pro-motional vehicles, attendance in the off-peak months had to be increased.

The second problem that they identified, the location east of Paris rather than to the west, was also something that could not be rectified. It was reported that this was again related to overconfidence on the part of the initial planning team, which thought that even though most Parisians who would visit the park currently live west of the city, the longer-term population growth would be in the east. Consequently, it was felt that the park should be built in the east. Again, they noted, Disney executives disre-garded the initial advice of the French.

French Labor Issues

Next to speak was a European labor economist. This prob-lem, which stemmed from differences in-the United-States and Europe, could potentially be solved. Disney did not understand the differences in U.S. versus European labor laws, he said. In the United States, given the cyclicality and seasonality of the attendance at the parks, U.S. workers were scheduled based on the day of the week and time of year. This provided U.S. management with a high degree of flexibility and economy in staffing the park to meet peak visitor demand. French labor laws, however, did not pro-vide this kind of flexibility and, as a result, management could not operate Euro Disney as efficiently and labor costs were significantly higher than the U.S. parks.

Financing and the Initial Business Plan

The consulting team had hired a major global investment banking concern to review the plan, identify the problems, and develop a restructuring plan.

The firm's senior managing director spoke: "Financing and the assumptions of the initial business plan is the area that has created the greatest problems for the park; its re-structuring is most critical to the ability of the venture to continue operating and become profitable and, as a result, is the most important problem that needed to be addressed short term."

His presentation identified the following problem areas:

1. The initial plan was highly optimistic and extraordi-narily complex. There was little room for error in this plan, which was based on over leveraged finan-cial scenarios that depended on the office parks and hotels surrounding the park to payoff, rather than the park itself.

In addition to the plan being highly leveraged, significant cost overruns in the construction of the park further increased the start-up costs, making the achievement of the promised returns even more unlikely.

Disney itself had imposed on arbitrary deadline of March 31 to develop a refinancing package with the creditor banks, further putting pressure on de-veloping a credible and viable restructuring plan. A separate team was already at work to develop such a restructuring plan.

2. The initial plan was presented as financially low risk; shares were largely sold to individual investors with little tolerance for risk.

   The plan was constructed in the mid-1980s, a period of high-flying free-market financing in the United States. European investors did not under-stand these kinds of deals and propositions.

3. A severe European recession, a drop in the French real estate market, and revaluation of European cur-rencies against the

French franc severely undercut all of the assumptions on which the plan was de-pending in order to succeed.

4. Euro Disney management, faced with the problem of trying to achieve an unrealistic plan, had made se-rious errors in pricing.

   Among the mistakes were charging $42.25/day for admission to the park compared with a $30 daily fee for the U.S. and Tokyo parks. Hotel prices were set similarly, with a room costing $340, equivalent to a top hotel room in Paris. Inside the park, food prices were also too high.

Competition from U.S. Disney Parks

Finally, given the strengthening of the European currencies against the French franc and U.S. dollar, it was often less expensive for Europeans to travel to the United States, espe-cially Florida. Not only did their currencies buy more, but there were other attractions surrounding Orlando and the weather was warm and sunny year around. In addition, the U.S. Park provided the real experience compared with the European simulation.

WHAT to Do?

The consultants' phase-one report was concluded. As these problems were identified, teams had already been formed to develop potential solutions to the problems that could be solved. The investment bankers were already examining re-structuring options. While it was critical to enable the park to remain open beyond the March 31 deadline, the long-term issues appeared to be in the area of marketing. In par-ticular, park attendance and revenues per visitor needed to be increased while providing value and meeting Euro-peans' expectations about the EURO Disney experience.

The meeting adjourned after the group had agreed that phase two of the consultants' report, identifying action plans for the most critical issues, would be presented on March 15.

Discussion Questions

1. What did Disney do wrong in its planning for Euro Disney?
2. What recommendations would you make to Disney to deal with the problems of Euro Disney?
3. What lessons can we learn from Disney's problems with Euro Disney?

EURO DISNEY(B)

The First Biennium: "Meltdown At The Cultural Chernobyl"

In the 24 months since it first opened in 1992, the Euro Disney theme park suffered from the confluence of a number of environmental and internal problems. On the one hand, Euro Disney was adversely affected by an untimely Euro-pean recession and a strong French franc, which, when com-bined with the park's high admission prices, conspired to keep European tourists from visiting the park and from spending money once they got there. Also, the financial performance of the park was greatly restrained by a mas-sive debt burden. This debt was largely due to the cost overruns incurred in building the park combined with a slump in the French property market, which had left Euro Disney with a number of hotels-each built with borrowed money-that it had originally hoped to sell once the park became operational. In all, the interest charges for fiscal year (FY) 1993 came to around US$1 million per day.

Although the parent company, Walt Disney Company, was quick to blame the poor performance of its French subsidiary on the adverse conditions in the European en-vironment, in reality these uncontrollable problems were exacerbated by the arrogant attitude and cultural naiveté of the American manage-ment. Inspired by their record fi-nancial performance during the 1980s, the Disney team had led itself to believe that it had perfected the recipe for success. In striving to apply this formula in the European market, however, Disney succeeded only in alienating its French stakeholders, namely the creditor banks, the mi-nority shareholders, the labor unions, and, most impor-tantly, the general public.

To its credit, Disney responded proactively and deci-sively once its mistakes had been recognized. To counter the perception of management hubris, Walt Disney actively pro-moted Europe-ans into the top management team. Robert Fitzpatrick, the French-speaking American chairman of Euro Disney SCA, was replaced by Philippe Bourguignon, a Frenchman who had spent 10 years working in the United States. The new chairman initiated a number of measures aimed at repositioning the theme park as a less expensive and more efficiently run resort. The admission price charged to locals was lowered and the park's stores had the number of lines of merchandise reduced from 30,000 to 17,000. In the Euro Disney hotels, labor-saving magnetic cards replaced meal vouchers, and the number of food items. offered was slashed from 5,400 to 2,000. Moreover, a central purchasing department replaced the separate arrange-ments each hotel had had with its own suppliers. Finally, staff in 950 adminis-trative posts, equivalent to 8.6 percent of the total workforce, were laid off in late 1993.

At the same time, environmental conditions in the Eu-ropean market were improving. Not only was the Euro-pean economy coming out of recession, but the opening of the Channel Tunnel, combined with the 50th anniversary of the Normandy Invasion, augured well for the tourist season of 1994.

Yet, despite these measures and environmental changes, Euro Disney's future was never darker. Atten-dance figures recorded for FY 1994 were only 8.8 million, the lowest since the park had opened, while total revenue from the park and the five hotels fell 21 percent to FFr1.16 billion. As one French analyst observed with perspicacity and clarity: "They're getting fewer visitors at a lower price; that's definitely no good at all."

Why had the number of visitors fallen? Largely be-cause of circulating rumors that Euro Disney was about to be closed down. As far back as the end of 1993, Euro Disney's financial situation had deteriorated so much that the usually upbeat Michael Eisner, who had earlier labeled Euro Disney "probably the best thing we ever built," dis-tanced himself from the prodigal subsidiary by stating in his annual report to Walt Disney shareholders:

We certainly are interested in aiding Euro Disney SCA, the public company that bears our name and rep-utation. We will deal in good faith. . . . But in doing so, I promise all shareholders of the Walt Disney company that we will take no action to endanger the health of Disney itself.

Statements such as these were no doubt intended to communi-cate Walt Disney's reluctance to bear the brunt of the growing financial burden of the theme park! By dis-tancing itself from its subsidiary, Disney hoped to counter the widespread perception among Euro Disney's other stakeholders that it had cut a "sweet deal" in structuring its relationship with the theme park. Back in 1989, when Euro Disney SCA had been floated, Walt Disney had purchased 49 percent of the new company's shares for FFr10 each. In contrast, pubic shareholders paid FFr72 and later, when the theme park had opened in 1992, share prices had soared to FFr164.

In all, Walt Disney had arranged US$4 billion to fi-nance the park, of which they had contributed only US$170 million (for a 49 percent equity stake) while the public had paid $1 billion (for the remaining 51 percent). The rest of the start-up capital (nearly $3 billion) had been borrowed. Also included in the initial deal was a management fee of 3 percent of gross revenues, an increasing "incentive man-agement fee" of 30 to 50 percent of pretax cash flow, and royalties of 5 percent and 10 percent on food and admis-sion, respectively. This meant that the parent company could make money even while Euro Disney was running at a loss. Indeed, analysts predicted that the profit per visitor to Euro Disney would actually decrease as attendance went up due to the proportion of fees that was to be repatri-ated to Walt Disney.

However; when Euro Disney's debt-reachedcFFr20 bil-lion, this no-loss &deal for Walt Disney meant that banks would no longer lend money to the French subsidiary with-out a guaran-

tee from the parent company. Thus, Euro Disney became an Achilles' heel to the parent company giving Walt Disney its first quarterly net loss (in September 1993) since Michael Eisner had become chairman in 1984.

In the end, things had come to a head as Euro Disney simply ran out of cash. Walt Disney provided emergency funds, but also imposed a deadline for a restructuring of the subsidiary's financial arrangements: Walt Disney had no intention of injecting further funds beyond the end of March 1994. Euro Disney's fate was sealed, and its stakeholders were compelled to come up with a rescue plan that either eliminated some of the crippling interest burden, converted debt into equity, or raised funds by some other means. The question was, who would pay how much and when?

The Rescue Plan

A number of issues affected the restructuring activities and influenced the bargaining power of the major stakeholders. On one side of the equation, Euro Disney's 63 creditor banks and bondholders agreed that Walt Disney should carry much of the burden for the bailout, reflecting its re-lationship with the French company. However, Walt Dis-ney's legal relationship was with Euro Disney SCA, the operating company, and not with the beleaguered theme park itself, which was owned by a finance company that leased the park back to the operating company. (Disney had just a 17 percent stake in the finance company.) Neverthe-less, the banks argued that the park was Disney's "creation and responsibility"-after all, Euro Disney's top manage-ment had been put in place by Walt Disney-and, conse-quently, called for "an asymmetrical sharing of the pain."

On the other side of the equation, Walt Disney wanted the banks to write down some of their debt or to convert the debt into equity. Although it appeared that Disney was not bargain-ing from a position of strength, the parent com-pany did have the option of putting Euro Disney into bankruptcy, a position from which it could dictate the terms of the restructuring.

However, although Michael Eisner had hinted at clos-ing the park, there were a number of good reasons why Disney probably would not exercise this option, not the least of which would be the impact on Disney's already tar-nished corporate image in France. Conversely, some of the French banks, including the recently privatized Banque National de Paris, were concerned about the risk of sub-stantial losses and the conse-quent effect-on their credit rat-ings. Similarly, other stakeholders (such as the French government) also stood to lose if the theme park closed and the 40,000 jobs that were indirectly related to the park were eliminated. Thus, there was some speculation that the state-owned Caisse de Depots and Consignations, which was Euro Disney's largest creditor with FFr4.4 billion in loans, might be compelled to lower its interest rates. How-ever, despite the common interest in keeping Euro Disney afloat (Exhibit 1), drafting a rescue plan that would' satisfy all the stakeholders seemed problematic.

Just prior to the March 31 deadline, Euro Disney was at its lowest point financially, with debts now approaching FFr24 billion. Curiously, a glimmer of hope was to be found across the Atlantic in the growing interest of U.S. "vulture" funds, which had begun purchasing Euro Disney debt at around 60 percent of face value. These secondary debt -market transactions reflected growing speculation that the debt would eventually be worth substantially more than what it was being purchased for.

Finally, 2 weeks ahead of schedule, a rescue plan was an-nounced: In essence, the plan contained two elements. First, the plan comprised a deferment of interest and roy-alty payments. Specifically, the creditor banks forgave 18 months of interest payments and postponed principal pay-ments for a period of 3 years. This reflected a saving to Euro Disney of FFr1.9 billion. Conversely, Walt Disney said it would eliminate management fees (worth FFr450 million per year) and royalties on sales of tickets and mer-chandise for a period of 5 years. It would, however, still re-ceive an *incentive* fee based on Euro Disney profits. Finally, Disney agreed to purchase some of the park's underuti-lized assets for FFr1.4 billion and lease them back on terms favorable to Euro Disney.

The second part of the plan called for a rights issue to raise funds, which would be used to eliminate debt. This issue worked by giving existing shareholders the right to purchase a number of shares at below-market prices (FFrl0) in the same proportion as their present equity stake. In this case, sharehold-ers were to be permitted to subscribe to seven new shares for every two shares held. This meant that Disney would end up paying just under FFr3 billion for 49 percent of the offering.

The rights issue was approved by a meeting of share-holders on 8 June 1994. (Getting shareholder approval was a mere formality given the size of Walt Disney's holdings.) Euro Disney's share price immediately fell, reflecting the dilative nature of the issue. Nevertheless, the rights issue succeeded in raising a total of FFr5.95 billion, which en-abled Euro Disney to reduce its debt burden by 23 percent to FFr16.1 billion.

In evaluating the efficacy of the rescue plan, it is worth noting how the major stakeholders fared in the exercise. First, who were the winners? Although the plan called for the parent company to substantially increase its financial stake in Euro Disney-an additional US$750 million on top of the $350 million already spent-Walt Disney bene-fited from the plan because the fees it deferred would have been lost if the park had closed down. Moreover, the con-cessions they, made served to improve their tarnished cor-P9rate image in the French market. The banks were pleased with the deal because they did not end up owning or managing the park's assets; while Euro Disney's bond-holders were happy just to be excluded from the plan. Fi-nally, it is safe to assume that the labor unions and the French government also benefited from the bailout.

Exhibit 1 Euro Disney's Stakeholders and Their Financial Interests

Walt Disney Co.	Total outlay of US$350 million (-FFr2.1 billion): based on initial outlay of $170 million for 49% equity and the subsequent injection of emergency funds
Public shareholders	Initial outlay of US$1 billion (-FFr6.4 billion) for subscribed shares
63 Creditor banks	FFr14 billion in loans
French government	Provided US$750 million (-FFr4.4 billion) in low-interest loans built road and rail links to the park, and sold Disneyland at low prices
Bondholders	FFr4 billion of convertible bonds

The only clear losers in the rescue plan were the mi-nority shareholders. With 770 million shares now in the market-about four times the original number-Euro Dis-ney's earnings per share inevitably fell, as did the company's share price. On the day the rights issue was announced, Euro Disney's market capitali-zation dipped 8 percent to FFr34 per share, and by the end of the month, shares were worth just FFr12.9. However, things were about to get worse before they got better, and within 2 months Euro Disney's share price had dropped to just FFr7.55.

Despite the drop in its share price; the magnitude of the devaluation of Euro Disney's market capitalization was mini-mized by the timely appearance of a new player in the market. In the spring of 1994, Prince Al- Waleed bin Talal bin Abdulaziz Al Saud, the 37-year-old nephew of Saudi Arabia's King Fahd, announced his intention to pur-chase a significant equity stake in the company. By mid--October, the prince had acquired 74.6 million shares, reflecting a 24.6 percent equity stake (acquired for around US$350 million). Some of these shares had been purchased from Walt Disney, whose stake in the company had conse-quently been reduced from 49 percent to 39 percent.

The Second Biennium: Euro Disney Gets A Reprieve

The rescue plan effectively gave Euro Disney a 3- to 5-year reprieve from its interest and royalty charges. However, im-plicit in this reprieve was the mandate to make Euro Disney a profitable company as soon as possible, and Philippe Bourguignon and his staff wasted little time in enacting a revamped marketing strategy geared to this objective.

Perhaps the most significant marketing change made was the renaming of the theme park itself. The name "Euro Disney" had been chosen in a period of pre-1992 unifica-tion hype. However, events in the past few years had seen some commen-tators come to equate Euro Disney with Euro Disaster. Consequently, and to reflect the new lease on life that had been given to it by the rescue plan, Euro Disney renamed the theme park "Disneyland Paris" to capitalize on its proximity to the French capital, the world's top tourist destination. (Euro Disney SCA would remain the name of the operating company.) By a fortuitous twist of fate, the newly renamed park received some timely pub-licity when Michael Jackson and Lisa Marie Presley visited Disneyland Paris on their honeymoon.

At the end of 1994 a 22 percent reduction in admission prices for the 1995 peak season was announced (Exhibit 3). Simulta-neously, further efficiency measures were intro-duced. The park's total workforce had now been reduced to *12,000* from 17,000, of which 4,000 staff were employed on a seasonal basis. Moreover, new trainees were now re-quired to undergo 6 to 12 months of training. Previously, new staff had received only one day of training. Also, ne-gotiations with labor unions were under way to make staffing arrangements more flexible, in line with fluctuat-ing attendance patterns. This meant that staff would now work longer hours on weekends and during the summer months when demand was greatest.

Other changes included the decentralization of deci-sion-making authority to "small world" up its consisting of 30 to 50 staff, with each unit given responsibility for achiev-ing manage-ment targets and improving visitor satisfac-tion. Managers of these autonomous units would received performance-based bonuses whereas other staff, or "cast members," would receive non-financial rewards, such as better promotion prospects.

At the end of FY 1995 the cumulative effect of these changes in strategy and the rescue plan were evident. Not only did the park receive a record attendance of 10.7 million visitors (Exhibit 4) but Euro Disney SCA also recorded its

Exhibit 3 Admission Price Changes

	Adult price (FFr)	
	Peak (1 April – 1 October)	off –peak
Old price	250	175 – 225
1995 price	195	150

Exhibit 4 Annual Attendance Figures

(FY ending 30 September)	
1993	9.8 billion
1994	8.8 million
1995	10.7 million

first-ever profit (Exhibit 5). However, it is sobering to note that the reported profit of FFr114 million is overstated be-cause of the deferred royalty and interest payments and Euro Disney's buyback of 2.7 million convertible bonds. Profit before exceptional items was only FFr2 million.

Although the figures for 1995 indicated that Euro Disney SCA had turned the corner, much remained to be done in the next few years before the long-term viability of the venture could be established. Although Disneyland Paris has become Europe's number one paid tourist desti-nation, there is a clear need to increase attendance even further. Philippe Bourguignon estimated that the park needs 12.5 million visitors per year to break even once roy-alty demands and interest payments resume in 1998. This figure, which before 1995 seemed an impossible target, even-now appears-highly optimistic.

Such an attendance target seems even more unlikely when the rapidly rising level of competition within the Eu-ropean amusement. Park industry is taken into considera-tion. While U.S. Disney parks posed a competitive threat in the early 1990s, the appearance of a number of new theme parks in Europe, such as Spain's Port Ventura, which opened in May 1995, and Germany's Warner Broth-ers Movie World, is likely to present a greater threat in the late 19908. Despite high barriers to entry, many new parks are being built while established parks are investing in new attractions. Much of this demand-driven investment activ-ity has been stimulated directly by the market-ing appeals of

Exhibit 5 Euro Disney profit and loss

	(FY Ending 30 September)	
	Revenue	Profit (Loss)
1993	4.9 billion	(5.3 billion)
1994	4.1 billion	(1.8 billion)
1995	4.8 billion	114 million)

Euro Disney. In 1993, an estimated 58 million people spent around US$1.5 billion on Europe's theme parks. As the managing director *of* the United Kingdom's Thorpe Park observed, "We enjoyed 1993 on the back *of* Disney's promotional budget, but it's a tough and competitive business."

Indeed, with around 30 to 40 amusement parks, West-ern Europe is fast coming to resemble the North American market where Disney is the dominant player among a crowd *of* competitors (including Six Flags, Universal Stu-dios, and Sea World). However, unlike North America, where there typically are clusters *of* parks in close proxim-ity in places such as Orlando and Southern California (thus creating an incentive for visitors to stay a week or more in each locale), in Europe the amusement parks are scattered across the continent.

In addition to the direct competition from parks such as Alton Towers, the United Kingdom's largest theme park, Disneyland Paris also competes indirectly with other en-tertainment-based attractions such as roller-coaster parks, including Blackpool's Pleasure Beach and Goteborg's Liseberg. Furthermore, a new competitive threat is also emerging in the form of computer-based interactive enter-tainment, which l)as led to the establishment *of* a number *of* tourist attractions such as Sega's new Virtual World Center, located in London's popular Trocadero complex.

Competition in the amusement park industry is per-haps most evident in the introduction *of* new rides and at-tractions. For example, Euro Disney's record-breaking attendance figures for 1995 were positively influenced by the opening *of* Space Mountain, a roller coaster ride based on Jules Verne's book, *From the Earth to the Moon.* Across the Channel, Alton Towers also enjoyed record atten-dances in 1995 based largely on the crowd-pulling power of two newly-opened rides, Nemesis and Energiser, while in Barcelona the Tussaud's -owned Port Aventura promotes its Dragon Khan roller coaster as being the first to turn thrill seekers upside down eight times.

The Third Biennium: What To Do?

In seeking to increase the attendance *of* Disneyland Paris and ensure the sustained profitability *of* the company beyond 1998, Philippe Bourguignon must deal with a number *of* issues.

1. How should the park differentiate itself from the competitive threat posed by the growing number *of* European amusement parks?
2. What target marketing strategy should be pursued in the face *of* the changing competitive environment?
3. What branding-strategy decisions are relevant?
4. What can be done to make better use *of* underuti-lized resources (such as the hotels) while increasing the profitability *of* well-patronized facilities?

LESSON 11
GLOBAL MARKETING INFORMATION SYSTEMS AND RESEARCH

"To survive in this new globally competitive world, we had to modernize. Information technology is the glue for everything we do."

James Wogsland

Vice Chairman, Caterpiller

"Nothing changes more constantly than the past; for the past that influences our lives does not consist of what happened, but of what men believe happened."

Gerald W. Johnsonston

The objective of the chapter is to make the student understand the importance of market research in international marketing. After the lesson the student would be able to appreciate the following:

1. Overview of Global Marketing Information Systems
2. Sources of Market Information
3. Formal Marketing Research
4. Current Issues in Global Marketing Research
5. An Integrated Approach to Information Collection

Information, or useful data, is the material of executive action the global marketer is faced with a dual problem in acquiring the information needed for decision making. In high-income countries, the an10unt of information available far exceeds the absorptive capacity of an individual or an organization. The in formation problem is superabundance, not scarcity. Although advanced countries all over the world are in the middle of an information explosion, there is a lack of information available on the market characteristics of less developed countries.

Thus, the global marketer is faced with the problem of information abundance an information scarcity. The global marketer must know where to go to obtain information the subject areas that should be covered and the different ways that information can bi acquired acquired information must be processed in an efficient and useful way. The technical term for the process of information acquisition is *scanning.* This chapter presents an information acquisition model for global marketing as well as an outline 0 the global n1arketing research process. Once acquired, information must be processed in an efficient and effective way. The chapter concludes with a discussion of how to manage the marketing information collection system and the marketing research effort.

For example, K.M.S. "Titoo" Ahuwalia is the president of ORG-MARG, the largest marketing research company in India. His client list reads like a "Who's Who" of global companies: Avon Products, Gillette, Coca-Cola, and Unilever. And, as Titoo is fond of telling' them, they are finding that "India is different." India is the second most populous nation on earth, with a middle class comprised of more than 200 million people.

Despite increasing affluence, however, centuries-old cultural traditions and customs still prevail. As a result, consumer behavior sometimes confounds Western expectations. Despite the fact that summer temperatures frequently reach triple digits; only 2 percent of urban dwellers use deodorant. Instead, Indians bathe twice daily. Only l' percent of households have air conditioners, and a recent Gallup survey revealed that only 1 percent intended to buy an air conditioner in the near future. The virtues of frugality once preached by Gandhi remain uppermost in the minds of many; smokers refill disposable lighters, and women recycle old sheets instead of spending money on sanitary napkins. Likewise, in a country where food is believed to shape personality and mood and hot breakfasts are thought to be a source of energy, Kellogg has had little luck winning converts to cold cereal.

For marketers hoping to achieve success in India and other emerging n1arkets, information about buyer behavior and the overall business environment is vital to ef1ective managerial decision making. When researching any market, marketers n1ust know where to go to obtain information, what subject areas to investigate and information to look for, the different ways information can be acquired, and the various analytical approaches that will yield important insights and understanding. Obviously, India's 16 languages, 200 dialects, and low level of urbanization create special research challenges. However, similar challenges are likely to present themselves wherever the marketer goes.

It is the marketer's good fortune that, since the n1id-1990s, a veritable cornucopia of market information has become available on the Internet. A few keystrokes can yield literally hundreds of articles, research findings, and Web sites that offer a wealth of information about particular country markets. Even so, marketers need to study several important .topics in order to make the most of modern information technology. First. they need to understand the importance of information technology and marketing information systems as strategic assets. Second, they need a framework for information scanning and opportunity identification. Third, they should have a general understanding of the formal market research process. Finally, they should know how to manage the marketing information collection system and the marketing research effort. These topics are the focus of this chapter.

Benetton's Information System

In the fashion business, the company that gets preferred styles and colors to market in the shortest time gains an edge over competitors. Lucuano Benetton, founder of the Italian company that bears his name, notes, " Benetton's market is, for reasons of product and target, very dynamic, evolving rapidly" the company's information system includes relational databases and a network for electronic data interchange. Benetoon

manager a rely heavily on inbound data generated at the point of purchase; data about each sales transaction are instantly transmitted via satellite to headquarters from cash registers at the company's 7,000 stores around the world. Analysts sift through the data to identify treads, which are conveyed to manufacturing.

Most of Benetton's Knitwear is produced as under " grey goods" garments are dyed in batches in accordance with the fashion trends identified by the MIS. Benetton's system helps cut inventory carrying costs and reduce the = number of slow selling items that must be marked down. The company's staff of field agents uses a tracking system to follow the movement of outbound merchandise. Te system shows whether a particular item is in production, in a warehouse, or in transit. In Benetton's state of the art, $57 million distribution center, computer controlled robots sort, store, and retrieve up to 12,000 bar coded boxes of merchandise each day.

The MIS even helps the designer team work more efficiently. Before the MIS was installed, designers had to personally visit the warehouse to review samples of clothing from previous seasons. With the new system, all clothing items are photographed and the images digitized and sorted on a laser disc connected to a personal computer. A designer sitting at the computer can request any item from seasonal collections dating back several years, and it will be displayed on screen.

Taken as a whole, Benetton's MIS has slashed the amount of time required to design and ship Knitwear from 6 months to a matter of weeks. Reorders from any ciano Benetton is not satisfied. He hopes to go beyond data processing and use information technology as a tool Zuccaro," he says it's not enough to know what we sold, but we need to know what we should have sold and that we lost X dollars by not realizing our potential."

Information Subject Agenda

A starting point for a global MIS is a list of subjects about which information is desired.

The resulting subject agenda should be tailored to the specific needs and objectives of the company. The general framework suggested in Table 6-1 consists of six broad information areas. The framework satisfies two essential criteria. First, it comprises all the information subject areas relevant to a company with global operations. Second, the categories in the framework are mutually exclusive Any kind of information encompassed by the framework can be correctly placed in one and only one category. The basic elements of the external environment-economic, social and cultural, legal and regulatory, and financial factors-will undoubtedly-be- on- the information agenda of most companies, as shown in the table.

Six Subject Agenda Categories For A Global Business

Category	Coverage
1. Markets	Demand estimates, consumer behaviour, products, channels, communication media availability and cost, and market responsiveness.
2. Competition	Corporate, business, and functional strategies and plans
3. Foreign Exchange	Balance of payments, interest rates, attractiveness of country currency, expectations of analysts.
4. Prescriptive Information	Laws, regulations, rulings concerning taxes, earnings, dividends in both host countries and home country.
5. Resource Information	Availability of human, financial, information, and physical resources.
6. General conditions	Overall review of socio-cultural, political, technological environments.

Scanning Modes: Surveillance and Search

Once the subject agenda has been determined, the next step is the actual collection of information. This can be accomplished using surveillance and search.

In the surveillance mode, the marketer engages in informal information gathering. Globally oriented marketers are constantly on the lookout for information about potential opportunities and threats in various parts of the world. They want to know everything about the industry, the business, the marketplace, and consumers. This passion shows up in _he way they keep their ears and eyes tuned for clues, rumors, nuggets of information, and insights from other people's experiences. Browsing through newspapers and magazines and surfing the Internet are ways to unsafe exposure to information on a regular basis. Global marketers may also develop a habit of watching news programs and commercials from around the world via satellite. This type of general exposure to information is known a_ viewing. If a particular news story has special relevance for a company-for example, entry of a new player into a global industry, say, Samsung into automobiles-marketers in the automobile and related industries and all competitors of Samsung will pay special attention, tracking the story as it develops. This is known as monitoring.

The search mode is characterized by more formal activity. Search is characterized by the deliberate seeking out of specific information. Search often involves investigation, a relatively limited arid informal type of search. Investigation often involves seeking out books or articles in trade publications or searching the Internet on a particular topic or issue. Search may also consist of research, a formally organized effort to acquire specific information for a specific purpose.

One study found that nearly 75 percent of the information acquired by headquarters executives at 'U.S. global companies comes from surveillance as opposed to search. However, the viewing mode generated only 13 percent of important external information, whereas monitoring generated 60 percent. Two factors contribute to the paucity of information generated by viewing. One is the limited extent to which executives are exposed to information that is not included in a clearly defined subject agenda. The other is the limited receptivity of the typical executive to information outside this agenda. Every executive limits his or her exposure to information that will not have a

high probability of being relevant to the job or-company. This is rational: A person can absorb only a minute fraction of the data available to him or her Exposure to and retention of information stimuli must be selective. Nevertheless, it is vital that" the organization as a whole be receptive to -information not explicitly recognized as important. Some organizations suffer from a variation of the NIH (not invented here) syndrome. If the information they are viewing has not been generated by their company, it is summarily missed. To be effective, a scanning system must ensure that the organization is viewing areas where developments that could be important to the company might occur. Innovations in information technology have increased the speed with which information is transmitted and simultaneously shortened the life of its usefulness to the company. Advances in technology have also placed new demands on the global firm in tenus of shrinking reaction times to acquired information. In some instances, the creation of a full-time scanning unit with responsibility for guiding and stimulating the process of acquiring and disseminating strategic information may be advisable.

Of all the changes in recent years affecting the availability of information, perhaps none is more apparent than the explosion of documentary and electronic information. An overabundance of information has created a major problem for anyone attempting to stay abreast of key developments in multiple national markets. Today, executives are overwhelmed with documentary information. However, too few companies employ a formal system for coordinating scanning activities. This situation results in considerable duplication of effort. for example, it is not uncommon for members of an entire management group to read a single publication covering a particular subject area despite the fact that several other excellent publications covering the same area may be available.

Wherever you are located, you can benefit from reading foreign publications. The Economist, The Financial Times, and The Wall-Street Journal's regional editions are good broad based sources. Also, review the Web site recommendations throughout and at the end of the chapter.

The best way to identify unnecessary duplication is to carry out an audit of reading activity by asking each person involved to list the publications he or she reads regularly. A consolidation of the lists will reveal the surveillance coverage. Often the scope of the group will be limited to a handful of publications to the exclusion of other worthwhile ones. A good remedy for this situation is consultation with outside experts regarding the availability and quality of publications in relevant fields or subject areas.

Over all, then, the global organization is faced with the following needs:

- An efficient, effective system that will scan and digest published sources and technical journals in the headquarters country as well as all countries in which the company has operations or customers.
- Daily scanning, translating; digesting, abstracting, and electronic input of information into a market intelligence system. Despite the advances in global information, its translation and electronic input are mostly manual. This will continue for the next few years, particularly in developing countries'.
- Expanding information coverage to other regions of the World.

Sources of Market Information

Human Sources

Although scanning is a vital source of information, research has shown that headquarters executives of global companies obtain as much as two thirds of the information they need from personal sources. A great deal of external information comes from executives based abroad in company. subsidiaries, affiliates, and branches. These executives are likely to have established communication with distributors, consumers, customers, suppliers, and government officials. Indeed, a striking feature of the global corporation-and a major source of competitive strength-is the role executives abroad play in acquiring and disseminating information about the world environment. Headquarters executives generally acknowledge that company executives overseas are the people who know best what is going on in their areas. The following is a typical comment of headquarters executives:

Our principal sources are internal. We have a very well informed and able overseas group. The local people have a double advantage. They know the local scene and they know our business. Therefore, they are an excellent source. They know what we are interested in learning, and because of their local knowledge they are able to effectively cover available information from all sources.

The information issue exposes one of the key weaknesses of a domestic company: Although more attractive opportunities may be present outside existing areas of operation, they will likely go unnoticed by inside sources in a domestic company because the scanning horizon tends to end at the home-country border. Similarly, a company with only' limited geographical operations may be at risk because internal sources abroad tend to scan only information about their own countries or region.

Other important information sources are friends, acquaintances, professional colleagues, consultants, and prospective new employees. The latter are particularly in1portant if they have worked for competitors. Sometimes, information-related ethical and legal issues arise when a person changes jobs. When Ignacio Lopez de Arriortua, head of purchasing at General Motors (GM), accepted a job as production chief with Volkswagen (VW), GM charged that Mr. Lopez had taken important documents and computer files when he moved to VW. Although he was acquitted by a German court, the resulting publicity was a source of embarrassment to Volkswagen.

It is hard to overstate the importance of travel and contact for building rapport and personal relationships. Moreover, one study found that three quarters of the information acquired from human sources is gained in face-to-face conversation. Why? Some information is *too* sensitive to transmit in any other way. For example, highly placed government employees could find their careers. compromised if they are identified as information sources. In such cases, the most secure way of transmitting information is face-to-face rather than "in writing.

Information that includes estimates of future developments or even appraisals of the significance of current happenings is often considered *too* uncertain to commit to writing. Commenting on this point, one executive said:

People are reluctant to commit themselves in writing to highly "iffy" things. They are not cowards or overly cautious; they simply' know ,that you are bound to be wrong in trying to predict the future, and they prefer to not have their names associated with documents that will someday Look foolish.

The great importance of face-to-face communication lies also in the dynamics of personal interaction. Personal contact provides an occasion for executives to get together for a long enough time to permit communication in some depth. Face-to-face discussion also exposes highly significant forms of nonverbal 'communication, as discussed in-Chapter 3. One executive described the value of face-to-face contact in these terms:

If you really want to find .out about an area, you must see people personally.

There is no comparison between written reports and actually sitting down with someone and talking. A personal meeting is worth a- thousand written reports. .

Documentary Sources

One of the most important developments in global marketing research is the extraordinary expansion in the quantity and quality of documentary sources of information. The information explosion is an explosion in the availability of documentary information not only in print but increasingly on-line and on the Internet and the intra net for company-restricted information. The two broad categories of documentary information are published public information and unpublished private documents. The former is available on the Internet, and the latter is available on the intranet or company password-restricted-access networks created by organizations for their own employees.

The vast quantities of published documentary information that are available create a unique challenge: how to find the exact information you want. One of the fast-growing industries in the world are companies that gather, analyze, and organize data from multiple sources, which they then make available to clients.

Internet Sources

The range and depth of information available on the Internet are vast and growing every day. Companies, governments, nongovernmental organizations, market research companies, data assemblers and packagers, security analysts, news gathering organizations, universities, and university faculty to mention just a few are all sources that can be accessed on-line. The Internet is a unique information source: It combines the three basic information source types: human, documentary (published and private), and direct perception.

An e-mail communication may be personal or impersonal. A document may be text only, or it may include pictures and music. The pictures may be still or full-motion video or animation. The document may be combined with music.

With the ever expanding bandwidth of transmission media, the ever increasing speed of processors that organize and transmit information, and the ever expanding universe of senders and receivers of information, the Internet is clearly a revolutionary development in global marketing research..

A number of electronic resources have been developed in recent years. The so include the National Trade Data Base, which is available on CD-ROM from the Department of Commerce. The GateWaze company in Manchester, Massachusetts, has developed PC software called "The World Trader" to help small firms find opportunities in. export markets. Similarly, the Port Authority of New York developed a program called "Export to win to help small business owners learn about exporting. In addition, the Internet and offer interactive information services feature bulletin boards where a great deal of information about various world markets is exchanged. Another on-line source is the EIU (Economist Intelligence Unit), which is maintained by The Economist.

Yet, some things never change. The information explosion is a Janus-faced monster. There is more and more information, but the sheer quantity of information makes it more and more difficult to find what you are looking for. The challenge is to develop search strategies and skills that ensure that you-get the information you need to better understand global markets, customers, and competition.

Direct Perception

Direct sensory perception provides a vital background for the information that comes from human and documentary sources. Direct perception gets all the senses involved. It means seeing, feeling, hearing, smelling, or tasting for oneself to find out what is going on in a particular country rather than getting secondhand information by hearing or reading about a particular issue. Some information is easily available from other sources but requires sensory experience to sink in.

Often, the background information or context one gets from observing a situation can help fill in the "big picture." For example, Niall Fitzgerald, cochairman of Unilever, relates a story about the disastrous rollout in the United Kingdom of Persil Power, a laundry powder with "an extra scrubbing chemical." Unfortunately, the chemical worked too well and ate through clothing. When trying to determine a solution for the problem, Fitz Gerald asked the 30 Unilever executives how many did their own laundry. No one responded. "There we were, trying to figure out why customers wouldn't buy our soap and we didn't even know the first thing about how it was used. The lesson he learned from this scenario was to never lose sight of your customer. Company recruits at Hindustan Lever are asked to spend six weeks living with a family in a remote Indian village.

The chief executive of a small U.S. company that manufactures an electronic device for controlling corrosion had a similar experience. After spending much time in Japan, the executive managed to book several orders for the device. Following an initial burst of success, Japanese orders dropped off; for one thing, the executive was told the packaging was too plain. We couldn't understand why we needed a five-color label and a custom-made box for this device, which- goes under the hood of a car or in the boiler room of a utility company," the

executive said. While waiting for the bullet train in Japan one day, the executive's local distributor purchased a cheap watch at the station and had it elegantly wrapped. The distributor asked the American executive to guess the value of the watch, based on the packaging. Despite everything he had heard and read about the Japanese obsession with quality, it was the first time the American understood that in Japan, "a book is judged by the cover." As a result, the company revamped its pack- aging, seeing to such details as ensuring that strips of tape used to seal the boxes were cut to precisely the same length.

Toyota relied heavily on direct perception when redesigning its flagship luxury car, the Lexus LS 400, for the 1995 model year. The chief engineer of Lexus and a five-person team came to the United States to get firsthand direct observation data on the market. They stayed in luxury hotels to gain an understanding of the level of service Lexus customers demanded. Design team members visited customers' homes and took notes on preferences for such things as furniture, paintings, and even briefcases. As Ron Brown, a ITS based product planning manager for Lexus, recalled, "It's like if you just bought a new washer-dryer, and the Kenmore people called and said they wanted to bring a bunch of people out to watch you wash your clothes." One thing the team discovered was that the cost hooks in the first generation LS 400 were too small. The Japanese thought a coat hook was, literally, for hanging a coat. In reality, Lexus owners regularly hang their dry cleaning in the car. The hook was redesigned. "You can get five coat hangers on it. But now it's big enough that you wouldn't want it out all the time, so it retracts," says Brown.

Euro Disney had been experiencing marketing and financial difficulties. Consumers were not flocking to the site and the consumers who visited were not very satisfied. One issue was the sale of alcohol with in the park. Disney had a no-alcohol policy but it wasn't until a vice president who was sent to France to solve-the problem realized, after living in France for several months, that wine with meals is the norm in, France. Not serving, wine was "an affront" to local customers. Based on his experience of living in the country, he worked diligently to have the policy changed?

As these examples show, cultural and language differences require firsthand visits to important markets to "get the lay of the land." Travel should be seen not only as a tool for management control of existing operations but also as a vital and indispensable tool in information scanning.

Formal Marketing Research

Information is a critical ingredient in formulating and implementing a successful marketing strategy. As described earlier, a MIS should produce a continuous flow of information.1vlarketing research, on the other hand, is the project-specific, systematic gathering of data in the search scanning mode. There are two ways to conduct marketing research. One is to design and implement a study with in-house staff. The other is to use an outside firm specializing in marketing research. The importance of the global market to research firms has increased considerably in recent years. For example, ACNielsen Company's 1998 revenues from non-U.S. research totaled $1.4 billion, over 70 percent of total revenue. (Marketing research companies are ranked in Table 6-2 according to revenues generated outside the United States.) ACNielsen with a combination of wholly owned subsidiaries and affiliates has offices in 80 countries and customers in more than 100 countries. If your company is in need of a research company in another country, the Green Book published by the New York Chapter of the American tv1arketing Association lists hundreds of companies around the world.

The process of collecting data and converting it into useful information can be divided into five basic steps: identifying the research problem, developing a research plan, collecting data, analyzing data, and presenting the research findings. Each step is discussed below.

Step 1: Identifying the Research Problem

The following story illustrates the first step in the formal marketing research process.

The vice presidents of finance and marketing of a shoe company were traveling around the world to estimate the market potential for their products. They arrived in a very poor country and both immediately noticed that none of the local citizens were wearing shoes. The finance vice president said, "We might as well get back on the plane. There is no market for shoes in this country." The vice president of marketing replied, "What an opportunity! Everyone in this country is a potential customer!"

The potential market for shoes was enormous in the eyes of the marketing executive. To formally confirm his instinct, some research would be required. As this story shows, research is often undertaken after a problem or opportunity has presented itself. Perhaps a competitor is making inroads in one or more important markets around the world, or, as in the story just recounted, a company may wish to determine whether a particular country- or regional market provides good growth potential. It is a truism of market research-that "a-problem well-defined is a problem half solved." Thus, regardless of what situation sets the research effort in motion, the first two questions a marketer should ask are, "What information do I need?" and "Why do I need this information?"

The research problem often involve assessing the nature of the market opportunity, a phase that is also known as research. This, in turn, depends in part on whether the market that is the focus of the research effort can be classified as existing or potential. Existing markets *ate* those in which client needs for secondary information are already being served. In many countries, data about the size of existing markets-in terms of dollar volume and unit sales-are readily available. In countries in which such data are not available, such as Cuba, a company must first estimate the market size, the level of demand, or the rate of product purchase or consumption. A second research objective in existing markets may be assessment of the company's overall competitiveness in terms of product appeal, price, distribution, and promotional coverage and effectiveness. Researchers may be able to pinpoint a weakness in the competitor's product or identify an unserved market segment.

Potential markets can be further subdivided into latent and incipient markets. A latent market is, in essence, an undiscov-

ered segment. It is a market in which demand would materialize if an appropriate product were made available. In a latent market, demand is zero before the product is offered. In the case of existing markets, the main research challenge is to understand the extent to which competition fully meets customer needs. With latent markets, initial success is not based on a company's competitiveness; Rather, it depends on the prime mover advantage-a company's ability to uncover the opportunity and launch a marketing program that taps the latent demand. Sometimes traditional marketing research is not an effective means for doing this. As Peter Drucker has pointed out, the failure of American companies to successfully commercialize fax machines-an American innovation-can be traced to research that indicated no potential demand for such a product. The problem, in Drucker's view, stems from the typical survey question for a product targeted at a latent market. Suppose a researcher asks, "Would you buy a telephone accessory that costs upward of $1,500 and enables you to send, for $1 a page, the same letter the post office delivers for 25 cents?" On the basis of economics alone, the respondent most likely will answer, "No."

Drucker explains that the reason Japanese companies are-the leading sellers of fax machines today is that their understanding of the market was not based on survey research. Instead, they reviewed the early days of mainframe computers, photocopy machines, cellular telephones, and other information and communications products. The Japanese realized that, judging only by the initial economics of buying and using these new products, the prospects of market acceptance were low. Yet, each of these products had become a huge success after people began to use them. This realization prompted the Japanese to focus on the market for the benefits provided by fax machines rather than the market for the machines themselves. By looking at the success of courier services such as Federal Express, the Japanese realized that, in essence, the fax machine market already existed.

Incipient demand is demand that will emerge if a particular economic, technological, political, or sociocultural trend continues. If a company offers a product to meet incipient demand before the trends have taken root, it will have little market response. After the trends have had a chance to unfold, the incipient demand will become latent, and later, existing demand. This can be illustrated by the impact of rising income on demand for automobiles and other expensive consumer durables. As per capita income rises in a country, the demand for automobiles will also rise. Therefore, if a company can predict a country's future rate of income growth, it can also predict the growth rate of its automobile market.

Step 2: Developing a Research Plan

After defining the problem to be studied or the question to be answered, the marketer must address a new set of questions. What is this information worth to me in dollars (or yen, etc.)? What will we gain by collecting these data? What would be the cost of not getting the data that could be converted into useful information? Research requires the investment of both money and managerial time, and it is necessary to perform a cost benefit analysis before proceeding further.

In some instances, a company may pursue the same course of action no matter what the research reveals. Even when more information is needed to ensure a high-quality.

Decision, a realistic estimate of a formal study may reveal that the cost to perform research is simply too high. As. discussed the next section, a great deal of potentially useful data already exists; utilizing such data instead of commissioning a. major study can result in significant savings. In. any event, during the planning step, methodologies, budgets, and time parameter are all spelled out. Only when the plan is completed should the next step be undertaken.

Step 3: Collecting Data

Are data available in company files, a library, industry or trade journals, or on-line? When is the information needed? Marketers must address these issues as they proceed to the-data collection step of the research. Using readily available data saves both money and time. A formal market study can cost hundreds of thousands of dollars and take many months to complete with no guarantee that the same conditions are still relevant.

Secondary Data

A low-cost approach to marketing research and data collection begins with desk research. Personal files, company or public libraries, on-line databases, government records, and trade associations are just a few of the data sources that can be tapped with minimal effort and often at no cost. Data from these sources already exist. Table 6-4 shows how specific free data based on U.S. Customs data can be. Such data are known as secondary data because they were not gathered for the specific. project at hand. Syndicated studies published by research companies are another source of secondary data and information. The Cambridge. Information Group publishes 'Findex, a directory of more than 13,000 reports and studies covering 90 industries. The Economist Intelligence Unit's EIU Country Data is another valuable source of information both in print and on-line. Another on-line example is the Global Market Information Database (GMID). It contains information on 330 consumer products in 49 countries such as the market for alcohol beverages in China. The cost of this report is contingent upon the various modules that are purchased and costs several thousands of dollars. It is available in many university libraries.

Primary Data and Survey Research

When data are not available through published statistics or studies, direct collection is necessary. Primary data pertain to the particular problem identified in step 1. Survey research, interviews, and focus groups are some of the tools used to collect primary market data. Personal interviews with individuals or groups allow researchers to ask "why" and then explore answers. A focus group is a group interview led by a trained moderator who facilitates discussion of a product concept, advertisement, social trend, or other topic. For example, the Coca-Cola Company convened focus groups in Japan, England, and the United States to explore potential consumer reaction to a prototype 12 ounce contoured aluminum soft-drink can. Coke was particularly anxious to counteract competition from private-label colas in key -markets. In England, for example, Simsbury's store-brand cola had an 18 percent market share9 and Virgin

Cola was a major competitor. There are, however, cultural differences that must be considered when using focus groups. In Asia, young people tend to defer to elders, and lower-level executives to higher-level executives when they are in the same group. In Latin America, respondents tend to overstate their enthusiasm and Asians tend to show diffidence.

In some instances, product characteristics dictate a particular country location for primary data collection. For- example, Case Corporation recently needed input from farmers about cab design on a new generation of tractors. Case markets tractors in North America, Europe, and Australia, but the prototypes it had developed were too expensive and fragile to ship. Working in conjunction with an Iowa-based marketing research company, Case invited 40 farmers to an engineering facility near Chicago for interviews and reactions to instrument and control mockups. The visiting fanners were also asked to examine tractors made by Case's competitors and evaluate them on more than 100 different -design elements. Case personnel from France and Germany were on hand to assist as interpreters.

Survey research often involves obtaining data from customers or some other designated group by means of a questionnaire. Surveys can be designed to generate quantitative data ("How often would you buy?"), qualitative data ("Why would you buy?"), or both. Survey research generally involves administering a questionnaire by mail, by telephone, or in person. Many good marketing research textbooks provide details on questionnaire design and administration. A good questionnaire has three main characteristics:

1. It is simple.
2. It is easy for respondents to answer and for the interviewer to record.
3. It keeps the interview to the point and obtains desired information.

An important survey issue in global marketing is potential bias due to the cultural background of the persons designing the questionnaire. For example, a survey designed and administered in the United States may be inappropriate in non-Western cultures, even if it is carefully translated.12 Sometimes bias is introduced when a survey is sponsored by a company that has a financial stake in the outcome and plans to publicize the results. For example, American Express joined with the French tourist bureau in producing a study that, among other things, covered the personality of the French people. The report ostensibly showed. that, contrary to a long-standing stereotype, the French are not "unfriendly" to foreigners. However, the survey respondents were people who already had traveled to France on pleasure trips in the previous two years-a fact that likely biased the result.

Sampling

Sampling is the selection of a subset or group "from a population that is representative of the entire population. The two basic sampling procedures are probability sampling and non-probability sampling. In a probability sample,. each unit chosen has a known chance of being included in the sample. There are five types of probability sampling: random, stratified_- systematic, -cluster, and-multistage. -In a-non-probability sample, the chance that any unit will be included in the sample is unknown. The four types of no probability sampling are: convenience, judgmental, quota, and snowball.

Four considerations for using a -probability sample are: the target population must be specified; the method of selection must be determined; the sample size must be determined; and non-responses must be addressed.

Step 4: Analyzing Research Data

Demand Pattern Analysis

Industrial growth patterns provide an insight into market demand. Because they generally reveal consumption patterns, production patterns are helpful in assessing market opportunities. Additionally, trends in manufacturing production indicate potential markets for companies that supply manufacturing inputs. At the early stages of growth in a country, when per capita incomes are low, manufacturing centers on such necessities as food and beverages, textiles, and other forms of light industry. As incomes rise, the relative importance of these industries declines as heavy industry begins to develop. As incomes continue to rise, service industries rise to overtake manufacturing in importance.

Income Elasticity Measurements

Income elasticity describes the relationship between demand for a good and changes in income. Income elasticity studies of consumer products show that necessities such as food and clothing are characterized by inelastic demand. Stated differently, expenditures on products in these categories increase but at a slower percentage rate than do increases in income. This is the corollary of Engel's law, which states that as incomes rise, smaller proportions of total income are spent on food. Demand for durable consumer goods such as furniture and appliances tends to be income elastic, increasing relatively faster than increases in income.

Market Estimation by Analogy

Estimating market size with available data presents challenging analytic tasks. When data are unavailable, as is frequently the case in both less developed and industrialized countries, resourceful techniques are required. One resourceful technique is estimation by analogy. There are two ways to use this technique. One way is to make cross-sectional comparisons, and the other is to displace a time series in time. The first method, cross-sectional comparisons, amounts simply *to* positing the assumption that there is an analogy between the relationship of a factor and demand for a particular product or commodity in two countries.

Cluster Analysis

The objective of cluster analysis is to group variables into clusters that maximize within group similarities and between-group differences. Cluster analysis is well suited to global marketing research because similarities and differences can be established between local, national, and regional markets of the world.

Analyzing Results

Because there are numerous analysis techniques and different assumptions may be used, the net conclusions that may be

drawn from market research may vary significantly. Two companies studying the same country or market segment can and often do reach different decisions accordingly. For example, the estimates of on-line shopping revenue for 1999 varied from $3.9 billion by the Direct Marketing Association to $36 billion by the Boston Consulting Group

Step 5: Presenting The Findings

The report based on the marketing research must be useful to managers as input to the decision-making process. Whether the report is presented in written form, orally, or electronically via videotape, it must relate clearly to the problem or opportunity identified in step 1. Many managers are uncomfortable with research jargon and complex quantitative analysis. Results should be clearly stated and -provide a basis for managerial action. Otherwise, the report may end up on the shelf where it will gather dust and serve as a reminder of wasted time and money. As the data provided by a corporate information system and marketing research become increasingly available on a worldwide basis, it becomes possible to analyze marketing expenditure effectiveness across national

boundaries. Managers can then decide where they are- achieving the greatest marginal effectiveness for their marketing expenditures and can adjust expenditures accordingly.

Current Issues in Global Marketing Research

Marketers engaged in global research face special problems and conditions that differentiate their task from that of the domestic market researcher. First, instead of analyzing a single national market, the global market researcher must analyze many national markets, each of which has unique characteristics that must be recognized in analysis. As noted earlier, for many countries, the availability of data is limited.

Second, the small markets around the world pose a special problem for the researcher. The relatively low profit potential in smaller markets permits only a modest marketing research expenditure. Therefore, the global researcher must devise techniques and methods that keep expenditures in line with the market's profit potentially smaller markets, there is pressure-on the researcher to discover economic and demographic relationships that permit estimates of demand based on a minimum of information. It may also be necessary *to* use inexpensive survey research that sacrifices some elegance or statistical rigor to achieve results within the constraints of the smaller marketing research budget.

Another frequently encountered problem in developing countries is that data may be inflated or deflated, either inadvertently or for political expediency. For example, *c* Middle Eastern country deliberately revised its balance of trade in a chemical production

Marketing Research in Developing Countries

Nestle demonstrates how understanding the market can lead to success. It successfully positioned its maggi brand noodles as a between meal snack food rather than pasta meal item. Nestle also caters to the Indian preference for local brands; although Nescafe is the company's flagship global coffee brand in may countries, Nestle created chicory flavored sunrise especially for the Indian market. Nestle managers have also learned that the 20 million wealthy households in its core target market exhibit a value orientation traditionally associated with mass markets. Nestle has responded by keeping prices down more than half of the predicts it sells in India cost less than 25 rupees about 70 cents.

The tobacco industry is also learning about India. Sixty percent of Indian men smoke, although many prefer the native bidi, *which is hand rolled with a leaf outer wrapper rather than paper. As Darry Jayson, economist at the Tobacco Merchants Association (TMA), noted recently, " many companies, local and international, are hoping that these bidi-smokers move up to cigarettes as India becomes more affluent." Although western brands enjoy high levels of awareness, the government taxes make up 70 percent of the retail price of a single pack. As a result, premium European brands such as Dunhgill cost $4 per pack, whereas Indian brands from Indian Tobacco company and other local manufactures sell for 50λ to $1.50. taste is an issue facing America tobaccos, while the typical American smoke uses oriental and burley blends. The TMA's Jayson says," Indian smokers perceive U.S. cigarettes as roasted and harsh. I think it is very difficult to change the smoking habits of the Indians. It may take up to 20 years to bring about the change."*

by adding 1,000 tons to its consumption statistics in "an attempt to encourage foreign investors to install domestic, production facilities. In Russia; Goskomstat, the state agency that measures the economy, generates mountains of misleading statistics. Real GDP may be 40 percent higher than the official numbers' because much of the economic activity in Russia's transitional economy is "off the books due to high taxes and confusing -laws.[15]although market research in developing' countries may have its challenges, the results-are often well worth the effort as the examples in the box "Market Research in Developing Countries" demonstrate.

Another problem is that the comparability of international statistics varies greatly. "An absence of standard data-gathering techniques contributes to the problem. In Germany, for example, consumer expenditures are-estimated largely on the basis of turnover tax receipts, whereas in the United Kingdom, data from tax receipts are used in conjunction with data from household surveys and production sources.

Even with standard data-gathering techniques, definitions differ around the world. In some cases, these differences are minor; in others, they are quite significant. Germany, for example, classifies television set purchases as expenditures for "recreation and entertainment," whereas the same expenditure falls into the "furniture, furnishings, and household equipment" classification in the United States.

Marketing Information System

A Marketing Information System (MIS) is an integrated network of information designed to provide marketing managers with relevant and useful information at the right time and place for planning, decision making, and control. As such, the MIS helps management identify opportunities, become aware of potential problems, and develop marketing plans. The marketing information system is an integral part of the broader management information system. For example, Benetton's stores around the world are linked by computer. When an item is sold, its color is noted. The data collected make it possible for

Benetton to determine the shade and amount of fabric to be dyed each day, enabling the firm to respond to color trends very quickly.

In spite of computer and other advanced technologies, "dark age'; methods of data collection and maintenance are still prevalent. In many parts of the world, a knowledge and application of modern management systems is nonexistent. In many offices, scores of desks are crammed together in the same room. Each employee may have his or her own unique ad disorganized system for filing documents and information. New employees inherit these filing and accounting systems and modify their to fit their needs. The unindexed filing system, a long-honored custom, makes each employee practically indispensable since no one knows how to find a document that has been filed by someone else.

Such problems are not just confined to LDCs. Advanced nations, such as some European countries and Japan, are still struggling with the automation of their information systems. U.S. firms are also not immune to this problem.

There is often a misconception that an MIS must be-automated or computerized. Although many firms' systems are computerized, it is possible for a company to set up and utilize a manual system that can later be computerized if desired. With modern technology and the availability of affordable computers, it seems quite worthwhile for an international firm to install a computer based information system. Yet no one should assume that the computer is a panacea for all system problems, especially if flaws are designed into the MIS. A poorly designed system, whether computerized or not, will never-perform satisfactorily.

For the MIS to achieve its desired purpose, the system must be carefully designed and developed. Development involves the three steps of system analysis, design: and implementation; System analysis involves the investigation of all users' information needs. The relevant parties must be contacted-to—determine the kinds of information they need, when it is needed, and the suitable format through which the information is made available. Because information is not free, it may not be feasible to satisfy all kinds of information needs. The benefit of the information provided must be compared with the cost of obtaining and maintaining it. Only when the benefit is greater than the cost can a- particular information need- be accommodated.

System design should be the next major consideration. System design transforms the various information requirements into one or more plans that clearly specify the procedures and programs in obtaining, recording, and analyzing marketing data. Alternative or competing plans are developed and compared, and the most suitable one is ultimately selected.

The last step comprises system implementation. The chosen system is installed and checked to make certain that it functions as planned. Both those who operate the system and those who use it must be trained, and their comments should be evaluated to ensure the smooth operation of the system. Even after implementation, the system should continue to be monitored and audited. In this way, management can make certain that the system serves the needs of all users properly while preventing unqualified persons from gaining access to the system. Security Pacific Bank, for example, lost $10.3 million when a consultant was able to obtain an electronics fund transfer code and use it to deposit money into his Swiss bank account.

For the MIS to be effective and efficient, it should possess certain characteristics. According to Sweeney and Boswell, the system should be user-oriented, expandable, comprehensive, flexible, integrated, efficient, cost-effective, reliable, timely, and controllable. The MIS should also be systematic and self-perpetuating. Marketing and environmental information should be routinely received, evaluated, and continuously updated.

As implied above, certain characteristics are universal in the sense that all information systems, whether large or small and whether domestic or global, should possess them. But unlike a domestic MIS, an international marketing information system (IMIS) needs to satisfy additional criteria in order to ensure that the system can effectively serve a company's international marketing strategy. Some of these criteria are time independence, location independence, cultural and linguistic compatibility, legal compatibility, standardization/uniformity, flexibility, and integration. An IMIS should be time independent by providing around-the-clock services. Being location independent means that the system must be capable of allowing submission and usage of data at the various strategic points globally. Cultural knowledge and linguistic capability, whenever possible, should be built into the software and system. Naturally, the implementation of an IMIS must conform to local laws. To assure uniformity, certain kinds of information need to be standardized. Yet some degree of flexibility is required as well since a good information system should be useroriented. Finally, given the number of users, countries, and locations involved, an IMIS must be designed to allow data integration.

Database and Some Format Considerations

A firm's database should be flexible enough to accommodate each country's preferred style in maintaining names and addresses. Concerning addresses, in France, Germany and Italy, the postcode usually precedes the town on a single line. In Britain, the postcode should follow the country name. If the country name is omitted, the postcode follows the town or city.

In France and the United Kingdom, the house number precedes the street name. In Germany, Italy, and other European countries, it is the opposite. Regarding address windows, the window should go on the left-hand side in the case of Britain, the Netherlands, and Ireland. But in France, Sweden, Belgium, and Germany, the right-hand side is the norm.

Regarding field sizes, flexibility is a necessity. The German language may require up to one-third more characters than the English-language equivalent.

A. C. Nielsen is the world's largest consumer market research company with operations in twenty-seven countries. Nielsen Europe has synchronized its continent wide reporting periods and implemented pan-European databases. The databases, as defined by international standards, should enable marketers to efficiently access and compare data on their - own products and those of their competitors. Although many key influencing

factors such as language, consumption habits, retail trade structure, and TV advertising will continue to have distinct local character, the uniform methods allow for a quick examination of market situations across the entire continent.

The MIS consists of several subsystems: internal reporting, marketing research, and marketing intelligence. The internal reporting subsystem is vital to the system-because a company handles a great deal of information on a daily basis. The marketing department has sales reports. The consumer service department receives consumers' praises and complaints. The accounting department routinely generates and collects such information as sales orders, shipments, inventory levels, promotional costs, and so- on. All- of these types of internally generated information should be kept and made available to all concerned and affected parties.

DATABASE MARKETING

Some 750,000 babies are born in France each year. The stable birth rate has forced marketers to try to increase sales at the expense of the competitors. In the early 1990's, grocery stores' distributors began to focus on market leaders Bledina and Nestle which have 50 percent and 25 percent of the market, respectively, thus edging out Gerber.

To capture market share, Gerber began to build a database of young mothers through mailings to rented lists, hospital samplings, maternity-room videos, print advertisements, and materials placed in waiting rooms (e.g. literature about a program through which young mothers earned items from a gift catalog). The efforts yielded names, addresses, and telephone numbers as well as children's ages for follow-up contacts. Gerber has used the database to mail special packets of natural instant cereals to some 150,000 young French mothers whose infants have reached eighteen months. After the first eighteen months, children switch from jarred baby foods to cereals or other foods. The direct mail packages provide nutritional information as well as price-off and two-for-one coupons for the product. It is important to influence a mother's brand selection at the outset. Once she chooses a brand, she does not change it often

For externally generated information, the MIS should consist of two subsystems. One of these is the marketing research subsystem. The activities of this subsystem have already been discussed extensively. The other subsystem is the marketing intelligence or environmental scanning subsystem. The responsibility of this subsystem is 10 track environmental changes or trends. This subsystem collects data from salespersons, distributors, syndicated research services, government agencies, and from publications about technology, social and cultural norms, the legal and political climate, economic conditions, and competitor's activities.

The implementation of the MIS must conform to local laws. Many countries, concerned with citizens' privacy, have laws that restrict free flow of information. In England data users are required by the Data Protection Act to register with the Office of Data Protection Registrar; otherwise, heavy fines are levied. Computer users must state how personal information was obtained and how it will be used. Furthermore, British residents have the right to see personal data about themselves. Similarly, Quebec's privacy legislation restricts the activities of direct marketers who target the French-speaking province. The law requires marketers to notify customers that a file is being created on them and to explain why a database record has been set up. Consumers must be given a "reasonable opportunity" to get their names off mailing list.

The MIS should be designed to do more than data collection and maintenance. It should go beyond data collection by adding value to the data so that the information will be of most use to users. The MIS thus requires an ana1ytical component that is responsible for conceptually and statistically analyzing the data. This component may even go a step further by offering conclusions and recommendations based on the analysis of the data.

Levi's/Benelux has maintained a retail database of fourteen:' to twenty-three year olds in the three Benelux countries. The database relies exclusively on company owned stores and Comer department via a questionnaire. The questionnaire is a self mailer that asks a customer's name, address, age, and gender.

Levi's has two free magazines: Tab and Corner. The magazines feature the full range of Levi's products on a larger poster and such assorted features as film and music profiles sprinkled among full-page fashion photos of young people wearing Levi's items. Since most young people ignore TV spots, direct mail is the best way to reach Levi's target groups. Not receiving much direct mail, young people are happy to receive Levi's, magazine. Unfortunately {or these young people, when they reach age thirty, they will be automatically cut off. It is a waste of money to use direct mail to reach the thirty-plus age group.)

Keep it Private

Because there is no pan-European law, each country's law must be analyzed. In France, it is illegal to collect data having to do-directly or indirectly-with membership of trade unions.

In Germany, as a consequence of the Nazis' use of personal information to identify enemies, the country's data-protection laws may be the most restrictive in the European Union. Germany prohibits virtually all activities regarding collecting, storing, and processing personal data. In general, all storage, communication, and erasure of personal data are not allowed unless expressly permitted by the data-protection act. Data processing is prohibited unless a person has given his or her written consent.

In England, data collection laws are similar to those in France. Great Britain's Direct Marketing Association Code of Practice requires list owners to warrant that "the data have been fairly and lawfully obtained and all private individuals whose data are included have been given an opportunity to object to the use of their data by persons other than the list owner and that the data of those who have objected have either have been deleted from or so marked in the list".

LESSON 12:
INTERNATIONAL MARKETING INTELLIGENCE

What Information Is Needed?

We assume that the firm has already decided to go international. Its next decision, then, is which world markets to enter. Since the firm cannot usually sell to all world markets, it must find a way of ranking them according to their attractiveness. This requires an investigation of their market potential and the local competitive situation. Once the firm has identified desirable target markets, it must decide how to serve those markets-by exporting, licensing, or local production, for example.

Once a decision has been made to market in a particular country, standard marketing questions arise, such as product decisions, pricing decisions, or channel decisions. These decisions can be further broken down until eventually a very specific local issue is reached-the kind of package and label that should be used for the firm's floor wax in the Philippines, for example. The information needed to make these decisions is frequently provided by marketing research.

Information for Marketing Decisions

Marketing Decision	Intelligence Needed
1. Go international or remain a domestic marketer	Assessment of global market demand and firm's potential share in it, in view of local and international competition and compared to domestic opportunities.
2. Which markets to enter	A ranking of world markets according to market potential, local competition, and the political situation.
3. How to enter target markets	Size of market, international trade barriers, transport costs, local competition, government requirements, and political stability.
4. How to market in target markets	For each market: buyer behaviour, competitive practice, distribution channels, promotional media and practice, company experience there and in other markets.

The Information Provided by Marketing Research

What information should international marketing research provide? Obtaining information about consumer behavior and product-related information come to mind as typical marketing research objectives, but the objectives of international marketing research should be broader.

The fact of being in a global market means that the firm must seek information to help it to understand the country and regional environment, as well as the consumer and the product. The firm must assess the global competitors that it will face in order to compete better with them. Only then does information about the industry and the product make sense, and better research and decisions on the marketing mix can result.

Marketing Environment

Research should emphasize gathering information about the country and region of interest and evaluating comparative information across countries. Both political and economic information are relevant. The political dimension of information gathering includes data on the following:

1. Political structure and ideology : What does the political leadership of the country seek? What roles do major institutions such as business, labor, the educational sector, and religion play in shaping national goals?
2. National objectives : What are the country's goals for the defense sector, its fiscal, monetary, and investment policy; and the foreign trade sector? What are its industrial and technology policies for sunrise or burgeoning industries and its social policy (for example, how do they affect income distribution and conspicuous consumption)? Is autonomy a goal, does the nation seek to reduce import dependence, and is developing national champions in industries considered critical?
3. The economic dimension of information gathering is more familiar. It includes obtaining data on economic performance, covering indicators such as GNP, per capita income levels and growth rates, stage of the business cycle, balance of trade and balance of payments, productivity, labor costs and capital availability, capacity utilization, inflation rates, savings and investment, employment levels, educational attainment, population demographics, age distribution, public health, and income distribution. Marketing infrastructure is also of interest, including the structure of wholesaling and retailing, laws concerning pricing and promotion, the physical distribution infrastructure, and the extent of development. It of consumer protection. All of these help determine the attractiveness of the market, as well as obstacles to entry and marketing of goods and services as well-as the long-term profit potential.
4. Government regulation is another area for market research, particularly with regard to product and safety standards, barriers to entry (affecting foreign companies and their products), and controls over managerial and marketing autonomy. Does the government implement industrial policies that benefit domestic companies and industries at the expense of foreign firms?

Competition

Assessing foreign competitors involves developing additional levels of understanding since foreign competitors may have distinct and different objectives that shape their strategy and tactics. They may also possess hidden resources and strengths that are culture specific and not apparent to the outside firm. For example, close family and other ties may exist between a competitor's top management and influential individuals in government and the political arena. In conducting such assessment, the firm must first investigate the assumptions it holds about its foreign competitors regarding their objectives and capabilities; then it can assess potential strategies and make plans in terms of which new markets to enter, what modes of entry to take, how vulnerable it will be, and the expected strength of reaction by competition to its moves in that market. Essentially, the firm must be able to anticipate how its foreign competitors might act or react and to use such information to prepare contingency plans for quick response as appropriate.

Users of the Product

The firm must understand users, both of its product and those of its competitors. A paramount consideration is documenting and understanding cultural differences as they affect customer needs, products demanded, and purchasing behavior. Analysis and market research can focus on end-user industry categories and, if relevant, on unique characteristics of consumers. Information to help in segmentation should be gathered, using parameters such as age, sex, size, income levels, growth rates of consumption, regional differences, purchasing power, influence over purchasing and purchasing intentions, and the role of credit granting in purchasing behavior. Another major area of research is product benchmarking or quality comparisons, which makes objective comparisons of a firm's products and its competitors' products; this can be used to understand product positioning issues by competitors within an industry, as well as positioning across countries, customer response to new product introductions, and the potential for customers' purchasing the firm's own brands instead of competitors' brands. Finally, research should identify market trends for the medium and long term, rather than solely providing information .for decision making on immediate marketing plans and actions.

Marketing Mix

As we shall see later, a company can standardize or adapt its product as well as its marketing mix to different country markets. Hence, it is also necessary to research marketing mix choice in international markets. The following are areas that should be investigated:

1. Distribution Channels : Their evolution and the firm's comparative performance in different channels and those of its competitors.
2. Comparative pricing strategies and tactics : The price positioning by all competitors, price elasticity's, and customer response to differential pricing behavior.
3. Advertising and promotion : The range of choices available, the differences in the allocation of promotion expenditures, the delineation of the advertising response function in different markets, and the comparison of competitor choices in advertising and promotion.
4. Media research : Useful in determining where to advertise in order to reach target audiences. Major market research firms such as' A C. Nielsen and the Kantar Group (part of WPP) provide media research and media measurement services.
5. Service quality issues : Relative to positioning by competitors' and customers' reactions to higher levels of service.
6. Logistic of network capabilities : Delivery and stock out performance and the use of information systems to improves delivery and customer service. This relatively new area of marketing concern results from increased emphasis on just-in-time inventory systems and customer-direct delivery, bypassing retail inventories. Other key research issues are comparative performance of competitors and customer requirements.

Firm-specific Historical Data

Forgotten in marketing research is the role of a firm's internal information system in providing data for marketing decisions. Marketing research often can be facilitated by setting up the required database outline and implementing internal data collection; this is particularly necessary for international markets since much information that could be generated within the firm is ignored or lost. Useful data could include sales history by product and product line, by customer and sales force, by distribution channel, within a country and across countries; analysis of such historic data for trends across countries and regions; derivation and analysis of contribution by product, product line, customer, and region; and development of market response functions across countries to permit comparison of past marketing mix decisions and to suggest future mix decisions that may differ from country to country, within a country, or across regions.

Once marketing research has been completed, the information that it generates must be analyzed so that questions about future marketing plans and actions can be answered. Major questions that are relevant in international marketing fall into two categories: market and competition decisions and product and marketing mix decisions. In regard to market and competition, the firm should mainly be concerned with three issues:

1. Understanding how customers rate it in comparison to the competition.
2. Determining its chances to attract customers.
3. Deciding whether to compete or cooperate with the competition.

As to product and marketing mix, the firm should look at several factors:

1. Choosing which products to introduce, which distribution channels to use, and how to advertise and promote the product.
2. Identifying barriers to attractive markets and finding ways to overcome them.

Marketing research can also playa role in helping formulate global strategy. While strategy sets a path for how a firm should interact with its customers, competition, and environment, market research can help by providing information and analyses on environmental trends; changes in competitive behavior and

government regulation; and shifting consumer tastes. In other words, market research can provide strategic information by focusing on futures research and scenario development. Market researchers who pride themselves on quantitative modeling and statistical rigor might disdain this "soft" world, leaving it to mega trend vision Aries such as Naisbitt. However, market research can resolve strategic planning is such as:

1. Determining the firm's mission, scope, and long-range objectives.
2. Anticipating environmental changes and their effects, and the resulting opportunities and threats they pose.
3. Understanding the firm's capabilities versus the strengths and weaknesses of competitors.

The above ideas are a far cry from information gathering about consumer responses to new products, prices, and advertising. Yet just as good information is necessary for tactical marketing, so, too, is good information needed to develop and assess long-range plans.

Problems in International Marketing Research

Because of its complexity, international marketing may encounter difficulties that are uncommon in domestic marketing research. One problem is that intelligence must be gathered for many markets-over 100 countries in some cases-and each country poses a unique challenge. A second problem is the frequent absence of secondary data (data from published and third-party sources). A third problem is the frequent difficulty in gathering primary data (data gathered firsthand through interviews and field research).

Problem of Numerous Market

Multiplying the number of countries in a research project multiplies the costs and problems involved, although not in a linear manner. Because markets are not identical £Tom one country to another, the research manager must be alert to the various errors that can arise in replicating a study multinationally. Mayer identifies five kinds of errors to look for in multinational research:

1. Definition error : caused by the way the problem is defined in each country.
2. Instrument error : which arises from the questionnaire and the interviewer.
3. Frame error : which occurs when sampling frames are available from different sources in different countries.
4. Selection error : which results from the way the actual sample is selected from the frame.
5. Non response error : which results when different cultural patterns of non-response are obtained. For example, in one five-country study, the response rate ranged- from 17 percent to 41 percent. Further more, in one country, women composed 64 percent of the respondents, but in another countrymen represented 80 percent of the respondents.

Problems with Secondary Data

Secondary data for market analysis are less available and less reliable for many foreign markets and low per capita income countries tend to have weaker statistical sources than those with higher per capita income. Secondary sources of information are relatively cheap to acquire, however, and can help prevent a £inn from making major mistakes in its international marketing. Major steps in using secondary data include:

1. Determining research objectives.
2. Clarifying what information is needed.
3. Identifying where such secondary information can be found.
4. Deciding whether the information source is reliable (who put out the information and whether there is a hidden agenda).
5. Assessing the quality of data (accuracy, timeliness, representativeness) and the compatibility of data from different sources.
6. Interpreting and analyzing the information.
7. Drawing conclusions and then relating them to the marketing problem at hand to see if conclusions suggest courses of action or backup planned decisions or actions.

The use of probability sampling is necessarily limited where the nature of the relevant universe cannot be reliably determined. Quota sampling is limited for the same reason, so the most frequently employed technique is the convenience sample. This is defensible primarily because of a lack of alternatives.

Comparing Several Markets. When data for several markets are compiled, the researcher may find that many gaps exist for example, current data on number of automobile registrations may only be available for a few countries in the group of interest. Data quality may vary and the estimates may not be reliable. The underlying definitions may not be the same, with some countries excluding light trucks from automobile registrations while others include them. Many countries lack specialized firms that develop industry data for specific industries such as automobiles or air conditioners.

Problems with Primary Data

Much of marketing research involves getting information from people about their perceptions concerning a company's products, brands, prices, or promotion. People differ from country to country in their income levels, culture, attitudes, and understanding of business issues, including specific items on surveys and questionnaires. Hence, personal interviews require skilled interviewers. Telephone surveys may work poorly and give biased results in countries with low rates of telephone penetration, such as in most of Africa and in countries such as China and India. The use of mall-intercept techniques to obtain personal interviews may give erroneous results because malls are not as widespread in many countries even in Europe, and then subgroup of people visiting a mall may be unrepresentative of the broader audience. Mail surveys require a developed postal system, good mailing lists, and an educated population. Accurate and complete street addresses are necessary to give representative samples for mail questionnaires. If mail and telephone surveys are not practical, the researcher is left with personal interviewing as an alternative. With a largely rural population in the poorer countries, the problem then becomes one of physically reaching the people. Poor roads and lack of regular public transportation may make interviewing them economically unfeasible. In tropical areas, many roads are

impassable during the rainy season. Surveys may be limited primarily to urban areas.

In addition, the environment may favor distinct research methodologies; such as instruments with a diversity of questions; the use of physical stimuli, such as the product, an advertisement, or a jingle;' the control of the data-collection environment; including using simulations' or, tests of products in use; other criteria such as the perceived anonymity of the respondent. The sensitivity of the information requested, the experience of personnel conducting the survey and the quality of the, data desired will also suggest specific research approaches. Respondents may feel social pressure to respond with answers they perceive to be "socially correct Speed cost, and Controlling for bias also affect the choice of technique

Languages

Language, is the initial cultural difference that comes to mind when one thinks of foreign markets. At the minimum, the language difference poses problems of communication; solutions to these problems may be expensive. First, the research design and specifications must be translated twice, first (in the, case of a U.S. firm) from English into the language of each country where the study is to be conducted, Then, on completion of the study, the results must be translated back into English. More important than translation expense is the communication problem, also discussed in Chapter 4. Even business respondents-may have difficulty if they are asked in their native language about stock turnover or other business concepts that they are unaccustomed to using.

Social Organization

Much of marketing research involves gaining insights into the buyer's decision process. Such research is predicated on the assumption that the decision makers and influencers have been identified. In foreign markets, the researcher usually finds that the social organization is different enough that it is necessary to identify anew the decision makers and influencers. (This subject, including the varying" roles of women, is discussed in Chapter 4.) Differences in social organization affect the industrial market as well as the consumer market. The nature of the decision making structure in foreign companies is possibly different £Tom that in U.S. companies, due to the greater importance of family business in other countries and a greater general stress on relationships.

Obtaining Responses

Respondents and businesspeople may be reluctant to participate in marketing research for various reasons. Respondents may suspect the questioner of being a government tax representative rather than a legitimate market researcher, or they may be reluctant to respond for fear of giving information to competitors. The idea of _business people giving information to anyone, whether the government or an individual, is not well accepted in many countries. In addition, one of the researcher's greatest problems is trying to demonstrate the value of the research to the respondent personally. Unless this can be done, little will be accomplished with many business respondents.

Consumers, too, may be reluctant to respond to marketing research inquiries.' This may be in part the result of a general unwillingness to talk to strangers. Foreign respondents are often more reluctant to discuss personal consumption habits and preferences than are Americans. In contrast to the reluctant respondent is the cooperative respondent who feels obliged to give responses that will please the interviewer rather than state true opinions or feelings. In some cultures this is a form of politeness, but it obviously does not contribute to effective research.

Reluctant or polite responses are not the only barriers. Occasionally, the respondent is not able to answer meaningfully. For example, illiteracy is a barrier when written materials used. This problem can be avoided by using oral interviews. Even when the interview is oral, however, a communication problem that could be called "technical illiteracy" may arise; that is, the terms or concepts used might be unfamiliar to respondents even though phrased in their native language They may not understand the questions and thus be unable to answer. Or they may answer without understanding giving a useless response. Quite apart from the terms used; respondents may be unable to cooperate effectively because they are asked to think in a way foreign to their normal though: patterns. They are being, asked to react analytically rather than intuitively. What ever the particular cause of the inability to Spend, it is basically a translation problem. The research designer must be able to translate not only the words but also the concepts. The cultural gap must be bridged by the research designer.

Researching Hispanic Consumers

International marketing research invariably comes up against - cultural differences that affect the use and efficacy of standard! Western methods and may lead to erroneous interpretation of findings because cultural misunderstandings. Professionals must then turn for help to expert's who can help bridge cultural gaps. These issues are addressed in a recent book on doing research on Hispanic populations in the United States and elsewhere.5 The book first addresses the question of who Hispanics in the United States are, summarizing demographic census results, describing their various countries of origin and identifying basic Hispanic values such as the importance of family, the importance of feeling empathy for others, views of prescribed gender roles, and time orientation.

While Hispanics may be broadly alike, researchers need to bear in mind differences among Hispanic subgroups of Cuban, Mexican, Puerto Rican, and Central American origin, and how these differences affect how they are identified in conducting research. Misidentification and mislabeling can affect response rate and willingness to participate, reliability, and the generalizability of studies. Other pertinent issues include how to gain access to survey participants, how to enhance completion of survey instruments, and how to get beyond socially desirable responses. Such cultural differences require that standard, culturally appropriate instruments be adapted. Questionnaire translation is equally important because often there is no one correct way to translate an English word into Spanish or some other language, and multiple attempts at validation with different native speakers may be necessary. .

Another study *of* Hispanic consumer behavior asserts that immigrant Mexicans have to learn to consume, and in doing so,

combine consumption patterns learned from being Mexican with consumption patterns learned £Tom American society. Eventual consumption patterns, therefore, are likely to be a hybrid *of* Mexican and *U.S.* consumption vahies.6 *As* an example, the study cites the initial unwillingness of Mexicans to buy frozen produce *or* meat, based on the custom of buying it fresh and on a daily basis.

The international marketer's job is made easier when concepts and measurement instruments have been developed and validated across several cultures. While anthropologists have a long history *of* instrument adaptation, similar efforts are at a rudimentary stage in marketing. An example *of* such a direction is the concept of consumer ethnocentrism and an associated scale, CETSCALE. Tested and proven to be reliable across four countries, which are one another's major trading partners, CETSCALE may be expected to be applied to other countries in the future.

Convergence of Consumer Behavior Across Countries

Just as one might expect significant divergence among consumers because of cultural and religious differences, a growing convergence of consumer behavior is occurring across countries caused by multinational media and the standardized global marketing strategies of multinationals. For example, a 1995 study from Roper Starch Worldwide suggests that four broad types of consumers exist-types generable to 1.97 billion consumers worldwide. In the same vein, a Gallup poll conducted in the major cities of Argentina, Brazil, Chile, Colombia, and Mexico divides consumers into eight segments across countries, based on questions about income, education occupation, type of home, and ownership of automobiles and durable goods.9 The survey excluded low-income workers (about 17percent of the working-population) and ignored rural markets. Based on its sample of 'I7,564 people call up divided Latin American consumers into eight categories:

Emerging professional elite:14%
Progressive upper-middle class: 13%
Traditional elite: 11 %
Self-made middle class: 11 %
Skilled middle class: 9%
Industrial working class: 14%
Self-skilled lower middle class: 13%
Struggling working class: 15%

Improvisation

Some improvisation is probably used in all marketing research, but a higher degree is needed in international markets. Improvisation may be loosely defined as unconventional ways of getting the desired market information and or finding proxy variables when data are not available on the primary variables.

One such approach is the use of national consumption statistics, by volume or units, for various items. Such statistics filter out exchange-rate anomalies that arise in the use of currency-based economic indicators. Examples of such information include the number, in units, of radios, televisions, and VCRs used; life expectancy at age one; the number of hospital beds available and doctors per 100,000 people; consumption of various food items on a per capita basis; the per capita availability of goods such as telephones, cars, and motorcycles; the number of airline and train revenue passenger miles sold per year; the consumption of electricity and steel; and the average number of years of schooling completed by the population. All such indicators are generally available for a variety of countries and can be used to group countries and can be correlated with market-size information.

New Services to Aid the International Firm

As international business continues to grow, more and more international marketing research services are available to aid firms. Existing international marketing research organizations are expanding into more countries with more services, and new organizations are entering the field. It is not possible to catalog all of these but an example is International Information Services Ltd. (IIS), a global product pickup service for consumer packaged goods manufacturers. It has 400 clients in over 30 countries, including Coca-Cola, General Foods, J. Walter Thompson, and Unilever. Each day supermarkets in 120 countries are "raided" by IIS shoppers buying products or searching for information needed by clients. They provide samples of competitive products, client products for monitoring of quality, and/or information on competing brands (ingredients, varieties, sizes, prices, etc.).

Learning by Doing

If the costs of primary marketing research are too great, another way to evaluate a market is by becoming an exporter. After a year or two of export experience, the firm will know more about actual market behavior than could be learned from a preliminary market study. If the market proves difficult or unprofitable, the firm can withdraw without major losses. If the market proves attractive, the firm might consider a heavier commitment in the country.

Other Research Techniques to Use in Developing Countries

Moyer has suggested four techniques that are relevant for researching small, lower income markets: analysis of demand patterns, multiple-factor indexes, estimation by analogy, and regression analysis.

Analysis of Demand Patterns

Countries at different levels of per capita income have diverse patterns of consumption and production. This commonplace observation is illustrated in Figure 7-1.) The importance of this statement lies in the fact that the researcher can usually get data at this macro level for most countries. This simple technique, known as the multiple-factor index approach, thus allows insights into the consumption production profiles of many countries. Though relatively crude, it gives a clue both to a country's present position and the direction it is going. This in turn helps the firm identify possibilities for export or local production in that market.

Multiple-Factor Indexes

A multiple-factor index measures market potential indirectly, using as proxies a number of variables that intuition or statistical analysis reveal to be closely correlated with the

potential market for the product in question. For example, a manufacturer of modular housing may look at these factors:

1. The rate of household formation.
2. Population demographics to gauge the percentage of the population in the age bracket from 20 to 30 years, a prime household forming segment.
3. Income-level segments with some minimum per capital household income such as $2,000 per year being used to gauge purchasing power.

Smoothing out these numbers over several time periods and relating them to historic house sales and new housing construction may provide useful estimates of potential market size.

Estimation by Analogy

For countries with limited data, estimating market potential can be a precarious exercise. Given the absence of hard data, one technique-estimation by analogy can be helpful in getting a better feel for market potential in such countries. This estimation is done in two ways: (1) through cross-section comparisons and (2) through the displacement of a time series in time.

The cross-section comparison approach involves taking the known market size of a product in one country and relating it to some economic indicator, such as disposable personal income, to derive a ratio. This ratio (of product consumption to disposable personal income in our illustration) is then applied to another country where disposable personal income is known in order to derive the market potential for the product in that country.

The time-series approach estimates the demand in the second country by assuming that it has the same level of consumption that the first country had at the same level of development (or per capita income). This technique assumes that product usage moves through a cycle, with the product being consumed in small quantities (or not at all) when countries are underdeveloped and in increasing amounts with economic growth. Thus, looking at meat and egg consumption in Taiwan in the late 60s and early 70s can allow a rough estimation of demand for meat and eggs in mainland China in the 90s, with Chinese incomes being at about the levels prevalent in Taiwan in the early 70s.

Both approaches have limitations. The cross-section method assumes a linear consumption function. Both assume comparable consumption patterns among countries. When these assumptions are not true, the comparisons are misleading. When more sophisticated techniques are not feasible, however, estimation by analogy is a useful first step. .

Using Long-Term Trend Data to Estimate Market Size

The parcel tanker industry provides an example of how long-term trend data can be used to estimate market size. Parcel tankers (as distinct from oil tankers) are used to transport bulk liquids such as chemicals. Freight rates can vary depending on demand and supply. In 1995, rates were about $60 per ton, compared to around $48 per ton in 1994 Operating leverage is high in the industry. A $1 increase in the freight rate, for example, can mean an additional $11 million in operating profit for a major parcel tanker company such as Stolt-Nielsen, a Norwegian tanker" company that transports, stores, and distributes bulk liquids. Such tankers are usually chartered for long periods, and as charters end and new charter periods are negotiated, charter rates can be increased depending on the prevailing demand supply patterns.

For a company such as Stolt, forecasting demand and supply is important in determining both what charter rates might be like in the future, as well as whether to order new tankers to be built. This decision is important because, depending on shipyard backlog, tankers must be ordered to precise design specifications and then built, with delivery from time of order stretching out to as long as two years. Several factors go into compiling such data, especially the forecasts for the near-term future period, 1995 to 2000. Demand figures are derived from estimating the rate at which worldwide transportation of chemicals is growing, which in turn is related to GDP growth, particularly in Southeast Asia; demand is growing at 5 to 7 percent a year. Then, on the supply side, the existing number of tankers available is known, and to that is added the number of new tankers being built and the rate of scrap page. That is, old, obsolete tankers nearing the end of their seaworthy days and posing environmental hazards because of leakage problems will be taken out of service, thus reducing the total supply.

As can be seen, demand will outstrip supply over the next few years by almost one million metric tons, suggesting that freight rates will rise sharply and that several new tanker orders will be placed. To the extent that a company such as Stolt Nielsen is armed with such information earlier than its-competitors, it can charge higher rates and lease its tankers on spot rates rather than on long-term charters, thus increasing its profits. It can also order new tankers earlier, thus being able to increase its capacity in a timely fashion, taking advantage of healthy demand conditions. By placing orders early, it can also be more sure of getting its tankers delivered on time (a latecomer may find that the shipyards are too busy, that delivery is far off, and that by the time delivery occurs, demand and supply may once more have moved into balance, reducing rates once again.)

Based on the demand and supply projections, Stolt-Nielsen has ordered 10 new parcel tankers for delivery over the next three years. It took delivery of a 37,000ton, alt-stainless-steel chemical tanker from Danyard in Denmark, and will be getting six more from the same yard, as well as three others of similar design from a shipyard in France. Stolt might scrap some older tankers during the same time frame. In addition, the company is expanding into Asia by establishing special tank container cleaning and repair facilities and developing bulk chemical storage locations in Japan, Korea, Taiwan, Mainland China, and Singapore. 13 The researcher should however, keep in mind that as global economic conditions change, such forecasts need to be updated. For example, during the 1997-913 period, the Asian economies fell into a recession, and their demand for basic products such as chemicals dropped sharply, affecting world demand for tankers to transport chemicals. At the same time, shipyards in countries such as Korea, China, and Japan attempted to preserve jobs by cutting ship prices, leading to a shift of demand for ships to these countries and creating the possibility of overbuying currently-in essence "borrowing"

from future demand, with the possibility of limiting future demand.

Regression Analysis

Regression analysis provides a quantitative technique to sharpen estimates derived by the estimation-by-analogy method just discussed. Cross-section studies using regression analysis benefit from existing predictable demand patterns for many products in countries at different stages of growth. The researcher studies the relationship between gross economic indicators and demand for a specific product for countries with both kinds of data. The relationship derived can then be transferred to those countries that have only the gross economic data but not the product-consumption data.

The equation used here was the simple regression $y = a + bx$, where y is the amount of product in use per thousand of population and x is per capita GNP.

GNP would result, on the average, in an increase of 10 automobiles, 10 refrigerators, 9 washing machines, 7 TV sets, and 27 radios per 1,000 populations. Construction of such a table relevant to the products of a specific firm can be very useful. The model can use additional independent variables beyond GNP per capita. For example, airlines forecast air traffic growth with two factors, per capita GNP growth and the yield in cents per mile ("yield" is the air fare for a route divided into the distance, or number of miles on that route). Over long periods, this regression model has proved reasonably accurate, with air traffic growing as incomes grow and dropping as fares rise.

There are limitations to using regression, however. For example, as a product approaches saturation levels, the rate of consumption declines, requiring a different equation to explain the relationship. Nevertheless, regression analysis can provide useful insights.

Comparative Analysis

Comparative analysis is an attempt to organize information and experience to maximize their usefulness. In international marketing, this means that the company gathers and organizes its intelligence from all its global operations to see what new insights can be gained.

Grouping or classifying objects is an important step in understanding markets. Competing products can be grouped together to understand the different segments that are being targeted. Consumers can be grouped to assess customer segments. And countries can be grouped to determine which markets are similar to 1 one another. In this way, a generic strategy can be prepared for the countries belonging to a group rather than approaching each country individually. Moreover, groups of countries can be compared in evaluating market performance. One of the difficulties of comparative market performance assessment is that markets are different so the comparison may be unfair. Performing comparisons only on countries that are similar enough to belong to a group mitigates this problem.

Cluster Analysis

The approaches used to develop a short list of potential markets include comparative analysis of countries using macroeconomic and consumption data. Cluster analysis is a favored technique of identifying similar markets. The goal here is to ensure that the countries with the greatest potential make it to the short list for further investigation.

The mathematical techniques of cluster analysis were used by Sethi to develop seven distinct groups of countries. To develop these distinct groups, Sethi first used four sets of variables for each of the countries to be analyzed:

1. Production and transportation variables : measured by items such as air passenger and cargo traffic, electricity usage, number of large cities, and population.
2. Consumption variables : based on income and GNP per capita, the number of cars, televisions, hospital beds, radios, and telephones per capita, and educational levels of the population.
3. Trade data : derived from import and export figures.
4. Health and education variables : using data such as life expectancy, school enrollment, and doctors per capita.

Once "scores" for these four variables are developed for each country, the countries themselves are grouped into seven distinct groups. The implication is that if similarity of countries within the groups is sufficiently strong that similar marketing strategies can be used for all countries within a group.

Similar cluster analysis techniques are used by Economist Intelligence Unit (EIU) to group markets based on the opportunities they offer. EIUs indexes cover market size, market growth rates, and market intensity (which measures the relative concentration of wealth and purchasing power in those countries). For example, the market-size index is derived from data on population, consumption statistics, steel consumption, cement and electricity production, and ownership of telephones, cars, and televisions. Note the similarity of the variables used at EIU to those used by Sethi in his analysis.

Clustering Countries by Product Diffusion Patterns

A problem with clustering countries on the basis of macroeconomic variables is that the resulting segments may not be helpful to international marketers because acceptance and diffusion of new products may vary within the proposed segments. An alternative is to segment countries based on how similar they are in the rate at which new products are adopted (the product diffusion rate). If such segments could be derived, managers could use information from the lead market, about variables such as growth in market size, when sales reach a peak, to make inferences on the same variables for lagging markets. This allows a country to belong to more than one segment at the same time. For example, the United States could be in the leading market segment for a product such as advanced personal computers, while lagging in the use of products such as smart cards or high-speed trains.

Macroeconomic data such as the standard of living are, of course, important in explaining the readiness of a country market to accept innovation; in addition, a diffusion-based segmentation approach uses data about factors such as lifestyle (use of phones per capita, for example), and cosmopolitanism (tourist expenditures and receipts). A recent research study looked at the relationship between such country-level variables and sales growth over a 14-year period for three consumer

durables—color TV sets, VCRs, and CD players-for 12 advanced industrial nations from Europe, as well as Japan and the United States.

The study showed that segments based on product adoption rates did not agree with segments derived from broad macroeconomic data alone, suggesting that countries that look similar from a broad macroeconomic perspective may differ in the rate at which they are willing to adopt and buy new products. Cultural factors such as language and religion, which were not specifically included in the study, may play an important role in explaining differences in the product diffusion rate. In addition, other recent studies have noted the importance of culture, mobility, and sex roles as important factors in explaining differences in product adoption rates.

Screening Potential International Markets

Another marketing research screening technique useful to derive a short list of key country markets is described here, as applied to the market for kidney dialysis equipment. 18 The first step is to determine which countries can afford such medical equipment. The high cost of kidney dialysis equipment and necessary supplies and personnel limits the market to wealthy countries. Hence, a first screen might be based on the wealth of a country, measured by the following:

1. A total GDP of over $15 billion.
2. GDP per capita of at least $1,500.

This screen alone reduces the number of potential markets to 28 countries outside North America.

Next, the markets must have specialized hospitals and doctors who can competently administer dialysis treatment. In addition, the treatment is expensive and requires a certain level of government support and subsidy, or the market for private patients alone would be too small to justify attempts at market penetration. Thus, a second screen would include other criteria:

1. No more than 200 people per hospital bed.
2. No more than 1,000 people per doctor.
3. Government health care expenditures of at least $100 million.
4. Government health care expenditures of at least $20 per capita.

This calculation then results in a set of 19 countries as potential markets.

A third screen analyzes the markets in terms of the current market for dialysis equipment Two factors are used:

1. At least 1,000 deaths per year, due to kidney-related causes. A lower number might indicate that the market for dialysis equipment is already being well served by competition:
2. At least 40 percent growth in the number of patients being treated with dialysis equipment.

This results in just three markets being considered: Italy, Greece, and Spain.

A fourth screen consists of carefully evaluating the three countries in terms of existing competition, political risk, and other factors. Management subjectivity can enter here because some managerial judgment is required in evaluating the strength of competition and political risk. Management may well decide to enter more than one of the three markets identified thus far. It may also go back to the third screening step and reduce the required rate of growth to, say, 30 percent, in 1 order to add some additional potential markets.

Once a short list of potential markets has been made up, individual markets must be studied more carefully. At this point, information can be obtained from the Department of Commerce's Comparison Shopping Service (CSS). A CSS survey covers a product in a particular country market, indicating the product's overall marketability, chief competitors, comparative prices, customary entry, distribution, and promotion practices, trade barriers, and the degree to which the company's product competes. About 50 key countries are covered by this low-cost and timely service

Gap Analysis

The goal of gap analysis is to analyze the difference ("gap") between estimated total market potential and a company's sales. The gap can be divided into four categories:

1. Usage gap : The usage gap refers to total industry sales being less than the estimated total market potential. Such gaps may have their explanation either in estimation errors or in unpredictable changes in consumer tastes and behavior, such as, for example, eggs being less in demand than expected. In the United States, such a usage gap would probably be traced. to health-related concerns.
2. Competitive gap : Competitive gap refers to existing market share compared with expected market share; analysis is needed to indicate why market share shifts have taken place and what is needed to regain market share from competitors.
3. Product-line gap : Product-line gap arises because a company does not have a full product line compared to its competitors; thus, it loses sales. All example might be in the computer industry, where a part of the product line is small, portable laptop computers. To the extent that Dell was late in marketing or did not have a laptop computer available, its market share was less than it would have been if it had fielded a full product line. . Toshiba faced the opposite problem, offering only laptops in the U.S. market and losing corporate sales because the clients wanted to buy both laptops and PC servers an? desktops from the same company.
4. Distribution gap : A company with a distribution gap is failing to target part of the market because of a lack of distribution facilities or agents. Closing such a gap would require that the firm extend distribution and product availability to cover all regions and segments of the market.

Input-Output Tables

Input-output tables, provide an analytical tool of great value in studying demand in foreign markets. They are becoming increasingly available, for many more countries, particularly for the advanced industrialized nations and: the newly industrializing countries such as Brazil, Taiwan, and India. They are useful both for industrial product analysis and for the analysis of market demand for intermediate components and materials. Input-output tables give specific attention to how production

functions vary among nations and thus allow the researcher to adjust market forecasts to account for such country differences.

Marketing Research Models

Modeling Consumer Behavior

Why U.S. Buyers Buy Japanese Cars?

Market research professionals often seek to model consumer behavior in the international marketplace. One model attempts to explain why U.S. households buy

Japanese cars. Developed by Dardis and Soberon-Ferrer, it hypothesizes that buying Japanese cars is affected by household characteristics that, in turn, determine the weight given to different product attributes, leading eventually to the decision to buy or not buy a Japanese car. Specifically, the variables used to profile household characteristics include income, age, sex, marital status, race, education of the head of the household, geographic location within the United States, and a variable labeled "the origin of disposed stock," meaning, whether a previous car sold (if any) was of Japanese or other origin (i.e., whether that household had previously owned a Japanese car).

In a similar fashion, product attributes modeled included variables that primarily capture automobile quality: cost of repair, frequency of repair, operating efficiency (miles per gallon), weight (a means of gauging comfort and safety), the depreciation rate (a reflection of the resale value of the car), and finally, the purchase price of the car, which is held constant to isolate the effect of the quality variables.

It is important to marketers to develop a model on which to base their data collection and analysis efforts. The model can be modified to include additional variables such as social class, religion, and occupation. The bottom line is that an explicit model allows a directed research effort to gather and analyze data, which permits validation and modification of the model. For example, the Dardis and Soberon-Ferrer model showed that lowering the depreciation rate of the car by percent a year increased the probability of buying a Japanese car from 22 to 26 percent. Similarly, lowering the fuel economy (miles per gallon) by 10 percent dropped the probability of buying a Japanese car from 22 percent to 14 percent.

The implications for marketing strategy are clear. For a U.S. company trying to catch up to the perception of Japanese cars, several methods exist to lower the probability that a household will buy a Japanese car: Rather than rely on vague appeals to buy American, companies should improve U.S. cars so that they depreciate slower, cost less to own and operate, and require repair less frequently. Significantly, the proposed model, when applied to past car-purchasing decisions, was able to correctly predict whether households would buy a Japanese or non-Japanese car 96 percent of the time.

Household Buying Behavior

A Study from Saudi Arabia

For many products, buying decisions are made jointly, by households, by husbands and wives, and in some cases, by children. Products such as houses, automobiles, furniture, and consumer durables such as refrigerators and stoves would fall in this category. Understanding whether households in different countries approach major purchasing decisions differently is critical in making international marketing decisions about product positioning, advertising appeals, direct-mail and telemarketing campaigns, and building loyalty. Marketers are interested in who makes the buying decisions in a family, and the relative influence during critical steps such as whether to buy, when to buy, where to buy, and how much to pay. Several competing theories exist to explain family purchasing behavior:

1. Culture-defined behavior : whereby cultural norms prescribe which spouse has more power in influencing purchase decisions.
2. Resource contribution-based power : whereby the spouse who contributes more resources (e.g., income, status, education, etc.) is more powerful in influencing decisions.
3. Relative involvement : whereby the spouse who has the greater interest and involvement in a product or service will have more influence over its purchase. Countries and societies can be categorized26 as: (1) patriarchies; (2) modified patriarchies, consisting of modernizing nations that were patriarchies in the recent past; (3) transitional egalitarian, with movement toward equality of influence within the family, and greater weight being given to education, occupation, and income; and (4) egalitarian, with strong norms about equality of husbands and wives and power sharing. Household purchasing behavior can be expected to differ across these different kinds of societies.

A study on family purchasing behavior in Saudi Arabia showed how role behaviors of husbands and wives can significantly differ across countries.27 Limited to a sample of 249 upscale, married Saudi women, the study is interesting as a study of family purchasing behavior in a developing country. It found that (1) husbands dominate consumer decision making in Saudi Arabia, as is the case in many developing countries; (2) husbands are dominant in deciding on buying a car and on "where to buy," except in the case of women's clothing; (3) in many cases, Saudi wives who work and/or are more educated, have more influence over purchasing decisions. Overall, husbands dominate purchase decisions in what is a predominantly patriarchal Saudi society.

Country-of-Origin Effects

An important variable affecting consumer purchase in international marketing is the country of origin (CO). There are many products where the CO is important to consumers, such as perfumes, cars, high-fashion clothes, consumer electronics, and software; for all these products country-specific stereotypes exist, with certain; countries being associated positively with certain products. Examples are French perfumes and German cars. For such products, knowing the CO affects how consumers evaluate a product. In many cases, the country of manufacture {COM) also relevant (e.g., in India, consumers often want to look inside TV sets to see where components have been manufactured).

Once consumers are aware of CO, their familiarity with the brand, level of involvement in the purchase decision, and existing preference for domestic products become relevant, as do product-, and market; level influences, such as the type of

product and brand image. In industrial product buying, "rational" purchasing might be more prevalent, and thus greater credence might be given to country-of-manufacture effects; product attributes might be relevant, such as quality, performance, design, aesthetics, price, and prestige,' powerful brand image may be associated with a company and may overcome origin of manufacture area. The reputation of the dealer or intermediary may muffle or enhance CO or COM effect, and truth-in-Labeling requirements as well as demand conditions can mediate the effect of CO.

Environmental influences also come into play, including the existence of global markets (when CO may become less important); level of economic development of the countries from which products come; and political, social, and cultural influences favoring certain nations. Together these influences result in a country-stereotyping effect and ultimately affect the purchase decision.

What does this mean for the firm? CO and COM effects have implications for standardization of marketing programs (whether to source from one or more locations, how to adapt), for positioning the product, selecting the image in advertising, and even plant location decisions, all other things being equal. Together, these disparate decisions affect overall brand profitability.

Religiosity and Consumer Behavior

Cultures differ in many ways, with a central difference being religion. It is natural to ask whether religion affects consumer behavior. For example, are devoutly religious people different from more secular people when it comes to enjoying shopping and buying a large variety of material goods? What sorts of advertising appeals are more likely to resonate with a religious person? In order to answer such questions, one first has to define religiosity and then attempt to relate it to different aspects of marketing and consumer behavior. Table 7-8 summarizes these ideas.

A recent study attempted to trace the effects of religiosity on consumption behavior for a sample of Japanese and U.S. consumers. The study found that consumer shopping behavior did not seem significantly different between devout and casually religious Japanese individuals. However, in the United States, devout Protestants were "more economic," buying products on sale, shopping in stores with lower prices, being open to buying foreign-made goods, believing that there was little relation between price and quality, tending to not believe advertising claims while preferring subtle and informative advertisements. Differences also existed at the national level, with Japanese shoppers preferring to buy domestically made products, visiting many stores to find the right brand, enjoying shopping, and preferring stores with better service. As an exploratory study, with a total sample of under 250 drawn from just two cities, Tokyo and Washington, D.C., and with none of the respondents having progressed beyond a high school education, we cannot generalize from this study. It is useful in suggesting directions for international marketing research, particularly when marketing to countries with distinct religious systems such as India, the Middle East, Japan, and China.

LESSON 13:
SEGMENTATION, TARGETING AND POSITIONING

This lesson aims to give a clear understanding to the student of the following:

1. Global Market Segmentation
2. Global Targeting
3. Global Product Positioning

Cigarettes are one of the most widely distributed and profitable global consumer products. However, as the number of smokers in high-income countries declines due to heightened antismoking sentiment and health concerns, tobacco industry giants such as Britain's B.A.T. Industries PLC and America's Philip Morris Company have set their sights on new market opportunities. In particular, tobacco companies are targeting smokers in developing countries such as China; Thailand, India, and Russia. These are nations in which a combination of forces-rising incomes in some countries and challenging economic conditions in others, smoking is fashionableness, and the status assigned to Western cigarette brands-interacts to expand the smoking market and brand share of the leading global brands. Moreover, because many women in these countries view smoking as a symbol of their improving status in society, the tobacco companies are aggressively targeting women.

The actions taken by managers at Philip Morris, B.A.T., and other tobacco companies are examples of market segmentation and targeting. Market segmentation represents an effort to identify and categorize groups of customers and countries according to various characteristics. Targeting is the process of evaluating the segments and focusing marketing efforts on a country, region, or group of people that has significant potential to respond. Such targeting reflects the reality that a company should identify those consumers it can reach most effectively and efficiently. Segmentation, targeting, and positioning are all examined in this chapter.

Global Market Segmentation

Market segmentation is the process of subdividing a market into distinct subsets of customers that behave in the same way or have similar needs. Each subset may conceivably be chosen as a market target to be reached with a distinctive marketing strategy. The process begins with a basis of segmentation-a product-specific factor that reflects differences in customers' requirements or responsiveness to marketing variables (possibilities are purchase behavior, usage, benefits sought, intentions, preference, or loyalty).

Global market segmentation is the process of dividing the world market into distinct subsets of customers that behave in the same way or have similar needs, or, as one author put it, it is the process of identifying specific segments-whether they be country groups or individual consumer groups-of potential customers with homogeneous attributes who are likely to exhibit similar buying behavior." Interest in global market segmentation dates back several decades. In the late 1960s, one observer suggested that the European market could be divided into three broad categories-international sophisticate, semi sophisticate, and provincial-solely on the basis of consumers' presumed receptivity to a common advertising approach. Another writer suggested that some themes (e.g.; the desire to be beautiful, the desire to be healthy and free of pain, the love of mother and child) were universal and could be used in advertising around the globe.

In the 1980s, Professor Theodore Levitt advanced the thesis that consumers in different countries increasingly seek variety and that the same new segments are likely to show up in multiple national markets. Thus, ethnic or- regional foods such as sushi, Greek salad, or hamburgers might be in demand anywhere in the world. Levitt described this trend as the "pluralization of consumption" and "segment simultaneity" that provides an opportunity-for-marketers to pursue a segment on a global scale.6

Today, global companies (and the advertising agencies that serve them) are likely to segment world market according to one or more .key criteria: geography, demographics (including national income and size of population), psychographics (values, attitudes, and lifestyles), behavioral characteristics, and benefits sought. It is also possible to cluster different national markets in terms of their environments (e.g., the presence or absence of government regulation in a particular industry) to establish groupings. An other powerful tool for global segmentation is horizontal segmentation by user category.

Geographic Segmentation

Geographic segmentation is dividing the world into geographic subsets. The advantage of geography is proximity: Markets in geographic segments are closer to each other and easier to visit on the same trip or to call on during the same time window. Geographic segmentation also has major limitations: The mere fact that" markets are in the same world geographic region does not meant that they are similar. Japan and Vietnam are both in East Asia, but one is a high income, postindustrial society and the other is an emerging, less developed, pre industrial society. The differences in the markets in these two countries overwhelm their similarities. Simon found in his sample of "hidden champions" that geography was ranked lowest as a basis for market segmentation (see Figure 7-1).

Demographic Segmentation

Demographic segmentation-is based on measurable characteristics of populations such as age, gender, income, education, and occupation. A number of demographic trends aging population, fewer children, more women working outside the home, and higher incomes and living standards-suggest the emergence of global segments.

For most consumer and industrial products, national income is the single most important segmentation variable and indicator

of market potential. Annual per capita income varies widely in world markets, from a low of $81 in the Congo to a high of $38,587 in Luxembourg. The World Bank segments countries into high income, upper middle income, lower middle income, and low income.

The U.S. market, with per capita income of $29,953, more than $8.3 trillion in 2000 national income, and a population of more than 275 million people, is enormous. Little wonder, then, that Americans are a favorite target market! Despite having comparable per capita incomes, other industrialized countries are nevertheless quite small in terms of total annual income. In Sweden, for example, per capita gross national product (GNP) is $24,487; however, Sweden's smaller population of 9 million means that annual national income is only about $220 billion. About 73 percent of world GNP is located in the Triad. Thus, by segmenting in terms of a single demographic variable-income-a company could reach the most affluent markets by targeting three regions: the European Union, North America, and Japan.

Many global companies also realize that for products with a low enough price-for example, cigarettes, soft drinks, and some packaged goods-population is a more important segmentation variable than income. Thus, China and India, with respective populations of 1.3 billion and 1.0 billion, might represent attractive target markets. In a country such as China, where "per capita GNP is only $930, the marketing challenge is to successfully serve the existing mass market for inexpensive consumer products. Procter & Gamble, Unilever, Kao, Johnson & Johnson, and other packaged-goods companies are targeting and developing the China market, lured in part by the possibility that as many - as 100 million Chinese customers are affluent enough to spend, say, 14 cents for a single use pouch of shampoo.

Segmenting decisions can be complicated by the fact that the national income figures such as those cited previously for China and India are averages. There are also large, fast-growing, high-income segments in both of these countries. In India, for example, 100 million people call be classified as "upper middle class," with average incomes of more than $1,400. Pinning down a demographic segment may require additional information; India's middle class has been estimated to be as low as a few million and as high as 250 million to 300 million people. If *middle class* is defined as "persons who own a refrigerator," the figure would be 30 million people. If television ownership were used as a benchmark, the middle class would be 100 million to 125 million people.8The important lesson for global marketers is to beware of the misleading effect of averages, which distort the true market conditions in emerging markets.

Note also that the average income figures quoted here do not reflect the standard of living in these countries. In order to really understand the standard of living in a country, it is necessary 10 determine the purchasing power of the local currency. In low income countries, the actual purchasing power of the local currency is much higher than that implied by exchange values. In India, for example, the authors' colleague recently returned from a trip during which he received a slight cut on his forehead from a taxi trunk lid. He decided to visit a doctor to get a tetanus shot and, because he knew that malaria was a hazard in India, he requested a prescription and a one-month supply of malaria pills. He did this, and the bill from the doctor for the shot, the pills, and the prescription was 30 rupees or US $1.00.

Age is another-useful demographic variable. One global segment based on demographics is global teenagers-young people between the ages of 12 and 19. Teens, by virtue of their interest in fashion, music, and a youthful lifestyle, exhibit consumption behavior that is remarkably consistent across borders. Young consumers may not yet have conformed to cultural norms-indeed; they may be rebelling against them. This fact, combined with shared universal needs, desires, and fantasies (for name brands, novelty, entertainment, and trendy and image-oriented products), make it possible to reach the global teen segment with a unified marketing program. This segment is attractive both in terms of its size (about 1.3 billion) and its multibillion-dollar purchasing power. Coca-Cola, Benetton, Swatch, and Sony are some of the company's pursuing the global teenage segment. The global telecommunications revolution is a critical driving force behind the emergence of this segment. Global media such as MTV are perfect vehicles for reaching this segment. Satellites such as Asia Sat I are beaming Western programming and commercials to millions of viewers in China, India, and other countries.

Another global segment is the so-called elite: older, more affluent consumers who are well traveled and have the money to spend on prestigious products with an image of exclusivity. This segment's needs and wants are spread over various product categories: durable goods (luxury automobiles); non durables (upscale beverages such as rare wines and champagne); and financial services (American Express gold and platinum cards). Technological change in telecommunications makes it easier to reach the global elite segment. Global telemarketing is a viable option today as AT&T International 800 services are available in more than 40 countries. Increased reliance on catalog marketing by upscale retailers such as Harrods, Laura Ashley and Ferragamo has also yielded impressive results.

Psychographic Segmentation

Psychographic segmentation involves grouping people in terms of their attitudes, values, and lifestyles. Data are obtained from questionnaires that require respondents to indicate the extent to which they agree or disagree with a series of statements. In the United States, psycho graphics is primarily associated with SRI International, a market research organization whose original V ALS and updated V ALS 2 analyses of U.S. consumers are widely known.

Porsche AG the German sports-car maker, turned to psychographics after watching worldwide sales decline from 50,000 units in 1986 to 'about 14,000 in 1993. Its U.S. subsidiary, Porsche Cars North America, already had a clear demographic profile of its customers: 40+-year-old n1ale college graduates whose annual income exceeded $200,000. A psychographics study showed that, demographics aside, Porsche buyers could be divided into five distinct categories. Top Guns, for example, buy Porsches and expect to be noticed; for Proud Patrons and Fantasists, on the other hand, such conspicuous consumption is irrelevant. Porsche will use the profiles to develop advertising

tailored to each type. Notes Richard Ford, Porsche vice president of sales and marketing, "We were selling to people whose profiles were diametrically opposed. You wouldn't want to tell an elitist how good he looks in the car or how fast he could go." Results have been promising Porsche's U.S. sales improved nearly 50 percent in 1994.

One early application of psychographics outside the United States focused on value orientations of consumers in the United Kingdom, France, and Germany. Although the study was limited in scope, the researcher concluded, "The underlying values structures in each country appeared to bear sufficient similarity to warrant a common overall communications strategy-. SRI International has recently conducted psychographics analyses of the Japanese market; broader-scope studies have been undertaken by several global advertising agencies, including Backer, Spiel Vogel & Bates Worldwide (BSB), D'arcy Massius Benton & Bowles (DMBB), and Young & Rubicam (Y&R). These in human behavior that are culture-free and so basic that they can be found all over the globe.

Table 7-1 : Psychographic profiles of Porsche's American customer

Category	% of all owners	Description
Top Guns	27%	Driven and ambitious; care about power and control; expect to be noticed
Elitists	24%	Old money; a car-even an expensive one-is just a car, not an extension of one's personality
Proud Patrons	23%	Ownership is what counts; a car is a trophy, a reward for working hard; being noticed doesn't matter
Bon Vivants	17%	Cosmopolitan jet setters and thrill seekers; car heightens excitement
Fantasists	9%	Car represents a form of escape; don't care about impressing others; may even feel guilty about owning car

Three overall groupings can be further subdivided into a total of seven segments: Constrained (Resigned Poor and Struggling Poor), Middle Majority (Mainstreamers, Aspirers, and Succeeders), and Innovators (Transitional and Reformers). The goals motivations, and values of these segments range from "survival,"" given up," and "subsistence" (Resigned Poor) to "social betterment," "social conscience," and "social altruism" (Reformers). Table 7-2 shows some of the attitudinal, work, lifestyle, and purchase behavior characteristics of the seven groups.

Combining the 4Cs data for a particular country with other data permits Y &R to predict product and category purchase behavior for the various segments. Yet, as noted previously in the discussion of Global Scan, marketers at global companies that are Y &R clients are cautioned not to assume that they can develop one strategy or one commercial to be used to reach a particular segment across cultures. As a Y &R staffer notes, "As you get closer to the evectional level, you need to be acutely sensitive to cultural differences. But at the origin, it's of enormous benefit to be able to think about people who share common values across cultures.

Attitudes	**Work**	**Lifestyle**	**Purchase Behavior**
Resigned Poor			
Unhappy	Labpr	Shut-in	Staples
Distrustful	Unskilled	Television	Price
Struggling Poor			
Unhappy	Labor	Sports	Price
Dissatisfied	Craftsmen	Television	Discount stores
Mainstreamers			
Happy	Craftsmen	Family	Habit
Belong	Teaching	Gardening	Brand loyal
Aspirers			
Unhappy	Sales	Trendy sports	Conspicuous
			Consumption
Ambitious	White collar	Fashion magazines	Credit
Succeeders			
Happy	Managerial	Travel	Luxury
Industrious	Professional	Dining out	Quality
Transitional			
Rebellious	Student	Arts/crafts	Impulse
Liberal	Health field	Special-interest magazines	Unique products
Reformers			
Inner growth	Professional	Reading	Ecology
Improve world	Entrepreneur	Cultural events	Homemade/grown

Behavior Segmentation

Behavior segmentation focuses on whether people buy and use a product, as well as how often and how much they use it. Consumers can be categorized in terms of usage rates for example, heavy, medium, light, and nonuser. Consumers can also be segmented according to user status: potential users, nonusers, ex-users, regulars, first-timers, and users of competitors' products. Although bottled water may be considered a luxury product in some high-income markets, Nestle is marketing bottled water In Pakistan where there is a huge market of nonusers who, despite their low income, are willing to pay 18 rupees a bottle for clean water because of the widespread presence of arsenic poisoning in well water and the pollution of surface water. Tobacco companies are targeting China because the Chinese are heavy smokers.

Financial institutions have to consider many different pieces of information regarding consumer behavior toward saving and spending n10ney. Japan has the highest number of cash dispensers, 1,115 per 1 million population, followed by Switzerland, Canada, and the United States where the average is slightly higher than 600. The average dollar amount withdrawn also varies considerably. In Japan, the average withdrawal is $289. This is followed by Switzerland at $187 and Italy at $185. The United States is far down the list with $68 as the -average withdrawal. Japanese people tend to carry around a lot more cash than people in other countries.

Benefit Segmentation

Global benefit segmentation focuses on the numerator of the value equation-the *B* in $V = B/P$. This approach can achieve excellent results by virtue of marketers' superior understanding of the problem a product solves or the benefit it offers, regardless of geography. For example, Nestle discovered that cat owners' attitudes toward feeding their pets are the same everywhere. In response, a pan-European campaign was created for Friskies dry cat food. The appeal was that dry cat food better suits a cat's universally recognized' independent nature.

Vertical Versus Horizontal Segmentation

Vertical segmentation is based on product category or modality and price points. For example, in medical imaging there is X-ray, computed axial tomography (CAT)" scan, magnetic resonance imaging (MRI), and so on. Each modality has its own price points. These price points were the traditional way of segmenting the medical imaging market. One company decided to take a different approach and segment the same market by the health care delivery system: national research and teaching hospitals, government hospitals, and so on. It then rolled out a campaign that was regional, national, and finally global, which was tailored for each different type of health care delivery. This horizontal segmentation approach worked as well in markets outside the home-country launch market as it did in the home country.

Global Targeting

As discussed earlier, segmenting is the process by which marketers identify groups of consumers with similar wants and-needs. Targeting is the act of evaluating and comparing the identified groups and then selecting one or more of them as the prospect(s) with the highest potential. A marketing mix is then devised that will provide the organization with the best return on sales while simultaneously creating the maximum amount of value to consumers.

Criteria For Targeting

The three basic criteria for assessing opportunity in global target markets are the same as in single-country targeting: current size of the segment and anticipated growth potential; competition; and compatibility with the company's overall objectives and the feasibility of successfully reaching a designated target.

1. Current Segment Size and Growth Potential

Is the market segment currently large enough that it presents a company with the opportunity to make a profit? If it is not large enough or profitable enough today, does it have high growth potential so that it is attractive in terms of a company's long-term strategy? Indeed, one of the advantages of targeting a market segment globally is that, whereas the segment in a single-country market might be too small, even a narrow segment can be served profitably with a standardized product if the segment exists in several countries? The billion-plus members of the global "MTV Generation" constitute a huge market that, by virtue of its size, is extremely attractive to many companies.

China represents an individual geographic market that offers attractive opportunities in many industries. Consider the growth opportunity in financial services for example. There are currently only about 3 million credit cards in circulation, mostly used by businesses. Low product saturation levels are also found for personal computers; there is one computer for every 1,250 people. The ratio in the United States is approaching one computer for every two people. The opportunity for automobile manufacturers is eyen greater. China has 1.2 million passenger cars, one car for every 20,000 Chinese. Even with the market in China growing at an annual rate of 33 percent, a tremendous potential market still exists.

2. Potential Competition

A market or market segment characterized by strong competition may be a segment to avoid or one in which to utilize a different strategy. Often a local brand may present competition to the entering multinational. In Peru, Inca Kola is as popular a Coca-Cola. In India, Thumbs Cola is a major brand. In the Siberian city of Krasnoyarsk, Crazy Cola has a 48 percent share of the market.18 The multinational might try more or different pro- motions or may acquire the local company or form an alliance with it.

Kodak's position as the undisputed leader in the $2.4 billion U.S. color film market did not deter Fuji from launching a competitive offensive. In addition to offering traditional types of 3Smm film at prices below Kodak's, Fuji quickly made inroads by introducing a number of new film products targeted at the "advanced amateur" segment that Kodak had neglected. Despite its early successes, after nearly two decades of effort, Fuji's U.S. market share has been in the 10 to 16 percent range. Part of the problem is Kodak's distribution clout: Kodak is well entrenched in supermarket and drugstore chains, where Fuji must also jostle with other newcomers such as Konica and Polaroid. In addition, Kodak has agreements with dozens of American amusement parks guaranteeing that only Kodak film will be sold on the premises. Fuji is also developing its market in Europe, where Kodak commands "only" 40 percent of the color film market Fuji currently enjoys 25 percent of the European market, compared with 10 percent a decade ago. Meanwhile, Kodak has spent half a billion dollars in Japan, the world's second-largest market for photographic supplies; its market share there currently stands at about 10 percent.

3. Compatibility and Feasibility

If a global target market is judged to be large enough, and if strong competitors are either absent or not deemed to represent insurmountable obstacles, then the final consideration is whether a company can and should target that market. In many cases, reaching global market segments requires considerable resources such as expenditures for distribution and travel by company personnel. Another question is whether the pursuit of a particular segment is compatible with the company's overall goals and established sources of competitive advantage. Although Pepsi was firmly entrenched in the Russian market, having entered in 1972, Coke waited. 15 years to n1ake its first move in Russia and 20 years before it decided to make major investments. At the time of C9ke's entry, Pepsi had 100 percent of the Russian cola market. This would appear to be a difficult position to challenge, but because of the size of the Coke investment and the skillful execution of its investment moves in Russia, by 1996 Coke's market share had reached 50 percent.

Selecting a Global Target Market Strategy

If, after evaluating the identified segments in terms of the three criteria presented earlier, a decision is made to proceed, an appropriate targeting strategy must be developed. There are three basic categories of target marketing strategies: standardized marketing, concentrated marketing, and differentiated marketing.

1. Standardized Global Marketing

Standardized global marketing is analogous to mass marketing in a single country. It involves creating the same marketing mix for a broad market of-potential buyers. This strategy calls for extensive distribution in the maximum number of retail outlets. The appeal of standardized global marketing is clear: greater sales volume, lower production costs, and greater profitability. The same is true of standardized global communications: lower production costs and, if done well, higher quality and greater effectiveness of marketing communications.

Coca-Cola, one of the world's most global brands, uses the appeal of youthful fun in its global advertising. Its sponsorship program is global and is adapted to events that are popular in specific countries such as soccer in -other parts of the world versus foot ball in the United States.

2. Concentrated Global Marketing

The second global targeting strategy involves devising' a marketing mix to reach a single segment of the global market. In cosmetics, this approach has been used successfully by the House of Lauder Channel and other cosmetics houses that target the upscale prestige segment of the market. This is the strategy employed by the hidden champions of global marketing: companies that most people have never heard of that have adopted strategies of concentrated marketing on a global scale. These companies define their markets narrowly. They go for global depth rather than national breadth. For example, winter halter (a German company) is a hidden champion in the dishwasher market, but the company has never. sold a dishwasher to a consumer. It has also never sold a dishwasher to a hospital, school, company, or any other organization. It focuses exclusively on dishwashers for hotels and restaurants. It offers dishwashers, water conditioners, detergents, and service. Juergen Winter halter commented in reference to the company's narrow market definition: "This narrowing of our market definition was the most important strategic decision we ever made. It is the very foundation of our success in the past decade.

3. Differentiated Global Marketing

The third target marketing strategy is a variation of concentrated global marketing. It entails targeting two or more distinct market segments with different marketing mixes. This strategy allows a company to achieve wider market coverage. For example, in the segment of sports-utility vehicles (SUV), Rover has a $50,000+ Range Rover at the high end of the market; a scaled-down version, the Land Rover Discoverer is priced at under $35,000, which competes directly with the Jeep Grand Cherokee. These are two different segments, and Rover has a concentrated strategy for each.

One of the world masters of differentiated global marketing is SMH, the Swiss Watch Company. SMH offers watches ranging from the Swatch fashion accessory watch at $50 worldwide to the $100,000+ Blancpain. Although the research and development (R&D) and manufacturing at SMH are integrated and serve the entire product line, each SMH brand is managed by a completely separate organization that targets a concentrated, narrow segment in the global market.

In the cosmetics industry, Uni-lever NV and Cosmair Inc. pursue differentiated global marketing strategies by targeting both ends of the perfume market. Uni-lever targets the luxury market with Calvin Klein and Elizabeth Taylor's Passion; Wind Song and Brut are its mass-market brands. Cosmair sells Tresnor and Giorgio Armani Gio to the upper end of the market and Gloria Vanderbilt to the lower end. Mass marketer Procter & Gamble (P&G), known for its Old Spice and Incognito brands, also embarked on this strategy with its 1991 acquisition of Revlon's EuroCos, marketers of Hugo Boss for men and Laura Biagiotti's Roma perfume. Now, P&G is launching a new prestige' fragrance, Venezia, in the United States and nine European countries.

Global Product Positioning

Positioning is the location of your product in the mind of your customer. Thus, one of the most powerful tools of marketing is not something that a marketer can do to the product or to any element of the marketing mix: Positioning is what happens in the mind of the customer. The position that a product occupies in the mind of a customer depends on a host of-variables, many of which "are controlled by the marketer.

After the global market has been segmented and one or more segments have been targeted it is essential to plan a way to reach the target(s}. To achieve this task, marketers use positioning. In today's global market environment, many companies find it increasingly important to have a unified global positioning strategy. For example, Chase Manhattan Bank launched a $75 million global advertising campaign geared to the theme "profit from experience." According to Aubrey Hawes, a vice president and corporate director of marketing for the bank, Chase's business and private banking clients "span the globe and travel the globe. They can only know one Chase in their minds, so why should we try to confuse them?"

Can global positioning work for all products? One study suggests that global positioning is most effective for product categories that approach either end of a "high-touch high-tech" continuum. Both ends of the continuum are characterized by high levels of customer involvement and by a shared "language" among consumers.

Global Marketing in Action-targeting Adventure Seekers with an American Classlc

Over the past decades, savvy export marketing has en-abled Harley-Davidson to dramatically increase world- wide sales of its heavyweight motorcycles. Export sales increased from 3,000 motorcycles in 1983 to 32,000 units for the 1999 model year. By 1999, non-U.S. sales exceeded $537 million, up from $400 million in 1996, and $115 million in 1989. From Australia, to Germany to Mexico City, Harley enthusiasts are paying the equiva-lent of up to $25,000 to own an

American-built classic. In many countries, dealers must put would-be buyers on a six-month waiting list because of high demand.

Harley's international success comes after years of neglecting overseas markets. Early on, the company was basically involved in export selling, symbolized by its underdeveloped dealer network. Moreover, print advertising simply used word-for-word translations of the U.S. ads. By the late 1980s, after recruiting dealers in the important Japanese and European markets, company executives discovered a basic principle of global marketing.

"As the saying goes, we needed to think global but act local," says Jerry G. Wilke; vice president for worldwide marketing. Harley began to adapt its international mar-keting, making it more responsive to local conditions.

In Japan, for example, Harley's rugged image and high quality helped make it the best-selling imported motorcycle. Still, Toshifumi Okui, president of Harley's Japanese division, was not satisfied. He worried that the tag line from the U.S. ads, "One steady constant in an in-creasingly screwed-up world," did not connect with Japanese riders. Okui finally convinced Milwaukee to allow him to launch a Japan-only advertising campaign, juxtaposing images from both Japan and America, such as American cyclists passing a rickshaw carrying a geisha. After learning that riders in Tokyo consider fashion and customized bikes to be essential, Harley opened two 'stores specializing in clothes and bike accessories. Today, Japan is Harley-Davidson's largest market outside of the United States.

Harley discovered that in Europe an "evening out" means something different than it does in America. The company sponsored a rally in France, where beer and live rock music were available until midnight. Recalls Wilke, "People asked us why we were ending the rally just as the evening was starting. So I had to go persuade the band to keep playing and reopen the bar until 3 or 4 A.M." Still, rallies are less common in Europe than in the United States, so Harley encourages its dealers to hold open houses at their dealerships.

While biking through Europe, Wilke also learned that German bikers often travel at speeds exceeding 100 miles per hour. This required the company to investigate design changes to create a smoother ride at autobahn speeds. Harley's German marketing effort also caused it to begin focusing on accessories to increase rider protection.

Despite high levels of demand, the company inten-tionally limits production increases in order to uphold Harley's recent improvements in quality and to keep the product supply limited in relation to demand. Harley is till careful to make home-country customers a higher priority than those living abroad; thus, only 18 percent of its production goes outside the North American Division. The Harley shortage seems to suit company executives just fine. Notes Harley's James H. Patterson, "Enough motorcycles is too many motorcycles.

High-tech Positioning

Personal computers, video and stereo equipment, and automobiles are examples of product categories in which high-tech positioning has proven effective. Such products are frequently purchased on the basis of concrete product features, although image may also be important. Buyers typically already possess or wish to acquire considerable technical information. High-tech products may be divided into three categories: technical products, special-interest products, and demonstrable products.

1. Technical Products

Computers, chemicals, tires, and financial services are just a sample of the product categories whose buyers have specialized needs, require a great deal of product information, and share a common "language." Computer buyers in Russia and the United States are equally knowledgeable about microprocessors, 20-gigabyte hard drives, modems, and RAM (random access memory). Marketing communication for high-tech products should be informative and emphasize features.

2. Special-Interest Products

Although less technical and more leisure or recreation oriented, special-interest products also are characterized by a shared experience and high involvement among users. Again, the common language and symbols associated with such products can transcend language and cultural barriers. Fuji bicycles, Adidas sports equipment, and Canon cameras .are examples of successful global special-interest products.

High-touch Positioning

Marketing of high-touch products requires less emphasis on specialized information and more emphasis on image. Like high-tech products, however, high-touch categories are highly involving for consumers. Buyers of high-touch products also share a common language and set of symbols relating to themes of wealth, materialism, and romance. The three categories of high-touch products are products tJ1at solve a common problem, global village products, and products with a. universal theme.

1. Products That Solve a Common Problem

At the other end of the price spectrum from high tech, products in-this category provide benefits linked to "life's little moments." Ads that show friends talking over a cup of coffee in a cafe or quenching thirst with a soft drink during a day at the beach put the product at the center of everyday life and communicate the benefit offered in a way that is understood worldwide.

2. Global Village Products

Channel fragrances, designer fashions, mineral water, and pizza are all examples of products whose positioning is strongly cosmopolitan in nature. Fragrances and fashions have traveled as a result of growing worldwide interest in high-quality, highly visible, high priced products that often enhance social status. However, the lower-priced food products just mentioned show that the global village category encompasses a broad price spectrum.

In global markets, products may have a global appeal by virtue of their country of origin. The "American-ness" of Levis, Marlboro, and Harley-Davidson enhances their appeal to cosmopolitans around the world. In consumer electronics, Sony is a name synonymous with vaunted Japanese quality; in automobiles, Mercedes is the embodiment of legendary German engineering.

3. Products That Use Universal Themes

As noted earlier, some advertising themes and product appeals are thought to be basic enough that they are truly transnational. Additional themes are materialism (keyed to images of well-

being or status), heroism (themes include rugged individuals or self sacrifice), play (leisure/recreation), and procreation (images of courtship and romance).

It should be noted that some products can be positioned in more than one way, within either the high-tech or high-touch poles of the continuum. A BMW car, for example, could simultaneously be classified as technical and special interest. To reinforce, the high-touch aspect, BMW publishes BMW Magazine for BMW owners. In addition to articles on the technical characteristics of the car, the magazine has lifestyle articles and advertisements for luxury products such as expensive watches, and jewelry.

Summary

The global environment must be analyzed before a company pursues expansion into new geographic markets. Through global market segmentation, the similarities and differences of potential buying customers can be identified and, grouped. Demographics, psychographics, behavioral characteristics, and benefits sought are common attributes used to segment world markets. After marketers have identified segments, the next step is targeting. The identified groups are evaluated and compared; the prospect(s) with the greatest potential is selected from them. The group are evaluated on the basis of several factors: segment size and growth potential, competition, and compatibility and feasibility. After evaluating the identified segments, marketers must decide on an appropriate targeting strategy. The three basic categories of global target marketing strategies are standardized marketing, concentrated marketing, and differentiated marketing. Finally, companies must plan a way to reach their chosen target market(s) by determining the best positioning for their product offerings. Here, marketers devise an appropriate marketing mix to fix the product in the mind of the potential buyers in the target market. High-tech and high-touch positioning are two strategies that can work well for a global product.

Discussion Questions

1. What is a global market segment? Pick a market that you know something about, and describe the global segments for this market.

2. Identify the major geographic and demographic segments in global markets.

3. Amazon.com has been an early winner in the on-line book business. Which market segments has Amazon served? Are the Amazon target market segments in the United States and the rest of the world identical?

4. Smoking is on the decline in high-income countries where the combination of higher life expectancy, education, income, and legal action has created a powerful antismoking campaign. Global tobacco companies are shifting their focus from high-income to emerging markets where the combination of rising income and the absence of antismoking campaigns is leading to ever-increasing demand for cigarettes. Is this shift in focus by the global tobacco companies ethical? What, if anything, should residents in high-income countries do about the rise in smoking in emerging markets?

TUTORIAL C
SWATCH WATCH U.S.A.: CREATIVE MARKETING STRATEGY

Introduction

As speaker after speaker paid tribute to the extraordinary skills that had earned him the award of "Marketing Executive of the Year", Max Imgruth, president of Swatch Watch U.S.A., grew more and more uneasy. Fully confident that the product that changed the watch industry forever, the Swatch watch, would enjoy continued success, Imgruth nonetheless felt the need to change gears. The competition, which was at first slow to react, had begun to implement strategies that stood to erode Swatch's position. Gazing from his privileged place on the dais, Imgruth saw an audience that was content to rehash past successes for a night, which was nice, but not at all his style.

Imgruth had recently guided his company through a fast paces and, some would say, controversial diversification program. Having already achieved spectacular success with the Swatch watch, Imgruth spearheaded a plan to establish Swatch as a total fashion enterprise. This move was accompanied by a good deal of skepticism from colleague and competitor alike. His next objective was to make sure that this year's #1 marketing executive did not become one of the decade's more memorable disappointments.

Background-the Swiss Watch Industry

1985 was a good year for the Swiss watch industry. The number of finished watches shipped abroad rose 41 percent to 25.1 million and the value of watch exports increased by 12.2 percent. Luxury watches still comprised the backbone of the Swiss watch trade, accounting for only 2.1 percent of total shipments but 41.8 percent of total earnings. In 1985, the Swiss raised their share of the world market to 10 percent by volume (number of units sold) and 45 percent by value. For the first time in 15 years, an increase in employment was registered as 1,000 new jobs were created. The industry's good performance in 1985, combined with a strong year in 1984, gave every indication that the Swiss watch industry was back on its feet after struggling for much of the previous decade.

The comeback had been led by the success of Swatch (a blend of Swiss and watch). Over 10 million of its brightly colored, plastic wristwatches were sold worldwide in 1984-85. Success had been most notable in the United States, where Swatch's latest move was the launching of a diversification program aimed at making the company a total fashion enterprise.

Whether or not this expansion of the Swatch product line proved successful remained to be seen. What was certain, on the other hand, is that the Swatch watch had given new life (and increased market share) to an industry that was recently engaged in a very difficult struggle with Asian competitors. What was also clear is that Swatch's willingness to break with convention, especially in the area of marketing strategy, gave it a head start in what had become a vast new market-the low prices watch as a fashion accessory.

Some might say that the Swatch watch was just another in a long line of Swiss successes. In the 1950's, few other industries enjoyed the domination known by the Swiss watch industry. In that decade, the Swiss possessed an estimated 80 percent share of the (non-Communist) world watch market. Production was centered in the Jura region where snowed-in farming families, doubling as skilled watchmakers, supplemented their incomes by assembling mechanical watch parts during the winter months. At the industry's peak in 1956, there were 2,332 such maisons. Two large watchmaking groups, Allgemeine Schweitzer Uhren AG (Asuag) and Societe Suisse pour I'Industrie Horlogere (SSIH), controlled most of the Swiss brands at this time.

The Swiss remained industry leaders until the mid 1970's when the mass production of electronic watches changed the watch industry forever. The most important difference between an electronic watch and a mechanical watch is that the former is much easier to manufacture. A mechanical watch is an intricate piece of machinery whose assembly necessitates a highly skilled workforce. The electronic watch is typically composed of microchips and printed units and lends itself well to mass production and automated processes. After having ruled supreme over the watch industry for decade, the Swiss suddenly found themselves faced with strong competition from Japan and such low wage producers as Hong Kong, Singapore, Taiwan, and Korea. These newcomers produces inexpensive watches with digital faces that were more accurate than mechanical watches.

Even though it was the Swiss who introduced the first electronic quartz watch in 1968, they were low to accept 'e importance of the new technology. Hindsight suggests that small and fragmented producers had a vested inters in keeping things as they were-the new technology Wt still unproven in the marketplace and the Swiss proposition was secure. In any event, the Swiss were late and reluctant entrants into a new market whose rules were different. In 1970s, for example, watches were introduced to mass outlets such as department stores and supermarkets. This was nothing short of blasphemous to the proud Swiss who required their watches to be sold in approved watch and jewelry stores. The Swiss continued to produce watches whose styles were no longer in touch with consumer de-mands, and they displayed a noticeable lack of marketing creativity. In reality, the Swiss had ceased to be leaders in the watch industry. The Swiss luxury watch market was still healthy, but they had lost a huge amount of market share at the lower end of the market. In 1974 Swiss watch exports still accounted for 60 percent of the worlds total. By 1979, the Swiss repre-sented about a third of the world's watch ex-ports. Economic recession and a sharp rise in the value of the Swiss franc played a part in the industry's problems. Most observers, however, now attribute the decline of the Swiss watch industry to too many

years of unqualified suc-cess that gave it an aura of invincibility. As one watch ex-ecutive put it: -

Just imagine the situation in the early post-war years when the Swiss were the only people making and selling watches; the industry had a waiting list of months; and selling prices were set to enable even in-efficient firms to survive. The more efficient ones were making enormous profits. Why would any manager in his senses want to change things?

As Switzerland entered the 1980s, the structure of its watch making industry, which had more or less retained its form since the late eighteenth century, finally began to adapt to the electronic age. This meant rationalization of production, automation, concentration, and the corol-lary of fewer jobs. Between 1980 and 1983, production of watches dropped by 50 percent. By 1983, only 686 *maisons remained* and overall employment stood at about 40,000 jobs, down from 90,000 in the early 1970s.

The Merger of Asuag-ssih

The merger of Asuag, whose flagship brand is Longines, and SSIH, whose best-known brand is now Swatch but also boasts Omega and Tissot, was Switzerland's first response to the Asian challenge. The new group was granted a fi-nancial package worth $310 million, representing the largest rescue scheme in the history of Swiss banking. Heavy reorganization took place in both groups, especially SSIH which had lost $77 million in the year ending March 31,1981. Most of SSIH's management was sacked and con-trol of the watch division was transferred to Ernst Thomke, a rank outsider to the industry, who possessed both a med-ical doctor's degree and an advance degree in chemistry.

The merger, as it turns out, was a sensible move be-cause Asuag was far better technologically equipped to face the 1980s than SSIH, having already made a substan-tial commitment to the research and development of elec-tronic watches. SSIH, for its part, possessed the better known brand names. (In the summer of 1985, Asuag-SSIH was renamed the Swiss Corporation for Microelectronics and Watch making Industries, SMH in short.)

Dr. Thomke made two important, tradition-breaking decisions in his first year. The first was to sell Swiss watch movements all over the world instead of restricting such sales to Switzerland, a move that allowed Asuag-SSIH to improve its technological base through increased pro-duction. The second was to recapture the lower end of the watch market by developing a product that was inexpen-sive to manufacture, low-priced, durable, technically ad-vanced and stylish. The result was the Swatch watch, which was especially successful in the United States, with total retail sales increasing from $3 million in 1983 to $150 million in 1985.

Product Description

The Swatch is a lightweight (3/4 ounce), shockproof, water-resistant (up to 100 feet), electronic watch with a plastic band that use's a quartz analog (with dial and hands) movement. It is manufactured by robots and sealed by lasers in a state of the art factory in Switzerland. The watch is comprised of only 51 components (the average is 91), which lends itself well to the thin look that is currently in vogue, and is manufactured off a single assembly line (the Japanese use three). What most distinguish the product is its design and its departure from convention. A wide va-riety of faces have been used and even glow in the dark and scented bands (banana, raspberry, and mint) have been tried. Battery life is estimated to be three years, and the watch retails from $30 to $35, which represents a substan-tial markup on cost.

The Swatch Marketing Strategy

Central to the marketing strategy of the Swatch watch is the notion of the watch as a fashion accessory. This is a novel approach in that it is typically used as a selling point for gold. and diamond-studded watches at the higher end of the market. Watches in the $30 to $35 range normally compete on the basis of price, performance or, in the case of digitals in the late 19705 and early 1980s, on accessory features such as a stopwatch and/ or calculator. Swatch, on the other hand, describes its target market as "fashion- oriented 12- to 24-year-olds."

One trend that worked in Swatch's favor from the start is that, during the period 1976-1986, more and more people bought watches. No longer was the watch primar-ily a gift item and no longer was it only the rich who owned more than one. In 1976,240 watches per 1,000 inhabitants were sold in America. Ten years later the figure was 425 watches per 1,000 inhabitants. About 90 percent of sales were composed of inexpensive electronic watches of vari-ous styles and brands.

Of course, Swatch never would have been able to take advan-tage of this trend without a sound marketing strategy. According to Imgruth, his company's strategy is divided into three elements: design, distribution, and production.

1. Design. An essential feature of the fashion-oriented approach is a constant variety of product lines whose designs suit seasonal fashions. According to Imgruth, the company has "a clear product concept based on four directions: young and trendy; active and sporty; cool and clean high style; and Classic. These four lines are available at all times. There are 12 small-faced models, and 12 larger ones. Every face is only out a restricted amount of time, some-times only three months, sometimes 12 months, de-pending on the design concept of the watch." Each line is given a distinct theme such as the "Cosmic Western" group which was described as a combina-tion of Buck Rodgers and the Wild, Wild West. New models are introduced four times a year, the seasons being spring/ summer/fall/holiday (see Ex-hibit 4). In addition, special versions of the Swatch Watch such as the $100 diamond-studded Limelight and limited edition art watches are added periodi-cally. Generally speaking; the trendier the design, the shorter it will remain available; the more classic the design, the longer it will remain on the market. Says Imgruth: "This is d6ne on purpose, to create collecting and spur multiple ownership. Ad-vertising media are chosen based on the product concept. There are four campaigns running simulta-neously, each geared to a specific element of the four-tiered product mix.
2. Distribution Distribution was originally limited to fashion outlets and now includes upscale depart-ment stores such as Bloomingdale's, Saks Fifth Avenue, Macy's, and so on. Such stores never used to handle Swiss watches and still only account for 10 percent of all watches sold. Imgruth

scrupulously -avoids distributing through drugstores and mass merchandisers such as Sears and JC Penney, even though these are the usual paths for watches priced under $100. Distribution is limited to 5,000 locations in the United States, although Imgruth claims that 5,000 more would love to sell his products. As one Swatch executive puts it: "You have to control distri-bution and not flood the market, or people lose their hunger for the product.

3. Production. The production process described pre-viously makes the design strategy possible. The flexibility that Swatch enjoys is unknown else where in the industry. Design changes for other watch-makers typically require a substantial capital investment whereas Swatch can make changes without adding cost. Such flexibility is absolutely essential because of Swatch's product strategy. Without it, design runs of three months would be out of the question.

Swatch Marketing Strategy In Action

In view of the fact that Swatch's strategy is unorthodox, it is not at all surprising that its marketing executives would look out of place in most corporate boardrooms. All advertising, marketing, and promotion activities are handled by 27 –year - old Steve Rechtschaffner, vice president/marketing, and Nancy Kadner, director of advertising, Rechtschaffner, a former member of the U.S. Ski Team and self-described workaholic who recently overcame a bout with thyroid cancer, has no formal business education. He began his career by forming his own sports promotion business. As for Kadner, prior to her work at Swatch she spent over 4 years in the marketing department at MTV.

Rechischaffner and Kadner are the creative forces behind Swatch's novel marketing strategy. Before Swatch entered the market, watches priced under $50 competed on the basis of price or performance. To gain an appreciation of just how different the Swatch strategy is, a glance at a typical advertisement for a low-priced watch would suf-fice. Normally, the watch is placed against a background in the hope that the right message is communicated. Timex developed one of the more creative performance oriented campaigns in the early 1980s when it strapped a watch to an auto tire and proclaimed that the product "Takes a lick in' and keeps on tick in'." Others have not been so imaginative. For example, it is not uncommon to see digital watch advertisements where product features are simply listed next to a black and white photograph of the watch.

Swatch, for its part, has taken roads previously UN traveled by watch producers. It employs the use of color-ful (and often humorous) print ads, multi-page advertising inserts in magazines such as *Vogue* and *Rolling Stone*, con-cert and event sponsorship, and the use of music videos and MTV.

A good example of the Swatch strategy in action is its use of a rap music group and a graffiti artist to promote and develop its products. In September 1984, Swatch spon-sored the World Break dancing Championships. One of the participating rap music groups, the Fat Boys, was hired to do a commercial on MTV on which its lead singer, the Human Beat Box, incessantly chants "BrrrSWATCHUM ha ha ha SWATCHUM." In addition, Swatch wanted an artist to help promote the break dancing championships so. It hired Keith Haring, New York's best-known graffiti artist. The result was a four-watch-series called the Keith Haring Swatch.

The Haring watches were promoted under the banner of "Great Modern Art That Tells Time." Swatch produced 9,999 of each edition. Each watch is numbered and, in Im-gruth's words are "a collectible piece of art, a distinctive fashion accessory, and a sturdy timepiece." The watches were introduced in separate months, the first being re-leased in December, and followed by new editions in April, May, and June.

The Competition

The under $50 watch segment is the most competitive in the watch industry in terms of the number of companies involved. Based on 1984 watch sales, this segment of the watch market also was responsible for the large majority of all U.S. watch sales (see Exhibit 5).

Because the Swatch watch was such a novelty at its introduction, the company had free reign over the plastic fashion watch market (some have called it "cheap chic")

Under $10	29%
$10--$50	52
Over $50	19

for well over a year. The picture has now changed consid-erably as strong competitors in the under $50 segment such as Casio, Timex, Lorus, Armitron; and Parker Watch have entered the fray. In addition to imitating some of the very styling and advertising techniques that Swatch employs (Exhibit 6), the new competition has targeted drug stores and mass retail outlets, the very areas Swatch has shied away from, as their primary points of distribution.

While it remained to be seen if the new entries could match Swatch's creativity and design flexibility (one Swatch insider said that technology-conscious Casio's bid to enter the fashion watch market was "like John Deere getting into sport scars"), the new array of low-cost watches was certain to exert downward pressure on retail prices. Lorus' initial line of plastic watches sold for $19.95 at full markup, Timex's Fun Timers sold for $17.95 and Casio's color Burst line started at $19.95. Most drug retailers feel prices will eventually fall to the $12 to $14 range.

Swatch has also had to concern itself with the sale of phony Swatch watches and unlicensed sales. In October 1985, 5,000 fakes were uncovered by U.S. Customs and Asuag-SSIH quickly sued three Swiss imitators. There is also a thriving "gray market" in which unlicensed traders exploit price differences between the United State's and Europe (the watch sells at a lower price in Europe). Swatch elected to buy up all such watches in 1985, spending an es-timated $500,000 in order to maximize control over the sale of its products.

The Next Step: Swatch As A Total Fashion Enterprise

It was perhaps with .an eye to an increasingly competitive environment that Swatch embarked on a fast-paced diversification program-in-Iate.1-98S. The. company created over 470 "Swatch Shops" within major department stores na-tionwide

selling, in addition to watches, a new ready-tower line called "Fun wear" and an accessories line called "Fun gear"

Swatch will continue to' employ the same strategies that' it uses to sell its watches. The new product groups are aimed at the same fashion-oriented 12- to 24-year-olds who are the target market for Swatch. Fun wear is described as "'a bright and whimsical line of unisex casual wear includ-ing shorts, T-shirts, tank tops, slip-on pants, big shirts, and beachwear.'" Each collection has a theme that ties in with a Swatch watch theme. Swatches own marketing and design people will introduce new collections every eight weeks, and prices range between $10 and $50. Fun gear is a collec-tion of leather and rubber knapsacks, belts, bags, and the jacket pack, which is a backpack containing a windbreaker and a hood. Prices range from $10 to $65.

Swatch offers more than just the preceding two prod-uct lines. There are Swatch Shields, which are described as high-fashion sunglasses; Swatch Guards, small, color-ful devices that cover watch faces; Swatch Chums, which are eyeglass holders; and umbrellas and sweats that fea-ture current watch designs. Swatch also imports and markets pens, notebooks, address books, key rings, and safety razors.

The Swatch drive to open shops within major de-partment stores is based on management's conviction that products should be sold in a total Swatch environment-an environment that has the Swatch "personality." The com-pany president, Max Imgruth, has predicted that ready-tower and accessories will represent from 30 percent to 40 percent of total 1986 sales. In the long term, he expects the new product lines to account for the majority of Swatch sales.

Other Examples of Brand Transfer

There are several examples of companies that have attempted, for better or worse, to build on the success of its first product by using its brand name on other, not neces-sarily related products. One of the more infamous exam-ples is that of Bill Blass, who put his name on chocolates only to see the idea fail miserably. Another example of fail-ure is that of Nike, which unsuccessfully expanded its col-lection of footwear to running wear and leisurewear. A Nike spokesman looking back at that experience notes: "When you're tremendously successful in one area, there's a tendency to develop an arrogance about your ability to transfer the value of a brand name.

On the other side of the coin, there was the example of Conran's, which successfully expanded from a producer of home furnishings to a retailer of everything from towels to desk lamps. Like Swatch, Conran's started out catering to the needs of young people and, when expansion took place, stayed with the same target market. Another point in Swatch's favor was its Swatch Shops, which spared the com-pany from having its new product lines being placed on shelves next to competi-tors who had the advantage of an es-tablished image as quality producers of ready-to-wear. In order to keep its shops and continue to avoid head-to-head competition with more established companies, Swatch had to remain a trend-setting, creative company. In this way they could avoid the fate of Bill Blass chocolates, which were sometimes found placed next to boxes of Godiva choco-lates, leaving the consumer with what might be a choice easily made.

Discussion Questions

1. Swatch is a unique success story. Why has the com-pany been so successful? Was it important that the Swiss watch industry recapture the lower end of the market? Why? Why not?
2. Do you see any parallels between the decline of the Swiss watch industry and other Western industries?
3. Evaluate the cultural dimension of the Swatch story, taking into account such practices as the willingness to bring in people from other industries, to delegate authority' to younger executives, and to employ new media such as rock concerts and music videos.
4. Swatch created a new market-can they continue to expand that market? What must they do to defend their position in this market?
5. What do you think of Swatch's chances for success as a total fashion enterprise? Do you agree with management's extension of the Swatch brand name. to other products? Why? Why not?
6. Swatch is a classic example of marketing success through creativity. What lessons can be learned from their experience?

Smart Car

In 1998, Daimler Chysler introduced a new car, a new brand, and a new technology in nine ED countries. It is named "Smart" and is certainly distinctive looking. (See Exhibit 1.)

The Smart car is only 2,500 mm long, 1,515 mm wide, and 1,529 mm high. It seats two adults or one adult and two children. The Smart car weights 720 kg, has a 22-liter gas tank, and gets 100 kilometers per-4.8 Liters. It is always two -toned in color. It has a frame called the Tridion Safety Cell, which comes in anthracite or silver color, and removable panels, which can be changed in less than an hour, in such colors as mad red, hello yellow, jack black, aqua orange, scodic blue, and boomerang blue, green, or orange. The op-tional leather seats are papaya colored. If you are thinking that the interchangeable panels and the wild colors remind you of a Swatch watch, you are correct, as the Swatch watch was the initial inspiration for developing this car. In the early stages of the project when Daimler-Benz and SMH (maker of the Swatch watch) formed a joint venture, the car was called a "Swatch mobile."

The Swatch mobile concept was based on Nicolas Hayek's (Chairman of SMH) conviction that consumers be-come emotionally attached to cars just as they do to watches. His vision was of high safety, ecology, and a very consumer- friendly area to sit in. Like the. Swatch, the Swatch mobile was to be affordable, durable, and stylish. Hayek noted that safety would be a key selling point, declaring, "This car will have the crash security of a Mercedes." Furthermore, the car was to emit almost no pollutants, thanks to its electric engine: The car would also be capable of gasoline-powered opera-tion, using a highly efficient, miniaturized engine. Hayek predicted worldwide sales would reach 1 million units, with the United States accounting for about half the market.

In 1998, shortly after the introduction, the joint venture between SMH and Daimler-Benz ended when Daimler-Benz bought out SMH's stake. Hayak was "disillusioned" with

Daimler-Benz, and Daimler-Benz found Hayak diffi-cult to work with.

To date, Smart car has two major criticisms: safety and price. Despite development of a crash management system that "enables smaller cars to be just as safe as larger ones," during its first winter (1999) on the road, there were reports of several accidents. In response, the company developed "Trust Plus" a software package that will cut power if the wheels start to slip.

As for the price, it originally sold for $10,500. After a period of disappointing sales in Italy and France, the price was reduced to $9,300. Although many buyers of the Smart car have high incomes or already own two cars, they are concerned about the price-value relationship.

Discussion Questions

1. What do you think of the market potential of the Smart car? Comment on the original premise that a car could be the by-product of the joint -venture of an automobile manufacturer and a non-automotive marketer.
2. Is the Smart car an international or a global prod-uct? Do you agree with the European-only launch? Why? Why not?
3. Identify target markets where you would introduce this car. What sequence of countries would you recommend for the introduction?
4. How would you position the Smart car in the target markets?
5. Who are the Smart car's major competitors? How are these products differentiated?
6. Should the price, assuming it would still make a profit, be reduced?

ORIFLAME

Introduction

This case will give you a general overview of the Swedish cosmetic company, Oriflame International S.A., with concentration on the impressive development of Oriflame's entry into Eastern and Central Europe. A special focus will be directed toward oriflame's operations in Poland.

Company Profile

Oriflame was founded in Sweden in.1967 by brothers Jonas and Robert af Jochnick and Bengt Hellsten. In 1972, the parent company, Oriflame International S.A. (OISA), Lux-embourg, was established. In 1982, OISA became listed on the London Stock Exchange.

Oriflame's specific market concept, which involves direct sales, also allowed for rapid market development outside the Nordic area. The company is currently repre-sented in 42 countries in Europe, the Far East, Australia, and the Americas.

In 1987, the mail-order operation was expanded fol-lowing the introduction of the Vevay brand name. In 1992, the natural cosmetics company Fleur de Sante became af-filiated with the group. ACO Hud was acquired in 1992 and is Sweden's best-known brand name in skin care products. The products are retailed through Swedish, Norwegian, and Icelandic pharmacies. Oriflame develops and produces its own naturally based products in its manufacturing plant in Ireland where the group's research laboratories are also located.

Oriflame Eastern—Europe S.A. (ORESA), which is managed from Brussels, was established in 1990 with the objective of penetrating Eastern European markets.

In 1994, direct sales accounted for 83 percent of the group's sales (DRESA and OISA). Oriflanie is represented by sales companies in 42 countries of which 29 are wholly owned and mainly located in Europe Oriflame has licensees operating in an additional 13 countries. The organizational structure of a country sales company is shown in Exhibit 1.

The Market

The market for cosmetic products is developing positively with recent growth averaging around 4 percent per year by volume, although, as with other consumer industries, growth in 1992-1993 decreased as a consequence of the general eco-nomic recession.

The company has experienced steady growth in sales since the start in 1967 with, in June 1994, sales totaling $230 million for the group. The increase has been particularly significant in Europe with the establishment of new oper-ations in Central and Eastern Europe. This growth is also explained by the fact that pe9ple are becoming more dis-cerning about how they buy things. Many people find vis-iting a department store tiresome and impersonal. The current trends are returning to -personal service, care, and attention. Combine that with Oriflame's commitment to offering value for money with a full 100 percent money back guarantee and the current sales growth is explained.

In addition to Europe, major growth has come from South and Central America. Oriflame's operations on the South American continent are directed from Chile, where the success of the local operation continues.

The global market for cosmetics and toiletries (C&T) is mature, and growth through the year 2000 is projected to reach the modest rate of 3 percent annually. Europe ac-counts for 37 percent of overall sales and is the major single market for C&T products. The growth rate in the region is among the strongest of any in the world when the results from Eastern Europe are considered. By contrast, the U.S. market is saturated and growth is slow.

In the global market for C&T, skin care is a large sector in most countries, except in the United States where skin care is less developed than in Europe in terms of user pen-etration. One key trend is the launch of products that are marketed as having benefits to the skin, which are not just cosmetic. This trend can be seen across the cosmetic mar-kets and indicates that demand is becoming more sophisti-cated. It usually involves a close association with health benefits. These therapeutic cosmetics, "cosmeceuticals," are expected to become a major growth area in the skin care market. The cosmetics industry has been very active in the development of such products in recent years, spending heavily on research and development (R&D) and often transfer-ring medical research to cosmetic products.

Although there is a continuous search for innovation in the C&T sector, the lack of legal protection in such forms as patents adds a factor of increased risk and hinders the potential for return on capital.

Pan- European sales of skin care lines increased by 8 to 10 percent during 1992. The growth trend continues in the area of antiaging products, with the quality demands on effective long-lasting moisturizers rising. The public's in-creasing concern about environmental pollution and the link to the harn1ful effects of the sun's ultraviolet rays is also of great interest to the industry.

Body care products continue to perform well in Europe, but market penetration levels are relatively low compared to the sun care market.

Cosmetics sold through direct -selling methods make up the following percentages of the following markets: Sweden (20), United Kingdom (15), Finland (13), France (7), Denmark (11), Eastern Europe (11), Spain (7), Hol-land (6), Norway (4), other (13).Over all, direct sales of cosmetics account for 10 to 15 percent of the entire cosmetics market.

The Direct-selling Industry

Direct selling, which was already a substantial industry in the United States by 1920, is defined by the Direct Selling Association as follows:

The selling of consumer goods direct to private in-dividuals, in their homes and places of work, through transactions initiated and concluded by a salesperson. Direct selling has several advantages over shop retail-ing, not only for the customer, but also for the manu-facturer. The customer can pick up the products at a service center or have them delivered at home. The manufacturer does not have to support advertising costs to attract its customers. The distributors playa double role being both customers and sales peopled in the recruitment of new customers.

In July 1994, the World Federation of Direct Selling Association indicated that direct selling was a $60 billion industry in the world, with 30 million people involved in this activity each year. As an example, the United States counted million to 7 million people in direct selling and Japan more than 2 million. Most people who sell direct do it not only because they like the products and want to in-crease their income, but also because it is a good opportu-nity for them to develop an independent activity. Direct sales are now a global activity, with many new players com-peting with traditional companies.

Most of today's successful direct selling companies use a sales system called Network Marketing or Multilevel Marketing. An article in *The Wall Street Journal* described Network Marketing in the following way:

Network marketing is a sales system which totally omits the stores. Networks sell all kinds of products: from pens or toothpaste to computers, cars, and even houses. These products are usually 15-50 percent cheaper than those purchased in the stores. By the end of this century, we will be buying 50-60 percent of all the products and services in this way.

The rules are about the same everywhere. An au-thorized distributor delivers the company's products directly to the customer's house. His first clients are his family and friends. A distributor buys the products at a price, which is 20-30.percent cheaper than the price the customer will later pay for them. The difference is where his profit is. If he wants to make more, he re-cruits new sales agents. Depending on the number of people he recruits and on the volume of goods he and the recruits buy, he receives a commission and a bonus. Sometimes it can be a prize, a nice trip abroad, some':' times even a retirement pension. Those who recruit the biggest number of new agents make the most. The company also makes money because it has no such costs as rent or a lease. It would have to pay for all of this if it sold its goods in the stores.

Oriflame is one of the main direct-sales companies in many of its markets and the largest direct-sales company in Scandinavia and in Central and Eastern Europe.

Oriflame

Direct Selling

Conventional selling involves moving a product through a hierarchy of middlemen from the manufacturer to the end customer. All these middlemen-wholesalers, retailers, and jobbers-earn a profit from handling the product. In a direct-selling environment, these positions are not neces-sary and profits are instead shared among the distributors. These cost cuttings also give Oriflame the possibility to sell a higher-quality product at lower, more competitive prices.

Oriflame's responsibility in the markets in which it operates is to package the products and handle the financing and data processing, warehousing, shipping, and market-ing, as well as creating training programs and materials to support the independent distributors.

The Oriflame distributors offer unique, value-added services such as cosmetics consultancy in their customers' homes or offices. It is company policy that prospective cus-tomers (1) are not subject to "pressure selling" nor are they obliged to purchase; (2) receive free skin analysis and per-sonalized advice on proper skin care; and (3) are offered free ongoing after-sales service.

Oriflame has 300,000 distributors worldwide. Dis-tributors usually have other jobs; thus, their involvement with Oriflame is sometimes only a hobby. Historically, dis-tributors have been paid strictly on commission, and their primary sales tool has been sales catalogs provided by Ori-flame. (More than. 12 million catalogs in 17 languages are distributed every year.)

Oriflame's selling method consists of selling a wide range of the highest-quality cosmetics to consumers on a person-to-person basis, backed by a unique, multilevel marketing plan.

Distributors get their catalogs every 2 to 4 weeks and use them to sell to friends, relatives, and colleagues-nor-mally, their primary customer base. Distributors order products they sell from the catalogs, receive bundled ship-ments from Oriflame, and then pass products on to indi-vidual customers.

Oriflame is now implementing and expanding a new (for them) marketing method. This involves the distributor's building up a sales network and receiving a bonus or commission on the sales made by each individual recruited to be a distributor, as well as on the sales made by the recruits. This system, often called multilevel marketing, can offer career opportunities for current "hobbyists" because the system permits "main source" levels of income. The method has worked most successfully for Oriflame in Latin Ameri-can and several Eastern European countries. Distributors in these countries often enjoy incomes well above national averages. Catalogs are an integral-part of this system, but are issued less frequently. Over time, Oriflame will adapt this method for use in its traditional Western European markets.

Oriflame has never been successful in the German and U.S. markets despite several start-up attempts. Direct sales accounted for 83 percent of Oriflame's sales in 1994 com--pared with 70 percent in 1994. It has been decided by the board of directors that Oriflame's future direction will be in the field of direct selling. This is where the company has its highest potential. (See appendix "The Marketing Plan: An Overview" for further explanations of the marketing plan.)

Other Activities

Mail order at OrifIame can be divided into two types. The first is by direct customer purchase of specially selected products appearing in sales catalogs that are distributed 10 to 12 times a year. This method is referred to as the pos-itive option.

The second category of mail-order sales is based on the book club type of system. Subscribers/members/cus-tomers are offered specially composed packages through a brochure. The parcel is sent to the customers unless they actively inform the company that they do not wish to re-ceive it (negative option).

The mail-order market accounts for around 5 percent of the total cosmetics market. The market is expanding, es-pecially in the Nordic area. The activities in Eastern Europe have a major potential as the time is right for this concept and strong develop-ment is anticipated generally. The market as a whole is subject to tough competition from companies such as Yves Rocher.

The mail—order market within the Oriflame group is com-posed of Oriflame's operation in Denmark-Vevay's cosmetic club and Fleur de Sante's natural cosmetics. In 1992, the mail-order operations were combined to from a division within the Oriflame group.

The mail-order operations started in Denmark in 1978 with Oriflame's cosmetics club. Today, Oriflame in Denmark has around 100,000 members and sales of around $8 million.

Vevay was founded in Sweden in 1987. Since then, op-erations have expanded to Norway, Finland, and Denmark and during 1993 ORESA started up its Will operations in Poland, Hungary, and the Czech Republic. Vevay has around 120,000 meP1bers and sales of around $4 million.

Fleur de Sante has been an associate company of Ori-flame - since May 1992 (36 percent ownership). The com-pany, located in Malmo, has a turnover of around $15 million in Sweden, Norway, and Finland. In August 1992, -Oriflame acquired the distribution rights for Fleur de Sante in Eastern Europe. A company was started in the Czech Re-public in February 1993.

Mail order in 1994 accounted for 7 percent of total Oriflame sales.

ACO

The ACO company evolved from the Swedish pharmacy op-erations, and the name ACO dates back to 1939. In connec-tion with the nationalization of Swedish pharmacies in 1972, ACO was transferred to the government owned pharmaceuticals company, Kabi Vitrum. Oriflame acquired ACO on January 1, 1992.

ACO's main market is Sweden, where the products are sold through pharmacies. ACO is the best-known brand name for skin care products in Sweden. Its main products are creams, lotions, sun care products, and hand care products.

The ACO products exist within the low and average price ranges, whereas the Nordic Light products compete with exclusive prestige brands

The growth in sales during the year has mainly been through new products or recently introduced products as well as sun care products. Sales increased to $24 million. ACO accounted for 10 percent of total Oriflame sales.

Manufacturing

At the end of 1977, Oriflame's board of directors decided to build a production plant on the outskirts of Dublin, Ire-land. The plant was completed 2 years later, in July 1979, following extensive project work, including transfers of technology fr*om* former subcontractors. The building cov-ered 2,800 square meters for production, research labora-tories, and quality control. Extensions were made in 1980, 1989, 1991-1992, and 1992-1993.The current extensions now have been completed and have increased the capacity for filling from 22 million to approximately 40 million units. This, of course, includes the ACO equipment transferred from Stockholm. In 1993, the factory covered 11,000 square meters for production, research laboratories, and quality control. The plant is one of Europe's most modern cosmetic manu-facturing units and is well equipped with high-technology production equipment.

AlI Oriflame products undergo strict physical, chem-ical, and microbiological control before reaching the cus-tomer. The objective is that the customer should be able to rely on the product to provide long-term quality, regardless of how it was purchased.

In order to attain this objective, all deliveries of raw materials and packaging are tested according to strict specification before they enter the production process. An overriding priority is to offer consumer products that meet the highest safety and quality standards. The- water used is tested daily to guarantee a high degree of micro-biological purity.

Research and product development in the Dublin plant is actively concentrated on developing new cosmetic formulations in line with the market demands and expectations.

Exhibits – 2

	1994 ($ *Thousands)*	**1993 ($ *Thousands)***
Sales	232,137	192,406
Operating profit	36,192	31,431
Profit before tax	37,206	31,556
Profit after tax	28,676	23,522
Capital expenditure	20,349	13,822
Profit margin %	16	16.4
Equity/assets ratio (%)	57	55
" Return on net capital employed (%)		
Gearing (%)	32	36
Employees	14	31
Exchange rate $ = 1.56	1,328	1,148

In production and development, products and pack-aging are tested continuously for microbiological stability and quality of packaging. The production philosophy, in-cluding packaging, is to concentrate on new consumer de-mands such as biodegrad-ability, recycling, and the absence of animal raw materials.

The Research and Development Department has gen-erated over 100 new products for Oriflame, Vevay, Fleur de Sante, and ACO in 1994.

Oriflame Results

In 1993 and 1994, the Oriflame Group results are shown in Exhibit 2.

Oriflame Eastern Europe

Decision to Start

When Oriflame decided, in 1990, to create Oriflame East-ern Europe, Jonas of Jochnick called back to Europe a young Swedish manager, Sven Mattsson, who at the time was managing director for the operations in the Philippines. The

year before, of Jochnick had-resigned from his position as Oriflame chairman in order to devote more time to look at new marketing opportunities, particularly in Eastern Europe. Af Jochnick, together with Mattsson and a secre-tary, opened an office in Brussels for the new company, ORESA. The objective was to exploit business opportuni-ties for the direct selling of cosmetic products in Eastern Europe, with initial emphasis on Czechoslovakia, Hungary, and Poland. In Eastern Europe, Oriflame targets for the later stage of its development were Bulgaria, Romania, the Soviet Union, and Yugoslavia.

On July 10,1990, af Jochnick was appointed Chairman of ORESA. In a letter to Oriflame shareholders, he wrote:

The opening up of the Eastern European markets offers new and exciting opportunities to establish busi-ness activities in these countries. There is a strong ambition and commitment by the new democratically elected governments in some of these countries to de-velop their markets along the lines of Western-style market economies, and legislation is being proposed or passed in a number of Eastern European countries to encour-age foreign investment.

In particular the Directors of ORESA believe that opportunities exist for companies:

1. Which are active in the consumer goods areas;
2. Which are prepared to re-invest cash and profits in the local markets and which are in a position to wait a considerable period before remitting profits;
3. With the resources to establish or invest in local manufacture;
4. Which are willing to invest in the development and professional training of local nationals as future management.

Currently there is a high degree of uncertainty as to where and how quickly these opportunities will de-velop since definite legal frameworks have not yet been established in all the countries in Eastern Europe. It is therefore impossible to predict with any degree of cer-tainty what financial returns can be expected or the timing 9f such returns.

Investment in these countries must instead be based on the belief that the recent political changes are irre-versible and that there will remain a strong commitment to develop these economies with policies based on Western economic principles. I believe that for the companies, which take the initiative early and take a long-term view, future reward and returns should far exceed what can be expected from mature markets in the West.

The initial objective of ORESA was to establish sales organiza-tions in Czechoslovakia, Hungary, and Poland, using the well-proven direct-selling techniques already used by the company in its existing markets. The tech-niques seemed particularly well suited to these countries due to the highly undeveloped retail distribution networks found there at that time.

ORESA was also examining the possibility of enter-ing into joint venture arrangements with existing cosmetic manufactur-ers in each of these countries to enable prod-ucts to be sourced locally. In the longer term, manufactur-ing for export of cosmetic products in Eastern Europe was envisaged.

The Development 1990-1994 (Exhibit 3)

The first country that Oriflame entered was Czechoslovakia. Eliska Wescia, a woman of Czech origin living in Malmo, was made all offer to return to Prague. She accepted and first sales ‘were made in December 1990. A 100-square-meter office was opened and after 3 months, $300,000 worth of sales were already made. Sales were growing so fast that

Eshibits - 3 Sales Statistic

Country: Czech Republic	***Start: December 1990***			
	1991	**1992**	**1993**	**1994**
Total sales (USS thousands)	4526	12684	12758	13700
Active file count	2320	7629	12494	18804
Activity %/month (average)	74%	81%	68%	61%
Sales/active/month. (USS average)	490	138	125	112
No. Of employees	9	33	51	61
Office space (square meters)	300	300	450	600
Warehouse space (square' meters)	600	660	700	1000
No. of service centers		16	17	21
Advertising spending (USS in thousands)		15	378	400

Country: Slovakia	**Start: January 1993**	**1993**	**1994**
Total sales (USS in thousands)		3197	6400
Active file count		3795	9090
Activity %/month (average)		66%	59%
Sales/active/month (USS average)		180	90
No. of employees		10	30
Office space (square meters)		280	550
Warehouse space (square meters)		0	600
No. of service centers		0	60
Advertising spending (USS in thousands)		23.5	89

Start May 1991

Country: Hungary	**1991**	**1992**	**1993**	**1994**
Total sales (USS in thousands)	1400	6500	9500	13500
Active file count	3602	13442	18933	23285
Activity %month (average)	65%	62%	53%	50%
Sales/active/month (USS average)	133	100	81	93
No. of employees	14	35	60	75
Office space (square meters)	60	180	280	400
Warehouse space (square. meters)	50	700	1200	1200
No. of service centers	0	1	4	9
Advertising spending (USS in thousands)	0	20	275	250

Start: April 1992

Country: Turkey	**1991**	**1992**	**1993**	**1994**
Total sales (USS in thousands)		1278	9933	12900
Active file count		2523	16224	28550
Active %/month (average)		83.7%	61.7%	47.4%
Sales/active/month (USS average)		289	167	98
No. of employees		11	37	74
Office space (square meters)		350	450	750
Warehouse space (square meters)		100	800	1500
No. of service centers		1	4	9
Advertising spending (USS in thousands)		8.7	44.4	70.3

Start: May 1993

Country: Greece	**1991**	**1992**	**1993**	**1994**
Total sales (USS in thousands)			554	1845
Active file count			819	3048
Activity %/month (average)			89%	66%
Sales/active/month (USS average)			218	196
No. of employees			11	26
Office space (square meters)			280	480
Warehouse space (square meters)			200	300
No. of service centers			1	3
Advertising spending (USS in thousands)			22	50

Start: August 1994

Country: Bulgaria	1991	1992	1993	1994
Total sales (USS in thousands)				810
Active file count				2450
Activity %/month (average)				93%
Sales/active/month (USS average)				200
No. of employees				15
Office space (square meters)				400
Warehouse space (square meters)				600
No. of service centers				0
Advertising spending (USS in thousands)				2

The company had to stop recruiting for a while to establish a warehouse and find new office facilities. In 1994, Oriflame had .a 600-square-meter office in Prague with a 1,000-square-meter warehouse, and 15 service centers spread over the country.

In Poland, the company recruited the- first 12 distrib-utors in March 1991. They ordered, among themselves, $20,000 in the first 2 weeks and are still today among the leaders in the Polish network. A Polish citizen who had spent 2 years in Iran and who was fluent in English was re-cruited as country manager.

In Hungary, where competitors like Avon and Amway were already established, Sven Mattsson was general man-ager of Oriflame until the company found a Swede with a Hungarian background, Thomas Grunwald, to assume re-sponsibility for Hungary in May-1991, which was when the first Oriflame products were sold. At the beginning, sales did not develop as fast as in Poland and Czechoslovakia. However, 3 years later, sales were developing faster in Hungary (plus 38 percent) than in the Czech Republic (plus 15 percent) or in Poland. Which had only a small in-crease. Mattsson says, "This can partly be explained by the fact that Oriflame naturally offers the best service level within the capital region. Approximately 25 percent of the Hungarian population lies in the Budapest area, a figure which is much higher then the other bordering countries.

Local management has also been very successful in work-ing with leaders of the network." In 1994, Oriflame had 75 employees in Hungary.

In April 1992, Oriflame started operations in Turkey. The company had great hopes for this more Western market where well-trained managers were available and where everything seemed to be a lot smoother and easier, in spite of a lot of red tape and bureaucracy. This was noth-ing compared with what the company had experienced in Eastern Europe up to now. The initial investment was paid back after 3 months of operations. In December 1992, Oriflame sales were $450,000. Turkish distributors appeared' to be entrepreneurial and cooperative. The operations have been greatly helped by the country's well-developed infrastructure (banking, telecommuni-cations, etc.). Ori-flame's high expectations were not met in 1994 because of the economic crisis Turkey faced during the year. In March, the dollar value moved from 14,000 to 40,000 Turkish liras over a few days. Sales dropped 40 percent below forecast, but Sven Mattsson remained optimistic about the medium and long-term future. In January 1995, Oriflame Turkey opened a new 1,200-square-meter office and a 2,OOO-square-meter warehouse near the Istanbul airport.

In May 1993, Oriflame started its sales in Greece, a member country of the European Union with no import duties. Oriflame had to pay 12 percent duties for the Czech Republic and from 10 to 50 percent for Hungary and 20 per-cent for Turkey. In 1994, Oriflame Greece showed profit.

In Bulgaria, Oriflame opened a 400-square-meter office and a 600-square-meter warehouse in August 1994. Success was immediate, and the company experienced its biggest initial growth, with distributors placing an average monthly order of $250 in this country where the average income is only about $80 per month.

In Russia, Ukraine, and Latvia, 0 RESA has, since 199(sold its products wholesale to retail outlets as high in-flation, inad-equate banking systems, and a relatively un-developed infrastructure has made it difficult to use the traditional Oriflame concept of selling through distribu-tors. However, the company is now ready to adopt direct sales there, implementing the same Marketing Plan as in other Eastern European countries. A Swedish manager, Fredrik Ekman, moved to Moscow in October 1993

From 1991 to 1995, ORESA increased its staff and office facilities in Brussels. In 1995 the head office was staffed by 30 people, ensuring centralized functions such as Operations and Marketing, Finance, Supply, Business De-velopment and Legal Affairs (see Exhibit 4).

In 1995, ORESA planned to open sales companies in Romania and Lithuania. A re-launch of Oriflame's activi-ties in Germany took place during the course of 1995. Ori-flame Germany is being managed from Brussels.

A 10,000-square-meter ultramodern manufacturing plant, located in Warsaw, was due to start operating in mid-1995. This involved a total investment of approximately 20 million U.S. dollars.

As Sven Mattsson likes to say, "Our initial aim was to start with Czechoslovakia and then to follow with Poland and Hungary and other markets according to our success in established markets, but also according to available management resources. Our ambition is to become market leaders, both in the direct selling industry as well as the cos-metic industry and to capitalize on all the advantages which result from being the first on a market."

Oriflame in Poland

Decision to Start

In December 1990, Edward Zieba, who had worked for a state chemical company in Poland and who had spent 3 years in Iran with a construction company, was recruited by Oriflame with the objective of starting operations in Warsaw. During that month, he had long discussions at the Brussels headquarters of ORESA and visited the Oriflame production plant in Ireland and the emerging sales com-pany in Czechoslovakia. Dudng the first months of 1991, Zieba became very skeptical about the development of Ori-flame in Poland with direct-selling techniques and a multi-level approach, which had never been used in his country.

"I really thought at that time that it could not possibly work in Poland. Our mentality is too different and what we have lived

through over past decades left little hope of im-plementing such methods with success. 1 had accepted the job because I treated it as something new and exciting, but I was very doubtful," commented Zieba to the case writer during his visit to Oriflame Warsaw in May 1994.

Oriflame started its operation in Poland in March 1991. At that time, Zieba gathered some 20 of his friends with their spouses for a cozy party during which he-did not speak about Oriflame but only displayed some products on a table in the kitchen. After a while, all of those gath-ered there started asking questions. At the end of the evening, he gave a few samples to those interested (all of them) while briefly explaining the opportunity of the Ori-flame marketing plan. Although the quality of the prod-ucts was fully recognized, each of the guests appeared concerned about the selling method. Three years later, in 1994, eight of them were selling Oriflame products as their only professional activity and were at the epicenter of sev-eral different networks of thousands of distributors.

Products and Pricing

Initially, a selection of 100 items was offered. One year later; the number increased to 150. Oriflame cosmetics are gentle but effective. They are produced from nonirritant, natural plant extracts and protect the skin against the harmful effects of pollution and stress. Oriflame products link the best of nature with the best of science to achieve the highest quality.

A first product selection was made by the Marketing Department in Brussels and one of Zieba's first assign-ments was to propose local pricing. Oriflame generally sells in local currency. At a later stage, free choice was given with regard to new introductions and discontinuations. Our intention was and still is to offer the most comprehensive range of skin care, color and fragrance products in the Polish market. The first months clearly showed that consumer habits differ in many areas from what we are used to in western countries.

Since conception, product price positioning has been one of the most important issues and intensive market studies are continuously carried out in this area. "It is nec-essary to keep on top of a rapidly changing economic en-vironment. At an early stage it was decided to offer very competitive prices in order to attract millions of new cus-tomers rather than selling a limited number of items' with traditionally high margins."

Merchandise Support

Twice a year, Oriflame issues 380,000 copies of its catalog: showing 250 products classified in the following categories: skin care, body care, family favorites, color, cosmetics, women's fragrance, and men's fragrance. Prices are not printed in the catalog but on a separate loose sheet. Ori-flame prints all its catalogs in Sweden, using the same cata-log in nine different countries. Translation and typesetting of the texts is made in each country before the printing. One of the difficulties the company has to face is a product sales forecast, which have to be made 15 months in advance.

Three catalogs, a product guide, information on the marketing plan, samples, and some real products are all in the starter kit that any new distributor has to buy at the cost of $28 in order to start their business. Additional cat-alogs can be acquired at cost by the distributors. The com-pany decided that the catalogs should always pass through the distributors and would never be sent directly by the company to a prospective consumer.

We see a catalogue as a major marketing tool and there is a lot of effort going into the preparation of every issue. I do not think that one can not over estimate its impact on the company image, product awareness, and finally on sales. We are still investing considerable amounts of money into it and experimenting with its look and content. It is one of the best investments.

Operations

When Oriflame started operating in Warsaw from a rented villa, people were lining up for hours in the street to buy some of the first product range. Rapidly, 70 percent of the products were out of stock, and the company decided to stop recruiting new distributors for 3 months. That time was used to reorganize all distribution procedures and open some service centers.

In March 1992, Oriflame Poland purchased Kamelia, a cooperative that produced cosmetic products in Vrsus; a suburb of Warsaw, later followed by the installation of pack-aging facilities in the old factory. By April .1992, B040na Karpinska had joined the company as operations manager in charge of distributors, warehouses, and customer service.

In 1993,12 service centers were opened, most of them in rented villas throughout the country, to allow distribu-tors to come and pick up the merchandise. In 1994, Ori-flame had created a total of 18 centers, 10 of which were company owned; the others were on an agreement basis with different entrepreneurs. A new warehouse has been completed along with new pick - and-pack facilities for a few thousand orders per day.

In 1994, Oriflame Poland employed 150 people, all of them of Polish origin. The distribution network counted over 50,000 registered members.

By 1995, Oriflame was selling a range of 200 products, 60 percent of which were filled and packed in Ursus, with the remaining 40 percent coming from the factory in Ireland.

On January 31, 1995, a daily newspaper published in Warsaw printed an article that said: "Swedish company Oriflame was the first direct selling company in our market (1991). According to Oriflame management, the speed of turnover growth and network development in Poland is the most remarkable in the 27 years history of the company."

Advertising and Public Relations

In 1993, it became evident that Oriflame was aiming toward a mass market with its sales volume and, therefore, the com-pany decided to invest into both advertising and public re-lations (PR) activities to strengthen its brand awareness. The first successful advertising campaign was run in the autumn of 1993, followed by spring and autumn of 1994. The media used were mainly public TV and all segments of women's magazines. The advertising budget for 1994 was almost $700:000, of which 70 percent was spent on TV.

Below-the-line activities included not only traditional PR but also exhibitions and company promotional days in all major cities in the country, with an estimated audience of 300,000.

Frequent contacts with the press resulted in broad media coverage, with little negative comment.

The Oriflame Distributors

When a new distributor registers with Oriflame, he or she can generally place orders on credit up to DS$50O, the av-erage order being $100. Given the state of the bank system, which was still very poor in 1994, distributors' cash pay-ment facilities are organized' in all service centers across the country.

In December 1994, Oriflame Poland had built a net-work of 50,000 active distributors (placing orders at least once during the preceding 3 months) plus 30,000 non-active distributors (no orders in the last 3 months). One distribu-tor, Jerzy Ruggier, a student at Warsaw University, explains: "I know that I have to create a place for my job. I learned responsibility. It is important for me to sell high-quality products, to be honest, and not to break the rules. It is a way to start a small business and to help people to under-stand the new laws and taxes." Another distributor, Joanna Szablinska, had set an objective for herself: "I wanted to become a Sapphire Director and buy a new car an Alpha Romeo. Oriflame is a way of socializing, something which gives you the opportunity to learn how to make safe contacts with other people-and buy some luxury in different forms."

Of the 573 distributors who have reached the director level and beyond, 90 percent of them devoted all their working time to Oriflame. Another several hundred are making a living that is far beyond average standards in Poland. The Oriflame network consists of some 75 percent of women and 25 percent of men, the majority being 25 to 35 years old. Bert Wozciech, after 3 years as area manager for Benetton in Poland, joined Oriflame as training man-ager for the whole network. Since 1993, he has organized training sessions for the directors. Every Monday at 4:30 P.M. in Warsaw, he conducted, in a lawyers' club, a seminar on motivation, which was free of charge and open to any active or prospective distributor who wished to attend.

In May 1994, Edward Zieba commented on the Ori-flame situation in Poland:

We want to intensify our support because we do not only want to do business but also develop social life and the individual distributor. We do not want to give only more money to the distributors; we want to develop a club, to make the distribu-tors more able to meet other people and belong to something special.

The years of rapid growth are over but I am con-vinced that in 3 years from now we will have at least 100,000 active distributors.

Competition

In 1994, it was estimated that over a million Poles were working for different networks in direct-selling, multina-tional companies such as Avon, Amway, Zepter, Oriflame, Herbalife, and so on. Two of them, Amway and Zepter, were described as follows:

Amway, one of the world's largest and most dynamic direct-sales companies, has been active in Poland since 1992. Although Amway came to our market relatively late, it now boasts the largest network of sales agents. In the opinion of the Amway bosses, Poland is their best market, both in terms of the number of distributors and in terms of sales. In the world, Amway has more than 2 million distrib-utors, who sell about 400 of the company's own products and a few thousand products manufactured by other firms from which Amway has acquired selling rights. Its total annual sales amount in 1994 was $4 billion. In Poland, the monthly turnover is about $30 million zloty. In 1992-1993, Amway managed to build a network of 100,000 distribu-tors. An Amway executive stated: "Poland is our best market in both sales and number of distributors in relation to its population." Amway distributors are not employees of the company but are independent entrepreneurs who have their own businesses. So far, Amway in Poland sells about 20 products: laundry detergents, dishwashing liquids, care cosmetics, and personal hygiene products. The big ad-vantage of the Amway products is that they can be returned even after they are taken out of the packaging.

Amway is not just cosmetics. It is also the author of a televi-sion serial, *Bliznes Start.* This program talks not only about the basics of entrepreneurship and a free market economy, it also presents people-Polish businessmen.

Exhibit – 5 Sales Statistics

Country: Poland	1991	1992	1993	1994
Total sales (in USS thousands)	2,250	21,566	35,390	37,180
Active file count	1,782	24,101	38,925	45,020
Activity % /month (average)	84	65	58	53
Sales/active/month (USS average)	355	288	161	118
No. of employees	14	81	130	154
Office space (in square meters)	130	600	800	1,000
Warehouse space (in square meters)	100	900	1100	2,400
No. of service centers	0	2	14	18
Advertising spending (in USS thousands)	0	20	320	700

In Sweden, Amway differs from its Swedish competi-tor in that, at the moment, it has no plans to start pro-duction. The only products Amway buys from Polish companies are advertising gadgets: bags, balloons and so forth. Total sales *for* 1994 were estimated to be$28 million.

Zepter is a Swiss-Austrian firm, which for the past year has been selling kitchen utensils. The demonstrations of its products take place in private homes. Using the prod-ucts purchased by the owner of the house, the person making the presentation demonstrates the advantages of using the Zepter pots and pans, which are expensive by Polish standards. Zepter products can also be purchased by installments. One becomes the owner of the chrome-nickel pots, pans, and silverware or 24-carat gold-plated coffee set only after the last installment is paid. In 1993, Zepter had 25,000 distributors in Poland but as the company's repre-sentative assures is, sales grow monthly.

Oriflame Manufacturing in Poland

The high demand for natural skin care and makeup products in Poland inclined the Oriflame corporate management to make the investment at Ursus. "We see Poland as a very big and important market for our products, a market which is still growing. We believe it is a prudent decision to broaden our activities here by building an ultramodern factory," said Jonas of Jochnick, the company's founder and president, during a press conference at Oriflame headquarters.

The $20 million manufacturing plant was due to start operating during 1995. It is a state-of-the-art production equipment and

complete research and laboratory facility, which will make it the most modern cosmetics factory in Poland. Products will be made from the same ingredients and under the same strict quality control as in all other Oriflame plants. All production processes will be environmentally safe.

Poland is the second country where Oriflame cosmet-ics will be manufactured. Part of the production will be ex-ported to neighboring countries. More than 300 people will be employed full time once the new plant is operational.

Key Factors In Oriflame's Success

Looking back over the years from 1990 onward and the development of Oriflame in Eastern European markets, Sven Mattsson identified these key factors to the com-pany's success.

Local Management.

Since the beginning, in 1990, Oriflame developed a local management policy. Sending expatriates to do the job, even if they had a solid knowledge and experience of both the company's products and the local culture was never considered as an appropriate solution. In each country, the company recruits a local manager and staff spending a lot of time during interviews explaining the nature and spirit of the free market economy, the direct-selling method, and the Oriflame marketing plan.

Marketing Plan.

The marketing plan itself is considered one of the main assets of the company. Support guidance, and training were supplied from Brussels, with staff spending a great amount of effort and time helping local markets. The marketing plan called "The Success Plan," was the same for each country, with minor adaptations where required.

Mattsson summarizes the Oriflame concept. "Oriflame considers itself as a company offering two kinds of products. First a concrete one originating from the product range of 200 products displayed in a catalog with a pricing policy that favored volume rather than margins. Second, a more intangible product, which originated from the business opportunity offered to each distributor to develop their own business."

PR and Advertising

Investing in PR has always been considered important. This is especially true of former communist countries who have long forgotten the knowledge and practice of a free market economy. Oriflame was spending approximately $45,000 per year in each country for PR and is planning to increase it in the coming years. A considerable amount was invested in "above the line" advertising to capitalize on the relative inexperience of media purchasing during 1991 to 1993. "Oriflame has reached 80 percent awareness in Poland, Czech Republic, and Hungary, which is definitely partly due to successful advertising campaigns during the past years," says Mattsson oriflamme used a mix of TV commercials, printed advertisements, and billboards.

Product and Price

Out of the range of approximately 200 products, the company manufactures about 65 percent; the remaining 35 percent come from subcontractors. Oriflame cosmetics are made from pure, natural ingredients. As Jonas of Jochnick explained, "The company is dedicated to ensuring that our customers receive the highest-quality products at reasonable prices each time they purchase Oriflame cosmetics." According to Mattsson, "Our aim is to have our products priced below our international competitors and at the same time be considered as an alternative to cheap local products."

Distribution

In order to facilitate the distributor's activity, the company has created in each country several service centers. This further improves the lead-time between order and delivery. In 1994. Poland had 18 service centers; the Czech Republic and Slovakia. 20; Hungary, 9; Turkey, 9: and Greece, 3. The aim has been to give a 48-hour service turnaround throughout the country, with a 24-hour service in the capitals. "Our distribution strategy has proven to be very successful. As in all arrears of life today, speed and accuracy are very important and this is especially true for direct selling".

Strategic Issues

After 14 years of activity in Eastern Europe, results have been well beyond early expectations Sven Mattsson is now facing various issues that will influence the recommendations he will make to Jonas af Jochnick and the ORESA board for the future.

How far should the company go to increase its service to the distributors who, of course, appreciate very much having products available as fast as possible? Moving the products faster always means higher costs. How much value should be attributed to distributor convenience? Should inventory of the whole Oriflame product range be kept at each service center?

Should the company invest in advertising campaigns? How important is the advertising for a direct selling company to keep the awareness high? Is it worthwhile continuing when the increased media prices are taken into considerations?

Should the company enlarge its product range with noncosmetic products to increase sales and possibly to attract new distributors?

A few countries into which Oriflame is considering expanding and where it is conducting marketing research still have high inflation rates. What kind of specific pricing and product policy would the company need to implement in order to ensure a minimum risk for its investment?

Should the company go for local management or expatriates? What kind of management is needed for starting up a new, more distant sales company? What kind of management is required when the company enters into a more mature stage?

Appendix: The Marketing Plan: An Overview

To become an Oriflame distributor, a candidate should be sponsored by an existing registered Oriflame distributor. Products are sold directly to the consumer by independent distributors who are not employed by Oriflame.

There are no exclusive territories or franchises available under the Oriflame policy. Any distributor is free to conduct his or her business in any area of the country. No distributor shall sell, demonstrate, or display Oriflame products in any retail outlet.

Oriflamme recommends a markup of 30 percent on all products purchased at distributor price. The distributor's income is based on a monthly accumulation of points. All products are assigned two sets of number: bonus points (BP), which normally remains a constant number, and business volume (BV), which is a monetary value that changes if prices change. In general, the value of the BV equals the distributor price (DP), excluding value-added tax (VAT).

The total BP of all the products a distributor buys and sells during the course of a month will determine the distributor's performance discount percentage. The monthly performance discount, but also on the business volume generated by any distributors who have been sponsored by him or her.

The monthly performance of discount is added to the 30 percent markup, the maximum being 21 percent, equivalent to 10,000 BP per month. Distributors can also earn a further 1 percent or 4 percent bonus if they meet certain criteria. Cash awards from $3000 to $20,000 can be earned when reaching the higher titles in the marketing plan.

If a customer is not satisfied, the products are replaced or refunded through the 100% customer satisfaction guarantee.

The available credit per order is $500. all outstanding payments must be made before a next order is placed, or within 30 days from the date of invoice. Payments can't be made at the Oriflame head office, at some Oriflame service centers, at the post office, or by bank transfer. Orders can be made at service centers or mail or fax by using a distributor order form.

Monthly BP	Monthly Performance Discount Percentage of BV
10,000+	21%
6,600-9,900	18%
4,000-6,599	15%
2,400-3,999	12%
1,200-2,399	9%
600-1,199	6%
200-599	3%

LESSON 14:
ENTRY AND EXPANSION STRATEGIES:
MARKETING AND SOURCING

The objective of this lesson is to understand the following:

1. Decision criteria for international Business
2. Entry and expansion decision model
3. Exporting
4. Additional international alter national
5. Marketing strategy alternatives

When a company decides to go international, it faces a host of decisions. Which countries should it enter and in what sequence? What criteria should be used to select entry markets: proximity, stage of development, geographic region, cultural and linguistic criteria, the competitive situation, or other factors? How should it enter new markets? Directly via "green fields" expansion, directly through acquisition of a local established company, or indirectly using agents or representatives? Should the new market be supplied with imported product from the home or third countries or locally manufactured product? This chapter addresses these questions and examines various strategies that a company can utilize to "go international" starting with exporting and advancing to foreign direct investment. These options are not mutually exclusive and may be used concurrently.

The automobile industry provides a good example. In which countries can a company obtain parts necessary for production? In which countries and through which channels should the automobiles be sold? Should production be relocated or expanded to another country?

Manufacturers can achieve competitive advantage by shifting production among different sites. It is little wonder that most of the world's leading automakers have set their sights on Brazil and China. Both countries are big emerging markets; they boast the biggest populations in their respective regions as well as rapidly growing economies. Nearly "2 million vehicles were sold in Brazil in 1996, and analysts forecast sales of 3 million units by 2000. Brazil represents Volkswagen AG's largest market outside of Germany; VW of Brazil operates seven plants, including a lean-production truck plant in Resende, that produces nearly half a million vehicles annually. Fiat, Brazil's number-two producer, has spent $1 billion to increase production; its rugged new Palio "world car" has been a hot seller since its introduction in 1996. American producers are also in the market. General Motors (GM) produces Blazers in Sao Jose dos Campos; GM has earmarked $1.25 billion for three new plants including a $600 million state-of-the-art small car works in the southern Brazil city of Rio Grande do SuI. Ford has invested more than $1 billion in a plant in Sao Bernardo do Campo that produces Fiesta subcompacts and the new Kaminicar. Chrysler has a production facility in Campo Largo and also participates in a small-displacement engine manufacturing joint venture with BMW. Surprisingly, Japan's automakers have been relatively slow to develop the market; Toyota is a minor player, and Honda's $100 million plant produces only 15,000 Civics each year.

The presence of VW, Fiat, GM, and other automakers in Brazil illustrates the fact that every firm, at various points in its history, faces a broad range of strategy alternatives. In far too many

Big Emerging Auto Markets

Like Brazil, China holds huge opportunities for auto: makers. The total vehicle market is expected to increase If from.1.6 million units in 1996 to 2.7 million by the turn of the century Volkswagen (VW) is currently the biggest player in the China market; the 200,000 Santana passenger cars produced each year by VW's joint venture with . Shanghai Automotive Industry Corporation (SAIC) represent half of the market. VW also produces its Jetta (model in Changchun in partnership with First Auto Works _ (FAW). Chrysler's joint venture with Beijing Auto Works has been producing Jeep Cherokees since the early 19805. (New investment plans are announced on a regular basis for example, GM launched a joint venture with SAIC in 1997 valued at more than $1.5 billion. The venture is slated to produce Buick sedans for government officials.

Despite the general euphoria about China, a variety of obstacles and pitfalls await those hoping to develop I the market. The Chinese government does not permit foreign companies to have majority stakes in joint ventures and reserves the right to set production levels and prices. The rhetoric from government officials can send chills down a car executive's spine. Recently, for example, an FAW official told a state newspaper, "We shouldn't be the appendage of the foreign automobile industry anymore. What the South Koreans and Japanese could achieve, so the Chinese can also manage." The business landscape is littered with stalled projects; in 1997, for *example, Peugeot was forced to abandon a joint venture in Guangzhou; Mercedes-Benz considered canceling its planned $1 billion joint venture with Nanfang South China Motor Corporation to build minivans and engines. The deal had been a triumph* for *Mercedes, which had bested both Chrysler and* GM *for the contract in 1995. Two years later, however, the venture was at a standstill, I and Jurgen Hubbert, a member of the Daimle Benz, board, had some sobering advice* for *anyone considering: business in China: "Whenever you're finalizing a project, you are really just starting."*

The competitive environment in Brazil is also uniquely challenging. For example, in 1987, Ford and VW established a joint venture called Autolatina. Internal rivalries bogged down that venture; by 1994, the partnership was dissolved. Meanwhile, as Ford prepared to build its own capacity, it supplied the market with imports. In 1996, however, the Brazilian government suddenly boosted tariffs on car imports to 70 percent from. *20 percent. Ford had no choice but to supply Brazilian dealers with a mixed bag of vehicles from a variety of " sources-a move that alienated the dealers and tarnished Ford's reputation. Even though the new Fiesta is a much needed hit with car buyers, production delays allowed Fiat to reach the market first with its Polio.*

cases, companies fail to appreciate the range of alternatives open to them and, therefore, employ only one strategy—often to their grave disadvantage. The same companies also fail to consider the strategy alternatives open to their competitors and thereby set themselves up to be victims' of the dreaded "Titanic" syndrome-the thud in the night that comes without warning and sinks the ship.

Some companies are making the decision to go global for the first time; other companies seek to expand their share of world markets. Companies in either situation face the same basic sourcing issues introduced in the previous chapter. Companies must also address issues of marketing and value chain management before deciding to enter or expand their share of global markets by means of licensing, joint ventures or minority ownership, and majority or 100 percent ownership. These decisions are affected by issues of investment and control as well as a company's attitude toward risk.

Decision Criteria for International Business

Before doing any business internationally through sourcing, exporting, investing, or a combination of these strategies, the company must look at conditions in the potential country to analyze what the advantages, disadvantages, and costs will be and whether it is worth the risk.

Political Risk

Political risk, or the risk of a change in government policy that would adversely impact a company's ability to operate effectively and profitably, is a deterrent to expanding internationally. The lower the level of political risk, the more likely it is that a company will invest in a country or market. 1ne difficulty of assessing political risk is inversely' proportional to a country's stage of economic development: All other things being equal the less developed a country, the more difficult it is to predict political risk. The political risk of the Triad countries, for example, is quite limited as compared to a less developed preindustrial country in Africa, Latin America, or Asia. In general, there is an inverse-relationship between political risk and the stage of development of a country. The higher the level of income per capita, the lower the level of political risk.

McDonald's in war-torn Belgrade, Yugoslavia, had to change its marketing strategy to survive and minimize its American origins, which were the basis of physical attacks. A Serbian cap was added to the Golden Arch logo, the basement was turned into an air-raid shelter, prices were lowered, and free hamburgers were distributed to anti NATO demonstrators. Needless to say, McDonald's corporate headquarters had little to say about these tactics but local management is quite happy and proud of their achievement.[1]

Market Access

A key factor in locating production facilities is market access. If a country or a region limits market access because of local content laws, balance-of-payments problems, or any other reason, it may be necessary to establish a production facility within the country itself. The Japanese automobile companies invested in U.S. plant capacity because of concerns about market access. By producing cars in the United States they have a source of supply that is not exposed to the threat of tariff or non tariff barriers. In the 1950sand 1960s, U.S. companies created production capacity abroad to ensure continued access to markets that had been established with supply exported from U.S. plants.

Factor Costs and Conditions

Factor costs are land, labor, and capital costs. Labor includes the cost of workers at every level: manufacturing and production, professional and technical, and management. Basic manufacturing direct labor costs today range from $0.50 per hour in the typical developed country (LDC) to $6 to $20 or more per hour in the typical developed country. Note that, compared to the United States, manufacturing compensation costs are higher in Western European countries despite a recent decline, and Asia's emerging countries have increased relative to the United States since 1980.

German hourly compensation costs for production workers in manufacturing are 155 percent of those in the United States, whereas those in Mexico are only 10 percent of those in the United States. For Volkswagen (VW),if wages were the sole criteria for making a decision, the wage differential between Mexico and Germany would dictate a Mexican manufacturing facility that builds Golf and Jetta models destined for the United States. Do lower wage rates demand that a company relocate its manufacturing to the low-wage country? Hardly. In Germany, VW Chairman Ferdinand Piech is trying to improve his company's competitiveness by convincing unions to allow flexible work schedules. For example, during peak demand, employees would work six-day weeks; when demand slows, factories would produce cars only three days per week.

Moreover, wages are only one of the costs of production and, many times, a small percentage of the total cost associated with the product. Many other considerations enter into the sourcing decision, such as management's aspirations. For example, SMH assembles all of the watches it sells, and it builds most of the components for the watches it assembles. It manufactures in Switzerland, the highest-income country in the world. SMH's Hayek decided that he wanted to manufacture in Switzerland in spite of the fact that a secretary in Switzerland makes more money than a chief engineer in Thailand: He did this by making a commitment to drive wage costs down to less than 10 percent of total costs. At this level, wages rates are no longer a significant factor in competitiveness. As Hayek puts it, he does not care if his competitor's workers work for free! He will still win in a competitive marketplace because his value is so much greater?

The other factors of production are land, materials, and capital The cost of these factors depends on their availability and relative abundance. Often, the differences in factor costs will offset each other so that, on balance, companies have a "level field" in the competitive arena. For example, the United States has abundant land and Germany has abundant capital These advantages partially offset each other. When this is the case, the critical factor is management, professional, and worker team effectiveness.

World factor costs that affect manufacturing an be divided into three tiers. The first tier consists of the industrialized countries where factor costs' are tending to equalize. The second tier consists of the industrializing countries-for example, Singapore

and other Pacific Rim countries-that offer significant factor costs savings as well as an increasingly developed infrastructure and political stability, making them extremely attractive manufacturing locations. The third tier includes Russia and other countries that have not yet become significant locations for manufacturing activity. Third-tier countries present the combination of lower factor costs (especially wages) offset by limited infrastructure development and greater political uncertainty.

The application of advanced computer controls and other new manufacturing technologies has reduced the proportion of labor relative to capital for many businesses. In formulating a sourcing strategy, company managers and executives should also recognize the declining importance of direct manufacturing labor as a percentage of total product cost. The most advanced global companies are no longer blindly chasing cheap labor manufacturing locations because direct labor may be a very small percentage of total. As a result, it may not be worthwhile to incur the costs and risks of establishing a manufacturing activity in a distant location. The experience of the Arrow Shirt Company also illustrates several issues relating to factor costs. During the 1980s, Arrow sourced 15 percent of its dress shirts from the Far East at a cost savings of $15 per dozen compared to U.S.-manufactured shirts. Arrow decided to phase out imports after spending $15 million to automate its U.S. plants. Productivity increased 25 percent and Arrow is no longer at the mercy of a 12-month lead time between ordering and delivery; U.S.-sourced shirts can be ordered a mere three months in advance-a critical issue in the fashion industry. Interestingly, the Arrow experience illustrates how the decision to source at home rather than abroad does not automatically defuse the political issue of exporting jobs: After automating, Arrow laid off 400 U.S. workers and closed four factories.

Many companies have been chagrined to discover that today's cheap factor costs can disappear as the law of supply and demand drives up wages and land prices. Shirt makers like Arrow began sourcing in Japan in the 1950s. As wages and real estate costs increased, production was shifted to Hong Kong and then to Taiwan and Korea. During the 1970s and 1980s, production kept shifting to China, Indonesia, Thailand, Malaysia, Bangladesh, and Singapore. In recent years, shirt production has shifted from the Far East to Costa Rica, the Dominican Republic, Guatemala, Honduras, and Puerto Rico. In addi60n to low wages, these countries offer tax incentives under the 1983 Caribbean Basin Initiative agreement.[4]

Shipping Considerations

In general, the greater the distance between the product source and the target market, the greater the time delay for delivery and the higher the transportation cost. However, innovation and new transportation technologies are cutting both time and dollar costs. To facilitate global delivery, transportation companies such as CSX Corporation are forming alliances and becoming an important part of industry value systems. Manufacturers can take advantage of inter modal services that allow containers to be transferred between rail, boat, air, and truck carriers. Today, transportation expenses for U.S. exports! and imports represent approximately 5 percent of total costs. In Europe, the advent of the single market means fewer border controls, which greatly speeds up delivery times and lowers costs.

Acer, a Taiwanese company and the seventh largest producer of computers, practices what it calls the "fast-food business model." Like a Big Mac at McDonald's, the final product is assembled just before the purchase. Acer divides computer components into two types, perishable and nonperishable. The nonperishable components such as housings, keyboards, and floppy disks are manufactured in Taiwan and shipped by sea to their 39 regional business units (RBUs). Perishables, such as drives, which are constantly being upgraded, are manufactured as needed and air shipped to the RBUs where the final product is assembled. Using this logistics strategy eliminates the minimum one- to two-month time lag for shipping goods by sea and costly inventory expense and provides consumers with the latest product.

Country Infrastructure

In order to present an attractive setting for a manufacturing operation, it is important that the country's infrastructure be sufficiently developed to support a manufacturing operation. The required infrastructure will vary from company to company, but minimally it will include power, transportation and roads, communications, service and component suppliers, a labor pool, civil order, and effective governance. In addition, a country must offer reliable access to foreign exchange for the purchase of necessary material and components from abroad as well as a physically secure setting where work can be done and product can be shipped to customers.

A country may have cheap labor, but does it have the necessary supporting services or infrastructure to support a manufacturing activity? Many developing countries offer these conditions, yet there are also many other countries that do not, such as Lebanon, Uganda, and El Salvador. One of the challenges of doing business in the Russian or Chinese market is an infrastructure that is woefully inadequate to handle the increased volume of shipments.

Foreign Exchange

In deciding where to locate a manufacturing activity, the cost of production supplied by "a country source will be determined in part by the prevailing foreign exchange rate for the country's currency. Exchange rates are so volatile today that many companies pursue global sourcing strategies as a way of limiting exchange-related risk. At any point in time, what has been an attractive location for production may become much less attractive due to exchange rate fluctuation. For example, the financial crisis in Russia in 1998 saw the ruble drop from 6 to the U.S.dollar to 25 rubles to the dollar. The prudent company will incorporate exchange volatility into its planning assumptions and be prepared to prosper under a variety of exchange rate relationships.

The dramatic shifts in price levels of commodities and currencies are a major characteristic of the world economy today. Such volatility argues for a sourcing strategy that provides alternative country options for supplying markets. Thus, if the dollar, the yen, or the mark becomes seriously over valued, a company with

production capacity in other locations can achieve competitive advantage by shifting production among different sites.

Creating a Product-market Profile

The first step in choosing export markets is to establish the key factors influencing sales and profitability of the product in question. If a company is getting started for the first time in exporting, its product-market profile will most likely be based on its experience in the home market, which may or may not be relevant to the individual export markets being considered. The basic questions to be answered can be summarized as the nine Ws:

1. " Who buys our product?
2. Who does not buy our product?
3. What need or function does our product serve?
4. What problem does our product solve?
5. What are customers currently buying to satisfy the need and/or solve the problem for which our product is targeted?
6. What price are they paying for the products they are currently buying?
1. When is our product purchased?
8. Where is our product purchased?
9. Why is our product purchased?

Any company must answer these critical questions if it is going to be successful in export markets. Each answer provides an input into decisions concerning the four Ps. Remember, the general rule in marketing is that, if a company wants to penetrate an existing market, it must offer more value than its competitors-better benefits, lower prices, or both. This applies to export marketing as well as marketing in the home country.

Market Selection Criteria

Once a company has created a product-market profile, the next step in choosing an export market is to appraise each possible market. Six criteria should be assessed: (1) market potential, (2) market access, (3) shipping costs, (4) potential competition, (5) service requirements, and (6) product fit.

1. Market Potential

What is the basic market potential for the product? To answer this question, secondary information is a good place to start. Valuable sources were discussed in Chapter 6, "Global Marketing Information Systems and Research." In the United States, the federal government has numerous publications available, compiled by the Central Intelligence Agency (CIA) and various other agencies and organizations.

The cost of assembling sales literature, catalogs, and technical bulletins should also be considered in comparison to market potential and profitability. This cost is particularly important in selling highly technical products.

2. Market Access

This aspect of market selection concerns the entire set of national controls that applies to imported merchandise and any restrictions that the home-country government might have. It includes such items as export license, import duties, import restrictions or quotas, foreign exchange regulations, and preference arrangements. Because this information is quite detailed, it is best to directly consult the trade bureaus of countries that are being considered.

3. Shipping Costs and Time

Preparation and shipping costs can affect the market potential for a product. if a similar product is already being manufactured in the target market, shipping costs may render the imported product uncompetitive. If it takes months for the product to reach the target market and the product competes in a rapidly changing category such as computers, alternative transportation strategies should be considered. It is important to investigate alternative modes of shipping as well as ways to differentiate a product to offset the price disadvantage.

4. Potential Competition

Using a country's commercial representatives abroad can also be valuable. When contacting country representatives abroad, it is important to provide as much specific information as possible. If a manufacturer simply says, "I make lawn mowers. Is there a market for them in your territory?," the representative cannot provide much helpful information. If, on the other hand, the manufacturer provides the following information: (1) sizes of lawn mowers-manufactured, (2) descriptive brochures indicating features and advantages, and (3) estimated cost insurance freight (C.I.E) and retail price in the target market, then the commercial representative could provide a very useful report based on a comparison of the company's product with market needs and offerings.

5. Service Requirements

If service is required for the product, can it be delivered at a cost that is consistent with the size of the market?

6. Product Fit

With information on market potential, cost of access to the market, and local competition, the final step is to decide how well a company's product fits the market in question. In general, a product fits a market if it satisfies the criteria discussed previously and is profitable.

Visits to The Potential Market

After the research effort has zeroed in on potential markets, there is no substitute for a personal visit to size up the market firsthand and begin the development of an actual export marketing plan. A market visit should do several things. First, it should confirm (or contradict) assumptions regarding market potential. A second major purpose is to gather additional data necessary to reach the final go/no-go decision.

One way to visit a potential market if through a trade. show. Hundreds. of trade fairs-usually organized around a product, a group of products, or activity-are held in major markets. For example, U.S. trade centers alone hold 60 product shows annually in major cities abroad.

By attending trade shows and missions, company representatives can conduct market assessment, develop or expand markets, find distributors or agents, and locate potential end users (i.e., engage in direct selling). Perhaps most important, by attending a trade show, it is possible to learn a great' deal about competitors' technology, pricing, and the depth of their market penetration. For example, while walking around the exhibit hall,

one can gather literature about products that often contains strategically useful technological information. Over all, company managers or sales personnel should be able to get a good general impression of competitors in the marketplace while at the same time trying to sell their own company's product.

Entry and Expansion Decision Model

The first issue that an expanding firm must address is whether to export or produce locally. In many emerging markets, this issue is resolved by a national policy that requires local production. Any company wishing to enter the market of such a country must source locally. In high-income countries, local production is normally not required, so the choice is up to the company.

Assuming that the choice is up to the company, the trade-offs for local versus regional or global production are cost, quality, delivery, and customer value. Costs include labor, materials, capital, land, and transportation. Scale economies are an important factor in determining cost: For every product, there is some minimum volume required to justify the investment required to establish a production site. If the product is heavy, transportation costs are greater and provide an incentive to locate production closer to the Customer. Offsetting transportation costs are scale economies that result from spreading fixed costs over a greater production volume.

International Market Entry and Expansion Decision Model

1. Sourcing: Home, third, or host country?

   Cost, market access, country of origin factors
2. In country or in-region marketing organization? Cost, market impact assessment. If choice is to establish own organization, must decide who to appoint to key positions
3. Selection, training, and motivation of local distributors and agents
4. Marketing mix strategy: Goals and objectives in sales, earnings, and share of market positioning; marketing mix strategy
5. Strategy implementation

If a company decides to source locally, it has a choice of buying, building, or renting its own manufacturing plant or signing a local contract manufacturer. A contract manufacturer may be in a position to add production to an existing plant with less investment than the manufacturer would require to achieve the same volume of production. If this is the case, the contract manufacturer is in a position to quote an attractive price.

Exporting

In Germany, exporting is a way of life for the Mittlestand, 2.5 million small and mid sized companies that generate two thirds of Germany's gross national product (GNP) and account for 30 percent of exports. For companies such as steel maker J. N. Eberle; Trumpf, a machine tool manufacturer; and J. Eberspacher, which makes auto exhaust systems, exports account for as much as 40 percent of sales. For other companies the share is even higher. For example, Mattah Hohner has 85 percent of the world mouth organ and accordion market.

Mittelstand owner-managers target global niche markets and prosper by focusing on quality, and innovation, and investing heavily in research and development. For example, the chief executive of G. W. Barth, a company that manufactures cocoa-bean roasting machines, invested nearly $2 million in infrared technology that reduced temperature variances. The company's global market share stands at 70 percent-a threefold increase in a 10-year period-as Ghirardelli Chocolate, Hershey Foods, and other companies have snapped up Barth's roasters. At ABM Baumtiller, a.$4O million manufacturer of motors and other components for cranes, a major investment in technology allows the company to tailor products to customer needs by means of flexible manufacturing. New automated production equipment was installed-at a cost of $20 million-that allows changeover to different products in a matter of seconds. The story is repeated throughout Germany; as a result, in industry after industry, the Mittelstand are world-class exporters.

The success of the Mittelstand serves as a reminder of the impact exporting can have on a country's economy. It also demonstrates the-difference between export selling and export marketing. Export selling does not involve tailoring the product, the price, or the promotional material to suit the requirements of global markets. The only marketing mix element that differs is the place-that is, the country where the product is sold. This selling approach may work for some products or services; for unique products with little or no international competition, such an approach is possible. Similarly, companies new to exporting may initially experience success with selling. Even today, the managerial mind-set in many companies still favors export selling. However, as companies mature in the global marketplace or as new competitors enter the picture, it becomes necessary to engage in export marketing.

Germany's Mittelstand

Part of the Mittelstand's success can also be attributed to Germany's export infrastructure. Diplomats, bankers, and other officials around the world are constantly on the lookout for opportunities; information about promising deals is conveyed back to Germany. Meanwhile, representatives from. trade associations, export trading companies, and banks assist exporters with documentation and other issues. Some banks have special Mittelstand departments to provide export financing and assist companies in obtaining insurance.The current business environment both outside and inside Germany is presenting difficult challenges to the Mittelstand. In response to the 1992-1993 recession in Europe, several countries-notably Great Britain, Italy, and Sweden-devalued their currencies. This move brought down prices on exports from those countries and made Germany's exports correspondingly less price W competitive. Meanwhile, German unions have won wage hikes for workers, and the mark's continued strength puts additional upward pressure on export prices. Mittelstand owners are taking steps to ensure their own survival, but a lack of organization has limited their political influence in Bonn. Germany's banks have tightened loan terms, resulting in a credit crunch. Many companies are going public to raise capital, but venture capital can be hard to find. Professional managers are being hired to assets owners some companies may even move production out of Germany. Melitta, for example, began assembling home coffeemakers in Portugal in 1995. For companies in which money is tight, licensing production is an economical alternative.

Exporting is just one strategy for a company that has decided to go international. Other options are licensing, franchising, joint

ventures, and foreign direct investment when it is an option for foreign companies (see Figure 8-1). In global marketing, the issue of customer value is inextricably tied to the sourcing decision. If customers are nation elastic, they may put a positive value on the feature "made in the home country. Such preferences must be identified using market research and factored in to solve for value in the equation. Global companies succeed by convincing customers in world markets that it is their brand that signifies value and quality, not the country or origin. A successful global company can source its product from any location: The customers trust the brand and don't care about the country of origin.

Exporting Decision Criteria

Export marketing targets the customer in the context of the total market environment. The export marketer does not take the domestic product "as is" and simply sell it to international customers. To the export marketer, the product offered in the home market is a starting point. It is modified as needed to meet the preferences of international target markets. Mittelstand companies such as ABM Baumiiller exemplify this approach. Similarly, the export marketer sets prices to fit the marketing strategy and does not merely extend home-coup-try pricing to the target market. Charges incurred in export preparation, transportation, and financing must be taken into account in determining prices. Finally, the export marketer also adjusts strategies and plans for communications and distribution to fit the market. In other words, effective communication about product features or uses to buyers in export markets may require creating brochures with different copy, photographs, or artwork. As the vice president of sales and marketing of one manufacturer noted, "We have to approach the international market with marketing literature as opposed to sales literature."

Export marketing is the integrated marketing of goods and services that are destined for customers in international markets. Export marketing requires.

1. An understanding of the target market environment
2. The use of marketing research and the identification of market potential
3. Decisions concerning product design, pricing, distribution and channels, advertising, and communications-the marketing mix

Research has shown that exporting, in and of itself, is essentially a developmental process that can be divided into the following distinct stages.

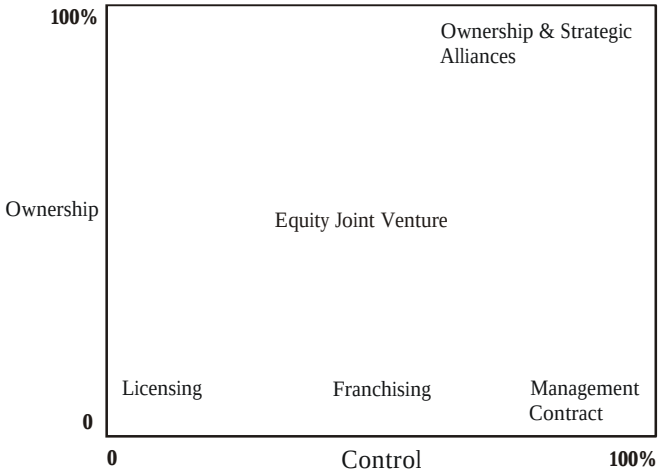
1. The firm is unwilling to export; it will not even fill an unsolicited export order.

This may be due to perceived lack of time ("too busy to fill the order") or to apathy or ignorance.

2. The firm fills unsolicited export orders but does not pursue unsolicited orders.

Such a firm would be an export seller.

3. The firm explores the feasibility of exporting (this stage may bypass stage 2).
4. The firm exports to one or more markets on a trial basis.
5. The firm is an experienced exporter to one or more markets.
6. After this success, the firm pursues country- or region-focused marketing based on certain criteria (e.g., all countries where English is spoken, all countries where it is not necessary to transport by water).
7. The firm evaluates global market potential before screening for the best target markets to include in its marketing strategy and plan. All markets-domestic and international-are regarded as equally worthy of consideration. At this point, other environmental factors may come into play and the marketer might want to explore joint ventures or foreign direct investment opportunities to maximize international opportunities.



The probability that a firm will advance from one stage to the next depends on different factors. Moving from stage 2 to stage 3 depends on management's attitude toward the attractiveness of exporting and its confidence in the firm's ability to compete internationally. However, commitment is the most important aspect of a company's international orientation. Before a firm can reach stage 4, it must receive and respond to unsolicited export orders. The quality and dynamism of management are important factors that can lead to such orders. Success in stage 4 can lead a firm to stages 5 and 6. A company that reaches stage 7 is a mature geocentric enterprise that is relating global resources to global Opportunity. To reach this stage requires management with vision and commitment.

One recent study noted that export procedural expertise and sufficient corporate resources are required for successful exporting. An interesting finding was that even the most experienced exporters express a lack of confidence in their knowledge about shipping arrangements, payment procedures, and regulations. The study also showed that, although profitability is an important expected benefit of exporting, other advantages include increased flexibility and resiliency and improved ability to deal with sales fluctuations in the home market. Whereas research generally supports the proposition that the probability of being an exporter increases with firm size, it is less clear that export intensity-the ratio of export sales to total sales-is positively correlated with firm size. Table summarizes some of the export-related problems that a company typically faces.

Logistics	Servicing Exports
1. Arranging transportation	12. Providing parts availability
2. Transport rate determination	13. Providing repair service
3. Handling documentation	14. Providing technical advice
4. Obtaining financial information	15. Providing warehousing
5. Distribution coordination	Sales Promotion
6. Packaging	16. Advertising
7. Obtaining insurance	17. Sales effort
Legal Procedure	18. Marketing information
8. Government red tape	Foreign Market Intelligence
9. Product liability	19. Locating markets
10. Licensing	20. Trade restrictions
11. Customer/duty	21. Competition overseas

The decision to engage in export marketing should be based on a number of criteria, including potential market size, competitor activities, and overall marketing mix issues such as price, distribution, and promotion. The next step is the choice of one or more export markets to target. The selection process should begin with a product market profile or plan.

Market data are also available from export census documents compiled by the Department of Commerce on the basis of Shipper's Export Declarations (known as "exdecs" or SEDs, these must be filled out for any export valued at $1,500 or more). Another important source of market data is the Foreign Commercial Service Web sites for the individual countries also provide much valuable information and contacts.

Whatever source of information is used, the ultimate goal is to determine the major factors affecting demand for a product Then, using the tools and techniques described in Chapter 7 on targeting and segmentation, and available data, it is possible to arrive at a rough estimate of total potential demand for the product in one or more particular international markets: National income- is often a good starting indicator on which to base demand estimates. A caveat, however, is income distribution within the country. India, with a population of 1 billion people, shows a per capita GNP of $424; however, 10 percent of the population or 100 million people are considered middle class and can afford most consumer goods. A market of 100 million customers should not be ignored. Additional statistical measures will considerably sharpen the estimate of total demand for example, when estimating the demand (or automobile-tires, data on the total number of cars registered in any country in the world should be easy to obtain. These data, combined with data on gasoline consumption, should permit estimation of the total mileage driven in the target market. When this figure is combined with tire life predictions, it is a straightforward matter to calculate demand estimates.

Organising for Exporting

Manufacturers interested in export marketing have two broad considerations: organizing in the home country and organizing in the target market country. The issues and approaches that relate to organizing are discussed next

Organizing in the Manufacturer's Country

Home-country issues involve deciding whether to assign export responsibility inside the company or work with an external organization specializing in a product or geographic area.

In-House Export Organization

Most companies handle export operations within their own organization. Depending on the company's size, responsibilities may be incorporated into an employee's domestic job description. Alternatively, these responsibilities may be handled as part of a separate division or organizational structure.

The possible arrangements for handling exports include the following:

1. As a part-time activity performed by domestic employees
2. Through an export partner affiliated with the domestic marketing structure that takes possession of the goods before they leave the country
3. Through an export department that is independent of the domestic marketing structure
4. Through an export department within an international division
5. For multidivisional companies, each of the foregoing possibilities exists within each division

A company that assigns a sufficiently high priority to its export business will establish an in-house organization. It then faces the question of how to organize effectively. This depends on two things: the company's appraisal of the opportunities in export marketing and its strategy for allocating resources to markets on a global basis. It may be Possible for a company to make export responsibility part of a domestic employee's job description. The advantage of this arrangement is obvious: It is a 'low-cost arrangement requiring no additional personnel. However this approach can work only under two conditions. First, the domestic employee assigned to the task must be thoroughly competent in terms of product/customer knowledge. Second, that competence must be applicable to the target international market(s). The key issue underlying the second condition is the extent to which the target export market is different from the domestic market. If customer circumstances and characteristics are similar, the requirements for specialized regional knowledge are reduced.

External independent Export Organizations

If a company chooses not to perform its own marketing and promotion in-house, there are numerous export services providers from which to choose. These include export trading companies (ETCs), export management companies, (EMCs), export merchants, export brokers, combination export managers, manufacturers' export representatives or commission agents, and 'export distributors. A typical EMC acts as the export department for several unrelated companies that lack export experience. EMCs perform a variety of services, including marketing research, channel selection, financing and shipping arrangements, and documentation. According to one recent survey of U.S.-based EMCs, the most important

activities for export success are gathering marketing information, communicating with markets, setting prices, and ensuring parts availability. The same survey ranked export activities in terms of degree of difficulty; analyzing political risk, sales force management, setting pricing, and obtaining financial information were deemed most difficult to accomplish. One of the study's conclusions was that the U.S. government should do a better job of helping EMCs and their clients analyze the political risk associated with foreign' markets. [8]

Organizing in the Market Country

In addition to deciding whether to rely on in-house or external export specialists in the home country, a company must also make arrangements to distribute the product in the target market country. The basic decision that every exporting organization faces is: To what extent do we rely on direct market representation as opposed to representation by independent intermediaries?

Direct Representation

There are, two major advantages to direct representation by a company's own employees in a market: control and communications. Direct representation allows decisions concerning program development, resource allocation, and price changes to be implemented unilaterally. Moreover, when a product is not yet established in a market, special efforts are necessary to achieve sales. The advantage of direct representation is that these special efforts are ensured by the marketer's investment. The other great advantage to direct representation is that the possibilities for feedback and information from the market are much greater. This information can vastly improve export marketing decisions concerning Product, price, communications, 'and distribution.

Direct representation does not mean that the exporter is selling directly to the consumer or customer. In most cases, direct representation involves selling to wholesalers or retailers. For example, the major automobile exporters in Germany and Japan rely on direct representation in the U.S. market in the form of their distributing agencies, which are owned and controlled by the manufacturing organization. The distributing agencies sell products to franchised dealers.

Independent Representation

In smaller markets, it is usually not feasible to establish direct representation because the low sales volume does not justify the cost. Even in larger markets, a small manufacturer usually lacks adequate sales volume to justify the cost of direct representation; therefore, use of an independent distributor is an effective method of sales distribution. Finding good distributors can be the key to export success.

Indirect or independent representation generally handles numerous other products for different Companies. In many cases, there is simply not enough incentive for independents to invest significant time and money in representing a product.

Piggyback Marketing

Piggyback marketing is an innovation in international distribution that has received much attention in recent years. This is an arrangement whereby one manufacturer obtains distribution of products through another's distribution channels. Both parties can benefit: The active distribution partner makes fuller use of its distribution system capacity and thereby increases the revenues generated by the system. The manufacturer using the piggyback arrangement does so at a cost that is much lower I than that required for any direct arrangement. Successful piggyback marketing requires that the combined product lines be complementary. They must appeal to the same customer, and they must not be competitive with each other. if these requirements are met, the piggyback arrangement can be a very effective way of fully utilizing an interlamination channel system to the advantage of both parties. A case in point is the Kauai Kookiel Kori1pany, whose owners observed Japanese tourists stocking up on cookies before returning home from Hawaii. Now the cookies are sold in a piggyback arrangement with) travel agencies in Japan. The cookies can be :purchased from 'a catalog after travelers have returned home, thus reducing the amount of baggage.

LESSON 15:
PLANNING PROCESS & ENTRY STRATEGIES

Planning for Global Markets

Planning is a systematized way of relating to the future. It is an attempt to manage the effects of external, uncontrollable factors on the firm's strengths, weaknesses, objectives, and goals to attain a desired end. Further, it is a commitment of resources to a country market to achieve specific goals. In other words, planning is the job of making things happen that may not otherwise occur.

Is there a difference between planning for a domestic company and for an international company? The principles of planning are not in themselves different, but the intricacies of the operating environments of the multinational corporation (i.e., host country, home, and corporate environments), its organizational structure, and the task of controlling a multicountry operation create differences in the complexity and process of international planning.

Planning allows for rapid growth of the international function, changing markets, increasing competition, and the ever-varying challenges of different national markets. The plan must blend the changing parameters of external country environments with corporate objectives and capabilities to develop a sound, workable marketing program. A strategic plan commits corporate resources to products and markets to increase competitiveness and profits.

Planning relates to the formulation of goals and methods of accomplishing them, so it is both a process and a philosophy. Structurally, planning may be viewed as corporate, strategic, and/or tactical. International corporate planning is essentially long-term, incorporating generalized goals for the enterprise as a whole. Strategic planning is conducted at the highest levels of management and deals with products, capital, and research, and long- and short-term goals of the company. Tactical planning, or market planning, pertains to specific actions and to the allocation of resources used to implement strategic planning goals in specific markets. Tactical plans are made at the local level and address marketing and advertising questions.

A major advantage to a multinational corporation (MNC) involved in planning is the discipline imposed by the process. An international marketer who has gone through the planning process has a framework for analyzing marketing problems and opportunities and a basis for coordinating information from different country markets. The process of planning may be as important as the plan itself because it forces decision makers to examine all factors that affect the success of a marketing program and involves those who will be responsible for its implementation. Another key to successful planning is evaluating company objectives, including management's commitment and philosophical orientation to international business.

Company Objectives and Resources

Evaluation of a company's objectives and resources is crucial in all stages of planning for international operations. Each new market can require a complete evaluation, including existing commitments, relative to the parent company's objectives and resources. As markets grow increasingly competitive, as companies find new opportunities, and as the cost of entering foreign markets increases, companies need such planning.

Defining objectives clarifies the orientation of the domestic and international divisions, permitting consistent policies. The lack of well-defined objectives has found companies rushing into promising foreign markets only to find activities that conflict with or detract from the companies' primary objectives.

Foreign market opportunities do not always parallel corporate objectives; it may be necessary to change the objectives, alter the scale of international plans, or abandon them. One market may offer immediate profit but have a poor long-run outlook, while another may offer the reverse. Only when corporate objectives are clear can such differences be reconciled effectively.

International Commitment

The planning approach taken by an international firm affects the degree of internationalization to which management is philosophically committed. Such commitment affects the specific international strategies and decisions of the firm. After company objectives have been identified, management needs to determine whether it is prepared to make the level of commitment required for successful international operations-commitment in terms of dollars to be invested, personnel for managing the international organization, and determination to stay in the market long enough to realize a return on these investments.

The degree of commitment to an international marketing cause reflects the extent of a company's involvement. A company uncertain of its prospects is likely to enter a market timidly, using inefficient marketing methods, channels, or organizational forms, thus setting the stage for the failure of a venture that might have succeeded with full commitment and support by the parent company. Any long-term marketing plan should be fully supported by senior management and have realistic time goals set for sales growth. Occasionally, casual market entry is successful, but more often than not, market success requires long-term commitment.

The Planning Process

Whether a company is marketing in several countries or is entering a foreign market for the first time, planning is essential to success. The first-time foreign marketer must decide what products to develop, in which markets, and with what level of resource commitment. For the company already committed, the key decisions involve allocating effort and resources among countries and product(s), deciding on new markets to develop

or old ones to withdraw from, and determining which products to develop or drop. Guidelines and systematic procedures are necessary for evaluating international opportunities and risks and for developing strategic plans to take advantage of such opportunities.

Phase I : Preliminary Analysis and Screening; Matching Company/Country

Whether a company is new to international marketing or heavily involved, an evaluation of potential markets is the first step in the planning process. A critical first step in the international planning process is deciding in which existing country market to make a market investment. A company's strengths and weaknesses, products, philosophies, and objectives must be matched with a country's constraining factors and market potential. In the first part of the planning process, countries are analyzed and screened to eliminate those that do not offer sufficient potential for further consideration. Emerging markets pose a special problem since many have inadequate marketing infrastructures, distribution channels are underdeveloped, and income level and distribution vary among countries.

The next step is to establish screening criteria against which prospective countries can be evaluated. These criteria are ascertained by an analysis of company objectives, resources, and other corporate capabilities and limitations. It is important to determine the reasons for entering a foreign market and the returns expected from such an investment. A company's commitment to international business and its objectives for going international are important in establishing evaluation criteria. A company guided by the global market concept looks for commonalties among markets and opportunities for standardization, whereas a company guided by the domestic market extension concept seeks markets that accept the domestic marketing mix as implemented in the home market. Minimum market potential, minimum profit, return on investment, acceptable competitive levels, standards of political stability, acceptable legal requirements, and other measures appropriate for the company's products are examples of the evaluation criteria to be established.

Once evaluation criteria are set, a complete analysis of the environment within which a company plans to operate is made. The environment consists of the uncontrollable elements discussed earlier and includes both home-country and host-country restraints, marketing objectives, and any other company limitations or strengths that exist at the beginning of each planning period. Although an understanding of uncontrollable environments is important in domestic market planning, the task is more complex in foreign marketing because each country under consideration presents the foreign marketer with a different set of unfamiliar environmental constraints. It is this stage in the planning process that more than anything else distinguishes international from domestic marketing planning.

The results of Phase 1 provide the marketer with the basic information necessary to: (1) evaluate the potential of a proposed country market; (2) identify problems that would eliminate the country from further consideration; (3) identify environmental elements which need further analysis; (4) determine which part of the marketing mix can be standardized for global companies or which part of and how the marketing mix must be adapted to meet local market needs; and (5) develop and implement a marketing action plan.

Information generated in Phase 1 helps a company avoid the mistakes that plagued Radio Shack Corporation, a leading merchandiser of consumer electronic equipment in the United States, when it first went international. Radio Shack's early attempts at international marketing in Western Europe resulted in a series of costly mistakes that could have been avoided had it properly analyzed the uncontrollable elements of the countries targeted for its first attempt at multinational marketing. The company staged its first Christmas promotion for December 25 in Holland, unaware that the Dutch celebrate St. Nicholas Day and gift giving on December 6. Furthermore, legal problems in various countries interfered with some of their plans; they were unaware that most European countries have laws prohibiting the sale of citizen-band radios, one of the company's most lucrative U.S. products and one they expected to sell in Europe. German courts promptly stopped a free flashlight promotion in German stores because giveaways violate German sales laws. In Belgium, the company overlooked a law requiring a government tax stamp on all window signs, and poorly selected store sites resulted in many of the new stores closing shortly after opening.

With the analysis in Phase 1 completed, the decision maker faces the more specific task of selecting country target markets, identifying problems and opportunities in these markets, and beginning the process of creating marketing programs.

Phase 2 : Adapting the Marketing Mix to Target Markets. A more detailed examination of the components of the marketing mix is the purpose of Phase 2. When target markets are selected, the market mix must be evaluated in light of the data generated in Phase 1. In which ways can the product, promotion, price, and distribution be standardized and in which ways must they be adapted to meet target market requirements? Incorrect decisions at this point lead to costly mistakes through lost efficiency from lack of standardization; products inappropriate for the intended market; and/or costly mistakes in improper pricing, advertising, and promotional blunders. The primary goal of Phase 2 is to decide on a marketing mix adjusted to the cultural constraints imposed by the uncontrollable elements of the environment that effectively achieve corporate objectives and goals.

The process used by the Nestle Company is an example of the type of analysis done in Phase 2. Each product manager has a country fact book that includes much of the information suggested in Phase 1. The country fact book analyzes in detail a variety of culturally related questions. In Germany, the product manager for coffee must furnish answers to a number of questions. How does a German rank coffee in the hierarchy of consumer products? Is Germany a high or a low per capita consumption market? (These facts alone can be of enormous consequence. In Sweden the annual per capita consumption of coffee is 18 pounds, while in Japan it's half a gram!) How is coffee used-in bean form, ground, or powdered? If it is ground, how is it brewed? Which coffee is preferred - Brazilian Santos blended with Colombian coffee, or robusta from the

Ivory Coast? Is it roasted? Do the people prefer dark roasted or blond coffee? (The color of Nestle's soluble coffee must resemble as closely as possible the color of the coffee consumed in the country.)

As a result of the answers to these and other questions, Nestle produces 200 types of instant coffee, from the dark robust espresso preferred in Latin countries to the lighter blends popular in the United States. Almost $50 million a year is spent in four research laboratories around the world experimenting with new shadings in color, aroma, and flavor. Do the Germans drink coffee after lunch or with their breakfast? Do they take it black or with cream or milk? Do they drink coffee in the evening? Do they sweeten it? (In France, the answer is clear: in the morning, coffee with milk; at noon, black coffee-i.e two totally different coffees.) At what age do people begin drinking coffee? Is it a traditional beverage as in France, is it a form of rebellion among the young as in England where coffee drinking has been taken up in defiance of tea-drinking parents, or is it a gift as in Japan? There is a coffee boom in tea-drinking Japan, where Nescafe is considered a luxury gift item; instead of chocolates and flowers, Nescafe is toted in fancy containers to dinners and birthday parties. With such depth of information, the product manager can evaluate the marketing mix in terms of the information in the country fact book.

Phase 2 also permits the marketer to determine possibilities for standardization. By grouping all countries together and looking at similarities, market characteristics that can be standardized become evident.

Frequently, the results of the analysis in Phase 2 indicate that the marketing mix would require such drastic adaptation that a decision not to enter a particular market is made. For example, a product may have to be reduced in physical size to fit the needs of the market, but the additional manufacturing cost of a smaller size may be too high to justify market entry. Also the price required to be profitable might be too high for a majority of the market to afford. If there is no way to reduce the price, sales potential at the higher price may be too low to justify entry.

On the other hand, additional research in this phase may provide information that can suggest ways to standardize marketing programs among two or more country markets. This was the case for Nestle when research revealed that young coffee drinkers in England and Japan had identical motivations. As a result, Nestle now uses principally the same message in both markets.

The answers to three major questions are generated in Phase 2: (1) Which elements of the marketing mix can be standardized and where is standardization not culturally possible? (2) Which cultural/environmental adaptations are necessary for successful acceptance of the marketing mix? and (3) Will adaptation costs allow profitable market entry? Based on the results in Phase 2, a second screening of countries may take place, with some countries dropped from further consideration. The next phase in the planning process is development of a marketing plan.

Phase 3 : Developing the Marketing Plan.

At this stage of the planning process, a marketing plan is developed for the target market-whether a single country or a global market set. The marketing plan begins with a situation analysis and culminates in the selection of an entry mode and a specific action program for the market. The specific plan establishes what is to be done, by whom, how it is to be done, and when. Included are budgets and sales and profit expectations. Just as in Phase 2, a decision not to enter a specific market may be made if it is determined that company marketing objectives and goals cannot be met.

Phase 4-Implementation and Control

A "go" decision in Phase 3 triggers implementation of specific plans and anticipation of successful marketing. However, the planning process does not end at this point. All marketing plans require coordination and control during the period of implementation. Many businesses do not control marketing plans as thoroughly as they could even though continuous monitoring and control could increase their success. An evaluation and control system requires performance objective action, that is, to bring the plan back on track should standards of performance fall short. A global orientation facilitates the difficult but extremely important management tasks of coordinating and controlling the complexities of international marketing.

While the model is presented as a series of sequential phases, the planning process is a dynamic, continuous set of interacting variables with information continuously building among phases. The phases outline a crucial path to be followed for effective, systematic planning.

Although the model depicts a global company operating in multiple country markets, it is equally applicable for a company interested in a single country. Phases 1 and 2 are completed for each country being considered, and Phases 3 and 4 are developed individually for the target market whether it consists of a single country or a series of separate country markets. A global company uses the same process but integrates planning and information to serve as many markets as feasible and then concentrates on a global market set in Phases 3 and 4.

Utilizing a planning process encourages the decision maker to consider all variables that affect the success of a company's plan. Furthermore, it provides the basis for viewing all country markets and their interrelationships as an integrated global unit. By following the guidelines presented in Part VI of the text, "The Country Notebook-A Guide for Developing a Marketing Plan," the international marketer can put the strategic planning process into operation.

As a company expands into more foreign markets with several products, it becomes more difficult to efficiently manage all products across all markets. Marketing planning helps the marketer focus on all the variables to be considered for successful global marketing. Regardless of which of the three strategies (domestic market extension, multidomestic, or global) a company chooses, rigorous information gathering, analysis, and planning are necessary for successful marketing.

With the information developed in the planning process and a country market selected, the decision of the entry mode can be made. The choice of mode of entry is one of the more critical

decisions for the firm because the choice will define the firm's operations and affects all future decisions in that market.

Additional International Alternatives

Sourcing

The opposite of exporting is obviously importing. In fact, the United States imports more goods than it exports, and this trend appears to be increasing over the years. In analyzing the import statistics, imports can be subdivided into two categories: goods that. are purchased ready-made and goods that a foreign company has a voice in their design and packing. 'These latter goods are referred to as' soured goods and merit different marketing considerations than goods that are solely imported.

Sourced goods can be found in both consumer and industrial goods. Nike doesn't make any athletic shoes. It does not own any manufacturing facilities. All its shoes are sourced in other countries, primarily in Asia. Turk, an industrial company known for its antennae, doesn't produce a single antenna. The antenna are all sourced in other countries under the specifications of Turk. How and why does a company select to employ this strategy?

There are no simple rules to guide sourcing decisions. Indeed, the sourcing decision is one of the cost complex and important decisions faced by a global company. As shown in Table, six factors must be taken into account in the sourcing decision.

Sourcing De3cision Factors

1. Factor costs and conditions
2. Logistics
3. Country Infrastructure
4. Political Risk
5. Market Access
6. Exchange rate, availability, and convertibility of local money.

Licensing

Licensing can be defined as a contractual arrangement whereby one company (the licensor) makes an asset available to another company (the licensee) In exchange for royalties; license fees, or some other form of compensation. The licensed assume may be a patent, trade secret, or company name. Licensing is a form of global market entry and an expansion strategy with considerable appeal. A company with advanced technology, know-how, or a strong brand image can use licensing agreements to supplement its bottom-line profitability with little initial investment. Licensing can offer an attractive return on investment for the life of the agreement, providing the necessary performance clauses are in the contract. The only cost is the cost of signing the agreement and of policing its implementation.

Of course, anything so easily attained has its disadvantages and risks. The principal disadvantage of licensing is that it can be a very limited form of participation. When licensing technology or know-how, what a company does not know can put it at risk. Potential returns from marketing and manufacturing may be lost, and the agreement may have a short life if the licensee develops its own know-how and capability to stay abreast of technology in the licensed product area. Eyen more distressing, licensees have a troublesome way of turning themselves into competitors *to* industry leaders. This is especially true because licensing enables a company to borrow-leverage and exploit-another company's resources. In Japan, for example, Meiji Milk produced and marketed Lady Borden premium ice cream under a licensing agreement with Borden, Inc. Meiji learned important skills in dairy product processing, and, as the expiration dates of the licensing contracts drew near, rolled out its own premium ice cream brands.

Perhaps the most famous U.S. licensing fiasco dates back to the mid-1950s, when Sony cofounder Masaru Ibuka obtained a licensing agreement for the transistor from AT&T's Bell Laboratories. Ibuka dreamed of using transistors to make small, battery-powered radios. Bell engineers informed Ibuka that it was impossible to manufacture transistors that could handle the high frequencies required for a radio; they advised him to try making hearing aids. Undeterred, Ibuka presented the challenge to his Japanese engineers, who spent many months improving high-frequency output. Sony was not the first company to unveil a transistor radio; an American-built product, the Regency, featured transistors from Texas Instruments and a colorful plastic case. However, it was Sony's high quality, distinctive approach to styling, and marketing savvy that ultimately translated into worldwide success.

Conversely, the failure to seize an opportunity to license can also lead to dire con" sequences. In the mid-1980s, Apple Computer chairman John Sculley decided against licensing Apple's famed operating system. Such a move would have allowed other computer manufacturers to produce Macintosh-compatible units. Meanwhile, Microsoft's growing world dominance in computer operating systems and applications got a boost from Windows, which featured a Mac-like graphical interface. Apple belatedly reversed direction and licensed its operating system, first to Power Computing Corporation in December 1994 and then to IBM and Motorola. The Mac clones have been very popular; Power Computing shipped 170,000 Macintosh clones in 1996, and in 1997 the. Mac clones had captured over 25 percent of the Mac market. Despite these actions, the global market share for Macintosh and Mac clones has slipped below 5 percent. Apple's failure to license its technology in the pre-Windows era ultimately cost the company over $125 billion dollars (the market capitalization of Microsoft, the company that won the operating system war).

Pokemon in the United States

It started in Japan. A cartoon character that engaged in Japanese role-playing was presented in a simplistic animated style. And it became popular in Japan. Very popular. In Japan, Nintendo, owner of Pokemon (whose name means "pocket monster"), first introduced the video game. This was followed by toys, comic books, and trading cards. Finally, the Pokemon television show was introduced: In Japan, 50 percent of children watch the Pokemon television show. Given its tremendous success in Japan, the marketing question became "Could this popularity be transferred to the United States?"Currently, Pokemon is a licensing success story in the United States. Despite initial hesitancy on the part of Nintendo, it was licensed to 4 Kids Entertainment, Inc. of New York. In the United States, 4 Kids decided to use the reverse introduction sequence of product introduction. The U.S. effort started with the television show and then

expanded with 90 different licensing agreements in- I eluding' 4 million video games. Merchandise sales were: estimated at a billion dollars in 1999. The Pokemon cartoon was the 1998-1999 season's top children's show in the United States.The show is also being shown in Canada, Australia, I New Zealand, England, Mexico, and Latin America. The U.S. owners, however, spend considerable money to . "westernize" the programs. Besides the translation to J English, they have had to adjust for the wide usage. of puns in the Japanese version, replace all Japanese writing, and even modify some of the characters. From a financial perspective, licensing can be quite I lucrative. The licensor receives between 5 and 15 percent of retail sales. The licensing agent receives 20 to 50 percent of the licensor's fees. Clearly, international licensing opportunities are not to be ignored.

As the Borden and transistor stories make clear, companies may find that the upfront, easy money obtained from licensing turns out to be a very expensive source of revenue. To prevent a licensor/competitor from gaining unilateral benefit, licensing agreements should provide for a cross-technology exchange between all parties. At the absolute minimum, any company that plans to remain in business must ensure that its license agreements provide for full cross-licensing-that is, the licensee shares its developments with the licensor. Overall, the licensing strategy must ensure ongoing competitive advantage. For example, license arrangements can create export market opportunities and open the door to low-risk manufacturing relationships. They can also speed diffusion of new products or technologies.

When companies do decide to license, they should sign agreements that anticipate more extensive market participation in the future. Insofar as is possible, a company should keep options and paths open for other forms of market participation. One path is a joint venture with the licensee.

Trademarks can be an important part of the creation and protection of opportunities for lucrative licenses. Image-oriented companies such as Coca-Cola and Disney. as well as designers such as Pierre Cardin, license their trademarked names and logos to overseas producers of clothing, toys, and watches. Business is booming: The top-tier names are expanding their fee income by 15 percent a year and more. When licensing a trademark, the challenge is to 'maintain and enhance the brand equity of the marque. This means that licensees must be carefully 'selected and supervised. A bad licensee can seriously depreciate the value of a marque by turning out merchandise or services that do not meet up to the standard of the marque.

Franchising is a form of licensing. It is the practice whereby a company permits its name, logo, cultural design, and operations to be used in establishing a new firm or store.

Investment: Joint Ventures

A joint venture with a local partner represents a more extensive form of participation in foreign markets than either exporting or licensing. The advantages of this strategy include the sharing of risk and the ability to combine different value chain strengths-for, example, international marketing capability and manufacturing. One company might have in-depth knowledge of a local market, an extensive distribution system, or access to low-cost labor or raw materials. Such a company might link up with a foreign partner possessing considerable know-how in the area of technology, manufacturing, and process applications. Companies that lack sufficient capital resources might seek 'partners to jointly finance a project. Finally, a joint venture may be the only way to enter a country or region if government bid award practices routinely favor local companies or if laws prohibit foreign control but permit joint ventures.

Because of these clear advantages, especially in emerging markets, the conventional wisdom is that a joint venture is the only way to go. Not all agree With this "wisdom." In China, according to Wilfried Vanhonacker, the situation is changing rapidly, and today companies should think beyond the equity joint venture (EJV) with a well-connected local partner and consider the alternative of a wholly foreign-owned enterprise (WFOE). In China, EJVs and WFOEs are substantially the same in terms of taxation and corporate liability. They operate under similar rules and regulations. There arc some technical differences, but the bottom line is that the WFOEs take less time to establish than EJVs and do not require a board of directors.

Today, there is a shift on the part of foreign investors in China from the EJV to the WFOE. The reasons are fundamental: Investors achieve greater flexibility and control with a WFOE, and-the government is becoming more concerned about what a company brings to the country in terms of jobs, technology, and know-how than it is about how its deals are structured. In China, as everywhere, each case must be decided on its merits. Two questions must be answered in every case: What does each partner bring to the deal, and what are the interests and capabilities of the partners going forward? The fact is that joint ventures are hard to sustain even in stable environments because the partners to a joint venture have different capabilities, resources, visions, and interests. In fast-growing and fast-changing environments, it is much more difficult to sustain joint ventures. In China, for example, access to markets has been hindered by what foreign investors thought was the essential success factor in China: guanxi (relationships). In fact, what many investors have discovered is that China is a big country and the scope of their partner's guanxi is limited. Many investors have discovered to their disappoin1ment that their partner lacked the guanx*i* needed to move forward. A WFOE can retain agents and advisors to assist it in acquiring the land; materials, approvals, and services that it needs to do business in China.

It is possible to use a joint venture as a source of supply for third-country markets. This must be carefully thought out in advance. One of the main reasons for joint venture "divorce" is disagreement about third-country markets in which partners face each other as actual or potential competitors. To avoid this, it is essential to work out a plan for approaching third-country markets as part of the venture agreement.

The disadvantages of joint venturing can be significant. Joint venture partners must share rewards as well as risks. The main disadvantage of this global expansion strategy is that a company incurs very significant costs associated with control and coordination issues that arise when working with a partner.

Also, as noted earlier with licensing, a dynamic joint venture partner can evolve into a stronger competitor. In some instances, country-specific restrictions limit the share of capital help by foreign companies. Cross-cultural differences in managerial attitudes and behavior can present formidable challenges as well.

James River's European joint venture, Jamont, brought together 13 companies from 10 countries. Major problems included computer systems and measures of production efficiency; Jamont uses committees to solve these and other problems as they arise. For example, agreement had to be reached on a standardized table napkin size; for-some country markets, 30 by 30 centimeters was the norm; for others, 35 by 35 centimeters' was preferred.

Difficulties such as those outlined previously are so serious that, according to one study of 170 multinational firms, more than one third of 1,100 joint ventures were unstable, ending in "divorce" or a significant increase in the U.S. firm's power over its partner.1S Another researcher found that 65 joint ventures with Japanese companies were either liquidated or, transferred to the Japanese interest in 1976. This was up from 6 in 1972, a 600 percent increase. The most fundamental problem was the different benefits ,that each side expected to receive.

In an alliance the real payoff is from learning skills from the partner rather than just getting products to sell while avoiding investment. Yet, compared to American and European firms, Japanese and Korean firms see to excel in their ability to leverage new knowledge that comes out of a joint venture. For example, Toyota learned many new things from its partnership with GM about U.S. supply and transportation and managing American workers-that have been subsequently applied at its Camry plant in Kentucky. However, some American managers involved in the venture complained that the manufacturing expertise they gained was not applied broadly throughout GM. To the extent that this complaint has validity, GM has missed opportunities to leverage new learning. Still, many companies have achieved great successes pursuing joint ventures. Gillette, for example, has used this strategy to introduce its shaving products in the Middle East and Africa.

Investment: Ownership and Ontrol

Another key variable in the location decision is the vision and values of company leadership. Some chief executives are obsessed with manufacturing in their home country. Nicolas Hayek is head of the Swiss Corporation for Microelectronics and Watch making (SMH), the company best known for its line of inexpensive Swatch watches. SMH's chief executive has presided over a spectacular comeback-the revitalization of the Swiss watch industry. Swatch has become a pop culture phenomenon, with sales approaching 1 billion watches. The flagship brand on the high end is Omega, whose models carry prices ranging from $700 to $20,000.. SMH. recently acquired Blancpain', a niche producer of luxury mechanical watches that retail for $200,000 and up. Hayek has demonstrated that, by embracing the fantasy and imagination of childhood and youth, a person can build mass-market products in countries such as Switzerland or the United States. The Swatch story is a triumph of engineering as well as a triumph of the imagination.

The sourcing decision highlights three roles for marketing in a global competitive strategy. The first relates to the configuration of marketing. Although many marketing activities must be performed in every country, advantage can be gained by concentrating some of the marketing activities in a single location. Service, for example, must be dispersed to every country. Training, however, might be at least partially concentrated in a single location for the world. A second role for marketing is the coordination of marketing activities across countries to leverage a company's know-how. This integration can take many forms, including the transfer of relevant experience across national boundaries in areas such as global account management and the use of similar approaches or methods for marketing research, product positioning, or other marketing activities. A third critical role of marketing is its role in tapping opportunities in product development and research and development (R&D). The development of Canon's AE-I camera is a case in point. Research provided the information on market requirements that enabled Canon to develop a world product. Canon was able to develop a physically uniform product that required fewer parts, far less engineering, lower inventories, and longer production runs. Such advantages would have been lacking if Canon had developed separate camera models that were adapted to the unique conditions in each national market.

As for the form of cooperation and control, there are many, ranging from the management contract to wholly owned subsidiaries and global strategic partnerships. The issues that these alternatives raise are control arid ownership. As shown in Table, the second issue that must be addressed in international marketing strategy is whether to establish an in-country or in-region marketing organization. This decision will be resolved by an assessment of the cost of creating such an organization compared to the expected impact of an in-country marketing organization on market share, sales, and earnings.

International Market Entry & Expansion Decision Model

1. Sourcing : Home, third, or host country.
   Cost, market access, country of origin factors.
2. In-country or in-region marketing organization?
   Cost, market impact assessment. Is choice is to establish own organization, must decide who to appoint to key positions.
3. Selection, training, and motivation of local distributors and agents.
4. marketing mix strategy: Goals and objectives in sales, earnings, and share of market; positioning; marketing mix strategy.
5. Strategy implementation.

The next task is the selection, training, and motivation of agents, distributors, and representatives. If it is decided to not establish an in-country marketing organization, the agent(s) or

distributor(s) selected will be the in-country marketing organization. The fourth task is to formulate marketing mix and positioning strategy and, finally, to implement the strategy. This will be done by the organization itself if it has created an in country marketing organization, and by the company ill cooperation with an agent or distributor if it has not.

There are many options that vary the amount of ownership and investment and the degree of control of country marketing. Although it is possible to have ownership without control and control without ownership, greater ownership is normally linked with greater control (see Figure 8-1 on page 240). Companies with wholly owned affiliates or subsidiaries have complete control over every aspect of the affiliates' operations: strategy and structure, human resources, financial strategy and policy, marketing strategy and policy, and so on.

In the equity joint venture (EJV), this is not the case. The 'shared ownership of this type of company gives control to each of the owners. Licensing and franchising require little investment, but they may be part of agreements that give the licensor or franchisor considerable control over the business.

Ownership/Investment

After companies gain experience outside the home country via exporting or licensing and joint ventures, the time comes for many companies when a more extensive form of participation in global markets is wanted. The desire for control and ownership of operations outside the home country drives .the decision to invest. Foreign direct investment (FDI) figures record investment flows as companies invest in or acquire plant, equipment, or other assets outside the home country. By definition, direct investment presumes that the investor has control or significant influence over the investment, as opposed to portfolio investment, in which it is assumed that the investor does not have significant influence or control. The operational definition of direct investment is ownership of 20 percent or more of the equity of a company. Companies, in addition to producing products, are products in themselves and it appears that many major international companies are on a shopping spree. While the United States had been the leader in overseas purchases" European companies have purchased many U.S. companies and these transactions carry large price tags. Vodafone, British Petroleum, and Scottish Power, which are all U.K. companies, have acquired Air Touch Communications, Amaco, and PacifiCorp, respectively. These three deals alone are valued at over $133 billion. Conversely, Kodak, because of its stagnant sales in the U.S. market, is investing $1 billion in China in an effort to preempt Fuji, which controls more than 40 percent of the market, from expanding. By producing locally, Kodak would circumvent the 60 percent tariff on imported - film. China is the world's third largest film market after the United States and Japan. Kodak currently has approximately 30 percent of the market. Lucky Film Co., a local producer, has 20 percent of the market.

The most extensive form of participation in global markets is 100 percent ownership, which may be achieved by start-up or acquisition. (In China this is now referred to as the wholly foreign-owned enterprise or WFOE.) Ownership requires the greatest commitment of capital and managerial effort and offers the fullest means of participating in a market. Companies may move from licensing or joint venture strategies to ownership in order to achieve faster expansion in a market, greater control, or higher profits. In 1991, for example, Ralston Purina ended a 20-year joint venture with a Japanese company to start its own pet-food subsidiary. Monsanto Company and Bayer AG, the German pharmaceutical company, are .two other companies that have also recently disbanded partnerships in favor of wholly owned subsidiaries in Japan.19 In many countries, government restrictions may prevent majority or 100 percent ownership by foreign companies.

Large-scale direct expansion .by means of establishing new facilities can be expensive and require a major commitment of managerial time and energy. Alternatively, acquisition is an instantaneous-and sometimes less expensive-approach to market entry. Although full ownership can yield the additional advantage of avoiding communication and conflict-of-interest problems that may arise with a joint venture or co-production partner, acquisitions still present the demanding and challenging task of integrating the acquired company into the worldwide organization and coordinating activities.

Table 8-8 lists some additional examples, grouped by industry, of companies that have pursued global expansion via acquisition.

Market Entry and Expansion by Acquisition

Product Category/Industry	**Acquiring Company**	**Target**
1. Automotive	Daimler Benz	Chrysler
2. Pharmaceutical	Rhone-Poulenc	Hoechst
3. Tobacco	British American Tobacco	Zurich
4. Oil	BP Amoco	Arco
5. Communications	Vodafone	Mannesmann Air Touch

The decision to invest abroad-whether by expansion or acquisition-sometimes clashes with short-term profitability goals. This is an especially important issue for publicly held companies. Despite these challenges, there is an increasing trend toward foreign investment by. companies. The market value of U.S. direct investment abroad and of foreign direct investment in the United States exceeds 1 trillion.

Several of the advantages of joint venture alliances also apply to ownership, including access to markets and avoidance of tariff or quota barriers. Like joint ventures, ownership also permits important technology experience transfers and provides a company with access to new manufacturing techniques. For example, the Stanley Works, a toolmaker with headquarters in New Britain, Connecticut, has bought more than a dozen companies since 1986, among them Taiwan's National Hand Tool/Chiro company, a socket wrench manufacturer and developer of a cold-forming process that speeds up production and reduces waste. Stanley is now using the technology in the manufacture of other tools. Chairman Richard H. Ayers sees such global cross-fertilization and blended technology as a key benefit of globalization.

The alternatives discussed earlier-licensing, joint ventures, and ownership-are in fact points along a continuum of alternative

strategies or tools for global market entry and expansion. The overall design of a company's global strategy may call for combinations of exporting/importing, licensing, joint ventures, and ownership among different operating units. Such is the case in Japan for Borden, Inc.; it is ending licensing and joint venture arrangements for branded food products and setting up its own production, distribution, and marketing capabilities for dairy products. Meanwhile, in nonfood products, Borden has maintained joint venture relationships with Japanese partners in flexible packaging and foundry materials.

A firm may decide to enter into a joint venture or co production agreement for purposes of manufacturing arid may either market the products manufactured under this agreement in a wholly owned marketing subsidiary or sell the products from the co production facility to an outside marketing organization. Joint ventures may be 50-50 partnerships or minority or majority partnerships. Majority ownership may range anywhere from 51 percent to 100 percent.

Investment in Developing Countries

Investment in developing nations grew rapidly in the 1990s. The appeal of the developing economies is their rapid growth, expanding purchasing power, and expanding markets. Major flows of investment have been directed toward emerging markets in Asia, the Americas, the Middle East, and Africa. Table 8-9 shows the sources of recent investment into Brazil.

Foreign investments may take the form of minority or majority shares in joint ventures, minority or majority equity stakes in another company, or, as in the case of Sandoz and Gerber, outright acquisition. A company may choose to use a combination of these entry strategies by acquiring one company, buying an equity stake in an Other, and operating a joint venture with a third. In recent years, for example, UPS has made more than 16 acquisitions in Europe and has also expanded its transportation hubs.

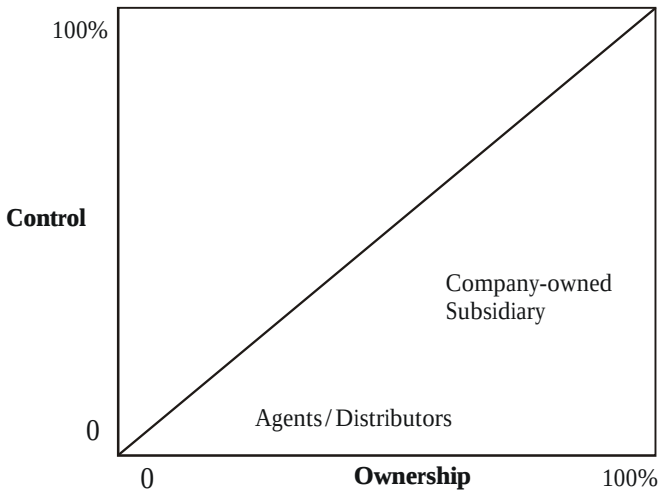
Marketing Strategy Alternatives

Regardless of the entry form selected, companies must decide on their marketing strategy for each market. Broadly, the alternatives are to use independent-agents and distributors or to establish a company-owned marketing subsidiary.

The advantage of the agent/distributor option is the fact that it requires little investment. It is a pay-as-you-go option. The disadvantage of this option is that it does not create a company presence in the market and it does not give a company control over its marketing effort. In addition, agents and distributors are not necessarily a no investment option. If the manufacturer has deep pockets, any -termination of an agency or distributorship agreement may lead to a claim by the agent or distributor for lost profits and damages. A written contract with a no-cause termination clause is 110 guarantee of protection from an agent/distributor lawsuit because agents and distributors may press claims on the grounds of a breach of good faith.

In many countries, companies combine the company-owned marketing subsidiary with agents and distributors. This option gives the company local presence- and control of the marketing effort and, where cost-effective, takes advantage of distributor and agent capabilities. The local presence of the company can provide a much better communications link with the regional and world headquarters and, if it is well executed, ensure that the company's effort reflects the fullest potential of the company's ability to execute a global strategy with local responsiveness.

With a local subsidiary presence, a company can focus on formulating and executing marketing strategies and plans that work. In China, Procter & Gamble (P&G) operates with a combination of joint venture-s and its own company presence, with P&G marketing executives directing the company's China strategy. This approach has enabled P&G to increase its share of the urban shampoo market to 60 percent as compared to 9 percent for Unilever. P&G has invested heavily in market research, advertising, and distribution, and in creating its own command presence in the market. As a result of these initiatives, Head & Shoulders, P&G's brand, is China's fastest growing hair care brand.



Five Market Expansion Strategies

Companies must decide whether to expand by seeking new markets in existing countries or, alternatively, seeking new country markets for already identified and served market segments. These two dimensions in combination produce four strategic options, as shown in Table 8-10. Strategy 1 concentrates on a few segments in a few countries. This is typically a starting point for most companies. It matches company resources and 'market investment needs. Unless a company is large and endowed with ample resources, this strategy may be the only realistic way to begin.

In strategy 2, country concentration and segment diversification, a company serves, many 'market 'in a few countries. This strategy was implemented by many European, companies 'that remained in Europe and sought growth by expanding into new markets. It is also the' approach of ' the American companies that decide to diversify in the U.S. market a opposed to going international with existing products or creating new global products: According *to* the U.S. Department of Commerce, more than *80* percent of American 'companies that export limit their sales to five or fewer markets. This means the majority of American companies are pursuing strategy 1 or 2.

Strategy 3;country diversification 'and market segment concentration, is the classic global strategy whereby a company seeks out the world market *for* a product. The appeal of this strategy is that by serving the world customer, a company can achieve a greater accumulated volume and lower costs than any competitor and, therefore, have an un assailable competitive advantage. This is the strategy of the well-managed business that serves a distinct need and customer category.

Strategy 4, country and segment diversification, is the corporate strategy of a global, multibusiness company such as Matsushita. Over all, Matsushita is multicountry in scope and its various business units and groups serve multiple segments, Thus, at the level of corporate strategy, Matsushita may be said to be pursuing strategy 4. At the operating business level, however, managers of individual units must focus on the needs of the world customer their particular global market. In Table 8-10, this is strategy 3-country diversification and market segment concentration. An increasing number of companies all over the world are beginning to see the importance of market share not only in the home or domestic market but also in the world market. Success in overseas markets can boost a company's total volume and lower its cost position.

		Concentration	Diversification
COUNTRY	Concentration	1. Narrow Focus	2. Country Focus
	Diversification	3. Country Diversification	4. Global Diversification

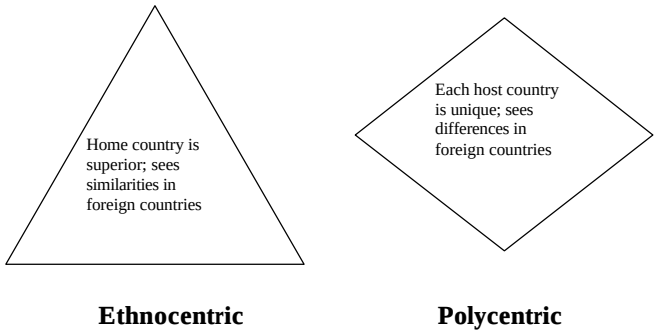
Alternative Strategies: Stages of Development Model

Table lists the stages in the evolution of the global corporation, from domestic to international, multinational, global, and transnational. As discussed in previous chapters, the differences between the stages can be quite significant. Unfortunately, there is little general agreement about the usage of each term. The terminology suggested here conforms to current usage by leading scholars however, it should be noted that executives, journalists, and others who are not familiar with the scholarly literature may use the terms in quite different ways.

Stage of Development I

Stage & Company	1 Domestic	2 International	3 Multinational	4 Global	5 Transnational
Strategy	Domestic	International	Multidomestic	Global	Global
Model	NA	Coordinated Federation	Decentralized Federation	Centralized Hub	Integrated Network
View of World	Home Country	Extension Markets	National Markets	Global Markets or Resources	Global markets and resources
Orientation	Ethnocentric	Ethnocentric	Polycentric	Mixed	Geocentric

Bartlett and Ghoshal provide an excellent discussion of three industries-branded packaged goods, consumer electronics, and telecommunications switching-in which individual competitors have exemplified the different stages at various times in their corporate histories. For example, P&G, General Electric (GE), and Ericsson were stage 2. international companies. For many years, Unilever, Philips, and International Telephone and Telegraph (ITT) were stage 3 multinationals. The stage 4 global companies included in the study were all from Japan: Kao, Matsushita, and NEC.



Orientation does not change as a company moves from domestic to international. The difference between the domestic and the international company is that the international is doing business in many countries. Like the domestic company, it is ethnocentric and home-country oriented. However, the stage 2 international company sees extension market opportunities outside the home 'country and extends marketing programs to exploit those opportunities. The first change in orientation occurs as a company moves to stage 3, multinational. At this point, its orientation shifts from ethnocentric to polycentric. The difference is quite important. The stage 2 ethnocentric company seeks to extend its products and practices to foreign countries. It sees similarities outside the home country but is relatively blind to differences. The stage 3 multinational is the opposite: It sees the differences and is relatively blind to similarities. The focus of the stage 3 multinational is on adapting to what is different in a country.

The stage 4 global company is a limited form of the transnational. Management's orientation is either on global markets or global resources but not on both. For example, Harley-Davidson is focused on global markets but not on global resources. The company has no interest in conducting R&D, design, engineering, or manufacturing outside of the United States. Until recently, the same was true for BMW and Mercedes. Both companies marketed globally but limited R&D,

engineering, design, and manufacturing activity to Germany. Mercedes now plans to double its purchases from outside suppliers and to build more than 10 percent of its vehicles outside Germany. Notes Mercedes chairman, Helmut Werner, "The fundamental problem of German exports is that we are producing in a country with a hard currency and selling in countries with soft currencies." When a company moves from stage 4 to stage 5, its orientation encompasses both global markets and global resources

Stage of Development II

Stage & Company	1 Domestic	2 International	3 Multinational	4 Global	5 Transnational
Key Assets	Located in home country	Core centralized others dispersed	Decentralized and self-sufficient	All in home country except marketing or sourcing	Dispersed interdependent and specialized
Role of country units	Single country	Adapting and leveraging competencies	Exploiting local opportunities	Marketing or sourcing	Contributions to company worldwide
Knowledge	Home Country	Created at center and transferred	Retained within operating units	Marketing or sourcing developed jointly and shared	All functions developed jointly and shared

Special mention must be made of some of the distinctive qualities of stage 4 companies that pursue integrated global strategies. Key assets are dispersed, specialized, and interdependent. A transnational automobile company-Toyota, for example-makes engines and transmissions in various countries and ships these components to assembly plants located in each of the world regions. Specialized design labs might be located in different countries and work together on the same project. The role of country units changes dramatically as a company moves across the stages of development. In the stage 2 international company, the role of the country unit is to adapt and leverage the competence of the parent or borne-country unit. In the stage 5 transnational, the role of each country is to contribute to the company worldwide; In the international and multinational, the responsibility of the marketing organization is to realize the potential of the individual national markets. In the transnational, the responsibility of the marketing unit is to realize the potential of the national market and, if possible, to contribute to the success of marketing efforts worldwide by sharing successful innovations and ideas with the entire organization.

The international company's strength is its ability to exploit the parent company's knowledge and capabilities outside the home country. In the telecommunications industry, Ericsson gained a competitive edge over NEC and ITT by pursuing this approach. The multinational's strength is its ability to adapt and respond to national differences. Unilever's local responsiveness was well suited to the packaged goods industry. Thus, in many markets, the company outperformed both Kao and P&G. The global company leverages internal skills and resources by taking advantage of global markets or global resources. In consumer electronics, Matsushita's ability to serve global markets from world-scale plants caused great woes for Philips and GE. (In fact, GE's Jack Welch decided to exit the business altogether)

The transnational combines the strengths of each of the earlier stages by serving global markets using global resources and leveraging global learning and experience.

In state 3, the most frequently preferred sourcing arrangement is local manufacture. In stage 5, product sourcing is based on an analysis that takes into account cost, delivery, and all other factors affecting competitiveness and profitabilility. This analysis produces a sourcing plan that maximizes both competitive effectiveness and profitability. When a company is in stage 2, key jobs go to home country nationals in both the subsidiaries and the headquarters, in stage 3, key jobs in host countries go to country nationals, whereas headquarters management positions are usually held by home country nationals. In stage 5, the best person is selected for all management positions regardless of nationality. Research and development (R$D) in stage 2 is conducted in the home country; in stage 3, R$D becomes decentralized and fragmented. By the time is typically decentralized. The transnational company in stage 5 can take advantage of resources as well as respond to local aspirations to produce a worldwide decentralized R&D program.

Table shoes an example of how fleet guard, inc., a wholly owned subsidiary of commons engine company, evolved over an 11 year period.

On occasion, the best marketing and management efforts fail when trying to expand into markets. In this case, it is equally important to know when to pull out.

Strengths at Each level

International Ability to exploit the parent company's knowledge and capabilities through worldwide diffusion of products
Multinational Flexible ability to respond to national differences
Global Global market or supplier reach, which leverages the home –country organization, skills, and resources.
Transnational Combines the strengths of each of the preceding stages in an integrated network, which leverages worldwide learning and experience.

LESSON 16:
COOPERATIVE STRATEGIES AND GLOBAL STRATEGIC PARTNERSHIPS

"Alliances are a big part of this game [of global competition}. They are critical to win on a global basis. . . the least attractive way to try to win on a global basis is to think you can take on the world by yourself".

-JACK WELCH
CEO, General Electric Corporation

"Business growth and expansion in different parts of the world will increasingly have to be based on alliances, partnerships, joint ventures and all kinds of relations with organizations located in other political jurisdictions,"

-PETER DRUCKER;
Author

"Alliances as a broad-based strategy will only ensure a company's mediocrity, not its international leadership. "

-MICHAEL PORTER

Professor, Harvard Business School

The learning objectives from this lesson could be as follows:

1. The Nature of Global Strategic Partnerships
2. Success Factors
3. Alliances Between Manufacturers and Marketers
4. International Partnerships in Developing Countries
5. Cooperative Strategies in Japan: Keiretsu
6. Beyond Strategic Alliances

What does a car, household appliance personal computer a beer, a deodorizer, and a travel company have in common? In Japan the answer is a brand. Five major companies (Toyota Motor, Matsushita Electric. Asahi Breweries and Kao) have formed a marketing alliance to share the brand name "Will.

Their purpose is to create a new, modern image that would appeal to consumers in their late twenties and early thirties. This age segment is composed of approximately 8 million consumers who want to express their own preferences and are cynical of traditional, conservative brands.

Airlines offer an excellent example of global strategic partnerships. Table lists the world's top airlines and the world's top airline fleets. United Airlines, the largest commercial airline in the world, has agreements with fourteen airlines: Air Canada, Air New Zealand, All Nippon, Ansett Australia, Austria, British Midland, Lauda Air, Lufthansa, Mexican, SAS, Singapore, Thai, Tyrolean, and Varig airlines. This alliance is known as the Star Alliance, whose motto is "The Airline Network for Earth."

Top25 Airlines — Top 25 Airline Fleets

Rank	Airline	1997 No. of RPK	Rank	Airline	No. of Aircraft
1	United	195,372	1	American	641
2	American	172,166	2	FedEx	616
3	Delta	160,398	3	United	575
4	Northwest	115.898	4	Delta	559
5	British Airways	98,405	5	Northwest	406
6	Japan Airlines	79.063	6	US Airways	352
7	Continental	77,081	7	Continental	327
8	Lufthansa	68.267	8	British Airways	268
9	US Airways	66,901	9	Southwest	261
10	Air France	63,812	10	Lufthansa	217
11	Qantas	59.199	11	UPS	208
12	KLM	55,418	12	Mesa Air Group	185
13	Singapore	55.388	13	TWA	185
14	All Nippon	51,219	14	Air France	182
15	Southwest	45,623	15	Air Canada	155
16	TWA	40,470	16	SAS	147
17	Korean	40,1 90	.17	Alitalia	144
18	Cathay Pacific	38.962	18	All Nippon	136
19	Air Canada	36,866	19	Japan Airlines	134
20	Alitalia	36.002	20	Iberia	124
21	Thai Intl	31.154	21	Continental Express	121
22	Iberia	27,679	22	Korean	117
23	Swissair	27,522	23	KLM	114
24	America West	26.072	24	Aeroflot Russian	113
25	Canadian	25.784	25	Airborne	106

" Revenue passenger kilometers

In previous lessons, we reviewed the range of options-exporting, licensing, joint ventures, and ownership-traditionally used by companies wishing either to enter global markets for the first time or expand their activities beyond present levels. However, recent changes in the political, economic, sociocultural, and technological environments of the global firm have combined to change the relative importance of those strategies. Trade barriers have fallen, markets have globalized, consumer needs and wants have converged, product life cycles have shortened, and new communications technologies and trends have emerged. Although these developments provide unprecedented market opportunities, there are strong strategic implications for the global organization and new challenges for the global marketer.

Like the airline example cited previously, such strategies will undoubtedly incorporate-or may even be structured around-a variety of collaborations. Once thought of as only joint ventures with the more dominant party reaping most of the benefits (or losses) of the partnership, cross-border alliances are taking on surprising new configurations and even more surprising players. Why would any firm-global or otherwise-seek to collaborate with another firm, be it local or foreign? Why do executives decide to pursue competitive collaboration with other firms, some of which are rivals?

Every company faces a business environment characterized by unprecedented degrees of dynamism, turbulence, and unpredictability. Today's firm must be equipped to respond to mounting economic and political pressures. Reaction time has been sharply cut by advances in technology. The firm of tomorrow must be ready to do whatever it takes to ensure that it is creating a unique value for customers and that it has a competitive advantage.

As suggested in the opening chapter quotations, there appears to be less than agreement by major strategic thinkers on the wisdom of cooperation. This chapter will address the fundamental issue: whether to cooperate and when to cooperate. It will focus on global strategic partnerships. The Japanese keiretsu, and various other types of cooperation strategies that may be an important element of the success of the global firm.

The Nature of Global Strategic Partnerships

The terminology used to describe the new forms of cooperation strategies varies widely. The phrases collaborative agreements strategic alliances, strategic international alliances, and global strategic partnerships (GSPs) are frequently used to refer to linkages between companies to jointly pursue a common goal. A broad spectrum of inter firm agreements, including joint ventures can be covered by this terminology. However, the strategic alliances discussed in this chapter exhibit three characteristics.

1. The participants remain independent subsequent to the formation of the alliance.
2. The participants share the benefits of the alliance as well as control over the performance of assigned tasks.
3. The participants make ongoing contributions in technology, products, and other key strategic areas.

According to estimates the number of strategic alliances has been growing at a rate of 20 to 30 percent since the mid-1980s. The upward trend for GSPs comes in part at the expense of traditional cross-border mergers and acquisitions.

Roland Smith, chairman of British Aerospace offers a straightforward reason why a firm would enter into a GSP:"A partnership is one of the quickest and cheapest ways to develop a global strategy. Like traditional joint ventures, GSPs have some disadvantages. Each partner must be willing to sacrifice some control, and there are potential risks associated with strengthening a competitor from another country. Despite these drawbacks, GSPs are attractive for several reasons. First, high product development costs may force a company to seek partners; this was part of the rationale for Boeing's partnership with a Japanese consortium to develop a new jet aircraft, the 77~. Second, the technology requirements of many contemporary products mean that an individual company may lack the skills, capital, or know-how to go it alone. Third, partnerships may be the best means of securing access to national and regional markets. Fourth, partnerships provide important learning opportunities; in fact, one expert regards GSPs as a "race to learn." Professor Gary Hamel of the London Business School has observed that the partner that proves to be the fastest learner can ultimately dominate the relationships

GSPs and joint ventures differ in significant ways. Traditional joint ventures are basically alliances focusing on a single national market or a specific problem. A true global strategic partnership is different. It is distinguished by the following six attributes:

1. Two or more companies develop a joint long-term strategy aimed at achieving world leadership by pursuing cost leadership, differentiation, or a combination of the two and by creating a variety, needs, or access-based position or a combination of the three.
2. The relationship is reciprocal. Each partner possesses specific strengths that it shares with the others; learning must take place on all sides.
3. The partners' vision and efforts are truly global, extending beyond home countries and home regions to the rest of the world.
4. If the relationship is organized along horizontal lines, continual transfer of resources laterally between partners is required, with technology sharing and resource pooling representing norms.
5. If the relationship is along vertical lines, both parties to the relationship must understand their core strengths and be able to defend their competitive position against the possibility of either a forward or backward integration move by their vertical partner, and they must work together to create a unique value for the customers of the downstream partner in the value chain.
6. When competing in markets excluded from the partnership, the participants retain their national and ideological identities.

The Iridium program described in the box" Iridium: Anatomy of Marketing Failure" embodied several prerequisites that experts believe are the hallmarks of good alliances. First, Motorola formed an alliance to exploit a unique strength, namely, its leadership in wireless communications. Second, the Iridium alliance partners possessed unique strengths of their own. Third, it was unlikely that any of the partners has the ability or the desire to acquire Motorola's unique strength. Finally, rather than focusing on a particular market or product, Iridium was an alliance based on skills., know-how, and technology.? However, when all was said and done, Iridium failed. The lesson is that getting all of the alliance elements aligned is of no use if the product does not offer a unique value. Iridium was overtaken by cellular and by alternative and more realistic satellite projects.

As James Brian 0uinn, Professor Emeritus at the Tuck School. pointed out, Nike, the largest producer of athletic footwear in the world, does not manufacture a single shoe; Gallo, the largest wine company on earth, does not grow a single grape; and Boeing, the preeminent aircraft manufacturer, makes little more than cockpits and wings While outsourcing manufacturing for many companies might be a tactical response dedicated to some immediate cost savings, it is clear that Nike, Gallo, and Boeing put significant thought into establishing their supply chains, and that they could view their supplier arrangements as strategic. In fact, Nike's ability to outsource its manufacturing to multiple low-cost producers in the Far East has been a critical component of its success. Although these vertical arrangements may be

critically important to the success of the firm, they are not alliances unless the partners are linked in a long-term relationship. If they are not then they are simply supply agreements.

Iridium: Anatomy of a Marketing Failure

In the spectrum of companies operating in the global marketplace, there are winners and there are losers. Irid-ium, which thought it had the resources and strategy to be a leader in the telecommunications industry, ended up as one of the most expensive marketing failures in history. Although marketing alone is rarely the sole cause of failure, in the case of Iridium, the fundamental and critical reason for failure was the total lack of mar-keting analysis and realistic marketing planning.

The Iridium project cost an estimated $5 billion in 1998. Its business consisted of a global satellite network of 66 satellites and the manufacture of digital phones and chips. The company was a consortium with many diverse partners from around the world. Motorola, a major investor, provided product systems and financing, and owned 18 percent of Iridium.

Iridium was supposed to revolutionize the telecom-munications industry. Its unique feature was that it could provide service anywhere in' the world. The primary was international business travelers a market es-timated to be about eight million.

What actually happened? The Iridium phone was described by users as a "brick-like device." It weighed 500g versus 120g for most cell phones. and required sev-eral attachments. Instructions for using the phone were difficult to understand. The phone cost $3,000 and air time ranged from $3 to $7 per minute.

Iridium spent $140 million in media to launch the product. Their slogan was "Anytime, anywhere." Unfor-tunately, this slogan was referring only to their world-wide service-the phone could not be used inside buildings or moving cars. Their advertisements appeared in The Wall Street Journal, Fortune, other business publi-cations and airline magazines. A direct mail campaign in numerous international markets and employing 20 different languages was utilized. The advertising campaign generated over one million sales leads. Unfortunately, the company bungled this effort by not adequately fol-lowing up on these leads,

As if all these conditions weren't enough to con-demn the product to failure, the first samples of the product were late in delivery and experienced software problems. The product had not been properly tested, there was not guarantee for the security of the system,' and only 25,000 users could be serviced at one time.

Iridium is an example of technology in search of a market. From the beginning, the project was driven by a technological vision that ignored both the competition and the consumer. In the end, it failed because it failed to create a unique value in a competitive marketplace.

Nike and many other companies have faced a growing consumer concern about the working conditions in supplier companies. Essentially, even though the legal link between the supplier and buyer is limited to the purchase agreement, consumers have insisted that the buyer be held responsible for working conditions in the supplier company.

An example of a strategic relationship of partners along vertical lines is in lean manufacturing; for example, the assembler of an automobile relies on suppliers to not only build but to also design key components of the automobile. This kind of cooperation can lead to shorter design cycles, superior quality, and lower cost but it will not occur unless there is a mutual commitment to work together and a confidence on both sides that the two parties will not invade each other's domain. This kind of cooperation can strengthen the competitive advantage of each of the partners by enabling them to identify and concentrate on their core strengths.

Another example of a strategic relationship is a university that contracts with a hospitality company to provide management services for lodging and meal service at a training center. The hospitality company provides superior service as compared to what the university could do itself, and thereby enables the university to be a more effective competitor in its market. The relationship is strategic because it enables the company to create greater value for its customers.

Success Factors

Assuming that a proposed alliance meets the six prerequisites just outlined, it is necessary to consider the following six basic factors that are deemed to have significant impact on the success of GSPs:

1. Mission. Successful GSPs create win-win situations, in which participants pursue objectives on the basis of mutual need or advantage.
2. Strategy. A company may establish separate GSPs with different partners strategy must be thought out up front to avoid conflicts.
3. Governance. Discussion and consensus must be the norms. Partners must be viewed as equals.
4. Culture. Personal chemistry is important, as is the successful development of a shared set of values. The failure of a partnership between Britain's General Electric Company and Siemens A. G. was blamed in part on the fact that the former was run by finance-oriented executives and the latter by engineers.
5 Organization. Innovative structures and designs may be needed to offset the complexity of multi country management.
6. Management GSPs invariably involve a different type of decision-making. Potentially divisive issues must be identified in advance and clear, unitary lines of authority established that would result in commitment by all partners.

Companies forming GSPs must keep these factors in mind. Moreover, successful Collaborators will be guided by the following four principles:

1. Despite the fact that partners are pursuing mutual goals in some areas, partners must remember that they are competitors in others.
2. Harmony is not the most important measure of success; some conflict is to be expected.
3. All employees, engineers, and managers must understand where cooperation ends and competitive compromise begins.
4. As noted earlier, learning from partners is critically important

The issue of learning deserves special attention. One team of researchers notes the following:

The challenge is to share enough skills to create advantage vis-a-vis companies outside the alliance while preventing a wholesale transfer of core skills to the partner. This is a very thin line to walk. Companies must carefully select what skills and technologies they pass to their partners. They must develop safeguards against unintended, informal transfers of information. The goal is to limit the transparency of their operations.

Alliances Between Manufacturers and Marketers

Many companies have decided to source their product from suppliers. Although many companies source in lower-wage countries; even domestic companies are outsourcing tasks to achieve greater efficiency. They contract out the manufacturing or service activities in the value chain to companies that can supply product at a lower cost than is possible with manufacturing in-house.

These companies may find themselves at a disadvantage in GSPs with a supplier; especially if the latter's manufacturing skills are the attractive quality. Unfortunately for the marketer, a company's manufacturing excellence represents a multifaceted competence that is not easily transferred. The higher-income country managers and engineers must also learn to be more receptive and attentive-they must overcome The "not invented-here" syndrome and begin to think of themselves as students, not teachers. At the same time, they must learn to be less eager to show off proprietary lab and engineering successes. To limit transparency, some companies involved in GSPs establish a collaboration section. Much like a corporate communications department, this department is designed to serve as a gatekeeper through which requests for access to people and information must be channeled. Such gate keeping serves an important control function those guards against unintended transfers.

A report by McKinsey and Company shed additional light on the specific problems of alliances between Western and Japanese firms. Often, problems between partners had less to do with objective levels of performance than with a feeling of mutual disillusionment and missed opportunity. The study identified four common problem areas in alliances gone wrong. The first problem was that each partner had a different dream: the Japanese partner saw itself emerging from the alliance as a leader in its business or entering new sectors and building a new basis for the future, while the Western partner sought relatively quick and risk -free financial returns. Said one Japanese manager, "Our partner came in looking for a return. They got it. Now they complain that they didn't build a business. But that isn't what they set out to create.

A second area of concern is the balance between partners. Each must contribute to the alliance, and each must depend on the other to a degree that justifies participation in the alliance. The most attractive partner in the short run is likely to be a company that is already established and competent in the business with the need to master, say, some new technological skills. The best long-term partner, however, is likely to be a less competent player or even one from outside the industry.

Another common cause of problems is frictional loss, caused by differences in management philosophy expectations, and approaches. All functions within the alliance may be affected and performance is likely to suffer as a consequence. Speaking of his Japanese counterpart a Western businessperson said, "Our partner just wanted to go ahead and invest without considering whether there would be a return or not." The Japanese partner stated that "the foreign partner took so long to decide on obvious points that we were always too slow."14 Such differences often cause much frustration and time-consuming debates, which stifle decision making.

Finally, the study found that short-term goals can result in the foreign partner's limiting the number of people allocated to the joint venture. Those involved in the venture may perform only two- or three-year assignments. The result is corporate amnesia; that is, little or no corporate memory is built up on how to compete in Japan. The original goals of the venture will be lost as each new group of managers takes their turn. When taken collectively, these four problems will almost always ensure that the Japanese partner will be the only one in it for the long haul.

Case Examples of Partnerships

CFM Imitational/ GE/Snecma-A Success Story

Commercial Fan Moteur (CFM) International, a partnership between General Electric's (GE's) jet engine division and Snecma, a government-owned French aerospace company, is a frequently cited example of a successful GSP. GE was motivated in part by the desire to gain access to the European market so it could sell engines to Airbus Industries; also, the $800 million in development costs was more than GE could risk on its own. While GE focused on system design and high-tech work, the French side handled fans, boosters, and other components. The partnership resulted in the development of a highly successful new engine that, to date has generated tens of billions of dollars in sales to 125 different customers.

The alliance got off to a strong start because of the personal chemistry between two top executives, GE's Gerhard Neumann and the late General Rene Ravaud of Snecma. The partnership thrives despite each side's differing views regarding governance, management, and organization. Brian Rowe, senior vice president of GE's engine group, has noted that the French like to bring in senior executives from outside the industry, whereas GE prefers to bring in experienced people from within the organization. Also, the French prefer to approach problem solving with copious amounts of data, whereas Americans may take a more intuitive approach is Still, senior executives from both sides involved in the partnership have been delegated substantial responsibility.

AT&T/ Olivetti-A Failure

In theory, the partnership in the mid-1980s between AT&T and Italy's Olivetti appeared to be a winner: The collective mission was to capture a major share of the global market for information processing and communications.16 Olivetti had what appeared to be a strong presence in the European office equipment market; AT &T executives, having just presided over the divestiture of their company's regional telephone units, had set their sights on overseas growth, with Europe as the starting

point. AT&T promised its partner $260 million and access to microprocessor and telecommunications technology. The partnership called for AT&T to sell Olivetti's personal computers in the United States; Olivetti, in turn, would sell AT&T computers and switching equipment in Europe. Underpinning the alliance was the expectation that synergies would result from the pairing of companies from different industries-communications and computers.

Unfortunately, that vision was nothing more than a hope: There was no real strength in Olivetti in the computer market, and Olivetti had no experience or capability in communications equipment. Tensions ran high when sales did not reach expected levels.

AT&T group executive Robert Kavner cited communication and cultural differences as being important factors leading to the breakdown of the alliance. "I don't think we or Olivetti spent enough time understanding behavior patterns," Kavner said. "We knew the culture was different but we never really penetrated. We would get angry, and they would get upset."17 In 1989, AT&T cashed in its Olivetti stake for a share in the parent company Compagnie Industrial Riunite S.p.A. (CIR). In 1993, citing a decline in CIR's value, AT&T sold its remaining stake.

Boeing/Japan-A Controversy

GSPs have been the target of criticism in some circles. Critics warn that employees of a company that become reliant on outside suppliers for critical components will lose expertise and experience erosion of their engineering skills. Such criticism is often directed at GSPs involving U.S. and Japanese firms. For example, a proposed alliance between Boeing and a Japanese consortium to build a new fuel-efficient airliner, the 717, generated a,great deal of controversy, The project's $4 billion price tag was too high for Boeing to shoulder alone. The Japanese were to contribute between $1 billion and $2 billion; in return, they would get a chance to learn manufacturing and marketing techniques from Boeing. Although the 717 project was shelved in 1988, a new wide-body aircraft, the 777, was developed with about 20 percent of the work subcontracted out to Mitsubishi, Fuji, and Kawasaki. Critics envision a scenario in which the Japanese use what they learn to build their own aircraft and compete directly with Boeing in the future-a disturbing thought because Boeing is a major exporter to world markets. One team of researchers has developed a framework outlining the stages that a company can go through as it becomes increasingly dependent on partnerships,

Stage One: Outsourcing of assembly for inexpensive labor

Stage Two: Outsourcing of low-value components to reduce product price.

Stage Three: Growing levels of value-added components move abroad

Stage Four: Manufacturing skills, designs, and functionally related technologies move abroad

Stage Five: Disciplines related to quality, precision manufacturing, testing, and future avenues of product derivatives leave

Stage Six: Core skills surrounding components, miniaturization, and complex systems integration move abroad.

Stage Seven: Competitor learns the entire spectrum of skills related to the under lying core competence

The next stage is obvious: The partner now has the complete manufacturing skill set and capability and may decide to push for forward integration, that is, to move closer to the customer by introducing its own brand into the marketplace,

International Partnerships in Developing Countries

Central and Eastern Europe, Asia, Mexico, and Central and South America offer exciting opportunities for firms seeking to enter gigantic and largely untapped markets. An obvious strategic alternative for entering these markets is the strategic alliance. Like the early joint ventures between American and Japanese firms, potential partners will trade market access for know-how, but the question of whether alliances are the best way to go to gain market access must be carefully evaluated.

In China, multinational companies are required to take local partners and many are doing quite well. Presently, the top 200 joint ventures in China are growing at an average compound annual growth rate of 38 percent at an 8 percent after-tax margin. Although investment spending is understandable in developing countries, many multinational companies have taken a long-term strategy too far and are rethinking their joint venture efforts in China. Rick Yan states, "If you're not making money in China now, there's little chance you will without changing your strategy. He concludes that companies who tolerate poor short-term results in the mistaken belief that such results are a trade-off for future probability should reexamine their strategies. Yan found that success is more a matter of managerial capacity, critical mass scale, and product portfolio than length of stay. Coca-Cola has been successful while Pepsi-Cola is not. When regulations were eased, Coca-Cola sought equity stakes and management Control in its joint ventures. Pepsi failed to do this until much later. It is not enough to have a local partner-marketing and management are also critical.

A Central European market with interesting potential is Hungary. Hungary already has the most liberal financial and commercial system in the region. It has also provided investment incentives to Westerners, especially in high-tech industries. This former communist economy has its share of problems. Digital's recent joint venture agreement with the Hungarian Research Institute for Physics and the state-supervised computer systems design firm Szamalk is a case in point. Though the venture was formed so Digital will be able to sell and service its equipment in Hungary, the underlying importance of the venture was to stop the cloning of Digital's computers by Central European firms.

Corporative Strategies in Japan: Keiretsu

Japan's keiretsu represent a special category of cooperative strategy. A keiretsu is an inter business alliance or enterprise group that, in the words of one observer, "resembles a fighting clan in which business families join together to vie for market share. Keiretsu exist in a broad spectrum of markets, including the capital market primary goods markets, and component parts markets. Keiretsu relationships are often cemented by bank ownership of large blocks of stock as well as cross-ownership

of stock between a company and its buyers and non financial suppliers. Furthermore, keiretsu executives can legally sit on each other's boards, as well as share information and coordinate prices in closed-door meetings of "presidents' councils." Thus, keiretsu are essentially cartels that have the government's blessing.

Some observers have disputed charges that keiretsu have an impact on market relationships in Japan, claiming instead that the groups primarily serve a 60cial function. Others acknowledge the past significance of preferential trading patterns associated with keiretsu but assert that the latter's influence is now weakening. It is beyond the scope of this chapter to address these issues in detail, but there can be no doubt that, for companies competing with the Japanese or wishing to enter the Japanese market, a general understanding of keiretsu is crucial. Imagine, for example, what it would mean in the United States if an automaker (e.g., General Motors [GM]), an electrical products company.

(GE), a steel maker (USX), and a computer firm (IBM) were interconnected rather than separate firms. Global competition in the era of keiretsu means competition exists not only among products but also between different systems of corporate governance and in dustrialorganization.

As the hypothetical example from America suggests, some pf Japan's biggest and best-known companies are at the center of keiretsu. For example, Mitsui Group and Mitsubishi Group are organized around big trading companies. These two, together with the I Sumitomo, FuYo, Sanwa, and DKB groups, make up the "big six" keiretsu. Each group I strives for a strong position in each major sector of the Japanese economy. Annual revenues in each group are in the hundreds of billions of dollars. In absolute terms, keiretsu constituted less than' 0.01 percent of all Japanese companies. However, they accounted for an astonishing 78 percent of the market valuation of shares on the Tokyo Stock Exchange, a third of Japan's business capital, and approximately one quarter of its sales. These alliances can effectively block foreign suppliers from entering the market and result in higher prices to Japanese consumers, while at the same time resulting in corporate stability, risk sharing, and long-term employment.

In addition to the big six, several other keiretsu have formed, bringing new configurations to the basic forms described previously. Vertical supply and distribution keiretsu are alliances between manufacturers and retailers. For example, Matsushita controls a chain of 25,000 National stores in Japan, through which it sells its Panasonic, Techniques, and Quasar brands. About half of Matsushita's domestic sales are genera led through the National chain, 50 to 80 percent of whose inventory consists of Matsushita's brands. Japan's other major consumer electronics manufacturers, including Toshiba and Hitachi, have similar alliances (Sony's chain of stores is much smaller and weaker by comparison). All are fierce competitors in the Japanese market.

Another type of manufacturing keiretsu outside the big six consists of vertical hierarchical alliances between assembly companies and suppliers and component manufacturers. Inter group operations and systems are closely integrated, with suppliers receiving long-term contracts. Toyota, for example, has a network of about 175 primary and 4,000 secondary suppliers. One supplier is Koit's Toyota owns about one fifth of Koito's shares and buys about half of its production. The net result of this arrangement is that Toyota produces about 25 percent of the sales value of its cars, compared with 50 percent for GM. Manufacturing keiretsu show the gains that can result from an optimal balance of supplier and buyer power. Because Toyota buys a given component from several suppliers (some are in the keiretsu, some are independent), discipline is imposed down the network. Also, since Toyota's suppliers do not work exclusively for Toyota, they have an incentive to be flexible and adaptable.

The practices described here lead to the question of whether or not keiretsu violate antitrust laws. As many observers have noted, the Japanese government frequently puts the interests of producers ahead of the interests of consumers. In fact, the keiretsu were formed in. the early 1950s as regroupings of four large conglomerates-zaibots/I-that dominated the Japanese economy until 1945. They were dissolved after the occupational forces introduced antitrust as part of the reconstruction. Today, Japan's Fair Trade Commission appears to favor harmony rather than pursuing anticompetitive behavior. As result, the U.S. Federal Trade Commission has launched several investigations of price fixing, price discrimination, and exclusive supply arrangements. Hitachi, Canon, and other Japanese companies have also been accused of restricting the availability of high-tech products in the U.S. market. The Justice Department has considered prosecuting the U.S. subsidiaries of Japanese companies if the parent company is found guilty of unfair trade practices in the Japanese market.

Beyond Strategic Alliances

The relationship enterprise is said to be the next stage of evolution of the strategic alliance. Groupings of firms in different industries and countries will be held together by common goals that encourage them to act almost as a single firm.

More than the simple strategic alliances we know today, relationship enterprises will be super alliances among global giants, with revenues approaching $1 trillion. They would be able to draw on extensive cash resources, circumvent antitrust barriers, and, with home bases in all major markets, enjoy the political advantage of being a "local" firm almost anywhere. This type of alliance is not driven simply by technological change but by the political necessity of having multiple home bases,

Another perspective on the future of cooperative strategies envisions the emergence of the virtual corporation. (The term virtual is borrowed from computer science; some computers feature virtual memory that allows them to function as though they have more storage capacity than is actually built into their memory chips.) As described in a Business Week cover story, the virtual corporation "will Seem to be a single entity with vast capabilities but will really be the result of numerous collaborations assembled only when they're needed."

On a global level, the virtual corporation could combine the twin competencies of cost-effectiveness and responsiveness;

thus, it could pursue the "think global, act local" philosophy with ease. This reflects the trend toward mass customization. The same forces that are driving the formation of the digital keiretsu-high-speed communication networks, for example-are embodied in the virtual corporation As noted by Davidow and Malone, "The success of a virtual corporation will depend on its ability to gather and integrate a massive flow of information throughout its organizational components and intelligently act upon that information."

Why has the virtual corporation suddenly burst onto the scene? Previously, firms lacked the technology to facilitate this type of data management. Today, distributed databases, networks, and open systems make possible the kinds of data flows required for the virtual corporation. In particular, these data flows permit supply-chain management. Ford provides an interesting example of how technology is improving information flows among the far-flung operations of a single company. Ford's $6 billion world car-known as the Mercury Mystique and Ford Contour in the United States and the Mondeo in Europe-was developed using an international communications network linking computer workstations of designers and engineers on three continents.

One of the hallmarks of the virtual corporation will be the production of virtual products-products that practically exist before they-are manufactured. As described by Davidow and Malone, the concept, design, and manufacture of virtual products are stored in the minds of cooperating teams, in computers, and in flexible production lines.

IKEA Cost Focused

IKEA, the Swedish furniture company described in the chapter introduction, is an example of the cost focus strategy. Notes George Bradley, president of Levitz Furniture in Boca Raton, Florida, "[IKEAJ has really made a splash They're going to capture their niche in every city they go into." Of course, such a strategy can be risky. As Bradley explains, "Their market is finite because it is so narrow. If you don't want contemporary, knockdown furniture, it's not for you. So it takes a certain Customer to buy it. And remember, fashions change. The issue of sustainability is

'central to this strategy concept. As noted, cost leadership is a sustainable source of competitive advantage only if barriers exist that prevent competitors from achieving the same low costs. Sustained differentiation depends on continued perceived value and the absence of imitation by competitors. Several factors determine whether focus can be sustained as a source of competitive advantage. First, a cost focus is sustainable if a firm's competitors are defining their target markets more broadly. A foeuser does not try to be all things to all people: Competitors may diminish their advantage by trying to satisfy the needs of a broader market segment-a strategy that, by definition, means a blunter focus. Second. a firm's differentiation focus advantage is sustainable only if competitors cannot define the segment even more narrowly. Also, focus can be sustained if competitors cannot overcome barriers that prevent imitation of the focus strategy, and if consumers in the target segment do not migrate to other segments that the focuser does not serve.

IKEA's approach to the furniture business has enabled it to rack up impressive growth in an industry in which overall sales have been flat. Sourcing furniture from more than 2,330 suppliers in 64 countries helps the company maintain its low-cost position.

IKEA's international growth has been quite successful but probably would not have been possible if the company had gone public according to its founder, Ingvar Kamprad. He does not feel a need to show constant profits and, therefore, can take more investment risks. During the 1990s, IKEA opened several stores in Central and Eastern Europe (Poland is one of its fastest. growing markets) and has since expanded into Russia ...here it plans to open a total of 10 outlets. Because many consumers in those regions have relatively low purchasing power, the stores offer a smaller selection of goods; some furniture was designed specifically for the cramped living styles typical in former Soviet bloc countries. Kamprad firmly believes in long-term investment and states: "It will take twenty-five years to furnish Russia." He believes that investment in Russia would not have been possible if the company had been a public company, which often suffers from a need to show short-term profits, Throughout Europe, IKEA benefits from the perception that Sweden is the source of high quality products. The United Kingdom represents the fastest-growing market in Europe; IKEA's London store has achieved annual sales growth of 20 percent. Germany currently accounts for more than one quarter of IKEA's total revenues. IKEA has also opened two stores in China but is having difficulty securing local suppliers and positioning for one store that is located in a shopping mall.

Industry observers predict the United States with eventually be IKEA's largest market (presently it accounts for 15 percent of IKEA's volume). The company opened its first U.S. store in Philadelphia in 1985; today, IKEA has 14 outlets in major metropolitan areas. Notes Jeff Young, chief operating officer of Lexington Furniture Industries, "IKEA is on the way to becoming the Wal-Mart stores of the home-furnishing industry. If you're in this business, you'd better take a look." Some American customers, however, are irked to find popular items are sometimes out of stock. Another problem is the long lines resulting from the company's no-frills approach. Complained one shopper, "Great idea, poor execution. The quality of much of what they sell is good, but the hassles make you question whether it's worth it."

Goran Carstedt, president of IKEA North America, responds to such criticism by referring to the company's mission. "If we offered more services. our prices would go up," he explains. "Our customers understand our p~ilosophy, which calls for each of us to do a little in order to save a lot. They value our low prices. And almOst all of them say they will come back &gain." To keep them coming back, IKEA is spending between $25 million and $35 million on advertising to get its mesSage across. Although it is a common industry practice to rely heavily on newspaper and radio advertising, two thirds of IKEA's North American advertising budget is allocated forty. John Sttnik, an executive at IKEA's U.S. Inc., says, "We distanced ourselves from the other furniture stores. We decided TV is something we can own."

LESSON 17:
COMPETITIVE ANALYSIS AND STRATEGY

"The best strategy is always to be very strong, first generally then at the decisive point. . . there is no more imperative and no simpler law for strategy than to keep the forces concentrated."

-CARL VON CLAUSE\VITZ, 1780—1831
Yom Kriege, Book III, Chapter XI,
"Assembly of Forces in Space," (1832-1837)

The following lesson aims to make the student understand the following topics:

1. Industry Analysis Forces Influencing Competition
2. Global Competition and National Competitive Advantage
3. Competitive Advantage and Strategic Models
4. Strategic Positions
5. Competitive Innovation and Strategic Intent

From its home base in Sweden, IKEA has become the world's largest furniture retailer doing $8.5 billion in annual sales in 1998-1999. With 150 stores in 29 countries, the company's success reflects founder Ingvar Kamprad's vision of selling a wide range of stylish, functional home furnishings at prices so low that the majority of people can afford to buy them. The store exteriors are painted bright blue and yellow-Sweden's national colors. Shoppers view furniture on the main floor in scores of realistic settings arranged throughout cavernous showrooms. In a departure from standard industry practice, IKEA's furniture bears names such as "Ivar" and "Sten" instead of model numbers. At IKEA, shopping is very much a self-service activity; after browsing and writing down the names of desired items, shoppers pick up their furniture on the lower level. There they find boxes containing the furniture in kit form; one of the cornerstones of IKEA's strategy is having customers take their purchases home in their own vehicles and assemble the furniture themselves. The lower level of a typical IKEA store also contains a restaurant, a grocery store called the Swede Shop, a supervised play area for children, and a baby care room.

The bottom line for IKEA is that the company creates a unique value for customers: Instead of salespersons, a limited number of display items, and a catalog from which to order, IKEA offers informative displays and product information for everything it sells. In a traditional furniture store, you place an order and wait weeks or months for delivery. At IKEA, you make a purchase and take it with you. Traditional furniture is assembled and ready to use. IKEA furniture is sold in kit form ready to assemble. The traditional store offers salespersons or consultants, assembled and ready to use product, delivery, and higher prices. IKEA offers rock-bottom prices.

IKEA is focused on the young customer or the young at heart: The core market is the customer with a limited budget who appreciates IKEA's product line, displays, and prices. Because IKEA knows the needs and wants of this market segment, it has been successful in serving customers not only in Sweden where the company was founded but also globally. IKEA's success in crossing borders has been instrumental in changing furniture retailing from a multidomestic industry to a global one.

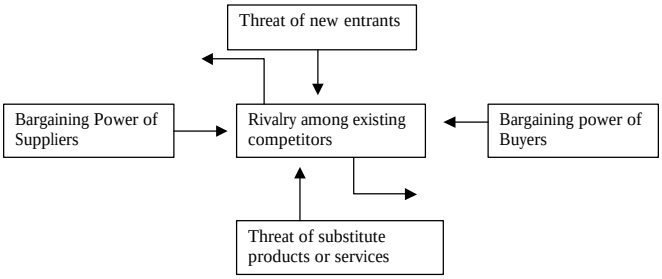
The essence of global marketing strategy is in successfully relating the strengths of an organization to its environment. As the horizons of marketers have expanded from domestic to global markets, so too have the horizons of competitors. The reality in almost every industry today-including home furnishings-is global competition This fact of life puts an organization under increasing pressure to master techniques for conducting industry analysis, competitor analysis, understanding competitive advantage at both the industry and national levels, and developing and maintaining competitive advantage.

Industry Analysis Forces Influencing Competition

A useful way of gaining insight into the nature of competition is through industry analysis. As a working definition, an industry can be defined as a group of firms that produce products that are close substitutes for each other. In any industry, competition works to drive down the rate of return on invested capital toward the rate that would be earned in the economist's perfectly' competitive industry. Rates of return that are greater than this so-called competitive rate will stimulate an inflow of capital either from new entrants or from existing competitors making additional investment. Rates of return below this competitive rate will result in withdrawal from the industry and a decline in the levels of activity and competition.

According to Michael E. Porter of Harvard University, a leading theorist of competitive strategy, there are five forces influencing competition in an industry (see Figure 10-1):

FIGURES 10 –1 Forces influencing Competition in an industry



The threat of new entrants; the threat of substitute products or services; the bargaining power of suppliers; the bargaining power of buyers; and the competitive rivalry between current members of the industry. In industries such as soft drinks, pharmaceuticals, and cosmetics, a favorable combination of the five forces has resulted in attractive returns for competitors. However, pressure from any of the forces can reduce or limit profitability, as evidenced by the recent fortunes of some

competitors in the personal computer (PC) and semiconductor industries. A discussion of each of the five forces follows.

Threat of New Entrants

New entrants to an industry bring new capacity, a desire to gain market share and position, and, very often, new approaches to serving customer needs. The decision to become a new entrant in an industry is often accompanied by a major commitment of resources. New players push prices downward and squeeze margins, resulting in reduced industry profitability. Porter describes eight major sources of barriers to entry, the presence or absence of which determines the extent of the threat of new industry entrants.

The first barrier, economies of scale, refers to the decline in per unit product costs as the absolute volume of production per period increases. Although the concept of scale economies is frequently associated with manufacturing, it is also applicable to research and development (R&D), general administration, marketing, and other business functions. Honda's efficiency at engine R&D, for example, results from the wide range of products it produces that feature gasoline-powered engines. When existing firms in an industry achieve significant economies of scale, it becomes difficult for potential new entrants to be competitive.

Product differentiation, the second major entry barrier, is the extent of a product's perceived uniqueness-in other words, whether or not it is a commodity. High levels of product differentiation and brand loyalty, whether the result of physical product attributes or effective marketing communication, "raise the bar" for would-be industry entrants For example, managers at Monsanto's G. D. Searle subsidiary achieved differentiation an.d erected a barrier in the artificial sweetener industry by insisting that the Nutrasweet logo and brand mark-a red-and-white swirl-appear on diet soft-drink cans and bottles.

A third entry barrier relates to capital requirements. Capital is required not only for manufacturing facilities (fixed capital) but also for financing R&D, advertising, field sales and service, customer credit, and inventories (working capital). The enormous capital requirements in such industries as pharmaceuticals, mainframe computers, chemicals, and mineral extraction present formidable entry barriers.

A fourth barrier to entry are one-time switching costs caused by the need to change suppliers and products. These might include retraining, ancillary equipment costs, the cost of evaluating a new source, and so on. The perceived cost to customers of switching to a new competitor's product may present an insurmountable obstacle preventing industry newcomers from achieving success. For example, Microsoft's huge installed base of PC operating systems and applications presents a formidable entry barrier.

A fifth barrier to entry is access to distribution channels. To the extent that channels are full, expensive to enter, or unavailable, the cost of entry is substantially increased because a new entrant must create and establish new channels. Most foreign companies have encountered this barrier in Japan. This is not a so-called non tariff barrier, or a barrier designed to discriminate against foreign firms-it applies to any firm, domestic or foreign, seeking market entry.

Government policy is frequently a major entry barrier. In some cases the government will restrict competitive entry. This is true in a number of industries, especially those in the low, lower-middle, and upper-middle income countries that have been designated as national industries by their respective governments. Japan's postwar industrialization strategy was based on a policy of preserving and protecting national industries in their, development and growth phases. In many cases, the Japanese companies in these protected industries have gone on to become major world competitors in their industries. Komatsu, for example, was a weal local company when Caterpillar announced its interest in entering the Japanese market. Komatsu was given two years of protection by the Japanese government, and today it is the number-two earth-moving equipment company in the world. China is following a policy today of requiring foreign investors in many industries to join with local partners in their Chinese investments. In telecommunications, for example, it is not possible to invest in China without a partner.

Established firms may also enjoy cost advantages independent of the scale economies that present barriers to entry. Access to raw materials, favorable locations, and government subsidies are several examples.

Finally, expected competitor response can be a major entry barrier. If new entrants expect existing competitors to respond strongly to entry, their expectations about the rewards of entry will certainly be affected, A potential competitor's belief that entry into an industry or market will be an unpleasant experience may serve as a strong deterrent. Bruce Henderson, former president of the Boston Consulting Group, used the term brinkmanship to describe a recommended approach for deterring competitive entry. Brinkmanship occurs when industry leaders convince potential competitors that any market entry effort will be countered with vigorous and unpleasant responses.

G. D. Searle used brinkmanship especially price cuts-to deter competitors from entering the low-calorie artificial sweetener market as Nutrasweet's patents expired. At the end of 1989, Systse T. Kuipers, a marketing manager at Holland Sweetener Company, complained that "it is a bloody fight and everybody's losing money. (Nutrasweet managers] go for the last kilo even if they have to give the product away." In Kuipers's view, G. D. Searle's tactic of deep price cuts on Nutrasweet had "the sole intent of chasing competitors out of the marketplace." In fact, several European producers have already abandoned the business, proof that G. D. Searle's policy of brinkmanship was an effective competitive response to the threat of new entrants.

Threat of Substitute Products

A second force influencing competition in an industry is the threat of substitute products. The availability of substitute products places limits on the prices market leaders can charge in an industry; high prices may induce buyers to switch to the substitute.

For example, Barnes & Noble watched the upstart Amazon create a new product the on-line bookstore. Customers could now order from millions of books and have them delivered to their doors in a matter of days. For a segment of the book

market, local bookstores with only a few thousand books and a Starbucks Coffee facility were not necessary. Since it started in 1995, Amazon.com has grown to over $1.6 billion, expanded its product line into CDs and videos, diversified into pet and drug supplies to name but two areas, and served 17 million customers in 160 countries. Amazon.com is growing at the rate of 169 percent while Barnes & Noble is only growing at 16 percent. Apparently, the virtual bookstore is an extremely successful replacement for a traditional format.

Bargaining Power of Suppliers

If suppliers have enough leverage over industry firms, they can raise prices high enough to significantly influence the profitability of the industry. Several factors influence supplier bargaining power:

1. Suppliers will have the advantage if they are large and relatively few in number.
2. When the suppliers' products or services are important inputs to user firms, are highly differentiated, or carry switching costs, the suppliers will have considerable leverage over buyers.
3. Suppliers will also enjoy bargaining power if their business is not threatened by alternative products.
4. The willingness and ability of suppliers to develop their own products and brand names if they are unable to get satisfactory terms from industry buyers will influence their power.

A good example of the bargaining power of suppliers is OPEC, which controls the price of oil. In the 1970s and again in 2000, gasoline prices were significantly raised. At one point in time gasoline prices at the pumps had increased about 33 percent in six months. Since there is no alternative, customers are forced to pay the higher prices.

Bargaining Power of Buyers

The ultimate aim of industrial customers is to pay the lowest possible price to obtain the products or services that they use as inputs. Usually, therefore, the buyers' best interests are served if they can drive down profitability in the supplier industry. The following are conditions under which buyers can exert power over suppliers:

1. When they purchase in such large quantities that supplier firms depend on the buyers' business for survival.
2. When the supplier's products are viewed as commodities-that is, as standard or undifferentiated-buyers are likely to bargain hard for low prices because many supplier firms can meet their needs.
3. When the supplier industry's products or services represent a significant portion of the buying firms' costs.
4. When the buyer is willing to achieve backward vertical integration.

Rivalry Among Competitors

Rivalry among firms refers to all the actions taken by firms in the industry to improve their positions and gain advantage over each other. Rivalry manifests itself in price competition, advertising battles, product positioning, and attempts at differentiation. To the extent that rivalry among firms forces companies to innovate and/or rationalize costs, it can be a positive force. To the extent that it drives down prices and, therefore, profitability, it creates instability and negatively influences the attractiveness of the industry. Several factors can create intense rivalry:

1. Once an industry becomes mature, firms focus on market share and how it can be gained at the expense of others.
2. Industries characterized by high fixed costs are always under pressure to keep production at full capacity to cover the fixed costs. Once the industry accumulates excess capacity, the drive to fill capacity will push prices-and profitability-down.
3. A lack of differentiation or an absence of switching costs encourages buyers to treat the products or services as commodities and shop for the best prices. Again, there is downward pressure on prices and profitability.
4. Firms with high strategic stakes in achieving success in an industry generally are destabilizing because they may be willing to accept unreasonably low profit margins to establish themselves, hold position, or expand.

Global Competition and National Competitive Advantage

An inevitable consequence of the expansion of global marketing activity is the growth of competition on a global basis. In industry after industry, global competition is a critical factor affecting success. In some industries, global companies have virtually excluded all other companies from their markets. An example is the detergent industry, in which three companies-Colgate, Unilever, and Procter & Gamble (P&G)-dominate an increasing number of detergent markets worldwide, including Latin America and the Pacific Rim. Because many companies can make a quality detergent, global brand-name muscle and marketing skills have become the sources of global competitive advantage that overwhelm local competition in market after market.

Based on recent changes in the way business is done around the world, Michael Porter urges global companies not to lose sight of "Local things-knowledge, relationships and motivation that distant rivals cannot match. (See discussion under "Related and Supporting Industries" later in this chapter.)

The automobile industry has also become' fiercely competitive on a global basis. Part of the reason for the initial success of foreign automakers in the United States was the reluctance or inability of US. Manufacturers to design and manufacture high-quality, inexpensive small cars The resistance of B.S. manufacturers was based on the economics of car production: the bigger the car, the higher the list price. Under this formula, small cars meant smaller unit profits. Therefore US. manufacturers resisted the growing preference of US. customers for smaller cars-a classic case of ethnocentrism and marketing myopia. Meanwhile, European and Japanese manufacturers' product lines have always included cars smaller than those made in the United States. In Europe and Japan, market conditions were much different than in America: less space, high taxes on engine displacement and on fuel, and greater market interest in functional design and engineering innovations. First Volkswagen and then Japanese automakers such as Nissan and

Toyota discovered a growing demand for their cars in the US. Market. It is noteworthy that many significant innovations and technical advances-including radial tires, anti lock brakes, and fuel injection-also came from Europe and Japan. Airbags are a no table exception.

Another major innovation in the auto industry, which has since spread to all industries, is the revolutionary innovation of lean manufacturing first introduced at Toyota. This radically different way of designing and building an automobile dramatically reduced costs and increased quality. Lean manufacturing was invented in Japan and gave the Japanese automobile companies a knockout advantage in world markets: lower costs and higher quality. Indeed, lean manufacturing has replaced mass production in the same way that mass production replaced craft production, and for the same reasons: It raised the bar on quality and dramatically reduced costs. Today, companies that have not mastered the art and science of lean manufacturing are no longer in the auto business.

The effect of global competition has been highly beneficial to consumers around the world. In the two examples cited-detergents and automobiles consumers have benefited. In Central America, detergent prices have fallen and quality has risen as a result of global competition. In the United States, for example, foreign companies have provided consumers with the automobile products, performance, and price characteristics they wanted. If smaller, lower-priced imported cars had not been available, it is unlikely that Detroit manufacturers would have provided a comparable product as quickly. What is true for automobiles in the United States is true for every product class around the world. Global competition expands the range of products and increases the likelihood that consumers will get what they want.

The downside of global competition is its impact on the producers of goods and services. When a company offers consumers in other countries a better product at a lower price, this company takes customers away from domestic suppliers. Unless the domestic supplier can create new values and find new customers, the jobs and livelihoods of the domestic supplier's employees are threatened. The social effects of these influences often prompt political responses that destabilize the business environment. Both business and government policy makers are trying to better understand the factors that make a specific nation a better (or worse) place for a company in a specific industry. Businesses want to understand how to choose locations for their activities that give them a competitive advantage. Governments want to know whether they should intervene in the business environment and, if so, how.

The following section addresses a number of questions. Why is a particular nation a good home- base for specific industries? Why, for example, is the United States the home base for the leading competitors in PCs, software, credit cards, and movies? Why is Germany the home of so many world leaders in printing presses, chemicals, and luxury cars? Why are so' many leading pharmaceutical, chocolate/confectionery, and trading companies located in Switzerland? Why are the world leaders in consumer electronics home based in Japan?

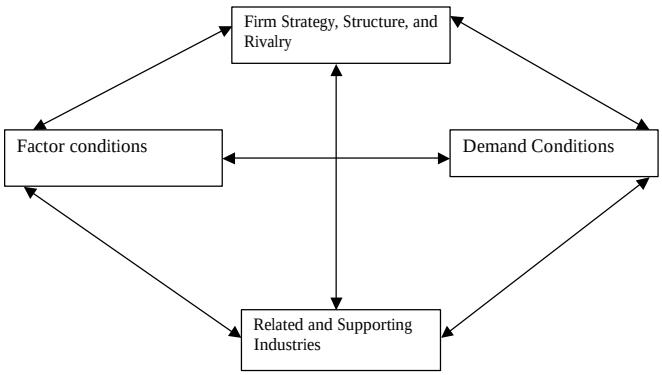
According to Michael E. Porter, the presence or absence of particular attributes in individual countries influences industry development. Porter describes these attributes factor conditions, demand conditions, related and supporting industry, and firm structure and rivalry-in terms of a national diamond. The diamond shapes the environment in which firms compete in their global industries.

Factor Conditions

The phrase factor conditions refers to a country's endowment of resources. Factor resources may have been created or inherited and are divided into five categories: human, physical, knowledge, capital, and infrastructure.

Human Resources

The quantity of workers available, the skills possessed by these workers, wage levels, and the overall work ethic of the workforce together constitute a nation's human resource factors. Countries with a plentiful supply of low-wage labor have an obvious advantage in the current production of labor-intensive products; however. in most manufacturing industries of the developed world, the cost of manual labor is rapidly becoming a smaller and smaller factor. Presently, labor averages about one eighth or less of total costs. Any cost advantage will disappear if wages increase and production moves to



Determinants of national advantage

Another country. However, low wage countries may be at disadvantage when it comes to the production of sophisticated products requiring highly skilled workers capable of working without extensive supervision.

Physical Resources

The availability, quantity, quality, and cost of land, water, minerals, and other natural resources determine a country's physical resources. A country's size and location are also included in this category because proximity to markets and sources of supply, as well as transportation costs, are strategic considerations. These factors are obviously important advantages or disadvantages to industries dependent on natural resources.

Knowledge Resources

The availability within a nation of a significant population with scientific, technical, and market-related knowledge means a nation is endowed with knowledge resources. The presence of these factors is usually a function of the educational orientation

of the society as well as the number of research facilities and universities-both government and private—operating in the country. These factors are important to success in sophisticated products and services and to doing business in sophisticated markets. 1his factor' relates directly to Germany's leadership in chemicals; for some 150 years, Germany has been home to top university chemistry programs, advanced scientific journals, and apprenticeship programs.

Capital Resources

Countries vary in the availability, amount, cost, and types of capital available to the country's industries. The nation's savings rate, interest rates, tax laws, and government deficits all affect the availability of capital. The advantage to industries with low capital costs versus those located in nations with relatively high costs is sometimes decisive. Firms paying high capital costs are frequently unable to stay in a market in which the competition comes from a nation with low capital costs. The firms with the low cost of capital can keep their prices low and force the firms paying high costs to either accept low returns on investment or leave the industry. The globalization of world capital markets is changing the manner in which capital is deployed. Investors can now send their capital to nations or markets with the best risk/return profile. Global firms will increasingly be following capital to the best places rather than operating in nations where capital is scarce or expensive.

Infrastructure Resources

Infrastructure includes a nation's banking system, health care system, transportation system, and communications system, as well as the availability and cost of using these systems. More sophisticated industries are more dependent on advanced infrastructures for success.

Basic Versus Advanced Factors

Factors can be further classified as either basic factors, such as natural resources and labor, or advanced factors, such as highly educated personnel and modem data communications infrastructure. Basic factors do not lead to sustainable international competitive advantage. For example, cheap labor is a transient national advantage that erodes as a nation's economy improves and average national income increases relative to other countries. Advanced factors, which lead to sustainable competitive advantage, are scarcer and require sustained investment. For example, the existence of a labor force of trained artisans offers Italy a basis of sustained competitive advantage in the Italian tile industry.

Generalized Versus Specialized Factors

Another categorization of factors differentiates between generalized factors, such as a suitable highway system, and specialized factors, such as focused educational systems. Generalized factors are precedents required for competitive advantage; however, sustainable advantage requires the development of specialized factors. For example, the competitive advantage of the Japanese robotics industry is fueled by extensive university robotics courses and programs that' graduate robotics skilled trainees of the highest caliber.

Competitive advantage may also be created indirectly by nations that have selective factor disadvantages. For example, the absence of suitable labor may force firms to Develop forms of mechanization that give the nation's firms an advantage. Scarcity of raw materials may motivate firms to develop new materials. For. example, Japan, faced with scarce raw materials, developed an industrial ceramics industry that leads the world in innovation.

Demand Conditions

The nature of home-market demand conditions for the firm's or industry's products and services is important because it determines the rate and nature of improvement and innovation by the firms in the nation. These are the factors that either train firms for world-class competition or fail to adequately prepare them to compete in the global marketplace. Three characteristics of home demand are particularly important to the creation of competitive advantage: (1) the composition of home demand, (2) the size and pattern of growth of home demand, and (3) the means by which a nation's home demand pulls the nation's products and services into foreign markets.

The composition of home demand determines how firms perceive, interpret, and respond to buyer needs. Competitive advantage can be achieved when the home demand sets the quality standard and gives local firms a better picture of buyer needs, at an earlier time, than is available to foreign rivals. This advantage is enhanced when home buyers pressure the nation's firms to innovate quickly and frequently. The basis for advantage is the fact that the nation's firms can stay ahead of the market when firms are more sensitive to and more responsive to home demand and when that demand, in turn, reflects or anticipates world demand.

The size and pattern of growth of home demand are important only if the composition of the home demand is sophisticated and anticipates foreign demand. Large home markets offer opportunities to achieve economies of scale and learning while dealing with familiar, comfortable markets. There is less apprehension about investing in large scale production facilities and expensive R&D programs when the home market is sufficient to absorb the increased capacity. If the home demand accurately reflects or anticipates foreign demand, and if the firms do not become content with serving the home market, the existence of huge-scale facilities and programs will be an advantage in global competition.

Rapid home-market growth is another incentive to invest in and adopt new technologies faster, and to build large, efficient facilities. The best example of this is Japan, where rapid home-market growth provided the incentive for Japanese firms to invest heavily in modern, automated facilities. Early home demand, especially if it anticipates international demand, gives local firms the advantage of getting established in an industry sooner than foreign rivals. Equally important is early market saturation, which puts pressure on a company to expand into international markets and innovate. Market saturation is especially important if it coincides with rapid growth in foreign markets.

The means by which a nation's products and services are pushed or pulled into foreign countries is the third aspect of demand conditions. The issue here is whether a nation's people and businesses go abroad and then demand the nation's

products and services in those second countries. For example, when the U.S. auto companies set up operations in foreign countries, the U.S. auto parts industry followed. The same is true for the Japanese auto industry. When the Japanese auto companies set up operations in the United States, Japanese parts suppliers followed their customers. Similarly, when overseas demand for the services of U.S. engineering firms skyrocketed after World War II, those firms in turn established demand for U.S. heavy construction equipment. This provided an impetus for Caterpillar to establish foreign operations.

A related issue is whether foreigners come to a nation for training, pleasure, business, or research. After returning home, they are likely to demand the products and services with which they became familiar while abroad. Similar effects can result from professional, scientific, and political relationships between nations. Those involved in the relationships begin to demand the products and services of the recognized leaders.

It is the interplay of demand conditions that contributes to competitive advantage. Of special importance are those conditions that lead to initial and continuing incentives to invest and innovate and to continuing competition in increasingly sophisticated markets.

Related and Supporting Industries

A nation has an advantage when it is home to internationally competitive industries in fields that are related to, or in direct support of, other industries. Internationally competitive supplier industries provide inputs to downstream industries that are likely to be internationally competitive in terms of technological innovation, price, and quality. Access is a function of proximity both in terms of physical distance and cultural similarity. It is not the inputs themselves that give advantage. It is the contact and coordination with the suppliers that allow the firm the opportunity to structure the value chain so that linkages with suppliers are optimized. These opportunities may not be available to foreign firms.

Similar advantages accrue when there are internationally competitive and related industries in a nation that coordinate and share value chain activities. These centers of competitive advantage are known as clusters. Clusters are geographic concentrations of interconnected companies and institutions in a particular field, which constitute a critical mass. Opportunities for sharing between computer hardware manufacturers and software developers provide a clear example of clusters. Related industries also create pull-through opportunities as described earlier. Sales of U.S. computers abroad have created demand for software from Microsoft and other U.S. companies. Porter notes that the development of the Swiss pharmaceuticals industry can be attributed in part to Switzerland's large synthetic dye industry; the discovery of the therapeutic effects of dyes in turn led to the development of pharmaceutical companies.

Other clusters are the leather fashion in Italy, chemicals, home appliances and household furniture in Germany, wood products in Portugal, and flower growing in the Netherlands. Multinational companies such as Nestle are incorporating this concept when establishing locations for their various businesses. They have relocated their headquarters for bottle water to France and moved the Rowntree Mackintosh confectionery division to York, England.

Firm Strategy, Structure, and Rivalry

Differences in management styles, organizational skills, and strategic perspectives create advantages and disadvantages for firms competing in different types of industries, as do differences in the intensity of domestic rivalry. In Germany, for example, company structure and management style tend to be hierarchical. Managers tend to come from technical backgrounds and to be most successful when dealing with industries that demand highly disciplined structures, such as chemicals and precision machinery. Italian firms, however, tend to look like, and be run like, small family businesses that stress customized rather than standardized products, niche markets, and substantial flexibility in meeting market demands.

Capital markets and attitudes toward investments are important components of national environments. For example, the majority of shares of U.S. publicly held companies are owned by institutional investors such as mutual funds and pension plans. These investors will buy and sell shares to reduce risk and increase return rather than get involved in an individual company's operations. These very mobile investors drive managers to operate with a short-term focus on quarterly and annual results. This fluid capital market structure will provide funds for new growth industries and rapidly expanding markets in which there are expectations of early returns. On the other hand, U.S. capital markets do not encourage more mature industries in which return on investment is lower and patient searching for innovations is required. Many other countries have an opposite orientation. For example, in Japan, banks are allowed to take equity stakes in the companies to which they loan money and provide other profitable banking services. These banks take a longer-term view than stock markets and are less concerned about short-term results.

Perhaps the most powerful influence on competitive advantage comes from domestic rivalry. Domestic rivalry keeps an industry dynamic and creates continual pressure to improve and innovate. Local rivalry forces firms to develop new products, improve existing ones, lower costs and prices, develop new technologies, and improve quality and service. Rivalry with foreign firms lacks this intensity. Domestic rivals have to fight each other not just for market share but also for employee talent, R&D breakthroughs, and prestige in the home market. Eventually, strong domestic rivalry will push firms to seek i international markets to support expansions in scale and R&D investments, as Japan, amply demonstrates. The absence of significant domestic rivalry will create complacency in the home firms and eventually cause them to become noncompetitive in the world markets.

It is not the number of domestic rivals that is important; rather, it is the intensity of the competition and the quality of the competitors that make the difference. It is also important that there be a fairly high rate of new business formations to create new competitors and safeguard against the older companies becoming comfortable with their market positions and products and services. As noted earlier in the discussion of the forces shaping industry competition, new entrants bring new

perspectives and new methods. They frequently define and serve new market segments that established companies have failed to recognize.

There are two final external variables to consider in the evaluation of national competitive advantage: chance and government.

Other Forces Acting on the Diamond

Two additional elements of Porter's model to consider in the evaluation of national' competitive advantage are chance and government. In addition, there are non market forces that are part of the environment and that should be considered as an expansion, of or supplement to government and chance.

Chance

Chance events playa role in shaping the competitive environment. Chance events are occurrences that are beyond the control of firms, industries, and usually governments. Included in this category are such things as wars and their aftermath, major technological breakthroughs, sudden dramatic shifts in factor or input cost (e.g., the oil crises), dramatic swings in exchange rates, and so on.

Chance events are important because they create major discontinuities in technologies that allow nations and firms that were not competitive to leapfrog over old competitors and become competitive—even leaders-in the changed industry. For example, the development of microelectronics allowed many Japanese firms to overtake American and German firms in industries that had been based on electromechanical technologies-areas traditionally dominated by the Americans and Germans.

From a systemic perspective, the role of chance events lies in the fact that they alter conditions in the diamond shown in Figure 10-2. The nation with the most favorable diamond, however, will be the one most likely to take advantage of these events and convert them into competitive advantage. For example, Canadian researchers were the first to isolate insulin, but they could not convert this breakthrough into an internationally competitive product. Firms in the United States and Denmark were able to do that because of their respective national diamonds.

Government

Although it is often argued that government is a major determinant of national competitive advantage, the fact is that government is not a determinant but rather an influence on determinants. Government influences determinants by virtue of its role as a buyer of products and services and by its role as a maker of policies on labor, education, capital formation, natural resources, and product standards. It also influences determinants by its role as a regulator of commerce, for example, by telling banks and telephone companies what they can and cannot do.

By reinforcing positive determinants of competitive advantage in an industry. Government can improve the competitive position of the nation's firms. Governments devise legal systems that influence competitive advantage by means of tariff and non tariff barriers and laws requiring local content and labor. The Yen's decline over the past decade was due in part to a deliberate policy to strengthen Japanese exports and stem imports. In other words, government can improve or lessen competitive advantage but cannot create it.

Other Non-market Factors

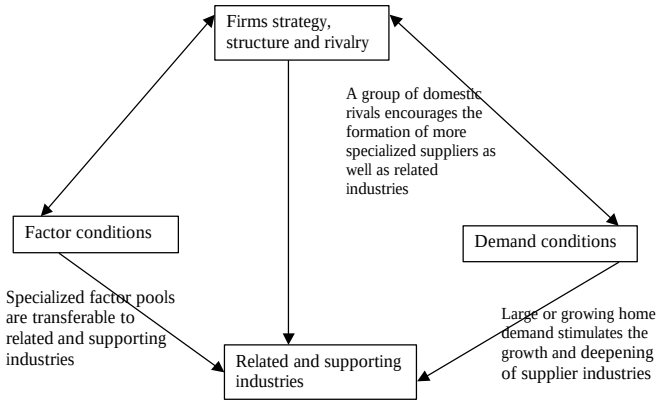
In addition to government and chance, there are other non market forces that affect the strategy system. The non market forces include, in addition to government, interest groups, activists, and the public. These non market forces are part of a non economic strategy system that operates on the basis of social, political, and legal forces that interact in the non market environment of the firm.9 An understanding of these forces is especially complicated and critical to the success of global strategies that are implemented in many different countries and cultures. The non market environment differs from the market environment in many ways. For example, the market environment is principally one involving economic exchange, whereas the non market environment includes regulatory bodies, interest groups, and others whose interest may not be driven by economic motives and often involve political motives. For example, in some countries, environmental groups have promoted regulations that dramatically increase capital and operating costs for businesses that operate manufacturing plants. In the pharmaceutical industry, religious groups have impeded progress in genetic research. Competing companies operating in different national or geographic markets that do not have these limitations or costs have a competitive advantage.

The System of Determinants

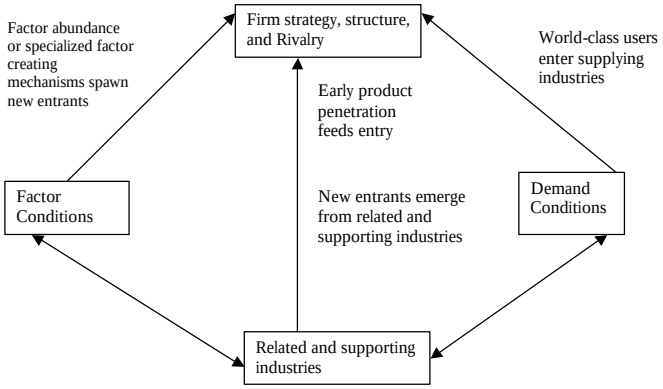
It is important to view the determinants of national competitive advantage as an interactive system in which activity in anyone of the four points of the diamond impacts on all the others and vice versa. This interplay between the determinants is depicted in Figure 10-3. The interaction of all of the forces is presented in Figure 10-4.

Single or Double Diamond?

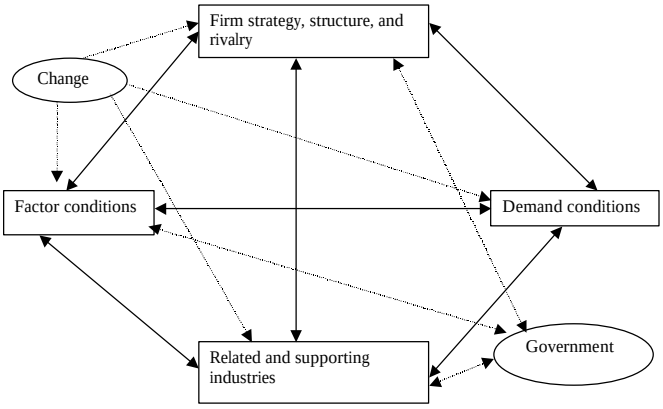
Other researchers have challenged Porter's thesis that a firm's home-base country is the main source of core competencies and innovation. For example, Professor Alan Rugman of the University of Toronto argues that the success of companies based in small economies such as Canada and New Zealand stems from the diamonds found in a particular host country or countries. For example, a company based in a European Union (EU) nation may rely on the national diamond of one of the 14 other EU members. Similarly, one impact of the North American Free Trade Agreement (NAFTA) on Canadian firms is to make the U.S. diamond relevant to competency creation. Rugman argues that, in such cases, the distinction between the home nation and host nation becomes blurred. He proposes that Canadian managers must look to a double diamond depicted in Figure 10-5 and assess the attributes of both Canada and the United States when formulating corporate strategy.



Influences on development of related and supporting industries



Influences on Domestic Rivalry



The Complete System

Competitive Advantage and Strategic Models

Strategy is integrated action in pursuit of competitive advantage. Successful strategy requires an understanding of the unique value that will be the source of the firm's competitive advantage. Firms ultimately succeed because of their ability to carry out specific activities or groups of activities better than their competitors. These activities enable the firm to create unique value for their customers. It is this value that is central to achieving and sustaining competitive advantage. This unique value must be something that competitors will not be able to easily match. The uniqueness and magnitude of the customer value created by a firm's strategy are ultimately determined by customer perception. Operating results such as sales and profits are measures that depend on the level of psychological value created for customers: the greater the perceived consumer value, the stronger the competitive advantage, and the better the strategy. A firm may market a better mousetrap, but the ultimate success of the product depends on customers deciding for themselves whether to buy it. Value is like beauty-it is in the eye of the beholder. In sum, competitive advantage is achieved by creating more value than the competition, and value is defined by customer perception.

Two different models of competitive advantage have received considerable attention. The first offers generic strategies, which are four alternative positions that organizations can seek in order to offer superior value and achieve competitive advantage. According to the second model, the generic strategies alone do not explain the astonishing success of many Japanese companies in recent years. A more recent model, based on the concept of strategic intent, proposes four different sources of competitive advantage. Both models are discussed next.

Generic Strategies for Creating Competitive Advantage

In addition to the five forces model of industry competition, Porter developed a framework of so-called generic business strategies based on two sources of competitive advantage: low cost and differentiation. Figure 10-6 shows that the combination of these two sources with the scope of the target market served (narrow or broad) or product mix width (narrow or wide) yields four generic strategies: cost leadership, product differentiation, focused differentiation, and cost focus.

Generic strategies aiming at the achievement of competitive advantage demand that the firm make choices. The choices are the position it seeks to attain from which to offer unique value (based on cost or differentiation) and the market scope or product mix width within which competitive advantage will be attained. The nature of the choice between positions and market scope is a gamble and involves risk. By choosing a given generic strategy, a firm always risks making the wrong choice.

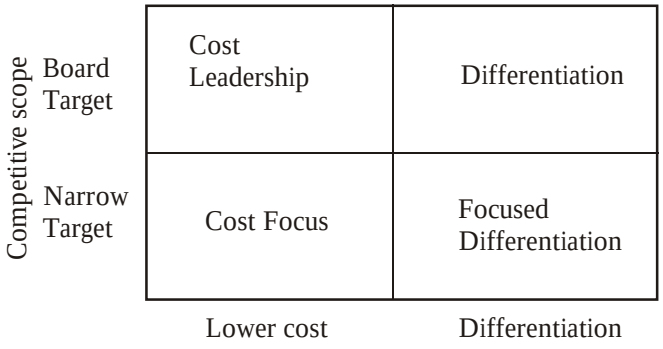
Broad Market Strategies

Cost-leadership Advantage

When the unique value delivered by a firm is based en its position as the industry's low-cost producer, in broadly defined markets or across a wide mix of products, a cost leadership advantage occurs. This strategy has become increasingly popular in recent years as a result of the popularization of the experience curve concept. A firm that bases its competitive strategy on overall cost leadership must con8truct the most efficient facilities (in terms of scale or technology) and obtain the largest share of market so that its cost per unit is the lowest in the industry. These advantages, in turn, give the producer a substantial lead in terms of experience with building the product. Experience then leads to more refinements of the entire process of

production, delivery, and service, which lead to further cost reductions.

Whatever its source, cost-leadership advantage can be the basis for offering lower prices (and more value) to customers in the late more competitive stages of the product life cycle,



Competitive advantage

Generic competitive strategies

In Japan, companies in a range of industries-35 mm cameras, consumer electronics and entertainment equipment, motorcycles, and automobiles-have achieved cost leadership on a worldwide basis. Cost leadership, however, is a sustainable source of competitive advantage only if barriers exist that prevent competitors from achieving the same low costs. In an era of process reengineering and increasing technological improvements in manufacturing, manufacturers constantly leapfrog over one another in pursuit of lower costs. At one time, for example, IBM enjoyed the low-cost advantage in the production of computer printers. Then the Japanese took the same technology and, after reducing production costs and improving product reliability, gained the low-cost advantage. IBM fought back with a highly automated printer plant in North Carolina, where the number of component parts was slashed by more than 50 percent and robots were used to snap many components into place. Despite these changes, IBM ultimately chose to exit the business and the plant was sold.

Differentiation

When a firm's product delivers unique value because of an actual or perceived uniqueness in a broad market, it is said to have a differentiation advantage. This can be an extremely effective strategy for defending market position and obtaining above-average financial returns; unique products often command premium price, Examples of successful differentiation include May tag In large home appliances, Nike in athletic shoes and almost any successful branded consumer product. Among motorcycle manufacturers, Harley-Davidson stands out as the market leader in the U.S. market but must adjust its marketing strategy in various countries depending on the local competition. Figure 10-7 shows Harley-Davidson's market share in its three geographical divisions.

Narrow Target Strategies

The preceding discussion of cost leadership and differentiation considered only the impact on broad markets. By contrast; strategies to achieve a narrow-focus advantage target a narrowly defined market or customer. This advantage is based on an ability to create more customer value for a narrowly targeted segment and results from a better understanding of customer needs and wants. A narrow-locus strategy can be combined with either cost or differentiation-advantage strategies. In other words, whereas cost focus means offering a narrow target market low prices, a firm pursuing focused differentiation will offer a narrow target market the perception of product uniqueness at a premium price.

Focused Differentiation

The German Mittelstand companies have been extremely successful pursuing focused differentiation strategies backed by a strong export effort. The world of high-end audio equipment offers another example of focused differentiation. A few hundred companies, in the United States and elsewhere, make speakers and amplifiers and related hi-fi gear that case thousands of dollars per component. Although audio components as a whole represent a $21 billion market worldwide, annual sales in the high-end segment are only $1 billion. In Japan alone, discriminating audiophiles purchase $200 million in high-end audio equipment each year-much of it American made. Also, the American companies are learning more about their overseas customers and building relationships with distributors outside the United States.

Cost Focus

The final strategy is cost focus, when a firm's lower-cost position enables it to offer a narrow target market lower prices than the competition. In the shipbuilding industry, for example, Polish and Chinese shipyards offer simple, standard vessel types at low prices that reflect low production costs.

LESSON 18:
STRATEGIC POSITIONING AND INTENT

Strategic Position

Strategic positions that provide competitive advantage are based on the activities that a firm chooses to perform and on where it chooses to perform them. IS From these positions, a firm can deliver unique value to its customers. A position is based on a set of activities that combine to create unique value for a market. Porter has identified three classifications for strategic positions. A firm may choose to develop one or a combination of these positions as the basis of its competitive advantage. The three positions and the related generic strategy are shown in Table.

Variety-based Positioning

Variety-based positioning is based on a firm's decision to carry out a limited number of activities related to delivering a limited product or service. This type of position is built by a firm such as Southwest Airlines that chooses to deliver value to its customers by limiting its product offering (point-to-point service no baggage transfer service, no seat reservations. no meals, etc.) in order to minimize its prices and maximize its reliability and efficiency. Another example is GIVI, an Italian company that makes luggage for motorcycles. GlVI's product is unique in design, integration, and fabrication. It is premium priced, but given its unique design and quality, it is a value winner in the motorcycle luggage marketplace.; The company is successfully expanding from its European variety based position to a world variety-based position.

Needs-based Positioning

Needs-based positioning occurs when a company attempts to deliver value to a specific customer segment by carrying out activities to satisfy a comparatively broad set of needs

Position	Examples	Generic Strategy
I. Variety based Producing a subset of an industry's product or service	Vanguard Bic Jiffy Lube Citibank	Cost leadership
2. Customer needs based	Bessemer Trust IKEA	Differentiation
3. Customer access based Segmenting customers who are accessible in different ways	CARmike Cinemas	Segmentation

of these customers. This position is well developed by firms such as IKEA, which offers everything the young (or young at heart), budget-conscious consumer might need to furnish an apartment or home. Another example of a company with a clear positioning strategy is Purdue Pharma, the world leader in narcotic analgesics for severe pain. Purdue has focused on a need, alleviation of pain, and developed an integrated program for addressing this need. It has developed products that offer more relief with fewer side effects. In addition to focusing on the need, Purdue has created the world's best-trained field sales force to call on doctors to answer their questions on how to effectively use Purdue's products. It has also been able to get its products listed on the formulary of hospitals and managed care organizations and government agencies. All of these activities are driven by the company's focus on the need to alleviate pain.

Access-based Positioning

The ability of a firm to uniquely or preferentially reach a specific market is an access based position. For example, international management recruitment firms, such as Korn Ferry International, establish relationships with executives and track them throughout their careers. They know where these executives are located and help their clients get to them. Access consideration can be a critical knockout factor. The first level of all international expiation is about access. Global marketing strategy must deal with barriers to access to national markets that are typically created by governmental authorities. Access to national markets is restricted by regulations, tariffs, distance, and a host of non-tariff barriers, which include ways of doing business and openness to new entrants. As a prerequisite to international expansion, firms must develop the ability to carry out the activities that deal with these barriers to access: However, developing the ability to operate in many national markets does not necessarily confer global competitive advantage on a firm. This is not the same as access-based positioning, which refers to the advantage that can be gained by preferential access or control of access to customers. In order to gain competitive advantage in the target market, the entrant must establish a perceived unique value to its customers. U other competitors can gain access or are already established in the market, it is not enough to merely be present in a market. The annals of international business failures are replete with examples of companies that did not understand this message. They believed that all they needed to do was to show up. When the market told them that they had a competitive disadvantage, they simply packed up and retreated. Renault did this in the U.S. automobile market in the 1960s, and Federal Express did it again in the express delivery market in Europe in the 1980s. FedEx has regrouped and restrategized its European entry, whereas Renault's setback in the United States sent it back to Europe, where its position today was as a regional player in a global industry. It has never attempted to reenter the U.S. market, but with its operations in Brazil and its control of Nissan, it is today a global player in a global industry.

Which Position to Take?

All real strategies are a combination of all three positions: Every winning strategy is based on a combination of doing the right thing (activity based), meeting a need (needs based), and on access. Nevertheless, it is valuable and useful to identify the principal thrust of a strategy: activity, need, or access. Company winners are ones that have established a strategic position that focuses on the decisive point and is, at the same time, everywhere very strong. This is the von Clausewitz maximum: The best strategy is to be very strong, first generally, and then at the decisive point.

Competitive Innovation and Strategic Intent

An alternative framework for understanding competitive advantage focuses on competitiveness as a function of the pace at which a company implants new advantages deep within its organization. This framework identifies strategic intent, growing out of ambition and obsession with winning, A the means for achieving competitive advantage. Writing in the Harvard Business Review, Hamel and Prahalad note:

Few competitive advantages are long lasting. Keeping score of existing advantages is not the same as building new advantages. The essence of strategy lies in creating tomorrow's competitive advantages faster than competitors mimic the ones you possess today. An organization's capacity to improve existing skills and learn new ones is the most defensible competitive advantage of all.

This approach is founded on the principles of W. E. Deming, who stressed that a company must commit itself to continuing improvement in order to be a winner in a competitive struggle. For years, Deming's message fell on deaf ears in the United States, whereas the Japanese heeded his message and benefited tremendously. Japan's most prestigious business award is named after him. Finally, however, U.S. manufacturers are starting to respond.

The significance of Hamel and Prahalad's framework becomes evident when comparing Caterpillar and Komatsu. As noted earlier, Caterpillar is a classic example of differentiation: The company became the largest manufacturer of earth-moving equipment in the world because it was fanatic about quality and service. Caterpillar's success as a global marketer has enabled it to achieve a 35 percent share of the worldwide market for earth-moving equipment, more than half of which represents sales to developing countries. The differentiation advantage was achieved with product durability, global spare parts service (including guaranteed parts delivery anywhere in the world within 48 hours), and a strong network of loyal dealers.

Caterpillar has faced a very challenging set of environmental forces. Many of Caterpillar's plants were closed by a lengthy strike in the early 1980s; a worldwide recession at the same time caused a downturn in the construction industry. This hurt companies that were Caterpillar customers. In addition, the strong dollar gave a cost advantage to foreign rivals.

Compounding Caterpillar's problems was a new competitive threat from Japan. Komatsu was the world's number-two construction equipment company and had been competing with Caterpillar in the Japanese market for years. Komatsu's products were generally acknowledged to offer a lower level of quality. The rivalry took on a new dimension after Komatsu adopted the slogan Maru-c, meaning "encircle Caterpillar." Emphasizing quality and taking advantage of low labor costs and the strong dollar, Komatsu surpassed Caterpillar in earth-moving equipment sales in Japan and made serious inroads in the United States and other markets. Yet, the company continued to develop new sources of competitive advantage even after it achieved world-class quality. For example, new-product development cycles were shortened, and manufacturing was rationalized. Caterpillar struggled to sustain its competitive advantage because many customers found that Komatsu's combination of quality, durability, and lower price created compelling value. Yet even as recession and a strong yen put new pressure on Komatsu, the company sought new opportunities by diversifying into machine tools and robots.

The Komatsu/Caterpillar saga is just one example of how global competitive battles are shaped by more than the pursuit of generic strategies. Many firms have gained competitive advantage by disadvantaging rivals through competitive innovation, defined by Hamel and Prahalad as "the art of containing competitive risks within manageable proportions." They identify four successful approaches utilized by Japanese competitors: building layers of advantage, searching for loose bricks, changing the rules of engagement, and collaborating.

Layers of Advantage

A company faces less risk in competitive encounters if it has a wide portfolio of advantages. Successful companies steadily build such portfolios by establishing layers of advantage on top of one another. Komatsu is an excellent example of this approach. Another is the TV industry in Japan. By 1970, Japan was not only the world's largest producer of black-and-white TV sets but was also well on its way to becoming the leader in producing color sets. The main competitive advantage for such companies as Matsushita at that time was low labor costs.

Because they realized that their cost advantage could be temporary, the Japanese also added additional layers of quality and reliability advantages by building plants large enough to serve world markets. Much of this output did not carry the manufacturer's brand name. For example, Matsushita Electric sold products to other companies such as RCA that marketed them under their own brand names. Matsushita was pursuing a simple idea: A product sold was a product sold, no matter whose label it carried.

In order to build the next layer of advantage, the Japanese spent the 1970s investing heavily in marketing channels and Japanese brand names to gain recognition. This strategy added yet another layer of competitive advantage: the global brand franchise-that is, a global customer base. By the late 1970s, channels and brand awareness were established well enough to support the introduction of new products that could benefit from global marketing-videocassette recorders (VCRs) and photocopy machines, for example. Finally, many companies have invested in regional manufacturing so their products can be differentiated and better adapted to customer needs in individual markets.

The process of building layers illustrates how a company can move along the value chain to strengthen competitive advantage. The Japanese began with manufacturing (an upstream value activity) and moved on to marketing (a downstream value activity) and then back upstream to basic R&D. All of these sources of competitive advantage represent mutually desirable layers that are accumulated over time.

Loose Bricks

A second approach takes advantage of the loose bricks left in the defensive walls of competitors whose attention i!; narrowly focused on a market segment or a geographic area. For example,

Caterpillar's attention was focused elsewhere when Komatsu made its first entry into the Eastern European market. A similar chain of events occurred in the global motorcycle industry. For many years, Harley-Davidson focused its eff0l1s on large motorcycles. Thus, it was not concerned when Honda first entered the U.S. motorcycle market with exports of bikes with small (50 cc) engines. Managers at Harley were not aware of -Dr did not appreciate the significance of-Honda's involvement with racing larger bikes in Europe. But Honda used this approach to gain important experience in large-displacement engine design and technology. Harley was caught off guard, and by 1983 Honda had more than 50 percent of the U.S. market share in motorcycles with 700 cc engines or larger.

That same year, import quotas were imposed on large motorcycles imported into the United States. Even though the quotas helped save Harley from extinction Honda was already using its core competence in engines to diversify. It created engines for other products, starting with cars. The first Honda Civic models were powered by overhead earns motorcycle engines. Today, Honda boasts a wide product mix that includes lawn mowers, outboard marine motors, welders, and generators-in short, anything powered by a gasoline engine. This approach, as noted earlier allows Honda to enjoy significant scale economies in R&D and production. Harley-Davidson eventually reshaped itself by dramatically improving product quality and has successfully won back much of it lost market share.

Changing the Rules

A third approach involves changing the so-called rules of engagement and refusing to play by the rules set by industry leaders. For example, in the copier market, IBM and Kodak imitated the marketing strategies used by market leader Xerox. Meanwhile, Canaan, a Japanese challenger, wrote a new rule book.

Whereas Xerox built a wide range of copiers, Canon built standardized machines and components, reducing manufacturing costs. Whereas Xerox employed a huge direct sales force, Canon chose to distribute through office-product dealers. Canon also designed serviceability, as well as reliability, into its products so that it could rely on dealers for service rather than incurring the expense required to create a national service network. Canon further decided to sell rather than lease its machines, freeing the company from the burden of financing the lease base. In another major departure, Canon targeted its copiers at secretaries and department managers rather than at the heads of corporate duplicating operations.

Canon introduced the first full-color copiers and the first copiers with connectivity the ability to print images from such sources as video camcorders and computers. The results have been impressive; in 1994, Canon's share of the U.S. color copier market was 64 percent. In both 1988 and 1992, Canon was granted more U.S. patents than any other company in the world. The Canon example shows how an innovative marketing strategy-with fresh approaches to the product. Pricing, distribution, and selling-can lead to overall competitive advantage in the marketplace.

Collaborating

A final source of competitive advantage is using know-how developed by other companies. Such collaboration may take the form of licensing agreements ,joint ventures, and partnerships. History has shown that the Japanese have excelled at using the collaborating strategy to achieve industry leadership. One of the legendary licensing agreements of modern business history is Sony's licensing of transistor technology from AT&T's Western Electric subsidiary in the 1950s for $25,000. This agreement gave Sony access to the transistor and allowed the company to become a world leader. Building on its initial successes in the manufacturing and marketing of portable radios, Sony has grown into a superb global marketer whose name is synonymous with a wide assortment of high quality consumer electronics products. More recent examples of Japanese collaboration are found in the aircraft industry. Today, Mitsubishi Heavy Industries Ltd, and other Japanese companies manufacture airplanes under license to American firms and also work as subcontractors for aircraft parts and systems. Many observers fear that the future of the American aircraft industry may be jeopardized as the Japanese gain technological expertise. Various examples of collaborative advantage are discussed in the next section.

Hamel and Prahlad have continued to refine and develop the concept of strategic intent since it was first introduced in their groundbreaking 1989 article. Recently, the authors outlined five broad categories of resource leverage that managers van use to achieve their aspirations: concentrating resources on strategic goals via convergence and focus; accumulating resources more efficiently via extracting and borrowing; complementing one resource with another by blending and balancing; and conversing resources by recycling, co-opting, and shielding.

Hypercompetition

Professor Richard D'Aveni suggests that the Porter strategy frameworks fail to adequately address the dynamics of competition in the 21st century. D'Aveni notes that, in today's business environment, market stability is undermined by short product life cycles, short product design cycles, new technologies, and globalization. The result is an excalation and acceleration of competitive forces. In light of these changes, D'Aveni believes the goal of strategy has shifted from sustaining to disrupting advantages. The limitation of the Porter models, D'Aveni argues, is that they provide a snapshot of competition at a given point in time. In other words, they are static models.

Acknowledging that Hamel and Prahalad broke new ground in recognizing that few advantages are sustainable, D'Aveni aims to build on their work to shape " a truly dynamic approach to the creation and destruction of traditional advantages." D'Aveni uses the term hypercompetition to describe a dynamic, competitive world in which no action or advantage can be sustained for long. In such a world, D'Aveni argues, everything changes because of the dynamic maneuvering and strategic interactions by hypercompetitive firms such as Microsoft and Gillette. According to D'Aveni's model, competition unfolds in a series of dynamic strategic interactions in four arenas: cost versus quality, timing and know-how, entry barriers, and deep pockets. Each of these arenas is "continuously destroyed and recreated

by the dynamic maneuvering of hypercompetitive firms. According to D'Aveni, the only source of a truly sustainable competitive advantage is a company's ability to manage its dynamic strategic interactions with competitors' frequent movements that maintain a relative position of strength in each of the four arenas. The irony and paradox of this model is that, in order to achieve a sustainable advantage, companies, must seek a series of unsustainable advantages. D'Aveni is in agreement with Peter Drucker, who has long counseled that the role of marketing is innovation and the creation of new markets. Innovation begins with abandonment of the old and obsolete. In Drucker's words, "Innovative organizations spend neither time nor resources on defending yesterday. Systematic abandonment of yesterday alone can transfer the resources…..for work on the new.

D'Aveni urges managers to reconsider and reevaluate the use of what he believes are old strategies tools and maxims. He warns of the dangers of commitment to a given strategy or course of action. The flexible, unpredictable player may have an advantage over the inflexible, committed opponent. D'Aveni notes that, in hypercompetition, pursuit of generic strategies results in short-term advantage at best. The winning companies are the ones that successfully move up the ladder of escalating competition, not the ones that lock into a fixed position. D'Aveni also is critical of the five forces model. The best entry barrier, he argues, is maintaining the initiative, not mounting a defensive attempt to exclude new entrants.

ISO-9000

Another strategy to achieve competitive advantage is the incorporation of ISO-9000 criteria in product development and manufacturing policies, although service companies are finding innovative ways to apply the criteria to their businesses.

In 1987, the International Organization for Standardization (ISO) published a series of five international product and service quality standards. This publication was titled "Quality Management and Quality Assurance Standards-Guidelines for Selection and Use" and is commonly referred to as ISO-9000 standards. The standards were originally designed with the intent to achieve conformity and congruence for two-party applications through normal supplier-customer relationships in a wide range of industries on either a contractual or noncontractual basis. This has now moved to another level whereby third-part assessment and certification of a supplier's processes is required by some customers. Basically, the application of ISO-9000 standards allows a supplier to direct and control the operations that determine the acceptability of a product or service being supplied. ISO-9000 standards represent the common denominator of business quality that is accepted internationally. In the United States, the standards are referred to as the ANSI/ASQC-Q 90 series.

The two major advantages of ISO-9000 registration and certification occur in domestic advantage and international advantage. Domestically, it provides (1) competitive advantage over suppliers who are not certified, (2) a focus on continuous improvement, (3) media awareness, and (4) customer perception. Internationally, having ISO-9000 certification eases entry into export markets and as part of product liability defense if it should become necessary. The ISO-9000 standards are widely accepted by EC members and serve as a "method of ensuring its citizens of the quality of goods freely moving within the EC." Approximately 15 percent of all products and services that are sold in the EC are currently regulated by ISO-9000 standards.

CASE 1
METRO CORPORATION : TECHNOLOGY LICENSING NEGOTIATION

Details of negotiations between Metro Corporation and Impecina Construcciones S.A. of Peru, for the licensing of Petroleum Tank Technology follow.

The Licensor Firm

Metro Corporation is diversified steel rolling, fabricating, and construction company based in the Midwest and con-siders itself to be in a mature industry. Innovations are few 'and far between. With transport and tariff barriers, and the support given by many governments to their own compa-nies, export-ing as a means of doing foreign business is rather limited. Similarly, given the large investment, modest return, and political sensitivity of the industry, direct for-eign investment is all but a closed option. In a global strate-gic sense then, Metro Corporation has far more frequently focused on licensing as a market entry method, with tech-nologies confined to (1) processes and engineering periph-eral to the basic steel-making process, for example, mining methods, coke oven door designs, galvanizing, and so on, and (2) applications of steel in construc-tion and other industries, for example, petroleum tank design, welding meth-ods, thermo adhesion, and .so on.

All Metro's licensing is handled by its international di-vision, International Construction and Engineering (ICE), which is beginning to develop a reputation in Western Europe and South America as a good source for special-ized construction technology.

The Proposed Licensee

Impecina, a private firm, is the largest construction com-pany in Peru and operates throughout Latin America. Im-pecina has a broad range of interests inducing residential and commercial buildings, hydraulic works, transportation, and maritime works. Employing several thousand person-nel, engineers, and technicians, its sales had doubled in the last five years. It was still primarily a Peruvian business with most turnover in Peru.. but was in the process of ex-panding into Colombia, the North African Mediterranean countries, and Argentina, Brazil, and Venezuela. Impecina has advanced computer capacity with a large IBM and other computers at their branches. In oil-storage tanks, Im-pecina experience was limited to the smaller fixed-cone roof designs under lS0-feet diameter.

The Technology

National Tank Inc., a fabrication division of Metro had de-veloped a computerized design procedure for floating-roof oil-storage tanks, which minimized the use of steel within American Petroleum Institute or any other oil industry standards. Particularly for the larger tanks, for instance, lS0-feet diameter and above, this would confer upon the bidding contractor a' significant cost advantage. National Tank had spent one labor-year at a direct cost of $225,000 to write the computer 'program alone. Patents were in-volved in an incidental manner, only for the seals on the floating roof. Metro had not bothered to file for this patent except in the United States.

The Market

Peru's indigenous oil output is very low, but it imports and refines annually 50 million tons mostly for domestic demand. Following the escalation of oil prices and tight-ening of supplies in 1973, the Peruvian government deter-minedly set about to formulate a program to augment Peru's oil-storage capacity. Impecina's representatives at a preliminary meeting with ICE in U.S. headquarters said their government planned $200 million expenditures on

oil-storage facilities over the next 3 years (mostly in large sized tanks). Of this, Impecina's "ambition" was to capture a one-third market share. That this appeared to be a cred-ible target was illustrated by their existing 30 percent share of the fixed-cone type under lSO-feet diameter. Addition-ally, they estimated private-sector construction value over the next three years to total $40 million.

Approximately half of a storage system's construction cost goes for the tank alone, the remainder being excava-tion, foundation, piping, instrumentation, and other ancil-lary equipment, all' of which Impecina's engineers were very familiar with Neighboring Colombia was building a 12 million ton refinery, but the tank installation plans of other South American nations were not known, according to the Im-pecina representative.

Each of Impecina's competitors in Peru for this busi-ness was affiliated with a prominent company: Umber-tomas with Jefferson Inc. in the United States, Zapa with Philadelphia Iron Steel, Cosmas with Peoria-Duluth Construction Inc., and so on. Thus, association with Metro would help Impecina in bidding.

The First Meeting

National Tank had in the past year bid jointly with Im-pecina on a project in southern Peru. Though that bid was unsuccess-ful, Impecina had learned about Metro's com-puterized design capabilities and initiated a formal first round of negotiations, which were to lead to a licensing agreement. The meeting took place in the United States. Two Impecina executives of sub-director rank were accom-panied by an American consultant. Metro was represented by the vice president of ICE, the ICE attorney and an ex-ecutive from National Tank.

Minutes of this meeting show it was exploratory. Both genuine and rhetorical questions were asked. Important information and perceptions were exchanged and' the groundwork laid for concluding negotiations. Following is a bare summary of important issues from the somewhat circular discussion:

1. **Licensee Market Coverage**: Impecina tried to repre-sent itself as essentially a Peruvian firm. It reviewed its government expenditure plans and its hoped-for market

share. Yet through the meeting, there kept cropping up the issue of the license also covering Libya, Algeria, Morocco, Colombia, Argentina, Brazil, and Venezuela.

2. **Exclusivity:** For Peru, Metro negotiators had no dif-ficulty conceding exclusivity. They mentioned that granting exclusivity to a licensee for any territory was agreeable in principle, provided a minimum per-formance guarantee was given. At this, the question was deferred for future discussion. At one point a Metro executive remarked, "We could give Impecina a 'nonexclusive-and say, for example, we wouldn't give another (licensee) a license for one year (in those nations)," proposing the idea of a trial period for Impecina to generate business in a territory.

3. **Agreement Life:** Impecina very quickly agreed to a to-year term, payment in U.S. dollars, and other minor issues.

4. **Trade Name**: The Impecina negotiators placed great emphasis on their ability to use Metro's name in bid- ' ding, explaining how their competition in Peru had technical collaboration with three U.S. companies (as noted previously). "Did that mean Metro's Na-tional Tank Division could compete with Impecina in Peru?" they were asked rhetorically. (Actually both sides seem to have tacitly agreed that it was not possible for Metro to do business directly in Peru.)

5. **Licensee Market Size**: Attention turned to the dollar value of the future-large (floating-roof) tank market in Peru. Impecina threw out an estimate of $200 million government expenditures and $40 million private- sector spending, over the coming three years, of which they targeted a one-third share. Later, a lower market-size estimate of $150 million (government and private) with a share of $50 million received by Impecina over three years was arrived at (memories are not clear on how the estimates were revised). "Will Impecina guarantee us they will obtain one- third of the market'?" brought the response "That's an optimistic figure that we hope we can realize," Impecina offered as evidence their existing one-third share of the "fixed roof under 150 feet market, an impressive achievement.

6. **Product Mix Covered by License**: It became clear that Impecina wanted floating-roof technology for all sizes, and fixed roof over 100 feet diameter. They suggested the agreement cover tanks over 100 feet in size. Impecina was asked if it would pay on all tanks (of any size) to simplify royalty calculation and mon-itoring. After considerable discussion, Metro seems to have acceded to Impecina's proposal (to cover both types, only over 100 feet) based on consensus over three points.

a. The competition probably does not pay (its licen-sors) on small tanks and, therefore, Impecina would be at a disadvantage if it had to pay on small tanks also.

b. The market in floating-roof tanks was usually over 100 feet.

c. Impecina claimed that customers normally dictate the dimensions of the tanks, so Impecina cannot-vary them in order to avoid paying a royalty to Metro.

7. **Compensation Formula**: Metro proposed an initial lump-sum payment (in two installments, one when the agreement is signed, the second on delivery of the computer program and designs), plus engineers and executives for bid assistance on a per diem rate, plus a royalty on successful bids based on the barrel capacity installed by Impecina. Impecina's American consul-tant countered with the idea of royalties on a sliding scale, lower with larger-capacity tanks, indicating talk about "1 million barrel capacity talks. "The (rheori-cal?) question about Peru's oil capacity seems to have brought the discussion down to earth and veered it off on a tangent, while both sides mentally regrouped.

   On returning to this topic, Impecina executives ventured that as a rule of thumb their profit markup on a turnkey job was 6 percent. (However, on excluding the more price-sensitive portions such as excavation, piping, and ancillary equipment, which typically constitute half the value, Impecina conceded that on the tank alone they might mark up as much as 12 percent, although they kept insist-ing. 5 to 6 percent was enough.)

   Impecina executives later offered only royalties (preferably sliding) and per diem fees for bid assis-tance from Metro executives and engineers.

   Metro countered by pointing out those per diem fees of $225 plus travel costs amounted at best to re-covering costs, not profit.

   The compensation design question was left at this stage, deferred for later negotiation, broad outlines having been laid. Metro's starting formal offer, which would mention specific numbers, was to be telexed to Lima in a week.

8. **The Royalty Basis:** Metro entertained the idea that Impecina engineers were very familiar with excavation, piping, wiring, and other ancillary equipment. Metro was transferring technology for the tank alone, which typically comprised half of overall installed value.

9. **Government Intervention:** Toward the end of the discussions, Impecina brought up the question of the Peruvian government having to approve of the agreement. This led to their retreat from the idea of a 10-year term agreed to earlier, and Impecina then mentioned five years. No agreement was reached. (Incidentally, Peru had in the last two years passed legislation indicating a "guideline" of five years for foreign licenses.)

Internal Discussion In Metro Leading To The Formal Offer

The advantages derived by the licensee would be acquisi-tion of floating-roof technology, time and money saved in attempting to generate the computerized design proce-dure in house, somewhat of a cost and efficiency advan-tage in bidding on larger tanks, and finally the use of Metro's name.

It was estimated that National Tank had spent $225,000 (one labor-year = two executives for six months, plus other costs) in developing the computer program. Additionally, it may cost $40,000 (three quarters of a labor-year) to con-vert the program into Spanish, the metric system, and adapt it to the material availability and labor cost factors peculiar to Peru. Simulta-

neously, there would be semifor-mal instruction of Impecina engineers in the use of the pro-gram, petroleum industry codes, and Metro fabrication methods. All this had to be done before the licensee would be ready for a single bid.

It was visualized that Metro would then assist Im-pecina for two labor-weeks for each bid preparation, and four labor-weeks on successful receipt of a contract award. Additionally, if Metro's specialized construction equip-ment were used, three labor-months of on-site training would be needed.

As the licensee's personnel moved along their learning curve, assistance of the type just described would diminish until it was no longer needed after a few successful bids.

Additional considerations that went into a determi-nation of the initial offer:

1. Metro obligations (and sunk costs) in development and conversion were fairly determinate, whereas their obligations to assist Impecina in bidding de-pended on the technical sophistication and absorptive capacity of the licensee's engineers, their success rate in bidding, and so on.
2. If Impecina's market estimates were used, over the next three year they would generate large tank orders worth $50 million, on which they would market a profit of $3 million (at 6 percent on $50 million or 12 percent on half the amount).
3. The market beyond three years was an unknown.
4. Exc1usiverights.might be given to Impecina in Peru and Colombia, with perhaps ICE reserving the right of conversion to nonexclusive if minimum market share was not captured,
5. While Impecina's multinational expansion plans were unknown, their business in the other nations was too small to justify granting them exclusivity. They may satisfied with a vague promise of future consideration as an exclusive licensee in those territories.
6. Metro would agree to a term of 10 years. It was felt that Impecina computer and engineering capability was strong enough so they would not need Metro assistance after a few bids.

Surprisingly, the discussions reveal no explicit consideration given to the idea that Impecina may emerge some day as a multinational competitor.

In view of the uncertainty about how successful the licensee would actually be in securing orders, the uncertainty surround-ing the Peruvian government's attitude, a, safe strategy seemed to be to try and get as large a front-end fee as possible. Almost arbitrarily a figure of $400,000 was thrown up. (This was roughly 150 percent of the development costs plus the initial costs of transferring the technology to the licensee.) There would be sufficient margin negotiations and to cover uncertain-ties. In order that the licensee's competitiveness not is diminished by the large lump-sum fee, a formula as described later may be devised whereby the first five years' royalties could be reduced.

The Formal Offer

The formal offer communicated in a telex a week later called for the following payment terms:

- $400,000 lump-sum fee payable in two installment
- A 2 percent royalty 'on any tanks constructed of size over 100 feet in diameter, with up to one has of royalties owed in each of the first 5 years reduced by an amount up to $40,000 each year, with out carryovers from year to year. The royalty percentage would apply to the total contract value less excavation, foundation, dikes, piping, instru-mentation, and pumps.
- Agreement life of10 years. . Metro to provide services to Impecina described earlier in consideration of the lump sum and royalty fees.
- For addition at service as described earlier, Metro would provide on request personnel paid up to $225 per day, plus travel and living costs while away from their place of business. The per diem rates would be subject to escalation based on a representative cost index. There would be a ceiling placed on the number of labor-days Impecina could request in any year.
- All payments to be made in U.S. dollars, net, after all local withholding, and other taxes.
- Impecina would receive exclusive rights for Peru and Colombia only, and nonexclusive rights for Morocco, Libya, Algeria, Argentina, Venezuela, and Brazil. These could be converted to an exclusive basis on demonstration of sufficient business in the future. For Peru and Colombia, Metro reserves the right to treat the agreement as nonexclusive if Impecina fails to get at least 30 percent of installed capacity of a type covered by the agreement.
- Impecina would have the right to sublicense only to any of its controlled subsidiaries.
- Impecina would supply free of charge to ICE all improvements made by it on the technology during the term of the agreement.
- Impecina would be entitled to advertise its associ-ation with Metro in assigned territories on prior approval of ICE as to wording, form, and content.

The Final Agreement

ICE executives report that the Peruvians "did not bat an eyelid" at their demands, and that an agreement was soon reached in a matter of weeks. The only significant change was Metro agreeing to take a lump sum of $300,000 (still a large margin over costs). In return, the provision for re-ducing one half of the royalties up to $40,000 per year was dropped. The final agreement called for a straight 2 percent royalty payment (on tank value alone, as before). Other changes were minor: Impecina to continue to receive ben-efit of further R&D; ICE to provide at cost a construction engineer if specialized welding equipment was used; the per diem fee fixed at $200 per day (indexed by an average hourly wage escalation factor used by the u.s. Department of Labor); and the $300,000 lump-sum fee to be paid in in-stallments over the first year.

In other respects such as territory, royalty rate, exclu-sivity, travel allowances, and so on, the agreement con-formed with Metro's initial offer.

An Upset

The Peruvian government disallowed a 10-year agree-ment life. By then, both parties had gone too far to want to reopen the entire negotiations and Metro appears to have resigned itself to an agreement life of five years, with a further extension of another five years subject to mutual consent. Given Impecina's in-house engineering and com-puter capability, extension of the agreement life was a very open question.

Discussion Questions

Analyze the negotiations from each party's perspective:

1. List what each party is offering and what it hopes to receive.
2. Identify the elements in each list that are "musts" and those where flexibility may be shown, and state why.
3. Describe negotiating tactics or ploys each party used or could have used.
4. Compute net cash flows for each party under several scenarios. For example:

a. Licensee fails to get a single order.

b. Licensee gets one-third market share in Peru for three years, no orders thereafter, and no orders in any other nation.

c. Licensee gets one-third share in Peru for ten years and half again as much in business in other nations, and so forth.

5. Compute the share of net present value of profits that each of the two parties will capture under various market scenarios.
6. What do you think of the rule of thumb, encoun-tered in licensing literature, that licensors should settle for roughly one quarter to one half of the licensee's incremental profit?
7. a. Are sunk costs relevant here?

   b. What, if any, are the opportunity costs?

c. In computing the licensor's cash flows, remember that in addition to the direct costs of implementing an agreement, there are sometimes substantial in-direct costs. What are they? How would you apply the licensor's development costs to this exercise?

8. Why did the licensee accept the offer (with small changes) without "batting an eyelid"? (Hint: Calculate break-even sales for both parties.)
9. Should the licensor have threatened to pull out when the government limited the agreement life to five years? (Hint: Recalculate question 5 under a five-year limit.)
10. Do you think the licensee knew this all along?
11. Discuss the role of government intervention in licensing negotiations in general.

CASE 2:
ASCOM HASLER MAILING SYSTEMS INC. :
COMPETING IN THE SHADOW OF A GIANT

Introduction

On a beautiful fall day in New England at the end of the millennium, Michael Allacca, president of Ascam Hasler Mailing Systems Inc., was struggling with the question of haw to move his company beyond its position as one of the three dwarfs of the postage meter industry. Although his company had achieved the greatest share gain of any competitor in the United States between 1985 and 1997, he was not complacent. He was number three in the U.S. market, and number one still had mare than 85 percent of the total market.

Moreover, there were technological, market, and regulatory changes occurring that opened up entry possibilities far new entrants who had in effect been blacked from entry to the industry far the past half-century and longer.

Globalization had come to the sleepy postage meter industry with a vengeance, and Mr. Allocca was worried. He knew that he needed a strategy to improve his position and questioned in his awn mind whether he had one. He remembered the famous Van Clausewitz maxim: “the best strategy is to be everywhere very strong, first generally and then at the decisive paint.” Easy to say, he thought, but haw could he be strong as a dwarf in the industry? And, fur-thermore, what was the decisive paint?

History and Evolution of The U.s. Postage Meter Industry

In 192O, Arthur Pitney and Walter Bowes received approval from the United States,. Past Office to market a device they had invented, which they called a postage meter. The postage meter was a complex mechanical device that pro-vided the secure staring of fund information, the dispens-ing of postage, and the printing of indicia an envelopes or tape. It was a convenient replacement far the postage stamp in higher-volume mail applications. Pitney Bowes, Inc. was barn, and a manufacturing and corporate facility was es-tablished in Stamford, Connecticut At about the same time, similar companies were independently established in Europe. Today there are four major players globally. Pitney Bowes (PB), remaining the largest by far, has three European counterparts.

Since it’s beginning, PB has aggressively defended its market share. Today, after the infiltration by three foreign competitors, it still retains about 85 percent of the US. market. It has very effectively used its portfolio of aver 3,000 patents as a weapon and barrier to the entry of other competitors. In 1959 the US. Justice Department challenged PB’s monopoly. As part of the consent decree that resulted, PB was required to license its patents, royalty free. This and other constraints were lifted late in the 1960s; however, it still offers its patents for a royalty fee to avoid further confrontation with the Justice Department and the US. Postal Service (USPS).

While there has been substantial growth in electronic communi-cations, facsimile, and other substitutes far the postal service, mail continues to grow and to be a cost-effective, major source of information transfer in the United States. Each year the USPS delivers aver 100 billion pieces of mail through aver 38,000 past offices, to. over 130 million delivery paints. The USPS handles 41 percent of the world’s mail volume, aver 630 million pieces every day. The next largest postal service market is in Japan, which handles 6 percent of the world’s mail volume. With its budget of aver $50 billion, and aver 750,000 career employees, if the USPS were in the Fortune 500, it would be ranked number eight.

While they have same presence in mast developed countries around the globe, all postage meter manufactur-ers concentrate their efforts in five main markets: the United States, Canada, France, Germany, and the United Kingdom.

The Major Players

A significant measure of U.S. market share is the division of the installed base of postage meters an rental, pub-lished -quarterly by the USPS. Exhibit 1 is an indication of recent trends.

1. Pitney Bowes

   Pitney Bowes, clearly the world leader in the manufacture and sale of mailing equipment, in 1998 had total revenues that exceeded $4.2 billions. Revenue from the sales and fi-nancing of mailing equipment, related supplies and services, and postage meters exceeded $2.7 billion. The remaining revenue comes primarily from its Office Solutions business, which includes the sale, financing, rental, and service of re-prographic and facsimile equipment and related supplies and facilities management services.

EXHIBIT –1

	1985 Units	%	1990 Units	%	1995 Units	%	1998 Units	%
PH	956,987	91.6	1,156,585	88.6	1,303,106	85.8	1,399,156	82.9
Neopost	52,077	5.0	67,277	5.1	87,912	5.8	123,367	7.3
Ascom	21,007	2.0	64,018	4.9	104,412.	6.9	118,774	7.0
Postalia	15,227	1.4	15,227	1.4	23,363	1.5	46,497	2.8
Totals	**1,045,298**	**100**	**1,303,107**	**100**	**1,518,793**	**100**	**1,687,794**	**100**

Figures Represent Installed Meters At Year-end.

PB’s historically strong financial performance is based on the foundation, of its postage meter rental base and equipment leasing business. Fortune. magazine, in its April 27, 1998 issue, ranked PB number one in the Office Equip-ment Industry Group for Net Operating Profit Margin, Return on Stockholder’s Equity, 3-YearTotal Return, and 10-year Total Return.,

In its mailing equipment business, PB offers the most comprehensive product line, including postage meter ma-chines, letter folders, inserters, openers, addressing machines, and PC-based mailing and shipping systems. It offers more “one-stop-shopping” opportunities than any of its competi-

tors. It prides itself on being a product innovator and uses its huge patent portfolio to defend its inventions and to provide an entry barrier to would-be encroachers in its highly valued and protected market. PB ranked among the top 200 recipi-ents of US. Patents for 13 years in a row. In..1998, it spent over $100 million in research and development, and was awarded 124 patents, with 44 percent more than in 1997, its highest year ever. PB has a precedent for effectively using its patent clout when each of its foreign competitors attempted to in-troduce electronic postage meters into the market.

When competitors introduced new products into PB's home market, its-strong technology base allowed it to re-spond quickly. It did so when Neopost introduced the first electronic postage meter, when Ascom Hasler introduced the first modular machines, and when Francotyp - Postalia introduced the first digital-printing meters. Iris trying to do so again, as two California start-ups introduced the first Web-based postage systems.

A primary ingredient in PB's formula For domination of the US. market has been its direct sales organization, con-sisting of over 100 branch offices and thousands of sales and service representatives distributed throughout the country. In 1998, it mounted a new distribution initiative to address the fast-growing SOHO (Small Office, Home Office) mar-ket, with the creation of its "Office Direct" business unit. It will provide channels for PB's future Web-based products and lower ticket items that cannot support direct sales. Channels include telemarketing, direct -mail marketing, tele-vision, the Internet, and retail office-supply store chains.

For the first time in its history, PB has boldly turned to an "outsider" (Brother of Japan) for the development and production of a core product, raising the potential creation of a formidable future competitor. It did so to produce a stand-alone meter product with very low cost to target a new market of very low-mail-volume users. It is using direct marketing and, again for the first time, TV advertising to convince these low-mail-volume users to switch from stamps to a cost-effective postage meter.

PB very effectively uses its wholly owned subsidiary, Pitney Bowes Credit Corporation to lease its mailing sys-tem products. Once "captured,"' a customer is continually - revisited for lease renewal.

2. Neopost

Neopost, based in Paris, France, started in the "mailing equipment business at about the same time as PB. Its US subsidiary began in1933 as Friden, a California-based calculator company. It later expanded into the mailing equip-ment business, becoming the second US. Supplier. It was later merged with Roneo, a British company that had been in the mailing equipment business since the 1930s. Neopost manufactures in France and in the United Kingdom.

The company prides itself on being a technical inno-vator in its new products. Friden had the distinction, in 1979, of - introducing the first electronic postage meter, before PE. At the time of the desertification of mechanical meters by the USPS, Neopost had mostly electronic meters in the US. market and was, therefore, less negatively im-pacted than its competitors. It has a full product-line of-fering, manufacturing a line of letter folders and inserters and "OEM'ing PC-based mail/ shipping management sys-tems to round out its product line. It was quick to develop a digital thermal, transfer meter after Francotyp - Pdstalia, and also got an early start in developing Internet-based postage evidencing products.

Neopost USA has its headquarters in Union City, Cal-ifornia, where it employs about 250 people. It distributes its products through 22 direct field offices in major markets and over 150 independent dealers. Total US. Employment is over 1,300. Like PB, it also 'has it's own subsidiary that provides equipment leasing to its customers.

3. Ascom Hasler Mailing Systems

Ascom A.G. (Ascom), a $2 billion corporation headquar-tered in Bern, Switzerland, focuses two thirds of its busi-ness in the telecommunications market in the areas of car-rier access, PBX, paging, defense and security systems, and terminals. The remaining third of its business is in an area it calls "Service Automation," which includes cash-handling systems, payphone systems, transport revenue systems (ticketing), and mailing systems (Ascom Hasler Mailing Systems [AHMS]). For at least the past 10 years, Ascom has experienced difficulty in its core business due to the privatization of the Swiss Telecom industry, which began to privatize and open its market to foreign competitors in the late 1980s.As a result, AHMS took a back seat to the needs of Ascom's telecom core business.

In recent years, its core telecommunications business has also suffered from an acquisition that resulted in a sig-nificant cash drain on the company before it failed. In-vestments in its non-core companies were minimized while it struggled to return its core business to profitability. As a result, ARMS fell behind all of its competitors in new product offerings. In fact, in the mid-1990s, it found itself without a low-end meter product when its mechanical model was decertified by the USPS, and it had no elec-tronic model to replace it.

Ascom Hasler can trace its origin back to the same era as PB, although it has been in the United States only since the early 1980s. Unlike its three competitors, it distributes exclusively through a network of independent dealers in the United States. It has no direct sales offices in the United States and the core of its product line consists of a range of electronic mailing machines manufactured in Bern that still print mechanically, most of which have been installed recently to replace the USPS decertified mechanical ma-chines. These machines are vulnerable to a further desertification by the USPS, which will ultimately require that all meters in service print digital, encrypted indicia. It is the only manufacturer that has not yet introduced a digital printing postage meter. It is also the only manufacturer that has not announced plans to market a PC-based postage product.

Over half of ARMS's business is in the United States. Their U.S. organization consists primarily of customer and distribution support. In the past few years, an engineering organization has been formed at its headquarters in Shel-ton,

Connecticut, to develop software-based products for global markets and to support development efforts in Bern, Switzerland. Engineering and manufacture of the company's core postage meter products are performed in Bern. Ascom uses a third party to lease its products.

4. Francotyp-postalia

Francotyp-Postalia, Inc. (FP) entered the U.S. market in 1961. It is a subsidiary of Francotyp-Postalia, A.G., of Berlin, Germany. The parent started in 1923 as a manufacturer of special machinery and office machines and as electric equipment wholesalers. It markets its mailing products in 86 coun-tries. The U.S. subsidiary, primarily a distributor, is located in Lisle, Illinois, and employs about 100 people. The German- based mailing equipment manufacturer, while a major player in its home market, has not made a noticeable impact on the market in the United States. Until recently its prod-uct line was extremely limited, causing it to market relabeled products manufactured by Neopost in England. Until the mid-1990s, FP was the only manufacturer that was not able to offer postage meter resetting by phone. At that time, FP appeared to mount a new initiative when it built a new, modem manufacturing facility in East Berlin and launched an extensive new-product development effort. FP was the first manufacturer to introduce a postage meter named "Conquest," which printed variable information digitally using a dot-matrix print head and thermal transfer technol-ogy. The introduction of Conquest, and later a higher-mail -volume machine using inkjet technology to print indicia, placed FP on a new market-share growth curve, making it the fastest-growing meter supplier in the United States.

In July 1998, FP entered into a strategic partnership with E-Stamp, a start-up company pioneering on-line postage.

FP has two direct sales offices in the United States but uses independent mailing and office equipment dealers as its main distribution network to sell and service its prod-ucts. It uses a third party to lease its products.

The Products

Early meters were totally mechanical and utilized an elec-tric motor to drive a rotary drum containing a print die of the indicia. When cost-effective electronics and micro-processors became available in the mid-1970s, they were utilized in postage meter design to provide keyboard input, display, calculation, and control. A motor driven print drum was still used to deliver the indicia to the envelope or tape. The transition from mechanical to electronic/software de-vices proved to be a challenge for all manufacturers.

In addition to postage meters, manufacturers also pro-duce mailing machines that allow for the automatic feeding, sealing, and stacking of mail at various speeds. Postage meters are mounted on these machines to perform the printing of postage indicia within the mail feeding-stacking process. In this configuration, the meter is rented and owned by the manufacturer (by U.S. postal regulation), while the mailing machine is sold. Other peripheral prod-ucts, including postal scales that compute postage rates based upon weight, folders, inserters, and mail openers, as well as PC-based mail management systems are manufac-tured or sourced from OEM suppliers in an effort to pro-vide a complete product line.

An Aggressive USPS Changes Orientation

A congressional hearing in 1967 concluded that despite a huge growth in mail volume, with the exception of the zip code, the mail was being handled the same Way it was 100 years ago. Years of mismanagement, labor problems, poor control of operations, and transportation facilities resulted in a post office that was inefficient and piling up debt. Its heavily subsidized rates bore little relationship to its costs.

In 1969, Congress passed the Postal Service Act, re-moving the Postmaster General from the President's Cab-inet, and creating a self-supporting postal corporation wholly owned by the federal government. The Post Office Department became the United States Postal Service (USPS), an independent establishment of the executive branch of the U.S. government. Operational authority transferred from the Congress to the USPS executive man-agement and the board of governors. Despite this new ori-entation, the USPS continued to face mounting financial and competitive pressures. Substitutes for mail, including facsimile and electronic messaging, and funds transfer threatened to reduce the volume of mail. Private compa-nies, such as Federal Express, dominated the market for urgent delivery of mail and packages.

On May 5, 1992, Marvin Runyon became the 70th Postmaster General of the United States. Unlike several of his predecessors, Runyon was not a postal career em-ployee. Following a 37-year career with Ford, he became CEO of Nissan, U.S.A. In 1988, he left Nissan to take the top job at the Tennessee Valley Authority, where he was re-sponsible for a major turnaround of the organization, achieving cumulative savings and efficiency improvements of $1.8 billion and stable rates for the first time in 20 years.

Runyon wasted no time in implementing similar cost cutting changes at the USPS. Within six months, he built a leaner management structure, improved customer service, and increased efficiency that resulted from 47,000 volun-tary employee retirements. His actions essentially elimi-nated a $2 billion deficit the USPS faced in 1993 and set records for on-time performance and customer satisfaction.

In 1993, Runyon targeted the postage meter as a device subject to tampering, claiming that losses to the USPS exceed $100 million annually. Meter manufacturers were criticized for not incorporating state-of-the-art tech-nology, particularly micropro-cessors, making the devices in-herently more tamper-proof. The new technology was not embraced because previous USPS administrations discour-aged its use, and the rental business model favored the lower-cost, longer-life attributes of the simpler mechanical meters. As part of Runyon's initiative, the USPS started a campaign to "decertify:' mechanical meters and demand that they be removed from the market and be replaced by safer, electronic meters. For postage meter manufacturers this meant that their existing, profitable rental base of meters would have to be replaced and recapitulated at great cost. Compared to their mechanical counterparts, electronic meters are significantly more costly to design, produce, and maintain, and have much

shorter life cycles, both factors having negative impact on the meter rental financial model.

'USPS desertification schedule announced in May 1996:

- June 1,1996: Placements of new mechanical meters would no longer-be allowed.
- March 1, 1997: Mechanical meters used by firms processing mail for a fee would have to be removed from service.
- December 31,1998: Mechanical meters mounted on machines that automatically feed, seal, and stack mail would have to be removed from service. This resulted in a one-time windfall for manufacturers whose customers were required to upgrade their automatic machines to handle the newly mandated electronic meters.
- March 1, 1999: All remaining mechanical meters (stand-alone meters), would have to be removed from service.

The new, financially oriented USPS openly encouraged the use of new technologies, promising an expedient certifica-tion process. At the same time, it used its power to start a process that would lead to the desertification and phasing out of all mechanical meters by March 31, 1999. It also ag-gressively took over the funds that manufacturers were holding in trust for its customers to allow for the resetting of postage meters by phone. Manufacturers lost the interest on those funds, which they claimed helped cover costs of oper-ating the system. PB sued the USPS for breach of contract and settled in mid-1999 for $52 million. It is expected that the other manufacturers affected will follow PB's lead.

Technology-driven Changes

Today, growth in the use of computers for electronic funds transfers (EFT) has led to the development of technologies to ensure the safety of such transfers. Microelectronics, software, and communications technologies provide sys-tems that are virtually impossible to infiltrate. Elaborate systems that encrypted data before transmission were de-veloped to ensure security.

Working closely with Carnegie Mellon University in its Informa-tion-Based Indicia Program, the USPS defined its own criteria for a system that would result in the secure printing of postage indicia. The system, developed and an-nounced by the USPS in .May 1995, is based upon en-crypted Information Base, Indicia (IEI). The IEI contains the following information: readable postage amount, mail class, date, device ID number, and town or licensing post office; in addition, a two-dimensional bar code that en-codes the readable information as well as a digital signa-ture (for security management), and delivery point code. Unlike the indicia produced by a demounted on a rotary drum, each printed indicia is unique, making counterfeit-ing virtually impossible.

Much of the new technology is covered by PBs' patent portfo-lio. On June 10,1999, PB announced that it had filed suit against E-Stamp, a new market entry, charging that E-Stamp was infringing on PB patents. At the same time PB announced that it was involved in "discussions" with other marketers of computer-based postal products, to grant patent licenses for use of PB-developed technology.

New Market Entries and The Internet

The USPS, as a regulator, had always been a barrier to new entrants into the postage meter business. In its new image, it has encouraged and openly promoted new entrants, and encouraged the use of new technology not requiring huge capital investments. As a result, two new, serious players have entered the market, providing a software alternative to postage stamps to a new segment of the market: the small office and the home (SOHO) having Internet access.

E-Stamp, a California start-up, developed a system en-titled E-Stamp Internet Postage that allows a user to access the Internet and download postage funds into a secure de-vice interfaced to the user's existing PC and printer. The se-cure device is rented to the user for a monthly fee. The user can draw funds from the secure device to print postal indi-cia developed on the PC, directly on envelopes, labels, or documents on an existing off-the-shelf PC printer. E-Stamp has received financing from Microsoft Corporation, AT&T Ventures, Compaq Computer Corporation, and FP. Its man-agement team includes computer industry veterans from Microsoft and Oracle. In the summer of 1999, its products were approved by the USPS and the company announced its intentions to go public.

Stamps.com, also a California start-up, developed a system called Stamps.com Internet Postage that utilizes the Internet, but does not require a secure device to interface with the user's Pc. Instead, it allows users to print the USPS-approved indicia on envelopes, labels, or documents directly as it is transmitted over the Internet. Printing is ac-complished on the user's existing off-the-shelf PC printer. Stamps.com will charge a premium of about 10 percent for postage, which the company claims is significantly less than the 18 to 25 percent levied by traditional postage meter systems. Stamps.com's business venture partners include Intel and AOL. In the summer of 1999, its products were approved by the USPS and the company went public.

While there are two on-line-postage products that have received the final approval of the USPS, there are also three additional products on test:

1. PC Stamp, a stand-alone product offered by Neopost.
2. Postage Plus, an on-line product offered by Neopost.
3. Click-stamp, a stand-alone product offered by PB (PB is also expected to offer an on-line product shortly).

What to Do

Mr. Allocca looked again at the beautiful New England land-scape. He knew that the clock was ticking, and that things would never be the same for the postage meter industry. He knew that he needed a strategy, and that it had to address both the competition and the need to create a unique value. As he saw the situation, there were four options:

1. Convince its parent company, Ascom, to significantly increase its investment in new-product development, manufacturing, and marketing. To be effective in the required time frame might require a total restructur-ing of the organization worldwide.

2. Establish a partnership with a competitor, or com-petitors, or perhaps the USPS, to address the imbal-ance in the marketplace caused by the dominance of the industry giant.
3. Phase out the company's postage meter business in favor of a related business in which a competitive advantage could reasonably be realized. Perhaps a source of opportunity could be the growing popula-tion of shipments over the Internet. Use of funds from the postage meter rental base could help to fund a new venture.
4. Ascom could divest itself of the mailing business and concentrate on its core telecommunications business. Perhaps a sale to a competitor would be a possibility.

Which option would you choose? Would you develop an-other?

Discussion Questions

1. Analyze the attractiveness of the U.S. postage meter mailing equipment industry for:

- Pitney Bowes
- PB's three foreign competitors
- An increasingly profit-oriented USPS
- New Internet-based market entries

2. Develop a SWOT analysis for each of the players listed in question 1.
3. What key issues must be considered in the development of a go-forward business strategy for each of the players listed in question 1?
4. Develop a scenario of how the industry structure might change over the next five years.
5. Which one of the options identified by Mr. Allocca would you choose? Why?
6. Formulate your recommended strategy for Ascom Hasler Inc. and Ascom A.G

CASE STUDY
KODAK VERSUS FUJI

"The Battle for Global Market Share"

As retail America undergoes a dramatic change with the 'constant consolidation of companies, management must strive to maintain a competitive advantage or risk being acquired. The worldwide success of Wal-Mart has led many to diversify and heed the adage that "bigger is indeed better." An example in the global grocery industry is the Ahoid Group (Netherlands) which now operates in more than 17 countries including its recent acquisition of New York based Path mark. In the U.S. grocery industry, the merger between Albertson's and American Stores, and the, U.S. drug chain landscape has rapidly changed over the last two years with only four major players left standing: CVS, Rite Aid, Walgreen's, and Eckerd.

As the retail community shrinks, retailers put greater emphasis on their suppliers for quality products at a com-petitive price that enables them to make healthy margins to attract consumers. If one manufacturer cannot supply the necessary ingredients, retailers will look for other al-ternatives. This environment has provided an opportunity to shake up an otherwise mature and stable industry, the photographic industry, and has paved the way for a viable competitor to Kodak, such as Fuji Photo Film U.S.A. The phenomenon has contributed to Fuji making significant in-roads into Kodak's once commanding U.S. market share in particular and to its global share in general.

This case study shows the evolution of the Kodak-Fuji relationship, specifically from Kodak's perspective. The case study will attempt to show how Kodak has fallen from its lofty position and how it has developed strategies to rectify the situation. H. Donald Hopkins provided the groundwork for this revised case study in his original work "Kodak vs. Fuji: A Case of Japanese-American Strategic Interaction." The follow-up study examines this relationship, with respect to market share battles (both globally and domestically), sponsorship battles, court battles, and the photographic in-dustry in general.

The relationship between Kodak and Fuji had always been adversarial, as competitors naturally are; however, the relationship took a very serious turn in May 1995, when Kodak filed a Section 301 petition under U.S. trade law. The petition claimed that Kodak's 7 to 10 percent market share in Japan was not a result of consumer choice and market-ing efforts but rather a result of four principal Japanese wholesalers, backed by the Japanese government, that are exclusive Fujifilm supporters.

As a result, the World Trade Organization, which eventually presided over the court decision, announced on January 30, 1998, a "sweeping rejection of Kodak's COJl1-plaints" about the film market in Japan.

At present, with the court battles 'behind them, it ap-pears that Kodak and Fuji can now pool their efforts to grow the photographic and imaging business as they did with their shared effort, along with Canon, Minolta, and Nikon, in releasing the Advanced Photo System in 1996. These types of efforts are necessary to stave off the real competition to photography, the computer-savvy consumer who demands digital imaging.

Kodak and Fuji. . . Not a Pretty Picture

"How can Kodak possibly sit on its hands and allow this to happen?" pondered Alex Henderson, an analyst at Pruden-tial Securities, Inc. in New York, as' quoted in an article in the Rochester Democrat & Chronicle. "You can't have your nearest competitor growing at this volume and not deal with it, Analysts stated that for the first time in Kodak's -113- year history, it could no longer take its home market for granted. Over the last decade, while the U.S.-based Eastman Kodak Company was sleeping, the Japanese firm Fuji Photo Film opened its first film-production plant in the United States, cut prices, marketed aggressively, and stole valuable market share.

Kodak maintains that it will not engage in a price war to win customers back due to potential profit erosion. The inroads that Fuji has made in the U.S. market will certainly continue to build its momentum. "They (Kodak) are com-peting against an extremely determined, extremely profi-cient and extremely well-financed company in Fuji," says Michael Ellman, who tracks Kodak for Schroder & Com-pany.3What then, begs the question, is Kodak to do? Many analysts are demanding that Kodak's CEO George Fisher take drastic action to cut costs, reduce debt, and right Kodak's sinking ship.

The Changing Customer

The dynamics within the photo industry have changed dramatically within the past 15 years. Once upon a time, the film industry within the United States was basically stable and predictable, with industry leader Eastman Kodak, a US. -based company headquartered in Rochester, New York, holding a commanding share of the industry, hover-ing between 80 to 90 percent.4 No competitors even had a double-digit percentage of the amateur photo market and many consumers automatically equated Kodak with film. Competitors were left to fight for the scraps off Kodak's table and the pickings were slim.

Then, beginning in 1984, the general photographic market and particularly Kodak noticed a subtle change in consumer attitude. Kodak still retains its enviable and com-manding share of the market, but the market-savvy con-sumers of the new millennium now have more choices and do not automatically equate film with Kodak alone. Three major functions have eroded consumer brand loyalty and allegiance to Kodak these past 15 years.

First, American consumers are more accepting of foreign-based products, although they enjoy preaching the virtues of "buying American." They celebrate their patri-otic freedom by waving the American flag at picnics on the Fourth of July. However, it is not uncommon for some guests to drive to the Independence

Day celebration in a Mercedes Benz (German) automobile, while listening to music on a Sony (Japanese) radio/disc player. In addition, while waiting for their all-American burgers to cook, many Americans are reaching into the ice chest to find Bass (En-glish) Ale, along with Perrier (French) bottled water.

A January 1999 study showed that the United States recorded its single largest trade deficit month ever at $17 billion dollars Imports outweighed exports. Unless pro-tectionist legislation is initiated and passed, U.S. consumers will continue to purchase what they perceive is the best deal (be it domestic or foreign) for their money.

Second, consumers have found a bona fide competi-tor to Kodak in the name of Fuji film. Clearly, Fuji has emerged from a minor player in the early 19805 to take a solid number-two position within the U.S. market and has caught the attention, as well as the wrath, of Kodak. Third, the landscape within retail America has changed dramati-cally in the past five years. The success of Wal-Mart has taught retailers that diversification, scrambled marketing, and "one-stop" shopping are important to consumers. As consolidation sweeps the nation in mass merchants, food, and drug accounts, retailers realize they must maintain their competitive advantage or close shop. To survive, they are squeezing manufacturers for quality products at competitive prices to capture profit margins for expansion within the industry. This environment has provided an op-portunity for Fuji to prosper in an otherwise stable and mature photographic industry.

Today an all-out war has emerged. While Kodak and Fuji fight for market share, the real winner and benefactor is the consumer. "Retailers and consumers will be the big

winners in this struggle for market share among the big players," says one retailer. "We are going to get more in-centives to sell merchandise and the consumer is going to see a lot more new product at lower prices. Kodak and Fuji deny they are engaging in a price war, but for each move Fuji makes, Kodak counters with a vengeance. "Smack them until they figure it out:' is how Eric Steen burgh, Kodak's assistant chief operating officer, describes its strategy toward Fuji.

Today's Picture

The amateur photo market's estimated worth is $14.2 bil-lion. Film sales generate 20 percent or $2.84 billion (Exhibit 1). Within film sales, 35-millimeter film commands 80.2 per-cent or $2.27 billion dollars (Exhibit 2). While unit film sales showed a moderate 2 percent growth rate, the real shining stars within this segment, which continues to exhibit strong growth, are the one-time-use cameras (OTUC), which are considered film within the industry. Unit sales grew at 23 percent in 1997 and a 20 percent annual growth rate is ex-pected to continue (Exhibit 3).

The New Players

While Kodak and Fuji are familiar competitors, they have to be aware as new competition enters the picture. In 1997, digital imaging accounted for 6.4 percent or just under $1 billion in the amateur photo market (Exhibit 1). As tech-nology inevitably increases and prices drop, the consumer may prefer digital imaging. A recent Salomon Smith Barney report on imaging stated that the digital camera market in the United States will be 12.7 million units by 2002, which is larger than the current conventional lens shutter business in the United States. The report also states that the average price of a digital camera in 2002 will be about $168. Digital cameras are being mainstreamed quickly.

Exhibit 1- 1997 Amateur Photo Market

Segment	Percentage	Dollars
Photo processing	43.50	$6,177,000,000
Film Sales	20.00	$2,840,000,000
Conventional		
Cameras	9.70	$1,377,400,000
Digital Imaging	6.40	$908,800,000
Portrait Studios	5.50	$781,000,000
Frames	3.30	$468,600,000
Photo Accessories	3.20	$454,400,000
Albums	2.50	$355,000,000
Camera Repair	1.00	$142,000,000
Consumables	0.90	$127,800,000
Video Camcorders	0.70	$99,400,000
Video Accessories	0.50	$71,000,000
Other	2.80	$397,600,000
	100.00	$14,200,000,000

Nontraditional competitors such as Sony, Casio, and Hewlett-Packard are entering the industry with digital cameras and printers. To combat these threats, Kodak and Fuji each have manufactured digital cameras and printers of their own to stay competitive as "film companies" in the 21st century: To capture this technological consumer, both Kodak (Kodak/AOL "You've Got Pictures") and Fuji (Fuji.Net) have instituted cutting-edge services to allow customers to order prints directly over the Internet.

The Global Market Share Battles

Traditionally, Kodak and Fuji have battled it out in the overseas film markets. In 1995 it was estimated that Kodak had a 44 percent global share while Fuji had 33 percents Today the global share has changed as the U.S. market and Asian markets have shifted. Experts estimate that both Kodak and Fuji were neck in neck, with roughly a third of the market each. Alex Henderson, managing director of technology research at Prudential Securities, Inc. in New York, has been watching the two companies since 1985. Henderson believes that Fuji will overtake Kodak by 2001. "When that happens," says Henderson, "Kodak will go from being Coke to being Pepsi.

In a letter to Kodak employees, Fisher and top man-agement stated, "Competitors are making bold claims. They claim they will dominate the future of this business. We speak for the tens of thousands of people who work for Kodak when we say, 'Not on our watch'.

The U.S. Market Share Battles

Eastman Kodak has a commanding, yet declining, 70 per-cent of the U.S. market share. Fuji film has approximately 17 percent of U.S. market share. Other minor players in the U.S. market include private-label brands, which constitute 7 percent. Agfa of

Germany and Konica of Japan each have less than 2 percent market share,

The Price Wars

Domestically speaking, Kodak and Fuji traditionally en-joyed healthy margins and treated the market as a mutu-ally profitable duopoly. Then in the spring of 1996, Fuji cut prices on film by 10 percent to 15 percent after Castco Wholesalers decided to go exclusively with Kodak. Fuji had excess inventory of 2.5 million rolls of film. They dis-tributed the heavily discounted film to other retailers to avoid losses from film expiration. This began a correlation between price-cutting and market share.

As Fuji's market share grew incrementally in 1997 at Kodak's expense, Kodak initially stated that it would not engage in a price war. Fisher stated in 1997 that: "Our chal-lenge is to figure out ways to introduce some exciting new products. That's a better way to fight an intense battle like the one we're in. Later in the year he said, "We do not intend to continue to lose share at the rate we lost over the summer months. Kodak stated that it did not intend to engage in a price war, and for good reason. Jonathan Rosenzweig, an analyst at Salomon Smith Barney, figures that "for very percent cut in Kodak film prices, a per-cent drop in earnings per share results."

Consumer reaction surprised the industry. Once con-sumers tried Fuji, they found they liked the product as long as it was priced lower than Kodak. By 1998 the hectic pace of competi-tion between Fuji and Kodak seemed to slow down, with toe exception of value packs. "Spurring sales this year was the fact that the category in general got more price competitive, with both Kodak and Fuji sharpening their prices, particularly in promoted prices," states Jerry Quindlan, Kodak's vice president and general manager of Mass and Wholesale Clubs. "I would not call it a price war, however; it is really just sharpening prices. Our average price did not go down that much, but we did get more ag-gressive to protect market share.

Sponsorship Battles

The rivalry between Kodak and Fuji does not stop on the grocery or camera specialty shelves. This rivalry has heated up in the sponsorship arena as well. In his visit to Pace Uni-versity's Lubin School of Business on April 28, 1999, Herb Baer, director of Marketing, Consumer Film and Quick-Snaps at Fuji, stated, "Fuji film sponsored the 1984 Los An-geles Olympic Games and this sponsorship really helped put Fuji on the map. As the story goes, Peter Ueberroth the Olympic organizer for the US. Olympic Games visited Rochester and asked Kodak to be the exclusive film spon-sor. Kodak refused the $1 million deal (far below its $4 mil-lion asking price). Ueberroth called Fuji and Fuji agreed on the spot. Fuji, a relatively small player in those days, still benefits from this agreement.

Kodak did not sit idle during the actual airing of the Olympic games. It initiated a legal ambush to divert at-tention away from Fuji. "While Fuji was a worldwide spon-sor of the Olympics, its competitor, Kodak, became a 'sponsor' of ABC television's broadcasts of the games and the 'official film' supplier to the US. Track team. Fuji re-turned the 1984 favor to Kodak during the 1988 Olympics and, thus, began the spon-sorship and ambush marketing that continues today.

Court Battles

Ironically, Kodak and Fuji each command roughly the same market share in their home-country markets: 70 per-cent. While Fuji has recently made significant strides in the US market to gain approximately 17 percent, Kodak hovers around 7 to 9 percent in the Japanese market.

The main differences between the U.S. and Japanese markets are the existing systems to distribute film, paper, and supplies to end-users. III the United States, film manu-facturers sell directly to retailers and photo finishers. In Japan, distributors mediate between the two parties. Fuji has close ties to the four principal distributors, while Kodak claims that these strong relationships prevent distribution of other brands.

Furthermore, Kodak states that Tokyo-based Fuji has hundreds of exclusive deals with photo finishing labs and that the Japanese government is backing the entire system in order to impede Kodak's success in the Japanese market.

On May 18, 1995, the Eastman Kodak Company asked the United States 1tade Representative (USTR), the US. Govern-ment official responsible for negotiating interna-tional trade disputes, to investigate whether the government of Japan had allowed anticompetitive practices to deny Kodak opportunities to sell film and color paper in Japan.

Kodak asked for this investigation under Section 301 of the US. Trade Act, a law that requires the USTR to de-termine whether trade practices by a foreign country are unreasonable and discriminate against US. Exporters.

In a news conference in Tokyo in July, Kodak's Ira Wolf said, "We understand the risks inherent in going ahead with a 301 case, especially given the feelings of the average Japanese consumer about 301. But we decided there was no alternative. The Office of the Trade and Investment Ombudsman (Japan) is too weak and the Geneva-based World Trade Organization does not cover competition policy.

Both companies claimed that injustices occurred in their respective market. Fisher said, "While Fuji competes with Kodak on a global basis, it makes virtually all of its profits in Japan, using those proceeds to finance low-price sales outside Japan. He also said, "The Japan market, a large percentage, maybe 70 percent, is closed to us. And as a result, Fuji is allowed to have a profit sanctuary and amass a great deal of money, which they use to buy market share in Europe and in the United States.

Fisher added, "All we are seeking is the opportunity to compete in an open market. We want resolution, not retal-iation. Nor do we want market share targets. We want an end to illegal market barriers. . . Kodak sells world-class products. If given a chance, we believe that our products can compete successfully in any market. We have not had that chance in Japan.

Fuji rebutted in a 588-page defense entitled, Rewriting I History, Kodak's Revisionist Account of the Japanese Con-sumer Photographic' Market. In the rebuttal, it cited that Kodak's problems in Japan stemmed from mismanagement and other factors, not unfair trade. Fuji film president Minoru Ohnishi called Kodak's allegations a violation of business ethics and said that Kodak "shamelessly made false allegations" against Fuji film.

Fuji drew upon some powerful quotes that people were making about the case. Some included, "The com-bined sales of these Eastman Kodak subsidiaries in Japan in 1994 was $1.2 billion, and Eastman Kodak is 43rd on the list of the largest foreign companies. Whatever its com-plaints, Eastman Kodak has a major position in the Japanese market. It has not been closed out.

Another convincing statement came from former Kodak president Kay Whitmore. He stated, "I think there is no further barrier in the Japanese market for Kodak to proceed with its business in Japan. If there should be some-thing, it would be only due to Kodak's own insufficient effort in the Japanese market.

After nearly two and one half years of court rulings, the World Trade Organization in Geneva issued a "sweep-ing rejection of Kodak's complaints" about the film market in Japan. Fuji Photo Film U.S.A. Inc. President Osamu Inoue said, "The World Trade Organization failed to find even minimal evidence to support the US. case. . . After today, there can longer be doubt: imported film is widely available and competitively priced in Japan.

The Eastman Kodak Company

For generations, employment at the Eastman Kodak Com-pany meant job security. Rochester, New York's biggest and most paternalistic employer gave a sense that Kodak would never relinquish its US market dominance to "for-eign competition."

Kodak opened photography to the masses with inex-pensive cameras and easy-to-use Kodak's name is one of the most recognized brand names it consumer goods in the world. Its slogan of "you push the button, we do the rest," enabled people to take the worry out of a compli-cated, scientific process and make photography accessible to nearly everyone who wanted to take pictures.

Kodak has been characterized as the leader in pho-tography, an industry that has gone from rudimentary glass plates to cutting-edge digital images. Yet, Kodak realizes that for all of its historical success throughout the world, it must now increas-ingly include digital technology into the product mix to stay at the forefront of the photographic and imaging industry.

The climate at Kodak over the past few years has been well documented. Wall Street has been nervous due in part to soft sales in the United States, which stemmed from the battles with Fuji and a botched launch of the New Ad-vanced Photo System. Massive layoffs (16,000), the strong U.S. dollar-meaning exports become less profitable and imports become more profitable for Kodak competitors and sluggish growth in emerging markets have all con-tributed to Kodak's decline in market share. "We went from 20 percent growth to about 7 percent, says CEO George Fisher glumly.

When Kodak hired Fisher in December 1993, he was hailed as the leader that would bring back the highest levels of success that recently had eluded Kodak. Indeed, Fisher has pared down costs, shed debt, sold off businesses not related to photography, and refocused goals, but ana-lysts say that Kodak was slow to react when it could see the writing on the wall. According to Eugene Glazer, a Fortis Advisers analyst who never changed his mind that Kodak was in a mature business that couldn't grow: "Fisher moved too slowly and didn't instill a sense of urgency.

Profits and sales at Kodak have been eroding through-out the 1990s. In 1998, sales were $13.4 billion as compared to $18.9 billion in 1990 (see Exhibit 6). Kodak's market share in 35-millimeter film has dropped; film prices have declined an average of 8 percent, which cuts into Kodak's profitability. The company is at risk of losing the title of world leader in the photographic industry. However, Kodak posted a net profit for the first quarter of 1999, bol-stered by steady film sales growth in China and Brazil as well as in low-end digital cameras in the United States.

Nielsen data indicate that film sales in the U.S. market rose 10 percent in the first quarter of1999, as compared to the first quarter of 1998. Unit sales have increased even though neither Kodak nor Fuji Photo Film dropped prices in 1999. "They're all finally realizing that it is marketing, not price, that makes the difference Ulysses Yannas, an analyst with Mercer, Bokert, Buckman & Reid, said.

Perhaps George Fisher's vision is taking hold. He has been successful in attracting new talent to Kodak's close-knit Rochester community. He appointed Daniel Carp, a 27-year'Kodak sales veteran in Canada, Latin America, and London, as president and chief operating officer in De-cember 1996. Carp fully realizes the changing industry as well as emerging markets. To help foster change, Kodak ad-mitted that they had to set up shop where the talent is. To that end, they have software operations in the Silicon Valley and marketing offices in Atlanta.

In the restructuring of Kodak, four main segments have emerged:

1. The Consumer Imaging Segment: traditional films, papers, processing, photo finishing, photographic chemicals, cameras (including one-time use), and the Advanced Photo System.
2. The Kodak Professional Segment: traditional films, pa-pers, digital cameras, printers, scanners, and chemicals.
3. The Health Imaging Segment: medical films, chemicals, and processing equipment as well as services.
4. Other (Digital and Applied Imaging) Imaging Segment: motion pictures, audiovisual equipment, certain digital cameras, printers, microfilm products, application software, scanners, and other equipment.

While these segments serve the advanced countries of the world and keep Kodak current with competitors, Kodak recognizes that there are untapped consumers in emerging markets, such as China. In an interview with Carp in the February 1999 issue of Photo Marketing, Carp explained, "In terms of strategy, it's evolving just as we predicted. We are building plants that will make world-class products to supply the domestic market. . . . The second part is to build a team to get the word out to consumers that photography is fun. . . . The third part is to build the infrastructure so it's a good experience for the consumer.

Exhibit 6 1998 Kodak Annual Report

Fiscal Year-End: December Income Statement ($mil)				
	1998	**1997**	**1996**	**1995**
Sales	13,406	14,538	15,968	14,980
Cost of Goods				
Sold	7,293	8,130	8,326	7,962
SG & A Expense	3,303	6,432	5,438	5,093
Net Income	1,390	5	1,288	1,252
EPS Primary ($)	4.30	0.01	3.82	3.67
EPS Fully				
Diluted ($)	4.24	0.01	3.82	3.67
Assets ($mil)				
	1998	**1997**	**1996**	**1995**
Cash	457	728	1,777	1,764
Receivables	2,527	2.271	2,738	3,145
Inventories	1,424	1,252	1,575	1,660
Current Assets	5,599	5,475	6,965	7,309
Total Assets	14,733	13.145	14,438	14,477
Equity ($mil)				
	1998	**1997**	**1996**	**1995**
Common Stock				
Equity	3,988	3,161	4,734	5,121
Shares				
Outstanding				
(mil.)	323.3	323.1	331.8	345.9

Countries	Japan United States	Australia Canada Korea France Germany United Kingdom	Italy Mexico Brazil Thailand	Indonesia China Russia India
Number of households in these regions	145,000,000	114,000,000	92,000,000	607,000,000
Average rolls of film consumed per household year	8.2	4.6	2.2	.5
Total rolls of film	1,189,000,000	524,400,000	202,400,000	303,500,000

Exhibit 7 Ratio of Households to Rolls of Film Consumed

Kodak believes that the future of photography, in ad-dition to advancing technology, is in getting more people to 'take pictures. To that end, it states in its 1998 annual report: "What if households in developing markets shot a full roll of Kodak film each year? The gain would be immense.

Fuji Photo Film Co., Ltd.

Fuji Photo Film Co., Ltd, was founded in 1934 and is head-quartered in Tokyo, Japan. If one person can claim to be the architect of Fuji's growth, it's Minoru Ohnishi. At the age of 55, he took over the company in 1980, making him Fuji's youngest president ever. It was under Ohnishi's reign that salespeople were encouraged to spend time with dis-tributors and build relationships. As Japanese insiders say, "One cup of sake means 100,000 yen (of business)."

Fuji Photo Film has always prided itself on having the " technology to produce superior products to drive sales. The company has consistently spent 7 percent of sales on re-search and development to maintain a competitive advantage. Because of this investment, Fuji was able to introduce faster film with brighter colors (400 speed, 1600 speed), which is what the professional and serious amateur photographers were asking for in the 19705. In 1986, Fuji was the first to introduce one-time-use cameras. By the time Kodak caught up with the technology, Fuji established a lead in one-time-use cameras that Kodak never experi-enced with traditional film.

This attention to detail and ability to occasionally outpace Kodak technologically has endeared Fuji to the pro-fessional market and served as a stepping-stone to build creditability 'in the larger amateur market. Originally, Fuji started out in' the U.S, market in 1965 as a private-brand supplier. In 1972, Fuji began to market film under its brand name and, after remaining a very small player in the shadow of Kodak in the United States; Fuji's initial success came with the sponsorship. of the 1984 Olympic Games in Los Angeles. Every year since, Fuji has been slowly and quietly progressing in the U.S. market. "The fact that Fuji has made inroads in the U.S. has surprised even Kodak," says Sugaya Aiko, an analyst at Kleinwort Benson in Tokyo. "That is one reason why they are fighting back in every other market.

"Fuji's greatest strength is that they always make sure that consumers are ready to buy their new products, and they actually get the products to the consumers," says Toby Williams, an analyst at SBC Wartburg in Tokyo.

As a company, Fuji Photo Film has three core business systems:

1. Imaging System: color films, motion picture film, cameras, magnetic audiovisual media, electronic imaging, and equipment.
2. Photo finishing System: photo-finishing equipment, paper, and chemicals.
3. Information System: graphic systems, medical diag-nostic systems, office automation systems, industrial materials, and data-recording media.

Fuji's long-term strategy in the United States is to pro-duce locally but compete globally. "Globalization through localization" translates to producing as much film and paper on U.S. soil as possible to avoid troublesome trade disputes, become more responsive to demanding U.S. ac-counts needs, and keep overall costs to a minimum. In 1981, Fuji produced just 3.5 percent of its goods outside of Japan; today the figure is roughly 40 percent, with manufacturing plants in the United States, the Netherlands, Germany, France, and the People's Republic of China.

Like Kodak, Fuji has to stay competitive with Silicon Valley to produce state-of-the-art digital products. To that end, Fuji established FUJIFILM Software (California), Inc. in October 1998.

Fuji is one of the leanest Japanese companies. In the past 10 years, Fuji's sales have almost doubled, yet the number of staff in Japan remains almost flat. Fuji's world-wide output per employee is $285,000, while Kodak s-even after extensive layoffs-is $155,000. It is this type of drive that has maintained Fuji's double-digit sales growth each year for the last decade (see Exhibit 8).

Still Fuji's drive to lead the industry has not come without a price. "As a company Fuji has been so obsessed with building its brand, improving product quality, and in-vesting in research and development and marketing that it has neglected areas like profitability," says Sugaya Aiko of Kleinwort Benson. "Payouts have been far lower than Kodak because they focused too much on long-term goals," according to Sugaya.

With world-class product quality in the balance for both Kodak and Fuji, both are poised to battle it out for global dominance. "There are two giants in this field and each wants to be bigger than the other," according to Sugary. -

Exhibit 8 Fuji Photo film Co, Ltd. 1998 Annual Report

Fiscal Year-End: March 31			
(Assumes Y132 = U.S.$1,3/31/98)			
Income Statement ($nu1)			
	1998	**1997**	**1996**
Sales	10,439	9,485	8,219
Income before taxes	1,230	1,214	993
Net income	672	646	552
Per share of common stock			
Net income	1.31	1.25	1.07
Cash dividends	0.17	0.16	0.15
R&D expenses	613	575	554
Acquisition of fixed assets	854	737	. 571
Depreciation	589	558	519
Total assets at year-end	16,148	15,041	13,991
Total shareholders' equity	10,837	10,188	9,488
Number of employees	36,580	33,154	29,903

"You'd have to spend billions of dollars on research and development, marketing and distribution and even then, there's no guarantee you could catch up with these two.

Conclusion

Based on Kodak's 1999 first-quarter earnings, it is too early to predict Kodak's status. However, Fuji film is a formida-ble opponent. To Kodak's surprise, statistics indicate that those consumers who have tried Fuji stay with it as long as there is a price advantage.

Generally speaking, the industry, Kodak and Fuji in-cluded, does not want to lower price for fear that it will fi1rn this industry into a commodity business. Healthy margins are desirable for everyone involved in the industry at the consum-ers' expense. The formula of V = BIP clearly is crystallized as consumers enjoy an increased value. For the past two years- the benefits remained constant, but prices have dropped. The longevity of this trend is a major concern.

Domestically, new products such as the Advanced Photo System, digital cameras, and Internet services are the keys to increasing usage, which will invigorate this mature market. Increased advertising and educated con-sumers will also drive sales for everyone involved.

From a global perspective, Kodak and Fuji are vying for hegemony in another battle, this time in emerging mar-kets, specifically in China. Both are poised to implement strategies that will give them market share in this vast region of the world. Generally speaking, Kodak win concentrate on push marketing, market share, and cross pro-motion with its photo processing network, while Fuji will focus on innovative new products, price advantages over Kodak, and research and development.

Discussion Questions

1. How can Kodak protect its strategic advantage from competitors, especially Fuji?
2. How can Kodak anticipate market changes faster and react accordingly?
3. What are Fuji's chances for future growth?
4. What are some disadvantages that Fuji has to overcome?
5. Should both Kodak and Fuji be concerned over digital integration into the silver halide Indus

LESSON 19:
PRODUCT DECISIONS

The learning objectives from this lesson are as follows:

1. To understand the basic concept of a product
2. How to position the product in the market.
3. Product design considerations
4. Strategic alternatives towards the product
5. New product in global marketing

Basic Concepts

We begin our introduction to global product decisions by briefly reviewing product concepts typically covered in a basic marketing course. All basic product concepts are fully applicable to global marketing/ additional concepts that apply specifically to global marketing are also discussed.

Products: Deffinition and Calssification

What is a product? On the surface, this seems like a simple question with an obvious answer. A product can be defined in terms of its tangible physical attributes – such as weight, dimensions, and materials, thus, an automobile could be defined as 3,000 pounds of metal or plastic, measuring 190" long, 75" wide, and 59" high. However, any description limited to physical attributes gives an incomplete account of the benefits a product provides. At a minimum, car buyers expect an automobile to provide safe, comfortable transportation, which derives from physical features such as air bags and adjustable seats. However, marketers cannot ignore status, mystique, and other intangible product attributes that a particular model of automobile may provide. Indeed, major segments of the auto market are developed around these intangible attributes.

A product, the, can be defined as a collection of physical, psychological, service, and symbolic attributes that collectively yield satisfaction. Or benefits, to a buyer or user.

A number of frameworks for classifying products have been developed. A frequently used classification is based on users and distinguishes between consumer and industrial goods. Both types of goods, in turn, can be further classified on the basis of other criteria, such as how they are purchased (convenience, preference, shopping, and specialty goods) and their life span (durable, nondurable, and disposable). These and other classification frameworks developed for domestic marketing are fully applicable to global marketing.

Products: Local, National, International, and Global

Many companies find that, as a result of expanding existing businesses or acquiring a new business, they have products for sale in a single national market. For example, Kraft Foods at one found itself in the chewing gum business in France, the ice cream business in Brazil, and the pasta business in Italy. Although each of these unrelated businesses was, in isolation, quite profitable, the scale of each was too small to justify heavy expenditures on R&D, let alone marketing, production, and financial management form international bead quarters, an important question regarding any product is whether it has the potential for expansion into other markets. The answer will depend on the company's goals and objectives and on perceptions of opportunity.

Managers run the risk of committing two types of errors regarding product decisions in global marketing. One error is to fall victim to the "not invented here" (NIH) syndrome, ignoring product decisions made by subsidiary or affiliate managers. Managers who behave in this way are essentially abandoning any effort to leverage product decision policy on all affiliate companies on the assumption that what is right for customers in the home market must also be right for customers everywhere.

The four product categories in the local-to-global continuum – local, national, international, and global— are described in the following sections.

Local Products

A local product is available in a portion of a national market. In the United states, the term regional product is synonymous with local product. These products may be new products that a company is introducing using a rollout strategy, or a product that is distributed exclusively in that region. Originally, cape Cod Potato Chips was a local product in the New England market. The company was later purchased by Frito-Lay and distribution was expanded to other regions of the United States.

National Products

A national product is one that, in the context of a particular company, is offered in a single national market. Sometimes national products appear when a global company caters to the needs and preferences of particular country markets. For example, Coca-Cola developed a no carbonated, ginseng-flavored beverage for sale only in Japan and a yellow, carbonated flavored drink called Pasturing to compete with Peru's favorite soft drink, Inca Cola. After years of failing to dislodge Inca Cola, Coke followed the old strategic maxim. " if you can't beat them, buy them," and acquired Inca Cola.

Similarly, Sony and other Japanese consumer electronics companies produce a variety of products that are not sold outside of Japan. The reason: Japanese consumers have a seemingly insatiable appetite for electronic gadgets.

International Products

international products are offered in multinational, regional markets. The classic inter-national product IS the Euro product, offered throughout Europe but not In the rest of the world. Renault was for many years a Euro product When Renault entered the Brazilian market, it became a multiregional company. Most recently, Renault invested, in Nissan and has taken

control of the company. The combination of Renault in Europe: and Latin America, and Nissan in Asia, the Americas, Europe, the Middle East and! Africa, has catapulted Renault from a multiregional to a global position. Renault is an example of how a company can move overnight through investment or acquisition from an international to a global position.

Global Products and Global Brands

Global products are offered in global markets. A truly global product is offered in the Triad, In every world region, and In counties at every stage of development. Some global products were designed to meet the needs of a global market; others were designed to meet the needs of a national market but also, happily, meet the needs of a global market.

Note that a product is not a brand. For example, portable personal sound systems or personal stereos are a category of global product; Sony is a global brand. A global brand, like a national or international brand, is a symbol about which customers have beliefs or perceptions. Many companies, including Sony, make personal stereos. Sony created the category more than 10 years ago, when it introduced the Walkman. It is important to understand that global brands must be created by marketers; a global brand name can be used as an umbrella for introducing new products. Although Sony, as noted previously, markets a number of local products, the company also has a stellar track record both as a global brand and "a manufacturer of global products.

The qualities of a global brand: It has the same name as is the case for Coke, Sony, BMW, Harley-Davidson, and so on; or it may be the same meaning in different languages, as is true of Unllever's Snuggle (United States) fabric softener, which carries a cuddly teddy bear logo and the local translation of a meaning identical or similar to the meaning of *snuggle* in American English. A global brand has a similar image, similar positioning, and is guided by the same strategic principles. However, the marketing mix for a global brand may vary from country to country. That means that the product, price, promotion, and place (channels of distribution) may vary from country to country. Indeed, if one tracks the examples-Marlboro, Coke, Sony, Mercedes, and Avon-one will indeed find that the marketing mix for these products varies from country to country. The Mercedes, which is exclusively a luxury car in the United States, is also a strong competitor in the taxi market in Europe. Avon, which is a premium-priced and packaged cosmetic line in Japan, is popularly priced in the rest of the world. In spite of these variations in marketing mix, each of these products is a world or global brand.

Global product differs from a global brand in one important respect: It does not carry the same name and image from country to country. Like the global brand, however, it is guided by the same strategic principles, is similarly positioned, and may have a marketing mix that varies from country to country. Whenever a company finds itself with global products, it faces an issue: Should the global product be turned into a global brand? This requires that the name and image of the product be standardized. The two biggest examples of this move were the shift from Standard Oil's many different local brands to Exxon, and Nissan's decision to drop the Datsun marque in the United States and adopt various model names for Nissan's worldwide product line.

When an industry globalizes, companies are under pressure to develop global products. A major driver for the globalization of products is the cost of product R&D. As competition intensifies, companies discover that they can reduce the cost of R&D for a product by developing a global product design. Even products such as automobiles, which must meet national safety and pollution standards, are under pressure to become global: With a global product, companies can offer an adaptation of a global design instead of a unique national design in each country.

Coke is arguably the quintessential global product and global brand. Coke's positioning and strategy are the same in all countries; it projects a global image of fun, good times, and enjoyment. Coke is "the real thing." There is only one Coke. It is unique. It is a brilliant example of marketing differentiation. The essence of discrimination is to show the difference between your products and other competing products and services.

This positioning is a considerable accomplishment when you consider the fact that Coke-is a low/no-tech product. It is flavored, carbonated, sweetened water in a plastic, glass, or metal container. The company's strategy is to make sure that the product is within arm's reach of desire. However, the marketing mix for Coke varies. The product itself is adapted to suit local tastes; for example, Coke increases the sweetness of its beverages in the Middle East, where customers prefer a sweeter drink. Also, prices may vary to suit local competitive conditions, and the channels of distribution may differ. However, the basic, underlying, strategic principles that guide the management of the brand are the same worldwide. Only an ideologue would insist that a global product cannot be adapted

Rank	**Brand Name**	**Industry**	**Country**
1	Coca-Cola	Beverage	United States
2	Microsoft	Software	United States
3	IBM	Computers	United States
4	General Electric	Diversified	United States
5	Ford	Automobiles	United States
6	Disney'	Entertainment	United States
7	Intel	Computers	United States
8	McDonald's	Food	United States
9	AT&T	Telecommunications	United States
10	Marlboro	Tobacco	United States
11	Nokia	Telecommunications	Finland
12	Mercedes	Automobiles	Germany
13	Nescafe	Beverages	Switzerland
14	Hewlett – Packard	Computers	United States
15	Gillette	Personal Care	United States
16	Kodak	Imaging	United States
17	Ericsson	Telecommunications	Sweden
18	Sony	Electronics	Japan
19	Amex	Financial Services	United States
20	Toyota	Automobiles	Japan

Source: lnterbrand, www.interbrand.com.

to meet local preferences; certainly, no company building a global brand needs to limit itself to absolute marketing mix uniformity. The issue is not exact uniformity but rather offering essentially the same value.

Global marketers should systematically identify and assess opportunities for developing global brands. Creating a global brand requires a different type of marketing effort-including up-front creative vision than that required to create one or more national brands. On the other hand, the ongoing effort to maintain brand awareness is less for a leading global brand than it is for a collection of local brands. What criteria do marketers use to decide whether to establish global brands? One expert has argued that the decision must be "determined by bottom-up consumer-driven considerations, not by top-down manufacturer-driven business convenience' A major determinant of success will be whether the marketing effort is starting from scratch with a "blank slate, or whether the task is to reposition or rename an existing local brand in an attempt to create a global brand. Starting with a blank slate is vastly easier-than repositioning existing brands.

Product Positioning

Product positioning is a communications strategy based on the notion of mental "space" *positioning* refers to the act of locating a brand in customers' minds over and against other products in terms of product attributes and benefits that the brand does and does not offer. The word *positioning,* first formally used in 1969 by Ries and Trout in an article that appeared in *Industrial Marketing,* describes a strategy for "staking out turf' or" filling a slot" in the minds of target customers[6].

Several general strategies have been suggested for positioning products: positioning by attribute or benefit, quality/price, use or application, and use/user? Two additional strategies, high-tech and high-touch, have been suggested for global products.

Attribute or Benefit

A frequently used positioning strategy exploits a particular product attribute, benefit, or feature. In global marketing, the fact that a product is imported can itself represent a benefit positioning. Economy, reliability, and durability are other frequently used attribute/benefit positions. Volvo automobiles are known for solid construction that offer safety in the event of a crash. In the ongoing credit card wars, VISA's advertising focuses on the benefit of worldwide merchant acceptance.

Quality/Price

This strategy can be thought of in terms of a continuum from high fashion/quality and 'nigh price to good value (rather than low quality) at a low price.8The American Express Card, for example, has traditionally been positioned as an upscale card whose prestige justifies higher annual fees than VISA or MasterCard. The Discover card is at the other end of the continuum. Discover's value position results from no annual fee and a cash rebate to cardholders each year.

Use/User

Positioning can also be achieved by describing how a product is used or associating a product with a user or class of users the same way in every market. For example, Benetton user s the same positioning for its clothing when it targets the global youth market. Marlboro's extraordinary success as a global brand is due in part to the product's association with cow-boys—the archetypal symbol of rugged independence, freedom, space, and Americana—and transformation advertis-ing that targets urban smokers.

Why choose Marlboro instead of another brand? Smoking Marlboro is a way of getting in touch with a powerful urge to be free and independent. Lack of physical space may be a reflection of the Marlboro user's own sense of " macho-ness" or a symbol of freedom and independence. The message is reinforced in advertising with an image carefully calculated to appeal to the universal human desire for those things and urges smokers to "join that rugged, independent cowboy in the Old West!" The advertising succeeds because it is very well done and, evidently, addresses a deep, powerful need that is found around the globe,[11] Not surprisingly, Marlboro is the most popular cigarette brand in the former Soviet Union.

High-tech Positioning

Personal computers, video and stereo equipment, and automo-biles are product categories for which high-tech positioning has proven effective. Such products are frequently purchased on the basis of physical product features, although image may also be important. Buyers typically already possess or wish to acquire considerable technical information. High-tech products may be divided into three categories technical products, special interest products, and demonstrable products.

Computers, chemicals, tires, and financial services are technical products in the sense that buyers have specialized needs, require a great deal of product information, and share a common language. Computer buyers in Russia and the United States are equally knowledgeable about Pentium microprocessors, hard drives, and random access memory (RAM) requirements. Marketing communications for high-tech products should be informative and emphasize features.

Special-interest products also are characterized by a shared experience and high involvement among users, although they are less technical and mote leisure or recreation oriented. Again, the common language and symbols associated with such products can transcend language and cultural barriers. Fuji bicycles, Adidas and Nike sports equipment, Canon cameras, and Sega video game players are examples of successful global special-interest products.

High-touch Positioning

Marketing of high-touch products requires less emphasis on specialized information and more emphasis on image. Like high-tech products, however, high-touch categories are highly involving for consumers. Buyers of high-touch products also share a common language and set of symbols relating to themes of wealth, materialism, and romance. There are three categories of high-touch products: products that solve a common problem, 'global village products, and products with a universal theme. At the other end of the price spectrum from high-tech, high-touch products that can solve a problem often provide benefits linked to "life's little moments." Ads that show friends talking over a cup of coffee in a cafe or quenching thirst with a soft drink during a day at the beach put the product at the center of everyday life and communicate the benefit offered in a way that is understood worldwide. Upscale fragrances and designer fashions are examples of products

whose positioning is strongly cosmopolitan in nature. Fragrances and fashions have traveled as a result of growing worldwide interest in high-quality, highly-visible, high-priced products that often 'enhance social status.

Products may have a global appeal by virtue of their country of origin. The Americanness of Levi's, Marlboro, McDonald's, and Harley-Davidson enhances their appeal to cosmopolitans around the world and offers opportunities for benefit positioning. In consumer electronics, Sony is a name synonymous with vaunted Japanese quality; in automobiles, Mercedes is the embodiment of legendary German engineering.

Some products can be positioned in more than one way, within either the high-tech or high-touch poles of the continuum. A sophisticated camera, for example, could simultaneously be classified as technical and special interest. Other products may be positioned in a bipolar fashion, that is, as both high-tech and high-touch. For example, Bang & Olufsen consumer electronics product by virtue of their design elegance, are perceived as both high-tech and high-touch.

Product Design Considerations

Product design is a key factor in determining success in global marketing. Should a company adapt product design for various national markets or offer a single design to the global market? In some instances, making a design change may increase sales. However, : the benefits of such potential sales increases must be weighed against the cost of changing a product's design and testing it in the market. Global marketers need to consider four factors when making product design decisions: preferences, cost, laws and regulations, and compatibility.

Preferences

There are marked and important differences in preferences around the world factors such as color and taste. Marketers who ignore preferences do so at their own peril. In the 1960s, for example, Italy's Olivetti Corporation had gained considerable distinction in Europe for its award-winning modern consumer typewriter designs; Olivetti typewriters had been displayed at the Museum of Modern Art in New York City. Although critically acclaimed, Olivetti's designs did not enjoy commercial success in the United States. The U.S. consumer wanted a heavy, bulky typewriter that was ugly by modern European design standards. Bulk and weight were considered prima facie evidence of quality by American consumers, and Olivetti was, therefore, forced to adapt its award-winning design in the United States.

Sometimes, a product design that is successful in one world region does meet with success in the rest of the world. BMW and Mercedes dominate the luxury car market in Europe and are strong competitors in the rest of the world, with exactly the same design. In effect, these companies have a world design. The other global luxury car manufacturers are Japanese, and they have expressed their flattery and appreciation for the appeal of the BMW and Mercedes look by styling cars that are influenced by the BMW and Mercedes line and design philosophy. If imitation is the most sincere form of flattery, BMW and Mercedes have been honored by their competition.

Cost

In approaching the issue of product design, company managers must consider cost factors broadly. Of course, the actual cost of producing the product will create a cost floor. Other design-related cost whether incurred by the manufacturer or the end user-must also be consider.

We noted that the cost of rep-air services varies around the world and has an impact on product design.

Laws and Regulations

Compliance with laws and regulations in different countries ahs a direct impact on product design decisions, frequently leading to product design adaptations that increase costs. This may be seen especially clearly in Europe, where one impetus for the creation of the single market was to dismantle regulatory and legal barriers-particularly in the areas of technical standards and health and safety standards-that prevented pan-European sales of standardized products. In the food industry, for example, there were 200 legal and regulatory barriers to cross-border trade within the European Union (EU) in 10 food categories. Among these were prohibitions or-taxes on products with certain ingredients, and different packaging and labeling laws. Experts predict that the removal of such barriers will reduce the need to adapt product designs and will result in the creation of standardized Euro-products.

Compatibility

the last product design issue that must be addressed by company managers is product compatibility with the environment in which it is used. A simple thing such as failing to translate the user's manual into various languages can hurt sales of American-made: home appliances built in America outside the United States. Also, electrical systems range from 50 to 230 volts and from 50 to 60 cycles. This means that the design of any product powered by electricity must be compatible with the power system in the country of use.

Manufacturers of televisions and video equipment find that the world is a very incompatible .place for reasons besides those related to electricity. Three different TV broadcast and video systems are found in the world today: the U.S. NTSC system, the French SECAM system, and the German PAL system. Companies that are targeting global markets design multi system TVs and VCRs that allow users to simply flip a witch for proper operation with any system. Companies that are not aiming for the global market design products that comply with a single type of technical requirements.

Measuring systems do not demand compatibility, but the absence of compatibility in measuring systems can create product resistance. The lack of compatibility is a particular danger for the United States, which is the only nonmetric country in the world. Products calibrated in inches and pounds are at a competitive disadvantage in metric markets. When companies integrate their worldwide manufacturing and design activity, the metric-English measuring system conflict requires expensive conversion and harmonization efforts.

Labeling and Instructions

Product labeling and instructions must comply with national law and regulation. For example, there are very precise labeling

requirements for prescription drugs and poisons. In addition, however, labeling can provide valuable consumer information on nutrition, for example. Finally, many products require operating and installation instructions.

In which languages should labeling and instructions be printed? One approach to this issue is to print labels and instructions in languages that are used in all of the "major markets for the product. The use of multiple languages on labels and instructions simplifies inventory control: The same packaging can be used for multiple markets. The savings from simplicity must be weighed against the cost of longer instruction booklet and more space on labels for information.

Geographic Expansion – Strategic Alternatives

Companies can grow in three different ways. The traditional methods of market expansion-further penetration of existing markets to increase market share and extension of the product line into new-product market areas in a single national market are both available in domestic operations. In addition, a company can expand by extending its existing operations into new countries and areas of the world. The latter method, geographic expansion, is one of the major opportunities of global marketing. To pursue geographic expansion effectively, a framework for considering alternatives is required. When a company has a product/market base, it can select from five strategic alternatives to extend this base into other geographic markets, or it can create a new product designed for global markets

Strategy 1: Product/Communication Extension (Dual Extension)

Many companies employ product/communication extension as a strategy for pursuing opportunities outside the home market. Under the right conditions, this is the easiest product marketing strategy and, in many instances, the most profitable one as well. Companies pursuing this strategy sell exactly the same product, with the same advertising and promotional appeals as used in the home country, in some or all world-market countries or segments.

The critical difference is one of execution and mind-set. In the stage 2 company, the dual extension strategy grows out of an ethnocentric orientation; the stage 2 company is making the assumption that all markets are alike. A company in stage 4 or 5 does not make such as assumptions; the company's geocentric orientation allows it to thorough understand its markets and consciously take advantage of similarities in world markets.

The product/ communication extension strategy has an enormous appeal to global companies because of the cost savings associated with this approach. The two most obvious sources of savings are manufacturing economies of scale and elimination of duplicate product R&D costs. Also important are the substantial economies associated with standardization of marketing communications. For a company with worldwide operations, the cost of preparing separate print and TV ads *for* each market can be enormous. Although these cost savings are important, they should not distract executives Item the more important objective of maximum profit performance, which may require the use of an adaptation or invention strategy. As we have seen, product extension, in spite of its immediate cost savings, may in fact result in market failure.

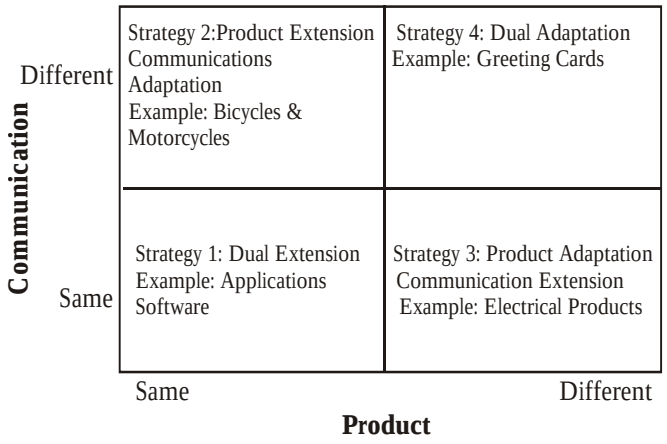
Strategy 2: Produt Extension/Communication Adaptation

When a product fills a different need, appeals to a different segment, or serves a different function under conditions of use that are the same or similar to those in the domestic market, the only adjustment that may be required is in marketing communications. Bicycles and motor scooters are examples of products that have been marketed with this approach. They satisfy recreational needs in the United States but serve as basic or urban transportation in many other countries. Similarly, outboard marine motors are usually sold to a recreation market in the high-income countries, whereas the same motors in most lower-income countries are mainly sold to fishing and transportation fleets. Another example is the U.S. farm machinery company that decided to market its U.S. line of home lawn and garden power equipment in: less developed countries (LDCs) as agricultural implements. The equipment was ideally suited to the needs of farmers in many LDCs. Equally important was the lower price almost a third less than competing equipment especially designed for small acreage farming, and offered for sale by competing foreign manufacturers.

As these examples show, the product extension/communication adaptation strategy either design or by accident-results in product transformation. The same physical product ends u serving a different function or use than that for which it was originally designed or created.

The appeal of the product extension/communication adaptation strategy is its relative y low cost of implementation. Because the product in this strategy is unchanged" R&D, tooling, manufacturing setup, and inventory costs associated with additions to the product line are avoided. The only costs of this approach are hi identifying different product functions and revising marketing communications (including advertising, sales promotion, and point of-sale material) around the newly identified function.

Global Product Planning Strategic Alternatives



Strategy 3: Product Adaptation/Communication Extension

A third approach to global product planning is to extend, without change, the basic home-market communications strategy while adapting the product to local use or preference conditions. Note that this strategy (and the one that follows) may be utilized by both stage 3 and stage 4 companies. The critical difference is, as noted earlier, one of execution and mind-set. In the stage 3 company, the product adaptation strategy grows out of a polycentric orientation; the stage 3 company assumes that all' markets are different. By contrast, the geocentric orientation of managers and executives in a Stage 4 global company has sensitized them to actual, rather than assumed, differences between markets.

Exxon adheres to this third strategy: It adapts its gasoline formulations to meet the weather conditions prevailing in different markets while extending the basic communications appeal, "Put a tiger in your tank," without change.

There are many other examples of products that have been adjusted to perform the same function around the globe under different environmental conditions. Soap and detergent manufacturers have adjusted their product formulations to meet local water and washing equipment conditions with no change in their basic communications approach. Household appliances have been scaled to sizes appropriate to different use environments, and clothing has been adapted to meet fashion criteria. Also, food products, by virtue of their potentially high degree of environmental sensitivity, are often adapted.

Strategy 4: Dual Adaptation

Sometimes, when comparing a new geographic market to the home market, marketers discover that environmental conditions or consumer preferences differ; the same may be true of the function a product serves or consumer receptivity to advertising appeals. In essence, this is a combination of the market conditions of strategies 2 and 3. In such a situation, a stage 4/5 company will utilize the strategy of product and communications adaptation. As is true about strategy 3, stage 3 companies will also use dual adaptation-regardless of whether the strategy is warranted by market conditions, Preferences, function, or receptivity.

Unilever's experience with fabric softener in Europe exemplifies the classic multinational road to adaptation. For years, the product was sold in 10 countries under seven different brand names, with different bottles and marketing strategies. Unllever's decentralized structure meant that product and marketing decisions were left to country managers. They chose names that had local-language appeal and selected 'package designs to fit local tastes. Today, rival Procter & Gamble is introducing competitive products with a pan-European strategy of standardized product$ with single names, suggesting that the European market is more similar than Unilever assumed. In response, Unilever's European brand managers are attempting to move gradually toward standardization

Sometimes, a company will draw on all four of these strategies simultaneously when marketing a given product in different parts of the world. For example, Heinz utilizes a mix of strategies in its ketchup marketing. Whereas a dual extension strategy works in England, spicier, hotter formulations are also popular in Central Europe and Sweden. Recent ads in France featured a cowboy lassoing a bottle of ketchup and, thus, reminded consumers of 'the product's American heritage. Swedish ads conveyed a more cosmopolitan message; by promoting Heinz as "the taste of the big world" and featuring well known landmarks such as the Eiffel Tower, the ads disguised the product's origin.

Strategy 5: Product Invention

Adaptation strategies are effective approaches to international (stage 2) and multinational (stage 3) marketing, but they may not respond. To global market opportunities. They do not respond to the situation in markets in which customers do not have the purchasing power to buy either the existing or adapted product. This latter situation applies to the LDCs of the world, which are home to roughly three quarters of the world's population. When potential customers have limited purchasing power, a company may need to develop an entirely new product, designed to satisfy the need or want at a price that is within the reach of the potential customer. Invention is a demanding but potentially rewarding product strategy for reaching mass markets ill LDCs.

The winners in global competition are the companies that can develop products offering the most benefits, which in turn create the greatest value for buyers. In some instances, value is not defined in terms of performance but rather in terms of customer perception. The latter is as important for an expensive perfume or champagne as it is for an inexpensive soft drink. Product quality is essential-indeed, it is frequently a given but it is also necessary to support the product quality with imaginative, value-creating advertising and marketing communications. Most industry experts believe that a global, appeal and a global advertising campaign are more effective in creating the perception, of value than a series of separate national campaigns.

How to Choose a Strategy

Most companies seek a product strategy that optimizes company profits over the long term. Which strategy for global markets best achieves this goal? There is, unfortunately, no general answer to this question. Rather, the answer depends on the specific product market-company mix.

Companies differ in both their willingness and capability to identify and produce profitable product adaptations. Unfortunately, too many stage one and stage two companies are oblivious to the foregoing issues. One new-product expert has described three stages that a company must go through as follows:

1. Cave dweller : The primary motivation behind launching new products internationally is to dispose of excess production or increase plant-capacity utilization.
2. Naive nationalist : The company recognizes growth opportunities outside the domestic market. It realizes that cultures and markets differ from country to country, and as a result, it sees' product adaptation as the only possible alternative.
3. Globally sensitive : This company views regions or the entire world as the competitive marketplace. New-product

opportunities are evaluated across countries, with some standardization planned as well as some differentiation to accommodate cultural variances. New-product planning processes and control systems are reasonably standardized.

To sum up, choice of product and communications strategy in international marketing is a function of three key factors: (1) the product itself, defined in terms of the function or need it serves; (2) the market, defined in terms of the conditions under which the product is used, the preferences of potential customer and the ability to buy the products in question; and (3) the costs of adaptation and manufacture to the company considering these product/communications approaches. Only after analysis of the product/ market fit and of company capabilities and costs can executives choose the most profitable international strategy.

New Products in Global Marketing

What is new product? Newness can be assessed in the context of the product itself, the organization, and the market. The product-may be an entirely new -invention or innovation-for example, the videocassette recorder (VCR) or the compact disc. It may be a line extension (a modification of an existing product) such as Diet Coke. Newness may also be organizational, as when a company acquires an already existing product with which it has no previous experience. Finally, an existing product that is not new to a company may be new to a particular market.

In today's dynamic, competitive market environment, many companies realize that continuous development and introduction of new products are keys to survival and growth. Which companies excel at these activities? Gary Rainer, a new-product specialist with the Boston Consulting Group, has compiled the following list: Honda Compaq, Motorola, Canon, Boeing, Merck, Microsoft, Intel, and Toyota. One common characteristic: They are global companies that pursue opportunities in global markets in which competition is fierce, thus ensuring that new products will be world class. Other characteristics noted by Reiner are as follows:

1. They focus on one or only a few businesses.
2. Senior management is actively involved in defining and improving the product development process.
3. They have the ability to recruit and retain the best and the brightest people in their fields.
4. They understand that speed in bringing new products to market reinforces product quality.

Identifying New-product Ideas

The starting point for an effective worldwide new-product program is an information system that seeks new-product ideas from all potentially useful sources and channels. Those ideas relevant to the company undergo screening at decision centers within the organization. There are many sources of new-product ideas, including customers, suppliers, competitors, company salespeople, distributors and agents, subsidiary executives;" headquarters executives, documentary sources (for example, information service reports and publications), and, finally, actual firsthand observation of the market environment. figure 11-3 shows how corporate spending on research and development varies by country.

New-product Development Location

A global company must make an important decision regarding new-product development. Should development activity be dispersed to different country/regional locations, or should new-product activities' be concentrated in a single location? The advantage of concentration is that all of the new-product development people can interact daily on a face-to-face basis. There may also be cost efficiencies in a single location. The disadvantage of concentration is that it does not take advantage of global thinking and separates the developers from the ultimate consumer. Utilizing a dispersed strategy requires coordination of employees and the effective transfer of information between locations, and may result in duplicated efforts.

Regardless of which strategy a company selects, a high volume of information flow is required to scan adequately for new-product opportunities, and considerable effort is subsequently required tO5creen these opportunities to identify candidates for product development. An organizational design for addressing these requirements is a new-product department. The function of such a department is fourfold: (1) to ensure that all relevant information sources are continuously tapped for new-product: ideas; (2) to screen these ideas to identify candidates for investigation; (3) to investigate and analyze selected new-product ideas; and (4) to ensure that the organization commits resources to the most likely. new-product candidates and is continuously involved in an orderly program of new-product introduction and development on a worldwide basis.

With the enormous number of possible new products, most companies establish screening grids to focus on those ideas that are most appropriate for investigation. The following questions are relevant to this task:

1. How big is the market for this product at various prices?
2. Can we market the product through our existing structure? If not, what changes will be necessary and what costs will be required to make the changes?
3. Given estimates of potential demand for this product at specified prices with estimated levels of competition, can we source the product at a cost that will yield an adequate profit?
4. What are the likely competitive moves in response to our activity with this product?
5. Does this product fit our strategic development plan?
   a. Is the product consistent with our overall goals and objectives?
   b. Is the product consistent with our available resources?
   c. Is the product consistent with our management structure?
   d. Does the product have adequate global potential?

Testing New Products in National Markets

The major lesson of new- product introduction outside the home market has been that whenever a product interacts with human, mechanical, or chemical elements, there is the potential for a surprising and unexpected incompatibility. Since virtually

every product matches this description, it is important to test a product under actual market conditions before proceeding with full-scale introduction. A test does not necessarily involve a full-scale test-marketing effort. It may simply involve observing the actual use of the product in the target market.

Failure to assess actual use conditions can lead to big surprises, as in the case of Singer sewing machines sold in African markets. These machines, manufactured in Scotland by Singer, were slightly redesigned by Scottish engineers. The location of a small bolt on the product's base was changed; the change had no effect on product performance but did save a few pennies per unit in manufacturing costs. Unfortunately, when the modified machine reached Africa, it was discovered that this small change was disastrous for product sales. The Scottish engineers did not take into account the fact that in Africa, it is customary for women to transport any bundle or load-including sewing machines-on their heads. The relocated bolt was positioned at exactly the place where head met machine for proper balance; since the sewing machines were no longer transportable, demand decreased substantially.

LESSON 20:
INTERNATIONAL PRODUCT STRATEGIES

The international product life cycle (IPLC) theory, developed and verified by economists to explain trade in a context of comparative advantage, describes the diffusion process of an innovation across national boundaries. The life cycle begins when a developed country, having a new product to satisfy consumer needs, wants to exploit its technological breakthrough by selling abroad. Other advanced nations soon start up their own production facilities, and before long LDCs do the same Efficiency/comparative advantage shifts from developed countries to developing nations. Finally, advanced nations, no longer cost-effective, import products from their former customers. The moral of this process could be that an advanced nation becomes a victim of its own creation.

IPLC theory has the potential to be a valuable framework for marketing planning on a multinational basis. In this section the IPLC is examined from the marketing perspective, and marketing implications for both innovators and initiators are discussed below.

Stages and Characteristics

There are five distinct stages (Stage 0 through Stage 4) in the IPLC. Table below shows the major characteristics of the IPLC stages, with the United States as the developer of the innovation in question. Exhibit shows three life-cycle curves for the same innovation: one for the initiating country (i.e., the United States in this instance), one for other advanced nations, and one for LDCs. For each curve, net export results when the curve is above the horizontal line; if under the horizontal line, net import results for that particular country. As the innovation moves through time, directions of all three curves change. Time is relative, because the time needed for a cycle to be completed varies from one kind of product to another. In addition, the time interval also varies from one stage to the next.

IPLC Stages and Characteristics (for the initiating country)

Stage	Import/Export	Target Market	Competitors	Production Costs
(0) Local Innovation	None	USA	Few: Local Firms	Initially High
(1) Overseas Innovation	Increasing Export	USA & advanced nations	Few:Local firms	Decline owing to economies of scale stable
(2) Maturity	Stable Export	Advanced nations & LDCs	Advanced Nations	Stable
(3) Worldwide Imitation	Declining Export	LDCs	Advanced Nations	Increase owing to lower economies of scale
(4) Reversal	Increasing Import	USA	Advanced nations & LDCs	Increase owing to comparative disadvantage

Stage O : Local Innovation

Stage 0, depicted as time 0 on the left of the vertical importing/exporting axis, represents a regular and highly familiar product life cycle in operation within its original market. Innovations are most likely to occur in highly developed countries because consumers in such countries are affluent and have relatively unlimited wants. From the supply side, firms in advanced nations have both the technological know-how and abundant capital to develop new products

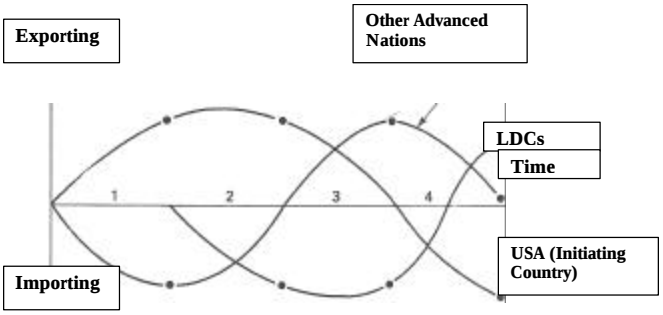
Many of the products found in the world's markets were originally created in the United States before being introduced and refined in other countries. In most instances, regardless of whether a product is intended for later export or not, an innovation is initially designed with an eye to capture the U.S. market, the largest consumer nation.

Stage 1 : Overseas Innovation

As soon as the new product is well developed, its original market well cultivated, and local demands adequately supplied, the innovating firm will look to overseas markets in order to expand its sales and profit. Thus, this stage is known as a "pioneering" or "international introduction" stage. The technological gap is first noticed in other advanced nations because of their similar needs and high income levels. Not surprisingly, English-speaking countries such as the United Kingdom, Canada, and Australia account for about half of the sales of U.S. innovations when such products are first introduced overseas. Countries with similar cultures and economic conditions are often perceived by exporters as posing less risk and thus are approached first before proceeding to less familiar territories.

Competition in this stage usually comes from U.S. firms since firms in other countries may -not have much knowledge about the innovation. Production cost tends to be decreasing at this stage because by this time the innovating firm will normally have improved the production process. Supported by overseas sales, aggregate production costs tend to decline further because of increased economies of scale. A low introductory price overseas is usually not necessary because of the technological breakthrough; a low price is not desirable because of the heavy and costly marketing effort needed in order to educate consumers in other countries about the new product. In any case. as the product penetrates the market during this stage, there will be more exports from the United States and, correspondingly, an increase in imports by other developed countries.

IPLC Curves



Stage 2 : Maturity

Growing demand in advanced nations provides an impetus for firms there to commit themselves to starting local production, often with the help of their government's protective measures to preserve infant industries. Thus, these firms can survive and thrive in spite of relative inefficiency.

Development of competition does not mean that the initiating country's export level will immediately suffer. The innovating firm's sales and export volumes are kept stable because LDC are now beginning to generate a need for the product. Introduction of the product in LDCs helps offset any reduction in export sales to advanced countries.

Stage 3 : Worldwide Imitation

This stage means tough times for the innovating nation because of its continuous decline in exports. There is no more new demand anywhere to cultivate. The decline will inevitably affect the U.S. innovating firm's economies of scale, and its production costs thus begin to rise again. Consequently, firms in other advanced nations use their lower prices (coupled with product differentiation techniques) to gain more consumer acceptance abroad at the expense of the U.S. firm. As the product becomes more and more widely disseminated, imitation picks up at a faster pace. Toward the end of this stage, U.S. export dwindles almost to nothing, and any U.S. production still remaining is basically for local consumption. The U.S. automobile industry is a good example of this phenomenon. There are about thirty different companies selling cars in the United States, with several on the rise. Of these, only three are U.S. firms, with the rest being from Western Europe, Japan, South Korea, Taiwan. Mexico. Brazil and Malaysia.

Stage 4 : Reversal

Not only must all good things end, but misfortune frequently accompanies the end of a favorable situation. The major functional characteristics of this stage are product standardization and comparative disadvantage. The innovating country's comparative advantage has disappeared, and what is left is comparative disadvantage. This disadvantage is brought about because the product is no longer capital-intensive or technology-intensive but instead has become labor-intensive-a strong advantage possessed by LDCs. Thus, LDCs-the last imitators—establish sufficient productive facilities to satisfy their own domestic needs as well as to produce for the biggest market in the world, the United States. U.S. firms are now undersold in their own country. Black-and-white television sets, for example, are no longer manufactured in the United States because many Asian firms can produce them much less expensively than any U.S. firm. Consumers' price sensitivity exacerbates this problem for the initiating country.

Validity of the IPLC

Several products have conformed to the characteristics described by the IPLC. The production of semiconductors started in the United States before diffusing to the United Kingdom, France, Germany, and Japan. Production facilities are now set up in Hong Kong and Taiwan, as well as in other Asian countries. Similarly, at one time the United States used to be an exporter of typewriters, adding machines, and cash registers. But with the passage of time, these simple machines (e.g., manual typewriters) are now being imported, while U.S. firms export only the sophisticated, electronic versions of such machines. Other products that have gone through a complete international life cycle are synthetic fibers, petrochemicals, leather goods, rubber products, and paper. The electronics sector, a positive contributor to the trade balance of the United States for a long time, turned negative for the first time ever in 1984 with a massive $6,8 billion deficit. A deficit also occurred at the same time for communications equipment, following the trend set by semiconductors in 1982.

The IPLC is probably more applicable for products related through an emerging technology. These newly emerging products are likely to provide functional utility rather than aesthetic values. Furthermore, these products likely satisfy basic needs that are universally common in most parts of the world. Washers, for example, are much more likely to fit this theory than are dryers. Dishwashing machines are not useful in countries where labor is plentiful and cheap, and the diffusion of this kind of innovation as described in IPLC is not likely to occur.

Marketing Strategies

For those U.S. industries in the worldwide imitation stage (e.g., automobile) or the maturity stage (e.g., computers), things are likely to get worse rather than better. The prospect, though bleak, can be favorably influenced. What is critical is for U.S. firms to understand the implications of the IPLC so that they can adjust marketing strategies accordingly

Product Policy

The IPLC emphasizes the importance of cost advantage. It would be very difficult for U.S. firms to match labor costs in low-wage nations since costs are only eight cents per minute in Japan, two cents in South Korea, and 0.5 cent in China. Still, the innovating firm must keep its product cost competitive. One way is to cut labor costs through automation and robotics. IBM converted its Lexington (Kentucky) plant into one of the most automated plants in the world. Likewise, Japanese VCR manufacturers are counting on automation to help them meet the challenge of South Korea.

Another way to reduce production costs is to eliminate unnecessary options, since such options increase inefficiency and complexity. This strategy may be critical for simple products or those at the low end of the price scale. In such cases it is

desirable to offer a standardized product with a standard package of features or options included. In the case of Chrysler's Neon, the company realized that the car must compete on features and performance and thus chose to cut costs where they did not matter much to customers. Based on research, small-car owners felt that power windows were not critical, allowing the design team to go with the crank variety. Also since buyers did not feel that the four-speed automatic transmission was anything special, Chryslers' engineers chose to adapt an existing Chrysler three-speed and saved more than - $300 million.

To keep costs rising at a minimum, a U.S. firm may use local manufacturing in other countries as an entry strategy. The company not only can minimize transportation costs and entry barriers but also can indirectly slow down potential local competition from starting up manufacturing facilities. Another benefit is that those countries can eventually become a spring-board for the U.S. company to market its products throughout that geographic region. In fact, sourcing should allow the American innovator to hold U.S. labor costs down and hold on to the original market as well. Ford Tracr is built by Ford in Taiwan for the Canadian market and in Mexico for the U.S. market. Similarly, stereo components sold in the United States are made in Japan, Taiwan, and South Korea.

Manufacturers should examine the traditional vertical structure in which they make all or most components and parts themselves because in many instances outsourcing may prove to be more cost-effective. Outsourcing is the practice of buying parts or whole products from other manufacturers while allowing a buyer to maintain its own brand name. For example, Ford Festiva is made by Kia Motors, Mitsubishi Precis by Hyundai, Pontiac Lemans by Daewoo, and OM Sprint by Suzuki.

A modification of outsourcing involves producing various components or having them produced under contract in different countries. That way, a firm takes advantage of the most abundant factor of production in each country before assembling components into final products for worldwide distribution. IBM's PC system consists mostly of components made in low-cost countries-monochrome monitor in South Korea; floppy disk drives in Singapore; and graphics printer, keyboard, power supply, and semiconductors in Japan. Only the semiconductors, case, and final assembly are undertaken in the United States. American firms need to take advantage of this strategy more extensively.

Once in the maturity stage, the innovator's comparative advantage is gone, and the firm should switch from producing simple versions to producing sophisticated models or new technologies in order to remove itself from cut-throat competition. Japanese VCR makers make 99 percent of the machines sold in the United States and 75 percent of all machines sold worldwide, but they still cannot compete with low wage Korean newcomers strictly on price, because labor content in VCRs is substantial. To retain their market share, the Japanese rely on new technology, such as 8 mm camcorders.

For a relatively high-tech product, an innovator may find it advantageous to get its product system to become the industry's standard, even if it means lending a helping hand to competitors through the licensing of product knowledge. Otherwise, there is always a danger that competitors will persevere in inventing an incompatible and superior system. A discussion of product adoption earlier should make it clear that several competing and incompatible systems serve only to confuse potential adopters who must acquire more information and who are uncertain as to which system will survive over the long term.

The worst scenario for an innovating firm is when another system supplants the innovators' product altogether to become the industry's standard. Sony's strategic blunder in guarding its Betamax video system is a good case to study. Matsushita and Victor Co. took the world leadership position away from Sony by being more liberal in licensing their VHS (Video Home System) to their competitors. Philips and Grundig did not introduce their Video 2000 system until VHS was just about to become the industry's standard in Europe and the world. By that time, despite price cutting, it was too late for Video 2000 to attract other manufacturers and consumers. The problem was so bad that Philips's own North American subsidiary refused to buy its parent's system. Ironically, Sony itself had to start making VHS-format machines in 1988.

A more recent case of competing technologies and strategic all1ances involves the digital videodisc (DVD) which can also store audio and computer data and software. Toshiba's system uses two 0.6 millimeter recording layers that could be bonded together into a 1.2 millimeter thick disc, thus storing five billion bytes on each side. The Multimedia Compact Disc system offered by Sony and Philips has less storage capacity-3.7 gigabytes of data on a single-sided disc. In addition, Toshiba aggressively courted movie makers (e.g., Warner Bros., MCA, and MGM/UA) while offering "open" licensing to other electronics companies. As a result, such manufacturing giants as Matsushita, Thomson, and Pioneer chose to ally with Toshiba. In the end, Sony and Philips had to come to a compromise by adopting a single format that was closer to Toshiba's system than theirs.

Pricing Policy

Initially, an innovating firm can afford to behave as a monopolist, charging a premium price for its innovation. But this price must be adjusted downward in the second and third stages of IPLC to discourage potential newcomers and to maintain market share. Anticipating a Korean challenge, Japanese VCR makers cut their prices in the United States by 25 percent and were able to slow down retailers' and consumers' acceptance of Korean brands. IBM, in comparison, was slow in reducing prices for its PC models. The error in judgment was the result of a belief that the IBM PC was too complex for Asian imitators. This proved to be a costly error because the basic PC hardly changed for several years. Before long, the product became nothing but an easily copied, standardized commodity suitable for intensive distribution-the kind that Asian companies thrive on. In addition to such brands as Daewoo's Leading Edge and Seiko's Epson, Computer Land even produced its own private brand. Inevitably, commodity pricing soon dominates the market.

In the last stage of the IPLC, it is not practical for the innovating firm to maintain low price because of competitors' cost advantage. But the firm's above-the market price is feasible only if it is accompanied by top-quality or sophisticated products. A high standard of excellence should partially insulate the firm's product from direct price competition. U.S. auto makers failed in this area-high prices are not matched by consumer perception of superior quality.

Promotion Policy

Promotion and pricing in the IPLC are highly related. The innovating firm's initial competitive edge is its unique product, which allows it to command a premium price. To maintain this price in the face of subsequent challenges from imitators, uniqueness can only be retained in the form of superior quality, style, or services.

The innovating marketer must plan for a nonprice promotional policy at the outset of a production diffusion. Timken is able to compete effectively against the Japanese by offering more services and meeting customers' needs at all times. For instance, it offers technological support by sending engineers to help customers design bearings in gearboxes.

One implication that can be drawn is that a new product should be promoted as a premium product with a high-quality image. By starting out with a high-quality reputation, the- innovating company can trade down later with a simpler version of the product while still holding on to the high-priced, most profitable segment of the market. One thing the company must never do is to allow its product to become a commodity item with prices as the only buying motive, since such a product can be easily duplicated by other firms. Aprica has been very successful in creating a status symbol for its stroller by using top artists and designers to create a product for mothers who are more concerned with style than price. The stroller is promoted as "anatomically correct" for babies to avoid hip dislocation, and the company uses the snob appeal and comfort to distinguish its brand from those of Taiwanese and Korean imitators. Therefore, product differentiation, not price, is most important for insulating a company from the crowded, low-profit market segment. A product can be so standardized that it can be easily duplicated, but image is a much different proposition.

Place (Distribution) Policy

A strong dealer network can provide the U.S. innovating firm with a good defensive strategy. Because of its near-monopoly situation at the beginning, the firm is in-a good position to be able to select only the most qualified agents/distributors, and the distribution network should be expanded further as the product becomes more diffused. Caterpillar's network of loyal dealers caused difficulty for Komatsu to line up its own dealers in the United States. In an ironic case, GM's old policy of limiting its dealers from carrying several GM brands inadvertently encouraged those dealers to start carrying imports. A firm must also watch closely for the development of any new alternative channel that may threaten the existing channel.

When it is too late or futile to keep an enemy out, the enemy should be invited in. U.S. firms-manufacturers as well as agents/distributors-can survive by becoming agents for their former competitors. The tactic involves providing a distribution network and marketing expertise at a profit to competitors who in all likelihood would welcome an easier entry into the marketplace. American automakers and their dealers seem to have accepted. the reality of the marketplace and have become partners with their Japanese and foreign competitors, as evidenced by General Motors' ventures with Toyota, Suzuki, and Isuzu (to produce Nova, Sprint, and Spectrum, respectively), American Motors' with France's Renault (before the subsequent sale to Chrysler), Chrysler's with Mitsubishi and Maserati, and Ford's with Mazda and the Korean Kia Motors.

Once a product is in the final stage of its life cycle, the innovating firm should strive to become a specialist, not a generalist, by concentrating its efforts in carefully selected market segments, where it can distinguish itself from foreign competitors. To achieve distinction, U.S. firms should either add product features or offer more services. For the alert firm, there are early warning signals that can be used to determine whether the time has come to adopt this strategy. One signal is that the product becomes so standardized that it can be manufactured in many LDCs. Another warning signal is a decline in the U.S. exports owing to the loss or narrowing of the U.S. technological lead. By that time, certain forms of market segmentation and product differentiation are highly recommended. As in the case of consumer electronics, such great American brands as Marantz and Scott were once synonymous with good sound and top quality but have since been bought up or driven out of business by Japanese and European manufacturers. Still, American firms dominate the segment of high-end stereo equipment where top systems may cost up to $100,000. American firms are successful because of the precision required and because production runs are short and usually done by hand.

Product Standardization Versus Product Adaptation

Product standardization means that a product originally designed for a local market is exported to other countries with virtually no change, except perhaps for the translation of words and other cosmetic changes. Revlon, for example, used to ship successful products abroad without changes in product formulation, packaging (without any translation, in some cases), and advertising. There are advantages and disadvantages to both standardization and individualization.

Arguments for Standardization

The strength of standardization in the production and distribution of products and services is in its simplicity and cost. It is an easy process for executives to understand and implement, and it also is cost-effective. If cost is the only factor being considered, then standardization is clearly a logical choice because economies of scale can operate to reduce production costs. Yet minimizing production costs does not necessarily mean that profit increases will follow. Simplicity is not always beneficial, and costs are often confused with profits. Cost reductions do not automatically lead to profit improvements, and in fact the reverse may apply. By trying to control production costs through standardization, the product involved may become unsuitable for a1tem_tive markets. The result may be

that demand abroad will decline, which leads to profit reduction. In some situations, cost control can be achieved but at the expense of overall profit. It is therefore prudent to remember that cost should not be overemphasized. The main marketing goal is to maximize profit, and production-cost reductions should be considered as a secondary objective. The two objectives are not, always convergent.

When appropriate, standardization is a good approach. For example when a consistent company or product image is needed, product uniformity is required. The worldwide success of McDonald's is based on consistent product quality and services. Hamburger meat, buns, and fruit pies must meet strict specifications. This obsession with product quality necessitates costly export of French fries from Canada to European franchises because the required kind of potato is not grown in Europe. In 1982 a Paris licensee was barred through a court order from using McDonald's trademarks and other trade processes because the licensee's twelve Paris eateries did not meet the required specifications.

Some products by their very nature are not or cannot be easily modified. Musical recordings and works of art are examples of products that are difficult to differentiate, as are books and motion pictures. When this is the case, the product must rise and fall according to its own merit. Whether such products will be successful in diverse markets is not easy to predict. Films that do well in the United States may do poorly in Japan. On the other hand, movies that were not box-office hits in the United States have turned out to be moneymakers in France (e.g., most of Jerry Lewis's films).

With regard to high-technology products, both users and manufacturers may find it desirable to reduce confusion and promote compatibility by introducing industry specifications that make standardization possible. In the case of the Japanese Posts & Telecommunications Ministry's proposal that all value-added networks (VANs) in Japan comply with an international standard known as X.75, the specification has been approved by the International Telecommunication Union and is widely used in many public data networks, including those of most European countries. Because most private networks sold by U.S. suppliers do not comply with X.75, they lamely accuse Japan of utilizing the standard to hurt the sales of their products.

A condition that may support the production and distribution of standardized products exists when certain products can be associated with particular cultural universals. That is, when consumers from different countries share similar need characteristics and therefore want essentially identical products. Watches are used to keep time around the world and thus can be standardized. The diamond is another example. Levi Strauss's attempt to penetrate the European market with lighter-weight jeans failed because European consumers wanted the standard heavy-duty American type after all.

One study confirms that the degree of strategic standardization is low. Three factors corporate orientation, nature of ownership, and consumer characteristics and behavior-underlie the degree of strategic standardization. Yet another study finds that the majority (81 percent) of the U.S. respondents exported their products without any modifications. The contradictory result of the second study is understandable because it focused on industrial products which are less likely to be affected by users' tastes. Furthermore, it may simply imply that U.S. firms, and not necessarily MNCs in general, are resistant to the idea of product adaptation.

A study of U.S. multinationals operating in Latin America reveals that their standardization and adaptation practices differed from those of U.S. multinationals operating in Europe. In terms of the type of product, consumer non durable goods demonstrated the greatest degree of adaptation to local conditions. Understandably, such products are most subject to differences in consumer preference. Consumer durables and industrial goods, on the other hand, were situated at the less-adapted end of the spectrum. An important discovery is that firms that produced more than 50 percent of their Latin American sales at local production facilities showed a greater commitment to the markets and adapted more elements of the marketing mix to local conditions. More technology-intensive firms standardized their marketing strategies more than. did less technology-intensive firms, probably as a result of the high cost of adapting high-technology products. Moreover, the smaller markets of Latin America seemed to encourage the firms to adapt less there than in the larger and more important European markets.

Another study also found that industrial managers and managers of consumer goods regarded certain marketing-related factors differently, thus implying that product standardization or customization depends in part on the type of product. Furthermore, respondents consistently regarded competitive environment as the most important variable affecting the extent of marketing standardization.

Arguments for Adaptation

There is nothing wrong with standardized products if consumers prefer those products. In many situations, domestic consumers may desire a particular design of a product produced for the American market. But when the product design is placed in foreign markets, foreign buyers are forced either to purchase that product from the manufacturer or not purchase anything at all. This manner of conducting business overseas is known as the "big-car" and "left-hand-drive" syndromes. Both describe U.S. firms' reluctance and/or unwillingness to modify their products to suit their customers' needs.

According to the big-car syndrome, U.S. marketers assume that products designed for Americans are superior and will be preferred by foreign consumers. U.S. automakers believe (or used to believe) that the American desire for big cars means that only big cars should be exported to overseas markets.

The left-hand drive syndrome is a corollary to the big-car syndrome. Americans drive on the right side of the road, with the steering wheel on the left side of the automobile. But many Asian and European countries have traffic laws requiring drivers to drive on the left side of the road, and cars with the steering wheel on the left present a serious safety problem. Yet exported U.S. cars are the same left-hand-drive models as are sold in the United States for the right-hand traffic patterns. According to the excuse used by U.S. automakers, a small sales volume

abroad does not justify converting exported cars to right-hand steering. And as explained by GM's president "There's a certain status in having a left-hand steer in Japan." This is one good reason why American automobile sales abroad have been disappointing. A half-hearted effort can only result in a half-hearted performance. American exporters have failed time and time again to realize that when in Rome one should do as the Romans do. Japanese automakers have not shown the same kind of indifference to market needs; Japanese firms have always adapted their automobiles to American driving customs.

Those American firms that have understood the need for product modification have done well even in Japan. Du Pont has customized its manufacturing and marketing for the Japanese market, and its design units work with Japanese customers to design parts to their specifications. Sprite became the best-selling' clear soft drink in Japan after being reformu-lated-the lime taste was taken out because Japanese were found to prefer a purer lemon flavor.18 Yamazaki-Nabisco's Ritz crackers sold in Japan are less salty than the Ritz crackers sold in America; similarly, Chips Ahoy are less sweet than versions sold elsewhere. Responding to the Japanese demand for quality, Ajinomoto-General Foods used a better grade of bean for its Maxim instant coffee,

Firms must choose the time when a product is to be modified to better suit its market. According to the Conference Board, important factors for product modification mentioned by more than 70 percent of firms surveyed are long-term profitability, long term market potential, product-market fit, short-term profitability, cost of altering or adapting (e.g, retooling), desire for consistency (e.g, maintaining a world image), and short-term market potential. These factors apply to consumer non durable and durable products as well as to industrial products.

Product adaptation is necessary under several conditions. Some are mandatory, whereas others are optional.

Mandatory Product Modification

The mandatory factors affecting product modification are the following:

1. Government's mandatory standards (i.e, country's regulations)
2. Electrical current standards
3. Measurement standards
4. Product standards and systems

The most important factor that makes modification mandatory is government regulation. To gain entry into a foreign market, certain requirements must be satisfied. Regulations are usually specified and explained when a potential customer requests a price quotation on a product to be imported. For example, starting in 1986, Switzerland banned the use of phosphates in detergents. Zeolites and nitrilotriacetates may be substituted for phosphates, but the permissible amount of nitrilotriacetates is fixed at 5 percent to avoid harmful effects in drinking water. The new regulation also requires labels and packages to show the chemical composition of the product. Avon shampoos had to be reformulated to remove the formaldehyde preservative, which is a violation of regulations in several Asian countries. Food products are usually heavily regulated.. Added vitamins in margarine, forbidden in Italy, are compulsory in the United Kingdom and Holland. In the case of processed cheese, the incorporation of a mold inhibitor may be fully allowed, allowed up to the permissible level, or forbidden altogether.

Frequently, products must be modified to compensate for differences in electrical current standards. In many countries, there may even be variations in electrical standards within the country. The different electrical standards (phase. frequency, and voltage) abroad can easily harm products designed for use in the United States, and such improper use can be a serious safety hazard for users as well. Stereo receivers and TV sets manufac-tured for the U.S. 110- to 120-volt mode will be severely damaged if used in markets where the voltages are twice as high. Therefore, products must be adapted to higher voltages. When there is no voltage problem, a product's operating efficiency can be impaired if the product is operated in the wrong electrical frequency. Alarm clocks, tape recorders, and turntables designed for the U.S. 60 Hz (60 cycles per minute) system will run more slowly in countries where the frequency is 50. Hz. To solve this problem, marketers may have to substi-tute a special motor or arrange for a different drive ratio to achieve the desirable operating RPM or service level.

Some U.S. companies that want to sell communications equipment in the huge Japanese market complain that NIT (Nippon Telegraph & Telephone) requires them to adapt their products to lower voltages and also to provide Japanese manuals. Yet foreign switchboard makers have to meet the U.S. technical standards in such areas as operating voltage, number of wires per cable, and other operating features. Plessy Co., a British firm, was surprised to learn that American customers wanted their PBX automatically to route all outgoing long-distance calls through the least-expensive carrier-a peculiar requirement for a European supplier because in Europe each country has only one long-distance company.

Like electrical standards, measurement systems can also vary from country to country. Although the United States has adopted the English (imperial) system of measurement (feet, pounds, etc.), most countries employ the metric system, and product quantity should or must be expressed in metric units. Since 1989 the EU countries no longer accept nonmetric products for sale. Many countries even go so far as to prohibit the sale of measuring devices with both metric and English markings. One New England company was ordered to stop selling its laboratory glassware in France because the markings were not exclusively metric.

In 1982 Congress abolished the U.S. Metric Board as well as a voluntary program for conversion to the metric system in order to save $2 million. That decision was shortsighted. Metric demands adversely affect U.S. firms' competitiveness because many American firms do not offennetric-products.19 A Middle East firm, *for* example, was unable to find an American producer that sold pipe with metric threads for oil machinery. A European firm had to rewire all imported electrical appliances because the U.S. standard wire diameters did not meet national standards. It is difficult to find a U.S. firm that cuts lumber to metric dimensions. Fortunately, the new trade act now requires the U.S. government and industry to use metric units in

documentation *of* exports and imports as prescribed by the International Convention on the Harmonized Commodity Description and Coding System. The Harmonized System is designed to standardize commodity classification *for* all major trading nations. The International System Units (Systeme International d'Unites (SI) is the official measurement system *of* the Harmonized System.

Very few countries still cling to the obsolete nonmetric systems. Among them are the United States, Burma, Brunei, and Liberia. Robert Heller *of* the Federal Reserve Board *of* Governors made the following comment: "Only Yemen and India have as Iowan export-to-GDP ratio as the United States. Would it come as a surprise to you to know that the U.S. and Yemen share something else in common? They are the only two countries in the world that have not yet gone metric! *If* an American manufacturer has to retool first in order to sell his wares abroad, his incentive to do is considerably reduced, and it makes his first step into export markets all that much more expensive.

American firms often cite non tariff barriers as contributing to their failure in establishing a foothold in the Japanese market. Some of these nontariff barriers used by the Japanese are intentionally designed to discourage imports. Yet the Japanese often point out that U.S. firms commonly refuse to modify their products. The importance of this refusal is often understated or underestimated. Japan's NIT is the second largest telecommunications company in the- world, but U.S. firms insist on selling their products without any kind of modification; even though without modification their products are not compatible with NTT's system. The NTT cannot convert its elaborate system to accommodate American specifications and materials. When purchases fail to materialize, many U.S. firms are quick to cite NTT's discrimination against U.S. imports. Hewlett-Packard, for example, withdrew from its effort to sell oscilloscopes after learning that its inch-denominated front panel screws would have to be replaced with metric screws. The requirement of measurement conversion would inconvenience the seller, but a buyer cannot be expected to change complex business systems in order to accommodate the vendor's selling requirements. American products will have to be produced in the metric system if those products are to be integrated with equipment in other countries.

Some products must be modified because of different operating systems adopted by various countries. Television systems provide a good example. There are three different TV operating systems used in different parts of the world: the American NTSC (National Television Systems Committee), the French SECAM (Systeme Electronique Pour Couleur Avec Memoire), and the German PAL (Phone Alternating Lines). In 1941 the United States became the first country to set the national standards for TV broadcasting, adopting 525 scanning lines per frame. Most other nations later decided to require 625 lines for a sharper image. In most cases a TV set designed for one broadcast system cannot receive signals broadcast through a different operating system. Videotex and HDTV(high-definition TV) are other- examples-of products that thus far do not have a universal system accepted by the industry. When differences in product operating systems exist, a company unwilling to change its products must limit the number of countries it can enter, unless proper modification is undertaken for other market requirements.

Optional Product Modification

The conditions dictating product modification mentioned so far are mandatory in the sense that without adaptation a product either cannot enter a market or is unable to perform its function there. Such mandatory standards make the adaptation decision easy: a marketer must either comply or remain out of the market. Italy's Piaggio withdrew its Vespa scooters from the U.S. market in 1983, choosing not to meet U.S. pollution control standards for its few exports.

A more complex and difficult decision is optional modification, which is based on the international marketer's discretion in taking action. Nescafe in- Switzerland, for instance, tastes quite different from the same brand sold just a short distance across the French border.

One condition that may make optional modification attractive is related to physical distribution, and this involves the facilitation of product transportation at the lowest cost. Since freight charges are assessed on either a weight or a volume basis, the carrier may charge on the basis of whichever is more profitable. The marketer may be able to reduce delivery costs if the products are assembled and then shipped. Many countries also have narrow roads, doorways, stairways, or elevators that can cause transit problems when products are large or are shipped assembled. Therefore, a slight product modification may greatly facilitate product movement.

Another determinant for optional adaptation involves local use conditions, including climatic conditions. The hot/cold, humid/dry conditions may affect product durability or performance. Avon modified its Candid moist lipstick line for a hot, humid climate. Certain changes may be required in gasoline formulations. If the heat is intense, gasoline requires a higher flash point to avoid vapor locks and engine stalling. In Brazil, automobiles are designed to run on low-quality gas, to withstand the country's rough dusty roads, and to weather its sizzling temperatures. As a result, these automobiles are attractive to customers in LDCs, especially when the automobiles are also durable and simple to maintain. American automobiles can experience difficulties in these markets, where people tend to overload their cars and trucks and do not perform regular maintenance, not to mention the unavailability of lead-free gasoline.

Another local use condition that can necessitate product change is space constraint. Sears's refrigerators were redesigned to be smaller in dimensions without sacrificing the original capacity, so that they could fit the compact Japanese home. Philips, similarly, had to reduce the size of its coffeemaker. In contrast, U.S. mills, for many years, resisted cutting plywood according to Japanese specifications, even though they were told repeatedly that the standard Japanese plywood dimensions were 3 by 6 ft not the U.S. standard of 4 by 8 ft. In a related case, Japanese style homes have exposed wood beams, but U.S. forest-products firms traditionally allow 2-by-4 studs to be dirty or slightly warped, since in the United States these studs will most always be covered over with wallboard. The firms have refused

to understand that wood grain and quality are important to the Japanese because an exposed post is part of the furniture.

Consumer demographics as related to physical appearance can also affect how products are used and how suitable those products are. Habitat Mothercare PLC found out that its British products were not consistent with American customs and sizes. Its comforters were not long enough to fit American beds, and its tumblers could not hold enough ice. Philips downsized its shaver to fit the smaller Japanese hand. One U.S. brassiere company did well initially in West Germany but failed to get repeat purchases. The problem was that German women have a tendency, not to try on merchandize in the store' and thus did not find out until later that the product was ill-fitting because of measurement variations between American and German customers usually do not return a product for refund or adjustment.

Even a doll may have to be modified to better resemble the physical appearance of local people. The Barbie doll, though available in Japan for decades, became popular only after Mattel allowed Takara (which holds the production and marketing agreement) to reconstruct the product. Of sixty countries, Japan is the only market where the product is modified. Barbie's Western-style features are modified in several ways: her blue eyes become brown, her vividly blond hair is darkened, and her bosom size is reduced.

Local use conditions include user's habits. Since the Japanese prefer to work with pencils-a big difference from the typed business correspondence common in the United States—copiers require special characteristics that allow the copying of light pencil lines. Microsoft's plant in Ireland was charged with the task of localizing Windows 95 into more than fifty languages. IBM, likewise, localized its OS/2 Warp system. It took four months for IBM to translate it for the Czech Republic. The words on the screen had to be first translated from Czech to English. Later. The program was adapted to the Czech operating system. But on the first try, the OS/2 could not accept any Windows applications because of the differences in the Czech system. Another month of adjustment was necessary before the Czech version was ready. The Polish, Hungarian. and Russian language versions were also made available.

Finally, other environmental characteristics related to use conditions should be examined. Examples are endless. Detergents should be reformulated to fit local water conditions. IBM had to come up with a completely new design so that its machine could inc1udeJapanese word-processing capability. Kodak made some changes in its graphic arts products for Japanese professionals, most of whom have no darkrooms and have to work in different light environments.

Price may often influence a product's success or failure in the marketplace. This factor becomes even more critical abroad because U.S. products tend to be expensive, but foreign consumers' incomes tend to be at lower levels than Americans' incomes. Frequently, the higher quality of American products cannot overcome the price disadvantage found in foreign markets. To solve this problem, American companies can reduce the contents of the product or remove any nonessential parts or do both. Foreign consumers are generally not convenience-oriented, and an elaborate product can be simplified by removing any "frills" that may unnecessarily drive up the price. This approach is used by General Motors in manufacturing and selling the so-called Basic Transportation Vehicle in less-industrialized nations.

One reason that international marketers often voluntarily modify their products in individual markets is their desire to maximize profit by limiting product movement across national borders. The rationale for this desire to discourage gray marketing is that some countries have price controls and other laws that restrict profits and prices. When other nearby countries have no such laws, marketers are encouraged to move products into those nearby countries where a higher price can be charged. A problem can arise in which local firms in countries where product prices are high are bypassed by marketers who buy directly from firms handling such products in countries where prices are low. In many cases, because of antitrust laws, international marketers who wish to maintain certain market prices cannot ban this kind of product movement by threatening to cut off supply from those firms re exporting products to high-priced countries. Johnson & Johnson, for example, was fined $300,000 by the EU for explicitly preventing British wholesalers and pharmacists from re exporting Gravindex pregnancy tests to Germany, where the kits cost almost twice as much.

In spite of authorities' efforts to prevent companies from keeping lower-priced goods out of higher-priced countries, marketers may do so anyway as long as they do not get caught. Some manufacturers try to hinder these practices by deliberately varying packaging, package coding, product characteristics, coloring, and even brand names in order to spot violators or to confuse consumers in markets where products have moved across borders.

Perhaps the most arbitrary yet most important reason for product change abroad is historical preference, or local customs and culture. Product size, color, speed, grade, and source may have to be redesigned in order to accommodate local preference. Kodak altered its film to cater to a Japanese idea of attractive skin tones. Kraft's Philadelphia Cream Cheese tastes different in the United States, Great Britain, Germany, and Canada. In Asia, Foremost sells chocolate and strawberry milk instead of low-fat and skim milk. Asians and Europeans by tradition prefer to shop on a daily basis, and thus they desire smaller refrigerators in order to reduce cost and electrical consumption.

When products clash with a culture, the likely loser is the product, not the culture. Strong religious 'beliefs make countries of the Middle East insist on halalled chickens. In soup-conscious Brazil, Campbell soups did not take hold because homemakers there have strong cultural traditions of a homemaker's role, and serving Campbell soup to their families would be a soup served not of their own making. As a result, these homemakers prefer dehydrated products manufactured by Knorr and Maggi, used as a soup $tarter to which the homemaker can add her own flair and ingredients. Campbell soups are usually purchased to be put aside for an emergency, such as if the family arrives home late.

Product changes are not necessarily related to functional attributes such as durability, quality, operation method, maintenance, and other engineering aspects. Frequently, aesthetic or secondary qualities must also be taken into account. There are instances in which minor, cosmetic changes have significantly increased sales. Therefore, functional and aesthetic changes should both be considered in regard to how they affect *the* total, complete product.

One company that incorporates multiple features of product modification in appealing to local tastes is Pillsbury. In marketing its Totino's line of pizzas in Japan, Pillsbury found it wise to make several mandatory and optional changes in its product. Japanese food standards ban many preservatives and dyes. The ban often necessitates an extensive redesign of a product just to get it into the Japanese market.

Totino's pizzas are basically a "belly stuffer" in the United States, a confirmation of many foreigner's perceptions that Americans have pedestrian tastes in food. But the Japanese "eat" with their eyes, too-all foods have an aesthetic dimension. They perceive American foods as being too sweet, too large, and too spicy, making it necessary to alter the ingredients to suit the Japanese palate. Furthermore, the pizza size had to be reduced from the U.S. twelve-ounce size to the Japanese 6.5-ounce size to fit into smaller Japanese ovens. In effect, Totino's frozen pizza and package were completely redesigned for the Japanese market, and Pillsbury's success confirms that its efforts were worthwhile.

In conclusion, marketers should not waste time resisting product modification. The reluctance to change a product may be the result of an insensitivity to cultural differences in foreign markets. Whatever the reason for this reluctance, there is no question that it is counterproductive in international marketing. Product adaptation should rarely become an important issue to the marketer. A good marketer compares the incremental profits against the incremental costs associated with product adaptation. If the incremental profit is greater than the associated incremental cost, then the product should be adjusted-without question. In making this comparison, marketers should primarily use only future earnings and costs.

LESSON 21:
MOVING TOWARD WORLD PRODUCT

A Move Toward World Product : International or National Product

Product standardization and modification may give the impression that a marketer must choose between these two processes and that one approach is better than the other. In many instances, a compromise between the two is more practical and far superior than in selecting either procedure exclusively. Black and Decker has stopped customizing products for every country in favor of a few global products that can be sold everywhere. Such U.S. publishers as Prentice Hall and HarperCollins also have adopted the "world book" concept, which makes it possible for an English-language book to have world copyrights. Publishers change, if necessary, only the title page, cover, and jacket.

World product and standardized product may sometimes be confused with each other. A world product is a product designed for the international market In comparison, a standardized product is a product developed for one national market and then exported with no change to international markets. Zenith and RCA TV sets are standardized products, whereas a German subsidiary of ITT makes a world product by producing a "world chassis" for its TV sets. This world chassis allows assemblage of TV sets for all three color TV systems of the world {i.e., NTSC, SECAM, and PAL) without changing all circuitry on the various modules.

Cultural Dimension

Food Brings the World Together

Because of McDonald's Hamburgers and Big Macs are a common sight around the world. In the United States, Mexican, Italian, Chinese, and even Thai foods have been quite strange some sixty years ago for anyone in the United States to predict that flat bread with tomato sauce and melted cheese on it would become mainstream. Nowadays, that flat bread (pizza) seems to be more American than Italian. Perhaps, following pizza in the same direction is pho, the Vietnamese and Thai fish sauce, is becoming more like soy sauce in terms of acceptance. The adaptive nature of American culture makes it easy for the foods and eating customs of immigrant groups to get assimilated into society.

Malaysians are used to fast food offered by KFC and McDonald's and are thus not averse to new American concepts in food. Newer chain restaurants cater to a more affluent clientele. Kenny Rogers Roasters, Chili's Grill & Bar, and T.G.I Friday's offer their own versions of an American culture, and they all have stuck closely to their U.S.formulas. Friday's imports 70 percent of its food, including beef, cheese, and potatoes. However, it has made one concession to Malaysian taste by adding a bottle of chili sauce next to Heinz ketchup on a table. Likewise, Chili's has kept its American menu intact with one exception: replacing pork ribs (which are inappropriate in mostly Muslim Malaysia) with beef ribs. While its customers have complained that the portions are too large, Chili's feels that it must keep that part of the culture. Besides, Malaysian customers can simply order a few different dishes and share them the local way.

KFC provides another good illustration of the adaptation process. In Japan it is necessary to have a Shinto priest periodically conduct mass funerals for the firm's millions of chickens. The restaurant's menu also has been changed. In addition to serving French fries instead of mashed potatoes and gravy, KFC sells chicken sandwiches and fish and chips. Another one of its products is yakitori (chicken in broiled and skewered bite-size chunks). Several products require reformulation as well. The company cuts out half of the sugar from the salads, because the Japanese like their salads to be tart. The firm's corn-on-the-cob is a three-inch piece, which is two inches less than the U.S. version, in order to satisfy the local preference for a lot of little things. For the Malaysian market, the company has even had to change its cooking method. Because Malaysians consider firm chicken to be fresh and soft chicken to be frozen, KFC cooks its chicken to firm texture instead of the standard soft texture.

A move toward a world product by a company is a logical and healthy move. If a company has to adapt its product for each market, this can be a very expensive proposition. But without the necessary adaptation, a product might not sell at all. Committing to the design of a world product can provide the solution to these two major concerns faced by most firms dealing in the international marketplace. GE, for example, produces a numerical control system suitable in both metric and English measures. In addition, it has designed machines to operate under the wide differences in voltage among the different European countries. GE refrigerators are built in such a way that they can be used regardless of whether the frequency is 50 Hz or 60 Hz. This emerging trend toward world products is also attractive for items with an international appeal or for those items purchased by international travelers. Electrical shavers made by Norelco and portable stereo radios made by Sony and Crown are produced having a universal-voltage feature.

One might question whether a world product would be more expensive than a national or local product, since the world product may need multipurpose parts. Actually, the world product should result in greater saving for two reasons. First, costly downtime in production is not needed to adjust or convert equipment to product" different national versions. Second, a world product greatly simplifies inventory control because only one universal part, not many individual parts, has to be stocked.

A world product may also be able to lower certain production costs *by* anticipating necessary local adaptation and thus being adaptation ready. As an example, the Japanese ministry requires thirty-two changes on most U.S.-built cars, and the changes include: replacing headlamps that, because of left-hand drive, dip in the wrong direction; changing "sharp-edged" door handles; replacing outside rearview mirrors, and filling the space

between the body and the rear bumper to prevent catching the sleeves of kimono-clad women. Honda is able to sell its U.S.-made cars in Japan at relatively low prices because it produces the car ready for sale in Japan. Because cars manufactured by GM, Ford, and Chrysler are built for the American market, they must undergo expensive alterations to meet Japanese regulations. The American automakers have taken some steps to remedy the problem.

MARKETING STRATEGY

A Global Product

Reader's Digest is perhaps the world's most global magazine. The publication has remained unchanged and has been successful despite changes of culture. The magazine has endured for decades, earning the distinction of being the only mass-circulation, general-interest magazine that has survived the advent of television. The popularity of this largely standardized medium is confirmed by the 100 million people who read the magazine's forty-seven editions in nineteen languages. It has a worldwide circulation of more than twenty-eight million. Its latest addition is the Thai-language edition which was introduced in 1991.

Reader's Digest has always used the same formula for all markets: the same upbeat editorial format, with the same folksy illustrations for the magazine's back cover in all of its editions. The key to its success in Eastern Europe is its formula for mixing feature editorial from the United States and international sources with local stories. When it entered Poland in 1994, Reader's Digest Association set up a wholly owned subsidiary to publish Reader's Digest Wybor. Its full page advertisement in the New York Times proclaimed: "Hello Poland! The newest local edition of the world's most global magazine". According to the company, "the key for us is to have local people manage the operations and to become a local company."

It must be pointed out that a world product has some inherent problems as well. As illustrated by Ford Escort, the car was designed in Europe as Ford's world car. The company's American executives, however, proceeded to thoroughly redesign it for the U.S. market. Therefore, corporate commitment is a necessity. There must be mechanisms to take care of the conflicting views of executives working in the different countries. For example, Opel and Cadillac have fought on the first joint transat1antic project involving Opel's Omega and its modified version (Cadillac Catera) for the U.S. market. The disputes ranged from. styling to acceleration. German engineers, appreciating the European obsession with fuel economy, resisted it request to make changes to accommodate American drivers' desire for more power when pulling away from a stop. In the end, the German product-development chief at GM's International Operations ordered lower gearing for more power.

MARKETING STRATEGY : 2

A World Car

Making a world car is anything but easy. When Ford Motor Co. wanted to buid a "worl car" that could satisfy every taste, the concept sounded good. To make Ford Escort a world car, Ford pooled design, engineering, and manufacturing from North America and Europe. Unfortunately, rivalries were great. The car was designed in Europe, but American executives were skeptical of their European counterpart's business and engineering judgment. In the end, Ford produced two very different models. The American version was so thoroughly redesigned that the only common part that remained was the tiny water pump seal.

Ford's subsequent cooperation with Mazda represented a better attempt to design world products. Mazda and Ford got together to design CT20 to be sold in ninety markets as Ford Escort or one of the various Mazdas (323, Protégé, or Familia). The process again was not easy. Mazda's designers correctly pointed out that Ford's license-plate recess was not large enough for all markets (e.g, Malaysian plates). They also had to agree on a rust-resistent alloy as well as the wheelbase length. While Mazda chose two lengths for different models)including a shorter one to achieve better handling on cramped Asian roads), Ford opted for just one wheelbase. To reduce noise, Mazda wanted to improve the engine, while Ford wanted other adjustments. A compromise was reached to retune the engine, add more insulation, and install the motor on softer rubber mounts. Mazda also manufactures Ford Probe, based on Mazda's MX-6.

Ford wanted to do the world car right the second time around when it bet $6 billion on the Mondeo. According to the company's rationale, a single car was worthwhile because of the convergence of emission standards, safety regulations, and consumer tastes. The plan was for the American and European versions to have 75 percent common parts. The American model is slightly longer and has more chrome.

Initial costs of this world car were high, but they were more than offset by the savings from engineering one car instead of two. There were obstacles, of course, and five European and American design studios had to compromise on design proposals that ranged from a soft and rounded body to a sharply angular one. Major responsibilities were divided, with Ford's chairman himself keeping an eye on the development. The U.S. division was responsible for automatic transmissions, while the European counterpart handled manual transmissions.

At last count, Mondeo is selling well in Europe. The American versions called Ford Contour and Mercury Mystique have also received critical acclaim, but the relatively high prices have hampered sales. Still Ford appeared to be successful in getting "two big elephants to dance".

As a product of compromise, a world product may have to be bland enough to partially please everyone while not really pleasing anyone. That is, it must satisfy the lowest common denominator of taste in different markets. Ford's Mondeo has done well in Europe, but American consumers have found the backseat of the American versions (Ford Contour and Mercury Mystique) to be too tight. Likewise, GM's 1997 front drive minivan is just right for the Europeans but a little bit too small for the Americans. As far as the automobile industry is concerned, a world car has another problem; it has to meet the world's toughest environmental and safety rules, thus increasing costs.

The trend toward an international or world product and away from a national product will continue as MNCs become more aware of the significance of world marketing. The willingness of several companies to consider designing a universal product for the world market is indeed a good indicator that this trend will continue.

COCA-COLA: UNIVERSAL APPEAL?

On April 15, 1996, Douglas N. Daft, the President of the Middle and Far East Group' for Coca-Cola Company was in a quandary He had just come back from a senior executive committee meeting where the main focus was on the concern over the additional investment in India and China, two countries that reported directly to him. He was baffled by the concern the committee was placing on funding these new investments. Coca-Cola's strategy had always been to take risks in emerging markets. It had always understood the need to be first in new markets to gain the competitive advantage. Even in tough markets, Coca-Cola ultimately wins market share. For instance, during apartheid in South Africa, the company stayed in the country by maintaining a-presence through independent bottlers while Pepsi left the country. Coke now dominates the market.

Daft could not understand the committee's reluctance to go ahead with these investments. China's market potential was vast. With a population of 1.2 billion and per capita consumption of only four (meaning each person in China consumed only four 8-ounce servings of a company beverage per year), the opportunities were infinite (see Exhibit 1). The investment slated for China was to build five additional plants in 1996 and two more in 1997, which would bring the total number of plants to 23.A recent survey done by the company indicated that Coke and Sprite were the two leading soft drink brands in China. In addition, China's gallon sales grew by 30 percent last year.

India's market potential was similar to China's. Its population of 936 million and per capita consumption of two also made it a desirable market to be in. Although gallon sales were up 21 percent over 1995, there was a concern about anti multinational sentiment. The company already had a large, visible presence there and given the negative attitude toward large multinationals, the committee felt further investment might not be a financially prudent decision at that time.

Daft quickly got on the phone to John Farrell, head of the China Division, and Andrew Angle, head of the Southeast and West Asia Division, to discuss this new turn of events. Information needed to be gathered, and things need to be hammered out before going back to committee with his recommendations. What were the political and economic risks of these two countries and how could it affect Coca-Cola? If Coca-Cola chose not to increase its investment in these countries, would it be missing out on an opportunity to further establish itself in these markets and to gain market share?

Coke articulated its vision in its annual report: "We have become mindful of one undeniable fact-the average body requires at least 64 ounces of liquid every day just to survive, and our beverages currently account for not even two of these ounces. For every person on this planet, consuming at least 64 ounces is not an option; but choosing where those ounces come from is." Draft's concerns addressed this vision.

Bottling

During the 1980s, Coca-Cola aggressively acquired smaller family-owned bottlers in the United States. Between 1980 and 1984, bottlers representing 50 percent of the company's volume underwent a change of ownership. Small, family-owned bottlers were purchased by either the company or large regional bottlers. This was done in order to control bottlers so that the company had the ability to do nationwide advertising. knowing that their bottlers would do the complementary promotional activities, as well as aggressive discounting when needed.

During the 1990s. Coke began the implementation of a program consolidation and company investment in bottling operations in the rest of the world. Currently, Coke is consolidating its bottlers in markets overseas.

Today, Coca-Cola is investing heavily in bottling operations in order to maximize the strength and efficiency of production, distribution, and marketing. Their strategy is to get involved in the bottling business so that it fuels continued growth of their

EXHIBIT 1 per capita consumption and market populations

Per Capital	*Markets*	*Population (in Millions)*
179	Argentina	35
292	Australia	18
169	Benelux Denmark	31
122	Brazil	162
181	Canada	29
248	Chile	14
4	China	1,221
107	Colombia	35
30	Egypt	63
71	France	58
201	Germany	82
114	Great Britain	56
125	Hungary	10
2	India	936
8	Indonesia	198
232	Israel	6
87	Italy	58
136	Japan	125
71	Korea	45
322	Mexico	94
45	Morocco	27
256	Norway	4
105	Philippines	68
65	Romania	23
6	Russia	147
147	South Africa	41
179	Spain	40
60	Thailand	59
343	United States	263
60	Zimbabwe	11

syrup business. The company has three criteria for making a bottling investment:

1. The company needs to move quickly in an emerging market
2. When an existing bottler lacks the resources to meet the company's objectives
3. To help ensure long-term strategic alignment with key bottling partners

Brand Equity

The Coca-Cola trademark is invaluable. If all of the company's assets burned to the ground today, it would have no trouble borrowing the money to rebuild, based on the strength of its trademark alone. Its brand is pervasive around the world. Exhibit 2 indicates how strong the brand Coca-Cola is in specified markets. The company's strategy for sustaining its brand image is the three Ps:

1. Pervasive Penetration in the marketplace
2. Offering consumers the best Price relative to value
3. Making Coca-Cola the Preferred beverage every where

In addition, Coca-Cola is finding new ways of building relevant value into Coke and all its other brands by further differentiating them, making them unique and distinctive. Three years ago, the company abandoned the use of entrusting all advertising and marketing to one single agency. Now, agencies are selected on the basis of their particular expertise in enhancing a particular brand; this year, agency compensation is being tied to the results their ads produce.

Moreover, Coca-Cola is reigniting the symbols that encapsulate the essence of its brand-the Dynamic Ribbon device, the contour bottle for Coke, the Coca-Cola script, the color red, and the dimpled bottle for Sprite. The new contour bottle, which was launched in April 1994, is credited with increasing sales by 500 million cases globally in 1994. Through June 1995, volume increases for Coke were approaching 45 percent in the United States, 23 percent in Japan, and 30 percent in Spain. In addition, it is currently linking its brands with one-of-a kind 7vents and activities such as the Olympic Games in 1996 and doing more-in store pollutions -and displays especially in the U.S. market where growth is considered slow.

Coca-Cola's commitment to building and sustaining its brand image is indicated by the amount of money it spends on marketing. For instance, in 1995, the company spent $3.8 billion for marketing. Ad spending, which is still considered one of the best tools for building brand equity, was $1.3 billion. Its major rival, PepsiCo, spent more on advertising, at $1.8 billion but had to allocate these funds for its restaurant and snack-food segments as well.

Financials

Coca-Cola is the largest and most profitable soft-drink company in the world. Over a 10-year period, revenues have grown at a compound growth rate of 11.9 percent. By 1995, worldwide revenues exceeded $18 billion, and net income was a little under $3 billion (see Exhibit 3). Its operating income margin outpaced its major competitor, PepsiCo, significantly. While PepsiCo's beverage segment operating margin was 10 percent for 1995, Coca-Cola's was 23 percent. Its superior performance is further indicated

	Market Leader	**Leadership Margin**	**Second Place**
Australia	Coca-Cola	3.9:1	Diet coke
Belgium	Coca-Cola	7.7:1	Coca cola light
Brazil	Coca-Cola	3.3:1	Brazilian brand
Chile	Coca-Cola	4.6:1	Fanta
France	Coca-Cola	4.3:1	French brand
Germany	Coca-Cola	3.1:1	Fanta
Great Britain	Coca-Cola	1.9:1	Diet coke
Greece	Coca-Cola	3.8:1	Fanta
Italy	Coca-Cola	3.1:1	Fanta
Japan	Coca-Cola	2.3:1	Fanta
Korea	Coca-Cola	2.1:1	Korean brand
Norway	Coca-Cola	3.3:1	Coca cola light
South Africa	Coca-Cola	4.1:1	Sparletta
Spain	Coca-Cola	3.0:1	Spanish brand
Sweden	Coca-Cola	3.8:1	Fanta

by its return on equity, which was 56 percent in 1995, and its market year-end price of $74.25 at the end of 1995, which showed an appreciation of 44 percent.

Coca-Cola's strong financial performance over the last 5 years has been due primarily to increased expansion overseas, especially in the company's bottling and canning operations. In fact, international operations account for the majority of Coca-Cola's revenues and operating profits: In 1995, the company derived 71 percent of its revenues and 82 percent of its operating profit outside the United States

EXHIBIT 3 Consolidated Statements of Income

Year Ended December 31 (In Millions Except Per-Share Data)	1995	1994	1993
Net Operating-Revenues	$18,018	$16,181	$13,963
Cost of goods sold	6,940	6,168	5,160
Gross-Profit	11,078	10,013	8,803
Selling, administrative, and general expenses	6,986	6,297	5,695
Operating Income	4,092	3,716	3,108
Interest income	245	181	144
Interest expense	272	199	168
Equity income	169	134	91
Other income (deductions)-net	20	(104)	(2)
Gain on issuance of stock by Coca-Cola Amatil	74	-	12
Income Before Income Taxes and Change in Accounting Principle	4,328	3,728	3,185
Income taxes	1,342	1,174	997
Income Before Change in Accounting Principle	2,986	2,554	2,188
Transition effect of change in accounting for post employment benefits	-	-	(12)
Net Income	$2,986	$2,554	$2,176
Income per Share			
Before change in accounting principle	$2.37	$1.98	$1.68
Transition effect of change in accounting for post employment benefits	-	-	(.01)
Net Income per Share	$2.37	$1. 98	$1.67
Average Shares Outstanding	1,262	1,290	1,302

Coke operates in 200 countries and employs 32,000 people worldwide.

Current Industry Outlook and Trends

The US. Soft-drink market is considered mature, growing at approximately 3 percent to 4 percent annually. This is down considerably from the 1985 growth rate of 6.5 percent. In 1994, domestic retail sales were $52 billion, up 2.6 percent, year to year. Coca-Cola had 41 percent of the retail market and Pepsi had 31 percent. Coca-Cola's growth outpaced the industry at 7 percent and accounted for 80 percent of the US soft drink's industry growth last year.

Although there is increased competition from other beverage choices, soft drinks remain the beverage of choice among US. Consumers, accounting for more than one of every four drinks consumed. Colas continue to dominate the soft drink category but are slowly losing market share. They were 66 percent of all soft drinks consumed in 1994, down from 70 percent in 1990. International markets appear to mirror this trend.

The international market has been the high growth segment in the beverage industry, growing at 8 percent to 10 percent annually. In 1996, Coke sales grew at 8 percent, and it had 47 percent of the world market. Growth rates varied considerably around the world. Some emerging markets grew phenomenally. For example, last year China grew at 32 percent and Brazil grew at 52 percent. In 1997, worldwide growth was expected to be 6 percent to 7 percent for soft drinks. The highest growth was expected from developing Asian countries, including China, India, Korea, and Indonesia. Moreover, continued growth from South America was expected. Internationally, Coke outsells Pepsi three to one.

Competition

Coca-Cola's major competitor is PepsiCo (see Exhibit 6). PepsiCo has three segments: beverage (35 percent of total revenues), snack foods (28 percent), and restaurants (37 percent). Over a 10 year period, revenues have grown at a compound rate of 15 percent. In 1995, $1.6 billion was generated from $30.4 billion of revenues, representing a net income margin of 5 percent. Its growth has been fueled by the success of its beverage-and snack -foods segments.

PepsiCo's beverage income was $10.5 billion for 1995, and it generated $1.3 billion in operating profit, representing a 10 percent margin. Although overall beverage revenue and operating income were *up* 9 percent and 8 percent, respectively, its significant revenue growth came from overseas, at 13 percent. Yet, international revenue and operating profit accounted for only 34 percent of total beverage revenue and 12percentof total beverage operating profits (see Exhibit 8).

To gain more market share internationally, Pepsi is unveiling a comeback plan called "Project Blue," which is expected to cost $500 million. It calls for revamping manufacturing and distribution to get a consistent-tasting drink around the globe, as well as an overhaul of marketing and advertising. The most risky part of the program calls for giving up the red, white, and blue can in favor of an electric blue one. In addition, Pepsi-Cola plans to establish new freshness standards and quality controls. Currently, Coke outsells Pepsi three to one overseas; however, Pepsi predicts that with its new marketing plan it will be able to close the gap to 2 to 1 by the year 2000. According to The Economist, this could be a risky strategy, considering the fact that Pepsi has spent decades convincing consumers that Pepsi in a red, white, and blue can is cool to drink. Image is a delicate thing. By changing the color of its can, it may appear to consumers that Pepsi-Cola is trying too hard to convince them to drink their brand; and thus, this plan may come off as just another blatantly obvious gimmick.

International Markets

Coca-Cola's worldwide philosophy has been:

"We understand that as a practical matter our universe is infinite, and that we, ourselves, are the key variable in just how much of it we can capture".

Coca-Cola always sees 64 daily ounces of opportunity. It currently has 2 percent of the world's daily consumption of 64 ounces of liquid. In emerging markets, its potential remains high, as 60 percent of the world's population live in markets where the average person consumes less than 10 servings of Coca-Cola products per year.

For decades, Coca-Cola has had an established position in foreign markets. The first foreign office was started in 1926, and

by the 1940s and 19508, Coke was already entrenched Overseas. In 1950, *Time* magazine wrote, "Coke's peaceful near conquest of the world is one of the remarkable phenomena of the age. It has put itself always within an arm if length of desire.

EXHIBIT 6 U S soft drink market share (percent)

	1989	1990	1991	1992	1993	1994
Coca-Cola	40.1	40.4	40.7	40.4	40.4	40.7
PepsiCo	31.8	31.8	31.5	31.3	30.9	30.9
Dr. Pepper / 7Up[a]	9.9	9.9	10.6	11.2	11.4	11.6
Cadbury Schweppes	5.0	5.0	5.0	5.0	4.9	4.8
National Beverage	2.2	2.1	2.1	2.0	1.9	2.0
Royal Crown	2.7	2.6	2.4	2.3	2.2	2.0

Exhibit 8 Pepsi Co Beverage Revenue and operating income

				% Growth Rates	
($ in Millions)	1995	1994	1993	1995	1994
Net Sales					
U.S.	$6,977	$6,541	$5,918	7	11
International	3,571	3,146	2,720	14	16
	$10,548	$9,687	$8,638	9	12
Operating Profit					
Reported					
U.S.	$1,145	$1,022	$937	12	9
.' International	164	195	172	(16)	13
	$1,309	$1,217	$1,109	8	10
Ongoing"					
U.S.	$1,145	$1,022	$937	12	9
International	226	195	172	16	13
	$1,371	$1,217	$1,109	13	10

Today, the international segment has grown so much that it now contributes 71 percent to total revenue. Because of the importance of international markets to Coca Cola's future growth, it has eliminated its prior structure of two groups-international and domestic-and formed five operating groups: North America, Latin America, Greater Europe, the Middle and Far East, and Africa. The breakdown of unit case volume by group is found in Exhibit 9. As indicated by the pie chart, North America, which includes the United States and Canada, accounted for the largest, at 32 percent, and Latin America accounted for 24 percent of sales. Greater Europe and the Middle and Far East accounted for 21 percent and 18 percent, respectively. Africa trails at only 5 percent.

The hottest battles between Coca-Cola and PepsiCo will be in international markets, especially emerging ones. First-mover advantages can be crucial in the international soft -drink war. The strategic challenge is to establish greater brand awareness and preference through advertising on a scale similar to that of the domestic market. Another challenge is to make their brands as accessible and ubiquitous as they are in the United States. This is not often easy, and the effort often requires the direct intervention of the country managers (CMs) to secure improvements in the efficiency, cooperation, and competitive aggressiveness of overseas bottlers. For example, in 1995, Coca-Cola acquired bottling interests in Italy and Venezuela and took steps to consolidate its system in Germany. Although Coca-Cola controls the wealthy markets of Greater Europe, PepsiCo has been more successful in emerging markets such as India, the Arab nations of the Middle East, and Russia. Entry into new markets has often required creative maneuvering and increasingly flexible accommodations by the CMs.

As the war heats up between Coca-Cola and PepsiCo, both CMs will be forced to take more risks. Pepsi is a company going global 50 years late and cannot afford to follow the leader, Coca-Cola, but must alter the market as indicated by its "Project Blue" plan. Moreover, PepsiCo has rejuvenated the Pepsi Challenge for overseas markets. In 1994, PepsiCo launched its first challenge internationally in Mexico, one of Pepsi's largest markets. The result was that 55 percent preferred Pepsi over Coke. In addition. PepsiCo plans to stage these challenges worldwide in such markets as Singapore, Malaysia, and Portugal. PepsiCo's international commitment is both long term and aggressive, as indicated by its approval of a $2 billion investment plan over 5 years for the international beverage segment. starting in 1994.

Of course, Coca-Cola does not take these aggressive moves sitting down. Coca-Cola will fight back, as it did with the Pepsi Challenge, by slashing price5, purchasing bottlers, and creating slick ads and promotions.

Daft's Report To The Committee

Douglas Daft recently met with John Farrell, who was responsible for China, and Andrew Angle, who was responsible for India. Both Farrell and Angle wished to go ahead with the investments in their respective countries. However, Douglas Daft was not sure he had enough information on the political and economic risks of each country to make an informed decision. Thus, he asked Farrell and Angle to update him on the political and economic status of their respective countries. After he read their reports, he would make his-recommendations to the senior executive committee. Their-reports are reproduced in Appendices I and II.

Discussion Questions

1. What is Coca-Cola's international strategy?
2. What competitive advantages does Coca-Cola have over its major rival, PepsiCo?
3. What are the pros and cons of Coca-Cola's investing further in India's market?
4. What are the pros and cons *of* Coca-Cola's investing further in China's market?
5. What should Douglas Daft recommend to the senior executive committee concerning further investment in the emerging markets of China and India? Why?

APPENDIX I

The India Report by Andrew Angle, Southeast and West Asia Division

In 1994, India's economy grew at 6 percent. 8 million new jobs were created, and there was $818 million of U.S direct investment. For all these positive signs however. It appears that there has been a backlash against the economic reforms started 5 years ago. Why? First, for the 190 million Indians who live below the poverty line, 5 years of economic reforms have not improved their standard of living. Millions of poor believe that only the elite have benefited from economic liberalization. Second, soaring short-term interest rates, coupled with competition from foreigners, have hurt local businesses and caused enthusiasm for further economic change to wane. Now that foreign companies can increase their investment to 51 percent, up from 40 percent, in most industries and even 100 percent in others, some locals worry that foreigners will run roughshod over them.

Third, the Hindu right, led by the Bharatiya Janata Party (BJP), is divided over just what kind of foreign investment should be allowed. The BJP has adopted a much used phrase-"microchips, not potato chips"-to describe what sort of investment should be allowed.5 Thus, it appears that the BJP is against big American consumer brands such as PepsiCo, McDonald's, Colgate, and even ourselves, and they are the ones protesting against the multinationals. Pepsi's KFC braved protests and saw one of its outlets briefly closed. Most of the anti multinational sentiment has been against American companies, which bear the brunt of Indian worries about cultural imperialism. In contrast, Japanese and German companies encounter few such problems.

Last, these anti multinational demonstrations are being allowed to continue due to the upcoming democratic elections, which will begin on April 27 and finish on May 7. The existing Indian government, led by Prime Minister P. V. Narasimha Rao, dismisses these protests against foreign companies as grumbling of fringe groups. In truth, Rao and his government face stiff competition from the BJP and do not want to alienate voters by seeming to be pro foreign. Therefore, the existing government does little to defend these-companies in the eyes of the public.

India's legal system, though it may be slow, provides some recourse against failure to perform in contracts. For instance, India backed away from a $2.8 billion power project with Enron, an American company. Negotiations are resuming primarily because Enron has a cast-iron case for compensation.

However, the most fundamental problem is that a backlash has set in before India has taken the most painful changes. The government has not touched sacrosanct labor laws that make it virtually impossible for any company employing more than 20'-workers to lay anyone off. In addition, India must come up with a policy to deal with the state sector. About 200 of the country's 220 centrally owned companies are chronic money losers. Heavy borrowing by government companies-$60 billion from the central government alone-drives up interest rates.

Regardless of who wins the upcoming election Rao's government, the BJP, or the Left-Front National Front, they will not turn back reforms already taken place. Some foreign investors have turned bullish on India, pouring $1.2 billion in the Bombay exchange for the first 4 months of 1996. Some companies such as McDonald's, Baskin-Robbins, and PepsiCo are moving ahead with investments despite the difficulties. The risk is that India's reforms will not be quick enough to appease the growing discontent among its large population. Moreover. there are many examples of foreign investors who have already had great success in China, but there are relatively few in India.

APPENDIX II

The China Report by John Farrell, China Division

According to a *Business Week* article entitled "Rethinking China":

"In stunningly short order, a powerful China has emerged. As an economic force, it is entering and altering the global marketplace-and in some cases writing its own rules".

China had a $35 billion trade surplus with the United States last year, whereas its own markets remain closed in sectors where U.S. businesses are competitive. Moreover, China is notorious as one of the world's greatest rip-off artists and bent on strong-arming U.S. and European companies into transferring jobs and technology as the cost for entering its markets. Although China has cleaned up some intellectual property abuses, piracy remains rampant, and the toll on U.S. businesses is growing. Trade officials estimate that bootlegging in China cost U.S. business nearly $2.5 billion in lost sales last year, far exceeding the $866 million in 1994.

Tax preferences for foreign investors have been scaled back, and there currently is a proposal to change the tax system in a way that puts foreign businesses at a disadvantage to local ones. In addition, foreign companies in China must grapple with changing central government rules, grasping local officials and capricious local business partners. The central government is cracking down on joint ventures that provincial officials used to wave through. In addition, contracts are not always enforceable in Chinese courts.

However, there is growing evidence that firms that are prepared to shrug off such obstacles and build a business presence in China will be rewarded. The playing field may be tilted against foreign companies, but domestic rivals are barely up and running. In the more open climate, domestic companies already competing are not able to rely so heavily on their connections. Privileged information and crony networks. Thus the battle for China's market has been and will continue to be played out by foreigners for the time being.

This is especially true in the fast-moving consumer goods markets in which gross margins average 18 percent to 25 percent, partly due to the fact that the Chinese love a good brand. Just as in the United States, Procter & Gamble fights Unlived for Chinese consumers. Many multinationals contend that transferring technology is largely risk free. Many pioneers in China have reaped rewards without creating new competitors. Yet, China's effort to milk more out of foreigners means few secrets are really safe. The demands on multinationals to help make Chinese industry competitive are unrelenting. For

example, Microsoft, under threat of having its software banned, codeveloped a Chinese version of Windows 95 with a local partner and agreed to aid efforts to develop a Chinese software industry.

To keep control of China's economy, Communist leaders are retreating on many risky economic policies, which means no major reform of state enterprises or the banking system-both seen as crucial to completing the transformation of China's economic system. There are two reasons. First, to control economic growth and its resulting inflation, Vice Premier Zhu Rongji engineered an austerity program in 1993 to curb inflation; it worked, Growth in 1995 slowed to about 10 percent from 12.6 percent, a year earlier, while retail price increases eased from 21.7 percent in 1994 to_15 percent in 1995. Second, the central government fears that the poor inland provinces are falling too far behind. Many of its 700 million peasants live in near-feudal conditions, and 100 million have flooded into cities looking for work. The government fears that high unemployment will only fuel crime and corruption, which is already on the rise.

This recentralization is an attempt to enable the central government to set the pace of economic development rather than cede the power to the coastal provinces. The most needed reforms are in the state sector, which is one of the biggest drags on the economy. However, because state-owned factories employ 50 percent of the urban population, the leadership will not let them go bust. Yet, the state's companies chum out goods that nobody wants and then demand loans from the state banks, ultimately causing more inflation.

Nevertheless, other economic reforms are accelerating, such as a convertible currency tied to outside financial markets and regulations to protect intellectual property rights. The best hope for major reform is for China to enter into the World Trade Organization (WTO) because as a member, China would be forced over a designated period of time to liberalize its economy by dropping many trade barriers. However, chances of China's entering are slim. China would like to enter with developing-country status, which would allow it to protect domestic industries from foreign competition, but the United States would like China to enter on terms similar to those of other industrial nations.

The bottom line is that China's already large economy is set to double in the next 8 years, making it the world's sixth-largest economy, and those companies anxious to get access to China's riches are willing to take the risks.

LESSON 22: BRANDING DECISIONS

The purpose of this lesson is to acknowledge the strategic significance of branding and packaging and to examine some of the problems commonly faced by MNCs. Among the subjects discussed are brandless products, private brands, manufacturer's brands, multiple brands, local brands, worldwide brands, brand consolidation, brand protection, and brand characteristics. The strengths and weaknesses of each branding alternative are evaluated. The chapter also examines both mandatory and optional packaging adaptation. The emphasis of the chapter is on the managerial implications of both branding and packaging.

Branding Decisions

To understand the role of trademark in strategic planning, one must understand what a trademark is from a legal standpoint. In Thailand, trademark is legally defined to include "a device, brand, heading, label, ticket, name, signature, word, letter, numeral, or any combination thereof used or proposed to be used, or in connection with goods of the proprietor of such trademark by virtue of manufacture, selection, certification, deciding with, or offering for sale." According to the Lanham Trade-Mark Act of 1947, trademark in the United States "includes any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others." If a trademark is registered for a service, it is known as a service mark {e.g., Berlitz). Even though the two definitions vary somewhat from each other, the essential idea of branding remains the same in both.

A trademark can be something other than a name. Biennium, the roly-poly corporate symbol, is Michelin's trademark. Nipper, the familiar fox terrier sitting next to a phonograph along with the phrase "his master's voice," is RCA's official symbol. Other easily recognized logos include Ralph Lauren's polo player and Goodyear's wing foot.

Although companies spend millions of dollars developing logos, some are more effective than others. One study asked consumers to judge a company's image by looking at its name alone as well as with its logo. Motorola Inc., for example, received a positive score of 55 percent, meaning that the logo adds a sense of quality and trustworthiness. British Airways and Infiniti, on the other hand, received negative scores of -20 percent and -16 percent, respectively. In the latter case, the logos, instead of being helpful, may actually hurt corporate image.

A logo, when inappropriate, ineffective, or dated, should be modified. In the case of Audi, wanting to further differentiate itself from parent Volkswagen, it replaced its corporate logo in 1995 with a new one featuring the four silver rings with the Audi name written underneath in red. It combines its history with modem design to provide a "readily identifiable image." The new logo, being the seventh change since 1913, replaced the one in use since 1985.

In many countries, branding. may be nothing more than the simple process of putting a manufacturer's name, signature, 'or picture on a product or its package. Many U.S. firms did precisely this in the old days, as illustrated by King Gillette's own portrait being used as a trademark for his Gillette razor blades.

The basic purposes of branding are the same everywhere in the world. In general, the functions of a brand are to (1) create identification and brand awareness, (2) guarantee a certain level of quality, quality, and satisfaction, and (3) help with promotion. All of these purposes have the same ultimate goal: to induce repeat sales. The Spalding name, for example, has a great deal of marketing clout in Japan. In fact, a group of investors bought the company in 1982 because they felt that Spalding was the best-known name in sports in the free world and that the name was underutilized.

For American consumers, brands are important. Overseas consumers are just as brand-conscious-if not more so-because of their social aspirations and the social meanings that brand names can offer. Eastern European consumers recognize many Western brand names, including some that are unavailable in their countries. Among the most powerful brand names are Sony, Adidas, Ford, Toyota, Volvo, BMW, and Mercedes. When International Semi-Tech Microelectronics Inc. acquired troubled SSMC Inc., the most important asset was probably the Singer trademark.

When a company is for sale, the remainder of the purchase price after deducting the fair value of the physical assets is called goodwill, "going concern value:' or an intangible asset. In the case of service businesses, nearly all of the purchase price that companies generate tends to be goodwill. The brand has brand equity when there is value that is attached to that brand. Perhaps, Coca-Cola's most valuable asset is its brand equity which is worth $39 billion.

Taking into consideration the importance of branding as a marketing tool, one would expect that corporate headquarters would normally have a major role in brand planning for overseas markets. As a component of an MNC's marketing mix, branding is the area in which standardization appears to be relatively high. One study found a standardization branding rate of 82.5 percent among U.S. consumer-goods manufacturers. In comparison to the large U.S.-based industrial firms' European marketing strategies, these same firms' marketing mix strategies in Latin America appear to be more standardized. As expected, branding and product were least adapted, probably because of the relatively greater cost of adapting products and brands Westinghouse, for example, requires its Westinghouse *do Brasil* affiliate to use the common logo, resulting in all the MNC's Brazilian companies using the familiar circled W symbol in their promotion programs. Thus, centralization is a common practice.

Another study found that international marketing managers considered some cultural and socioeconomic. conditions of foreign countries in making global brand image strategy decisions. If the markets are similar, a firm may be able to use the standardization strategy by extending its brand-image theme to the other markets. However, when markets differ in cultural uncertainty avoidance, individualism, and national socioeconomic, managers tend to employ the image-customization strategy.

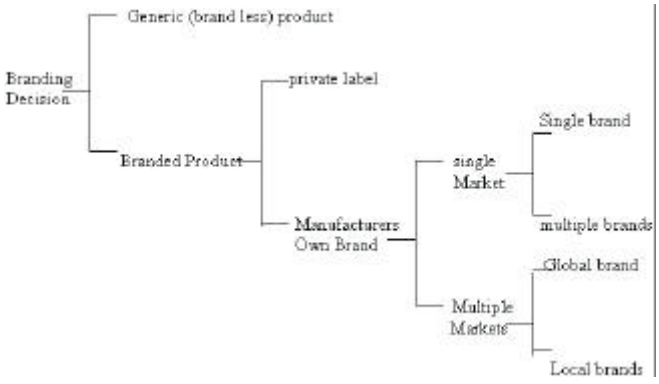
Branding Levels and Alternatives

There are four levels of branding decisions:

1. No brand versus brand
2. Private brand versus manufacturer's brand
3. Single brand versus multiple brands
4. Local brands versus worldwide brand

Branding versus No Brand

To brand or not to brand, that is the question. Most U.S. exported products are branded, but that does not mean that all products should be. Branding is not a cost-free proposition because of the added costs associated with marking, labeling, packaging, and legal procedures. These costs are especially relevant in the case of commodities (e.g..



salt, cement, diamonds, produce, beef, and other agricultural and chemical products). Commodities are "unbranded or undifferentiated products which are sold by grade, not by brands." As such, there is no uniqueness, other than grade differential, that can be used to distinguish the offerings of one supplier from those of another. Branding is then probably undesirable because brand promotion is ineffective in a practical sense and adds unnecessary expenses to operations costs. The value of a diamond, for example, is determined by the so-called four Cs—cut, color, clarity, and carat weight-and not by brand. This is why DeBeers promotes the primary demand for diamonds in general rather than the selective demand for specific brands of diamonds.

On the positive scale, a brand less product allows flexibility in quality and quantity control, resulting in lower production costs along with lower marketing and legal costs.

The basic problem with a commodity or unbranded product is that its demand is strictly a function of price. The brand less product is thus vulnerable to any price swing or price cutting. Farmers can well attest to this vulnerability because prices of farm products have been greatly affected by competition from overseas producers. Yet, there are-ways to—remove-a company from this kind-of cutthroat competition Branding, when feasible, transforms a commodity into a product (e.g.,/Chiquita bananas, Dole pineapples, Sunkist oranges, Morton salt, Holly Farms fryers, and Perdue fryers). A product is a "value-added commodity," and this bundle of added values includes the brand itself as well as other product attributes, regardless of whether such attributes are physical or psychological and whether they are real or imaginary. The 3M company developed brand identity and packaging for its Scotch videotapes for the specific purpose of preventing them from becoming just another commodity item in the worldwide, price-sensitive market.

Branding makes premium pricing possible because of better identification, awareness, promotion, differentiation, consumer confidence, brand loyalty, and repeats sales. According to one Supreme Court decision (No. 649, May 4, 1942, Mishawaka Rubber and Woolen Manufacturing Co. v. S. S. Kresge. 53 USPQ 323),

The owner of a mark exploits this human propensity by making every effort to impregnate-the-atmosphere-of the market with the drawing power of a congenial symbol. . . . Once established, the trademark owner has something of value." Exhibit 11-5 on page 430 examines the importance of brand names.

Although branding provides the manufacturer with some insulation from price competition, a firm must still find out whether it is worthwhile to brand the product. In general, these prerequisites should be met:

1. Quality and quantity consistency, not necessarily the best quality or the greatest quantity.
2. The possibility of product differentiation.
3. The degree of importance consumers place on the product attribute to be differentiated.

As an example, Nike's unique designs (e.-g.. waffle sole) allowed the company to differentiate its brand from others and to become the top-rated brand among serious joggers.

EXHIBIT Advantages of Each Branding Alternative (from manufacturer's viewpoint)

No Brand lower production cost lower marketing cost lower legal cost more flexibility in quality and quantity control (i.e., possibility of less rigidity in control) good for commodities (undifferentiated items)	**Brand** better identification better awareness better chance for product differentiation better chance for repeat sales possible premium pricing (i.e., removal from price com petition) possibility of making demand more price inelastic
Private Brand ease in gaining dealers' acceptance possibility of larger market share no promotional hassles and expenses good for small manufacturer with unknown brand and identity	**Manufacturer's Brand** better control of products and features better price because of more price inelasticity retention of brand loyalty better bargaining power assurance of not being bypassed by channel members
Multiple Brands (in single market) utilization of market segmentation technique creation of excitement among employees creation of competitive spirits avoidance of negative connotation of existing brand gain of more retail shelf space retention of customers who are not brand loyal allowance of trading up or down without hurting existing brand	Single Brand (in single market) better marketing impact permitting more focused marketing brand receiving full attention reduction of advertising costs because of better economies of scale and lack of duplication elimination of brand confusion among employees, dealer , and consumers good for product with good reputation and quality (halo effect)
Local Brands legal necessity (e.g., name already used by someone else in local market) elimination of difficulty in pronunciation allowance for more meaningful names (i.e., more local identification! elimination of negative connotations. avoidance of taxation on international brand quick market penetration by acquiring local brand allowance of variations of quantity and quality across markets	**Worldwide Brand** better marketing impact and focus reduction of advertising costs elimination of brand confusion good for culture-free product good for prestigious brand easy identification/recognition for international travelers good for well-known designer

Private Brand versus Manufacturer's Brand

Branding to promote sales and move product: necessitates a further branding decision: whether the manufacturer should use its own brand or a distributor's brand on its product. Distributors in the world of international business include trading companies, importers, and retailers, among others; their brands are called private brands. Many portable TV sets made in Japan for the U.S. market are under private labels. In rare instances, Japanese marketers put their brands on products made by U.S. companies, as evidenced by Matsushita's purchases of major appliances from White and D&M for sale in the United States. The Oleg Cassini trademark is put on the shirts actually made by Daewoo.

Even though it may seem logical for a distributor to carry the manufacturer's well-known brand, many distributors often insist on their own private brands for several reasons. First, a distributor may be able to create a unique product by bundling or unbundling product attributes and then adjusting the price to reflect the proper value.

Carrefour, a French retail giant, sells some 3,000 in-house products at prices about 15 percent lower than national brands. J. Sainsbury PLC, a British retailer, has a private brand that is able to get 30 percent of the detergent market, moving it ahead of Unilever's Persil and just behind Procter & Gamble's Ariel which is the market leader. It is believed that private-label products now account for 32 percent of supermarket sales in the United Kingdom and 24 percent in France.

Second, a private brand is a defensive strategy that guarantees that a distributor is not bypassed by its supplier. For example, Ponder and Best, after losing the Rolleiflex and Olympus distributorships, came up with its own brand of photographic products, Vivitar.

Third, distributors can convert fixed production costs into variable costs by buying products made by others. Sperry's products are made by more than 200 manufacturers (e.g., Sperry's personal computer is manufactured by Mitsubishi). With this practice, Sperry is able to save cash and research-and-development expenses. Of course, it is important for a distributor with a private brand to have a reliable supplier.

Fourth and perhaps the most important reason for a distributor's insistence on a private brand is brand loyalty, bargaining power, and price. In spite of the lower prices paid by the distributor and ultimately by its customers, the distributor is still able to command a higher gross margin than what a manufacturer's brand usually offers. The lower price can also be attributed to the distributor's refusal to pay for the manufacturer's full costs. A distributor may want to pay for the manufactures variable costs but not all of the fixed costs. Or a distributor may want to pay for production costs only but not the manufacturer's promotional expenditures, because a distributor gets no benefit from the goodwill of a manufacturer's advertised brand. If a firm has any problem with the supplier (manufacturer), it has the flexibility of switching .to another supplier to make the-identical product, thus maintaining brand loyalty and bargaining power without any adverse effect on sales. RCA; for example, switched' from Matsushita to Hitachi for its portable units of VCRs.

Compaq Computer Corp. illustrates the potential benefits and problems of private branding. It has finally decided to buy multimedia laptops and home PCs from Taiwanese- subcontractors Invented Group and international Corp. By putting a Compaq nameplate on the computers made by outside suppliers, the company is able to take care of the gap in its product line quickly and economically while solving its inventory problems. However, after a decade of convincing customers that Compaq's engineering and manufacturing expertise has differentiated its products from those made by other PC clonemakers, this new strategy may make buyers wonder

whether the Compaq name is enough of a reason for them to buy a Compaq PC.

There are a number of reasons that the strategy of private branding is not necessarily bad for the manufacturer. First, the ease if gaining market entry and dealers' acceptance may allow a larger market share overall while contributing to offset fixed costs. Toronto-based Cott Corp., once an obscure regional bottling company, has emerged as a leading privatl1-label player by manufacturing dozens of store-brand sodas. It sells more than one billion servings of soft drinks to Wal-Mart Stores Inc. under the label of Sam's American Choice. Cott bottles Sainsbury Classic Cola for L Sainsbury PLC which is the top food retailer in Britain. In the United States, Safeway Inc. is one of Cott's largest customers. Safeway feels that it can give consumers value' while earning better margins than on national brands. As a result, both Coke and Pepsi have to lower their prices to stay competitive.

Second, there are no promotional headaches and expenses associated with private branding, thus making the strategy suitable for a manufacturer with an unknown brand. Suzuki cars are sold in the United States under the GM Sprint brand name. Ricoh's facsimile machines are sold under AT&T's well-known name. Brother has had virtually no name recognition because it has marketed its many products under the private labels of U.S. major retail chains; to secure recognition, it has begun to mount a major campaign.

Third, a manufacturer may judge that the sales of its own product are going to suffer to a greater or lesser degree by various private brands. In that case, the manufacturer might' as well be cannibalized by one of those private brands made by the manufacturer.

There are also reasons why private branding is not good for the manufacturer. By using a private brand, the manufacturer's product becomes a commodity, at least to the distributor. To remain in business and retain sales to the distributor, the manufacturer must compete on the basis of price, because the distributor can always switch suppliers Cott Corp., for example, lost its contract to brew its President's Choice beer for Loblaw Cos., Canada's top supermarket, when John Labatt Ltd. paid Loblaw $28 million for the contract.

By not having its own identity, the manufacturer can easily be bypassed. Furthermore, it loses control over how its product should be-promoted-this fact may become critical if the distributor does not do a good job in pushing the product. For example, Mitsubishi, which manufactures' Dodge Colt and Plymouth Champ for Chrysler" felt that its products did not receive Chrysler's proper attention. As a result, Mitsubishi began to create its own dealer network and brand identity (e.g., Mitsubishi Mirage). Ricoh used to sell copiers in the United States only under such private brands Savin and Nashua, whose sales lagged. After switching to its own brand name in 1981, Ricoh's sales increased tenfold to take second place in: unit sales behind only Canon.

The manufacturers' dilemma is best illustrated by Heinz's experience in the United Kingdom, where consumer recognition for its brand is stronger than in any other. Country in the world. Whereas Campbell Soup and Nestle's Crosse & Blackwell make some products under private labels to accommodate giant supermarkets' insistence, Heinz produces products only under its own brand because, as the largest supplier of canned foods there; it has the most to lose. To preserve its long-term market leadership at the expense of short-term earnings, Heinz has held down prices, stepped up new product introductions; launched big capital-spending programs, and increased advertising. Heinz does make private-label merchandise in the United States, where private brands account for 10 percent of its U.S. sales. Its logic is that the slow growth of U.S. private labeling does not pose a serious threat as in the United Kingdom.

Clearly, the manufacturer has two basic alternatives: (l)its brand or (2) a private brand. Its choice depends it part on its bargaining power. If the distributor is prominent and the manufacturer itself is unknown and anxious to penetrate a market, then the latter may have to use the formers brand on the product. But if the manufacturer has superior strength, it can afford to put its own brand on the product and can insist that the distributor accept that brand as part of the product. For example, Kinishiroku had U.S. film sales derived primarily from some thirty original-equipment-manufacturer channels, such as mail order and drugstore film processors. Fatomat accounted for 70 percent of the company's original-equipment-manufacturer film sales. In the process of taking over Fotomat, Kinishiroku announced plans to expand from private-label manufacturing to direct distribution under its own brand name of Konica.

The hypothesis of the "least dependent person" can be quite applicable in determining the power of the manufacturer and that of its dealer. The stronger party is the one with resources and alternatives, and that party can demand more because it needs the other party less. The weaker party needs the other partner more because of a lack of resources and/or alternatives, and thus the weaker must give in to the "least dependent" party. In most cases the interests of both parties are interdependent, and neither party may have absolute power. For instance, Kunnan, a maker of highquality tennis rackets, lost some of its well-known customers when they began doing their own manufacturing. When those companies later discovered that they could not produce as well in terms of cost and quality, they came back to Kunnan for the private-brand manufacturing.

Private branding and manufacturer's branding is not necessarily an either/or proposition: a compromise can often be reached to ensure mutual coexistence. If desired~ both options can be employed together. Michelin, for instance, is world renowned for its own brand, and most people do not realize that Michelin also makes tires for Sears, Montgomery Ward, and Venture. Sanyo, another major international brand, is relatively unknown in the United States because it has relied heavily on private-label sales to Sears and other big companies. To rectify this identity problem, Sanyo has been pushing its own name simultaneously.

Single Brand versus Multiple Brands

When a single brand is marketed by the manufacturer, the brand is assured of receiv4tg full attention for maximum impact. But a company may choose to market several brands within a single market based on the assumption that the market

is heterogeneous and thus-must be segmented. Consequently, a specific brand is designed for a specific market segment.

The watch industry provides a good illustration for the practice-of-using-multiple brands in a single market for different market segments. Bulova, a well-known brand, also has the Accutron and Caravelle brands. Citizen, in its attempt to capture the new youth and multiple-watch owners market, traded down to include a new brand called Vega. Likewise, Hattori Seiko is well known for its Seiko brand, which is sold at the upper-medium price range ($100-300) in better stores; to appeal to a more affluent segment, the firm traded up with the Lassale name. Seiko's strategy is to deliberately divorce the Seiko and Lassale names, once used together, in the public mind, with the gold-plated Lassale line retailing for $225-750 and the karat-gold Jean Lassale line retailing for $675-35,000. Lassale watches have Seiko movements but are made only in the United States and Western Europe in order to curb parallel trading and they are distributed only through jewelers and department stores. The company also trades down, with Pulsar (the cheapest model at $50). Lorus ($12.95-49.95), and Alba ($9.95-19.95) for Asia.

Multiple brands are suitable when a company wants to trade either up or down because both moves have a tendency to hurt the firm's main business. If a company has the reputation for quality, trading down without creating a new brand will hurt the prestige of the existing brand. By the same rationale, if a company is known for its low-priced. Mass-produced products, trading up without creating a new brand is hampered by the image of the existing products. Casio is perceived as a manufacturer of low-priced watches and calculators and the name adversely affects its attempt to trade up to personal computers and electronic musical instruments. To overcome this kind of problem, Honda uses the Acura name for its sporty cars so that Acura's image is not affected by the more pedestrian Honda image.

IBM has begun to segment the PC market and has employed a multi brand strategy. Toward this end, the company aims different brands and separate sales channels at different groups of customers. In Europe it has four product lines which range from a law-priced PS/1 home model to a relatively expensive PS/2 hub far corporate networks. The other two lines are Ambra and Value Paint. Ambra is noteworthy because it is it product line of imparted Asian computers which are said in Europe under a non-IBM label.

Cultural Dimension 1 Multi-brand Marketing

Timex's most *valuable asset may be its brand name. Its advertisements showing how rugged Timex watches have been well received over the years. As a matter* of *fact, the 1992 Gallup Watch Brand Survey found that Timex is number one in terms* of *name recogni-tion, with 98 percent* of *consumers knowing the Timex name. Seiko, with 87 percent recognition, took second place.*

Timex's marketing error was its failure to *keep' up with market trends as the watch evolved from a functional object* to *a fashion accessory. According* to *the Jewelers* of *America, the average consumer has five watches, drastically different from 1.5 watches from thirty years ago. Timex's Japanese rivals, Seiko and Cit-izen, have long adjusted by introducing a wide variety* of *styles and prices* so *that customers can have differ-ent watches* for *different looks. In the meantime, Timex was moving along as a one-brand company. The* com-*pany has finally decided* to go *multi-brand.*

Source: *"At Timex, They're Positively Glowing," Business Week, 12 July 1993. 141.*

Local Brands versus Worldwide Brand

When the manufacturer decides to put its awn brand name an the product, the problem does not end there if the manufacturer is an International marketer. The possibility of having to modify the trademark cannot be dismissed: The international marketer must then consider whether to use just one brand name worldwide are different brands far different markets are countries. To market brands worldwide and to market worldwide brands are not the same thing

A single, worldwide brand is also known as: an international, universal, or global brand. A Euro-brand is a slight modification of this approach, as it is a single product far a single market (i.e the European Union and the other Western European countries), with an emphasis on the search far inter-market similarities rather than differences.

For a brand to be global or worldwide it must by definition have a commonly understood set of characteristics and benefits in all of the markets where it is marketed. Coca cola is a global brand in the sense that it has been successful in maintaining similar perceptions across countries and cultures. However, most other brand does not enjoy this kind of consistency thus making it debatable whether a gullible brand is a practical solution.

A worldwide brand has several advantages. First, it tends to be associated with status and prestige. Second, it achieves maximum market impact overall while reducing advertising costs because only one brand is pushed. Bata Ltd. a Canadian shoe marketer and retailer in ninety two countries, found out form it s research that consumers greatly though Bata to be a local concern, no matter the country surveyed. The company thus decided to become and official sponsor of world cup soccer in order to enhance Bata's international stature. For Bata and others it is easier to achiever worldwide exposure for one brand than it is for multiple local brands. Too many brands create confusion and fragmentation.

Third, a worldwide brand provides a convenient identification, and international travelers can easily recognize the product. There would be no sense in creating multiple brands for such international products as *Time* magazine, American Express credit card, Diner's Club credit card, Shell gasoline, and so on;

Finally, a worldwide brand is an appropriate approach when a product has a good reputation or is known for quality. In such a case, a company would be wise to extend the brand name to other products in the product line. This strategy has been used extensively by GE In another case, 3M perceived commonalities in consumer demographics and market development worldwide; in response, it devised a "convergence remarketing" strategy to develop global identity for its Scotch brand of

electronic recording products, whose design prominently displays the Scotch name and a globelike logo.

The use of multiple brands, also known as the local or individual approach, is probably much more common than many people realize. The automobile industry is a good example. The Japanese strategy is to introduce a new car in Japan for one year before exporting it to the U.S. market under a different name. Toyota XX and Datsun Sunny, dubbed Toyota Supra and Nissan Sentra for the United States, are examples of this practice. In the case of Unilever, its fabric softener is sold in ten European countries under seven names. Due to decentralization, the multinational firm allows country managers to choose names, packages, and formulas that will appeal to local tastes. More recently, the company, while keeping local brand names, has been gradually standardizing packaging and product formulas.

There-are several reasons for using local brands. First, less developed countries resent international brands because the brands' goodwill is created by an advertising budget that is much greater them research-and-development costs, resulting in no benefit derived from research and development for local economies. In addition, local consumers are forced to pay higher prices for advertising and goodwill, benefiting MNCs but hindering the development of local competitive capacity. Such resentment may explain why India's ministries, responding to domestic soft-drink producers' pressure, rejected Pepsi's 35 percent Pepsi-owned joint venture. Some governments have considered taxing international brands or limiting the use of such brands, as in the case of South. Korea, which has considered placing restrictions on foreign trademarks intended for domestic consumption.

Second, when manufacturer is unable to ensure uniform product quality across countries; it should consider local brands. Third, when an existing brand is difficult to pronounce, a new brand maybe desirable. Sometimes, consumers avoid buying a certain brand when it is difficult to -pronounce because they want to avoid the embarrassment of wrong pronunciation. Wrigley had trouble with its Spearmint name in Germany until the spelling was changed to Speermint.

Fourth, a local-brand is more easily understood and more meaningful for local consumers. By considering foreign tastes and preferences, a company achieves a better marketing impact. Post-it note pads made by 3M are marketed as Yellow Butterflies in France. Grey, an international advertising agency, worked with Playtex-to creates appropriate names for Playtex's brassieres in different languages. The result was Wow in England and Traumbilgel (dream wire) in Germany. Translation can also make a brand more meaningful. This approach is sometimes mistaken for a single brand approach when in fact a new brand is created. Close-Up (toothpaste) was translated as Klai-Chid (literally meaning "very close") in Thailand; the translation retained the meaning and the logo of the brand as well as the package design.

Fifth, a local brand can avoid a negative connotation. Pepsi introduced a-11oncola line under the Patio name in America but under the Mirinda name elsewhere because of the unpleasant connotation of *patio* in Spanish.

Sixth, some MNCs acquire local brands for a quick market penetration in order to save time, not to mention money, which otherwise would be, needed to build the recognition for a new, unknown brand in local markets. Renault would have been foolish to abandon the AMC (American Motors) name after a costly acquisition. Thus, Renault 9, for example, became AMC Alliance in the United States. Chrysler subsequently bought AMC from Renault, one reason being AMC's coveted Jeep trademark.

Seventh, multiple brands may have to be used, not by design but by necessity, because of legal complications. One problem is the restrictions placed on the usage of certain words. Diet Coke in countries that restrict the use of the word *diet* becomes Coke Light. Antitrust problems can also dictate this strategy. Gillette, after acquiring Braun A.G., a German firm, had to sign a consent decree not to use the name in the U.S. market until 1985, The decree forced Braun to create the Eltron brand, which had little success.

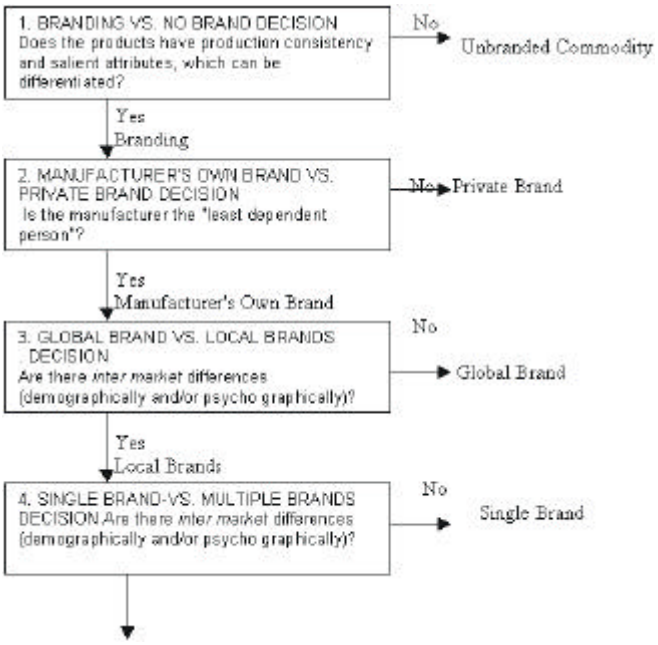
Eighth and perhaps the most compelling reason for creating new local brands is because local firms may have already used the names that multinational firms have been using elsewhere. In such a case, to buy the right to use the name from a local business can prove expensive. Unilever markets sure antiperspirant in the United Kingdom but had to test market the product under the Trust name in the United States, where Sure is Procter & Gamble's deodorant trademark. In an interesting case, Anheuser-Busch bought the American rights to the Budweiser name and recipe from the brewer of Budweis in Czechoslovakia; Budejovicky Budvar Narodni Podnik, the Czech brewer, holds the rights in Europe. Operating from the town of Ceske Budejovice, known as Budweis before World War this brewer claims exclusive rights to the Budweiser name in the United Kingdom, France and several European countries. Courts have ruled that both companies have the right to sell in the United Kingdom, but Anheuser-Busch has to use the Busch name in France and the corporate name in other parts of Europe.

Ninth, a local brand may have to be introduced because of price control. This problem is especially acute in countries with inflationary pressures. Price control is also one reason for the growth of these called gray marketers, as the phenomenon contributes to price variations among countries for the same product. Thus instead of buying a locally produced product or one from an authorized distributor/ importer, a local retailer can buy exactly the same brand from wholesalers in countries where prices are significantly lower. A manufacturer will have a hard time prohibiting importation of gray market goods, especially in EU countries where products are supposed to be able to move freely. Parallel trading can be minimized by having different national brands rather than just a worldwide brand

As mentioned earlier brand standardization is a common strategy. One study of brand managers in firms operating in Canada found that brand standardization was utilized to a much higher degree than advertising standardization. The most common combination is brand standardization and advertising non-standardization. In other words, companies tend to brand globally but advertise locally. Interestingly, although the McDonald's logo is one of the most recognizable trademarks in

the world, McDonald's has changed its advertising logo just for Quebec, perhaps the only market in the world with this special treatment. The most well-known logo in Quebec is J'M. This is a play on "j' aime" which means "I love" in English.

The strategy of using a worldwide brand is thus not superior (or inferior) to using multiple local brands. Each strategy has its merits and serves its own useful functions. This is where managerial judgment comes in. Unilever, for example, considers consumer responses to a particular brand mix. It uses an international brand for



Market Segmentation and Multiple Brands

EXHIBIT A Branding Model for Decision Making

such products as detergents and personal products because common factors among countries outweigh any differences. Food products, however, are another story. Food markets are much more complex because of variations in needs and responses to different products. The southern half of Europe mainly uses oil for cooking rather than margarine, white fats, or butter. The French more than the Dutch consider butter to be an appropriate cooking medium. German homemakers, when compared to British homemakers, are more interested in health and diet products. Soup is a lightweight precursor to the main dish in Great Britain but can almost be a meal by itself in Germany. Under such circumstances of preferential variations, the potential for local brands is greatly enhanced. Exhibit provides a branding model for decision-making.

Brand Consolidation

Frequently, it is either by accident or by lack-of coordination that multiple local brands result. Despite the advantages offered by the multiple-brand strategy, it may be desirable to consolidate multiple brands under one brand when the number of labels reaches the point of being cumbersome or confusing. National Bank Americard used to issue cards around the world under twenty-two names before consolidating them all under the Visa umbrella.

Another way of consolidating the brand franchise simply is to drop weak brand Assuag-SSIH weeded out all but its most prominent watch brands. Its Eterna brand, for example, was never marketed in the United States, and that brand was eventually sold to another company.

Brand consolidation on a global scale is a strategy that has been hotly debated. As in the case of Scott Paper Co., the company felt that the Scott name, just like Coca-Cola, should command respect all over the world. 15 Also global branding would allow Scott to use common advertising messages internationally while saving costs. So the company has been phasing out local brand names in its eighty national markets. Even Andrex, a top selling bath tissue in England, will suffer the same fate, thus diluting or destroying the goodwill that has been earned.

Marketin g Strategy

Life is Like a Box of Chocolates

Mars Inc. wants to standardize products not jus~il1 Europe but worldwide. As a result, the company got-rid of several highly successful European brand names. In the United Kingdom its big-selling Marathon chocolate bar became Snickers. Raider, Europe's most successful chocolate biscuit, became Twix which is the name used in the United States. Bonitos in France became M&Ms with changes in color, coating, and chocolate formula.

Mars, however, has not yet solved problem it encounters in its effort to standardize Milky Way and Mars candy bars. These two brands, while existing worldwide, refer to different things in different countries. In Europe, Mars is a caramel and chocolate bar which is called

Milky Way in the United States. The Milky Way which exists in Europe does not have any caramel. Furthermore the U.S. version of Mars has almonds.

When a marketer wants to change brands or consolidate them under one brand in order to unify all marketing efforts, the process on an international scale is complex and extremely costly. Although a unified brand across frontiers provides cost savings by eliminating duplication of design and artwork, production, distribution, communications, and other related issues, such a change is fraught with pitfalls and, if not well planned and executed, can cause more problems than it solves. Nestle uses a gradual evolutionary process in preparing its European brands for 1992. Its package-design unification involves having the Nestle name appear along with the local brand. The Nestle name will be gradually enlarged over a period of four or five years until it replaces the local brand names entirely.

Another kind of problem presents itself when a brand i~ well known but the corporate name is not, complicating communication for the company. In this situation, it is probably easier to change the corporate name to fit the better-known brand, a strategy used by Sony, Aprica, Olympus, and Amoco.

Nissan's name change in comparison, was risky because it followed an opposite route. Nissan's half-hearted entry into the U.S. market led to the use of the Datsun name to avoid embarrassment just in case the effort failed. But the company was later unhappy that the proud corporate name was not as widely recognized as its Datsun brand, which enjoyed an 85 percent recognition rate in the United States (compared to 10-15 percent for Nissan). The company decided to institute a worldwide brand by phasing out Datsun and phasing in Nissan. Some critics questioned the move because the change cost Nissan $150 million. Furthermore, years of goodwill gained from the Datsun name would be lost. To minimize this problem, both Nissan and Datsun names appeared together at first.

Despite Nissan's efforts and hundreds of millions of dollars on the new name, unfortunately, many American consumers thought that Nissan was a division of Toyota. Furthermore, not recognizing the names of individual cars, they thought that Pulsar was a popular watch brand and Maxima was an interest-bearing checking account.

It is debatable whether the corporate name and the product's brand name should even be the same. When the name is the 'same, a brand that performs poorly or gains notoriety through bad publicity hurts the corporate image as well, as the images of the corporation and the product are so intertwined. The strategy is even riskier for fashion products because fashion comes and goes. Using the same name, however, is a relatively safe strategy and should work well if a firm has good quality control and the reputation of its no fashion products has withstood the test of time.

Brand Origin and Selection

Brand names can come from a variety of sources, such as from a firm's founders (e.g., Francois Michelin, Albert G. Spalding, Pierre Cardin, and Yves St. Laurent), places (e.g., Budweiser), letters-and numbers (e.g., IBM), and coined words (e.g., 10rdache, a modified acronym for the three brothers Joseph, Ralph, and Avi Nakash). Sometimes it is easier simply to purchase an existing brand from another company, Hong Kong Universal International bought Matchbox, a British toy carmaker. W. Haking Enterprises, another Hong Kong company, acquired the Ansco name from GAF, and most Americans do not realize that Haking's low-priced cameras are actually a Hong Kong brand. North American Philips (NAP) bought the Schick shaver trade name. Underscoring the value of this name. Remington even filed a complaint alleging that the Schick name enabled NAP to avoid spending $25 million needed to launch new shaver to supplement the Norelco line.

Brand selection is far from being an exact science, a illustrated by the origins of many successful brands. Gabrielle channel liked the scent of the fifth sampled bottle in 1921. Feeling that 5 was a pretty number, she named the perfume channel No. 5 Denmark's Lego Group, well known for its interlocking plastic bricks, is the work's fifth largest toy maker his company Lego which is a combination of the Danish worked leg god, meaning "Play well."

More recently, brand selection has shifted away from being an art and is becoming more of a science. There are several companies that specialize in creating brand and corporate names and they use computer programs that can run prefixes, suffixes and other word combinations.

Still, it must be pointed out that marketers often do not have the luxury of picking and choosing names that they like. Nor is it always feasible to conduct marketing research to investigate the appropriateness of a name. In Brazil Philip Morris chose the Galaxy name without marketing research because it happened to be one of the company's registered names. NUMMI's use of the Nova trademark for cars produced jointly by Toyota and General Motors was due in part to GM's ownership of the Nova brand name.

LESSON 23:
BRANDING AND PACKAGING DECISIONS

Brand Characteristics

A good brand name should possess certain characteristics, and such characteristics are thoroughly discussed in most advertising and marketing textbooks. In essence, a brand should be short, distinctive, easy to pronounce, and able to suggest product benefits without negative connotations. In the international arena these qualities are also relevant.

In selecting a brand name, a marketer should first find out whether a brand name has any negative connotation in the target market One company in the business of brand-name selection felt that Probe was all inappropriate name for Ford's car, having an unpleasant gynecological reference. IS One reason why Japan's Daihatsu Motor Co. Ltd. did not succeed in the United States may have to do with its name. According to research, many American consumers thought that the company was Korean, and it' was a negative association.

An international brand name should reflect the desired product image. Toward this end, consumer perception should be taken into account. For instance, worldwide consumers usually perceive French perfumes to be superior, and French-sounding names for this kind of product may prove beneficial. Likewise, good watches are perceived to be made in Switzerland, toiletries in the United States, machinery and beer in Germany, 'and so on. If appropriate, brands should reflect such images. Russian sounding names can be used to position a vodka brand positively. Smirnoff originated in the Soviet Union but has been made in the United States for decades-a fact not known by many Americans.

Marketing Strategy 1

Name Selection

Brand name selection, although an artistic process has become more scientific. In the case of automobiles, brand names are carefully chosen so they can con-note certain positive meanings.

Oldsmobile has changed some of its name plates. Calais has become Achieva. Calais is a Seaport in north-ern France on the Strait of Dover. Achieva, in contrast, can communicate the idea that the car is a "compact, dependable, nimble, and responsive automobile". Achieva is a computer-generated name. Although- it does not really mean anything, it connotes achieve-ment. Olds mobile initially called it the Achiever, which implied somewhat negatively a young urban profes-sional who had "made it."

Just like Achieva, Acura is a neologism. Created by Name Lab, the name suggests precision. One of Honda's desired hallmarks for the brand was precise engineering.

Altima is a neologism. The word has no real meaning but hints at ultimate or best.

Geo is a morpheme or the smallest meaningful language unit. It means world in many languages.

Mondeo menad world in Italian

Mitsubishi, in Japanese, means three pebbles. The company changed it to three diamonds whose design serves as the company's logo.

The wives of the vice president and the top en-gineer of ford car product development were born under the Taurus sign of the Zodiac. As a result, Tau-rus was used as the project code name and in the end stayed as the name of the car.

Wind star is a successor to Ford's aero star mini-van. The company, while wanting to keep a family re-lationship to the Aerostar, also wanted a different name to tell buyers that Wind star was a new vehicle.

Marketers may want to consider foreign branding which is a strategy of pronouncing or spelling a brand name in a foreign language. Foreign branding, by triggering cultural stereotypes, may influence product perceptions and attitudes. As shown in one experimental study, a brand name's French pronunciation affects the perceived hedonism: of the products as well as attitudes toward the brand name and the brand. Even with the presence of direct sensory experience, French branding still changes perceptions of a product.

One way of creating a desired image is to have a brand name that is unique or distinctive. Exxon has this quality. Aprica, a status-symbol stroller, is also unique in several respects. In choosing the name, Kenzo Kassai, the company's owner, wanted something cute like "apple" for his folding stroller. During a trip to Italy, he found apri-an appropriate name for something that opens and closes. As stroller in Japanese is said as "baby car," theca syllable (for "car") is a natural ending. In effect, Aprica is a blend of English, Italian, and Japanese, meaning "open to the sun."

A unique name often renders itself to graphic design possibilities, another desirable feature of a trademark. Exxon was chosen because of its distinctiveness, usefulness in world markets, and graphic design possibilities. After rejecting Hot-Line and Sound-About for not being appealing, Sony selected Walkman because of the distinctive logotype with two legs sticking out from the bottom of the letter A in walk.

An international product should have an international brand name, and this name should be chosen with the international market in mind. When possible, the name should suggest significant benefits. Although Emery Air Freight ships everything large and small anywhere in the world, its name gave no indication of this advantage. To overcome a secretary's fear of shipping a letter to foreign countries with a carrier specializing in freight, the corporate name was changed to Emery Worldwide. Not wanting the trademark to because identified with the United States, U.S. Rubber adopted Unifoyal to reflect its diverse businesses around the world. The former French-born chairman of Revlon viewed Amoroso as unsuitable for a

fragrance for the international audience; consequently, the name was changed to Jontue.

A Brief Guide to a Pronunciation of Romanized Chinese

There are four romanized Chinese consonants that cause pronunciation problems. Here is a guide to pronouncing them accurately:

- *c* equals the ts of tsar or its; thus cai(finance) sounds like tsai
- q equals the ch of *China* or *child; thus Qin* (a Dynasty) sounds like *chin*
- *X* equals, the sh of shine or *sheet;* thus *xi (west)* sounds like *shee*
- *zh* equals the J of Jim of jig; *thus Zhang* (a surname) sounds like *Jang*

Chinese vowels are broader, and longer than American vowels otherwise they are very close in Pronunciation, except for the Chinese e as in the names Hebei and Henan. The Chinese e is somewhat like the o of other.

Unless otherwise indicated, two Chinese vowels placed next to one another are pronounced as one sound, i.e., as a diphthong. The sister state of Illinois, Liaoning, is-a two syllable word-Iyao-ning.

Chinese surnames come first. The given names are not hyphenated in modern Chinese. Thus Huang Zhirong (the Chinese consul general) should be addressed as Mr. Huang.

Sometimes Chinese, especially those from Beijing, have a tendency to add an r sound at the end of certain words. Don't be confused by it. It is analogous to a Harvard r.

One way of making a brand -name more international is by paying special attention to pronunciation. Many languages do not have all the letters, and the English language is no exception. The Spanish alphabet does not include the letter w, and the Italian language has no j, k, w, or y.

Stenographers can easily see why many American words are misunderstood overseas because shorthand notations are based on how a word is pronounced and not on the way it is spelled. In general, any prefix, suffix" or word containing such letters as ph, gh, ch, and sh invites difficulty. Phoenix sewing machines provide a good example-it is inconceivable to many foreign consumers how the brand can be pronounced fe-nix and not pe-nix or fo-nix. It is difficult to understand why the 0 and not the e is silent in this case. Also, if the 0 is silent, why should it be in there in the first place? By the same token, people in many countries do not make any distinction, as far as pronunciation is concerned, for the following pairs: v and w; z and s; c and z; and ch and sh. A similar lack of distinction often exists with the trio ofj, g, and y. The letter c in English words can be confusing because it can be pronounced like an s, as in the words audience and fragrance, or like a k, as in the words cat and cost. The letter y also poses some problems because it can sound like an e at one time and an i at another time. Consider the hair product Brylcream. Foreign consumers may think that the I is silent and that the y should sound like a long i. A simple test could have easily revealed any pronunciation difficulties.

Brand Protection

The job of branding cannot be considered done just because a name has been chosen. The brand must also be protected. The first protective step is to obtain trademark registration. Because of the cost involve, it may be neither practical nor desirable to register the name in all countries especially in places where demand seems weak, it is inexcusable, however, not to do so in major markets.

There are international arrangements that simplify the registration process. The Paris Convention (International Convention for the Protection of Industrial Property) is the most significant multilateral agreement on trademark rights because it establishes reciprocity, which allows a foreign trademark owner to obtain the same protection in other convention-member countries as in the owner's home country, Although preventing discrimination against non-nationals, the degree of protection v1lries with individual national laws. In the case of the Madrid Convention, nationals of the participating countries can have simultaneous trademark filing among all member countries. The Trademark Registration Treaty (TRT) allows a company to file for trademark protection with the International Bureau of the World Intellectual Property Organization (WIPO) without being required, as in the case of the Madrid Agreement, to have a proof home registration. Other treaties include the Central American Arrangement and the African Intellectual Property Organization (OAPI). The Arrangement of Nice [France] Concerning the International Classification of Goods and Services to Which Trade Marks Apply is the most widely used trademark classification system. Adopted by the United States and some sixty countries, the system has thirty four product and seven service categories.

The United States has two registers. The Principal Register provides federal protection, a benefit not provided for by the Supplemental Register. A trademark owner who is unable to place a mark on the Principal Register may be able to do so later when the mark has acquired distinctiveness over the years. The Supplemental Register is still useful for a U.S. marketer who must obtain registration in the home country before becoming eligible to do the same in host countries.

The courts have developed a hierarchy of registration eligibility. Moving from highly protect able to unprotect able, these categories are "fanciful (Kodak), arbitrary (Camel), suggestive (Eveready), descriptive (Ivory), and generic (aspirin)." In general, for a trademark to be eligible for registration, it must be "distinctive" or, if not, must be "capable of being distinctive."

Although a valid brand name suggest or imply a product's benefits, it cannot merely describe the fact or the product. A suggestive mark is revisable, but a descriptive name is not legally acceptable unless it has acquired distinctiveness through long-continued exclusive use. Even if the descriptive mark might somehow have been registered, the mark can still be cancelled for lack of distinctiveness. Of course, it is not always easy to distinguish a suggestive mark from a descriptive mark: Wheedles, as lawn care product, may be either suggestive or-descriptive.

A generic term merely identifies the product rather than the maker of that product. As such it receives no protection and

cannot function as a trademark. Labatt, a Canadian brewer, attempted to win U.S. trademark protection for the name "ice beer" by claiming that it invented the manufacturing process, Anheuser Busch Cos. Sued and was awarded $5 million in punitive damage when it St. Louis jury ruled that ice beer was not a trademark.

The policy of the U.S. government is to contest applications for generic trademarks abroad (e.g., Wash-and-Wear or such foreign variants as Lava y Listo). If allowed to be registered, such trademarks could create significant problems in international trade. A U.S. exporter, for example, will find it impossible to use common product names in advertising abroad without the risk of being sued for trademark infringement, or the exporter may find that the goods are refused entry "into a foreign Country altogether.

Most countries do not require the display of a trademark in a specific language or the translation of the trademark. Still, to be registered, a foreign trademark may have to be written in a local language in such a way as to give the equivalent pronunciation. China requires a trademark to be displayed in Chinese characters. Coca-Cola, depending on a group of Chinese characters used, may have the right sound but the wrong -interpretations. The original registered characters (Koo-Kah-koo-lah, when translated, mean either "a wax-fattened mare" or "bite the wax tadpole." The company then switched slightly to the new char1icters to read Kah-koo-kah-lah, which translate. to "may the happy mouth rejoice."

Unlike patents, trademark registrations can be renewed indefinitely. To keep registrations in force, trademark owners are required to pay an annual tax or maintenance fee in most countries (though not in the United States). The technical requirements must also be observed. Some countries (e.g., Australia) allow the fees to be paid by a foreign trademark owner residing abroad or by the owner' s representative /agent in a third country. In other countries (e.g., Brazil), the fees can be paid by only a local or domestically domiciled representative/ agent.

Politics may make registration and maintenance of a trademark difficult. Most U.S. companies have lost their trademarks in Vietnam because of invalidation of those trademark registrations that were obtained in South Vietnam before.]975 and were not reregistered in the Socialist Republic of Vietnam by 1982.24 While McDonald's registered its trademark in South Africa in]968, the company did not open a restaurant there due to international economic sanctions. According to the South African law, a foreign company could lose its right by not using the trademark for five years.

As a result, when McDonald's finally entered the market in 1995, a local court ruled that the company did not have an exclusive right to its various trademarks. As a matter' of fact, Dax Properties, which opened its own McDonalds hamburger outlet there selling such things as Little Mac, even tried to bar the real McDonald's from using the name. Under international pressure, South Africa passed a new law in 1995 to conform to international law and to offer protection to world-recognized names.

It's the Law1

Just Do it

The Nike name was first registered in Spain by a Barcelona sock maker who produced knitted wear during the 1936 –39 Spanish Civil War. The trademark is a photographic negative of the headless Winged Victory of Samothrace statue in the louver museum. Although the sock maker stopped production long age, he kept the trademark which was subsequently sold to a Spanish attorney. Spain allows a name to be registered and renewed even without any production the registration applies only to sports apparel, not shoes.

In 1990, Nike Inc., the shoemaker was given a registration for its name and swoosh symbol. The company planned to showcase to showcase its new line of clothing in Barcelona. Two Spanish courts, however, upheld the lawyers earlier trademark. Nike argued that the ban did not apply to the outfits worn by the American and Algerian Track and field teams which were paid millions of dollars to wear the Nike name. Finally spans constitutional court, the highest Spanish appeals court, rejected Nike's appeal, court, rejected Nike's appeal, it thus cannot sell or advertise its sports apparel in Spains, athletes were not allowed to wear the Nike name, Nike figured that it suffered losses of $ 20 million in Spain and several times that amount world wide.

Registration by itself does not offer automatic or complete protection. Other legal requirements must be met in order to maintain copyright. Use is a universal requirement. In China, publication, advertising, and exhibiting of a product with the trademark all constitute use. To establish use in most countries, a manufacturer must sell or make that product in the intended market.

The legal procedure to acquire and maintain a trademark varies from country to country. Whereas some countries recognize registration but not prior use, other countries do exactly the opposite. In most countries, a company can register a mark subject to cancellation if that mark is not used or continued to be used within a reasonable period of time. The failure to register, even with actual prior use, may force the company to forfeit its rights to another person who registers the same mark later but before anybody else. The first user can be held for ransom this way.

Going back as far as the 1870s, trademark rights in the United States were based on the "no trade, no trademark" premise. Until recently, the U.S. Patent and Trademark Office was practically alone in the world in requiring a potential mark owner to put the trademark into interstate or foreign commercial use first before it could even be registered. Registration in the United States was merely a formality because registration was optional. The problem with this practice is that more than one company may invest in an identical mark, not knowing that there are legal conflicts with others using or working on the identical or similar mark. A U.S. firm thus could not be certain that a proposed mark would still be available for registration when the product reached the consumer years after it was conceived. To solve the problem, American business has traditionally relied on token use by making a small-scale shipment of the product for purposes of filing a trademark

application, even though the product might not be ready for full-scale commercial sale for years.

The Trademark Acrof-1946 (the-Lanhan Act) has been updated, and several changes have been made. One change involves intent-to-use trademark applications; the change permits companies to file an application based on projected future use. Now a declaration of a bona fide intent to use the mark in commerce is sufficient. A trademark registration is subsequently issued-when the applications files a statement showing evidence of actual use of the mark in commerce. To demonstrate use of the mark, specimens the form of containers, labels, tags, or displays associated with the goods must be filed. There is no penalty for reserving names that are never actually used. The second change is the constructive-use provision. For goods or services specified in the Principal Registration, an applicant receives a nationwide priority effect as though the1applicarit had used the mark. Throughout the nation as of the filing date. The definition of "use of the mark" has been changed to require that use be in the ordinary- course of trade, and token use is prohibited. To reserve the intent to use- application becomes the sole avenue. Finally, the term of federal registration has been reduced from twenty to ten years to clear out trade-marks no longer used.

Although a single use of a mark may be adequate to register the mark, a company must exploit the mark commercially in good faith to prevent the loss of it. The rationale is to prevent a company *from* abusing the law to its advantage when the owner has no intention of using the trademark other than to bar potential competitors with genuine interests from utilizing a Competitive tool. An example is Snob perfume. a name owned in France by Le Galion, a French company, and in the United States by Jean Patou an American company. Le Galion was able to challenge Patou's rights successfully because Patou (1) sold only eighty-nine bottles of Snob perfume in twenty-one years, (2) never supported the product with promotion, and (3) made only $100 in gross profit. Thus, Patou was suspected of registering the name just to bar a potential competitor from entering the market.

The quickest way to lose a trademark is by not using it. A failure to use a registered trademark for three years terminates all rights in China. In the case of South Korea, nonuse after a period of one year is grounds for cancellation of registrations. In Central and South America, due to inflation, currency devaluations, and political uncertainty, a manufacturer may find it difficult to maintain operations there. However, the company risks losing its trademark if it stops the business activities. It is thus wise to consider some temporary licensing agreements with local firms until the situation improves. By doing so, brand awareness and trademark ownership are sustained. This is exactly what some international firms did while being forced to retreat from South Africa at the height of the antiapartheid movement.

Another caveat is to make sure that the brand does not become so *generic* that it is identified with the product itself. A loss of trademark can occur if the name becomes part of the language; that is, when members of the consuming public use the brand name to denote the product or its common function rather than the producer of the product. Yo-yo (a foreign trademark), Roquefort cheese, and Champagne are proprietary names in France but generic names in the United States. The reverse is true of Ping-Pong, a U.S. registered trademark that is a generic name in China for table tennis. In Japan, there is no word for vulcanized rubber, and the Goodyear name is used to identify this product. Cyanamid has had to fight to keep Formica from denoting all plastic laminate or laminated 'wood. Bayer's loss of the Aspirin trademark in the United States was due partly to the anti-German sentiment during World War II and partly to its failure to create a generic word for the product, whose chemical name is acetylsalicylic acid. Bayer would have been on more solid legal ground if it had established a generic term for household use (e.g., headache tablet or pain reliever tablet).

To avoid this problem of a brand. name becoming a generic name, a firm must never use the brand name in a generic sense (i.e., using it as a verb or adjective to denote the product). Promotional materials should reflect the proper usage, and the public should be informed accordingly. Willy Motors always emphasizes that Jeep is a trademark, and uses an advertisement to inform consumers not to use Jeep as an adjective(e.g. jeeplike, jeepy or jeep-type), a verb (e.g.. jeep around or go jeeping), a plural (e.g. jeeps) or a generic without the capital *J.* In the Philippines, however, Jeep has become, a generic: name, and people there use privately owned small buses mown *as jeepnies* for transportation Jeep is now a registered trademark of Chrysler Corporation.

It is not legally sound to combine trademarks. It may seem remote that Honda will have trouble, with its Honda Accord and Honda Civic marks but the fact remains that the second mark (Accord, Civic) is in jeopardy through inference that it is the product's generic name. The public may thus assume that manufacturers other than Honda also make Accord and Civic cars.

Tabasco provides a good illustration of the various legal issues that have been discussed. Unlike Worcestershire sauce and soy sauce, Tabasco is a properly registered trademark. It is the name of a river and a state of southern Mexico. One may question how a geographical name could ever have been accepted for registration, as the name is not distinctive. The answer is that the name was capable of being distinctive and did become distinctive because it has been used continuously and exclusively by the manufacturer for a long time. Thus, the name has become associated with this particular company. Furthermore, Tabasco is the official botanical name of the hot red peppers, but those peppers were actually named for the sauce (i.e., product) and not the other way around. Tabasco is aware that consumers might use the brand to denote the product (i.e., hot sauce) rather than the maker of the product. It has thus hired two legal firms to police the world for any misappropriation of the trademark. Its vigorous enforcement enabled it to defeat B. F. Trappey Sons's legal bid for the right to use the word.

To hold the legal rights to a registered trademark is one thing, but to prevent others from illegally using it through counterfeiting is another matter altogether:. In fact, counterfeiters, though acknowledging the illegality of the activity, may see nothing morally wrong with it. In China, the basic cultural values relevant to counterfeiting are neutral-it is not a violation to copy

someone's ideas. Great artists' works for example, are copied as a sign of respect.

It's the Law 2

Professional Bootlegging

Apple House Music, an Australian firm, is a professional bootlegger unlike other bootleggers who make and sell bogus goods and then take the money and run before getting caught. Apple House Music is quite open about its business plans~ It has announced that it would release unauthorized recordings of live performances by stars such as Michael Jackson, 'Madonna, Prince, Bruce Springs teen, and Elton John. In the process, Apple House would deprive legitimate companies of millions of dollars.

Unlike over producers of unauthorized material, Apple House has obtained expert legal advice. The company's live recordings were made in countries such as Bulgaria where artists have gone and willingly given live performances even though they were aware that they have no protection under international conventions. Apple House told the courts that it planned to put a disclaimer on its records stating "this live recording and its release has not been authorized by the artist or his recording company and the sound recording may not be of the same quality as ,an authorized release."

Sony unsuccessfully sought an injunction against Apple House Music in Federal Court. But the full bench of the court ruled that artists had no protection against unauthorized recordings of their live performances made before 1992 when Australia amended the Copyright Act.

Source: *"Aussie Boodeg Record Has Sony in II Spin," The* Nation, *2 October 1993.*

To prevent the importation into the United States of counterfeits and, to a lesser extent, gray market goods, a trademark owner whose mark is accepted for the Principal Register can raster a mark with the U.S. Customs Service for the purpose of preventing entry of goods bearing an infringing mark. The Customs Service distinguishes colorable imitation from counterfeit trademark. A colorable imitation is a mark so similar as to be confused with a registered mark, whereas a counterfeit trade mark is basically indistinguishable from a registered trademark. Colorable imitations are treated more leniently in that can still gains entry as long as the objectionable mark is removed. But in the case of counterfeits, the- Customs Reform and Simplification act of 1978 allows the seizure as well as "forfeiture to the government of any articles bearing counterfeit trademark.

Packaging: Functions and Criteria

Much like the brand name packaging is another integral part of a product. Packaging serves two primary purposes: functional and promotional. First and foremost, a package must be functional in the sense that it is capable of protecting the product at minimum cost.

If a product is not manufactured locally and has to be exported to another country, extra protection is needed to compensate for the time and distance involved. A country's adverse environment should also be taken into account. When moisture is a problem, a company may have to wrap pills in foil or put food in tin boxes or vacuum-sealed cans. Still, the type of package chosen must be economical. In Mexico, where most consumers cannot afford to buy detergents in large packages, detergent suppliers found it necessary to use plastic bags for small packages because cardboard would be too expensive for that purpose.

For most packaging applications, marketers should keep in mind that foreign consumers are more concerned with the functional aspect of a package than they are with convenience. As such, there is usually no reason to offer the great variety of package sizes or styles demanded by Americans. Plastic and throw-away bottles are regarded as being wasteful, especially in LDCs, where the labor cost for handling returnable is modest. Non-American consumers prefer a package to have secondary functions. A tin box or a glass bottle can be used after the product content is gone to store something else. Empty glass containers can be sold by consumers to recoup a part of the purchase price.

From the marketing standpoint, the promotional function of packaging is just as critical as the functional aspect. To satisfy the Japanese preference for beautiful packaging, Avon upgraded its inexpensive plastic packaging to crystalline glass. Similarly, BSR packs its product into two cartons, one for shipping and one for point-of purchase display, because Japanese buyers want a carton to be in top condition. The successful campaign for Bailey's Irish Cream in the United States included a fancy gold foil box package that promotes this whiskey-based drink's upscale image. In any case, packaging does not have to be dull. Novel shapes and designs can be used to stimulate interest and create excitement.

Mandatory Package Modification

A package change may be either mandatory or at the discretion of the marketer. A mandatory change is usually necessitated by government regulations. Sometimes, it is for safety and other reasons. Sometimes, packaging regulations are designed more for protection against imports than for consumer protection.

Several countries require bilinguality (e.g., French and English in Canada and French and Flemish in Belgium). This requirement may force the manufacturer to increase package size or shorten messages and product name, as a bilingual package must have twice the space for copy communications. In some cases, modification is dictated by mechanical or technical difficulties, such as the unavailability of certain typographic fonts or good advertising typographers:

In many cases, packaging and labeling are highway related. Packages may be required to describe contents, quantity, manufacturer's name and address, and so on in letters of designated sizes. Any pictorial illustration that is used should not be misleading. In Singapore, Certain foods must be labeled to conform to defined standards. When terms, are used, that-imply added vitamins or minerals (e.g., enriched, fortified, vitaminized), packages must show the quantities of vitamins or minerals added per metric unit. In addition, if the product is hazardous m. any way, marketers should adopt the United Nations' recommendations for the labeling and packaging of hazardous materials.

Exporters of textile products must conform to countries' varying regulations. Spain has specific and extensive requirements concerning fiber content, labeling, and packaging. In addition to its flammability requirements, Sweden's labeling regulations include size, material, care, and origin. Venezuela requires all packaged goods to be labeled in metric units while specifically prohibiting dual labeling to show both metric and non metric units. Germany wants the description of fiber content to be in German, but labeling for Denmark must be in Danish or kindred. In the case of France care labeling (if used) must meet an International Standardization Organization (ISO) directive.

As discussed in a previous chapter, countries' different measurel'1ent systems may necessitate some form of product modification, and necessity applies to packaging as well. Products, toiletries included, cannot be sold in Australia in ounces. The Australian regulations require products to be sold in metric numbers, in increments of 25 mm. In Germany, liquid products must be bottled or packaged in standard metric sizes. Interestingly, the United States, a non-metric nation, has the same requirement for liquor products.

Optional Package Modification

Optional modification of package, although not absolutely necessary, may have to be undertaken for marketing impact or for facilitating marketing activities. Through accidents and history, users in many countries have grown accustomed to particular types of packages. Mayonnaise, cheese, and mustard come in tubes in Europe, but mustard is sold in jars in the United States. Orange bottles are popular in the Netherlands. While non-Dutch beer drinkers all over the world readily recognize a green Heineken bottle; the domestic Heineken beer comes in a brown bottle. Ironically, because of a strike at home, Heineken was forced to import 1.8 million gallons at one time from some of its ninety breweries worldwide.

In selecting or modifying a package, a marketer should consider local conditions related to purchasing habits. Products conventionally sold in packs in the United States are not necessarily sold that way elsewhere and may require further bulk breaking. This phenomenon is in part the result of lower income levels overseas and in part the result of a lack of unit pricing, which makes it difficult for buyers to see any savings derived from the purchase of a bigger package. Foreign consumers may, desire to buy one bottle of beer or soft drink at a time instead of buying a six-pack or eight pack. Likewise, one cigarette, not the whole pack, may be bought in a purchase transaction.

Cultural Dimension 1

Will the Euroconsumers Please Stand Up?

In terms of consumer behavior, European countries are both similar and different.

On the one 'hand, marketers have been pushing to -develop Europe wide brands. On the other hand, many still believe that. It is essential to adapt products to local tastes. AS in 'the case of Sara Lee's Douwe Egberts coffee while the coffee bens are toasted less in Germany and the Netherlands, they are ground to the consistency of talcum powder in Greece.

Although Rotterdam is only about thirty miles from Belgium, Unilever's tomato soup there is differ-ent from the one sold in Brussels. The company uses another recipe for Germany, while France has yet an-other recipe. These variations exist even though many of the soups are made in the same plant.

Procter & Gamble has only one formula, one brand name, and one package for its fabric softener. For historical reasons, Unilever sold its Teddy Bear or 'Snuggle fabric softener in ten European countries while selling Comfort (a creamier, more expensive version) 'in seven other countries. The company wanted to merge the two in order to cut production and mar-keting costs. Its first step was to introduce identical bottles. In 1993: But since it 'does not want to upset loyal consumers, Comfort is still a thicker liquid with a mother and child on its label, while Teddy Bear fea-tures a bear. There are other complications. German consumers do not mind paying a premium price for a product that is gentle on lakes and rivers. Spaniards, on the other hand, want cheaper products that can get shirts white and soft. In the case of Greeks they want smaller packages so that they can hold down the cost of each store visit.

In addition to conditions of use, other cultural factors should be taken into consideration because such factors often determine and influence consumer preference. Although the UHT (ultra-high temperature) process for packaging milk and juices in un refrigerated cartons has long been popular in Europe, it took quite a while for American consumers who were accustomed to fresh products to start accepting aseptic packaging.

Symbols and colors of packages may have to be changed to be consistent with cultural norms. If packages are offensive, they must be made more acceptable if the product is to be marketed successfully. For example, the controversial Jovan packages, with their sexual connotations, can prove to be too - suggestive in some countries. In Japan, because manufacturers of condoms have female customers in mind, packaging tends to be cute. One brand, for example, has a pink box with two dancing pigs and the 'words "BuBu Friend." BuBu is the Japanese equivalent of oink-oink.

Sometimes, it is difficult to tell whether package modification is mandatory or optional. Take the case of Germany's "green dot" packaging laws. Since the early 1990s, Germany has required manufacturers, distributors, and retailers to take back sales packaging (used packaging materials) either directly from the consumer's domicile or from designated local collection points. Those manufacturers who participate in the "green dot" program are exempted from this requirement. The green dot is the symbol which has been adopted by the Duales System Deutschland GmbH (DSD Dual System of Germany), a corporation established in 1990, with over 400 participating companies (shareholders). The DSD collects a fee from the participating manufacturers for the right to display the green dot symbol on the products. The revenue is used to finance local packaging-waste collection and recycling programs. The green dot tells consumers that such packaging may not be returned to the retailer but should be consigned to especially dedicated collection containers or be taken to the local recycling center. The symbols also indicate that the packaging will be recycled or reused rather than dumped or incinerated. While goods without the green dot are not illegal they are unlikely to be

accepted by the market-retailers, wholesalers, and importers. The DSD estimates that over ten billion units currently being marketed in Germany carry the green dot.

One helpful sign that should deduce packaging confusion is the European Union's standardization- attempt Changes in the EU food packaging requirements should allow foreign food manufacturers and packaging agents to follow one unified EU regulation. Although size requirements differ by product, the EU has harmonized the sizes of sealed packages and containers. The uniformity assists consumers in comparing prices for the same quantity, thus abolishing the need for unit pricing. EU packaging regulations also help to promote conservation by decreasing the amount of paper utilized in packaging.

Because there is no EU-wide general product-labeling directive, manufacturers have to label their products differently for each country, thus increasing expenses. There is also a question about language requirements. The EU suggests that most products should have at least two EU official languages so as to increase the marketability of the products. In terms of what is to be placed on the product label, EU officials -recommend the following: (1) the name of the product, (2) a name of the manufacturer or distributor within the marketing country, (3) any care conditions, (4) special storage conditions, (5) country of origin, especially where labels might mislead, (6) metric requirements and (7) list of chemicals/ingredients included.

Conclusion

A product is a bundle of utilities, and the brand and package are part of this bundle. There is nothing unusual about consumers' reliance on brand names as a guide to product quality. As shown by the perfume industry, the mystique of a brand name may be so strong as to overshadow the product's physical attributes. When practical and well executed, branding allows a commodity to be transformed into a product. In doing so with the aid of product differentiation, brand loyalty is created, and the product can command a premium price.

Branding decisions involve more than merely deciding whether a product should be branded or not. Branding entails other managerial decisions. A manufacturer must decide whether to use its own brand or that of its dealer on its product. A marketer must also determine whether to use a single brand for maximum impact or multiple brands to satisfy the different segments and markets more precisely. Regardless of the number of brands used, each brand name must be selected carefully with the international market in mind. Once selected, the brand name must be protected through registration, and other measures should be taken to prevent any infringement on that name.

Like the brand name, which may have to be varied from one country to another, packaging should be changed when needed. Mandatory modification of packaging should not be considered a problem because the marketer has no choice in the matter-if a marketer wants to market a product, the marketer must conform to the country's stated packaging requirements. Unilever, for instance, has to conform to the French requirement of selling cube-shaped packs, not rectangular packs, of margarine. Its descriptions for mayonnaise and-salad dressing also have to vary from country to country.

Optional or discretionary packaging modification, in contrast, is a more controllable variable within a marketer's marketing mix. Usually, discretionary packaging is moreJe1ated-to product promotion, and it can take on the same importance as mandatory packaging. Soft-drink containers are a good example-of-how packaging requirements. must be observed. In many countries bottles are manufactured in metric sizes because of government requirements. And the containers must be made of glass because consumers abroad regard plastic throw-away bottles as being wasteful. Therefore, both mandatory and optional packaging changes should be considered at the same time.

Questions

I. What are the requirements that must be met so that a commodity can effectively be transformed into a branded product?

2. Explain the "least dependent person" hypothesis and its branding implications.

3. When is it appropriate to use multiple brands in (a) the same market and (b) several markets/countries?

4. What are the characteristics of a good international brand name?

5. Explain these legal requirements related to branding: (a) registration, (b) registration eligibility, (c) use, (d) renewal, and (e) generic trademark.

6. Distinguish colorable imitation from counterfeit trademark.

7. Cite the factors that may force a company to modify its package for overseas markets. Discuss both mandatory and optional modification.

Discussion Assignments and Minicases

1. Should U.S. farmers brand their exported commodities (e.g., soybean, corn, beef)?

2. Some U.S. retailers (e.g.. Sears) and manufacturers (e.g., General Motors) place their trademarks on products actually made by foreign suppliers. Discuss the rationale for these actions by these U.S. firms and foreign manufacturers.

3. Discuss how certain English letters, prefixes, suffixes, syllables, or words create pronunciation difficulties for those whose native language is not English.

4. Is Hyundai a good name to use for an international brand? On what do you base your evaluation?

5. Go to the soft-drink section of a supermarket. How many different types of soft-drink packages are there (in terms of size, form, and so on.)? Should any of them be modified for overseas markets?

CASE 1

Majorica S.A. versus R. H. Macy

Majorca is a place well known for its pearls. One Spanish firm, Majorica S.A, has used Majorica, an ancient name for Majorca, since 1954 as its trade name as well as a brand name to describe its pearls.

Majorica was alarmed to lean that R. H. Macy, a major U.S. department store chain, was selling Majorca-labeled pearls that were made by Hobe Cie. Ltd., a competitor *of* Majorica S.A

Contacts with Macy produced no fruitful results in resolving the difficulty. Macy felt that it had a right to use the name in question because Majorca was the name of an island and because the pearls in question were indeed made there.

Subsequently, Majorica filed a lawsuit in a federal court, asking for a judgment to stop Macy from using the name. Majorica S.A. cited trademark infringement as the reason for seeking relief. It argued that Macy's action caused confusion among consumers as well as erosion of goodwill.

Questions

1. Is Majorica a valid brand name or just a generic trademark? Does the fact that it is the name of a place (i.e., island) affect the registration eligibility and legal protection of Majorica S.A?
2. Was Macy's action legally defensible? Assuming that you are a federal court judge, do you think that Macy's use of the name could cause consumer confusion Do you think that Macy's labeling constituted trademark infringement? Can the branding/labeling be somehow modified to prevent consumer confusion?

LESSON 24:
MARKETING INDUSTRIAL PRODUCTS

The learning Objectives from this lesson would be the following:

- The importance of derived demand in industrial markets.
- The relationship between a country environment and its industrial market needs.
- How demand is affected by technology.
- Characteristics of an industrial product.
- The importance of ISO 9000 certification.
- The importance of relationship marketing and industrial products.
- The importance of trade shows in promoting industrial goods.
- The growth of business services and nuances of their marketing.

Global Perspective

How Far Is Up for Intel?

Fortune's cover story, Intel, Andy Grove's amazing profit machine – and his plan for five more years of explosive growth is capped only by time's man of the year story, Intel's and Grove, his Microchips have changed the world – and its economy. 1997 was the eighth consecutive year of record, revenue ($25.1 billion) and earnings ($6.5 billion) for the company grove helped found. Yet at the beginning of 1998, the real question was will the world change Intel? Judging from Intel own forecasts for a flat first quarter in 1998 chairman of the board Grove and his associates were concerned that the financial meltdown in Asian markets would affect Intel's plans for "five more years of explosive growth. " some 30 percent of the firm's record 1997 revenues had come from Asian markets. Indeed, one pundit has earlier predicted, " I see no clear technology threats. The biggest long term threat to Intel is that the market growth slows" others warned there's some thing wrong out there computer industry overcapacity.

Actually Intel had an even longer list of threats all posted as a disclaimer to its published forecast:

"Other factors that could cause actual results to differ materially are the following business and economic conditions, and growth in the computing industry in various geographic regions; changes in customer order patterns, including changes in customer and channel inventory levels and seasonal PC buying patterns: changes in the mixes of microprocessor types and speeds, motherboards, purchased components and other products; competitive factors, such as rival chip architectures, and manufacturing technologies, competing software – compatible micro – processors and acceptance of new products in specific market segments; pricing pressures; changes in end users preferences; risk of inventory obsolescence and variations in inventory valuation; timing of software industry product introductions; continued success in technological advances, including development, implementation and initial production of new strategic products and processes in a cost effective manner; execution of manufacturing ramp; excess storage of manufacturing capacity; the ability to successfully integrate any acquired businesses, enter new market segments and manage growth of such business; unanticipated costs or other adverse effects associated with processors and other products containing errata; risks associated with foreign operations; litigation involving intellectual property and consumer issues; and other risk factors listed from time to time in the company's SEC reports.

Time's Man of the year had a lot to worry about – most of all that industrial market booms are always followed by busts. Will the rise truly last five more years?

The issues of standardization versus adaptation have less relevancy to marketing industrial goods than consumer goods since there are more similari-ties in marketing industrial products across country markets than there are differences. The inherent nature of industrial goods and the sameness in motives and behavior among industrial goods customers create a market where product and marketing mix standardization are commonplace. Photocopy machines are sold in Belarus for the same reasons as in the United States: to make photocopies: Some minor modification may be necessary to accommodate different electrical power supplies or paper size but, basi-cally, photocopy machines are standardized across markets, as are the vast majority of industrial goods. For industrial products that are basically custom made (specialized steel, customized machine tools, and so on), adaptation takes place for domestic as well as foreign markets.

Two basic factors account for greater market similarities among industrial goods customers than among consumer goods customers. First is the inherent nature of the product: industrial services are used in the process of creating other goods and services; consumer goods are in their final form and are consumed by individuals. And second, the motive or intent of the user differs: industrial consumers are seeking profit, whereas the ultimate consumer is seeking satisfaction. These factors are manifest in specific buy-ing patterns and demand characteristics, and in a special emphasis on relationship mar-keting as a competitive tool. Whether a company is marketing at home or abroad, the differences between industrial and consumer markets merit special consideration.

Along with industrial goods, services are a highly competitive growth market seek-ing quality and value. Manufactured products generally come to mind when we think of international trade. Yet the most rapidly growing sector of U.S. international trade today consists of business and consumer services-accounting, advertising, banking, consult-ing, construction, hotels, insurance, law, transportation, travel, television programs, and movies sold by U.S. firms in global markets. The

intangibility of services creates a set of unique problems to which the service provider must respond. A further complication is a lack of uniform laws that regulate market entry. Protectionism, while prevalent for industrial goods, can be much more pronounced for the service provider.

The Volatility of Industrial Demand

There are numerous reasons why consumer products firms market internationally-exposure to more demanding customers, keeping up with the competition, extending prod-uct life cycles, growing sales and profits, to name a few. For firms producing products and services for industrial markets there is an additional crucial reason for venturing abroad: dampening the natural volatility of industrial markets. Indeed, perhaps the sin-gle most important difference between consumer and industrial marketing is the huge, cyclical swings in demand inherent in the latter. It is true that demand for consumer durables such as cars, furniture, or home computers can be quite volatile. In industrial markets, however, two other factors come into play that exacerbate both the ups and downs in demand: (1) professional buyers tend to act in concert; and (2) derived de-mand accelerates changes in markets.

Purchasing agents at large personal computer manufacturers such as IBM, Apple, Acer, Samsung, and Toshiba are responsible for obtaining component parts for their firms as cheaply as possible and in a timely manner. They monitor demand for PCs and prices of components like microprocessors or disk drives, and changes in either cus-tomer markets or supplier prices directly affect their ordering. Declines in PC demand or supplier prices can cause these professionals to "slam on the brakes" in their buying; in the latter case they wait for further price cuts. And because the purchasing agents at all the PC companies, here and abroad are monitoring the same data, they all brake (or accelerate) simultaneously. Consumers do monitor markets as well, but not nearly to the same degree. Purchases of clothing and cars tends to be steadier.

For managers selling capital equipment and big-ticket industrial services, under-standing the concept of derived demand is absolutely fundamental to their success. *De-rived demand* can be defined as demand dependent on another source. Thus, the demand for Boeing 747s is derived from the worldwide consumer demand for air travel services, and the demand for Fluor Daniel's global construction and engineering services to de-sign and build oil refineries in China is derived from Chinese consumers' demands for gasoline. Minor changes in consumer demand mean major changes in the related indus-trial demand. In the example in Exhibit 13-1, a 10 percent increase in consumer de-mand for shower stalls in year 2 translates into a 100 percent increase in demand for the machines to make shower stalls. The 15 percent decline in consumer demand in year 5 results in a complete shutdown of demand for shower-stall making machines. For Boe-ing circa 1998, Asian financial problems directly caused reductions in air travel (both vacation and commercial) to and within the region, which in turn caused cancellations of orders for aircraft. Indeed, the commercial aircraft industry has always been and will continue to be one of the most volatile of all.

Exhibits 13 –1 Derived Demand Example

Time Period	Consumer demand for Premolded Fiberglass shower stalls			Number of Machines in use to produce the shower stalls			Demand for the machines		
Year	Previous year	Current year	Net change	Previous year	Current year	Net change	Replacement	New	Total
1	100000	100000	--	500	500	--	50	--	50
2	10000	110000	+10000	500	550	+50	50	50	100
3	110000	115000	+5000	550	575	+25	50	25	75
4	115000	118000	+3000	575	590	+15	50	15	65
5	118000	100000	-18000	590	500	-90	--	40	- 40
6	100000	100000	--	500	500	--	10	--	10

Crossing Borders 1

Your Hoses Are a Threat to Public Security!

Universal standards have made life miserable for Evan Segal. He is president of Dor-mont Manufacturing Co., which makes hoses that hook up deep-fat fryers and the like to gas outlets and which once sold these hoses throughout Europe. But one day in 1989, one of his top customers, Frymaster Corp. of Shreveport, LA, called to alert him that McDonalds was being told it could no longer use his hoses in its British restaurants. Similar problems popped up elsewhere, including Euro-Disney outside Paris; shortly be-fore the theme park opened, French inspectors demanded that Dormont's hoses be re-placed with French-approved equipment.

The disparate national standards stemmed from the fact that the hoses are crucial to safe operation of gas appliances and thus fall under the product-safety provisions allow-ing each country to set up its own standards. . . . In Dormont's case, the specifications were written by committees often dominated by domestic producers. They spell out minutiae of each country's acceptable gas hose design-such as the color of plastic coating or how the end pieces should be attached to the rest of the hose.

Mr. Segal thought he had made a major breakthrough when the British Standards In-stitute, one of the European agencies that test equipment and hand out approvals, issued Dormont a certificate authorizing the company to paste a seal of approval on its prod-ucts signifying that the hoses conformed with European Union rules for gas appliances, enabling the company to sell them throughout the region.

But the victory was short-lived. A miffed German competitor fired off a formal com-plaint to the European Commission, the EU's Brussels-based executive body. Commis-sion officials familiar with the case say the rival argued that the British office erred be-cause hoses are not really part of a gas appliance. The approval was withdrawn.

ISO 9000 Certification: An International Standard of Quality

With quality becoming the cornerstone of global competition, companies are requiring assurance of standard conformance from suppliers just as their customers are requiring the same from them.

ISO 9000s, a series of five international industrial standards (ISO *9000-9004)* orig-inally designed by the International Organization for Standardization in Geneva to meet the need for product quality assurances in purchasing agreements, are becoming a qual-ity assurance certification program that has competitive and legal ramifications when doing business in the European Union and elsewhere.

ISO 9000 refers to the registration and certification of a manufacturer's quality sys-tem. It is a certification of the existence of a quality control system a company has in place to ensure it can meet published quality standards. ISO *9000* standards do not apply to specific products. They relate to generic system standards that enable a com-pany, through a mix of internal and external audits, to provide assurance that it has a quality control system. It is a certification of the production process only, and does not guarantee a manufacturer produces a "quality" product. The series describes three qual-ity system models, defines quality concepts, and gives guidelines for using international standards in quality systems.

To receive ISO 9000 certification a company requests a certifying body (a third party authorized to provide an ISO 9000 audit) to conduct a registration assessment- that is, an audit of the key business processes of a company. The assessor will ask questions about everything from blueprints to sales calls to filing. Does the supplier meet promised delivery dates? And is there evidence of customer satisfaction? Are two of the questions asked and the issues explored. The object is to develop a comprehensive plan to ensure minute details are not overlooked. The assessor helps management create a quality manual, which will be made available to customers wishing to verify the organi-zation's reliability. When accreditation is granted, the company receives certification. A complete assessment for re-certification is done every four years, with intermediate eval-uations during the four-year period.

Although ISO 9000 is generally voluntary, except for certain regulated products, the *EU Product Liability Directive* puts pressure on all companies to become certified. The directive holds that a manufacturer, including an exporter, will be liable, regardless of fault or negligence, if a person is harmed by a product that fails because of a faulty component. Thus, customers in the ED need to be assured that the components of their products are free of defects or deficiencies. A manufacturer with a well-documented qual-ity system will be better able to prove that products are defect-free and thus minimize liability claims.

A strong level of interest in ISO 9000 is being driven more by "marketplace" re-quirements than by government regulations, and ISO 9000 is becoming an important competitive marketing tool in Europe. As the market demands quality and more and more companies adopt some form of TQM (total quality management), manufacturers are increasingly requiring ISO 9000 registration of their suppliers. Companies manufacturing parts and components in China are quickly discovering that ISO 9000 certification is a virtual necessity and the Japanese construction industry now requires ISO 9000 as part of the government procurement process.13 More and more buyers, particularly those in Europe, are refusing to buy from manufacturers that do not have internationally recognized third-party proof of their quality capabilities. ISO 9000 may also be used to serve as a means of differentiating different "classes" of suppliers (particularly in high -tech areas) where high product reliability is crucial. In other words, if two suppliers are competing for the same contract, the one with ISO 9000 registration may have a competi-tive edge.

While more and more countries (now more than 100) and companies continue to adopt ISO 9000 standards, many have complaints about the system and its spread. For example, 39 electronics companies battled against special Japanese software criteria for ISO 9000. Electronics companies also protested against the establishment of a new ISO Health and Safety Standard. Still others are calling for more comprehensive interna-tional standards along the lines of America's Malcolm Baldridge Award, which consid-ers seven criteria-leadership, strategic planning, customer and market focus, informa-tion and analysis, human resource development, management, and business results. Perhaps the most pertinent kind of quality standard is now being developed by the Uni-versity of Michigan Business School and the American Society for Quality Control. Us-ing survey methods, their American Customer Satisfaction Index (ACSI) measures cus-tomers' satisfaction and perceptions of quality of a representative sample of America's goods and services. The approach was actually developed in Sweden and is now being considered in other European countries. The appeal of the ACSI approach is its focus on results, that is, quality as perceived by product and service users. So far the ACSI ap-proach has been applied only in consumer product/service contexts; however, the funda-mental notion that customers are the best judges of quality is certainly applicable to in-ternational industrial marketing settings as well.

Relationship Marketing and Industrial Products

The characteristics that define the uniqueness of industrial products discussed above lead naturally to relationship marketing. The long-term relationship with customers, which is at the core of relationship marketing, fits the characteristics inherent in indus-trial products and is a viable strategy for industrial goods marketing. The first and fore-most characteristic of industrial goods markets is the motive of the buyer: to make a profit. Industrial products fit into a business or manufacturing process, and their contri-butions will be judged on how well they contribute to that process. In order for an indus-trial marketer to fulfill the needs of its customer, the marketer must understand those needs as they exist today and how they will change as the buyer strives to compete in global markets that call for long-term relationships.

Crossing Borders 2

In the European Community, Standards Are a Must for Telecommunications

The hodge-podge of European telephone industry standard is and was one of the most daunting problems facing continental unification. Even in the early 1990s connections were not being made well: in Spain the busy signal was three pips a second; in Denmark, two. French telephone numbers were 8 and soon to be 10 digits long; Italian numbers were almost any length. German phones ran on 60 volts of electricity; else where, it is 48. The list of difference went on and on; only 30 percent of the technical specifications involved in phone systems were common from one country to the next. In telephones, as in much else in European, each country went its own way.

Technical conflicts abounded. Each national telephone authority set different technical requirements for equipment to enter its market. One representative from an electronics company estimated that an average of 50 to 100 labor years of costly software engineering were needed to rework computerized exchange equipment for each additional European country his company entered.

The European learned their lesson well and have now been adopting the most widely standardized global system for mobile communication (GSM) even faster than American buyers, for some 30 million users form Oslo to Rome there is no problem; cellular is skipping over the spaghetti plate of wires down on he ground. Indeed, "roaming" in Rome is no problem. Compared with Europe, the U.S. system is still in the Dark Ages. In an effort to catch up, American wireless companies are importing rate plans, phone features, marketing strategic, and executives from Europe.

Relationship marketing ranges all the way from gathering information on customer needs to designing products and services, channeling products to the customer in a timely and convenient manner, and following up to make sure the customer is satisfied. For example, SKF, the bearing manufacturer, seeks strong customer relations with posts ales follow-through. The end of the transaction is not delivery; it continues, as SKF makes sure the bearings are properly mounted and maintained. This helps cus-tomers reduce downtime, thus creating value in the relationship with SKF. SKF marketing efforts encompass an array of activities to support long-term relationships which go beyond "merely satisfying the next link in the distribution chain to meeting the more complex needs of the end user, whether those needs are technical, operational, or financial." In short, "the business [SKF does] consists of providing service" to its customers.

The industrial customer's needs in global markets are continuously changing, and suppliers' offerings must also continue to change. The need for the latest technology means that it is not a matter of selling the right product the first time but one of con-tinuously changing the product to keep it right over time. The objective of relation-ship marketing is to make the relationship an important attribute of the transaction, thus differentiating oneself from competitors. It shifts the focus away from price to service and long-term benefits. The reward is loyal customers that translate into substantial profits.

Focusing on long-term relationship building will be especially important in most in-ternational markets where culture dictates stronger ties between people and companies. Particularly in countries with collectivistic and high-context cultures such as those in Latin America or Asia, trust will be a crucial aspect of commercial relationships. Constant and close communication with customers will be the single most important source of information about the development of new industrial products and services. Indeed, in a recent survey of Japanese professional buyers a key choice criterion for suppliers was a trait they called "caring" (those who defer to the requests without argu-ment and recognize that in return buyers will care for the long-term interests of sell-ers). Longer-term and more communication-rich relationships are keys to success in international industrial markets.

IBM of Brazil stresses stronger ties with its customers by offering planning semi-nars that address corporate strategies, competition, quality, and how to identify market-ing opportunities. One of these seminars showed a food import/export firm how it could increase efficiency by decentralizing its computer facilities to better serve its customers. The company's computers were centralized at headquarters; while branches took orders manually and mailed them to the home office for processing and invoicing. It took sev-eral days before the customer's order was entered and added several days to delivery time. The seminar helped the company realize it could streamline its order processing by installing branch office terminals that were connected to computers at the food com-pany's headquarters. A customer could then place an order and receive an invoice on the spot, shortening the delivery time by several days or weeks. Helping a client or supplier identify a problem and its solution also helped IBM sell equipment to the company. Not all participants who attend the different seminars offered annually become IBM cus-tomers, but it creates a continuing relationship among potential customers. "So much so," as one executive commented, "when a customer does need increased computer power, he will likely turn to us.

Promoting Industrial Products

The promotional problems encountered by foreign industrial marketers are little differ-ent from the problems faced by domestic marketers. Until recently there has been a paucity of specialized advertising media in many countries. In the last decade, however, specialized industrial media have been developed to provide the industrial marketer with a means of communicating with potential customers, especially in Western Europe and to some extent in Eastern Europe, the Commonwealth of Independent States (CIS), and Asia.

In addition to advertising in print media and reaching industrial customers through catalogs (now including Web sites) and direct mail, the trade show or trade fair has be-come the primary vehicle for doing business in many foreign countries. As part of its in-ternational promotion activities, the U.S. Department of Commerce sponsors trade fairs in many cities around the world. Additionally, there are annual trade shows sponsored by local governments in most countries. African countries, for example, host more than 70 industry-specific trade shows.

Trade shows serve as the most important vehicles for selling products, reaching prospective customers, contacting and evaluating potential agents and distributors, and marketing in

most countries. Although important in the United States, they serve a much more important role in other countries. They have been at the center of commerce in Eu-rope for centuries and are where most prospects are found. European trade shows attract high-level decision makers who are not attending just to see the latest products but are there to buy. Preshow promotional expenditures are often used in Europe to set formal appointments. The importance of trade shows to Europeans is reflected in percentage of their media budget spent on participating in trade events and how they spend those dol-lars. On average, Europeans spend 22 percent of their total annual media budget on trade events, while American firms typically spend less than 5 percent. Europeans tend not to spend money on circus like promotions, gimmicks, and such; rather, they focus on providing an environment for in-depth dealings. More than 2,000 major trade shows are held worldwide every year. The Hannover Industry Fair (Germany), the largest trade fair in the world, has nearly 6,000 exhibitors who show a wide range of industrial products to 600,000 visitors.

Trade shows provide the facilities for a manufacturer to exhibit and demonstrate products to potential users and to view competitors' products. They are an opportunity to create sales and establish relationships with agents, distributors, and suppliers that can lead to more-permanent distribution channels in foreign markets. **In** fact, a trade show may be the only way to reach some prospects. Trade show experts estimate that 80 to 85 percent of the people seen on a trade show floor never have a salesperson call on them. Most recently, several Internet Web sites now specialize in virtual trade shows. They often include multimedia and elaborate product display booths that can be virtu-ally toured. Some of this virtual trade shows last only a few days during an associated actual trade show.

The number and variety of trade shows is such that almost any target market in any given country can be found through this medium. **In** Eastern Europe, fairs and exhibi-tions offer companies the opportunity to meet new customers, including private traders, young entrepreneurs, and representatives of non-state organizations. The exhibitions in countries such as Russia and Poland offer a cost-effective way of reaching a large num-ber of customers who might otherwise be difficult to target through individual sales calls. Specialized fairs in individual sectors such as computers, the automotive industry, fashion, and home furnishings regularly take place.

Besides country-sponsored trade shows, U.S. government-sponsored trade shows have proved to be effective marketing events. A U.S.-sponsored show called Made in USA attracted 20,000 South Africans to visit 335 U.S. companies. Thirty-nine Ameri-can firms participated in a seven-day electronics production equipment exhibition in Os-aka, Japan, and came home with $1.6 million in confirmed orders along with estimates for the following year of $10 million. Five of the companies were seeking Asian agent/distributors through the show, and each was able to sign a representative before the show closed. Trade shows and trade fairs are scheduled periodically and any interested business can reserve space to exhibit.

LESSON 25:
NTERNATIONAL MARKETING OF SERVICES

Trade in services is growing faster than the international trade in goods. Services have special characteristics that pose special problems in international marketing.

The following lesson tries to accomplish the following learning objectives:

1. Identify the characteristics that distinguish services from goods and that influence the way they are marketed internationally.
2. Determine the basis of comparative advantage in service industries.
3. Discuss the service industries.

Introduction

What are services? Industries such as wholesaling and retailing, communications, transportation, utilities, banking and insurance, tourism, and business and personal services are all service industries. Service account for the largest portion of output and employment in the advanced industrialized countries. In 1994, services as a percent of gross domestic product (GDP) were 62 percent in Germany, 69 percent in France, 75 percent in Canada and the United States, 66 percent in Japan, 69 percent in Italy, and 77 percent in the United Kingdom.

Given the importance of services in the national economies, it is not surprising that they are becoming increasingly important in world trade. Trade in services accounts for between 20 and 25 percent of all world trade, having grown at about 16 percent a year for the past decade compared to a 7 percent growth rate for merchandise trade.

Hence, the $750 billion estimate for services exports worldwide underestimates the total size of the international market for services. U.S. services that have been exported include the following:

- Construction, design and engineering services
- Banking and Financial services
- Insurance services
- Legal and accounting services
- Computer software and data services
- Training and education
- Entertainment, music, film and sports
- Management consulting
- Franchising
- Hotel and lodging services
- Transportation services, including airline and maritime services, and both passenger and cargo service.

Services: How are They Different From Products?

Services have been defined as "those fruits of economic activity that you cannot drop on your toe: banking to butchery, acting to accountancy. Indeed services are mostly intangible. The distinguishing characteristics of services include intangibility, heterogeneity, perishability, and often, simultaneous production and consumption. Because of these characteristics, services are more difficult to price and measure than products.

1. Intangibility

   Services are often performances, such as performing an audit, designing a building, fixing a car. In this sense, they are intangible. Questions pertinent to the international marketing of services would include (1) whether actions are being performed on people (e.g., education) or things (e.g., air freight) (2) whether the customer needed to be physically present during the service or only at initiation and termination of the service, and (3) whether it is enough that the customer be mentally present-that is, can the service be performed at a distance?

2. Heterogeneity

   Different customers going to the same service company may not receive exactly the same service. This quality of heterogeneity occurs because different people perform the service. It is therefore impossible to make sure that the service is performed in exactly the same way each time. One sales clerk may be less polite or amiable than another, resulting in consumer dissatisfaction. The implication of heterogeneity is that quality is difficult to control.

   When extending the service to international markets, there is also the question whether the service standardized for one national market will satisfy customers in other markets. For example, one way to standardize a service is to personalize the interaction between customer and service provider by training retail salespersons to greet customers by name and use certain standard conversational gambits. When such "scripts" are to be followed, though, cultural factors probably demand a somewhat different "script" for each country market.

3. Perishability

   Services are perishable in that they cannot be inventoried, saved, or stored; thus a plane seat that is not sold when the flight takes off is lost forever. This makes it harder to adjust the supply of a service to fluctuating demand, especially at times of peak demand. Service companies therefore seek innovations that allow the service to be "inventoried" in some fashion, or that allow demand to be managed so that the supply of services is adequate and can be economically provided. An example would be providing a restricted number of reduced-fare, advance-purchase seats on flights, with the number of such seats being increased if seats on the flight do not appear to be selling as forecast.

Marketing services internationally makes the task of forecasting demand for services more complex because the vagaries of the individual national markets affects demand in unique ways. Further, service must match demand in many different markets. It is likely that idle capacity exists in some markets while excess demand is encountered in other markets.

4. Simultaneous Production and Consumption

   Production and consumption of the service often take place at the same time; that is, the producer and the seller of the service are often the same person. Moreover, the customer must often be present for the service to take place. Unlike products, services usually cannot be exported, so international marketing means that the service must be performed by the firm itself in the country market, whether through franchising, licensing, a direct investment, or an acquisition. The fundamental question is, Can the service be performed at a distance? And if not, how should the firm position itself in a distant market in order to offer the service? An example would be the use of ATMs, which allow customers to conduct certain banking transactions without a teller being present.

5. Pricing Services

   Services are difficult to price because calculating the cost of producing them is difficult. Price can be set in relation to full costs, based on what the competition charges, or simply set at whatever the customer is willing to pay. Service businesses have a high fixed-cost ratio. Hence, if the service can be offered without much modification in many national markets, prices can be lower because the fixed costs have presumably been recovered in the home market. Some advantages of scale therefore accrue to the company that is first to market with a new service. For example, in the case of a banking innovation such as a credit card, U.S. firms have already recovered much of their fixed costs of developing the credit-card concept through sales in the U.S. market. Hence, their foreign credit-card service prices can be lower because they do not have to incur the fixed costs of product development a second time.

6. Measuring Service Quality

   Service quality is difficult to measure because it is often unclear what the consumer expects; yet quality is a matter of meeting customer expectations. In other words, it depends on consumer perception, which in turn is determined by the following:

   a. The person doing the service
   b. The technical outcome of the service
   c. He overall image of the company whose employee is carrying out the service

   Consumer dissatisfaction may result from unrealistic expectations. Other reasons for the gap between desired quality and perceived quality include not understanding what consumers expect from a service, inability, or unwillingness to meet customer expectations; problems with service delivery; and communications gaps when the firm fails to communicate realistic expectations about what service quality will be offered.

7. Importance of Customer Loyalty to Services

   Because services cannot be stored, a basic marketing strategy is to ensure repeat business by generating loyalty in existing customers. Devices such as frequent-flyer plans may be used to reward customer loyalty. But given that consumers have different characteristics in different countries, are such plans necessary for all national markets, or should they be shaped mainly by competitive variations in each market? Loyalty can also be maintained and rewarded through pricing, and the question for each national market is whatever volume discounts and membership strategies work equally well in all markets.

8. Advertising

   How are services best advertised? By word of mouth, direct mail, satisfied customer referrals, or ads in newspapers and on television? Are there national differences in the relative appeal of these different forms of advertising of services? What should the focus of advertising be? Which is more important, the image and name of the company providing the service, or facets of the service being sold? These questions will have to be answered for each country market.

9. Organization

   A decentralized organization seems more apt for service industries, given the inherent heterogeneity of the product and the customer base. But is a firm moves to standardize the service performance, can it do so without considerable centralization? This is a key decision for the firm that chooses to market its services internationally.

10. Cultural Variables

    Because services generally involve close interaction between the service provider and the customer, cultural variables affect user satisfaction; they also affect service design and the nature of interaction with the customer.

Services Characteristics and Their Implications

Service Characteristics	Implications for Globalization
1. Intangibility	How to differentiate the service? Advertising mainly through word of mouth: who are the influential opinion makers in each market? Validity of a follow-the client strategy in entering international markets? Manage corporate image in multiple markets.
2. Heterogeneity	How to reduce across-country variations in service quality influenced by variations among service providers? Can all service personnel in several countries be trained to the same level and quality of performance? Impact of cultural differences affecting extent and kind of training in each market. Develop ownership and control stake sufficient to influence recruitment and training.

3. Inseparability: The simultaneity of production and consumption	Can service be provided at a distance internationally? Enhancing role of technology, electronic delivery (e.g., ATMs-automatic teller machines). How much of service production can be placed in the "back office"? Sharing of back office functions across markets. The need to find service providers places a constraint on the pace of international expansion. If technology cannot facilitate service exporting, then franchising, licensing, joint venture, and foreign direct investment are better avenues.
4. Service Quality and consumer participation in service creation / delivery	How do consumers determine service quality? A matter of consumer perceptions. Moreover, are customers in all markets equally willing to participate in the service creation process? What turns off the customer (variations in customer defection rates across markets)? How to ensure customer loyalty and repeat business? Developing market-specific plans to maintain customer loyalty. Customer perceptions of service quality may be affected by culture.
5. Implications of fixed-cost structure for pricing	Can scale economies lower costs of international entry? Will price-bundling strategies work in all markets? Can price discrimination be practiced across markets? Prioritizing markets by volume necessary to reach break-even. Scale necessitates internationalization, and hence foreign direct investment, joint ventures.
6. Service as a process	Is the service concept culture-bound? Adaptation versus standardization of the service of the service concept for overseas markets. Can standardized "scripts" for the service encounter be used across countries? Franchising and licensing more appealing as greater adaptation needed.

Mcdonald's in Hungary and Russia

McDonald's began operations in Budapest, Hungary, on April 30, 1988. On its first day of operation, it broke a McDonald's record for the most transactions. Today it is one of the busiest McDonald's in the world, with 9,000 transactions daily.

Plans to establish a McDonald's in Hungary began with a joint-venture agreement in November 1986, although negotiations began back in 1985. McDonald's is a 50 percent owner, its partner being Hungary's Babolna Agricultural Cooperative.

Mc Donald's supplied all of the restaurant equipment, including equipment to established sources of supply such as a bakery to make hamburger buns. McDonald's also contributed something intangible: a standard of quality for the fast-food industry. It had to develop a supplier infrastructure by introducing new food-processing techniques and forcing development of new products in Hungary, as well as insisting on the improvement of existing products to meet world standards of quality. Products such as hamburger buns, the kind of cheese used in its cheeseburgers, and orange juice concentrate were unavailable in Hungary. Ketchup was available, but it did not meet McDonald's quality standards. It took over a year to develop supply sources. McDonald's experts in purchasing and quality control then worked with suppliers on a monthly basis to get the desired product and quality.

Locally produced food products are used, except for McCormick spices, which are used exclusively by McDonald's around the world, and sesame seeds, which cannot be grown in Hungary. Paper products such as paper cups are imported. McDonald's opened with seven partially trained managers and with another 20 employees loaned from stores in other countries. Most of the loaned employees returned home after a month, with the exception of a U.S. manager who stayed on as an adviser and trainer. New employees had training, but little experience, and had to learn on the job in the ways outside the store. Some of the training focused on inculcating attitudes of customer service. In a country of shortages where people are accustomed to waiting. Customer service was to some degree an unfamiliar concept. McDonald's found it impossible to get part-time help, which it relies on in most countries. However, with a successful opening behind it, McDonald's plans to open another five outlets in the next five years in Budapest. Real estate is difficult to buy at any price, so the company must build its restaurants in existing buildings. As yet, McDonald's has not chosen franchisees but plans to do so for perhaps three of the proposed five restaurants.

After its Hungarian experience, McDonald's natural response was to turn to Russia. McDonald's Russian entry was shepherded by its head of Canadian operations, Mr. George Cohon, who had made the initial contact with some Russian delegation members during the Montreal Olympics in 1976. But the joint-venture agreement was not signed until April 1988 because of intervening events such as the U.S.Olympics boycott. McDonald's Russian venture had some unusual features. Its joint-venture partner with a 51 percent ownership was the food service department of the Moscow City Council. Normally, McDonald's worked with entrepreneurs, but in Russia in the late 19801s they had no choice but to work with a leading entity within the Communist party. The joint venture was also a "rubles-only" joint venture at a time when the ruble was inconvertible. This meant that McDonald's would sell its hamburgers to Russians for rubles and would buy mostly local supplies paid for in rubles. As in Hungary, the company had difficulty maintaining its reputation because of poor-quality local suppliers.

Ultimately, McDonald's had to invest over $40 million in setting up a raw material processing plant to supply it with the requisite buns, French fries, hamburger patties, and so forth. Amortizing this large injection of foreign capital at a time when the ruble was rapidly devaluing meant that McDonald's was making no money in the short run. It might well have been selling Ray Kroc's original dream of 15-cent hamburgers. But overall, McDonald's is hugely profitable and was planning to open over 2,000 restaurants outside the United States in 1995 alone. If one has faith in the long-term promise of Russia, losing money for a few years might seem a reasonable investment to ensure front row seats for the Russian renaissance.

Activity 1: A group of student should give a presentation on one service industry and compare it with product industry.

Government Intervention In The Trade In Services

As is true for goods, international trade in services is also subject to government interference and protection. U.S. manufacturers in a survey noted several government barriers:

- Rights of establishment (meaning the right to establish a branch or subsidiary in a foreign country; for example, many nations ban ownership of television stations by foreigners)

- Trade barriers, including limitations on the proportion of a market that can be served by a foreign company, and discriminatory taxation of services provided by a foreign company.
- Foreign exchange controls; limits on remitting profits from service businesses.
- Government procurement barriers because government buys services only from "national" companies.
- Technical issues that may serve to keep out foreign firms, such as through the use of standards and certification conditions.
- Government subsidies, counterveiling duties, and high customs valuation of foreign services, leading to higher total tariffs.
- Licensing regulations that impose unreasonable terms of entry or insist on licensing as the only mode of entry.
- Restrictions on professional qualifications, including ban on entry of qualified service company personnel.
- Tolerance of commercial counterfeiting.

Fair Trade in Services: The Uruguay Round

As services grow in importance in world trade, nations have begun seeking a consensus on fair trade practices with regard to services. The last round of GATT (now WTO) talks, the "Uruguay Round", gave special attention to protecting intellectual property rights, referring to the ideas that form the basis for many high-technology services, such as custom software. These provisions address the issues of barriers to trade in services, national treatment of foreign firms, allowance of FDI in services without undue restrictions, temporary admissions of foreign-service workers, international agreement on the extent of regulation of international data flows and ownership rights in international databases, and the importation of materials and equipment necessary for provision of services. Other thorny issues included establishing a framework to control restrictive licensing practices and the right of "nonestablishment", which is growing increasingly important as service firms deliver their services electronically or through the mail without being physically present in a country. This governs the conditions under which a foreign firm can be said to have established a presence in a foreign market, which may determine whether the foreign firm qualifies for treatment as a domestic firm; similarly, establishing a domestic presence is often necessary to qualify for protection under the laws of intellectual property rights in that country.

Globalizing Services: Federal Express

Federal Express is the U.S. market leader, holding nearly half of the market for overnight pac-or Federal Express.

Difficulties in using hub-and spoke operations overseas: *Federal Express shipped all its packages to Memphis, where packages are sorted, regrouped, and rerouted; this permitted standardized sorting and tracking of packages. Overseas regulators were in no hurry to let Federal Express develop an efficient international hub-and-spoke system, often preferring to nurture their own companies.*

Protectionism: *Just three days before scheduled start of operations, Japan prevented Federal Express from shipping packages over 70 pounds through Tokyo, and three years elapsed before Federal Express received permission to fly four times a week from Memphis to Tokyo*

Hence, Federal Express has begun to adapt to overseas environments. For example, in the United States, it stops picking up packages after 5 p.m, but it had to modify this overseas, where later business hours are the norm, as in Spain where business is conducted as late as 8 p.m. In Japan, Federal Express began offering an express freighter service to appeal to computer manufacturers who wanted to ship heavy cargo to the United States faster. Federal Express also decided to use alliances, such as teaming up with Qantas in Australia, and considered using local companies to handle the local transportation end of the overall business. Federal Express also began acquiring overseas companies, including Tiger International, which it bought for $880 million. Ultimately, Federal Express hopes for a profitable worldwide operation rivaling the U.S. operations. But being number one at home is no guarantee that foreign success is ensured.

An additional complication for Federal Express is the threat that it poses to Japanese cargo operators. This led Japanese air traffic rights negotiators to threaten to take away the rights of Federal Express (and other U.S. operators) to pick up cargo and passengers in Japan during stopovers, and transport them onwards to other points in Asia. Such threats are often bargaining ploys to extract greater concessions for that country's companies but highlight the uncertainty and dependence on government support that Federal Express faces in order to fully implement its global strategies.

Marketing Services Globally

Exports of services are growing faster than merchandise exports. Additionally, because of the dynamism of the sector, the United States main-tains a comfortable trade surplus in services. The growing importance of American ser-vices exports clearly reflects the dramatic growth in the services segment of the U.S. economy itself-80 percent of all Americans were employed in the services sector in the late 1990s. Perhaps most amazing, 2.4 million of the 2.6 million jobs created in the U.S. economy in 1997 were in services. Further, most of these jobs were created in such well-paid fields as information, health, education, and social services. Services domi-nate the economies of other developed nations as well. In OECD countries, services companies employ more than half the labor force and produce more than half the GDP.

Services Opportunities in Global Markets

International tourism is by far the largest services export of the United States, ranking behind only capital goods and industrial supplies when all exports are counted. In 1996 foreigners spent some $64 billion while visiting destinations in the United States. Compare that with Boeing's worldwide sales of jet aircraft at $37 billion for 1996. Worldwide tourists spent some $400 billion in 1996 and an agency of the United Na-tions projects that number will grow to $2 trillion by 2020. That same agency predicts that China will be followed by the United States, France, Spain, Hong Kong, Italy, Britain, Mexico, Russia, and the Czech Republic as the most popular destinations in the next century. Most tourists will be, as they are today, Germans, Japanese, and Ameri-cans; and Chinese will be the fourth largest group. Currently, Japanese tourists con-tribute the most to U.S. tourism income at some $20 billion.

The dramatic growth in tourism has prompted American firms and institutions to re-spond by developing new travel services. For example, the Four Seasons Hotel in Philadelphia offers a two-day package including local concerts and museum visits. In addition to its attractions for kids, Orlando, Florida, now sells its Opera Company with performances by Domingo, Sills, and Pavarotti. This year the cities of Phoenix, Las Ve-gas, and San Diego have formed a consortium and put together a $500,000 marketing bud-get specifically appealing to foreign visitors to stop at all three destinations in one trip.

Other top services exports include transportation, financial services, education, business services, telecommunications, entertainment, information, and healthcare, in that order. Consider the following examples of each:

- American airlines are falling all over themselves to capture greater shares of the fast expanding Latin American travel market through investments in local carriers.
- Insurance sales are also burgeoning in Latin America with joint ventures between local and global firms making the most progress.
- Banking in China is about to undergo a revolution with National Cash Register ATMs popping up everywhere.
- Merrill Lynch is going after the investment-trust business expected to take off after Japan allows brokers and banks to enter that business for the first time in 1998.
- Foreign students spend some $7 billion a year in tuition to attend American universities and colleges.
- American engineering consulting firms will provide services to design and manage construction of more than $1 trillion worth of infrastructure development worldwide during the next decade.
- Currently phone rates in markets such as Germany, Italy, and Spain are so high that American companies cannot maintain toll-free information hotlines or solicit phone-order catalogue sales.
- "Xena," "Hercules," and comparably "dumbed-down" (i.e., heavy on action, violence, and sex) video-game heroes are conquering electronic screens worldwide.
- Cable TV is exploding in Latin America. The latest Gallup poll in China indicates that 43 percent of Beijing residents are aware of the Internet.
- Finally, not only are foreigners coming to the United States for health care services in fast growing numbers, but also North American firms are building hospitals abroad as well. Most recently two infants, one from Sweden and one from Japan, received heart transplants at Lorna Linda hospital in California laws in both their countries prohibit such life-saving operations. Beijing Toronto International Hospital will soon open its doors for some 250 Chinese patients, and the services include a 24-hour satellite link for consultations to Toronto.

Entering Global Markets

Trade creates demands for international services. That is, most U.S. service companies enter international markets to service their U.S. clients, business travelers, and tourist's abroad.

Accounting and advertising firms were among the earlier companies to establish branches or acquire local affiliations abroad to serve their U.S. multinational clients. Hotels and auto-rental agencies followed the business traveler and tourist abroad. Their primary purpose for marketing their services internationally was to service home -country clients. Once established, many of these *client followers*, as one researcher refers to them, expanded their client base to include local companies. As global markets grew, creating greater demand for business services, service companies became *mar-ket seekers* in that they actively sought customers for their services worldwide.

Because of the varied characteristics of business services, not all of the traditional methods of market entry are applicable to all types of services. Although most services have the inseparability of *creation* and *consumption* just dis-cussed, there are those where these occurrences can be separated. Such services are those whose intrinsic value can be "embodied in some tangible form (such as a blue-print or architectural design) and thus can be produced in one country and exported to another." Data processing and data analysis services are other examples. The analysis or processing is completed on a computer located in the United States and the output (the service) is transmitted via satellite to a distant customer. Some banking services could be exported from one country to another on a limited basis through the use of ATMs. Architecture and engineering consulting services are exportable when the consultant travels to the client's site and later returns home to write and submit a report. In addition to exporting as an entry mode, these services also use franchising, direct investment (wholly owned subsidiaries), joint ventures, and licensing.

Most other services-automobile rentals, airline services, entertainment, hotels, and tourism, to name a few-are inseparable and require production and consumption to oc-cur almost simultaneously, and thus, exporting is not a viable entry method for them. The vast majority of services (some 85 percent) enter foreign markets by licensing, fran-chising, and/or direct investment.

Market Environment for Business Services

Service firms face most of the same environmental constraints and problems con-fronting merchandise traders. Protectionism, control of trans-border data flows, competi-tion, the protection of intellectual property, and cultural barriers are the most important problems confronting the MNC in today's international services market.

1. **Protectionism.** The most serious threat to the continued expansion of international services trade is protectionism. The growth of international services has been so rapid during the last decade it has drawn the attention of local companies and governments. As a result, direct and indirect trade barriers have been imposed to restrict foreign companies from domestic markets. Every reason, from the protection of infant industries to national security, has been used to justify some of the restrictive practices. A list of more than 2,000 instances of barriers to the free flow of services among nations was re-cently compiled by the U.S.

government. In response to the threat of increasing restriction, the United States has successfully negotiated to open services markets in both NAFTA and GAIT.

Until the GATT and NAFTA agreements there were few international rules of fair play governing trade in services. Service companies faced a complex group of national regulations that impeded the movement of people and technology from country to coun-try. The United States and other industrialized nations want their banks, insurance com-panies, construction firms, and other service providers to be allowed to move people, capital, and technology around the globe unimpeded. Restrictions designed to protect local markets range from not being allowed to do business in a country to requirements that all foreign professionals pass certification exams in the local language before being permitted to practice. In Argentina, for example, an accountant must have the equivalent of a high school education in Argentinean geography and history before being permitted to audit the books of a multinational company's branch in Buenos Aires.

The European Union is making modest progress toward establishing a single mar-ket for services. However, it is not now clear exactly how foreign service providers will be treated as unification proceeds. Reciprocity and harmonization, key concepts in the Single European Act, possibly will be used to curtail the entrance of some service industries into Europe. Legal services and the U.S. film industry seem to be two that is very difficult to negotiate. A directive regarding Trans-frontier Television Broadcasting created a quota for European programs requiring EU member states to ensure that at least 50 percent of entertainment airtime is devoted to "European Works." The EU ar-gues that this set-aside for domestic programming is necessary to preserve Europe's cultural identity. The consequences for the U.S. film industry are significant, since over 40 percent of U.S. film industry profits come from foreign revenues.

Crossing Borders 1

Garbage collection an international services?

The service industry in the United States has a bright future with a variety of services to sell. Ten thousand house hungry Londoners signed up for more than $ 500 million of mortgages. When a wall street subsidiary of Salomon brothers has European executives eager to get a package form Amsterdam to Atlanta, increasingly, they are Turing to Federal Express, a Memphis company whose international revenues have been doubling every year since it began operating overseas. That is only part of the story; there are many services we don't hear about. For example, hospital Corporation of America, the biggest operator of private hospitals in the United States, has acquired 28 hospitals abroad and signed contracts to operate 9 others.

In Japan, service Master of the united states is showing those masters of industry quality control a few things about improving productivity and cutting costs when it comes to scrubbing floors and washing laundry. Services master has in the past few years launched more than 500 home clearing franchises in Japan and won contracts to do the housekeeping for 40 hospitals.

Having persuaded hundreds of local governments in the united states to contract out street cleaning and trash collection, WMX technologies is collecting trash, cleaning streets, and constructing sanitary landfills in 20 countries, including Argentina, new Zealand, and Saudi Arabia. It also has a 15-year contract to run a hazardous waste treatment plant that will process all of Hong Kong industrial and chemical waste.

2. **Trans-border Data Flow.** Restrictions on trans-border data flows are potentially the most damaging to both the communications industry and other MNCs that rely on data transfers across borders to conduct business. Some countries impose tariffs on the trans-mission of data and many others are passing laws forcing companies to open their com-puter files to inspection by government agencies or tightly control transmission domesti-cally. Data transmission was tightly controlled in India via a government monopoly whose high pricing policies limited Internet usage to about 50,000 in 1997. However, now the Indian Cabinet has voted to open the Net to private competitors hoping that us-age will expand to 1-2 million users by the turn of the millennium.

   Most countries have a variety of laws to deal with the processing and electronic transmission of data across borders. There is intense concern about how to deal with this relatively new technology. In some cases, concern stems from not understanding how best to tax trans border data flows; in other cases, there is concern over the protection of individual rights when personal data are involved. The European Commission is con-cerned that data on individuals (such as income, spending preferences, debt repayment histories, medical conditions, and employment data) are being collected, manipulated, and transferred between companies with little regard to the privacy of the individuals on whom the data are collected. A proposed directive by the Commission would require the consent of the individual before data are collected or processed. A wide range of U.S. service companies would be affected by such a directive; insurance underwriters, banks, credit reporting firms, direct marketing companies, and tour operators are a few exam-ples. The directive would have wide-ranging effect on data processing and data analysis firms since it will prevent a firm from transferring information electronically to the United States for computer processing if it concerns individual European consumers. Hidden in all the laws and directives are the unstated motives of most countries: a desire to inhibit the activities of multinationals and to protect local industry. As the global data transmission business continues to explode into the next century, regulators will focus increased attention in that direction.

3. **Competition.** As mentioned earlier, competition in all phases of the service industry is increasing as host-country markets are invaded by many foreign firms. The practice of following a client into foreign markets and then expanding into international markets is not restricted to U.S. firms. German, British, Japanese, and service firms from other

countries follow their clients into foreign markets and then expand to include local busi-ness as well. Telecommunications, advertising, construction, and hotels are U.S. ser-vices that face major competition, not only from European and Japanese companies but also from representatives of Brazil, India, and other parts of the world.

4. **Protection of Intellectual Property.** An important form of competition that is diffi-cult to combat is pirated trademarks, processes, and patents. Computer design and soft-ware, trademarks, brand names, and other intellectual properties are easy to duplicate and difficult to protect. The protection of intellectual property rights is a major problem in the services industries. Countries seldom have adequate-or any-legislation, and any laws they do have are extremely difficult to enforce. The Trade Related Intellectual Property Rights (TRIPS) part of the GATT agreement obligates all members to provide strong protection for copyright and related rights, patents, trademarks, trade secrets, in-dustrial designs, geographic indications, and layout designs for integrated circuits. The TRIPS agreement is helpful in protection services but the key issue is that enforcement is very difficult without full cooperation of host countries. The situation in China has been particularly bad since that country has not been active in enforcing piracy of intel-lectual property. The annual cost of pirated software, CDs, books, and movies in China alone totals more than $827 million. Worldwide, industry estimates are that U.S. companies lost $60 billion annually on piracy of all types of intellectual property. Since it is so easy to duplicate software, electronically recorded music, and movies, pi-rated copies often are available within a few days of their release. In Thailand, for ex-ample, illegal copies of movies are available within 10 days of their release in the United States. In Russia, pirated movies are sometimes available before their (legal) U.S. debut!

Crossing Borders 2

Homecare Isn't Home Decorating!

Can U.S.-based home healthcare companies expand their services beyond U.S. borders? There are a number of reasons why this might not be a viable idea. First, Home health-care was invented in the United States in response to an aging population and double--digit healthcare inflation in the 1980s giving rise to cost-containment pressures from the government and managed-care payers. The level of home healthcare sophistication in the U.S. has significantly lowered hospital lengths of stay and provided an alternative to hospital admissions resulting in significant cost savings. In Western Europe, however, homecare is viewed as a lower level of care and not accepted as clinically viable for pe-diatric, oncology, or medically complex patients with co-morbidities. Hence, there is a general reluctance to discharge to home.

Second, exporters of home healthcare are thwarted by the lack of trained clinicians to deliver the care and sales representatives to communicate the viability of homecare. In the United Kingdom, homecare is often confused with "home decorating." Third, there are technological barriers to homecare stemming from electrical incompatibility. In many instances, home medical equipment and diagnostic instruments were designed to meet U.S. specifications, thus making them inoperable in the rest of the world.

And finally, medieval traditions stemming from feudal guilds and aristocracies prevent mod-ern companies from utilizing existing distribution systems. For example, in the U.K. the royal postal service cannot be used for the distribution of medications.

Even with these challenges, Western Europe, Asia, and Canada are primary expan-sion markets for U.S.-based homecare for the next several decades. Moreover, the na-tional healthcare services in these areas of the world are looking for alternatives to insti-tutional care to avoid bankrupt-ing the national coffers for an expanding elderly population.

5. **Cultural Barriers and Adaptation.** Because trade in services more frequently in-volves people-to-people contact, culture plays a much bigger role in services than in merchandise trade. Examples are many: Eastern Europeans are perplexed by Western expectations that unhappy workers put on a "happy face" when dealing with customers. But McDonald's requires Polish employees to smile whenever they interact with cus-tomers. Such a requirement strikes many employees as artificial and insincere. The com-pany has learned to encourage managers in Poland to probe employee problems and to assign troubled workers to the kitchen rather than to the food counter. As another ex-ample, notice if the Japanese student sitting next to you in class ever verbally disagrees with your instructor. Classroom interactions vary substantially around the world. Stu-dents in Japan listen to lectures, take notes, and ask questions only after class, if then. In Japan the idea of grading class participation is nonsense. Alternatively, because Spaniards are used to large undergraduate classes (hundreds rather than dozens), they tend to talk to their friends even when the instructor is talking. Likewise, healthcare de-livery systems and doctor/patient interactions also reflect cultural differences. Ameri-cans ask questions and get second opinions. Innovative healthcare services are devel-oped on the basis of extensive marketing research. However, in Japan the social hierarchy is reflected heavily in the patients' deference to their doctors. While Japanese patient compliance is excellent and longevity is the best in the world, the healthcare sys-tem there is quite unresponsive to the expressed concerns of consumers.

   Japanese also tend to take a few long vacations-seven to 10 days is the norm. Thus, vacation packages designed for them are packed with activities. Phoenix, Las Ve-gas, and San Diego or Rome, Geneva, Paris, and London in 10 days makes sense to them. The Four Seasons Hotel chain provides special pillows, kimonos, slippers, and teas for Japanese guests. Virgin Atlantic Airways and other long-haul carriers now have interactive screens available for each passenger, allowing viewing of Japanese (or Amer-ican, French, etc.) movies and TV.

   Managing a global services workforce is certainly no simple task. Just ask the folks at UPS:

   "Some of the surprises UPS ran into: indignation in France, when drivers were told they couldn't have wine with lunch; protests in Britain, when drivers' dogs were banned from de-livery trucks; dismay in Spain, when it was found that the brown UPS trucks resembled the local hearses; and shock in

Germany, when brown shirts were required for the first time since 1945."

And, while tips of 10-15 percent are an important part of services workers' incentives in the United States, this is not the case in Germany, where tips are rounded to the nearest deutsche mark, or in China, where they are considered an insult. Thus, closer manage-ment of service personnel is required in those countries to maintain high levels of customer satisfaction.

Clearly opportunities for the marketing of services will continue to grow well into the next century. International marketers will have to be quite creative in responding to the legal and cultural challenges of delivering high-quality services in foreign markets and to foreign customers.

Marketing Services Overseas: What Have We Learned?

Experience has taught that because services are intangible, exporting them is often unfeasible without also exporting the personnel to provide them. Hence, foreign direct investment, licensing and franchising and joint ventures are common vehicles for providing services in international markets.

Intangibility makes selling services overseas more difficult because the buyer must take the quality of service on faith. Corporate brand name and reputation sometimes help.

Financing the overseas expansion of services can be difficult, with the cost structure leaning toward fixed costs. Although heavy capital investment may not be necessary, working capital needs may be high initially, especially in regard to the personnel required to provide the service. This is another reason that joint ventures and strategic alliances are common when a firm seeks to sell services overseas.

Clearly, because direct interaction between buyer and service provider is essential to marketing services, cultural differences must be accounted for in seeking buyer satisfaction. Establishing a local presence and using local personnel are usually recommended for this reason. And if the service must be adapted to the foreign market, the interaction between buyer and foreign provider takes on additional importance because direct contact can facilitate cooperation and result in more appropriate adaptation.

Service markets are largest in the advanced industrial countries. The U.S. market is generally saturated for a variety of services, making foreign expansion attractive. Even with stiff competition in the advanced industrial nations, service markets as a whole offer greater unrealized potential than goods markets, especially for U.S. firms with their accumulated experience in service industry sectors.

However, service exports or foreign sales do not take place in a vacuum. They often accompany sales of goods. Thus, if exports of goods are faltering, service sales will be affected. For example, the billings of U.S.-based advertising agencies overseas depend somewhat on the success of their U.S. clients overseas. To the extent that a client such as IBM or Coca-Cola generates overseas sales growth, U.S. advertising agencies are more likely to have opportunities to increase their overseas billings.

This last point also suggests a path of least resistance for overseas growth: Follow the client. Such a strategy has been successful for Japanese auto parts companies in the United States and for Japanese banks providing Japanese-language, yen based financial software and services to their Japanese clients.

Concepts from the international marketing of goods can be carried over to services. For example, gap analysis can be used to determine whether the actual market for a particular service (say, the use of overnight parcel and small package delivery) is below the forecast potential. Similarly, the international product lifecycle model can be used to predict, for example, when a developing nation will begin accelerating its consumption of long-distance phone and facsimile services based on the experiences of the more developed nations.

In conclusion, the ways in which the international marketing of services differs from that of goods create closer links to an overall strategy, with issues such as acquisitions and joint ventures being as important as pure marketing issues.

Discussion Questions

1. Discuss the importance of international business services to total U.S. export trade. How do most U.S. service companies become international?

2. Discuss the international market environment for business services.

LESSON 26: BASIC PRICING CONCEPTS

In any country, three basic factors determine the boundaries within which market prices should be set. The first is product cost, which establishes a price floor, or minimum price. Although it is certainly possible to price a product below the cost boundary, few firms can afford to do this for extended periods of time. Second, competitive prices for comparable products create a price ceiling, or upper boundary. International competition almost always puts pressure on the prices of domestic companies. A widespread effect of international trade is to lower prices. Indeed, one of the major benefits to a country of international business is the favorable impact of international competition on national price levels and, in turn, on a country's rate of inflation. Between the lower and upper boundaries for every product there is an optimum price, which is a function of the demand for the product as determined by the willingness and ability of customers to buy. As the gray marketing example illustrates, however, sometimes the optimum price can be affected by arbitrageurs, who exploit price differences in different countries.

The interplay of these factors is reflected in the pricing policies adopted by companies. With increasing globalization, there is greater competitive pressure on companies to restrain price increases. In a globalized industry, companies must compete with other companies from all over the world. Automobiles are a good example. In the United States, one of the most open and competitive automobile markets in the world, the fierce struggle for market share by American, European, Japanese, and Korean companies makes it difficult for any company to raise prices. If a manufacturer does raise prices, it is important to make sure that the increase does not put the company's product out of line with competitive alternatives. Notes John Ballard, chief executive officer (CEO) of a California-based engineering company, "We thought about price increases. But our research of competitors and what the market would bear told us it was not worth pursuing."

Basic Pricing Concepts

As CEO Ballard's experience shows, the global manager must develop pricing systems and pricing policies that address price floors, price ceilings, and optimum prices in each of the national markets in which his or her company operates. The following list identi-fies eight basic pricing considerations for marketing outside the home country.

1. Does the price reflect the product's quality?
2. Is the price competitive?
3. Should the firm pursue market penetration, market skimming, or some other pricing objective?
4. What type of discounts (trade, cash, quantity) and allowance (advertising, trade-off) should the firm offer its international customers?
5. Should prices differ by market segment?
6. What pricing options are available if the firm's costs increase or decrease? Is demand in the target market elastic or inelastic?
7. Are the firm's prices likely to be viewed by the host-country government as reaso1nable or exploitative?
8. Do the target country's dumping laws pose a problem?

The task of determining prices in global marketing is compli-cated by fluctuating ex-change rates, which may bear only limited relationship to underlying costs. According to the concept of purchasing power parity, changes in domestic prices will be reflected in the exchange rate of the country's currency. Thus, in theory, fluctuating exchange rates should not present serious problems for the global marketer because a rise or decline in domestic price levels should be offset by an opposite rise or decline in the value of the home-country currency and vice versa. In the real world, however, exchange rates do not move in lockstep fashion with inflation. This means that global marketers are faced with difficult decisions about how to deal with windfalls resulting from favorable exchange rates, as well as losses due to unfavorable exchange rates.

A firm's pricing system and policies must also 'be consistent with other uniquely global constraints. Those responsible for global pricing decisions must take into account international transportation costs, middlemen in elongated international channels of dis-tribution, and the demands of global accounts for equal price treatment regardless of lo-cation. In addition to the diversity of national markets in all three basic dimensions-cost, competition, and demand-the international executive is also confronted by conflicting governmental tax policies and claims as well as various types of price controls. These in-clude dumping legislation, resale price maintenance legislation, price ceilings, and gen-eral reviews of price levels. For example, Procter & Gamble (P&G) encountered strict price controls in Venezuela in the late 19808. Despite increases in the cost of raw mate-rials, P&G was granted only about 50 percent of the price increases it requested; even then, months passed before permission to raise prices was forthcoming. As a result, by 1988 detergent prices in Venezuela were less than what they were in the United States.

The textbook approach outlined earlier is used in part or in whole by most experi-enced global firms, but it must be noted that the inexperienced or part-time exporter does not usually go to all this effort to determine the best price for a product in international markets. Such a company will frequently use a much simpler approach to pricing, such as the cost -plus method explained later in this chapter. As managers gain experience and become more sophisticated in their approach, however, they realize that the factors iden-tified previously should be considered when making pricing decisions.

There are other important internal organizational considerations besides cost. Within the typical corporation, there are many interest groups and, frequently, conflicting price objectives. Divisional vice presidents, regional executives, and country managers are each concerned about profitability at their respective organizational levels Similarly, the di-rector of international marketing seeks competitive prices in world markets. The controller and financial vice president are also concerned about profits. The manufacturing vice president seeks long runs for maximum manufacturing efficiency. The tax manager is concerned about compliance with government transfer pricing legislation, and company' counsel is concerned about the antitrust implications of international pricing practices.

Compounding the problem is the rapidly changing global marketplace and the in-accurate and distorted nature of much of the available information regarding demand. In many parts of the world, external market information is distorted and inaccurate. It is often not possible to obtain the definitive and precise information that would be the basis of an optimal price. The same may be true about internal information. In Russia, for example, market research is a fairly new concept. Historically, detailed market in-formation was not gathered or distributed. Also, managers at newly privatized factories are having difficulty setting prices because cost accounting data relating to manufacturing are frequently unavailable.

There are other problems. When attempting to estimate demand, for example, it is important to consider product appeal relative to competitive products. Although it is possible to arrive at such estimates after conducting market research, the effort can be costly and time consuming. Company managers and executives have to rely on intuition and experience. One way of improving the estimates of potential demand is to use analogy. As described in Chapter 6, this approach basically means extrapolating potential demand for target markets from actual sales in markets judged to be similar. -

Environmental Influences On Pricing Decisions

Global marketers must deal with a number of environmental considerations when making pricing decisions. Among these are currency fluctuations, inflation, government controls and subsidies, competitive behavior, and market demand. Some of these fac-tors work in conjunction with others; for example, inflation may be accompanied by government controls. Each consideration is discussed in detail next.

1. Currency Fluctuations

Fluctuating currency values are a fact of life in international business. The marketer must decide what to do about this fact. Are price adjustments appropriate when currencies strengthen or weaken? There are two extreme positions; one is to fix the price of prod-ucts in country target markets. If this is done, any appreciation or depreciation of the value of the currency in the country of production will lead to gains or losses for the seller. The other extreme position is to fix the price of products in home country currency. If this is done, any appreciation or depreciation of the home-country currency will result in price increases or decreases for customers with no immediate consequences for the seller.

In practice, companies rarely assume either of these extreme positions. Pricing de-cisions should be consistent with the company's overall business and marketing strat-egy: If the strategy is long term, then it makes no sense to give up market share in order to maintain export margins. When currency fluctuations result in appreciation in the value of the currency of a country that is an exporter, wise companies do two things: They accept that currency fluctuations may unfavorably impact operating margins, and

Table 1 Global Pricing Strategies

When domestic currency is weak	When domestic currency is strong
1. Stress price benefits. 2. Expand product line and add more costly features. 3. Shift sourcing to domestic market. 4. Exploit market opportunities in all markets. 5. Use full-costing approach but employ marginal-cost pricing to penetrate new or competitive markets. 6. Speed repatriation of foreign-earned income and collections. 7. Minimize expenditures in local or host country currency. 8. Buy advertising, insurance, transportation, and other services in domestic market. 9. Bill foreign customers in their own currency.	1. Engage in non-price competition by improving quality, delivery, and after-sale service. 2. Improve productivity and engage in cost reduction. 3. Shift sourcing outside home country. 4. Give priority to exports to countries with stronger currencies. **5. Trim profit margins and use marginal cost pricing.** 6. Keep the foreign-earned income in host country; slow down collections. 7. Maximize expenditures in local or host country currency. 8. Buy needed services abroad and pay for them in local currencies. 9. Bill foreign customers in the domestic currency.

They double their efforts to reduce costs. In the short run, lower margins enable them to hold prices in target markets, and in the longer run, driving down costs enables them to improve operating margins.

For companies that are in a strong, competitive market position, price increases can be passed on to customers without significant decreases in sales volume. In more com-petitive market situations, companies in a strong-currency country will often absorb any price increase by maintaining international market prices at pre-revaluation levels. In actual practice, a manufacturer and its distributor may work together to maintain market share in international markets. Either party, or both, may choose to take a lower profit percentage. The distributor may also choose to purchase more product to achieve volume discounts; another alternative is to maintain leaner inventories if the manufacturer can provide just-in-time delivery. By using these approaches, it is possible to remain price competitive in

markets in which currency devaluation in the importing country is a price consideration.

If a country's currency weakens relative to a trading partner's currency, a producer in a weak-currency country can cut export prices to hold market share or leave prices alone for healthier profit margins. The Euro is a good example. In the first 17 months after the launch of the Euro at the beginning of 1999, the currency lost nearly a quarter of its value. One option for the European Central Bank (ECB) was to raise interest rates to strengthen the Euro. While the Euro remains weak, Germany is enjoying an export boom.

'The crisis that occurred with the Russian ruble in 1998 is another good example of how currency fluctuations can affect marketing. Prior to the devaluation of the ruble from January 1998 to Juneu1998, the market share for Russian shampoos, face care prod-ucts, hair coloring, toothpaste, deodorants, and soaps in Russia was only 27 percent.

Table 2

Purpose: *To protect parties from unforeseen large swings in currencies.*
Exchange rate review is made quarterly to determine possible adjustments for the next period.
Comparison basis is the three-month daily average and the initial average.

When the price of imported products rose dramatically, many Russian women switched to local products. By January to June 2000, the market share official products rose to 44 percent and had forced some foreign producers out of the market.

2. Exchange Rate Clauses

Many sales are contracts to supply goods or services over time. When these contracts are between parties in two countries, the problem of exchange rate fluctuations and exchange risk must be addressed.

An exchange rate clause allows the buyer and seller to agree to supply and purchase at fixed prices in each company's national currency. If the exchange rate fluctuates within a specified range, say plus or minus 5 percent, the fluctuations do not affect the pricing agreement that is spelled out in the exchange rate clause. Small fluctuations in exchange rates are not a problem for most buyers and sellers. Exchange rate clauses are designed to protect both the buyer and the seller from unforeseen large swings in currencies. Figure 12-1 summarizes the key elements of an exchange rate clause. An example of an actual clause used by one U.S.-headquartered Fortune 100 Company is shown in Table 2

Initial Base Exchange Rate Per US $

Base U.S. Dollar	Italy Lira	Spain Peseta	Britain Pound	Germany Mark	Sweden Krona	Denmark Krone	Turkey Lira
$ 1 =	1500	115	0.699	1.622	7.277	6.261	8849.597
Product price $5	7500	575	3.495	8.11	36.385	31.305	44247.985

Compare initial base to three-month daily average:

If rate difference are greater than $\pm$ 5% adjust prices for the next three-month period.

If greater than 10% open discussion negotiation.

The basic design of an exchange rate clause is straightforward: Review exchange rates periodically (this is determined by the parties; any interval is possible, but most clauses specify a monthly or quarterly review), and compare the daily average during the review period and the initial base average. If the comparison produces exchange rate fluctuations that are outside the agreed range of fluctuation, an adjustment is made to align prices with the new exchange rate if the fluctuation is within some range. If the fluctu-ation is greater than some limit (10 percent in our example), the parties agree to discuss and negotiate new prices.

In other words, the clause accepts the foreign exchange market's effect on currency value, but only if it is within the range of 5 to 10 percent. Anything less than 5 percent does not affect pricing, and anything more than 10 percent opens up a renegotiation of prices.

3. Pricing In An Inflationary Environment

Inflation, or a persistent upward change in price levels, is a worldwide phenomenon. In-flation requires periodic price adjustments. These adjustments are necessitated by rising costs that must be covered by increased selling prices. An essential requirement when pricing in an inflationary environment is the maintenance of operating profit margins. Regardless of cost accounting practices, if a company maintains its margins, it has effectively protected itself from the effects of inflation. To keep up with inflation in Peru, for example, Procter & Gamble has resorted to weekly increases in detergent prices of 20 percent to 30 percent. 5

Within the scope of this chapter, it is possible only to touch on the major account-ing issues and conventions relating to price adjustments in international markets. In particular, it is worth noting that the traditional FIFO (first -in, first -out) costing method is hardly appropriate for an inflationary situation. A more appropriate accounting prac-tice under conditions of rising prices is the LIFO (last-in, first-out) method, which takes the most recent raw material acquisition price and uses it as the basis for costing the product sold. In highly inflationary environments, historical approaches are less I appropriate costing methods than replacement cost. The latter amounts to a next-in first-out approach. Although this method does not conform to generally accepted accounting principles (GAAP), it is used to estimate future prices that will be paid for I raw and component materials. These replacement costs can then be used to set prices. This approach is useful in managerial decision-making, but it cannot be used in financial statements. Regardless of the accounting methods used, an essential requirement under inflationary conditions of any costing system is that it maintains gross and operating profit margins. Managerial actions can maintain these margins subject to the following constraints.

4. Government Controls and Subsidies

If government action limits the freedom of management to adjust prices, the mainte-nance of margins is definitely compromised. Under certain conditions, government action is a real threat to the profitability of a subsidiary operation. In a country that is undergoing severe financial difficulties

and is in the midst of a financial crisis (e.g., a foreign exchange shortage caused in part by runaway inflation), government officials are under pressure to take some type of action. This has been true in Brazil for many years. In some cases, governments will take expedient steps rather than getting at the underlying causes of inflation and foreign exchange shortages. Such steps might in-clude the use of broad or selective price controls. When selective controls are imposed, foreign companies are more vulnerable to control than local businesses, particularly if the outsiders lack the political influence over government decision-making possessed by local managers.

Government control can also take the form of prior cash deposit requirements im-posed on importers. This is a requirement that a company has to tie up funds in the form of a non-interest-bearing deposit for a specified period of time if it wishes to import prod-ucts. Such requirements clearly create an incentive for a company to minimize the price of the imported product; lower prices mean smaller deposits. Other government re-quirements that affect the pricing decision are profit transfer rules that restrict the con-ditions under which profits can be transferred out of a country. Under such rules, a high transfer price paid for imported goods by an affiliated company can be interpreted as a device for transferring profits out of a country.

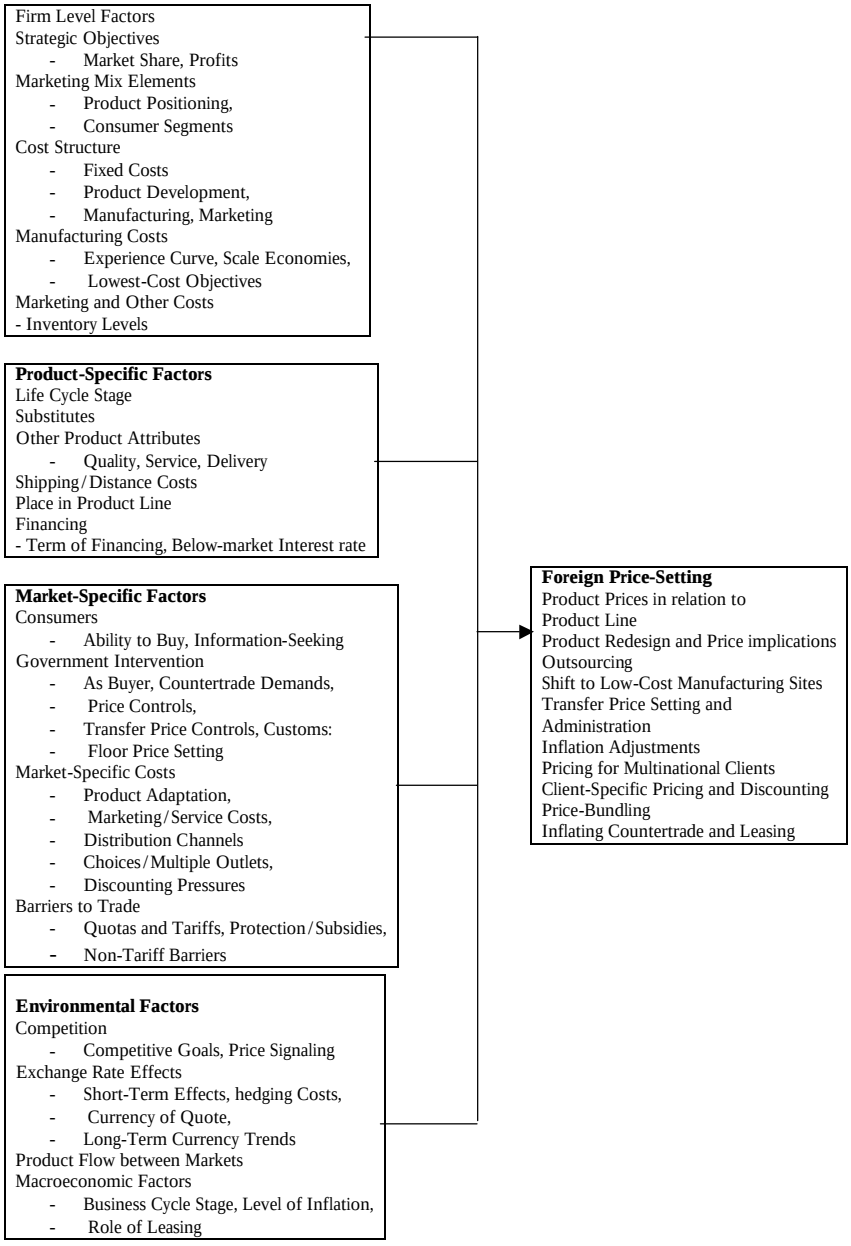
Government subsidies can also force a company to make strategic use of sourcing to be price competitive. In Europe, government subsidies to the agricultural sector make it difficult for foreign marketers of processed food to compete on price when exporting to the European Union (EU). In the United States, some, but not all, agricultural sec-tors are subsidized. For example, U.S. poultry producers and processors are not subsi-dized, a situation that makes their prices noncompetitive in world markets. One Midwestern chicken processor with European customers sourced its product in France for resale in the Netherlands. By doing so, the company took advantage of lower costs derived from subsidies and eliminated price escalation due to tariffs and duties.

5. Competitive Behavior

As noted at the beginning of this chapter, pricing decisions are bounded not only by cost and the nature of demand but also by competitive action. If competitors do not adjust their prices in response to rising costs, management even if acutely aware of the effect of rising costs on operating margins-will be severely constrained in its ability to adjust prices accordingly. Conversely, if competitors are manufacturing or sourcing in a lowermost country, it may be necessary to cut prices to stay competitive.

6. Price And Quality Relationships

Is there a relationship between price and quality? Do you, in fact, get what you pay for? During the past several decades, studies conducted in the United States have indicated that the overall relationship between price and quality as measured by consumer test-ing organizations is quite weak. A recent four-country international study found a high degree of similarity with the results from the U.S. studies. The authors conclude that the lack of a strong price-quality relationship appears to be an international phenomenon.6 This is not surprising when one recognizes that consumers make purchase decisions with limited information and rely more on product appearance and style and less on technical quality as measured by testing organizations.



Framework For International Pricing Strategy

Global Pricing Objectives and Strategies

A number of different pricing strategies are available to global marketers. An overall goal must be to contribute to company sales and profit objectives worldwide. Customer oriented strategies such as market skimming, penetration, and market holding can be used when consumer perceptions, as determined by the value equation, are used as a guide. Global pricing can also be based on other external criteria such as the escalation in costs when goods are shipped long distances across national boundaries. The issue of global pricing can also be fully integrated in the product design process, an approach widely used by Japanese companies. Prices in global markets are not carved in stone; they must be evaluated at regular intervals and adjusted if necessary. Similarly, pricing objectives may vary, depending on a product's life-cycle stage and the country-specific competitive situation.

1. Market Skimming

   The market skimming pricing strategy is a deliberate attempt to reach a market segment that is willing to pay a premium price for a product. In such instances, the product must create high value for buyers. This pricing strategy is often used in the introductory phase of the product life cycle, when both production capacity and competition are limited. By setting a deliberately high price, demand is limited to early adopters who are willing and able to pay the price. One goal of this pricing strategy is to maximize revenue on limited volume and to match demand to available supply. Another goal of market skim-ming pricing is to reinforce customers' perceptions of high product value. When this is done, the price is part of the total product positioning strategy.

   When Sony first began selling Betamax videocassette recorders (VCRs) in the United States, it used a skimming strategy. Harvey Schein, who was president of Sony of America at the time, recalled the response to the $1,295 price tag.

   It was fantastic, really. When you have a new product that is as jazzy as a video-tape recorder, you really skim off the cream of the consuming public. The Beta-max was selling for over a thousand dollars. . . . But there were so many wealthy people who wanted to be the first in the neighborhood that it just went whoof-like a vacuum. It flew off the shelf.

   The initial success of the Betamax proved that consumers were willing to pay a high price for a piece of consumer electronics equipment that would allow them to watch their favorite television shows at any time of the day or night.

2. Penetration Pricing

   Penetration pricing uses price as a competitive weapon to gain market position. The ma-jority of companies using this type of pricing in international marketing are located in the Pacific Rim. Scale-efficient plants and low-cost labor allow these companies to blitz the market.

   It should be noted that a first-time exporter is unlikely to use penetration pricing. The reason is simple: Penetration pricing often means that the product may be sold at a loss for a certain length of time. Companies that are new to exporting cannot absorb such losses. They are not likely to have the marketing system in place (including trans-portation, distribution, and sales organizations) that allows global companies such as Sony to make effective use of a penetration strategy. However, a company whose prod-uct is not penetrable may wish to use penetration pricing to achieve market saturation before the product is copied by competitors.

   When Sony developed the portable compact disc player, the cost per unit at initial sales volumes was estimated to exceed $600. Since this was a "no-go" price in the United States and other target markets, Akio Morita instructed management to price the unit in the $300 range to achieve penetration. Because Sony was a global marketer, the sales volume it expected to achieve in these markets led to scale economies and lower costs.

   The Sony example illustrates the penetration approach to pricing as it is practiced by Japanese firms. As shown in Figure 12-3, the Japanese begin with market research and product characteristics. Up to this point, the processes are parallel in the United States and Japan. At the next step, the processes diverge. In Japan, the planned selling price minus the desired profit is calculated, resulting in a target cost figure. It is only at this point that design, engineering, and supplier pricing issues are dealt with; extensive consultation among all value-chain members is used to meet the target. Once the-nec-essary negotiations and trade-offs have been settled, manufacturing begins, followed by continuous cost reduction. In the U.S. process, cost is typically determined after design, engineering, and marketing decisions have been made in sequential fashion; if the cost is too high, the process cycles back to square one-the design stage.

3. Market Holding

   The market holding strategy is frequently adopted by companies that want to maintain their share of the market. In single-country marketing, this strategy often involves reacting to price adjustments by competitors. For example, when one airline announces I special bargain fares, most competing carriers must match the offer or risk losing pas-sengers. In global marketing, currency fluctuations often trigger price adjustments.

   Market holding strategies dictate that source country currency appreciation will not be automatically passed on in the form of higher prices. If the competitive situation in market countries is price sensitive, manufacturers must absorb the cost of currency appreciation by accepting lower margins in order to maintain competitive prices in country markets.

   A strong home currency and rising costs in the home country may also force a com-pany to shift its sourcing to in-country or third-country manufacturing or licensing agreements, rather than exporting from the home country, to maintain market share. IKEA, the Swedish home furnishing company, sourced 50 percent of its products in the United States in 1992, compared with only 10 percent in 1989.

   Chrysler-Daimler and BMW built manufacturing and assembly plants in the United States to produce Mercedes

and BMW sport-utility and two-seater sport car vehicles for the United States and the world market. This was a decision to invest in new locations for capacity expansion. Market holding means that a company must carefully examine all its costs to ensure that it will be able to remain competitive in target markets. In the case of the German automobile manufacturers, the expansion of production out-side Germany meant that the companies were no longer tied exclusively to German costs in their manufacturing.

When the currency of a country weakens, it becomes more difficult-to compete on price with imported product. However, a weak-currency country can be a windfall for, a global company with production operations in a weak-currency country. When the In donation rupee fell from 2,400 to 18,000 and then recovered to below 8,000 to the U.S. dollar during the Asian Flu of the late 1990s, global companies with production opera-tions in Indonesia made windfall profits. Their costs in rupiah increased 100 percent but the value of their production in dollars or any "hard" currency increased by 300 to 700 percent. Thus, while the country was in a crisis, many of the global companies in In-donesia were having their best years ever.

4. Cost Plus/Price Escalation

Companies new to exporting frequently use a strategy known as cost -plus pricing to gain a toehold in the global marketplace. There are two cost-plus pricing methods: The older is the historical accounting cost method, which defines cost as the sum of all direct and I indirect manufacturing and overhead costs. An approach used in recent years is known as the estimated future cost method.

Cost-plus pricing requires adding up all the costs required to get the product to where it must go, plus shipping and ancillary charges, and a profit percentage. The obvious advantage of using this method is its low threshold: It is relatively easy to arrive at a selling price, assuming that accounting costs are readily available. The disadvantage of using historical accounting costs to arrive at a price is that this approach completely ignores demand and competitive conditions in target markets. Therefore, historical ac-counting cost-plus prices will frequently be either too high or too low in the light of market and competitive conditions. If historical accounting cost-plus prices are right, it is only by chance.

However, novice exporters do not care-they are reactively responding to global market opportunities, not proactively seeking them. Experienced global marketers real-ize that nothing in the historical accounting cost-plus formula directly addresses the com-petitive and customer-value issues that must be considered in a rational pricing strategy.

Price escalation is the increase in a product's price as transportation, duty, and dis-tributor margins are added to the factory price. Table is a typical example of the kind of price escalation that can occur when a product is destined for international mar-kets. In this example, a distributor of agricultural equipment in Kansas City is shipping a container load of farm implements to Tokyo, Japan. A shipment of product that costs ex-works $30,000 in Kansas City ends up having a total retail price in excess of US$50,000 in Tokyo-almost double the ex-works Kansas City price.

Let us examine this shipment to see what happened. First, there is the total ship-ping charge of $5,453.07, which is 18 percent of the ex-works Kansas City price. The prin-cipal component of this shipping charge is a combination of land and ocean freight totaling $5,267.80. A currency adjustment factor (CAF) is charged due to, the strength of the dollar relative to the yen; this figure will fluctuate as currency values change.

AU import charges are assessed against the landed price of the shipment (cost, insur-ance, freight, or C.I.F. value). Note that there is no line item for duty in this example; no duties are charged on agricultural equipment sent to Japan. Duties may be charged in other countries. A nominal distributor markup of 10 percent ($3,652) actually represents 12 percent of the C.I.F. Yokohama price, because it is a markup not only on the ex-works price but on freight and value-added tax (VAT) as well. (It is assumed here that the dis-tributor's markup includes the cost of transportation from the port to Tokyo.) Finally, a

Table 3 Price Escalation: A 20 Foot Container of Agricultural Equipment form Kansas City to Yokohama

Item			Percentage of FOB Price
Ex-works Kansas City		$30000	
Container freight charges			
From Kansas city to Seattle	$1475.00		
Terminal handling fee	350.00		
Ocean freight for 2O-foot container	2280.00		
Currency adjustment factor (CAF)	1162.80		18
(51 % of ocean freight)	35.27		
Insurance (110% of C.I.F. value)	150.00		
Forwarding fee	5453.07		3
Total shipping charges		35453.07	
Total CLF. Yokohama value		1063.69	12
VAT (3% of CLF. value)		36516.76	
Distributor markup (10%)		3651.67	33
Dealer markup (25%)		40168.43	166%
Total retail price		10042.10	
		$50210.53	

dealer markup of 25 percent adds up to $10,042-33 percent-of the C.LF. Yokohama price. Like distributor markup, dealer markup is based on the total landed cost.

The net effect of this add-on accumulating process is a total retail price in Tokyo of $50,210, or 166 percent of the ex-works Kansas City price. This is price escalation. The example provided here is by no means an extreme case. Indeed, longer distribu-tion channels, or channels that require a higher operating margin-as are typically found in export marketing-can contribute to price escalation. Because of the layered distribution system in Japan, the markups in Tokyo could easily result in a price that is 200 percent of the C.L.F value.

The example of cost-plus pricing shows an approach that a beginning exporter might use to determine the C.LF. price. Another cost-plus example is the export of household cleaning products from the United States to South America. The escalation; of the U.S. C.LF price to the retail shelf in South America, with transportation, import duties and

taxes, wholesaler and distributor margins, retail margins, and the VAT is in excess of 300 percent! This kind of escalation provides a major incentive to locate pro-duction closer to the customer to reduce and eliminate costs that are part of the export sourcing arrangement. Experienced global marketers view price as a major strategic variable that can help achieve marketing and business objectives.

5. Using Sourcing As A Strategic Pricing Tool

The global marketer has several options when addressing the problem of price escala-tion described in the last section. The choices are dictated in part by product and market competition. Marketers of domestically manufactured finished products may be forced to switch to lower-income, lower-wage countries for the sourcing of certain components or even of finished goods to keep costs and prices competitive. The athletic footwear in- dusty is an example of an industry in which the leading companies have opted for low- income, low-wage country sourcing of their production. Even companies such as the U.S. firm New Balance, which continues to manufacture athletic footwear in the United States, imports components from lower-income countries.

The low-wage strategy option should never become a formula, however. The problem with shifting production to a low-wage country is that it provides a one-time advantage. This is no substitute for ongoing innovation in creating value. High-income countries are the home of thriving manufacturing operations run by companies that have been creative in figuring out ways to drive down the cost of labor as a percentage of total costs and in creating a unique value. The Swiss watch industry, which owns the world's luxury watch business, did not achieve and maintain its preeminence by chasing cheap labor: It continues to succeed because it has focused on creating a unique value for its Customers. Labor as a percent of the selling price in Swiss watches is so small that the price of labor is irrelevant in determining competitive advantage.

The third option is a thorough audit of the distribution structure in the target mar-kets. A rationalization of the distribution structure can substantially reduce the total markups required to achieve distribution in international markets. Rationalization may include selecting new intermediaries, assigning new responsibilities to old intermedi-aries, or establishing direct-marketing operations.

Gray Market Goods

Gray market good are trademarked products that are exported from one country to another where they are sold by unautho-rized persons or organizations. Sometimes, gray marketers bring a product produced in one country-French champagne, for example into a second-country market in competition with authorized importers. The gray mar-keters sell at prices that undercut those set by the legitimate importers. This' practice, known as parallel importing, may flourish when a product is in short supply or when producers attempt to set high prices. This has happened with French champagne sold in the United States; it is also true of the European market for pharmaceuticals, where prices vary widely from country to country. In the United Kingdom and the Netherlands, for example, parallel imports account for as much as 10 percent of the sales of some pharmaceutical brands.

In another type of gray marketing, a company manufactures a product in the home country market as well as in foreign markets. In this case, products manufactured abroad by the company's foreign affiliate for sales abroad are sometimes sold by a foreign dis-tributor to gray marketers The latter then bring the products into the producing com-pany's home-country market, where they compete with domestically produced goods. For example, in the mid-1980s, Caterpillar's U.S. dealers found themselves competing with gray market construction equip-ment manufactured in Europe. The strong dollar had provided gray marketers with an opportunity to bring Caterpillar equipment into the United States at lower prices than domesti-cally produced equipment. Even though the gray market goods carry the same trademarks as the domestically produced ones, they may differ in quality, ingredients, or some other way. Manufacturers may not honor warranties on some types of gray market imports such as cameras and consumer electron-ics equipments.

As these examples show, the marketing opportunity that presents itself requires gray market g09ds to be priced lower than goods sold by authorized distributors or do-mestically produced goods. Clearly, buyers gain from lower prices and increased choice. In the United Kingdom alone, for example, total annual retail sales of gray market goods are estimated to be as high as $1.6 billion. A recent case in Europe resulted in a ruling that strengthened the rights of brand owners. Silhouette, an Austrian manufacturer of upscale sunglasses, sued the Hartlauer discount chain after the latter obtained thou-sands of pairs of sunglasses that Silhouette had intended for sale in Eastern Europe. The European Court of Justice found in favor of Silhouette. In clarifying a 1989 directive, the court ruled that stores couldn't import branded goods from outside the EU and then sell them at discounted prices without permission of the brand owner. The Financial Times denounced the ruling as "bad for consumers, bad for competition, and bad for Eu-ropean economies.

In the United States, gray market goods are subject to a 70-year-old law, the Tariff Act of 1930. Section 526 of the act expressly forbids importation of goods of foreign manufacture without the permission of the trademark owner. There are, however, sev-eral exceptions spelled out in the act; the U.S. Customs Service, which implements the

Gray Marketing

Another type of gray marketing occurs when a company manufactures a product in multiple locations-in the, home-country market as well as in foreign markets. In this case products manufactured abroad by the company foreign affiliate for sales abroad by a foreign distributor to gray marketers. The latter then bring the products in6to the producing company home country market, where they compete with domestically produced goods. Even though the gray market goods carry the same trademarks as the domestically produced ones, they often differ in quality ingredients, or in some other way. For example in the mid 1980s. Caterpillar's U.S. dealers found themselves competing with gray market construction equipment manufactured in Europe. The strong dollar has provided gray

marketers with an opportunity to bring caterpillar equipment into the United States at lower prices than domestically produced equipment. As these examples show, the marketing opportunity that presents itself depends on gray market goods being priced lower than goods sold by authorized distributors or domestically produced goods. Clearly, buyers gain from lower prices and increased choices. However gray market goods – especially cameras and consumer electronics equipment – may not be covered by manufacturers warranties. In the united states gray market goods are subject to a 60 year old law, the Tariff act of 1930 section 526 of the act expressly forbids importation of goods of foreign manufactures without the permission of the trademark owner. There are however, several exceptions spelled out in the act, this provides the U.S. customs service, which implements the regulations, and the court system considerable leeway in decisions regarding gray market goods. For example in 1988 the U.S supreme court ruled that trademarked goods of foreign manufactured such as champagne could legally be imported and sold by gray marketers. In many instances, however, the courts interpretation of the law differs from that customs service. Because of problems associated with regulating gray markets, one legal expert has argued that in the name of free markets and free trade, the U.S, congress should repeal section 526 in its place a new law should require gray market goods to bear labels clearly explaining any differences between them and goods a that come through authorized channels. Other experts believe that instead of changing the laws, companies should develop proactive strategic responses to gray markets. One such strategy would be improved market gray market products less attractive; another would be to aggressively identify and terminate distributors that are involved in selling to gray markets.

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LESSON 27:
DUMPING AND COUNTERTRADE

Dumping

Dumping is an important global pricing strategy issue. GATT's 1979 Antidumping Code defined dumping as the sale of an imported product at a price lower than that nominally charged in a domestic market or country of origin in addition, many countries have their own policies and procedures for protecting national companies from dumping. The U.S. Antidumping Act of 1921, which is enforced by the U.S. Treasury, did not define dumping specifically but instead referred to unfair competition. However, Congress has defined dumping as an unfair trade practice that results in "injury, destruction, or prevention of the establishment of American industry." Under this definition, dumping occurs when imports sold in the U.S. market are priced either at levels that represent less than the cost of production plus an 8 percent profit margin or at levels below those prevailing in the producing country.

Dumping was a major issue in the Uruguay Round of GATT negotiations. Many countries disapproved of the U.S. system of antidumping laws, in part because the Commerce Department historically almost always ruled in favor of a U.S. company filing a complaint. Another issue was the fact that U.S. exporters were often targeted in antidumping investigations in countries with few formal rules for due process. The US negotiators hoped to improve the ability of US. Companies to defend their interests and understand the bases for rulings.

The result of the GATT negotiations was an Agreement on Interpretation of Article VI. From the US point of view, one of the most significant changes between the agreement and the 1979 code is the addition of a standard of review that makes it harder to dispute US. Antidumping determinations. There were also a number of procedural and methodological changes. In some instances, these have the effect of bringing regulations more in line with U.S. law. For example, in calculating fair price for a given product, any sales of the product at below cost prices in the exporting country are not included in the calculations; inclusion of such sales would have the effect of exerting downward pressure on the fair price. The agreement also brought GATT standards into line with US. Standards by prohibiting governments from penalizing differences between home-market and export-market prices of less than 2 percent

As the nature of these issues and regulations suggests, some countries use dumping legislation as a legitimate device to protect local enterprise from predatory pricing practices by foreign companies. In other nations, they represent protectionism, a device for limiting foreign competition in a market. The rationale for dumping legislation is that dumping is harmful to the orderly development of enterprise within an economy. Few economists would object to long run or continuous dumping. If this were done, it would be an opportunity for a country to take advantage of a low-cost source of a particular good and to specialize in other areas. However, continuous dumping rarely occurs; the sale of agricultural products at international prices, with fanners receiving subsidized higher prices, is an example of continuous dumping. The type of dumping practiced by most companies is sporadic and unpredictable and does not provide a reliable basis for national economic planning. Instead, it may hurt domestic enterprise.

Recently, there has been a shift in the countries bringing charges of dumping. In 1998, the United States, EU, Australia, and Canada brought approximately one third or 225 of the cases opened. This is down significantly from the late 1980s when these same countries accounted for four fifths of all cases.12 The leading countries bringing suit were South Africa, the United States, India, the European Union and Brazil.

Nearly 20 percent of the cases were brought against the EU or member countries followed by China and Korea.

One U.S, company, Smith Corona Corporation of New Canaan, Connecticut, filed an antidumping complaint against Brother Industries of Japan in 1974 and was involved in dumping-related litigation until the day it declared bankruptcy. One of the lessons from this saga is that it can take years to get relief from the International Trade Commission (ITC). Smith Corona had to retile its original complaint; the ITC finally found in its favor in 1980, ordering a 48,7 percent duty on imports of portable typewriters.

However, the duties only applied to typewriters; Brother responded by designing new products with chip-based memory functions. Because this new product was no longer classified as a typewriter-rather, it was a word processor-Brother effectively sidestepped the duties. Brother also began assembling typewriters and word processors from imported parts in a plant in Tennessee. This example shows to what lengths a company will go to get around dumping regulations; Brother used both product innovation and a new sourcing strategy. Finally, in an ironic twist, Brother turned the tables on Smith Corona by accusing the latter of dumping. The rationale: Many of Smith Corona's typewriters are imported from a plant in Singapore; Brother pointed to its own U.S. plant as evidence that it was the true U.S. producer.

For a positive proof of dumping to occur in the United States, both price discrimination and injury must be demonstrated. The existence of either one without the other is an insufficient condition to constitute dumping. Companies concerned with running afoul of antidumping legislation have developed a number of approaches for avoiding the dumping laws. One approach is to differentiate the product sold from that sold in the home market. An example of this is. An auto accessory that one company packaged with a wrench and an instruction book, thereby changing the accessory to a tool. The tariff rate in the export market happened to be lower on tools, and the company also acquired immunity from antidumping laws because the package was not comparable to competing goods in the target

market. Another approach is to make non-price-competitive adjustments in arrangements with affiliates and distributors. For example, credit can be extended and essentially have the same effect as a price reduction.

Types of Dumping

There are several types of dumping: sporadic, predatory, persistent, and reverse. Sporadic dumping occurs when a manufacturer with unsold inventories warts to get rid of distressed and excess merchandise. To preserve its competitive position at home, the manufacturer must avoid starting a price war that could harm its home market. One way to find a solution involves destroying excess supplies, as in the example of Asian farmers dumping small chickens in the sea or burning them. Another way to solve the problem is to cut losses by selling for any price that can be realized. The excess supply is dumped abroad in a market where tee product is normally not sold.

The Contrarian Views of James Bovard

James Bovard might be considered the Ralph Nader of global marketing. He is a tireless advocate of unrestricted trade and a vocal critic of U.S trade policy who campaigns to influence the views of policy makers and the general public. In his recent book, the myth of Fair Trade, and in numerous articles and essays, Bovard argues that U.S trade laws are hypocritical because they reduce rather than encourage competition, the result, he asserts, is higher prices for U.S consumers, his positions and opinions on two trade issues, dumping and super 301 are summarized next, along with a sampling of response.Dumping: Bovard believes America antidumping laws should be repealed. Calling dumping laws a relic of the fixed exchange rate era, he notes that the U.S. commerce Department can convict a company of dumping on the basis of dumping margins (price differences) as small as one half of 1 percent, even though the dollar can experience double-digit fluctuations relative to other world currencies. Moreover, a dumping conviction can restrict a company's market access for 15 years, long after an offense has occurred, Bovard cautions that other nations may copy America's antidumping regulations, to the ultimate detriment of U.S. companies.Although the Uruguay Round of GATT negotiations resulted in some changes addressing Bovard's specific concerns, the broader issue is still open. Should America's antidumping laws be repealed? Not according to Don E. Newquist, former chairman of the international Trade commission. He argues that antidumping laws help preserve America's manufacturing and technology base. He warns that without the laws, foreign producers who are sheltered form import competitions in their home markets (e.g., Japanese companies) can use excess profits from domestic sales to subsidize low cost exports to America. This could lead to market share losses, cash flow reductions, and even plant closing in the United States.Super 301 and section 301 -In march 1994 Bovard blasted the Clinton administration decision to reinstate super 301 to punish Japan for unfair trade practices. Super 301 was a 1998 trade provision that allowed the united states to single out individual nations as unfair traders and impose 100 percent tariffs on exports forms those nations unless U.S. demands were granted. An earlier regulation section 301 of the Trade Act of 1974 allowed the U.S. government to investigate and retaliate against unfair trade barriers in other nations. Bovard's specific complaint about president Clinton action was that both 301 provisions have been ineffective and that threats of retaliation have brought results in only a handful of casesBovard has also frequently argued that the united states is hypocritical when it comes to trade policy, citing numerous examples of U.S. trade practices over the past 20 years to supports his claim, for example, in 1990 the united states initiated a case against Canada for limiting American beer imports, even though the united states imposes its own complicated regulations on Canadian beer imports. In 1989, the united states threatened Japan with section 301 on the grounds that Motorola had not been granted a large enough geographic selling area. Bovard ascribed Motorola's sales problems in Japan to a simple lack of product adaptation, the company initially exported cellular phones designed for American frequencies; Japanese's cellular phone exports to the united states are designed for U.S. frequencies.

Predatory Dumping is more permanent than sporadic dumping. This strategy involves selling at a loss to gain access to a market and perhaps to drive out competition. Once the competition is gone or the market established, the company uses its monopoly position to increase price. Some critics question the allegation that predatory dumping is harmful by pointing out that if price is subsequently raised by the firm that does the dumping, former competitors can rejoin the market when it becomes more profitable again.

Hitachi was accused of employing predatory pricing for its EPROM (electrically programmable read-only memory) chips. A memo prepared by the company urged U.S. distributors to "quote 10 percent below competition (until) the bidding stops, when Hitachi wins." The Justice Department, after a year along investigation, dropped the probe because it found that there was insufficient evidence to prosecute.

Zenith has long accused Japanese television manufacturers of using predatory dumping. It charged in its antitrust suit that major Japanese manufacturers, through false billing and secret rebates, conspired to set low, predatory prices on TV sets in the U.S. market with the purpose of driving U.S. firms out of business in order to gain a monopoly. Both the Japanese and U.S. governments defended the Japanese firms' cooperation on the grounds of "sovereign compulsion." In other words, the defendants' cooperation was the result of a compliance with the Japanese government's export policy. After sixteen years of legal maneuvering, the Supreme Court dismissed the conspiracy theory but ordered a trial concerning the dumping charge.

Persistent dumping is the most permanent type of dumping, requiring a consistent selling at lower prices in one market than in others. This practice may be the result of a firm's recognition that markets are different in terms of overhead costs and demand characteristics. For example, a firm may assume that demand abroad is more elastic than it is at home. Based on this perception, the firm may decide to use incremental or marginal-cost pricing abroad while using full-cost pricing to cover fixed costs at home. This practice benefits foreign consumers, but it works to the disadvantage of local consumers. Japan, for example, is able to keep prices-high at home, especially for consumer electronics, because it has no foreign competition there. But it is more than willing to lower prices in the U.S market .in order to gain or maintain market share. Japanese consumers, as a result, must "Sacrifice by paying higher prices for Japanese products that are priced much lower in other markets.

The three kinds of dumping just discussed have one characteristic in common: each involves charging lower prices abroad than at home. It is possible, however, to have the opposite tactic**-reverse dumping**. In order to have such a case, the overseas demand must be less elastic, and the market will tolerate a higher price. Any dumping will thus be done in the manufacturer's home market by selling locally at a lower price.

Activity 1: Two students should give a real life case study presentation on dumping and WTO decision on it.

Legal Aspect of Dumping

Whether dumping is illegal or not depends on whether the practice is tolerated in a particular country. Switzerland has no specific antidumping laws. Most countries, however, have dumping laws that set a minimum price or a floor on prices that can be charged in the market.

Illegal dumping occurs when the price charged drops below a specified level. What are the unfair or illegal price level, and what kind of evidence is needed to substantiate a charge of dumping? The case of Melex golf carts from Poland illustrates the difficulty in determining a fair price. The success of Melex in the United States led to an accusation of dumping. The Treasury Department was unable to ascertain whether Melex's U.S. price was lower than prices at home in Poland because Poland has no golf courses and no demand for such a product. The cost of production was unsuitable for determining its fair price. Poland, as a socialist economy, does not let market forces fully dictate the costs of factors of production. For this reason, the 1974 Trade Act does not allow production costs in a communist/socialist country to be used for comparison purpose.

To determine fair costs, the Treasury began to use a small Canadian manufacturer's costs as reference prices, only to see the Canadian firm stop making golf carts. Also, Poland protested that the Canadian firm's production costs were too high and unsuitable for comparison. The Treasury's next step was to rely on reference prices of a comparable product from free-market countries. Mexico and Spain were chosen because they were considered to be similar to Poland in terms of their level of economic development. Even though Mexico and Spain do not produce golf carts, they were used anyway to determine what their production costs would be if they produced such a product. After much review and discussion, the ruling was that the "constructed" value did not differ appreciably from Melex's actual price.

The 1980 ruling did not end the matter. The American producers still wanted Melex to pay the dumping charges for the years 1979 to 1980, and the Commerce Department's 1992 review imposed a duty of $599,053.51 plus interest. Melex has continued to fight the case, which has outlasted five U.S. administrations, Poland's martial law, and the Soviet Union empire.

One item of evidence of dumping occurs when a product is sold at less than fair value. The Commerce Department, for example, made a final determination that imports of certain small-business telephone systems and subassemblies from Japan and Taiwan were being sold in America at less than fair value. Subsequently, the U.S. International Trade Commission made final determinations and found injury to industries in the United States from such imports. The Commission's injury finding led to antidumping duties being placed on imported products to offset their price advantage.

Another example of dumping evidence is a product sold at a price below its borne-market price or production cost. The United States relies on the official U.S. trigger price, which is designed to curb dumping by giving an early signal of an unacceptable import price. In the case of steel, the trigger price sets a minimum price on imported steel that is pegged to the cost of producing steel in Japan. According to the General Accounting Office, some 40 percent of all imports at one time were priced below the trigger price.

To provide relief, the Antidumping Act requires the Department of Commerce to impose duties equal to the dumping margin. The antidumping duty is based on the amount by which the foreign market value or constructed value exceeds the purchase price or an exporter's sale price.

How to Dump (Legally and Illegally)

Dumping is a widespread practice. Exporters and their importers insist on its use, when necessary,' and will find ways to conceal the practice. One can 'team from the Mitsui case. Mitsui was responsible for generating the largest dumping case and pleaded guilty to all twenty-one counts involving kickbacks and the falsifying of documents to customs officials in order to sell steel below trigger prices. Mitsui attempted to conceal its dumping activities through several means. It hid the origin of the Japanese steel products by disguising them as U.S. made (e.g., wire rope imported to Houston). It submitted false documents to conceal the true merchandise value and backdated invoices to avoid trigger prices. Furthermore, it gave its U.S. customers a rebate equal to, the difference between the nominal exchange rate and the actual exchange rate, and the calculations were made after product entry. These illegal rebates totaled, $1.3 million between 1978 and 1981. Another deceptive method involved the use of damage claims. Mitsui honored false claims that goods were damaged during shipment and granted credits of $22,676 for damaged Korean wire nails without investigating or reporting these losses to its insurance company. In spite of these ingenious methods, Mitsui was exposed and paid heavy fines for dumping and fraud.

Sears was similarly indicted for conspiring with Sanyo and Toshiba to file false customs invoices involving the-importation of Japanese TV sets between 1968 and 1975. To avoid customs penalties on low-priced Japanese sets whose prices were below Japanese market prices, Sears certified the purchase prices to be higher than what was actually paid. For two of those seven years, Sears overstated Toshiba's price by $1.66 million and Sanyo's prices by $7 million.

To prevent Japanese firms from dumping their EPROM chips in the U.S. market, the United States and Japan have established "fair market values" or minimum prices for these chips. But American chip makers asserted that the Japanese violated the trade agreement by dumping chips in Hong Kong, Taiwan, and Singapore and by selling chips to Korean users at fair market value but with rebate. The problem was that these chips could find their way to the U.S. market or that U.S. semiconductor

customers might move their manufacturing operations to these other markets to take advantage of lower chip prices.

Without doubt, dumping is a risky practice that can cause a great deal of embarrassment, in addition to the payment of large financial penalties. Thus, a preferable strategy is to use other means to legally overcome dumping laws. One method that can help avoid charges of dumping is to differentiate the exported item from the item being sold in the home market. By deliberately making the home product and its overseas version not comparable, there is no home-market price that can be used as a basis for price comparison. This may be one reason why Japanese automakers market their automobiles under new or different names in the United States. Another method used to circumvent dumping laws is to provide financing terms that can have the same effect as a price reduction.

The dumping problem can also be overcome if the production of a product, rather than its importation is carried out in the host country. This option has become necessary for Japanese manufacturers, who have no desire to lower prices in Japan because they do not have to contend with foreign competitors. The high prices at home, however, work to the disadvantage of Japanese manufacturers because it is easy to prove that they are engaged in dumping in the U.S. market.

The Strange World of Dumping

In 1974, Smith Corona Corp. claimed that rival Japanese manufacturers unfairly dumped typewriters at below-cost prices in the U.S. market. Subsequently, Smith Corona moved most of its manufacturing to Singapore and switched from being America's largest manufacturer of portable electric typewriters to being the largest U.S. importer of such typewriters. In the meantime, Brother Industries USA Inc, a wholly owned Japanese subsidiary, began assembling typewriters in Tennessee. Ironically, Brother later filed charges under U.S. trade law alleging that Smith Corona dumped its Singapore-made portable electric typewriter products in the United States by selling below costs and cutting the price from $120 per unit in early 1989 to $82.99 by late 1990. The Commerce Department's International Trade administration, seeing no proof of injury to a U.S. firm, dismissed Brother Industries (USA) Inc's complaint. The Department did not view Brother as a U.S. firm since its U.S. plant performed only the final assembly of portable electric typewriters with mostly Japanese-made components. On the other hand, the Department ruled a month earlier that Smith Corona Corp., a British-controlled company with mostly U.S. operations, was a U.S. firm. Acting on Smith Corona's complaint, the Department imposed duties of 58.3 percent on Brother's imports of portable word processors.

Case Study

Pricing for (No) Profit?

U.S. firms pioneered the semiconductor industry but soon found them under; a great deal of pressure from Japanese competitors. American firms felt- that the Japanese market was closed to them while they were undercut at home and elsewhere by Japanese firms' unfair and below the-cost prices Whatever the reason, American firms lost some $500, million over two years. Because of the Japanese firms' dumping of DRAMs (dynamic, random-access memory chips), they gained 78 percent of the U.S. market and, in the process, drove eleven of fourteen U.S. DRAM makers out of business. In the 1 990s, Micron and Texas Instruments are the only two American firms that sill manufacture DRAMs domestically; IBM Corp. primarily manufactures them for internal use.

Contending that Japan exported unemployment to the United State by dumping its chips, the United States was successful in forcing Japan to sign a five-year semiconductor trade agreement in 1986. The agreement required Japan to stop selling semiconductors at prices below cost.

The historic agreement soon turned sour. The United States accused Japanese manufacturers of continuing to dump their products elsewhere. In third countries such as Singapore, Japanese chips were 'available at low, prices, and those chips found their way to the U.S. market. In its defense, Japan explained that it could not control all but major manufacturers. Also, it could not prevent gray-market dealers and brokers who came to Japan and left with suitcases full of chips. The gray marketers' clients included American consumer-product manufacturers.

The violation of the trade agreement led the United States to impose penalties in 19.87 against Japanese products. Tariffs of 100 percent were imposed on a minimum of $135 million and up to $300 million of Japanese goods. The products singled out for sanction included all black-and-white and some color television sets, automobile tape players, blank tape, refrigerators, computers, cash registers, and communications satellites. The U.S. government claimed that there should be no major price increases because the targeted products could be obtained from non-Japanese manufacturers. In reality it was inevitable that consumers had to pay more for Japanese electronics goods. Japanese electronics companies seemed to face more hurdles than other Japanese companies. In addition to the phenomenal rise in the value of the yen, which made exports difficult, the electronics industry had other problems. Because of the dumping charge£ and subsequent agreement, the Japanese firms had to agree to export products at prices mandated by the U.S. Department of Commerce. The additional penalty duties resulting from the semiconductor violation worsened the situation even more. Initially, Japanese electronics firms did not fare well and exports dropped a record II percent in 1986. Since, then, the strong ones have become leaner and stronger.

In the early 1990s, it was South Korean firms' turn to be accused of dumping memory chips in the United States. The U.S. Department of, Commerce ruled that Korean firms were illegally selling semiconductors for a fraction of their manufacturing cost. The number one DRAM-maker in the world, Samsung Electronic Co. was found to be selling its chips at 87 percent below cost (i.e., selling a $10 chip for only $1.30). Goldstar Co., likewise, was selling DRAMs at 52 percent below cost, while Hyundai Electronics Co. had a dumping margin of 6 percent. Not surprisingly, Korean firms' aggressive pricing enabled them to capture 20 percent of the worldwide market for DRAMs. Thus, the U.S. government required them to post bonds and face duties ranging from 6 percent to 87 percent. A day after the Commerce Department's preliminary finding, prices for DRAMs surged by as much as 20 percent on the spot

market. A month earlier, the European Community also imposed a 10.1 percent duty on Korean imports.

Questions

1. Does the U.S. government's action to force up the prices of semiconductors serve a useful purpose?
2. Should semiconductors be considered products or commodities? How does the classification affect the pricing of semiconductors?
3. How should Japanese electronics companies react to quotas and duties? What should be their pricing and other strategies?

Countertrade

Counter trade constitutes an estimated 5 to 30 percent of total world trade. Counter trade greatly proliferated in the 1980s. Perhaps, the 8lhgle most important contributing factor is LDCs' decreasing ability to finance their import needs through bank loans. I Regarding Russia, its officials have estimated that 90 percent or more of the transactions having to do with "critical imports" involve reciprocal trade exchanges. Counter trade in Russia may proliferate because, with the Russian banking system in disarray, it is difficult to arrange traditional export financing (e.g., letter of credit).

Counter trade, one of the oldest forms of trade, is a government mandate to pay for goods and services with something other than cash. It is a practice, which requires a seller as a condition of sale, to commit contractually to reciprocate and undertake certain business initiatives that compensate and benefit the buyer. In short, a goods-for-goods deal is counter trade.

Unlike monetary trade, suppliers are required to take customers' products for their use or for resale. In most cases, there are multiple deals that are separate yet related, and a contract links these separable transactions. Counter trade may involve several products, and such products may move at different points in time while involving several countries. Monetary payments' may or may not be part of the deal.

Cultural Dimension 1

Price Distortion ***Price controls are a common practice in communist and socialist countries that have state planning. China is a typical example. Its price system in the final analysis causes a distortion in the operation of the market. The state deliberately keeps the price of coal and other raw materials low while pricing some consumer durables well above the true market value. In several cases production plants are trapped between artificially high prices for material inputs and artificially low prices for factory outputs. As a result the plants may choose to stop producing inexpensive, everyday items because Of low profit margins. These price distortions encourage, some plants to produce such high-priced goods as washing machines watches bicycles and sewing machines even though these goods are too costly for consumers to purchase and are stored in warehouses that are already full of this kind of merchandise. Therefore. a poorly managed factory can show a hefty profit, at least on paper, because of the distortion that exists between profit incentive and centrally planned prices.In an attempt to solve the problem. China has experimented with the free market method. Which emphasizes material incentive free enterprise market oriented prices profits and bonuses. Farmers were allowed to plant crops on private plots and sell their surplus in, a "free market" at market prices for profit. The result of this experiment was that output almost doubled. The experiment was later extended to 6.600 factories in various large cities. State enterprises have been allowed to function as independent companies in determining profit and production. Certain factories have been permitted to keep a portion of their profits for reinvestment in new capital equipment or distribution to workers. Once the quota is filled the companies can diversify into new products or market the surplus directly and managers can reward and punish workers. Realistic prices should help market excess or unpopular items as well as goods that are in short supply. Prices of unsold durables should fall whereas the prices of popular but unavailable refrigerators for example should increase.***

There are three primary reasons for counter trade: (1) counter trade provides a trade financing alternative to those countries that have international debt and liquidity problems, (2) counter trade relationships may provide LDCs and MNCs with access to new markets, and (3) counter trade fits well conceptually with the resurgence of bilateral trade agreements' between governments. The advantages of counter trade cluster around three subjects: market access, foreign exchange, and pricing. Counter trade offers several advantages. It moves inventory for both a buyer and a seller. The seller gains other benefits, too. Other than the tax advantage, the seller is able to sell the product at full price and can convert the inventory to an account receivable. The cash-tight buyer that lacks hard currency is able to use any cash received for other operating purposes.

Types of Counter trade

There are several types of counter trade, including barter, counter purchase, compensation trade, switch trading, offsets and clearing agreements.

1. **Barter-** Barter, possibly the simplest of the many types of counter trade, is a onetime direct and simultaneous exchange of products of equal value (i.e., one product for another). By removing money as a medium of exchange barter makes it possible for cash-tight countries to buy and sell. Although price must be considered in any counter trade, price is only implicit at best in the case of barter. For example, Chinese coal was exchanged for the construction of a seaport by the Dutch, and Polish coal was exchanged for concerts given by a Swedish band in Poland. In these cases. the agreement dealt with how many tons of coal was to be given by China and Poland rather than the actual monetary value of the construction project or concerts. It is estimated that about half of the U.S. corporations engage in some form of barter primarily within the local markets of the United States.

2. **Counter purchase (Parallel Barter)**- Counter purchase occurs when there are two contracts or a set of parallel cash sales agreements, each paid in cash. Unlike barter which is a single transaction with an exchange price only implied. a counter purchase involves two separate transactions-each with its own cash value. A supplier sells a facility or product at a set price and orders unrelated or non-resultant products to offset the cost to the initial buyer. Thus, the buyer pays with hard currency, whereas the supplier agrees to buy certain products within a specified period. Therefore money does not need to change hands. In effect, the practice allows the original buyer to earn back the currency. GE won a contract worth $300'million to build aircraft engines for Sweden's JAS fighters for cash only after agreeing to buy Swedish industrial products over a period of time in the same amount through a counter purchase deal. Iraq persuaded the New Zealand Meat Board to sell $200 million worth of frozen lamb for a purchase of the same value of crude oil. Brazil exports vehicles, steel, and farm products to oil-producing countries from which it buys oil in return.
3. **Compensation Trade (Buyback)**-A compensation trade requires a company' to provide machinery, factories, or technology and to buy products made from this machinery over an agreed-on period. Unlike counter purchase, which involves two unrelated products, the two contracts in a compensation trade are highly related. Under a separate agreement to the sale of plant or equipment, a supplier agrees to buy part of the plant's output for a number of years. For example, a Japanese company sold sewing machines to China and received payment in the form of 300,000 pairs 'of pajamas. Russia welcomes buyback.
4. **Switch Trading**-Switch trading involves a triangular rather than bilateral trade agreement. When goods, all or part, from the buying country are not easily usable or salable; it may be necessary to bring in a third party to dispose of the merchandise. The third party pays hard currency for the unwanted merchandise at a considerable discount. A hypothetical example could involve Italy having a credit of $4 million for Austria's hams, which Italy cannot use, A third-party company may decide to sell Italy some desired merchandise worth $3 million for a claim on the Austrian hams. The price differential or margin is accepted as being necessary to cover the costs of doing business this way. The company can 'then sell the acquired hams to Switzerland for Swiss francs, which are freely convertible to dollars.
5. **Offset-** In an offset, a foreign supplier is required to manufacture/assemble the product locally and/or purchase local components as an exchange for the right to sell its products locally. In effect, the supplier has to manufacture at a location that may not be optimal from an economic standpoint. Offsets are often found in purchases of aircraft and military equipment. One study found that more than half of the companies counter trading with the Middle East were in the defense industry and that the most common type of counter trade was offset.4 These companies felt that counter trade was a required element in order to enter these markets.
6. **Clearing Agreement-** A clearing agreement is clearing account barter with no currency transaction required. With a line of credit being established in the central banks of the two countries, the trade in this case is continuous, and the exchange of products between two governments is designed to achieve an agreed-on value or volume of trade tabulated or calculated in nonconvertible "clearing account units." For example, the former Soviet Union's rationing of hard currency limited imports and payment of copiers. Rank Xerox decided to circumvent the problem by making copiers in India for sale to the Soviets under the country's "clearing" agreement with India. The contract set forth goods, ratio of exchange, and time length for completion. Any imbalances after the end of the year were settled by credit into the next year, acceptance of unwanted goods, payment of penalty, or hard currency payment. Although nonconvertible in theory, clearing units in practice can be sold at a discount to trading specialists who use them to buy salable products.

Problems and Opportunities

Although counter trade is a common and growing practice, it has been criticized on several fronts. First, counter trade is considered by some as a form of protectionism that poses a new threat to world trade. Such countries as Sweden, Australia, Spain, Brazil, Indonesia, and much of Eastern Europe demand reciprocity in order to impose a discipline on their balance of payments. In other words, imports must be offset by exports. Indonesia links government import requirements in contracts worth more than Rp. 500 million to the export of Indonesian products, other than oil and natural gas, in an equivalent amount to the foreign-exchange value of the contract. Mexico took a hard line in 1981 against foreign automakers by ordering them to earn back hard currency *if* they wanted to stay in business with Mexico. As a result, VW de Mexico had to purchase and export Mexican coffee. Nissan Mexicana agreed to accept coffee, horsemeat, chickpeas, and honey. Brazil enacted a similar requirement and was able to extract agreements from foreign-owned automobile and truck makers to export nearly $21 billion worth *of* vehicles and other products in return for the right to import duty-free parts for their Brazilian plants. Despite this charge, there is evidence that counter trade does not necessarily restrict the overall trade volume.

Second, counter trade is alleged to be nothing but "covert dumping." To compensate any supplying partners for the nuisance of taking another-product as payment, a counter trading country frequently trades its products away at a discount. If the counter trading country discounts directly by selling its goods itself in another market instead of through a foreign firm, dumping would clearly occur. But according to an International Trade Commission study, the practice does not seem to be harmful to the United States. Counter trade activity actually results in U.S. exports always greatly exceeding the value *of* imports. Thus, it would appear that many products that U.S. firms agree to take from their customers for overseas marketing are not dumped back in the U.S. market.

Third, counter trade is alleged to increase overhead costs and ultj.n1ately the price of a product. Counter trade involves time, personnel, and expenses in selling a customer's product-often at

a discount. If another middleman is used to dispose of the product a commission must also be paid. Because *of* these expenses, a selling company has to raise- the price *of* the original order to compensate for such expenses as well as for the risk *of* taking another product in return as payment. The fact that the goods are saleable—either for other goods or, in the end, for cash somewhere else means that additional and probably unnecessary costs must be incurred. As explained by Fitzgerald, "Counter trade requirements, like any trade restrictions, increase the cost *of* doing business. These cost cannot be passed into the international market but must be borne within the country imposing the requirements." It is believed that barter transactions are responsible for reducing Russia's revenues by 500 billion rubles.

Related to this charge *of* increasing costs is the problem *of* marketing unwanted merchandise that may remain unsold? A company may have to take on the added job of marketing its customer's goods if it does not want to lose business to rivals who are willing to do so. GE lost a major sale *of* CAT scanners to Austrian hospitals a*fter* Siemens agreed to preserve 4,000 jobs by stepping up production of unrelated electronic goods within its Austrian plants. McDonnell Douglas was able to secure a contract to sell 250 planes to former Yugoslavia only after agreeing to market such Yugoslav goods as hams and other foods, textiles, leather goods, wine, *beer*, mineral water, and tours. The company had a difficult time selling the $5 million worth of hams and finally did so to its own employees and suppliers. With Regard to the Yugoslavian tours, the best the company could do was to offer the trips as incentives to employees.

Financing, essential in virtually all types of conventional transactions, becomes more complicated in the case of counter trade this is especially true when the sale of one product is contingent on the purchase of an unrelated product in return. Understandably, banks may hesitate to provide credit for such a deal because of their concern that the exporter may not be able to profitably dispose of the product given to the exporter as payment.

When a company is unable or does not want to be concerned with disposing of the product taken from its customer, it can turn to companies that act as intermediaries. The intermediaries may agree to dispose of the merchandise for a commission or they may agree to buy the goods outright. The Mediators is one such middleman organization that operates a $500 million a year business globally.

An examination of counter trade literature found that an overwhelming number of the published articles were theoretical rather than empirical. There are a few empirical studies, however, that have shed some light on the practice of counter trade. According to one model, developing countries, which impose counter trade, have these characteristics: declining foreign exchange reserves, commodity terms of trade, and balance of trade and increasing debt-service ratios. There is some evidence that these variables can help exporters identify those countries, which are likely to be counter traders.

The results of one study dispel some widely held views about counter trade. First the relationship between a country's credit rating and its propensity to counter trade is not as strong as commonly believed. Second, buyback and counter purchase are substitutes .to foreign direct investment. Third, there is a surprisingly large volume of counter trade between developing countries themselves. Fourth, each counter trade type seems to have its own separate motivation. Barter -allows exchange without the use of money and explicit prices. Barter is therefore useful in order to bypass: (1) exchange controls, (2) public or private price controls, and (3) a creditors' monitoring of imports.

Those firms that tend to benefit from counter trade are the following: (1) large firms that have extensive trade operations from large, complex products; (2) vertically integrated firms that can accommodate counter trade take backs; and (3) firms that trade with countries that have inappropriate exchange rates, rationed foreign exchange, import restrictions, and importers inexperienced in assessing technology or in export marketing. In contrast firms whose characteristics are the opposite of those just enumerated are likely to encounter significant barriers to counter trade operations and to receive few benefits.

In general, the U.S. government is opposed to government-mandated countertrade. However, recognizing that counter trade is a fact of life, the U.S. government has maintained a hands-off policy toward counter trade arrangements that do not have government intervention or those American exporters choose to pursue. It does not oppose participation by American firms in counter trade transactions when they do not have a negative impact on national security. But the U.S. policy prohibits federal agencies from promoting counter trade in their business and official contacts.

Interestingly, the U.S. government itself has published a guide on counter trade practices so that U.S. firms can take advantage of marketing opportunities in the former Soviet Union. The irony is that the Russian government, seeking hard currency earnings, now appears to prefer cash transactions and has begun to discourage counter trade transactions of marketable commodities. Still, those Russian products that do not have a ready market probably will still require some form of counter trade.

There is no question that counter trade is a cumbersome process. Yet a firm is unwise not to consider it. Much like other trade practices, counter trade presents both problems and opportunities. More often than not, problems of counter trade are more psychological rather than real obstacles. Problems can be overcome. One need only remember that in the final analysis all goods can be converted into cash.

Case Study

Countertrade: Counterproductive?

In modern times barter and its numerous derivations, which have conceptually been gathered together under the rubric "counter trade," have gained renewed stature in international trade. This has occurred despite the fact that international money and credit markets have attained unparalleled levels of sophistication.

Where readily acceptable forms of money exchange and viable credit facilities are available, markets shun cumbersome and inefficient barter-type transactions. But, international liquidity

problems and government restrictions on the operation of markets have prompted many less-developed countries (LDCs) and non market economies (NMEs), as well as industrial countries, to promote "creative" trade transactions that circumvent the normal exchange medium of modern markets.

The *shortcomings* of counter trade include the following:

1. Counter trade has a high inherent transaction cost.
2. Counter trade limits competitive markets.
3. Counter trade contributes to market distortions that lead to inappropriate economic planning.

Inefficiency In Transactions Costs

The underlying weakness of counter trade as a mechanism of trade and exchange is its inefficiency. The indivisibility of goods made barter inefficient, for example, and forced those involved with such trade to search for a better way. Barter gave way to goods/ services-for-money exchange, which permitted transactions to incorporate divisibility as well as time shifting. The opportunity for more convenient (i.e., efficient), multiparty trade became a reality.

A major factor in. the expansion of world trade during the last half of the twentieth century has been the emergence of a few widely accepted currencies, especially the U.S. dollar, as settlement currencies for international transactions. The development of international credit markets to support trade depended on the fact that transactions could be entered into without undue concern by the parties involved as to the delivery of the specific quantity and quality of goods and the timeliness of payment. A key characteristic of this type of market is that the channels of communication and exchange are well defined and relatively simple.

As a consequence of this clarity and simplicity, such markets are efficient. Specifically, the direct and indirect costs involved in the process of exchange account for a relatively small portion of the total cost of the transaction.

Such efficiency is not present in the conditional transactions that make up counter trade. The inefficiency cost must be borne by one or more of the parties involved.

Many counter trade transactions are entered into because the importing country is unable to obtain financing in the international markets and is short of hard-currency reserves. The lack of access, or limited access, to the credit markets may be due to restrictions on the country, placed as a condition for specific new lending by the International Monetary Fund (IMF) or foreign commercial banks. In this environment counter trade is sometimes viewed by an LDC government as a means of engaging in trade without the cost of entering the international finance markets.

'Whereas it is correct that counter trade may mean that the international financial markets may not have to be tapped, it is not correct to assume that there are no financing costs associated with a counter trade transaction. In fact, because of the complexity associated with carrying out a counter trade transaction, the cost is higher than if the LDC has had access to those credit markets. Moreover, counter trade may end up subverting the capital and austerity restrictions that in some cases are a part of an IMF/LDC lending agreement.

In counter trade the costs of financing are shifted. They become implicit rather than explicit. The seller may absorb this cost in the form of accepting the obligation to buy. or use or resell goods it otherwise would not accept (thus reducing its return on the transaction). Alternatively, the seller may build the transaction's finance costs into the price the buyer must pay. The finance costs are there, though hidden.

Limiting Competition

There is another implicit cost when counter trade is required by the LDC or non-market economy (NME) buyer as a condition of the transaction. Counter trade limits the potential number of sellers in the market. Not every seller firm is willing or able to engage in counter trade thus, an LDC or NME buyer that insists on counter trade as part of a trade package limits its potential for obtaining a competitive product, service, or price. The fact is that engaging in counter trade costs the LDC or NME economy more in terms of real resources than a straight commercial transaction.

Market Distortions and False Signals

Developing countries may not have well-developed international marketing facilities. As a result they often find it difficult to break into international markets with goods and services that are nontraditional for their economy.

In other cases an LDC or NME may choose to develop a new domestic industry by buying the technology and plan from abroad. Domestic demand may not be adequate for an efficient plant size. In response, they may opt for a larger, more efficient (but possibly from a world supply view, redundant) plant with the expectation of placing the marginal production on the international market.

Under such conditions counter purchase or buyback agreements may be sought by the LDC or NME to finance the importation" of plant and equipment for a new industry (as in a buyback agreement) or general imports (as in a counter purchase agreement). The LDC or NME also may be seeking a more knowledgeable partner to handle the international marketing of goods for which it does not have the expertise. .

The difficulty with this approach is that counter trade may be used to get goods onto the international market that would not "make it" under usual conditions and will not be competitive once the buyback agreement expires. Further, the industrial country firm that accepted the counter traded goods may dump them, which would be disruptive to international markets. The result may be that the LDC or NME producer may falsely interpret the signals and overestimate the real market demand for the dumped goods as being stronger than a longer-.term, unsubsidized, market can bear.

Moreover, the secondary consequences of counter trade transactions are not benign. The inefficiencies of counter trade-the false-price signals that result in the building of redundant plant and equipment-tend to promote the establishment of bureaucracies within governments and private firms that have "bought into" counter trade. In turn, these bureaucracies have a vested interest in maintaining the economic distortions that under gird the growth in counter trade.

Summing Up

Counter trade is a significant factor in modern international trade. In its different forms it is used as a marketing tool, as a competitive tool, as a tool to restrict trade alternatives, and as a tool to tie the trade of one country to another country. Counter trade in a modern world economy with highly developed goods, capital, and financial markets appears on its face to be an incongruous development. Counter trade is a costly, inefficient, and disruptive anomaly. Yet observers of international trade suggest that the volume of counter trade is growing.

Counter trade takes place in a world of imperfection where the political and economic policies of government and industry distort the relationships between and within the goods, capital, and financial markets.

Questions

1. Discuss the pros and cons of counter trade as a form of trade.
2. As a manufacturing firm located in a developed country, you are interested in taking advantage of the Eastern European markets' movement toward market-oriented economies. However, your potential customers lack hard currency and have asked you to consider counter trade. Are you willing to engage in counter trade? Why or why not?

Trade Terms

A number of terms covering the condition of the delivery are commonly used in international trade. The internationally accepted terms of trade are known as Incoterms. Every commercial transaction is based on a contract of sale, and the trade terms used in that contract have the important function of naming the exact point at which the ownership of merchandise is transferred from the seller to the buyer.The simplest type of export sale is ex-works (manufacturer's location). Under this type of contract, the seller assists the buyer in obtaining an export license, but the buyer's responsibility ends there. At the other extreme, the easiest terms of sale for the buyer are Delivered Duty Paid (named place of destination), including duty and local transportation to his or her warehouse. Under this contract, the buyer's only responsibility is to obtain an import license if one is needed and to pass the customs entry at the seller's expense. Between these two terms, there are many expenses that accrue to the goods as they move from the place of manufacture to the buyer's warehouse. Following are some of the steps involved in moving goods from a factory to a buyer's warehouse:

1. Obtaining an export license if required (in the United States, nonstrategic goods are exported under a general license that requires no specific permit).

2. Obtaining a currency permit if required.

3. Packing the goods for export.

4. Transporting the goods to the place of departure (this would normally involve transport by truck or rail to a seaport or airport).

5. Preparing a land bill of lading.

6. Completing necessary customs export papers.

7. Preparing customs or consular invoices as required by the country of destination.

8. Arranging for ocean freight and preparation.

9.Obtaining marine insurance and certificate of the policy.Who carries out these steps? It depends on the terms of the sale. In the following paragraphs, some of the major terms are defined.The following two terms are acceptable Incoterms for all modes of transportation: Ex-works. ***In this contract, the seller places goods at the disposal of the buyer at the time specified in the contract. The buyer takes delivery at the premises of the seller and bears all risks and expenses from that point on.*** Delivered Duty Paid. ***Under this contract, the seller undertakes to deliver the goods to the buyer at the place he or she names in the country of import with all costs, including duties, paid. The seller is responsible under this contract for getting the import license if one is required.The following are acceptable Incoterms for sea and inland waterway transportation only:*** *FAS (Free Alongside Ship) Named Port of Shipment* ***Under this contract, the seller must place goods alongside, or available to, the vessel or other mode of transportation and pay all charges up to that point. The seller's legal responsibility ends once he or she has obtained a clean wharfage receipt.*** *FOB (Free on Board).* ***In an FOB contract, the responsibility and liability of the seller does not end until the goods have actually been placed aboard a ship. Terms should preferably be "FOB ship (name port)." The term FOB is frequently misused in international sales. FOB means, "goods must be loaded on board, and buyer pays freight." Since freight charges generally include loading the goods, in essence, a double payment is made; the buyer pays twice.*** *CIF (Cost, Insurance, Freight) Named Port of Importations.* ***Under this contract, as in the FOB contract, the risk of loss or damage to goods is transferred to the buyer once the goods have passed the ship's rail. However, the seller has to pay the expense of transportation for the goods up to the port of destination, including the expense of insurance.*** *CFR (Cost and Freight).* ***The terminology is the same as CIF except the seller is not responsible for risk or loss at any point outside the factory.The following Incoterm is acceptable for air, rail shipments, and multinational shipments:*** *FCA (Free Carrier) Named Place.* ***Seller fulfills obligations when he or she hands over goods cleared for exports to the carrier named by the buyer at the named place or point (e.g, airport, rail siding, or seller's factory).***

LESSON 28:
TRANSFER PRICING AND OTHER PRICING APPROACHES

Transfer Pricing

Transfer pricing refers to the pricing of goods and service bought and sold by operating units or divisions of a single company. In other words, transfer pricing concerns intra--corporate exchanges-transactions between buyers and sellers that have the same corporate parent. For example, Toyota subsidiaries sell to, and buy from, each other. The same is true of other companies operating globally. As companies expand and create de-centralized operations, profit centers become an increasingly important component in the overall corporate financial picture. Appropriate intra-corporate transfer pricing systems and policies are required to ensure profitability at each level. When a company extends its operations across national boundaries, transfer pricing takes on new dimensions and complications. In determining transfer prices to subsidiaries, global companies must ad-dress a number of issues, including taxes, duties and tariffs, country profit transfer rules, conflicting objectives of joint venture partners, and government regulations.

There are three major alternative approaches to transfer pricing. The approach used will vary with the nature of the firm, products, markets, and the historical circumstances of each case. The alternatives are (1) cost-based transfer pricing, (2) market-based trans-fer pricing, and (3) negotiated prices.

1. Cost-based Transfer Pricing

   Because companies define costs differently, some companies using the cost-based ap-proach may arrive at transfer prices that reflect variable and fixed manufacturing costs only. Alternatively, transfer prices may be based-on full costs, including overhead costs from marketing, research and development (R&D), and other functional areas. The way costs are defined may have an impact on tariffs and duties on sales to affiliates and sub-sidiaries by global companies.

   Cost-plus pricing is a variation of the cost-based approach. Companies that follow the cost-plus pricing method are taking the position that profit must be shown for any product or service at every stage of movement through the corporate system. In such an instance, transfer prices may be set at a certain percentage of fixed costs, such as “110 percent of cost” While cost-plus pricing may result in a price that is completely unre-lated to competitive or demand conditions in international markets, many exporters use this approach successfully.

2. Market-based Transfer Price

   A market based transfer price is derived from the price required to be competitive in the international market The constraint on this price is cost However, as noted previously, there is a considerable degree of variation in how costs are defined. Because costs gen-erally decline with volume, a decision must be made regarding whether to price on the basis of current or planned volume levels. To use market-based transfer prices to enter a new market that is too small to support local manufacturing, third-country sourcing may be required. This enables a company to establish its name or franchise in the market without committing to a major capital investment.

3. Negotiated Transfer Prices

   A third alternative is to allow the organization’s affiliates to negotiate transfer prices among themselves. In some instances, the final transfer price may reflect costs and market prices, but this is not a requirement. The gold standard of negotiated transfer prices is known as an arm’s-length price: the price that two independent, unrelated en-tities would negotiate.

4. Tax Regulations And Transfer Prices

   Because the global corporation conducts business in a world with different corporate tax rates, there is an incentive to maximize system income in countries with the lowest tax rates and to minimize income in high-tax countries. Governments, naturally, are well aware of this situation. In recent years, many governments have tried to maximize national tax revenues by examining company returns and mandating reallocation of income and expenses.

   Although a full treatment of tax issues is beyond the scope of this book, students should understand that a basic pricing question facing global marketers is, “What can a company do in the international pricing area in the light of current tax law?” It is im-portant to note that U.S. Treasury regulations do not have the weight of law until they are upheld by the courts Global marketers must examine the regulations carefully, not only because they are the tax laws but because they guide the Internal Revenue Service (IRS) when it reviews transactions between related business organizations. In the United States, Section 482 of the tax code and the accompanying regulations are devoted to transfer pricing. The complete text of Section 482 appears in. Appendix 2 at the end of this chapter

a. Sales of Tangible and Intangible Property

   Section 482 of the U.S. Treasury regulations deals with controlled intra-company trans-fers of raw materials and finished and intermediate goods, as well as intangibles such as charges for the use of manufacturing technology. The general rule that applies to rules of tangible property is known as the arm’s-length formula, defined as the prices that would have’ been charged in independent transactions between unrelated parties under similar circumstances. Three methods-listed next in order of priority-are spelled out in the regulations for establishing an arm’s-length price. The regulations require that a company disprove the applicability of one method before utilizing a lower-priority one.

According to the comparable uncontrolled price method, uncontrolled sales (be-tween unrelated seller and buyer) are considered comparable to controlled sales (sales between related parties) if the property and circumstances involved are identical or nearly identical to those in controlled sales. Frequently, no comparable uncontrolled sale is available to use as a reference. In such instances, it may be' necessary to deter-mine an applicable resale price, that is, the price at which property purchased in a con-trolled sale is resold by the buyer in an uncontrolled sale. Using this approach, which is sometimes referred to as retail price minus, an arm's-length price can be established by reducing the applicable resale price by an amount that reflects an appropriate markup. This is the resale price method of determining transfer prices. The third and lowest pri-ority method is the cost-plus method. When the quest for an arm's-length price brings a global company to cost-plus pricing, it has come full circle to the basic transfer pric-ing methods described earlier.

Table 4 summarizes the results of recent studies comparing transfer-pricing methods by country. As shown in the table, nearly half of U.S.-based companies doing business internationally use some form of cost-based transfer pricing.

b. Competitive Pricing

Because Section 482 places so much emphasis on arm's-length price, a manager at an American company who examines the regulations might wonder whether the spirit of these regulations permits pricing decisions to be made with regard to market and com-petitive factors. Clearly, if only the arm's-length standard is applied, a company may not be able to respond to competitive factors existing in every market, domestic and global. Fortunately, the regulations provide an opening for the company that seeks to be price competitive or to aggressively price U.S.-sourced products in its international opera-tions. Many interpret the regulations to mean that it is proper for a company to reduce prices and increase marketing expenditures through a controlled affiliate to gain market share even when it would not do so in an arm's-length transaction with an independent distributor. This is because market position represents, in effect, an investment and an asset. A company would invest in such an asset only if it controlled the reseller-that is, if the reseller is a subsidiary. The regulations may also be interpreted as permitting a company to lower its transfer price for the purpose of entering a new market or meet-ing competition in an existing market either by instituting price reductions or by in-creased marketing efforts in the target markets. Companies must have and use this latitude in making price decisions if they are to achieve significant success in interna-tional markets with US sourced goods.

Table 4

Methods	United states	Canada	Japan	United kingdom
Cost based	46%	33%	41%	38%
Market price	35%	37%	37%	31%
based	14%	26%	22%	20%
Negotiated	5%	4%	0%	11%
Other	100%	100%	100%	100%

c. Importance of Section 482 Regulations

Whatever the pricing rationale, it is important that executives and managers involved in international pricing policy decisions familiarize themselves with the Section482 reg-ulations. The pricing rationale must conform with the intention of these regulations. In an effort to develop more workable transfer pricing rules, the US. Internal Revenue Ser-vice (IRS) issued regulations calling for contemporaneous documentation that supports transfer price decisions. Such documentation will require participation of management and marketing personnel in transfer pricing decisions, as opposed to the tax department. Companies should be prepared to demonstrate that their pricing methods are the result of informed choice, not oversight.

It is true that US Treasury regulations and IRS enforcement policy often seem perplexingly inscrutable. However, there is ample evidence that the government simply seeks to prevent tax avoidance and to ensure fair distribution of income from the operations of companies doing business internationally. Still, the government does not always succeed in its efforts to enforce Section 482 by reallocating income. In one recent court decision, Merck & Co. sued the U.S. government on the grounds that the IRS's al-location of 7 percent of the income from a wholly owned subsidiary to the parent com-pany was "arbitrary, capricious, and unreasonable." The IRS had argued that Merck artificially shifted income to the subsidiary by sharing costs associated with research and, development, marketing facilities, and management personnel. The court agreed with Merck and ordered the IRS to issue a tax refund.

As the Merck case demonstrates, even companies that make a conscientious effort to comply with the regulations and that document this effort may find them in tax court. Should a tax auditor raise questions, executives should be able to make a strong case for their decisions: Fortunately, consulting services are available to help managers deal with the arcane world of transfer pricing.

Transfer pricing to tax liabilities can lead to unexpected and undesired dis-tortions. A classic example is a major US. Company with a decentralized, profit-centered organizations that promoted and gave frequent and substantial salary increases to its divisional manager in Switzerland. The reason for the manager's rapid rise was his out- standing profit record. His stellar numbers were picked up by the company's performance appraisal control system, which in turn triggered the salary and promotion actions. The problem in this company was that the financial control system had not been adjusted to recognize that a Swiss tax haven profit center had been created. The man-ager's sky-high profits were simply the result of artificially low transfer pricing into the tax haven operations and artificially high transfer pricing out of the Swiss tax haven to operating subsidiaries. It took a team of outside consultants to discover the situation. In this case, the company's profit and loss records were a gross distortion of true operat-ing results. The company had to adjust its control system and use different criteria to evaluate managerial performance in tax havens.

Transfer Pricing at Hewlett-packard

Transfer pricing plays a key role in coordinating numerous and distant profit centers at Hewlett-Packard (HP), a multinational firm that gets over half of its sale from outside the United States. HP's transfer pricing objectives include (1) motivating local managers who wish to show large profits, (2) minimizing the chances of a tax audit, and (3) moving profits to low-tax jurisdictions while satisfying tax authorities of the business reasons for such moves. HP's accounting and finance manual describes the basis for transfer pricing, using either a list price minus a discount or a cost-plus method. HP typically uses cost plus 10 percent as the desired company rate of return. The U.S. Internal Revenue Service (IRS) generally advises corporations to base transfer pricing markups on a return on assets method.

HP believes, however, that such a return on assets method is more appropriate to capital-intensive and machinery-based industries; HP and other high-tech companies spend an enormous amount on R&D, which is often expensed. Thus, capital assets may be understated. Hence, HP argues that using a cost-plus method allows adequate return to R&D. Hp's tax department breaks down the profit from each product line and shows how it is allocated among R&D, manufacturing, and sales.

To avoid ongoing conflicts with the IRS over transfer pricing, however, HP has considered whether to adhere to the new IRS approach to transfer pricing, called advanced determination rulings (ADR). The ADR method suggests that companies submit proposed transfer pricing plans to it to determine whether they comply with IRS regulations rather than wait for an audit to rule on the acceptability of a formula already in use. However, HP believes that the ADR approach needs to be modified to make it more attractive. Several areas of concern exist:

1. The amount of detailed information and economic analysis required by the IRS; HP found this burden to be as great as the requirements of a tax audit.

2. The financial information disclosed might become available to competitors.

3. The information submitted would later be used by other parts of the IRS in a tax audit. HP wanted the department carrying out the ADR to be in a different jurisdiction from the one doing previous year's tax audits. Similarly, HP wanted IRS agents involved in the ADR to agree not to disclose information gained from the ADR to agents conducting an audit.

Given the importance of transfer pricing, ADR's look promising, especially because other countries such as Japan and Germany use them, and bilateral agreements are being developed. Under bilateral agreements between two countries, the results of one country's ADR investigations would be accepted in the other country.

5. Duty and Tariff Constraints

Corporate costs and profits are also affected by import duties. The higher the duty rate, the more desirable a low transfer price. The high duty creates an incentive to reduce transfer prices to minimize the customs duty. Duties in many industry sectors were substantially reduced or eliminated by the Uruguay Round of GATT negotiations. Many companies tend to downplay the influence of taxes when developing pricing policies. There are a number of reasons for this. First, some companies consider tax savings to be trivial in comparison with the earnings that can be obtained by concentrating on effective systems of motivation and corporate resource allocation. Second, management may consider any effort at systematic tax minimization to be un-ethical. Another argument is that a simple, consistent, and straightforward pricing policy minimizes the tax investigation problems that can develop if sharper pricing policies are pursued. According to this argument, the savings in executive time and the costs of outside counsel offset any additional taxes that might be paid using such an approach. Fi-nally, after analyzing the worldwide trend toward harmonization of tax rates, many chief financial officers (CFOs) have concluded that any set of policies appropriate to a would characterized by wide differentials in tax rates will soon become obsolete. They have, therefore, concentrated on developing pricing policies that are appropriate for a world that is very rapidly evolving toward relatively similar tax rates.

Thunderbird: The American Classic

Tariff structures in a country can lead to some opportunities for products. In some situations, they can even dictate taste. In Kuala Lumpur, Malaysia, Ms. Muthu, on her way to a party, stops by a premier supermarket for a favorite California wine to help ring in the New Year. She heads straight for the Thunderbird and Night Train Express, cheap forfeited apple wines often associated with skid-row drinking in the U.S. "We like the taste of it" as well as the low price, she says.

Thunderbird, which promotes itself, as "The American Classic," and Night Train Express don't have much of an image problem in Kuala Lumpur. They are prominently displayed in upscale department stores and at some of the toniest supermarkets in this affluent capital. "They sell like hot cakes," says the liquor department head. Night Train Express (label instructions: serve very cold) was such a hot seller that the store ran out of stock in the crucial days before the long New Year's holiday weekend.

The popularity of these two wines shows how a tariff system can help dictate taste. Malaysia's bureaucrats decided years ago that so-called "beverages wines"-those made from fruit other than grapes-should be taxed at a significantly lower rate than grape wines. As a result, cheap table wine, until recently, sold at more than twice the price of Thunderbird, which retails for less than $5. Night Train Express is a little more expensive. Obviously the wine market in Kuala Lumpur has little understanding of the nuances of wine and that makes price differences critical.

6. Joint Ventures

Joint ventures present an incentive to set transfer prices at higher levels than would be used in sales to wholly owned affiliates because a company's share of the joint venture earnings is less than 100 percent. Any profits that occur in the joint venture must be shared. The increasing frequency of tax authority audits is an important reason for working out an agreement that will also be acceptable to the tax authorities. The tax authorities' crite-rion of arm's-length prices is probably most appropriate for the majority of joint ventures.

To avoid potential conflict, companies with joint ventures should work out pricing agreements in advance that are

acceptable to both sides. The following are several considerations for joint venture transfer pricing:

1. The way in which transfers prices will be adjusted in response to exchange rate changes. -
2. Expected reductions in manufacturing costs arising from learning curve improve-ments and the way these will be reflected in transfer prices.
3. Shifts in the sourcing of products or components from parents to alternative sources.
4. The effects of competition on volume and overall margins.

Global Pricing Three Policy Alternatives

What pricing policy should a global company pursue? Viewed broadly, there are three alternative positions a company can take on worldwide pricing.

1. Extension / Ethnocentric

   The first can be called an extension/ethnocentric pricing policy. This policy requires that the price of an item be the same around the world and that the importer absorb freight and import duties. This approach has the advantage of extreme simplicity because no information on competitive or market conditions is required for implementation. The disadvantage of this approach is directly tied to its simplicity. Extension pricing does not respond to the competitive and market conditions of each national market and, there-fore, neither maximizes the company's profits in each national market nor globally. The box, "Pricing Reeboks in India," gives' an example of a company that is trying to main-tain its image of high quality in global markets.

2. Adaptation/Polycentric

   The second pricing policy can be termed adaptation/polycentric. This policy permits sub-sidiary or affiliate managers to establish whatever price they feel is most desirable in their circumstances. Under such an approach, there is no control or firm requirement that prices be coordinated from one country to the next. The only constraint on this approach is in setting transfer prices within the corporate system. Such an approach is sensitive to local conditions, but it may create product arbitrage opportunities in cases in which disparities in local market prices exceed the transportation and duty cost separating markets.

Pricing Reeboks In India

When Reebok, the world's number two athletic shoe company, decided to enter India in 1995, it faced several basic marketing challenges. For one thing, Reebok was creating a market from scratch. Upscale sports shoes were virtually unknown, and the most expensive sneakers available at the time cost 1,000 rupees (about $23). Reebok officials also had to select a market entry mode. The decision was made to subcontract with four local sup-pliers, one of which became a joint venture partner. Only a limited number of distribution options were available. Bata, a Canadian company with global operations, was the sole shoe retailer with national coverage. American- style sports stores were unknown in India. To reinforce Reebok's high-tech' brand image, company officials de-cided to establish their own retail infrastructure: There were two other crucial pieces of the puzzle: product and price. Should Reebok create a line of mass-market shoes specifically for India and priced at. Rs 1,000? The alternative was to offer the same designs sold in other parts of the world and price them at Rs 2,500 ($58), a figure that represented the equivalent of a month's salary for a junior civil servant.In the end, Reebok decided to offer Indian consumer about 60 models chosen from the company's global offerings. The decision was based in part on a desire to sustain Reebok's brand image of high quality. Management realized that the decision would limit the size of the market. Despite estimates that India's "middle class" was comprised of 300 million people, the number who could afford premium-priced products was estimated to be about 30 million. Reebok's least expensive shoes were priced at about Rs 2,000 per pair; for about the same amount of money, a farmer could buy a dairy cow or a homeowner could buy a new refrigerator. Nevertheless, customer response was very favorable, especially among middle-class Youth .As Muktesh Pant, Reebok regional manager, noted, "For Rs 2,000 to Rs 3,000, people feel they can really make a statement. It's cheaper than buying a new watch, for instance: if you want to make a splash at a party. And though our higher-priced shoes put us ill competition with things like refrigerators and cows, the upside is that we're new being treated as a prestigious brand.Reebok was also pleased to discover that demand was strong outside of key metropolitan markets such as Delhi, Mumbai, and Chennai. The cost of living is lower in small towns, so consumers have more disposable income to spend. In addition, inhabitants of rural areas have had less opportunity to travel abroad and therefore have not had the opportunity to shop for trendy brands elsewhere. Reebok now has about 100 branded franchise stores that sell about 300,000 pairs of athletic shoes in India each year. The company exports twice that number of Indian-made shoes to Europe and the United States. As Pant observed, "At first we Were embarrassed about our pricing. But it has ended up serving us well

When such a condition exists, there is an opportunity for the enterprising business manager to take advantage of these price disparities by buying in the lower-price market and selling in the higher-price market There is also the problem that under such a policy, valuable knowledge and experience within the corporate system concerning effective pric-ing strategies are not applied to each local pricing decision. The strategies are not applied because the local managers are free to price in the way they feel is most

desirable, and they may not be fully informed about company experience when they make their decision.

Letting each country unit make price decisions carries another disadvantage: It may send a signal to the rest of the world that is contrary to company interests. For example, drug companies must be extremely careful when setting prices for drugs sold to agen-cies in different countries. They are dealing with monopoly buyers in many countries, and these buyers have the resources and motivation to negotiate the lowest possible price. Without headquarters control, a small country might decide for various reasons to sell a drug at a low price that would be extremely disadvantageous and unwise for the company in the rest of the world. In the chemical industry, a price move anywhere in the world is known instantly all over the world. It is, therefore, important for pricing to be under the control of the headquarters organization.

3. Invention/Geocentric

   The third approach to international pricing can be termed invention/geocentric. Using this approach, a company

neither fixes a single price worldwide nor remains aloof from sub-sidiary pricing decisions but instead strikes an intermediate position. A company pursu-ing this approach works on the assumption that there are unique local market factors that should be recognized in arriving at a pricing decision. These factors include local costs, income levels, competition, and the local marketing strategy. Local costs plus a return on invested capital and personnel fix the price floor for the long term. However, for the short term, a company might decide to pursue a market penetration objective and price at less than the cost-plus return figure using export sourcing to establish a market An-other short-term objective might be to estimate the size of a market at a price that would be profitable given local sourcing and a certain scale of output Instead of building facil-ities, the target market might first be supplied from existing higher-cost external supply sources. If the price and product are accepted by the market the company can then build a local manufacturing facility to further develop the identified market opportunity in a profitable way. If the market opportunity does not materialize, the company can exper-iment with the product at other prices because it is not committed to a fixed sales volume by existing local manufacturing facilities.

Selecting a price that recognizes local competition is essential. Many international market efforts have floundered on this point. A major U.S. appliance manufacturer in-troduced its line of household appliances in Germany and, using U.S. sourcing, set price by simply marking up every item in its line by 28.5 percent. The result of this pricing method was a line that contained a mixture of under priced and overpriced products. The overpriced products did not sell because better values were offered by local companies the under priced products sold very well, but they would have yielded greater profits at higher prices. What was needed was product line pricing, which took lower than normal margins in some products and higher margins in others to maximize the profitability of the full line.

For consumer products, local income levels are critical in the pricing decision. If the product is normally priced well above full manufacturing costs, the global marketer has the latitude to price below prevailing levels in low-income markets and, as a result, reduce the gross margin on the product. No business manager enjoys reducing margins; however, margins should be regarded as a guide to the ultimate objective, which is profitability. In some markets, income conditions may dictate that the maximum profitability will be ob-tained by sacrificing normal margins. The important point here is that in global market-ing there is no such thing as a normal margin.

The final factor bearing on the price decision is the local marketing strategy and mix. Price must fit the other elements of the marketing program. For example, when it is decided to pursue a pull strategy that uses mass-media advertising and intensive dis-tribution, the price selected must be consistent not only with income levels and compe-tition but also with the costs and extensive advertising programs.

In addition to these local factors, the geocentric approach recognizes that head-quarters price coordination is necessary in dealing with international accounts and product arbitrage (the purchase and sale of product in different markets to profit from price discrepancies). Finally, the geocentric approach consciously and systematically seeks to ensure that accumulated national pricing experience is leveraged and applied wherever relevant.

Of the three methods, only the geocentric approach lends itself to global competi-tive strategy. A global competitor will take into account global markets and global competitors in establishing prices. Prices will support global strategy objectives rather than the objective of maximizing performance in a single country.

4. Actual Pricing Practices

   Samli and Jacobs studied the pricing practices of US multinational firms. Based on a mail survey, they concluded that 70 percent of the firms in their sample of the top 350 of the Fortune 500 largest industrial companies and the 100 largest US multinational companies standardized their prices, whereas 30 percent used variable pricing in world markets. The survey raises two interesting questions. The first is: What are the actual pricing practices of companies operating globally? Are 70 percent of US firms approach-ing global markets with standardized prices? As Samli and Jacobs suggest, if indeed this is true, it would appear that many companies should consider reviewing the pricing poli-cies. What are the practices of non-US firms? However, results of a mail survey on a subject as sensitive and complex as pricing must always be considered suspect.

   The second question is: What should be the pricing policy of firms operating glob-ally? As we outlined earlier, there are three options: extension/ethnocentric or stan-dardized, adaptation/polycentric or localized, and invention/geocentric. Of the three, the third is clearly superior theoretically. It requires more information and integration) between headquarters and subsidiaries than either of the other two approaches, but it is clearly superior in its ability to respond to both the customer's ability to pay and competitive pricing in each national market.

Price Quotations

In quoting the price of goods for international sale, a contract may include specific elements affecting the price, such as credit, sales terms, and transportation. Parties to the transaction must be certain that the quotation settled on appropriately locates responsibility for the goods during transportation and spells out who pays transportation charges and from what point. Price quotations must also specify the currency to be used, credit terms, and the type of documentation required. Finally, the price quotation and contract should define quantity and quality. A quantity definition might be necessary because different countries use different units of measurement. In specifying a ton, for example, the contract should identify it as a metric or an English ton, and as a long or short ton. Quality specifications can also be misunderstood if not completely spelled out. Furthermore, there should be complete agreement on quality standards to be used in evaluating the product. For example,

"customary merchantable quality" may be clearly understood among U.S. customers but have a completely different interpretation in another country. The international trader must review all terms of the contract; failure to do so may have the effect of modifying prices even though such a change was not intended.

Administered Pricing

Administered pricing relates to attempts to establish prices for an entire market. Such prices may be arranged through the cooperation of competitors, through national, state, or local governments, or by international agreement. The legality of administered pricing arrangements of various kinds differs from country to country and from time to time. A country may condone price fixing for foreign markets but condemn it for the domestic market, for instance.

In general, the end goal of all administered pricing activities is to reduce the impact of price competition or eliminate it. Price fixing by business is not viewed as an acceptable practice (at least in the domestic market), but when governments enter the field of price administration, they presume to do it for the general welfare to lessen the effects of "destructive" competition.

The point when competition becomes destructive depends largely on the country in question. To the Japanese, excessive competition is any competition in the home market that disturbs the existing balance of trade or gives rise to market disruptions. Few countries apply more rigorous standards in judging competition as excessive than Japan, but no country favors or permits totally free competition. Economists, the traditional champions of pure competition, acknowledge that perfect competition is unlikely and agree that some form of workable competition must be developed.

The pervasiveness of price-fixing attempts in business is reflected by the diversity of the language of administered prices; pricing arrangements are known as agreements, arrangements, combines, conspiracies, cartels, communities of profit, profit pools, licensing, trade associations, price leadership, customary pricing, or informal interfirm agreements. The arrangements themselves vary from the completely informal, with no spoken or acknowledged agreement, to highly formalized and structured arrangements. Any type of price-fixing arrangement can be adapted to international business, but of all the forms mentioned, cartels are the most directly associated with international marketing.

Cartels

A cartel exists when various companies producing similar products or services work together to control markets for the types of goods and services they produce. The cartel association may use formal agreements to set prices, establish levels of production and sales for the participating companies, allocate market territories, and even redistribute profits. In some instances, the cartel organization itself takes over the entire selling function, sells the goods of all the producers and distribute the profits.

The economic role of cartels is highly debatable, but their proponents argue that they eliminate cutthroat competition and "rationalize" business, permitting greater technical progress and lower prices to consumers. However, in the view of most experts, it is doubtful that the consumer benefits very often from cartels.

The Organization of Petroleum Exporting Countries (OPEC) is probably the best-known international outlet. Its power in controlling the price of oil resulted from the percentage of oil production it controlled. In the early 1970s, when OPEC members provided the industrial world with 67 percent of its oil, OPEC was able to quadruple the price of oil. The sudden rise in price from $10 or $12 barrel to $50 or more a barrel was a primary factor in throwing the world into a major recession. Non-OPEC oil-exporting countries benefited from the price increase while net importers of foreign oil suffered economic downturns. Among Third World countries, those producing oil prospered while oil importers suffered economically from the high prices.

One important aspect of cartels is their inability to maintain control for indefinite periods. Greed by a cartel member and other problems generally weaken the control of the cartel. OPEC's control began to erode as member nations began violating production quotas, users were taking effective steps for conservation, and new sources of oil production by non-OPEC members were developed.

A lesser-known cartel but one that has a direct impact on international trade is the shipping cartel that exists among the world's shipping companies. Every two weeks about 20 shipping-line managers gather for their usual meeting to set rates on tens of billions of dollars of cargo. They do not refer to themselves as a cartel but rather operate under such innocuous names as "The Trans-Atlantic Conference Agreement." Regardless of the name, they set the rates on about 70 percent of the cargo shipped between the United States and Northern Europe. Shipping between the United States and Latin America ports and between the United States and Asian ports also is affected by shipping cartels. Not all shipping lines are members of cartels, but a large number are and thus they have a definite impact upon shipping. Although legal, shipping cartels are coming under scrutiny by the U.S. Congress, and new regulations may soon be passed.

The legality of cartels at present is not defined. Domestic cartelization is illegal in the United States, and the European Community also has provisions for controlling cartels. The United States, however, does permit firms to take cartel-like actions in foreign markets although it does not sanction foreign market cartels if the results have an adverse impact on the United States economy. Archer Daniels Midland Company, the U.S. agribusiness giant, was fined $205 million for its role in fixing prices for two food additives, lysine and citric acid. German, Japanese, Swiss, and Korean firms were also involved in the cartel.

The group agreed on process to charge and then allocated the share of the world market each company would get down to the tenth of a decimal point. At the end of the year, any company that sold more than its allotted share was required to purchase in the following year the excess from a co-conspirator that had not reached its volume allocation target. Increasingly, it has become apparent that many governments, concluding they cannot ignore or destroy cartels completely, have chosen to

establish ground rules and regulatory agencies to oversee the cartel-like activities of businesses within their jurisdiction.

Government Influenced Pricing

Companies doing business in foreign countries encounter a number of different types of government price setting. To control prices, governments may establish margins, set prices and floors or ceilings, restrict price changes, compete in the market, grant subsidies, and act as a purchasing monopsony or selling monopoly. The government may also influence prices by permitting, or even encouraging, businesses to collude in setting manipulative prices.

The Japanese government traditionally has encouraged a variety of government influenced price-setting schemes. However, in a spirit of deregulation that is gradually moving through Japan, Japan's Ministry of health and Welfare will soon abolish regulations of business hours and price setting for such businesses as barbershops, beauty parlours, and laundries. Under the current practice, 17 sanitation related businesses could establish such price-setting schemes, which are exempt from the Japanese Anti-Trust Law.

Governments of producing and consuming countries seem to play an ever-increasing role in the establishment of international prices for certain basic commodities. There is, for example, an international coffee agreement, an international cocoa agreement, and an international sugar agreement. And the world price of wheat has long been at least partially determined by negotiations between national governments.

Despite the pressure of business, government, and international price agreements, most marketers still have wide latitude in their pricing decisions for most products and markets

LESSON 29: GLOBAL ADVERTISING

Global Advertising Content: The Extension Verus Adaptation Debate

Communication experts generally agree that the overall requirements of effective Communication and persuasion are fixed and do not vary from country to country. The same thing is true of the components of the communication process: The marketer or sender's message must be encoded, conveyed via the appropriate channel(s), and decoded by the customer or receiver. Communication takes place only when meaning is transferred. Four major difficulties can compromise an organization's attempt to communicate with customers in any location

1. The message may not get through to the intended recipient. This problem may be the result of an advertiser's lack of knowledge about appropriate media for reaching certain types of audiences. For example, the effectiveness of television as: a medium for reaching mass audiences will vary proportionately with the extent to which television viewing occurs with a country.
2. The message may reach the target audience but may not be understood or may even be misunderstood. This can be the result of an inadequate understanding of the target audience's level of sophistication or improper encoding.
3. The message may reach the target audience and may be understood but still may' not induce the recipient to take the action desired by the sender. This could result from alack of cultural knowledge about a target audience.
4. The effectiveness of the message can be impaired by noise. Noise in this case is an external influence such as competitive advertising, other sales personnel, and con-fusion at the receiving end, which can detract from the ultimate effectiveness of the communication.

The key question for global marketers is whether the specific advertising message and media strategy' must be changed from region to region or country-to-country because of environmental requirements. Proponents of the one world, one voice" approach to global advertising believe that the era of the global village is fast approaching and that tastes and preferences are converging worldwide. According to the standard-ization argument, because people everywhere want the same products for the same rea-sons, companies can achieve great economies of scale by unifying advertising around the globe. Advertisers who follow the localized approach are skeptical of the global village argument. Even Coca-Cola, the most global brand in the world, records radio spots in 40 languages with 140 different music backgrounds. Coca-Cola asserts at consumers still differ from country to country must be reached by advertising tailored to their respective countries. Proponents of localization point out that most blunders occur because advertisers have failed to understand and adapt to foreign cultures. Nick Brien, managing director of Leo Burnett, explains the situation this way:

As the potency of traditional media declines on a daily basis, brand building locally becomes more costly and international brand building becomes more cost effective. The challenge for advertisers and agencies is finding ads, which work in different countries and cultures. At the same time as this global tendency, there is a growing local tendency. It's becoming increasingly important to understand the requirements of both.

During the 1950s, the widespread opinion of advertising professionals was that effective international advertising required assigning responsibility for campaign preparation to a local agency. In the early 1960s, this idea of local delegation was repeatedly challenged. For example, Eric Elinder, head of a Swedish advertising agency wrote: "Why should three artists in three different countries sit drawing the same electric iron and three copy Writers write about what after all is largely the same copy for the same iron? Elinder argued that consumer differences between countries were diminishing and that he would more effectively serve a client's interest by putting top specialists to work devising a strong international campaign. The campaign would then be presented with insignificant modifications that mainly entailed translating the copy into language well suited for a particular country.

Global Campaigns For Global Products

Certain consumer products lend themselves to advertising extension. If a product appeals to the same need around the world, there is a possibility of extending the appeal to that need. The list of products "going global," once con-fined to a score of consumer and luxury goods, is growing. Global advertising is partly responsible for increased worldwide sales of disposable diapers, diamond watches, shampoos, and athletic shoes Some longtime global ad-vertisers are benefiting from fresh campaigns. Jeans mar-keter Levi Strauss & Company racked up record sales in Europe in 1991 on the strength of a campaign extended unchanged to Europeans, Latin Americans, and Australians. The basic issue is whether there is in fact a global market for the product. If the market is global, appeals can be standardized and extended. Soft drinks, Scotch whiskey, Swiss watches, and designer clothing are exam-ples of product categories whose markets are truly global. For example, Seagram's recently ran a global campaign keyed to the theme line, "There will always be a Chivas Regal" The campaign ran in 34 countries and was transited into 15 languages. In 1991, Seagram's launched a global billboard campaign to enhance the universal ap-peal for Chivas. The theory: The rich all over will sip the brand, no matter where they made their fortune.

Gillette Company took a standardized "one product/ one brand name/one strategy" global approach when it introduced the Sensor razor in 1990. The campaign slogan was "Gillette. The Best a Man Can. Get," an appeal that was expected to cross boundaries with ease. Peter Hoff-man, marketing vice president of the North Atlantic Shaving Group, noted 'in a press release: "We are blessed with a product category where we're able to market shav-ing systems across multinational boundaries as if they were one country. Gillette Sensor is the trigger for a total Gillette mega-brand strategy which will revolutionize the entire shaving market." In the Japanese market, Gillette's standardized advertising campaign differs

strikingly from -that of archrival Schick. Prior to the Sensor launch, Gillette custom-made advertising for the Japanese mar-ket; now, except that the phrase, "The best a man can get," is translated into Japanese, the ads shown in Japan are the same as those shown in the United States and the rest of the world. Schick, meanwhile, uses Japanese actors in its ads.

The standardized-versus-localized debate picked up tremendous momentum after the publication in 1983 of Professor Ted Levitt's Harvard Business Review article titled "The Globalization of Markets," noted in earlier chapters. In contrast to the view expounded by Levitt and Liotard Vogt, some recent scholarly research suggests that the trend is toward the increased use of-Localized international advertising. Kanso reached that conclusion in a study surveying two different groups of advertising managers -those taking localized approaches to overseas advertising and those taking standardized approaches. Another finding was that managers who are attuned to cultural issues tended to prefer the localized approach, whereas managers less sensitive to cultural issues preferred a standardized approach. Bruce Steinberg, ad sales director for MTV Europe, has discovered that the people responsible for executing global campaigns locally can exhibit strong resistance to a global campaign. Steinberg sometimes has to visit as many as 20 marketing directors from the same company to get approval for a pan European MTV ad.

As Kanso correctly notes, the controversy over advertising approaches will proba-bly continue for years to come. Localized and standardized advertising both have their place and both will continue to be used Kanso's conclusion: What is needed for suc-cessful international advertising is a global commitment to local vision. In the final analysis, the decision of whether to use a global or localized campaign depends on recog-nition by managers of the trade-offs involved. On the one hand, a global campaign will result in the substantial benefits of cost savings, increased control, and the potential cre-ative leverage of a global appeal. On the other hand, localized campaigns have the advantage of appeals that focus on the most important attributes of a product in each nation or culture. The question of when to use each approach depends on the product involved and a company's objectives in a particular market.

In Japan, for example, PepsiCo has achieved great success with a local campaign fea-turing "Pepsiman," a superhero action figure. Prior to 1996, the ads shown in Japan were the same global spots used throughout the rest of the world. However, in Japan's $24 billion soft-drink market, Pepsi trailed far behind Coca-Cola; Pepsi had a mere 3 per-cent market share compared with Coke's 30 percent share. The Pepsiman character was designed by local Japanese talent, but Industrial Light & Magic, the special-effects house owned by Star Wars creator George Lucas, was retained to give the TV spots a U.S.-style, high-tech edge. By breaking with its usual strategy of running global ads and increasing the ad budget by 50 percent over 1995, Pepsi's 1996 sales in Japan rose by 14 percent.

McDonald's advertising has also enjoyed a surge of popularity in Japan, but for the opposite reason: McDonald's is including Japan in its global approach that invites consumers to associate the restaurant with family members interacting in various situations. Starting in 1996, McDonald's campaign in Japan depicted various aspects of fatherhood. One spot showed a father and son bicycling home with burgers and fries; another showed a father driving a vanful of boisterous kids to McDonald's for milkshakes. The ads come at a time when many Japanese "salary-men" are reassessing the balance between work and family life. The campaign illustrates the use of localized global advertising; Japanese actors are used in the spots and local musicians composed music reminiscent of Japan-ese prime time TV shows.

Activity 1: Two groups of students should give presentation on comparison of two brands and their advertising campaigns in India and abroad.

Selecting An Advertising Agency

Another global advertising issue companies face is whether to create ads in, house, use an outside agency, or combine both strategies. For example, Chanel, Benetton, and Diesel rely on in-house marketing and advertising staffs for creative; Coca-Cola has its own agency, Edge Creative, but also uses the services of outside agencies such as Leo Burnett. When one or more outside agencies are used, they can serve product accounts on a multi-country or even global basis. It is possible to select a local agency in each na-tional market or an agency with both domestic and overseas offices. In addition to Coca-Cola, Levi Strauss and Polaroid use local agencies. Today, however, there is a growing tendency for Western clients to designate global agencies for product accounts in order to support the integration of the marketing and advertising functions; Japan- based companies are less inclined to use this approach. Agencies are aware of this trend and are themselves pursuing international acquisitions and joint ventures to extend their geographic reach and their ability to serve clients on a global account basis. The 20 largest global advertising organizations ranked by 1998 gross income are shown in Table below

The organizations identified in Table may include one or more core advertis-ing agencies as well as units specializing in direct marketing, public relations, or research. The family tree of Adidas AG's advertising agency reflects the structure that is typical of agency ownership today: Leagas is owned by Abbott Mead Vickers/BBDO, which in turn is a unit of BBDO Worldwide, whose parent is the Omnicom Group. Als9 interesting to note is that the only three agencies to show declines were Japanese and that the declines were greater than 10 percent, the direct result of the Asian "economic crisis. Total gross income in Japan fell 2.2 percent, 33.1 percent in Thailand, 33.9 percent in Malaysia, 39.1 percent in South Korea, and 68.1 percent in Indonesia.

In selecting an advertising agency, the following issues should be considered:

- ***Company organization.*** Companies that are decentralized may want to leave the choice to the local subsidiary.
- ***National responsiveness.*** Is the global agency familiar with local culture and buying habits in a particular country, or should a local selection be made? .

- ***Area coverage***. Does the candidate agency cover all relevant markets?
- ***Buyer perception***. What kind of brand age does the company want to project? If the product needs a strong local identification, it would be best to select a national agency.

It should be noted that advertising agencies in other countries might differ in their structure and strategies. In Japan, the advertising is much more concentrated than in the United States. There are two super agencies, Hakuhodo and Dentsu, while global agencies

Rank			Worldwide Gross Income	
1998	Ad Organization	Headquarters	1998	% Change
1	Omnicom Group	New York	$4,812.	12.0
2	Intrpublic Group of Coso	New York	0	13.1
3	WPP Group	London	4,304.5	14.9
4	Dentsu	Tokyo	4,156.8	-10.2
5	Young & Rubicam	New York	1,786.0	10.8
6	Havas Advertising	Paris	1,659:9	9.7
7	True North Communications	Chicago	1,297.9	3.1
8	Grey Advertising	New York	1,242.3	8.5
9	Leo Burnett Cp.	Chicago	1,240.4	8.2
10	Publicis	New York	949.8	28.8
11	Snyder Communications	Bethesda, MD	930.0	29.1
12	MacManus Group	New York	904.2	2.0
13	Hakuhodo	Tokyo	859.2	-13.4
14	Saatchi & Saatchi	New York	734.8	7.5
15	Cordiant Communications Group	London	682.1	1.0
16	TMP Worldwide	New York	603.2	13.7
17	Asatsu-DK	Tokyo	347.4	-12.5
18	Carlson Marketing Group	Plymouth, MN	343.4	15.2
19	USWeb/CKS	Santa Clara	326.8	100.0
20	HA-Lo	Niles, IL	228.6	37.4
			224.0	

only account for approximately 6 percent of billings. The Japanese place much more em-phasis on media and it is not unusual for an agency to represent direct competitors.

Advertising Appeals and Product Characteristics

Advertising must communicate appeals that are relevant and effective in the target market environment. Because products are frequently at different stages in their life cycle in various national markets, and because of the basic cultural, social, and economic differences that exist in markets, the most effective appeal for a product may vary from market to market. Yet, global marketers should attempt to identify situations in which

1. Potential cost reductions exist because of the presence of economies of scale;
2. Bar-riers to standardization such as cultural differences are not, significant; and
3. Products satisfy similar functional and emotional needs across different cultures.

Green, Cunningham, and Cunningham conducted a cross-cultural study to deter-mine the extent to which consumers of different nationalities use the same criteria to evaluate two common consumer products: soft drinks and toothpaste. Their subjects were college students from the United States, France, India, and Brazil. Compared to France and India, the U.S. sample placed more emphasis on the subjective and less on functional product attributes, and the Brazilian sample appeared even more concerned with the subjective attributes than did the U.S. sample. The authors concluded that advertising messages should not use the same appeal for these countries if the Advertiser is con-cerned with communicating the most important attributes of its product in each market.

Effective advertising may also require developing different creative executions or presentations using a product's basic appeal or selling proposition as a point of depar-ture. In other words, there can be differences between what one says and how one says it. If the creative execution in one key market is closely tied to a particular cultural at-tribute, the execution may have to be adapted to other markets. For example; the sell-ing proposition for many products and services is fun or pleasure, and the creative presentation should show people having fun as appropriate for a country or culture.

According to one recent survey, experienced advertising executives indicated that strong selling propositions can be transferred more than 50 percent of the time. An ex-ample of a selling proposal that transfers well is top quality. The promise of low price or of value for money regularly surmounts national barriers. In the same survey, most ex-ecutives indicated that they did not believe that creative presentations traveled well. The obstacles are cultural barriers, communications barriers, legislative problems (for ex-ample, children Cannot be used in France to merchandise products), competitive posi-tions (the advertising strategy for a leading brand or product is normally quite different from that for a minor brand), and execution problems.

Food is the product category most likely to exhibit cultural sensitivity. Thus, mar-keters of food and food products must be alert to the need to localize their advertising. A good example of this is the recent effort by H. J. Heinz Company to develop the in-ternational market for ketchup. Heinz's strategy called for adapting both the product and advertising to target country tastes. In Greece, for example, ads show ketchup pouring over pasta, eggs, and cuts of meat. In Japan, they instruct Japanese homemakers on using ketchup as an ingredient in Western-style food such as omelets, sausages, and pasta. Barry Tilley, London-based general manager of Heinz's Western Hemisphere trading division, says Heinz uses focus groups to determine what foreign consumers want in the way of taste and image. Americans like a relatively sweet ketchup, but Europeans prefer a spicier, more piquant variety. Significantly, Heinz's foreign marketing efforts are most successful when the company quickly adapts to local cultural preferences. In Sweden, the "made-in-America theme is so muted in Heinz's ads that "Swedes don't realize Heinz is American. They think it is German because of the name," says Mr. Tilley. In contrast to this, American themes still work well in Germany. Kraft and Heinz are trying to outdo each other with ads featuring strong American images. In Heinz's latest TV ad, Ameri-can football players in a restaurant become very angry when the 12 steaks they ordered arrive without ketchup. The ad ends happily, of course, with plenty of Heinz ketchup to go around.

In general, the fewer the number of purchasers of a product, the less important advertising is as an element of the promotion mix. For example, successful marketing of expensive and

technically complex industrial products generally requires a highly trained direct sales force. The, more sophisticated and technically complicated an industrial product is, the more necessary this becomes. For such products, there is no point in letting national agencies duplicate each other's efforts. Advertising of industrial products computers and telecommunications equipment, for example does play an important role in setting the stage for the work of the sales force. A good advertising campaign can make it significantly easier for a salesperson to get in the door and, once inside, make the sale.

Creating Advertising

Art Direction

Art direction is concerned with visual presentation-the body language of print and broadcast advertising. Some forms of visual presentation are universally understood. Revlon, for example, has used a French producer to develop television commercials in English and Spanish for use in 'international markets. These commercials, which are filmed in, Parisian settings, communicate the universal appeals and specific advantages of Revlon products. By producing its ads in France, Revlon obtains effective television commercials at a much lower price than it would have to pay for similar-length com-mercials produced in the United States. PepsiCo has used four basic commercials to communicate its advertising themes. The basic setting of young people having fun at a party or on a beach has been adapted to reflect the general physical environment and racial characteristics of North America, South America, Europe, Africa, and Asia. The music in these commercials has also been adapted to suit regional tastes, ranging from rock and roll in North America to boss a nova in Latin America to high life in Africa.

The international advertiser must make sure that visual executions are not inappro-priately extended into markets. Benetton recently encountered a problem with its "United Colors of Benetton" campaign. The campaign appeared in countries, pri-marily in print and on billboards. The art direction focused on striking, provocative inter-racial juxtapositions-a white hand and a black hand handcuffed together, for example. Another version of the campaign, depicting a black woman nursing a white baby, won ad-vertising awards in France and Italy. However because the image evoked the history of slavery in America that particular creative execution was not used in the U.S. market.

Copy

Translating copy or the written text of an advertisement, has been the subject of great debate in advertising circles. Copy should be relatively short and avoid slang or idioms. This is because other languages invariably take more space to convey the same message; thus, the increased use of pictures and illustrations. More and more European and Japanese advertisements are purely visual, conveying a specific message and invoking the company name. Low literacy rates in many countries seriously compromise the use of print as a communications device and require greater creativity in the use of audio-oriented media.

It is important to recognize overlap in the use of languages in many areas of the world (e.g., the EU, Latin America, and North America). Capitalizing on this, global ad-vertisers can realize economies of scale in producing advertising copy with the same lan-guage and message for these markets. Of course, the success of this approach will depend in part on avoiding unintended ambiguity in the ad copy. On the other hand, in some situations ad copy must be translated into the local language. Advertising slogans often present the most difficult translation problems. The challenge of encoding and doing slogans and tag lines in different national and cultural contexts can lead to hilarious errors. For example, Kentucky Fried Chicken's "Finger-licking' good" came out in Chi-nese as "eat your fingers off'; the Asian version of Pepsi's "Come Alive" copy line was rendered as a call to bring ancestors back from the grave.

Advertising executives may elect to prepare new copy for a foreign market in the language of the target country, or to translate the original copy into the target language. A third option is to leave some (or all) copy elements in the original (home-country) language. In choosing from among these alternatives, the advertiser must consider whether a translated message can be received and comprehended by the intended foreign audi-ence. Anyone with a knowledge of foreign languages realizes that the ability to think in that language facilitates accurate communication: One must understand the connota-tions of words, phrases, and sentence structures, as well as their translated meaning, in order to be confident that a message will be understood correctly-after it is received. The same principle applies to advertising, perhaps to an even greater degree. A copywriter who can think in the target language and understands the consumers in the target coun-try will be able to create the most effective appeals, organize the ideas, and craft the specific language, especially if colloquialisms, idioms, and humor are involved. For example, in southern China, McDonald's is careful not to advertise prices with multiple occurrences of the number four. The reason is simple: In Cantonese, the pronunciation of the word four is similar to that of the word death. In its efforts to develop a global brand image, Citicorp discovered that translations of its slogan "City Never Sleeps" conveyed the meaning that Citibank had a sleeping disorder such as insomnia. Company execu-tives decided to retain the slogan but use English throughout the world.

When formulating television and print advertising for use in high-income countries such as the United States, Canada, Japan, and the EU, the advertiser must recognize major style and content differences. Ads that strike viewers in some countries as irritating may not necessarily be perceived that way by viewers in other countries. American ads make frequent use of spokespersons and direct product comparisons and use logical arguments to try to appeal to the reason of audiences. Japanese advertising is more images oriented and appeals to audience sentiment. In Japan, what is most important frequently is not what is stated explicitly but, rather, what is implied. Nike's U.S. advertising is legendary for its irreverent, "in your face" style and relies heavily on celebrity sports endorsers such as Michael Jordan. In other parts of the world, where soccer is the top sport, some Nike ads are considered to be in poor taste and its pitchmen have less relevance. Nike has re-sponded by adjusting its approach; notes Geoffrey Frost, director of global advertising, "We have to root ourselves in the passions of other countries. It's part of our growing up.

Regulations of Tobacco Advertising

China

Effective October 31. 1994, the Chinese government banned all types of tobacco advertising. With a popula-tion of 1.2 billion people and having one out of every three smokers in the world, China is considered to be a massive potential market for cigarette manufacturers at a time when Western markets are shrinking. The ban which prohibits advertising in the media and public places such as theaters and sporting events-was part of China's first Law of Advertisements. The law means that the green neon sign for R. J. Reynolds' (RJR's) Salem brand will be removed from the Shanghai airport, where freelance antismoking police are employed to collect fines from violators of the smoking ban.

Central And Eastern Europe

The recent flood of Western goods, from Mars candy bars and Winston cigarettes to Mercedes cars, has begun to cause some hard feelings in Russia. As one observer noted, hostility to Western advertising and sales goes back to the communist era, when the Soviets were afraid of being cheated in arms talks or trade agreements. Now that the Cold War is over, the animosity is manifesting itself at the consumer level. Advertising opponents are receiving help from the West: Late in 1993, TV spots advocating a ban on all types of cigarette advertising began appearing on most Russian' channels. The ads were financed by Andrew Tobias, a Time columnist and financial guru, and Smoke-free Educational Services, a U.S. antismoking group.A spokeswoman for RJR in Winston-Salem, North Carolina, said the company is simply fulfilling a need that was already there. The company was asked by the Russian government to help. fill a demand after riots over a cigarette shortage several years ago. Still, many Russians believe Western tobacco companies spend heavily on ads in their country because they know there are enormous profits to be made from Russian smok-ers. As one Russian noted, In most countries, tobacco advertising is banned. Is our health worth less than theirs? Please, President Yeltsin, put a stop to cigarette advertising."There have been efforts in other countries such as Hungary and Romania to crack down on tobacco advertising with bans or "partial bans, but the new laws tend to be so confusing and poorly enforced that marketers frequently ignore them. Nonetheless, some tobacco mar-keters have already prepared for growing restrictions on tobacco advertising by eliminating all mention of cigarettes and even the pack itself from their ads. As one example, Philip Morris's Marlboro ads are widely recog-nizable from just their red and white logo.

Australia

In June 1994, the Philip Morris Company began legal action to overturn the Australian government's ban on cigarette advertising, contending that it infringes on the company's freedom of speech. Under legislation passed in 1992, tobacco advertising and sponsorship in Australia are being phased out and will be banned entirely by 1996, except for international events such as Formula One racing. Philip Morris is trying to have the Commonwealth Tobacco Advertising Prohibition Act declared invalid. Vice president David Davies believes the act goes be-yond preventing cigarette advertising and imposes a wide array of restrictions that infringe on basic rights. Accord-ing to Davies, "The Philip Morris Australian subsidiary says the anti-tobacco laws breach the Australian Consti-tution's implied guarantee of freedom of communication, breaches the states and is beyond the powers of the fed-eral Government."

European Union

Portugal, Norway, and France have banned tobacco ad-vertising altogether. However, print ads in France and Norway offer branded products such as Camel boots and Marlboro lighters. In the United Kingdom, voluntary re-strictions have been in force since 1971; cigarette ads are barred from shop windows, TV, and movie theaters, but outside posters, billboards, and sponsorship of sporting events are allowed. In a 1997 speech, Queen Elizabeth called for a. total ban. A Union-wide tobacco ad ban pro-posal was introduced in mid-1991 with the aim of fulfill-ing single-market rules of the Maastricht Treaty on European Union. Not surprisingly, the ban has been op-posed by tobacco companies and advertising associations. The commission justified the ban, noting that various countries had or were considering restrictions on tobacco advertising and that there was a need for common rules on cross-border trade.The hotly debated directive to ban tobacco adver-tising across the European Union (EU) is losing steam and was sent back to the negotiating table. Greece, a country that has opposed the ban, officially took over the EU presidency in January 1994 and set the agenda for the ED negotiations. A big campaign to save the tobacco directive is highly unlikely. EU members are coming to the conclusion that each country should handle the ban individually rather than blindly following 'the ED direc-tive. For example, in January 1994, the Dutch prime min-ister pressed leaders at the Brussels European Council to withdraw the tobacco directive and allow countries to decide their own fates.For R. J. Reynolds International, Philip Morris In-ternational, B.A.T., and other tobacco marketers, the re-ceding threat of a pan-European ban on tobacco ads is welcome news. 1he industry spends between $600 mil-lion and $1- billion on advertising in the ED annually. An EU ban would have hurt them most in the countries where they compete with entrenched state tobacco mo-nopolies, namely France, Italy, and Spain.

Cultural Considerations

Knowledge of cultural diversity, especially the symbolism associated with cultural traits, is essential when creating advertising. Local country managers will be able to share important information, such as when to use caution in advertising creativity. Use of colors and man-woman relationships can often be stumbling blocks. For example, white in Asia is associated with death. In Japan, intimate scenes between men and woman are considered to be in bad taste; they are outlawed in Saudi Arabia. Veteran adman John O'Toole offers the following insights to global advertisers:

"Transplanted American creative people always want to photograph Euro-pean men kissing women's hands. But they seldom know that the nose must never touch the hand or that this rite is reserved solely for married women. And how do you know that the woman in the photograph is married? By the ring on her left hand, of course. Well, in Spain, Denmark, Holland, and Ger-many, Catholic women wear the wedding ring on the right hand."

When photographing a couple entering a restaurant or theater, you show the woman preceding the man, correct? No. Not in Germany and France. And this would be laughable in Japan. Having someone in a commercial hold up his hand with the back of it to you, the viewer, and the fingers moving toward him should communicate, "Come here." In Italy it means "good-bye."

Tamotsu Kishii identified seven characteristics that distinguish Japanese from American creative strategy.

1. Indirect rather than direct forms of expression are preferred in the messages. This avoidance of directness in expression is pervasive in all types of communi-cation among the Japanese, including their advertising. Many television ads do not mention what is desirable about the brand in use and let the audience judge for them.
2. There is often little relationship between ad content and the advertised product.
3. Only brief dialogue or narration is used in television commercials, with minimal explanatory content. In the Japanese culture, the more one talks, the less others will perceive him or her trustworthy or self-confident. A 30-second advertisement for young men swear shows five models in varying and seasonal attire, ending with a brief statement from the narrator: "Our life is a fashion show!"
4. Humor is used to create a bond, of mutual feelings. Rather than slapstick, humorous dramatizations involve family members, neighbors, and office colleagues.
5. Famous celebrities appear as close acquaintances or everyday people.
6. Priority is placed on company trust rather than product quality. Japanese tend to believe that if the firm is large and has a good image, the quality of its products should also be outstanding.
7. The product name is impressed on the viewer with short, 15-second commercials.

A recent survey of Japanese marketing and advertising executives identifies five pri-mary approaches to advertising copy in Japan:

Connectors (30%) Focuses on fostering personal bonds. between the brand and consumer.

Product Pusher (19%) Focuses on the product's strength. A short-term sales tactic.

Ubiquity Seeker (19%) Desire to win awards and popular acclaim through integrated marketing activities.

Cut-Through (18%) Use of celebrities, exaggerated product attributes and other memorable associations.

Entertainers (14%) Feel that advertising should be entertaining or newsworthy.

Global Media Considerations

Marketers and their advertising agencies invest great amounts of-time and money to de-velop the appropriate advertising appeals, but effective media must be se1ededto reach consumers with these advertising appeals. The creative task of developing appeals in turn should be informed by knowledge of the media channels that will be used to com-municate the appeals.

Media Decisions

Although markets are becoming increasingly similar in indus-trial countries, media sit-uations still vary to a great extent. The availability of television, newspapers, and other forms of electronic and print media varies around the world. The rapid increase of In-ternet users is also changing global advertising. This can have an impact on media deci-sions. Spending for on-line advertising by U.S. companies is expected to triple by 2004. This would place the spending ahead of advertising in the Yellow Pages and magazines and would rival advertising expenditures on radio. For example, circulation figures of newspapers on a per capita basis cover a wide range. In Japan, where readership is high, there is one newspaper in circulation for every two people. There are approximately million newspa-pers in daily circulation in the United States, a per capita ratio of ap-proximately one to four. The ratio is one paper to 10 to 20 people in Latin America and one to 200 persons in Nigeria and Sweden.

Even when media availability is high, its use as an advertising vehicle may be lim-ited. For example, in Europe, television advertising either does not exist or is very limited, as in Denmark, Sweden, and Norway. The time allowed for advertis-ing each day varies from 1minutes in Finland to 80 in Italy, with 12 minutes per hour per channel allowed in France and 20 in Switzerland, Germany, and Austria. Regulations concerning content of commercials vary, and there are waiting periods of up to two years in several coun-tries before an advertiser can obtain broadcast time. In Germany, advertising time slots are reserved and paid for one -year in advance.

In Saudi Arabia, where all advertising is subject to censorship, regulations prohibit a long list of subject matter, including the following:

- Advertisements of horoscope or fortune-telling books, publications, or magazines- are prohibited. -
- Advertisements that frighten or disturb children are to be avoided.
- Use of preludes to advertisements that appear to indicate a news item or official statement is to be avoided.
- Use of comparative advertising claims is prohibited.
- Non-censored films cannot be advertised.
- Women may appear only in those commercials that relate to family affairs, and their appearance must be in a decent manner that ensures their feminine dignity.
- Female children under 6 years of age may appear in commercials provided that their roles are limited to a childhood-like activity.
- Women should wear a long, suitable dress that fully covers their body except face and palms. Sweat suits or similar garments are not allowed.

Media Vehicles and Expenditures

As with all marketing decisions, advertisers must choose between global or local media vehicles. Global media consist primarily of cable television such as MTV, ITN, and CNN, which are rapidly expanding, and regional editions of publica-tions. An exploding new global advertising medium is the World Wide Web. Any company, organization, or indi-vidual can plant a flag on the Net, and if they are willing to create their Web site, they have established a global presence!

Table Media Spending In Japan Versus United Kingdom

	%1996	
	Japan	United Kingdom
Television	33%	36%
Newspapers	22%	38%
Magazines	7%	17%
Radio	4%	4%
Outdoor	34%	5%
	100%	100%

A key issue in advertising is that of which of the measured media-print, broadcast, transit and so forth-to utilize. Print advertising continues to be the number one adver-tising vehicle in most countries. However, spending on print media in the United States has been declining. The use of newspapers for print advertising is so varied around the world as to almost defy description. In Mexico, an advertiser that can pay for a full-page ad may get the front page, whereas in India, paper shortages may require booking an ad six months in advance.

In some countries, especially those where the electronic media are government owned, television and radio stations can broadcast only a restricted number of advertising messages. In Saudi Arabia, no commercial television advertising was allowed prior to 1986; currently, ad content and visual presentation are restricted. In such countries the proportion of advertising funds allocated to print is extremely high. In 1995 Russia national Channel banned all commercial advertising; the ban was subsequently lifted.

As ownership of television sets increases in other areas of the world, such as South-east Asia, television advertising will become more important as a communication vehicle.

Worldwide, radio continues to be a less important advertising medium than print and television. As a proportion of total measured media advertising expenditures, radio trails consider-ably behind print, television, and direct advertising. However, in countries where advertising budgets are limited, radio's enor-mous reach can provide a cost-effective means of Communicating with a large consumer market. Also, radio can be effective in countries where literacy rates are low. Radio accounted for more than 20 percent of the total measured media in only two countries, which were both less developed countries.

As countries add mass-transportation systems and build and improve their highway infrastructures, advertisers are utilizing more indoor and outdoor posters and billboards to reach the buying public. Transit advertising was recently introduced in Russia, where drab streetcars and buses have been emblazoned with the bright colors of Western brands.

Another issue facing advertising agencies is whether they will be compensated on a flat rate or on performance basis. In using the Internet, rates are either based on a flat' rate per 1,000 banner ads or by the number of people who actually click onto a site. Tracking performance in the various, markets around the world will not be easy, but major advertisers are pressing for it in the United States.

The Millennium

What will advertising look like in this millennium? The advertising agency of the future will be very different. The major differences will be the increasing use of computers for all functional areas of the agency and in all markets. Computers will be the source of more timely market research creative who live in different countries will be able to work together on the same campaign. And as a global advertising medium, the number of Internet users around the world will increase. Agencies will have alliances around the world as advertising becomes more global and as consumers simultaneously become more global and more individualistic at the same time. There will be an in- creasing integration of marketing analysis and strategy and creativity as the old divi-sions between marketing consulting and creative agencies give way to a new integration of these activities.

LESSON 30: ADVERTISING SCHOOL OF THOUGHTS

Standardized International Advertising

Standardized international advertising is the practice of advertising the same prod-uct in the same way everywhere in the world. The controversy of the standardization of global advertising centers on the appropriateness of the variation (or the lack of it) within advertising content from country to country. The technique has generated heated and lively debate for more than thirty years and has been both praised am condemned-passionately.

Doing research is difficult in this area because of the ambiguous definition a: standardization itself. Strictly speaking, a standardized advertisement is an advertise-ment that is used internationally with virtually no change in its theme, copy, or Illustration (other than translation). More recently a new breed of advocates of standardization has claimed that an advertisement with changes in its copy or illustration (e.g., a foreign model used in an overseas version) is still a standardized advertise-ment as long as the same theme is maintained. This new and broadened definite can cloud the issue even more with the added element of subjectivity: Because standardization is a matter of degree rather than an all-or-nothing phenomenon, a precise definition of standardized advertising, conceptually and operationally, would go a long way toward solving the confusion created by contradictory claims.

The issue of advertising standardization, without doubt, has far reaching impli-cations. If it is a valid strategy, international business managers should definitely take advantage of the accompanying benefits of decision simplification, cost reduction, and efficiency. On the other hand, if the premise of this approach is false, the indis-criminate application of standardized advertising in the marketplace will cause more harm than good since it can result in consumers misinterpreting the intended mes-sage. Consequently, the important function of advertising to facilitate a consumer's search process can be seriously impaired.

Three Schools of Thought

There are three schools of thought on the issue of standardized advertising: (1) stan-dardization, (2) individualization, and (3) compromise. The standardization school, so known as the universal, internationalized, common, or uniform approach, questions the traditional belief in the heterogeneity of the market and the importance of the localized approach. This school of thought assumes that better and faster communication has forged a convergence of art, literature, media availability, tastes, thoughts, re-ligious beliefs, culture, living conditions, language, and, therefore; advertising. Even when people are different, their basic physiological and psychological needs are still presumed to remain the same. Therefore, success in advertising depends on motiva-tion patterns rather than on geography. This belief is held by Elinder, Roostal, Fatt, Strouse, and Levitt, among others. British Airways's image advertisements, which were designed by Saatchi and Saatchi to trumpet the newly sleek British Airways, have been cited as an example of a successful standardized campaign.

The opposite view of the standardization school is the individualization school. also known as the non-standardization, specificity, and localization, of customization ap-proach. This conventional school of thought holds that advertisers must particularly make note of the differences among countries (e.g., culture, taste, media, discretionary income). These differences make it necessary to develop specific advertising pro-grams to achieve impact in the local markets. Authorities sharing this view include Nielsen, Lenormand, Lipson, and Lamont.

A good illustration of the importance of individualization is the Shiseido case. That company, the world's third largest cosmetic company, did poorly in its first at-tempt to penetrate the U.S. market because its advertisements featured only Japanese models.

Between these two extreme schools is the compromise school of thought. While recognizing local differences and cautioning against a wholesale or automatic use of standardization, this middle-of-the-road school holds that it may be possible, and in certain cases even desirable, to use U.S. marketing techniques under some conditions. Those with this moderate view include Dunn, Keegan, Peebles, Ryans, and Vernon.

Jain has proposed a framework for determining marketing program standard-ization. Standardization is more practical and effective under these conditions:

1. Markets are economically alike.
2. Worldwide customers, not countries, are the basis for identifying the segments to serve.
3. Countries have similar customer behavior and lifestyle.'
4. The product has cultural compatibility across countries.
5. There is a great degree of similarity in the firm's competitive position in different mar-kets.
6. The firm competes against the same adversaries with similar share positions in differ-ent markets.
7. Product is industrial or high-tech (versus consumer product).
8. Home-market positioning strategy is meaningful in the host market.
9. Countries have similar physical, political, and legal environments.
10. There are similar marketing infrastructures in the home and host countries
11. Firms possess key managers who share a common worldview.
12. Strategic consensus exists among parent-subsidiary managers.

13. Authority for setting policies and allocating resources is centralized.

Keegan provides a set of guidelines that can help in determining when it is ap-propriate to use standardized advertising. According to Keegan there are five inter-national product and promotion strategies. The choice of strategy depends on such factors as cost, need, and use conditions. A particular product can be extended (i.e., unchanged) if use conditions are uniform across- markets. Likewise, a promotional campaign can be standardized or extended if consumer need for this particular prod-uct is universal. As a company moves from the first strategy toward the last, there is a corresponding increase in cost.

The first of the five strategies is ***one product, one message, worldwide***. This strategy is feasible if both the need and use conditions are uniform across countries. Not many products satisfy these conditions, though Coke and Pepsi are often cited as examples. Other examples include diamonds, Chivas Regal scotch, and BMW automobiles. Mentioned in jest by some authorities are prod-ucts that may even be more truly global, such as Israeli Uzi submachine guns, French Exocet missiles, Russian Kalashnikov rifles, and nuclear weapons.

The second of the five strategies is ***product extension-communications adapta-tion***. A product may be extended to other countries because of uniform use condi-tions, but the promotional message very likely must be changed because needs vary. Toothpaste is used in the same manner everywhere but often for different reasons. People in the north of England and in the French-speaking areas of Canada use tooth-paste primarily for breath control, making the appeal of fluoride toothpastes rather limited. Anheuser-Busch and its partners market the same beer in many countries but customize their advertisements (based on American themes) for each national mar-ket.

Product adaptation-communications extension is the third strategy. When use conditions differ but need remains constant across markets, modification of product but not promotion is necessary. Black and Decker, although wanting to globalize its power tools, must make several product adjustments to fit certain markets. The tools everywhere look the same on the outside. But inside it is another matter, especially for markets in which the variations in electrical outlets and voltages require different circuits and cords.

Dual adaptation is the fourth strategy. Both the product and promotion have to be changed for a foreign market owing to variations in need as well as use conditions in various countries. Refrigerators made for the United States, for example, must be modified to accommodate 220-volt and 50 Hz electricity overseas. The large refrig-erator and its large freezer compart-ment do not appeal to people in countries where shopping for fresh food is done daily and where a refrigerator is used mainly for short--term storage. Additionally, with the high cost of electricity in virtually all markets outside the United States, the advertising appeal must be based on low electricity con-sumption; durability, reliability, and compactness.

Product invention is the last strategy. This strategy may have to be used if the existing product is too expensive for foreign consumers. A brand new product with different features may have to be designed in order to make it affordable. For gener-ations, Indians have called dhobis to collect dirty laundry from middle-class neigh-borhoods and wash it upon the rocks at the; river. Seeing this as an opportunity for product invention, Whirlpool Corp. has appealed to young professional Indian cou-ples who want Western-style automatic washing machines by offering what it calls the World Washer. Whirlpool's compact washers have specially designed agitators that do not tangle saris, the flowing outfits worn by a large number of Indian women. Variations of the World Washer are also manufactured and sold in Brazil and Mexico, and there are plans to export them to other Asian and Latin American countries. Except for minor variations in the controls, the three versions are nearly identical and sell for $270 to $650. The World Washer is a simple, affordable, bare-bones washer that does only eleven pounds of wash, or about one-half the capacity of the typical US. model.

Keegan's guidelines, although useful, are quite general. Thus, one must con-sider other relevant factors and treat them explicitly.

1. Feasibility and Desirability

   For an international advertising manager the decision is affected by his or her perception of whether it is "feasible" and "desirable" to implement standardization. In some cases, it may be feasible but not desirable to use a standardized advertisement; in other cases, it may be desirable but not feasible to do so. The applicability of-ad-vertising standardization is a function of these two conditions.

   The feasibility issue has to do with whether environmental restrictions or diffi-culties may prohibit the use of a standardized campaign. Three common problems are literacy (for print advertisements), local regulations; and media and agency availability.

   Because illiteracy adversely affects the comprehension of advertising copy, the text portion of an advertisement must frequently be minimized or replaced with pictures. Nevertheless, although pictures may appear to be an effective means of communicating with non-literate market segments, there are problems in pictorial perception, and certain types of pictures are likely to fail to communicate with non-Literate markets in developing countries. Therefore, international marketers should research their markets before attempting to communicate with them through pictures.

   Many countries have laws that place restrictions on the nature, content, and style of advertising messages. The Marlboro cowboy was banned in England on the grounds that cowboy worship among children might induce them to take up smoking. So the company had to use non-cow boys driving around Marlboro country in a Jeep.

   Germany's emphasis on fair competition results in the prohibition of slander against competitors. As a result, the advertiser must be wary of using comparatives (e.g., better, superior) and superlatives (e.g., best, most durable). In China, Duracell battery commercials were taken off the air because the drumming bunny's endurance claim violated the

rules that prohibit superlative claims and comparative advertising. Likewise, Budweiser's "King of Beers" slogan was found to be unacceptable.

A multinational advertiser wishing to use a standardized, advertising campaign needs to rely on an advertising agency with a worldwide network to coordinate the campaign across nations. Unfortunately, almost no agencies, regardless of size, are in a position to control local agencies overseas. In spite of this difficulty, a few multination-als (e.g., Bayer, Colgate-Palmolive) have decided to consolidate their global advertising at one agency. Ogilvy & Mather Worldwide, overseeing 272 offices, created "White on White" TV commercials to sell laundry detergent in France and was later used to re-place twenty different local campaigns in thirty countries. Similarly, IBM's Personal Systems Group awarded its entire sales-promotion business to Einson Freeman Pr0-motional Campaigns, making it the first global brand to use a single agency.

It must be noted that the use of a single agency to handle worldwide advertis-ing, while resembling the standardization approach, does not necessarily mean that the approach is purely standardization. While Colgate-Palmolive believes that there is no need to reinvent a winning formula, the directive of IBM's Personal Systems Group is "do it once, replicate, and localize."

According to one study, advertising agency executives believe that client pres-sure will result in greater use of standardization. However, they also feel that client pressure and "saving money" are among the least important reasons for standardiza-tion because it makes no sense to use: a bad or unproven campaign just to save money. Local agencies tend to think that they can produce better advertisements for their lo-cal markets and that creative impact should be the most important reason as to whether an advertisement should be standardized or localized.

Degree of feasibility varies from country to country, facilitating the implemen-tation of standardization in some countries while creating problems in others. Fur-thermore, an environment may change, permitting either more or less opportunity for standardization in the future. Therefore, feasibility is dependent on the situation and does not offer solid support for either of the two extreme schools of thought.

Two major criteria exit to judge the degree of desirability of a standardized ad-vertisement. One of these is the amount of cost savings that might be achieved. Thus, standardization is desirable only when the derived saving in production cost of this type of advertisement is significant.

Another criterion of desirability is consumer homogeneity, a major assumption of the uniform approach. If consumers were indeed homogeneous across countries, the debate would be resolved, since consumers could then be motivated in exactly the same way. Are consumers homogeneous? The proponents of each school of thought have offered real-life examples that are subjective and highly judgmental. Consumers would be better served if the collection of empirical data were based on research de-signs that eliminate the effect of confounding factors. The results of the literature re-view of management responses, consumer characteristics, and consumer responses in-dicate that there is no theoretical or empirical evidence to support the standardization perspective in its present form.

2. Researches and Empirical Evidence

   At present, the research focus has shifted toward a more limited level of horizontal homogeneity. Instead of showing that multiple countries are basically equivalent (when it is now quite clear that they are not), several researchers have moved away from the country as a unit of analysis. Instead, they focus on examining whether a subset of one national market is similar to another subset of another national market. This is what Hassan and Blackwell and Unnavaand others call a global segment.

   One recent study focused on "marketing universals" which are defined as "con-sumer behaviors within a segment and toward a particular product category that are invariant across cultures." The researchers used a sample representing thirty-eight na-tionalities and found that, while certain behaviors are likely to be universal, others are not. Therefore, marketing strategies should not be uniform across countries.

   Examinations of advertisement content have repeatedly found that, in practice, the content or message of advertisements varies significantly from one market to an-other. A study of the information content of U.S. and British TV commercials found that advertisements for high-involvement and rational products contain the most in-formation, with generally higher levels in the United States than in England. A study of automobile advertisements that appeared in business magazines in Brazil and in the United States found that Brazilian advertisements used urban themes more fre-quently, but that American advertisements used leisure themes more frequently.

Cultural Dimension 1

Is Murphy Brown French?

Although Murphy Brown is a popular show in the United States, it is not a hit in Quebec. Candice Bergen, the show's star, is as well known in the United States as the Murphy Brown character and for her spokesper-son role for the long-distance telephone carrier Sprint. Since Quebec residents prefer watching made-in-Que-bec shows to watching American networks, they were not widely exposed to Sprint's U.S. advertising cam-paign and do not perceive Bergen to be a star.

In 1993, Bergen, who speaks French, filmed two sets of advertisements for Sprint's "The Most World-wide" service. The service is called "Le Maxiphone" in French. Quebec's response to the commercials was be-low that in English-speaking Canada. Since the Murphy Brown show is dubbed in French in Quebec, Quebec consumers do not associate Candice Bergen's natural voice with that of Murphy Brown. Instead, Bergen in the commercials was, just an Englishwoman speaking French.

Cultural Dimension 2

Children Should Be Seen but Not Heard

A print advertisement for a children's nutritional sup-plement showed a boy wearing a baseball cap sideways. The boy, with his fist raised, said: "Come' on, Dad. If you can play golf five times a week, I can have Susta-gen once a day." Singapore's Prime Minister G6h Chok Tong was unhappy with the advertisement since it pro-moted American-style insolence to parents. He criti-cized attitudes and manners that undermine Asian children's traditional politeness and deference to parents and elders. Singapore has waged a campaign against "Western values" that focus on individual rights at the expense of family and society. The advertisement in question was subsequently discontinued. Ironically, the advertisement originated in 'Malaysia and was created by Asians.

Brazilian and U.S. advertisements were about equal in using work themes. Because values differ between the business culture of Brazil and that of the United States, ad-vertisers considering a standardized advertising theme should carefully research each national market.

At present, the available empirical data deal with the effectiveness of standard-ization only in an indirect manner. The available data are primarily concerned with showing how national markets differ in some ways without showing whether such differences actually influence the effectiveness of international standardization. Most of the recent studies have shifted the emphasis to national advertising practices. The evidence is rather overwhelming that certain advertising methods (e.g., use of symbols, comparative advertising, etc.) may be the norm in some countries but the ex-ception in others (see Table 15-5). The researchers are virtually unanimous in cau-tioning against the automatic use of standardization. According to them, since consumers are used to a certain advertising method, which is predominant in their country, these consumers may not be receptive to other advertising tactics.

One group of researchers has focused on corporate responses by investigating whether multinational firms prefer to standardize or localize their campaigns Ac-cording to one recent study most of the firms employed the localized approach.

TABLE 15-5 Empirical Evidence: National Advertising Approaches

Author	Media	Results
Benedetto, Tamate, and Chandran (1992)	TV	creative differences between U.S. and Japanese commercials
Cutler, Javalgi, and Erramilli (1992)	print	substantial differences across the United States, the United Kingdom, France, India, and Korea
Cutler and Javalgi and (1992)	print	country differences exceeding country similarities
Englis, Solomon, and Olofsson	music video	stylistic differences between music videos produced by U.S. and European artists
Miracle, Taylor, and Chang (1992)	TV	significant differences between U.S. and Japanese advertising
Miracle, Chang, and Taylor (1992)	TV	significant differences between U.S. and Korean advertising
Mueller (1992)	print	Japanese advertising far from being Westernized
Mueller (1991)	print and TV	messages more standardized when transferred between Western markets and Less when transferred between Western and Eastern markets
Ramaprasad and Hasegawa (1992)	TV	significant differences between U.S. and Japanese commercial
Razzouk and AI-Khatib (1993)	TV	advertising in Saudi Arabia adhering to Islamic values
Zandpour, Chang, and Catalano (1992)	TV	cross-national differences among U.S., French, and Taiwanese commercials
Zandpour et al. (1994)	TV	cultural traits affecting style of TV advertising in the United States, the United Kingdom, Mexico, France, Germany Spain, Taiwan, Korea, etc.
Cutler, Javalgi, and Lee (1995)	print	different emphasis on youthful appearance, celebrities, etc.

Likewise, another study involving 344 affiliates of u.s. advertising agencies in six major world regions found that only a small percentage of practitioners standardized their multi-country campaigns. There is also evidence that the degree of product/pro-motion adaptation is a function of company, product/industry, and export market char-acteristics.

In practice, the degree of standardization depends in part on corporate policy and strategic planning. At the same time it also depends on the importance of a par-ticular overseas market and the insistence of the head of that subsidiary. As in the case of Harley-Davidson, the corporate headquarters had always required the Japan-ese to use the U.S. print advertisements. But the president of the Japanese unit felt that desolate scenes and the tag line "one steady constant in an increasingly screwed up world" were not meaningful to Japanese buyers. He was finally able to get per-mission to run a separate advertising campaign. The advertisements juxtaposed Amer-ican images with traditional Japanese ones (e.g., American riders passing a geisha in a rickshaw). While it is difficult to determine the effect of the new campaign on sales, the waiting lists for Harley-Davidson motorcycles have grown longer.

After having seen or experienced difficulties in implementing the standardiza-tion concept, most international advertisers today have had second thoughts about standardization and

have moved toward some degree of localization. Parker Pen Co. launched an ambitious "one world, one voice" program in 1984 to sell writing in-struments all over the world. The campaign was a big disappointment, and the com-pany has once again tailored advertisements to local markets. As Procter & Gamble's international chief has pointed out, although "technology" (e.g., gel toothpaste) is global, other aspects such as taste, coloring, packaging, and advertising of the tech-nology are usually local.

3. A Decision-Making Framework

   All forms of advertising standardization should not be ignored by the marketer. This technique may be appropriate on a modest scale, though definitely not on a world-wide basis. A limited homogeneity does exist in many cultures around the world. Thus, it is a good idea to find out when and where this limited scale of homogeneity exists so that some level of standardization can be considered.

   A market should be segmented when five requirements are met: identification, accessibility, differential response, segment size, and cost/profit. Each country (or re-gion) should be considered a distinct segment if the following conditions are met:

1. The marketer can identify the country's unique demographic characteristics.
2. The country is accessible through available selective advertising media with minimum promotion waste.
3. The responses to a unique marking mix of customers in the country will be favorably different from those of other countries.
4. The country's population size is large enough to justify the specially designed market-ing campaign.
5. Incremental cost as a result of the segmentation is less than incremental profit.

Marketing Strategy 1

A Tough Grandma

Gertrude Boyle, in her 70s, is the owner of Columbia Sportswear Co., an outerwear company based in Port-land. The company sells jackets and hats to hunters and fishermen. Columbia's big break came when it in-troduced a jacket with a zip-out lining (Bugaboo parka) that could be worn separately.

In 1983, Columbia's advertising agency put Gertrude Boyle and her son, Tim, in a humorous cam-paign. She was portrayed as a tough lady who, in one commercial, forced Tim to walk through a car wash to demonstrate the jacket's waterproofing. A more re-cent commercial showed Tim accidentally push his mother off a cliff. He was able to rescue her by knot-ting together the shell and liner of his Bugaboo parka. The jacket's resilience allowed him to pull her up. The campaign has been a huge success, turning the fledg-ling company into the world's largest manufacturer of outdoor apparel. It has captured 30 percent of the, out-door apparel market in the United States and wants to penetrate overseas markets.

Gertrude was told that her campaign depicting her as a tough-talking matriarch might not be well re-ceived in Tokyo. Her Japanese distributor was con-cerned that Japanese shoppers would find her to be too abusive. But the campaign worked well in Japan and elsewhere, making Columbia's jackets best sellers. Overseas sales have tripled in two years.

Although Boyle's "Tough other" image works almost everywhere, certain points are difficult to ex-port. For instance, the "Born to Nag" tattoo she sports in some advertisements was too difficult to translate.

When all these segmentation criteria are met, market segmentation is applicable but advertising standardization is not.

There is no question that the United States is a market segment of its own be-cause of its unique characteristics and responses, media availability, market size, and great profit potential. As such, Asian marketers and European firms (including those from the United Kingdom) as a rule design advertisements specifically for the U.S. market. In contrast, these marketers are more likely to introduce in, say, Asian coun-tries (except Japan) the advertisements that they have already used in their own coun-tries. This action may be due to their belief that these other markets are either simi-lar or are not economically significant enough to justify non-standardized advertising.

Marketers should understand that standardization is not a universal tool that can be automatically used without proper consideration. It makes no sense to forge world-wide uniformity and conformity for management's convenience if consumers seek di-versity and individuality. Standardization and advertising are not synonymous. Ad-vertising is supposed to (1) inform and (2) persuade customers (3) effectively. Standardization may fail to perform any (Of all) of these three objectives. Thus, it is critical to pretest each advertisement in an international context to determine the ef-fectiveness in terms of attention getting, comprehension, and persuasion.

It is probably a mistake to use either standardization or localization on a whole-sale basis. Some degree of standardization or localization on an international or re-gional basis should be carefully considered. While a U.S. campaign may not work well in Europe, some type of pan-European advertising may be possible. But even then, some country-specific information may still be required. It is important to real-ize that a well-thought-out advertising idea tends to perform reasonably well in mul-tiple markets without a great deal of adjustment. But for a flawed or weak concept "mistakes multiply in tandem with the number of countries. As advised by Mc-Collum Spielman Worldwide's chief executive officer, "the best precept to follow is to do your homework. When entering another country, make sure that your ad cam-paign meets the basic rules and preconditions of its targeted culture. Test it! And be sure to test through a researcher who is part of that culture.

Marketing Strategy 2

Global, Maybe; Effective, Maybe Not

PepsiCo ran a teaser advertisement repeatedly to an-nounce its big event. The event was the debut of its commercial with pop singer Madonna who reportedly received $5 million for three Pepsi commercials. It would be "a record and advertising first" because the commercial would accompany the first public airing of Madonna's new song "Like a Prayer." It was a novel approach since it was customary to launch pop songs on radio. Pepsi felt that its revolutionary approach might change-the way popular tunes were released.

Pepsi's novel approach involved placing the ad-vertisement on a top-rated evening show in each coun-try, representing one of the "largest single-day media buys" in history. It purchased two minutes of prime TV time in each of forty countries from Finland to the Philippines, and the company expected 250 million peo-ple to witness the event.

The event did not work out as planned. Madonna's video music was heavily criticized as having an antireligious tone. Because of the backlash, the com-pany was forced to withdraw the advertisement later. It should be obvious that just simply running the same advertisement in numerous countries does not make it automatically effective. A bad advertisement run glob-ally will achieve great impact-negatively.

Marketing Strategy 3

Pan-European Advertising

The Whirlpool brand was virtually unknown in Europe when Whirlpool Corp. formed a joint venture with Philips Electronics NY in 1989. Although Whirlpool could brand its appliances Philips-Whirlpool until 1998, it wanted its own image. Toward this end, Whirlpool wanted an advertising idea that could overcome Europe's national barriers. Electrolux and other competitors plus some of Whirlpool's national managers as well as Whirlpool's own advertising agency were quite skeptical of the pan-European approach.

Whirlpool carefully formulated ground rules and evaluated more than twenty proposed campaigns. It decided on a campaign under the slogan "Philips and Whirlpool bring quality to life." The campaign featured a cool, bluish dream world of dryers and dishwashers and emphasized high technology and the universal de-sire for more free time. The campaign worked as polls showed that more consumers were aware of Whirlpool and that they had positive associations with the company's products. Also in 1991 at the time when industry sales of major appliances in Europe stagnated, Whirlpool instead gained market share in Europe as a whole and in Germany, France, and Britain in particu-lar. Subsequently, it dropped the Philips name in Britain, Ireland, the Netherlands, and Austria and planned to do the same in the rest of Europe long before 1998.

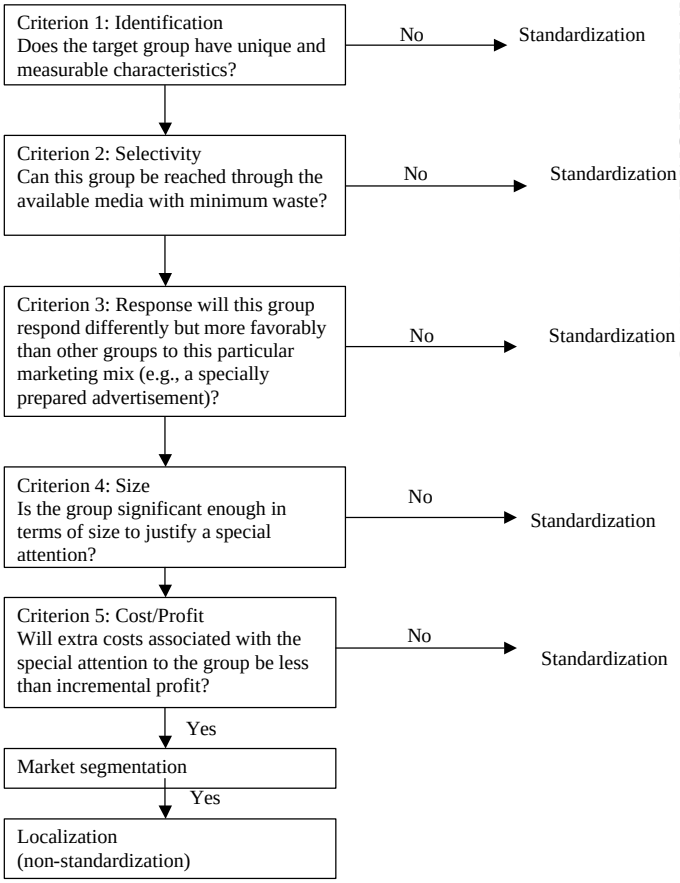


Exhibit 1 A Decision-making Framework For Advertising Standardization

4. Global Advertising: True Geocentricity

Criticisms of myopic standardization should not be interpreted as an endorsement for a polycentric approach, which requires custom-made campaigns for each individual market. Localization, practiced for its own sake, can be just as myopic. What is de-sirable is a kind of geocentricity, which is not the same thing as standardization.

Standardization is basically a campaign designed for one market but exported to other markets regardless of justification. In contrast, a geocentric campaign requires an advertisement to be designed for the worldwide audience from the outset in order to appeal to shared common denominators while allowing for some modification to suit each market. The geocentric approach combines the best of both worlds (i.e., the cost-reduction advantage of standardization and the advantages of local relevance and effective appeal of individualization). For example, Levi Strauss has switched from all localized advertisements to a pattern advertising strategy that provides the broad outlines, but not the details, of the campaign.

Devising a global advertisement is anything but easy. However, with some plan-ning, it is possible to create an advertisement, which can maintain the main theme in-ternationally while allowing necessary adaptation. A global advertisement should be adaptation-ready in the sense that necessary and desirable adaptation is planned at the time of

conception rather than after the fact. Coca-Cola Co.'s "General Assembly" campaign is a good example. The campaign shows a thousand children singing the praises of Coke. Because each McCann office had permission to edit the film to in-clude close-ups of a youngster from its market, at least twenty-one different versions of the spot existed.

The success of IBM's Subtitles campaign has demonstrated that it is possible to integrate global and local action if the markets are similar and if the product/brand is perceived similarly in those markets. Previously, the company allowed each of its core thirteen semiautonomous business entities to develop its own independent busi-ness strategy. Seeing greatness in the sum of the parts, IBM's new chairman reinte-grated these units into a cohesive whole in 1993. One advertising agency was ap-pointed in 1994 to have the prime responsibility for executing IBM's communication programs with a single voice worldwide.

The Subtitles campaign achieved global imagery through the use of the same footage in each country while employing local subtitles to translate the foreign lan-guage of the commercial. Local subtitling permits each country to retain its home cul-tural accent. The message of the campaign was that IBM—could deliver simple and yet powerful solutions to manage information anywhere and anytime for individuals and companies of all sizes. The company wanted to communicate that it was vigor-ous and innovative while maintaining the latent strengths of global scope, leadership, and reliability. Naturally, the international implementation encountered some local difficulties ranging from a limited access to television commercials to .the common practice of dubbing for foreign language films and commercials.

The campaign was run in 47 countries, and it was pretested and/or tracked in over 20 markets worldwide. Although individual markets showed some response vari-ations, the responses to the campaign were considerably consistent. Among those who were aware of the campaign, their responses showed that the company key attribute dimensions improved significantly while measures of negative attribute dimensions declined. In comparison, the other brands tracked did not show a positive movement. Thus, the Subtitles campaign has proved to be one of IBM's longest and most suc-cessful runs of the company's image campaign in recent-history.

Case Study

The Marlboro Man

Should We Modify His Image Overseas?

JEFFREY A. FADIMAN

San Jose State University

The downfall of Winston was due in part to the broadcast ban on cigarette advertising. R. J. Reynolds had a difficult time adapting Winston's appeal to the print media. In contrast, Marlboro did not have this problem and Philip Morris was able to use magazines and other print media to promote its Marlboro brand effectively. Overtaking Winston in 1976. Marlboro is now the undisputed leader in both the United States and worldwide.Marlboro's success was quite spectacular. It was responsible for the transformation of Philip Morris from a small tobacco company to the number-one cig-arette company in the United States. But it was riot an overnight success. Initially introduced in a soft box with, among other filters, a red-cork tip, Marlboro had a female image, which made the brand unpopular among men. The company decided to make a few changes, which included the neutral-cork tip and the addition of a flip-top, crush-proof box. Perhaps the most important change was the advertising theme. Marlboro's advertisements featured rugged-looking men, tattooed laborers, and cowboys "who came up the hard way." These virile men usually told something about their he-man lives and explained why they chose Marlboro. Philip Morris was extremely successful in creating a unique image that allowed a man to project himself through the cigarettes he smoked. Winston, on the other hand, could not acquire this distinct image.The Marlboro cowboy is now a legend. Most U.S. consumers (including many others in all parts of the world) are accustomed to seeing the Marlboro Man. All advertisements of the Marlboro line (full-flavored Marlboro, Marlboro Lights, Marlboro Menthol, Marl-boro Mediums, Marlboro 25s, and Marlboro 100s) have one thing in common-the cowboy. He may ride a horse or he may sit at a campfire. He may be alone or he may be with other cowboys. But he is always in the advertisements. The image is so strong that the copy needs only a few words. Yet the message is readily understood.

Questions

Consider the Marlboro advertisement and select a certain country. as your target market. Write a for-mal business memo to a chief executive officer of a small international advertising agency in which you sub-mit suggestions about

1. How you would modify the advertisement in order to make it more attractive to a selected target clien-tele (identify) within the country you have chosen.

2. Why each change you suggest would help the prod-uct image to conform more closely to their ex-pectations.Note: Rough sketches would be nice but are not nec-essary. Word-pictures can be drawn with equal skill. Simply show each change that you are making: It is the originality, imagination, and effectiveness of each sug-gestion, not your artistic skill that will count.

LESSON 31:
GLOBAL PROMOTION

The following lesson aims at making the following topics understood by the students:

1. Public Relations and Publicity
2. Personal Selling
3. Sales Promotion
4. Direct Marketing
5. Trade Shows and Exhibitions
6. Sponsorship Promotion

In the last lesson we focused on advertising, one of the forms of communication available to marketers. In this chapter, we focus on global promotion, which includes public relations (sometimes known as marketing publicity), personal selling, sales promotion direct marketing, trade shows, and sponsorship.

Public Relations and Publicity

A company's public relations (PR) effort should-foster goodwill and understanding among constituents both inside and outside the company. PR practitioners attempt to I generate favorable publicity, which, by definition, is a non-paid form of communication. (in the PR world, publicity is sometimes referred. to as earned media, whereas advertising and promotions are known unearned media.) PR personnel also playa key role in responding to unflattering media reports or controversies that arise because of company activities in different parts of the globe. In such instances, PR's job is to make sure that the company responds promptly and gets its side of the story told. The basic tools of PR include news releases, newsletters, press conferences, tours of plants and ether company facilities, articles in trade or professional journals, company publications and brochures, TV and radio talk show appearances by company personnel, special events, and homepages on Internet. As noted earlier, a company exerts complete control over the content of its advertising and pays for message placement in the media. How ever, the media typically receive far more press releases and other PR materials than they can use. Generally speaking, a company has little control over when, or if, a news story runs. The company cannot directly control the "spin," slant, or tone of the story. In addition to the examples discussed later, Table summarizes several recent instances of global publicity involving well-known firms.

Indeed, even in the field of PR itself, there are often great differences between the theory and the practice. One specific area of discourse is the notion of PR as a "two-way symmetrical model" of communication that should occur between equal entities. This mode holds that public relations efforts should be oriented toward social responsibility and problem solving and be characterized by dialogue -and harmonization of interests. As such, the symmetrical model takes PR beyond an advocacy role that benefits the organi-zation. A similar model developed in Austria known as consensus-oriented public rela-tions" supports the view that two-way symmetrical communication is more desirable and successful than asymmetrical PR. The two-way and consensus models are presumed to be especially effective in situations with a potential for conflict between differing parties. The issues pertaining to planning a hazardous waste landfill would-be one example. However, as one expert has noted, implementation of these models remains problematic.

PepsiCo made good use of integrated marketing communications when it under-took an ambitious global program to revamp the packaging outs flagship cola. To raise awareness of its new blue can, Pepsi leased a Concorde jet and painted it in the new blue color. Pepsi also garnered some "free ink" by spending $5 million to film an ad with two Russian cosmonauts holding a giant replica of the new can while orbiting the earth in the Mir space station. As Massimo d'Amore, PepsiCo's head of international market-ing, told reporters, "Space is the ultimate frontier of global marketing. The cola -wars have been fought all over the place, and it's time to take them to space." It remains to be seen whether this effort will payoff in terms of increased brand loyalty.

IBM spent about $5 million to stage a rematch of a 1996 chess game between Gary Kaparov and a computer called Deep Blue. The match, which took place in New York

Company/Brand (Home country)	Nature of Publicity
Bruno Magli (Italy)	Markets shoes, allegedly worn by O.J. Simpson on the night Nicole Simpson was murdered; widespread attention in newsreels and. print media estimated to be worth $100 million. Shoe sales increased 50 percent during trial.
Nike (United States)	Victims of Heaven's Gate suicide cult wore Nikes when they died.
Mitsubishi (Japan)	Charges of sexual harassment at a plant in Illinois received widespread media coverage.
McDonald's (United States)	Plaintiff in the longest civil trial in British history. McDonald's charged two vegetarian activists with libel after the two distributed pamphlets calling McDonald's a "multinational menace" that abused animals and workers. The defendants gained worldwide publicity for their cause.

City was hailed as one of the best publicity stunts in recent years. To build visibility and interest, IBM purchased full-page newspaper ads, sent out numerous press releases, established an Internet site, and purchased bus posters in Manhattan. The effort was -a text... book study in integrated marketing communications; the match was widely covered by the world media. As Peter Harleman of Landor Associates, a corporate-identity firm, told The Wall Street Journal, "Money almost can't buy the

advertising [IBM] is getting -out of this." John Lister, of the Lister Butler brand identity-consulting firm, agreed. "They're doing a tremendous job of leveraging the brand in this. Not only do they have the IBM name attached to virtually every news report about it, but they even branded their computer the corporate color, blue." Industry experts estimate that the match generated about $100 million in favorable earned media. IBM's Internet site provided live coverage and generated a million visits during a single match, a number that was believed to be a record for the World Wide Web at that time. The publicity was especially gratifying to IBM officials because its problems with its much-ballyhooed information system at the 1996 Olympics resulted in a great deal of negative news coverage.

Sometimes publicity is generated when a company simply goes about the business of global marketing activities. Nike and other marketers have received a great deal of negative publicity regarding alleged sweatshop conditions in factories run by subcontractors. To date, Nikes public relations team has not done an effective job of counter-acting the criticism by effectively communicating the positive economic impact Nike has had on the nations where its sneakers are manufactured. Volkswagen received a great deal of press coverage over a period of several months after its newly hired operations chief was accused of industrial espionage.

The ultimate test of an organization's understanding of the power and importance of public relations occurs during a time of environmental turbulence, especially a potential or actual crisis. When disaster strikes, a company or industry often finds itself thrust into the spotlight. A company's swift and effective handling of communications during such times can have significant implications. The best response is to be forthright and direct, reassuring the public and providing the media with accurate information.

Any company that is increasing its activities outside the home country can utilize PR personnel as boundary spanners between its stakeholders: the company and employees, unions, stock-holders, customers, the media, financial analysts, governments, and suppliers. Many companies have their own in-house PR staff. Companies may choose to engage the services of an outside PR firm. Some PR firms are associated with advertising organizations; for example, Burston - Marsteller is a PR unit of Young & Rubicam, while Fleishman-Hillard is affiliated with D' Arcy Masius Benton & Bowles. Other PR firms, including the London-based Shandwick PLC and Edelman Public Relations Worldwide and Canada's Hill & Knowlton, are independent. Several independent PR firms in the United Kingdom, Germany, Italy, Spain, Austria, and the Netherlands have joined together in a network known as Globalink. The purpose of the network is to provide members with various forms of assistance such as press contacts, event planning, literature design, and suggestions for tailoring global campaigns to local needs in a particular country or region.

The Growing Role of Public Relations In Global Marketing Communications

Public relations professionals with international responsibility must go beyond media relations and serve as more than a company mouthpiece; they are called on to simulta-neously build consensus's and understanding, create trust and harmony, articulate and in-fluence public opinion, anticipate conflicts, and resolve disputes. As companies become more involved in global marketing and the globalization of industries continues, it is im-portant that company management recognize the value of international public relations. One recent study found that, internationally; PR expenditures are growing an average of 20 percent annually. Fueled by soaring foreign investment, industry privatization, and a boom in initial public offerings (IPOs), PR expenditures in India are reported to be growing by 200 percent annually.

The number of international PR associations is growing as well. The new Austrian Public Relations Association is a case in point; many European PR trade associations are part of the Confederation Europeans des Relations Publiques and the Interna-tional Public Relations Association. Another factor fueling the growth of international PR is increased governmen-tal relations between countries. Governments and organi-zations are dealing with broad-based issues of mutual concern such as the environment and world peace. Finally, the technology-driven communication revolution that has ush-ered in the information age makes public relations a profession with truly global reach. Faxes, satellites, high-speed modems, and the Internet allow PR professionals to be in contact with media virtually anywhere in the world.

In spite of these technological advances, PR professionals must still build good per-sonal working relationships with journalists and other media representatives as well as leaders of other primary constituencies. Therefore, strong interpersonal skills are needed. One of the cost basic concepts of the practice of public relations is to know the audi-ence. For the global PR practitio-ner, this means knowing the audiences in both the home country and the host country or countries. Specific skills needed include the ability to communicate in the language of the host country and familiarity with local customs. Ob-viously a PR professional who is unable to speak the language of the host country will be unable to communicate directly with a huge portion of an essential audience. Like-wise the PR professional working outside the home country must be sensitive to non-verbal communication issues in order to maintain good working relationships with host-country nationals. Comment-ing on the complexity of the international PR profes-sional's job, one expert notes that, in general, audiences are "increasingly more unfamil-iar and more hostile, as well more organized and powerful . . . more demanding, more skeptical, and more' diverse." International PR practitioners can play an important role as "brides over the shrinking chasm of the global village.

PROCTER AND GAMBLE'S ETHICAL PHILOSOPHY

Constituent Groups	Company Responsibilities to each Group
1. Customers	To provide products with superior benefits To listen and respond to customer opinion To ensure products are safe for intended use and anticipate accidental misuse.
2. Suppliers & Channel Members	To strive for fair and open business relationships To help business partners improve performance To reject illegal or deceptive activities anywhere in the World
3. Employees	To provide a safe workplace To show concern for the well being of all employees To create opportunities for individual achievement, creativity, and personal reward.
4. Shareholders	To provide a fair annual return to the owners To build for the future to maintain growth To safeguard the environment
5. Society	To encourage employees to participate in community activities To be a good neighbor in communities in which business

How Public Relations Practices Differ Around The World

Public relations practices in specific countries can be affected by cultural traditions, social and political contexts, and economic environments. As noted earlier, the mass media and the written word are important vehicles for information dissemination in many industri-alized countries. In developing countries, however, the best way to communicate might be through the gong man, the town crier, the market square, or the chief's courts. In Ghana, dance, songs, and storytelling are important communication channels. In India, where half of the population cannot read, writing press releases will not be the most effective way to communicate.6 In Turkey, the practice of PR is thriving in spite of that country's reputation for harsh treatment of political prisoners. Although the Turkish government still asserts absolute control as it has for generations, corporate PR and journalism are allowed to flourish so that Turkish organizations can compete globally.

Even in industrialized countries, there are some important differences between PR practices. In the United States, much of the news in a small, local newspaper is placed by means of the hometown news release. In Canada, on the other hand, large metropolitan population centers have combined with Canadian economic and climatic conditions to thwart the emergence of a local press. The dearth of small newspapers means that the practice of sending out hometown news releases is almost nonexistent'? In the United States, PR is increasingly viewed as a separate management function. In Europe, that perspective has not been widely accepted; PR professionals are viewed as part of the marketing function rather than distinct and separate specialists in a company. In Europe, fewer colleges and universities offer courses and degree programs in public relations than in the United States. Also, European coursework in PR is more theoretical; in the United States, PR programs are often part of mass communication or journalism schools and there is more emphasis on practical job skills.

A company that is ethnocentric in its approach to PR will extend home-country PR activities into host countries. The rationale behind this approach is that people everywhere are motivated and persuaded in much the same manner. Obviously, this approach does not take cultural considerations into account. A company adopting a polycentric approach to '1 PR gives the host-country practitioner more leeway to incorporate local customs and practices into the PR effort. Although such an approach has the advantage of local responsiveness, the lack of global communication and coordination can lead to a PR disaster.

In 1994, computer chip maker Intel showed a poor understanding of public relations basics after a college professor discovered a technical defect in the company's flagship .Pentium chip. The professor, Thomas Nicely, contacted Intel and asked for a replacement chip, but his request was refused. Intel acknowledged that Pentium had a flaw but insisted " it would cause a computing error only once in 27,000 years. Having received no satisfaction from the semiconductor giant-Intel commands an 80 percent share of the global semiconductor market-Nicely posted his complaint on the Internet. 'Word about the Pentium flaw and Intel's response spread quickly. Intel chief executive officer (CEO) Andrew Grove added fuel to the fire when he issued an apology' via the Internet. Grove said, "No chip is ever perfect," and offered to replace defective chips 'if customers could prove they used computers to perform complicated mathematical calculations. Grove's lack of humility, coupled with revelations that the chipmaker itself had been aware of the Pentium flaw for months, only worsened the public's perception of the company. After weeks of negative publicity around the world, Intel finally announced that new Pentium chips would be available to anyone who requested them. The furor eventually died down without permanent damage to Intel's reputation.

Personal Selling

Personal selling is two-way, personal communication between a company representative and a potential customer as well as back to the company. The salesperson's job is to cor-rectly understand the buyer's needs, match those needs to the company's product(s), and then persuade the customer to buy. Effective personal selling in a salesperson's home country requires building a relationship' with the customer; global marketing presents ad-ditional challenges because the buyer and seller may come from different national or cul-tural backgrounds. It is difficult to overstate the importance of a face-to-face, personal selling effort for industrial products in global markets. In 1993 a Malaysian developer; YTL Corp, sought bids on a $700 million contract for power-generation turbines. Siemens AG of Germany and General Electric (GE) were among the bidders Datuk Francis Yeoh, managing director of YTL, requested meetings with top executives from both companies wanted to look them in the eye to see if we can do business," Yeoh said Siemens com-plied with the request; GE did not send an executive Siemens was awarded the contract.

The selling process is typically divided into several stages: prospecting, pre-approach-ing, approaching, presenting, problem solving, handling objections, closing the sale, and following up. The relative importance of each stage can vary by country or region. Expe-rienced American sales reps know that persistence is one tactic often required to win an order in the

United States; however, persistence in the United States often means tenac-ity, as in "don't take 'no' for an answer." Persistence is also required if a global industrial marketing effort is to succeed; in some countries, however, persistence often means en-durance, a willingness to patiently invest months or years before' the effort results in an actual sale. For example, a company wishing to enter the Japanese market must be prepared for negotiations to take from 3 to 10 years.

Prospecting is the process of identifying potential purchasers and assessing their probability of purchase. If Ford wanted to sell vans in another country where they would be used as delivery vehicle, which businesses would need delivery vehicles? Which businesses have the financial resources to purchase such a van? Those businesses that match these two needs are better prospects than those who do not. Successful prospect-ing requires problem-solving techniques, which involve understanding and matching the customer's needs and the company's products in developing a sales presentation.

The purpose of the pre-approach or problem solving stage is to gather information on a prospective customer's problem areas and tailor a presentation that demonstrates how the company's product can solve these specific problems. If a potential customer has a grocery business, their needs in a van would be different from a customer who owns a carpentry business. The sales representative would need to select the best models of Ford vans, collect the appropriate model specifications, and so on to prepare for an effective presentation.

The next two steps, the approach and the presentation, involve one or more meet-ings between seller and buyer. In global selling, it is absolutely essential for the sales-person to understand cultural norms and proper protocol. In some countries, the approach is drawn out as the buyer-gets to know or takes the measure of the salesper-son on a personal level with no mention of the pending deal. In such instances, the presentation comes only after rapport has been firmly established.

During the presentation, the salesperson must deal with objections. Objections may be of business or personal nature. A common theme in sales training is the notion of active listening; naturally, in cross-cultural selling, verbal and nonverbal communication barriers present special challenges for the salesperson. When objections are successfully overcome, the salesperson moves on to the close and asks for the order. A successful sale does not end there however; the final step of the selling process involves following up with the customer to ensure his or her ongoing satisfaction with the purchase.

Personal Selling In India

New Delhi

India is one market where Coke trails Pepsi. As part of its catch-up strategy, Coke recruited paraplegics to sell Coke in New Delhi. They were encouraged in this by the New Delhi Handicapped Welfare Society. The Society supplies the handpowered tricycles and Coke expects public relations benefits as well as sales from these new vendors.

Rural India

Colgate is a strong leader in the toothpaste market in India, but most of its sales are in urban areas, which account for less than one-third of India's population.

To reach rural customers, Colgate began a program of traveling video-vans to the villages. The van arrives, playing music from a popular movie, and invites villagers to come. When the back door opens, there is a video screen and soon about 100 villagers gather. A 27-minute infomercial is shown. It is a romantic story about a wedding and wedding night where the message comes through that Colgate is good for your breath, your teeth, and your love life.

Free samples are given out after the video and there is a tooth brushing demonstration. A van will visit about three villages a day and returns to ach village one month later. In one year, these vans reached over 16,000 villages and over 10 million people. Colgate attributes a doubling of rural toothpaste consumption to these efforts and expects over 50 percent of its sales from rural areas in the new millennium.

Sales Promotion

Sales promotion refers to any consumer or trade program of limited duration that adds tangible value to a product or brand. Saks promotion laws and usage vary around the world but may consist of any of the following: promotional pricing tactics, contests, sweepstakes and games, premium and specialties, dealer loaders, merchandising materials, tie-ins and cross-promotions, packaging, trade shows (also known as exhibitions), and spon-sorship. The EU, however, is working to harmonize promotional tactics across its member countries. It is considering "mutual recognition" that would allow a company to carry out promotional activities in another country as long as that tactic is legal in the company's I home country. The tangible value created by the promotion may come in venous forms, such as a price reduction or a "buy one, get one free" offer. The purpose of a sales promo-tion may be to stimulate customers to sample a product or to increase consumer demand. Trade promotions are designed to increase product availability in distribution channels.

The increasing popularity of sales promotion as a marketing communication tool outside the United States can be explained in terms of several strengths and advantages. Besides providing a tangible incentive to buyers, sales promotion also reduces the perceived risk buyers may associate with purchasing the product. From the point of view of the company, sales promotion provides accountability; the manager in charge of the promotion can immediately track the results of the promotion. Moreover, some con-sumer sales promotions, including sweepstakes and rebates, require buyers to fill out a form and mail it to the company. This allows a company to build up

information in its database, which it can use when communicating with customers in the future.

Many international managers have learned about American-style promotion strate-gies and tactics by attending seminars such as those offered by the Promotional Mar-keting Association of America (PMAA). Sometimes, adaptation to country-specific conditions is required; for example, TV ads in France cannot have movie tie-ins. Ads must be designed to focus on the promotion rather than the movie. According to Joseph, Potacki, who teaches a Basics of Promotion seminar for the PMAA, the biggest difference between promotion in the United States and in other countries pertains to couponing. In the- United States, couponing accounts for 70 percent of consumer promotion spending. That percentage is much lower outside the United States. According to Potacki, "It is far less—or nonexistent— in most other countries simply because the cultures don't accept couponing." Potacki notes that couponing is gaining importance in countries such as the United Kingdom as retailers learn more about couponing.

Despite efforts to harmonize regulations, sales promotion within the EU is still quite: -diverse, as shown in Table 2. Germany is the most strict while France and the United' Kingdom are the most open. More important is the fact that several types of promotion techniques are under review by individual countries, thus warranting constant monitor-ing of regulations to assure that a company's promotions comply with local regulations.

Companies must take extreme care when designing a sales promotion. A 1992 promotion sponsored by Maytag Corporation's Hoover European Appliance Group was a smashing success that turned into a financial and public relations fiasco. Over a period of several months, Hoover offered free round-trip airline tickets to the United States- and Europe to purchasers of vacuum cleaners or other Hoover appliances. The promo-tion was designed to take advantage of low-cost, "space available" tickets; executives hoped that the cost of the tickets would be offset by commissions paid to Hoover when customers rented cars or booked hotel rooms. Finally, it was expected that a percentage' of customers who bought appliances would fail to meet certain eligibility requirements and, thus, be denied free tickets.

The number of people who actually qualified for the free tickets-more than 200000 in all-far exceeded company forecasts, while the number of car rentals and hotel book-ings was lower than expected. Hoover was swamped by the volume of inquiries; many customers were angered by long delays in responses to their requests for the tickets. The

Table 2

Tactic	Germany	France	U.K.	Netherlands	Belgium
On-pack price					
reductions	Yes	Yes	Yes	Yes	Yes
In-pack gift	??	??	Yes	??	??
Extra product	??	Yes	Yes	??	??
Money-off vouchers	No	Yes	Yes	Yes	Yes
Free prize contest	No	Yes	Yes	No	No

KEY: Yes-legally allowed; ??-Under review; No-not legally allowed

bottom line was that Hoover had failed to budget enough for the promotion, forcing Maytag CEO Leonard Hadley to take pretax charges of $72.6 million. In an effort to honor its commitment to Hoover customers, May tag bought several thousand seats on vari9us airlines. "The Hoover name in the United Kingdom is valuable, and this invest-ment in our customer base there is essential to our future," Hadley said.

Hadley fired the president and director of marketing services at Hoover Europe and the vice president of marketing at Hoover UK. Fallout from the promotion became an ongoing PR nightmare, as headlines in the London Daily Mail trumpeted "Hoover Fiasco: Bosses Sacked" and "How Dumb Can You Get?" Meanwhile, complaints from angry Eu-ropeans poured into May tag's Newton, Iowa, headquarters. A Hoover Holiday Pressure Group was rumored to have thousands of members; three people even traveled to Newton in an unsuccessful attempt to meet with CEO Hadley. By May 1995, Hadley was ready to throw in the towel: He decided to sell Hoover Europe to Italy's Candy SpA for $170 million. Hadley intends to refocus May tag on the North American market.

Direct Marketing

The use of direct marketing is growing rapidly in many parts of the world due to increased use of computer databases, credit cards, and toll-free numbers, as well as changing life styles. Direct marketing is a system of marketing that integrates ordinarily separate mar-keting mix elements to sell directly to both consumers and other businesses, bypassing retail stores and personal sales calls. It is used by virtually every consumer and business to-business category from banks to airlines to nonprofit organizations. Because the cus-tomer responds directly to the company making the offer, international consider-ations that apply to communications, distribution, and sales have to be considered. Direct marketing uses a wide spectrum of media, including direct mail; telephone; broadcast, in-cluding television and radio; and print, including newspapers and magazines.

The usage of direct mail, the most popular type of direct marketing, varies around the world based on literacy rates, level of acceptance, infrastructure, and culture. In coun-tries with low levels of literacy, a medium that requires reading is not effective. In other countries, the literacy rate may be high, but consumers are unfamiliar with direct mail and suspicious of products they cannot see.

The infrastructure of a country must be developed sufficiently to handle direct mail the postal system must deliver mail on a timely basis and be free of corruption. In addition to physical infrastructure, a system for developing databases and retrieving appropriate target names and the tracking results is necessary. In one former Soviet re-public, merchants were resistant to having their name and address publicly listed in the telephone directory. They feared that the local "mafia" could readily use this informa-tion to extort protection money from these businesses.

Direct Mail In Mexico

Mexico is an often-ignored market for direct mail, yet actually has a lot of potential. Recently, the country's 99 mil- lion plus consumers have been enjoying a gross national product (GNP) per capita real growth rate of approximately 6 percent, with GNP per capita of $US 3,943. Inflation is in check, and the North American Free. Trade Agreement (NAFTA) has resulted in lower tariffs and more jobs.

To date, Mexicans receive very little direct mail, so they are not as jaded as consumers in the United States, who refer to direct mail as "junk mail." Mexicans love bargains and are brand conscious and brand loyal. An added benefit to marketers is that postage and fulfillment costs are low.

In a recent direct-mail campaign, an automobile financing company, Gruppo Financiero Serfin, distributed 8,000 pieces, had a 10 percent response rate, and converted 33 percent of respondents.

Culture also plays a significant role in the decision to use direct mail. In Thailand, the local astrologer plays an important role in many business decisions. If the day that a direct-mail campaign is scheduled to begin is not auspicious, the marketer may delay j the mailing until a more fortuitous day appears.

Database marketing uses extensive lists of prospects and relevant demographic and psycho-graphic information to narrow target markets to serious prospects and then to cus-tomize an offer to the prospect's interests. This is essential not only for direct marketing but also for market research and personal selling. Lists can be created in house from the J company's current customers, from responses to previous direct-marketing offers, or from I telephone or membership directories. These lists may also be purchased from list brokers, companies that specialize in the acquisition and sale of lists of prospective customers.

Trade Shows and Exhibitions

Trade shows and exhibitions are other promotion vehicles that are increasingly important in the promotional mix, especially for industrial products and in the international marketplace. At two recent international packaging trade shows, the percentages of international companies were 33 percent and 40 percent. International trade shows offer businesses the opportunity to identify and recruit importers/exporters and agents and to make contact with trade bureaus of foreign governments. They also offer an inexpensive and efficient way to meet -potential customers from other countries. Trade shows differ from country to country. For example, in the United States printed material and promotion giveaways are much more common than in many other countries. Figure 1 is a general model for trade shows performance, which suggests the variables that should influence the selection of shows, and the management of show performance.

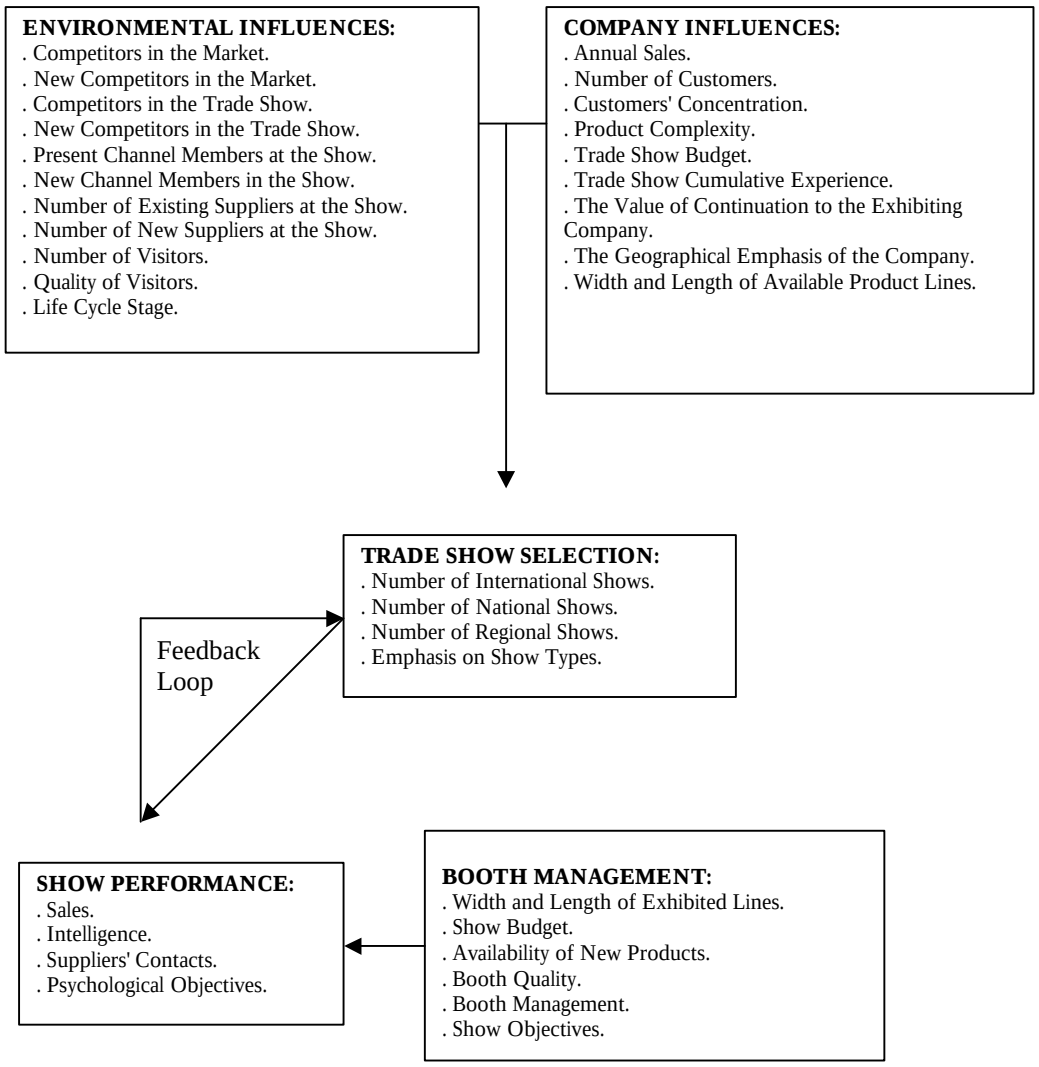


Figure 1 A General Model of trade show performance

Sponsorship Promotion

Sponsorship serves purposes other than sales promotion. Sponsorship can be used to in-crease awareness and esteem, to build the brand identification, to-enhance the brand's positioning and sales, and to circumvent advertising restrictions in some countries. Examples of global sponsorship are the Olympics, the World Cup in Soccer, the Grand Prix, and the Tour de France. An example of a regional sponsorship event is the Pan American Games while a local sponsorship event is the Vasaloppet Ski Race in Sweden or sumo wrestling in Japan. Table below shows how Coca-Cola varies its sponsorship programs around the world.

Table: Coca Cola sponsorship Around the world

Canada	Leftie Rightie Golf Match Annual Big Rock Games for Waiters, Waitresses, and Bartenders
Zambia Ghana	Soccer camp, squash tournament
Malaysia Ireland China	Soccer tournament Youth participation in Malaysia World Cup Industry Challenge for Primary Schools contest International breeding program to protect pandas

Spending By Region

	Spending	% Total	% Change'
Total	US$ 19.2B	100	+11%
North America	7.6B	40	+ 12 %
Europe	5.6B	29	+11%
Pacific Rim	3.4B	18	+ 4%
Central and South America	1.5B	8	+19%
Other	1.1B	5	+10%

Just as with media, the effectiveness of sponsorship varies across geographic regions and should be taken into consideration when planning programs in in-dividual countries or measuring program effectiveness.

Expenditures on sponsorship are rising and expected to continue to do so. Two causes for this trend are increases in corporate mergers and cause marketing. Many companies that are consolidating want to quickly increase awareness of the merger and to establish a new image. Cause marketing, which is the use of marketing funds to enhance a cause while acting as a good corporate citizen, is gaining popularity. In the United States, Clairol Professional Care Products supports AIDS research while Avon supports breast cancer research.

Sponsorship, however, does have its distractors. Many people claim the Olympics are over commercialized and that sponsors "McDonaldize" local events. Needless to say, these people are in the minority given the wide acceptance of sponsorship, but some may generate negative publicity for the company.

Uncle Sam As International Marketer

Protection and promotion of a country's economic interests have long been a part of an ambassador's job but usually only a small part for U.S. ambassadors. After the collapse of Communism, economic matters have become a much more important part of a U.S. ambassador's job. This began in the Bush administration and continued under Clinton. Secretary of State Albright noted in her confirmation hearing that a major administration goal was to assure that "American economic interests can be pursued globally". Trade is now covered in the two-week seminar given new ambassadors before assignment. In recent years, embassies have helped U.S. firms win contracts in such diverse places as Belgium and Indonesia.

The Department of Commerce opened an Advocacy Center in 1994 as a new form of trade promotion. In its first year, it helped U.S. companies win 70 contracts with an export value of $ 20 billion.

Ron Brown, former Secretary of Commerce under Clinton, became an active "international marketer", flying to China and other countries with a planeload of CEOs to promote U.S. businesses abroad. Brown also helped get Ex-Im Bank support for some U.S. contracts abroad.

President Clinton himself became active in promoting U.S. businesses abroad. Some examples:

1. Clinton called and wrote King Fahd of Saudi Arabia about a potential airplane contract. This was influential in Boeing and McDonnell-Douglas winning a $6 billion contract against Airbus.

2. Clinton again intervened in a telecommunications contract in Saudi Arabia. AT&T won a $4 billion contract even though Ericsson and Northern Telecom claimed lower bids.

3. In Brazil, Raytheon won a contract with Clinton's help.

Chevron participated in a $20 billion oil deal in Kazakhstan aided by the president

LESSON 32: CHANNELS OF DISTRIBUTION

Introduction

The lesson describes the varieties of intermediaries (i.e., agents, wholesaler and retailers) involved in moving products between countries as well as within countries. The tasks and functions of the various intermediaries will be examined. It should be kept in mind that certain types of intermediaries do not exist in some countries and that the pattern of use as well as the importance of each type of intermediary varies widely from country to country.

A manufacturer is required to make several decisions that will affect its channel strategy, including the length, width, and number of distribution channels to b used. The chapter examines the various factors that influence these decisions. For an operation to be a success, a good relationship among channel members is vital.

Direct and Indirect Selling Channels

Companies use two principal channels of distribution when marketing abroad: (1) in direct selling and (2) direct selling. Indirect selling, also known as the local or domestic channel, is employed when a manufacturer in the United States, for example, market its product through another U.S. firm that acts as the manufacturer's sales intermediary (or middleman). As such, the sales intermediary is just another local or domestic channel for the manufacturer because there are no dealings abroad with a foreign firm. By exporting through an independent local middleman, the manufacturer has no need to set up an international department. The middleman, acting as the manufacturer's ex-ternal export organization, usually assumes the responsibility for moving the product overseas. The intermediary may be a domestic agent if it does not take title to the goods, or it may be it domestic merchant if it does take title to the goods.

There are several advantages to be gained by employing an indirect domestic channel. For example, the channel is simple and inexpensive. The manufacturer in-curs-no-start-up cost for the channel and is relieved of the responsibility of physically moving the goods overseas. Because the intermediary very likely represents several clients who can help share distribution costs, the costs for moving the goods are fur-ther reduced.

An indirect channel does, however, have limitations. The manufacturer has been relieved of any immediate marketing costs but, in effect, has given up control over the marketing of its product to another firm. This situation may adversely affect the product's success in the future. If the chosen intermediary is not aggressive, the man-ufacturer may become vulnerable, especially in the case where competitors are care-ful about their distribution practices. Moreover, the indirect channel may not neces-sarily be permanent. Being in the business of handling products for profit. The intermediary can easily discontinue handling a manufacturer's product if there is no profit or if a competitive product offers a better profit potential.

Direct selling is employed when a manufacturer develops an overseas channel. This channel requires that the manufacturer deal directly with a foreign party with-out going through an intermediary in the home country. The manufacturer must set up the overseas channel to take care of the business activities between the countries

Being responsible for shipping the product to foreign markets itself, the manufacturer exports through its own internal export department or organization.

One advantage gained in using the direct-selling channel is active market exploiter since the manufacturer is more directly committed to its foreign markets. Another advantage is greater control. The channel improves communication because approval does not have to be given to a middleman before a transaction is completed. Therefore, the channel allows the company's policy to be followed more uniformly.

Direct selling is not without its problems. It is a difficult channel to manage if the manufacturer is unfamiliar with the foreign market. Moreover, the channel is time consuming and expensive. Without a large volume of business, the manufacturer may find it too costly to maintain the channel. Hiram Walker, a Canadian distiller, used to have its own marketing operation in New York City to distribute such brands as Ballantine Scotch, Kahlua, and CC Rye. Poor earnings finally forced the company to phase out its costly U.S. selling organization along with its New York City market-ing operation.

Exporters who do not undertake international marketing research have a ten-dency to sell directly to a U.S. export agent. In contrast, those who undertake more formal international marketing research tend to be committed to exporting and invest resources in establishing a separate department to export their product directly to end users.

One study found a positive relationship between channel directness and export performance of Hong Kong and Singaporean exporting firms. Another study found that American exporters who are committed to exporting and are formally trained in international business prefer to sell directly to end-users and utilize their own export department. Since these exporters charge higher prices for exported products than for sales in the domestic market, they also perform better financially.

A survey of exporting firms in the electrical machine tool builders food equipment, and fluid power industries found that firms that export industrial goods use dis-tribution channel members identical Jo those used at home. The export distribution channels used most often by these industrial firms were sales representatives and ex-port distributors. Although respondents appeared to be somewhat satisfied with their overall distribution system,

they also showed relative dissatisfaction with trading com-panies in general. In the balance, firms that have been exporting for a while are hap-pier with their distribution system than firms that have relatively little exporting ex-perience.

Marketing Strategy 1

Wanted: A Good Agent

Pantresse, Inc. is a Massachusetts manufacturer and dis-tributor of hair-care products (shampoos and condi-tioners) for the professional beauty trade. The Mexi-can market is important to Pantresse since it accounts for one-third of the company's total sales. There are two keys to the company's success in Mexico: having a top-notch local agent and a strong promotion and advertising program. It was critical for Pantresse to find a local agent that had experience in selling its particu-lar product line. The agent must also have strong mar-keting skills and viable contacts. Pantresse was able to develop a business link with one of Mexico's largest pharmaceutical supply companies. This Mexican firm also has extensive media holdings.

Types of Intermediaries

Direct Channel

There are several types of intermediaries associated with both the direct and indirect channels. Exhibit 1 compares the two channels and lists the various types of do-mestic and foreign intermediaries.

1. Foreign Distributor

   A foreign distributor is a foreign firm that has exclusive rights to carry out distrib-ution for a manufacturer in a foreign country or specific area. For example, when Don Wood returned to Detroit, he still remembered the MG sports car he drove in Eng-land during World War II. His letter asking MG's chairman to sell and ship one car to him brought the response that MG's policy was to sell only through authorized dis-tributors. But MG was willing to appoint Wood its Midwest distributor if he would order two cars instead. Wood agreed to do so and went on to become a successful distributor.

   Orders must be channeled through the distributor, even when the distributor chooses to appoint a subagent or sub-distributor. The distributor purchases merchandise from the manufacturer at a discount and then resells or distributes the merchandise to retailers and sometimes-final consumers. In this regard, the distributor's function in many countries may be a combination of wholesaler and retailer. But in most cases the distributor is usually considered as an importer or foreign wholesaler. The length of as-sociation between the manufacturer and its foreign distributor is established by a con-tract that is renewable provided the continued arrangement is satisfactory to both.

   In some situations, the foreign distributor is merely a subsidiary of the manu-facturer. Seiko U.S.A., for example, is a distributor for its Japanese parent (Hattori Seiko), which manufactures Seiko watches. More frequently, however, a foreign dis-tributor is an independent merchant. Charles of the Ritz Group has been the U.S. dis-tributor for Opium, a very popular perfume made in France. A distributor may some-times take on the name of the brand distributed even though the distributor is an independent operator and not owned by me manufacturer. Brother International Corp. is an independent U.S. distributor of Brother Industries, Ltd., a Japanese firm. Longines- Wittnauer Watch Co. distributes the Swiss-made Longines watch in the U.S. market. This distributorship is actually a subsidiary of the Westinghouse Electric Corp.

   There are a number of benefits in using a foreign distributor. Unlike agents, the distributor is a merchant who buys and maintains merchandise in its own name. This arrangement simplifies the credit and payment activities for the manufacturer. To carry out the distribution function, the foreign distributor is often required to warehouse ad-equate products, parts, and accessories and to have facilities and personnel immediately available to service buyers and users. Still, the manufacturer must be careful in select-ing a foreign distributor or it may end up with a distributor who is deficient in mar-keting and servicing the product. Apple Computer now does its own distribution in Japan because the services of Toray Industries, its former distributor, proved inadequate.

2. Foreign Retailer

   If foreign retailers are- used, the product in question must be a consumer product rather than an industrial product. There are several means by which a manufacturer may contact foreign retailers and interest them in carrying a product, ranging from a personal visit by the manufacturer's representative to mailings of catalogs, brochures, and other literature to prospective retailers. The use of personal selling or a visit, al-though expensive because of travel costs and commissions for the manufacturer's rep-resentative provides for a more effective sales presentation as well as for better screening of retailers for the distribution purpose. The use of direct mail, although less expensive, may not sufficiently catch the retailers' attention.

   For such big-ticket items as automobiles or for high-volume products, it may be worthwhile for a manufacturer to sell to retailers without going through a foreign distributor. In fact, most large retailers prefer to deal directly with a manufacturer. In Europe, for example, a number of retail food chains are becoming larger and more powerful, and they prefer to be in direct contact with foreign manufacturers in order to obtain price concessions.

3. State-Controlled Trading Company

   For some products, particularly utility and telecommunication equipment, a manu-facturer must contact and sell to state-controlled companies. In addition, many coun-tries, especially those in Eastern Europe, have state-controlled trading companies, which are companies that have a complete monopoly in the buying and selling of goods. Hungary has about one hundred state trading organizations for a variety of products, ranging from poultry to telecommunication equipment and for both imported and exported products.

Cultural Dimension 1

Exporting a Shopping Experience

Pier I is a Texas based retailer, and its many stores can be readily found in the United States. Its retail for-mula is to import and stock unusual items, price them moderately, and display them in an integrated fashion to give an atmosphere of the United Nations. Blue Japanese sake cups, for example, are displayed with blue European plates rather than with other Japanese goods.

Pier I wants to repeat its retail magic overseas and plans to open 250 stores outside North America in seven years which will account for 5 percent of the company's sales and 10 percent of operating profits. This is not an easy task. Few American retailers have tried to do retailing abroad, and most foreign retailers that have opened stores in the United States have per-formed very poorly. Naturally, retailing is a local phe-nomenon.

The company believes that its formula is unique and can travel overseas. But some adaptation is re-quired. Stores in Asia definitely have no need to carry chopsticks (which are popular in the U.S. stores) but will focus on American goods. Furniture will be made smaller for the Japanese market to suit tiny apartments. Also in Europe and Asia, Pier I will stock posters of American' pop heroes and other American-related items.

For most countries Pier I will use joint ventures and licensing to penetrate the markets. In the case of Puerto Rico, the retailer feels that the market resem-bles Florida and that it knows enough about the mar-ket. Therefore. it does not need a partner in Puerto Rico where its thirty-five stores use the same inven-tory found elsewhere in the United States to attract Cuban and Hispanic Americans.

Being government sanctioned and controlled for trading in certain goods, buy-ers for state-controlled trading companies are very definitely influenced by their gov-ernments' trade policies and politics. Most opportunities for manufacturers are lim-ited to raw materials, agricultural machinery, manufacturing equipment, and technical instruments rather than consumer or household goods. Reasons for this limitation in-clude shortage of foreign exchange, an emphasis on self-sufficiency, and the central planning systems of the communist and socialist countries.

4. End User

Sometimes, a manufacturer is able to sell directly to foreign end users with no in-termediary involved in the process. This direct channel is a logical and natural choice for costly industrial products. For most consumer product the approach is only prac-tical for some products and in some countries. A significant problem with consumer purchases can result from duty and clearance problems. A consumer may place an order without understanding his or her country's import regulations. When the mer-chandise arrives, the consumer may not be able to claim it. As a result, the product may be seized or returned on a freight-collect basis. Continued occurrence of this problem could become expensive for the manufacturer.

To solicit orders, a manufacturer may use publications to attract consumers Many U.S. magazines receive overseas distribution, and the advertisements inside are read by foreign consumers. Other U.S. magazines including Time, Newsweek, and Business Week facilitate the ordering process because they publish international edi-tions. Of course, an advertiser can also place its advertisement directly with foreign publishers. This is the process many countries follow in order to promote the local tourism industry.

Marketing Strategy 2

Direct Marketing

Dell Computer Corp. builds and markets a full line of desktop, notebook, and network-server PCs. After having found success in the United States, Dell Com-puter Corp. has gone overseas. The company operates wholly owned subsidiaries in fifteen countries, which in-clude most of the European Union countries, Mexico, Canada, and Poland. Its manufacturing plants are lo-cated in Ireland and Malaysia. Being committed to in-ternational markets, Dell has operations in 115 coun-tries.

Several skeptics questioned whether Dell's direct marketing strategy would work outside of the United States since Europe does not have the same telephone culture. Actually, consumers in most countries prefer to do business directly with a manufacturer rather than a third-party vendor. Dell's worldwide telephone sales force handles 35,000 calls each day.

Dell's formula is to emphasize a solid product line, attractive prices, aggressive marketing, and qual-ity service and support. In earn country the company advertises in the leading PC publications that are widely read by PC users and buyers. Not only has Dell been successful in building its business, but it has also legitimized the computer mail-order market.

The company's subsidiaries are run by locals—not expatriates. Since countries differ in size, language, social structure, and business philosophy, the locals keep Dell abreast of the nuances of doing business in each market.

How successful is Dell? It is the world's largest direct marketer of IBM-compatible PCs.

Types of Intermediaries: Indirect Channel

For a majority of products, a manufacturer may find it impracti-cal to sell directly to the various foreign parties (i.e., foreign distributors, foreign retailers, state-controlled trading compa-nies, and end users). Other intermediaries, more often than not have to come between- these-foreign buyers and the manufac-turer. This section examines the roles of those middlemen located in the manufacturer's country.

With an indirect channel, a manufacturer does not have to correspond with for-eign parties in foreign countries. Instead; the manufacturer deals with one or more domestic middlemen, who in turn move and/or sell the product to foreign middle-men or final users. Although there are many kinds of local sales intermediaries, all can be grouped under two broad categories: (1) domestic agents and (2) domestic merchants. The basic difference between the two is ownership (title) rather than just the physi-cal possession of the merchandise. Domestic agents never take title to the goods, re-gardless of whether the agents take possession of the goods or not. Domestic mer-chants, on the other hand, own the merchandise, regardless of whether the merchants take possession or not. An agent represents the manufacturer. Whereas a merchant (e.g., distributor) represents the manufacturer's product. The merchant has no power to

contract on behalf of the manufacturer, but the agent can bind the manufacturer in authorized matters to contracts made on the manufacturer's behalf.

Agents can be further classified according to the principal whom they represent. Some agent intermediaries represent the buyer; others represent the interests of the manufacturer. Those who work for the manufacturer include export brokers; manufacturers export agents or sales representatives, export management companies, co-operative exporters, and Webb Pomerene associations. Agents who look after the in-terests of the buyer include purchasing (buying) agents/offices and country-controlled buying agents

1. Export Broker

   The function of an export broker is to bring a buyer and a seller together for a fee. The broker may be assigned some or all-foreign market in seeking potential buyers. It negotiates the best terms for the seller (i.e., manufacturer) but cannot conclude the transaction without the principal's approval of the arrangement. As a representative of the manufacturer, the export broker may operate under its own name or that of the manufacturer. For any action performed, the broker receives a fee or commission. An export broker does not take possession or title to the goods. In effect, it has no fi-nancial responsibility other than sometimes making an arrangement for credit. An ex-port broker is less frequently involved in the export (shipping) of goods than in the import (receiving) of goods.

   The export broker is useful because of its extensive knowledge of the market supply, demand, and foreign customers. This knowledge enables the broker to nego-tiate the most favorable terms for the principal. The broker is also a valuable associate for highly specialized goods and seasonal products that do" not require constant distribution. An export broker may be thus used on a one-time basis by small manufacturers with limited financial resources who are selling in broad markets.

2. Manufacturer's Export Agent or Sales Representative

   Because of the title of this intermediary, one might easily mistake an export agent or sales representative for a manufacturer's employee when, in fact, this is an inde-pendent businessperson who usually retains his or her own identity by not using the manufacturer's name. Having more freedom that the manufacturer's own salesper-son, a sales representative can select when, where, and how to work within the as-signed territory. Working methods include presenting product literature and samples to potential buyers. An export agent pays his or her own expenses and may represent manufacturers of related and non-competing products. The person may operate on ei-ther an exclusive or nonexclusive basis.

   Like a broker, the manufacturer's export agent works for commission. Unlike the broker, the relationship with the manufacturer is continuous and more permanent. The contract is for a definite period of time and. the contract is renewable by mutual agreement. The manufacturer, however, retains some control because the contract de-fines the territory, terms of sale, method of compensation, and so on.

   The manufacturer's export agent may present some problems to the manufac-turer because an agent does not offer all services. Such services as advertising, credit assistance, repair, and installation may be excluded. An export agent may take pos-session but not title to the goods and thus assumes no risk-the risk of loss remains with the manufacturer. Finally, the manufacturer relinquishes control over marketing activities, and this can hurt a manufacturer whose volume is too small to receive the agent's strong support. The experience of Arthur C. Bell, a British firm, is a case in point. James B. Beam, its previous agent in the United States, neglected Bell because its salespeople had too many other products to handle. Bell switched to Monsieur Henri as its new agent. However, this hardly improved the situation because Henri also preferred to concentrate on larger accounts. As a result, Bell was left out of Christmas catalogs or dropped by many retailers. Bell thus contemplated acquiring a U.S. importer to have stronger control over its own marketing destiny.

   Under certain circumstances, it may not be justifiable for a small manufacturer to set up its own sales force and distribution network. Such circumstances include the following:

1. When the manufacturer has a geographically widespread market-the usual case in in-ternational marketing.
2. When some overseas markets are too thin.
3. When the manufacturer's product is new and the demand is uncertain.
4. When the manufacturer is inexperienced in international marketing.
5. When the manufacturer wants to simplify business activities.

   A manufacturer can avoid fixed costs associated with having its own sales and dis-tribution organization when it employs an agent, since the commission is paid only when sales are made. A manufacturer's export agent has extensive knowledge of spe-cific foreign markets and has more incentive to work than the manufacturers own salespersons. Additionally, the agent carries several product lines, and the result is that the expense of doing business is shared by other manufacturers. This arrange-ment allows the manufacturer to concentrate time, capital, and expertise on the pro-duction of goods rather than on having to deal with the marketing aspect. Of course, if the product is successful, the manufacturer can always set op its own sales force.

Activity 1: Students should be encouraged to differentiate between the various types of intermediaries, their merits and demerits.

3. Export Management Company (EMC)

   An export management company (EMC) manages, under contract, the entire ex-port program of a manufacturer. An EMC is also known as a combination export manager (CEM) because it may function as an export department for several allied but non-competing manufacturers. In this regard, those export brokers and manufac-turers' export agents who represent a combination of clients can also be called EMCs. When compared with export brokers and

manufacturers' export agents, the EMC has greater freedom and considerable authority. The EMC provides extensive services, ranging from promotion to shipping arrangement and documentation. Moreover the EMC handles all, not just a portion, of its principal's products. In short, the EMC is responsible for all of the manufacturer's international activities.

Foreign buyers usually prefer to deal directly with the manufacturer rather than through a third party. Therefore, an EMC usually solicits business in the name of the manufacturer and may even use the manufacturer's letterhead. Identifying it as the manufacturer's export department or international division, the EMC signs correspondence and documents in the name of the manufacturer. This may be an advan-tageous arrangement for small and medium-sized firms that lack expertise and ade-quate human and financial resources to obtain exports. This arrangement may be a good way for a firm to develop foreign markets while creating its own identity abroad. The EMC, on the other hand, faces a dilemma because of a double risk: it can easily be dropped by its clients either for doing a poor job or for making the manufac-turer's products too successful.

American EMCs are typically small. While the number of employee's ranges from two to fifty, a majority of them have six or fewer employees. It is normal for an EMC to have only one or a few managers or market specialists.

An EMC typically requires at least a one-year contract to handle a manufac-turer's products. More often, it is a three-year contract. This is understandable be-cause it takes at least six to twelve months to produce significant results.6 Interest-ingly, due to uncertainties about the relationships, most U.S. manufacturers and EMCs do not have a formal, written agreement.

EMCs are compensated in several ways. Frequently, compensation is in the form of a commission, salary, or retainer plus commission. Depending on the product, the commission may be as high as 20 percent, with the 6 percent to 10 percent range be-ing the most prevalent. Some EMCs may require a manufacturer to pay a one-time pro-ject fee, and such start-up costs may range from a few hundred dollars to tens of thou-sands of dollars. Meridian Group, a Los Angeles EMC, has stated that it can help handle sales, distribution, credit, shipping, and everything else. Typically, an export manager charges a fee of between 10 percent and 15 percent of a shipment's wholesale value.

Many EMCs are also traders (i.e., export merchants). As a matter of fact, as both agents and merchants, EMCs engage in more of the buy-and-reseal method than the commission arrangement. In such cases, they buy merchandise outright and thus take title to the goods. They are compensated by receiving discounts on goods pur-chased for resale overseas, and such discounts may be greater than what other mid-dlemen receive for the domestic market. They may receive promotion allowances as well. As in the case of Overseas Operations, Inc., it markets builders' hardware, hous-ing accessories, door closures and locks, and computer software and accessories. As an exclusive representative of a number of American manufacturers, the company buys products when orders are received and makes its profit on the markup.

Both the nature of the promotional function and the type of product impact the pricing method. When an EMC has to assume a promotional function, it passes on the costs to the producer by receiving a discount. EMCs which market highly differ-entiated products and spend large but predictable sums of money on non-price promotional activities (e.g., foreign trade fairs) may ask for a fixed percentage discount off the producer's domestic wholesale price. But those EMCs marketing undifferen-tiated products while spending unpredictable sums of money in non-price promotion (e.g., promotional product brochures) are more likely to use a negotiated pricing pro-cedure.

There are several reasons why a firm uses an EMC. It has international market-ing expertise and distribution contacts 0verseas. For the many services provided, an EMC's costs are relatively low because of the efficiencies of scale; that is, costs can be spread over the products of-several clients. In addition, the EMC provides shipping efficiency because it can consolidate several manufacturers products in one shipment. The orders are consolidated at the port and shipped on one ocean bill of lading to the same foreign buyer. By consolidating shipments of products from several principals, a company obtains better freight rates. Also, many EMCs provide financial services. By guaranteeing payments and collecting from overseas buyers, a manufacturer is as-sured of immediate payment. By providing all of these services, the EMC allows the manufacturer to concentrate on internal efforts and its domestic market.

Using EMCs, like using other types of intermediaries, does have its disadvantages. First, an EMC prefers new clients whose products complement the EMC's ex-isting product lines. The EMC is very likely not interested in unknown products or new technologies that require too much time and effort in opening new markets over-seas. A problem for a small manufacturer may be the extent of support it receives. If a firm seeks to do business with a large EMC, the EMC is not likely to give the small client adequate attention. If a small EMC is used, the EMC may be too small to give attention to all products of its clients. In general, most EMCs do put forth a serious effort and are willing and able to provide sufficient services for new clients.

According to one study, EMCs believe that gathering marketing information and communicating with markets are most important to successful exporting. They also feel that political-risk analysis and sales-force management are the two most difficult things to accomplish.

4. Cooperative Exporter

A cooperative exporter is a manufacturer with its own export organization that is retained by other manufacturers to sell in some or all-foreign markets. Except for the fact that this intermediary is also a manufacturer, the cooperative exporter functions like any other export agent. The usual arrangement is to operate as an export distrib-utor for other suppliers,

sometimes acting as a commission representative or broker. Because the cooperative exporter arranges shipping, it takes possession of goods but not title.

The cooperative exporter's motive in representing other manufacturers primar-ily involves its own financial interests. Having fixed costs' for the marketing of its own products, the cooperative exporter desires to share its expenses and expertise with others who want to sell in the same markets abroad. Because of these activities, a cooperative exporter is often referred to as a "mother hen," a "piggyback exporter," or an "export vendor". Examples of cooperative exporters include such well-known companies as GE, Singer, and Borg-Warner. By representing several clients, the co-operative exporter is regarded as a form of EMC.

The relationship between the cooperative exporter and its principal is a long--term one. The arrangement provides an easy, low-risk way for the principal to start marketing overseas, and the relationship should ordinarily continue as long as unre-lated or noncompetitive products are involved. A problem may arise if the principal decides to market a new product that competes directly with the cooperative exporter's own product or those of the exporter's other clients.

5. Webb – Pomerene Association

A Webb-Pomerene association is formed when two or more firms, usually in the same industry, join together to market their products overseas. The association con-stitutes an organization jointly owned by competing U.S. manufacturers exclusively for the purpose of export. It may seem strange for competing firms (rather than non-competing firms) to cooperate, but experience has shown that joint export operations are not effective for unrelated products. The largest such association has almost 300 members, whereas the Northwest Dried Fruit Association has only two members.

Basically, a Webb-Pomerene association is an export cartel. Although cartels are illegal in the United States, this kind of cartel is allowed to operate as long as it has no anticompetitive impact on domestic marketing in the U.S. market. Although receiving no prior certification of antitrust exemption, the Webb-Pomerene Act pro-vides the association with a qualified exemption. The only legal requirement is that the association must file with the Federal Trade Commission within thirty days after its organization.

The Webb-Pomerene association performs several useful functions. It provides information to member firms, sets prices, allocates orders, and sell products. It arranges shipping of the merchandise by providing for freight consolidation, rate negotiation, and ship chartering or booking. The association thus takes possession of goods and makes all necessary arrangements but without taking title of the goods. As coopera-tive organizations, these associations tend to operate on a nonprofit or expense basis.

There are disadvantages in this type of long-term relationship. First, this type of arrangement is not available in the service sector because the act prohibits service firms from joining together. Second, convenient financing is not available because banks have not been allowed to participate in this type of commercial venture since the 1920s. Third, as expected for most partnerships, some opposition and disagree-ment among members is inevitable. If members fail to agree or cooperate, the asso-ciation's effectiveness is seriously impaired. Finally, member firms lose individual identity because exports are done in the name of the association, making the arrange-ment somewhat more suitable for unbranded goods or commodities. Specialized prod-ucts and popular brands are able to do their own exporting and thus do not want their brands replaced by a common association label or trademark. An unusual but possi-ble arrangement is for members to retain individual identity (i.e., individual brand names); the machine-tool associations are a prime example. These associations were formed primarily to offer technical assistance and credit in markets too small to jus-tify each exporter's own facilities.

6. Purchasing/Buying Agent

An export agent represents a seller or manufacturer; the purchasing buying agent represents the foreign buyer. By residing and conducting business in the exporter's country, the purchasing agent is in a favorable position to seek a product that matches the foreign principal's preferences and requirements. Operating on the overseas cus-tomer's behalf, the purchasing agent acts in the interest of the buyer by seeking the best possible price. Therefore, the purchasing agent's client pays a fee or commis-sion for the services rendered. The purchasing agent is also known by such names as commission agent; buyer for export, export commission house, and export buying agent. This agent may also become an export-confirming house when confirming pay-ment and paying the seller after receiving invoice and title documents for the client.

The buying agent is valuable for manufacture because it seeks those-firms-out and offers them services. However, since the agent operates on an order basis, the relationship with either seller or buying is not continuous. This arrangement thus does not offer a steady volume of business for the manufacturer and neither does it offer any reduction in financial risk. In any case, the transaction between the manufacturer and the buying agent (or the agent's customer) may be completed as a domestic en-terprise in the sense that the agent will take care of all shipping arrangements Oth-erwise, the manufacturer will have to make its own arrangement.

7. Country-Controlled Buying Agent

A variation on the purchasing agent is a country-controlled buying agent. This kind of agent performs exactly the same function as the purchasing buying agent, the only distinction being that a country-controlled buying agent is actually a foreign govern-ment's agency or quasi-governmental firm. The country-controlled buying agent is empowered to locate and purchase goods for its country. This agent may have a per-manent office location in countries that are major suppliers, or the country's repre-sentative may make formal visits to supplier countries when the purchasing need arises.

8. Resident Buyer

Another variation on the purchasing agent is the resident buyer. As implied by the name, the resident buyer is an independent agent that is usually located near highly centralized production industries. Although functioning much like a regular purchas-ing agent, the resident buyer is different because it is retained by the principal on a continuous basis to maintain a search for new products that may be suitable. The long--term relationship makes it possible for the resident buyer to be compensated with a retainer and a commission for business transacted.

The resident buyer provides many useful services for a manufacturer. It can of-fer a favorable opportunity for a supplier to maintain a steady and continuous busi-ness relationship as long as the supplier remains competitive in terms of price, ser-vice, style, and quality.

For a foreign buyer, the resident buyer offers several useful services, one of which is the purchasing function. The resident buyer uses its judgment to make de-cisions for its overseas client which does not have the time to send someone to visit production sites or firms or which cannot wait to examine samples. Another service provided by the resident buyer is the follow-up function. The resident buyer can make certain that delivery is made as promised. A late delivery can make the purchase meaningless, especially in the case of seasonable or fashion products. If the foreign client decides to visit manufacturing plan~ or offices, the resident buyer can assist by making' hotel reservations, announcing the visit to suppliers, arranging vendor ap-pointments, and so on

9. Export Merchant

The intermediaries covered so far have certain factors in common: they take neither risks nor title, preferring to receive fees for their services. Unlike these middlemen domestic merchants are independent businesses that are' in business to make a profit rather than to receive a fee. There are several types of domestic merchants. Because they all take title, they are distinguished by other features such as physical posses-sion goods and services rendered

One kind of domestic merchant is the export merchant. An export merchant seeks out needs in foreign markets and makes purchases from manufacturers in its own country to fill those needs. Usually the merchant handles staple goods, undif-ferentiated products, or those in which brands are unimportant. After having the mer-chandise packed and marked to specifications, the export merchant resells the goods in its own name through contacts in foreign markets. In completing all these arrange-ments, the merchant assumes all risks associated with ownership.

The export merchant's compensation is a function of how product is priced. The markup is affected by the profit motive as well as by market conditions. In any case, the export merchant hopes that the price at which the product is sold will exceed all costs and expenses in order to provide a profit. An export merchant may sometimes seek extra income by importing goods to complement its export activities. The mer-chant mayor may not offer a steady business relationship for his supplier.

10. Export Drop Shipper

An export drop shipper, also known as a desk jobber or cable merchant, is a spe-cial kind of export merchant. As all these names imply, the mode of operation re-quires the drop shipper to request a manufacturer to "drop ship" a product directly to the overseas customer. It is neither practical nor desirable for the shipper to physi-cally handle or possess the product. Based on this operational method, the shipper's ownership of the goods may only last for a few hours.

Upon the receipt of an order from overseas, the export drop shipper in turn places an order with a manufacturer, directing the manufacturer to deliver the prod-uct directly to the foreign buyer. The manufacturer collects payment from the drop shipper, who in turn is paid by the foreign buyer.

Use of a drop shipper is common in the international marketing of bulky prod-ucts of low unit value (e.g., coal, lumber, construction materials). The high freight volume relative to the low unit value makes it prohibitively expensive to handle such products physically several times. Minimizing physical handling reduces the cost ac-cordingly. .

One may question why a manufacturer does not simply deal directly with a for-eign buyer, bypassing the drop shipper and saving money in the process-the ship-ping instructions would reveal the name and address of the foreign buyer. The an-swer is that the manufacturer can reduce the risk while simplifying the transactional tasks. It is a great deal easier for the manufacturer to call the export drop shipper in the manufacturer's own country instead of trying to sell to and collect from the buyer in a far-away destination.

There are also good reasons why the foreign buyer may not be able to or want to bypass the export drop shipper. The buyer may not have adequate product knowl-edge or supply knowledge, and the buyer's order may be too small to entice the man-ufacturer to deal directly. The drop shipper is thus valuable because this kind of mer-chant is highly specialized in knowing the sources of supply and markets. The drop shipper also has information and advice about the needed product and can arrange all details for obtaining it.

11. Export Distributor

Whereas export merchants and drop shipper's purchase from a manufacturer when-ever they—receive-orders from overseas, an export distributor deals with the manu-facturer on a continuous basis. This distributor is authorized and granted an exclu-sive right to represent the manufacturer and to sell in some or all-foreign markets. It pays for goods in its domestic transaction with the manufacturer and handles all fi-nancial risks in the foreign sale.

An export distributor differs from a foreign distributor simply in location. The foreign distributor is located in a particular foreign country and is authorized to dis-tribute and sell the product there. The export distributor, in comparison, is located in the manufacturer's country and is authorized to sell in one or more markets abroad. Consider Mamiya, a Japanese manufacturer. J. Osawa is Mamiya's

worldwide dis-tributor (i.e., export distributor). Bell and Howell: Mamiya is in turn J. asawa's ex-clusive U.S. distributor (i.e., foreign distributor).

The export distributor operates in its own name or that of the manufacturers handles all shipping detail, thus relieving the manufacturer of having to pay atten-tion to overseas activities. In other words, the sale made to the export distributor is just like another domestic transaction for the manufacturer. Because the export dis-tributor as a rule represents several manufacturing firms, it is sometimes regarded as a form of EMC.

The export distributor usually sells the manufacturer's product abroad at the manufactured list price and receives an agreed percentage of the list price as remu-neration That is, the export distributor is either paid by commission or allowed a dis. count for It's purchase. The manufacturer may bill a foreign buyer directly or may let the distributor bill the buyer to obtain the desired margin.

12. Trading Company

Those that want to sell and those that want to buy often have no knowledge of each other or no knowledge of how to contact each other. Trading companies have come into existence to fill this void. In international marketing activities for many coun-tries, this type of intermediary may be the most dominant form in volume of busi-ness and in influence. Many trading companies are large and have branches wherever they do business. They operate in LDCs, developed countries, and their own home markets. Half of Taiwan's exports are controlled by trading companies. In Japan, gen-eral trading houses are known as sogo shosha, and the largest traders include such well-known MNCs as Mitsubishi, Mitsui, and C. Itoh. The nine largest trading firms handle roughly half of Japan's imports and exports. Even large Japanese domestic companies buy through trading companies.

A trading company performs many functions; the term describes many intermediaries that are neither brokers nor import merchants. A trading company may buy and sell as a merchant. It may handle goods on consignment, or it may act as a com-mission house for some buyers. By representing several clients, it resembles an EMC, except for the fact that it (1) has more diverse product lines, (2) offers more services. (3) Is largest and letter financed, (4) takes' title (ownership) 'to merchandise, (5). Is not exclusively restricted to engaging in export trade, and (6) goes beyond the role of an intermediary (which provides only export facilitation services) by engaging directly in production physical distribution channel development, financing, and resource development.

As the name implies, the trading company trades on its own account for profit. By frequently taking title to the goods it. Handles, its risks of doing business greatly increase. A trading company does not merely represent manufacturers and/or buyers thus reducing risks, because increased risks are usually accompanied by increased re-wards. In the case of WSJ International, which are a trader as well as a representative profit margins gained on trading are about four times greater than margins on repre-sentative sales. It is thus not surprising that trading accounts for half of the company's revenues. -

Manufacturers and buyers use trading companies for good reasons. The trading company gathers market information; does market planning; finds buyers; package and warehouses merchandise; arranges and prepares documents for transportation. In-surance and customs; provides financing for suppliers and/or buyers; accepts busi-ness risks; and serves foreign customers after sales. It is, in short a valuable entity in overcoming cultural and institutional barriers. Nanodata for example concluded that it was too expensive to reach unfamiliar and distant market areas. The company decided to hire TKB Technology Trading Corporation, a trading company, to iden-tify good European markets for Nanodata's computer and to develop a distribution channel by choosing agents, distributors, or direct subsidiaries. TKB offered entry without expensive staff buildup until Nanodata was ready to do so on its own.

Like other intermediaries, however, the trading company must always face the possibility of being bypassed by its clients, and it thus must offer something of value to its customers. This holds true even for Mitsubishi, the world's largest trader with more than $164 billion in sales. Without its own production, this company could be squeezed out by Japanese clients that would set up their own marketing departments. Mitsubishi's solution in keeping old customers and getting new ones is to give buy-ers and sellers an incentive to do business with it. It has formed joint ventures with American and Japanese partners with an aim to acquire ownership influence with both its suppliers and customers. Furthermore, this firm cannot be easily replaced because of its long experience, expertise, and established networks.

Japanese Trading Companies Because of the spectacular success of the huge Japanese trading companies, many companies-especially those in the United States-would like to emulate or duplicate them. Japanese trading companies perform a number of marketing functions: market identification and analysis, sales forecasts, buying goods from manufacturers, selling goods to customers, and bearing financial risks.

Japanese trading companies have several distinct characteristics. They are sup-ported by domestic Japanese business. They are partners with groups of banks and other financial intermediaries, allowing them to have easy, convenient, and almost permanent access to enormous amounts of capital and financing.

Traditionally, Japanese manufacturers prefer to separate manufacturing from mar-keting, leaving the marketing function to trading firms. A new breed of Japanese manufacturers, however, prefers to have more marketing control and has been shifting away from this pattern of specialization by pursuing forward integration. Responding to this adverse trend, the sogo shosha is emphasizing its core competence: information gath-ering. It has transformed itself into an information-based organization.

13. Export Trading Companies In the United States the entities most resembling trad-ing companies are Webb-

Pomerene associations and EMCs, which together account for 12 percent of U.S. exports. Although EMCs and trading companies perform sev-eral—similar-functions. EMGs- are-different-because-they tend to be—smaller, with just a few employees. EMCs also lack easy access to sources of financing and thus are usually undercapitalized. As a result, EMCs are less diversified in product and geo-graphic area, and they restrict their business to exports with very little import focus. Thus, EMCs are not able to provide the complete range of services required by man-ufacturers.

Because of the limited success of EMCs and Webb-Pomerene companies (along with a concern over trade deficits), the United States has begun to turn to trading companies for a solution. The Export Trading Company (ETC) Act was passed in 1982. In Section 103 of the act, an export trading company is defined as a firm

Which is organized and operated principally for the purposes of -(a) exporting goods and services produced in the United States; and (b) facilitating the exportation of goods and services produced in the United States by unaffiliated persons by providing one or more export trade services. . . . The term "export trade services" includes, but is not lim-ited to, consulting, international market research, advertising, marketing, insurance, product research and design, legal assistance, transportation, including trade documen-tation and freight forwarding, communication and processing of foreign orders to and for exporters and foreign purchasers, warehousing, foreign exchange, and financing, when provided in order to facilitate the export of goods or services produced in the United States.

This act removed legal roadblocks that had impaired the effectiveness of EMCs and Webb-Pomerene associations. The two entities have not grown satisfactorily for two main reasons: lack of financing and antitrust restrictions. In the past, dealing with one of those two problems often involved getting into difficulty with the other. If firms tried to join together to strengthen their financial resources, they would be Violating the antitrust laws. In trying to avoid antitrust problems, they remained resource poor.

For more than half a century, the Glass-Steag all Act of 1934 banned banks from engaging in non-financial activities and bank ownership of commercial enterprises. Ti-tle III of the ETC Act removed this ban, allowing banks to hold equity positions in export trading companies. An amendment to the banking regulations permitted banks to participate in ownership indirectly through bank holding companies, Bankers' Banks, or Edge Act cooperatives. The act still bars any direct bank equity in ETCs, however. Also, unlike non-bank investors who can import freely, a bank-affiliated ETC must be either exclusively related to exporting activities or operated principally to fa-cilitate U.S. exports. That is, revenue derived from export must be greater than 50 percent of the ETC's revenue.

The participation of banks in export trading is critical. The obvious benefit is financial resources, but banks have other strengths. They provide many of the ser-vices that ETCs do. They can reach out to small and medium-sized firms by using their foreign branches to identify foreign buyers and domestic branches in order to contact U.S. manufacturers. Because trading companies often take title to goods to expedite deals the act has provided banks with an incentive to overcome their re-luctance to take ownership. The- banks are now in a position Jo derive higher profit margins than when they, merely' acted as agents.

The 1982 act provided a remedy for the antitrust problem as well. For decades, the Webb-Pomerene Export Trade Act of 1918 allowed firms to-participate in joint export but may have discouraged participation unintentionally by granting antitrust exemption to only a limited degree. Title III of the 1982-act solved this problem by allowing domestic competitors to obtain binding antitrust preclearance for specified export activities: By granting prior antitrust immunity, the antitrust threat was re-moved, creating a favorable environment for the formation of joint export ventures. Such ventures, through large-scale operations and economies of scale, can now re-duce cost and risk while promoting efficiencies. In order to be certified as not vio-lating antitrust laws, 3' group of companies and banks that join forces for the purpose of export can obtain a Certificate of Review from the Department of Commerce (with the concurrence of the Justice Department) for certification as an ETC. This certifi-cate functions as an antitrust "insurance policy: The ETC is then exempted from both criminal and civil antitrust activities and is immune from federal and state antitrust suits as long as the overseas cooperation does not filter back to affect competition and prices at home. When challenged, the certificate holder can recover legal ex-penses if the holder prevails.

Many of the companies applying for antitrust certificates were members of Webb-Pomerence associations and they in all likelihood decided to obtain more com-prehensive antitrust immunity. One study of U.S. intermediaries found that they have responded to various environmental factors by making changes in terms of their prod-ucts markets and services and that they have shifted from being a pure EMC to be-come a trading company the firms that have recently formed ETCs are from various backgrounds. Some are manufacturers with subsidiaries that have ready access to the parents' products. GE Trading Company for example, has access to GE's 300.000 prod-ucts. Other manufacturers include Rockwell International and GM, which have set up Rockwell International Trading Company and General Motors Trading Com-pany respectively. Retailers have also formed ETCs (e.g., Sears Roebuck Trading Company formed by Sears). Retailers such as Sears and Kmart have a great deal of bargaining power because of their enormous purchases and this leverage serves them well in marketing U.S. exports through foreign retail chains. Other organi-zations forming ETCs are hanks. Which seem natural for this purpose. Because banks can own up to 100 percent of an ETC's stock, these ETCs are guaranteed to have adequate financial resources. In some cases, banks and other business firms may want to form a joint venture, as in the case of First Chicago and Sears World Trade. Inc.

One problem with ETCs is that the ETC Act is designed to promote only U.S. exports. Thus ETCs' import activities must take a secondary position, undertaken only when they are needed to promote exports. Consequently, ETCs may lack an efficient infrastructure for developing two-way trade. In this regard, ETCs differ greatly from Japanese trading companies, which achieve their efficiencies through domestic, for-eign, and third-country trading activities. American ETCs may thus lack a compre-hensive international perspective. Responses to the formation of ETCs have not been enthusiastic.

LESSON 33:
CHANNEL DEVELOPMENT & ADAPTATION

Channel Development

The suitability of a particular channel depends greatly upon the country in which it is used. A particular type of intermediary that works well in one country may not work well elsewhere or may lose effectiveness over time. This does not necessarily mean that each country requires a unique channel. But a company may find that a country classification system is useful, a system that can be used to determine how the distribution, strategy should be set up from one group of countries to another.

Litvak and Banting suggest the use of a country temperature gradient to clas-sify countries. Their classification system is based on these environmental charac-teristics: (1) political stability, (2) market opportunity, (3) economic development and performance, (4) cultural unity, (5) legal barriers/restrictions, (6) physiographic bar-riers, and (7) geocultural distance. Based on these characteristics, countries may be classified as hot, moder-ate, or cold. A hot country is one that scores high on the first four characteristics and low on the last three. A cold country is exactly the opposite and a moderate one is medium on all seven characteristics.

The United States generally falls in line with the characteristics of a hot coun-try. So does Canada, even though its cultural unity is moderate (rather than high) and its physiographic barriers are moderate (rather than low). Germany, likewise, is a hot country in spite of some slight interference in the sense that its legal barriers and geo-cultural distance are moderate rather than low. Brazil, in contrast, largely conforms to a cold country's characteristics.

It is a judgment call whether so many characteristics are necessary for the pur-pose of classifying countries. The level of economic development could be used as the sole indicator, but such a classification would be misleading because hot coun-tries are not the same as industrialized countries. Still, one must question whether the refinement and improvement in the classification process justifies the extra effort nec-essary to wade through all relevant characteristics, especially since the level of eco-nomic development correlates well with these characteristics. For practicality, a short-cut appears to be desirable.

Classification is a means to an end, and the purpose of the country temperature gradient is to determine which intermedi-ary should be used in a given country. The temperature gradient also indicates which kind of intermediary is likely to be func-tioning in a country. In a cold country, competitive pressures on institutional change are not dynamic. Legal restrictions, for example, can prevent or slow down new dis-tribution innova-tions. Consider Egypt as an example. Only persons born of Egyptian fathers or Egyptian legal entities can represent foreign principals. Being "comfortably cold," middlemen see few threats to their existence. In China all tobacco must be sold through the China National Tobacco Co. monopoly.

For a hot country, environmental forces may be so hot that new institutional structures arise. Middlemen who fail to adjust will be bypassed and go out of exis-tence. The survival of a channel member is thus a function of the ability to adapt to changing environmental conditions because the channel member cannot hide behind local regulations for protection. For example, in the United Kingdom, either the prin-cipal or the intermediary can terminate an agency relationship provided there is a rea-sonable notice.

The country temperature gradient has implications for all channel members. A foreign manufacturer can exercise maxi-mum control over the evolutionary process in the distribution channel. The firm can initially rely on middlemen/distributors. If sales increase, the manufacturer can bypass the intermediary by setting up a sales branch or subsidiary. This is the trend being followed by foreign liquor suppliers in the U.S. market. These suppliers now very much control their own destiny by being respon-sible for their own distribution. E. Remy Martin & Co. took its cognac away from Glenmore Distillers and became its own U.S; distributor through its Premier Wine Merchants. Distillers Co. a Scottish firm, did like wise by buying Somerset-Importers from Esmark. Pernod Ricard and Monet-Hennessy adopted the same strategy by buy-ing AU3tin Nichols and Schieffelin, respectively.

A local manufacturer should be alert to any new channel since the new chan-nel may pose a threat to the existing channel. When possible, the manufacturer must preempt the competi-tion from utilizing it. Xerox was successful and secure with its direct sales-force channel-so secure that, when the Japanese competition entered the market, Xerox was totally unprepared. The Japanese invaded the U.S. market quickly and cheaply by using independent office equipment dealers, a channel that had been ignored by Xerox. The Japanese firms had their own direct sales-force large met-ropolitan areas, but they also supplied their machines to such U.S. firms as firm, Mon-roe, and Pitney Bowes, thus exploiting these U.S. firms' extensive sales and distrib-ution networks. Xerox was forced to experiment with such alternative channels as re-tail stores, direct mail, and part-time representatives.

Wholesalers, especially those involved in high-margin, low-volume operations, are particularly vulnerable to the threat posed by modem institutions. Wholesalers can easily be bypassed if they are successful in promoting their principals' products. Super scope, for example, lost the Sony franchise. On the other hand, if wholesalers do the job poorly, they are also likely to be eliminated or their authority and responsi-bility reduced. Mitsubishi was so unhappy with Chrysler's perfor-mance that the Japan-ese company developed its own independent dealer network in order to catch up with Toyota and Nissan.

Local retailers in a hot country are not exempt from innovations either. In Eu-rope, computer makers have to depend on highly

fragmented channels consisting of small retailers without financial resources for large inventories. Computer land has mounted an effort to change this distribution network by using its mass-marketing technique to duplicate its U.S. success in Europe. The company has opened several stores there.

Innovations tend to take place in a hot country before spreading to other hot countries and finally LDCs. Retailing innovations that conform to this description in-clude self-service stores, discount houses, and supermarkets, all of which initially developed in the United States. Hypermarche, on the other hand, utilizes a mass-mer-chandising method developed in Europe. This retail store is an enormous self-service combination of food and general merchandise, generally displayed in shipping con-tainers. A single set of checkout counters is used. This innovation has had only lim-ited success when introduced in the United States.

In another example, Apple has attempted to establish "Apple Centers" in the United States-a retailing concept utilized successfully in Europe. In 1985 Apple had few dealers and little public visibility in England. Apple thus developed the concept of "Apple Centers" as part of a strategy to improve its performance. The strategy in-volves having independently owned and managed retail outlets that are focused pri-marily on Apple products but also include software and peripherals from various man-ufacturers. The centers are offices that, under one roof, combine computer marketing, sales, training, support, and service. The concept was later extended to other Euro-pean countries; resulting in more than sixty Apple Centers, which have 'helped the European unit become the biggest contributor to corporate profit. Because markets vary, Apple has made substantial adjustments in its Apple Centers to perform different functions in different markets.

The success of an innovation is affected not only by the country temperature gradient but also by several other factors. A certain minimum level of economic de-velopment is required to support any form of outlet beyond simple retailing methods. General stores, a dying breed in the United States, are still very common in many countries. Firms 'aggressive "behavior will also be a determinant of the success of a new retailing method. Other cultural, legal, and competitive factors play an impor-tant role too. In LDCs, where there is plenty of low-cost labor and where people are accustomed to being waited on, self-service stores, discount houses, and supermar-kets are slow in gaining widespread acceptance. In developed countries, by compar-ison, various factors work in the favor of large modem discount stores/supermarkets, including high population density, urbanization, literacy, and labor costs. Also, the high-income level and relatively even income distribution make refrigerators and au-tomobiles affordable and accommodate infrequent shopping trips and large purchases.

Channel Adaptation

Because the standardized/globalized approach to international marketing strategy may not apply to distribution strategy in foreign markets, it is imperative that international marketers understand the distribution structures and patterns in those markets. To-ward this end, comparative marketing analysis should be conducted. A study of the degree of standardization in the marketing mix by large U.S.-based industrial firms in their Latin American business found that distribution was highly adapted to the different conditions in Latin America. The region's government regulation, a barrier to standardization, appears to force firms to adjust their prices, advertising, and distribution more than their products and brands.

Some channel adaptation is frequently a necessity. Suspicion and privacy can limit the effectiveness of door-to-door selling or other direct-selling methods. Avon has had to develop other distribution methods in Japan and Thailand. Discount retailing may not be effective in countries where there are many middlemen handling small volumes of merchandise. A traditional distribution channel may seem ineffi-cient, but it may maximize the utilization of inexpensive labor, leaving no idle re-sources.

A manufacturer must keep in mind that, because of adaptation, a particular type of retailer may not operate in exactly the same manner in all countries. Whereas a U.S. supermarket emphasizes low gross margin, its foreign counterpart may have a relatively high gross margin, emphasizing specialty goods and imported goods to a high degree. Furthermore, that foreign counterpart often operates a ready-to-eat food section. Interestingly, American supermarkets, especially those that have converted into superstores, have begun to do the same.

A particular distribution concept proven useful in one country may have to be further refined in another. Although 7-Eleven pioneered the convenience food store concept in Japan; the Japanese operation has evolved into being more sophisticated than the original Counterpart in United States. Even Japan offers its customers steaming fish cakes, canned tea and rice balls, while accepting payment for utility bills and accepting orders form the Tiffany's catalog. The 4,328 Japanese stores, viewing "slurpie" and ice drinks as passé, stopped serving them some years ago. To provide the most popular and latest products, about two thirds of a typical store's 3000 items will change in a year.

Channel Decision

As in any domestic market, the international market requires a marketer to make at least three channel decisions: length, width, and number of channels of distribution. **Channel length** is concerned with the number of times a product changes hands among intermediaries before it reaches the final consumer. The channel is considered long when a manufacturer is required to move its product through several middle-men. The channel is short when the product has to change hands just once or twice. If the manufacturer elects to sell directly to final consumers, the channel is direct. U.S. and Japanese manufacturers of TV sets employ different strategies in the length of channel. Zenith uses a two-step distribution, system, requiring retailers to buy from independent distributors. The system is unsuitable for video specialty stores. Which prefer to buy directly from manufacturers. As a result, video specialty stores have turned to Japanese manufacturers who in addition to having lower prices are willing to distribute direct to these stores.

Channel width is related to the number of middlemen at a particular point or step in the distribution channel. Channel width is a function of the number of whole-salers and the

different kinds that are used, as well as a function of the number and kind of retailers used. As more intermediaries or more types are used at a certain point in the channel. The channel becomes wider and more intensive. If only a few quali-fied intermediaries are needed to provide proper product support at a particular level or at a specific location, the channel is selective. The product though perhaps not available everywhere, is still carried by at least a few qualified middlemen within the same area. Finally, the distribution becomes exclusive if only one intermediary of one type is used in that particular area.

The watch industry and its distribution strategies provide a good illustration of an industry with various channel widths. Timex, as a low-priced, mass-market prod-uct, is intensively distributed in the sense that any intermediary, no matter what kind, is allowed to carry the brand. Seiko is more selective. Seiko, as an upper-medium-priced brand, is sold through jewelry stores and catalog showrooms and is less likely to be found in discount or drug stores.

Channel width is relative. Both Seiko and Omega employ selective distribution, though Omega is much more selective. Omega's tighter policy of selective, limited distribution results in the brand being available only in top jewelry, specialty, and de-partment stores. Because of the relative nature of channel width, it is inappropriate to compare width at the retail level with wholesale width. Because there are many more retailers than wholesalers, the issue of channel width applies only to a particu-lar distribution level rather than through distribution levels. The degree of selectivity depends on the relative, not the absolute, number of intermediaries at a particular dis-tribution level. As a product is moved closer to end users, the distribu-tion channel tends to become broader. At a point closer to the manufacturer, the channel is not as broad. For example, at the distributor level, Brother International is the exclusive U.S. distributor for Japan's Brother Industries.

Another decision that concerns the manufacturer is the number of distribution channels to be used. In some circumstances, the manufacturer may employ many channels to move its product to consumers. For example, it may use a long channel and a direct channel simultaneously. The use of dual distribution is common if the manufacturer has different brands intended for different kinds of consumers. Another reason for using multiple channels may involve the manufacturer's setting up its own direct sales force in a foreign market where the manufac-turer cannot remove the orig-inal-channel (e.g., agents) because of strategic or legal reasons. Although Seiko, Las-sale, and Jean Lassale are all made by the same Japanese firm, dual channels are used for these brands. Seiko and Lassale are sold through distributors in the United States, whereas Jean Lassale is sold by the manufacturer directly to retailers Gewelers).

Determinants of Channel Types

There is no single across the board solution for all manufactur-ers' channel decisions. Yet there are certain guidelines that can assist a manufacturer in making a good decision factors that must be taken into account include legal regulations, product image, product characteristics, intermediaries loyalty and conflict, and local customs.

1. Legal Regulations

A country may have specific laws that rule out the use of particular channels or mid-dlemen for example, prohibits the use of doors to door selling. Although private importers in Iraq may choose to deal through commission agents, Iraqi legislation prohibits state enterprises form dealing with third party intermediaries (including commission agents) in obtaining foreign supplies, Saudi Arabia requires every foreign company with work there to have a local sponsor who receives about 5 percent of any contract. Not surprisingly, many Saudis, acting as agents, have become millionaires almost overnight.

The overseas distribution channel often has to be longer than desired. Because of government regulations, a foreign company may find it necessary to go through a local agent/ distributor. In china, foreign firms cannot wholly own retail outlets, and they can to engage in wholesaling activities. In addition, only fourteen foreign retail ventures have direct import authority, forcing those without direct import authority to add another layer of middlemen.

Channel width may be affected by the law as well. In general, exclusive representation may be viewed as a restraint of especially if the product has it dominant market, position. In Germany, the Federal cartel Office may intervene with exclusive dealing and distribution requirements.

Due to the EU's single market program, geographic barriers between national markets have blurred, making it possible for consumers outside national sales territories to gain greater access to products and services. Therefore, EU antitrust au-thorities have increased their scrutiny of "national" and exclusive sales agreements. The Treaty of Rome prohibits distribution arrangements that affect trade or restrict competition (i.e., restrictions on territory, non-competition clauses, and grants of ex-clusivity). As a matter of fact, in the case of automobiles, the Commission has de-termined that exclusive distribution limited trade between the member countries and that manufacturers thus had less incentive to price cars on a competitive basis. It has directed the manufacturers to allow the distributors to sell to other dealers and con-sumers throughout the EU.

It's the Law

Cross-Border Pricing

Yves Rocher a French cosmetic company and cata-loger sent a catalog direct-mail offer that made use of price comparisons to German consumers. The promotion showed a slashing of the old price, and the cheaper price was shown in big red type. Because the technique used was eye catching, it was considered illegal in Germany and was thus challenged under Germany's unfair competition laws, which restrict sales promotion techniques.

Although Yves Rocher's advertisement was translated into German and prices into deutsche marks, the promotion originated in France. The company ap-pealed the ruling and the European Court of Justice ruled that, according to Article 30 of the EEC Treaty, the German decision was a barrier to trade. The court stated that, since the advertisement was not mislead-ing, the ban would affect "advertising without any misleading

nature comparing actual prices. Which can be very useful to a consumer when making his choice with all the facts in hand."

Another case involved Inno-GB. A large super -market based in Belgium. The company sent an un-ad-dressed promotion in French across the Luxembourg border to generate store traffic. However, Luxem-bourg and German laws prohibit promotions from be-ing run outside a specific period of the year. But EU courts have ruled that Inno-GM did not do anything il-legal. Luxembourg could not use its different laws to keep out advertising material from another country.

2. Product Image

The product image desired by a manufacturer can dictate the manner in which the product is distributed. A product with a low- rice image requires intensive distribution. On the other hand, it is not necessary nor even desirable for a prestigious product to have wide distribution. Clinique's products are sold in only sixty-four department stores in Japan. Waterford Glass has always carefully nurtured its posh Image by limiting its distribution to top-flight department and specialty stores. At one time it did not take on any retail accounts for a period of a year. Its effort to create an air of exclusivity has worked so well that Waterford Glass commands a quarter of the U.S. market, easily making it the best-selling fine crystal.

Although intensive distribution may increase sales in the short run, it is poten-tially harmful to the products image in the long run. This is problem faced by Aprica as If moves its -strollers beyond department and specialty stores into mass-mar-ket outlets such as J.C. Penney and Sears. Tiffany & Co. lost many upper-class customers when it broadened its clientele bas; artier, trying to restore its esteem, has pared its retail its distribution network," which- it had proliferated unwisely, by 50 per-cent in the United States and 25 percent worldwide.

3. Product Characteristics

The type of product determines how that product should be distributed. For low- high-turnover convenience products, the requirement is for an intensive distribution network. The intensive distribution of ice cream is an example walls (formerly Foremast's) success in Thailand can be attributed in part to its intensive distribution and channel adaptation tailored its distribution activities to the lo-cal Thai scene by sending its products (Ice cream, milk, and other dairy products) into market in every conceivable manner. Such traditional channels as wholesalers and such new channels as company-owned retail outlets (modern soda fountains) and push-carts are also used. Pushcarts are supplied by the company and manned by indepen-dent retailers (i.e., sidewalk salesmen)" who keep a 20 percent margin. However, tra-ditional channels employing wholesalers, small stores, restaurants, hotels, and schools still account for a majority of sales.

For high unit value, low turnover specially goods, a manufacture can shorten and narrow its distribution channel. Consumers are likely to do some comparison-shopping and will more of less actively seek information about all brands under consideration. In such cases, limited product exposure is not an impediment to market success.

One should always remember that products are dynamic, and the specialty goods to today may be nothing more than the shopping or even convenience goods of to morrow. Consider computers, which were once an expensive specialty product that required a direct and exclusive channel. Since the early 1980s, computers have become more of a shopping good, necessitating a longer and" more intensive channel.

This change in the nature of the product serves to explain why such American com-puter makers as Nixdorf, ICL, and Philips were anything but successful when they persisted in using a direct sales force as their primary channel of distribution abroad. As an indication of how dramatically the distribution of computers has changed. Hyundai's personal computer for Blue Chip (a U.S. distributor) is sold like a TV set in such up-scaled discount stores as Target and Caldor instead of through computer specialty stores.

4. Middlemen's Loyalty and Conflict

One ingredient for an effective channel is satisfied channel member. As the channel widens and as the number of channels increases, more direct competition among channel members in inevitable. Some members will perceive large competing member and self-service members as being unfair. Some members will blame the manufacturer for being motivated be greed when setting up a more intensive network. In effect for being motivated by greed when setting up a more intensive network. In effect intensive distribution reduces channel members. Cooperation and their loyalty as well as Increases channel conflict Michelin has been accused of undercutting its own dealers in the U.S: market by not only expanding its dealer network by 50 percent but also adding a direct channel to take national accounts away from dealers. Both actions increased price competition and reduced dealers' loyalty. Apple's problems in Japan owed in part to its addition of new channels even though it already had a big distributor.

5. Local Customs

Local business practices, whether outmoded or not, can interfere with efficiency and productivity and may force a manufacturer to employ a channel of distribution that is longer and wider than desired. Because of Japan's multitiered distribution system, which relies on numerous layers of middlemen, companies often find it necessary to form a joint venture with Japanese firm, such as Pillsbury with snow Brand, Xerox with Fuji, and KFC with Mitsubishi Japan many layered distribution system is not entirely unique in that part of the world, since the custom in many Far Eastern countries is to have multiple intermediary markups on imported goods. Yet the rule of thumb in Hong Kong is that there should be no more than two layers between a U.S. exporter of finished goods and Hong Kong consumers, usually consisting of an importer agent retailer, or distributor.

Domestic customs can explain why a particular channel is in existence. Yet cus-toms may change or may be overcome,

especially if consumer tastes change. For ex-ample, there" are some 82,00 British pubs, 50,000 — of which are owned by brewing companies; the problem they faced the trend toward beer consumption at home. The pubs have had to adjust by emulating trendy American bars, selling more wine and such food as hamburgers.

6. Power and Coercion

The "least dependent person" hypothesis, mentioned earlier, states that the one party with resources and alternatives can demand more because it needs the other party less. As such, the least dependent member of the channel has more power and may be able to force to the channel member to accept its plan. This hypothesis explains why it has been difficult for Japanese and Korean semiconductor manufacturers to recruit U.S. distributors to reach customers who are too small to buy directly from computer chip manufacturers. The major U.S. semiconductor manu-facturers have long adopted a tacit policy of not allowing their distributors to sell Japanese competitors' products. Avnet Inc., the largest distributor in the United States, had to stop buying chips from Japan's NEC Corp. Samsung Semiconductor was ini-tially happy when Arrow Electronics Inc., the nation's second-largest distributor of semiconductors, agreed to sell its products. Arrow abruptly terminated the agreement a few weeks later, citing changing business conditions. What happened was that In-tel Corp. and Texas Instruments reduced the amount of business conducted with Ar-row. It is thus not surprising that only one of the electronics industry's top ten dis-tributors distributes Japanese or Korean chips.

Contrary to a prediction made by reciprocal action theory, dealers in a devel-oping country do not retaliate against the manufacturers use of coercive influence strategies. Apparently, dealers in sellers markets are so highly dependent on manu-facturers that they have fewer equity concerns and higher tolerance than dealers in other channel contexts. In the industrial product channel, the model holds up very well in the empirical analysis.

One must be careful in applying Western models overseas because their impact may differ in LDCs. The applicability of those models may vary from country to country as well. A survey of Japanese distributors of U.S. products examined how perceptions of influence affect control and conflict in the relationship. The findings indicated that aggressive influence evoked resistance and conflict but that more sub-tle influence strategies appeared to reduce conflict. Therefore, influence, as practiced in Western channels, may not be effective in relationships with Japanese firms.

7. Control

If it has a choice, a manufacturer that wants to have better control over its product distribution may want To both shorten 'and-narrow 'its distribution channel- One study of Bntaill's' machine tool importers-f6imd that, in light of the EU integration and com-petitive pressures, there has been an increase in the number of sales subsidiaries as compared with distributors or agents. Apparently, manufacturers want to get closer to final customers.

One study employed a model based on transaction cost analysis to explain ex-porters' vertical control selections. Exporters of specialized products should establish channel structures that require a greater commitment of resource. Such structures, however, require larger fixed costs. Conversely, in the case of a relatively competitive market with large numbers of buyers and sellers, an exporter may want to give up some control and switch to a looser structure by contracting in the market place for the provision of marketing functions.

In conclusion, there are a number of factors that affect channel decisions. Some of these factors are interrelated. Empirically, it has been shown that overseas distri-bution channel choice is affected by culture and other product constraints. Entering firms, for example, tend to use intermediaries when introducing products to non-West-ern markets. A recent study of 269 manufacturers also found that a choice between foreign-based agents and distributors is affected by mark-et-diversity, type of transac-tion-specific asset; and production cost economies. Agents are used only to find cus-tomers when manufacturers want to safeguard technology by self-performing most of the export functions.

The A.T. Cross Company

Francine Newth

Providence College

The Legacy

As stated in the A.T. Cross Company 1986 annual report, "Everything begins with quality." Cross pens and pencils are known worldwide as standing for the ultimate expression of excellence. The story began in 1846 with the company's founder, Alonzo T.Cross. Mr. Cross, an immigrant inventor and craftsman, started his business in his Rhode Island home with a goal to "manufacture and market elegant, hand-tooled gold and silver filigree casings for wooden pencils." Today, The A.T. Cross Company is as devoted to design perfection and craftsmanship as Alonzo T.Cross was in 1846, which explains the enduring legacy of A.T. Cross. In fact, Cross offers a full perpetual warranty.

The Cross Profile

With ambition, vision, and a commitment to excellence, the A.T.Cross Company has grown into a major international manufacturer of fine writing instruments. The company has two plants, one in Lincoln, Rhode Island, and one in Ballinasloe, Ireland. Cross products are sold to the consumer gift market through selected stores (jewelery, department, stationary, gift, and book stores). They are also sold to the business gift market through selected companies specializing in recognition programs.

The Industry

The fine writing instrument industry is truly an international industry with different market leaders in all parts of the world. The major international competitors are A.T. Cross, Schaeffer, Parker, Waterman, Pelikan, and Montblanc. As of 1996, Parker and Waterman are owned by the Gillette Company and Montblanc is owned by the Vendome Holding Company.

Writing needs vary throughout the world. For example, in Europe, fountain pens are very popular; in the Far East, most writing instruments must include finepoint catridges. However, packaging, advertising, and

promotion truly constitute the major change elements in international markets rather than any change in the product per se.

Most international manufacturers of writing instruments have established either networks of distribution. Therefore, the distribution choices of a new entrant in a particular country are very limited.

International Expansion For A. T. Cross

In the early 1960s, the A.T.Cross Company began to receive several foreign inquiries concerning the availability of the Cross pens and pencils overseas. More specifically, businesses from Europe and the Far East were asking where, in their country, they could acquire Cross-pens. These inquiries and demands for the fine writing instruments led the A.T. Cross Company to pursue the overseas marketplace.

A.T.Cross was particularly interested in distributing its products in Spain, France, the United Kingdom, and Germany. However, there were some strong existing competitors with well-established distributors in these countries. Furthermore, many distributors had exclusive arrangements with existing manufacturers.

Ideal foreign distributors should be small enough to want to take on a new manufacturer but large enough to advertise. More European countries have their own national brand of writing instruments manufactured in each respective country. The following manufacturers of fine writing instruments have substantial market share in these countries: Inoxchrome (Spain), Waterman (national brand in France), Parker (national brand in the United Kingdom), and MontBlanc/Pelikan/Lamy (Germany).

There were also some other imported writing instruments within each one of these countries. As a result, the overseas marketplace was highly competitive. Regardless, A.T. Cross decided to enter these markets. At first it could not find suitable distributors, so it began considering other distribution channels.

A.T. Cross Global Distribution Profile Update

In response to growing international demand for its products, A.T. Cross decided to establish its own distribution subsidiaries by acquiring existing distributors in Spain, France, the United Kingdom, Germany, Italy, and Japan. The decision to pursue an acquisition strategy in these markets was primarily based on market size and market potential. In addition, a network of independent distributors was developed by negotiating a mix of exclusive and nonexclusive agreements to ensure proper market penetration in this mature and fragmented global market. The A.T. Cross global-distribution strategy reaches approximately 50 percent of the world (100 countries). As a result, in 1995, 42 percent of A.T.Cross's sales were from non-U.S markets compared to 25 percent in 1989, representing an increase of 68 percent in non-U.S. sales, constituting an average yearly growth rate of 11 percent.

Questions:

1. What are the global distribution issues now faced by A.T. Cross?

2. What factors should A.T.Cross consider in the development of its regional distribution strategy in emerging markets (i.e., Eastern Europe), within the context of its global distribution strategy?

Automotive Components, Inc.

Dirk Wassenaar

San Jose State University

Pat Small, the newly appointed assistant export manager for Automotive Components, Inc; looked out of his office window while contemplating the responsibilities of his new job. As a graduate with a major in international business, he was delighted to have found this challenging, well paying position. Yet, in taking a closer look at his new assignment, he kept wondering about the direction of the company.

Automotive Components, Inc; (ACI) was started over fifty years ago, designing and building automotive components, including electrical systems and gauges of various types. The company's innovative, high quality products had gained it a first class reputation, a healthy growth rate, and excellent profitability.

ACI's founder and his sons, who took over the business upon their father's retirement, managed to develop close relationships with the leading car and truck builders in the U.S. the result was that the company became a leader in many of the market niches in which it competed. As far as participating in the international markets was concerned, the company had been very cautious. ACI's founder, in particular, liked to point out that the U.S. market was by far the most important one in the world and offered plenty of opportunities for growth.

ACI's international involvement had largely been limited to the licensing of a British firm to make certain proprietary products and exporting products from the U.S. through an Export Management Company (EMC). The EMC assumed full responsibility for the marketing of ACI's products outside the U.S. ACI's management had been very pleased with the growth of the company's exports and licensing income. Currently, foreign sales revenues accounted for almost 20% of total sales and were growing at a faster rate than the domestic business. In addition, as the president liked to point out, these export sales are very profitable, requiring little investment and effort on the part of the company since the EMC handles most marketing activities. Although it would be difficult to calculate an accurate rate of return on resources invested in this area, everyone agrees that the number must be very attractive.

Pat Small, as the new assistant export manager, was hired to work closely with the EMC in trying to increase exports at an even faster pace. While contemplating this responsibility, Pat could not help thinking back to an international business course he took in college not too long ago. There he learned about companies, which had gone far beyond simple exporting as a way to increase their business in foreign markets. Many of these companies had their own sales offices and even production facilities abroad. Sometimes they would work with local foreign companies in joint ventures. Such an aggressive approach in foreign markets obviously required substantial investments and involved various risks. However, based on other companies' experiences, it seemed that the potential of many foreign markets fully warranted these investments and efforts.

Suddenly Pat knew what he should do. He would conduct some research, review his old international business texts and, if his first impression was confirmed, write a memo to his boss summarizing as concisely and forcefully as possible (1) why ACI should more aggressively pursue foreign markets, and (2) how ACI could best enter various markets abroad. To do the latter, he would list all possible entry strategies in an appendix to his memo and summarize the major advantages and disadvantages of each.

Your Assignment

1. You are Pat Small. Write a memo which clearly addresses the following issues: (1) why should ACI become more aggressively involved in foreign markets, and (2) how should ACI do so?

Prepare a complete list of the various entry strategies ACI can use to enter foreign markets. List the advantages and disadvantages of each.

LESSON 34:
A GUIDE FOR DEVELOPING A MARKETING PLAN

The first stage in the planning process is a preliminary country analysis. The marketer needs basic information to (1) evaluate a country-market's potential; (2) identify problems that would eliminate a country from further consideration; (3) identify aspects of the coun-try's environment that need further study; (4) evaluate the components of the marketing mix for possible adaptation: and (5) develop a strategic marketing plan. One further use of the information collected in the preliminary analysis is as a basis for a country notebook.

Many companies, large and small, have a country notebook for each country in which they do business. The country notebook contains information a marketer should be aware of when making decisions involving a specific country-market. As new information is col-lected, the country notebook is continually updated by the country or product manager. Whenever a marketing decision is made involving a country, the country notebook is the first database consulted. New product intro-ductions, changes in advertising programs, and other marketing program decisions begin with the country notebook. It also serves as a quick introduction for new personnel assuming responsibility for a country-market.

This section presents four separate guidelines for collection and analysis of market data and preparation of a country notebook: (1) guideline for cultural analysis; (2) guideline for economic analysis; (3) guideline for market audit and competitive analy-sis; and (4) guideline for preliminary marketing plan. These guidelines suggest the kinds of information a marketer can gather to enhance planning.

The points in each of the guidelines are general. They are designed to provide di-rection to areas to explore for relevant data. In each guideline, specific points must be adapted to reflect a company's products. The decision as to the appropriateness of spe-cific data and the depth of coverage depends on company objectives, product character-istics, and the country-market. Some points in the guidelines are unimportant for some countries and/or some products and should be ignored. Preceding chapters of this book provide specific content suggestions for the topics in each guideline.

1. Cultural Analysis

   The data suggested in the cultural analysis include information that helps the marketer make market-planning decisions. However, its application extends beyond product/mar-ket analysis to an important source of information for someone interested in understand-ing business customs and other important cultural features of the country.

   The information in this analysis must be more than a collection of facts. Whoever is responsible for the preparation of this material should attempt to interpret the meaning of cultural information. That is, how does the information help in understanding the ef-fect on the market? For example, the fact that almost all the populations of Italy and Mexico are Catholic is an interesting statistic but not nearly as useful as understanding the effect of Catholicism on values, beliefs, and other aspects of market behavior. Fur-thermore, even though both countries are predominantly Catholic, the influence of their individual and unique interpretation and practice of Catholicism can result in important differences in market behavior.

Guidelines

1. Introduction.

   Include short profiles of the company, the product to be exported, and the country with which you wish to trade.

2. Brief discussion of the country's relevant history.

3. Geographical setting.

   A. Location.

   B. Climate.

   C. Topography.

4. Social institutions.

   A. Family.

      1. The nuclear family.

      2. The extended family.

      3. Dynamics of the family.

         a. Parental roles.

         b. Marriage and courtship.

4. Female/male roles (are they changing or static?).

   B. Education.

      1. The role of education in society.

         a. Primary education (quality, levels of development, etc.).

         b. Secondary education (quality, levels of development, etc.).

         c. Higher education (quality, levels of development, etc.).

      2. Literacy rates.

C. Political system.

      1. Political structure.

      2. Political parties.

      3. Stability of government.

      4. Special taxes.

      5. Role of local government.

D. Legal system.

      1. Organization of the judiciary system.

      2. Code, common, socialist, or Islamic-law country?

3. Participation in patents, trademarks, and other conventions.

E. Social organizations.

1. Group behavior.
2. Social classes.
3. Clubs, other organizations.
4. Race, ethnicity, and subcultures.

F. Business customs and practices.

6. Religion and aesthetics.

A. Religion and other belief systems.

1. Orthodox doctrines and structures.
2. Relationship with the people.
3. Which religions are prominent?
4. Membership of each religion.
5. Are there any powerful or influential cults?

B. Aesthetics.

1. Visual arts (fine arts, plastics, graphics, public art, colors, etc.).
2. Music.
3. Drama, ballet, and other performing arts.
4. Folklore and relevant symbols.

6. Living conditions.

A. Diet and nutrition.

1. Meat and vegetable consumption rates.
2. Typical meals.
3. Malnutrition rates.
4. Foods available.

B. Housing.

1. Types of housing available.
2. Do most people own or rent?
3. Do most people live in one-family dwellings or with other families?

C. Clothing.

1. National dress.
2. Types of clothing worn at work.

D. Recreation, sports, and other leisure activities.

1. Types available and in demand.
2. Percentage of income spent on such activities.

E. Social security.

F. Health care.

7. Language.

A. Official language(s).

B. Spoken versus written language(s).

C. Dialects.

8. Executive summary.

After completing all of the other sections, prepare a two-page (maximum length) summary of the major points and place it at the front of the report. The purpose of an executive summary is to give the reader a brief glance at the critical points of your report. Those aspects of the culture a reader should know to do business in the country but would not be expected to know or would find different based on his or her SRC should be included in this summary.

9. Sources of information.

10. Appendixes.

2. Economic Analysis

The reader may find the data collected for the economic analysis guideline are more straightforward than for the cultural analysis guideline. There are two broad categories of information in this guideline: general economic data that serve as a basis for an eval-uation of the economic soundness of a country; and, information on channels of distri-bution and media availability. As mentioned earlier, the guideline focuses only on broad categories of data and must be adapted to particular company/product needs.

Guidelines

I. Introduction.

II. Population.

A. Total.

1. Growth rates.
2. Number of live births.
3. Birthrates.

B. Distribution of population.

1. Age.
2. Sex.
3. Geographic areas (urban, suburban, and rural density and concentration).
4. Migration rates and patterns.
5. Ethnic groups.

III. Economic statistics and activity.

A. Gross national product (GNP or GDP).

1. Total.
2. Rate of growth (real GNP or GDP).

B. Personal income per capita.

C. Average family income.

D. Distribution of wealth.

1. Income classes.
2. Proportion of the population in each class.
3. Is the distribution distorted?

E. Minerals and resources.

F. Surface transportation.

1. Modes.
2. Availability.
3. Usage rates.
4. Ports.

G. Communication systems.

1. Types.

2. Availability.
3. Usage rates.

H. Working conditions.
1. Employer-employee relations.
2. Employee participation. .
3. Salaries and benefits.

I. Principal industries.
1. What proportion of the GNP does each industry contribute?

2. Ratio of private to publicly owned industries.

J. Foreign investment.
1. Opportunities?
2. Which industries?

K. International trade statistics.
1. Major exports.
a. Dollar value.
b. Trends.
2. Major imports.
a. Dollar value.
b. Trends.
3. Balance-of-payments situation.
a. Surplus or deficit?
b. Recent trends.
4. Exchange rates.
a. Single or multiple exchange rates?
b. Current rate of exchange.
c. Trends.

L. Trade restrictions.
1. Embargoes.
2. Quotas.
3. Import taxes.
4. Tariffs.
5. Licensing.
6. Customs duties.

M. Extent of economic activity not included in cash income activities.
1. Counter trades.
a. Products generally offered for counter trading.
b. Types of counter trades requested (i.e., barter, counter purchase, etc.).
2. Foreign aid received.

N. Labor force.
1. Size.
2. Unemployment rates.

O. Inflation rates.

IV. Developments in science and technology.
A. Current technology available (computers, machinery, tools, etc.).
B. Percentage of GNP invested in research and development.
C. Technological skills of the labor force and general population.

V. Channels of distribution (macro analysis).

This section reports data on all channel middlemen available within the market. Later, you will select a specific channel as part of your distribution strategy.

A. Middlemen.
1. Retailers.
a. Number of retailers.
b. Typical size of retail outlets.
c. Customary markup for various classes of goods.
d. Methods of operation (cash/credit).
e. Scale of operation (large/small).
f. Role of chain stores, department stores, and specialty shops.
2. Wholesale middlemen.
a. Number and size.
b. Customary markup for various classes of goods.
c. Method of operation (cash/credit).
3. Import/export agents.
4. Warehousing.
5. Penetration of urban and rural markets.

VI. Media.

This section reports data on all media available within the country/market. Later, you will select specific media as part of the promotional mix/strategy.

A. Availability of media.
B. Costs.
1. Television.
2. Radio.
3. Print.
4. Other media (cinema, outdoor, etc.).
C. Agency assistance.
D. Coverage of various media.
E. Percentage of population reached by each of the media.

VII. Executive summary.

After completing the research for this report, prepare a two-page (maximum) summary of the major economic points and place it at the front.

VIII. Sources of information.

IX. Appendixes.

3. Market Audit and Competitive Market Analysis

of the guidelines presented, this is the most product- or brand-specific. Information in the other guidelines is general in nature, focusing on product categories, whereas data in this guideline are brand-specific and are used to determine, competitive market condi-tions and market potential.

Two different components of the planning process are reflected in this guideline. In-formation in Parts I and II, Cultural Analysis and Economic Analysis, serve as the basis for an evaluation of the product-brand in a specific country market. Information in this guideline provides an estimate of market potential and an evaluation of the strengths and weaknesses of competitive marketing efforts. The data generated in this step are used to determine the extent of adaptation of the company's marketing mix necessary for suc-cessful market entry and to develop the final step, the action plan.

The detailed information needed to complete this guideline is not necessarily avail-able without conducting a thorough marketing research investigation. Thus, another pur-pose of this part of the country notebook is to identify the correct questions to ask in a formal market study.

Guidelines

I. Introduction.

II. The product.

A. Evaluate the product as an innovation as it is perceived by the intended mar-ket.

1. Relative advantage.
2. Compatibility.
3. Complexity.
4. Trial ability.
5. Observability.

B. Major problems and resistances to product acceptance based on the preceding evaluation.

III. The market.

A. Describe the market(s) in which the product is to be sold.

1. Geographical region(s).
2. Forms of transportation and communication available in that (those) re-gion(s).
3. Consumer buying habits.
   a. Product-use patterns.
   b. Product feature preferences.
   c. Shopping habits.
4. Distribution of the product.
   a. Typical retail outlets.
   b. Product sales by other middlemen.
5. Advertising and promotion.
   a. Advertising media usually used to reach your target market(s).
   b. Sales promotions customarily used (sampling, coupons, etc.).
6. Pricing strategy.
   a. Customary markups.
   b. Types of discounts available.

B. Compare and contrast your product and the competition's product(s).

1. Competitor's product(s).
   a. Brand name.
   b. Features.
   c. Package.
2. Competitor's prices.
3. Competitor's promotion and advertising methods.
4. Competitor's distribution channels.

C. Market size.

1. Estimated industry sales for the planning year.
2. Estimated sales for your company for the planning year.

D. Government participation in the marketplace.

1. Agencies that can help you.
2. Regulations you must follow.

IV. Executive summary.

Based on your analysis of the market, briefly summarize (two-page maximum) the major problems and opportunities requiring attention in your marketing mix, and place the summary at the front of the report.

V. Sources of information.

VI. Appendixes.

4. Preliminary Marketing Plan

Information gathered in Guidelines I through III serves as the basis for developing a marketing plan for your product-brand in a target market. How the problems and oppor-tunities that surfaced in the preceding steps are overcome and/or exploited to produce maximum sales/profits is presented here. The action plan reflects, in your judgment, the most effective means of marketing your product in a country market. Budgets, ex-pected profits and/or losses, and additional resources necessary to implement the pro-posed plan are also presented.

Guidelines

I. The marketing plan.

A. Marketing objectives.

1. Target market(s) (specific description of the market).
2. Expected sales 20-.
3. Profit expectations 20-.
4. Market penetration and coverage.

B. Product adaptation, or modification-Using the product component model as your guide, indicate how your product can be adapted for the market.

1. Core component.
2. Packaging component.
3. Support services component.

C. Promotion mix.

1. Advertising.
   a. Objectives.
   b. Media mix.

c. Message.
d. Costs.

2. Sales promotions.
a. Objectives.
b. Coupons.
c. Premiums.
d. Costs.

3. Personal selling.

4. Other promotional methods

D. Distribution: From origin to destination.

1. Port selection.
a. Origin port.
b. Destination port.

2. Mode selection: Advantages/disadvantages of each mode.
a. Railroads.
b. Air carriers.
c. Ocean carriers.
d. Motor carriers.

3. Packing.
a. Marking and labeling regulations.
b. Containerization.
c. Costs.

4. Documentation required.
a. Bill of lading.
b. Dock receipt.
c. Air bill
d. Commercial invoice.
e. Proforma invoice.
f. Shipper's export declaration.
g. Statement of origin.
h. Special documentation.

5. Insurance claims.

6. Freight forwarder.

If your company does not have a transportation or traffic management department, then consider using a freight forwarder. There are distinct ad-vantages and disadvantages to hiring one.

E. Channels of distribution (micro analysis).

This section presents details about the specific types of distribution in your marketing plan.

1. Retailers.
a. Type and number of retail stores.
b. Retail markups for products in each type of retail store.
c. Methods of operation for each type (cash/credit).
d. Scale of operation for each type (small/large).

2. Wholesale middlemen.
a. Type and number of wholesale middlemen.
b. Markup for class of products by each type.
c. Methods of operation for each type (cash/credit).
d. Scale of operation (small/large).

3. Import/export agents.

4. Warehousing.
a. Type.
b. Location.

F. Price determination.
1. Cost of the shipment of goods.
2. Transportation costs.
3. Handling expenses.
a. Pier charges.
b. Wharfage fees.
c. Loading and unloading charges.
4. Insurance costs.
5. Customs duties.
6. Import taxes and value-added tax.
7. Wholesale and retail markups and discounts.
8. Company's gross margins.
9. Retail price.

G. Terms of sale.
1. Ex works, fob, fas, c&f, cif.
2. Advantages/disadvantages of each.

H. Methods of payment.
1. Cash in advance.
2. Open accounts.
3. Consignment sales.
4. Sight, time, or date drafts.
5. Letters of credit.

II. Proforma financial statements and budgets.

A. Marketing budget.
1. Selling expense.
2. Advertising/promotion expense.
3. Distribution expense.
4. Product cost.
5. Other costs.

B. Pro forma annual profit and loss statement (first year and fifth year).

III. Resource requirements.

A. Finances.

B. Personnel.

C. Production capacity.

4. Executive summary.

After completing the research for this report, prepare a two-page (maximum) summary of the major points of your successful marketing plan, and place it at the front of the report.

5. Sources of information.
6. Appendixes.

The intricacies of international operations and the complexity of the environment within which the international marketer must operate create an extraordinary demand for information. When operating in foreign markets, the need for thorough information as a substitute for uninformed opinion is equally as important as it is in domestic mar-keting. Sources of information needed to develop the country notebook and answer other marketing questions are discussed in Chapter 8 and appendix.

Summary

Market-oriented firms build strategic market plans around company objectives, markets, and the competitive environment. Planning for marketing can be complicated even for one country, but when a company is doing business internationally, the prob-lems are multiplied. Company objectives may vary from market to market and from time to time; the structure of international markets also changes periodically and from country to country; and the competitive, governmental, and economic parameters af-fecting market planning are in a constant state of flux. These variations require international marketing executives to be spe-cially flexible and creative in their approach to strategic market-ing planning.

LESSON 35
PHYSICAL DISTRIBUTION & DOCUMENTATION

Distribution is a necessary as well as costly activity. According to one executive at Procter & Gamble, the average time required to move a typical product from "farm to shelf" is four to five months. Although it takes only about seventeen minutes to actually produce a product, the rest of the time is spent in logistical activities- storage, handling, transportation, packing and so on.

Modes of Transportation

The availability of transportation is one important factor affecting a company's site selection. To move a product both between countries and within a country, there are three fundamental modes of transportation: air, water (ocean and inland), and land (rail and truck). Ocean and air shipments are appropriate for transportation between countries, especially when the distance is con-siderable and the boundaries are not joined. Inland water, rail, and highway are more suitable for inland and domestic transportation. When countries are connected by land (e.g., -North America), it is possible to use rail and highway to move merchandise from locations, such as from the United States to Canada. In Europe, rail (train) is an important mode because of the contiguity of land areas and the availability of a mod-em and efficient train system.

The appropriate transportation mode depends on (1) market location, (2) speed, and (3) cost. A firm must first consider *market location.* Contiguous markets can be served by rail or truck, and such is the case when goods are shipped from the United States to Canada or Mexico. To move goods, between continents, ocean or air trans-portation is needed.

Speed is another consideration. When speed is essential, air transport is with-out question the preferred mode of distribution. Air transport; is also necessary when the need is urgent or when delivery must be quickly completed as promised. For perishable items, a direct flight is preferable because a shorter period in transport reduces both spoilage and theft.

Finally, *cost* must be considered as well. Cost is directly related to speed-a quick delivery costs more. But there is a trade-off between the two in terms of other kinds of savings. Packing costs for air freight are less than for ocean freight because for air freight the merchandise does not have to be in transit for a long period of time, and the hazards are relatively lower. For similar reasons, the air mode reduces the in-ventory in float (i.e., in the movement process). Thus, there is less investment cost because the overall inventory is minimized and inventory is turned over faster.

A firm must understand that there is no one ideal transportation mode. Each mode has its own special kinds of hazards. Hazards related to the ocean/water mode include wave impact, navigation exposures, water damage, and the various vessel motions (rolling, pitching, heaving, surging, swaying, and yawing). Hazards related to the air mode include ground handling and changes in atmospheric pressure and tem-perature. Hazards related to the rail and highway modes include acceleration/deceleration (braking), coupling impact, swaying on curves, and shock and vibration.

1. Land

   Land transportation is an integral part of any shipment, whether locally or internationally. Some type of land transportation is necessary in moving goods to and from an airport or seaport. The land transportation mode involves Tail and truck. When goods in a large quantity must be moved over a long distance over land. Rail can prove to be quite economical. Europe and Japan have modern train systems that are capable of moving merchandise efficiently.

   On the other hand, trucks are capable of going to more places. In addition, trucks may be needed to take cargo to and from a railway station. When countries have joint boundaries, moving cargo by truck or train is often a practical solution. As a matter of fact, the U.S. trucking industry is quite concerned about a NAFTA agreement, which allows Mexican drivers to drive their trucks into the United States. It is debatable whether the real issue is a safety concern or a trade barrier.

   Less developed countries generally rely on road transport. In sub-Saharan Africa, road transport is the dominant form of transport. This form of transport accounts for 80 to 90 percent of the region's passenger and freight movements. Unfortunately, the nearly two million kilometers of roads in Africa have been greatly damaged due to years of neglect. In any case, road transport may be the only access to most rural communities-a situation common in Africa as well as other developing economies**.**

Cultural Dimension 1

Asian Distribution

Soft drinks produced by Coca-Cola's 29 percent-owned bottler, Swire Bottlers Ltd., account for 70 per-cent of Hong Kong's $400 million market. Because of Hong Kong's limited spaces, Coca-Cola's plant there is odd-looking. Inside the seventeen-story building, con-veyor belts take cans; and bottles from floor to floor. Massive lifts hoist delivery trucks from street level to loading docks high above the street.

7 -Eleven Japan employs a very efficient delivery system. Each customer's purchase, sex, and approxi-mate age are immediately recorded in a computer that keeps records for the just-in-time delivery system. Each store receives twelve deliveries daily and allows no ex-cess products on the shelves. The government at one time felt that convenience store delivery trucks con-tributed to traffic jams and air pollution. A government panel's study. however, later applauded the system since each truck was filled to capacity carrying goods for several stores.

2. Air

Of all the various transportation modes, air accounts for only 1 percent of total in-ternational freight movement. Yet it is the fastest-growing mode and is becoming less confined to expensive products. Air transport has the highest absolute rate, but ex-porters have discovered that there are many advantages associated with this mode. First, air transport speeds up delivery, minimizes the time the goods are in transit, and achieves great flexibility in delivery schedules. Second, it delivers perishables in prime condition. Harris Ranch uses a 747 jumbo jet to fly live cattle from the United States to Japan. A premium price commanded by high-quality beef in Japan makes it possible to use airfreight.

Third, it can respond rapidly to unpredictable and urgent demand. For instance, quick replacement of broken machinery, equipment, or a component part can be made by air. Fourth, it reduces to a minimum damage, packing, and insurance costs. Fi-nally, it can help control costly inventory and other hidden costs, including ware-housing, time in transit, inventory carrying cost, inventory losses, and the paperwork necessary to file claims for lost or damaged goods. These costs will increase as the time in transit increases. Furthermore, opportunity costs (e.g., lost sales and customer dissatisfaction) also adversely affect profit, especially in the long term. All of these costs can be minimized with air transport.

Traditionally, the appropriateness of airfreight was determined solely by a **value-to-weight equation,** which dictated that air cargo should be confined to high value products. One reason for that determination was that transport cost is a small proportion to such products' value. Another reason was that the amount of capital tied up with these products while in transit is high and should be released as soon as possible.

The dominant form of the international transportation of merchandise has al-ways been ocean transport. Its main advantage is its low rate, though the savings achieved for many products are not necessarily greater than other transport modes on an overall basis. This helps explain why, when all the hidden costs related to ocean transportation are considered, air transportation is growing at a very rapid rate.

3. Water

Bulk shipping is important in international trade because it is one of the most prac-tical and efficient means of transporting petroleum, industrial raw materials, and agri-cultural commodities over long distances. About 51 percent of the global bulk fleet consists of oil tankers, while dry bulk carriers account for 43 percent. The remainder of the fleet is made up of combination carriers, which are capable of carrying either wet (crude oil and refined petroleum products) or dry (coal, iron ore, and grain) bulk cargoes. The bulk shipping industry, being highly fragmented, has no one organisation, which holds more than 2 percent of the total world fleet.

Quotations for ocean shipping can be obtained from a shipping company of freight forwarder. Steamship rates are commonly quoted on weight and measurement. Goods are both weighed and measured, and the ship will use the method that yields a *higher* freight charge. Less-than container shipments carry a *higher* rate than full -container shipments.

There are three basic types of shipping company: (l) conference lines, (2) in-dependent lines, and (3) tramp vessels. An ocean freight conference line is an association of ocean carriers that have joined together to establish common rules with re-gard to freight rates and shipping conditions. Consequently the operators in the group charge identical rates. The steamship conference has also adopted a dual rate system, giving a preferential treatment to contract exporters. A contract exporter agrees to ship all or a large portion of its cargo on a regular basis on vessels of conference member lines in exchange for a lower rate than charged for a noncontract shipper. Nevertheless, the contract exporter is allowed to use another vessel, after obtaining the conference's permission, when no conference service is available within a reasonable period of time.

An independent line, as the name implies, is a line that operates and quotes freight rates individually and independently without the use of a dual-rate contract. Independent lines accept bookings from all shippers. When they compete with con-ference lines for noncontract shippers, they may lower their rates. In general, inde-pendent lines do not offer any special advantage for a contract shipper because they do not have significant price advantage. Furthermore, their services are more limited and not as readily available.

Finally, a tramp vessel is a ship 'not operating on a regular route or schedule. That is, tramp steamers do not have the established schedules of the other two types of carriers. Tramp vessels operate, on a charter basis whenever and wherever they can get cargo. They operate mainly in carrying bulk cargoes.

Cargo or Transportation Insurance

Inland carriers generally bear the responsibility for any damage to goods while in their possession. The same thing cannot be said for ocean carriers. Their reluctance to accept responsibility is due to the numerous unavoidable perils found at sea. Such perils include severe weather, seawater, stranding, fire, collision, and sinking. As a result, ocean carriers refuse to accept any liability for loss or damage unless a ship-per can prove that they were purposefully negligent-a difficult task indeed. To pro-tect against loss or damage and to avoid disputes witi1 overseas buyers, exporters should obtain marine insurance.

Marine cargo insurance is an insurance that covers loss or damage at sea, though in practice it also applies to shipments by mail, air, and ship. It is similar to domestic cargo insurance but provides much broader coverage. The purpose of this insurance is to insure export shipments against loss or damage in transit. The insurance may be arranged by either a buyer or seller, depending on the terms of sale.

There are two basic forms of marine insurance: (1) special (one time) coverage and (2) open (blanket) coverage. A special policy is a one-time policy that insures a single specific shipment. One

time insurance is relatively inexpensive because the risk cannot be spread over a number of shipments. Nevertheless, it is a practical insurance solution if a seller's export business is infrequent.

An open policy is an insurance contract issued to a firm in order to cover all its shipments as described in the policy within named geographic regions. The pol-icy is open in the sense that it is continuous by automatically providing coverage on all cargo moving at the seller's risk. The policy is also open in the sense that the val-ues of the individual shipments cannot be known in advance. Under this policy, no reports of individual shipments are required, although the insured must declare all shipments to the underwriter. The underwriter agrees to insure all shipments at the agreed rates within the terms and conditions of the policy. Open marine cargo poli-cies are written only for a specified time period. A single premium is charged for this time period, based on the insured's estimated total value of goods to be shipped un-der the policy during the term of the contract. The contract has no predetermined ter-mination date, though it may be cancelled by either party. A firm can also insure profit through a Valuation Clause in the cargo policy, which insures exports and con-tains a fixed basis of valuation. The following is an example of a typical valuation clause in a marine policy: "valued at amount of invoice, plus 10 percent."

Packing

Packaging may be viewed as consisting of two distinct types: (l) industrial (exterior) and (2) consumer (interior). Consumer packaging is designed for the purpose of af-fecting sales acceptance. The aim of industrial packaging is to prepare and protect merchandise for shipment and storage, and this type of packaging accounts for seven cents of each retail dollar as well as 30 percent of total packaging costs. Packing is even more critical for overseas shipment than for domestic shipment because of the longer transit time and a greater number of hazards. Consumer packaging is covered extensively in Chapter Eleven; this section concentrates instead on industrial packing.

Packing Problems

There are four common packing problems, some of which are in direct conflict with one another: (1) weight, (2) breakage, (3) moisture and temperature, and (4) pilfer-age and theft.

Weight Over packing not only directly increases packing cost but also increases the weight and size of cargo. Any undue increase in weight or size only serves to raise freight charges. Moreover, import fees or customs duties may also rise when import duties are based on gross weight. Thus, overprotection of the cargo can cost more than it is worth.

Breakage Although overpacking is undesirable, so is under packing because the lat-ter allows a product to be susceptible to breakage or damage. The breakage problem is present in every step of ocean transport. In addition to normal domestic handling, ocean cargo is loaded aboard a vessel by use of a sling (with several items together in a net), conveyor, chute, or other methods, all of which put added stress and strain on the package. Once the cargo is on the vessel, other cargo may be stacked on top of it, or packages may come in violent contact during the course of the voyage. To complicate matters, handling facilities at an overseas port may be unsophisticated. The cargo may be dropped, dragged, pushed, and rolled during unloading, moving in and out of customs, or in transit to the final destination. In China, primitive methods (i.e., carts, sampans, junks, and so on) are used to move a great deal of cargo, There-fore, packing must be prepared to accommodate rough manual handling.

To guard against breakage it may be desirable to use such package-testing equip-ment as vibration; drop, compression, incline-impact, and revolving drum. The cargo must riot exceed the rated capacity of the box or crate. Attempts should be made to make certain that internal blocking and bracing will distribute the cargo's weight evenly. Cushioning may be needed to absorb the impact. Cautionary markings, in words and symbols, are necessary to reduce mishandling because of misunder-standing.

One universal packing rule is "Pack for the toughest leg of the journey," To ac-commodate this rule, cargo should be unitized or palletized, whenever possible. Pal-letizing is the assembly of one or more items into a compact load to a pallet base and the securing of the load to the pallet. Unitizing is the assembly of one or move cargo load, secured together and provided with skids and cleats for ease of handing. These two packing methods force cargo handlers to use mechanical handling equipment to move cargo.

Moisture and Temperature-Certain products can easily be damaged by moisture and temperature. Such products are subject to condensation even in the hold of a ship equipped with air conditioning or dehumidifying equipment. Another problem is that the cargo may be unloaded in the rain. Many foreign ports do not have covered stor-age facilities, and the cargo may have to be left in the open subject to heat, rain, cold, or other adverse elements. In Morocco, bulk cargo and large items are stored in the open. Mozambique does the same with hazardous, bulk, and heavy items. Cargo thus needs extra strong packing, containerization, or unitization in order to have some mea-sure of protection under these conditions.

One very effective means of eliminating moisture is shrink-wrapping, which involves sealing merchandise in a plastic film. Waterproofing can also be provided by using waterproof inner lines or moisture-absorbing agents and by coating finished metal parts with a preservative or rust inhibitor. Desiccants (moisture-absorbing ma-terials), moisture-barrier or vapor-barrier paper, or plastic wraps, sheets, and shrouds will also protect cargo from water leakage or condensate damage. Cargo can be kept away from water on the ground if placed on skids, pallets, or dunnage while having drain holes for crates.

Marketing Strategy 1

Materials Handling

Japan and Europe, major mail order firms have imported the most advanced materials-handling technology (in terms of bar-coding, automated warehouse- and radio-frequency technology) when building new contribution systems.

Regarding warehousing, instead of using conven-tional lift trucks to insert and remove stock from bulk rage racks, computers direct automated and semi automated cranes to move along rails between the rage racks. Bar-coded labels affixed to incoming stock during receiving/inspection are read by fixed optical scanning devices as the stock moves via conveyor the

storage area. To move stock out of the authored storage area to the picking and packing areas, control computers direct the stacker cranes to do so.

Automated warehousing systems can be differ-entiated by the unit load that they handle (i.e., pallet, (or case). Pallet systems employ pallet-rack story- and are best suited for long-term storage of a sin item per pallet. System efficiency is reduced when system involves more than one item per pallet or replenishing picking or shipping areas with less-than- pallet-load quantities. In order to remove a few cases few cases on the pallet must be off-loaded because there is usually no efficient method to replace the pallet with the remaining cases back onto the rack.

Tray systems use trays to store merchandise and are effective for short-term storage and in the frequent movement of less-than-pallet-load quantities. Unlike pallet systems, tray systems allow for the picking up of partial trays. The tray with the remaining cases can eas-ily be returned to the storage rack.

Case systems use case racks to store merchan-dise and are well suited for a distribution center that has a high number of stock-keeping units with low ac-tivity per SKU. The case system can be reasonably ef-fective in bulk picking, single-item shipments directly from the storage area.

The high degree of automation found in these systems significantly reduces the labor requirements as-sociated with the warehousing function. Also the rack structures are considerably higher (i.e., 20 to 30 me-ters) than conventional storage racks and thus have su-perior capacity.

There are several steps to ensure the proper way of packing to minimize mois-ture and breakage problems. These steps are

1. Place water-barrier material on interior of sides and roof.
2. Use vertical sheathing.
3. Block, brace, and tie down heavy items.
4. Use new, clear, dry lubber and provide adequate diagonals:
5. 'Unitize multiple similar items.
6. Use waterproof tape to seal fiberboard boxes.
7. Palletize shipping bags.
8. Use proper gauge, type, and number of straps.

Pilferage and Theft- Cargo should be adequately protected against theft. Studies have fixed such losses in all transportation modes in a range from $1 billion to in ex-cess of $5 billion.13 In the United States alone, the annual value of cargo stolen in transit exceeds $2.5 billion. Annual loss through theft is well over 100 million pounds in Great Britain, with employees' criminal activity being the main contributing fac-tor.14 Pilferage levels are consistently high in Bangladesh and substantial in India. There are a few techniques that can be used as deterrents. One method of discourag-ing theft is to use shrink wrapping, seals, or strapping. Gummed sealing tapes with patterns, when used, will quickly reveal any sign of tampering. Also, only well-constructed packing in good condition should be used.

Another area of concern is **marking**. The main purpose of marking is to iden-tify shipments so that the carrier can forward the shipment to the designated con-signee. Markings thus should not be used to advertise the contents, especially when they are valuable or highly desirable in nature. A firm is also wise to avoid men-tioning the contents, trade names, consignee names or shippers' names on the pack-age because these markings reveal the nature of the contents. Because markings are still a necessity, they should be permanent, though called blind marks should be used. To avoid handlers' becoming familiar with the markings, blind marks should be changed periodically. Bright color-coding helps in spotting the pieces.

Packing alone should not be expected to eliminate theft. Packing should be used in conjunction with other precautionary measures. One of the most effective means of reducing exposure to theft, pilferage, and hijacking is to insist on prompt pickup and delivery. Another good idea is to avoid shipping the cargo if it will arrive at its destination on a weekend or holiday. One Chicago importer of jewelry found on Mon-day when he went to pick up his merchandise at O'Hare airport that the cargo had already been claimed by someone else over the weekend.

Container

An increasingly popular method of shipment is containeriza-tion. A container is a large box made of durable material such as steel, aluminum, plywood, and glass reinforced plastics. A container varies in size, material, and construction. Its dimen-sions are typically 8 ft high and 8 ft wide, with lengths usually varying in multiples of 10 ft up to a maximum of 40 ft

A container can accommodate most cargo but is most suitable to packages of standard size and shape. Some containers are no more than truck bodies that have been lifted off their wheels and placed on a vessel at the port of export. These containers then are transferred to another set of wheels at the port of import for inland movement. This type of container can be put on a ship, or can become a bar car when placed on a rail-way flatcar, or can be made into a trailer when provided with a chassis. Containers are ordinarily obtained from either carriers or private parties.

Containers can take care of most of the four main packing problems. Because of a container's construction, a product does not have to have heavy packing. The container by itself provides good protection for the product against breakage, mois-ture, and temperature. Because breaking into a container is difficult, this method of shipment discourages pilferage and theft as well.

It is important to select the right container because containers come in varying sizes and types. Two basic types of container can be identified: (1) *dry cargo con-tainers* and (2) *special purpose containers.* Some of the various types of dry cargo containers are end loading, fully enclosed; side loading, fully enclosed; and open top, ventilated, insulated. Special purpose containers come in different types for refriger-ated, liquid bulk, dry bulk, flat rack, auto, livestock, and sea shed.

Exporters may have to plan for the return of secondary packaging or the con-tainer or both. Argentina's inefficient exports force those who do business with Ar-gentina to ship most containers back empty. One U.S. automaker, after experi-menting with containers, resumed shipping *parts* in wooden crates instead Japanese firms have partially solved the Argentina problem by using collapsible racking and shipping systems so that items can be more densely packaged for return shipment.

Shipments by air do not usually require e heavy packing that ocean shipments require. Standard domestic packing should prove sufficient in most cases. When in doubt, however, a

company should consult the carrier or a marine insurance company for the best packing strategy. For a case in which a firm is not equipped to do its own packing, there are professional firms that package for export.

Freight Forwarder and Customhouse Broker

There are two intermediaries whose services are quite essential in moving cargo for their principals, across countries as well as within countries: freight forwarders and customhouse brokers. Freight forwarder generally works for exporters whereas the **customhouse broker** generally works for importers. Because the functions are similar, freight forwarders sometimes act as customs brokers and vice versa.

A freight forwarder is a person responsible for the forwarding of freight locally as well as internationally. He or she is an independent businessperson who handles, shipments for compensation. The kind of freight forwarder of concern here is the for-eign or international freight forwarder who moves goods destined for overseas desti-nations.

A foreign freight forwarder is an exporter's agent who performs virtually all as-pects of physical distribution necessary to move cargo to overseas destinations in the most efficient and economic manner. This freight forwarder can represent shippers in both air and ocean freight shipments because the procedures and documents required are very similar.

The freight forwarder's major contribution to the exporter is his or her ability to provide traffic and documentation responsibili-ties for international freight move-ments. This middleman handles the voluminous paperwork required in international trade, and is highly specialized in (1) traffic operations (methods of shipping), (2) government export regulations, (3) overseas import regulations, and (4) documents connected with foreign trade and customs clearances. Ill' brief, the freight forwarder arranges all necessary details for the proper shipping, insuring, and documenting of overseas shipments. An exporter's need for the freight forwarder's services varies ac-cording to the exporter's exporting effort or life -cycle. As the exporter's business grows, the exporter tends to perform more of the forwarding function itself.

The freight forwarder can assist an exporter from the very beginning in getting a shipment ready for overseas. Once the exporter receives an "inquiry, it can turn to the freight forwarder for assistance in preparing its quotation. The freight forwarder can advise the exporter on freight costs, port charges, consular fees, cost of special documentation, insurance costs, and the forwarder's handling fees, as well as recom-mend the degree of packing needed or arrange to have the merchandise packed or have it containerized.

The freight forwarder also prepares ocean bills of lading and any special con-sular documents -and reviews letters of credit, packing lists, and so on to ensure that all procedures are in order. After the shipment is made, the freight forwarder forwards all documents to the customer's paying bank with instructions to credit the exporter's account.

The freight forwarder can assist the exporter .in other areas. This person can re-serve space aboard an ocean vessel. He or she may consolidate small shipments into full container loads and, by doing so, can receive a lower rate from the carrier and pass on the savings to the shipper. The freight forwarder can arrange to clear goods through customs and to have the goods delivered to the pier in time for loading. This middleman then handles the goods from exit port to destination. If desired, the freight forwarder can further move goods inland in a foreign country through various affili-ates. According to one study, freight forwarders feel that the United Kingdom is the easiest and China is the most difficult with regard to arranging international freight operations.

The freight forwarder receives a fee from exporters. The service cost is a legit-imate export cost and should be figured into the contract price charged to buyers. In addition, this person may receive brokerage fee and/or rebates from shopping companies for booked space. In such cases, the freight forwarder's commis-sion is paid by the ship lines. Because freight forwarders control most of the smaller shipments and because the less-than-container (LTC) traffic accounts for 17-18 percent of the business, carriers woo freight forwarders with extra rebates.

The counterpart of the freight forwarder for an exporter is the customhouse bro-ker for an importer. As an individual or firm -licensed to enter and clear goods through customs, a **custom-house broker** is a person or firm employed by an importer to take over the responsibility of clearing the importer's shipments through customs on a fee basis, A licensed customhouse broker named in a Customs Power of Attorney can make entry. This broker is bonded, and the broker's bond provides the required cov-erage to carryon the responsibilities of the job. A custom-house broker may also act as freight forwarder once the shipment is cleared. A customs broker must be li-censed by the Treasury Department in order to perform these services.

The customhouse broker is indispensable in the receipt of goods from overseas. The services are valuable because the requirements for customs clearance are com-plicated. For example, U.S. Customs requires that entry documents must be filed within five days after the goods have reached the United States. To make entry, a person must have evidence of right to make entry (carrier's certificate), in addition to the commercial invoice, packing list, and surety. For infrequent entry, a single en-try bond must be obtained from a U.S. surety company to cover potential duties and penalties incurred, but the surety may also be posted in the form of cash. Moreover, the person must fill out forms with regard to dutiable status and must also have the goods examined under conditions that safeguard the goods before they are released. Overall, entry is a two-step process-getting goods released and providing informa-tion for duty -assessment and statistical purposes. The customhouse broker is in the best position to provide for these requirements.

Documentation

It is not an exaggeration to say "paper moves cargo." To move cargo, docu-mentation is a necessity. American firms used to complain about the cost of docu-mentation and shipping in the European Community. Documentation alone added 3 to 5 percent of the total cost of goods sold. Cabot age rules, for example, prevented a trucker from returning with a loaded truck after delivery.

In many or perhaps most cases, marketers may find that it is much more prac-tical to leave the physical distribution activities to specialists. Dell Computer Corp., for example, sells computers in 115 countries. It has -arranged for Roadway Services Inc. to handle Dell's worldwide shipping. Earlier, Dell had to deal with dozens of carriers and found that it would have to hire 1,000 to 2,000 additional workers to meet the projected growth. Roadway, as a single-source provider, subcontracts and manages all customer shipments-both inbound and outbound.

International direct marketers need to make certain that their delivery methods are convenient for their customers. As in the case of Wear Guard Work Clothes, a U.S. company, it had four options to fill orders for Canadian customers: U.S. Postal Service parcel post, courier companies, bulk shipment, and local fulfillment. In the end it chose TNT Mail fast to bring Wear Guard's parcels into Canada, clear them at customs, and give them to Canada Post for local delivery. This method allows Cana-dian customers to receive the merchandise without having to pay duties or additional fees. The company also has a Canadian address so that Canadian customers can con-veniently mail packages in case of customer returns.

Product transportation in the European Union has become easier and more efficient. Systematic stops at customs posts were replaced by spot checks, and multi-ple customs forms were replaced by a Single Administrative Document (SAD). As of 1993, border controls were removed, and the SAD had been eliminated. Border stops are limited to checking on legal matters such as illegal immigration and drug trafficking. In 1995, some EU states had begun to allow people to move freely within the EU without having to show their passports.

To facilitate cargo movement, nations have been working toward automated customs-paperless international customs procedures. The Customs Cooperation Coun-cil, representing more than 130 nations, has approved a plan by which customs ad-ministrations around the world can work toward electronic data interchange. The main standards body for international electronic messages is a United Nations-backed group called Edifact (Electronic Data Interchange for Administration, Commerce, and Trans-port). While Japanese companies do business with one another electronically, they use their own standards, which force outsiders wanting to establish computerized links to engage in expensive programming and translation efforts. Edifact, however, works everywhere. Japan has finally agreed to join with Singapore to create a regional Ed-ifact board. By sending standardized digital messages at computer speeds, importers can bypass piles of bureaucratic paperwork. Use of paperless trading technology should significantly improve the speed and efficiency of data and global trade.

Exporters may want to consider purchasing export-automation software. Some IWO dozen companies sell such programs, which start at $5,000 and run on personal computers. More expensive programs may cost more than $250,000 and run on mini-computers. Some of the export automation software incorporates the electronic data interchange (EDI) technology, making it possible for exporters to send computer-gen-erated forms electronically\ rather than mailing the documents to freight forwarders, customers, banks, and government agencies.

To fill out the required documents, a company must insert the proper identification number for its product. All products must be "shoehorned" into some kind of category. If a product is constructed out of several materials, it may be classified b) the material that gives it its essential character. Prior to 1989, the Standard Industrial Classification (SIC) was the most common classification of products and services in the United States, and it was similar to the Standard Industrial Trade Classification (SITC) used by international organizations and a number of countries. On January 1, 1989, the Harmonized Tariff Schedule (HS) went into effect. The new system, de-signed to replace previous systems for classifying exports, contains logically structured nomenclature. There are twenty-one sections and ninety-nine chapters to arrange commodities according to general economic activity. The sections and chapters are arranged according to levels of processing, with primary commodities classified first, followed by the technically more complex products. The HS number consists of six digits, which are used by all participating countries. To meet each country's statisti-cal and tariff requirements, the remaining digits are country-specific. Certain coun-tries also use either alphabetical subdivision after the six digits or combined al-phanumerical systems. As an example, if the HS code for "widgets" is 12.34.56.78.90, the breakdowns are 12 (chapter), 12.34 (heading), 12.34.56 (subheading), 12.34.56.78 (tariff item), and 12.34.56.78.90 (HS Classification Number)

There are many kinds of documents, and they can be grouped under two broad categories: (1) shipping documents and (2) collection documents. *Shipping documents* are prepared to move shipment through customs, allowing the cargo to be loaded, shipped, and unloaded. *Collection documents*, in contrast, are submitted to a customer or the customer's bank for payment.

Shipping Documents

There are several kinds of shipping documents. Such documents include export li-censes and shippers export declaration forms, among others.

1. **Export License** An *export license* is a permit allowing merchandise to be exported. It is needed for all exports being shipped from the United States, except for shipments going to Canada and U.S. territories and possessions. International Harvester's sale to the Soviet Union of a $300 million industrial plant to make combines was thwarted when the company's license was revoked. This action was taken because of the United States' unhappiness with Soviet political involvement in Poland.

   In the case of the United States, there is two broad categories of export li-censes: general and validated. The difference between the two has to do with whether a particular license requires prior, written approval from the U.S. Department of Com-merce. The type of license required depends on the sophistication of the product, the destination country, the end use, and the end user. [24]

   A **general license** is a license for which no application is required and for which no document or written authorization is granted. It is a general authorization permitting the export of certain commodities and technical data without the necessity of ap-plying for a license document A

general license allows the export through the Ex-port Administration Regulations of all goods published in an authorization list and covers the export of nonstrategic goods (commodities not under restriction or con-trol). Products that meet specific conditions can be shipped by merely inserting a cor-rect General License symbol on the export control document known as a Shipper's Export Declaration.

If an exporter does not qualify *for* a general license, the exporter may apply *for* a **validated export license**, which, in effect, is a formal authorization document. The United States requires this kind *of* licensing *for* reasons *of* national security (strate-gic significance), short supply, *or* foreign policy. National security controls were necessary to prevent the export *of* strategic commodities and technical data to the So-viet Union and other Warsaw Pact countries. Foreign policy controls, such as the re-strictions placed on exports to South Africa and Namibia, are instituted by such li-censing to promote U.S. foreign policy. In the case *of* short-supply controls, the licenses are granted with an eye to preventing the depletion *of* scarce materials (e.g., western red cedar and petroleum).

Many *of* the products shipped under individual validated licenses (IVLs) and special licenses need pre export paperwork (e.g., a foreign consignee/purchaser state-ment *or* a government-issued import certificate) to obtain the necessary license. IVLs authorize individual sales *of* a certain product to a certain customer in a certain coun-try. Special licenses (e.g., project and distribution licenses) authorize the sale *of* a range of products to many customers if exporters can show that they have imple-mented a strict control process.

The following are some possible indicators that an illegal diversion might be planned by an export customer:

- The customer or purchasing agent is reluctant to offer information about the end use of a product.
- The product's capabilities do not fit the buyer's line of business: for example, an order for several sophisticated computers for a small bakery.
- The product ordered is incompatible with the technical level of the country to which the product is being shipped. Semiconductor manufacturing equipment would be of little use in a country without an electronics industry.
- The customer is willing to pay cash for a very expensive item when the terms of the sale call for financing.
- The customer has little or no business background.
- The customer is unfamiliar with the product's performance characteristics but still wants the product.
- Routine installation, training, or maintenance services are declined by the customer.
- Delivery dates are vague, or deliveries are planned for out-of-the-way destina-tions.
- A freight-forwarding firm is listed as the product's final destination.
- The shipping route is abnormal for the product and destination.
- Packaging is inconsistent with the stated method of shipment or destination.
- When questioned, the buyer is evasive and especially unclear about whether the purchased product is for domestic use, export, or re-export.

Shipper's Export Declaration (SED) Form SEDs are required to be filed for virtu-ally all shipments, including hand-carried merchandise, and they must be deposited with an exporting carrier regardless of the type of export license. Exemptions apply to shipments to certain countries when the value is $2,500 or less and when the shipment is not moving under a validated export. For foreign merchandise that has entered the United States and that is be-ing re-exported, the form used is Form 7513-SED for in-transit merchandise.

The SED is a multipurpose document. One of its purposes is to serve as an export control document. It declares the proper authorization for export by making reference to either a General License symbol or the license number of a validated li-cense. The SED thus makes it possible to administer the requirements of the Export Administration Act.

Another purpose of the SED is to aid the Bureau of Census in compiling basic statistical information on export shipments. These data are compiled and published monthly and show the types of commodities exported and the countries that im-ported them.

Report of Request for Restrictive Trade Practice or Boycott (Form IT A-621P) The restrictive trade practice report is a form used to report illegal requests regard-ing boycott practices received from one country against another. This form must be submitted to the U.S. Department of Commerce when a company receives an illegal or legal reportable request regarding a company's business practices as outlined in the "Restrictive Trade Practices, Bulletin 369."

Certificate of Registration (Customs Form 4455) The certificate of registration is used to register a shipment with U.S. Customs. This registration is desirable for shipments that were originally imported and are now being returned. to the country of origin for repair, replacement, alteration, or processing. If the shipment reenters the United States within one year of the date of export, it will reenter duty-free.

Hazardous Certificate To export hazardous cargo, an exporter must use a ship-per's certification or declaration of dangerous cargo. This document, required for all hazardous shipments, is used to describe the contents by providing the details and qualities of the items being shipped, their proper classification, required labels, and so on. This declaration must always be completed by the shipper (preferably on the shipper's letter-head) and signed by the shipper. There is no prescribed form for ocean shipment; of hazardous materials at the present time. For all hazardous shipments moving via airfreight, a shipper's declaration of dangerous cargo (air cargo) must be submitted to the airline.

Packing List A packing list is a document that lists the type and number of pieces, the contents, weight, and measurement

of each, as well as the marks and numbers. Its purpose is to facilitate customs clearance, keep track of inventory of goods, and assist in tracing lost goods. For insurance purposes the packing list can be used in de-termining the contents of a lost piece. Furthermore, it is also useful in estimating ship-ping cost prior to export.

U.S. DEPARTMENT OF COMMERCE — BUREAU OF THE CENSUS — INTERNATIONAL TRADE ADMINISTRATION

FORM 7525-V (3-15-85) **SHIPPER'S EXPORT DECLARATION** OMB No. 0607-0018

1a. EXPORTER (Name and address including ZIP code)
Brown & Company
123 Samantha Rd.
Toledo, OH
ZIP CODE 43624

2. DATE OF EXPORTATION 7-8-85

3. BILL OF LADING/AIR WAYBILL NO. 000-1234-5678

b. EXPORTER EIN NO. 12-3456789

c. PARTIES TO TRANSACTION ☐ Related ☒ Non-related

4a. ULTIMATE CONSIGNEE
Kirk Sales LTD.
162 Belva Street
London, England

b. INTERMEDIATE CONSIGNEE
Bolden Service Company
3456 Fred Lane
London, England

5. FORWARDING AGENT
Sharyn Exports
P.O. Box XYZ
New York, NY 10047

6. POINT (STATE) OF ORIGIN OR FTZ NO. OH

7. COUNTRY OF ULTIMATE DESTINATION England

8. LOADING PIER/TERMINAL

9. MODE OF TRANSPORT (Specify) Air

10. EXPORTING CARRIER Fairway Air

11. PORT OF EXPORT Kennedy Airport

12. FOREIGN PORT OF UNLOADING Gatwick, England

13. CONTAINERIZED (Vessel only) ☐ Yes ☐ No

14. SCHEDULE B DESCRIPTION OF COMMODITIES. (Use columns 15 – 19)

MARKS, NOS., AND KINDS OF PKGS. (15)	D/F (16)	SCHEDULE B NUMBER (17)	QUANTITY — SCHEDULE B UNIT(S) (18)	SHIPPING WEIGHT (Kilos) (19)	VALUE (U.S. dollars, omit cents) (20)
B/1, B/2 2 boxes		Signal generators, operating at frequencies over 10 MHZ, Model 525 sweep generator.			
	D	688.4010	2	146	$2,375
B/3 1 Box		Specially designed parts for Model 525 sweep generators, consisting of probes, tees, detectors, and detector mounts.			
	D	688.4060	X	68	$1,854

SAMPLE COPY

21. VALIDATED LICENSE NO./GENERAL LICENSE SYMBOL A123456

22. ECCN (When required) 1529

23. Duly authorized officer or employee H. Brown
The exporter authorizes the forwarder named above to act as forwarding agent for export control and customs purposes.

24. I certify that all statements made and all information contained herein are true and correct and that I have read and understand the instructions for preparation of this document, set forth in the "Correct Way to Fill Out the Shipper's Export Declaration." I understand that civil and criminal penalties, including forfeiture and sale, may be imposed for making false or fraudulent statements herein, failing to provide the requested information or for violation of U.S. laws on exportation (13 U.S.C. Sec. 305; 22 U.S.C. Sec. 401; 18 U.S.C. Sec. 1001; 50 U.S.C. App. 2410).

Signature S. Sharyn
Title President
Date 7-8-85

Confidential - For use solely for official purposes authorized by the Secretary of Commerce (13 U.S.C. 301 (g)).
Export shipments are subject to inspection by U.S. Customs Service and/or Office of Export Enforcement.

25. AUTHENTICATION (When required)

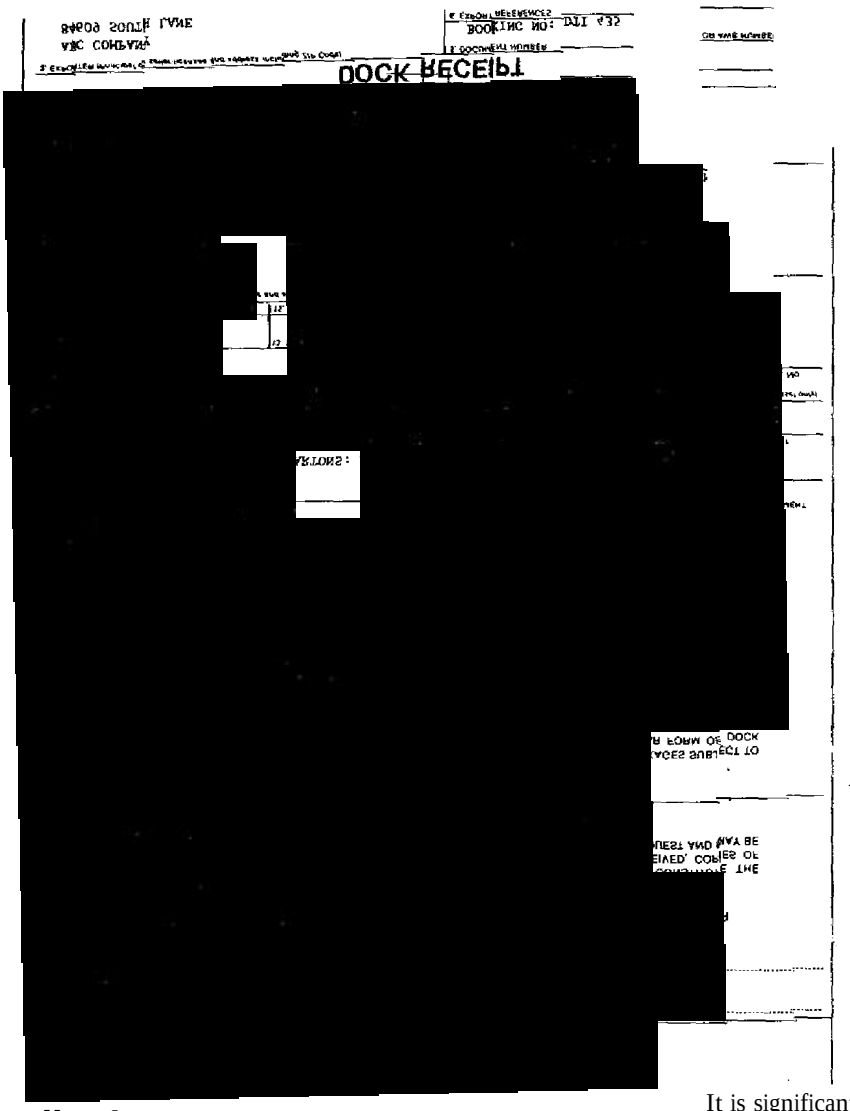
This form may be printed by private parties provided it conforms to the official form. For sale by the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402, and local Customs District Directors. The "Correct Way to Fill Out the Shipper's Export Declaration" is available from the Bureau of the Census, Washington, D.C. 20233.

Shipper's Letter of Instructions The shipper's letter of instructions is a form pro-vided to the freight forwarder from the shipper giving all pertinent information and instruction regarding the shipment and how it is to be handled. When signed by the shipper, it also authorizes the forwarder to issue and sign documents on behalf of the shipper

Dock Receipt A dock receipt is proof of delivery for goods received at the dock or warehouse of the steamship line. This document is required for the pro forma invoice in order to be able to apply for an import license and/or a let-ter of credit.

A commercial invoice is a document that provides an itemized list of goods shipped and other charges. As a complete record of the business transaction between two parties, it provides a complete description of merchandise, quantity, price, and shipping and payment terms. It is desirable that this invoice contains a breakdown of charges such as those related to inland transportation, loading, insurance, freight, handling, and certification. Because the invoice is required to clear goods through customs, all necessary information required by the buyer's government must be included.

The requirements of the exporter's country must be satisfied a well. The United States prohibits certain goods from being diverted to countries such as North Korea and Cuba. Therefore, the invoice may have to be prepared so it includes an anti di-version clause or destination control statement. According to sec- shipments sailing from ports on the U.S. East and Gulf coasts. Six copies of the dock receipt must be lodged at the receiving warehouse before freight can be accepted.



Collection Documents

Before a seller can request payment, the seller must provide the buyer with a num-ber of documents showing that the terms agreed upon have been fulfilled. The buyer requires such documents to protect itself and to satisfy its government's requirements.

Commercial Invoice To collect payment, an invoice is needed. There are two kinds of invoices: (1) *pro forma* and (2) commercial. A pro forma invoice is an invoice provided by a supplier prior to the shipment of merchandise. The purpose of this invoice is to inform the buyer of the kinds and quantities of goods to be sent, their value, and important specifications (weight, size, and so on). The buyer may also need the pro-forma invoice in order to be able to apply for an import license and/or a letter of credit.

A commercial invoice is a document that provides an itemized list of goods shipped and other charges. As a complete record of the business transaction between two parties, it provides a complete description of merchandise quantity, price, and shipping and payment terms. It is desirable that this invoice contain breakdown of charges such as those related to inland transportation, loading, insurance, freight, handling, and certification. Because the invoice is required to clear goods through customs, all necessary information required by the buyer's government must be included.

Foreign Customs Invoice -A customs invoice is a special format invoice required by customs officials in some countries in lieu of the commercial invoice, as those of-ficials may not recognize the commercial invoice for customs purposes. This type of invoice gener-ally contains the same information as the commercial invoice and may also contain certifications with regard to value and origin of the shipment.

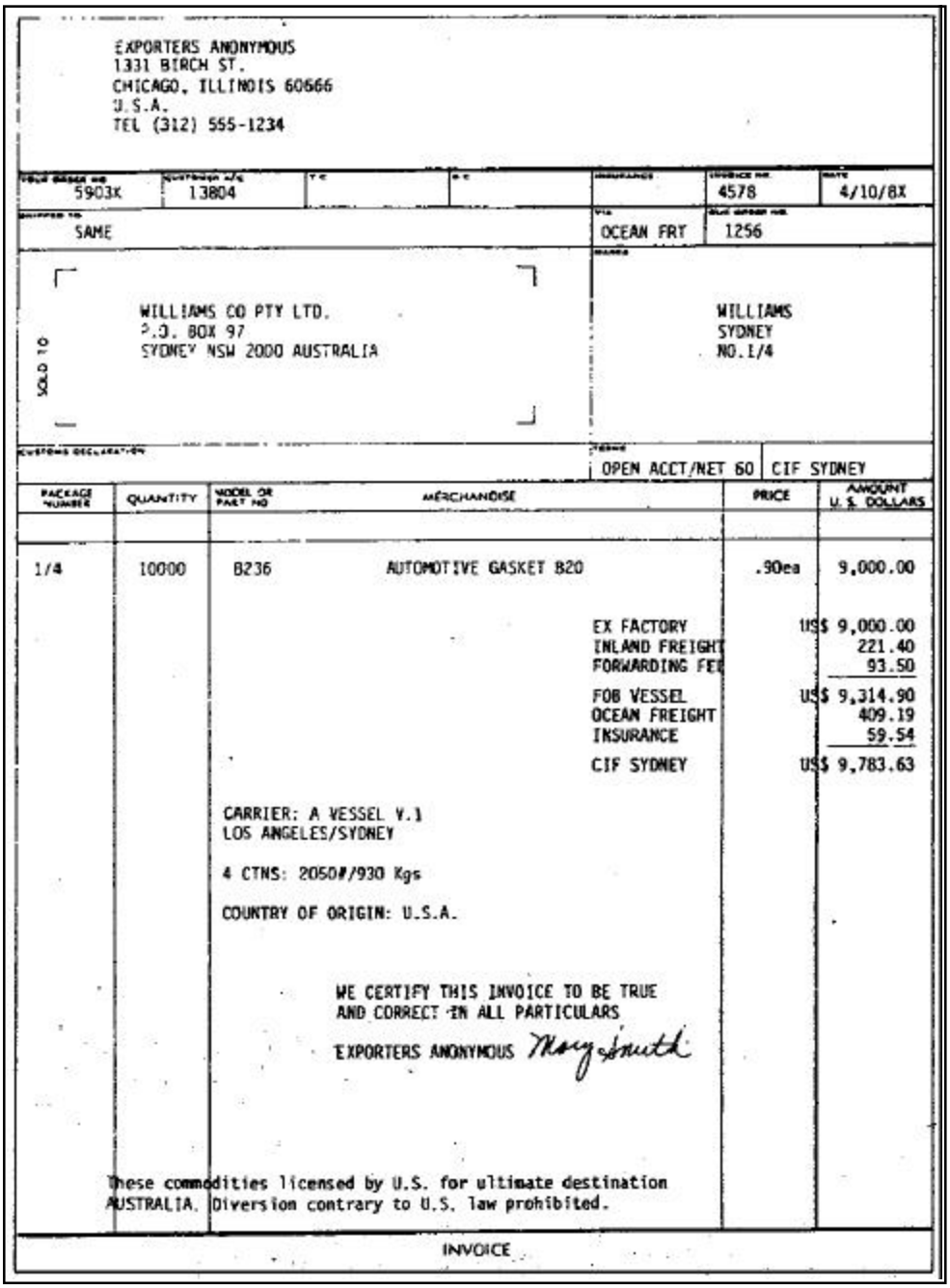
Consular Invoice- In addition to the regular commercial invoice, several countries, notably those in Latin America, require legalized or visaed documents that often in-clude a special kind of invoice known as a consular invoice. A consular invoice is a detailed document prepared by a seller in the importing country's language on an of-ficial form supplied by the importer's government. Its purpose is to monitor merchandise and capital flows.

A consular invoice must have an official stamp, seal, or signature affixed to it. This is the responsibility of the consulate general, which is a representative of the gov-ernment of the importing country. The resident consul is supposed to verify the con-tents of the invoice (e.g., value, quantity, and nature of shipment) and to certify its authenticity and correctness. Usually, there is a fee for this service. Bolivia's con-sular fees for the notarization of invoices are 1 percent of the FOB value.

It is significant to keep in mind that the consulate is not obligated to facilitate imports by approving the submitted documents quickly. Because the consul may take his or her time in returning the visaed documents, an exporter should allow reason-able time for the processing of a consular invoice. It can be a frustrating experience to rush the consulate for the documents while the shipment is waiting.

Because a consular invoice is a legal document, any errors noted later require special consideration. An exporter cannot simply make corrections on a consular in-voice that has been certified. Such corrections are considered forgery, and the crim-inal penalty can be quite severe.

Although a consular invoice usually contains the same information as a com-mercial invoice, the actual information required by the consulate depends on where the shipping is to be made. The best way to find out what is specifically required is to speak directly with the consulate or consult one of the reference manuals available, such as Dun and Bradstreet or the International Trade Reporter of the Bureau of Na-tional Affairs (BNA).



EXPORTERS ANONYMOUS
1331 BIRCH ST.
CHICAGO, ILLINOIS 60666
U.S.A.
TEL (312) 555-1234

5903X	13804			4578	4/10/8X

SAME — OCEAN FRT — 1256

SOLD TO
WILLIAMS CO PTY LTD.
P.O. BOX 97
SYDNEY NSW 2000 AUSTRALIA

WILLIAMS
SYDNEY
NO.1/4

OPEN ACCT/NET 60 — CIF SYDNEY

PACKAGE NUMBER	QUANTITY	MODEL OR PART NO	MERCHANDISE	PRICE	AMOUNT U.S. DOLLARS
1/4	10000	B236	AUTOMOTIVE GASKET B20	.90ea	9,000.00

EX FACTORY	US$ 9,000.00
INLAND FREIGHT	221.40
FORWARDING FEE	93.50
FOB VESSEL	US$ 9,314.90
OCEAN FREIGHT	409.19
INSURANCE	59.54
CIF SYDNEY	US$ 9,783.63

CARRIER: A VESSEL V.1
LOS ANGELES/SYDNEY

4 CTNS: 2050#/930 Kgs

COUNTRY OF ORIGIN: U.S.A.

WE CERTIFY THIS INVOICE TO BE TRUE
AND CORRECT IN ALL PARTICULARS

EXPORTERS ANONYMOUS Mary Smith

These commodities licensed by U.S. for ultimate destination
AUSTRALIA. Diversion contrary to U.S. law prohibited.

INVOICE

Certificate of Origin A certificate of origin is a document prepared by the exporter and used to identify or declare that the merchandise originated in d certain country. It assures the buyer or importer of the country of manufacture. This document is nec-essary for tariff and control purposes. Some countries may require statements of ori-gin to establish possible preferential rates of import duties under the Most Favored

Nation arrangements. This certificate also prevents, the inadvert-ent importation of goods from prohibited or unfriendly countries. The forms can vary, ranging from a shipper's own letterhead certificate to a countersigning by the Chamber of Commerce. In some cases, such forms must be visaed by an importing country's resident consul. The United Nations provides and recommends the use of Form A for this purpose. For international use, this docu-ment is generally notarized and chamberized.

Inspection Certificate An inspection certificate is a document certifying that the merchandise was in good condition immediately prior to shipment. Many foreign buy-ers protect themselves by requiring a shipper's affidavit or an independent inspection firm to certify quality and quantity and conformity of goods in relation to the order, as well as to ensure that the goods contracted for have actually been shipped. This certificate is normally prepared by an independent firm other than the exporter, attesting to the quality or quantity of goods being shipped.

Special Purpose Documents As in the case of an inspection certificate, an importer may request other special documents, such as a certificate of weight/measurement and certificate of analysis in order to protect the importer's interests. A certificate of weight/measure-ment is issued by an independent party attesting to the weight or measurement of the merchandise to be shipped. A certificate of analysis contains an ex-pert's report on the findings or grading have the substance or composition of the prod-uct shipped. The document assures the buyer that the goods are those that an exporter contracted for shipment.

Insurance Certificate A certificate of insurance is a negotiable document issued to provide coverage for a specific shipment. It briefly describes the transac-tion and its coverage. Usually, an insurance certificate is issued as an open-coverage policy to protect any and all shipments and transportation as long as a certificate is filed for each shipment. Generally, the policy will cover most losses sustained during transit. Not restricted only to ocean shipments is a marine insurance policy, which covers all modes of transportation.

Air Waybill. An air waybill is basically a bill of lading issued by air carriers for air shipments. This transport instrument is not a negotiable document. As a result a car-rier will release goods to a designated consignee without the waybill.

Bill of Lading A bill of lading is a document issued to record shipment trans-portation. Usually prepared by a shipper on the shipper's car-rier's forms, this document serves three useful functions. First, as a document of ti-tle, it is a certificate of

ownership that allows a holder or consignee to claim the merchandise described. Second, as a receipt of goods, it is issued by the carrier to the shipper for goods entrusted, to the carrier's care for transportation. A bill of lading is thus proof of the carrier's possession of the freight. Third, as a contract of carriage, the bill of lading defines the contract terms between the shipper and his carrier. The conditions under which the goods are to be carried and the carrier's responsibility for the deli very are specified.

Bills of lading can be issued for inland (overland), ocean, or air transport. An inland and bill of lading is issued by railroad or truck lines. It authorizes movement of goods from the shipper's warehouse to the port or point of export. An ocean bill of lading, in contrast, applies to goods shipped by water and is issued by steamship lines. When the document is issued by an air carrier, it becomes an air waybill. In these of a so-called through bill of lading, shipment is provided for two or more trans-portation modes for delivery to a final destination. Another kind of bill of lading is the NVQCC, which is issued by a nonvessel operator common carrier that consol-idates freight into a container for shipping by regular liner vessels.

According to the International Chamber of Commerce, the bill of lading is ac-ceptable only when it is marked clean and on board. The bill of lading is clean when the carrier sees no evidence of damage to the packing or condition of the cargo. The cargo thus must be received in good order and condition without exception or irregularity. A bill of lading is foul when there is indication of damage to the goods re-ceived. For an on-board bill of lading to be issued, the cargo must be loaded aboard the named vessel on the specified date of loading. In comparison, even though a re-ceived for shipment bill of lading also mentions a particular vessel, this document only implies that the goods have been received by the steamship company. In such a case, because the goods are not yet loaded on board a particular vessel, it is possible that the goods may end up on another vessel instead.

In addition to being classified as clean or foul and by types of transportation carriers, a bill of lading can be straight or negotiable. A straight bill of lading, un-der international law, is nonnegotiable. It is consigned directly to a consignee rather than to order. As such, it allows delivery only to the consignee or party named on the bill. The carrier must be certain that the party receiving goods is actually the named party. To obtain possession of the shipment, the foreign buyer simply shows one's proof of identity.

A shipper's order or negotiable bill of lading is a negotiable instrument that is consigned to order. When endorsed, it allows transfer of title to the holder of docu-ments, and delivery can be made to a named party or anyone designated.

Both the straight and order bills of lading serve as collection documents. The buyer must pay for the goods, post bond, or meet other specified conditions before obtaining the bill of lading to claim the goods. The shipper endorses the bill and pre-sents it to the bank for collection as evidence of satisfying the conditions stated in the letter of credit.

LESSON 36:
GLOBAL E-MARKETING

The following lesson tries to make the students understand the following topics:

1. The Death of Distance
2. Communications
3. Targeting the Individual Customer: Beyond Segmentation
4. Relationship Marketing
5. Interactivity
6. Speed to Market
7. Living in an Age of Technological Discontinuities
8. New Technologies Change the Rules of Competition
9. Components of the Electronic Value Chain

Concepts and Definitions

E-marketing	The integration of information technology (IT) and the Internet into marketing
Internet	The largest computer network in the world, which links over 130 million people. By 2003, this number is projected to grow to 350 million users, split between North America-35 percent; Europe-30 percent; Asia Pacific-21 percent; South America9 percent; and the rest of the world-about 5 percent.
Intranet	A computer network that links users in a single company or organization. Access to an intranet is limited to authorized users who are company or organization employees or members.
Extranet	A computer network that links authorized users. In contrast to the Internet, it is not open to the general public and, in contrast to the intranet, it is not limited to members of a single organization or company.
World Wide Web	Makes the Internet more accessible and easier to use by non-experts. Technically it is a system of hypermedia linking text, graphics, sounds, and video on computers spread across the globe.
Portals	Context suppliers that attract millions of Web users with a wide swath of information, search services, e-mail and chat rooms. Among the most important context providers are Internet online services such as America Online, Web browsers such as Netscape Communicator, and search engines such as Yahoo!
Web Browser	Software used to navigate the hyperlinks that make up the World Wide Web.
Virtual Reality	Imaginary "worlds" created by cutting edge computer technology. For example, wearing special headsets, consumers might get the impression of walking through a house and visualizing and experiencing the rooms before the house is actually built.
E-Commerce	Selling goods and services over the Internet, both business to consumer (B2C), consumer to consumer (C2C), and business to business (B2B). The latter is sometimes also referred to as e-business.

Introduction

E marketing is a term that can be used to label the potential of information technol-ogy (IT) and the Internet, and the impact on marketing. E marketing is perhaps the single most important new development in technology in the entire history of market-ing, particularly in its ability to leap over distance. It is clear that marketing is undergo-ing a revolution as a result of the explosion of information technology and the World Wide Web. In this chapter we will review the known and speculate about the unknown impact of the Web and information technology on global marketing.

In this chapter, we look at some of the basic elements of the new technological environment and discuss how the changes we are experiencing impact the way global marketing is conducted. The chapter opens by considering some of the key drivers of the ICT revolution, most importantly the Internet. Subsequently, we discuss the in-fluence of these fundamental changes on competitive strategies. Finally, we consider the changes the technological environment brings to the configuration of the global value chain.

The Death of Distance

Distance was, in the pre modern world, a variable of the greatest marketing significance. As the real estate maxim has it, the three rules of real estate valuation are location, lo-cation, and location. In global marketing, strategies and practice reflected the importance of distance. The most important variable impacting trade behavior, for example, is distance. The primary trading partners of every county are the proximate neighbors: for the United States they are Canada and Mexico, for Canada and Mexico it is the United States. For France it is Germany, and for Germany it is France, and so on around the world. There has always been a positive correlation between trade and proximity. However, the internet is totally independent of distance. Electrons traveling at the speed of light get to anywhere in the world in the same time and at the same cost. If I send an e-mail, it does not make a difference in time or cost whether the mail is addressed to my next door neighbor or to someone halfway around the world. The same thing is true of a Web site: The location of the site does not affect the cost or speed of access.

For the first time in history, the world has become a level playing field. Anyone, anywhere in the world can communicate with anyone else in the world in real time with no premium charged for distance.

These long standing historical patterns of trade are a reflection of the importance of physical distance in global marketing. The improvement of transportation and com-munications technologies has been a major driver pushing the world toward

greater globalization. Costs have come down and service has improved steadily and dramati-cally since the end of World War II. The Internet and IT have been major new drivers of globalization since the beginning of the *1990s.* A Web presence is instantly global. The global reach of credit card issuers, package delivery services, and the Internet has cre-ated a whole new level of possibilities for global retail and business-to-business mar-keting by even the smallest firms.

For example, until the Internet, the aftermarket for motorcycle accessories was frag-mented by country. The only way an accessory would cross national boundaries was if the manufacturer set up marketing and distribution operations in overseas or foreign mar-kets. Today, this is no longer necessary. M*otorcycle Consumer News,* a reader-sponsored magazine, which does not accept paid advertising, reviews new accessories and products for motorcyclists. For the past year, the magazine has included reviews of products that are marketed in other countries with the telephone number, and Web and e-mail addresses of the manufacturer. Readers of the magazine anywhere in the world can communicate directly with the supplier, who can receive payment via credit card with card authoriza-tion and ship anywhere in the world via express delivery. The dramatic decline in com-munications and shipping costs and the decline of both tariff and no tariff barriers to trade have opened up world markets to companies that were formerly too small to par-ticipate in world markets.

Communications

E-mail is a major new communications tool that supplements the fax and telephone to eliminate the barrier of distance. It is instant, cheap (free to most users), and insensitive to time zone. You can read e-mail when you wish regardless of time zone considerations. E-mail is a marketing communications-tool that offers unprecedented power for one--on-one messages for both B2B and B2C communications. Remarkably, it has emerged as a universal communications tool in a mere five years.

Targeting The Individual Customer: Beyond Segmentation

The aim of marketing segmentation has always been to create a unique value offer for as many customers as possible. Before the Internet, this meant, in practice, creating an offer for a segment of the market that was an aggregation of customers. Almost over-night, the World Wide Web has emerged as a powerful new tool for accomplishing what in the past was only a theoretical possibility in marketing: creating marketing programs that target a segment of one. With the Internet, that theoretical possibility has become a reality. Indeed, the whole notion of segmentation has to be reconsidered. Segmenta-tion was a goal in marketing because it was too expensive to address the individual cus-tomer. With the available tools of the Internet and IT, it is now possible to respond to the individual customer regardless of where the customer is located.

Relationship Marketing

Another major thrust of marketing in recent years has been relationship marketing. The Internet has opened up immense new possibilities for creating a relationship with global customers, potential customers, suppliers, and channel members. The end of segmenta-tion means that marketers can now focus on delivering value to the individual customer. The best way to do this is to create a win-win relationship with the customer. The com-pany should offer the customer a unique value, and serving the customer should be prof-itable for the company. The relationship should be mutually beneficial. Whel1ever the benefit is one sided, the relationship is threatened.

Interactivity

Before the emergence of the Internet and IT, communications between companies and their customers were generally limited to one-way communications. Companies made offers, and customers voted in the marketplace. The possibility of an interactive relation-ship between customers and prospects has new emerged. This is particularly true for on-line retailers who can use customer purchase behavior information to uniquely tailor communications to their customers. A customer who purchases sun screen skin protection from an on-line retailer can be advised of other products that also provide sun protection.

Speed To Market

Globalization has unfolded in stages. The first stage was the move of companies to make sure that their products were sold in global markets. Before the Internet and IT created a new world of instant global communications, the pace of information and company communications traveled slowly. Products were introduced in one country at a time or at best one region at a time. Today, that has changed.

The Web is causing the Hollywood movie industry to rethink its America-First policy. Take Mel Gibson's epic *Brave-heart,* for example. It was released in the United States on May 24, 1995, and it crept around the world. Some countries, such as Portugal, waited seven months to see the movie.

When Mel Gibson returned to the screen with a new movie, *The Patriot,* on June 28,2000, the studio rolled it out around the world in two months:

What happened? The Internet. As Warren Lieberfarb, president of Time Warner Inc.'s Warner Home Video put it, "The world is discovering movies on the weekend they open in the U.S. One of the pressures for global releases of new films is the DVD version. Consumers are modifying DVD players to enable players to play DVD disks from anywhere in the world; defeating the effect of a regional coding system designed to stop consumers from playing DVD disks that were purchased from outside their region. When the DVD version of a film goes on sale in the United States, it can be played any-where in the world on a modified player.

The solution to this problem is to move to a global release of new films. This offers a number of advantages. It helps movies that "bomb" in the United States because, when this happens, it has no effect on the international market, which makes an independent judgment on a new release. It also has opened up new costs savings since there is no time to develop expensive, customized marketing programs for each country. Studios are simply recycling art and photos from the US campaign to create a global campaign with the same look around the world.

Living In An Age of Technological Discontinuities

1. Price Plunges Indicate Speed Of Technological Progress

So what are the drivers of the technology revolution we are witnessing? Arguably, the changes with the most dramatic impact on globalization occurred in two fields: transportation and communication. Dicken refers to these two areas as "enabling technolo-gies. In transportation, key advances have been made in air travel and the speedier loading and unloading of container shipments. On the communication side, the reduced cost of long-distance telecommunication is most remarkable. Today, a three-minute tele-phone call between New York and London costs about $0.30; in 1930 it would have cost about $250 when expressed in today's prices. That is an 83,333 percent decrease in prices in 70 years. (This is a reminder that When it comes to technology, prices decline instead of increase.) Market liberalization is expected to bring down international rates by as much as 80 percent over five years. Cambridge Strategic Management predicts that by 2005, a transatlantic videophone call will cost only a "a few cents an hours Already, about two thirds of the world's new telephone subscriptions are for mobile phones and, in some developed countries, this share is as high as 75 percent.

A second important cost reduction is the dizzying decline in the cost of computer processing power: It now costs only 1 percent of what it did in the early 1970s. Expressed differently, "If cars had developed at the same pace as microprocessors…. a typical car would now cost less than $5 and do more than 250,000 miles to the gallon. These price reductions reflect the breathtaking speed of technological change; indeed" never before have such dramatic price falls been-observed.

2. Technological Convergence And The Ubiquity Of Technology

In information and communication technology, it is not only the improved speed and reliability of devices that have brought about the rapid technological change but also the convergence between the transmission of information and the processing of infor-mation. Moreover, it is expected that the next few years will witness a convergence of different types of information and communication technologies into one common In-ternet standard.

A second development has been labeled technological ubiquity. Andersen Consulting describes it as "a world in which information technology is an integral part of everything we see and do in the workplace and at home. Thus, every kitchen device, car, or exercise machine will be packed with easy-to-use electronics that will add value to the product, for example, by tailoring it to personal preferences, enabling remote communication, and so on.

3. Explosive Growth of The Internet

Arguably, the Internet represents one of the most important drivers of the technologically revolution because it has led to the development of an entirely new form of doing busi-ness called e-commerce or e-business. The history of the Internet can be traced back to 1969, when the U.S. Department of Defense introduced ARPANET. Apart from enabling access to remote computers, the network also permitted the transfer of electronic mes-sages (e-mail). At this stage, the users were restricted to a few military researchers. Although subsequent years witnessed an extension of users and the development of simi-lar networks springing up from a cooperative effort among NASA, IBM, and MCI, the true breakthrough occurred as recently as 1992. In this year, Tim Berners-Lee at the Con-seil Europeen pour la Recherche Nucleaire (CERN), a European research institute in Switzerland, introduced the World Wide Web (WWW). For the first time, this-protocol permitted the graphic representation of information in the Internet. In connection with Web browsers used to navigate the network of hyperlinks that make up the World Wide Web, this development is widely seen as the origin of the explosive growth of the Inter-net. Today, the World Wide Web is often used synonymously for the entire Internet, al-though the latter also hosts traditional Internet services such as Telnet, Gopher.

Web access is still very much skewed toward developed countries. Moreover, a number of countries connected to the Internet offer only e-mail and are, consequently, cut off from the wealth of information available on the Web. Despite the fact that cur-rent developments and growth rates, particularly in China and South America, will help ease the problem of geographically unequal access, there is still concern. Richard Jolly, author of the latest development report of the United Nations, notes that technology is a double-edged sword, opening new ways for many but also cutting off access for others.12 In Bangladesh, for example, a computer costs eight times the average annual income.

Technological change as such, of course, is nothing new. What is remarkable today is the speed of change. For example, although it took some 38 and 25 years, respectively, for the radio and telephone to reach 50 million U.S. consumers, television only needed 13 years and cable television 10 years to reach the same threshold. The Internet with the World Wide Web achieved the same penetration level in less than 5 years. On a worldwide basis, the Internet has expanded by about 2,000 percent in the last decade and is doubling in size every 6 to 10 months. By 2003, there are projected to be 350 mil-lion users, split between North America (35 percent), Europe (30 percent), Asia Pacific (21 percent), S0uth America (9 percent), and the rest of the world (about 5 percent). Other forecasts expect the Internet to reach the 1 billion-user mark by 2008; to appreci-ate the magnitude of this growth note that it took until 1999 for telephone users to reach the 1 Million mark. Freeing Internet access from the confines of computer keyboards and enabling access via mobile phones, pagers AND so on will fuel this growth.

Another revolution, voice recognition technology, is just round the corner. Render-ing keyboards largely superfluous and, thus, finally fulfilling the science fiction notion of commanding it machine through the human voice, this technology will dramatically ac-celerate the use of computers

and drive information and communication technology (ICT) into completely new applications: objects we talk to, drive with, touch, or wear.

4. The Development Of E-commerce

Technology, particularly information and communication technology (ICT), is more than merely an enabler. It has become the basis for an entirely new business model. Starting with electronic data exchange (EDI, i.e., the transfer of standardized data be-tween corporations), the Internet has undergone a metamorphosis from a medium pri-marily used to advertise a product or service to e-commerce platform combining information, transactions, dialogue, and exchange. In short, the Internet has given birth to an entirely new business model and opened completely novel opportunities for global marketing.

The scope for new developments arising from the new technologies is considerable. Consider the example of the well-known electronic bookseller Amazon.com. Using a virtual network that seamlessly connects suppliers and customers, the firm has changed the way in which books are traded. Over 30,000 associated Web sites are recommend-ing the company for a commission and provide links to the Amazon site. Of course, Amazon not only offers books but also informs customers about new publications and encourages readers to post reviews of books they have read. Virtual chat rooms and meetings with authors also foster the formation of an Amazon community. More than half the business Amazon conducts is with loyal customers.

Further examples of companies that developed their business around the possibil-ities offered through e-commerce are Dell Computers, which shows growth rates that exceed those of conventional computer manufacturers by a factor of four, E *Trade, an on-line brokerage with annual growth rates of 200 percent, and eBay, which offers on-line auc-tions and has an annual transaction volume of more than $300 million. At eBay, customers provide the entire content, starting from the goods on offer up to the chat rooms in which they exchange background information on these goods.

Although most media attention has focused on consumer marketing on the Internet, more of Internet transactions ate generated in the business-to-business field. Forester Research puts the relationship between business-to-business (B2B) and business-to- consumer (B2C) e-commerce at 5:1

Rapid technological change does not only affect high-tech companies that like to in-clude an *e* in their name. Michael Hruby presents the example of sport shoes. Thirty years ago, he argues, such shoes were inexpensive, made out of canvas, and came in two designs and three colors. Today, their high-tech descendants boast inflatable air bladders and gel inserts. They come in dozens of styles, colors, and materials, and, of course, are different for each sport. They are not athletic shoes any longer, they are equipment. And they are not cheap. Moreover, some of the household names in the business, such as Nike, do not produce a single shoe. Instead they use outsourcing to get the shoes manufactured in low -labor-cost countries and concentrate on what they can do best, that is, global marketing.

For a global marketer, rapid technological advances in general and the unprece-dented speed of change in ICT in particular have resulted in numerous new challenges; virtual organizations, symbiotic relationships, electronic markets, new forms of co-option, blurring corporate boundaries, and flatter organizational hierarchies are among the most important.

Although these challenges open entirely new business opportunities, they also rep-resent fundamental threats to established organizations. Companies have to learn how to live with a high degree of volatility. John Stopford of the London Business School elo-quently pointed to the reduced value of incumbency. Companies that were success stories only a few years ago are now fighting to survive; Westinghouse or DEC spring to mind. On the other hand, there are companies that have appeared virtually overnight. In this context, the author coined the phrase *mushroom companies.* A well-known char-acteristic of mushrooms is, of course, that they grow virtually overnight but then often disappear rather quickly. Consider Yahoo!, which provides the largest search engine on the Internet. Only a few years ago, Yahoo!'s cofounder, David Filo, was a relatively poor ex-student. Today, his on-line service leads the field in both traffic and advertising rev-enues. But while Internet search companies such as Yahoo!, Infoseek, Lycos, and Excite raised $170 million by going public in 1996, Internet search facilities have become a com-modity. There are now hundreds of ways to find and retrieve information on the Web. The Internet search business, in which a number of engines compete for a pool of will-ing advertisers, may soon take some casualties. However, Yahoo! might well survive. It has three times the market share of any of its competitors and has the advantage of being the first kid on the block.

Another example is Netscape, which was founded in 1994 as Mosaic Communica-tions. It offered the first version of its Internet navigator one year later and. at its peak in the first quarter of 1997, generated revenues in excess of $150 million per year. How-ever, since October 1997, the company's stock has lost value on fears that it will be the big loser in its browser war with Microsoft's Internet Explorer.

Given these dramatic business histories, it is not surprising that Microsoft's CEO Bill Gates supposedly said, "We are always two years away from failure," and Intel's CEO Andy Grove coined the motto, "Only the paranoid survive."

New Technologies Change The Rules of Competition

In addition to increasing volatility, the move from an industrial to a postindustrial e-econ-omy also presents the global marketer with a new set of business rules. Long established principles, such as the emphasis of retailers on "location, location, location," are passe. Why should a busy executive spend her valuable time and fight traffic to buy some books or videos for her children in town? She can do the same in much greater comfort from home via the Web.

In a similar vein, Andersen Consulting stated that the new economy will force com-panies to adopt some new game plans. Among the most important follow.

1. Secure a dominant market position as quickly as possible.
2. Form alliances based on their potential for market access and synergies.
3. Anticipate very high start-up investments.
4. Defend positions through an ongoing process of innovations.

We will look next at some of these issues in more depth.

1. Importance Of Dominant Market Positions

In the industrial environment, scale advantages have their limits. This is referred to as decreasing returns to scale. Although a large factory might be more cost-efficient than a small one, there is a point at which adding capacity at the same location will be uneconomical. The cost of adding labor and material will exceed the added returns. This effect permits smaller competitors to compete against those with larger market shares, providing they can achieve production sizes that yield optimal efficiency. Under the new technological regime, the rule of decreasing returns to scale no longer holds universally. In many cases, the optimal output is not determined by the factory size but is based on the point of market saturation. This can be observed in markets in which fixed costs are much higher than variable costs. Examples are computer software or pharmaceutical products, which demand a high degree of intellectual factor input. The same holds for products or services that become more valuable when used by more people, that is, prod-ucts that develop into de facto standard and profit from the frequently mentioned *net-work effect.* Microsoft Office is an example that shows how useful it is to use the same product used by many other people. In all these cases, the returns achieved through in-creasing market shares do not diminish over time but grow in a reversal of the "law" of decreasing returns.

Being placed in such a technological environment, it is important for companies to gain market share quickly and, as Rangaswamy states, to achieve strategic control. This explains why America Online (AOL) distributes; its disks through all sorts of available media (e.g., glued into journals and handed out at supermarkets). New subscribers are lured with irresistible trial offers. Netscape pursued a different strategy. It gave its prod-uct away in the hope of earning money with follow-up deals. The new technological en-vironment has increased the importance of achieving market share. Conversely, the global marketer can no longer afford to tolerate even small attacks from competitors and must be prepared for a vigorous defense of its market position.

Global Perspective

U.S. Airlines "Handoffs" Raise Safety Concerns

A burgeoning practice of sharing or combining flights, known as code-sharing, *allows airlines to create market-ing alliances that give passengers almost seamless travel around the globe. But the scramble for partnerships into regions such (IS Asia and Africa-with some of the world's least safe airlines, has begun to trouble some airline exec-utives and federal officials. China Airlines of Taiwan, for example, is an Ameri-can Airlines and Continental Airlines code- share partner. Airclaims Ltd. of London, ", which tracks airline accidents, lists three China Airlines crashes with 465 deaths in the past decade. And a 1996 Conde Nast survey listed China Airlines as having an accident rate throughout its exis-tence of 11.43 fatal accidents per 1 million flights, com-pared with a 0.15 rate for American and a 0.29 rate for Continental.*

A person flying from Dallas to Taipei tonight for in-stance, would depart on American Flight 691 and transfer in San Francisco to American Flight 6123. At least that's what the ticket would say. But American Flight 6123, which leaves shortly after midnight, is really China Air-lines Flight 3, American Airlines has been quietly work-ing with the Taiwanese airline on safety in the past few months, officials said

Under code sharing, one airline buys a block of tick-ets on another airline's flight and lists the flight in reser-vation systems under its name, or code. The tickets will read as if the passengers are flying on a U.S. carrier even though they actually transfer to a plane flown by another airline. Passengers are supposed to be notified, but many pay little attention until they show up at the gate and find themselves boarding a plane of a different color. Code--sharing is attractive for airlines because it increases feeder traffic on domestic routes and makes an airline's interna-tional reach seem much greater.

2. Importance of Strategic Alliances

The postindustrial e-economy is more and more characterized by a dilution of tradi-tional corporate structures and boundaries in favor of a move toward symbiotic alliances with external partners. Companies involve legally and economically independent firms to fulfill various tasks. Technology is important in this context, since the use of ICT leads to a reduction of transaction costs and, thus, promotes the market and alliances orien-tation of companies. Videoconferencing, electronic data exchange, extranets, and other technologies offer companies involved in symbiotic alliances cost-efficient means of communication.

Three types of alliances can be distinguished. Vertical cooperation describes partner-ships between companies active in different stages of the value chain, such as a collabo-ration between a manufacturer and a retailer in the marketing of an innovative product. Horizontal cooperation involves companies in the same industry, such as research and de-velopment cooperation of two or more microelectronic companies. Diagonal coopera-tion, finally, refers to situations in which companies from different industries collaborate.

While cooperation and alliances as such are not a new phenomenon, the changes in the technological environment have not only- made cross-country alliances easier to manage but have also influenced the motivation behind the alliances. Besides the desire to increase efficiency, it is now primarily the desire to gain market access and market share that drives cooperation. The desire to utilize network effects and to achieve syn-ergies in products and services, for example, was behind the cooperation between the American Broadcasting Company (ABC), the New York Times, and America Online (AOL). Indeed, the benefit of gaining access to its customers allowed AOL to bill the other two companies $1 billion. Airlines can serve as another example of strategic al-liances. E-commerce permits airlines to utilize their brand names in on-line reservations through so called "code-sharing." This,

in turn, eventually results in higher market shares for the globally networked partner airlines.

3. Importance Of Anticipating High Start-up Investments

   Increasing returns to scale in many e-based industries necessitate high start-up costs in order to achieve the desired market share. A substantial part of the investment must be committed for years before the revenues eventually exceed the costs. AOL, for example, had to invest $500 million per year into marketing and sales before it reached its current position as market leader. Toys" {" Us recently announced that it planned to update its Web site organized as a separate company in order to fight increasing Web competi-tion in the toy industry. The anticipated costs for this Web site update are $80 million. Many e-based companies need the backing of well-established, financially strong corpo-rations or are forced to turn to the stock exchange to raise the required capital. The high stock market valuation of the so-called Internet stocks in comparison to the stocks of tra-ditional companies shows that the market, contrary to its reputation as being too short -term oriented, is willing to take a long-term view.

4. Importance of Ongoing Innovations

   In the traditional technical environment, innovations were primarily a means to gain a few points of market share. It was a rare event that consumers changed allegiances in droves. Information about goods and services diffused relatively slowly and there were significant gaps between lead and lag countries in the adoption of technology.

   In today's technological environment, the situation is drastically different. Not only has the diffusion speed increased significantly (70 percent of the computer industry's rev-enue, for example, comes from products that did not exist two years ago), but also the penal-ties for falling behind the latest world-class technological standard are quick and sharp. Consider WordPerfect, which for a long time was the world's leading word-processing package. When Microsoft Word offered a more up-to-date technological standard, WordPerfect suffered a drastic fall.

   Increasing use of ICT is leading to greater efficiencies in all stages of the new-product development process. Many companies are encouraging their employees, customers, and suppliers to submit ideas for new products or improvements through interactive Web sites or e-mail. Toyota, for example, generated over 2 million suggestions for improvements from its employees alone. After new ideas are generated, expert systems can be used in the evaluation of these ideas. At the design stage, computer-aided design (CAD) and design teams that work in parallel in different time zones substantially speed up this stage. lCT applications such as virtual reality further aid the development process. To achieve a better fit between product features and customer needs, customers are increasingly in-volved in the design of the product. Smart, a European automobile marque, for example, permits customers to design their own version of the car on the Web.

Digital economy valuations			Traditional Economy Valuations		
	(1998)			(1998)	
	Annual Revenues	Market Cap	Market Cap	Annual Revenues	
Company	($m)	($m)	($m)	($m)	Company
AOL	2600.0	149800	149,800	14,700	Pfizer
Yahoo!	203.3	34500	34,700	15,100	Allied Signal
EBay	47.4	24000	24,300	18,400	J.P. Morgan
Amazon	610.0	23000	23,000	15,500	Alcoa
Priceline	35.2	17900	17,700	15,900	FedEx
@Home	48.0	16800	16,900	26,300	Lockheed Martin
E* Trade	285.0	12900	13,500	19,200	AMR
CMGI	91.5	11200	11,400	8,300	Ingersoll Rand
Real Networks	64.8	5700	5,500	11, 200	Toys" 5!" Us

Business and marketing analyses, running concurrently with the technical develop-ment of new-product ideas, may use ICT in the form of data mining to identify whether there is a likely demand for the new product from existing customers. Finally, simulated test markets again speed up the new-product development process. Such approaches use mathematical modeling of marketing mix data to gauge the likelihood of the new prod-uct's success and may render real-life test marketing superfluous.

Components of The Electronic Value Chain

For global marketers, one of the most dramatic and relevant effects of technological changes has been the "death of distance." As Frances Cairncross of the *Economist* put it: "The death of distance as a determinant of the cost of communica-tions will probably be the single most important economic force shaping society in the first half of the [21st] century. It will alter, in ways that are only dimly imaginable, decisions about where people live and work, concepts of national borders, patterns of international trade. Its effects will be as pervasive as those of the discovery of electricity. Some effects are already emerg-ing in the shape of a reconfiguration of the value chain.

A major part of the attractiveness and dynamics of the new technological environ-ment stems from the ability to "modularize," "segment," or "fragment" the value chain into small and distinct customer-oriented processes. ICT facilitates the coordination between these modules in largely nonhierarchical systems and increases the scope for outsourcing specific modules. Closely related to the modularization within companies is the trans-formation of linear value chains into multidimensional networks. For the customer, it is often not transparent which part of a transaction is carried out by which particular member of the network For example, the customer usually does not know which reser-vation system a travel agency uses to book a flight. Indeed, most often the customer does not care as long as the required goods or services are delivered as requested. What ap-pears to emerge under the new technologi-cal regime is a network of specialists, which per-mits participants to focus on their respective core values.

1. Context Suppliers

   Context suppliers, also called *portals*, support the use of the electronic channel both for customers and suppliers. Their

key functions are to offer access to the channel and reduce the complexity of the electronic environment. Among the most important context providers are Internet on-line services such as America Online, Web browsers such as Netscape Communicator and Microsoft Explorer, or search engines such as Yahoo! and Lycos. In 1998, the top nine portals generated approximately 15 percent of all Internet traf-fic. However, their growth appears to be slowing down, and it has been estimated that by 2003, the Internet traffic flowing through the top nine portals will plateau at 20 percent.

2. Sales Agents

Sales agents support suppliers primarily through offering high-quality address banks of potential customers. Metro-mail provides an example. It offers suppliers carefully sifted address banks of potential customers that typically contain a wealth of information about customer preferences, demographics, and other data. One of the latest services is referred to as the "firefly technique." It helps companies to target consumer groups and provide special product offerings based on profiles of musical and reading preferences.

Penop: Signing Up For E - Commerce

One of the last hurdles facing the introduction of e-com-merce and a paperless business culture is the need for a signature on documents such as contracts, loans, and gov-ernment-related forms. But Penop, a British company, has achieved considerable success with its electronic sig-nature technology that legally binds a handwritten digi-tal signature to electronic documentation. Penop now has 60,000 users worldwide, mostly in the United States, ranging from the Food and Drug Administration (FDA) and judges in Georgia to insurance salespeople. Penop's software is linked to the personal computer either as an integral software kit or used via an electronic signature pad now commonly found on laptops, dedicated PC pe-ripherals, and Palm Pilots. When a manager writes his or her signature on the pad, Penop notes 30 different phys-ical aspects of the action, including pressure of the pen and its angle of elevation. The rhythm of the action is recorded 100 times per second, as well as the exact sym-metry in the curves of the script. The signature's elec-tronic profile is then automatically encrypted.

To deter fraud, the date and time of the event are also logged. "This element delivers evidential force to the signature," says Christopher Smithies, who founded the company with Jeremy Newman, "and can be used in future audit trails or forensic examinations." The software also includes a "ceremony box" to remind the writer that a legally binding act under common law is taking place. Even more important, Penop's software prevents the content of that document from being altered after it has been signed. Penop's chief financial officer, Robert Levin, says, "Our technology's security is much stronger than paper. . . . With paper, a buyer can subsequently re-pudiate an order for whatever reason, but with secure, ir-refutable electronic signatures this isn't so easy."

In the United States it is estimated that 2.8 million signatures are written on paper every minute, and the total cost of printing and postage can cost $50 each. But using Penop, the FDA has set up on-line drug trial forms that open the way to a completely electronic application pro-cess for pharmaceutical companies. In Gwinnett County, Georgia, where distances are large, judges who once had to be visited in person by police officers to sign off-hours arrest and home search warrants are now connected via PCs to local police stations. "A video conference link en-ables the judges to discuss the Warrant and, if they're sat-isfied, sign it using the Penop system, which no one at the police station can tamper with," says Mr. Levin. In Ten-nessee, the First American Bank offers insurance at its retail branches using Penop software to verify signatures, and a local insurance company with a sales force of 7,000 uses it to collect signatures for policy application forms. American General Life and Accident, the insurer, has saved $2 to $3 million in costs, cut its error rate to nil, and accelerated the dispatch of policy certificates.

With the cost of peripheral digitizers falling from $200 to as little as $30 Penop believes the market is ready to explode. "It's an end-solution that removes paper com-pletely,? says Mr. Levin. "We think it's the 'last mile' in en-abling e-commerce." Recently, the software has been made compatible with Windows CE technology. In the United Kingdom, Penop has been used at DSS offices in Liverpool to combat fraud based on impersonation. "When three dole claimants saw that they had to sign on a computer, they left quickly," says Mr. Smithies. Penop also expects digitizers to become widespread for the checking of signatures on credit card transactions. "Credit card companies charge retailers more when no signature is involved in the transaction," says Mr. Smithies. "And, by contrast, identification via smart cards does not provide proof of intent. Ours does." Soon, Penop will launch a second patented product that combines its technology with that of IriScan, a U.S. company. James Cambier, chief technology officer at IriScan, says his system will provide confirmation of the person's identity while Penop will secure legal proof of intent by the author as well as the "bonding" of the signature to the document. In stream-lining the signatory process, whether across the Internet, intranets, or extranets, Penop believes it can remove an important and unnecessary bottleneck hindering the de-velopment of e-commerce.

3. Purchase Agents

On the customers' side, electronic purchase agents help the Internet shopper to find the desired goods or services. Auto-By- Tel, for example, is a service that helps customers find the right car for the right price. Similarly, search robots such as Price SCAN permit con-sumers to find the best price on thousands of computer hardware and software products. Such programs automatically travel the Web and gather data from magazine ads and vendor catalogs. Web robots are also sometimes referred to as Web crawlers or spiders. Companies such as BizBots are developing a "real time 24 by 7 (24 hours a day, 7 days a week) automated market of markets" that link multiple sites in various business sectors (such as chemicals) to provide complete transparency for buyers and sellers.

4. Market Makers

Market makers are mediators that bring together buyers and sellers and increase market efficiency. Typical examples are the numerous auction sites that have sprung up on the Web. According to its Web site, on sale, for example, had more than 160,000 visitors per day and in excess of 1 million registered users. And the need to innovate can also be felt in this part of the supply chain. eBay, with some 5.6 million registered users as the world's leading person-to-person on-line trading community, recently announced the availability of pagers featuring "eBay a-go-go," a new service that allows

users to receive updates on their eBay auctions via pagers.36 PlasticNet.com *for* plastics, Metals.com *for* steel, and var-ious other sites bring together buyers and sellers in business-to-business markets.

5. Payment And Logistic Specialists

Currently, one of the main stumbling blocks *for* the use of electronic markets continues to be the means of payment via the Internet. However, the development of efficient electronic payment systems is advancing rapidly. It is expected that by the year 2005, some 30 percent of all consumer payments will be based on digital payment systems.37 In the meantime traditional credit card companies such as VISA are managing the transfer of payments and the associated risks. The box "Penop: Signing Up *for* E-Commerce" pro-vides some insights on how a British company helps to overcome one of the last hurdles facing a paperless business culture, namely the need *for* a signature on documents.

Physical distribution via the Internet is only possible *for* software products or in-formation services (e.g., investor, stock market, and database information). All other products have to be shipped via traditional channels. Nevertheless, the Internet and the Web offer a completely new view of the traditional distribution function. Although phys-ical distribution was one of the core functions *for* the traditional retail/ commerce sys-tems, this aspect can be unbundled and outsourced using international distribution experts (e.g., UPS). Moreover, the logistic functions of warehouses get outsourced to lo-gistic experts and software companies.

ODYSSEUS. INC. (THE DECISION TO GO.INTERNATIONAL.)

She faced him waiting. And Odysseus came, debating inwardly what he should do; embrace this beauty's knees in supplication or stand apart and use honeyed speech, inquire the way to town and beg some clothing? In his swift reckoning, he thought it best to trust in words to please her-and keep away; he might anger the girl, touching her knees.

-HOMER

The Odyssey, Book Six, "The Princess

at the River," Robert Fitzgerald Trans.

In early 1991, Mr. Donald R. Odysseus, president of the Odysseus Manufacturing Company of Kansas City, Kansas, was actively considering the possibilities of major expan-sion of the firm's currently limited international activities and the form and scale such expansion might take.

Odysseus was founded in 1926 by Edward Odysseus as a small machine shop. By 1991, the head office and production facilities of the company were located in a 500,000-square-foot modem factory on a 30 - acre site near the original location. Odysseus products were sold throughout the United States and Canada. In1990, net sales were over $83,800,000 while after-tax profits were about $4,835,000. In early 1990, Odysseus employed just over 1,000 people, and its stock was held by 1,000 shareholders. (The com-pany's 1990 income statement and balance sheet are given in Exhibits 1 and 2.)

Odysseus produced a line of coupling and clutches in-cluding flange, compression, gear type, flex pin, and flexible disc couplings, and overrunning and multiple disc clutches.

In all, the company manufactured about 600 different sizes and types of its eight standard items. The company's single most important product was the Odysseus Flexible Cou-pling, which its research department had developed in 1985 and which, produced in about 70 different sizes and combi-nations, and now accounted for one third of Odysseus's sales. Odysseus held patents throughout the world on its flexible coupling as well as several other devices. By 1991, Odysseus had carved itself a secure niche in the clutch and couplings market, despite the competition in this market of larger firms with widely diversified product lines.

Exhibit 1. Consolidated Income Statement, Year Ending December 31, 1990 (In $ Thousands)

Income		
Net sales	$84700	
Royalties, interest, and other income	174	
	$84874	$84874
Costs and expenses		
Cost of goods sold	$54019	
Depreciation	1773	
Selling, administrative, and general expense	18845	
Interest on long term debt	219	
	$74856	$74856
Income before income taxes		10018
Federal taxes on income (estimated)		
Net income		5157
		$4861

Exhibit 2 Balance Sheet, December 31, 1990 (In $ Thou-sands)

Assets		
Cash	5667	
Marketable securities	3688	
Accounts receivable	6399	
Inventories	25578	
Total current assets	41332	41332
Investments and other assets		1351
Property, plant, and equipment (net)		23177
Total assets		65860
Liabilities		
Accounts payable	2015	
Dividends payable	745	
Accruals	3394	
Federal income tax liability (estimated)	3752	
Installment on long terms debt	277	
	10183	10183
Total current liabilities		
Ling term debt (20 year 67/85 notes final maturity 1987)		5051
Preferred stock		6370
Common stock and retained earnings		44256
Total liabilities		65860

Odysseus was not dependent on any single customer or industry. Sales were made through distributors to origi-nal equipment manufacturers for use in small motor drives for a wide range of products including machine tools, test gear, conveyors, farm implements, mining equipment, hoist-ing equipment, cranes, shovels, and so on. No more than 10 percent of its output went to any single industry; its largest single customer took less than 4 percent of production. Speaking generally, Odysseus couplings and clutches were used more by small- and medium-sized producers of general-.

purpose equipment than by large manufacturers pf highly automated machines. Odysseus's sales manager believed that demand for the company's couplings and clutches would benefit from continuation of a long-term trend toward in-creased installation of laborsaving equipment in medium enterprises. This trend and the breadth of its market had provided some protection against cyclical fluctuations in business activities. During the period 1977 to 1990, sales had increased from $32 million to over $84 million; the largest annual decline during the period had been 8 percent, while in the most recent recession year sales had actually increased by 5 percent.

The company's commercial objective was to operate as a specialist in a product field in which its patents and dis-tinctive skills would give it a strong competitive position. In the past, the company had experimented with various products outside. It's coupling and clutch line; it had tried to make components for egg-candling machinery, among other things. The invest-ment in these products was initially considered a means of more efficiently utilizing the com-pany's forging and machining capacity, but the firm had not been particularly successful. The Odysseus management had come to the conclusion that it should concentrate its ef-forts on its line of couplings and clutches; and in 1991, Mr. Odysseus stated the company's corporate objectives ex-plicitly as being a coupling and clutch manufacturer. New investments were made to develop better products within this field, and to open new markets for Odysseus products.

Odysseus's production and assembly facilities were lo-cated in its modern-factory near Kansas City, Kansas. The site offered ample room for expansion and was well 10-cated for both rail and highway transportation. The com-pany maintained warehousing facilities in Boston, Jersey City, Atlanta, Colum-bus, Ohio, and Oakland, California. The scale economies stemming from concentrating pro-duction in one factory can be seen from the following ex-amples. One of the company's largest selling items, product K-2A (a flexible coupling compo-nent) produced in lots of 750, cost $5.19 each; in lots of 1,200, $4.22 each. The incre-mental 450 units produced after the initial 750, therefore, cost only $2.6 each. Put differently, on this particular prod-uct, a 50 percent cost saving could be realized on the mar-ginal production from the 750-unit level to the 1,200-unit level. Although specific cost savings from higher volume varied among its products, a fundamental characteristic of Odysseus's cost structure was that marginal cost typically was significantly less than average cost and that importance econo-mies of scale could be obtained by achieving larger lot sizes and longer production runs.

Odysseus's cost structure was of course, dictated by its manu-facturing process. In the first of three major steps m the manufacture of couplings or clutches, steel bars or -tubing were .cut and forged. Apart from the unit cost re-ductions stemming from more complete utilization of the existing forging facilities, economies of scale in this dependent were limited. Second, the forged steel pieces were ma-chined to close tolerances in the machine shop. Here cost varied significantly with lot sizes. For most products, the choice among two or three alternative methods of produc-tion depended on the lot size. If a large lot size were indicated, special-purpose automatic machines with large setup costs and lower variable unit costs were used. Smaller lot sizes were produced on general-purpose turret and engine lathes where setup time was less but unit costs were higher.

Typically, production of smaller lot sizes was more labor intensive than the larger runs. For example, one operates; running three automatic machines could perform all the boring and cutting operations on 300 $2\frac{1}{2}$inch coupling flange units in an hour. The same output on general-purpose lathes and boring machines would require about six personhoods. To set up the automatic machines required a day and a half, however, while the lathes could be set up in about two hours. Further-more, the burden charge on the automatics was considerably higher. On the other hand, of the third step, assembly did not vary under different -sizes. (Exhibit 3 presents a breakdown of the costs of some representative components.)

Mr. Odysseus regarded Odysseus's U.S. and Canadian market position as a strong one. The -patented Odysseus-

Exhibit 3 Typical Variation Of Production Costs With Lot Sizes Product N – 15 D

Operation	Lots of 150	Lots of 400
I. Foundry	$51.67	$51.6
II. Machine Shop		
1. Boring	55.67	32.
2. Turning	14.17	11.4
3. Facing	19.79	16.25
4; Drilling	32.23	26.30
5. Turning	18.95	15.41
6. Facing	19.95	14.76
7. Finishing	18.76	18.76
8. Finishing	17.95	18.24
III. Assembly	7.96	7.96
	257.10	$213.49
Product L-36G:		
Lots of 3: $108.6 each		
Lots of 4: $90.6 each		

Flexible Coupling possessed unique characteristics that no other coupling device duplicated, and many other Odysseus products served special functions not performed by com-petitive devices. Of course, other coupling and clutch sys-tems competed with Odysseus, but no single company could be said to compete directly by introducing an identical prod-uct line. Mr. Odysseus estimated that Odysseus accounted for roughly 10 percent of total sales of its products in the American market and that was ample room for Odysseus to expand its sales in this domestic market as the total market grew and through an increase in its share of industry sales. Odysseus products were sold by distribu-tors who generally, but not always, carried the entire line of Odysseus couplings and clutches. These distributor organizations were comple-mented by a 45-person Odysseus sales force.

In 1990, export sales were $1,353,862, on which the company made a $161,174 operating profit. Although ex-port sales had never been actively solicited, a small but steady stream of orders for export trickled into the Kansas City sales office. These orders

were always filled expedi-tiously, but the active exploitation of export markets was considered too difficult in view of the barriers of language, custom, and currency. Furthermore, although he recognized that foreign wages were increasing more rapidly than those in the United States, Mr. Odysseus had always believed that Odysseus could not compete in export markets because its costs in Kansas City were too high. Also, tariffs imposed on Odysseus products by foreign governments were typically 10 percent ad valorem or higher.

Odysseus sold all products on flat price basis (FOB warehouse) to all customers. In-competing with other sup-pliers of similar products, Odysseus stressed delivery time, quality, service, and merchandising, but not price.

In its management's view, improvements in its products or in delivery or service promised more than temporary competitive advantage. Price-cutting moves, in contrast, would likely be matched by competitors the same day. No added sales would be gained, and total revenues would be cut. The company's export pricing policy was identical to its domestic policy. This meant that the foreign importer paid the U.S. free-on-board (FOB) price plus freight and im-port duties.

Along with filling orders, Odysseus's activities outside the United States and Canada consisted of a licensing agree-ment with an English coupling manufacturer. In 1985, on a vacation trip in England, where Odysseus's vice president in charge of engineering had spent his youth, he met the chair-person of Siren Ltd. of Manchester. Siren, a manufacturer of related equipment with sales of $14.6 million in 1984, was anxious to diversify by adding other power transmission products. Consequently, Siren became interested in several Odysseus patents, particularly those on the Odysseus Flex-ible Coupling. In late 1985, Odysseus granted the English concern an exclusive 15-year license to manufacture and sell all present and future Odysseus products in the United Kingdom. The licensing arrangement specifically defined the United Kingdom to include England, Scotland, Wales, and Northern Ireland. Siren was granted also a nonexclu-sive license to sell products produced from Odysseus pa-tents in all other countries except the United States, Canada, Mexico, and France. The terms of the license agreement stip-ulated a 1.5 percent royalty on the ex-factory sales price of all products in which devices manufactured from Odysseus patents were incorporated. The 1990 royalty income from Siren amounted to $128,939 and was expected to rise to $161,174 in 1991

Mr. Odysseus had noted Siren's success with consid-erable interest. The royalty payments were a welcome ad-dition to Odysseus income, especially since they had not necessitated any additional investment. Mr. Odysseus felt that the licensee was receiving very generous profits from this deal, as Siren had almost tripled its sales (which by 1990 were equivalent to $35.5 million) during its five-year association with. Odysseus and its equity had appreciated many times the total royalties of about $483,522 that Odys-seus had received.

During the five years Odysseus and Siren had worked together, however, the English firm had made it under-stood that in general it considered its territory to be the Eastern Hemisphere, while Odysseus's was in the Western Hemisphere. Siren was especially interested in the German market for couplings and clutches and was a licensee of a German brake shoe manufacturer.

In addition, Odysseus had a licensing agreement on the same terms (1.5 percent royalty) with Scylla, S.A. Scylla was a medium-sized French manufacturer of clutches and com-plementary lines located near Paris. The company was fi-nancially sound and well headed by a young and aggressive management team. Scylla had been granted an exclusive license in France and a nonexclu-sive license In Belgium to sell products incorporating Odysseus-patented devices. Odysseus had entered the agree-ment during 1989 for an ini-tial period of 10 years. Royalty income in 1990, the first full year of operation in France, had totaled roughly $32,200. Odysseus expected a doubling of this figure in 1991.

In February 1991, M. Scylla, the president of the French firm, had proposed to Mr. Odysseus a closer asso-ciation of their two companies. M. Scylla was anxious to expand his operations and needed capital to do this. He, therefore, proposed that Odysseus form a joint venture with Scylla. According to the terms of the proposal, Odys-seus would bring $645,000 into the joint venture, paid in cash, while Scylla would provide a 40,000-square-foot plant, equipment, a national distribution system, and man-agerial personnel. Scylla S.A. would cease to exist as a cor-porate entity; its expanded organization and plant would become Scylla Odysseus, S.A. (SOSA). The original owners of Scylla, S.A. (the Scylla family) would own 60 percent of SOSA, and their return would be in the form of dividends plus salaries of members of the Scylla family employed by SOSA. Odysseus would own 40 percent of SO SA and, for tax reasons, would receive fees and royalties rather than dividends totaling 5 percent of the ex-factory price of all products incorporating Odysseus patents.

Mr. Odysseus thought that he should give this proposal serious attention. The French market for couplings looked very attractive. Moreover, the geographical location of SOSA within the European Community would make it possible to supply the even larger German market from the SOSA piant near Paris. M. Scylla had indicated that he con-sidered Germany a primary target for future expansion.

So' far, Odysseus had not actively pursued business leads in Germany in spite of several inquiries about li-censing from German companies. Odysseus even had the possibility of acquiring an existing German manufacturer of couplings, Charybdis Metallfabrik GmbH (CMF) of Kassel. Mr. Odysseus had learned that CMF's aging owner managers were anxious to sell their equity interest in the company but would stay on in managerial capacity. Odys-seus's British licensee, Siren, had made it clear, however, that although it had no sizable business in Germany, it con-sidered this market to be in Siren's sales territory and a move into Germany by Odysseus without Siren an "un-friendly act." In the light of Odysseus's growing royalty income from Siren, Mr. Odysseus did not wait to antago-nize the British licensee.

Mr. Odysseus had no ready means of precisely quan-tifying the market potential for clutches and couplings in Germany and in France. He knew, however, that the total market for Odysseus's "type L" couplings in the United States was $72.5 million in.

1990, or 14 percent of the *US.* market. Odysseus assumed that the coupling market in France was correlated with sales of durable equipment in France, which were 12 percent of the *US.* total. The French type-L coupling market, therefore, would be $8.7 million a year, of which SOSA should expect to capture 14 percent, or $1,218,000. Similarly in Germany, durable equipment sales were 20 percent of those in the United States. The type-L coupling market could, therefore, be expected to be about $14.5 million, of which a company using Odysseus patents and know-how should obtain between 10 percent and 15 percent. Sales of comparable lines by both Scylla, S.A. and CMF appeared to justify these estimates; Scylla had sold $870,000 of a device closely comparable to the type-L coupling, or 10 percent of the assumed French market, and CMF had sold $1,160,000 of virtually the same device, or 8 percent of the assumed German market.

In 1991, the European market with its accelerating pace of industrial development and mechanization ap-peared to offer great opportunities for Odysseus. Mr. Odys-seus was therefore most anxious to capitalize on these opportunities, presumably by manufacturing in Europe in cooperation with a European firm. He saw three reasons why Odysseus should expand its foreign operations.

First, the corporate objectives of focusing on a single line of products sold in as large a market as possible-the policy of area instead of products diversification-dictated expansion into markets outside the United States and Can-ada. The nature of the demand for Odysseus's products appeared to limit near-term sales potential in less devel-oped areas but especially in Europe. Odysseus couplings and clutches appeared to find ready acceptance. Proof of this seemed to be contained in Siren's success in the United Kingdom.

Second, an important improvement on the Odysseus multiple disc clutch had been the result of European re-search. Mr. Odysseus felt that by becoming an active par-ticipant in the European market, the company could obtain valuable recent innovations that would be important to its competitive position in the United States. There was con-siderable activity in the clutch and coupling field in Europe, and Mr. Odysseus wanted to be in touch with the latest de-velopments in the industry.

Third, Mr. Odysseus was seriously worried about the trend of costs in his Kansas City plant. He had heard that a French firm was planning to invest in a manufacturing plant in Mexico where wages were 16 percent of those in the United States. How could Odysseus compete against this kind of cost advantage? Ultimately, Odysseus might have to follow the lead of *US.* watch and bicycle firms and perform much of its manufacturing abroad and import parts, or even finished products, into the United States. At the present time, Mr. Odysseus felt that there was some reluctance on the part of American manufacturers to buy foreign cou-plings and clutches, and foreign competition was virtually nil in this market in 1991. But Mr. Odysseus was worried about the future and wanted to preserve 'Odysseus's com-petitive position by assuring a foreign source of supply. Also, the company would be in a better position to with-stand exorbitant demands from the local labor union *if* it possessed alternative manufacturing facilities.

Before definitely deciding whether Odysseus should become more deeply involved in foreign operations, Mr. Odysseus wanted to review the ways this might be. done. First, Odysseus could establish foreign markets by expand-ing export sales. Mr. Odysseus believed, however, that Odys-seus's costs might be too high for it to compete successful on this basis. Second, the company could enter into addi-tional licensing agreements. This it had done with Siren in England and Scylla in France, but there was a definite ceiling on the possible profit potential from exclusive use of this method. Third, the company could enter joint venture with a firm already established in foreign markets. Presum-ably, Odysseus would supply capital and know-how and the foreign firms would supply personnel (both local manage-rial skill and a labor force), market outlets, and familiar-ity with the local business climate. This approach appeared particularly promising to Mr. Odysseus. Finally, the company could establish wholly owned foreign subsidiaries. Mr Odysseus saw formidable barriers to such action, since Odysseus lacked managerial skill in foreign operations. They were unfamiliar with foreign markets and business practices. They did not have executives to spare from the Kansas City operations who might learn the intricacies foreign business, and the development of wholly owned operations from scratch would require significant investment of time and money.

As he reflected on these issues, he looked at a set of tables on global income and population, productivity, wages, exports/imports, and trade and investment (Exhibits 4-9 on the following pages) and decided to attempt to comprehend what, if any, significance the data in these tables had for Odysseus. Mr. Odysseus recognized that certain deep-seated ideas of his tended to make him predisposed toward active development of overseas business. These included a view that his business should not shrink from difficult tasks- organizations, he believed, couldn't stand still-the choice was one of moving forward or falling backward. He considered "taking the plunge" into less familiar areas and learning from the experience was generally preferable to long-extended and expensive inquiry before taking action.

Nonetheless, he wanted to be sure that the most basic issues related to expansion overseas by Odysseus were thought through before firm decisions were made.

Exhibit 4 Global Income and Population 1992

Global Income and Population	*GNP ($ billion)*	*GNP per Capita ($)*	GNP	*1992 Population (million)*	*%01 World Population*
Country Summary					
World Total	1,427.1	3,905	100.0	5,486.98	100.0
High Income	17,110.0	20,906	79.9	818.44	14.9
Triad Total	16,573.6	21,127	77.3	784.49	14.3
United States and Canada	6,379.1	22,540	29.8	283.01	5.2
Japan	3,403.8	27,233	15.9	124.99	2.3
European Economic Area	6,790.7	18,037	31.7	376.49	6.9
Other High Income	536.4	15,800	2.5	33.95	0.6
Upper-Middle Income	2,469.4	2,708	11.5	912.03	16.6
Lower-Middle Income	1,318.2	668	6.2	1,974.37	36.0
Low Income and Unavailable Data	529.5	307	2.5	1,782.13	32.5
Expansion of High-Income Countries	17,110.0	20,906	79.9	818.44	14.9
GNP per Capita >$12,000					
United States	5,799.9	22,657	27.1	255.99	4.7
Canada	579.2	21,433	2.7	27.02	0.5
Japan	3,403.8	27,233	15.9	124.99	2.3
EC	5,851.4	17,717	27.3	330.26	6.0
Belgium	159.0	15,848	0.7	10.04	'0.2
Denmark	118.3	23,008	0.6	5.19	0.1
France	1,148.7	20,186	5.4	56.91	1.0
Germany	1,642.3	21,328	7.7	77.00	1.4
Italy	1,017.8	17,603	4.7	57.82	1.1
Luxembourg	11.8	31,172	0.1	0.38	0.0
Netherlands	268.7	17,820	1.3	15.08	0.3
Portugal	53.8	5,123	0.3	10.50	0.2
Spain	456.4	11,514	2.1	39.64	0.7
United Kingdom	974.5	16,886	4.5	57.71	1.1
EFTA	843:2	25,883	3.9	32.58	0.6
Austria	153.3	20,012	0.7	7.66	0.1
Finland	139.3	27,763	0.7	5.02	0.1
Iceland	5.7	21,652	0.0	0.26	0.0
Norway	104.4	24,381	0.5	4.28	0.1
Sweden	211.1	24,536	1.0	8.60	0.2
Switzerland	229.5	33,971	1.1	6.76	0.1
Asia	114.7	13,138	0.5	8.73	0.2
Hong Kong	76.3	12,845	0.4.	5.94	0.1
Singapore	38.4	13,763	0.2	2.79	0.1

Exhibit 4 (cont.)

Global Income and Population	GNP ($ Billion)	GNP per Capita ($)	GNP	1992 Population (Million)	% Of World Population
Caribbean	2.9	16,771	0.0	0.17	0.0
Bermuda	1.4	24,365	0.0	0.06	0.0
Virgin Islands, U.S.	1.4	12,798	0.0	0.11	0.0
Oceania	353.8	16,865	1.7	20.98	0.4
Australia	309.4	17,662	1.4	17.52	0.3
New Zealand	44.4	12,834	0.2	3.46	0.1
Oil-Producing Countries	65.0	15,977	0.3	4.07	0.1
Kuwait (est.)	35.3	15,136	0.2	2.33	0.0
United Arab Emirates	29.7	17,1 07	0.1	1.74	0.0

Exhibit 5 Productivity and investment in the world Economy, 1971 – 1990 (Thousand of 1980 Dollars)

	1971-75	1976-80	1981-85	1986-90
Gross Product per Worker				
Developed market economies	20.2	22.2	23.0	25.8
Eastern Europe and USSR	6.0	7.3	8.2	9.2
Developing Countries of which:	1.5	1.7	1.8	1.9
Africa	1.8	2.0	1.8	1.8
Asia, excluding West Asia	0.6	0.8	0.9	1.2
Latin America and Caribbean	5.4	6.0	5.9	5.8
World	5.5	6.0	6.2	6.6
Investment per Worker				
Developed market economies	5.1	5.2	5.1	6.2
Eastern Europe and USSR	1.9	2.3	2.3	2.4
Developing Countries of which:	0.3	0.4	0.5	0.5
Africa	0.4	0.5	0.4	0.3
Asia, excluding West Asia	0.2	0.2	0.3	0.4
Latin America and Caribbean	1.2	1.5	1.1	0.9
World	1.4	1.5	1.5	1.6

Indexes of Hourly Compensation Costs for Production Workers in Manufacturing Selected Countries: 1975 to 1989 United States = 100. Compensation costs include pay for time worked, other direct pay, employer expenditures for legally required insurance programs, and contractual and private benefits plan, and for some countries, other labor taxes. Data adjusted for exchange rates. Area averages are trade-weighted to account for difference in countries' relative importance to U.S. trade in manufactured goods. The trade weights used are the sum of U.S. imports of manufactured products for consumption (customs value) and U.S. domestic exports of manufactured products (x.a.s. value) in 1986; see source for detail.

Hourly Compensation Costs-Industrial Structure

Area or Country	1975	1980	1985	1987	1988	1989
United States	100	100	100	100	100	100
Total	62	70	54	75	82	82
OECD	75	83	85	91	99	97
Europe	82	103	63	101	105	100
Asian newly indo economies	6	12	13	16	19	23
Canada	91	85	83	89	98	103
Brazil	14	14	9	10	11	12
Mexico	31	30	16	12	14	16
Australia	67	66	63	70	81	85
Hong Kong	12	15	13	16	17	19
Israel	35	39	31	47	55	54
Japan	48	57	50	81	92	88
South Korea	6	10	10	13	16	25
New Zealand	50	54	34	51	59	55
Singapore	13	15	19	17	19	22
Sri Lanka	4	2	2	2	NA	NA
China: Taiwan	6	10	12	17	20	25
Austria	68	87	56	98	101	95
Belgium	101	133	69	112	112	106
Denmark	99	111	63	109	115	106
Finland	72	84	62	100	113	116
France	71	91	58	93	94	89
Germany	100	125	74	126	131	123
Greece	27	38	26	34	36	38
Ireland	47	60	45	60	70	66
Italy	73	81	56	91	93	92
Luxembourg	100	122	59	97	100	NA
Netherlands	103	123	69	116	117	109
Norway	107	119	82	129	136	131
Portugal	25	21	12	19	19	19
Spain	41	61	37	59	64	64
Sweden	113	127	75	113	121	122
Switzerland	96	113	75	127	130	117
United Kingdom	52	76	49	67	76	73

Exhibit 8 20 Leading Exporters And Importers In World Merchandise Trade In 1990

Imports (CIF)	1990	'90/'89	Exports (FOB)	1990	'90/'89
1. United States [1]	516,987	4.88	1. Germany [2]	410,104	20.18
2. Germany [2]	346,153	28.35	2. United States [1]	393,592	8.19
3. Japan [3]	235,368	12.23	3. Japan [3]	287,581	4.98
4. France [5]	234426	21.47	4. France [4]	216,580	20.73
5. United Kingdom [4]	2,22,777	12.67	5. United Kingdom [5]	185,160	21.54
6. Italy [6]	18984	18.94	6. Italy [6]	170,348	21.20
7. Netherlands [8]	12698	-20.86	7.Netherlimds [8]	131,802	22.22
8. Canada [7]	124,422	3.87	8. Canada [7]	131,665	9.50
9. Belgium [9]	119,971	21.83	9. Belgium [9]	118,156	18.14
10. Spain [11]	87,696	22.70	10. Hong Kong [10]	82,160	12.33
11. Hong Kong [10]	82,474	14.30	11. Korea [11]	64,956	4.21
12. Korea [13]	69,640	13.61	12. Switzerland [14]	63,784	23.79
13. Switzerland [12]	58,194	-16.49	13. China, P.R. [12]	60,920	18.00
14. Sweden [16]	54,435	11.15	14. Sweden [13]	57,574	11.69
15. China, P.R. [15]	52,275	-10.31	15. Spain [16]	55,642	25.06
16. Singapore [14]	49,667	-18.44	16. Singapore [15]	52,752	18.11
17. Austria [18]	49,146	26.08	17. Austria [18]	41,265	29.34
18. Australia [17]	42,\)32	-6.46	18. Australia [17]	39,837	5.78
19. Thailand [20].	33,379	29.52	19. Denmark [19]	35,065	24.76
20. Denmark 119]	31,760	19.00	20. Norway [20]	34,030	25.75

Note: Figures in brackets indicate rank in 1989.

Exhibit 9 Trade and investment Exports and imports of the world to and from the Areas Listed

Exports (FOB) Imports (CIF)						
	1988	1989	1990	1988	1989	1990
Areas						
IFS World Total (US$ Bi)	2,699.3	2,913.8	3,325.0	2,774.8	3,009.4	3,455.0
DOTS World Total	2,693.4	2,912.8	3,339.6	2,773.8	3,002.2	3,450.6
Ind. Countries (US$ Bi)	1,958	2,118.	2,449	2,016.1	2,160.9	2,500.1
Developing Countries	689,839	744,726	835,509	746,592	832,674	935,954
Africa	64,507	65,103	73,846	66,131	74,466	86,196
Asia	342,136	381,836	433,172	362,822	403,131	456448
Europe	80,139	83,095	95,105	84,684	85,714.	86,086
Middle East	99,008	100,572	105,801	103,082	124,568	150,387
Western Hemisphere	104,048	114,120	127,585	129,874	144,794	156,837
USS and selected other						
Countries n.i.e.	81,676	86,095	73,905	78319	78,997	68,476
Memorandum Items						
EEC (US$ Bi)	1,043	1,125	1,357	1,058 '	1,122	1,359
Triad** (US$ Bi)	1,740	1,881	2,182	1,780	1,909	.2,208
Oil-Exporting Countries	96,543	98,488	108,864	132,497	160,121	195,419
Nonoil Developing Countries	593,296	646,238	726,646	614,095	672,553	740,535
Annual Percent Change						
World	14.4	8.1	14.7	14.6	8.2	14.9
Industrial Countries	13.2	8.2	15.7	14.9	7.2	15.7
Developing Countries	18.1	8.0	12.2	14.1	11.5	12.4
Africa	12.1	0.9	13.4	5.9	12.6	15.8
Asia	29.0	11.6	13.4	22.5	11.1	13.2
Europe	5.7	3.7	14.5	11.4	1.2	0.4
Middle East	7.4	1.6	5.2	-3.1	20.8	20.7
Western Hemisphere	11.4	9.7	11.8	15.1	11.5	8.3
USSR and selected other.						
Countries n.i.e.	14.8	5.4	-14.1	8.5	0.9	-13.2

Discussion Questions

1. Should. Odysseus expands international business operations?

2. Rightly or wrongly, Odysseus management has. decided in the affirmative. What form should these operations take? What *scope* will be required for Odysseus's international activities to achieve suc-cess? Possible forms, which in turn may be combined, include (a) exporting, (b) licensing, (c) joint ventures, and' (d) wholly owned subsidiaries, either by starting them from scratch or by acquiring one or more existing companies. This decision should take into account Odysseus's capabilities (as determined, for example, by its products, its capital and labor strength, and its marketing and research needs) as well as the industry's competitive requirements and foreign conditions, such as trade and business barri-ers, the number and sizes of countries to be covered, and political and business risk.

3. Evaluate the arrangement with Siren, particularly the following questions:

a. What assumptions were in Mr. Odysseus's mind when he concluded the licensing arrangement with Siren?

b. Do you consider it a success?

c. How does the timing of this arrangement fit into Odysseus's overall business strategy?

4. Evaluate the Scylla, S.A. proposal and the Charybdis possibility.

5. Recommend a global strategic plan to Mr. Odysseus

CASE STUDY 1
BASEBALL: THE JAPANESE GAME

Babe Ruth toured Japan with an All Star team in 1931. Pro baseball resumed in Japan after the war in 1950. Japanese teams play each other all the time. There are 12 professional teams, divided into two leagues, the Pacific and the Central. The champion from each league plays in an end – of –season playoff, a Japanese "World" series. The teams are:

Central League	Pacific League
Yomiuri Giants	Nippon Ham Fighters
Yakult Swallows	Lotte Orions
Taiyo Whales	Seibu Lions
Chunichi Dragons	Nankai Hawks
Hanshin Tigers	Kintetsu Buffaloes
Hiroshima Carp	Hankyu Braves

Four of these teams are located in Tokyo and four in Osaka; all teams are owned by corporations. The Yomiuri Giants are owned and run by Japan's leading newspaper chain, the Yomiuri. The Chunichi Dragons are owned by another newspaper chain. Five teams are owned by railroads: Seibu, Hankyu, Kintetsu, and Nankai, all ion the Pacific League, and the Hanshin Tigers in the Central. Other team owners include Taiyo, a fish producer; Nippon Ham, a meat producer; Lotte, a chewing gum manufacturer; Yakult, a soft – drink company ; and Maxda, which owns the Hiroshima Carp. The Central League is stronger, with an attendance of 12million compared with 7 million for the Pacific League in 1987. The Yomiuri Giants alone are on TV five or six nights a week, and all 65 of their home games and most of their away games are covered. Similarly, Taiyo and Yakult both have separate TV contracts and hence strong fan loyalty, and home attendance is high.

The Japanese players are smaller in size. They come up the traditional way: through high school baseball and then into Japan's only minor league or through four years of college. Once in college, they cannot be drafted for four years. Japanese players know that the Americans are better paid and stronger, and accept that the current generation of U.S. players is bigger, stronger, and faster and hits with more power than most Japanese players. Mike Lum, a hitting coach with Kansas City who played in Japan, noted, however, that Japanese pitching is good. It helps that the Japanese strike zone is wider and deeper, from below the belt to the armpits.

As in the United States, TV is a strong influence on baseball. The Yomiuri Giants have a national following because of TV and with Sadaharu Oh (who has 868 home runs to his name) they won nine straight national championships between 1965 and 1973. They play in the new Tokyo Dome, modeled after the Metrodome in Minnesota, which they share with the Nippon Ham Fighters.

Built by the Korokuen Corp. for about $280 million, the new Tokyo Dome produced first – year revenues of over $325 million. It can draw on a population of nearly 30 million in a 100 square – mile radius (due to Japan's excellent and fast public transportation system). The 56,000 – seat arena also hosts track meets, bicycle races (on which big bets are placed in Japan), rugby matches, and events that have been as diverse as Michael Jackson concerts and Mike Tyson boxing matches.

To combat the greater financial strength of the Central League, the Pacific League began importing U.S. players. The practice is now standard in both leagues. Each team can have two active foreign players, with an additional "imported" player in the minor leagues who can be called up in case of injury. Japanese baseball now offers an opportunity for the young U.S. ballplayer who almost makes the U.S. major league teams. An example is Jim Paciorek, who played in the Milwaukee Brewer farm club organization for five years. Unable to make the Brewer team, he moved to Japan to play for the Taiyo Whales in Yokohama.

The foreign players, gaijin sanshu, are well paid, with the appreciating yen making Japanese salaries look even better. For example, Mike Easler signed with the Nippon Ham Fighters in May 1988 for $975,000 for one year. He had been cut by the Yankees and, at age 37, saw Japan as his only chance to continue playing in the majors. Others signing the same year were Doug DeCinces, Bill Madlock, and Bill Gullickson. The transition was made easier by playing in the Tokyo Dome, the only real major – league facility in Japan. It may have helped that Easler had played 10 seasons of winter ball in Mexico and Venezuela, thus becoming more comfortable with foreign cultures. Salaries for U.S. baseball players are high when compared with the following average 1988 salaries for Japanese players: $93,680 for pitchers, $76,160 for catchers, and between $112,000 and $113,000 for infielders and outfielders in the Central League.

But for the Japanese player, the pay difference is not a major bone of contention: The player is ultimately a company employee who knows that the company that owns his team will absorb him into the company culture and find him a position if he quits baseball.

The pay is good, but life is not easy for the U.S. ballplayer in Japan. For one thing, the entire team relies heavily on him. For another, although teams hire inter

Prater who works the player nonstop he and his family must adjust to the culture, the scarce housing and the expensive way of life. The there are the playing fields them selves. The Tokyo dome is fine, as are three other stadiums that have artificial turf. But the remaining clubs have all dirt infields and grass outfields, or even all dirt fields. When it rains, the field can be a swamp, and playing during the hot season has been compared to playing during the hot season has been compared to playing on a basketball court. The work ethic, quintessentially Japanese, often is the undoing of the aging U.S. baseball player who comes to Japan expecting some easy money. It is not surprising

that, faced with the demand to believe that the company or team is what matters and that the manager must be listened to, many U.S. players quit after a year.

Randy Bass's story is an example of the culture gap. He became Japan's leading slugger, winning the triple crown in Japan, but he left the hashing tigers for San Francisco in may 1988 when his son was hospitalized. He was contravening the Japanese cultural code that puts loyalty to the company above personal considerations. When he did not return by June 17, as he had agreed, he was released.

Unlike U.S. baseball, Japanese teams play each other frequently because there are only six teams in each league. Pitchers watch and learn about batters. The pitcher's chief weapons are the curve, the slider, and the forkball—in other words, control. After facing a hitter so many times during the Japanese season (and studying him like a hawk), the better pitcher has a distinct advantage. As washer puts it, " what you can't before the everything in great detail. The practice habits and work habits here are just exceptional…. It's like spring training every day." One other difference is the stress on pitching completed games. Easler thinks that this builds confidence because the pitcher learns to bail him out. : patience is the key to hitting in Japan. You are definitely going to have to hit the ball to be a dead pull hitter, has returned to the spray hitting style that he learned under Walter Harinhiak with the Boston Red sox. As a result, he was hitting 3.12 after 39 games by mid July 1988.

Will There Be A True World Series Some Day?

What of the future? Because of the strong yen, Japanese clubs can bid more dollars for better U.S. players if they so choose. The concentration of teams in Tokyo and Osaka may hinder attempts to expand baseball in Japan by adding new teams in other cities. On the other hand, the success of the Tokyo Dome points to the possibility of moving franchisees and creating expansion teams linked to new major league – quality stadiums. And now that baseball is an Olympic sport, on the horizon is the possibility of Japanese – U.S. world series, with the Japanese champions challenging the U.S. World Series winners. This means raising the quality of Japanese baseball, increasing the size of the roster from the present 25 men, and perhaps raising he current three – man ceiling for foreign players.

Baseball Trade Opportunities

Selling U.S. baseball to Japan is an "export" possibility. Growing TV revenues in the United States may indicate that a similar high – paying market might exist in Japan. TV rights for baseball games to be shown on Japanese TV might bring yen – based revenues for U.S. entrepreneurs. Promotional opportunities for ballplayers in Japan are under exploited, being currently under control of the company owning the team. There are no Japanese baseball cards. And if baseball can be exported, can ownership rights be far behind? Would Sony buy up a U.S. baseball team? After all, the owner of Nintendo was given permission by U.S. baseball team owners to purchase the Seattle Mariners when the team was for sale. If the two richest markets in the world are baseball crazy, there are surely opportunities for further trade in baseball between these nations.

Questions

1. How is Japanese baseball marketed? In what ways does it differ from the selling of U.S. baseball?
2. How would an aging U.S. baseball player market himself to a Japanese team?
3. How is the growing popularity of baseball in Japan likely to affect U.S. baseball?
4. Does U.S. Japanese collaboration change the market for U.S. baseball players? How should the Major League Players Association (the union) react to protect its member interests?
5. Why would U.S. entrepreneurs and agents be interested in Japanese baseball players?
6. Why would someone in Japan want to buy a U.S. baseball team? What are the implications of an internationalization of the baseball scene?
7. How can trade in baseball be seen as an example of trade in services?

CASE STUDY 2
SONY CORP

Sony has ling been known for its innovative consumer electronics products, such as the pioneering Walkman. It is an international corporation with 70 percent of its sales coming from outside Japan and non – Japanese owner owning 23 percent of its stock. Sony manufactures about 20 percent of its output outside Japan. As of 1986 its sales mix was video equipment 33 percent, audio equipment 22 percent, TVs (the Trinitron) 22 percent, and other products (recorded, floppy disk drives and semiconductors) 17 percent Sony has always emphasized R & D spending about 9 percent of sales on it.

The Betamax Experience

Sony has been facing increasing competition form other Japanese companies and from countries with lower labor costs, such as Taiwan and South Korea. Its strategy of inventing new advanced technology products and then waiting for the market to buy seemed to be faltering. Sony biggest failure was the Betamax, however. Having invented the Betamax format for VCRs it effused to license the technology to other manufacturers. Betamax was higher priced, and recording times were somewhat shorter than those of the competing VHS format, although quality of the images was better.

Sony competitors such as Matsushita (Panasonic), Hitachi and Toshiba, all banded together around the VHS format. They licensed the format to any manufacturer who wanted it. Consequently the total number of VHS set produced and sold was far higher than the Betamax format volume and resulting economies of scale. Also, far more "software" was available for the VHS format; that is movie producers were more likely to make home video copies of their films available for purchase and rental on VHS tapes. This further increased demand for VHS format VCRs. The net result was that Betamax gradually faded, and Sony stopped its production in 1988.

Rethinking Basic Strategy

The difficulty of selling advanced technology coupled with the speed of imitation and the impact of low wage country competitors led Sony to change its basic corporate strategy. The CBS / Sony Group, Inc. a 50-50 joint venture between Sony and CBS, Inc. has grown dramatically over a 20 year period to become an industry leader in the multibillion yen Japanese music industry. It release recordings in Japan Hong Kong and Macau on compact disk and other format by popular Japanese artists such as Seiko Matsuda and Rebecca, as well as foreign artists.

Sony Diversification into the Entertainment industry

Sony's diversification into the global music industry is, there fore, not unexpected in January 1988 it agreed to buy CBS Records worldwide for $2billion. But subsequent moves have dramatically transformed Sony as it moves to become more a service company. Table 1 summarizes the major entertainment industry acquisitions made by Sony since 1988.

Table 1
Form Electronic To Entertainment : Sony Acquisitions Since 1988

Date	Company Acquired	Price
October 1989	Guber peters productions	$200 millions
September 1989	Solumbia pictures	$3.4 billion
January 1989	Tree international country music publishers	$30 millions
January 1989	CBS Records	$ 2 billion

The acquisitions themselves are large totaling over $5 billion or about half of Sony's total assets. More interesting is the reasoning behind Sony's decision to acquire a slew of entertainment companies. A summary of the acquisitions follows:

CBS Records For $2 billion, Sony was able to acquire control of the world's largest record company, CBS Records. CBS Records, Inc. consists of CBS Records (Domestic), CBS Masterworks. CBS Records International, CBS/Sony, Columbia House, and CBS Musicvideo. The Acquisition gave Sony an immediate international presence in the music industry. Traditionally selling music hardware, Sony was one of the world's largest producers of compact disk players (CDs), tape recorders (including the phenomenally successful Walkman), and stereo television. But all of these products were subject to competition because innovative ideas could be imitated and prices cut. Sony realized that being in the music business allowed it to take advantage of the entire installed base of compact disk players around the world, not just those it alone manufactured. Imitation was impossible because each musical performance was unique; however, managing such a creative business required great cultural sensitivity and the use of local managers rather predominantly Japanese management.

The music industry is a fast-growing business. In 1988 over 150 million CDs were sold in the United States alone, and there were over 11 million CD players in households.

Columbia Pictures: The major attraction of Columbia Pictures was its large library of movies that continue to earn revenues every time they are shown at cinemas and on video around the world. Columbia also had a profitable TV production and syndication business. Thus, the acquisition gave Sony products to sell to owners of TV sets and VCRs in a manner analogous to providing music on record and tape for owners of CD players and tape recorders.

There are two other reasons that Sony might have found Columbia Pictures attractive. First, TV in Japan is being liberalized, with a doubling in the number of TV stations and on airtime because of the launch of satellite television. There will be a sudden increase in demand for product, such as films

and TV shows, to fill airtime on Japan's satellite stations. Sony will be in a position to supply such product for premium prices in yen at a time when demand will be increasing.

The other reason is hardware related. Sony has been trying to establish its 8 mm camcorder format, again in compensation with a VHS-C- based format from competing Japanese producers. This standards battle is reminiscent of Sony's experience with Betamax. This time, however, Sony realizes the need to build the installed base. Hence, it has licensed the 8 mm technology to other producers and is willing to manufacture the camcorders for sale by others under their brand names. Sony is thus making sure that volume sales of the 8 mm camcorder will be achieved, resulting in economies of scale and lower prices The next step is to stimulate demand by making available a variety of movies in this format. Sony can do this by putting the entire Columbia Pictures catalog on 8 mm video, thus giving consumers a reason to buy the camcorder, which can also be used as a video player. This availability will be crucial to the success of Sony's newly introduced 8 mm video walkman, a pocket-sized portable color TV set that will appeal to the extent that videos are available for use with the video walkman.

Thus, with the CBS Records and Columbia Pictures acquisition, Sony becomes one of the world's major producers of entertainment hardware and software: record producer and CD player producer; a leading manufacturer of TV sets and an owner of a library of classic films.

Guber-Peters Productions When Sony purchased Columbia Pictures; it obtained a film library as well as a studio for film production. Columbia had gone through four producers in five years, however, and needed more capable film production management. The logical step was to take over one of Hollywood's most successful film production companies, Guber-Peters (G-P) (formerly Barris Productions), which had been responsible for Batman, one of Warner Communications' all-time best selling films. In fact, G-P had signed a five-year exclusive agreement with Warner to produce movies on its behalf. G-Ps expertise lay in spotting hot properties, signing them, and then convincing major studios to bankroll the films and distribute them. G-P had a unique culture-specific talent for working in and with Hollywood, producing successful films for the huge U.S TV and film audience. Sony acquired G-P for over $200 million, or about five times G-Ps latest year revenues. The two key producers, Peter Guber and Jon Peters, received about $50 million for their stock in G-P, a 10 percent stake in future profits at Columbia Pictures, 8 percent of the future appreciation of Columbia Pictures' market value, and about $50 million in total deferred compensation.

Warner immediately sued Sony for acquiring G-P. Warner refused to release Peter Guber from a long-term contract. Of course, Sony and Warner ultimately settled out of court, exchanging valuable assets such as a share of the movie studio, video rights, and so on. Clearly, Sony wanted the management talent, Americans who knew Hollywood and could hire the right people, had the appropriate financial and creative contacts, and, most important, knew how to make hit films.

Tree International Sony also acquired, through CBS Records, the ownership of Tree, the premier country music publishing company. The ownership of rights to several generations of his country songs guarantees a steady stream of revenue, especially as the catalog becomes a popular around the world and in Japan through Sony's music and video production divisions. This is a minor acquisition, but it may point to a trend toward acquiring other music publishing companies as a means to further control the software end of the entertainment business.

Sony's Future

Looking to the future, Sony's heavy involvement in new hardware technologies such as advanced high-definition TV, computer workstations, and compact disk interactive technology will require further research and development; but their acceptance by consumers will depend equally on the availability of software products that showcase the new hardware products. Sony's long-term plans focus more on services and entertainment; paradoxically, this will help it to become a stronger hardware company and to reduced risk by smooth fluctuations and providing the stability of recurring earnings from sales of music film and videotapes.

Questions

1. What were the threats facing Sony?
2. Trace the various entertainment industry acquisitions made by Sony. Why did Sony make these acquisitions? Have they helped the company compete more effectively in international markets?
3. What are the risks of Sony strategy of buying US entertainment companies?
4. What would you recommend that Sony do next? And how do you think Sony Japanese's competitors might respond to its action?
5. Is Sony becoming a global company, or is it becoming a company with products adapted for each specific country market?
6. What generalizations can you make about the global service industry from Sony's experience?

CASE STUDY 3
SONY IN 1996

In December 1994 Sony announced that it was taking a $ 2.7 billion write off in connection with its 1980 acquisition of Columbia pictures. Furthermore, Sony pictures reported a loss of $500 million for the year; the combined losses of $3.2 billions were dome of the largest losses incurred in Hollywood's shortly there after, Matsushita, which had copied Sony by buying MCA, announced that it was selling MCA to Seagram, incurring a large loss in the process. MCA's top management had threatened to leave MCA because Matsushita did not wish to invest additional funds into MCA, MCA' a main film producing partner Steven Spielberg, would have accompanied MCA's management and stopped distributing his films through MCA's.

Back in Japan meanwhile, an appreciating yen made Sony consumer electronics products more expensive in its sport markets. It was facing competitions from producers in south Korea and Taiwan that could offer a basic VCR in U.S. were such as Circuit City for $ 99 a price at which Sony could compete.

Changes at the Top

Major changes occurred within top management ranks at Mr. Morita, Sony's founder, had suffered a stoke and withdrawn form management involvement Mr. Ohga the CEO who had himself undergone a by pass operation missed being able to chat with his mentor, and the gradual decline in Sony's fortunes led him to think carefully about what sort of person should lead Sony into the 21st century. Both Morita and Ohga had agreed years earlier that they would step down as president of Sony at age 65. It had been widely assumed that an engineer, Mr. Minoru Morio, the president of Sony audiovisuals products and head of Sony's digital video disc (DCD) efforts, would step in. Ohga, however, turned to a marketer, Mr. Nobuyuki Idei as Sony's next president. Mr. Idei as Sony next president. Mr. Idei had worked for Sony in overseas locations and been in charges of marketing Sony's design center, responsible for songs merchandising and products promotions and corporate communications. As such, he represented Sony across the world at major trade shows and industry gatherings. His appointment signaled a major change in Sony's strategic directions and visions of itself. Mr. Idei was an enthusiastic proponent of digital video, and saw opportunities for Sony in the convergence of entertainment, consumer electronics products, and PCs.

The Digital Video Era

Digital video could be to VCRs and films on videotape what CDs were to the older analog LPs (long playing records). Digital video allows entire films to be stored on CD-ROM sized disks and accessed at any point, manipulated and reused.

Sony had been working with the Dutch company Philips in developing a DVD standard that would be used in digital video devices. Sony's standard called for a single-sided disk containing about 3.7 gigabytes of information, equal to about 135 minutes of video.

Establishing an industry standard can be enormously profitable, as can be seen in the examples if Intel and Microsoft- Sony (and Philips0 earned a nickel in royalties for each CD sold. But in 1993 Sony found out that Toshiba and Time Warner were working on a DVD standard of their own. Their super-density, or SD, format would use both sides of the disk and store five gigabytes on each side; Time Warner also found it easier to get the attention of movie studios in Hollywood and get them to clarify what performance criteria they expected from DVD. (Mr. Morio, who headed Sony's DVD effort, in contrast, spoke little English and came from an engineering, not marketing, background.) With mounting compensation form Toshiba and Time Warner, Mr. Idei was asked to formulate a new DVD strategy, which he crafted by stressing the role of DVD as a format for multimedia PCs. By January 1995, Matsushita had joined Hitachi, pioneer, JVC, Thomson, and Mitsubishi in supporting the Toshiba SD standard. With the Betamax fiasco possibly in mind, Sony ultimately compromised and agreed to work out a unified DVD standard.

New Business Directions

One of Sony's successes has been the Sony Playstation, which competed against the Nintendo and Sega 16-bit game machines, but offered superior video and sound and faster speed through 32-bit processors. Planning for the playstation began in 1988 when Ken Kutaragi, who was designing Sony workstations using advanced chips, realized that the prices of these chips would fall to the point that it made sense to build game machine around these 32-bit semiconductors, with added features such as a CD-ROM input device and superior graphics screen. However, game machines sell because their customers want the hit games that are exclusive to that platform. Hence an executive from Sony Music, which was a distributor on Nintendo machines, suggested that Mr. Kutaragi think about building reusable modules that programmers could use to quickly create entertaining and impressive new games. Based on this, Mr. Kutaragi built a dictionary of images that could be combined on the fly to build game characters that could exhibit subtle and lifelike movements, while cutting game development time by half. Sony also created a joint venture with in the company with Sony Music to focus on selling both hardware (the Playstation) and software (that is, newly developed games). This allowed the Playstation to be priced at $299 in the United States, a full $100 below the competing Sega Saturn (with the expectation that a growing installed base offered a fertile and captive market for the sale of high-margin hit games, the typical Nintendo owner purchased 6 to 12 games for a machine). Sony's Playstation became the best-selling 32-bit game machine in Japan and the United States in 195. About a year later, Nintendo introduced its N64 machine and both companies

reduced their game machine prices to under $150. Loyal Nintendo fans brought its new machine in large numbers, but Sony's lead and larger number of games available ensured that it continued to hold a larger market share over Nintendo in the new generation video game segment of the market.

Under Mr. Idei's leadership, Sony entered into an alliance with Intel to make multimedia PCs, what he termed "Intelligent TV". He visualized "the intelligence of computers, the access power of on-line communications, and the visual power of full-motion video integrated into a new form of viewing experience". Other new products that Sony targeted for the age of digital TV included wide-screen living room televisions that could access the Internet using Web browsers, eyeglasses onto which TV and E-mail could be projected using wireless technology, as well as low-cost computers acting a Web browsers The new Sony PCs could include Sony Playstation game-playing abilities as well as the ability to access digital TV programs, and use screensavers featuring images and sound from Sony films and Sony music acts. Moreover, Sony's library of 3,000 films and over 35,000 hours of TV programs would be a valuable resource for an age of digital TV.

Outside the United States, Sony saw strong growth possibilities in satellite TV. It formed a joint venture with Singapore-based Argos Communications to launch a Hindi-language satellite TV channel beamed to India. The channel would feature locally produced Indian shows and movies, as well as films and programs from Sony's library. Initially, the channel would be offered free to cable TV operators who would redistribute it; Sony expected to generate revenues from sale of advertising time. Sony also became a partner in HBO OIC, a Spanish-language service aimed at Latin America.

Management Shake-up in the United States

Mr. Schulhof, a physicist and jet pilot (like Mr. Ohga), was the head of U.S operations and a close ally of Morita and Ohga. He had authorized the payment of $200 million to buy Guber-Peters Entertainment and to buy out their contract with Warner Brothers. He allowed Guber and Peters to choose their managers, sometimes resulting in the appointment of friends and associates (Guber named his lawyer as the number two executive). This may have resulted in an atmosphere where politics and whom one knew became important.

Guber and peters had little management experience in running studio, but spent lavishly, updating the gulver city studios at a cost of $200 million. There were no cost controls, and several new films released were expensive failures such as the last action hero, Hudson hawk, geranium, and Frankenstein. Mr. Schulh of also backed Sony's entry into programs for radio syndication and into theme parks featuring Sony characters and goods. He did not agree with the move into PCs, which he characterised as allow margin business with very rapid change and short product cyscles an environment with which Sony had no experience. By the end of 1995 he had resigned form Sony, as Mr. Idei moved to reestablish Japanese headquarters control over Sony pictures and U.S. operations.

Sony Finances

Table 1 summarizes Sony's financial performance between 1996 and 1995. Sales grew dramatically, from $707 billion to over $46 billion in decade. 1995 sales were nearly evenly distributed across Japan, the United States, and Europe, with sales of $ 13.9 and $ 10.2 billion respectively. However, net income was at half the profitability levels of 1986, and long-term debt grew tenfold. Sony had to choose in allocating its cash flow between the entertainment division and the support of R&D in the hardware divisions. In 1995, sales of TV, audio, and video equipment were about 58 percent of total sales, compared to about 20 percent form music of films. In 1995, U.S. consumer electronics revenue3s actually exceeded U.S. music and film revenues.

Alternatives for Sony's entertainment operations

Matsushita's sale of MCA immediately raised questions as to whether Sony should do the same. Mr. Idei remarked that matsushita was shortsighted in selling its film division. In a digital age, content and copyrights can be distributed in myriad formats, and the large film library that came with the co. there are few Hollywood film studios left to buy for any media company eager to enter into the software or content generation side of the business's when Mr. Idei took over as his entertainment division in the united states. His priority, wanted to see more pictures made with lower budgets, stressing cost controls. When Mr. Schulhof, head of Sony U.S. operations, mentioned that Sony's market share was rising. Me Idei remarked that he was more interested in profits.

If Sony were to sell, several choices existed. Should it sell all of to entertainment business? If so, whom should it sell to? Mindful that it did not want to create a strong competitor down the road. Interested parties included GE. Which owns NBC-TV. News corp., which already has the fox studios, and overseas buyers such as ploy gram and Bertelsmann, neither of which had a major Hollywood studio. Another alternative was to sell only part of the US. Entertainment business, perhaps selling a portion in a U.S. pubic stock offering, or, selling a stake in the company to a strategic partner.

Mr. Idei had specific ideas on how Sony should be run. He expressed little interest in buying media channels as Disney did with ABC—" buying a network in a digital age with so many channels won't bring any benefits to us." He disliked the idea of selling the U.S. music and film business and the taking on of a partner for fear of losing control and having to put up with interference from U.S. owners with different perspectives. " I also want to set a new future direction for our R&D. so that it is not merely trying to extend our current business, but attempting to identify new opportunities for the

Table 1

Sony Corporation: 1986-1995 Financial Statements ($ Billions)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Sales	7.700	10.700	17.100	20.500	26.100	29.600	32.200	34.800	40.40	46.200
Operating	0.200	0.400	1.200	2.100	2.100	1.400	1.00	0.900	-1.70	2.300
income	.0245	0.269	0.562	.0717	0.827	0.904	0.292	0.143	-2.97	0.683
Net income	0.880	1.580	1.670	4.100	4.910	6.650	7.650	9.360	10.49	8.470
Long term debt	3.700	5.200	6.900	9.100	10.400	11.600	12.400	12.600	11.70	10.700
Net worth										

21st century, and of course DVD is a very high priority because setting a format standard energizes the company."[1]

Question

1. Evaluate the performance of Sony's U.S. entertainment division. Why did they do poorly?
2. What are the challenges facing Sony in 1996? Assess its strategy for coping with these challenges.
3. Looking back would Sony have been better off not buying into the U.S. film and music businesses?
4. What do you thing of Mr. Idei's approach to running Sony?

CASE STUDY 4
ENRON: SUPPLYING ELECTRIC POWER IN INDIA

Rapid economic growth in emerging nations, principally in Southeast Asia, has taxed their existing infrastructure. Their future growth is dependent on resolving bottlenecks in critical infrastructure industries such as electricity generation and transmission, roads, telecommunications, port facilities, rail roads, and airline service. A particularly pressing need is to increase electricity power GENERATION AND AVAILABILITY. Table 1 set out the relationship between GDP per capita and energy production as well as energy consumption. Both energy production and consumption rise with growing incomes, and the current levels of energy consumption in countries such as India and China are far below levels in countries such as the United States. China's consumption (below 600 kwh per capita) is at about one-quarter of the world average, while India's (below 300 kwh per capita) is at about one-eighth of the world average.

There is no question that energy consumption and production must rise if these emerging nations are to continue their rapid growth. If not, energy shortages will pose bottlenecks, impeding and arresting growth and putting a damper on the rising prosperity of people all across Asia. The World Bank estimates that Asia will need 290,000 megawatts (mw) of new generating capacity until 2004, which works out to new capacity coming on line at the rate of 2,000 to 2,400 mw a moth! Such a pace of new capacity build-up will require investments of $35 billion a year; emerging nations cannot finance the level of investment needed by them. A typical 300-mw plant could cost $500 million, and China alone might require around 300 plants over the next decade, implying $150 billion for investment in electricity generation in China alone!

Therein lie the promise and the risk of international energy investments for private – sector, independent power producers (IPPs) and energy multinationals. The high – growth potential markets of Asia offer electric utilities (and other firms) the opportunity of significantly increase sales and profits.

Table 1 – Electricity Consumption, Production, and GDP per Capita

Country	GDP per Capita (US$, 1991)	Electricity Production (Billions KWH, 1991)	Energy Consumption (Kg. Oil Equivalent per capita, 1990)
United States	22,449	3,079.0	6,971
Japan	27,005	857.0	2,904
India	350	286.0	217
China	600	671.0	569
Indonesia	620	44.0	211
South Korea	6,540	119.0	1,731
Philippines	720	22.5	210
Thailand	1,623	50.1	516
Hong Kong	14,500	28.4	1,240

Enron's Dabhol Power Project in India.

Enron, a Texas – based utility, launched a separate subsidiary to begin to sell its power – generating expertise in international markets. One of its first major projects was in India. India has a great need for power, with per capita consumption of only 270 kwh per capita, capacity shortages of 23 percent at peak utilization, and transmission and distribution losses of 22 and 24 percent. While installed capacity in India was at 80,000 mw in 1994 (a doubling of capacity since 1985), an additional 142,000 mw is forecast to be needed by 2005 to keep pace with demand growing at 8 to 10 percent a year; this implies invest-ments of around $165 billiol1, of which over half has to come from outside India.

The Indian government announced policies that would allow IPPs to receive pr1ces four electricity such that full costs would be recovered with a 16 percent rate of return at a 68.5 present load factor. Foreign participation has been welcomed, and India's central government has offered counter-guarantees concerning power purchase agreements by local State Electricity Boards (SEBs) to eight "fast-track" sole-source pro-jects, Enron being one. Enron those to receive an Indian gov-ernment guarantee covering the price -it would be paid for fuel during the first 12 years, hoping to earn returns in excess of 16 percent on capital by operating above 90 percent of capacity and achieving higher thermal' efficiency.

Enron announced a $2.8 billion, 2,015-megawatt (mw) gas-fired plant to be built in Dabhol in Maharashtra state on the west coast of India. The build-operate-transfer (BOT) plant was to be operated by Enron for 20 years, - with power sold at a fixed rate of 7.47 US$ cents per kW hour. Enron holds 80 percent of the equity, with 10 percent each held by GE and Bechtel. The project was to be implemented in two stages, based on fuel availability and growth in demand for energy, with the plant switching to imported liquefied natural gas (LNG) in the second stage. Enron hoped to supply the LNG from its fields in Qatar in the Persian Gulf. Debt is70"percent of the project, to be supplied by the U: S. Eximbank, IFC, and others, including Indian financial institutions. -

The project attracts opposition from the start, includ-ing a negative report by the World Bank, which refused to par-ticipate in financing the project. More important, the opposi-tion party began campaigning against the Enron project during the run-up to state government elections in 1994,-1995 They alleged that Enron had indulged in bribery to win the -contract and that the project was costly and not in the best in-terests of the state of Maharastra. Several major criticisms of the Enron project (see Table 2) existed

1. High capital cost of the project. Enron justified the cost by citing the need to create special additional infrastructure, for, Example, new port facilities to handle imports of LNG (needed in the second, stage). Enron's cost to produce energy

has been judged to be high. It is estimated, for example, that Daphol's power will cost around $1,300 per k.w, while a new-technology, combined-cycle gas-fired plant should cost between *$l700* and $800 per kw.4

2. *High price of energy*. To' be sold at 7.47 cents per kw hour, the price of energy was also criticized as high, being above the existing electricity prices charged by the-MSEB (Maharashtra State Electricity Board). Further, since the capital recovery charge was backloaded, rates would increase as the capital charge was added" to the electricity tariff down the road. Market pricing of energy may have salutary effects on the efficient use of energy (the OECD average is about 8 cents per kw hour). However, market-driven price increases in the price of a basic input such as electricity may be politically unpalatable. The problem is political readiness of the market to accept higher market prices for a good that has long been subsidized. The Indian government has been subsidizing energy for farmers for 40 years, and a sudden withdrawal is not in the cards. Indian electricity tariffs are among the lowest in the world, presenting a problem for private power production.5 In 1994-1995, electricity rates were about Indian rupees *(Rs.)* 1.74 per kw hour against the Rs. 2.40 that MSE: would have to charge in 1997. It is conceivable that Indian inflation, however, could raise current rates to the Rs. 2.40 level anyway.

3. *A poor bargain for the MSEB.* The MSEB is committed to buying electricity up to a plant load factor (PLF) of 90 percent, and it has been suggested that such a volume is greater than -that required by consumers; 6 as a result, MSEB would have to rut back purchases of energy from older plants with cheaper electricity. Moreover, LNG-based plants-which is what Dabhol-is-are more suited to be run as peak-load plats, adding energy to the grid during periods Of high" demand (that is, in peak hours); however, the 90 percent PLF means that Dabhol will be operated continuously as a base-load-supplying plant, and other older plants would have to be turned on and shut down to accommodate peak demands, with deleterious consequences on their efficiency and economic life.

4. *MSEB bears the foreign exchange risk*. Guaranteeing the price of electricity in foreign currency has insulated Enron from-the problem of local currency electricity tariffs not keeping pace with local inflation. MSEB would be paying Enron for its electricity at a rate guaranteed in U.S. dollars, but might not be able to Pass on foreign exchange rate increases through higher tariffs, thus facing the prospect of absorbing exchange rate rises and increasing its losses.

In March 1995 the opposition party won the election, somewhat unexpectedly. One of their first acts was to repudi-ate the contract with Enron. Enron had spent about $300 mil-lion and almost a year working on the project. Enron pro-ceeded to place the case before arbitrators in London while continuing to negotiate with the newly elected government. The cultural background to this opposition was the adherence by many political parries and intellectuals to the Gandhian ideals of" swadeshi"- self-reliance-who are both to depend on and allow entry of multinationals into spheres such as elec-tricity. Local business interests can also hide behind such populist appeals as a way of avoiding strong foreign competition.

Given that construction had begun and that contracts had been signed, a cancellation of the Dabhol project would have had serious impact on the willingness of other foreign IPPs to enter the Indian energy market. A walkout by Enron would also have kept it from participating in future development of the Indian energy sector. Hence, Enron announced a willingness to renegotiate some of the terms of the Dabhol project, while preserving its rights to seek mediation in London as agreed upon at the time of project negotiations.

In January 1996, Enron and the local state government settled their differences, allowing the project to restart. Enron made concessions by lowering the selling price of energy to 53 cents (a 22.5 percent reduction), increasing the size of the project to 2,450 mw, and lowering the capital cost by $300 million. Enron also reduced its equity stake to 50 percent, selling 30 percent ownership of the project to the state – owned MSEB. The renegotiated

Table 2 Enron's Debhol Power Project in India

Perceived Negatives	***Enron's Rebuttal***
High capital cost, averaging about $1.4 million per mw.	Due to additional infrastructure, including a port facility to handle LNG, new roads, schools, hospital, water supply, and housing.
High cost of power to MSEB, fixed in US$ 7.47 cents, forcing MSEB to reduce power intake from older cheaper plants	Inflation will bring up power costs from older plants to the 7.47-cent level; also relevant are the greater inefficiency and environmental cost of the old plants.
Produce power in excess of MSEB base – load requirements.	Maharashtra is expected to receive about 1/3 of all FDI in India; hence its power needs will grow sufficiently over time to use up plant capacity.
Plant's inflexible design, leading to uneconomical load dispatch, financial burden on MSEB.	Older obsolete plants are wasteful and would have to be upgraded at some point.
Technology: Why not use coal, even imported coals, rather than oil and imported LNG?	Cost of a coal – fired plant with scrubbers would be higher; if such pollution control were to be ignored, there could be negative environmental Impact on an agricultural region.
Favoritism and corruption in granting the project to Enron without competitive bidding; opposition politicians suggested the collusion of the Maharashtra State government, controlled by the Congress Party then in power.	Exhaustive investigation conducted by the U.S. government prior to granting Eximbank financing, to ensure that the U.S. Foreign Corrupt Practices Act has been scrupulously adhered to.

terms, which probably lower Enron's return from the project, also demonstrate the increased willingness of nation – states to drive hard bargains as more Western suppliers seek to participate in the high – potential Asian energy markets.

Questions

1. What are the opportunities for electricity generation in emerging markets such as Asia?
2. Discuss the terms Enron agreed to initially in starting its Dabhol project in India. Were these terms fair to India? To Enron?
3. Are the criticisms of the Enron Dabhol project in India valid?
4. Do you agree with Enron's decision to renegotiate with the state government? What is your assessment of the renegotiated deal?
5. What lessons can be learned from Enron's experience in India about the advisability of participating in the markets for electricity generation in Asia and elsewhere?

LESSON 37:
SOURCES OF FINANCING AND INTERNATIONAL MONEY MARKETS

Owe your banker a thousand pounds, and you are at his mercy. Owe him a mil-lion, and the position is reversed.

-John Maynard Keynes

Marketing Illustration

Money Is an Emotional Subject

To win a project in a developing nation, an exporting country may provide **tied aid** which is concessionary financing terms conditioned on the purchase of the equipment and services from the donor country. Trade-motivated tied aid may thus persuade a buyer to lean in the direction of the donor-not necessarily on the merit of product quality and true price, Ellicott Machine Corp. International, a small U.S. company, lost market share in Indonesia where the Indonesian government has been the company's largest single customer for dredging equipment for over 100 years. The market-share loss was due to European competitors' use of tied aid soft loans.

To win back market share, a team of trade promotion agencies-Export-Import Bank, the Department of Commerce, the Department of Transportation, the U.S. em-bassy, and IDA-joined forces. Export-Import Bank approved a $22 million direct loan to Ellicott. The Secretary of the Department of Transportation wrote a letter to the In-donesian Minister of Communications. Further more, IDA hosted a reverse trade mission, which allowed Indonesian officials to visit the United States to learn about Amer-ican-made equipment. As a result, Ellicott was able to sell five split barges, one tugboat, and spare parts to P.T. Runkindo, Indonesia's state-owned dredging company.

Amway Asia Pacific Ltd., a Hong Kong-based company, is the exclusive distrib-utor for about 175 products of its parent [um, Amway Corp (see Exhibit 18-1). Amway Asia Pacific distributes the products in Australia, Hong Kong, Macao, Malaysia, New Zealand Taiwan and Thailand. To raise capital to finance its operations, Amway Asia Pacific made an initial public offering in late 1993. Its stock was valued at $18 11 share. The stock opened on the New York Stock Exchange at $26.50 and moved up to $35.625 by mid-1994. One reason why the company's stock is attractive is that it gives investors an opportunity to profit from the burgeoning market in China.

The examples in the marketing illustration demonstrate the critical role that financ-ing plays in securing overseas projects. Financing is important to the operations of both importers and exporters. Importers seek financing for the purchase of merchan-dise. Exporters likewise need financing for the manufacturing of their products and the maintenance of their inventories. Furthermore, overseas buyers attempt to shift the financing function to their suppliers. If an exporter agrees to extend credit, the exporter must in turn obtain financing for this purpose. Financing is not a problem only for small firms. In fact, in the case of international multi-million dollar projects, sellers' financing is usually expected, and financing terms often separate winners from losers.

Trade finance arises from the export of goods and services, when the buyer and seller negotiate the amount, time, and terms of payment. "The financing needs of the seller and buyer almost always differ, and sometimes conflict Naturally, the buyer desires a competitive price and a payment arrangement that does not tie up one's credit line, whereas the seller wants a financing arrangement that offers quick payment and protection against default. The method of trade finance attempts to accommodate these differences. Trade finance can be supplied by parties in the private sector (e.g., the buyer's cash in advance payment) or by parties in the public sector.

The purpose of this chapter is to discuss the various aspects of financing. The chapter covers both the local and international sources of financing that are available to public and private buyers, including the various private and nonprofit financial institutions. The chapter also examines such offshore financial centers as the Euro market and the Asian Dollar Market.

Any business, no matter how large or small, domestic or international, always requires some kind of financing for its operations. Because international financing must deal with financial and economic conditions in more than one country, this ac-tivity involves more uncertainty and complexity than domestic financing. The greater complexity of international financing, however, is accompanied by a greater, number of financing options. In addition to the standard channels, there are also other sources available almost exclusively for international business. These sources include:

1. Non-financial institutions
2. Private financial institutions
3. International agencies
4. Government agencies
5. The International Monetary Fund (IMF)
6. The Euro-market

Nonfinancial Institutions

1. Self-Financing and Debt Financing

   There are several non-financial institutions that can provide financing. First, there is self-financing because a business can use its own capital or can withhold dividends so that profits can be plowed back into the organization for further business expan-sion. Second, retailers and manufacturers alike may be able to seek trade credit and financial assistance from certain middlemen, such as export merchants and trading companies. Third, when joint ventures are formed, foreign partners can also lend a helping hand. Fourth, subsidiaries of MNCs may borrow from affiliated firms as well as from the employee retirement fund.

Finally, the business may decide to raise equity capital by selling stocks, or it may depend on debt financing by selling commercial paper or bonds. Bond buyers or holders are the firm's creditors rather than its owners. U.S. firms can sell bonds in either the United States or foreign countries, with Eurobonds as a prime example. Treasurers of U.S. firms must decide whether their bonds to be sold abroad are to be denominated in the dollar or in foreign currencies. In any case, it should be noted that debt financing requires the services of investment banks. Virtually every multinational bank or multinational brokerage house has a division that acts as an investment bank.

Another source of financing is venture capital. Venture capitalists invest funds in a firm in exchange for a share of ownership. Although known for their investments in high-technology firms, venture capitalists have diversified their portfolios. There are about six, hundred venture capital firms in the United States. Private investors. However, fund most ventures. Venture Capital Network in Durham New Hampshire is a nonprofit service affiliated with the University of New Hampshire. Attempting to match entrepreneurs with investors, the Network charges investors $200 a year and those seeking capital $500 annually for registration.

When self-financing is used, a company should take advantage of a tax shelter for its export profit. A foreign sales corporation (FSC. pronounced "fisk") is a special kind of corporation in the eye of tax authorities making it possible for a FSC to gain a corporate tax exemption from 15 to 32 percent of the earnings generated by the sale or lease of exported goods (50 percent U.S. content) and a limited number of services.

Cultural Dimension 1

Credit Clubs

One method of financing is to borrow money from ***credit clubs or rotating credit associations.*** *Such clubs popular among Asians have long existed in Asia. especially in villages or rural areas where banks usually do not exist. Probably originating in China some eight hundred years ago the system later spread to other Countries. The clubs are called kye (pronounced "kay") by Koreans. tontines by Cambodians. and share by Thais. Such clubs are attractive because they allow members to borrow money at a lower rate than what they pay banks while also allowing investors to receive a higher return than what they can get from their banks. These highly informal and sometimes secretive credit clubs rely on the honor system and allow members to get quick loans without collateral. Club members pool their money each putting a set amount into a monthly pool. A club operates for as many months as there are members. Each month a different member gets the pool. Members bid for the pool which goes to the low-est bidder. Those who win the early pools contribute more to the club while also receiving less money than those receiving later pools. Those who wait thus make more profits though at a higher risk. Having no writ-ten contracts members nevertheless usually consider their investments safe because they know each other. In reality horror stories abound, as it is a fairly com-mon practice for early bidders to disappear with the pool. In the United States, rotating clubs have flour-ished because recent Asian immigrants, without a credit history, have difficulty obtaining conventional bank loans. Members may meet at homes or restau-rants and use these social gatherings for the purpose of carrying out bids.*

In general, a FSC must maintain a foreign presence. That is, it must have a for-eign office maintaining books and records. The board and shareholders must meet outside the United States, and one of the directors must be non-American. Another requirement is foreign economic substance. The office must perform business activ-ities that result in business income. A minimum percentage of orders for goods must be procured through the foreign office, which must carry out such normal business operations as billing. This office must also account for at last 50 percent of five of the direct transaction costs (i.e., advertising, order processing, transportation, invoic-ing, and credit risk assumption).

Equity Financing

With regard to other means of self-financing, it is a common practice for MNCs to use both equity and debt financing. A company can raise equity capital by selling stock, both in its own country and in foreign markets. U.S. stocks, for example, are traded in London. GSS Electronics Ltd. (Thailand), a manufacturer of electronic parts and assemblies for computer hard disk drives, was the first U.S.-owned high-tech-nology company to be listed on the Securities Exchange of Thailand when the firm sought new funding to complete a large plant expansion. Israel has sixty-two com-panies quoted on U.S. exchanges, second only to Canada.

It is not surprising that international exchanges like to attract new listings. The New York Stock Exchange, with 234 foreign firms, has been trying to get newly pri-vatized companies in Europe to list in New York. 3 The London Stock Exchange has 524 foreign companies. It claims that it is less expensive to list in London than in New York because its regulatory branch is not as strict as the Securities and Exchange Commission. Also a new European Union rule, which took effect in 1996, allows brokers licensed in one country to deal directly on other European Union exchanges.

American investors interested in buying foreign securities, instead of working through foreign securities firms and exchange currencies should consider American Depository Receipts (ADRs). Issued by U.S. banks, ADRs represent ownership of a set amount of the respective security on deposit in a foreign branch. Behetton, for ex-ample, offers eight million to nine million (ADRs) worth approximately $150 mil-lion On the New York Stock Exchange. Those wanting to own foreign securities when ADRs are not available, they may find it easier to deal with mutual funds that invest in a particular country or region of the world.

Although many firms limit the listing of their securities to their domestic ex-changes, the growing internationalization of capital markets suggests that more and more firms perceive that the benefits of listing their stocks on foreign exchanges out-weigh the related costs. A study of 459 internationally traded MNCs, with at least one foreign listing on one of nine major stock exchanges, found strong evidence that financial disclosure levels and the level of exports to a given foreign country signif-icantly influenced foreign listing locations.

Equity markets appear to have a life cycle consisting of four distinct stages as an equity market becomes more developed and has some degree of credibility, mar-ket liquidity increases. In the

final (mature) stage, the- most active stocks are just as liquid as those listed on industrial country exchanges. There is strong evidence that greater stock market liquidity supports (or precedes) economic growth.

Emerging stock markets vary greatly in terms of the number of firms listed, the number of new listings per year, market capitalization, etc. Naturally such markets carry significant risk. But emerging stock markets are likely to play an increasingly important role in financing companies' growth. During the last decade, the total value of stocks listed in all of the world's stock markets increased from $4.7 trillion to $15.2 trillion. The share of total word capitalization represented by the emerging markets has more than tripled from 4 percent to 13 percent At the same time, trading in the emerging markets has surged from less than 3 percent of the world total (in terms of the value of shares traded) in 1985 to 17 percent in 1995

It's The Law 1
Better Safe Than Sorry

The Jardine Group is a British firm based in Hong Kong, and its wide range of businesses includes retailing and real estate. In the 1840s, the company's drug trade was responsible for starting the Opium Wars. When China was defeated by the Western powers, it was forced to open the country to foreigners. Not surprisingly, al-most 150 years later, China has not forgiven Jardine.

In the 1980, the British group, instead of trying to please China, appeared to' anger China even more. First, it shifted its legal domicile from Hong Kong to Bermuda, showing a lack of confidence in China's abil-ity to run Hong Kong after 1997. In 1994, China blamed a Jardine director for allowing Hong Kong Governor Chris Patten's electoral reforms to pass. Moreover, Jar-dine upset China by quitting the Hong Kong Stock Ex-change. First, Jardine Matheson and affiliate Jardine Strategic Holdings made the 3nnouncement. Later, other affiliates (Hongkong Land Holdings, Mandarin Oriental International, and Dairy farm International) announced similar moves. Because of the Jardines' moves, about 10 percent of the Hang Seng Index will be delisted.

It is understandable why Jardine has to take ac-tions to protect the company's interests. After 1997, securities rules will be set by China, and new rules may make the firm vulnerable to an unfriendly takeover. On the other hand, some criticize Jardine concerning whether its moves to minimize political risks are rea-sonable and whether other actions should have been taken instead.

Because of various regulatory and traditional barriers to entry, stocks have his-torically played a relatively minor role in corporate financing in many European coun-tries. In the case of German equity markets, for example, until recently, the largest banks that had a monopoly on brokerage effectively controlled access to the stock ex-change. Small firms, being kept from issuing equity, remained captive loan clients. Additionally, the integration of banking and commerce in Germany has contrib-uted to large German firms' traditional reliance more on bank credit and bonds than on equity to finance growth. German firms use their equity holdings to exert ownership control over industrial firms. As could be expected, stock exchanges were small, in-efficient, and illiquid.

Financial Institutions

International companies have several options in financial institutions that have the ca-pability of dealing in international finance. The most common alternative is banks (and non-bank banks), both domestic and overseas. In addition to the well-k nown gi-ant banks that operate globally, there are many medium-sized banks that have international banking depart-ments. The multinational banks can make arrangements to sat-isfy all kinds of financing needs.

Other than making loans, banks are also involved in financing indirectly by dis-counting (i.e., factoring) letters of credit and time drafts. Some factoring houses buy accounts receivable with or without recourse at face value and then provide loans at competitive rates on 90 percent of the factors acquired but not-yet-collected receiv-ables. In general, factors help clients eliminate several internal credit costs by pro-viding credit guarantee of receivables, by managing and collecting accounts receivable, and by performing related bookkeeping functions. The industry average factor-ing commission for these services is 1 percent. Factoring is a substantial part of the business for a company such as Heller International. In 1991 export factoring accounted for 6 percent (or $15-16 billion) of the total $266 billion in worldwide factoring.

An exporter usually initiates a factoring arrangement by contacting a factor offering export services. This factor then Requests a credit undertaking on the importer from an affiliate (import) factor, through an international correspondent factor net-work. After local approval of credit, the exporter ships the goods on open account and submits the invoice to the export factor. The export factor then sends it to the import factor for credit risk assumption and administration and collection of the re-ceivables. Typically, the exporter does not deal with the import factor. In any case, factoring export receivables allows small- and medium-sized exporters to be com-petitive since it is a hassle-free method of financing export sales and collecting pay-ment from buyers.

Another familiar financing tool for European exporters but rather an unknown tool for American firms is forfaiting, which finances about 2 percent of all world trade. Forfaiting originates from the French term "a forfait" which means to surren-der or relinquish rights to something. When used, an exporter surrenders possession of export receivables by selling them at a discount. The cost depends on country risk. For sales to Japan and France the discount rate may be 6.75 percent, and terms may reach five years, whereas sales to Pakistan may boost the discount rate to 7.75 per-cent with a one-year term limit. Generally, an exporter consults with a forfaiter be-fore incorpo-rating the discount rate into the final selling price.

Marketing Strategy 1

Emerging Stock Markets

According to the Emerging Stock Markets Factbook, 1992 published by the International Finance Corpora-tion (IFC) eight of the world's top ten performing stock markets (in terms of price appreciation) were emerging markets. Unfortunately, six of the ten worst performers in 1991 were also emerging markets.

The top performer was Argentina rising by al-most 400 percent in U.S.-dollar terms. In second place was Colombia, which was up 174 percent. Other top performers were: Pakistan (160 percent), Brazil (152 percent) and Mexico (100 percent). The only two in-dustrial-country markets in the top ten were Hong Kong and Australia, which were up 43 percent and 29 percent, respectively.

The worst performing market was Zimbabwe, which was down 55 percent. Other poor performers included: Turkey (-53 percent), Indonesia (-43 per-cent) and Greece (-22 percent). Korea and Taiwan were the two largest emerging markets in terms of market capitalization, and they also declined.

Interestingly in the year ending June 1993, Turkey went from being a poor performer to become the world's top-performing stock market (up III per-cent in U.S.-do liar terms). The next best performers were Brazil (up 83 percent) and Indonesia (up 29 per-cent).

Export factoring and forfaiting are similar since both involve selling export re-ceivable to a third party at a discount. There are a few differences, however, between the two parties. First, factors like a large percentage of an exporter's business, but forfait houses do not mind working on a one-shot basis. Second, while factors spe-cialize in short-term receivables (up to 180 days), forfaiters tend to work with medium--term receiv-ables. Finally, forfaiters are more willing to deal with high-risk countries. To protect themselves, forfait houses require a guarantee from a reputable commer-cial bank in the importer's country. The guarantee is in the form of an aval (bank guaran-tee). An endorsement with the words "PER AVAL" or "GUARANTEED PER AVAL" is stamped directly onto the notes or bills by the guarantor bank.

Banks may provide equipment leasing as another alternative form of financ-ing. The most attractive benefit of leasing is its low cost while allowing an exporter to conserve capital and improve cash flow. Leasing may involve 100 percent financing with no down payment. It can be used in con-junction with conventional lending sources.

In the United Kingdom, companies have a number of financial institutions to contact for loans. These institutions include foreign banks, British clearing banks, merchant banks (factor houses), finance houses, investment trust companies, pension funds and insurance companies, leasing firms, and develop-ment capital and other spe-cialist venture-capital organizations. In Germany, companies may be able to obtain short-term loans from German and foreign banks, usually by overdraft.

Government Agencies

It is not unusual for governments to provide concessionary financing. Such public loans, as a rule, carry lower-than-market interest rates, and their terms are more fa-vorable than those of private financial institutions. Governments' role in financing can also be indirect but significant. Japan for example, uses qualification for public loans as an inducement for private banks to confidence. The qualification carries this significance by implying that any investment would be in the national interest and that the firm in question is financially sound.

The United States has several government agencies that provide financial assistance. One of them is the Small Business Admin-istration (SBA). In addition to its regular SBA loans, this agency can assist small firms in their export activities through its Export Revolving Line of Credit Loan (ERLC), which is under the SBA's guar-antee plan.

Another agency is the Overseas Private Investment Corporation (OPIC). Al-though best known for its Insurance Department's political risk insurance programs, OPIC also makes direct loans through its Finance Department. Its Direct Investment Fund (DIF) is for projects too small to interest large institutional lenders or for pro-jects too short for institutional lending but too long for commercial banks.

A major source of funding for U.S. firms is the U.S. Export-Import Bank (Eximbank), which is responsible for the promotion of exports through financial as-sistance. Among its activities are direct loans, protective guarantees for banks' loans and export credit insurance. Eximbank has several financial assistance programs. Its Working Capital Guarantee program allows exporters to obtain pre export financing by providing repayment protection for U.S. bank loans. Another kind of payment pro-tection is through the Foreign Credit Insurance Association (FCIA) Export Credit In-surance policy, which protects those exporters that extend credit to foreign customers.

In addition to providing direct loans, Eximbank may induce commercial banks to make loans by guaranteeing payment in case of default. The process is a simple one: An exporter applies to a bank for the financing of export sales, and the bank then applies to Eximbank for guaranteed coverage of both commer-cial and political risks. In addition, Eximbank may buy the bank's export loans at a discount through its Discount Loan Program so that banks can acquire funds for further lending.

European governments have been offering mixed or blended credit. This type of financing package combines an official, conventional loan with either outright grants or foreign aid grants at below-market rates, in effect reducing the actual in-terest rate based on the condition that donor countries' products are bought. France the heaviest user of this technique won Malaysia's contract for a $200 million turnkey power plant by disguising its thirty-year loan .at a 4.5 percent rate as an aid grant, which made up almost half of the financing package. Mixed credit is particularly im-portant in the sale of high-technology capital goods, and the indiscriminate use of this technique in foreign aid/export financing packages has fostered a built-in expectation for it on the part of buyers.

The United States, considering the use of mixed credit as unfair export credit subsidies, has again fought back by making financing more costly for OECD mem-bers. The new OECD guidelines, which took effect in July of 1988, require mixed credit to include at least 50 percent grants, up from the internationally agreed 25 per-cent. Furthermore, the United States has begun to

play the same game by offering some unusually low-interest loans. For example, it assisted General Electric with a $30 million gas-turbine project in India with a 32.5 percent aid grant. GE had the lower bid, but credit assistance from Eximbank was nevertheless crucial in securing the project. In another case, the Eximbank offered a $100 million mixed credit line to Thailand for the purchase of U.S. high-technology products.

Another technique used to create a built-in disincentive for cheap credit is for the United States to retaliate against its European competitors with longer payback terms. Knowing that European governments have difficulty raising money for fifteen years even on a very selective basis, the U.S. Eximbank is able to win out over for-eign competitors by simply offering fifteen- to twenty-year loans. The Europeans are no match for the United States in the maturity contest because the U.S. Treasury rou-tinely borrows money for twenty or thirty years by auctioning Treasury bonds.

This discussion should illustrate to international marketers that a low price by itself does not necessarily provide advantages, especially in the case of expensive pro-jects. Government financing is a necessity, and this involves more than just a low in-terest rate. The effective rate can be greatly moderated by the amount to be financed, outright grants, varying maturity dates, and other financing techniques.

International Financial Institutions / Development Banks

One major source of financing is international nonprofit agencies. There are several regional development banks, such as the Asian Development Bank, the African De-velopment Bank and Fund, and the Caribbean Development Bank. The primary purpose of these agencies is to finance productive development projects or to promote economic development in a particular region. The Inter-American Development Bank, for example, has as its principal purpose the acceleration of the economic develop-ment of its Latin American member countries. The European Bank for Reconstruc-tion and Development (EBRD), located in London, is funded by thirty-nine countries and two European Community organizations. The United States, with a 10 percent share, is the largest single shareholder. The bank targets 60 percent of its loans for the private sector in Central and Eastern Europe. The five multilateral development banks (World Bank, Inter-American Development Bank, Asian Development Bank, African Development Bank, and the European Bank for Reconstruction arid Devel-opment) have annual commitments topping $45 billion. They are active in all major economic sectors and offer good long-1erm export opportunities for equipment sup-pliers, contractors, and consultants. Therefore, they are an important financing source.

In general, both public and private entities are eligible to borrow money from such agencies as long as private funds are not available at reasonable rates and terms. Although the interest rate can vary from agency to agency, these loan rates are very attractive and very much in demand.

Of all the international financial organizations, the most familiar is the World Bank, formally known as the International Bank for Reconstruction and Development (IRD). The World Bank has two affiliates that are legally and financially distinct entities, the International Development Association (IDA) and the International Fi-nance Corporation (IFC). All three organizations have the same central goal: to pro-mote economic and social progress in poor or developing countries by helping to raise standards of living and productivity to the point at which development becomes self sustaining.

Toward this common objective, the Bank, IDA, and IFC have three interrelated functions, and these are to lend funds, to provide advice, and to serve as a catalyst in stimulating investments by others. In the process, financial resources are channeled from developed countries to the developing world. The hope is that developing coun-tries, through this assistance, will progress to a level that will permit them, in turn, to contribute to the development process in other less fortunate countries. Japan is a prime example of a country that has come full circle. From being a borrower, Japan is now a major lender to these three organizations. South Korea is moving in a direction similar to that of Japan nearly a quarter century ago.

1. World Bank

   The World Bank is owned by the governments of the 178 countries that have sub-scribed to providing its capital. Only countries that are members of the International Monetary Fund can qualify for World Bank membership. The United States, with 22.4 percent of the subscribed capital and 20.6 percent of the voting power, is the bank's largest shareholder. By tradition, the World Bank's president is an American. The members are quite diverse in their characteristics, ranging from China, the most populous, to Vanuatu, which has a population of slightly more than 100,000, and from the United Arab Emirates, with a per capita GNP of more than $30,000, to Bhutan, which has a $180 per capita GNP. Eritrea joined in 1996.

   The IBRD obtains most of its funds through borrowing in the capital markets of the United States, Europe, Japan, and the Middle East the process is not unlike a private firm's seeking debt financing through the sale of securities. Such funds, in turn are made available only to creditworthy borrowers, mainly for those projects that have high real rates of economic return. The bank's decisions are based on economic considerations only, and the political character of a member country is irrele-vant. As a result, the World Bank does not make loans in support of military or po-litical goals. Financial assistance is otherwise restricted in the sense that it may be used to purchase goods and services from any member country as well as from Switzer-land, which is not a member.

   IBRD loans are usually repayable over fifteen to twenty years, with a grace pe-riod of three to five years. Each loan must be made to, or be guaranteed by, the gov-ernment concerned. The interest rate that IBRD loans carry depends on the cost at which the Bank raises funds in capital markets.

   In order not to expose the World Bank to excessive interest-rate risk, a pool -based variable-rate lending system was initiated in 1982. Interest charges applicable to the outstanding balance on all loans are uniformly adjusted every six months up or down, in accord with the average cost of the pool of IBRD borrowings. A spread of fifty basis

points is added to the World Bank's own cost of borrowings. Because the new lending system has added a potential element of votality to borrowers costs, the bank strives to find a point at which there is a balance between the susceptibility of the lending rate to change and the pursuit of the bank's other important objectives. In any case a degree of volatility is inevitable, though the World Bank attempts through its policies to reduce the impact of these variations.

2. International Development Association (IDA)

   Because very poor countries may have difficulty in borrowing on IBRD terms, the IDA was established specifically to assist such countries. IDA has 158 nations as members, with Eritrea and Azerbaijan Republic being the latest. By definition, a very poor country is generally one with an annual per capita GNP of $696 or less (in 1993 dollars), and approximately fifty countries fall under this classification. In practice, most of the IDA loans go to those countries that barely exceed half of the specified annual per capita GNP, and most of these countries are located in Africa south of the Sahara and in South Asia. These countries, though very poor, must still have suffi-cient economic, financial, and political stability to qualify for IDA loans.

   Whereas the World Bank makes "loans," the IDA provides "credits." These credits are made only to governments even though these governments routinely re-lend funds to their private and public enterprises. The credits must be repaid over fifty years, and there is a ten-year grace period before the beginning of the repayment of the principal. IDA credits carry no interest, but there is an annual commitment charge of 0.5 percent on the un-disbursed portion and a service charge of 0.75 percent on the disbursed amount of each credit. These charges are intended to cover the adminis-trative costs of running the IDA program.

3. International Finance Corporation (IFC)

   Although the IDA shares the World Bank's staff, the IFC has its own operating and legal staff. Unlike the bank and the IDA, which have many operating aspects in com-mon, the IFC works closely with private investors. In addition to providing convert-ible debentures, underwriting, and standby commitments, the IFC invests in com-mercial enterprises within developing countries and is able to take equity positions. By functioning in this area, the IFC complements the work of the Word Bank by providing assistance in business areas that are impractical for the bank to operate. As of 1996, the IFC's total membership has become 165 countries.

   The IFC's main function is to assist in the economic advancement of LDCs by promoting growth in the private sector of their economies and by helping to mobi-lize domestic and foreign capital for this purpose. The IFC provides financial, legal, and technical advice and contributes an element of confidence to the venture of the parties. Its special role is to mobilize resources on commercial terms for business ven-tures and financial institutions where a market-oriented approach is both applicable and preferable. It will not, however, provide financing if sufficient capital can be ob-tained on reasonable terms from other sources. Its lending criteria include foreign ex-change earnings, increased employment, skill improvement and acquisition, higher productivity, and development of a country's natural resources on reasonable terms.

   The International Finance Corporation has become more active in helping companies in developing countries raise financing through international offerings of in-vestment funds and individual corporate securities. Toward this goal, the International Securities Group (ISG) was established in 1989 to provide investment-banking ser-vices to corporate clients in developing countries.

4. Multilateral Investment Guarantee Agency (MIGA)

   The activities of the World Bank IDA and IFC are supplemented by those of a new affiliated international organization-the Multilateral Investment Guarantee Agency (MIGA). Established in 1988, MIGA has a specialized mandate: to encourage equity investment and other direct investment flows to developing countries through the mit-igation of noncommercial investment barriers. To encourage international corporate investment so that developing countries can attract qualified investors, MIGA offers investors guarantees against noncommercial risks (especially risk of war or repatria-tion); advises developing member governments on the design and implementation of policies, programs, and procedures related to foreign investments; and sponsors a di-alogue between the international business community and host governments on in-vestment issues. Industrialized countries should also benefit from MIGA's augmen-tation of the existing capacity to insure their overseas investors, from its innovative types of guarantees, and from the efficiency derived from the free flow of investment resources.

International Monetary Fund (IMF)

During the Great Depression of the 1930s, many countries resorted to competitive currency devaluation and trade restrictions to maintain domestic income, resulting in lower trade and employment for everyone. Concern over these "beggar-thy-neighbor" policies led to a July 1-22, 1994, conference at Bretton Woods, New liampsh1re, at-tended by delegates from forty-four countries. The IMP was born there on Decem-ber 27, 1945, to institute an open and stable monetary system.

The IMF is a cooperative apolitical intergovernmental monetary and financial institution. As a "pluralist" international monetary organization, its multiple activities encompass financing, regulatory, and promotional purposes. It acts as a source of balance-of-payments assistance-cum-adjustment to members, as a source and creator of international liquidity, as a reserve depository and intermediary for members, as a trustee, and as a catalyst. The use of the IMF's resources is based on balance-of-payments need, on equal and nondiscriminatory treatment of members, and on due regard for members' domestic, social, and political systems and policies.

Guided by its charter (Articles of Agreement), the IMF has six prescribed ob-jectives:

1. To promote international cooperation among members on international monetary issues.

2. To facilitate the balanced growth of international trade and to contribute to high levels of employment, real income, and productive capacity.
3. To promote exchange stability and orderly exchange arrangements while avoiding com-petitive currency devaluation.
4. To foster a multilateral system of payments and transfers while eliminating exchange restrictions.
5. To make financial resources available to members.
6. To seek reduction of payment imbalances.

IMF has 180 members, with Brunei Darussalam being the latest. Membership in the IMF is open to any nation that controls its own foreign relations and is will-ing and able to fulfill the obligations of membership. Each member has a quota based on its subscription contribution to the fund. This quota determines the member's vot-ing power and access to the IMF's financial resources. The-IMF employs a system of weighted voting power that combines a basic allotment with a variable allotment.

To recognize the sovereign equality of nations, each member has a basic allotment of 250 votes. To protect the interest of members with a greater magnitude of inter-national trade and financial transactions as well as to account for the differences in subscriptions, variable allotment is used as well, resulting in one vote for each part of the member's quota that is equivalent to a special drawing right (SDR) of 100,000. The United States accounts for some 19 percent of the total.

SDR

In former times, gold and foreign exchange were the major reserve assets, and there was some concern that an increase in the rate of such assets might not be adequate to sustain trade and maintain full employment. Furthermore, deficits in the balance of payments of reserve-currency countries could interfere with the confidence in the reserve currencies. In response to this apprehension, the First Amendment to the Articles of Agreement was created and took effect on July 28, 1969, and the special drawing right (SDR) was established. Created by the IMF as a new asset, SDR is a composite fiduciary reserve asset to supplement existing reserve assets. It is the unit of account in which the fund expresses the value of its assets. The value of the SDR is generally more stable than that of any single currency in the basket because movement in the exchange rate of one of the component currencies tends to be partly or fully offset by movements in the exchange rates of the other currencies. The SDR basket consists of the five members with the largest exports.

The term special drawing rights partly emphasizes the similarity with members' drawing rights on the General Resources Account, whereas special conveys the no-tion of SDR's uniqueness and difference from other existing drawing rights in the IMF. From a historical perspective, SDR is the first kind of an interest-bearing re-serve asset created by international consensus. Unlike commodity money, the value of SDR as an asset is derived from the commitments of voluntary participants to hold and accept SDRs rather than from any intrinsic properties. SDR has been allocated to its members since 1970 in proportion to their respective quotas.

Some Facts About the SDR

The special drawing right (SDR) is an international reserve asset created by the IMF in 1969 to supplement existing reserve assets. The SDR serves as a unit of account for the IMF and a number of other international and regional organizations. In addition, a few countries peg the exchange rates of their currencies to the SDR. While the SDR has been used at times to denominate financial instruments and transactions outside the IMF by the private sector and some governments, the market for such private SDRs is limited.

· ***Valuation.*** *The SDR was initially valued by the IMF in terms of a fixed quantity of gold and was redefined in June 1974 as a basket of 16 currencies. Since 1981, the SDR basket has consisted of fixed quantities of the currencies of the five IMF members that are the largest exporters of goods and services. The basket is revised every five years, most recently on January 1, 1996. The weights in the basket reflect the relative shares of countries in exports of goods and services and the relative shares of the five curren-cies in official reserve holdings. For the current basket, the weights, in percent, are 39 for the U.S. dollar, 21 for the deutsche mark, 18 for the Japanese yen, and 11 each for the French franc and the pound sterling. As of March 12, 1996, one SDR was worth $1.46 at market exchange rates.*

· ***Allocations.*** *Since the adoption of the First Amendment of the IMF's Articles of Agreement in 1969"the IMF has been authorized to allocate SDRs to member countries. Decisions to allocate (or cancel) SDRs require an 85 percent-majority vote of the Board of Governors and are made for basic periods," which, unless otherwise decided, run for five consecutive years. Cumulative allocations to date total SDR 21.4 billion SDR al-locations are distributed in proportion to IMF members' quota shares. Because of con-siderable expansion in the IMF's membership since SDRs were last allocated in 1981,38 of the IMF's 181 member countries have never received SDR allocations. Another 37 members have participated in some, but not all, allocations. The current Articles of Agree-ment do not authorize the IMF to allocate SDRs selectively among members or to itself.*

· ***Share of Global Reserves.*** *SDRs are counted as a part of a country's interna-tional reserves, along with official holdings of gold, foreign exchange, and reserve position In the IMF. The share of SDRs in global holdings of non-gold reserves has declined from 8.4 percent at the end of 1972, to 6.5 percent at the end of 1981, and to 2.3 percent at the end of 1995.*

Functions

Among intergovernmental organizations, the IMF is unique in its combination of reg-ulatory, consultative, and financial functions.

1. **Regulatory Function** Reflecting its objective of avoiding disruptive fluctuations and the rigidity of rates, the IMF administers a code of conduct with respect to ex-change rate policies and restrictions on payments. Having the authority to influence some of its members' practices, the IMF must exercise firm surveillance over their policies. Toward this end, the fund has adopted three principles, spelled out in the document entitled Surveillance Over Exchange Rate Policies,

to guide members in their conduct and to specify their rights and obligations. First, members are obligated to refrain from manipulating exchange rates to gain an unfair competitive advantage. Second, members must intervene if necessary to counter disorderly conditions that disrupt short-term movements in the exchange rates of their currencies: Last but not least, members should consider the interests of other members in their intervention policies.

2. **Consultative Function** A number of countries are handicapped in the effort to de-sign suitable foreign exchange programs by the scarcity of reliable statistical data add of personnel with suitable skills in economic analysis and management. This is the area in which the IMF can be of assistance for such members. Because of the nature of the work, the IMF has built up a body of practical knowledge of balance-of payments statistics, analysis, and policy, and of associated fields. The IMF's research in these topics makes it well qualified to offer advice.

   Financial Function The IMF's primary financial purpose, as set out in Article I, sections v and vi "to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments with-out resorting to measures destructive of national or international prosperity" and "to shorten the duration and lessen the degree of disequilibrium in the international bal-ances of payments of members."

   The IMF's financial resources are made available under a spectrum of policies and facilities that differ mainly in the type of balance-of-payments need and in the degree of conditionality. Access to resources is open to members in amounts related to their quotas, and the rules governing access apply uniformly to all members. Based on guidelines related to the economic indicators of the external position of a coun-try, the fund assesses both a member's balance-of-payments need (the magnitude of financing) and the adequacy of measures to correct the underlying balance-of-pay-ments disequilibrium (adjustment program). "Need" is a function of the member's balance-of-payments position, its foreign reserve position, and the developments in its reserve position. Even though the three elements are considered distinct and sep-arate and each one alone can represent the member's need, it is the IMF's judgmen-tal consideration of all three in combination with which it justifies that need.

Financial Centers

MNCs have made it an increasingly common practice to raise capital offshore. There are four broad types of offshore financial centers: primary, booking, funding, and col-lection. A primary center (e.g., London, New York) is an international financial center located in a highway developed industrial country. With financial systems highly de-veloped, these centers serve world-wide clients by offering all kinds of financial services.

A primary center is at one extreme; a booking center (e.g., Nassau) is at the other. International banks may wish to take advantage of a country's highly favor-able tax regulatory system by opening a "shell branch" there that may be nothing but one small room or a post office box. The purpose is to serve the financial needs of those outside the country by booking Eurocurrency deposits and international loans.

A **funding** center (e.g., Singapore) collects funds from outside a region for that region's internal use. A funding center can thus be characterized by inward intermediation of offshore funds. In contrast, outward financial intermediation is a charac-teristic of a **collection center** (e.g., Bahrain). This type of center has low absorptive capacity of the region's economies, resulting in excess savings accumulated in the collection center for international banks to invest.

According to the results of one study, the growing integration of major domes-tic and international offshore financial markets in the 1980s has resulted in an increase in the efficiency of international capital markets. However, structural changes in financial markets may have influenced the effectiveness of monetary and fiscal policies created new systemic risks associated with increased asset price variability, and re-duced the certainty of developing-country access to international capital markets.

Euro-market

One place where governments and business can go to borrow money of a desired cur-rency at a competitive rate is the Euro-market. This international market of foreign currency deposits in Europe has no fixed physical boundary, though London, as a hub, is its main location. Actually, the Euro-market is simply a telephone and telex network run by a few dozen international giant banks. Citicorp, for example, oper-ates through its foreign branches in dozens of countries to provide global banking services to MNCs in any type of currency.

Unlike American banks, which accept nothing but U.S. dollars for deposit, Eu-ropean banks are relatively liberal and routinely accept all types of money, which do not have to be converted into any specific local currency. When a depositor needs funds and must withdraw them, no conversion is required, and the depositor will get back the same currency as deposited earlier.

Traded on the Euro-market are Eurocurrencies, which the world's major banks bid for and employ. Eurocurrencies are monies traded outside of the country of their origin. A Belgian franc becomes a Eurocurrency (i.e., Euro Belgian franc) when it is traded anywhere outside Belgium. Despite the Euro prefix, a Eurocurrency is not nec-essarily restricted to denominations of European and American currencies. Repre-senting a claim against North American, Asian, and Caribbean banks, the currency can be a European, for example, held by a Hong Kong bank in the Caribbean.

The Eurodollar, just one of many Eurocurrencies, is simply dollars deposited in banks outside of the United States (e.g., in Europe, Canada, and Japan). When Hong Kong or Singapore banks accept deposits and make loans in U.S. dollars, such dol-lars become Asian dollars. The Eurodollar once commanded more than 90 percent of the Euro-market, with the German mark in second place, holding about 10 percent of the Euro-market.

Eurocurrency deposits have continued to grow rapidly. Because it is easier and cheaper than issuing corporate bonds in Japan, the Japanese are the biggest issuers of 'Eurobonds.

One unique feature of the Euro-market is its stateless financial system. Although governments place restrictions on the operations of their national money markets, such restrictive measures do not apply to the Euro-market in spite of the fact that it shares the same locations and facilities, as do the national markets. There is no central bank to control, and the Euro-market has no international authority to which it must answer. As an independent market of its own, it has its own interest-rate structure, and any- one can invest or trade in it. Because it has no reserve requirements, it is able to of-fer high rates on deposits and also to make loans at lower rates.

Asian Dollar Market

Since inception in 1968, the Asian Dollar Market has grown at a rapid rate. The need for this offshore financial market in Asia is the result of the time zone differences among East Asia. Europe, and the United States, making it difficult for Asian bankers to complete transactions within the same day. The growth was decided by the liberal-ization of regulations in Singapore.

The Asian Dollar Market is a group of banks in Singapore and Hong Kong that accept deposits and make loans in U.S. dollars. Their deposits are time, rather than checking accounts. The two major centers, through different, complement each other. Hong Kong serves as the major center for syndicated loans in- the Far East, whereas Singapore dominates the funding side of the market. Put simply, Singapore gathers deposits- from various sources while Hong Kong deploys them.

Case Study

Too Close For Comfort

Because of the technology that allows international trading hookups and because of the existence of multi-national investment banks', it is quite easy to trade stocks, bonds, currencies, futures, and options on a twenty-four-hour basis and move money across the world in minutes. Because of the industrialized world's laissez-faire approach, there is virtually no authority to control the flow of capital. As a result, for better or worse, some $2 trillion move around among securities markets every day. Although some people applaud the liberalization of world capital markets, just as many people would like to have more government supervi-sion and control.

Bad news travels fast. In the case of financial mar-kets, it can be a matter of seconds. The speed of in-formation transmission was most evident on Black Monday of October 19, 1987. It was a day of financial meltdown. In two sessions during the week preceding Black Monday, the Dow Jones Industrial Average (DJIA) stock index dropped 95 points and 108 points. When world trading resumed on Monday, Hong Kong recorded a 420-point drop. When the New York mar-ket opened, waves of selling began. At the end of the day, the DJIA had a record one-day decline of 508 points, which wiped out 23 percent of the index's value or the equivalent of $1.1 trillion. The plunge, when compared to the 1929 stock market crash, was worse in terms' of percentage and speed.

Other markets soon followed the New York Stock Exchange-down. There were sell signals every-where. Tokyo, the world's largest capitalized market, saw a drop in stock value of 14 percent of $400 bil-lion in capital. The decline there of 3,836 points was four times the previous single-day drop of 831 points. Sydney lost 25 percent, or $39 billion of _e value of Australian stocks. London followed suit, with a plunge of 250 points, or 12 percent of the Financial Times In-dex of I 00 stocks, bringing the two-day loss to 500 points, or 22 percent. Sharp declines were recorded on exchanges in Taiwan, South Korea, Malaysia, Thai-land, and Singapore. The same thing happened in Frankfurt and Dusseldorf, Amsterdam, Toronto, and Mex-ico City. The Hong Kong market was closed for the rest of the week.

The panic repeated itself the following week. On October 26, the Hong Kong market reopened and promptly lost 33 percent of the stock value. The losses elsewhere were as follows: Tokyo (5 percent), London (6 percent), and Frankfurt (6 percent). Then it was New York's turn-a loss of 8 percent or 156 points of the DJIA. The problem seemed to go around and around like an echo. In all, the world witnessed a loss of $1.6 trillion in global stock-market value within days.

There is no question of the chain reaction, like knocking over domino pieces. Not so clear however, were the causes of the panic. The various explanations were the Reagan' administrations apparent willingness to let the dollar fall, the U.S. trade deficits fear of global economic recession, mutual funds' massive selling, and computerized program trading.

Also unclear was whether the financial markets in the United States led the declines of the others or whether it was the other way around. Did New York lead Hong Kong, or did Asian markets influence Euro-pean markets before affecting the' New York and Chicago markets that would open later on the same day? At one time, the dominance of the United States was obvious. When the United States sneezed, others caught the cold. But today, Japan has nine of the world's ten leading banks, and its own financial force allows it to act on its own. What is obvious is the interrelat-edness of the various markets. They all can quickly act and react to the developments in other markets.

Another piece of the puzzle is the reactions of consumers and investors in the short run and long run. Consumers who lost their wealth on the stock mar-kets may decide to curb their spending. The decline in consumption may then lead to a cut in production and employee layoffs. The group that took the immediate brunt, ironically, was the people employed in the se-curities industry.

Some experts think that the globalization of fi-nancial markets is inevitable because of the common denominator-money. The global economy has already been closely linked with the aid of technology. Conse-quently, each financial market is not and cannot be in-dependent. In reality it is more like a single global se-curities exchange with branches in other countries. This reality provides investors and MNCs with more flexibility-so much flexibility that any individual coun-try will find it exceedingly difficult to impose capital controls. The price of this flexibility is a greater degree of market volatility and perhaps chaos in global equi-ties.

Questions

1. Can an event like that of Black Monday happen again?
2. At the time of those difficult weeks in October

1987, former West Germany was in better eco-nomic shape than the Unites States, which had record trade deficits and budget deficits. West Ger-many planned just before Black Monday to sell its 16 percent stake in Volkswagen. Should the crash of the U.S. markets have- any impact on West Ger-many's plan?

3. Because of the globalization of financial markets, some financial experts predict that the international stock indices (based on stock prices of companies worldwide) may eventually replace such national in-dices as the DJIA and S&P 500 in representing the equity investment sentiment. The Salomon-Russell Global Equity Index and the Salomon-Russell Non--U.S. Equity Index is examples of this development. Do you agree with the prediction? Why or why not?

LESSON 38:
NEGOTIATING WITH INTERNATIONAL CUSTOMERS, PARTNERS AND REGULATORS

A Japanese Aisatsu

It is not so much that speaking only English's is a disadvantage in international business. Instead, its more that being bilingual is a huge advantage. Observations from sitting in on a Aisatsu (a meeting or formal greeting for high level executive typical in Japan) involving the president of a large Japanese industrial distributor and the marketing vice president of an American machinery manufacturer are instructive. The two companies were typing of reach an agreement of a long-term partnership in Japan.

Business cards were exchanged and formal introduced made. Even though the president spoke and understood English, one of his three subordinates acted as an interpreter for the Japanese president. The president the president asked everyone to be seated. The interpreter sat on a stool between the two senior executives. The general attitude between the parties was friendly but polite. Tea and a Japanese orange drink were served.

The Japanese president controlled the interaction completely asking questions of all American through the interpreter. Attention of all the participants was given to each speaker in turn. After this initial round of question for all the Americans. The Japanese president focused on developing a conversation with the American vice president. During this interaction an interesting pattern in non-verbal behavior developed. The Japanese president would ask a question in Japanese. The interpreter then translated the question for the American attention (gaze direction) was given to the interpreter. However, the Japanese's president gaze direction was at the American. Thus the Japanese president could carefully and unobtrusively observer the American's facial expressions and non – verbal response. Alternatively, when the American spoke the Japanese president had twice the response time. Because he understood English, he could formulate his responses during the translation process.

What is this extra response time worth in a strategic conversation? What is it worth to be able to carefully observe the nonverbal responses of your top-level counter part in a high – stakes business negotiation?

Face-to-face negotiations are an omnipresent activity in international commerce. Once global marketing strategies have been formulated, once marketing research has been conducted to support those strategies, and once products, pricing, promotion, and place decisions have been made, then the focus of managers turns to implementation of the plans. In international business such plans are almost always implemented through face-to-face negotiations with business partners and customers from foreign countries. The sales of goods and services; the management of distribution channels, the contracting for marketing research and advertising services, licensing and franchise agreements, and strategic alliances all require managers from different cultures to sit and talk with one another to exchange ideas and express needs and preferences. Executives must also negotiate with representatives of foreign governments who might approve a variety of their marketing actions or in fact be the actual ultimate customer for goods and services. In many countries governmental officials may also be joint venture partners, and in some cases vendors. For example, negotiations for the television broadcast rights for the 1998 Winter Olympics in Nagano, Japan, included CBS, the International Olympic Committee, and Japanese governmental officials.

One authority on international joint ventures suggests that a crucial aspect of all in-ternational commercial relationships is the negotiation of the original agreement. The seeds of success or failure often are sown at the negotiation table, vis-a-vis (face-to - face), where not only are financial and legal details agreed to, but perhaps more impor-tant, the ambiance of cooperation is established. Indeed, the legal details and the struc-ture of international business ventures are almost always modified over time, and usually through negotiations. But the atmosphere of cooperation initially established face-to-face at the negotiation table persists-or the venture fails.

Business negotiations between business partners from the same country can be difficult. And the added complication of cross-cultural communication can turn an al-ready daunting task into an impossible one. On the other hand, if cultural differences are taken into account, often times wonderful business agreements can be made that lead to long-term, profitable relationships across borders. The purpose of this final chapter is to help prepare managers for the challenges and opportunities of international business negotiations. To do this, we will discuss the dangers of stereotypes, the impact of culture on negotiation behavior, and the implications of culture for managers and negotiators.

The Dangers of Stereotypes

The images of John Wayne, the cowboy, and the samurai, the fierce warrior, often are used as cultural stereotypes in discussions of international business negotiations. There is almost always a grain of truth to such representations-an American cowboy kind of competitiveness versus a samurai kind of organizational (company) loyalty. One Dutch expert on international business negotiations argues, "The best negotiators are the Japanese because they will spend days trying to get to know their opponents. The worst are Americans because they think everything works in foreign countries as it does in the USA." There are, of course, some Americans who are excellent international negotia-tors and some Japanese who are ineffective. The point is that negotiations are not con-ducted between national stereotypes; negotiations are conducted between people and cultural factors often make huge differences.

Recall our discussion on the cultural diversity within countries, and consider its relevance to negotiation. For example, we might expect substantial differences in negotiation styles between English-speaking and French-speaking Cana-dians. The genteel style of talk prevalent in the American Deep South is quite differ-ent from the faster speech patterns and pushiness

more common in places like New York City. Experts tell us that negotiation styles differ across genders in America, as well. Still others tell us that the urbane negotiation behaviors of Japanese bankers are very different from the relative aggressiveness of those in the retail industry in that country. Finally, age and experience can also make important differences. The older Chinese executive with no experience dealing with foreigners is apt to behave quite differ-ently from her young assistant with undergraduate and MBA degrees from American uni-versities.

The focus of this chapter is culture's influence on international negotiation behav-ior. However, it should be clearly understood that individual personalities and back-grounds also heavily influence behavior at the negotiation table-and it is the manager's responsibility to consider these factors. Remember: Companies and countries do not negotiate, people do. Consider the culture of your customers and business partners, but treat them as individuals.

The Pervasive Impact of Culture on Negotiation Behavior

The primary purpose of this section is to demonstrate the extent of cultural differences in negotiation styles, and how these differences can cause problems in international business negotiations. The material in this section is based on a systematic study of the topic over the last two decades in which the negotiation styles of more than 1,000 businesspeople in 16 countries (18 cultures) were considered. The countries studied were: Japan, Korea, Tai-wan, China (northern and southern), Hong Kong, the Philippines, Russia, the Czech Re-public, Germany, France, the United Kingdom, Spain, Brazil, Mexico, Canada (English- speaking and French-speaking), and the United States. The countries were chosen because they comprise America's most important present and future trading partners.

Looking broadly across the several cultures two important lessons stand out. The first is that regional generalizations usually are not correct. For example, Japanese and Korean negotiation styles are quite similar in some ways, but in other ways they could not be more different. The second lesson learned from this study is that Japan is an ex-ceptional place: On almost every dimension of negotiation style considered, the Japan-ese are on or near the end of the scale. Sometimes, Americans are on the other end. But actually, most of the time Americans are somewhere in the middle. The reader will see this evinced in the data presented below. The Japanese approach, however, is most dis-tinct, even sui-generis.

Cultural differences cause four kinds of problems in international business negotia-tions-at the levels of:

1. Language
2. Nonverbal behaviors
3. Values
4. Thinking and decision-making processes

The order is important; the problems lower on the list are more serious because they are more subtle. For example, two negotiators would notice immediately if one is speaking Japanese and the other German. The solution to the problem may be as simple as hiring an interpreter or talking in a common third language, or it may be as difficult as learning a lan-guage. Regardless of the solution, the problem is obvious. Cultural differences in nonverbal behaviors, on the other hand, are almost always hidden below our awareness. That is to say, in a face-to-face negotiation participants nonverbally-and more subtly-give off and take in a great deal of information. Some experts argue that this information is more important than verbal information. Almost all this signaling goes on below our levels of conscious-ness. When the nonverbal signals from foreign partners are different, negotiators are most apt to misinterpret them without even being conscious of the mistake. For example, when a French client consistently interrupts, Americans tend to feel uncomfortable without noticing exactly why. In this manner, interpersonal friction often colors business relationships, goes on undetected, and, consequently, uncorrected. Differences in values and thinking and decision-making processes are hidden even deeper and therefore are even harder to cure. We discuss these differences below, starting with language and nonverbal behaviors.

Differences in Language and Nonverbal Behaviors

Americans are clearly quite near the bottom of the languages skills list, although Aus-tralians assert that Australians are even worse. It should be added, however, that American undergrads recently have begun to see the light and are flocking to language classes. Un-fortunately, foreign language teaching resources in the U.S. are inadequate to satisfy the increasing demand. In contrast, the Czechs are now throwing away a hard-earned competi-tive advantage: Young Czechs will not take Russian anymore. It is easy to understand why, but the result will be a generation of Czechs who cannot leverage their geographic advan-tage because they will not be able to speak to their neighbors to the east.

The language advantages of the Japanese executive in the description of the Aisatsu that opened the chapter were quite clear. However, the most common complaint heard from American managers regards foreign clients and partners breaking into side conver-sations in their native languages. At best, it is seen as impolite and, quite often, Ameri-can negotiators are likely to attribute something sinister to the content of the foreign talk - "They're plotting or telling secrets or. . ."

This is a frequent American mistake. The usual purpose of such side conversations is to straighten out a translation problem. For instance, one Korean may lean over to an-other and ask, "What'd he say?" Or, the side conversation can regard a disagreement among the foreign team members. Both circumstances should be seen as positive signs by Americans, because getting translations straight enhances the efficiency of the interactions, and concessions often follow internal disagreements. But because most Ameri-cans speak only one language, neither circumstance is appreciated. By the way, people from other countries are advised to give Americans a brief explanation of the content of their first few side conversations to assuage the sinister attributions.

Japan. Consistent with most descriptions of Japanese negotiation behavior, the results of this analysis suggest their style of interaction is among the least aggressive (or most polite). Threats, commands, and warnings appear to be deemphasized

in favor of the more positive promises, recommendations, and commitments. Particularly indicative of their polite conversational style was their infrequent use of "no" and "you" and facial gazing, as well as more frequent silent periods.

Korea. Perhaps one of the more interesting aspects of the analysis is the contrast of the Asian styles of negotiations. Non-Asians often generalize about the Orient; the find-ings demonstrate, however, that this is a mistake. Korean negotiators used considerably more punishments and commands than did the Japanese. Koreans used the word "no" and interrupted more than three times as frequently as the Japanese. Moreover, no silent periods occurred between Korean negotiators.

China (Northern). The behaviors of the negotiators from Northern China (i.e., in and around Tianjin) are most remarkable in the emphasis on asking questions at 34 per-cent. Indeed, 70 percent of the statements made by the Chinese negotiators were classi-fied as information-exchange tactics. Other aspects of their behavior were quite similar to the Japanese, particularly the use of "no" and "you" and silent periods.

Taiwan. The behavior of the businesspeople in Taiwan was quite different from that in China and Japan but similar to that in Korea. The Chinese on Taiwan were exceptional in the time of facial gazing-on the average almost 20 out of 30 minutes. They asked fewer questions and provided more information (self-disclosures) than did any of the other Asian groups.

Russia. The Russians' style was quite different from that of any other European group, and, indeed, was quite similar in many respects to the style of the Japanese. They used "no" and "you" infrequently and used the most silent periods of any group. Only the Japanese did less facial gazing, and only the Chinese asked a greater percentage of questions.

'Germany. The behaviors of the western Germans are difficult to characterize because they fell toward the center of almost all the continua. However, the Germans were ex-ceptional in the high percentage of self-disclosures at 47 percent and the low percentage of questions at 11 percent.

United Kingdom. The behaviors of the British negotiators are remarkably similar to those of the Americans in all respects.

Spain. Diga is perhaps a good metaphor for the Spanish approach to negotiations evinced in our data. When you make a phone call in Madrid, the usual greeting on the other end is not hola (hello) but is, instead, diga (speak). It is not surprising, then, that the Spaniards in the videotaped negotiations likewise used the highest percentage of commands (17 percent) of any of the groups and gave comparatively little information (self-disclosures, 34 percent). Moreover, they interrupted one another more frequently than any other group, and they used the terms "no" and "you" very frequently.

France. The style of the French negotiators is perhaps the most aggressive of all the groups. In particular, they used the highest percentage of threats and warnings (together, 8 percent). They also used interruptions, facial gazing, and "no" and "you" very fre-quently compared to the other groups, and one of the French negotiators touched his partner on the arm during the simulation.

Brazil. The Brazilian businesspeople, like the French and Spanish, were quite aggres-sive. They used the second highest percentage of commands of all the groups. On average, the Brazilians said the word "no" 42 times, "you" 90 times, and touched one another on the arm about 5 times during 30 minutes of negotiation. Facial gazing was also high.

Mexico. The patterns of Mexican behavior in our negotiations are good reminders of the dangers of regional or language-group generalizations. Both verbal and nonverbal behaviors are quite different than those of their Latin American (Brazilian) or continen-tal (Spanish) cousins. Indeed, Mexicans answer the telephone with the much less de-manding bueno (short for good day). In many respects, the Mexican behavior is very similar to that of the negotiators from the United States.

French-Speaking Canada. The French-speaking Canadians behaved quite similarly to their continental cousins. Like the negotiators from France, they too used high percentages of threats and warnings, and even more interruptions and eye contact. Such an aggressive interaction style would not mix well with some of the more low-key styles of some of the Asian groups or with English speakers, including English-speaking Canadians.

English-Speaking Canada. The Canadians who speak English as their first language used the lowest percentage of aggressive persuasive tactics (threats, warnings, and pun-ishments totaled only 1 percent) of all 14 groups. Perhaps, as communications re-searchers suggest, such stylistic differences are the seeds of interethnic discord as wit-nessed in Canada over the years. With respect to international negotiations, the English-speaking Canadians used noticeably more interruptions and "no's" than nego-tiators from either of Canada's major trading partners, the United States and Japan.

United States. Like the Germans and the British, the Americans fell in the middle of most continua. They did interrupt one another less frequently than all the others, but that was their sole distinction.

These differences across the cultures are quite complex, and this material by itself should not be used to predict the behaviors of foreign counterparts. Instead, great care should be taken with respect to the aforementioned dangers of stereotypes. The key here is to be aware of these kinds of differences so the Japanese silence, the Brazilian "no, no, no. .," or the French threat are not misinterpreted.

Differences in Values

Four values-objectivity, competitiveness, equality, and punctuality - which are held strongly and deeply by most Americans, seem to frequently cause misunderstandings and bad feelings in international business negotiations.

Objectivity. "Americans make decisions based upon the bottom line and on cold, hard facts." "Americans don't play favorites." "Economics and performance count, not peo-ple." "Business is business." Such statements well reflect American notions of the im-portance of objectivity.

The single most important book on the topic of negotiation, Getting to YES, is highly recommended for both American and foreign readers. The latter will learn not only about negotiations

but, perhaps more important, about how Americans think about negotiations. The authors are quite emphatic about "separating the people from the problem," and they state, "Every negotiator has two kinds of interests: in the substance and in the relationship." This advice is probably quite worthwhile in the United States or perhaps in Germany, but in most places in the world such advice is nonsense. In most places in the world, personalities and substance are not separate issues and cannot be made so.

For example, consider how important nepotism is in Chinese or Hispanic cultures. Experts tell us that businesses don't grow beyond the bounds and bonds of tight fam-ily control in the burgeoning "Chinese Commonwealth." Things work the same way in Spain, Mexico, and the Philippines by nature. And, just as naturally, negotiators from such countries not only will take things personally but will be personally affected by ne-gotiation outcomes. What happens to them at the negotiation table will affect the busi-ness relationship regardless of the economics involved.

Competitiveness and Equality. Simulated negotiations can be viewed as a kind of experimental economics wherein the values of each participating cultural group are roughly reflected in the economic outcomes. The simple simulation used in the study represents the essence of commercial negotiations-it has both competitive and cooper-ative aspects. At least 40 businesspeople from each culture played the same buyer-seller game, negotiating over the prices of three products. Depending on the agreement reached, the "negotiation pie" could be made larger through cooperation (as high as $10,400 in joint profits) before it is divided between the buyer and seller.

The Japanese were the champions at making the pie big. Their joint profits in the simulation were the highest (at $9,590) among the 18 cultural groups. The American pie was more average-sized (at $9,030), but at least it was divided relatively equitably (51.8 percent of the profits went to the buyers). Alternatively, the Japanese (and others) split their pies in strange ways, with buyers making higher percentages of the profits (53.8 percent). The implications of these simulated business negotiations are completely con-sistent with the comments of other authors and the adage that in Japan the buyer is "kinger." By nature, Americans have little understanding of the Japanese practice of giv-ing complete deference to the needs and wishes of buyers. That is not the way things work in America. American sellers tend to treat American buyers more as equals, and the egalitarian values of American society support this behavior. Moreover, most Ameri-cans will, by nature, treat Japanese buyers more frequently as equals. Likewise, Ameri-can buyers will generally not "take care of' American sellers or Japanese sellers. The American emphasis on competition and individualism represented in these findings is quite consistent with the work of Geert Hofstede, which indi-cated that Americans scored the highest among 40 other cultural groups on the individu-alism (versus collectivism) scale.

Finally, not only do Japanese buyers achieve higher results than Americans buyers, but compared to American sellers ($4,350), Japanese sellers also get more of the com-mercial pie ($4,430), as well. Interestingly, when shown these results, Americans in ex-ecutive seminars still often prefer the American seller's role. In other words, even though the American sellers make lower profits than the Japanese, many American man-agers apparently prefer lower profits if those profits are yielded from a more equal split of the joint profits.

Time. "Just make them wait." Everyone else in the world knows no negotiation tactic is more useful with Americans, because no one places more value on time, no one has less patience when things slow down, and no one looks at their wristwatches more than Americans do. The material on P-time versus M-time is quite pertinent here. Edward T. Hall in his seminal writing is best at explaining how the passage of time is viewed differently across cultures and how these differences most often hurt Americans.

Even Americans try to manipulate time to their advantage however. As a case in point, Solar Turbines Incorporated (a division of Caterpillar) once sold $34 million worth of industrial gas turbines and compressors for a Russian natural gas pipeline pro-ject. Both parties agreed that final negotiations would be held in a neutral location, the south of France. In previous negotiations, the Russians had been tough but reasonable. But in Nice, the Russians were not nice. They became tougher and, in fact, completely unreasonable, according to the solar executives involved.

It took a couple of discouraging days before the Americans diagnosed the problem. but once they did, a crucial call was made back to headquarters in San Diego. Why had the Russians turned so cold? They were enjoying the warm weather in Nice and weren't interested in making a quick deal and heading back to Moscow! The call to California was the key event in this negotiation. Solar's headquarters people in San Diego were so-phisticated enough to allow their negotiators to take their time. From that point on, the routine of the negotiations changed to brief, 45-minute meetings in the mornings, with afternoons at the golf course, beach, or hotel, making calls and doing paperwork.

Crossing Borders 1

Changing Your Internal Clock

Vincente Lopez spent five years making the Tijunan to san Diego commute. Each time he crossed the order, it felt like a button was pushed inside him. When entering the united states, he felt is whole being switch to rapid clock time mode: he would walk faster, drive faster, talk faster, and meet deadlines, when returning home, his body would relax and slow the moment he saw the Mexico customs agent. "There is a large group of people like me who move back and forth between the times." Lopez observes many, he believes; insist on keeping their homes on the Mexican side precisely because of its slower pace of life.

Finally, during the fourth week, the Russians began to make concessions and to ask for longer meetings. Why? They could not go back to Moscow after four weeks on the Mediterranean without a signed contract. This strategic reversal of the time pressure yielded a wonderful contract for Solar.

Differences in Thinking and Decision-Making Processes

When faced with a complex negotiation task, most Westerners (notice the generalization here) divide the large task up into a

series of smaller tasks. Issues such as prices, deliv-ery, warranty, and service contracts may be settled one issue at a time, with the final agreement being the sum of the sequence of smaller agreements. In Asia, however, a different approach is more often taken wherein all the issues are discussed at once, in no apparent order, and concessions are made on all issues at the end of the discussion. The Western sequential approach and the Eastern holistic approach do not mix well.

For example, American managers report great difficulties in measuring progress in Japan. After all, in America, you are half done when half the issues are settled. But in Japan, nothing seems to get settled. Then, surprise, you are done. Often, Americans make unnecessary concessions right before agree-ments are announced by the Japanese. For example, one American department store buyer traveling to Japan to buy six differ-ent consumer products for his chain lamented that negotiations for his first purchase took an entire week. In the United States, such a purchase would be consummated in an afternoon. So, by his calculations, he expected to have to spend six weeks in Japan to complete his purchases. He considered raising his purchase prices to try to move things along faster. But before he was able to make such a concession, the Japanese quickly agreed on the other five products in just three days. This particular businessman was, by his own admission, lucky in his first encounter with Japanese bargainers.

This American businessman's near blunder reflects more than just a difference in decision-making style. To Americans, a business negotiation is a problem-solving activ-ity, the best deal for both parties being the solution. To a Japanese businessperson. on the other hand, a business negotiation is a time to develop a business relationship with the goal of long-term mutual benefit. The economic issues are the context, not the con-tent, of the talks. Thus, settling anyone issue really is not that important. Such details will take care of themselves once a viable, harmonious business relationship is estab-lished. And, as happened in the case of our retail goods buyer, once the relationship was established-signaled by the first agreement-the other "details" were settled quickly.

American bargainers should anticipate such a holistic approach and be prepared to discuss all issues simultaneously and in an apparently haphazard order. Progress in the talks should not be measured by how many issues have been settled. Rather, Americans must try to gauge the quality of the business relationship. Important signals of progress can be:

- Higher-level foreigners being included in the discussions.
- Their questions beginning to focus on specific areas of the deal.
- A softening of their attitudes and position on some of the issues- "Let us take some time to study this issue."
- At the negotiation table, increased talk among themselves in their own language, which may often mean they're trying to decide something.
- Increased bargaining and use of the lower level, informal, and other channels of communication.

Lesson 39:
Implication of Negotiations Differences for Managers

Implications for Managers and Negotiators

Considering all the potential problems in cross-cultural negotiations, it is a wonder that any international business gets done at all. Obviously, the economic imperatives of global trade make much of it happen despite the potential pitfalls. But an appreciation of cultural differences can lead to even better international commercial transactions-it is not just business deals but highly profitable business relationships that are the real goal of international business negotiations.

Four steps lead to more efficient and effective international business negotiations. They are: (1) selection of the appropriate negotiation team; (2) management of prelimi-naries, including training, preparations, and manipulation of negotiation settings; (3) management of the process of negotiations, that is, what happens at the negotiation table; and (4) appropriate follow-up procedures and practices. Each is discussed below.

Negotiation Teams

One reason for global business successes is the large numbers of skillful international negotiators. These are the managers who have lived in foreign countries and speak for-eign languages. In many cases, they are immigrants to the United States or those who have been immersed in foreign cultures in other capacities (Peace Corps volunteers and Mormon missionaries are common examples). Thankfully, more business schools are beginning to reemphasize language training and visits abroad. Indeed, it is interesting to note that the original Harvard Business School catalogue of 1908-09 listed German, French, and Spanish correspondence within its curriculum.

The selection criteria for international marketing and sales personnel are applicable in selecting negotiators as well. Traits such as maturity, emotional stability, breadth of knowledge, optimism, flexibility, empathy, and stamina are all important, not only for marketing executives involved in interna-tional negotiations, but also for the technical experts who often accompany and support them. In studies conducted at Ford Motor Company and AT&T, three additional traits were found to be important predictors of negotiator success with interna-tional clients and partners: willingness to use team assistance, listening skill, and influence at head-quarters.

Willingness to use team assistance is particularly important for American negotia-tors. Because of a cultural heritage of independence and individualism Americans often make the mistake of going it alone against greater numbers of foreigners. One American sitting across the negotiation table from three or four Chinese negotiators is unfortu-nately an all too common sight. The number of brains in the room does make a difference. Moreover, business negotiations are social processes, and the social reality is that a larger number of nodding heads can exercise greater influence than even the best argu-ments. It is also much easier to gather detailed information when teams are negotiating rather than individuals. For example, the Japanese are quite good at bringing along ju-nior executives for the dual purposes of training via observation and careful note taking. Compensation schemes that overly emphasize individual performance can also get in the way of team negotiating-a negotiation team requires a split commission, which many Americans naturally eschew. Finally, negotiators may have to request the accom-paniment' of senior executives to better match up with client's and partner's negotiation teams. Particularly in high-context, hierarchical cultures rank speaks quite loudly in both persuasion and the demonstration of interests in the business relationship.

The single most important activity of negotiations is listening. The negotiator's primary job is collecting information with the goal of enhancing creativity. This may mean assigning one team member the sole responsibility of taking careful notes and not worrying about speaking during the meetings. This may also mean that knowing the lan-guage of clients and partners will be crucial for the most complete understanding of their needs and preferences. The importance of listening skills in international business negotiations cannot be overstated.

Bringing along a senior executive is important because influence at headquarters is crucial to success. Indeed, many experienced international negotiators argue that half the negotiation is with headquarters. The representatives lament goes something like this, "The better I understand my customer, the tougher time I have with headquarters." Of course, this misery associated with boundary spanning roles is precisely why interna-tional negotiators and sales executives make so much money.

Finally, it is also important to reiterate a point made in: Gender should not be used as a selection criterion for international negotiation teams. This is so despite the great differences in the roles of women across cultures. Even in countries where women do not participate in management, American women negotiators are treated as foreigners first. For obvious reasons it may not be appropriate for women managers to participate in some forms of business entertainment-common baths in locker rooms at Japanese golf course club houses, for example. However, it is still important for women executives to establish personal rapport at restaurants and other informal settings. Indeed, one expert on cross-gender communication suggests that women may actually have some advantages in international negotiations:

"In general, women are more comfortable talking one-an-one. The situation of speaking up in a meeting is a lot closer to boys' experience of using language to establish their position in a large group than it is to girls' experience using language to maintain intimacy. That's some-thing that can be exploited. Don't wait for the meeting; try to make your point in advance; one-to-one. This is what the Japanese do, and in many ways

American women's style is a lot closer to the Japanese style than to American men's."

Negotiation Preliminaries

Many companies in the United States provide employees with negotiations training. For example, through his training programs, Chester Karrass24 has taught more people to negotiate than any other purveyor of the service-see his ads in almost all in-flight mag-azines of domestic air carriers. How-ever, very few companies provide training for nego-tiations with managers from other countries. Ford Motor Company is an exception.

Crossing Borders 2

Ford Trains Executives for Negotiations with Japanese

Proactive and direct is the approach ford uses to develop competence in employees who interact with the Japanese. This occurs through a variety of practices, including programs that help ford personnel better understand the Japanese culture and negotiating practices, and by encouraging the study of the spoken language. By designing training that highlights both the pitfalls and the opportunities in negotiations, ford increases the change to "expand the negotiation pie".

Back in 1988 the key personnel on Ford's minivan team attended one of the first sessions of a managing Negotiations Japan (MNJ) program at the ford Executive "Development Center. Its negotiations with the Nissan Team improved immediately. But perhaps the best measure of the usefulness of the MNJ program is the success of the Nissan joint venture product itself. Reflected in the villager / quest are countless hours of effective face-to-face meetings with fords Japanese partner.

Not everyone negotiating outside the US has the advantages of in house training. However, many sources of information are available – books (particularly, on Japan), periodicals, and colleagues with first hand experience. To succeed negotiators have to be truly interested in and challenged by the international negotiating environment structuring negotiations to achieve win – win results and building a long – term relationship takes thoughtful attention and commitment.

Ford does more business with Japanese companies than any other firm. Ford owns 33 percent of Mazda, it built a successful minivan with Nissan, and it buys and sells component parts and completed cars from and to Japanese companies. But perhaps the best measure of Ford's Japanese business is the 8,000 or so U.S. to Japan round-trip air-line tickets the company buys annually! Ford has made a large investment in training its managers with Japanese responsibilities. More than 1,500 of its executives have at-tended a three-day program on Japanese history and culture and the company's Japanese business strategies. More than 1,000 Ford managers who work face-to-face with Japan-ese have attended a three-day program, "Managing Negotiations: Japan" (MNJ). The MNJ program includes negotiation simulations with videotape feedback, lectures with cultural differences demonstrated via videotapes of Japanese/American interactions, and rehearsals of upcoming negotiations. The company also conducts similar programs on Korea and the Peoples Republic of China.

In addition to MNJ, the broader Japan training efforts at Ford must be credited for their successes in Japan. Certainly, MNJ alumni can be seen exercising influence across and up the ranks regarding Japanese relationships. But the organizational awareness of the cultural dimensions of the Japanese business system was quickly raised as well by their broader, three-day program on Japanese business strategies. Remember the story about the Russians in Nice? Two critical events took place. First, the Solar Turbines (Inc.) negotiators diagnosed the problem. Second, and equally important, their Califor-nia superiors appreciated the problem and approved the investments in time and money to outwait the Russians. So it is that the Ford programs have targeted not only the nego-tiators working directly with the Japanese but also their managers who spend most of their time in the company's Detroit headquarters. Negotiators need information specific to the cultures in which they work. Just as critical, their managers back in the United States need a basic awareness and appreciation for the impor-tance of culture in interna-tional business so that they will be more apt to listen to the "odd-sounding" recommen-dations coming from their people in Moscow, Rio, or Tokyo.

Any experienced business negotiator will tell you that there is never enough time to get ready. Given the time constraints of international negotiations, preparations must be accomplished efficiently the homework must be done before the bargaining begins. We recommend the following checklist to ensure proper preparation and planning for international negotiations:

1. Assessment of the situation and the people.
2. Facts to confirm during the negotiation.
3. Agenda.
4. Best alternative to a negotiated agreement (BATNA).
5. Concession strategies.
6. Team assignments.

Preparation and planning skill is at the top of almost everyone's list of negotiator traits, yet it seems many Americans are still planning strategies during over-ocean flights when they should be trying to rest. Quick wits are important in business negotia-tions, and ar-duous travel schedules and jet lag dull even the sharpest minds. Obviously information about the other side's goals and preferences should be sought ahead of time. Also im-portant are clear directions from headquarters and detailed information about market conditions.

No matter how thorough the preliminary research, negotiators should always make a list of key facts to reconfirm at the negotiation table. Information gathered about for-eign customers and markets almost always includes errors, and things can change dur-ing those long airline flights. Next, anticipate that managers from other cultures may put less emphasis on a detailed agenda, but it still makes sense to have one to propose and help organize the meetings.

The most important idea in Getting to YES is the notion of the best alternative to a negotiated agreement (BATNA). This is how power in negotiations is best measured. Even the smallest companies can possess great power in negotiations if they have many good alternatives and their large-company counterparts do not. It is also important to plan out and write down concession strategies. Concessions can often snowball, and

writing them down ahead of time helps negotiators keep them under control.

Finally, specific team assignments should be made clear-who handles technical details, who takes notes, who plays the tough guy, who does most of the talking for the group, etc. Obviously this last consideration presumes a negotiation team is involved.

There are at least seven aspects of the negotiation setting that should be manipu-lated ahead of time if possible:

1. Location.
2. Physical arrangements.
3. Number of parties.
4. Number of participants.
5. Audiences (news media, competitors, fellow vendors, etc.).
6. Communications channels.
7. Time limits.

Location speaks loudly about power relations. Traveling to a negotiating counterpart's home turf is a big disadvantage, and not just so because of the costs of travel in money and fatigue. A neutral location may be preferred-indeed; many trans-Pacific business negotiations are conducted in Hawaii. The weather and golf are nice and the jet lag is about equal. Location is also an important consideration because it may determine legal jurisdictions if disputes arise. If you must travel to your negotiating counterpart's city then a useful tactic is to invite clients or partners to work in a meeting room at your hotel. You can certainly get more done if they are away from the distractions of their offices.

Physical arrangements can affect cooperativeness in subtle ways. In high-context cultures the physical arrangements of rooms can be quite a source of embarrassment and irritation if handled improperly. To the detriment of their foreign business relationships Americans tend to be casual about such arrangements. Furthermore, views about who should attend negotiations vary across cultures. Americans tend to want to get everyone together to "hammer out an agreement" even if opinions and positions are divergent. Japanese prefer to talk to everyone separately, and then once everyone agrees more inclusive meetings are scheduled. Russians tend toward a cumulative approach, meeting with one party, reaching an agreement, then both the first two call on a third party, and so on. In addition, the importance of not being outnumbered in international business negotia-tions has already been mentioned.

Audiences can have crucial influences on negotiation processes. Purchasing execu-tives at PetroBras, the Brazilian national oil company, were well known for putting competitive bidders in rooms adjacent to one another to increase competitive pressures on both vendors. Likewise, news leaks to the press played a crucial role in pushing along the negotiations between General Motors and Toyota regarding a joint-venture production agreement.

As electronic media become more available and efficient, more business can be con-ducted without face-to-face communication. However, Americans should recognize that their counterparts in many other countries do not necessarily share their attraction to the In-ternet and teleconferencing. Indeed, a conversation over a long dinner may be the most effi-cient way to communicate with clients and partners in places like Mexico and Malaysia.

Finally, it is important to manipulate time limits. Recall the example about the Rus-sians and Americans in Nice. The patience of the home office may be indispensable, and major differences in time orientation should be planned for when business negotiations are conducted in most other countries.

At the Negotiation Table

The most difficult aspect of international business negotiations is the actual conduct of the face-to-face meeting. Assuming that the best representatives have been chosen, and assuming those representatives are well prepared and that situational factors have been manipulated in one's favor, things can still go sour at the negotiation table. Obviously, if these other preliminaries have not been managed properly, things will go wrong during the meetings. Even with great care and attention to preliminary details, managing the dynamics of the negotiation process is almost always the greatest challenge facing Americans seeking to do business in other countries.

Going into a business negotiation, most people have expectations about the "proper" or normal process of such a meeting. Based on these expectations, progress is measured and appropriate bargaining strategies are selected. That is, things may be done differently in the latter stages of a negotiation than they were in the earlier. Higher risk strategies may be employed to conclude talks-as in the final two minutes of a close soccer match. But all such decisions about strategy are made relative to perceptions of progress through an expected course of events.

Differences in the expectations held by parties from different cultures are one of the major difficulties in any international business negotiation. Before these differences are discussed, however, it is important to point out similarities. Everywhere around the world we have found that business negotiations proceed through four stages:

1. Non-task sounding.
2. Task-related exchange of information.
3. Persuasion.
4. Concessions and agreement.

The first stage, non-task sounding, includes all those activities that might be described as establishing a rapport or getting to know one another, but it does not include informa-tion related to the "business" of the meeting. The information exchanged in the second stage of business negotiations regards the parties' needs and preferences. The third stage, persuasion, involves the parties' attempts to modify one another's needs and preferences through the use of various persuasive tactics. The final stage of business negoti-ations involves the consummation of an agreement, which is often the summation of a series of concessions or smaller agreements.

Despite the consistency of this process across diverse cultures, the content and du-ration of the four stages differ substantially. For example, Exhibit 1 details such pro-cedural differences in Japan and the United States, as well as differences in language, nonverbal behavior, and values.

Non-task Sounding. Americans always discuss topics other than business at the nego-tiation table (for example, the weather, family, sports, politics, and business conditions in general), but not for long. Usually the discussion is moved to the specific business at hand after five to ten minutes. Such preliminary talk, known as non-task sounding, is much more than just friendly or polite; it helps to learn how the other side feels that par-ticular day. One can determine during non-task sounding if a client's attention is focused on business or distracted by other matters, personal or professional.

Exhibit 1 Summary of Japanese and American Business Negotiation Styles

Category	Japanese	Americans
Language	Most Japanese executives understand English, although interpreters are often used.	Americans have less time to formulate answers and observe Japanese nonverbal responses because of a lack of knowledge of Japanese.
Nonverbal behaviors	The Japanese interpersonal communication style includes less eye contact, fewer negative facial expressions, and more periods of silence.	American businesspeople tend to "fill" silent periods with arguments or concessions.
Values	Indirectness and face saving are important Vertical buyer/seller relationships with sellers depending on goodwill of buyers (amae) is typical	Speaking one's mind is important. Buyer/seller relationships are horizontal.
1.Non-task sounding"	Considerable time and expense devoted- to such efforts is the - practice, in Japan.	Very short periods are typical.
2.Task-related exchange of information	This the most important step high first offers with long explanations and in-depth clarifications.	Information is given briefly and directly. "Fair" first offers are more typical.
3. Persuasion	Persuasion is accomplished primarily behind the scenes. Vertical status relations dictate bargaining outcomes.	The most important step: Minds are changed at the negotiation table and aggressive persuasive tactics are often used.
4. Concessions and agreement	Concessions are made only toward the end of negotiations a holistic approach to decision making. Progress is difficult to measure for Americans.	Concessions and commitments are made throughout-a sequential approach to decision making.

Four Stages of Business Negotiations

Learning about a client's background and interests also provides important cues about appropriate communication styles. To the extent that people's backgrounds are similar, communication can be more efficient. Engineers can use technical jargon when talking to other engineers. Sports enthusiasts can use sports analogies. Those with chil-dren can compare the cash drain of "putting a kid through college," and so on.

During these initial stages of conversation, judgments, too, are made about the "kind" of person(s) with whom one is dealing: Can this person be trusted? Will he be re-liable? How much power does she have in her organization? All such judgments are made before business discussions ever begin.

There is a definite purpose to these preliminary non-task discussions. Although most people are often unaware of it, such time almost always is used to size up one's clients. Depending on the results of this process, proposals and arguments are formed using dif-ferent jargon and analogies. Or it may be decided not to discuss business at all if clients are distracted by other personal matters or if the other person seems untrustworthy. All this sounds like a lot to accomplish in five to ten minutes, but that's how long it usually takes in the United States. This is not the case in other high-context countries like China or Brazil; the goals of the non-task sounding are identical, but the time spent is much, much longer.

Crossing Borders 3

Fishing for Business in Brazil

How important is non-task sounding? Consider this description about an American banker's meeting in Brazil, as told by an observer.

Introductions were made. The talk began with the usual "How do you like Rio?" questions-Have you been to Ipanema, Copacabana, Corcovado, etc? There was also talk about the flight down from New York. After about five minutes of this chatting, the senior American quite conspicuously glanced at his watch, and then asked his client what he knew about the bank's new services.

"A little," responded the Brazilian.' The senior, American whipped a brochure out of his briefcase, opened it on the desk in front of the client, and began his sales pitch.

After about three minutes 'of "fewer forms, electronic transfers, and reducing ac-counts receivables," the Brazilian jumped back in, "Yes, that should make us more com-petitive…. and competition is important here in Brazil. In fact, have you been follow-ing the World Cup football (soccer) matches recently? Great games." And so the reel began to whir, paying out that monofilament line right there in that hot high-rise office.

After a few minutes' dissertation on the local futbol teams, Pele, and why football isn't popular in the United States, the American started to try to crank the Brazilian back in. The first signal was the long look at his watch, then the interruption, "Perhaps we can get back to the new services we have to offer.

The Brazilian did get reeled back into the subject of the sale for a couple of minutes, but then the reel started to sing again. This time he went from efficient banking transac-tions to the nuances of the Brazilian financial system to the Brazilian economy. Pretty soon we were "all talking about the world economy and making predictions about the U.S. presidential elections.

Another look at his Rolex, and the American started this little "sport fishing" ritual all over again. From my perspective (I wasn't investing time and money toward the success of this activity), this all seemed pretty funny, every time the American VP loaded at his watch during the next 45 minutes, I had to bite my cheeks to keep form laughing out loud. He never did get to page two of his brochure. The Brazilian just wasn't interested in talking business with someone he didn't know pretty well.

In the United States, firms resort to the legal system and their lawyers when they've made a bad deal because of a mistake in sizing up a customer or vendor. In most other countries the legal system cannot be depended upon for such purposes. Instead, execu-tives in places like Korea and Egypt spend substantial time and effort in non-task sound-ing so that problems do not develop later. Americans need to reconsider, from the for-eigner's perspective, the importance of this first stage of negotiations if they hope to succeed in Seoul or Cairo.

Task-Related Information Exchange. Only when non-task sounding is complete and a trusting personal relationship estab-lished, should business be introduced. American executives are advised to let the foreign counterpart decide when such substantive nego-tiations should begin, to let them bring up business.

A task-related information exchange implies a two-way communication process. However, observations suggest that when Americans meet executives from some cul-tures across the negotiation table, the information flow is unidirectional. Japanese, Chi-nese, and Russian negotiators all appear to ask "thousands" of questions and to give lit-tle feedback. The barrage of questions severely tests American negotiators' patience, and the latter causes them great anxiety. Both can add up too much longer stays in these countries, which means higher travel expenses.

Certainly it is an excellent negotiation tactic to drain information from one's negoti-ation counterparts. But the oft-reported behaviors of Chinese, Japanese, and Russians may not necessarily represent a sophisticated negotiation ploy. Indeed, in careful studies of conversational patterns of Americans negotiating with Japanese, the Americans seem to fill the silent periods and do most of the talking. These results suggest that American negotiators must take special care to keep their mouths shut and let foreign counterparts give them information.

Exchanging information across language barriers can be quite difficult as well. Most of us understand about 80-90 percent of what our same-culture spouses or room-mates say-that means 10-20 percent is misunderstood or misheard. That latter percent-age goes up dramatically when someone is speaking a second language, no matter the highest fluency levels and length of acquaintance. And when the second language capa-bility is limited, entire conversations may be totally misunderstood. Using multiple communication channels during presentations writing, exhibits, speaking, repetition works to minimize the inevitable errors.

In many cultures negative feedback is very difficult to obtain. In high-context cul-tures like Mexico and Japan, speakers are reluctant to voice objections lest they damage the all-important personal relationships. Some languages themselves are by nature indi-rect and indefinite. English is relatively clear, but translations from languages like Japanese can leave much to be understood. In more collectivistic cultures like China, negotia-tors may be reluctant to speak for the decision-making group they represent, or they may not even know how the group feels about a particular proposal. All such prob-lems suggest the importance of having natives of customer countries on your negotia-tion team and/or spending extra time in business and informal entertainment settings trying to understand better the information provided by foreign clients and partners. Al-ternatively, low-context German executives often complain that American presentations include too much "fluff' -they are interested in information only, not the hyperbole and hedges so common in American speech. Negative feedback from Germans can seem brutally frank to higher-context Americans.

A final point of potential conflict in information exchange has to do with first offers. Price padding varies across cultures, and Americans' first over tend to come in relatively close to what they really want. "A million dollars is the goal, let's start at $1.2 million," seems about right to most Americans. Implicit in such a first offer is the hope that things will get done quickly. Ameri-cans do not expect to move far from first offers. Negotiators in many other countries do not share the goal of finishing quickly, however. In places like China, Brazil, or Spain the expectation is for a relatively longer period of haggling, and first offers are more aggressive to reflect these expecta-tions. "If the goal is one million, we better start at two," makes sense there. Americans react to such aggressive first offers in one of two ways: They either laugh or get mad. And when foreign counterparts' second offers reflect deep discounts, Americans' ire in-creases.

Crossing Borders 4

Who Adapts to Whom?

It depends on the capabilities on both sides of the table and power relationships.

For their discussions over construction of the tunnel under the English Channel, British and French representatives agreed to partition talks and alternate the site between Paris and London At each site, the negotiators were to use established, local ways including the language The two approaches were thus clearly punctuated by time and space. Although each

side was able to use its customary approach some of the time, it used the script of the other culture the rest of the time.

At the outset of a meeting: to discuss the telecommunications policies of France's Ministry of Industry and Tourism, the minister's chief of staff and his American visitor each voiced concerned about speaking in the other's native language. They expressed con-fidence in their listening capabilities and lacked immediate access to an interpreter, so they agreed to proceed by each speaking in his own language. Their discussion went on or an hour that way, they American speaking in English to the Frenchman, and the Frenchman speaking French to the American.

A good example of this problem regards an American CEO shopping for a Euro-pean plant site. When he selected a $20 million plot in Ireland, the Spanish real estate developer he had visited earlier called wondering why the American had not asked for a lower price for the Madrid site before choosing Dublin. He told the Spaniard that his first offer "wasn't even in the ball park." He wasn't laughing when the Spaniard then of-fered to beat the Irish price. In fact, the American executive was quite mad. A poten-tially good deal was forgone because of different expectations about first offers. Yes, numbers were exchanged, but information was not. Aggressive first offers made by for-eigners should be met with questions, not anger.

Persuasion. In Japan, a clear separation does not exist between task-related informa-tion exchange and persuasion. The two stages tend to blend together as each side defines and refines its needs and preferences. Much time is spent in the task-related exchange of information, leaving little to "argue" about during the persuasion stage. Alternatively, Americans tend to lay their cards on the table and hurry through the information ex-change to persuasion. After all, the persuasion is the heart of the matter. Why hold a meeting unless someone's mind is to be changed? A key aspect of sales training in the U.S. is "handling objections." So the goal in information exchange among Americans is to quickly get those objections out in the open so they can be handled.

This handling can mean providing clients with more informa-tion. It can also mean getting mean. Americans make threats and issue warn-ings in negotiations. They do not use such tactics often, but negotiators in other cultures use such tactics even less frequently and in different circumstances. For example, no-tice how infrequently the Mexican and English-speaking Canadians used threats and warnings in the simulated negotia-tions. In China the use of such aggressive negotiation tactics can result in the loss of face and the destruction of important personal relation-ships. Such tough tactics may be used in Japan but by buyers only and usually only in informal circumstances-not at the formal negotiation table. Americans also get mad during negotiations and express emotions that may be completely inappropriate in for-eign countries. Such emotional outbursts may be seen as infantile or even barbaric be-havior in places like Hong Kong and Bangkok.

The most powerful persuasive tactic is actually asking more questions. Foreign counterparts can be politely asked to explain why they must have delivery in two months or why they must have a 10 percent discount. Chester Karrass, in his still useful book The Negotiation Game, suggests that it is "smart to be a little dumb" in business negotiations. Repeat questions, for example, "I didn't completely understand what you meant-can you please explain that again?" If clients or potential business partners have good answers, then perhaps it is best to compro-mise on the issue. Often, however, under close and repeated scrutiny their answers are not very good. When their weak position is exposed, they are obliged to concede. Questions can elicit key information, being the most powerful yet passive persuasive devices. Indeed, the use of questions is a favored Japanese tactic, one they use with great effect on Americans.

Finally, third parties and informal channels of communication are the indispensable media of persuasion in many countries. Meetings in restaurants and/or with references and mutual friends who originally provided introductions may be used to handle diffi-cult problems with partners in other countries. The value of such informal settings and trusted intermediaries is greatest when problems are emotion laden. They provide a means for simultaneously delivering difficult messages and saving face. Although American managers may eschew such "behind the scenes" approaches, they are stan-dard practice in many countries.

Concessions and Agreement. Comments made previously about the importance of writing down concession-making strategies and differences in decision-making styles-se-quential versus holistic-are pertinent here. Americans often make concessions early, ex-pecting foreign counterparts to reciprocate. However, in many cultures no concessions are made until the end of the negotiations. Americans often get frustrated and express anger when foreign clients and partners are simply following a different approach to concession making, one that can also work quite well when both sides understand what is going on.

After Negotiations

Contracts between American firms are often longer than 100 pages and include carefully worded clauses regarding every aspect of the agreement. American lawyers go to great lengths to protect their companies against all circumstances, contingencies, and actions of the other party. The best contracts are ones written so tightly that the other party would not think of going to court to challenge any provision. The American adversarial system requires such contracts.

In most other countries, particularly the high-context ones, legal systems are not de-pended upon to settle disputes. Indeed, the term "disputes" does not reflect how a busi-ness relationship should work. Each side should be concerned about mutual benefits of the relationship, and therefore should consider the interests of the other. Consequently, in places like Japan written contracts are very short two to three pages-are purposely loosely written, and primarily contain comments on principles of the relationship. From the Japanese point of view, the American emphasis on tight contracts is tantamount to planning the divorce before the wedding.

In other countries such as China contracts are more a descrip-tion of what business partners view their respective responsibilities to be. For complicated business relation-ships they may be quite long and detailed. However, their purpose is

different from the American understanding. When circumstances change, then responsibilities must also be adjusted, despite the provisions of the signed contract. The notion of enforcing a con-tract in China makes little sense.

Informality being a way of life in the United States, even the largest contracts be-tween companies is often sent through the mail for signature. In America, ceremony is considered a waste of time and money. But when a major agreement is reached with foreign companies, their executives may expect a formal signing ceremony involving CEOs of the respective companies. American companies are wise to accommodate such expectations.

Finally, follow-up communications are an important part of business negotiations with partners and clients from most foreign countries. Particularly in high-context cul-tures, where personal relationships are crucial, high-level executives must stay in touch with their counterparts. Letters, pictures, and mutual visits remain important long after contracts are signed. Indeed, "warm" relationships at the top often prove to be the best medicine for any problems that may arise in the future.

Conclusions

Despite the litany of potential pitfalls facing international negotiators, things are getting better. The "innocents abroad" and cowboy stereotypes of American managers are be-coming less accurate. Likewise, we hope it is obvious that the stereotypes of the reticent Japanese or the pushy Brazilian evinced in the lesson may no longer hold so true. Experience levels are going up worldwide, and individual personalities are important. So you can find talkative Japanese, quiet Brazilians, and effective American negotiators. But culture still does, and always will, count. Hopefully, it is fast becoming the natural behaviour of American managers to take it into account.

English author Rudyard Kipling said some one hundred years ago: "Oh, East is East, and West is West, and never the twain shall meet." Since then most have imbued his words with an undeserved pessimism. Some even wrongly say he was wrong. The problem is that not many have bothered to read his entire poem, *The Ballad of East and West:*

Oh, East is East, and West is West, and never the twain shall meet,

Till Earth and Sky stand presently at God's great Judgement Seat;

But There is neither East nor West, border, nor breed, nor birth,

When two strong men stand face to face, though they come from the ends of the earth.

The poem can stand some editing for these more modern times. Now should be included the other directions, North is North and South is South. And the last line properly should read, "When two strong people stand face to face." But Kipling's positive sentiment remains. Differences between countries and cultures, no matter how difficult, can be worked out when people talk to each other in face-to-face settings. Kipling rightly places the responsibility for international cooperation not on companies or governments, but instead directly on the shoulders of individual managers, present and future, like you.

Discussion Questions

1. Define:
   a. BATNA
   b. Non task sounding
   c. Task related information exchange
2. Why can cultural stereotypes be dangerous? Give some examples.
3. List three ways that culture influences negotiation behaviour.
4. Describe the kinds of problems that usually come up during international business negotiations.
5. Why are foreign language skills important for international negotiators?

6. Describe three cultural differences in nonverbal behaviours and explain how they might cause problems in international business negotiations.

7. Why is time an important consideration in international business organization?

8. What can be different about how a Japanese manager might address a complex negotiation compared to an American negotiator?

9. What are the most important considerations in selecting a negotiation team? Give examples.

10. What kinds of training are most useful for international business negotiators?

11. Name three aspects of negotiation situations, which might be manipulated before talks begin. Suggest how this might be done.

12. Explain why Americans spend so little time on nontask sounding and Brazilians so much.

13. Why is it difficult to get negative feedback from counterparts in many foreign countries? Give examples.

14. Why won't getting mad work in Mexico or Japan?

15. Why are questions the most useful persuasive tactic?

LESSON 40:
LEADING, ORGANIZING, AND MONITORING THE GLOBAL MARKETING EFFORT

It seems incredible, and yet it has happened a hundred times, that troops have been divided and separated merely through a mysterious feeling of conventional manner, without any clear perception of the reason.

-carl Von Clausewitz, 1780-1831

Vom Kriege (1832-1837) *Book Ill,*

Chapter Xl, "Assembly of Forces in Space"

Leadership in this new landscape is not about controlling decision-making. We don't have time anymore to control decision-making. It's about creating the right environment. It's about en-ablement, empowerment. It is about setting guidelines and boundaries and parameters and setting the people free.

Carleton "Carly" S. Fiorina

Commencement Address, Massachusetts

Institute of Technology, June 2, *2000*

This lesson focuses on the integration of each element of the marketing mix into a total plan that addresses expected opportunities and threats in the global marketing environment. Bill Gates of Microsoft, Rupert Murdoch of the News Corporation, Jack Welch of General Electric (GE), Richard Branson of Virgin, Percy Barnavik of ABB, and Hank Green burgh of AIG are just a few of the global leaders who by their example and the success of their organizations illustrate the critical role of leadership in a global firm. Leaders must be capable of articulating a coherent global vision and strategy that inte-grates local responsiveness, global efficiency, and leverage. The challenge is to direct the efforts and creativity of everyone in the company toward a global effort that best uti-lizes organizational resources to exploit global opportunities.

Leadership

Global marketing demands exceptional leadership. As we have said throughout this book, the hallmark of a global company is the capacity to formulate and implement global strategies that leverage worldwide learning, respond fully to local needs and wants, and draw on all of the talent and energy of every member of the organization. This is a heroic task requiring global vision and a sensitivity to local needs. Members of each operating unit must address their immediate responsibilities and at the same time cooperate with functional, product, and country experts in different locations

As Carly Fiorina put it so eloquently in her MIT commencement address:

"Leadership is not about hierarchy or title' or status: it is about having influ-ence and mastering change. Leadership is not about bragging rights or battles or even the accumulation of wealth; it's about connecting and engaging at multiple levels. It's about challenging minds and capturing hearts. Leadership in this new era is about empowering others to decide for themselves. Leader-ship is about empowering others to reach their full potential. Leaders can no longer view strategy and execution as abstract concepts, but must realize that both elements are ultimately about people."

1. TEAMS

The practice of using self-directed Work teams to respond to competitive challenges is becoming more widespread. Reports vary as to how widely teams are being used today. One study found that 47 percent of *Fortune* 1000 companies used teams with at least some of their employees. With the increased usage of e-mail, team members can even I be located on different continents.

Jon Katzenbach and Douglas Smith believe "teams will become the primary unit of performance in high-performance organizations. The implementation of self-directed work teams is another example of the need for organizational innovation to maintain competitiveness. They represent another corporate response to the need to flatten the organization, to reduce costs and overheads, and to be more responsive.

Companies are looking to reduce bureaucracy and hierarchy to improve responsiveness and to reduce costs. As Tom Peters put it, you can't survive, let alone thrive, in a time-competitive world with a six- to eight-layer organization structure. The time-obsessed organization is flat-no barriers among functions, no borders with the outside.

Philip J. Quigley, president and chief executive officer (CEO) of Pacific Bell, sees two kinds of organizations: the large, powerful, yet cumbersome organization that is like an elephant; and the agile, quick, but weaker, small organization that is like a rabbit. Neither, however, is completely suited to compete in today's competitive global market- I place. Quigley's answer is a new form of organization, the rabbiphant, which combines I the strength and agility of the two present types of organizations.

2. Mind-set

A major role of top management is to instill important values necessary for success in a global marketplace throughout their organization. One critical value vital to an effective global organization is to have the proper mind-set for both the leadership and the orga-nization. Gupta and Govindarajan suggest that the following be reviewed:

"Composition of the board of directors-mix of nationalities, international experience, language skills.

Choice of locations for board meetings.

Background of the chief executive, executive committee and business unit managers in terms of international experience and language skills.

Distribution of time spent by the chief executive in various regions.

Choice of locations for business unit headquarters.

Proportion of middle and senior managers who are members of cross border teams.

Executive career ladders that reward international experience.

Performance measurement and incentive system that motivate senior managers to optimize not only local but also global performance."

Organization

The goal in organizing for global marketing is to find a structure that enables the com-pany to respond to relevant market environment differences while ensuring the diffu-sion of corporate knowledge and experience from national markets throughout the entire corporate system. The pull between the value of centralized knowledge and coordination and the need for individualized response to the local situation creates a con-stant tension in the global marketing organization. A key issue in global organization is how to achieve balance between autonomy and integration. Subsidiaries need autonomy in order to adapt to their local environment. However, the business as a whole needs integration to implement global strategy.

When management at a domestic company decides to pursue international expan-sion, the issue of how to organize arises immediately. Who should be responsible for this expansion? Should product divisions operate directly or should an interna-tional division be established? Should individual country subsidiaries report directly to the company president or should a special corporate officer be appointed to take full-time responsibility for international activities? Once the first decision of how to organize initial in-ternational operations has been reached, a growing company is faced with a number of reap-praisal points during the development of its international business activities. Should a company abandon its international division and, if so, what alternative structure should be adopted? Should an area or regional headquarters be formed? What should be the relationship of staff executives at corpo-rate, regional, and subsidiary offices? Specifically, how should the marketing function be organized? To what extent should regional and corporate marketing executives become involved in subsidiary marketing management?

It is important to recognize that there is no single correct organizational structure for global marketing. Even' within an industry, worldwide companies have developed very different strategic and organizational responses to changes in their environments.

Still, it is possible to make some generalizations. Leading-edge global competitors share one key organizational design characteristic: Their corporate structure is simple and flat, rather than tall and complex. The message is clear: The world is complicated enough; there is no need to add to the confusion with a complex internal structuring. Simple struc-tures increase the speed and clarity of communication and allow the concen-tration of organizational energy and valuable resources on learning, rather than on controlling, monitoring, and reporting? According to David Whitwam, CEO of Whirlpool, "You must create an organization whose people are adept at exchanging ideas, processes, and systems across borders, people who are absolutely free of the 'not-invented-here' syndrome, people who are constantly working together to identify the best global opportunities and the biggest global problems facing the organization

A geographically dispersed company cannot limit its knowledge to product, function, and the home territory. Company personnel must acquire knowledge of the complex set *of* social, political, economic, and institutional arrangements that exist within each international market. Most companies, after initial ad hoc arrangements-for example, I all foreign subsidiaries reporting to a designated vice president or to the president establish an international division to manage their geographi-cally dispersed new busi-ness. It is clear, however, that the international division in the multi product company is an unstable organizational arrangement. As a company grows, this initial organizational structure frequently gives way to various alternative structures.

In today's fast-changing, competitive global environment, corporations have to find new and more creative ways to organize. New forms of flexibility, efficiency, and responsive-ness are required to meet the market demands. The need to be cost-effective, to be customer driven, to deliver the best quality, and to deliver that quality quickly are some of today's market realities.

Several authors have described new organizational designs that represent responses to the competitive environment of the 21st century. These designs acknowledge the need to find more responsive and flexible structures, to flatten the organization, and to employ teams. There is also the recognition of the need to develop networks, to develop stronger relationships among participants, and to exploit technology. They also reflect an evolution in approaches to organizational effectiveness. At the beginning of the twentieth century, Fredrick Taylor claimed that all managers had to see the world the same way. Then came the contingency theorists who said that effective organizations design themselves to match their conditions. These two basic theories are reflected in today's popular management writings. As Henry Mintzberg has observed, "To Michael Porter, effectiveness resides in strategy, while to Tom Peters it is the operations that count-executing any strategy with excellence." Successful companies, the real global winners, must have both: good strate-gies and good execution.

Patterns of International Organizational Development

Organizations vary in terms of the size and potential of targeted global markets and local management competence in different country markets. Conflicting pressures may arise from the need for product and technical knowledge, functional expertise in marketing, finance, and operations, and area and country knowledge. Because the con-stellation of pressures that shape organizations is never exactly the same, no two or-ganizations pass through organizational stages in exactly the same way, nor do they arrive at precisely the same organizational pattern. Nevertheless, some general pat-terns have developed.

Most companies undertake initial foreign expansion with an organization similar to that in Figures 1. When a company is organized on this basis, foreign sub-sidiaries report directly to

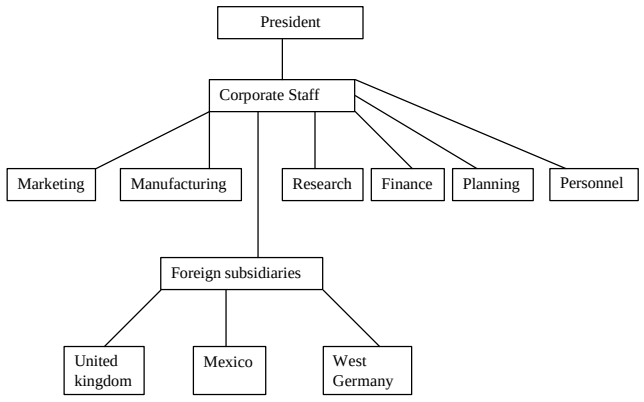
the company president or other designated company officer, which carries out his or her responsibilities without assistance from a headquarters staff group. This is a typical initial arrangement for companies getting started in international marketing operations.

International Division Structure

As a company's international business grows, the complexity of coordinating and di-recting this activity extends beyond the scope of a single person. Pressure is created to assemble a staff group that will take responsibility for coordination and direction of the growing international activities of the organization. Eventually, this pressure leads to the creation of the international division.

Four factors contribute to the establishment of an international division. First, top management's commitment to global operations has increased enough to justify an organizational unit headed by a senior manager. Second, the complexity of interna-tional operations requires a single organization unit whose management has sufficient authority to make its own determination on important issues such as which market entry strategy to employ. Third, an international division is frequently formed when the firm has recognized the need for internal specialists to deal with the special de-mands of global operations. A fourth contributing factor arises when management exhibits the desire to develop the ability to scan the global horizon for opportunities and competitive threats rather than simply respond to situations that are presented to the company.

FIGURE 1 Functional corporate structure Domestic corporate staff orientation, Pre-international division



Regional Management Centers

Another stage of organizational evolution is the emergence of an area or regional head-quarters as a management layer between the country organization and the international division headquarters. When business is conducted in a single region that is characterized by similarities in economic, social, geographic, and political conditions, there is both justification and need for a management center. The center coordinates decisions on pricing, sourcing, and other matters. Execu-tives at the regional center also participate in the planning and control of each country's operations with an eye toward applying company knowledge and optimal utilization of corporate resources on a regional basis.

Regional management can offer a company several advantages. First many regional managers agree that an on-the-scene regional management unit makes sense when there is a real need for coordinated, pan-regional decision making. Coordinated regional plan-ning and control is becoming necessary as the national subsidiary continues to lose its relevance as an independent operating unit. Regional management can probably achieve the best balance of geographic, product, and functional considerations required to im-plement corporate objectives effectively. By shifting operations and decision making to the region, the company is better able to maintain an insider advantage.

A major disadvantage of a regional center is its cost. Even a two-person office could cost in excess of $600,000 per year. The scale of regional management must be in line with scale of operations in a region. A regional headquarters is premature whenever the size of the operations it manages is inadequate to cover the costs of the additional layer of management. Thus, the basic issue with regard. to the regional headquarters is, "Does it contribute enough to organizational effectiveness to justify its cost and the complex-ity of another layer of management?"

Geographic Structure

The geographic structure involves the assignment of operational responsibility for geographic areas of the world to line managers, the corporate headquarters retains responsibilities for world wide planning and control, and each area of the world – including the "home" or base market-is organizationally equal. For the company with French origins, trance is simply another geographic market under this organizational arrange-ment. The most common appearance of this structure is in companies with closely related product lines that are sold in similar end-use markets around the world. For ex-ample, the major international oil companies utilize the geographic structure.

Global Product Division Structure

When an organization assigns worldwide product responsibility to its product divisions the product divisions must decide whether to rely on an international division, there by dividing their world into domestic and foreign, or to rely on an area structure with each region of the world organizationally treated on an equal basis. In most cases in which a divisional company shifts from a corporate international division to worldwide product divisions, there are two stages in the internationalization of the product divisions. The first stage occurs when international responsibility is shifted from a corporate international division to the product division international departments. The second occurs when the product divisions themselves shift international responsibility from interna-tional departments within the divisions to the total divisional organization. In effect, this shift is the utilization of a geographic structure within each product division. The product structure works best when a company's product line is widely diversified, when products go into a variety of end-use markets, and when a relatively high-technological capability is required.

The Matrix Strucure

The most sophisticated organizational arrangement brings to bear four basic compe-tencies on a worldwide basis. These

competencies are as follows:

1. ***Geographic knowledge***. An understanding of the basic economic, social, cultural, political, and governmental market and competitive dimensions of a country is essential. The country subsidiary is the major structural device employed today to enable the corporation to acquire geographic knowledge.
2. ***Product knowledge and know-how.*** Product managers with a worldwide responsi-bility can achieve this level of competence on a global basis. Another way of achieving global product competence is simply to duplicate product management organizations in domestic and international divisions, achieving high competence in both organizational units.
3. ***Functional competence in such fields as finance, production, and especially market-ing***. Corporate functional staff with worldwide responsibility contributes to the development of functional competence on a global basis. In a handful of companies, the appointment of country subsidiary functional managers is reviewed by the corporate functional manager who is responsible .for the development of his or her functional activity in the organization on a global basis.

   What has emerged in a growing number of companies is a dotted-line rela-tionship among corporate, regional, and country staff. The dotted-line relationship ranges from nothing more than advice offered by corporate or regional staff to regional country staff to a much heavier" line relationship in which staff activi-ties of a lower organizational level are directed and approved by higher-level staff. The relationship of staff organizations can become a source of tension and conflict in an organization if top management *does* not create a climate that encourages organizational integration. Headquarters staff wants to extend its control or influence over the activities of lower-level staff.

   For example, in marketing research, unless there is coordination of research design and activity, the international headquarters is unable to compare one market with another. If line management, instead of recognizing the potential contribution of an integrated worldwide staff, wishes to operate as autonomously as possible, the influence of corporate staff is perceived as undesirable. In such a situation, the stronger party wins. This can be avoided if the level of management to which both line and staff report creates a climate and structure that expect and require the cooperation of line and staff and that recognize that each has respon-sibility for important aspects of the management of international markets.
4. ***A knowledge of the customer or industry and its needs***. In certain large and very sophisticated international companies, staff with a responsibility for serving industries on a global basis exists to assist the line managers in the country organizations in their efforts to penetrate specific customer markets.

In the fully developed, large-scale international company, product, function, area, and customer know-how are simulta-neously focused on the organization's worldwide mar-keting objectives. This type of total competence is a matrix organiza-tion. In the matrix organization, the task of management is to achieve an organizational balance that brings together different perspectives and skills to accomplish the organization's objectives. Under this arrangement, instead of designating national organizations or product divi-sions as profit centers, both are responsible for profitability: the national organization for country profits and the product divisions for national and worldwide product profitabil-ity.

This organization chart starts with a bottom section that represents a single-country responsibility level moves to representing the area or international level, and finally moves to representing global responsibility from the product divisions to the corporate staff, to the chief executive at the top of the structure.

The key to successful matrix management is the extent to which managers in the organization are able to resolve conflicts and achieve integration of organization pro-grams and plans. Thus the mere adoption of a matrix design or structure does not create a matrix organization. The matrix organization requires a fundamental change in man-agement behavior, organizational culture, and technical systems. In a matrix, influence is based on technical competence and interpersonal sensitivity, not on formal authority.

In a matrix culture, managers recognize the absolute need to resolve issues and choices at the lowest possible level and do not rely on higher authority.

Relationship Among Structure, Foreign Product Diversification, And Size

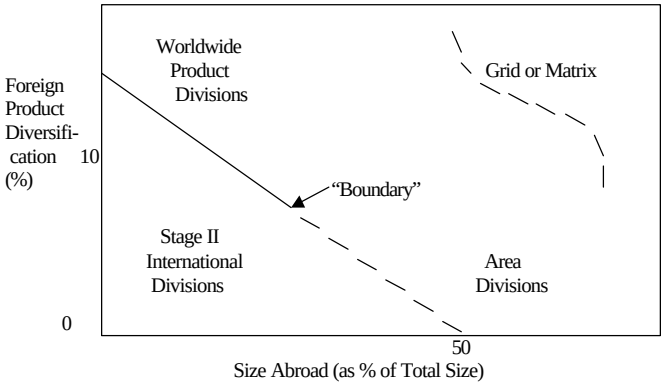
John Stopford and Louis T. Wells, Jr., have hypothesized the relationship among struc-ture, foreign product diversification (defined as sales of a firm outside its major product line expressed as a percentage of the total sales), and size. This formulation posits that when size abroad grows, the emergence of an area division develops so that whenever size abroad is 50 percent of total size or more, several area divisions will probably be adopted. On the other hand, as foreign product diversifica-tion increases, the likelihood that product divisions will operate on a worldwide basis increases. In a company in which there is both worldwide product diversity and large-scale business abroad as a percent-age of total business, foreign operation will tend to move toward the matrix structure. Companies with limited foreign product diversification (under 10 percent) and limited size, as a percentage of total size will utilize the international structure.

Organizational Structure and National Origin

Before 1960, the American multidivisional structure was rarely found outside the United States. This structure was introduced in the United States as early as 1921 by Alfred P Sloan at General Motors. The multidivisional structure in the United States had three distinctive characteristics. First, profit responsibility for operating decisions was assigned' to general managers of self-

contained business units. Second, there was a corporate headquarters that was concerned with strategic planning, appraisal, and the allocation of resources among the business divisions. Third, executives at the corporate headquarters were separated from operations and were psychologically committed to the whole or-ganization rather than the individual businesses. During the 196Os, European enter-prises underwent a period of unprecedented reorganization. Essentially, they adopted the American divisional structure. Today, at the overall level, there is little difference be-tween European and American organizations.

The organizational structure of Japanese and other Asian companies is quite dif-ferent from the U.S. model. Japanese organizations, for example, rely on generalists as opposed to functional specialists and make greater use of project teams to design and manufacture products. They also form much closer relationships with suppliers than do American companies, are in a different relationship to sources of capital: and have a fundamentally different governance structure than U.S. companies. The success of Japan-ese companies has recommended their organizational structure and design for careful evaluation, and many non-Japanese companies have successfully adopted Japanese organizational design features.



The Relationship Among Structure, Foreign Product Diversification, and Size, Abroad (as a % of total size)

Structuring For Global Brands

P. Hankinson and G. Hankinson conclude that the organizational structure necessary for global brands requires a much greater emphasis on integrating and/or "globalizing" the marketing process at a worldwide level as well as promoting and embedding within the corporate culture inter- and intra-organizational cooperation. They identified eight new organizational arrangements to support global brand management:

Global Co-ordinations Groups*:* Similar to discussion groups but with the focus on implementation. They are task oriented and instrumental in the establishment *of* a corporate culture.

Strategic Planning Groups*:* These involve multidisciplinary or cross-functional brand management teams whose purpose is to implement centrally developed policies and strategies with a local focus,

Lead Country Concept*:* Different countries take leadership responsibility for a particular brand or aspect *of* marketing policy. In the case *of* Mars Candy, Snickers is led from Germany, M&Ms from Holland, Twix from France, and Galaxy and Bounty from the United Kingdom.

Global Brand Managers*:* This position is at a high level *of* seniority and functions in the role *of* brand champion.

Starbursts: As new products and services are developed, the entrepreneurial enterprise is spun off from the parent company and is encouraged to grow into a separate subsidiary. An example is Thermo Electron.

Cluster Organizations*:* Individual members may work on different enterprises within the company as and when their particular skills are required. General Electric and Volvo are examples.

Strategic Alliances, Joint Ventures, Mergers and Acquisitions: These structures - form a continuum and collectively are termed *hybrid, inter organizational relationships.* Examples are Hewlett-Packard and Matsushita.

Network Structures*:* Although known in various forms, at the heart *of* each structure is the fundamental principle that a number *of* different organizations, companies, and individuals work together on a common business project.

Implications For Changing Organizational Structure

Based on their research, Hankinson and Hankinson identified the following eight im-plications for management in global companies.

1. Declining profitability and shareholder value are greater motivators *of* change than increasing economic turbulence.
2. A charismatic or transformation style *of* leadership is helpful.
3. Those who implement change need a firm grasp on *all* aspects *of* the business.
4. A correct balance between long-term strategic objectives and short-term atten-tion to shareholder value.
5. "Loose-tight" balance. (The balance *of* power shifts back and forth from the headquarters to the regional offices.)
6. Employees need to learn' to behave differently and a learning culture helps to achieve this.
7. Knowing when the strategic imperative is strong enough to require changes to the organizational structure.
8. A loose organizational structure requires a common understanding of the mea-sures of success.

Gettlng Off The Reorganization Merry-go-round

Bartlett studied 10 U.S.-based multinational corporations (MNCs) that, according to the theory outlined earlier, should have moved from the international division to the world- wide product division, area, or matrix structure but did not. He found that these successful companies avoided the myth of the ideal organizational structure and instead concentrated on building and maintaining a complex decision-making, resource-transfer, and information-sharing process. For example, Coming Glass Works' TV tube marketing strategy required local decision making for service and delivery and global decision making for pricing.

The successful companies, Bartlett found, developed in three stages. The first was to recognize the diversity of the world. In other words, the companies made the transition from ethnocentric and polycentric orientations to a geocentric orientation. The second stage involved building channels of communication between managers in various parts of the organization. An example of a communications channel-building move I might be a world meeting of executives at a conference center where, for the *first* time, executives in the companies' businesses from all over the world get a chance to meet each other and to learn about the business strategies of their counterparts in other coun-tries and businesses.

In the third stage, the company develops norms and values within the organization to support shared decisions and corporate (as opposed to country or product) perspec-tives. The highest value is placed on corporate goals and cooperative effort as opposed to parochial interests and adversarial relationships. Many Japanese companies fit this description perfectly, which is why they have been so successful.

The important task of top management is to eliminate a one-dimensional approach to decisions and encourage the development of multiple management perspectives and an organization that will sense and respond to a complex and fast-changing world. By thinking in terms of changing behavior rather than changing structural design, compa-nies can free themselves from the static nature and limitations of the structural diagram and instead can focus on achieving The best possible results with available resources.

Global Marketing Management Audit

Global marketing presents formidable, problems to managers responsible for marketing control. Each national market is different from every other market. Distance and differences in language, custom, and practices create communications prob-lems. As noted earlier in the chapter, in larger companies, the size of operations and number of country subsidiaries often result in the creation of an intermediate headquarters. This adds an organizational level to the control system. This section reviews global marketing control practices, compares these practices with domestic marketing Control, and identifies the major factors that influence the design of a global control system.

In the managerial literature, control is defined as the process by which managers ensure that resources are used effectively and efficiently in the accomplishment of or-ganizational objectives, Control activities are directed toward marketing programs and other programs and projects initiated by the planning process. Data measures and eval-uations generated by the control process in the form of a global audit are also a major input to the planning process.

The Global Marketing Audit

A global marketing "audit can be defined as a comprehensive, systematic, and periodic examination of a company's or business unit's marketing environment, objectives, strategies, programs, policies, and activities, which is conducted with the objective of identifying existing and potential problems and opportunities and recommending a plan of action to improve a company's marketing performance.

The global marketing audit is a tool for evaluating and improving a company's global marketing operations. The audit is an effort to assess effectiveness and efficiency of marketing strategies, practices, policies, and procedures vis-a-vis the firm's opportu-nities, objectives, and resources.

A full marketing audit has two basic characteristics. The first is that it is formal and systematic. Asking questions at random as they occur to the questioner may bring about useful insights, but this is not a marketing audit. The effectiveness of an audit normally increases to the extent that it involves a sequence of orderly diagnostic steps, as is the case in the conduct of a public accounting audit.

The second characteristic of a marketing audit is that it is conducted annually. Most companies in trouble are well on their way to disaster before the trouble is fully appar-ent. It is, therefore, important that the audit be conducted periodically—even when there are no apparent problems or difficulties inherent in the company's operations.

The audit may be broad or it may be a narrowly focused assessment. A full mar-keting audit is comprehensive. It reviews the company's marketing environment, competition, objectives, strategies, organization, systems, procedures, and practices in every area of the marketing mix including product, pricing, distribution, communications, cus-tomer service, and research strategy and policy.

Audits are either independent or internal. An independent marketing audit is con-ducted by someone who is free from influence of the organization being audited. The independent audit mayor may not be objective: It is quite possible to influence a con-sultant or professional firm that you are paying. The company that wants a truly inde-pendent audit should discuss with the independent auditor the importance of objectivity. A potential limitation of an independent marketing audit is the lack of understanding of the industry by the auditor. In many industries, there is no substitute for experience, because if you do not have it, you are simply not going to see the stable clues that any pro would easily recognize. On the other hand, the independent auditor may see obvi-ous indications that the experienced pro may be unable to see.

An internal or self-audit may be quite valuable because it is conducted by the com-pany's marketing personnel who understand the industry. However, it may lack the ob-jectivity of an independent audit. Because of the strengths and limitations of the two types of audit, we recommend that both be conducted periodically for the same scope and time period, and that the results be compared. The comparison may lead to insights on how to strengthen the performance of the marketing team.

Setting Objectives and Scope of the Audit

The first step of an audit is a meeting between company executives and the auditor to agree on objectives, coverage, depth, data sources, report format, and time period for the audit.

1. **Gathering Data** One of the major tasks in conducting an audit is data collection. A de-tailed plan of interviews, secondary research, review of internal documents, and so forth is required. This effort usually involves an auditing team.

   A basic rule in data collection is not to rely solely on the opinion of people being audited for data. In auditing a sales organization, it is absolutely essential to talk to field sales personnel as well as sales management; and, of course, no audit is complete with-out direct contact with customers and suppliers.

   Creative auditing techniques should be encouraged and explored by the auditing team. For example, if you are auditing an organization and you want to determine whether the chief executive or operating officer of the organization unit is really in touch with the organization and all of its activities, send an auditor into the mailroom. Find out if the chief executive has ever visited the mailroom. If he or she has never been there, it tells you volumes about the management style and the degree of hands-on management in the organization. If an organization has developed an elaborate marketing incentive program that is purported to generate results with customers, an audit should involve customer contact to find out if indeed the program is actually having any impact. For ex- j ample, you can be certain that 99 percent of the material that is associated with frequent flier plans is never read or noted by fliers who have got better things to do with their time than read complicated rules and announcements.

2. **Analyzing the Data** A library is filled with data, but just like the marketing audit, unless that data is properly analyzed it is useless. In fact, many companies assume that just gathering data is sufficient to the process ("Hey-look at this 100-page report did) or that the more data the better. Despite the abundance of information available about the mar-keting environment, this abundance does not directly provide value in making decisions.

   When a marketing audit involves international markets, the data should be analyzed by both local employees who are familiar with the specific implications of the data and also by headquarters staff who are aware of corporate strategic issues and similar experiences in other countries.

3. **Preparing and Presenting the Report** After data collection and analysis, the next step is the preparation and presentation of the audit report. This presentation should restate the objectives and scope of the audit, present the main findings, and present major recom-mendations and conclusions as well as major headings for further study and investigation.

Components of the Marketing Audit

There are six major components of a full global marketing audit:

1. Marketing environment audit
2. Marketing strategy audit
3. Marketing organization audit
4. Marketing systems audit
5. Marketing productivity audit
6. Marketing function audit

Problems, Pitfalls, and Potential of the Global Marketing Audit

The marketing audit presents a number of problems and pitfalls. Setting objectives can be a pitfall, if indeed the objectives are blind to a major problem. It is important for the auditor to be open to expand or shift objectives and priorities while in the conduct of the audit itself.

Similarly, new data sources may appear during the course of an audit, and the au-ditor should be open to such sources. The approach of the auditor should simultaneously be systematic, following a predetermined outline, and perceptive and open to new di-rections and sources that appear in the course of the audit investigation.

4. **Report Presentation** One of the biggest problems in marketing auditing is that the ex-ecutive who commissions the audit may have higher expectations about what the audit will do for the company than the actual results seem to offer. An audit is valuable even if it does not offer major new directions or panaceas. It is important for all concerned to recognize that improvements at the margin are what truly make a difference between success and mediocrity. In major league baseball, the difference between a batter with a .350 batting average (3.5 hits out of 10 times at bat) and a .250 (2.5 hits out of 10 times at bat) is the difference between a major league hitter and someone who is not even good enough for the minor leagues. Major league marketers understand this fact and recog-nize it in the audit. Do not look for dramatic revolutionary findings or panaceas. Accept and recognize that improvement at the margin is the winner's game in global marketing.

   Global marketers, even more than their domestic counterparts, need marketing audits to assess far-flung efforts in highway diverse environments. The global marketing audit should be at the top of the list of programs for strategic excellence and implementation excellence for the winning global company.

Planning and control are intertwined and interdependent. With the information from the global marketing audit, the planning process can begin and result in a more ef-fective document. The planning process can be divided into two related phases. Strategic planning is the selection of opportunities defined in terms of products and markets, and the commitment of resources, both human and financial, to achieve these objectives. Operational planning is the process in which strategic market objectives and resource commitments to these objectives are translated into specific projects and programs. The relationship among strategic planning, operational planning, and control is illustrated in Figure 17-11.

For companies with global operations, marketing control presents additional chal-lenges. The rate of environmental change in a global company is a dimension of each of the national markets in which it operates. At the beginning of this book, we examined these environments; each is changing at a

different rate, and each exhibits unique char-acteristics. The multiplicity of national environments challenges the global marketing control system with much greater environmental heterogeneity and, therefore, greater complexity in its control. Finally, global marketing can create special communications problems associated with the great distance between markets and headquarters and dif-ferences among managers in" languages, customs, and practices.

When company management decides that it wants to develop a global strategy, it is essential that control of the subsidiary operations of the company shifts from the sub-sidiary to the headquarters. The subsidiary will continue to make vital inputs into the strategic planning process, but the control of the strategy must shift from subsidiary to headquarters. This involves a shift in the balance of power in the organization and may result in strong resistance to change. In many companies, a tradition of subsidiary auton-omy and self-sufficiency limits the influence of headquarters. Three types of mechanisms are available to help headquarters acquire control: (1) data management mechanisms,

(2) Managers' management mechanisms that shift the perception of self-interest from subsidiary autonomy to global business performance, and (3) conflict resolution mecha-nisms that resolve conflicts triggered by necessary trade-offs.

Planning and Budgeting

Planning and budgeting are two basic tools of monitoring the global marketing effort. Planning involves expressing planned sales, profit objectives, and expenditures on mar-keting programs in unit and money terms and these are translated into a budget. The budget spells out the financial objectives and necessary expenditures to achieve these objectives. Monitoring consists of measuring actual sales and expenditures. In the case of no variance or a favorable variance between actual and budget, no action is usually taken. An unfavorable variance-lower unit sales than planned, for example-acts as a red flag that attracts the attention of line and staff executives at regional and interna-tional headquarters. They will investigate and attempt to determine the cause of the un-favorable variance and what might be done to improve performance.

Evaluating Performance

In evaluating performance, actual performance is compared with budgeted perfor-mance, as described in the previous section. Thus, the key question is, "How is the budget established?" Most companies in both domestic and global operations place heavy re-liance on two standards: last year's actual performance and some kind of industry av-erage or historical norm. A more normative approach is for headquarters to develop an estimate of the kind of growth that would be desirable and attainable in each national market. This estimate can be based on company studies of national markets.

Larger companies may have sufficient business volume to justify staff product spe-cialists at corporate headquarters who follow the performance of products worldwide. They have staff responsibility for their product from its introduction to its termination. Normally, new product is first introduced in the largest and most sophisticated markets and then sequentially introduced in smaller and less developed markets. As a result, the company's products are typically at different stages of the product life cycle in different markets. A major responsibility of staff specialists is to ensure that lessons learned in more advanced markets are applied to the management of their products in smaller, less developed markets. Wherever possible, the specialists try to avoid making the same mis-take twice, and they try to capitalize on what they have learned and apply it elsewhere. They also ensure that useful ideas from markets at similar stages of development are fully applied. Smaller companies focus on key products in key markets. Key products are those that are important to the company's sales, profit objectives, and competitive position. They are frequently new products that require close attention in their introductory stage in a market. If any budget variances develop with a key product, headquarters intervenes directly to learn about the nature of the problem and to assist local management in dealing with the problem.

Influences On Marketing Plans and Budgets

In preparing a budget or plan, the following factors are important.

Market Potential

How large is the potential market for the product being planned? In every domestic market, management must address this question in formulating a product plan. A com-pany that introduces a product in more than one national market must answer this ques-tion for each market.

Competition

A marketing plan or budget must be prepared in light of the competitive level in the market. The more entrenched the competition, the more difficult it is to achieve market share and the more likely a competitive reaction will occur to any move that promises significant success in the target market. Competitive moves are particularly important as a variable in international market planning because many companies are moving from strong competitive positions in their base markets to foreign markets in which they have a minor position and must compete against entrenched companies. Domestic market standards and expectations of marketing performance are based on experience in mar-kets in which the company has a major position. These standards and expectations are simply not relevant to a market in which the company is in a minor position trying to break into the market.

Impact of Substitute Products

One of the sources of competition for a product in a market is the frequent existence of substitute products. As a product is moved into markets at different stages of develop-ment, improbable substitute products often emerge. For example, in Colombia, a major source of competition for manufactured boxes and other packaging products is woven bags and wood boxes made in the handicraft sector of the economy. Marketing officials of multinational companies in the packaging industry in Columbia report that the garage operator producing a handmade product is very difficult competition because of low costs of materials and labor.

Process

The manner in which targets are communicated to subsidiary management is as impor-tant as the way in which they are derived. One of the most sophisticated methods used today is the so-called indicative planning method. Headquarters' estimates of regional I potential are disaggregated and communicated to subsidiary management as guidance. The subsidiaries are in no way bound by guidance. They are expected to produce their own plan, taking into account the headquarters guidance that is based on global data and their own data from the market, including a detailed review of customers, competitors, and other relevant market developments. This method produces excellent results because it combines a global perspective and estimate with specific country marketing plans that are developed from the objective to the program by the country management j teams themselves.

Headquarters, in providing guidance, -does not need to understand a market in depth. For example, it is not necessary that the headquarters of a manufacturer of electrical products know how to sell electric motors to a French buyer. What headquarters can do is gather data on the expected expansion in generating capacity in France and use experience tables drawn from world studies that indicate what each megawatt of additional generating capacity will mean in terms of the growth in demand in France for electrical motors. The estimate of total market potential together with information on the competitiveness of the French subsidiary can be the basis for guidance in terms of expected sales and earnings in France. The guidance may not be accepted by the French subsidiary. If the indicative planning method is used properly, the subsidiary educates the headquarters if its guidance is unrealistic. If headquarters does a good job, it will select an attainable but ambitious target. If the subsidiary does not see how it can achieve the headquarters goal, discussion and headquarters involvement in the planning process, will either lead to a plan that will achieve the guidance objective or it will result in are vision of the guidance by headquarters.

Share of Market

Another principal measure of marketing performance is share of market. This is a valu-able measure because it provides a comparison of company performance with that of other competitors in the market. Companies that do not obtain this measure, even if it is an estimate, are flying blind. In larger markets, data are reported for subsidiaries and, where significant sales are involved, on a product-by-product basis. Share-of-market data in larger markets are often obtained *from* independent market audit groups. In smaller markets, share-of-market data are often not available because the market is not large enough to justify the development of an independent commercial marketing audit ser-vice. In smaller markets, it is possible for a country manager or agent to hide a deterio-rating market position or share of market behind absolute gains in sales and earnings.

Informal Control Methods

In addition to budgeting, informal control methods play an important role. The main in-formal control method is the transfer of people from one market to another. When people are transferred, they take with them their experience in previous markets, which I will normally include, some standards for marketing performance. When investigating a new market that has lower standards than a previous market, the investigation will lead to revised standards or to discovery of why there is a difference. Another valuable in-formal control device is face-to-face contact between subsidiary staff and headquarters staff as well as contact among subsidiary staff. These contacts provide an opportunity for an exchange of information and judgment that can be a valuable input to the plan-.

LESSON 41:
THE FUTURE OF GLOBAL MARKETING

We describe our emerging culture by an awkward but descriptive name: "boundary less." It is the soul of our integrated diversity and at the heart of everything we do well. It is the small-company culture we've been after for all these years.

E-business is the final nail in the coffin for bureaucracy at GE. The utter transparency it brings about is a perfect fit for our boundary less culture and means everyone in the organization has total access to everything worth knowing.

-JOHN F. WELCH, JR.

Chairman of the Board and Chief Executive

Officer, General Electric Company

The world economy has undergone revolutionary changes during the past 50 years. Perhaps the greatest and most profound change is the emergence of global markets, global competitors, and winners and losers in global competition.

Six Major Changes

The changes continue. Six major changes that will continue well into this century are listed next.

1. **World growth.** Many of the poor countries of the world, which have always been poor, are getting richer faster than the rich countries of the world, which are also getting richer. Most of the world is in a stage of economic growth. The geographic exception to this world growth Is Africa south of the Sahara where many countries are economically stagnant or in economic decline.
2. **The world economy dominates**. The world economy is the dominant economic unit. The macroeconomics of the nation-state no longer control economic outcomes in countries, and even the large superpower countries such as the United States can no longer dictate to poorer countries how they should behave.
3. **End of the so-called trade-cycle decision rule**. The old trade-cycle model, which implied to a generation of managers that as a product matures, the location of production must shift to low-wage countries, has been clarified. The location of production is not dictated exclusively by wage levels. Wages are simply one ele-ment of the cost equation. For any product in which labor is less than, say, 15 per-cent to 20 percent of total costs, the location of production of mature products may be anywhere in the world. Factors such as transportation costs, availability of skilled labor, market responsiveness, and market access and high levels of innovation in product design and manufacturability may all indicate that the best location for production is a high-income, high-wage country.
4. **Free markets rule the world**. The 75-year "contest" between capitalism and com-munism is over. The clear success of the capitalist market-driven system over the communist centrally controlled model has led to the collapse of communism as a model for the organization of economic- activity and as an ideology. Markets are in control of the allocation of resources all over the world with the exception of the two autocratic national anachronisms, Cuba and North Korea.
5. **Accelerating growth of global markets**. Global markets will grow at rates that were one thought impossible. The engine behind this accelerating growth is the high rate of growth in both the high- and low-income countries. The high- income county growth leadership has shifted from Japan to the United States. Low- and lower-middle-income country growth leadership has been concen-trated in Southeast Asia and' southern Asia with China as a unique, high-growth, large country in the region and the world, and Singapore, Taiwan, and South Korea at the vanguard of the small countries in the region. The driving forces of this growth are technology, deregulation, global integration, and the triumph of marketing.
6. The rise of the Internet and information technology. As Jack Welch, CEO of GE suggests in the quotation at the beginning of this chapter, e-business is revolutionizing the way the world does business. We are now seeing the payoff for the huge investments in information technology over the past two decades. These investments are transforming the strategy and structure of every com-pany in the world.

World Growth

The first change is that most of the world's poor Countries are getting richer. The emergence of the newly rich countries from among the ranks of the formerly less developed group breaks the long monopoly of Western Europe, the United States, Canada, and Japan on the rich-nation status. These countries are proving that it is not necessary to be European, North Ameri-can (north of the Rio Grande), or Japanese to be rich. Countries such as Singapore and Hong Kong are already high-income countries; eastern Asia in par-ticular is home to many countries that have been growing at annual rates of 7 percent or higher. A 7 percent real growth rate will double real income in a decade. The emerging rich countries include smaller countries such as South Korea as well as the largest coun-tries in the world, China and India, which have begun to develop a middle class.

The exception to this growth in the emerging markets is Africa south of the Sahara, where the promise of economic progress has been set back by incompetent leadership and fundamentally by widespread ignorance, poverty, and disease. With the exception of South Africa, the economic progress in Africa south of the Sahara has been disap-pointing and discouraging.

Nevertheless, with the exception of Africa, for the first time in the history of the world, there is the very real likelihood of a much broader global prosperity in the first half of this century.

The population within the developed economies of the world is continuing to gray (see Table 1). The change from 1995 to the year 2050 will be quite dramatic. In 1995 nine countries had between 14.0 and 17.5 percent of their populations over the age of 65. In 2050 in the six countries of Spain, Hong Kong, Italy, Greece, Japan, and Germany, 30.0 percent or more of their populations will be over the age of 65. What impact will this graying shift have on marketing? Certainly, it will impact medical markets, but not all opportunities will be in medicines and adult diapers. The older populations are living more active, healthier lives and will be a major market for goods and services across a broad spectrum of consumer products.

Hand in hand with older populations, the birthrate in the high-income countries is collapsing. In fact, Peter Drucker claims that this is the most important, single, new cer-tainty for the future of business.2 In Japan and many European countries, the number of births has dropped to below population equilibrium level. The combination of low birthrates and wealth will drive a continuation of the global movement of people from poor, undeveloped countries to the rich, developed countries.

The World Economy Dominates

The second major change is the emergence of the world economy as the dominant eco-nomic unit. Companies and countries that recognize this fact have the greatest chance of success. The United States is still a superpower, but it is no longer in a position to tell other successful nations how to behave in matters of internal affairs. As the poor countries grow richer, they assume that their values are responsible for their success, and they do not listen to lectures from their less successful former world leaders. Indeed, they start giving the lectures. Wealth creates the foundation for political and military power and the basis for an assumption of moral superiority. The attitude of politicians and businesspeople

Table 1

	1995(% of total)		2050(Prj.) (%of total)
Sweden	17.5	Spain	34.6
Norway	16.0	Hong Kong	34.5
Germany	16.0	Italy	34.3
United Kingdom	15.7	Greece	31.4
Switzerland	15.7	Japan	30.2
Belgium	15.7	Germany	30.0
Denmark	15.4	Austria	26.4
Greece	15.2	Slovenia	26.3
France	15.1	Portugal	25.9
Austria	15.0	Netherlands	25.6
Japan	14.0	Switzerland	25.3
United States	12.7	Belgium	24.8

from rich countries and from countries that are successfully developing is that if we are rich or fast growing, we must be doing something right. The United States has long lec-tured the world from the pulpit of its economic success, and Southeast Asia was quick to join in with lectures on Asian values when it was growing at 7 percent plus per annum.

The "Asian Flu" that began in 1997 and continued into 1998 (the sudden collapse of currency values, employment, and economic output and the realization that many of the companies of the region were insolvent because of their dollar-denominated debt), which infected Southeast Asia, did not impact only the economic well-being of countries in Asia. It clearly threatened the growth rate and economic well being of the rest; of the world, including the high-income countries. It also underlined the vulnerability of smaller countries to currency fluctuations and capital outflows and the urgent need for economic and political reform at the national, regional, and global levels. Most of the countries that were hit by the Asian Flu in 1997 to 1998 have resumed economic growth. In Indonesia, the crisis led to the emergence of a popular movement for more democratic expression and a move from the autocratic rule of the Suharto regime to and elected head of state.

Trade - Cycle Model Clarified

The trade-cycle model, which suggested to many managers that as a product matures, its production location would shift to lower-income countries, has been clarified. In the early 21st century, it is clear that product maturity is a concept that must be carefully defined in a dynamic world. The automobile is a mature product in -the sense that growth has leveled in all of the high-income countries of the world. Does this mean that it is stan-dardized? Far from it, the automobile is a highly differentiated, incredibly complicated, increasingly sophisticated, high-value product, and the way cars are designed and manufactured has been revolutionized. The result is that automobiles continue to be designed manufactured, and assembled in high-income countries. The reason is simple: Labor is a factor in the production cost of an automobile, but as a percentage of total cost, it is not high enough to determine the location of all automobile production. Automobiles today are produced in countries at every stage of development, but 98 percent of world pro-duction is from high- and upper-middle-income countries.

In the 1980s, the Swiss banks concluded that Switzerland was finished in the low end of the watch business. One man, Nicolas Hayek, disagreed. He formed the company Swatch and demonstrated that in spite of the high wage costs in Switzerland, the co entry could compete in world watch markets not only in the luxury watch segment but also in the low-priced segment of fashion accessory watches. The Swiss understand the watch business, and they have been creative innovators in the design, manufacturability, and marketing of watches. All luxury watches; which account for a small percentage of volume in units but more than half of the value of world watch production, are made in Europe, and over 95 percent of European luxury watch production is in Switzerland.

In the meantime, there are mature products that have become relatively standardized in their manufacture and continue to require a relatively high percentage of labor to produce. These products today are made almost exclusively in lower-income countries. A good example of a product in this mature category is athletic footwear. The entire industry has shifted its production to low-income countries, and no company has been able to reverse this trend. This has offered employment opportunity for the lower-income countries and a challenge for the higher-income countries to shift labor to other industries in which the

cost of labor is not such a significant factor in the production lo-cation decision.

Changes in global competition are bringing companies into more direct competi-tion with economic rivals in other parts of the world than was the case in the past. Yesterday's global f9rces were founded on exports of products and services not available to competing nations. In the past, countries would export agricultural products others could not grow, raw materials others did not have, and high-tech products others could not build. Today, companies in the same industries in different countries and regions compete ferociously with each other in manufactured goods, agricultural products, nat-ural resources, and services.

Is Competitiveness A Dangerous Obsession?

Stanford University economist Paul Krugman wants every student of international trade to reflect carefully on the following proposition:

Today, America is part of a truly global economy. To maintain our standard of living, America must learn t9 compete in an ever tougher world marketplace. That's why high productivity and product quality have become essential. We can only be competitive in the new global economy if we forge a new partnership between government and business.

To many, this proposition will sound reasonable. In style and substance, it echoes assertions being made in the 19905 by such well-known figures as economist Lester Thurow, presidential advisor Ira Magaziner, and U.S. Sec-retary of Labor Robert Reich. KruglJ1an, however, says that the proposition is "baloney." In his words, it repre-sents "the rhetoric of competitiveness," in which the United States is likened to a large corporation such as General Motors (GM). According to the rhetoric of com-petitiveness, America-like GM-is suffering because of global competition, and the nation's standard of living has stagnated as a result.

In numerous articles and a recent book, Krugman offers a painstaking analysis of what he believes to be a mistakenly held proposition. In sorting out the salient issues, Krugman's reasoning flies in the face of positions held by Thurow, Magaziner, Reich, and others; Krugman calls these individuals strategic traders and-policy entre-preneurs. Surprisingly, Krugman's critiques are not based on partisan politics; he himself is a liberal. His complaint is that fundamental economic concepts—especially comparative advantage-are being misinterpreted, misap-plied, or ignored altogether in the name of public policy.

First, Krugman disputes the assertion that America is "part of a truly global economy." The reason: Approx-imately 90 percent of the 'goods and services produced in the United States are for domestic consumption; only 10 percent are destined for world markets. Indeed, 70 per-cent of the U.S. economy is based on services, and services are less likely than manufactured products to be marketed abroad. Thus, despite all the talk about global integration, the global economy is not as interconnected as people might think.

Next, Krugman attacks the notion that America itself "competes in the global marketplace." Krugman argues that Japan, the United States, and other nations of the world are not in competition with each other in the sense that, say, Coca-Cola and PepsiCo or Reebok and Nike are. Few Coca-Cola employees buy Pepsi products, and vice versa. Thus, a company is not like a nation: No company sells 90 percent of its output to its own em-ployees. In the "cola wars," PepsiCo can only win by taking customers away from Coca-Cola. The same can-not be said of nations, Krugman asserts. The world's major industrial nations can be successful without caus-ing harm to each other because they are not just com-petitors; trading partners also represent export markets and sources of imports. In other words, every potential problem also presents opportunities, and those opportu-nities may outweigh the problems.

Third, Krugman objects to linking the issue of higher U.S. productivity with international trade. Contrary to the message coming out of Washington; the fact that produc-tivity improvement rates in other nations exceed those in the United States does not make the United States less competitive or lessen Americans' standard of living. Krugman asserts quite simply that America needs to be productive to produce more. That may sound tautologi-cal, but it is a plain and simple economic truth that would be valid even if the United States did not engage in in-ternational trade. In his writings, Krugman reviews the basics of comparative advantage to demonstrate that, in fact, no special problems are created for a country that is less productive than its trading partners.

Finally, Krugman argues that the issues relating to the rhetoric of competitiveness are not simply academic ones. If the strategic traders' rhetoric of Competitiveness message is heeded, the results could have far-reaching, undesirable consequences. First, it could lead to wasteful government spending in a misguided effort to enhance competitiveness. In the interest of competitiveness, gov-ernment support might be directed at manufacturing. Yet it is the service sector, which is not a major part of inter-national trade, where productivity is lagging. Second, it could lead to protectionism and trade wars. Finally, it could lead to poor public policy decisions in a variety of areas -health care, for "example-that are unrelated to trade.

The Triumph of Markets

After almost a century of debate in the world about the merits of markets and market-ing versus a state-controlled system of allocating resources and controlling production, the capitalist/ marketing model has clearly won. Markets are king the world around, with the exception of Cuba and North Korea. The big issue today is whether economic I democracy (the market allocation of resources, one dollar, yen, or rupiah /one vote) must be combined with political democracy. This debate will continue. What is no longer de-bated is the global emergence of the acceptance of markets and marketing.

The Rise of Global Markets

The fifth trend that will change the future of global marketing is the rise of global market segments. Today more than ever before, there are global segment opportunities. In cat-egory after category, global efforts succeed. For example, the soft-drink industry was first successful in reaching a global cola segment and has now moved to address the fast- growing fruit-and-flavor segment.

There are global segments for luxury cars, wine and spirits, every type of medical and industrial product, teenagers, senior citizens, and enthusiasts of every stripe and type, from scuba divers to snowboarders.

The rapidly growing diffusion of Internet access combined with the rapidly ex-panding bandwidth and capacity of the global Internet itself will playa major role in supporting the growth of global markets and global marketing. Amazon.com can reach customers in Taiwan and Tokyo just as easily as it can reach

customers in Boston. Cus-tomers anywhere in the world are only a click away from the book of their choice. With express mail service, customers are only two days away from delivery wherever they live, and with credit cards they can pay for goods and services in any currency.

These are the new economic realities. The rich are getting richer, the poor in many countries are getting richer faster, and the world economy is becoming more and more in-tegrated. This means new opportunities and new challenges for companies and countries.

What is the future for the average ‘consumer? The possibilities are unlimited. How about high-tech “pets” to care for the elderly? Matsushita Electric has developed “pets,” which record the number of times their owners talk to them or hold them. This infor-mation is transmitted to an agency that monitors these elderly. The pet “can respond to a greeting, engage in simple conversation and even express remorse when scolded. In every field, from medicine and health care to transportation to information technology to entertainment to retailing, there will continue to be revolutionary changes.

The Rise of the Internet and Information Technology

The sixth and perhaps the most significant of all of the changes impacting global mar-keting is the rise of the Internet and information technology (IT). Marketing, for the first time in history, can address the individual customer. Before the Internet, the small-est marketing segment was a group or cluster of customers with similar needs. Today, marketing has the tools to address the segment of one, the individual customer and his or her needs.

This capability is available to address markets from local to global. In addition, com-panies can for the first time really focus on the customer. Today, small companies can act like large companies, and large, giant companies can act like small companies. This is energizing every sector of the global economy, especially in the high-income countries that have the resources to invest in IT. In addition to e-commerce, the Internet revolu-tion is creating a new medium for information, entertainment, communication, and ad-vertising and a new e-commerce retail segment.

Careers in Global Marketing

There has never been a better time to prepare for a career in global marketing. Now that you are completing this book, the author would like to offer a few suggestions on how to jump-start your global marketing career.

First, remember that times have changed. Until very recently, one sure way to put your career at risk in many companies (especially U.S. companies) was to go overseas. There was nothing wrong with being overseas per se, but the problem for careers was that management did not recognize the value of global experience and turned to exec-utives who were close at hand when making promotions. “Out of sight, out of mind” seemed to be the operative phrase.

Today, this is changing. Global experience counts. Only the truly lost do not recog-nize that we are in a global market with global competition, and those with global ex-perience have a definite advantage. Top U.S. executives with international experience include Samir F. Gibara, president and chief executive officer (CEO) of Goodyear Tire & Rubber; Michael Hawley, president and chief operating officer (COO) of Gillette; Harry Bowman, chairman, president, and CEO of Outboard Marine; Lucio A. Noto, chairman and CEO of Mobil; and Raymond G. Viault, vice chairman of General Mills. 4 According to Cendant International, the most frequent locations for international em-ployees are the United States, United Kingdom, Mexico, Canada, Singapore, Saudi Arabia, Germany, France, China, and Japans

Ray Viault was a vice president of General Foods in charge of the Maxwell House Coffee Division. When Philip Morris acquired General Foods, it kept Viault on as pres-ident of the Maxwell House division. Later, when Philip Morris acquired Jacob Suchard, the Zurich-based chocolate and coffee company, it chose Viault as the new CEO of the acquired company Viault was able to take his grounding in the U.S. coffee market to Europe and did an outstanding job of leading the global marketing effort of Jacob Suchard. Following this assignment, Viault returned to the United States to become a vice chair-man of General Mills.

How do you establish a career in global marketing? There are two broad paths:

1. Go directly into a job outside your home country or into a headquarters job in a global company.
2. Get experience with a company in an industry that prepares you for promotion to a job with multi-country responsibility or to an assignment outside your home country.

For many the second choice is better than the first. There is no substitute for solid experience in a company in an industry. Your best opportunity to get solid experience may be in your home country. You speak the language, understand the culture, and are trained in business and marketing. You are ready to learn.

Another option is to get this basic experience in a different country. The advantage of this move is that you will learn a new culture and language and broaden your inter-national experience while you learn about a company and industry.

Summary

The future of global marketing will reflect five major changes in world growth but with some major new directions. The growth of Southeast Asia has been interrupted. That region now offers exceptional risk and reward equations for global markets that are willing to make a bet on the long-t6rm potential of the region. The cost of market entry has dropped as dramatically as the decline in values of national currencies. For compa-nies with a stomach for risk, there is an opportunity to invest, building market positions in countries that most experts believe will soon return to long-term growth. In the mean-time, other world regions will continue to grow, and world wealth will become more evenly distributed.

The trade cycle has not eliminated manufacturing as a source of employment and income in the high-income countries. By investing in capital equipment and by design-ing products for manufacturability, rich countries have proven that they can continue to successfully compete as manufacturing locations.

Global markets will continue to grow in importance as global marketers continue their quest to identify and serve global segments. This growth will enhance and expand the value of global experience for managers and executives worldwide.

Finally, marketing is at the threshold of a new and exciting era: e-business, e-commerce, and e marketing, for the first time in history, marketers have the tools to address the needs of the individual customer.

Discussion Questions

1. Do you believe that economic democracy (free markets) will inevitably lead to political democracy? Why? Why not?

2. Why did markets and marketing win out in the competition with communism?

3. Is the trade cycle relevant to companies today? Why? Why not?

4. How has the Internet changed marketing?

CASE STUDY
PARKER PEN CO. (A)

International Marketing Strategy Review

"It is circumstance and proper timing that give an action its character and make it either good or bad."

Agesilaus

Introduction

The meeting at sunny Palm Beach concluded with nary a whimper of dissent from its participants. After years of being' run as a completely decentralized company whose managers in all corners of the world enjoyed a high degree of flexibility, Parker Pen Co., of Janesville, Wisconsin, was forced to reexamine itself. The company had enjoyed decade after decade of success until the early 1980s. By this time, Parker faced strong competitive threats and a deteri-orating internal situation. A new management team was brought in from outside the company-an unprecedented step for what had been until then an essentially family-run business. At the March 1984 Palm Beach meeting, this new group of decision makers would outline a course of action that would hopefully set Parker back on a path to success.

The men behind the new strategy were supremely confident of its chances for success-and with good reason. Each was recognized as a highly skilled practitioner of imitational business and their combined extensive experience gave them an air of invincibility. They had been recruited from larger companies had left high paying, re-, warding jobs, and each had come to Janesville with a grand ': sense of purpose. For decades, Parker had been a domi-nant player in the pen industry. In the early 19805, how- ever, the company had seen its market share dwindle to a mere 6 percent and, in 1982, net income plunged a whop-ping 60 percent.

To reverse this decline, Parker recruited James Peterson, an executive vice president at R. J. Reynolds, as the new president and CEO. Peterson hired Manville Smith as president of the writing instruments group at Parker. Smith, who was born in Ecuador and had a broad international background, came from 3M where he had been appointed division president at the tender age of 30. Richard Swart was vice president/marketing of the writing instruments group. He spent 11 years at the advertising agency BBDO and was an expert on marketing planning and theory. Jack Marks was head of writing instruments advertising. Marks came to Parker from Gillette, where, among other things, he assisted in the worldwide marketing of Paper Mate pens. Rounding out the team was Carlos Del Nero, manager of global marketing planning, who brought with him considerable international experience at Fisher-Price. Each of these men was convinced that Parker would right itself by following the plan they unveiled at Palm Beach.

A Brief History of Parker Pen

The Rolls Royce" of the Pen Industry

The Parker name has been identified with pens since 1888 when George S. Parker delighted ink-splotched pen users everywhere by introducing a leak proof- fountain model called the Parker Lucky Curve. Parker Pen would eventu-ally blossom into America's, if not the worlds, largest and best-known pen maker. Parker's products, which would eventually include ballpoint pens, felt-tip pens, desk sets, mechanical pencils, inks, leads, erasers, and, of course, the fountain pen, were also known for their high price tags. In 1921, for example, Parker introduced the Duo fold pen. The Duo fold, even though it was comparable to other $3 pens on the market, was extravagantly priced at $7. Parker was able to charge a premium price because of its reputation for quality and style, and its skill in positioning products in the top p rice segment.

Parker's position as America's leading pen maker was solidified during the years when the pen was mainly viewed as a gift item. High school and college graduates in the 19405 and 19505, for example, were quite likely to receive a Parker "51" fountain pen (priced at $1250) commemorating their achievement. Indeed, it was with a "51" that Gen-eral Douglas Mac Arthur signed the Japanese Peace Treaty in 1945. Parker's stylish products and high' profile name would keep it at the top of the pen market until the late sixties when American competitors A. T. Cross and Shaffer, as well as a few foreign brands, knocked them out of first place once and for all.

Of course, Parker would not have lost its hold on the market had it not made some oversights along the way. In addition to a more competitive environment, Parker failed to come to terms with a fundamental change in the pen market-the development of the disposable, ballpoint market. When Parker unveiled the $25 "75" pen in 1963, it showed that it remained committed to supplying high-priced pens to the upper end of the market. As the 1960s wore on, a clear trend toward cheap ballpoint and soft-tip pens developed. Meanwhile, Parker's only ultimately suc-cessful addition to its product range in the late sixties was the "75" Classic line, yet another high-priced pen.

A Brief Flirtation with Low-Priced Pens

Parker did, however, make an effort to compete in the lower price segment of the market in the late 19605 only to see it fail. In an attempt to capitalize on the trend toward inexpensive pens, Parker introduced the T-Ball Jotter, priced at $1.98. The success of the Jotter led it to move even further down the price ladder when it acquired Ever sharp. Whereas the Jotter had given Parker reason to believe it could make the shift from pricey pens to cheap pens with little or no difficulty, the Ever sharp experience proved to be different. George Parker, a grandnephew of the company's founder and president of Parker at the time, stated the rea-sons for the Ever sharp failure, as well as its consequences:

All the market research surveys said go lower, go lower, and go lower, that's where the business is. So I said, 'Go lower? Fine. But we don't know how.' We bought Ever sharp and tried to run it ourselves, and we couldn't do it. Our people just couldn't think in terms of big units, and they didn't know how to sell people on the lower-priced end of the business-grocers, supermar-kets, and rack jobbers. The result was, Bic and Paper Mate were cleaning up in the lower-priced end, cross in the high, and Parker was getting squeezed in the middle. Volume was going up, but our costs went up faster, and our profits were squeezed.

The 1970s: The Illusion Of Success

Despite the difficulties Parker encountered when it left its niche in the upper end of the pen market, the company ex-perienced a healthy period of growth and profitability for most of the 19705. Demand for its products remained strong, and its worldwide markets expanded significantly due to a rise in consumer income and increasing literacy rates in much of the Third World. Parker also chose to di-versify during this decade, and its most noteworthy acqui-sition, Manpower, Inc., proved to be a very strong asset. In 1975, when it acquired Manpower, a temporary-help firm, Parker was the slightly more profitable of the two. With the boom in temporary services in the late seventies and early eighties, however, Manpower eclipsed Parker in sales and earnings and eventually subsidized its parent company during down periods.

Why did Parker fall from its position of leadership in the writing instrument market? There were many reasons, and one of the most important was the weakening of the U.S. dollars. At its peak, Parker accounted for half of all U.S. exports of writing instruments and 80 percent of its total sales came from 154 foreign countries. Parker was es-pecially strong in Europe, most particularly in the United Kingdom. When sales in the strong European currencies were translated into dollars, Parker earned huge profits.

The downside of a weak dollar, however, was that it gave Parker the illusion that it was a well-run company. In fact, throughout the 19705, Parker was a model of inefficiency; Manufacturing facilities were dated and inefficient. Production was so erratic that the marketing department often had no idea what type of pens they would be selling from year to year or even month to month. Under the lead-ership of George Parker, nothing was done by company headquarters to update these facilities or to develop new products. As a result, subsidiaries and distributors around the world saw fit to develop their own products. By the end of George Parker's reign, the company's product line in-cluded 500 writing instruments.

That distant subsidiaries would have the leeway to make such decisions was not at all unusual at Parker, for it had long been known as One of the most globally de-centralized companies in the world. Decentralization, in fact, was something that Parker took pride in and consid-ered to be vital to its success as a multinational. Yet it was this very concept that Peterson and his new management team would hold to be responsible for much of what ailed Parker Pen.

Parker's Global Operations Before Peterson

In addition to having a hand in manufacturing and product line decisions, Parker's subsidiaries developed their own marketing strategies. More than 40 different advertising agencies promoted Parker pens in all the comers of the globe. When Peterson came to Parker, he was proudly in-formed that the company was a "federation" of autonomous geographical units. The downside to the "federation" con-cept, Peterson thought, was that home country management often lacked the information needed to make and coordi-nate basic business decisions. Control was so com-pletely de-centralized that Parker didn't even know how many pens it was selling by the time Peterson and his group arrived.

On the other hand, decentralization obviously had its positive aspects, most noticeably in the field of advertising. Pens mean different things to different people. Whereas Eu-ropeans are more likely to choose a pen based on its style and feel, a consumer from a lesser-developed country in the seventies viewed the pen as nothing less than a badge of lit-eracy. In addition, tastes varied widely from country to coun-try. The French, for example, remained attached to the fountain pen. Scandinavians, for their part, showed a marked preference for the ballpoint. The logic behind having so many different advertising agencies was that, even if it ap-peared to be some-what inefficient, in the end the company was better off from a sales standpoint.

Some of the individual advertising agencies were able to devise excellent, imaginative campaigns that struck a re-sponsive chord among their local audiences. One example was the Lowe Howard-Spink agency in London. The Parker UK division became the company's most prof-itable during the tenure of the Lowe agency. An example of its creativity is an ad entitled "Rediscover the lost art of the insult." Gracing the ad is a picture of a dead plumber, on his back, with a giant Parker pen protruding from his heart. Part of the text is as follows:

Do you know plumbers who never turn up?

Hairdressers who missed their vocations as butchers?

Drycleaners who make your stains disappear-and your clothes with them?

Today, we at Parker give you the chance to get your own back.

Not only are we offering a beautiful new pen called the Laque, which owes its deep lustre to a Chinese technique 2000 years old, but also we are attempting to revive something that went out when the telephone came in.

The well-armed witty, malicious dart.

Although the Parker UK division was Ii success, how-ever, the company's general inefficiencies, loss of market share, and lack of strategic direction were finally revealed in the early 19805 with the rise of the US dollar. Parker's financial decline was even more precipitous than - the dollar's increase. When the huge 1982 losses were regis-tered, Peterson was brought in from R. J. Reynolds to try and turn things around for Parker. He decided that every aspect of the company needed to be closely examined, not the least of which was' Parker's decentralization of global operations.

Discussion Questions (A)

1. What would you do if you were in James Peterson's shoes in January 1982?
2. What changes, if any, would you make in Parker's marketing strategy?
3. Which aspects of Parker's structure would you dis-card? Which would you keep?
4. Assume that you are James Peterson and you have just hired a new management team composed of highly qualified executives from outside companies. You and your new team are convinced that you have the solution to Parker's problems but there are many holdovers that disagree with you. How would you implement your plan? To what extent would you incorporate the views of Parker management into your plan?

PARKER PEN CO. (B)

Parker Goes Global

"We will be creating more news in the next two years than we have in the past ten."

-JAMES PETERSON

July 1982

James Peterson relished the chance to be the top man at Parker Pen. He spent 24 years at Pillsbury and had a taste of what it was like to be at the helm of a corporation when he rose to the rank of president, the number two power spot in the company. At R. J. Reynolds, he was an execu-tive vice president-an influential position, to be sure, but " not one that afforded him the freedom of movement that he would have liked. When he was brought to Parker in January 1982, Peterson, then 54, had finally had the chance I to run a company. All the theories he held to be true would I be tested. All the lessons he had learned after some 30 years of practical business experience-much of it in international operations-would now are applied.

His years at R. J. Reynolds had convinced him of the superiority of global marketing, which he understood to mean standard-ized product and promotion strategies the whole world over. This view made him unalterably opposed to the loose structure that had characterized Parker Pen before his arrival. In the opinion of Peterson, there was ab-solutely no way that any company operating in the modem world would be able to survive such disarray. That a sub-sidiary thousands of miles away could decide not only what products it would manufacture but also how they would market them ran counter to every-thing Peterson believed.

Peterson quickly moved to remold Parker Pen in his own image; In addition to too much decentralization, Peter-son thought Parker lacked "a good enunciation of business philosophy." According to Peterson, "every good company has to have one." In order to correct this problem. Peter-son devised an eight-point statement of his management philosophy and had it translated into more than 40 lan-guages and sent in letterform to Parker managers all over the world. The statement contained such 'phrases as, "There is no substitute for" quality," and, "Like most managers, I don't like surprises." The letter concluded by saying: "As I get to meet each of you in the months ahead, I will be dis-cussing this business philosophy with you and asking you how you have used it.

The Dismantling of Decentralization: From 40 Agencies To 1

The core of Peterson's revitalization efforts would be di-rected at dismantling the geographical organization that Parker had evolved into over the years. He slashed the product line from 500 to the 100 most profitable items. The manufacturing function was consolidated, greatly reducing the number of units produced overseas. As for what prod-ucts would be manufactured; that was to be strictly decided by the manage-ment team at the Janesville 'headquarters. Of course, the manufacturing facilities themselves would have to' be updated, for no longer could the production de-partment be allowed to dictate to marketing executives ex-actly what kind of products it would be selling. None of these measures in and of themselves was startling-each addressed problem that needed to be corrected. However, when Peterson decided to get rid of Parker's 40-odd ad-vertising agencies in favor of one "world-class agency, "more than a few eyebrows were raised.

The logic behind the decision to go with one adver-tising agency (Ogilvy & Mather) was consistent with Pe-terson's desire to make Parker Pen a global marketing corporation. With one agency instead of 40, not only could money be saved, but also strategies could be coordinated on a global scale. One problem, however, was that formerly pro-ductive agencies such as Lowe Howard-Spink in London were fired. This had a devastating effect on morale at Parker U.K., the company's most profitable subsidiary which had in effect been subsidizing the same American di-vision that was now telling it how to advertise.

The World's No.1 Pen Company"

Even though Parker had experienced' many problems before Peterson arrived, the company was still very proud of its tradition as a leading producer of "quality writing instruments." Of course, this pride was sometimes trans-lated into over-blown statements such as, "Parker is the world's No.1 pen company." This indeed was the party line at Parker even though it was 'paid little more than lip ser-vice. When Manville Smith arrived in 1982, he commis-sioned a study to see just how important Parker was. His findings shocked him: Parker had only a 6 percent share of the global pen market and it didn't even attempt to par-ticipate in a segment that was responsible for 65 percent of all sales of pens in the world-that is, pens that sold for less than $3.

The new management team wanted to make Parker more than just a fictitious number-one company. In order to recapture market share, Parker would have to partici-pate in the lower end of the market-the same area that George Parker himself had so hastily abandoned in the late 1960s. A new $15 million state-of-the-art plant would be built whose main function would be to manufacture the Vector, a roller-ball pen selling for $2.98. The Vector was Manville Smith's pet project. Using a new automated line at Parker's new plant, Smith calculated that the Vector could be produced for 27 cents per unit and therefore gen-erate huge profits for the company. After the Vector, Smith, planned to plunge even deeper into the low-price market with the l13la, an even cheaper model that would be Parker's first disposable pen.

The First Rumblings of Dissent:

George Parker

Although George Parker was still formally the chairman of Parker Pen, he was expected to lead a quiet, charmed life in

Marco Island, Florida, and never to be heard from again. In fact, George Parker was paying very close attention to the new developments in the company that bore his name, and he was none too happy. As his earlier remarks might suggest, he was scornful of a strict market research approach to the pen business. He also took pride in Parker Pen's autono-mous federation system that provided a high degree of flexibility to the company's many subsidiaries. Even more disturbing to him was the planned foray into the lower depths of the marketplace, as he might put it. Cheap pens were beneath Parker Pen, in his opinion, and nothing could be more disgraceful than a disposable pen bearing his name. What were they manufactur-ing anyway, garbage bags?

Compounding George Parker's displeasure, was his sincere dislike for James Peterson, whom he dubbed "motor mouth." To him, Peterson was the embodiment of everything that was wrong with the new Parker Pen. The grandnephew of the company's founder still had many well-placed friends in the company, and his constant criticism of the new management team probably did little to aid their cause.

Problems: Financial Losses, Smith Gets Fired, One World Marketing Fails

Despite all the complaints from George Parker, Peterson's major problems lay elsewhere. The strong dollar that had exposed so many of his company's weaknesses got even stronger. Recession was a worldwide plague. The costs of new plant development were not absorbed by profits and the company lost $13.6 million in fiscal 1983 (as shown in Exhibit 1). Still, Peterson had the luxury of time on his side, since he had little more than one full year under his belt. One more year like 1983, however, and he was gone.

Exhibit 1

Year Ended	Revenues	Net Income		Dividends	
Feb. 28	(Millions)		Earnings	(Per Share)	Range
1985	$843.7	$5.4	$0.32	$0.52	21-13
1984	708.8	11.8	0.70	0.52	21-12
1983	635.3	d13.6	D0.80	0.52	17-11
1982	679.1	15.7	0.92	0.50	24-14
1981	723.2	37.7	2.23	0.44	26-14

d = Deficit.

Balance sheet as of June 30, 1985:

Current assets: $284.5 million

Current liabilities: $239.5 million

Current ratio: 1.1-to-1

Long-term debt: $27.1 million

Common shares: 17,635,000

Book value: $7.65

In Peterson's opinion, only a full-fledged global mar-keting effort could save Parker. At the March 1984 Palm Beach meeting, it was decided that Parker would partici-pate "in every viable segment of the writing instrument business." In addition, it was declared that, "The concept of marketing by centralized direction has been discussed and consensus was reached. "The management team, filled with a sense of purpose, then set out to achieve its lofty goals.

There remained one major problem: Parker's new plant was proving to be a failure. The plant was not func-tional for the 1983 Christmas season, costing the company millions of dollars in sales. Even as Peterson arid his group were working round-the-clock to see its strategy through, the computer-automated plant which was supposed to spearhead Parker's drive into the lower end of the market, broke down repeatedly. With automation having failed, the r company was forced to hire labor again and its costs sky-, rocketed. Manville Smith, who had placed his name next to the fully automated Vector project, was fired by Peter-son as a result.

Smith's departure was important because he was the only member of the management team that held out for local advertising flexibility. Smith had worked closely with Ogilvy & Mather (O & M) on Parker's first worldwide ad-vertising campaign. At Smith's urging 0 & M devised a campaign that allowed for some degree of local. Flexibility -When Smith left, however, Peterson took over the adver-tising reins and pushed very hard for "one-look" advertis-ing and the results were disastrous.

The fashion in which Peterson promoted his adver-tising policy was enough to alienate once and for all those remaining managers that supported his efforts. A procla-mation issued from the Janesville office and sent across the globe headquarters stated that: "Advertising for Parker pens [no matter model or mode] will be based on a common creative strategy and positioning. . . . The world-wide advertising theme, 'Make your mark with a Parker: has been adopted . . . . [It] will utilize similar graphic layout and photography. It will utilize an agreed-upon typeface. It will utilize the approved parker logo/graphic design. It will be adapted from centrally supplied materials.

The new advertising campaign was indeed rigidly controlled. Subsidiaries were sent their materials and told to get on with it. Managers abroad were seen as simple im-plementers of the global marketing strategy with little or no input. The problem was that many of them realized right away that the new advertising campaign wouldn't work in their markets. In fact, the campaign really didn't work any-where. Jack Marks would later qualify it as "lowest common denominator advertising" that "tried to say something to everybody, and didn't say anything to anybody.

The last to admit failure was Peterson himself, who ignored all evidence and tried to move forward with a second wave of global advertising in January of 1985, this ~e for the Vector, which had finally made it off the production line. By this time, however, Peterson's position was termi-nally weakened. Production problems persisted, morale was low, resentment of the manage-ment team was high and reaction to yet another generic campaign was so negative that Peterson felt compelled to resign.

Postscript: "Global Marketing Is Dead"

The successor to Peterson as CEO was Mitcheill Fromstein, president of what once was Parker's Manpower subsidiary. Since

it was purchased in 1975 by Parker, Manpower con-tinued to grow to the point where it was far more profitable than its parent and, indeed, subsidized it for several years. Manpower would wind up taking over Parker, finally sell-ing it to a group of British investors in 1986.

Fromstein was an implacable foe of Peterson's. Man-power was as international as Parker Pen, and Fromstein had his own views as to how an international business should be run. When he assumed control of Parker in Jan-uary 1985, he gathered the company's country managers in Janesville and told them: "Global marketing is dead. You're free again.

Discussion Questions (B)

1. Why did Peterson's global strategy fail?
2. What lessons can be drawn from the decline and fall of Parker Pen?

PARKER PEN CO. (C)

"Global Marketing Strategy: An Interview with Dr. Dennis Thomas of the Berol Corporation"

Charles Anderer: I would first like to thank you for taking the time to share your views on global marketing and Parker Pen in this interview.

Dennis Thomas: It's my pleasure.

CA: I would like to start out by asking you a question about an agreement that we both have read.4 Do you agree with the notion that the big issue today is not whether to go global but how to tailor the global marketing concept to each business?

DT: If it's an either-or proposition, I am broadly in agree-ment with the proposition. I believe that there are rela-tively few major markets where the local conditions are so self-contained, so capable of being kept self-contained, and so different, either for cultural or other kinds of reasons, that the underlying, increasing level of similarity that is coming into most major marketplaces, as opposed to the nuances of necessary local difference, 'cannot form the bedrock of acceptable product offerings, positioning and what you have. Also, the economies of scale and the rela-tive size of self-contained markets, in and of themselves, are of decreasing appeal other than for a small business, which chooses to remain small. But in many indus-tries and many marketplaces, the products which adequately serve market needs increasingly have within them either out-right commodities or commodity-like ingredients if they are likely to be products that are positioned in a market-place over a period of decades rather than over a few fash-ion cycles of a few months or a few years. . . . The real ques-tion is: What is the appropriate international scale for the business and what is the appropriate international scale for the underlying marketplace?

CA: What forces do you see behind the increasing similarities of markets? Telecommunications is one that comes to mind.

DT: Sure. We are much more aware, whether we are con-scious of it or not, of what other parts of the world look like. . . . Broadly speaking, people behave as consumers who may be appealed to in the same kinds of ways. Whether they are at level two or level four of a Maslow hierarchy or any kind of structure you would like to adopt, we are becoming more steadily accepting of the fact that they are likely to go through the same kinds of progressions. The form that a status need may take in one society as opposed to another may be somewhat different, but status needs exist in both. How well developed they are, whether people may exercise them, how many people, in what kinds of ways, and what they will be looking for-those are all to my mind subsidiary kinds of questions, but you know it's going to be there.

You do, also, have the fact of increasing international communi-ties. People travel, they go from one culture and from one history to another. The world is becoming more in-terrelated, either directly through people transfer or indi-rectly through visual transfer, on a much more regular basis. Something that has already happened in Tokyo will be there for you to see on the 6 o'clock news. It sounds as though it's a long way between that phenomenon and whether or not you can sell the same pen in Japan and the United States. But I don't think it's as far-fetched as many have historically supposed when you stop and think about it.

There is no reason why the intervention of water I should be a cutoff point between groups of people and their often similar characteristics.

CEAC-CHINA

At the end of October 1995 the Board of Directors of CEAC held a meeting in Barcelona. With the company approaching its 50th anniversary, CEAC's directors were facing what could well be one of the most far-reaching decisions in the company's history: after almost two years of preliminary ne-gotiations, they had to decide what action to take in China.

CEAC was an entirely Spanish, family-owned group of companies that had been founded in 1946 and was ac-tive in the closely related fields of vocational distance learning and publishing

The Group had significant international experience. Starting in Argentina in 1964, it had achieved a presence in practically all Spanish-speaking countries. Subsequently, it had extended its activities, either directly or indirectly, to other countries such as Switzerland, Sweden, France and Portugal.

In the early 1990s-after the fall *of* Communism -CEAC had commenced activities in the Polish and Hungar-ian markets and had also begun exploring its possibilities in Romania and Russia.

In April 1994, Juan Antonio Marti Castro, Group Managing Director and founder of the FECEAI Founda-tion, had taken part in a trade mission to China organized by the said Foundation.

The task *of* organizing the contacts that the delegates were to make in China had been entrusted to Manuel Vallejo, a Spanish citizen with almost ten years' experience in China. At the end *of* 1993 he had joined Taxon, a com-pany with permanent head offices in Beijing, to act as a commercial and business consultant in China.

Thanks to Manuel Vallejo's perseverance and dedica-tion, after a number *of* tentative and unfruitful contacts, a possible Chinese partner for CEAC had eventually been found: New World-Publishing *Co.*, a company belonging to the State-run Foreign Language Publications Bureau. After several months' negotia-tions, they had hammered out the fi-nancial and operational details of an agreement to set up a joint venture, which, curiously enough, would be formally set up as a consulting company: "Beijing New World-CEAC Consulting *Co.* Ltd."

By October 1995, the CEAC Group had invested around US$100,OOO in trips, surveys and exploratory work for the project. But now, if CEAC's Board of Directors de-cided to go ahead and sign the agreement negotiated with New World Publishing *Co.*, they would most likely have to invest a further US$300,000 at least.

Everyone present at the board meeting fully realized that the moment *of* truth had arrived and that if- they ap-proved the signing of the agreement with New World Pub-lishing *Co.*, they would be putting an end to the "sounding out and explora-tion" stage and embarking upon a course that would involve far more substantial commitments of financial, human and technological resources. In fact, the decision could significantly influence the CEAC Group's strategic development in the 21st century.

Background

The CEAC Group originated in 1945, when Juan Marti-Salavedra took the initiative *of* writing a course to prepare students for the entrance exam to the Architectural Technicians' Colleges of Barcelona and Madrid. These courses were adver-tised in the press and the material was mailed to the student's home address and paid for, lesson by lesson, on delivery.

Those first mimeographed lessons bore the words "Centro de Estudios A.C." on the cover, which quite simply meant Architectural Technicians by Mail ("Aparejadorespor Correspondencia").

Marti-Salavedra secured the help of his brother-in- law, and subsequently that of Jose Menal Ramon, who was somewhat younger than Marti, had a degree in busi-ness administration, and worked in a construction com-pany. Jose Menal became Marti's chief collaborator and partner.

They gradually developed other vocational distance learning courses: At first, these new courses were all on sub-jects connected with the building industry ("Draftsman," "Rein-forced Concrete Technician," "Surveyor," etc.). Later on, they started offering sold-by-mail courses for other pro-fessions, such as machinist ("Milling Machine Operator," "Lathe Operator," etc.) and automobile repairman.

The procedure for developing courses in each new specialty was the same as for the building sector: they first produced a general course (e.g. "Automobile Repairs"). If this were a success, they would write other more highly spe-cialized courses on the same subject (e.g. "Automobile Electrical Circuits," "Automobile Mechanics," "Body-works," etc.). They later went on to offer distance learning courses on hobbies and artistic subjects, such as "Drawing," "Oil Painting," and "Photography."

Another significant development was the eventual separation of their two lines of business: producing and marketing vocational distance learning courses, on the one hand, and book and magazine publishing activities on the other. The latter were later consolidated in a new company: Grupo Editorial CEAC, S.A.

The growth of the company had been entirely self- financed.

"We have never taken bills to the bank for discount," declared Juan Marti Salavedra proudly in 1995. "We have confined ourselves to doing what we could finance out of our own resources, and if we could not finance something, we simply did not do it. This superbly sound financial po-sition has always given us great peace of mind, and also lib-erty to experiment with new ideas and to embark upon entrepreneurial innovations and adventures, since if one of our new undertakings was unsuccess-ful, no damage was done. It was our own money, which we

ourselves had generated and which, therefore, obviously did not have to be paid back to any financial institution."

Selling Process For Distance Learning Courses In Spain, Up To 1985

CEAC gradually developed distance-learning courses in a number of different fields. When CEAC first started up, students who signed up received one lesson a week by mail, paying cash on delivery (C.O.D.).

As early as 1955, the company management decided to offer- and, of course, by subsequently honors –a total guar-antee on their courses. Under this guarantee, students who had completed a course-and had done all the exercises- and were not fully satisfied, would be entitled to a full refund of the amount they had paid and, moreover, to keep all the teaching materials they had received.

The selling process for a specific course began with advertisements in newspapers and magazines, or direct mail campaigns targeted at certain segments of potential customers, which were defined according to demographic criteria or the content of the course.

Potential students sent CEAC a request for further in-formation, using the coupon from the advert or the coupon and prepaid envelope included in the direct mail piece.

CEAC immediately sent them a full-colour glossy bro-chure of several pages. The brochure emphasized the impor-tance of the subject of the course for the student's career and gave a detailed description of the teaching programme, which was divided up into a number of chapters or teaching units. It also explained how the course would be carried out with the help of a teacher-tutor and gave CEAC's guarantee *of* a refund should the student not be fully satisfied at the end of the course. The brochure came with a registration form, which gave the price of each complete course.

If the potential students were persuaded, they would register by completing and signing the registration form, and mailing it to CEAC. A few days later, they would re-ceive a letter from CEAC, congratulating them on their decision and enclosing, the first lesson of the course, which was paid for on delivery. They would subsequently receive the rest of the course, lesson by lesson, paying for each one C.O.D., until the course and been completed.

From 1974 onward, still faithful to their guarantee, Juan Marti Salavedra and Jose Menal Ramon decided that students who enrolled on a course would receive all the rel-evant material In one go, immediately upon registration (all the teaching, units, evaluation tests and other material), al-though they would continue to pay for it month by month, against a simple reimbursement card mailed to them.

Should a potential student who had shown interest and received the brochure not register for the course, CEAC would send him/her up to seven reminder letters. It should be noted that at that time (1950s and 19608) all con-tact with students was by mail.

Instructor Attention For Enrolled Students

After the initial years, during which Juan Marti Salavedra or Jose Menal personally attended to students' queries and corrected their exercises and exams, CEAC engaged an ever-expanding team of collaborators to handle these tasks. Eventually, CEAC created a Studies Department to cover two broad areas of responsibility: the development 6f new courses, and attention to and monitoring of enrolled students.

The monitoring was done by an ample staff of teacher -tutors specialists in their respective subjects. These tutors were responsible for correcting tests and giving students guidance, both on the content of the course and on study methods and any difficulties that might arise during the learn-ing period. The average length of a course was 15 months, the shortest being 6 months and the longest 36 months.

Each teacher-tutor was responsible for a certain num-ber of students, whose progress he would monitor until the course was concluded, at which time they received the ap-propriate CEAC diploma.

Initial International Activities

In the early 1960s, by which time the company was quite well consolidated in Spain, CEAC management began to think about ways of selling their courses in other Spanish- speaking countries. In 1964, with the help of the Ibero--American Education Office (OEI) and UNESCO, they started promoting the courses- in various Latin American markets starting with Argentina. They decided to share the business with local partners, one in each country. These partners were called "Licensees." CEAC gave its Licensees the benefit of the teaching and business experience it had acquired in distance learning, either by bringing the Licensee to Barcelona for training or by having Juan Marti Salavedra do it 'on the spot."

The courses were designed and printed in Barcelona. The Licensee would buy this material at cost, plus an "in-dustrial margin," and had one year in which to pay for it. The Licensee would then, at its own expense, take care of all marketing activities, as well as the support and moni-toring of enrolled students. In 'addition to, buying the courses from CEAC, the Licensee had to pay Barcelona a royalty of 10% on sales, to be settled once the Licensee had received payment from its students.

CEAC had to deal with certain "surmountable" prob-lems, such as differences in terminology or in the words used for certain materials in the different Latin American countries. The real problem was finding Licensees who would put enough effort into the business and were capa-ble of running it in a professional and responsible manner and were reliable as far as payments were concerned.

They also found that sudden, drastic devaluations of the local currency, or a scarcity of convertible currency, often led to situation where a Licensee was unable to pay its debts. How-ever, in spite of these difficulties, CEAC at one time had up to 40,000 students enrolled with its Li-censees in Argentina, Uruguay, Venezuela, Peru, Colombia, Bolivia, Costa Rica-Central America and Mexico. As Marti Salavedra admitted, "on the whole, it was very profitable for CEAC."

Outside of Spanish America, instead of negotiating and signing agreements with Licensees to sell the same courses as in Spain, CEAC opted to sell the translation and sales rights for its courses. This brought revenues from countries such as Switzerland, Sweden, France, Germany, Greece and Portugal. In some cases, a local firm would take on the job of translating, printing and selling the courses and moni-toring students. The local firm would sell the courses to-gether with its own courses-or courses acquired from other sources-under its own name on the domestic market, so that the students never actually saw the name CEAC or knew where the course came from. In some cases, CEAC reached an agreement to exchange courses. In this way, it also sold courses designed in other countries, duly translated and revised, in Spain and Spanish-speaking countries.

In the specific case of Portugal, an agreement was reached in 1965 with a local publishing company. The pub-lisher would act as Licensee, although with certain special concessions, such as that CEAC would assist in translating its courses into Portuguese. The Portuguese Licensee set up a separate company called CETOP (Centro de Edu-cacion a Distancia de Portugal).

Juan Antonio Marti Castro

Joins The Company

In 1974, Juan Antonio Marti Castro, the only son among Juan Marti Salavedra's five children, obtained his degree in Business Administration at ESADR He joined the com-pany after graduation and over the following ten years held posts of increasing responsibility in the different de-partments of the companies belonging to the Group, whose activities by then extended beyond vocational distance learning (with some complementary activities *w* the field of direct classroom teaching) to publishing, graphic arts and bookbinding.

In 1985 Juan Antonio Marti Castro was appointed Chief Executive Officer of the CEAC Group, taking the reins from his father, who, having reached the age of 65, stayed on as President of the Group.

By 1989 the conversion rate of "potential students" (those who had shown an interest in a specific course by re-plying to an advertisement or direct mail) into "fully en-rolled students" had fallen quite considerably, to reach a low of around 10%, compared with 25-30% in the past. As a consequence the advertising and promotional costs per fully enrolled student increased significantly. At the same time, "drop-out rates rose alarmingly.

In view of the situation, Juan Antonio Marti Castro took a number of decisions that radically changed the way CEAC conducted its marketing in Spain:

First of all, whereas previously the company had always promoted its courses through its own internal Advertising Department, they now started to use an outside advertising and direct marketing agency: Ogilvy & Mather Direct.

Secondly, and much more importantly, they started to build up a company sales force, which was gradually extended throughout Spain. The new sales force initiated a process of personal selling to potential students who an-swered the adverts or direct mail.

Under to the new sales procedure, potential students who had responded to an advert or direct mail were visited in their homes by a "cultural advisor" from CEAC, who per-sonally gave them all the details of the course and encour-aged them to sign up and enroll. If the customer was convinced, the "cultural advisor" himself would hand over all the material for the course, and at the same time prepare the official payment documents. The payment documents took the legal form of a hire purchase agreement. Payment was no longer made through cards submitted each month for payment in cash through the Post Office but by means of a monthly direct charge to a designated bank account. The student him or herself, or a parent, would therefore autho-rize the necessary standing order for monthly payments until the total cost of the course had been paid. This new system of collecting payment through the bank was much more formal and reliable than the earlier arrangement by mail.

Lastly, the company went to great lengths to renew and update the range of courses it offered, in part by re-vising and updating the courses it planned to keep, in part by discarding certain courses altogether and replacing them with totally new ones.

Similar efforts were being made in Latin America where, due to the general economic difficulties during the "lost decade" of the 80's, in 1995 CEAC had some 10,000 enrolled students.

Implementing A New Approach To International Activities

Although the Licensee in Portugal had set up CETOP as a separate subsidiary, the company still had the mentality more of a book publisher than of a distance learning company.

Consequently in 1990 CEAC took an unprecedented decision in its international expansion: it purchased 100% of CETUOP and terminated its relationship with the Li-censee. The name of the company was changed to, CEAC Portugal and 49.9% of the new company was sold to another Portuguese publishing house (Pilatano Editora), which was already working with CEAC in the field of pub-lishing. From then on, CEA-Spain took full responsibility for the management of the Portuguese firm and changed its operating policy: the subsidiary was to be an exact replica of the Barcelona head office, except that the courses would continue to be designed in Barcelona. But from now on the courses were to be translated, adapted and printed in Por-tugal. And, of course, all the marketing and everything to do with assisting and monitoring students were to be done there too.

CEAC's management team then decided to adopt the Portuguese model as standard: from then on, no more Li-censees would be appointed (although the existing ones would be kept).

This new way of operating meant setting up local sub-sidiaries in all new markets where CEAC planned to start selling its courses. CEAC-Spain would be the majority shareholder in these subsidiaries, but it was considered de-sirable to have a local partner as a minority shareholder in each country. As in Portugal, each local subsidiary would be an absolute replica of CEAC-Spain, except that all the courses would be designed in Barcelona.

This decision coincided in time with the fall of the Communist regimes in Central and Eastern Europe. Thanks to the experience it had acquired in Latin America and Portugal, CEAC was the first Western company in the field of vocational distance learning to start operations in these countries.

Poland

In January 1990, a small trade mission of Spanish businessmen led by Josep Antoni Duran i Lleida-head of Union Democratica de Catalunya, a Catalan political party -visited Poland and held a meeting with Lech Walesa while he was still leader of Solidarity.

After this initial contact, CEAC management entered into collaboration with Merce Soley, a secretary at the Spanish Embassy, who had been living in Poland for over 20 years and was married to a Polish citizen. Merce Soley had set up an office offering services to Spanish companies.

In September 1990 they carried out the first, very ten-tative, market test, which consisted of placing advertise-ments in the press offering courses that had not yet been translated into Polish. It was soon discovered that there were hardly any requests for further information on voca-tional training courses. However, there was a lot of inter-est in the English Language course.

Consequently, after writing to the interested students to tell them that the course would be slightly delayed, within a month CEAC was established in Poland and was selling the English Language course. It was able to do this because the course it sold in Spain was not in fact a Spanish- English course but a progressive immersion course, written completely in English, so that it could be sold in Poland in virtually the same form.

What was intended to be just an initial market test, therefore, became the basis for setting up the new sub-sidiary in Warsaw.

CEAC invested some US$200,000 in the new sub-sidiary, including the subsequent translation of several courses into Polish. Initially, the subsidiary was managed by a Pole, a former high-ranking civil servant in the Polish ministry of Education, who spoke Spanish. Unfortunately, after a period of successful growth in 1991 and 1992, sales leveled off in 1993 and began to fall in 1994. Accordingly, a new manager was appointed in 1995, a Spaniard, whose mission was to reorganize the company and set up-as in Spain-a team of "cultural advisors," who would person-ally follow up all requests for information about courses, with a view to clinching more sales.

At the end of 1995, CEAC management felt that Poland was potentially a reasonably attractive market, al-though not the "gold mine" they had originally though the market could perhaps stabilize at around *5000* en-rollments per year. Nevertheless it should be pointed out that in view of the low purchasing power of pointed out that in view, of the low purchasing power of polish consumers, CEAC was selling at an average price of around 50000 pesetas per course.

Hungary

Encouraged by the initial success in Poland. CEAC started to sell its courses in Hungary in 1991 and six courses were translated.

Unfortunately, after a promising start, the business quickly came to a standstill and in 1995 the company de-cided to end its activities in Hungary.

Russia

In 1991-92, members of CEAC's management team con-tacted a State-run university that had some distance learn-ing activities. However, the discussions were cut short after a strange dinner at which CEAC's managers felt it was being suggested that the project could not go ahead unless it had the "protection" of certain unsavory-looking indi-viduals among the guests.

Romania

CEAC made contacts with a number of government institutions during 1994-95, but nothing came of them, so no courses were translated.

The Ceac Group In Spain At The End Of 1995

The CEAC Group was expected to close the 1995 financial year with a total turnover (all the companies throughout the world) of approximately 13 billion pesetas. Of this figure, 10.5 billion pesetas came from sales in Spain and 2.5 billion from CEAC Group activities outside Spain.

a. Vocational Distance Training Activities

At the end of 1995, the CEAC Group was offering 58 different vocational distance-learning courses. The total num-ber of courses available was stable since whenever a new course was launched, one of the older courses was discon-tinued, in a process of constant renewal and updating.

The General Manager, Tomas Blay estimated that by the end of 1995,25,000 new students would have enrolled. Since the courses lasted an average of 15 months, the CEAC Group would at anyone time be training some 32,000 stu-dents in Spain. The record year for enrollments was 1991, with 41,000 new student registrations.

The average price of a course was around 125,000 pe-setas. (Prices ranged from 75,000 pesetas for a course last-ing 6 month to 175,000 pesetas for a 36-month course, which included audio-visual material and videotapes.) The student could choose between a numbers of different pay-ment options.

Each pupil was assigned a tutor, who was an expert in his/her subject and an employee of the company. The tutor could be consulted at any time, in person, by telephone, by letter, by fax or on the Internet. The exercises that the pupil had to do at the end of each teaching unit were reviewed by a teacher-reviewer, who was not an employee of the company and who passed the reviewed exercises on to the tutor. The reviewers were normally specialists in their sub-ject who worked in the relevant sector.

The whole process of following up and monitoring the progress of each student was highly computerized, so that if any student failed to send in-his exercises on time, he was automatically sent a reminder note.

On finishing the course, students had to take a final exam, also by correspondence. If they passed the exam, they received the appropriate CEAC diploma, which, al-though not officially recognized, was held in high regard by Spanish companies.

The profile of the students naturally varied according to the subject matter of the course. Overall, however, they were between 18 and 25 years old, of both sexes, of middle or lower-middle class families, and they tended-though not to any significant decree-to live in rural areas.

According to company management, the main *key suc-cess factors* in this vocational distance training activity in 1995 were the following:

1. Juan Marti Salavedra, Group President, insisted in 1995 that the company depended for its very exis-tence, and always would depend, on the intrinsic quality of the courses, as well as on the quality of the constant monitoring, attention and support it gave to students.

   Still sprightly at 75, Juan Marti Salavedra's face lit up when he said, with total conviction:

   "Our primary goal has to be prestige based on the quality of our courses and the service we give our students. Over and above any considera-tion of money and profit, we must ensure that people think of CEAC first and foremost as a centre of learning. The student must always come first. Internally, we have to operate as a company, with an organization chart, budgets, and all sorts, of economic and financial calculations. But we would fail in our mission if our students did not receive more than they expect from us. We must ensure that the students feel they are getting more than their money's worth. We must be caring and encouraging and convey warm-hearted understanding."

2. Juan Antonio Marti Castro, Chief Executive Officer, agreed with his father; then, following the different steps in the business process, he said that the next key success factor was creativity in the advertising message. The advertisements in the press and those sent by mail had to generate enough serious requests for further information.

3. The key success factor, closely related to the previous one, was to accurately monitor the cost of a request for further information. CEAC had set up control systems and mechanisms that told them exactly now many requests for information had been generated by each press advert or direct mail piece. Knowing the cost of each action in each medium, it was possible to calculate the "yield" or cost in pesetas of each request for information they received.

   With this information it was possible to continu-ously adjust and fine-tune a wide range of variables, such as the advertising, message, the size of the reply coupon, whether a fun-colour advert was more effective than a black-'and-white one, the size of the press advert, etc.

4. Ultimately, the most important thing was to effec-tively monitor and control the cost per new student enrolled. Juan Antonio Marti Castro emphasized that these two cost variables (the cost per request for information received and the cost per student enrolled) were not totally independent of each other, but were interrelated. For example, an advert for the guitar course published in the music maga-zine "Super Pop," which was read by youngsters, might generate a large number of requests for fur-ther information, but few actual enrollments. At the other extreme, adverts for certain vocational courses, such as the Tax and Fiscal Advisor course, which were inserted in more serious professional publications and targeted at a more adult audience, usually generated fewer requests for further infor-mation, but the rate of conversion into actual en-rollments was higher. In summary, a whole range of variables was involved, such as the content of the course offered, the advertising medium, the average age of the readers, etc.

5. Another key factor was the quality of the sales team, which CEAC called the "network of cultural advi-sors." At the end of 1995, CEAC had a strong team of. sales representatives, who visited prospective stu-dents in their homes to explain the content of the course they had shown an interest in, the teaching method, methods of payment, and other details. They also filled in the enrollment forms.

   The team covered the whole of Spain and was made up of a sales manager, 8 area managers, 23 assistant area managers and some *170* cultural advisors. The cultural advisors worked full-time for the company; however, they were not actually on the company payroll, but acted as mercantile agents. They worked entirely on commission and none of their expenses were covered by the company. In spite of this, the turnover rate was relatively low and *120* of the *170* could be considered to be working permanently for the company.

6. The last key-success factor was the payment default rate. In 1995, the company's internal accounts in-cluded a provision for unpaid debts of 11 % of the total cross value of the enrollment fees.

7. As a result of the above-mentioned key success ac-tors, the breakdown of the company's profit and loss account in Spain was as follows:

Gross sales 100% = average 125,000 pesetas per course

Cost of goods sold	6%
Marketing costs	22%
Sales force	20%
Personnel	10%
Bad debts	11%
Overheads	16%
Profits before tax	15%

Personnel expenses included the salaries of the tutors and the approximately *120* general administrative em-ployees. Overheads included the variable compensation of the correctors of students' exercises and exams, together with depreciation and financial expenses.

b. Book Publishing Activities: Grupo Editorial CEAC, S.A.

   This company published books. There were several trade-marks or registered publishing names within the Group, such as Ediciones CEAC, Timun Mas and Vidonima. Each of them specialized in publishing a particular kind of book: technical books, children's and fantasy books, art books, etc.

   In 1995 the Group was publishing around *250* new books per year, with a turnover of approximately 1.8 billion pesetas.

c. Other Business Activities

The CEAC Group held a substantial majority shareholding in Home English, S.A., a company that sold language courses by mail. In 1995 its turnover was expected to be around *3,000* million pesetas.

It also had a majority share holding in a company that sold women's underwear, using direct selling methods.

Another group company was in partnership with the Caixa d'Estalvis i Pensions de Barcelona, Spain's largest savings bank. It had a team of some *500* female sales per-sonnel, working under an agency agreement, who carried out cross-selling activities to persuade customers of La Caixa to buy a wider range of financial products and ser-vices from the bank.

Finally, other companies belonging to the CEAC Group were involved in a variety of industrial activities, such as printing and bookbinding, plastic lamination of published materials, etc.

Brief Background on The People's Republic of China

Economic reforms had begun in china in 1978, after the death of Mao Tse-tung. The first regulations on foreign investment were issued in 1980. Step foreign investment was authorized in the fields of oil prospecting and extraction, the hotel business, and light industry.

In 1990 after the Tiananmen Square incidents, the pace of foreign investment was to a certain extent frozen, to be resumed with great momentum after Deng Xiaoping's famous voyage and speech at shenzhen in February 1992.

One of the main consequences was heavy investment in real estate and major infrastructure. And the first stirrings of activity on the stock exchange even so, investment was still severely restricted in certain sectors, such as financial services (banking and insurance), the media (radio and television) and publishing. As in other countries, the defence and telecommunications industries were closed to foreign investment.

Ceac's Activities In China

In January 1994, the FECEA foundation charged Manuel Vallejo with the task of organizing the visits to be made by the members of a trade mission that was due to visit China from 14 to 25 April of that year. Manuel Vallejo was a Spanish citizen with considerable international experience, particularly in China (see Exhibit 3 for a summary of his career up to 1994), where he had just become a partner in the consultancy Taxon.

Juan Antonio Marti Castro had known Manuel Vallejo for more than 25 years. They had both studied at ESADE, although with a difference of two years.

At the beginning of 1994, Marti Castro was fully aware that CEAC had achieved its highest sales peak In Spain back in 1991 and was now suffering from certain inertia in sales. In 1993, as a result of what some called the "post- Olympic shock;' Spain's gross domestic product had fallen each quarter and the country had entered the deepest and longest -lasting recession since the oil crisis of the 1970s.

Moreover, the company's attempts to penetrate new markets, such as Poland or Hungary, had not worked out.

Marti Castro came to the conclusion that CEAC should opt for entering developing countries with large populations, where it could establish a "complete" sub-sidiary, i.e. one that was capable of operating just as CEAC did in Spain.

During Marti Castro's trip to China with the FECEA mission, Vallejo arranged for him to visit five State-run uni-versities that already had a distance-learning department or were active in that field, though in a very badly orga-nized way. They all expressed an interest in exploring ways of collaborating with CEAC.

"My intuition told me that we would find a market there," affirmed Marti Castro. "Our incursions into some of the countries of Central and Eastern Europe were not too success-ful, but I felt that it would at least be worth our while to tryout the Chinese market; this was relatively easy to do, with Manolo Vallejo working and living there for a good part of the year."

Therefore, in June 1994, after a few months' reflection, Marti Castro formally entrusted Vallejo with the task of carrying out studies and surveys of the potential market, and making contacts with a view to identifying, and possi-bly negotiating with, a prospective local partner. Vallejo would not be working exclusively for CEAC and would re-ceive a fixed monthly retainer fee, plus a success fee, which would take the form of a small share in the capital of the hypothetical future CEAC subsidiary in China. The as-signment was for an initial mini-mum period of fifteen months, renewable for a further length of time.

Vallejo started to work on the project in June 1994, with occasional help from his Chinese partner in Taxon. He was fully aware of the great difficulty of the undertaking:

"I knew that CEAC had two main activities: voca-tional distance training and book publishing. Both of these fields were subject to strict State and ideologi-cal control in China. CEAC's Chinese partner would therefore have to be institution-ally sound and to have good connections. So I patiently went about visiting a number of colleges and universities in Beijing and Tian-jing. I soon came to the conclusion that the universi-ties would never be suitable partners for CEAC, for at least 1\\10 reasons: a) because their standard response was that education in China could not be carried out by joint ventures, nor could it be done for profit. At most there could be some kind of institutional collaboration under a non-commercial legal arrangement. And b) be-cause, naturally enough, the people I dealt with at the Chinese universities belonged to the academic world, not the business world. Some of them even disapproved of commercial activities. . . ."

Vallejo consequently decided to change his tactics and began to focus his efforts on the publishing world. But, once more, the contacts were unfruitful. One day he had dinner with a Colom-bian friend who worked as a transla-tor and copy editor for the State-run firm New World Pub-lishing Co., which belonged to the Foreign Language Publishing Group, formerly the Interna-tional Publications Bureau of the Council of State. The Colombian friend very kindly offered to introduce Vallejo to some of the man-agers of New World Publishing Co.

"The first contact was fruitless, because the person we visited had no interest whatsoever in our proposal. However, the

second interview, held on the same day, was with a real gentleman, who spoke exquisite Span-ish and who, as he later told me, had agreed to receive me purely for the pleasure of speaking Spanish for a while. His name was Zheng Mou Da, and he turned out to be a lucky find for our project."

Vallejo told Zheng Mou Da about CEAC and its activities in Spain and other countries. The first meeting was followed by a series of interviews-two or three a month between July and December 1994-in which the two par-ties got to know each other better.

"Gradually', as we slowly built up a relationship of trust, Zheng Mou Da told me that the Chinese government was putting pressure on them to find new busi-ness opportunities. A publishing operation for Taiwan for example. They also realized that they needed to im-prove their business administration skills. Their interest in CEAC was completely centered on book publishing activities. He also felt comfortable talking to the repre-sentative of a small Spanish publishing company, which did not have the same approach as the large American and German publishing groups. Later, he confessed that they had turned down proposals for collaboration with other large Western publishing groups."

In October 1994, Zheng Mou Da gave Manuel Vallejo a draft that outlined a possible operating agreement be-tween CEAC and New World Publishing Co. This draft had in principle, been approved by Zheng Mou Da's su-periors. Vallejo analyzed the document, added his own comments and sent it to Marti Castro.

In November 1994, CEAC's CEO, accompanied by Esteve Julia, manager of the International Division, went to Beijing, where they had several meetings with Zheng. This was a preliminary direct contact, basically just so they could get to know each other, since Vallejo had stressed how important it was in China first and foremost to estab-lish good personal relationships. It soon became clear that an atmosphere of trust and understanding had built up be-tween Zheng Mou Da and Juan Antonio Marti Castro. Among the various issues that were dealt with, Marti Castro came to the conclusion that the Chinese expected CEAC, should an agreement be reached, to appoint one of its most experienced managers, one who had a thorough knowledge of the industry, to run the hypothetical future operation in China.

During these meetings, they also started to work out some of the details of a possible letter of intent.

Having made progress on both points, Marti Castro in-vited Zheng Mou Da to visit CEAC in Barcelona, alone, with some of his managers, so that they could see for themselves how the company worked. 'Their expenses, in Spain would be paid by CEAC.

In January 1995, Zheng Mou Da visited Barcelona with two of his executives (future members of the Board of Di-rectors of the hypothetical joint venture), where, with the help of an interpreter hired locally by CEAC, they were given a comprehensive presentation of the company's activities. They were also received by the President of the Cata-lan Parliament and had dinner with the Chinese Consul in Barcelona. Vallejo had recommended that CEAC show that it was well connected and had good contacts. Finally, CEAC invited the visitors, accompanied by Vallejo, on a trip to Madrid and Granada, once the Protocol of Intentions had been signed. This document specified the objectives of a joint venture to be formed by the two parties and the finan-cial and other contributions to be made by each partner. It was stipulated that 70% or the capital would be held by CEAC and 30% by New World Publishing Co. All of this tal-lied with the framework mandate that had previously been approved by Zheng Mou Da's superiors.

The contract articles of association and operating pro-cedures for the new joint venture were negotiated by Manuel Vallejo in Beijing between February and June 1995 at the halfway point, in April, Vallejo came to Barcelona to analyze the way the plan was progressing with Marti Castro and his whole management team.

By 25 June 1995, Zheng Mou Da and Vallejo had com-pleted their work, in that they had prepared drafts of all the documents needed to set up the new joint venture and start operations. Now it was up to New World Publishing Co. to obtain approval from the relevant Chinese authorities.

Meanwhile, on the strength of the Protocol of Inten-tions signed in Barcelona, CEAC had applied for an ECIP loan 9 from the European Community, which was to be ap-proved in September 1995;for the amount of 250,000 ecus (approximately 41 million pesetas).

Finally, at the beginning of October 1995, Zheng Mou Da informed them that everything had been ap-proved and that New World Publishing Co. agreed to the contents of the draft documents. It was now up to the CEAC Group's Board of Directors to ratify the project. Then, if both parties agreed, the new joint venture would be set up under the name: *"Beijing New World CEAC Consulting Co. Ltd."*

"This Is All Very Well. But. . . Who Among The Ceac Management Team Will Be Willing To Go To China To Set It All Up?"

This was a question that Marti Castro had been asking him-self for some months. After signing the Protocol of Inten-tions in Barcelona in January 1995, it was becoming more and more crucial and urgent to find an answer.

Marti Castro was convinced that he would need to send a high-ranking CEAC manager to China to head the joint venture as Managing Director. This post could not easily be occupied by Manuel Vallejo-not because of any lack of personal ability but because his consulting firm, Taxon, had other assignments to fulfill. Furthermore, al-though Vallejo had gradually become acquainted with the CEAC Group's business policy, he was far from having the intimate operational knowledge required to start up a sub-sidiary located so far away.

At the end of February 1995, Marti Castro was won-dering whether he would have to resort to a headhunting company to find a Managing Director for China from out-side the CEAC Group. However, one day, while he was dis-cussing some details of the China project quite informally, over lunch, with a group of managers, it suddenly occurred to him to say, more as

a joke than 2S a serious proposition: Well, if any of you wants to go to Beijing to he in charge of this project, speak up.

Among the managers having lunch with Marti Castro was Jesus Flores, Director of the Data Processing Depart-ment of all the companies within the CEAC Group. He recalled that moment:

"I had made several trips to Portugal and had been to Poland a couple of times. Naturally, when the Chi-nese delegation led by Zheng Mou Da visited our com-pany in Barcelona in January 1995, I had explained the Group's data processing systems to them. When Juan Antonio asked the question, I had to give an evasive answer at the time, but the truth is that, from that mo-ment on, I started thinking about it. I saw it as a com-pletely new challenge. After a few days of thinking it over to myself, I mentioned the idea at home. To my surprise, my wife Mireia agreed."

A few days later Flores discussed the matter formally with Marti Castro, who thought it a marvelous idea. Thus in April 1995, the "China project" was assigned to Flores, once certain details had been settled, such as his acceptance of the assignment for a term of three years, which was the time it was expected to take to start up the new company in China.

In July, husband and wife spent a fortnight in Beijing to sort out everything to do with living there, especially housing and schools for their children. When they saw that these matters could be satisfactorily settled their decision to go to China was confirmed, in spite of the fact that Mireia, who was an indus-trial engineer and a PDD gradu-ate from IESE, would have to leave a good job.

During the following months, -Flores gradually de-voted more of his time to the China project and handed over responsibili-ties to his replacement at the head of the Data Processing Department. "During that time, I was in contact with Vallejo almost daily via the Internet."

Market Survey Carried Out By Ogilvy & Mather

In October 1995, Ogilvy & Mather carried out a market survey by conducting a series of focus groups in Yantai (Shandong). The aim was to get to know the initial reaction of the market, that is, of the potential CEAC students in China. The partici-pants in the focus groups were asked about their educational needs, their opinions on vocational distance training in general, their reactions to the type of courses that New World-CEAC Consulting Co. would be offering both as regards content and as regards the system for monitoring students' progress by means of tutors, the exercises, the final exam, etc.

The opinions of about 50 participants were gathered. The following is a summary of the conclusions:

The focus group participants did not consider what New World-CEAC was offering as "distance training." For them, "distance training" Was something quite dif-ferent, with much lower quality materials and content, and without any real monitoring of students at all. Dis-tance learning was seen as archaic, and as a "poor re-lation" of the university, to the extent that the very words "distance learning" made them nervous and tense. They said: "Everything you have been showing us and telling us about is NOT distance training! It is something quite different much better!" It was there-fore decided that New World-CEAC would offer "PERSONALIZED training" courses.

The potential students expected to receive some sort of - officially recognized certificate at the end of the course.

Distance training, though of poorer quality, did exist in China in traditional subjects such as accounting, fashion design, English and medicine. However, there were no courses on subjects such as finance, market-ing, automobile mechanics, air-conditioning systems or childcare.

There was obviously a certain demand for courses like the CEAC courses-that were not simply texts but a complete system for independent distance learn-ing, taking the student through the material step by step breaking it down into manageable chunks, high- lighting the key features, so that ". . . pupils who are studying on their own do not feel that they are left to their own devices, given that they are accompanied by the text itself, the exercises and the teacher-tutor."

The participants in the focus groups were also asked about the price they would be prepared to pay for a course of this type. The conclusion was that they would be prepared to pay up to 100 yuan for each monthly lesson or teaching unit, i.e. about 1,500 pese-tas per month. This represented approximately 20% of the average official wage of New World- CEAC's target market, which was around 500 yuan per month.

If it sold its courses at this price, New World-CEAC would obtain income equivalent to about 30,000 pese-tas for a complete course (1,500 pesetas per teaching unit x 20 monthly teaching units), whereas the average price of a course in Spain was around 125,000-130,000 pesetas. However, the economic effort made by the Chinese students would be- relatively much greater, since the average CEAC client in Spain could pay for the whole course out of one month's wages, whereas in China they were willing to pay the equivalent of FOUR months' wages for a course!

This seemed to confirm .the view expressed by Manuel Vallejo and the executives of Ogilvy & Mather that the average Chinese citizen earns little, but nev-ertheless has money to spend, perhaps partly from ac-tivities in the informal economy.

Curiously, the participants were convinced that any-thing to do with education was a "local issue." They found it difficult to understand how anyone could pos-sibly offer educational services from one city to an-other, or even across the whole country. They thought that. . . "a school in Beijing is designed to serve the citizens of Beijing."

Finally, contrary to what they had found in certain for-merly Communist countries of Central and Eastern Europe, it became apparent that in China people were anxious to do things, to improve themselves, to build a better future, to make money.

Sales Forecasts and Quantification of the Project

In October 1995, using the information gathered by Manuel Vallejo and bearing in mind the results of the focus groups and CEAC's experience in Spain and Poland, Jesus Flores prepared forecasts of enrollments and sales (see Exhibit 4).

Flores estimated that if the first adverts appeared in the press in September 1996, the company could expect around 1,504 student enrollments in the last four months of that year. In 1997, the first full year of operations there would be 13,750 new enrollments, and 18,100 in 1998.

Flores then applied high drop- out rates. He assumed that only 45.7% of those who enrolled on a course would actually complete it. For example, of the first 280 students to enroll in October 1996, he assumed that a certain proportion would drop out each month, so that by May 1998-after 20 months- only 128 students would buy and pay for lesson No. 20 and so complete the course.

Exhibit 4 forecasts prepared by Jestic flares in oct

1996													
	January February March			**April. May**		**June**	**July**	**Augt. Sept. Oct. Nov. Dec.**					**Total**
Print run (thousand uriits) of media used									8,000	8,000	8,000	8,000	32,000
Response rate from media adverts									0.04%	0.07%	0.09%	0.09%	0.07%
Number of requests for information									2,800	5,600	7,;WO	7,200	22,800
Conversion rate requests/enrollments									0%	5%	7%	10%	6.60%
Enrollments (new students)									0	280	504	720	1,504
1997													
	Jan. February March			**April**	**May**	**June**	**July**	**Augut. Sept. October Nov. Dec.**					**Total**
Print run (thousand units) of media used	10,000	10,000	10,000	11,590 11,500 11,500			11 ,500	11 ,500	13,000	13,000	13,000	13,000	139,500
Replies from media adverts	0.09%	0.09%	0.10%	0.10% 0.10% 0.10%			0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Number of requests for information	9,000	9,000	10,000	11,500 11,500 11,500			11,500	11,500	13,000	13,000	13,000	13,000	137,500
Conversion rate requests/enrollments	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10.0%
Enrollments (new students)	900	900	1,000	1,150	1,150	1,150	1,150	1,150	1,300	1,300	1,300	1,300	13,750
1998													
	Jan. Feb. March			**April**	**May**	**June**	**July**	**Aug. Sept. Oct. Nov. Dec.**					**Total**
Print run (thousand units)' of media used	16,000	16,000	18,000	18,000 20,000 20,000			22,000	22,000	22,000	22,000	22,000	22,000	240,000
Response rate from media adverts	0.08%	0.08%	0.08%	0.08% 0.08% 0.08%			0.08%	0.07%	0.07%	0.07%	0.07%	0.07%	0.08%
Number of requests for information	12,800	12,800	14,400	14,400 16,000 16,000			17,600	15,400	15,400	15,400	15,400	15,400	181,000
Conversion rate requests/enrollments	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10.00%
Enrollments (new students)	1,280	1,280	1,440	1,440	1,600	1,600	1,760	1,540	1,540	1,540	1,540	1,540	18,100

Exhibit 5

| | | |

Exhibit 5 (cont.)

									Revenue						
1998															
% *of Drop-Outs/*															
Total Enrollments		*January*	*February*	*March*	*April*	*May*	*June*	*July*	*August*	*September*	*October*	*November*	*December*	*Total*
Number of														
students enrolled		1,280	1,280	1,440	1,440	1,600	1,600	1,760	1,540	1,540	1,540	1,540	1,540	18,100
Unit 1	3.44%	1,236	1,236	1,390	1,390	1,545	1,545	1,699	1,487	1,487	1,487	1,487	1,487	17,477
Unit 2	16.50%	1,048	1,032	1,032	1,161	1,161	1,290	1,190	1,419	1,242	1,242	1,242	1,242	] 4,400
Unit 3	8.25%	962	962	947	947	1,065	1,065	1,184	1,184	1,302	1,139	l,139	1,139	13,035
Unit4	4.81%	915	915	915	901	901	1,014	1,014	1,127	1,127	1,239	1,084	1,084	12.239
Unit 5	6.87%	853	853	853	853	839	839	944	944	1,049	1,049	1,154	1.010	11,240
Unit 6	7.90%	695	785	785	785	785	773	773	870	870	966	966	1,063	10,117
Unit 7	2.06%	680	680	769	769	769	769	757	757	852	852	946	946	9,548
Unit 8	4.47%	650	650,	650	735	735	735	735	723	723	814	814	904	.8,867
Unit 9	2.75%	632	632	632	632	714	714	714	714	703	703	791	791	8,375
Unit 10	3.09%	612	612	612	612	612	692	692	692	692	682	682.	767	7,962
Unit 11	0.35%	531	610	610	610	610	610	690	690	690	690	679	679	7,701
Unit 12	1.03 'X,	473	525	604	604	604	604	604	683	683	683	683	672	7,422
Unit 13	1.72%	465	465	516	594	594	594	594	594.	671	671	671	671	7,098
Unit l4	2.06%	364	455	455	506	581	581	581	581	'581	657	657	657	6,659
Unit 15	1.72%	250	358	447	447	497	571	571	571	57]	571	646	646	6,149
Unit 16	2.06%	136	245	350	438	438	487	560	560	560	560	560	633	5,525
Unit 17	3.09%	0	132	238	340	424	424	472	542	542	542	542	542	4,742
Unil18	0.28%		0	132	237	339	423	423	470	541.	541	541	541	4,188
Unit 19	1.50%		0	0	130	233	334	417	417	463	533	533	533	3,592
Unit 20	1.00%		0	0	0	128	231	330	413	413	459	527	527	3,029
											i			
Total		11 ,782	12,296	13,009	13,424	14,052	14,485	15,163	15,137	] 5 .344	15,546	]5,742	15.933	171,913
Amount in RMB		1,402,029	1,463,189	1,548,084	1,597,502	1,672,199	1,723,687	1,804,436	1,801,266	1,825,899	1,849,957	1 ,873,341	1,896,009	20,457,598
Amount in Pesetas 18,991,959 19,820,437 20,970,42421,639,840 22,651;685 23,349,154 24,442,980 24,400,045 24,733,721 25,059,604 25,376,368 25,683,428 277,119,644														
Retail Price:	119RMB													
1RMB	= 13.55 ptas.													

Assuming gradually increasing selling prices and a gradually decreasing Yuan /Peseta exchange rate, Flores es-timated that total revenues from students would be around 5.4 million pesetas in 1996 (3 months); 126.4 million in 1997; and 277.1 million in 1998. By the end *of* 1998, New World-CEAC would be enrolling 1,540 new students per month. Taking into account the estimated "drop-out rates", by December 1998 the company would be selling 16,000 lessons or teaching units per month to students who had enrolled during the previous 20 months.

Flores used these sales figures to prepare the pro-jected profit and loss accounts for 1996,1997 and 1998 (see Exhibit 6).

According to these projections, the new subsidiary would lose around 14.4 million pesetas in 1996, but would earn 26.4 million pesetas before tax in 1997, and 72.8 mil-lion in 1998. In theory, these profits were to be shared be-tween the partners in proportion to the capital each one *of* them had put in, i.e. 70% for CEAC and 30% for New World Publishing Co. However, CEAC's management felt that, for many years to come, all profits should be plowed back into the business.

The action plan specified that students would pay for their monthly lessons month by month. The lessons would be sent and paid for on delivery, or could be picked up and paid for in person at any *of* New World Publishing Co.'s 2,300 retail bookshops. The new company would initially launch three courses, English Language, Marketing, and Accounting, with a view to extending this number to six during the first full year *of* operations.

The formal accounting procedures were as follows: CEAC-Spain would supply Beijing New World-CEAC Con-sulting Co. Ltd. with business and teaching expertise in ex-change for a 6%

royalty on sales to students. New World Publishing Co., in cooperation with an adult education cen-ter, would take care *of* selling the courses and collecting payment. From these sales revenues it would deduct its translation, adaptation, printing, advertising and distribution expenses, as well as a commission for its services. The con-sulting company would then invoice New World Publishing Co. for the amount *of* this gross margin arid from it deduct its own expenses (personnel, administration, communications, utilities, financing), plus the 6% royalty on sales payable to CEAC-Spain. The remainder, after tax, was the amount available, in theory, to self-finance the development *of* the joint venture or, even more theoretically, to be dis-tributed to the partners in proportion to their shareholdings.

The accounting procedure was clearly rather compli-cated, since the idea was to specify and take into account the contributions and activities of each partner, allocating the costs incurred. There was a danger *of* disagreements in

Exhibit 6

		1996				1997				
			Percentage				*Percentage*			*Percentage*
	RMB	*Ptas.*	*of Sales*	*RMB*		*Ptas.*	*of Sales*	*RMB*	*Ptas.*	*of Sales*
Gross sales	372	5,412		9,148		126,446		20,458	277,120	
Taxes (VAT,	43	623		1,052		14,547		2,354	31,881	
consumption)										
Net sales	329	4,789	100	8,095		111,899	100	18,104	245,239	100
Cost of goods sold	86	1,253	26.16	2,219		30,672	27.41	4,526	61,310	25.00
Distribution costs	6	84	1.75	145		2,003	1.79	324	4,390	1.79
Sales commission	11	159	3.33	270		3,726	3.33	603	8,166	3.33
Marketing expenses	320	4,656	97.21	*!,4V-*		20,355	18.19	3,174	42,995	17.53
Cost of reviewing	3	38	0.80	132		1,824	1.63	295	3,997	1.63
students exercises										
Depreciation	35	507	10.59	100		1,376	1.23	208	2,820	1.15
Overheads	724	10,537	220.00	1,545		21,362	19.09	3,259	44,143	18.00
(general expenses)										
Office rental	70	1,019	21.27	140		1,935	1.73	280	3,793	1.55
Technology royalties	44	640	13.37	46		636	0.57	48	650	0.27
Profit before	(969)	(14,104)	-294.48	2,026		28,011	25.03	5,3"87	72,974	29.76
Interest and tax										
Interest	(25)	(364)	-7.59	(115)		(1,590)	-1.42	(15)	(203)	-0.08
Profit before tax	(994)	(14,467)	-302.07	1,911		26,422	23.61	5,372	72,771	29.67

the future as to how it should be interpreted, but it seemed a workable system for publishing and selling CEAC's courses on the Chinese market, with royalties payable to the Spanish partner:

The Ceac Board Meeting at The End of October 1995

In making their decision whether to sign the agreement with New World Publishing Co., the members of CEAC's Board of Directors considered the following points in favour and against:

In Favour:

1. We have already invested around 100,000 dollars in the project. If we decide to back out now, this sum will have to be computed directly to losses.
2. Jesus Flores is willing to take charge of the project. It is very important that we have our man on the spot, managing the project.
3. We can also count on the continued collaboration of Manuel Vallejo as a consultant and as a member of the Board of Directors of the joint venture. Vallejo can back Flores in any "power relations" with the Chinese partners.
4. The ECIP loan has been approved. by Brussels since September 1995. This means not only that CEAC- Spain Will have to put up less capital of its own, but also-according to the rules governing ECIP loans-that if the project eventually fails, the entire loan will be written off.
5. Manuel Vallejo-who attended the meeting with a right to speak but not to vote-summed up his experience in the Chinese market: "If you want to get into China, you have to do it gradually, step by step. There is an old Chinese proverb that says you must cross a river slowly, feeling the stones under your feet. It will be a process of trial and error. Although at the moment we are not too sure about the project, the important thing is to be there, to start doing business, to start gaining the confidence of our local partner and the Chinese authorities. They must see that we mean business that we are loyal, cooperative partners. If we do that, we may find that opportunities start to emerge, sometimes even unexpectedly and in surprising ways."
6. And, of course, for its sheer size the Chinese market is every entrepreneur's dream. More than 1.2 billion people, hungry for knowledge and for good-quality services. CEAC's

vocational distance training courses would have practically no competition.

Against:

Other members of CEAC's Board of Directors raised the following points against the project:

1. My first objection is a question of priorities. China is very far away and possibly more remote, culturally and politically, to us in Spain than any other country. Why don't we give priority to the Central and East European countries for the time being? Once we have consolidated our position there, I would be in favour of setting ourselves more ambitious goals. Going to China now seems like too great a leap. We should take a more gradual approach.
2. I don't like the substance of the agreement. We will be too dependent on our local partner. We are effec-tively placing ourselves in the hands of New World Publishing Co., since they are the ones who do the invoicing and collect payment from the students.
3. If we give our approval, we had better prepare our-selves to invest at least another 300,000 dollars in the project. And what is worse, if we start the project and it does not work, it could turn into a bottomless pit. The bigger our investment becomes, the more diffi-cult it will be to abandon it if things do not work out.
4. We know practically nothing about the market or the way it might react. We hardly know what adver-tising media we would use, or what the cost per newly enrolled student might be. In fact, we do not even know whether the Chinese will be remotely in-terested in the courses we sell in Spain. . .
5. New World Publishing Co. is in the publishing busi-ness. We have an agreement with them to create a *consulting* company! As things stand. If we sign documents, the only thing we would *really* be authorized to do in China would be to provide Consultancy services in areas connected with publishing such as photocomposition software and desktop publishing. *Nowhere is it clearly stated that this new subsidiary can sell vocational distance learning courses, because it* is *legally FORBIDDEN for a joint venture with a foreign partner to carry* out *educa-tional activities.* We have known for months that what little vocational distance training there is in China is run by State -owned universities in other words, non-profit public corporations which naturally, do not have any foreign shareholders. It is im-possible to guess how many years we might have to wait for a change in the laws, in a Communist coun-try like China!
6. Furthermore, the market research carried out through the focus groups in Yantai clearly indicates that stu-dents will expect to receive a diploma or certificate on completing their studies. Not even New World Pub-lishing Co: is authorized to issue such certificates -and it never will be authorized, because it does not belong to the Ministry of Education but to the Bureau of Publications. Our local partner is simply a publishing house, not a university or a school
7. Manuel Vallejo warned: "We are entering virgin ter-ritory, taking the first steps in an environment so far unexplored by foreign companies. We must maintain a presence, until the laws that govern this industry in China start to change. . . assuming they do eventu-ally change, as we all expect we must trust and rely on our local partner. They are institutionally power-ful, and they seem to be ready to take active steps to ensure that we are allowed to operate, maybe under some exception to current legislation, or by finding some unexpected way around it. Of course, every-thing will be under the absolute control of the Chi-nese, to the extent that they will even censor the text of the courses we sell. All things considered, we do not know with any precision what our starting point is, and there is no guarantees that we will ever reach our target destination. . . and we have even less idea where all this might lead."

NOKIA AND THE CELLULAR PHONE INDUSTRY

In the early spring of 1994, Mr. Jorma Ollila, CEO of the Nokia group, looked back on a successful year where his company's cellular phone sales had increased by more than 70 percent and his profits had more than doubled. In a growing market, the Finnish company had managed to in-crease its market share, moving from a global market share of 13 percent in early 199210 20 percent at the end of 1993. Rapidly increasing development costs had forced many of Nokia's competitors to shut down or sell out to large rivals. How could Nokia sustain its growth in such a turbulent industry? How could the management make de-cisions in light of such uncertainty?

Evolution Of The Industry

The mobile phone industry was born as a result of the need for professionals to contact others on the move. With only a restricted amount of the radio spectrum, it meant that an open broadcast system needed to squeeze every conversation out on the same limited bandwidth. The cellular break-through was achieved at AT&T's Bell laboratories in 1979, making it possible for the same tiny bandwidth to be used by thousands of individual¥, switched messages. By the beginning of 1993, cellular service was in place in more than 90 countries.

There were several categories of products on the market for wireless communication. Mobile communica-tion was, beside cellular telephones largely represented by pagers, with an estimated 50 million subscribers 1 world-wide in 1993. The pagers can, like the cellular phones, also receive short messages in both data and voice. Computer companies like Apple, AT&T, IBM, and AST Research in-troduced personal digital assistants (PDAs). These hand-held, pen-based computers could send wireless facsimile and electronic mail and were expected to include voice communication eventually. The mode of communication used depended mainly on the complexity and urgency of the message. E-mail, pagers., computers., or facsimile did not provide instant Confirmation that the message was re-ceived. This was possible only with the telephone.

The cellular telephone industry consisted, like the tele-commu-nication industry, of production of phones, infrastructure, and operators of the infrastructure. Infrastructure refers to the transmitting towers, and the many categories of switch-ing technology used to establish the connections. Motorola, Ericsson, and Nokia were manufacturers of both infrastruc-ture and cellular phones. The interdependency between these two sectors is very tight, as a feature developed for handsets only is functional if the infrastructure can accommodate it (see Appendix). Operators of the cellular networks were often also those providing fixed wire telecommunication in a given area, although competitors were starting to make ag-gressive moves on that market. Well-known companies such as Sprint, AT&T, McCaw cellular, and most of the national operators in Europe were players in this arena.

The Nordic governments had chosen the NMT (Nor-dic Mobile Telephone) 450 analog standard in 1981, when this region became one of the first areas in the world to es-tablish cellular services. Sparsely populated areas cost too much to connect by fixed wire, and this posed a further in-centive for establishing cellular services. Unique to the Nordic countries were the roaming possibilities between the countries (see Appendix), creating a system covering the entire Nordic area. Cellular users roam as they move from the coverage of one service provider to another. The existence of roaming agreements between service providers/ operators of different areas widen the geographic coverage provided to the users. By 1994 the fruits, resulting from an early move into cellular communication along with a common standard and a coherent set of roaming agree-ments, had begun to show: Penetration rates in this region, of up to 10 percent, were the highest in the world. The NMT-450, and the newer NMT-900 standard had also been adopted in many other countries, such as the Netherlands, France, Belgium, Spain, Austria, and Thailand, but roaming across borders was only possible within the Nordic NMT system due to the agreements existing between the gov-ernments in these countries.

Several producers of cellular telephones existed in the Nordic region. The dominant producers were Swedish L. M. Ericsson and Nokia Mobile Phones, headquartered in Finland. These were also the main providers of cellular infrastructure to the system. Other European producers of cellular telephones were Siemens, primarily focused on the German market, and Technophone Ltd., the main pro-ducer of cellular phones in the U.K. market. Several small, innovative companies were on the scene in the industry's infancy, like Storno and Cetelco, and major multinationals like Philips and Bosch were marketing phones under OEM agreements.

Before the implementation of the European digital standard, as described later, several analog standards pre-vailed in the area. There were seven non-compatible analog standards in Europe, led by the NMT-450 and NMT-900 standards, and the British developed TACS standard.

Most of the European telecommunications services were state owned, resulting in monopolistic situations with the effect of slowing the growth in cellular phones and ser-vices due to the high calling fees that were demanded. In 1993, the German penetration rate was as low as 2.47 per-cent due also to a poorly integrated cross-country coverage.

In the United States, commercial cellular telecommu-nications began in 1983, with the implementation of the AMPS (Ameri-can Mobile Phone System) standard. The Federal Communications Commission (FCC) sets the rules for

competition on the cellular communication scene in the United States, and has given licenses to several re-gional operators.

The American structure was based upon regionally competing companies/operators, which have made the overall network differentiated and incoherent. Roaming possibilities were technically possible, but agreements be-tween the operators uncommon. Furthermore, the U.S. an-titrust laws complicated the rise of nationwide agreements between competing entities. The penetration rate in 1993 was approximately 6 percent, and the American manufac-turer Motorola Inc. dominated this market. At this point, the innovator of the technology, AT&T, had only just started to manufacture cellular phones themselves.

Japan was the first country to license cellular service in 1981, but the development of a nationwide service was not achieved until 1984. This service was offered by the Nippon Telegraph and Telephone Corporation, who had a monopoly position on the Japanese market. After 1985, NIT was to be privatized over a five-year period and other private companies got access to providing cellular services. The structure was controlled by the government in such a way that NIT provided national services, and the com-petitors had their own regional area, in which NIT was the only other competitor. The structure caused a slow growth in subscribers because of the high connection prices, and a low level of geographical coverage. This manifested itself with a base of only 1.7 million subscribers in 1993.

The Asian-Pacific countries, except for Japan, had adopted diverse standards including NMT, TACS, and AMPS, and the Latin American countries had chosen the AMPS. Growth within the standards in these markets was relatively low compared to the other regions, with a sub-scriber base account-ing only for approximately 10 percent of the worldwide number of both analog and digital sub-scribers in 1993.

In the middle of 1993, there were an estimated 27.3 million analog subscribers worldwide, where the United States counted for 48 percent, Europe 25 percent, and Asia-Pacific (including Japan) 15 percent.

Change in Technology

By 1991, the limitations of the analog standards were be-coming critical due to the high growth in subscribers, prompting the emergence of the digital technologies. The analog standards had less capacity within a given fre-quency band and were also affected by wave interference thereby easily absorbing noise.

The first standards employing digital technology were the pan-European GSM and the American TDMA. The new systems were based on digital transmission of signals (bits), eliminating noise in the transmission. Digital take up less bandwidth in the radio spectrum. Allowing a given allotted channel range to carry more information -and as a result allowing more users on a system than the analog technology. The digital standards also made it pos-sible to transmit facsimile and computer files at far higher speeds and higher quality, which opened up the pros-pects for these functions. The digital standards were, over a period of time, likely to replace the analog standards but as has been the case with the analog technology, several different standards already existed within the digital tech-nology. As a result, the global market was divided up into smaller segments according to which standards (both analog and digital) prevailed in the regional markets.

Some drastic changes occurred in the industry along with the technological shift. In the initial stage of the digi-tal era, development costs rose sharply, as the knowledge required to develop a handset in a digital standard was far greater than the same effort in the analog field. Developing an analog handset took roughly 10 man-years of engineering, while, initially, a model in the new digital standards re-quired 150 man-years, or 15 times the amount of work, posing far larger requirements for the size of the develop-ment team. The development of software was becoming an activity of importance, as much of the functionality of hand-sets and networks would now depend on this component.

A notable difference between the digital and analog technologies was an overall shift in the production process. While the analog standards were relatively low in knowl-edge content, they were harder to mass-produce. The dig-ital standards required a lot of development, increasing fixed costs, but were better suited for mass production due to lower marginal costs. Moreover, the pace of develop-ment grew and the number of standards on the global market, as a whole, rose. As with the analog stan-dards, having developed models in one of the digital standards increased a company's knowledge base for entering the next generation of standards, creating a springboard effect. Another factor necessitating scale was the constant short-ening of the model life spans. The PLC curve can be viewed as an aggregate of the sales of all the cellu-lar phone models on the market at a point in time. It is made up of the life-span curves of the different models introduced over time.

The average market life of the various top models used to be over a year. In early 1994, a premium model marketed six months earlier was already moving into the discount segment, having been replaced by a more sophis-ticated version.

Many of the small national producers were hit hard by this change in the structural environment. At the time when these firms had managed to develop a digital model, the three large players were already promoting their second generation of terminals. Some of the small players disap-peared, while others were bought out by rivals. Meanwhile, entrants were trying to acquire the competence to partici-pate on the scene. A fierce battle was raging.

The Market Implications of the Technological Change

The large potential for economies of scale did not, how-ever, result in a convergence of the many standards. The es-tablishment of the standards had not been controlled by government intervention or voluntary international stan-dards agreement, but rather resulted from innovations taking place in the individual markets, and this was still the case as the digital standards emerged.

Europe now had two digital standards, the Group Special Mobile (GSM), promoted by the European Union (EU) countries, and the DCS 1800, which is explained later. The argument for implementing a pan-European digital standard

was to promote the development of the European telecommunication industry and provide other industries with improved communication and information possibili-ties. As was the case with the NMT, the GSM was designed- as an open standard in a collaborative effort between gov-ernments and industry-and could thus be adopted by any producer capable of developing the technology. The GSM was meant by the EU to replace the existing analog stan-dards and was supposed to reach 13 million subscribers by 1997, but the analog systems were cash cows for the opera-tors, so their life span was projected to reach some" that beyond the turn of the millennium.

The GSM roaming agreements stretched across bor-ders, allowing, for example, the use of the GSM standard to communicate to/from all EU countries and several nations on the periphery, where a base-station was in reach. The vision of the GSM system was technical compatibility com-bined with roaming agreements to provide access within the system. A system could conceivably also encompass two standards, if dual standard terminals were made and roam-ing was agreed upon between the two subsystems. The GSM networks in other areas of the world can be said to have used the same standard, but made up separate systems of roaming. To have access to cellular communication, it was necessary to have both a handset and a service agreement. In most cellular phones, the service agreement was identi-fied by an electronic code stored in the handset, which would identify the caller and give her access to the network. For the GSM standard, this caller ID was stored on an elec-tronic card the size of a credit card, which was inserted in the handset in order to make it operable. Thus, the same phones could be used, but they required separate service agreements (SIM cards). GSM had already been adopted by 62 countries at the end of 1993.

Another digital system, the Public Communication Network (PCN), came about due to the recognized prob-lems of GSM capacity limitations in highly populated areas. PCNs following the DCS-1800 standard use a higher operating frequency than the GSM standard, and each con-nection takes up only half the bandwidth, thereby ensuring higher capacity. Each base station covers an area of approx-imately 500-meter radius (or smaller). The capacity is greatly increased, as each of the small cells is capable of carrying twice the connections of the larger one, while using only the same frequency width. Costs per connection were also ex-pected to be much lower than for the larger radius systems, resulting over time in lower calling fees. Because of the shorter range required of the PCN terminals, battery time would increase significantly. In all, PCN was directed at the mass market, making quick reduction in unit costs possible, and thereby also lower prices. PCN systems were installed in the United Kingdom and Germany by the end of 1994.

In the United States, the FCC did not interfere in the imple-mentation of the digital standards. The fight stood be-tween the TDMA standard, which was largely provided by Swedish L. M. Ericsson, and the CDMA standard, which was provided by Motorola. These two standards could exist side by side, but were not compatible. Implementation of digital standards in the United States was based upon a co-existence with the prevailing analog standards (quite the opposite of the European strategy of replacing the analog standards with the GSM system). PCN systems were also to be installed in the United States as a third digital standard.

Exhibit

Millions of Subscribers			
	End	***End***	***End***
	1988	**1992**	**1993**
Europe"	1.5	6.0	8.3
United States	1.6	NA	15.0
Japan	*O4*[b]	*0.9*	1.7
Asia-Pacific			
Excluding Japan	NA	1.6	2.6
Latin America	NA	NA	1.1
Others	NA	NA	4.4
Total subscribers	4.1	22.1	33.1

Exhibit 3

Segment	1994	1998
Consumers	15%	40%
Business	80%	45%
Mobile data	5%	15%
Source: Nokia Mobile Phones.		

The analog standards were still profitable and had excess capacity, which, together with the voluntary choice of transition to digital standards, had set the pace of digi-tal implementation to be slower than that in Europe. Crit-ics argued that this delay would be problematic for the evolution of international standards, where some (perhaps inferior) technologies get a head start, and thereby hamper the introduction of superior technologies.

In Japan, the analog systems were experiencing ca-pacity overload, and implementation of a digital standard was expected in 1994. By that time, another two service providers had been licensed, but the licenses given to those other than NTT were still only regional, therefore, creat-ing a poorly developed nationwide net for cellular services, with a low penetration rate as a result.

Market Growth and Expected Changes in Segments

The cellular phone market growth rates from 1991 to 1992 and 1992 to 1993 were 60 percent and 50 percent, respec-tively. The total number of subscribers amounted to 33 mil-lion by the end of 1993. Predictions on the total number of subscribers in the year 2000 range from 100 to 170 million, suggesting high compounded annual growth rates (see Ex-hibits 2 to 5).

Up to 1994, market predictions had been mostly un-derstated. There was no doubt that the number of sub-scribers would rise sharply in the coming years, but the price level and, thus, the market size would be shaped by conditions about which there was great uncertainty. As-pects affecting growth were cost of the terminals, the pric-ing of airtime, versatility of the product, ease of use, and coverage of the service agreements.

"Nokia Mobile Phones forecast the increased impor-tance of the consumer and mobile data market segment.

The level of product differentiation was not high, al-though special features were used to a certain degree, aiming to attract the higher-priced business segment.

With investments made in the digital networks that had still not borne fruit, and a still low base of subscribers, operators deemed it necessary to boost sales in order to reach the degree of utilization that would ensure returns on their investments. This was often done by subsidizing the handsets when consumers signed up for service agree-ments. The retail promotions boosted demand from the op-erators to the producers. Ability to deliver was key to the operators so they pressured producers on delivery sched-ules rather than price.

Nokia group M$	1993	1992	1991	1990	1989
Net sales	4,096	3,463	3,747	6,103	5627
Costs and expenses	3,898	3,493	3,668	5,907	5478
Earnings excluding tax, etc.	198	-30	79	196	149
Taxes/minorities, etc.	397	108	130	120	110
Net earnings	-199	-138	-51	76	39

Source: Nokia Annual Report 1993.

Operating profit nokia Group M$	1993	1992	1991	1990	1989
Telecommunications	170	81			
Mobile Phones	164	83			
Consumer Electronics	*-129*	-149			
Electronic Groups total a	-	-	-56	144	57
Cables and Machinery	45	22	24	106	100
Basic Industries [b]			52	68	86
Other Operations	3	18	-43	-19	-2
Nokia Group	253	55	-23	299	241

The larger part of the sales derived from the United States and Europe, but other markets were rapidly starting to emerge. Eastern Europe and China and other Asian countries were starting to demand both infrastructure and handsets. Because of the economic growth in the regions, the demand for communications services was rising, and cellular technology was a cost-effective and speedy alter-native to investing in a new fixed wire network.

Exhibit 7

Nokia

Nokia started as a paper and pulp mill in 1865, where the first ground-wood mill was situated on the Nokia River in Finland.

In 1967, the company expanded by merging with large rubber and cable interests. Later on, through the 1970s and 1980s, Nokia added plastic, metal products, chemicals, and electronics to the group by acquisition. In 1994, Nokia con-sisted of five business groups: Consumer Electronics, Tele-communications, Cables & Machinery, Mobile Phones, and Other Operations (e.g., tires), but had over a relatively short period changed its focus toward telecommunications (see Exhibits 6 and 7), where it ranked as the ninth largest telecommunications equipment vendor globally. Total assets of the Nokia group were $3.9 billion, with a debt to asset ratio of approximately 50 percent.

Nokia Mobile Phones

Nokia Mobile Phones represented 26 percent of the group net sales, corresponding to $1.1 billion (see Exhibit 8). Re-search and development (R&D) expenditures were $50.3 million and $73.6 million in 1992 and 1993, respectively. The productivity within the cellular phone division increased dramatically after 1990, with an increase in sales per em-ployee of 138 percent.

The firm was shaped by vigorous rivalry because Fin-land has one of Europe's most innovative and competi-tive markets in telecommunications, with some 52 communica-tions providers in 1991.

In the beginning of the 1980s, the Nokia group started producing analog infrastructure and cellular phones for the NMT-450 standard. The small home market meant that Nokia had to export from day one in order to increase volume. Soon, the company was manufacturing multiple standards and had thus acquired a wide base of knowledge and scale at an early stage.

The firm's main objective was to satisfy its customers, and this was used as the guiding principle on which all ac-tivities were focused. An objective was to acquire 25 percent global market share in 1995 (see Exhibit 9), emphasiz-ing expansion on all markets. The importance of not getting trapped producing low value-added commodity products, and remaining flexible in order to produce cellular phones to many different standards, and being able to market them, was emphasized. Priority was placed on design, consumer adaptation, and user friendliness, including a focus on size and weight of the cellular phones.

The firm's strengths in fast development enabled them to be the first supplier of the GSM network in Europe and the first in the market with a commercial GSM portable phone. Further-more, they delivered phones and network infrastructure to three of the world's four PCN systems. Nokia develops and markets all cellular infrastructure through Nokia Mobile Phones. In all, they had a broad well-developed knowledge base built upon the competence gained from the many offered standards. Even so, Nokia recognized the necessity of increasing the development effort to meet future challenges.

The product range included all major analog and dig-ital standards. They also had original equipment manufac-turer (OEM) producer status for Philips, Hitachi, Swatch, and AT &T. The agreement with AT&T was made in April 1994 and valued by Nokia at $170 million a year. Joint ven-tures with Japanese cellular companies like Mitsui and Kansai in develop-ing digital cellular phones for the Japan-ese market has improved access to this market. Nokia's global market share

rose when they acquired the British cellular producer Techno phone Ltd. in 1991.

Production facilities were situated in Finland, Ger-many, the United Kingdom, the United States, Hong Kong,

Exhibit

Market shares (and Ranks) of incumbents of the cellular phone industry 1988, 1992 and 1993

Market shares	May 1988	Feburary 1992	End 1993
Motorola, Inc.	12.8%	22.0%	36.0%(1)
Nokia	13.4%	13.0%(2)	20.0%(2)
L.M. Ericsson	3.9%	NA	10.0%(3)
Panasonic	NA	NA	4.0%(4)

and Korea. Even though the main costs of producing a phone derived from the components and development, there were still cost advantages to assembling handsets in low-wage countries. The attractiveness of these locations was often augmented by the availability of government sub-sidized loans.

Nokia was not vertically integrated. Semiconductors were bought mainly from AT&T, supplying also the essen-tial Digital Systems Processor. Components were also bought from Motorola. Nokia focused on designing the electronic compo-nents themselves, and out sourced the manufacturing to other companies. They manufactured both cellular infrastructure and - handsets providing the ability to offer complete packages to operators, as well as technological spillovers.

Distribution channels to consumer markets were, however, not yet well established. Nokia though had a rel-ative advantage because of their Consumer Electronics Di-vision, which had experience promoting products to the consumer segment, and which had established access to distributions channels. Brand identification was becoming increasingly important, with the transition toward the mass market the firm was still struggling with a low degree of recognition, but expected to intensify marketing efforts.

A study made on this subject revealed that consumers had positive opinions of Sony's cellular phone, eyen though it was not yet marketed-where it became clear that the major players in the cellular phone industry did not enjoy nearly the same degree of recognition among the consumers. Nokia was often thought of as a Japanese brand, which caused a problem due to still lingering neg-ative images of Japanese producers, especially in the U.S. market when up against an American firm. Nokia had fur-thermore formed numerous alliances and agreements with other firms such as Tandy Corporation in the United States in 1983;mainly to overcome some of the marketing hurdles. Nokia cellular telephones were sold under the names Nokia, Technophone, Mobira and, as mentioned, via numerous OEM deals. The terminals were sold through specialized stores, retail chains, and operators. Nokia's market share in GSM phones was higher than in analog phones. Sales in the United States increased 73 percent in 1993, yielding a 19 percent United States market share, while European sales "only" doubled. The growth in cellular subscribers was smaller in these two regions in 1993, meaning that Nokia gained overall market share. The - number of potential users of the digital TDMA standard in the United States was increasing with positive implica-tions for Nokia's prospects.

Nokia believed open communication to be indispens-able for setting mutual targets, and each employee bore re-sponsibility in this respect. Knowledge is a capacity only when it is shared. The development of products employed the Concurrent Engineering Process. This meant that, when designing new products, the product development, market-ing, sourcing, and production departments cooperated closely as a team, making the developing process faster and more cost-efficient, and cutting the product's time to mar-ket. Nokia's operations were based on decentralized struc-tures and measured control. Fast change in the environment and technology brought opportuni-ties, which in turn pro-vided the firm with the possibility to discover new abilities and resources within the organization. The company con-sisted *of* young, flexible, and cooperative employees, but the pressure on them was great, increasing the risk of organi-zational defects. They were, however, equipped with the strong fighting spirit expressed by the Finnish word *Sisu*.

Nokia's Main Existing And Potential Competitors

Motorola, Inc.

Motorola was founded in 1928 as Galvin Manufacturing Corporation and was the leading company in the cellular phone industry (see Exhibit 7). Furthermore, it held a strong position in the field of cellular infrastructure, wire-less communications, semiconductors, and advanced elec-tronic systems and services. Of the turnover in 1993,54 percent was in wireless communica-tions (including two- way radios, etc. Figures for cellular communications can-not be isolated. See Exhibit 10). The total assets were $13.5 billion, with a debt to assets ratio of 56 percent. They held a position as the third largest telecom equipment provider on a global scale.

Motorola focused on gaining market share, and set a goal of obtaining more than 50 percent of the global market for cellular terminals. Another important factor was the concept of constant renewal of technology and processes. Motorola stayed close to four closely coupled sectors in-cluding communications, components, computers, and con-trol and constantly sought to create bridges between them. The company was characterized as a huge venture capital outfit, constantly spinning off technology and capita: into new businesses. The R&D expenditures for the group were $1.5 billion in 1993. A prime example was Motorola's am-bitious Iridium project, a low-orbit satellite system that conceived with the objective of bringing wireless phone ser-vice to the world by 1998. By 1994, they had spent 8 years and $100 million backing the Iridium system. However, some analysts were skeptical of Iridium's profitability, as the average connection price would be $3 per minute, and handsets would cost approximately $3,000. Motorola aimed at 1 million subscribers for this system by 2002, 2 percent of the projected 200 million users of wireless telephony. The wireless connection charges in the United States were roughly one seventh of what Iridium intended to charge.

Motorola had a large home market, which was an advantage in the beginning when lag times between markets were still significant. Every time a new product was intro-duced, it could readily achieve higher volume in sales than companies in smaller countries. With rapid international-ization, this advantage decreased in significance.

Motorola, Inc. M$	**1993**	**1992**	**1991**	**1990**	**1989**
Net sales	16,963	13,303	11,341	10,855	9,620
Costs and expenses	15,438	12,503	10,728	10,219	8,974
Earnings before tax	1,525	800	613	666	646
Income taxes	503	224	159	167	148
Net earnings	1,022	453	454	499	498
Source: Motorola Annual Report 1993.					

High competence at mass production was core to the strategy at Motorola. A quality program called *Six Sigma* had been introduced and aimed at only three to four mis-takes per million processes (not per million units produced). Motorola produced cellular infrastructure equipment and competed in all major analog and digital standards and had delivered. GSM infrastructure equipment to seven countries, and several U.S. operators had ordered the Motorola devel-oped CDMA digital standard infrastructure. The company also produced the digital systems processor (DSP), crucial to the digital standard terminal, in contrast to other major cellular phone producers who had to obtain this component from suppliers. Moreover, the company held fundamental patents required for the GSM standard, but was not able to deliver the complete range of infrastructure for the GSM system due to a lack of the very sophisticated switching tech-nology needed for the roaming function. The takeover of the Danish company Storno in the early 1990s was a step to gain more know-how in this area.

Motorola had a wide distribution network covering most of the world. Its phones were sold through *operators*, mass merchants, specialty retailers, direct sales, and as orig-inal options on cars. The marketing activities stretched over more than 80 countries either under the Motorola name or as parts of OEM agreements with companies such as Bosch and Pioneer. Motorola lacked experience in consumer mar-keting and focused mainly on production and market shares.

Motorola opted for a policy of decentralization. Or-ganizational boundaries were broken down, and coopera-tion between personnel and management was promoted. The result was an atmosphere of informality, where people contacted each other across the former boundaries, creat-ing flexibility and a better flow of information. This re-sulted in an increase in productiv-ity (sales per employee) of 126 percent between 1986 and 1993.

L. M. Ericsson

L. M. Ericsson was founded in 1876 as a *producer* of wire based network equipment. The company, with assets of $8.'1 billion manufactured equipment for both wired and mobile communi-cation and also produced advanced elec-tronic defense systems (see Exhibit 11 for key financials). Ericsson was positioned as number five on the ranking of global telecommunications providers.

Net sales of cellular telephones was $325 million in 1992, and increased 2.5 times in 1993. With in cellular com-munications the company controlled a leading 40 percent of the world market for traditional analog cellular infrastruc-ture, and had been able to acquire 60 percent of the surging market for digital cellular infrastructure equipment.

The objective of L. M. Ericsson was to keep its strong position in the cellular business, and to gain a part of the expected future growth in the industry, especially within infrastructure equip-ment, and an important factor in real-izing these goals was product development, a cornerstone at Ericsson. Concurrent Engineering was an important fea-ture in achieving an effectively short cycle from a product's initial development stage to the market launch. The impor-tance of R&D was emphasized by its budget of $1.3 billion in 1993.

The firm produced semiconductors and a1so bad sup-pliers such as General Electrics and Analog Devices firm which the crucial Digital Systems Processor was acquired.

Ericsson focused on small production batches, having traditions in ordinary telecommunications and phones. On the cellular side, they concentrated on minor batches of ad-vanced units.

The home market of Ericsson was rather small, necessitating exports in order to get volume in sales. This forced the company to be internationally oriented at an early stage, and it already had an integrated distribution network around the world due to sales of ordinary telecommunica-tion equipment. Ericsson was also into several partnerships around the world, such as with Alcatel and NEC and with Nokia in China. Heavy spending on advertising in foreign markets provided the firm with a degree of brand recognition in most markets.

At Ericsson, human capabilities took on a central role. Motiva-tion of employees through personal responsibility, and a high degree of freedom at work combined with cooperation and also a degree of independence, explained some of the success of the project-oriented organization.

L. M. Ericsson M$	**1993**	**1992**	**1991**	***1990***	**1989**
Net sales	7,630	6,770	8,395	7,702	6,130
Costs and expenses	7,207	6,492	8,019	6,883	5,424
Earnings before tax	423	278	376	818	576
Tax/minorities	82	210	216	NA	NA
Net earrings	341	68	160	NA	NA

The Japanese Competitors

Japan had about 20 companies selling cellular phones in 1991.5 Some had their own production, of which Matsushita (using the brand name Panasonic) and NEC were the only ones with significant sales of cellular phones outside Japan, though they were still operating at a rather small scale com-pared to

Motorola, Nokia, and Ericsson (see Exhibit 7). Others had signed OEM agreements with major producers outside Japan such as Motorola and Nokia. The best known in this category were Sony, Pioneer, and Hitachi.

The Japanese were trying to establish themselves in the fast - growing cellular phone market. They were attracted by the high future potential in the consumer segment, espe-cially because of the high knowledge they possessed in this area due to their consumer electronics. They were regarded as having an advan-tage in this area.

The Japanese home market was large, providing potential for high volume. The consumer electronics mar-ket, however, was usually characterized by being pro-tected by import restrictions with fierce competition raging between a large numbers of national companies. These companies had access to low cost capital, due to the favorable financial environment created by the-culture, en-compassing longer perspectives, higher savings, and high degrees of inter corporate lending. The Japanese shareowners were traditionally less focused on high and imme-diate returns.

The Japanese generally had competence in large- scale, low-priced, high-quality production, and a compre-hensive distribution network all over the world, which they coupled with strong brand names. This was particu-larly exhibited by their position on the consumer elec-tronics market. However, the speed of development and the many existing cellular standards did not favor the use of reverse engineering, which was a commonly used method of development.

By 1994, Matsushita had not yet launched a globally competitive cellular terminal for the digital systems. With the industry environment current at that time, the Japan-ese had some difficulty entering the scene. The companies also lacked knowl-edge in cellular infrastructure.

Future Expectations In The Industry

In 1994, the industry was in turbulence, but this was ex-pected to calm down with product standardization. A pre-diction of when this would happen and which standard would become dominant was not possible due to the many possibilities of further systems' innovations.

Development could also slow down within certain standards as technologies stabilized, as was predicted to happen with the GSM not far beyond 1994. 'This has pro-vided firms like the Korean company Maxon with an op-portunity to enter the field. Maxon planned to produce low price GSM phones to be marketed in Europe and other regions employing the GSM standard. In 1994, the highway innovative firms still had an edge over late entrants, in handset technology and in their ability to cover multiple standards. Two tendencies were predicted: short-term high innovation and turbulence, and medium-term maturity.

The major future objective of Nokia was to protect and expand its position. This required awareness of changes in the environ-ment and a continuous accumulation of re-sources and capabilities inside the organization in order to establish the capacity needed to cope with the expected growth in the cellular phone market.

Appendix: How Does Cellular Communication Work?

An illustrative example is used to explain the functioning of the cellular technology

Discerning between the terms *system* and *standard* is important in order to comprehend the different solutions to cellular communications offered on the market. A system, in the context of this case, is understood to be the network within which a personal service agreement and terminal can be used. This, in other words, is defined by the extent of the existing roaming (see later) agreements and whether the same terminal is compatible with the whole system. A standard defines the specific; technology used for the contact to take place. In order for a terminal to be used, it must be compatible in standard and the user must have a service agreement with an operator within the system.

A person moving down the highway dials a number on a cellular handset. The handset sends a signal, with a range of 10 to 30 km, that is received by a base station (Tower), as shown by A in Exhibit 12. The base station has to use the same techno-logical standard as the phone does. The base station with the best contact to the cellular phone is chosen by the network and the signal passes through the public fixed wire network to the MTX (Mobile Telephone Ex-change, [B]).The MTX is the *brain* in the system, constantly keeping track of the cellular phone on stand-by, in order to track its position. The MTX sends the signal back through the fixed public network, which, if the call is to a stationary phone, connects the call to the dialed number (C in exhibit). If the dialed number is to another cellular telephone, the MTX locates the other terminal (the MTX tracks this, if the terminal is on standby and within range of a base station) and sends the signal to the base station-through the fixed network (D)-closest to the receiving terminal, and final contact is made (E). The second cellular phone does not have to be covered by the same service provider as the one calling. If the two service providers are different, the MTX of the first service provider will simply connect through the fixed network to the MTX of the second.

The people using cellular phones are often moving from one area (cell) to another during a conversation. The MTX ensures that seamless contact is sustained by switch-ing the transmis-sion from one base station to another; this is referred to as the hand-off function. The MTX will typi-cally serve the base stations in one area. As the user moves into another area, her conversation is "handed off" to the MTX serving that area and this capability is referred to as roaming, and provides the user with a wider area of use for her terminal.

The question of channel allocation and terminal iden-tification also needs to be addressed. The telephone calling is registered through a signal with an access code, in order to bill the calling fee to the owner. The cellular system is closed, meaning that a terminal will not be recognized and serviced without the access code. Each operator is licensed to use a portion of the frequency band allocated for the total system/standard in a given area. This frequency por-tion is able to carry a certain number of simultaneous contacts. The frequency used for transmission is chosen in-dividually for each separate call by the MTX. Each

base station can utilize the whole allocated frequency band. The MTX only has to ensure that adjacent towers do not trans-mit two separate contacts using the same frequency, as this would cause interference between the signals.

As the systems work now, the interconnect problem using the public fixed wire lines, affects the prices charged by the operators. The national monopolies can use discrimina-tory pricing on the connections used by the external cellu-lar operators. To overcome this problem, there are examples of operators that intend to use parabolic antennae between the base stations, in order to avoid using the fixed wire net-work (at least when the contact is cellular to cellular).

The Launch of Gsm Cellular Telephones In South Africa

Driving to Jan Smuts Airport for yet another flight to Cape Town, Vodacom's Managing Director, Alan Knott-Craig contemplated the year ahead in anticipation of tomorrow's management strategy meeting. South Africa's cellular in-dustry had not only recorded the world's fastest launch of a GSM cellular subscriber base but had also become the world's fastest-growing cellular market and the second largest GSM cellular subscriber base in the world in just one year. Such an achievement, during the transition to Mandela and De Klerk's new South Africa, surprised in-dustry experts around the world. Solid market leaders with a 65 percent estimated share, Knott-Craig's team would be contemplating the next phase of market growth and competitive strategy.

The Cellular Communications Industry

South Africa's cellular communications industry consisted of four main players: network operators, service providers, dealers, and equipment manufacturers.

Network Operators Vodacom and Mobile Telephone Networks (MTN) were awarded the first two network operator licenses by the gov-ernment regulator. The licenses empowered each operator to set up and operate the network infrastructure necessary to provide national GSM digital cellular coverage. Although Europe's GSM digital cellular standard was more expensive than the analogue cellular standard most common to the United States, Britain, and other countries, GSM's many advanced capabilities such as fax and data transmission were leading to growing acceptance as a global standard. After many debates, the South African government specified the GSM standard. Vodacom and MTN were assigned separate frequencies for transmission and reception from the avail-able radio frequency band. Some frequencies were reserved for a potential third network in the future.

The ownership of both network operators included international firms, government or quasi-governmental bodies, and local black business consortia. Vodacom's re-lationship to Telcom, the state-owned, fixed-wire tele-phone monopoly, almost assured it of appointment as the first network operator.

Licenses were awarded to both Vodacom and MTN on September 30,1993 and they began building network infrastructure. However, due to the certainty that Vodacom or Telkom would be awarded at least one of the licenses, MTN began building network infrastructure later and was well behind on April 1, 1994 when the test period began for a limited number of subscribers. Although MTN had made gains by the official launch date of June 1, 1994, it was clear that Vodacom remained ahead in many important geo-graphic coverage areas.

The regulator leveled the playing field by requiring both network operators to allow "roaming" during the test period and the first 3 months of normal operations. Roam-ing allowed an MTN subscriber to place calls in an area", where only Vodacom base stations existed or where MTN base stations were operating at capacity when a subscriber call was placed. Similarly, Vodacom callers could place calls using MTN infrastructure if Vodacom coverage was not available. The two networks agreed to cease roaming ahead of schedule in August 1994, except for emergency calls. Sub-scribers from either network could make a "112" emer-gency call on any network-even from phones without the Subscriber Identity Module (SIM) card inserted in the cel-lular phone. The SIM card was a *smart card* containing an integrated circuit chip to identify the caller at network-level for billing and administrative purposes.

The regulator allowed the network operators to set up and manage their own distribution channel. Following the international trend, both network operators appointed ser-vice providers.

Service Providers

Service providers marketed network services and provided the bulk of customer care. Exclusive service providers acted on behalf of one network-dual service providers repre-sented both: but in all cases a client wishing to subscribe to a cellular network was required to sign a contract with one of the network operators' appointed service providers. The South African Cellular Service Providers Association (SACSPA) was established to promote the interests of ser-vice providers and provided a forum for cooperating on matters of common concern such as fraud and bad debt. Both network operators encouraged service providers to become SACSPA members.

Service providers were responsible for the sale of handsets, car kits and other cellular equipment, airtime sub-scriptions, account billing and collection, and ongoing client service. Customers did not have any direct relationship with the network operators. The network operators billed service providers for total calls made by each subscriber (airtime) less a discount of approximately 25 percent to 30 percent (depending on the number of subscribers enrolled by the service provider and a loyalty bonus) plus a monthly sub-scription fee, which varied according to the tariff the cus-tomer chose. Certain incentive payments also were paid. Connection bonuses were paid for net new subscriptions signed by a service provider. Although these subsidies were confidential, the media regularly speculated that subsidies ranged from Rs 500 to R2, 000. Most media sources indicated that service providers used the subsidies to lower the price of cellular handsets. The loyalty bonuses were designed to entice dual service providers to concentrate business with one network and varied according to the proportion of a ser-vice provider's total subscribers using a particular network.

Network operators received and transmitted cus-tomer calls. Every time a cell phone was turned on, the Vo-dacom system would record the nearest base station(s). This allowed the placement of a call from any telephone or cellphone to interconnect into the appropriate switches for ultimate transmission to the cell user. Thus, a particular call might utilize not only Vodacom's equipment, but also equip-ment of Telkom. Vodacom's network equipment recorded the SIM card number, the number called, the cellular hand-set IMEI identification number, the starting and ending time of the call and the type of call for every call as part of a call data record (CDR). The network operators down-loaded the resulting CDRs, and reports concerning calls, to service providers on multiple occasions during the day via node-to-node links. Data were formatted to be readable by the service providers' billing systems.

Service providers received the CDR transmissions and other reports for use with internal accounting and management software-the most important component being the billing system. Billing systems performed the mission-critical function of allocating CDRs to subscribers so subscribers were billed for calls placed. In addition, some billing systems offered integrated application pro-cessing capabilities that included issuance, activation, and deactivation of handsets and SIM cards on the network as well as performance of certain record-keeping in custo-mer care centers. The software used was complicated and most service providers procured the EPPIX billing system marketed by a U.K. firm that specialized in cellular billing systems. Other service providers formed strategic al-liances with overseas service providers and adapted the partner's administrative systems and business strategies to the local market. A few service providers developed local administrative and billing systems. There was little stan-dardization of billing systems and even EPPIX installa-tions could be configured quite differently. Vodacom's own information technology division was headquartered in Cape Town.

There was little doubt that all service providers had experienced administrative and financial difficulties that were exacerbated by the short notice' many had received concerning their appointments. As a result, some service providers did not have billing systems up and running when the test period began.

Service providers were hard hit by the faster than ex-pected growth, especially the financial management and management information departments. It was obvious that many were having difficulties getting costs under control The first -year results announced by the two publicly traded service providers showed signs of the severe trading con-ditions: Knott -Craig had heard rumors that the published results were typical, perhaps better, than many privately held service providers, and he had heard the reverse. In any case, the persistent rumors that smaller service providers would not last 6 months had not been fulfilled, and the in-dustry ended the first year with 17 service providers-the same number that had begun the year.

Vodacom owned service provider- VODAC. MTN's major shareholders controlled another service provider, M-TEL. Suspicions of favoritism to these service pro-viders tainted relationships with some service providers. The network operators' licenses did not require them to use service providers, but Vodacom believed that service providers had been proven to speed market penetration around the world and the firm had committed to contracts with 11 service providers.

Dealers

Service providers often appointed dealers to sell airtime subscriptions on their behalf. Vodacom had gained an early competitive advantage when Teljoy and Vodac signed dealer agreements with certain major retail outlets and dealers. This had resulted in fast growth. Teljoy, the leading national TV rental chain with shops located in top retail sites, had become the world's second largest GSM cellular service provider and captured over one third of the South African market, largely as a result of its retail presence and exten-sive advertising prior to and during the launch of cellular. Teljoy had been advertising heavily in advance of the launch of national satellite TV in recent months.

Many dealers had come and gone during the first year. For some, this was an intentional strategy to take advan-tage of short-term opportunities created by the explosive launch. Others were undercapitalized, and service provider billing system problems allegedly held up incentive pay-ments far too long to allow dealer survival in many cases.

International and local fraud syndicates had pene-trated the dealer network, and the police had made many arrests. Service providers often used the full connection bonus payment and other promotional funds to subsidize the price of equipment sold on longer-term airtime sub-scriber contracts-often comparing the sale of Rs 2,500 phones for little or nothing to the sale of razors below cost to promote usage of blades.

Posing as legitimate clients, fraud teams either bought cellular, phones at the low, subsidized prices or stole them and exported them to other GSM countries. Theft of air-time represented a far greater hazard. Many "phone shops" had been discovered in urban areas where local and inter-national phone calls were sold at reduced rates. Call charges exceeding many thousands of Rands were sometimes com-pleted before service providers became aware of the prob-lem. Customers were reporting their cell phones stolen from restaurants, cafes, and even from their bedside tables while they slept.

Fraud team links to African and Asian drug syndicates had been reported in the press. A "phone shop" could quickly run up a Rs 10, 000 bill on a stolen SIM card in a weekend, offsetting the total monthly airtime (calls) rev-enue of more than 65 average subscribers. SACSPA had shared police evidence concerning the infiltration of the country by international fraud syndicates in anticipation of the 1995 Rugby World Cup (which South Africa later won). A classic tournament watched by billions around the world, this was the first time the World Cup had been held in one country and experts wondered if the police force was up to the challenge of international fraud teams.

Regulation

The Postmaster General was the official regulator of the telecommunications' industry Pallo Jordan, Minister of Posts, Telecommunications, and Broadcasting, was responsible for the government's overall communications strategy. The minister

was rethinking telecommunications policy, and an extensive Green Paper had been circulated for dis-cussion to the South African public and all interested par-ties. The continuation of Telkom's fixed wire telephone monopoly was debated in the Green Paper but seemed un-likely to change. The regulator had approved a number of Vodacom tariff plans. Service providers could not charge I more than the regulated call tariffs, although they were free to discount any tariff.

Knott-Craig was conscious that the Vodacom and Telkom cultures were different due to the nature of the businesses but felt that certain aspects of culture were shared. He was particu-larly pleased that he could draw on Telkom and Vodafone technical expertise and business ex-perience when required. However, the impression that Vodacom received special favors either from Telkom or the Regulator, were a constant source of irritation that Knott-Craig was tired of denying. He also tired of rejecting alle-gations that Vodacom favored Vodac or Teljoy over other service providers.

Equipment Manufacturers

Equipment manufacturers participated in the industry in two ways: by supplying cellular base stations and infrastruc-ture to network operators and by supplying cellular hand-sets and accessories to service providers and dealers. Nokia, Ericsson; Alcatel, Siemens, Panasonic, and Motorola were among the leading brands participating in the latter. Voda-com sourced base stations from Siemens and Alcatel while MTN's network standardized on Ericsson equipment.

Service providers felt that the equipment manufac-turers were becoming problematic. Consumer dissatisfac-tion with manufacturers was a serious problem, according to the SACSPA. Some manufacturers were taking up to 6 months to repair handsets under warranty, and this necessitated significant investments in loan phones. No doubt, Motorola's decision to appoint major retailers as distribu-tors would affect service providers, even though retailers would require a service provider to connect their sub-scribers to a network operator.

There was also a constant threat of stock shortages as new countries adopted the GSM standard. Many manufac-turers shipped stock only after receiving q letter of credit and then shipped amounts less than those ordered by the major service providers. News of a Chinese consortium be-ginning the manufacture of GSM handsets had appeared in the South African business press. Manufacturers also were organized in a trade association, the CTMIA.

THE BUSINESS ENVIRONMENT

South Africa's cellular industry received a baptism of fire in its first year. Violence racked the country in the run-up to President Nelson Mandela's election on April 29, 1994. When the government announced that two network oper-ators would be appointed, the appointment of a second network operator became highly politicized, delaying the appointment of a second network operator.

The first half of 1994 had been politically turbulent. There were constant rumors right wing or left-wing forces would attempt to sabotage the elections or overthrow the government if Nelson Mandela's African National Con-gress (ANC) won. Many skilled people were leaving the country and, paradoxically, many were returning. Some po-litical parties spoke of privatiz-ing state-run monopolies, such as Telkom, and the parastatals controlling the trans-portation, iron and steel, and electrical distribution indus-tries. Although these bodies represented a comparatively high percentage of GNP compared to other countries, ANC supporters such as the labor unions and the Communist Party of South Africa voiced disapproval of privatization schemes. Some political parties were advocating that re-construction and development required nothing less than a centrally planned Marxist/ Leninist economy.

Cellular telephony was viewed with suspicion by many parties who viewed the proposed launch as a thinly dis-guised attempt to keep the control of telecommunications in the hands of the white minority. Thus, even though both licenses were awarded on September 30, 1993, an agree-ment was reached with the African National Congress only on October 22, 1993. Equip-ment purchases and service provider appointments could only begin thereafter. South Africa traditionally comes to a standstill during the mid--December to mid-January Christmas break, and this cre-ated additional problems. Some service providers had been appointed as late as a few weeks prior to the April 1994 roll-out to a limited subscriber base for testing.

Both licenses required the network operators to sub-sidize cellular telephony in the historically disadvantaged communities. Both networks had initiated projects in this regard and ap-pointed black-owned service providers. In addition, Vodacom and MTN were to engage in economic activities outside their mainstream business to the value of R1 billion to the govern-ment at the end of five years. At-tempts to increase the historically disadvantaged popula-tion's access to telecommuni-cations resulted in Vodacom's telephone shop, which was designed to house up to 10 cel-lular pay telephones. The shops also created much-needed jobs. MTN could take credit for the invention of the world's first working GSM cellular pay phone in a similar project.

The Market

South Africa blends First and Third World characteristics. First World shopping malls and business areas and Third World squatter shacks often coexist within kilometers. Ur-banized areas generally have high economic activity and income, but rural areas are much poorer. Exhibit 1 highlights some indicators of human and economic development.

Knott-Craig was concerned about the escalating vio-lence in the country during early 1995. Violent crime had reached the levels experienced prior to the election in some areas, and the police were clearly experiencing diffi-culty in combating crime. Security had positive and nega-tive impacts on cellular telephone usage. Security was a popular reason for buying a cellular phone and promotions featuring on-call security services by Auto page Cellular and Teljoy both seemed to have done well. However, it was fanoo early for reliable usage statistics to be available for subscribers interested in security.

The Government of National Unity was exceeding the expecta-tions many held prior to the election. President Mandela was especially popular. However, ANC's Recon-struction and Development Programme was moving more

EXHIBIT 1 Selected development statistics for selected countries

	Population in 1992 in millions	Gross domestic product in 1992 in $US million	Energy use per capita in 1992(per capita kilograms)	Telephone main lines in 1990 (in Thousand)	Access to safe drinking water (%)	Crude birthrate in 1992 (per 10000 population)	Human development index
United states	255.4	5920199	7662	136337		16	.925
New Zealand	3.4	41304	4284	1469	97	17	.907
Korea	43.7	296136	2569	13276	93	16	.859
China	13.6	41203	837	861	87	23	.848
Mexico	85.0	329011	1525	5355	89	28	.804
South Africa	39.8	103651	2487	3315		31	.650
Indonesia	184.3	126364	303	1069	34	25	.586
Kenya	25.7	6884	223	183	49	37	.434
Pakistan	119.3	41904	92	843	72	40	.393

slowly than expected, and President Mandela had recently ordered his cabinet to pursue economic growth with in-creased vigor. The school system was a particular worry for many people with school-aged children, and there was a perception that managerial and professional people with kids were leaving the country in record numbers, although official emigration statistics did not confirm this perception. There was a possibil-ity that the stringent exchange controls placed on emigrating people may have had some impact on how many people actually reported immigration.

Marketing

Achieving competitive advantage required careful analy-sis on the network operator and-service provider tier. The nature of government regulation often made it difficult to differentiate a business in meaningful ways from one's competitor.

Product

Network coverage, that is, the area in which calls could be placed and received by cellular users, was a common way to differenti-ate cellular networks. With the exception of a dif-ficult period of over subscription during August and Sep-tember 1994, Vodacom felt that its network covered a far larger area and boasted superior quality. Network quality was measured by counting calls dropped (disconnected due to *some* network problem) and consumer complaints about the quality of the audio transmission Although MTN's net-work started building months after Vodacom, it was clear that MTN would catch up to Vodacom within the short term.

Promotion

The coverage advantage had been the focus of Vodacom's major selling effort masterminded by GM Joan Joffe and was a major reason that two out of three subscribers had chosen Vodacom. The award-winning Launch of GSM Cellular Telephone in South Africa TV advertisement fo-cused on this coverage advantage. The R21 million mea-sured ad spending placed the combined TV, press, and radio spending in the top 20 South African companies' ad spending for 1994-just behind MTN's R23 million. Ser-vice providers also promoted network brands in their own advertising and both networks enjoyed widespread brand awareness. Exact figures were unavailable but the com-bined advertising spend of the service providers probably exceeded R20 million.

Joffe was particularly proud of the recent promotions con-nected to Vodacom's sponsorship of the Rugby World Cup. Adverts had high recognition and had received high liking and noting scores. Market research indicated that the TV advertise-ments were particularly well liked and \ *Toda*-com's share of purchase intent had increased significantly- Joffe could not say whether this was due to MTN's ongo-ing coverage problems or the promotional campaigns but believed it might be due to both.

MTN's advertising also had been very effective. Fea-turing a unique and humorous monotonic delivery by a male gravelly-voiced announcer, the TV and radio ad shared the advantages of having the magic of MTN's mobile commu-nications at one's disposal. MTN positioned its brand as "the better connection" and achieved high recognition and branding. The innovative use of an MTN airship also aided brand recognition.

Pricing

Government regulation affected pricing strategies most. Consumers generally judged two costs when considering adopting cellular telephony. Initial one-time costs included the cost of the cellular handset and any accessories (such as a hands-free car kit), the cost of the SIM card (R65.00), and the cost of activating the SIM card on the network (the connection fee R125.00). Ongoing costs included the monthly subscription (R125.00) and call charges (RUO per minute during peak hours and R.65 during off-peak hours). The av-erage user received a monthly bill of R250 to R300.

Call charge tariffs, monthly subscription fees, SIM card charges and connection fees were regulated, and both net-work operators charged the same amounts. Network oper-ators could ask for new tariffs to be approved but the other network was

also free to apply to use the same new tariff immediately. Service providers were allowed to discount call tariffs in order to gain business. However, a discount of even 10 percent of the call tariff would be reduced directly from the service provider's 25 percent to 30 percent of the total call charge-thus, a 10 percent discount could result in almost a 40 percent reduction in sales revenue at the ser-vice provider tier. SACSPA felt that such discounting would seriously jeopardize the long-term survival of the service provider tier, and there was some question as to how dis-counts could be applied without infringing on the network requirements for approval of new tariffs by the regulator. Indeed, one firm that was alleged to discount tariffs ran into financial trouble almost immediately. Some service providers were devilry bundling packages with added value emergency services and other augmented product offers that were clearly legal.

Both networks subsidized the cost of handsets. Initial subsidies did not affect the price of handsets significantly but, as competition heated up at the end of the first year, subsidies had increased to a very significant level. The large subsidies allowed service providers to sell low-end R1, 500 handsets for almost nothing and to sell top range handsets for as little as R 2,000.00. Indeed, Auto page had bought up the total available stock of a new Alcatel hand-set that was offered with an added-value emergency ser-vices package free of charge to qualifying applicants. Free phones fueled rapid growth but also created the problems noted earlier.

Distribution

The service provider distribution model was a cause of some concern. Vodafone was experimenting with a direct-to -market approach in the United Kingdom. The U.S. model featured network operators and dealers. In the U.S. model, dealers were marketing agents and the networks took total responsibility for the billing and customer service functions. Both approaches had been successful.

Most industry experts would attribute Vodacom's commanding market share to its superior network cover-age and quality and its exclusive presence in leading retail outlets. Teljoy sold cellular subscriptions through its retail outlets located in most shop-ping mall locations across the country. In addition, exclusive service providers-primar-ily Teljoy and Vodac-had tied up exclusive dealerships with major retailers, office supply outlets, and dealers. MTN had also tied up exclusive agreements, but Knott- Craig was confident he had won the early rounds of this fight as he approached a traffic jam on the R24.

The Current Situation

As he thought about tomorrow's strategy meeting, Knott-Craig became frustrated at the traffic jam ahead. It was not normally so crowded at this time of day on the R24 and, as he changed from the CD to hear the traffic report on Radio 702, tomorrow's strategy meeting continued to dominate his thinking. The industry had exceeded forecasts of 100,000 subscribers and achieved 350,000 in its first year.

He sensed that new problems would require very dif-ferent solutions to the past. It seemed certain that explo-sive growth would not be repeated but that the industry could achieve 1 million subscribers by the end of the first three years. It seemed certain that the quality of new subscribers (as measured by average airtime and bad debt) would deteriorate as cellular usage expanded. New sub-scriptions had declined dramatically since both networks had reduced connection bonuses on April 1, 1995. Balanc-ing the desirability for growth against the profit-ability re-quired to satisfy shareholders and to make the RDP payment was not going to be easy.

Technologically, Knott-Craig planned for Vodacom to stay ahead. MTN had recently announced a host of value-added network services that allowed users to use a cellular phone as a pager or to call for a host of services, such as legal advice. Both networks had launched fax and data services and paging services at about the same time. Caller identifi-cation would also be available soon on both networks.

Teljoy had already taken the initiative to launch a 112 emergency service enhancement using the 911 number popularized by an American TV series shown on South African TV. Fax services were to be enhanced shortly. A fax would then be held similarly to voice mail to be re-trieved later when desirable.

The traffic jam cleared as he passed a minor motorcar accident on the freeway, and Knott-Craig could see the air-port in the distance. He would arrive on time.

Harley-davidson Motor Co., Inc.: Defending A Piece Of The Domestic Pie

Introduction

Throughout the 20th century, motorcycles have been produced by a host of American companies. Names such as Indian, Yale, Pope, and Minnesota can be found in the graveyard of defunct American motorcycle producers. Today, only one company in the United States is a manu-facturer of motorcycles-Harley-Davidson. Founded in 1903 by William S. Harley and a trio of Davidsons, Harley -Davidson was for many years the unchal-lenged leader in American motorcycle sales. The company's success was due to a combination of factors-innovative engineering and product design and a company image that inspired fierce loyalty on the part of its customers. In fact, few American manufacturers have ever boasted a product as ingrained in the country's folklore as Harley-Davidson. Be it in movies such as *The Wild One* or *Easy Rider*, or in real life with mo-torcycle gangs like the Hell's Angels, the Harley-Davidson trademark has always evoked an image that is, for better or worse, distinctly American Seen in this light, it is not so sur-prising that the first far-reaching piece of protectionist leg-islation of the Reagan presidency was granted in favor of none other than Harley-Davidson, the only remaining American manufacturer of motorcycles.

On April 1, 1983, the President heeded the recom-mendations of the International Trade Commission (ITC) that a five-year tariff relief program be accorded Harley- Davidson. The ruling culminated a six-year effort on the part of Harley for govern-mental help. Predictably, the com-pany felt it had been vindicated by the Reagan administra-tion. Vaughn Beals, chairman and CEO of Harley-Davidson had this to say: "The President's courageous action demon-strates his support for the concept that free trade must also be fair trade. The

administration's decision, on the merits of the case, tells our trading partners that the U.S. fully sup-ports the concept of free trade, but that does not mean that our government will tolerate unfair competition."

Background To The Tariff Ruling

In the 1950s, Harley-Davidson possessed a share of the American market *of* anywhere from 60 percent to 70 per-cent. It produced powerful, uniquely styled motorcycles that inspired an unusually high degree of brand loyalty. It was in this decade that other American motorcycle makers ceased to exist. Harley was totally unprepared for what it would call the" Japanese invasion" *of* the 19608. The Japanese were able to produce quality merchandise for cheaper prices because of their size and efficient production techniques. These companies were also willing to spend huge amounts on ad-vertising and they successfully introduced millions of Amer-icans (and Europe-ans) to the joys of motorcycling.

Harley- Davidson, for its part, was bogged down with an image problem that was largely *of* its own making. For years it had catered to the rough-hewn biker because he was, after all, Harley's most loyal customer. This strategy did not at all mesh with the spirit *of* the 19608 most typified by Honda's, "You meet the nicest people on a Honda" campaign. Unable to capitalize on this huge new market for motorcycles 'sales increased by 35 percent in 1962 and by an average of 1S per-cent for 10 years afterward), Harley watched its market share drop precipitously. In 1970, it claimed a mere 5 percent *of* the American market (see Exhibit 1 for Current data)

AMF-Harley-Davidson

In 1969, Harley-Davidson was bought by AMF, a recrea-tional equipment conglomerate. AMF proceeded to manage the company in a way that "only portfolio theory can em-brace. Product lines that were deemed unprofitable were dropped instead *of* improved and very little money was di-rected to shore up Harley's position. By 1976, the company offered only four models to consumers, whereas the four big Japanese producers routinely offered 20 to 25 models. Harley's only remaining strength was in large bikes (70Occ and up), and here too they would lose a huge amount of market share. In 1972, Harley-Davidson sold 99.6 percent of the heavy bikes purchased in America. By 1975, this figure was down to 44.4 percent.

The company's initial reaction to these results was to accuse the Japanese of "dumping" their products at unfairly low prices and of copying some of the Harley-Davidson bigbike models. A petition for some form of protection was un-successfully submitted to the government in 1977. At the same time, Harley did very little to extricate itself from its poor market position. The company experienced a gradual decline both in terms of share and product performance. "Quality went to hell and labor relations went to pot," CEO Beals would later say. Harley continued to emphasize the emotional appeal of its machines rather than stress their performance features: "No other motorcycle arouses the same pride, passion, even fanaticism," proclaimed one ad? Later, they would direct much of their energies toward the Japanese, giving their seal of approval to T-shirts bearing the message "I'd rather eat worms than ride a Honda.3

Leveraged Buyout (1981)

Perhaps the most important development of the past decade was the leveraged buyout of Harley-Davidson in 1981 led by Vaughn Beals himself. Beals has since established himself as a charismatic and dedicated manager. In fact, company lit-erature describes him as providing the perfect blend of tech-nical expertise and management skill required to spearhead the "new" Harley-Davidson's aggressive revitalization pro-grams. The most important feature of the buyout, beyond putting Mr. Beals in charge, was- that it got the company away from the short-term mentality that characterized the AMF years Freed from the duty to annually present its per-formance to a group of dividend-hungry shareholders, man-agement has been able to concentrate on spending the necessary funds to put Harley on its feet again.

The Tariff Ruling (1983)

Essential to the rebirth of Harley-Davidson, argued Beals, was a tariff program that would allow time for its program to prove successful. Particularly annoying to Beals was the way in which each Japanese company would slash its prices whenever its inventories built up due to faulty demand as-sessments or a general economic slowdown. This practice irked Harley to no end because its products were more ex-pensive to begin with. The recession years of 1981 to 1982 were very bad for Harley. The company, teetering near the edge of bankruptcy, decided to once again petition for help from Washington. This time, it got some.

The five-year tariff, which went into effect April 15, 1983, provided an additional 45 percent tariff (on top' of the existing 4.4 percent) on motorcycles having an engine dis-placement of 700cc or more, in the first year, with reductions to 35,20, 15, and 10 percent respectively, in the four suc-ceeding years. European imports are effectively excluded from the surcharge through tariff-rate quotas, which provide that only motorcycle exporters of significant size (i.e., X number of units exported) have to absorb the surcharge cost.

Without getting involved in a debate on the merits of free trade versus protectionism, two basic arguments on this ruling have been advanced. First, free trade purists would argue that the tariff is unfair because it protects an inefficient producer of motorcycles. Harley-Davidson is inefficient, they would say, because it has shown itself incapable of offering the consumer anything but overpriced bikes of second-rate quality. The proof of this lies in the vote of the customers in the marketplace. On the other hand, Harley-Davidson argues that the ruling is necessary because the government has a duty to protect its only remaining producer of motor-cycles, who, in addition to competing in an unfair environ-ment, has showed itself to be more than willing to make the financial commitment to improve, but needs time to do so.

The "New" Harley-davidson (1981-1985)

Operational Improvements

The most remarkable aspect of Harley's new approach is how heavily it borrows from the Japanese. Today, the com-pany stresses employee involvement, uses "just-in-time" in-ventory and manufacturing principles, and manages all of its processes

statistically. This, from a company that had said the Japanese owed their success to unfair practices and the copy-ing of Harley's own models. Intelligently, Harley-Davidson has admitted that there might be something to the Japan-ese approach after all. Says Thomas A. Gelb, Vice President/ Operations: "Initially, our management attributed the price and quality differences of Japanese motorcycles to culture, wage rates, and illegal trade practices such as dumping. Only after extensive research did it become apparent that a large part of the competitive edge they enjoyed was achieved through a truly different manufacturing approach, using im-proved and more efficient manufacturing techniques.

"One of the first examples of HarIey-Davidson's will-ingness to adopt innovative manufacturing techniques is in the employee involvement area. Harley-Davidson was the second U.S. manufacturing company to implement Quality Circles-back in 1978. At this point, over half of the com-pany's employees in Wisconsin are active participants in this program. This employee involvement and participation program permits employees to contribute their ideas, do hands-on problem solving, and improve the efficiency and quality of their work. Doors that were previously closed to employees are now being opened. For example, company policy now requires that employees be consulted in the planning of any changes to an employee's workplace or layout, or where equipment or process changes are being considered. Rapport and morale are up. Grievances have been cut in half; absenteeism has been reduced by 44 per-cent, and a job security committee (with representa-tives of both labor and senior management) meets regularly-

"The second area of Harley-Davidson leadership is the 'Just-in-Time' manufacturing program. Since JIT is based on large numbers of small parts runs, it is critical that machines set-up times be held to an absolute minimum. This was one of the first hurdles that were attacked. Set-up re-duction is being approached aggressively and, to date has resulted in an average of 75 percent reduction in the set-up times of the machines to which the process has been ap-plied. These reductions have not been achieved through major capital investments, but rather, through team efforts. Usage of it has also helped reduce floor space require-ments by 40 percent, required movement through the com-plete production process by 62 percent.

"In the Statistical Process Control (SPC) area, Harley- Davidson is proving daily the premise that a continual improvement in quality reduces overall operating costs, Essentially, SPC uses statistics to identify variations in a 'process' (be it in the office, shop, or field) and thus pin-points items that need tighter controls and improvement.

"These three areas-Statistical Process Control, Just-in-Time manufacturing, and Employee Involvement-are producing dramatic quality and efficiency results, such as:

- 50 percent reduction in rejects rates;
- 40 percent reduction in warranty costs;
- 300 percents increases in defect free vehicles received by dealers since 1982;
- Consumers rating quality and reliability as" excellent" increased by 25 percent from 1982 to 1984(Diagnostic Research Inc. study);
- Increasing inventory turns from 4.5 turns in 1982 to 16 turns in 1984;
- Improving productivity by 19.8 percent per employee, from 1982 to 1984,"

Development of quality product line

Harley Davidson has increased the number of models it offers to the consumer to 12 from the low point of 4 in 1976. More importantly the new Harleys have been praised more for their performance than for their trademark. Since the buyout in 1981 Harley Davidson has spent two and a half times the national average for manufacturing companies on research and develop-ment, resulting in numerous product improvement. The single most notable achievement has been the introduction of the Evolution engine, the product of five years of intensive engineering development. The evolution engine features all new major components using the latest design techniques and advanced materials. The result is an engine that produces 15 percent more using 10 percent less fuel. The engine is designed for high reliability and durability with a minimum of scheduled maintenance, making it simpler and less expensive to operate and maintain.

Exhibit 3 Harley Davidson 1986 Model Year Price List

Model code	Model name	Retail price
FLHTC Lib	Electra Glide Lib.	$10474.00
FLHTC	Electra glide classic	10224.00
FLHT	Electra glide	9624.00
FXRD	Grand touring Sport glide	9474.00
FXRT	Sport glide	8749
FXRT	Softail custom	9499.00
FXST –C	Softail	8949.00
FXST	Wide glide	8899.00
FXWG	Low Rider Lib.	8849.00
FXRS Lib	Low rider	8499.00
FXRS	Low rider special	8649.00
FXRS	Super Glide	7549.00
FXR	Sportster 1100 Lib	5699.00
XLH Lib	Sportster 1100	5399.00
XLH	Sportster	4545.00
XLH	Sportster 883	4195.00

Product Innovations

Harley-Davidson has also succeeded in, introducing a host of product innovations:

1. 1984 introduction of a patent-pending "anti-dive" air suspension system that keeps the front end of the motorcycle stable during a hard stop to increase braking efficiency and safety for the rider.

2. Application of elastomer-isolated engines to reduce the vibration previously" associated with Harley Davidson engines.
3. Introduction of a new-design, smooth shifting, five- speed transmission.
4. The first application in the motorcycle industry of solid-state electronic ignition (in 1979) to improve performance and reliability, followed by the first computer-controlled ignition system in 1983.
5. Changes in chassis design and steering geometries to improve handling and increase rider comfort and safety, including introduction of computer-designed frames in *1981*.

These improvements have not gone unnoticed by long- time Harley customers. Motorcycle gangs and police forces a like have returned to buying Harleys. Michael O'Farrell, president of the Oakland Hell's Angel chapter remarked in a recent article in *The New York Times:* "It's amazing, the difference. (The motorcycles}'don't beat you to death any more and your kidneys are still intact"

Development of new Harley image

Management has strived to make a break witl1 the past by changing the company's image. Rather than continuing to cultivate the impression that" Harley-Davidson represents quality because it is the motorcycle of choice for law-breaker and lawman alike, the company now portrays doc-tors, lawyers, craftsmen, and foremen as being the "real" Harley riders. In an attempt to differentiate itself from others. in the crowded big bike sector (which remains Harley's meal ticket), the company cites market research data, which indicates that the Harley rider is generally more educated and has a higher income and a more responsible job than Japanese motorcycle owners:

- 44 percent of Harley purchasers have attended col-lege, versus 34 percent to 39 percent for the owners of Japanese imports.
- Only 11 percent of Harley owners *do not* have a high school diploma versus 18 percent for Honda arid 30 percent for Kawasaki owners.
- Harley purch'11sers have significantly higher incomes than the owners of Japanese machines. A full 28J'per-cent of Harley purchasers earn more.than$35,OQO, compared with 11 percent of Kawasaki owners. At incomes from $25,000 to $35,000 the contrast is even sharper- 35 percent of Harley purchasers earn in this range, with only 12 percent of 14 percent of the owners of Japanese motorcycles earning at this level.

Reactions from Harley Dealers and Riders

Harley-Davidson's efforts to improve its product have not at all been in vain, those familiar with the company will tell you. In Harley's New York City showroom a dealer points to a handful of bikes and says that this is all that is left from the 1985 stock. In general, the mood is upbeat concerning Harley-Davidson: "Here in New York City, at least, man-agement's commitment to quality is showing up both in sales figures and performance. Vaughn Beals is the Lee Ia-cocca of the motorcycle industry."

In suburban White Plains, 42-year-old Richie Pierce, a long-time cycling enthusiast, sells both Harley-Davidsons and Suzukis. Pierce fully acknowledges all that Harley has done to improve itself, yet he says that Harleys and Suzukis, or any other Japanese bike for that matter, should never be compared. "The Harley is, and always has been, an image bike. Japanese bikes are performance bikes. Even with the tariff Harleys sell at a premium. This is because Harley- Davidsons are prestige bikes. As for performance, Harleys just don't match up. The Japanese can easily outspend them and it shows up in the type of motorcycles they produce."

Even though there is a significant difference in per-formance, Pierce feels there will always be a market for Harleys: "I own three bikes and one of them is a Harley. There is something about Harley-Davidson that sets them apart from other bikes. The Japanese have tried to copy the Harley look but it just doesn't work. That's why it is so much easier to resell a Harley than a Japanese bike. If you're going to buy performance, why buy used performance? Harleys have an inimitable style and that's what keeps them going. Besides; the government would never let the only American motorcycle company left go down the tubes."

Harley-Davidsons do indeed seem to have that special something that other bikes lack. When asked to review one of Harleys large touring bikes, -the FLTC, for the magazine *Cycle Guide,* Marc Cook came back with these remarks: "The Harley makes me giggle. Out on the highway, with little else to do but watch the white line, the FLTC makes me laugh out loud inside my helmet. And I'm not entirely sure why. Perhaps it's the seductive rhythm of the engine pulses, or the way that massive vee-twin never seems to run out of torque. Or it could be the uncanny directional sta-bility of the big 'Hog.' Maybe it's the response of the young ladies at the local Haagen-Dazs But; really, I don't think any of these is the answer. The truth is, the Harley flat surprises me. It works so well on the open road-in spite of its rough edges and idiosyncrasies-that I have a hard time *not* watching the scenery."

Harley's Posttariff Performance

In spite of the preceding improvements, Harley-Davidson has yet to return to profitability. The company is certainly in better shape compared to 1981-1982 and yet manage-ment doesn't forsee any substantial profits before 1987.

Demand for motorcycles has yet to bounce back from the reversionary levels of 1982. A glimpse at new motorcycle wholesale sales data reveals that sales in the big bike seg-ment have declined sharply since 1981. As for Harley, its sales have actually decreased since the petrify era. There have, however, been gains made in terms of market share. In 1984, Harley's share of the big bike seg-ment increased 3.2 percent, from 12.3 percent to 15.5 per-cent. Harley-Davidson has also succeeded in reducing the gap between itself and Honda, the leader in the heavy-weight segment. On the other hand, Harley-Davidson's overall share of the American market has actually de-creased since 1981, from 5 percent to 3.7 percent.

The impact of the tariff on the Japanese has been offset, in part, by Honda and Kawasaki, who both have production facilities in the United States. According to Beals, this has

enabled the Japanese to sidestep the tariff: "The Japanese have managed to duck the tariff on about two-thirds of the vehicles that should have been subject to it, by stepping up their U.S. final assembly operations and through the introduction 699cc motorcycles which fall just below the 700cc tariff limit" On the other hand, statistics show dramatic de-creases both in the number of Japanese-produced motorcy-cles entering the United States since 1982 and in the number of Japanese-produced motorcycles with an engine displace-ment larger than 790cc (see Exhibits 5 and 6).

International Sales/Global Strategy

Harley-Davidson, although it has made some key changes in the areas of operations, design, and product image, has chosen to remain an essentially domestic company. This point is under-scored by the fact that, in 1984, Japanese motorcycle manufacturers exported 660,484 units to the United States, while a mere 1,046 Harleys made their *way to* Japan. European export figures are similarly low. Is the passion American Harley owners feet for their machines exportable? Alfred E. Eckes, chairman of the ITC, hopes as much. Eckes wrote in his tariff ruling that "as exports become more competitive with the depreciation of the dollar, it is reasonable to think that Harley. . . will partic-ipate again in export sales."

The difference in size between Harley-Davidson and the four Japanese companies means that it will continue to operate with severe technological and cost disadvantages in relation to its competitors. Tariff or no tariff, the Japan-ese were able to produce 4,026,307 motorcycles in 1984, or one hundred times as many units as Harley-Davidson pro-duced. The only other surviving small motorcycle maker is BMW and it does so with the benefit of the technological and production experience gained through its large auto-mobile division.

When the tariff on large displacement motorcycles ex-pires in 1988, Harley Davidson's fate will be determined by the market-place. What remains to be seen is if its reputation and history, combined with some noticeable improvements over the last five years, will enable it to survive on its own in the *face* of stiff competition *from* companies much larger than itself.

Exhibit - 8 U.S. motorcycle imports by country 1978-1984

	1978	1979	1980	1981	1982	1983	1984
Japan							
Units	882038	848959	1072856	1032520	879861	522573	417825
$ Value	$741232155	$825909951	$1091699966	$1270949357	$1079362753	$666284854	$482238238
European Countries							
Units	50623[a]	33824[a]	40455[a]	21112[a]	16100[a]	13597[a]	17397[a]
$ Value	$54297847	$40121247	$44199496	$39213065	$27977592[a]	$29266634	$38296805
All other							
Units	2825[a]	3969[a]	6905[a]	2081[a]	3242[a]	4043[a]	6198[a]
$ Value	$1737985	$4258537	$6036560	$3624403	$2827574	$1633326	$2851599
Total							
Units	935486[a]	886752[a]	1120216[a]	1056713[a]	917203[a]	540213[a]	441420[a]
$ Value	$797267987	$870289735	$1141936022	$1313786825	$1110167919	$697184814	$523386642

Discussion Questions

1. Do you consider Harley-Davidson to be the victim of unfair competitive practices or of its own lack of strategic vision?
2. How does the size difference between Harley- Davidson and its Japanese competitors affect Harley-Davidson's ability to compete?
3. What are the basic strategic alternatives for Harley- Davidson? What do you recommend? Why?

Appendix 4

AMF-Harley-Davidson

Contrary to your statement, AMF was most generous in their investment in Harley-Davidson. In the period from 1969 to 1975 (prior to my association), they invested very heavily in facility expansion and in new product develop-ment. Most, if not all, the new product development effort was wasted.

From the period 1975 to 1981 they also met the vast majority of our capital needs. That is not to say it wasn't a subject of annual debate, but there was only one major cap-ital program that they refused (and in hind-sight that wasn't a bad decision).

The Japanese copying *of* Harley styling did not com-mence until after we filed the dumping suit in 1977 and re-ceived the decision in 1978. It was in the late 1970s that the Japanese started to copy our styling (Yamaha first), and it took them until early in 1981 *for* them to copy our V-engine format (again Yamaha). In fact, the time *from* the ITC de-cision to copying correlates almost perfectly with the time to modify their products.

Rest assured, we have not given our seal *of* approval to nasty t-shirts. To the contrary, we undertook a trademark license program three or *four* years ago. While this was par-tially motivated by need to protect our trademarks by vigorously defending them, it also served the key purpose *of* cleaning up the offensive t-shirts, etc. which were em-blazoned with Harley trademarks. We didn't believe then, and we don't believe now, that insulting the rider of a com-petitive product is a good way to convince him to switch to your product. Unfortunately, there are still a large number

Exhibit 6 U.S. motorcycle imports by engine displacement 1978-1984

	1978	1979	1980	1981	1982	1983	1984
Under 191cc							
Unit	410260	390900[a]	418829[a]	313944[a]	312891[a]	175212[a]	191856[a]
$ Value	$163144748	$173583756	$189667483	$154771771	$152019038	$94634569	$97761171
191 –490cc							
Unit	203659	166768	316596	249586	182948	75321	67792
$ Value	$173111295	$167195874	$307104651	$259816032	$198421920	$82609565	$78049993
491 – 790cc							
Units	226584	224984	240604	369142	298182	215975	141716
$ Value	$301554886	$326914082	$372062671	$639025333	$532150565	$362771480	$256491632
Over 790cc							
Units	76182	93222	127518	120224	119625	65093	34828
Value	$153575906	$198020881	$266590704	$258903692	$226188672	$153545173	$88441983
Unspecified							
units	18801	10878	16669	3817	3557	8612	5228
$ Value	$5881152	$4575142	$6510513	$1269997	$1387633	$3624017	$2641863
Total							
Units	935486[a]	886752[a]	1120216[a]	1056713[a]	917203[a]	540213[a]	441420[a]
$ Value	$797267987	$870289735	$1141936022	$1313786825	$1110167919	$697184814	$523386642

of offensive t-shirts out there, but far less of them are now displayed at our dealers and only rarely do they use our logo and then illegally.

As part of our program to combat this, We have seized merchandise under court order where trademark viola-tions are involved.

Leyeraged Buyout (1981)

Your statement, “putting Mr. Beals in charge,” etc. is mis-leading. I was Deputy Group Executive (no. 2 responsible for the Motorcycle Group) from 1975’through 1977. From 1977 to 1981, I was Group Executive with full responsibility for the Motorcycle Group and became CEO in June 1981. Basically,} have, directed the organization since No-vember 1977.

The Tariff Ruling (1983)

You referenced “faulty demand assessments” by the Japan-ese as a cause for price reductions. Unquestionably from time to time they, like Harley misjudged the market. The facts sur-rounding our complaint in September, 1982 were that the Japanese had *increased* production substantially (if I recall correctly, it was. like ’20 percent) at a time when the world market for motor Cycles had been depressed for the better part of two years.

Published Japanese production data only shows the segment from above 25Occ. However because of the d0m-inance of the U.S. in the world market for these large placement motorcycles, it isn’t a great leap of logic .0 correlate this with increases in the heavyweight (700cc and up) category.

Harley’s Posttariff Performance

Harley returned to profitability in 1983 and has remained so since. The company was profitable in every year from the depression through 1980. In fact, 1979-”and 1980 were years of record profit for the Motor Company. While these years were records for Harley, they were not outstandingly high in an absolute sense for a couple of reasons. During the late 1970s we were making extraordinarily heavy investments in new product development, which was reducing earnings; secondly, our basic c9st structure prevented us from being high earners in competi-tion against the Japanese who were steadily driving their prices down.

In 1981 and 1982, we had record losses, but by down-sizing, we were able to return the total corporation to prof-itability in 1983 and improve that a bit in 1984. Through October 1985, we were a bit ahead of last year.

Our contract business, which is wholly performed at the York plant, has grown significantly since 1982 in both revenue and profit. This has been a vital contributor to the profitability of the c0mpany. In the future, the benefits of an extensive cost reduction program plus manufacturing productivity improve-ments will bring us pretty close to cost parity with the Japanese on our basic motorcycle busi-ness. Even despite record losses in 1982, we generated a small positive cash flow as a result of our downsizing of the company and our very tight control of raw material and work-in-process. We have maintained a positive op-erating cash flow (prior to principal repayment) in 1983, 1984, and 1985.

You indicated in the same paragraph “Harley sales have actually decreased since the pre-tariff era.” In discussing sales it is important to distinguish between retail and wholesale sales. Since retail inventories vary from time to time, the focus should be on *retail* sales. We measure these by daily reports from our dealers whom we audit sev-eral times per year. Occasionally, there are discrepancies between our estimated retail sales and reported registra-tions. In most cases, we believe our data is more reliable than that published by Polk.

In this context, our U.S. retail sales were as follows:

(000) Units

1981	1982	1983	1984
41.0	31.2	26.3	31.5

You commented on the decrease of Harley's market share in the total market. That is correct, but the data is grossly distorted by the tremendous growth of three and four wheeler (balloon tire) off-road bikes plus scooters. We recently extracted this information from registration data with the results shown in Exhibit 7.

Let me reemphasize the data is for the first nine months of each of those years. This study was just com-pleted and that happened to be our frame of interest.

As you can see, there has been a significant drop in the total motorcycle market. In this environment, Harley's share has been increasing significantly. I believe this reflects the greater commitment of Harley riders to the sport, as well as the fact that the destruction of used motorcycle values by Japanese pricing practices in the last three or four years has removed many of them from the market. We expect the de-mographics (which are very favorable to motorcycling and Harley-Davidson), combined with a firming up of Japanese prices when they liquidate their excess inventories, to re-verse this downward trend in two-wheelers. When that hap-pens, I would not expect Harley's market share to hold the current levels. In short, we believe our share improves in a shrinking market and worsens in an expanding market.

International Sales-Global Strategy

I don't believe that Harley is operating with severe technological disadvantages versus our competitors today. This is verified by the fact that we have been first to market with many innovations (belt drive, computer ignition, true anti--dive suspension, vibration isolation, etc.). Except for the last year we have also been able to dominate dirt track racing. We temporarily lost first position in 1984 and 1985 as a result of a massive investment by Honda (probably 10 times Harley's investment). By the end of the 1985 season, we showed the ability to beat them on many occasions. With some updating to our race engine, 'we expect to be fully competitive in 1986 or 1987 at the latest.

While the above may represent the claims of a proud CEO, I believe a quick reading of the last couple of years of motorcycle press reviews of our product will provide third-party judgment as to our technical ability.

We clearly are at a cost disadvantage versus our com-petitors. Our entire manufacturing strategy, and more re-cently our cost reduction strategy, has been aimed at eliminating this disadvantage. Our objective is to attain cost parity, which we think is achievable.

It is interesting to observe, when you look at market share, that Honda is clearly our only competitor of signifi-cance. Now all of Honda's heavyweights are assembled in

Exhibit 7 Total motorcycle Registrations

1978	1979	*1980*	1981	1982	1983	1984	1985
671	722	699	667	536	534	458	366
Harley Volume (000) Units							
44.7	48.0	35.6	37.5	28.6	23.7	25.2	25.6
H-D Market Share (000) Units							
6.7%	6.6%	5.1%	5.6%	5.3%	4.4%	5.5%	7.0%

the United States. We believe that Honda's labor rates in their chassis plant are now higher than those in our chas-sis plant. With the opening of a new motorcycle engine plant in Ohio" we expect to see increasing U.S. content in Honda's heavyweight motorcycles. Thus, relatively soon we will both be using U.S. employees and paying comparable rates to manufacture the bulk of our products. Thus, the game with our critical competitor degenerates to who can manage best. Today, we would acknowledge their lead, but we don't believe it is necessary or appropriate to concede them the race in the long run.

The premise for your third paragraph is that the tariffs have helped Harley in the marketplace. I would strongly argue that. All the tariffs have done is to force the Japan-ese to finally liquidate their excess inventories in the U.S. They are still way in excess of current needs, despite the fact that they have been substantially discounting the old product. In a recent analysis I conducted, I picked one heavyweight model of each of our four competitors and contrasted the original suggested retail price (in 1981 or 1982) to the current price of the same *new* motorcycle of the same model year. (A quick check will confirm that you can still buy 3- and 4-year-old new motorcycles at Japan-ese stores.) This showed a range from 48 percent to 52 per-cent price reduction-in itself, an interesting consistency in pricing practices.

, Harley's share increase in its heavyweight market and the entire two-wheel market (as shown above) has been accomplished in an environment of heavy discounting. Our large displacement motorcycles (FX designation), which represent the largest of our three generic product lines and also the most profitable, are priced two to three times above comparable competitive models. Despite this, our unit volume and share from this segment of our business is slowly but steadily increasing. (Effectively, we're selling Mercedes versus Fords.)

Additionally, the Japanese have succeeded in evading virtually all tariff payments. All Honda and Kawasaki heavy-weight motorcycles are now *assembled* in the United States; previously Kawasaki was virtually out of U.S. assembly. Nearly all 750cc displacements (half of the heavyweight volume prior to the tariffs) have been downsized to 695 to 699cc to evade, the tariff. Thus, as a practical matter, only Suzuki and Yamaha, who do not have U.S. assembly facili-ties, have been paying tariff and then only on their motor-cycles of 1,000cc displacement and above. Since the special tariff provides for a few thousand (7,000 to 8,000, if I recall correctly) of tariff-free imports, my 'guess is that this has cov-ered the vast majority of imported Yamahas and Suzukis.

A final comment-an International Trade Commis-sion report on the first year after the tariffs reported a 2 percent *reduction* in the average retail price of heavy-weight motorcycles despite the 45 percent tariff increase. Realize, when reading that number, that this included the period during which Kawasaki, in

particular, and Honda to a lesser extent, were moving assembly on - shore.

That finishes the comments on your specific draft. All in all, I thought it was a very good effort. I hope the above will clarify a few points.

To the above let me add the following-some thoughts I had while reading your case study:

1. ***Lightweights:*** Harley was not asleep at the switch on lightweights. If you go back in time, Harley has been in the scooter business (in the 1960s), mopeds, lightweights, etc. The company bought a 50% inter-est in Aermacchi, an Italian lightweight motorcycle manufacturer, many years ago and purchased the balance of that interest in the mid- to late 1960s. They made a good motorcycle, but basically could not remain competitive with the Japanese. Market scale was the difference. We had a plant in Italy making 25,000 motorcycles with 500 people as contrasted-to a Honda plant making 985,000 motorcycles with 1,400 people.

   Undoubtedly, we were too late in discovering that difference or we would have taken action ear-lier. However, the capital investment in tooling up for that large Honda scale production plus the in-vestment in developing the distribution system to sell that many products was orders of magnitude beyond the ability of Harley-Davidson as a private company, and I suspect would not-have been even possible under AMF ownership. Frankly, I think that's an area where the industrial banking relation-ships in Japan make high risk taking possible. A book published a couple of years ago on Honda re-ported on the tremendous increases in investment and the resultant volume increases during some of those periods. Frankly, I don't believe that is possible in the United States in today's capital markets.

2. ***Product Quality:*** I think it would be helpful to elaborate on Harley's quality/product situation in the early 1970s.

   From 1969 to approximately 1973, the first four years of AMF ownership, the company's unit volume increased by three to four times and revenues quad-rupled. At the beginning of that period you had a small manufacturing company in which each functional head was a family member who had run that function for literally decades. Systems were appro-priate to a closely held family company that had a fairly stable volume history. Manufacturing was characterized by craftsmen knowing what to do without reference to drawings.

   The tremendous growth imposed upon the com-pany in that state in the early 1970s caused utter chaos. They converted from a craftsman to a pro-duction line environment, and the systems utterly failed to keep the company under control. The ultimate result was terrible quality and worse labor relations. The whole thing came unglued in 1974 with a 100-day plus strike. As a result, management was changed and the rebuilding process which is still going on was initiated.

   A new group executive was brought in early 1974. (I'm not sure whether this was before or during the strike.) His first effort was to quickly get manufacturing under control. He then started a major effort in 1975 to expand the Engineering De-partment staff and facilities and to totally redesign the product line. As a practical matter, the last major piece of that program was completed in June of 1985 when we introduced our last new engine.

   When those efforts were well underway in the late 1970s, we then turned our attention to improving quality and then productivity. Briefly then the 1975 to 1980 period could be defined as "getting the product line modernized" and the 1980 to 1985 period getting manufacturing pointed in the right direction.

   As I noted above, the catch-up game in product development is behind us. The manufacturing improvements now have their own momentum and require little input from senior management. The current focus in the last year has been on strength-ening the dealer network. We are already starting with a network that we believe is the most effective and most profitable (albeit the smallest).

   With our catch-up work well along in the engi-neering and manufacturing area, we deemed it ap-propriate about a year ago to really kick off a major effort to further strengthen our dealer network. This is aimed at making them better businessmen and improving their ability to close on sales. As a result, we expanded the sales force by about 50% and have started to invest more heavily in their training and later in dealer training.

3. ***Contract Business:*** There has been a legacy of con-tract business at the York plant for some years. This represented only 2 to 3 percent of sales i'1 1982, but now it is between 15 and 17 percent. This provides a source of profit, but more importantly a source of jobs to absorb people freed up by productivity improvements in the motorcycle business. We are aggressively trying to expand that business at York and to develop a similar ability to successfully per-form contract business in our Wisconsin operations. It is our expectation that this business will represent a quarter to a third of our business in three or four years, thus, also giving us some degree of internal diversification.

   By adopting various Japanese manufacturing methods in our motorcycle business, we are improv-ing our position relative to the Japanese, but we are not there yet. However, when these methods are ap-plied in domestic markets (which all of our contract business represents), they give us an extremely great competitive advantage which has been directly responsible for our rapid growth in this area.

4. ***Parts and Accessories****:* The company has had a suc-cessful parts and accessories business for many years. In late 1976 we established this as a separate division, ultimately giving it its own president, ad-ministrative staff, etc. As a result it grew very rapidly in the late 1970s. Shortly after buying the company in an effort to reduce our overhead, we consolidated it back into the Marketing organization. As a result of that and having to 'cherry pick" some of our best people out of that area we lost ground. About a year ago, we again spun it off as a separate entity to give it greater senior management focus.

As in most companies, the parts business is extremely profitable. Because of the stability of Harley's designs as opposed to the Japanese and also because of the very large population of older Harleys in the field (most of the Japanese motor-cycles don't last beyond three or four years due to high repair costs in the context of a decreasing new price), Harley represents a prime target for after-market competitors. A couple of years ago we intro-duced a second-tier product line (Eagle Iron) to combat this. These products are sourced in the orient (as are our aftermarket competitors' parts) rather than the United States, as are most of our OEM parts. This new product line is growing rapidly, and we expect it to recapture a significant part of the lost parts business today.

We also have tried to become "the" motorcycle store for rider apparel, helmets, etc. as a way of de-veloping floor traffic. Large numbers of our dealers have set up apparel boutiques, which are achieving this purpose as well as generating considerable prof-itability for the individual dealerships.

5. ***Recreational versus*** *Transportation Vehicles:* In viewing Harley-Davidson's position in the motor-cycle industry, it is important to distinguish between a motorcycle as a recreational vehicle and a trans-portation device. In the US. Motorcycles are toys. While they are occasionally used for transportation. It is rare indeed to find someone whose sole means of transport is a motorcycle.

   By contrast, in many less developed countries a motorcycle is the first step above a bicycle. Classically, motorcycle sales drop as the economy strengthens and people move into small automo-biles. Only after they satisfy their need for four - wheel transportation do they then come back to motorcycles as toys.

   As you know, Harley's displacement ranges until last June started from 1,000cc and up; today. We start at 883cc and go up. In the 1960s and 1970s. We of-fered a wide variety of smaller displacement motor-cycles from 50cc to 3.50cc. As noted above we could not remain cost competitive in that area. Frankly we never expect to be able to reenter that market.

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Rai Technology University

ENGINEERING MINDS

Rai Technology University Campus

Dhodballapur Nelmangala Road, SH -74, Off Highway 207, Dhodballapur Taluk, Bangalore - 561204

E-mail: info@raitechuniversity.in | Web: www.raitechuniversity.in