

INTRODUCTORY MARKETING MANAGEMENT COURSE

*Canada.*

DEPARTMENT OF INDUSTRY, TRADE AND COMMERCE,

Training and Development  
Division

*Handwritten signature*  
Dr. I. A. Litvak  
Carleton University

## INTRODUCTORY MARKETING MANAGEMENT SEMINAR

February 27, 28 and March 1, 1974

### PARTICIPANTS

|                                  |   |
|----------------------------------|---|
| D.H. Lees                        | Grain Marketing Office                      |
| P. Blanchard                     | International Financing Branch ✓            |
| R.N. Bentley                     | Program Office - Industry                   |
| F.J. Mathews                     | Fairs & Missions Branch                     |
| G.P. Cosgrove                    | Information Services Branch                 |
| H. Juelich                       | Transportation Industries Branch            |
| H. Roberts                       | Transportation Industries Branch            |
| P. Lau                           | Transportation Industries Branch            |
| A.J.A. Morrison                  | Machinery Branch                            |
| S.B. Legatt                      | Office of Tourism                           |
| B.F. Campbell                    | Office of Tourism                           |
| T.L. Hill                        | Office of Tourism                           |
| R.G. Davis (Winnipeg)            | Regional Offices                            |
| (Miss) M.R. Wilson (Fredericton) | Regional Offices ✓                          |
| B. Côté                          | European Bureau                             |
| R.J. Hauser                      | International Special Projects              |
| R.E. Evans                       | International Special Projects              |
| M. Zalman                        | Textiles & Consumer Products                |
| (Miss) S. Bulow-Hube             | Office of Design                            |
| Peter Lee                        | Office of Design                            |
| D.G. Tate                        | Program Planning & Industry Branch          |
| B.C. Barclay                     | Pacific, Asia and Africa Bureau             |
| W.W. Johnston                    | Pacific, Asia and Africa Bureau             |
| J.W. Hall                        | Resource Industries and Construction Branch |
| J.K. Woyzbun                     | Chemicals Branch                            |
| C.E. Stedman                     | Western Hemisphere Bureau                   |
| R. Brooks                        | Western Hemisphere Bureau                   |

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SYNDICATES  
(February 27th)

- A -

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F.J. Mathews  
G.P. Cosgrove  
H. Juelich

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Program Office - Industry  
Fairs & Missions Branch  
Information Services Branch  
Transportation Industries Branch

- B -

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Machinery Branch  
Office of Tourism  
Regional Offices  
European Bureau  
Int'l Special Projects  
Western Hemisphere Bureau

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Regional Offices  
Program Planning & Industry Branch  
Pacific, Asia and Africa Bureau  
Transportation Industries Branch  
Textiles & Consumer Products



## INTRODUCTORY MARKETING MANAGEMENT COURSE

### Objectives

1. To obtain an appreciation of key marketing concepts, and their application in both the public and private sectors.
2. To interpret market developments both in Canada and abroad from the standpoint of capitalizing on existing and future commercial opportunities for Canadian business.

### COURSE SCHEDULE

#### DAY - 1

#### THE MARKETING MANAGEMENT SYSTEM

1. Marketing Management and the Marketing System
2. Analyzing Marketing Opportunities
3. The Marketing Strategy
4. Marketing and Industrial Strategies
5. Government - Business Interface

Two Case Studies

## DAY - 2

### INTERNATIONAL MARKETING

1. Key Global Marketing Developments - Economic, Political - Legal and Socio-cultural
2. Classifying International Markets - Developed Economies, Less Developed Economies and Socialist (East) Economies
3. Options for International Marketing Operations - Export Transactions, Branch Operations, Wholly and Partially - Owned Subsidiaries, Joint - Ventures, Grouping for Export, Contractual Arrangements, etc.
4. The Multinational Company and Marketing

Two Case Studies

## DAY - 3

### DESIGNING THE MARKETING MIX

1. Product and Service - Pricing Strategies and Competitive Bidding
2. Distribution - Channel Decisions and Strategies
3. Communications - The Mass Media and Personal Selling
4. Consumerism and Social Marketing

Two Case Studies

INTRODUCTORY MARKETING MANAGEMENT COURSE  
DEPARTMENT OF INDUSTRY, TRADE AND COMMERCE  
TRAINING AND DEVELOPMENT DIVISION

CASES

A. MARKETING MANAGEMENT AND STRATEGY PLANNING

- Case 1 - Canadian  
Cases in  
Marketing - Canadian Tillage and Harvesting  
Equipment Company Limited (A)
- Case 2 - Centaur Manufacturing (A)
- Case 3 - Halliday Homes
- Case 4 - Circuit Systems Limited

B. MARKETING RESEARCH

- Case 5 - Canadian Inland Limited

C. PRODUCT PLANNING

- Case 6 - Centaur Manufacturing (B)

D. PRICING POLICIES

- Case 7 - Produits Bernard S.A.

E. DESIGNING THE DISTRIBUTIVE SYSTEM

- Case 8 - Valleyfield Carpeting Limited

F. PROMOTION

- Case 9 - Kipp Kelly Limited
- Case 10 - Claire Haddad High Fashions

G. MANAGING THE OVERSEAS OPERATION

- Case 11 - Tridon Manufacturing

H. ADAPTING TO THE INTERNATIONAL ENVIRONMENT

- Case 12 - Canadian Control Systems (A)
- Case 13 - Canadian Control Systems (B)

## INTRODUCTORY MARKETING MANAGEMENT COURSE

### SUPPLEMENTARY READING

1. The Multinational Corporation: Some Perspectives
2. Branch Plant Entrepreneurship and Managing the Entrepreneurial Enterprise
3. Selecting Export Markets
4. International Business: What is the Best Strategy?
5. The Silent Language in Overseas Business
6. Marketing Groups for Small and Medium-Sized Firms
  - (a) Adaptation of Small and Medium-Sized Firms to Changing Market Conditions
  - (b) Basic Considerations in Connection with the Establishment of Export Marketing Groups
7. Strategic Planning for Export Marketing
8. A Product Life Cycle for International Trade?
9. Societal Pressures: How Big Business Perceives Them
10. A Conceptual Framework for International Business Arrangement

NOTE: ITEMS NUMBER 3, 4, 5, 6 and 7 ARE ESSENTIAL  
PRE-READING FOR THIS COURSE.

MARKETING MANAGEMENT AND STRATEGY PLANNING

Case 1 - Canadian  
Cases in  
Marketing - Canadian Tillage and Harvesting  
Equipment Company Limited (A)

Case 2 - Centaur Manufacturing (A)

Case 3 - Halliday Homes

Case 4 - Circuit Systems Limited

INTRODUCTORY MARKETING MANAGEMENT COURSE

CANADIAN TILLAGE AND HARVESTING  
EQUIPMENT COMPANY LIMITED (A)<sup>+</sup>

by

DR. I. A. LITVAK and DR. P. M. BANTING

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CANADIAN TILLAGE AND HARVESTING  
EQUIPMENT COMPANY LIMITED (A)

With sales of approximately 550 million dollars a year, Canadian Tillage and Harvesting Equipment Company is one of the foremost farm equipment manufacturers in Canada. The firm's head office is in Montreal with its manufacturing plant for harvesting equipment located in St. Jerome, Quebec; tillage equipment facilities in Oshawa; and gasoline and diesel engine plant in St. Catherines, Ontario. The marketing, sales and finance functions are centralized in the Montreal head office, and the products are distributed to exclusive dealers across Canada either directly from the manufacturing plants or through transfer warehouses in Winnipeg and Halifax. In addition, a sales force working with the dealers operates from one district office in each province.

The district sales offices are responsible for maintaining emergency inventories of service parts, directing a small group of product specialists to train dealers in technical servicing of their products, checking dealers' orders and transferring them to head-office, following-up on dealer invoices from head-office, extending credit to dealers' customers, conducting limited marketing research studies, and ordering and distributing dealer literature, catalogues, displays, service manuals, and other sales promotion materials. One of the most important functions of the district office is to organize for and participate in community fall fairs, plowing matches, and farm equipment shows. The district offices are also responsible for training the dealers in establishing good accounting practices which conform to the company operating standards and provide data for sales analysis.

The district salesforce is responsible for training and assisting dealers in effective selling techniques, educating dealers on product and service features, providing dealers with advertising materials from head-office, and assisting them in planning their promotional campaigns. Occasionally the district salesman will travel

farm to farm with the dealer or the dealer's salesman to handle difficult customer accounts, demonstrate new products and sales techniques, and gather first hand information.

#### Head-Office Sales

Over the past fifty years the dominant group within CTHE has been the sales department. At the turn of the century, one of the highest paid and most respected men in the organization was the "Blockman". In today's terminology he would be classified as the District Sales Manager. For the past six decades the presidents of the company have traditionally followed the sales route, spending many years on the road working with dealers and their customers. Consequently, the whole tone of the organization is geared towards selling.

In 1962 Jack Weir, who had recently received a certificate in business from the extension department of McGill University, was promoted from Eastern Regional Sales Manager, to the newly created position of Dealer Development Manager. The major tasks facing Jack Weir in his new position were to critically evaluate dealer territories, sales performance, contribution to the company image, promotional activities, service facilities, and inventory control procedures. Generally speaking, he was expected to completely revitalize and revamp the company's dealer network which, while successful in meeting sales quotas, had been experiencing decreasing profit margins, and generating a higher level of customer complaints than ever before in the company's history. One of the statements made by the President when assigning Weir his task was "I have a strong feeling that the trend to larger farms is shrinking the number of customers in our dealer's territories, and we must find a way to expand their territories and eliminate, perhaps, one third of our present dealers."



Marketing to Agribusiness

Shortly after his promotion, the company sent Mr. Weir on a one week Continuing Education seminar at Michigan State University to assist him in organizing and running his new department.

One of the keynote speakers at the seminar was Professor Everett M. Rogers who discussed the "Adoption and Diffusion of New Farm Products." Professor Rogers stated that in the case of agriculture, diffusion is the process by which new farm practices or ideas are communicated from sources of origin, such as scientists and implement firms, to farmers. Adoption may be viewed as a mental process through which an individual passes from first hearing about a new idea to using the new practice on a full scale and incorporating it into his way of farming. Examples of new ideas studied are hybrid corn, wheat sprays, livestock feed additives, bulk milk tanks, pesticides, fertilizer, tillage practices, and new farm machinery. Some of the interesting observations articulated during this particular session are as follows:

- farmers who feel they gain high status by planting straight rows are slow to accept contouring
- innovators for one practice tend to be innovators for other practices
- laggards and late majority farmers believe in "agricultural magic" such as planting crops or dehorning cattle by the signs of the moon
- early adopters are willing to take risks and borrow money to realize profits through adopting high capital investment practices such as new farm machinery, sprinkler irrigation or bulk milk tanks
- older farmers tend to be conservative and laggards
- early adopters and innovators are among the most highly educated farmers
- innovators tend to have larger farms, higher gross farm income, greater farm efficiency, are more specialized, and have greater equity in their farm

Exhibit I shows the distribution of farmers according to time of adoption. Exhibit II summarized the characteristics of the adopter categories. These exhibits appeared in the North Central Regional Extension Publication No. 13 titled "Adopters of New Farm Ideas" which was distributed to the participants at the seminar.

#### Reviewing the Seminar

Upon his return to Montreal, Mr. Weir had to submit a report on the seminar to the president of CTHE. In this report Mr. Weir stated that there were certain limitations in the way CTHE's dealer organization was structured. Specifically, he stressed that the seminar made him realize that for years CTHE had been product oriented, and even further, sales oriented. The great majority of the company's efforts were spent "pushing" products at the dealers, and relying on the dealers to "push" products at the farmers. In the light of the new perspective he had acquired at the seminar, Mr. Weir suggested that perhaps the company's current difficulties were the result of too much emphasis on just selling, and not enough emphasis on recognizing the characteristics of the company's ultimate customers - the farmers.

In his report, Mr. Weir strongly recommended that the company allot him a special marketing research budget to study the characteristics of the Canadian farm market. Until this time the company simply had been analyzing sales and product performance.

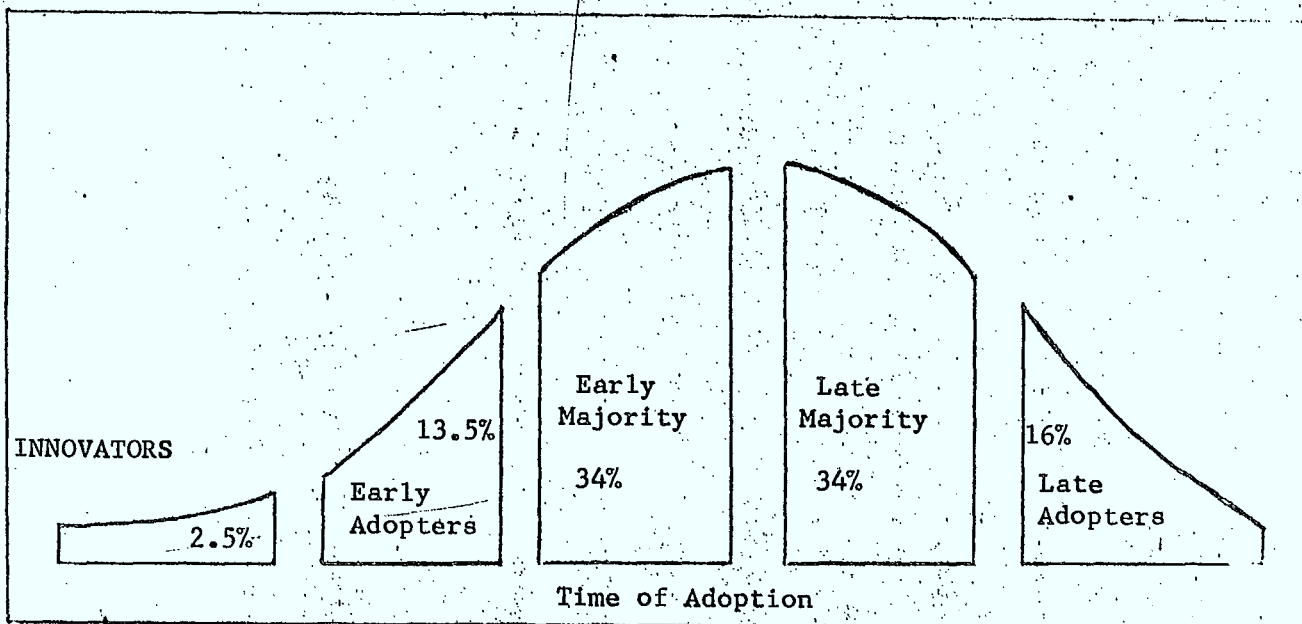
#### Questions

1. Can the diffusion and adoption information Mr. Weir was exposed to at the Michigan State Seminar be applied with equal validity to Canada?
2. What questions should Weir attempt to answer through his marketing research?
3. Assuming that Mr. Weir is able to identify well defined characteristics of his customers, according to the adopter categories illustrated in the exhibits, how will this help

accomplish his dealer development program?

EXHIBIT I

Distribution of farmers among the five categories according to time of adoption.



# EXHIBIT II

## Summary of Characteristics and Communication Behaviour of Adopter Categories

| Characteristic<br>or<br>Behaviour | <u>Innovators</u>  | <u>Early<br/>Adopters</u>   | <u>Majority</u>                             |   | <u>Laggards or<br/>Late Adopters</u>   |
|-----------------------------------|--|---|---|---|--|
|                                   |  |   | <u>Early</u>                                | <u>Late</u>   |  |
| 1. Time of Adoption               | First 2.5 per cent to adopt new ideas                                  | Next 13.5 per cent to adopt   | Next 34 per cent to adopt                   | Next 34 per cent to adopt   | Last 16 per cent to adopt  |
| 2. Attitudes and values           | Scientific and venturesome   | Progressive   | More conservative and traditional           | Skeptical of new ideas  | Agricultural magic and folk beliefs; fear of debt                                |
| 3. Abilities                      | High level of education; ability to deal with abstractions             | Above average education   | Slightly above average education            | Slightly below average education  | Low level of education; have trouble dealing with abstractions and relationships |
| 4. Group memberships              | Leaders in county wide or state organizations; travel widely           | Leaders in organizations within the community                                 | Many informal contacts within the community | Little travel out of community; little activity in formal organizations | Few memberships in formal organizations other than church; semi-isolates         |
| 5. Social status                  | Highest social status, but their farming practices may not be accepted | High social status; looked to by neighbors as "good farmer"                   | About average social status                 | About average social status   | Lowest social status   |
| 6. Farm businesses                | Largest, most specialized, and most efficient                          | Large farms; slightly less specialized and efficient                          | Slightly larger than average sized farm     | Slightly smaller than averaged sized farms                              | Small farms; low incomes; seldom farm owners                                     |
| 7. Sources of information         | Scientists; other innovators; research bulletins                       | Highest contact with local change agents; farm magazines; Extension bulletins | Farm magazines; friends and neighbors       | Friends and neighbors   | Mainly friends and neighbors; radio farm shows                                   |

MARKET MANAGEMENT COURSE

CENTAUR MANUFACTURING (A)<sup>+</sup>

by

DR. I. A. LITVAK and DR. P. M. BANTING

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## CENTAUR MANUFACTURING (A)

### The Company

Centaur Manufacturing, a small company located in Richmond Hill, was formed in 1959 with the basic aim of producing and selling a capacitive discharge ignition system called Centi-Spark, which was designed and developed by the company's president, Don Hamilton. Mr. Hamilton handles the total affairs of the company himself and only requires personnel for production. The company is 80% owned by Mr. Hamilton with the other 20% being held by two friends. There is a relatively small amount of capital tied up in the business with, as Mr. Hamilton jokingly says, the desk being the biggest investment.

During the past few years, the company has added several other products to its line. These include such things as tachometers and gas line pressure regulators. However, the main objective of the company is to produce and sell Mr. Hamilton's innovations.

Don Hamilton is a professional engineer who gains his greatest pleasures from: a) being innovative in the automotive field; b) producing a high quality product; c) having his product accepted in the market place; and d) dealing in foreign markets.

### Characteristics of Capacitive Discharge Electronic Ignition

The normal ignition system (Kettering) takes the battery voltage (sometimes reduced by a ballast resistor) and converts it to a high voltage pulse via the ignition coil and breaker point contacts in the distributor. The cam shaft turns the distributor shaft which in turn activates the breaker points. When the contacts are closed current flows in the primary winding of the coil and builds up a magnetic field. When the contacts are opened this magnetic field collapses and produces a stepped-up voltage in the secondary or high voltage winding in the coil. The distributor rotor switches the high voltage pulse produced by the coil when the contacts are opened and sends it to the spark-plugs in a predetermined sequence.

The capacitive discharge electronic ignition system (C-D) charges up a capacitor in series with the primary winding of the ignition coil. When the breaker point contacts are opened the capacitor discharges through the primary winding and produced a high voltage pulse in the secondary winding which arcs to ground between the electrodes of the selected spark-plug.

### Advantages of C-D Ignition

The capacitor and accompanying electronic circuitry added to the ignition produce the following advantages:

- i) As soon as the capacitor is charged current ceases to flow and hence less power is dissipated in the coil.

ii) The capacitor is charged to about 300 volts and hence a large voltage is produced in the secondary of the ignition coil for the spark-plug. This aids starting, especially in cold weather when the battery is weaker and the starting motor load is longer. Fouling resistance at the spark-plugs and along the high tension wires is overcome with the higher voltage available at all engine speeds.

iii) Less current flows through the breaker contacts which are only used as an electronic signal for the capacitive discharge (C-D) system. Point life is extended up to 100,000 miles, much longer than the average automobile life.

iv) The capacitor is discharged by a fast-acting electronic switch thus producing a fast, crisp pulse for the spark-plug. In the Centi-Spark the discharge is preceded by a reverse polarity pulse of extremely short duration. This quick discharge (in about 2% of the conventional mechanically-triggered pulse time) delivers about three times the energy and hence produces better ignition and keeps the spark-plug electrodes from fouling. Spark-plug life is increased from a normal 15,000 to 50,000 miles. The shorter pulse with higher energy (90 milli-joules for Centi-Spark) produces superior ignition especially at higher speeds. This provides more complete combustion and greater fuel economy.

v) The distributor points do not control the time of discharge and hence the dwell time, contact spacing and breaker contact bounce are not as critical with C-D ignition



systems. C-D systems make dual point contact systems obsolete.

#### Disadvantages of Using C-D Ignition System

i) Because of the lower current arcing at the distributor points the contacts are less self cleaning and hence oxidation builds up a resistance layer. This can be overcome with occasional buffing.

ii) The crisp discharge wave form and resulting spark-plug arc will accentuate bad timing. This can be overcome with proper timing maintenance.

iii) Some C-D systems are only suited for 12 volt negative ground electrical systems. This would eliminate their use in 6 volt or positive ground systems. However, these are becoming a smaller segment of the automotive market.

iv) In some special cases the higher discharge voltage will cause arc-over in the distributor and result in ignition of two cylinders simultaneously. This is not a common situation and for most cases can be ignored. A simple formula for racers is not to exceed the r.p.m. of 40,000 divided by the number of cylinders of the engine.

#### Competition

The competition can be divided into two groups. First there are the large companies, such as G.M. which sells C-D systems through Delco, their subsidiary. These companies rely on their corporate image to sell their product

and are not aggressive in marketing the system. The systems offered by these large manufacturers are more elaborate and include a heavy duty coil along with the basic unit. The price of their system is high (about \$120 to \$280), and thus they are not considered a great threat. They are important, however, because they financially back some distributors, and have a good part of the automotive channel tied up.

The other competitive group is composed of small outfits similar to Centaur which appear on the market for a short time, then fold. Fifteen to twenty-five of these companies have been in the market for various lengths of time. Most of the failures are centred around extremely poor product quality. These firms have hurt Centaur by the image they have created in the market. Two firms, Blitz and Black Demon are reasonably active in the market and are using a personal sales force and low prices (\$45-50) to gain acceptance. As far as competition on a quality basis goes, Delta, located in Colorado, has a good product but sells only through mail order and has not concentrated much effort in the Canadian market.

Japanese motorcycle manufacturers have a C-D system powered by magneto. Some highpower outboard motors for boats have also incorporated C-D ignition systems.

Centi-Spark

The system is composed of high quality components, some produced especially for use in the Centi-Spark system. These are no T.V. quality components in the system as Mr. Hamilton feels that cutting quality is the quickest way to disaster.

Installation of the system is extremely simple, accomplished by connecting four wires to the existing ignition system. The unit is transferable from one vehicle to another and requires no servicing once installed. Technical support and information is provided by the agents and distributors handling the product, by Don Hamilton himself, and by descriptive literature. The warranty on the unit runs for a period of two years with expiration dates of the warranty period determined by the colour coding of the unit's label.

There is no patent protection on the unit but the entire unit is sealed in an epoxy resin which has so far prevented detailed analysis of the system by outsiders.

The package design is basically functional with the main purpose of being protective. A square metal box covers the unit, with a simple label giving the name of the product and the manufacturer.

Approximately 100 units are produced per month by a hand-assembly operation. Output is flexible and can be raised to several times the present level by simply hiring a few more people and arranging a work table for them. In

addition to Richmond Hill output licenses have been granted to manufacturers in other countries. Control over licenses is maintained by insisting that they purchase a critical component from a Canadian supplier, who then notifies Hamilton of the size of the purchase orders, thus allowing Centaur to collect the appropriate royalties.

#### Market Acceptance

Although Centi-Spark has been in existence for a number of years, Centaur has yet to create market acceptance for the product in Canada. One reason is the bad image of the transistorized ignition system, the predecessor to capacitive discharge systems. Many people associate Centi-Spark with such a system. A second reason is the poor quality of competing C-D ignition system, which have given C-D systems a bad image.

In general, the consumer market consists of people who care about their cars for one reason or another. There tend to be two main types within the group:

- a) the do-it-yourselfer who is cost conscious and enjoys shopping for such things as Centi-Spark.
- b) the person who cares about his car but does not do his own repairs.

The Canadian industrial market is interested in what Centi-Spark can do to help reduce either breakdown or preventative maintenance costs. The market is amenable to cost-benefit analyses and is generally impressed after trial periods

using Centi-Spark. Even so, Centaur has experienced great difficulty selling to this market. This could be attributed to three possible obstacles: the unfavourable image of such systems, customer inability to understand C-D system benefits, or Centaur's difficulty in reaching the decision maker in a setting characterized by multiple buying influences.

Centaur's major successes have been in the foreign market. Although a great deal of effort is required to develop contacts abroad, with the help of both provincial and federal departments of trade, and with many personal trips overseas, Mr. Hamilton has obtained most of his business in countries other than Canada. Perhaps one characteristic of the foreign market that has led to market acceptability is that many of these countries have not been saturated by automotive gadgetry. Thus an unfavourable association between Centi-Spark and gadgetry has not been made.

#### Distribution

Centi-Spark is distributed in a very selective manner through agents or distributors. The selection criteria established by Centaur is as follows:

1. The agent or distributor must be highly technically oriented.
2. He must have a small compatible product line.
3. He must have an inclination towards industrial

markets and if possible a clientele to which Centi-Spark could be sold.

4. If a distributor, he must maintain an excellent credit rating by paying his bills within a short period of time. There is no consignment of products.

In return for meeting these criteria, Centaur offers:

1. Exclusive one year agreements for distributors if they make an initial order to twelve units.
2. Sales leads gathered by Centaur which apply to the agent's or distributor's geographic area.
3. Technical data sheets for selling purposes.
4. Generous commissions to agents, and volume discounts to distributors.

Centaur currently has agents covering the industrial market in Halifax, St. John, Toronto, Vancouver, Baltimore and Buffalo. Efforts to sell to the consumer market have been unsuccessful. Mr. Hamilton handles the entire foreign market personally.

Price to the final buyer in consumer market is \$75, while price to industrial accounts is \$55.

Promotion by Centaur is primarily through advertising in automotive and technical journals, relying on coupons clipped from ads to supply further information to interested readers, and generate leads for distributors and agents. In the foreign market, sales are the direct results of Don Hamilton's personal selling efforts.

Questions:

1. Evaluate Centaur's current situation.
2. What market target should Centi-Spark be aimed at?
3. How should Mr. Hamilton determine the market segments having greatest marketing potential for Centi-Spark?

MARKET MANAGEMENT COURSE

HALLIDAY HOMES



## HALLIDAY HOMES

### Marketing Prefabricated Houses in Germany

Formed in 1888 as a building materials mail order house, the Halliday Company Limited was for many years Canada's largest specialized mail order establishment. Shortly after World War II Halliday entered the prefabricated home market, and began the manufacture of prefabricated houses, cottages, and garages.

### THE MARKET FOR MANUFACTURED HOMES

The market for prefabricated buildings can be divided into three segments. The consumer market is by far the largest and most important to the company. The people making up this segment tend to be in the 25 to 40 year age class, and in an income bracket of \$4,500 to \$6,000 per annum. The other two markets are government housing contracts, and northern-Canadian mining and logging operations.

### The Product

Prefabricated houses offer the buyer four advantages over on-site constructed homes:

- 1) Quality: Manufactured homes have the advantage of being cut to close tolerances, thus giving a uniformly high quality product when erected.
- 2) Economy: If the customer is doing some of the construction himself, it is possible to save up to one-quarter of the value of the finished home.
- 3) Definite Cost: The customer will have an exact estimate of the total cost of the finished product.
- 4) Speed: A prefabricated home can be easily erected in one day, once the foundation has been completed. Interior finishing can be done either immediately or at the leisure of the owner.

There are several factors which greatly affect the sales of manufactured homes, the most important of which are:

- 1) Availability of Mortgage Money: The greatest single group of consumers for this product are in an income range where conventional mortgages are the main source of funds. Consequently, when tight money policies are introduced, the market is affected immediately.

2) Shortages of Skilled Tradesmen: Manufactured homes can be produced with a semi-skilled labour force. Consequently, when a severe shortage of skilled builders occurs, tremendous sales can be generated for this product.

### THE GERMAN EXPERIENCE

The Company became interested in the potential for the export of prefabricated houses to the European market in 1960. Through the services of the Ontario Department of Economics and Development, the management of the Halliday Company singled out the enquiry of a businessman in West Germany who was very interested in importing prefabricated houses.

This gentleman, Herald Lippert, was a man of demonstrated business ability and resourcefulness. In the years following the Second World War he had successfully undertaken the complete rebuilding of a profitable import-export business, mainly heavy dry cleaning equipment, which had been totally destroyed during the war. Having accomplished this feat, Herr Lippert was anxious to turn his energies to what he considered to be a substantial and profitable opportunity for the marketing of prefabricated houses in West Germany and throughout Western Europe.

In West Germany in particular a shortage of skilled tradesmen was restricting the rate of completion of conventional houses to a level considerably below the indicated demand. As a result, some prefabricated units were being brought in from Sweden, where domestic housing construction is about 60% prefabricated. Herr Lippert was of the opinion that a potential market existed which was much larger than the Swedish manufacturers were able to supply.

This belief prompted him to investigate the Halliday Company's expressed interest in exporting to Europe. Initially, through Ontario's Department of Economics and Development representative in Germany, and later, by direct correspondence, the management of the Halliday Company and Herr Lippert found promise of a mutually profitable arrangement.

In the fall of 1961, Herr Lippert came to Canada to meet the Halliday management and to inspect their production techniques. Immediately following Herr Lippert's return to West Germany the General Manager of Halliday, Mr. Gordon, sent him written confirmation of their intent to appoint him exclusive agent for the sale and distribution of Halliday houses in the Common Market.

## "CANADA-HAUS"

Herr Lippert launched a promotion centred on the purchase of a display house for assembly near Frankfurt under the name "Canada Haus". This was supplemented by newspaper advertising and the preparation of sales catalogues in German. The prefabricated unit reached the site in June of 1962 and was officially opened during the first week of October. On July 6th, 1962 in a letter to Mr. Gordon, Herald Lippert wrote:

"...I can assure you that we are working very hard and methodically in building up our selling organization.

Our German catalogues showing 10 types of HALLIDAY HOMES are proceeding slowly, but splendidly. We are having a catalogue-cover showing cedar trees in your Canadian forests and these pictures were supplied to us by the Canadian Lumber Association.

In addition, we are having printed standard forms for quotations with type of house, sizes, etc. to be filled in. We have advertised in a number of leading German newspapers for district agents and I may mention that we have already several good men on our books, who are willing to start work as soon as our display house is complete.

Now, for the opening of the display house, we are planning a big splash. We are going to invite the Canadian Ambassador and his Trade Commissioner, the German Minister for Building, also, of course, the press and several other important people including the Chamber of Commerce."

And in closing Herr Lippert displayed his confidence in the market potential by saying:

"It may interest you to hear that we are enthusiastic about the whole proposition to such an extent that I have altered my arrangement in the machinery export line with a turnover of several million marks and this is now placed on a commission basis, giving us practically all our time, also our capital and available credit for the "CANADA HAUS PROPOSITION."

The display house was reported to be a great success by Herr Lippert. However, he found that the potential customers had some difficulty in understanding that the furnishings used to enhance the model home were not included in the price. The potential customer also was puzzled by the artist's drawings of Halliday Homes. As Herr Lippert expressed in his letter dated October 17th, 1962:

"...a few articles about the Canada-Haus have appeared in German papers with photos of our display-house, but we are still hoping that you will send us a real good photo of Halliday Homes in Canada which we could use for advertising purposes here.

...It is difficult enough to sell houses from catalogues only but from artist's pictures which do not fit the German taste is very difficult indeed."

During the next few months a number of orders were entered. However, to meet the tastes of his customers, Herr Lippert found it necessary to include substantial modifications to the standard Halliday plans. The Halliday management were dismayed by his lack of understanding of the high degree of standardization necessary to the realization of the economies of prefabrication, and as stated by Mr. Gordon in his November 26, 1962 correspondence to Herr Lippert:

"...There is bound to be a divergence of opinion when we are catering to such a far-away market, and also while we are in the process of getting used to each other's methods. Certain of the structural changes which you have requested can be incorporated in future shipments, while some are totally impractical. You may be assured, however, that we will do everything possible to improve your competitive position."

Herr Lippert, for his part, found it extremely difficult to accept the resistance of the Halliday Company management to such things as the steeply pitched roof, which is so commonplace in a considerable part of West Germany.

After much searching for a workable compromise, on March 18, 1963, the General Manager of Halliday was prompted to observe:

"I realize that so far both companies have experienced disappointments. You have at times not been too happy with the reactions and co-operation of the Halliday Company, and we have not been too happy with the amount of orders either. At least we both learned that our past approach apparently has not worked.

At this stage I think we both have to seriously consider how we shall co-operate our future operations better. I personally believe that the future potential European market could be even better than our own Canadian. The best proof of this is the amount of new competition you have to face yourself.

Our basic mistake in the past has been the illusion that a house, totally designed and fabricated for a North American market, can be sold successfully in Germany. Your conditions are rather different, far more complex and often far more cumbersome than our own. But on the other hand, you are not realizing, at present, the techniques, possibilities and certain limitations of mass production."

An attempt was made to develop a "component" system which would give Herr Lippert greater freedom to meet his market's requirement, while at the same time retaining the economies and technical advantages of factory assembly. Progress in this direction was limited and eventually ceased when the Halliday management came to doubt that the potential sales could justify the development and pre-production costs involved.

This situation was related to Herr Lippert on March 25, 1963:

"...Our Company is currently faced with the necessity of being totally realistic about any sale in which it becomes involved and this situation has been created by new limitations placed upon us by our banking authority. Our borrowing ability has been reduced and we accordingly are having to restrict any business that involves a long term payable.

Our parent company is also most reluctant to have us spend any more money on involvements in the German market until such time as volume sales are forthcoming.

...It is utterly impossible for us to make a profit on the sale of custom designed homes,... all of the economies of the component system of manufacture are forfeited in this kind of business."

Although sixteen units, including the original display house, were eventually shipped, the General Manager of the Halliday

Company concluded on September 13th, 1963 that mutual interest dictated the termination of the supplier-agent relationship. In so doing, Mr. Gordon stressed:

"I do not believe it is necessary for your fine aggressive efforts in the German housing market to be wasted, as I know of at least two Companies who are extremely interested in looking after your requirements.

Each of them in turn have expressed sincere interest in your market, but with the qualification that they would be able to ship standard house plans. This, of course, is the feature that has discouraged me as far as your market is concerned, because it appears that in each instance, we estimate on what undoubtedly will be a custom built house. It is therefore my decision that if this is the only manner in which we can fight tradition and accordingly meet your market requirements, then it is absolutely impossible for us to make money on a transaction of this nature.

...I have endeavoured to enthuse each of the gentlemen with whom I have talked regarding the possibilities of the German housing market, but I am sure that they, even with adequate financing, will take a very dim view of the highly specialized plans which have been the basis of our negotiations."

#### QUESTIONS

1. Critically evaluate the marketing strategy employed by Halliday in West Germany.
2. What type of marketing strategy should Halliday have employed?

MARKET MANAGEMENT COURSE

4

CIRCUIT SYSTEMS LIMITED<sup>+</sup>

by

DR. I. A. LITVAK and DR. P. M. BANTING

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MARKET MANAGEMENT COURSE

CIRCUIT SYSTEMS LIMITED<sup>+</sup>

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## CIRCUIT SYSTEMS LIMITED

Circuit Systems Limited (CSL) is one of the largest Canadian-owned electronic companies. Through acquisition of Carruthers Engineering Limited and Spencerfield Electronics Limited, both the size and scope of the Company have been significantly changed. The CSL Group now comprises eight operating companies with a current annual sales volume of \$52 million, employing approximately 3,200 persons and with a total plant area in excess of 750,000 square feet. Of the eight companies, six are in Canada, one in the United States and one in the United Kingdom. Sales are equally divided between consumer and industrial markets with about 60% of the total being exported.

Products within the CSL Group are highly technically oriented and range across a wide spectrum of the aviation and electronics industries. They break down into four basic categories; electronic systems such as flight data recorders and crash position indicators; electro-mechanical assemblies for other electronic manufacturers; electronic components such as circuit boards, radio frequency crystals, hermetic seals and transformers; and industrial instrumentation such as steel probes for basic oxygen furnaces and data loggers for aircraft.

In the four year period from June 30, 1967 to June 30, 1971 prior to the acquisition of Carruthers and Spencerfield, sales increased from about \$1,000,000 to \$13,000,000 and profits after taxes increased from \$56,000 to \$1,000,000. Research and development expenditures have always been significant in relation to revenue and in the latest fiscal year totalled \$2.6 million or 20% of sales.

The following is a description of the products and operations of the CSL Group. The products and operations of the founding company are described first followed by those of the seven subsidiary companies.

#### Circuit Systems Limited

Circuit Systems Limited is engaged in the design, development and manufacture of aircraft location and recording systems, aircraft instruments and some specialized electronic products.

##### a) Aircraft Location Systems.

Upon release from the aircraft, the Crash Position Indicator (CPI) will descend slowly to the ground, whereupon it will signal the location of the downed aircraft. The CPI has so far produced the largest sales volume of any of CSL's products. It has been installed in a wide variety

of aircraft of the U.S. Air Force Material Air Transport Command. While the CPI was initially fitted on aircraft which were already operational, it has now become part of the standard specifications for U.S. Air Force transport aircraft and in the case of the C-5 "Galaxy" is being installed as original equipment.

b) Aircraft Recorder Systems.

CSL has developed four recorder systems: the accident data recorder system (ADR), the ADR contained in an airfoil (ADR/CPI), a non-ejectable accident data recorder system and a maintenance recorder system. The maintenance recorder system is specifically designed to determine the fatigue life of aircraft structures. It is limited to recording acceleration, airspeed, altitude, the calendar date, mission type and aircraft weight. The recording tape can be played back on existing data processing equipment. Recently the Company received a contract from the Canadian Armed Forces for 25 systems to be installed in F-5 fighter aircraft.

c) Aircraft Instruments.

In competition with leading U.S. and Canadian manufacturers, CSL has won design and production contracts from the Canadian Armed Forces for a number of aircraft instruments, including a new altimeter which is currently in the final test stage.

d) Other Products.

To reduce its reliance on the military market, CSL in 1969 established a Special Products Department to search for and develop products having primarily commercial and industrial uses. Close communications are maintained with such agencies as the National Research Council, the Ontario Research Foundation and the Department of Energy, Mines and Resources with a view to finding such products. It is from these sources that CSL obtained licences to further develop and manufacture an oxygen probe, a forestry survey radar altimeter and a automatic fluoride analyser. The oxygen probe is currently undergoing field evaluation by eight steel companies in Canada and the United States.

Solid State Products Limited

Solid State Products Limited manufactures quartz crystals, filters and crystal ovens for radio communication equipment and navigational equipment such as radar and sonar. Quartz crystals and crystals filters are used to stabilize frequencies and circuit elements in transmitting and receiving equipment, while crystal ovens maintain quartz crystals at fixed temperatures to permit more effective performance. These products are always custom made to customer specifications.

Solid State Products Limited is one of the principal Canadian manufacturers of such components and its sales to customers in Canada during the last ten years represented in excess of 50% of the market. Approximately one-third of the company's production is exported, primarily to Western Europe.

Circuit Systems, Inc.

Circuit Systems, Inc. (CSI) carries on a manufacturing, repair and overhaul operation for the products of CSL sold in the United States, and also operates as a sales outlet in the U.S. In September, 1970, CSI commenced engineering research and development with respect to the application of electronics systems in the areas of medical electronics and pollution.

Aviation Electronics Limited

Aviation Electronics Limited manufactures components for the electronics industry. These components consist primarily of printed circuit boards and assemblies and also include terminal boards, nameplates, instrument panels, dials and component boards made to customer specifications.

Grosvenor Industries Limited

Grosvenor Industries Limited is a United Kingdom

company incorporated in 1952, all the loan and share capital of which was acquired by CSL on June 7, 1969 for £1,100,000. Grosvenor produces flight data recorders, magnetic tape recorders and industrial electronic products.

The Grosvenor flight data recorder called "aircraft data acquisition system" (ADAS) differs from those developed by CSL in that it is a wire recorder. It is capable of 200 hours of recording time and is protected by armour for crash survival. The ADAS is available in several versions suitable for different applications. The information recorded by the system when processed by the Grosvenor ground playback unit can be transcribed in chart form, on an electric typewriter, on punch tape or magnetic tape and can be processed by computers. Grosvenor entered the flight recorder market in 1966 and its ADAS is fitted to the BOAC fleet of VC-10 and Boeing 707 aircraft and is currently an order for four other overseas airlines.

The magnetic tape recorders produced by Grosvenor are offered in a variety of models and are sold in commercial and military markets under the Grosvenor trade mark. They are computer compatible, have a wide range of duration times, and accept either analogue or digital signals. Tape recorders have been produced by

Grosvenor for more than 12 years and a high order of practical experience in a field demanding stringent electro-mechanical standards has been acquired.

The industrial electronic products produced by Grosvenor include closed circuit television systems, metering devices, and a highly sensitive temperature control unit. Grosvenor is co-operating with Barclay's Bank Limited in the development of a bank card reader.

#### Interface Limited

Interface Limited, an Ontario company, was incorporated in 1965. It is the only independent manufacturer of glass to metal hermetic seals in Canada. These seals are sold to most Canadian manufacturers of sophisticated electronic communications, guidance and electronic control systems and electronic components and modules. Interface, because of its expertise in the techniques of heat treatment and glass manufacture, is manufacturing the tip of the steel probe for CSL.

#### Carruthers Engineering Limited

Carruthers Engineering Limited, an enterprise established in 1932 and incorporated in Ontario in 1965 was, prior to 1965, engaged for the greater part in the production of components for sound systems. In the intervening years, the strengthening of its engineering

staff and the improvement and expansion of its manufacturing facilities enabled Carruthers to increase its product lines to include a variety of electrical, mechanical and other systems and components sold to a number of industrial and military customers.

The activity which currently accounts for the largest proportion of the sales volume of Carruthers is the manufacture of mechanical assemblies for the United States Armed Forces. These assemblies are mechanical devices composed of 65 parts, the great majority of which are produced in precision machine shops.

Carruthers has for many years produced speakers, tuners, amplifiers and microphones for the home entertainment industry as well as complete sound systems for industrial and commercial customers. Recently Carruthers has become an important Canadian supplier of components such as memory cores and hydraulic drive units for high speed printers for computer manufacturers in Canada and in the United States. In 1969 Carruthers acquired the assets of the transformer division of Oshawa Manufacturing Limited. These transformers are being produced primarily for customers in the automotive industry.



### Spencerfield Electronics Limited

Spencerfield Electronics Limited, an Ontario company incorporated in 1962, is engaged directly and through wholly-owned subsidiaries in the development and manufacture of electronic and mechanical components. Products include printed circuits for use in electronic, telephone and computer equipment, a wide variety of instrument panels and precision dials for the automotive and aircraft industries, and flexible printed circuits for the automotive industry.

### The Corporate Environment

Circuit Systems Limited is unique in Canada. Its strength lies in its product lines and worldwide sales potential. It has made a significant commitment to research and development. The major impact on the company in recent years has come from a conscious policy of acquiring sound companies in the electronics field.

Until this time, each company in the group has maintained self-sufficient operations and unique identity. The recent acquisition of Carruthers Engineering Limited and Spencerfield Electronics Limited, however, has created some difficulties for the parent company. Corporate management is now considering a number of alternative ways of reorganizing the circuit systems limited group.

The corporate vice-president in charge of manufacturing has submitted a proposal to rationalize the scattered and varied production operations as a way of increasing production efficiency and minimizing costs. He envisions all assembly operations being brought together under one department with centralized research and development, but retaining separate sales organizations so that the identity of the various companies remain intact in the customers' eyes.

On the other hand, the senior marketing executive has responded that should any rationalization be implemented, its effect would be most beneficial in having the sales personnel organized under a separate marketing company responsible for world-wide sales of all CSL products. But the controller resisted this suggestion since it would add yet another company to an already unwieldy group.

Questions:

1. Examine the various ways in which the company can be reorganized for greater marketing effectiveness (e.g. centralized versus decentralized; geographic, functional, product line, and industry grouping; etc.)
2. Examine the relationship between marketing control and financial accountability.

3. Given that the company is committed to a strategy of growth through acquisition, what impact will this have on the company's marketing efforts and how would this affect the organization of the marketing function?

MARKETING RESEARCH

Case 5 - Canadian Inland Limited

MARKET MANAGEMENT COURSE

5

CANADIAN INLAND LIMITED<sup>+</sup>

by

DR. I. A. LITVAK and DR. P. M. BANTING

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## CANADIAN INLAND LIMITED

Inland Manufacturing Corporation, a medium sized U.S. manufacturer of aluminum products, entered Canada in 1957 by acquiring the assets of two Canadian extrusion<sup>1</sup> companies. These two companies were then merged into a single Canadian extrusion enterprise with plants in Toronto and Hamilton.

Canadian Inland Limited has two main divisions -- industrial and consumer. The industrial division produces semi-fabricated extrusions which are supplied to manufacturers. The consumer division produces finished aluminum products such as garden furniture, aluminum ladders, umbrella-type clothes lines, scaffolding, moldings, cabinet edgings, etc. In addition, Inland owns several aluminum door and window firms. Canadian Inland's sales reached \$15 million in 1971.

### COMPANY POLICY

The parent company's international division looks after all foreign operations. These include plants in France, Germany, Belgium, Spain, Italy, England and Canada. All subsidiaries operate with a reasonably high degree of autonomy. Of the foreign subsidiaries, however, the Canadian firm is the only one with a

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<sup>1</sup>Extrusion is the process of forcing aluminum billets under great heat and pressure through dies to form pre-determined shapes.

consumer products division. It alone has experience, know-how, and marketing knowledge in the consumer area.

Having successfully cultivated the home market, with the prior approval of the parent company, the Canadian firm decided to probe foreign markets. The objective was to stimulate demand for Inland's products in foreign markets, and make Inland's other subsidiaries recognize the potential for consumer sales in their respective markets. Sales volume developed by the Canadian company, when sufficiently large, would be turned over to the local subsidiary to expand, and ultimately result in the establishment of domestic manufacturing by the sister subsidiary.

#### Export Contacts

On this basis, the Canadian consumer division went "international" in January of 1970. The sales manager, John Foreman, believed that the growing affluence of the European worker, his developing taste for leisure, and his life-style preferences would permit the company's consumer products to quickly gain market acceptance.

John's first step was to investigate foreign markets. The Ontario Department of Economics and Development in March, 1970 was organizing a trade mission to Europe. After some consultations with members of the department, John accepted their invitation to join this trade mission, which toured Italy, Germany, Holland, France and England. During the course of the trip, John was officially introduced to leading buyers for department store chains, import-houses, wholesalers and buying groups. The two-week trip convinced

John Foreman that there was ample buying power in some of the countries to make the exportation of Canadian made aluminum consumer products a profitable undertaking.

On his return to Canada, John's next step was to obtain credit references for the firms he considered as potential distributors. To those judged acceptable, he sent letters expressing interest, samples, prices and other relevant information.

The first orders received were from a German wholesaler who imported on his own account. Sales in this market totalled \$40 thousand in 1970. Similar success was achieved in France and England. Italy, on the other hand, did not produce sales. This was attributed to the semi-luxury nature of the company's products. John Foreman concluded that due to the lower level of incomes in Italy, Italians had developed a predisposition toward "making do" with serviceable items rather than looking for goods and services which would make life easier.

#### DISTRIBUTION CHANNELS

In Canada, Inland distributes through stocking hardware distributors, and buying groups such as co-operatives and hardware chains. In foreign markets, however, there is no recognizable pattern and channel systems vary from country to country. In one country, sales are made to an individual who stocks goods on his own account. In another, an agent, a buying group, or a hardware wholesaler is engaged. To avoid crossing channels of distribution, Inland has only one account in each country. The chosen distributor enjoys exclusive representation.



### Distributor Profiles

Germany: Inland distributes through a wholesaler based in the Southern Ruhr which is the central distribution area for Western Germany. This wholesaler has a force of five salesmen: one covering the Bavarian area, one the Ruhr Valley, one the northern area around Bremen and Hanover, one in West Berlin, and one in the Heidleberg-Manheim territory. The firm specializes in small housewares and has contacts with leading buying groups, wholesalers, and department stores. John Foreman was impressed with the firm's aggressiveness and knowledge of merchandising techniques. He noted that they had won an award from a large American carpet sweeper firm, as their best single foreign representative in 1969, which he considered a good indication of sales ability.

France: The company sells to a Paris-based buying group of a chain of hardware wholesalers with representation throughout France. It was felt that this group would provide excellent coverage of the market because of their extensive distributive network.

Denmark: The Canadian company's line is sold to a buying group representing a chain of hardware retailers in Denmark. This group recently expanded to include their counterparts in Sweden, Finland, and Norway. Together, they purchase goods for about 500 hardware retailers. The buying power of the Scandinavians is quite high, and it is expected that Inland's products will prove very successful in this market.

The United Kingdom: An importer-distributor who both buys on his own account and acts as a sales agent handles the company's line in Great Britain. This firm sells to department stores and hardware wholesalers. The distribution chain in England is quite cumbersome and the company has found it difficult to attain acceptance in the British market. John Foreman, however, is convinced that this market has the highest potential of all the foreign countries. To date, the do-it-yourself market in Great Britain has brought in a lot of business in aluminum moldings.

Australia: The Australian market was established indirectly and successfully. A number of letters were received from Australian merchants who had heard of Inland through the Department of Industry, Trade and Commerce. The supply of garden furniture in Australia was small and prices were high. Prices were quoted and samples sent to the businessmen recommended by the Canadian trade commissioner. The distributor selected is an Australian importer who operates a chain of discount houses and retails on his own account. This firm discovered it could land aluminum furniture in Melbourne at prices competitive with American and Japanese imports.

Venezuela: This market was developed by an American who came to Canada from Venezuela in search of new lines. Inland attributes success in Venezuela to the efforts of this aggressive and capable agent. He has built up a sizeable trade in aluminum ladders.

The Carribean: In Trinidad and Jamaica, Inland's consumer products are handled by traders who carry such diversified lines as insurance, apples, plums, fish and so on. They have been successful in selling aluminum ladders.

## THE SALES MANAGER'S EXPORT STRATEGY

1. Product: No product modifications will be made in selling to foreign customers. This might be considered later, after a substantial sales volume has developed.
2. Price: The company will not concern itself with retail prices and will not publish suggested list prices. Distributors add their own markups to their landed cost. Supply prices will be kept as low as possible. This is accomplished by:
  - (1) removing advertising expenses and other strictly domestic overhead charges from price calculations,
  - (2) finding the most economical packages for shipment (smallest volume per unit), and
  - (3) bargaining with carriers to obtain the lowest shipping rates possible.
3. Promotion: Removal of advertising expenses from price calculations is accomplished because the firm does no advertising in foreign markets. Brochures and sales literature already being used in Canada are supplied to foreign distributors. Inland will continue to promote its consumer products by participating in overseas trade shows. These are manned by the consumer sales manager. All exhibition inquiries are forwarded to the firm's distributor in the country.
4. Distribution: New distributors will be contacted through foreign trade shows. John Foreman considers large distributors desirable. He feels, however, that they are not as receptive as smaller distributors to a new unestablished product line. Consequently, he prefers to appoint small distributors. Larger

distributors may be appointed after the company has gained a strong consumer franchise.

5. Financing: Inland sees no need to provide financial help to distributors. The company views its major contribution as providing operational products at the lowest possible price.

6. Marketing and Planning Assistance: John Foreman contends that foreign distributors know their own markets best. Consequently, they are equipped to plan for themselves.

7. Selection of Foreign Markets: The evaluation of foreign market opportunities for the company's consumer products is based primarily upon disposable income and life-style patterns. For example, John fails to see any market in North Africa for his products, which he categorizes as a semi-luxurious line. It is his opinion that cheaper products such as wooden ladders, (often home-made), are preferred to pre-fabricated aluminum ladders in countries such as North Africa, Italy and Spain. Venezuela, on the other hand, he contends is a more highly industrialized market with luxury tastes. Thus, John sees Inland's consumer products as being essentially tailored for a highly industrialized and affluent society.

#### QUESTIONS

1. Critically evaluate John Foreman's approach to probing foreign markets and to selecting distribution channels.
2. Design an overseas distributive strategy for Inland.

PRODUCT PLANNING

Case 6 - Centaur Manufacturing (B)

MARKET MANAGEMENT COURSE

CENTAUR MANUFACTURING (B)<sup>+</sup>

by

DR. I. A. LITVAK and DR. P. M. BANTING

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## CENTAUR MANUFACTURING (B)

Centaur Manufacturing is a small, highly specialized, automobile accessory manufacturing plant. The company's principal product, Centi-Spark, is a capacitive discharge ignition system which can easily be added to the ignition system of most gasoline engines. The modification results in a significant increase in the life of spark plugs and points, reduces gas consumption, increases the interval between tune-ups, improves cold weather starting, and increases acceleration.

Of greatest importance to the company is the quality of this product. Centaur contends that quality is Centi-Spark's principle competitive advantage in a market characterized by many fly-by-night low quality capacitive discharge ignition systems (C-D). Centi-spark retails at \$75, and is sold in the industrial market at \$55. It is distributed through agents and distributors, who have focussed their efforts on industrial sales to the exclusion of the consumer market. The bulk of the company's sales have been generated by the personal selling efforts of Centaur's president, Don Hamilton, in overseas markets.

Currently, Mr. Hamilton wishes to expand his minimal Canadian sales volume. In Hamilton's estimation, this might be accomplished through product adjustment. Centi-Spark is available in one model only. As a highly engineered electronic device, Mr. Hamilton feels little internal modification

is necessary. It is already of highest technical quality. However, Mr. Hamilton thinks that the outside container which holds and protects the electronic device may be changed, at relatively little expense, to provide greater appeal to the various types of potential customers in the market. He notes that among competing products packaging varies between gold anodized aluminum boxes with elaborate cooling fins for the power transistors, to plain functional packages. Centi-Spark is enclosed in a simple, square steel box, painted grey, with a silver label identifying the firm and the product.

As a first step in his decision to modify the container for greater sales appeal, Mr. Hamilton has attempted to classify the types of customers to whom he might sell Centi-Spark. The following description provides the characteristics of the various groups Mr. Hamilton thinks comprise the Canadian market for his Centi-Spark C-D system.

#### The Industrial Market

The industrial market includes those commercial outfits which employ gasoline powered engines in pick-up trucks, gasoline fueled fleet trucks, fork lift trucks, margins in-board motors, delivery trucks, and specialty engines, for example on the back of mobile cement mixers.

Industrial goods buyers do relatively little shopping compared to the consumer goods buyers, consequently the seller must go to the buyer. The industrial customer must first



be made aware of the product, then must be informed about the characteristics of the product and finally must be sold on the product in terms of a realizable benefit. A further important criterion that must be considered when selling to the industrial market is the existence of the multiple buying influence. For the C-D systems, in the small outfits the chief mechanic acts as both the decision influencer and maker; whereas in the larger outfits, especially the multi-location ones, the chief mechanic acts only as the decision influencer, while a fleet superintendent or service manager acts as the decision maker. In the case of the latter, the benefits of the C-D system must be communicated to both.

In both cases C-D systems fall into the category of accessory equipment. The product is regarded as a capital investment and thus must be sold on an economic justification basis. In addition, some personal convenience factors could be used as selling points.

The potential industrial target market areas include:

1. Highway, High Mileage Fleets

This market segment represents the greatest potential for the C-D systems. This category contains the largest volume of commercial vehicles which could benefit from these systems, and also represents by far the greatest mileage consumers. As well as depending a great deal upon keeping their trucks operating at peak efficiency, any lost service time due to ignition problems could be quite costly. Consequently,

these people would evaluate the C-D system on economy during highway running, on improving the service factor on their trucks, as well as on the standard incentive of the reduced ignition service maintenance.

Most of the people in this market are blue collar workers, truck drivers, mechanics, etc., and are quite knowledgeable about technical aspects. They are always on the look-out for new automotive accessories that could improve the performance of their trucks and would well be able to recognize the difference between a good accessory and a gimmick. Consequently, they should be quite receptive to the C-D system.

In terms of the customer adoption concept, many of the larger truck fleets would fall into the early adopter category. Once several of the fleets were sold on the benefit of the C-D system, their testimonials would help convince other fleet operators to buy the product.

The justification for purchasing and installing the C-D system would be mainly economic. These people would want to see on paper and consequently test for themselves, with samples, what maintenance, service factor and performance savings they could realize. With many of these customers both the mechanics and the fleet superintendents or service managers must be convinced and sold.

## 2. In-Plant Vehicle Service

While this market segment is not nearly as large as the previous one, it does represent good potential. The vehicles in this area generally operate under severe conditions -- slow driving, heavy idling, dirty environment -- and consequently require substantial ignition maintenance. However, these severe operating conditions put such a large strain on all aspects of the vehicles that the overall maintenance bills are extremely high, often as much as 25% of cost per year. This market segment is generally not looking for devices to improve their ignition maintenance; it represents such a small portion of the costs. However, a willingness may develop to try such systems after awareness and evaluation have been encouraged. Trials are mandatory.

The type of vehicles included in this group are in-plant trucks and pick-ups, plus portable gasoline driven compressors, and fork lift trucks.

The interested parties in this market also range from mechanics to garage supervisors, the latter in many cases being former chief mechanics who were promoted to supervisory capacity. The purchase of a number of such C-D systems would be tightly budget controlled and the performance benefits and economic incentives would have to be demonstrated. The decision influencers and makers are generally blue collar workers who are familiar with

automotive vehicles. Consequently, they are well able to judge that Centi-Spark is not a gimmick.

This market would fall into the early majority category in the diffusion of innovations, so the sales effort would have to be a little stronger or delayed until the early adopters' influence can take effect.

### 3. City Traffic

This potential market segment includes automobile fleets owned or operated by municipal governments for their police departments, public health and welfare services, etc., which are confined to urban areas. Other potential customers include taxi and limousine fleets, company owned automobiles used for salesmen, pick-up and delivery, and personnel shuttle services. Very few taxi fleets are company owned. Most of the vehicles are owned by the operators who are franchised by the taxi company.

The chief characteristic in this segment is the frequency of purchase of replacement vehicles. Currently owned or leased vehicles are seldom less than two or three years old. Frequently after 50-60,000 miles the cars are traded for new models.

Except for large fleet owners, maintenance is minimal or according to manufacturer's warrantee requirements. For those not willing to have preventive maintenance, a C-D system is not likely to be wanted. For the others, ignition system maintenance is such a small portion of their maintenance

expenses that they tend to overlook this cost. The owners do not wish to jeopardize their warrantee and hence are not interested in a C-D system unless it is authorized or installed by the manufacturer. The owners of small fleets or decentralized larger fleets use conveniently located independent garages for all their automotive service. The most interested customer in this market is the one who owns the vehicles and has direct control of maintenance expenses. He quite frequently will have his own mechanic and facilities to do minor repairs.

#### 4. City Delivery

This market segment is characterized by Dairy, Bakery and Department Store home delivery. Some trucks may run continuously for nine hours and only cover 25-50 miles. The low speeds and long idling hours help to produce carbon and deposit build up which fouls the spark-plugs and consequently reduces gasoline mileage.

Many of these firms have their own service facilities and mechanics and hence are ideal customers for C-D systems. Motor maintenance crews are usually overworked, so a C-D system would give the mechanics more time on maintaining other important service areas. Labour savings due to reduced tune-up maintenance cannot really be justified unless there is alternate work for the mechanic which can be done during the time saved. The firms that lease trucks or service are of secondary importance to those who do their own tune-up maintenance work.

Once again these people would probably like to test a

unit to see if it will perform according to specifications. They usually give their trucks new spark-plugs two to four times per year and check them at six-week intervals, and hence would see the test results relatively quickly.

#### 5. Original Equipment Manufacturers

The significant characteristics of this market are: very high volume demand, high product quality requirements, very technically oriented buyers, and price consciousness. This market is extremely hard to reach, especially by small suppliers. Often in such a situation, personal contacts are the main entry into the market. The market tends to be very conservative in its outlook, suggesting the need for a strong personal sales effort. The OEM is also very conscious of and would demand a rigorous delivery schedule.

#### 6. Military Market

The military market for vehicle modifications can be described as conservative, cost conscious, slow to adopt innovations, and exceedingly large.

Until 1967, about 99% of all armed forces vehicles were gasoline powered. With the advent of the armoured personnel carrier (M113), extensive dieselization has taken place. However, it is expected that all support vehicles will continue to be gas powered. The average combat brigade (Canada has 5 of them) has about 1,500 vehicles, of which 61% are currently estimated to be gas powered. This alone is a potential of

4,500 vehicles. In addition, there are at least 30 major armed forces bases across Canada having at least a fleet of 100 vehicles, giving a total potential of around 7,500 vehicles under one centralized technical control.

The Armed Forces are strongly oriented toward preventative maintenance.

Each vehicle has an extensive log showing fuel consumption, repairs, and mileage. Moreover, the forces are continually conducting user trials on new products. These can be accurately evaluated using the vehicle logs.

The Armed Forces have a centralized purchasing system through the Department of Supply, and a centralized equipment testing agency in Ottawa manned extensively by military officers.

#### CONSUMER MARKET

##### 1. Family Car Market

The family car market comprises all those cars which have not been equipped with a C-D system by an OEM. This potential for the C-D system in the market segment appears to be small and consists of a special type of car owner, judged to have the following characteristics:

##### a) Pride in his Car

The family car owner who is a potential C-D purchaser takes pride that his car as an efficient machine. He likely performs his own tune-ups and is concerned that his car will last longer than the normal ownership period. No doubt he has higher than average mechanical ability and the intelligence to understand automotive technology.

b) Cost Consciousness

He is likely to be cost conscious and probably takes the trouble to shop for quality parts and service at a reasonable price. The effort involved in recording gasoline mileage and tire performance would not be onerous for this consumer. Any system that has been proved to save operating costs would interest this individual.

c) Innovativeness

The potential C-D purchaser is the innovator and early adopter of new products. An important characteristic of this buyer is that he has many contacts outside his own social group and community. He tends to rely on impersonal and scientific information sources, or other innovators. He often reads articles in technical publications, or informative advertisements, to acquire information.

It should be emphasized that if original equipment manufacturers should decide to install C-D systems on new cars in the future, the market for C-D systems for used cars would explode. At that time the family car market may become the most important segment.

2. Rally and Sports Car Market

Another potential market segment in the consumer area is the rally and sports car market. The buyers in this particular market, account for a very small portion, in absolute numbers, of the overall consumer market but because of their peculiar characteristics, they represent



a market which must not be overlooked. The term rally and sports car enthusiast does not refer particularly to the type of individual who pursues this sport at the professional or semi-professional level, but rather to the individual who purchases a car for normal use based largely upon its performance characteristics. Performance in this case refers to characteristics in handling, power, economy, ride, and appearance. This buyer is more of a "shopper" than the average consumer. Once he has been informed of the product and its merits, he is willing to spend some time looking and browsing for this speciality good.

The sports car or rally enthusiast is characterized by his functional and technical orientation. He must be convinced that the Centi-Spark unit does what it purports to do and understand how or why it is able to accomplish this. Because of his functional orientation, he is not so interested in the appearance or installation aspects of the product, but rather in the direct results or benefits which are expected. His understanding of the capacitive discharge system's operation and the benefits associated with it will be of particular importance if this particular consumer is a member of an organized sports or rally car club. The pride that this enthusiast has in his car can be compounded by accentuating the merits of the C-D system vis-a-vis the standard ignition system.

### 3. Power and Speed Market

The power and speed enthusiast is similar in some respects to the sports car buyer. Both are interested in the performance of their cars. However, the sports car buyer is interested more in the overall performance of his car -- starting, idling, economy and acceleration; whereas the speed enthusiast is interested primarily in the brute power of his vehicle.

The power buyer does not have the same degree of technical orientation that the rally buyer exhibits. He is interested in a simple "bolt-on" accessory that is easy to install and produces measurable results the instant his tachometer enters the 5,000 RPM range. Like the sports car and rally enthusiast, he likes to browse in speed and sport specialty shops and is not particularly price conscious. However, he is more conscious of the external appearance of the product. The quality of the product in this particular case, is more likely to be measured in terms of price and external appearance.

### Questions

1. How can Mr. Hamilton verify that these six industrial and three consumer groups accurately portray the markets to which Centi-Spark should be aimed?
2. How should Mr. Hamilton use this information to determine what product adjustment is required?
3. Given these nine market segments, what product adjust-

ments would you recommend?

4. How would your recommended product adjustment affect Centaur's price, promotion and distribution strategies?

PRICING POLICIES

Case 7 - Produits Bernard S.A.

MARKET MANAGEMENT COURSE

7

PRODUITS BERNARD S.A.<sup>+</sup>

<sup>+</sup>D. Leighton, International Marketing, McGraw-Hill, 1966, pp. 389-390.

## PRODUITS BERNARD S.A.

In 1963, Produits Bernard S.A., a French producer of corrugated shipping boxes, obtained the exclusive French rights to manufacture and sell a patented box called the Lock-Seal box. This box, developed and sold in the United States by the Cleveland Box Corporation, contained a plastic-dipped lining which made the container waterproof, provided an excellent insulation, and resulted in great strength and dimensional stability. Because of technical problems, no box manufacturer had previously been able to provide a satisfactory product of this type and Cleveland had been successful in patenting its secret process.

Bernard was a relatively small box manufacturer, with a modern plant located very close to several major industrial markets of France and also to important fruit-growing and poultry-raising areas of the country. Sales were made direct to industrial users by a seven-man sales force. Prices were very competitive. A large, expensive, and very efficient box-making machine had recently been installed, with capacity several times existing sales volume. The machine had been purchased in an attempt to match competitors in quality and costs. If volume could be increased, very satisfactory profit margins could be realized over production costs; but in 1963 the company was running at well below the break-even point. In fact, the financial position of the company was considered very serious, and there was considerable pressure on management to begin to show a profit.

Great hopes were held for the new box in improving volume and profits. The basic box would be produced on the new machine as with any corrugated container, then dipped, cooled, and dried to give the Lock-Seal box. The present manufacturing cost (labor plus materials) for what was known in the trade as the standard 60-pound carton was NF0.825.<sup>1</sup> The new process would add NF0.75 to this, giving direct manufacturing costs before overhead of NF1.575 per Lock-Seal box.

Management felt that the box would have a great potential for fishermen and farmers in handling fruit, eggs, poultry, and other agricultural products requiring icing. A consulting firm was engaged to assist in devising a marketing program. This firm investigated the potential markets and reported the following data:

1. *Poultry and egg producers* use boxes for shipping fresh products in ice. Twelve large producers account for 75 per cent of business. Total business for shipping containers: about NF5 million per year. Currently using:
  - a. Round wooden hampers (80 per cent) lined with waxed paper; used mostly for local shipments (less than 200 kilometers). Problems: poor insulator, round shape, no advertising surface. Price: NF2 for the equivalent of a 60-pound box.

<sup>1</sup> US\$1 = 5 French new francs (NF).

- b. Wooden boxes (20 per cent), wire bound and reusable, in equivalent of 66-pound and 90-pound sizes. Used for shipments over 200 kilometers. Problems: bulky, poor insulation, not a good advertising surface, but strong. Price: NF3.25 for 90-pound container (main use) and NF2.25 for 66-pound box.
2. *Fisheries* use boxes for shipping fresh seafood in ice. Estimated total volume in neighboring area only: about NF5 million. Roughly 15 large fisheries do bulk of business. Currently use wooden box, heavier and stronger than poultry and egg boxes, and also reusable. Price: NF3.5 to NF4 for equivalent of a 50-pound box.
3. *Produce, fruit and vegetables* usage pattern is similar to poultry and eggs, with some corrugated cartons coming in. Many smaller producers. Total box volume: NF4 million. Price on corrugated cartons now: NF1.40.

With this data, Bernard's management was attempting to arrive at a conclusion on a satisfactory price for the Lock-Seal box.

- 1 What strategy would you use in pricing the new box?
- 2 What would be the specific price that you would recommend?

DESIGNING THE DISTRIBUTIVE SYSTEM

Case 8 - Valleyfield Carpeting Limited



MARKET MANAGEMENT COURSE

VALLEYFIELD CARPETING LIMITED<sup>+</sup>

by

DR. I. A. LITVAK and DR. P.M. BANTING

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## VALLEYFIELD CARPETING LIMITED

Valleyfield Carpeting Limited (VCL) was founded in 1925 with 19 employees, and today has 470, with 1971 sales of \$10 million. VCL manufactures and sells more than 300 different lines of carpet. Production facilities are located at Valleyfield, P.Q., with the head office in Montreal.

Originally, the firm produced rug squares, usually heavily patterned in many designs and in oriental styles. However, during the 1930's the trend shifted away from rug squares for living rooms, toward wall-to-wall broadloom throughout the house. In 1961, VCL adopted a new innovation, the tufting process, and, with man-made fibre, lower costs and heavy promotion, saw tufted carpeting grow to become the most popular type of carpet in the market.

The firm maintains three divisions -- domestic, contract, and automobile (newly established). The domestic business is primarily oriented to home-end-users. Initially, VCL sold to every dealer who carried carpets and rugs, or had facilities to do so. With the tremendous increase in business resulting from the use of man-made fibre and the tufting process, the company found its distribution channels were not operating effectively. Conflict arose between dealers with respect to territorial coverage. In 1960, the

firm switched to exclusive distribution using four distributors located in New Brunswick, Quebec, Ontario and British Columbia. Small retailers buy their carpets and rugs from these distributors and are serviced by the distributors' salesmen. Direct accounts include large retail chains such as T. Eaton Company, The Hudson Bay Company, Simpson-Sears, Robert Simpson, etc. This market takes a sizeable share of VCL's output which is then sold under the chains' private labels.

The contract division of these chains and VCL's distributors service institutions such as cocktail lounges, hotels, restaurants, schools and so on, who have special design, styling, colouring, or size requirements that must be custom-made. While such institutions must purchase through a retail chain store or VCL distributor, their orders receive special attention. These three account categories are served by VCL's own regional sales offices in Montreal, Toronto, Winnipeg, Vancouver, Halifax and Hamilton. The sales offices maintain show-rooms where large department store buyers and distributors can inspect the firm's products. The regional offices assist distributors, insure that distributors follow VCL policies, and co-ordinate distributors' advertising and promotional efforts. The regional offices' personnel also act as order-getting salesmen, assisting distributors by dealing directly with the retail trade, developing business and keeping VCL products foremost in their

overall sales effort.

The automobile carpeting division deals directly with such firms as Ford Motor Company, General Motors, Chrysler of Canada and American Motors.

#### THE DECISION TO EXPORT

While carpet manufacturers have been exporting to Canada from Belgium, the United Kingdom and elsewhere for many years, until recently Canadian manufacturers of carpets were not willing to enter foreign markets. They were limited by costs and technical ability. However, the advent of tufting and man-made fibres changed this situation.

The European manufacturers were slow to adopt tufting and they were also slow to shift to the use of man-made fibres. This gave VCL a potential advantage in foreign markets. The firm had unique materials, an efficient manufacturing process, and could price competitively overseas. Furthermore, VCL had decided to expand production facilities in Valleyfield with a new plant. Looking toward the future, the company saw export marketing as a method of absorbing excess capacity, and as a way to expand operations if and when the saturation point was reached in the domestic market.

#### MARKETING IN AUSTRALIA

VCL's greatest success in exporting took place in Australia. The Australian carpet market was estimated at \$20 million. The proportion of this market that was

serviced through imports was carefully examined by Charles Picard, the company's sales manager. The data he received indicated that VCL could compete in Australia with imports from the U.K., the U.S.A. and Belgium. Australia was similar to Canada in that demand had originally been concentrated in the rug square and woven wool market. Later, fibre manufacturers had gone into Australia and done a tremendous amount of advertising and promotion of synthetic fibres, not only in carpeting, but also in wearing apparel. Thus the public was aware of what a synthetic fibre was and how it stood up against traditional wool fibres. They had already been convinced of the advantages of fibre materials.

Mr. Picard established contact with an importing agency in Australia on the recommendation of the Canadian trade commissioner, and submitted samples to this agency. This agent had been in the business for a number of years, he knew the trade and he had excellent contacts.

Duties, freight rates, insurance rates and the prices of comparable products were all examined. In the Australian market buyers wanted to know what their landed price would be in terms of their own currency. They were not interested in F.O.B. factory prices in Canadian dollars. Moreover, VCL's prices had to include the commission for the agent. Duty was calculated on the F.O.B. price rather than the C.I.F. price. VCL

enjoyed an advantage under the British Preferential Tariff with a 12 1/2% duty as opposed to 27.5% which American firms faced under the most favoured nation agreement. Prices were quoted both in Canadian funds and Australian currency.

Samples were sent to Australia in May, 1970 and an order was received the following autumn. The agent had issued the samples to his sales personnel, who had in turn used them to sell to dealers and buyers from large chains in Adelaide, Sydney and Melbourne. Between May of 1970 and the autumn of 1971, there was a great exchange of correspondence between the agent and Picard. The agent outlined what the Australian consumers were already buying, and what he thought buyers would be interested in purchasing from VCL. No one from VCL visited Australia, but occasionally buyers from Australia were met by Mr. Picard in Montreal or Toronto.

Orders are currently received directly from the agent. Terms are letters of credit or documents against payment. The agent is advised of the prices, and he in turn advises his account. Terms are only extended to a large firm like Patterson's in Australia, which is comparable to the T. Eaton Company.

Payment on foreign orders is negotiated between VCL and the buyer, without the assistance of the agent. He is a pure manufacturers' agent and receives a commission. The agent advises the buyer of the initial cost

per yard, and then has the buyer establish a letter of credit. In Australia the distribution pattern is totally different from Canada's. Manufacturers sell directly to retail accounts, and carpet manufacturers do not employ jobbers.

Mr. Picard did not set any minimum size order for Australia. VCL was primarily interested in getting its foot in the door, and a rug on the floor. The agent was sent samples in the form of sample books with 13 x 18 inch pieces of carpeting and yard samples, to give him a true representation of VCL's colours, patterns and designs.

#### PRODUCT MODIFICATION

Buyers in Australia prefer a secondary jute backing. This gives the rug dimensional stability, commonly referred to as "hand" or "feel". Until 1965 this secondary backing was kraft cord or a woven skim of treated paper which would be applied with latex to the back of the carpet. Manufacturers who were already supplying the Australian market from the United States were using a double jute backing rather than the kraft cord skim. Thus, jute backing was very popular in Australia and VCL had to follow suit to export to Australia.

#### THE MARKET POTENTIAL

Unlike in Canada, VCL does not take part in any co-operative advertising in Australia. Instead, it supplies advertising materials to the agents and dealers in the form of banners. Advertising mats are supplied

if desired, but any consumer advertising is at the initiative of the agent or the dealers in Australia.

In 1972, sales in Australia are expected to reach 125,000 dollars, and the figure is expected to be more than doubled by the end of 1973. British imports, which enjoy the same tariff treatment as Canadian imports have been used to establish target sales volumes for VCL carpets in Australia. Mr. Picard believes that VCL could realize an annual sales figure of one million dollars by 1975 with the right marketing program.

#### QUESTIONS

1. Evaluate Charles Picard's export marketing strategy, particularly his distribution arrangement.
2. Formulate an export marketing strategy which would enable VCL to achieve the million dollar sales target.



PROMOTION

Case 9 - Kipp Kelly Limited

Case 10 - Claire Haddad High Fashions

MARKET MANAGEMENT COURSE

KIPP KELLY LIMITED

## KIPP KELLY LIMITED

### Planning a Promotional Campaign for the Communist Chinese Market

Kipp Kelly Limited, a specialized engineering, manufacturing and distributing firm located in Winnipeg, exports to over sixty-five countries. The company has a reputation for being the pioneer in the dry separation and dry materials handling fields.

Kipp Kelly's search for export market opportunities began in the early 1930's when it became obvious that the potential demand in the Canadian Milling Industry was limited. In fact, demand fell short of plant capacity. In 1936, Robert Kipp, son of the founder of the firm, became head of the export division and went to England to organize Separations Engineering Ltd., now Kipp Kelly (London) Ltd. From the beginning Kipp Kelly manufactured quality products, a fact which is recognized internationally. It has become common for Kipp Kelly separation equipment to be incorporated into complete plant installations designed and constructed by leading European and Asiatic mill and engineering firms. But emphasis on the quality factor had its drawbacks too because once a machine was sold, it usually did not require replacements for years.

#### THE PRODUCT-MIX

The first separators produced used air tabling based on product weight differential. This separation led to the development of other types affecting separation, upgrading, and removal of contaminations by variations in electrical susceptibility and magnetic conductivity.

A plant laboratory was established with services offered free of charge for full scale separation tests. This offered more visible assurance of the equipment's application than any other sales approach. Separation tests have been carried out on such diverse products as coffee, cocoa, rice, edible beans, soy beans, cereal grains, sesame, breakfast cereals, peanuts, spices, bone meal, flower seeds, pharmaceuticals, wood flakes, gypsum, diamonds, copra, tungsten, monazite, volcanic stone, tin sands, and film scrap. Although this is by no means a complete list, it demonstrates the diversity of products submitted for tests and recovery procedures.

## EXPORT MARKETING

Robert Kipp, the President of the company, attributed the firm's success to three major factors: (1) imaginative sales approach, (2) quality products whether manufactured or distributed, (3) service.

Export sales of separation equipment has risen from approximately 40 units worth \$70,000 in 1948 to 130 units worth \$400,000 in 1965. Gross sales of separation equipment represent about 20% of the company's total sales, and approximately 85% of total separation equipment production is exported.

The full range of Kipp Kelly equipment was first introduced to foreign customers via direct mail. This was followed by personal contacts wherever possible. In addition, Kipp Kelly has always capitalized on the benefits derived from trade fairs and exhibitions. In many cases, the results of participation have been immediately apparent. The firm, however, gained its widest publicity in 1951 when Robert Kipp flew to Tanganyika with a range of specially fabricated laboratory units to assist the Williamson Diamond Mines at Mwadui develop more accurate methods of recovering diamonds previously lost in tailings. The tests were successful and the necessary equipment was purchased and incorporated into the Williamson Mine.

Since the majority of separation equipment sales are made overseas, and installations are relatively inaccessible for service calls, all units are designed with an eye to rugged dependability and lowest possible maintenance costs. The result is that the units operate for long periods without repairs or downtime. The obsolescence factor is minimal and because the machines sold seldom require replacement for many years, Ross Stewart, the export sales manager, devotes a great deal of his time to surveying new foreign market opportunities.

As export sales increased, particularly to Europe, agents were selected with the assistance of Canadian Government Trade Commissioners. Wherever possible, agents selected were established firms, already dealing in allied or complementary lines. The agents are kept up-to-date on the most recent developments and product applications. They are supplied with sales literature, dimensional drawings and laboratory findings. To the extent that it is economically feasible, catalogues, treatises, and equipment operating manuals are provided in the language of the country where equipment is installed. Plates, photographs, texts and drawings are supplied where agents wish to advertise locally.

## COMMUNIST MARKETS

The first entry into Communist countries took place immediately following World War II. Robert Kipp approached the State Trading Corporations of Poland. There was no immediate result other than an

interest in separators. Subsequently, the company was able to negotiate a number of sales to Poland and orders from Poland have continued steadily ever since. In the case of Czechoslovakia and Yugoslavia, the State Trading Corporations approached Kipp Kelly, possibly through the knowledge of Kipp Kelly transactions in Poland. The company was asked to bid competitively with European manufacturers of similar equipment. These bids were for major installations in flour and rice mills in a third country.

Mr. Ross Stewart explained that when dealing with Communist Trading Corporations the following conditions were encountered:

- a) The State Trading Corporations handle all negotiations and it is seldom that Kipp Kelly has direct contact with the firm responsible for the fabrication, design and engineering of facilities to house the equipment.
- b) Communist technical competence is equivalent to Canadian sophistication.
- c) A company would require the long view when dealing with a State Corporation. You do not get the American approach to business. They will not be hurried; they take a long period of time to consider any proposal.
- d) It is extremely difficult to estimate the potential demand in Communist countries. Kipp Kelly relies on the advice and recommendation of the Canadian Trade Commissioners.
- e) There is a high turnover among Communist personnel and you rarely deal with the same person twice.
- f) State Trading Corporations are generally lax in terms of correspondence. These conditions vary from country to country but you must be patient and take the long view. A sale is never lost until they advise you that they have either thrown out the whole project or that they will utilize equipment other than yours.
- g) Bilateral trade discussions do not come up in personal visits to the Corporations or when dealing by correspondence. Bilateral trade only crops up when a Communist mission is travelling in Canada and is primarily interested in selling its own goods.
- h) Kipp Kelly has no agents in the Communist world.

- 1) Formal contracts are not always employed: Czechoslovakia simply placed an order. Polish orders are usually small and they do not require formal contracts.

Some manufacturers in Canada have suggested that the Communist countries like to send technicians over ostensibly to familiarize themselves with the machinery. Mr. Stewart agrees that this would be advantageous. He states, however, "I have to feel sure that this is not an industrial spy system and we would want to at least be hopeful of completing a contract before making such arrangements. If these representatives were members of a recognized industry with whom we had been dealing for many years, there would be no hesitation to train them in the operation of the equipment."

#### COMMUNIST CHINA

In 1964, a mission from Communist China was on tour of the Kipp Kelly Plant. The mission was composed of well educated men in the milling field. All had technical training and asked very intelligent questions. They were pleased to receive literature on the whole range of equipment and asked for more technical data and additional literature on their return to Mainland China. They were aware of Canada's international reputation in the milling industry and they assured Kipp Kelly that they were giving full consideration to present equipment. They intimated that it would possibly be a period of years before any decision to purchase was made.

Mr. Ross Stewart is confident, as in the case of some of the other large Communist countries, that when they do crack the market, it will be big. In order to bring attention to the Kipp Kelly name, reputation and equipment, technical data sheets were forwarded to a Chinese State Trading Corporation and the Canadian Trade Commissioner in Hong Kong.

#### QUESTIONS

1. What promotional techniques could Ross Stewart employ to maintain Chinese awareness of Kipp Kelly?
2. How heavily should each technique be weighed in the promotion mix, considering the peculiarities of the Communist method of buying?



**MARKET MANAGEMENT COURSE**

**CLAIRE HADDAD HIGH FASHIONS**

10

## CLAIRE HADDAD HIGH FASHIONS

### Grouping for Profits

In the spring of 1964 the Cloverdale Shopping Centre in Toronto's west end decided to put on a fashion show to promote Canadian fashion designs. Select high fashion designers from Toronto were invited to participate, not only by exhibiting their creations, but also by being personally introduced during the show. The day was climaxed by a wine and cheese-tasting party in which the guests could meet and chat with the designers.

Later, after the eventful day, the designers decided to relax over a cup of coffee in a nearby restaurant. They were all pleased with the way the show had gone and enjoyed spending a few minutes talking shop. While they were chatting, one member of the group came up with a novel idea. It was Mr. Albert Haddad, who operated a lingerie manufacturing establishment.

"Wouldn't it be nice if we could get together and do something along the line of to-day's show for the export market?" he suggested.

The idea was discussed but no concrete proposals materialized. Mr. Haddad had completely forgotten about his suggestion until a few days later, when another of the exhibitors, Ruth Dukas, telephoned and said, "I like the exporting idea that you suggested after the show. Why don't we get together and attempt to organize such a group?"

They then proceeded to call several of the local fashion houses which would fit the category of creative designer-manufacturer. In total, seven firms were interested.

#### 1. CLAIRE HADDAD LIMITED

Before this firm was established, Mrs. Haddad worked in her parents' housecoat manufacturing business, J.H. Bardwell Limited. When her father died, her husband, Albert, took over the firm's management, doubling the sales in four years. But Claire liked high fashion and wanted to create exciting lingerie designs instead of the same routine housecoats, year in and year out. Together the husband-wife team founded Claire Haddad Limited, a high fashion lingerie house, in January, 1964.



2. ELEN HENDERSON

This firm was a very small manufacturer of children's wear and children's fancy -- in fact, practically a couturier. It had done a few hundred dollars' worth of exporting to one United States' firm, and in England to Harrods.

3. RUTH DUKAS

Ruth Dukas created ball gowns.

4. DAVID E. REA, LIMITED

This company specialized in wedding dresses and ball gowns.

5. HIGHLAND QUEEN

Highland Queen designed and made ladies' sportswear. This firm was already actively involved in exporting to the United States, and had a permanent salesman covering the entire Eastern area of the United States.

6. NORMAN ROGUL

Norman Rogul was a well known Toronto furrier.

7. JACK GOLDSTEIN

This establishment specialized in ladies' coats and suits, under the name of Allenby Fashions.

AMEGO

These seven firms met together several times and agreed to co-operate in exhibiting their products outside of Canada. They called their association A.M.E.G.O. (Apparel Manufacturers' Export Group of Ontario).

The AMEGO group's first project was Canada Week in Philadelphia. Highland Queen's U.S. salesman had been in contact with the Canadian Consul in Philadelphia and had informed that office of AMEGO's objectives. Consequently, the Canadian trade commissioner in Philadelphia invited AMEGO to participate in a charity fashion show organized by a women's group to support Philadelphia's Chestnut Hill Hospital.

The fashion show was presented in October 1964 and was considered a success. Exhibiting firms received orders from leading Philadelphia department stores and specialty shops. But, more important, it encouraged the group to continue. It proved that the acceptance of Canadian fashion goods was high in the United States, that styling was

considered distinctive, that quality and workmanship were superior, and that price was acceptable. The AMEGO group concluded that there was decided potential in this type of presentation.

### THE HIGH FASHION MARKET

Establishing new customers in the high fashion market is a slow process. Products are high priced, and styles are all-important. Initial sales are in the hundreds of dollars, rather than being in the thousands. The big problem is to establish a reputation for products previously unknown. The medium through which this is done is the fashion show.

The average fashion show takes about an hour with one garment being shown per minute. If the buyer who attends such a show likes a particular type of garment or design, he will make arrangements to see the designer's full line. On more expensive articles, he may purchase no more than three or four items. On less expensive ones, he may buy as many as a dozen gowns in each style.

Care must be taken not to sell the same style to stores in the same area. Volume is obtained by selling the same style to stores in different cities. Six garments sold to one store, twelve to another, etc., add up to a hundred or a hundred and fifty articles in any particular high fashion style of garment. Thus, if thirty or forty stores buy two each of a \$120 style garment, the 80 or so garments ordered make it worthwhile to cut that particular style.

Once a firm's line is accepted in a new market, if the firm continues to show in that location, business volume builds up. There is no difference between selling in the United States market and the Canadian market. Customers' buying habits are similar. Once they have dealt with a firm and consider it as one of their prime suppliers, then the firm is placed on their books as a regular supplier. Even when the firm is established as a regular supplier, the buyers rarely visit its plant.

The fashion cycle is primarily semi-annual. New lines are brought out in January and June. January is the spring line and June the autumn line. In addition, many have a small holiday line showing in September. Department stores are the prime market. Twice a year all large department stores send their buyers to New York, and on occasion to Chicago and Montreal. Every department store is represented by a resident buyer or their own buying office in New York. Those who are interested in selling congregate in New York, and for a period of six weeks buyers visit suppliers, view their lines, and place orders.

## SETTING THE PRICE

Supply prices depend on the cost of fabrics, materials, labour, plus a loading of overhead, selling and administrative expenses. The actual volume of sales does not have to be estimated, but there is a certain minimum number of garments that must be sold to make it worthwhile to cut a style. The Canadian market is large enough for medium priced fashions, but without the American market, a firm cannot produce the very expensive high fashion gowns. The most difficult area of pricing is costing the designer's contribution. Here there is an element of psychological pricing. The style of a garment may have the appearance of value far beyond what its production costs would suggest. Hence, it is necessary to provide certain psychic satisfaction in pricing up to the level of its image.

## PRICING FOR THE U.S. MARKET

In exporting to the United States, additional costs are incurred. There is a 42.5 per cent rate of duty imposed on fabrics that enter the United States. Thus goods that retail in Canada for \$20 may reach the retail racks in the United States at around \$35, or almost double the Canadian retail price, when extra costs of travelling and manufacturers' agents' commissions are added. Further, American suppliers give an 8 per cent discount to their customers; consequently, Canadian fashion houses must do the same. However, this is offset by the present dollar exchange difference. A \$20 wholesale price in Canada amounts to a \$32 wholesale price in the United States, and a retail price of around \$60.

## GROUPING FOR EXPORT

Since there were not sufficient stores in Canada to warrant the costs involved in producing truly high fashion lines, and the United States offered the additional necessary outlets, the seven designer-manufacturers saw grouping for export as a method of breaking into this affluent market. Individually, it is very difficult to go to a city in the U.S. and interest a good number of buyers to view a single line. By grouping, several manufacturers could present a broader product line, put on a show with a lot of publicity, and attract the attention of many buyers.

Thus AMEGO was formed primarily to promote and arrange contracts, whereas individuals in the group would make their own sales after the group performance had cultivated interest and attracted prospective buyers.

The AMEGO group was loosely knit, meeting only two or three times a year. In this informal setting, members became good friends. Rules and regulations were drawn up by the Highland Queen salesman who was thoroughly familiar with the United States market. The only criterion

set for membership was that the new firm be not only a manufacturer, but a creative designer of high quality merchandise. Initiation fee for all members was \$250. Costs for promotion for AMEGO were shared equally by all members -- regardless of size of participant, or export success.

None of the AMEGO members had ever before heard of companies grouping for export. They were all novices. The smallest member of the group had a sales volume under one hundred thousand dollars; the largest was in the vicinity of one million dollars. Each had equal say in the group's government. Their objective was to promote a distinctively Canadian fashion image, both at home and abroad, through the group's fashion shows.

Their success in Philadelphia encouraged them to continue, putting on another show in Boston in the spring of 1965. They found that they had no real problems selling in the United States. In fact, United States' buyers were astonished at the high quality of the Canadian goods. For example, rather than the unfinished seams they were used to, they discovered that Claire Haddad's seams were finished with lace. Everybody in the group soon became extremely busy filling export orders to the United States. Business of the smallest firm doubled, primarily because of the publicity it derived from membership in AMEGO.

#### DOMESTIC PROMOTION OF CANADIAN FASHION

Two organizations were very instrumental in promoting Canadian fashions. The Ontario Garment Salesmen's Association established an annual "Judy Award" for excellence in merchandising. It is given to the retailers, manufacturers, news media and other special categories who did outstanding jobs in merchandising Canadian products during the year. The Ontario Government established "EEDIE Awards" for excellence in design, ingenuity, quality and workmanship. And in 1966, the members of AMEGO captured twelve of the thirty-two EEDIE Awards bestowed by the Government of Ontario.

One of the most original ideas in Canadian fashion was the development of a Canadian tartan by Highland Queen. Called the maple leaf tartan, it represents the evolution of the maple leaf through the seasons of the year, with the colours green, brown, gold and red. This distinctively Canadian tartan has been used by other members of AMEGO.

#### HADDAD'S EXPORT EXPERIENCE

The Philadelphia show with AMEGO sparked Claire Haddad's interest in the United States' market. Mr. Haddad followed this up with his own trips back to Philadelphia, and two trade missions trips sponsored by the Ontario Government to the southern states, including Dallas, Houston and New Orleans.

In July 1965 Canada's trade commissioner in Australia heard of the Philadelphia show and contacted Haddad with information about a prospective customer. Samples were submitted and Haddad developed a substantial Australian business.

Haddad's excellent designs and exposure in the U.S. market not only brought in sizeable orders from such elite stores as Neiman-Marcus in Dallas, Strawbridge-Clothiers and Nan Duskin in Philadelphia, Jordan Marsh and Grover Cronin in Boston, Massachusetts, Sakowitz in Houston, and Henri Bendel, Sak's Fifth Avenue, Bergdorf-Goodman, Elizabeth Arden in New York, but also resulted in a great deal of free publicity in Women's Wear Daily, the bible of the fashion-wear industry, numerous newspapers and trade magazines, and even Vogue. In fact, Haddad is the only Canadian designer to receive a full page and editorial coverage in Vogue.

Twenty per cent of Haddad's sales are now made in the United States and the export business is only beginning to grow. But already Haddad is pressed, for business is each year running 25 to 30 per cent ahead of what the firm can handle.

Mr. Haddad points out that all AMEGO members are doing more business than they anticipated. Consequently, their use of AMEGO is limited because they are too busy to devote much time to it. They maintain that even though they are all interested in it, AMEGO will remain an ad hoc group. They once thought of hiring a secretary to look after the group's business, but were unable to decide upon a format for it. There are no regular meetings.

The AMEGO members feel it would be foolish to have one brand for all the products in the group because different buyers buy different lines of apparel. At one time they thought of having a common showroom in New York, but felt it would be difficult to have a sales-person to man it who would be sufficiently conversant with all lines to do a good selling job.

At present AMEGO is used exclusively for promoting fashion shows to attract buyers in Canadian and U.S. cities.

#### QUESTIONS

1. Is AMEGO being used to its full advantage as an exporting vehicle?
2. How should AMEGO be organized in the short and long run?

MANAGING THE OVERSEAS OPERATION

Case 11 - Tridon Manufacturing

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MARKET MANAGEMENT COURSE

TRIDON MANUFACTURING



1, 2, 7, 1

## TRIDON MANUFACTURING

### Organizing for the Mexican Market

Tridon Manufacturing is a private Canadian company located in Southern Ontario. It was founded in 1923, under the name Hamilton Clamp and Stampings, and until the late 1950's, it was primarily engaged in the manufacture of small metal stampings and custom parts for the automotive industry.

In 1957, the company foresaw a growing market for hose clamps both for the automotive and plastic pipe industries. Consequently, it started to develop a gear type clamp, but encountered design problems because of the tight patent situation. At about this time, the largest manufacturer of gear clamps, Ideal Corporation of Brooklyn, New York, was searching for a company to manufacture their product for the Canadian market. They heard about Hamilton Clamp and Stampings' efforts in this direction, and made them an offer.

After negotiations in 1958, Hamilton Clamp and Stampings began manufacturing the patented U.S. stainless steel hose clamps under a licensing agreement. This event marked a turning point for the company. Previously, sales had grown satisfactorily, but with the fast expanding clamp market of the early 1960's, the company's growth rate rose dramatically.

In February 1961, it was decided that the Company would change its name to Tridon Manufacturing Limited. This action simply reflected a change in name, not a change in the organization. Management felt that the new name, Tridon, would project a modern image of the company's operations.

#### The Five-Year Plan

In 1960, management developed a detailed five-year plan. One of the plan's major objectives was to bring about a four-fold increase in annual sales by 1965. This objective was to be realized through the introduction of new product lines, the launching of an export programme, and the construction of a new plant in Burlington.

Between 1960 and 1965, Tridon's yearly sales did in fact quadruple from \$600 thousand to \$2.5 million. Although clamps still accounted for a major portion of the company's sales volume (sixty per cent), in line with the 1960 product diversification plan, signal flasher units accounted for about thirty per cent of sales, with the remaining ten per cent being made up of other product lines.



At this time Tridon manufactures the following products:

- 1) Turn Signal and Hazard Warning Flashers
- 2) Assorted types of Hose Clamps
- 3) Plastic polyethylene pipe and plastic insert fittings
- 4) Rigid plastic pipe and fittings for drainage use
- 5) Rigid vinyl (frames and sashes) windows
- 6) Assorted custom extrusions

Hose clamps and flashers are sold to car manufacturers as original equipment, and are also distributed through independent warehouses to the automotive replacement market. Clamps for other industrial applications are sold directly to manufacturers. The pipe and fittings, and the rigid vinyl windows are both used in the construction trade, but the methods of distribution are different. The pipe and fittings are distributed to users through wholesale plumbing houses, whereas the windows are marketed more directly to custom builders and architects. In total, about 600 active accounts appear on the books.

Additional information on the organization and product lines of Tridon Manufacturing is presented in Exhibits I and II.

#### THE EXPORT BUSINESS

By the end of 1965, exports to foreign countries accounted for approximately five per cent of sales. In order of dollar volume, these countries were: Australia, Mexico, England, Norway, Venezuela, Sweden, Denmark, Holland, South Africa, Singapore, New Zealand and Jamaica.

Commenting on the rationale of researching foreign markets, a senior executive at Tridon said:

"It is difficult to assess the real profit potential of foreign markets, and the marketing strategy which ought to be employed to realize the potential unless one lives in the foreign country for a while, and does a detailed market study. However, when Tridon first began exporting, it could not afford this kind of study. Consequently, management initially made some mistakes in Australia and in Sweden. We set up existing clamp manufac-

2 - 3

turers to handle our line. At first this seemed like a good idea since they had the appropriate production facilities, established distribution system, and market knowledge. But we soon found that there was a conflict of interest, that is, the foreign manufacturers would sell our clamp only when he could not sell his own."

This situation (1960-62) has since been corrected. Tridon executives make it a rule to research the foreign markets personally, and employ established distributors as agents for their auto parts products.

### The Mexican Venture

In 1965, Tridon prepared its second five year plan. Although pleased with the four-fold sales increase it had achieved over the previous five years, it now faced problems of excess plant capacity and high overhead. Consequently, to overcome these problems, management formulated plans for a three fold increase in sales by 1970. Exports were to account for a minimum of fifteen per cent of total sales, (including to the United States), with greater attention being given to the Mexican market.

Tridon's Executive Committee articulated its sales potential emphasis in the Mexican market in the following manner:

"We looked at the European market first, then the Australian market, when it occurred to us that perhaps we were looking too far from home, and thus took a more critical look at Mexico which seemed to be sleeping on the other side of the giant, United States." To date Tridon's exports to Mexico have been minimal consisting only of the automotive turn signal flashers.

The type of products being manufactured by Tridon are already being sold in Mexico by other firms. The Vice-President of Marketing commented:

Fortunately, we latched on to an agent who was absolutely first-rate<sup>1</sup> and as an example, he took our turn signal flasher and sold it in

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1. The Agent, Mr. L. Villanueva, is situated in Mexico City. He has a staff of four people, and has an annual sales volume of approximately one hundred thousand dollars. Mr. Villanueva acts as an agent for U.S. Automotive Parts Manufacturers, selling his products to Automotive Jobbers.

Mexico at four times the price of the lower quality Japanese type, and sold it very successfully. The Tridon Heavy Duty Flashers are marketed at \$0.90¢ - \$0.95¢ U.S. and the Standard Flashers at \$0.35¢ U.S. Japanese competitive flashers are priced at \$0.25¢ U.S. Total annual sales amount to approximately \$6,500. U.S. Presently, we are making a net profit of ten per cent of the sales and have approximately ten per cent of the market. But if we wish to expand, exporting products to Mexico on a small scale isn't the answer. We must go in there and manufacture.

His trips to Mexico, briefings with the Canadian Trade Commissioner and Tridon's agent, and the many discussions with Mexican government officials and businessmen convinced the Vice-President of Marketing, Mr. Ken Forsyth, that Tridon should give serious consideration to manufacturing in Mexico. With the exception of the President, none of the other members of the Management Committee had visited Mexico. To help them better understand the dynamics of the Mexican market, Ken Forsyth prepared the following short report, highlighting some of the outstanding features of the Mexican nation.

#### A Report on the Mexican Market

Mexico is challenged by three national problems which can be summed up under the heading of communications, agriculture and explosion of population. The energy thrown into the expansion and diversification of the country's industry is the response to these challenges. This drive to industrialize has created one of the biggest demands for capital goods in the world.

Mexico is as big as Western Europe and, after Brazil, the second most populous state in Latin America. About half of its forty-two million people live in the central region of the country, within two hundred miles of Mexico City, the Industrial hub with a population of six million.

The lay of the land, so much mountain, arid desert or swamp, has in the past tended to cut off region from region and aggravated the problem of the rural poor. There are varying estimates of the average annual per capita income of this half of the population: one has it they make about \$450., but since only one-third of the population is economically active one might estimate

that there are thirteen million people with an average annual income of \$1,500. Certainly there is great disparity, and large numbers of people are under-employed. Further, the population is growing at the dangerous rate of around 3.5 per cent a year.

In its intense drive to industrialize, rather than subsidize the rural areas, Mexico has chosen to decentralize industry, to bring factories, work and wages closer to the poor areas.

In recent years Mexico has had one of the fastest rates of economic growth in the world. The average annual increase in gross national product between 1960 and 1964 was six per cent: in 1964 it was a record ten per cent. In 1965 G.N.P. is estimated to have risen to \$20,400 million, a growth of 5.1 per cent over 1964. By 1980 G.N.P. is expected to reach more than \$31,500 million. Industrial output now accounts for one-third of the national income.

The role of the Government in this expansion is a dominating one. It identifies the growth sectors of the economy, and then plans their development. Special treatment is accorded to heavy industry, which the Mexican government considers essential for national development. About eighty to ninety per cent of capital is generated locally, but there is a need for foreign capital. The Government is relying on Mexico's good reputation as a creditor to attract foreign participation.

Generally speaking, Mexico inspires confidence in international financial circles. First, its rate of growth and the broad base of its economy are recommendations. Second, political stability is another attraction. Third, the country's geographical location is a strong attraction for those considering local manufacture - it is an obvious base for exporting to other Latin American countries, since Mexico is a member of The Latin American Free Trade Association. Fourth, the country's natural resources are highly developed, and most raw materials are available. In addition, the Mexicans are very good with their hands, thus skilled or semi-skilled help is readily available. But management personnel are hard to come by.

Many companies are already taking advantage of the opportunities existing in Mexico, fully aware of the central concept of Mexico's development policy -

"Mexicanization" (the aim of which is to make Mexican industry as self-governing and self-sufficient as possible).

The tentacles of "Mexicanization" have reached into virtually every productive branch of the country's economy. Mexico's policy of excluding foreign investment in one sector at a time has been supported by increasing the restrictions on foreign business. The Mexican government's programme of economic integration has resulted in many investors accepting "Mexicanization" as a fact of life.

The case of the automobile industry is instructive. Since the early 1930's the automotive industry in Mexico has been burdened by government regulations. Foreign cars had been assembled in Mexico for several years when in 1962 the authorities announced that in future sixty per cent of the value of their construction must come from local sources. The idea was to reduce imports, and consequently, the drain on dollar reserves. American, French, German and Japanese companies willing to collaborate on these terms joined with Mexican groups in some nine companies. (Exhibit III presents the current picture of the Mexican Automotive Industry).

This automotive example illustrates why foreign investors and exporters should keep a close watch on trends of official thinking. Obviously the exporter must be on his guard for a veto on imports and be ready to manufacture locally if he has created a substantial demand for his product, with possibly a major share of the company held by Mexicans.

As Mexico makes progress in its industrialization programme, present needs will increase and new demands will be generated. To quote one Mexican official: 'During the coming five years the development of Mexico's economy will continue to be one of the fastest in the world and we believe that Canada is in an excellent position to share in it.'

A week after the submission of Mr. Forsyth's report, the President of Tridon, Mr. Don Green, called for a meeting of the Management Committee to critically examine Tridon's approach to the Mexican market. At the start of the meeting, Mr. Forsyth argued that:



It is best for Tridon to be first in the Mexican market. If we are first into Mexico with our products, the border will be closed immediately to imports of similar items from other industrial firms, and Mexican car builders will be forced to use our products in the manufacture of their automobiles. This is how the law stands. If a product is made in Mexico they have no choice but to install that product in their car. So if Tridon were to manufacture in Mexico, it would automatically have a jump on the market.

"But the immediate profit potential is not large enough to justify us establishing a manufacturing plant in Mexico," countered the Vice-President of Finance.

#### Management Proposals

Mr. Forsyth then explained that there are numerous ways of entering the Mexican market. Specifically, he proposed three alternate routes - licensing, joint-venture, or wholly-owned subsidiary. Mr. Green requested that the members explore the alternatives at the next meeting.

Management first gave careful consideration to setting up a plant in Mexico. It was found that although the cost of land and buildings had skyrocketed in Mexico, the initial cost of equipment was reasonably low. A minimum operation in a small plant completing semi-finished parts from Canada would require a capital investment of about \$20,000.

Operations in Mexico could be set up in three phases. Under Phase I, manufacturing and the major portion of assembly would be done in Burlington, with the last two or three operations being completed in Mexico. Phase II would involve more assembly work being done in Mexico, and under Phase III, all manufacturing operations would be carried out there. The phasing out period would take three or four years during which period the Mexicans would gradually acquire the necessary equipment and technological know-how from Tridon.

Some members of management, however, favoured a licensing agreement because in this way little or no capital investment would be needed. "As you know", they argued, "all we would have to do is pass on to some Mexican company the right to manufacture our product and then supply them with engineering skills. They would put in the equipment and we would charge them a fee on a royalty basis for the information and advice we give them."

But the chief critic of the licensing agreement proposal remarked:

I went to a few plants while I was down in Mexico on vacation last summer, and it was like going back thirty years in Canada. In many of the places I visited they had very antiquated methods. On the other hand, I must confess I did see a few specialized factories which were very up-to-date. The question is what kind of firms are really available? And if they are available, are they interested in a licensing agreement?

The possibilities of a joint venture were also explored. Such an arrangement would permit a sharing of the capital cost involved, would make available the business know-how of the existing Mexican firm, and would probably provide the skilled help required. Net profit on sales would be the same as if Tridon were to open its own manufacturing plant, but would be split in the ratio of Mexican ownership to Canadian ownership, the desirable ratio being 51.49 according to Mexican guidelines.

Management also examined briefly the possibility of transferring the Canadian plant operation to Mexico, from which it would export to Canada and the rest of the world.

While there were differences of opinion on the kind of organizational set-up Tridon should structure for itself in Mexico, the management committee was unanimous in recommending that Tridon enter Mexico to protect and increase its sales.

#### QUESTION

1. Which alternative should the company adopt?

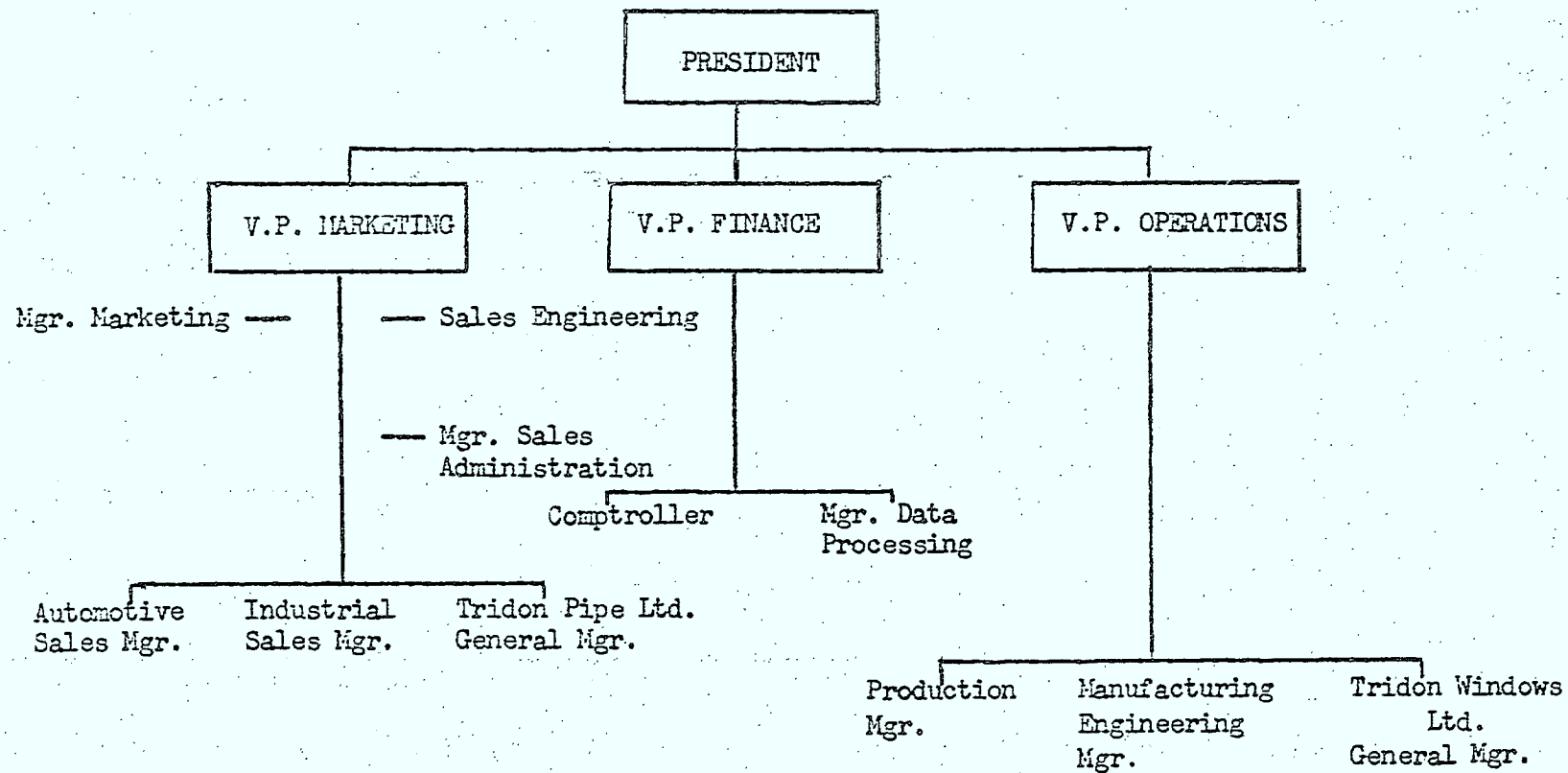
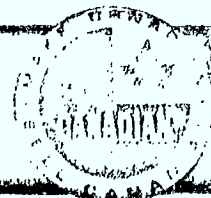


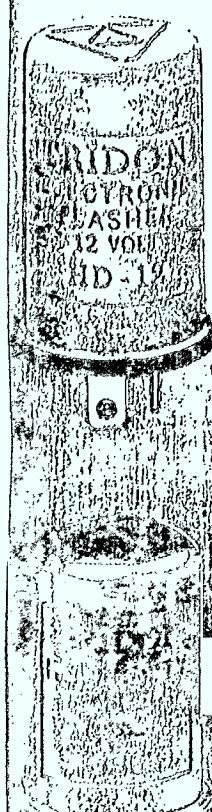
EXHIBIT I



# TRIDON



## "ELECTRONIC" FLASHERS



3 "ELECTRONIC" FLASHERS  
SERVICE 90%  
OF ALL VEHICLES

10 PER PACKAGE  
Perfect for all cars, trucks, buses and trailers. Can be used with standard or heavy duty filament bulbs. Fast first flash. Uses only one-hundredth the power required by other types. Operates smoothly in new or old vehicles.

FEATURING:  
Green, thin-to-plastic cover. Superior mechanism design. Longer lasting precious metal contacts.

|                                     | Suggested List Each |   | Suggested Trade Each |
|-------------------------------------|---------------------|---|----------------------|
| <b>12 AND 6 VOLT FLASHERS</b>       |                     |   |                      |
| H.D. 12                             |                     | For most Canadian and American made cars with 12 volt systems — 2 pin receptacle.                                 |                      |
| H.D. 13                             |                     | For most Canadian and American made commercial vehicles and imported cars with 12 volt systems — 3 pin receptacle |                      |
| H.D. 63                             |                     | For all vehicles with 6 volt systems — 3 pin receptacle.  |                      |
| <b>24 VOLT AND 36 VOLT FLASHERS</b> |                     |   |                      |
| H.D. 22                             |                     | For vehicles with 24 volt systems — 2 pin receptacle.   |                      |
| H.D. 23                             |                     | For commercial vehicles with 24 volt systems — 3 pin receptacle.  |                      |
| H.D. 32                             |                     | For commercial vehicles with 36 volt systems — 2 pin receptacle.  |                      |
| <b>ALTERNATING CURRENTS</b>         |                     |   |                      |
| H.D. 63A                            |                     | For vehicles with 6 volt systems  |                      |
| H.D. 13A                            |                     | For vehicles with 12 volt systems   |                      |
| H.D. 23A                            |                     | For vehicles with 24 volt systems   |                      |

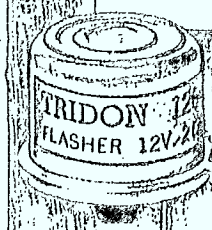
## H.D. "THERMAL" FLASHERS

Flash from 2 to 3 lamps for turn signal or hazard warning use.

FEATURING:  
Extra strong mechanism frame support. Larger, stronger snap blade. Shatterproof glass bead insulator. Doubly secured thermal wire.

|                               |  |  |  |
|-------------------------------|--|--|--|
| <b>12 AND 6 VOLT FLASHERS</b> |  |  |  |
| 636                           |  | For most vehicles with 12 volt systems — 2 pin receptacle. Use with 21 or 32 c.p. standard or LL signal lamps. |  |
| 660                           |  | For most vehicles with 12 volt systems — 3 pin receptacle. Use with 21 or 32 c.p. standard or LL signal lamps. |  |
| 636                           |  | For most vehicles with 6 volt systems — 3 pin receptacle. Use with 21 c.p. signal lamps.                       |  |

## "FIXED LOAD" FLASHERS



For late model cars and light trucks.

FEATURING:  
High sound level for maximum audibility.

10 PER PACKAGE

|                         |  |  |  |
|-------------------------|--|--|--|
| <b>12 VOLT FLASHERS</b> |  |  |  |
| 126                     |  | For vehicles with 12 volt systems, 2 pin receptacle, flashing 2 — 32 c.p. #1034 bulbs (or equivalent) 1 front - 1 rear |  |
| 1264H                   |  | For vehicles as above using 2 LL #1157 bulbs.  |  |
| 1296                    |  | For vehicles with 12 volt systems, 2 pin receptacle, flashing 3 — 32 c.p. #1034 bulbs (or equivalent) 1 front - 2 rear |  |
| 1296H                   |  | For vehicles as above using 3 LL #1157 bulbs   |  |

**TRIDON**  
MANUFACTURING LIMITED  
BURLINGTON, ONTARIO

Makers of Tridon stainless steel hose clamps.  
Featuring exclusive interlock design — no rivets — no welds — no place for corrosion to start.



# TRIDON

## GEAR CLAMPS

### "G" SERIES

Stainless steel band and housing with safety collared chrome-treated zinc plated screw.

### "HS" SERIES

Stainless steel band and housing with hexagon head chrome-treated zinc plated screw.

### "HAS" SERIES

Stainless steel band and housing with stainless steel hexagon head screw.

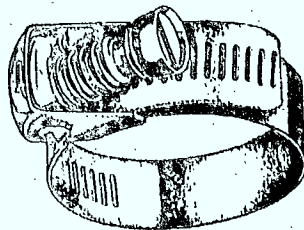
Note: "HAS" part numbers start at 8. There is no part number 6 in this series.

**NOTE:** When ordering please prefix part number required with series of gear clamp desired — "G" — "HS" — "HAS".

Clamps over the nominal size of 6-1/2" are classified as specials. Prices available on request.

## TRIDON

## SNAPLOCK



Swivel screw speeds installation. The clamp is applied in an open position — the screw is snapped down to engage the slotted band. As the screw is tightened, downward pressure is exerted on the screw — the greater the pressure, the tighter the grip. Made with stainless steel housing and band with either stainless steel screw or carbon screw.

**NOTE:** When ordering, please specify "LS" for carbon screw or "LAS" for stainless steel screw.

| Part No. | Nominal Size | Range Min. — Max.  | Weight per 100 (lbs.) |
|----------|--------------|--------------------|-----------------------|
| 6        | 3/8"         | 3/8" — 3/4"        | 4                     |
| 8        | 1/2"         | 7/16" — 15/16"     | 5                     |
| 10       | 5/8"         | 9/16" — 1-1/8"     | 6                     |
| 12       | 3/4"         | 9/16" — 1-1/4"     | 6                     |
| 16       | 1"           | 11/16" — 1-1/2"    | 7                     |
| 20       | 1-1/4"       | 15/16" — 1-3/4"    | 8                     |
| 24       | 1-1/2"       | 1-5/16" — 2"       | 8                     |
| 28       | 1-3/4"       | 1-21/64" — 2-1/16" | 8                     |
| 32       | 2"           | 1-7/8" — 2-1/2"    | 9                     |
| 36       | 2-1/4"       | 1-7/8" — 2-27/32"  | 9                     |
| 40       | 2-1/2"       | 2-3/16" — 3"       | 10                    |
| 44       | 2-3/4"       | 2-1/2" — 3-1/4"    | 10                    |
| 48       | 3"           | 2-5/8" — 3-9/16"   | 10                    |
| 52       | 3-1/4"       | 3" — 3-3/4"        | 11                    |
| 54       | 3-3/4"       | 3-1/2" — 4-1/4"    | 13                    |
| 64       | 4"           | 3-3/4" — 4-9/16"   | 13                    |
| 72       | 4-1/2"       | 4-3/16" — 5"       | 14                    |
| 88       | 5-1/2"       | 5-5/16" — 6"       | 14                    |
| 104      | 6-1/2"       | 5-1/8" — 7"        | 14                    |

| Part No. | Nominal Size | Range Min. — Max.  | Weight per 100 (lbs.) |
|----------|--------------|--------------------|-----------------------|
| 10       | 5/8"         | 9/16" — 1-1/8"     | 6                     |
| * 12     | 3/4"         | 9/16" — 1-1/4"     | 6                     |
| 16       | 1"           | 11/16" — 1-1/2"    | 7                     |
| * 20     | 1-1/4"       | 15/16" — 1-3/4"    | 8                     |
| * 24     | 1-1/2"       | 1-5/16" — 2"       | 8                     |
| 28       | 1-3/4"       | 1-21/64" — 2-1/16" | 8                     |
| 32       | 2"           | 1-7/8" — 2-1/2"    | 9                     |
| * 36     | 2-1/4"       | 1-7/8" — 2-27/32"  | 9                     |
| 40       | 2-1/2"       | 2-3/16" — 3"       | 10                    |
| 44       | 2-3/4"       | 2-1/2" — 3-1/4"    | 10                    |
| * 48     | 3"           | 2-5/8" — 3-9/16"   | 10                    |
| 52       | 3-1/4"       | 3" — 3-3/4"        | 11                    |
| 54       | 3-3/4"       | 3-1/2" — 4-1/4"    | 13                    |
| 64       | 4"           | 3-3/4" — 4-9/16"   | 13                    |
| 72       | 4-1/2"       | 4-3/16" — 5"       | 14                    |
| 104      | 6-1/2"       | 5-1/8" — 7"        | 14                    |

\* Stock Sizes only available — refer all others for minimum quantity

## TRIDON

MANUFACTURING LIMITED

BURLINGTON, ONTARIO



### EXHIBIT III

#### AUTOMOBILE INDUSTRY: MEXICO

##### 1962 DECREE

In an effort to bring order out of the chaos the new regulations were inducing, the Mexican government, in consultation with the Mexican Association of the Automotive Industry, undertook to draw up a master plan for the development of the industry. After a number of months of work the plan was released as a presidential decree, August 23, 1962.

The primary objective of the 1962 decree was to bring about the conditions necessary for the manufacture of automotive vehicles in Mexico rather than merely their assembly as heretofore had occurred. Stipulated in the decree was the requirement that all automotive vehicles were to contain Mexican-made parts representing at least 60 per cent of the direct cost of the vehicle. The decree further stipulated that those companies intending to conform to the new law were to submit plans to the Minister of Industry and Commerce for his approval. Ultimately eleven companies received approval to operate under the law:

For those companies not in compliance with the 1962 law, assembly quotas were reduced and import of parts prohibited. Among those forced to close was Studebaker-Packard.

##### Current Characteristics

Of the eleven firms permitted to continue producing automotive vehicles following the decree of 1962 only seven are actually turning out cars or trucks.

##### Employment:

Unfortunately only a brief period is covered by the available statistics on employment in the automotive industry. Despite this however, the impetus to employment provided by the government's integration programme can be discerned in the data presented in Table 1. Considering that by 1960 the auto industry was thirty-five years old, a total employment of 5,600 does not reflect much growth. But from 1960 to 1965 employment nearly tripled.

TABLE 1

EMPLOYMENT IN THE MEXICAN AUTOMOTIVE VEHICLE INDUSTRY

1959 - 1965

| Year | Employment |
|------|------------|
| 1959 | 5,268      |
| 1960 | 5,596      |
| 1961 | 6,510      |
| 1962 | 7,921      |
| 1963 | 8,548      |
| 1964 | 10,312     |
| 1965 | 14,935*    |

Source: 1959-1964, Secretaria de Industria y Comercio, Dirreccion General de Estadistica; 1965; Asociation Mexicana de la Industria Automotriz.

\* March, 1965.

Production

Table 2 shows the distribution of units sold according to particular companies. Of the approximately 91,000 units sold in Mexico 59,000 were cars and 32,000 were trucks.

It should be kept in mind that the number of units produced by each company is dependent on two factors: the quota allotted by the Mexican government; and the market demand for the particular make.

TABLE 2

UNITS SOLD IN THE MEXICAN AUTOMOBILE INDUSTRY

1964

| <u>Company</u>                                 | <u>Units Sold</u> |
|--|-------------------|
| Ford   | 24,762            |
| General Motors                                 | 21,525            |
| Automex (Chrysler)                             | 20,115            |
| Volkswagen                                     | 8,386             |
| Diesel Nacional (Renault)                      | 6,102             |
| Vehículos Automotores Mexicanos (Rambler-Jeep) | 5,009             |
| International Harvester                        | 3,056             |
| Delta Representaciones                         | 1,815             |
| Miscellaneous                                  | <u>77</u>         |
| Total  | 90,847            |

Source: Asociación Mexicana de la Industria Automotriz

Investment:

Given the fact that few auto manufacturers were incorporating more than 20-25 per cent Mexican made parts in the assembly of their vehicles, the Presidential Decree of 1962 raised real problems. With a prohibition on the importation of motors and a requirement that all cars be 60 per cent or more in national content, car makers were forced to retool their production lines to include not only assembly operations but those of fabrication as well.

The total amount to be invested by the eleven firms remaining in the industry exceeded 2.8 billion pesos, nearly 240 million dollars.

Productivity:

The restriction of production occasioned by the government quota system has resulted in a low ratio of output to capacity for nearly all car makers. It is estimated, for example, that on an

Exhibit III  
Continued.

industry-wide basis, at the end of 1965, installed production capacity will be 466,000 units annually, while actual production will equal little more than 148,000 units. The industry will therefore be operating at a level of about 32 per cent of capacity.

The low level of operation has resulted in very high costs of production. In most cases, Mexican-made automobiles cost 35 per cent more than comparative models in the United States. It is generally agreed that the major problem facing Mexican automotive manufacturers is to reduce these high production costs. Even in the absence of government quotas, the high prices tend to restrict sales, which in turn reduce output, keeping unit costs high - a vicious circle.

Profitability:

According to estimates, car manufacturers currently require a minimum production of 15,000 units to reach the break-even point. Reference to Table 2 indicates that only three automotive vehicle makers reached this mark in 1964: Ford, General Motors, and Automex (Chrysler). The remaining companies were considerably below this mark and will probably continue to be so for several years to come.

While the so-called "Big Three" have been consistently profitable, the remaining firms have not.

ADAPTING TO THE INTERNATIONAL ENVIRONMENT

Case 12 - Canadian Control Systems (A)

Case 13 - Canadian Control Systems (B)

MARKET MANAGEMENT COURSE

CANADIAN CONTROL SYSTEMS (A)



CANADIAN CONTROL SYSTEMS (A)  
Bidding for a Nigerian Project

In 1961, with a seventy per cent share of the Remote Supervisory Control Systems market in Canada, Canadian Control Systems<sup>o</sup> (C.C.S.) management felt they had reached the domestic saturation level and decided to examine export opportunities. A problem of excess capacity and high overhead costs strengthened the need to export.

C.C.S.<sup>o</sup> senior executives met with officials of the Ontario Department of Economics and Development and the Federal Department of Trade and Commerce to determine the firm's capabilities to engage in exporting activities. The Canadian Government officials agreed to notify certain trade commissioners of the company's interest, and this resulted in enquiries from Australia, the Carribean, Nigeria and Venezuela.

Australia was considered too difficult a market to penetrate because of the thorough entrenchment of British firms. Moreover, Australian design concepts would raise problems of creating equipment compatible with that already installed. And the Carribean and Venezuelan markets had to be by-passed because C.C.S.<sup>o</sup>, U.S. licensor wished to maintain this market for himself.

However, the Canadian trade commissioner in Lagos, Nigeria informed C.C.S. that the Electrical Corporation of Nigeria (ECN) was contemplating installing remote control in the country's electrical distribution system. C.C.S. confirmed its interest, and submitted detailed information to the Nigerian Government citing Canadian installations and C.C.S., experience and ability in the controls area.

Probing the Nigerian Market

C.C.S. decided to investigate the Nigerian market in more detail and one executive, Mr. Player, visited Nigeria to discover facts that would help them operate in this foreign market. He found that Nigeria was rapidly gaining stature as a major political and commercial leader in tropical Africa. Nigeria gained independence from Great Britain in 1960 and was governed on a federal basis. Nigeria has a population of 55 million people and this accounts for one quarter of the entire population of tropical Africa. The Gross National Product is in excess of \$3 billion and the value of foreign transactions is over \$1 billion each year.

Nigeria's extension of its power system was being backed by the World Bank with a loan of \$30 million to the E.C.N. The risk to outside suppliers was very low as the World Bank would honour any contracts as far as costs had been incurred if there was internal disruption of the Nigerian economy through political or other turmoil.

Mr. Player's visit to Nigeria produced one other important finding. Although Nigeria's government favoured free enterprise, governmental or political considerations were very important in nearly all commercial contracts. Governmental influence extended much further into the business world in Nigeria than in Canada. Mr. Player returned to Canada with the feeling that whom you knew was as important in Nigeria as what you knew and what you could do for them in a purely business sense.

#### Bidding for the Contract

After further discussions with federal and provincial trade officials in Canada, a number of problem areas were identified. They were of a technical, financial and marketing nature.

##### a) Technical

The technical problems developed from several considerations. The equipment required for the Nigerian tender would have to be designed and manufactured to withstand a semi-tropical environment. However, C.C.S. had some experience in this area and this was not regarded as crucial. The contract also required the complete installation of the equipment by the supplier. C.C.S. did not have any experience in these "turn-key" operations as Canadian customers usually look after their own installation.

Another technical consideration arose from the fact that the Nigerian government had engaged a consulting firm located in London, England, to draw up specifications, choose prospective suppliers, analyze the bids, and select the company to install the system. The consulting firm drew up specifications in terms of British concepts and techniques in remote supervisory control which were quite different from C.C.S.' methods. In addition, the consulting firm was unaware of C.C.S.' experience and competence, since this was their first attempt to sell internationally.

The final technical consideration was that C.C.S. would have to sub-contract half of the equipment needed for the installation, since C.C.S. did not manufacture power line carrier equipment. Investigation showed that no Canadian firms were interested and the only firm that would submit a sub-contract bid to C.C.S. was Brown-Boveri of Switzerland. This would require considerable liaison between the two firms to ensure that all equipment was compatible.

## b) Financial

Financial problems developed for two reasons. Concurrent with trying to enter the export market, C.C.S. was investing a large proportion of their financial resources into the development of solid state equipment. This was straining their financial resources considerably.

The magnitude of the contract, \$1.8 million, would also cause financial problems. Financial assistance was not available from the federal or provincial governments since the Canadian content of the tender was less than \$2 million. Since the terms of the contract were 90% on shipment, 5% on acceptance, and 5% on successful operation of the equipment, costs of engineering and production would have to be borne by C.C.S. until the goods were shipped. This meant financing orders of a quarter of a million dollars from 90 to 120 days. Furthermore, investigation showed that it takes an additional 90 to 120 days to obtain remissions from Nigeria. Therefore, if C.C.S. bid for and obtained the contract, they would need financial assistance from outside agencies.

After a review of the technical and financial problems, C.C.S.' management decided to bid on the contract. They felt that these considerations were outweighed by the problems of excess plant capacity and a saturated Canadian market for their products.

## c) Marketing

The marketing consideration developed from the simple fact that Canada and Nigeria were separated by thousands of miles and it would be quite difficult to maintain close contact with the Nigerian situation. C.C.S. felt that this might be overcome by employing a Nigerian representative. The need for a representative was reinforced by the fact that C.C.S.' two main competitors were giant, world-wide, English communications companies. C.C.S.' size and reputation was dwarfed by these two firms.

The Canadian government representative recommended several major Greek or Arab companies which were located in Lagos. These companies had the technical and professional background to enable easy communication between C.C.S. and their representative, as well as between the representative and members of the E.C.N.

The alternative was to pick a Nigerian national as their local representative. However, investigation showed that there were no Nigerian representatives who were technically competent. The Nigerian nationals also insisted upon substantial fees and commissions, to be disposed of at their own discretion. Nevertheless, these Nigerians did appear to have access to officials in the government and in the E.C.N.

Thus, C.C.S. was faced with the problems of formulating an appropriate bidding strategy, and of choosing a representative who would look after the company's best interests in any situation that might arise in Nigeria.

MARKET MANAGEMENT COURSE

CANADIAN CONTROL SYSTEMS (B)

## CANADIAN CONTROL SYSTEMS (B)

## Interpreting Foreign Business Practices

C.C.S. hired a Nigerian national to act as their representative in Nigeria. Management felt that the advantages of the national's access to all levels of government and the Electrical Corporation of Nigeria outweighed his incompetence in the technical area. This was acceptable because the primary purpose of a representative was to present a favorable image of C.C.S., and to act as a two-way communicator, rather than to be a technical expert. Mr. Player's impressions of the importance of having government contacts for Nigerian business was another consideration.

The Nigerian selected was a local Lagos contractor who was a representative for several foreign firms. The Nigerian was also associated with a Canadian consultant. This arrangement meant that C.C.S. could deal with the Canadian in Toronto and still be in close contact with the Nigerian representative. The representative did not have any direct authority to conclude transactions for C.C.S. However, he was to establish contacts for them, to ensure that C.C.S. got a fair hearing in Nigeria, to keep them informed, and to smooth out details if they were awarded the contract.

The bid was submitted in March of 1963. It turned out that all other competing bids included power line equipment subcontracted by the Swiss firm Brown-Boveri. The two closest competitors were English firms. C.C.S. had the low bid at \$1.8 million, three percent below the next bidder. Shortly thereafter, C.C.S. sent engineers to England to pursue more detailed technical discussions with the consultants. At that time it became apparent that the English engineering consultants had not expected C.C.S. to submit a bid that would have to be considered seriously. They were unaware of C.C.S.' experience, competence, or reputation in the remote controls field. The consultants expected that they would be working with one of the giant English firms in the field. Nevertheless, even though they expressed doubt of C.C.S.' ability to handle the job, they proceeded to work out most of the details with them.

THE NIGERIAN SITUATION

In late 1963, C.C.S. received a report from the Canadian Commissioner in Nigeria that a Lagos newspaper stated that they were no longer the lowest bidder. C.C.S. had started with the lowest bid and, in spite of all the technical changes in clarifying the system

with the English consultants, they had kept costs to a minimum, and indeed had lowered the total cost below that of their initial bid. Unless some other firm had been asked to re-bid, C.C.S. still should have been the lowest bidder.

Upon receipt of this report, C.C.S. wrote a long letter on December 27, 1963, to the English consultants indicating their extreme displeasure:

"We have received (a) most disturbing report, which, if correct, could have the most serious consequences from our standpoint. It is to the effect that the total price submitted to the Corporation for our equipment and services is considerably higher than our original tendered price. We can not conceive that this is possible ... (as) our final price adjustments resulting from technical discussions with you, result in a contract price lower than our original tender."

The letter went on to quote from correspondence between C.C.S. and the consultants that showed to C.C.S.' satisfaction that the consultants did not have any outstanding problems with C.C.S.' bid.

"You will recall the last paragraphs of our letter of July 23rd which read as follows:

"Please do not hesitate to request any information from us which would be of assistance to you. We would indeed be happy if you would phone us at our expense to discuss any points which may still require clarification."

and our cable of September 5th:

"Nigerian project have we provided all information prices required and in a satisfactory form."

to which you replied by letter on September 6th as follows:

"There are in fact still some outstanding points but we believe that these could best be dealt with at a joint meeting with yourselves and Brown-Boveri... Further immediate action is not required..."



C.C.S. replied that they were disturbed that there were outstanding points and offered to go to London to settle them. The consultants did not reply to this letter. C.C.S. concluded their letter of December 27, 1963:

"We hope, therefore, that there have been no assumptions made regarding our equipment, services or prices, which may have resulted in a higher cost being submitted to the Corporation, without our knowledge or approval. Such a development would be a most serious matter from our standpoint, for it could jeopardize our position and result in considerable damage to this Company. If adjustments in prices have been made without our knowledge we must request that they are brought to our attention forthwith and be subject to our approval before they can be considered as valid. Simultaneously, we would request a complete list of the equipment, services and prices relative to our tender which you submitted to the Corporation."

The consultants' total reply on January 9th said:

"We have received your letter of 27th of December and we note your comments and figures. Our report is, however, confidential to our Clients and we are not at liberty to divulge its contents."

C.C.S. wrote two other letters on December 27th. Each included a copy of their strongly worded letter to the English consultants. First, in their letter to the Nigerian Minister of Mines and Power, they asked for clarification and they remarked that their report:

"...indicates that some incorrect prices for our equipment have been submitted to the Corporation by the consultants.

Depending on the figures submitted by the consultants, this clarification could mean a considerable saving in public funds..."

Their second letter to the General Manager and Chief Executive Officer of the E.C.N. expressed similar feelings.

On January 8th there was a further newspaper report regarding the contract. This report quoted a much higher C.C.S.' bid than they had submitted to the English consultants. C.C.S. wrote on January 14th to the consultants:



"The article referred to a figure of £644,000 as the one being considered by the Electricity Corporation as our tender. This figure, if correct, we cannot understand, for it does not compare at all with the figures which we have submitted to you. The difference is substantially higher and we look forward to receiving comments clarifying the matter."

As before, C.C.S. also corresponded directly with the Minister of Mines and Power and the General Manager of the E.C.N. In both letters they pointed out the substantial difference in tender prices and their surprise at the newspaper articles:

"This article has been prepared and released entirely without our knowledge, for the contents of our letters of December 27th relating to the project were considered by us as most confidential. We were surprised to see it and express our regret...

We hope we shall hear from you shortly so that any differences which may be found to exist can be clarified and the correct figures considered by the Corporation."

C.C.S. received a reply to its Nigerian letters in January from the General Manager of the E.C.N. He said:

"We have seen the publication in the January 8 issue of the "Daily Express" relating to this matter, and while noting your remarks that the publication was made without your knowledge and approval, it is intriguing to note the accurate details of the report. You will, however, be pleased to note that the award of the contract has been suspended by the Board of the Corporation and this will not be made until we have had the opportunity of seeing your representatives whom we expect to meet here on February 5th and 6th at 11 a.m."

Mr. Player was somewhat relieved to learn that their arguments would be considered since he had also discovered that the Board of the E.C.N. had approved a contract with another firm and it had reached the Minister of Mines and Power for final approval. However, the tone of the letter from the General Manager indicated that the E.C.N. was not too favorably disposed towards C.C.S.' interests. Mr. Player now had a strong feeling that his competitors had firm contacts high in the E.C.N. and he would have a difficult time selling C.C.S.' case when he arrived in Nigeria. He wondered what would be the best way to handle this situation.

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

THE MULTINATIONAL CORPORATION:

SOME PERSPECTIVES

by

I. A. LITVAK and C.J. MAULE

# THE MULTINATIONAL CORPORATION: SOME PERSPECTIVES\*

*I. A. Litvak and C. J. Maule*

## 1. THE MULTINATIONAL CORPORATION

### *Nature*

The existence of multinational corporations in some form has been with us for many years, but the sharp increase in their number and importance has been largely a post-World War II phenomenon. Moreover, one might even argue that Canada has inadvertently been the catalyst to this growth. The success of us subsidiaries in Canada has motivated many a "parent firm" to extend its international operations – an intermediary step in evolving into a multinational corporation. In recent years, the multinational corporation has come under increasing attack by "host" governments, some of whom regard this type of firm as a new form of imperialism. It is charged that the multinational corporation threatens both the economic and political sovereignties of the host country. Before proceeding to examine some of these charges, it is necessary to describe just what is a multinational corporation.

The term "multinational" in this context is often used interchangeably with terms such as international, global, world, or transnational. Each concept carries with it a definition of its own and there is seldom consensus among writers who employ the same term. The criteria employed for most of the definitions will usually include some of the following: dispersion and nationality of corporate ownership; degree of international specialization of production; extent of listing on foreign stock exchanges; nationality of corporate management; number and location of subsidiary operations; and foreign sales, earnings, assets or employment, as a percentage of their respective company totals. The evaluation of a firm against certain of the foregoing criteria would provide a measure of the degree of internationalization of corporate power in the firm.

According to some writers, a company is truly "multinational" only when it views its world-wide responsibilities as transcending national boundaries; companies are often ranked according to degree of internationalization to suggest an evolutionary process. For example, a company may be

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viewed as progressing through various stages of development – domestic, international, and multinational. An interesting example of such a progression is offered by Professor H. Perlmutter. He states that

Three primary attitudes among international executives toward building a multinational enterprise are identifiable. These attitudes can be inferred from the assumptions upon which key product, functional and geographic decisions were made.

These states of mind or attitudes may be described as ethnocentric (or home-country oriented), polycentric (or host-country oriented) and geocentric (or world oriented).<sup>1</sup>

Perlmutter's definition is essentially behavioralistic; others favour employing criteria such as international ownership and control.<sup>2</sup>

It is beyond the scope of this paper to examine all such criteria, some of which if applied would succeed in identifying, in the extreme, only a handful of "multinational corporations." As a case in point, Professors J. K. Bruck and F. A. Lees found that by employing the criterion of at least 50 per cent foreign content in more than one of the following – total sales, earnings, assets, employment, or production located overseas – only eleven of the Fortune list of the 500 largest us companies in 1965 would qualify. These companies were International Packers, Burroughs, Standard Oil (NJ), H. J. Heinz, International Milling, International Telephone & Telegraph, United Shoe Machine, Colgate-Palmolive, Anaconda, H. H. Robertson and Singer.<sup>3</sup>

Thus, in order to come to grips with an operational definition of a multinational corporation for the purposes of our discussion, we would offer the following:

... [A company is multinational when it] no longer distinguishes between domestic and international business. Domestic business is subordinated to and fully integrated with a global plan of action. The head office management staff becomes multinational in outlook and responsibility. Such a company would be receptive to moving towards both international ownership and control of the corporate structure.<sup>4</sup>

We view this as a commercial definition of a multinational corporation, phrased in the form of a corporate philosophy. It is perhaps less contentious than others, but somewhat more realistic for the task that lies ahead of us, namely, to examine the challenges posed by the multinational corporation to the sovereignty of the nation-state.

<sup>1</sup>H. Perlmutter, "The Tortuous Evolution of the Multinational Corporation," *Columbia Journal of World Business*, vol. 4, no. 1, January-February 1969, p. 11.

<sup>2</sup>See D. P. Kircher, "Now the Transnational Enterprise," *Harvard Business Review*, March-April 1964, p. 6.

<sup>3</sup>J. K. Bruck and F. A. Lees, *Foreign Investment, Capital Controls, and the Balance of Payments*, New York University, 1968, pp. 83-5.

<sup>4</sup>I. A. Litvak and C. J. Maule, "The Multinational Firm and Conflicting National Interests," *Journal of World Trade Law*, vol. 3, no. 3, May-June 1969, p. 318.

*Power and Flexibility*

An understanding of the challenges and the policies which may be required can only be made after considering the form and behaviour of the multinational corporation. We view such a firm as a chain of companies, operating simultaneously in different countries and therefore under different national jurisdictions, but under the corporate control of the parent company. Thus, this firm has its base in one country but operates and resides under the laws and customs of other countries as well. To be multinational in the commercial sense, it is not necessary for local nationals to own shares in the subsidiary operations, although they may. The parent company is one with world-wide business interests and views its activities in any one country as part of its total global operations. The affiliates which may be branch plants, wholly-owned or partially-owned subsidiaries or joint-ventures, sometimes involving licensing agreements and management contract arrangements, do not all have the same relationship to the parent company and are not comparable to one another in size, character, and managerial autonomy. These differences are critical in explaining the probable impact of host governments' policies on the behaviour of the affiliate.<sup>5</sup>

In the multinational firm, corporate management of the parent is continually exposed to the dynamic forces of the global environment, to which it must adapt, assimilate, innovate and reconcile conflicting pressures. The organizational structure is never static, responding to new incentives and dis-incentives, to the growth of one affiliate and the decline of another, to legal, political, socio-cultural and economic changes in the countries in which it operates.

The ultimate control of the affiliates resides with the parent company. Multinational firms like national firms have their own set of objectives, plans, strategies and tactics required for the realization of their corporate goals. The achievement of these goals necessitates coordination and control at the centre which prevents the affiliates from ever having complete autonomy over their commercial activities. The fact that the affiliates reside in different nation-states does not obviate this characteristic of parental control. Whatever autonomy the affiliate has and appears to possess will in fact always be subject to the constraints laid down and exercised by parent management. In short, the autonomy enjoyed by the affiliates in the final analysis is determined by parent management. The degree of management control exercised by the parent may differ between affiliates, but the critical channel of control is almost always through the financial reporting relationships augmented by various forms of contractual arrangements, especially in the area of research and development.

A key characteristic of the multinational firm is its commercial flexibility. Initially, it can, of course, decide whether or not to enter a particular

<sup>5</sup>For further details, *ibid.*, pp. 308-18.

country. It can often negotiate favourable terms of entry because of the strong desire by countries for new capital investment. Once entered, and confronted with an unfavourable economic or political environment, it can revise its initial plans, and in extreme cases shut down its operations. It can, of course, also through lobbying, attempt to change such an unfavourable environment from within. Through its financial arrangements it can alter the flow of earnings from the affiliate to the parent. This is perhaps the most crucial and least well-documented characteristic of the multinational corporation's flexibility. The parent company obviously wants to have the maximum control over the earnings of each affiliate. Only in this way can it exercise the commercial flexibility of switching investment between different host countries. The repatriation of earnings can take place in a number of ways; the payment of interest and dividends, of fees for licensing arrangements and management contracts, and of the expenses for research and development performed by the parent company. In addition, where intra-company trade occurs between parent and affiliate, the parent has the additional flexibility of being involved in a non-arms-length transaction and therefore having to establish a transfer price for the goods traded. The transfer price problem is a complex one and its significance is that it provides the multinational corporation with added flexibility in affecting the commercial activities of the affiliates in host countries.<sup>6</sup> Although we have stressed the flexibility associated with the financial control linkage, the parent company also affects the activities of affiliates in such areas as marketing, production, personnel, purchasing, and exporting. With few exceptions, the autonomy enjoyed by the affiliates is determined by "grants of authority" delegated to it from the parent.

Our analysis of the structural form and behaviour of the multinational corporation poses certain implications for the policies of host governments, such as Canada, which are designed to affect the behaviour of subsidiaries within their jurisdiction.

## 2. THE CHALLENGES

An appreciation of the challenges to host countries posed by multinational corporations requires both an understanding of their commercial power and a realization of the fact that there is no international corporate law to control the behaviour of multinational corporations. We have deliberately chosen the word "challenge" as falling somewhere within the spectrum between the terms "issue" and "threat."

We categorize the challenges under two headings: (1) economic and (2) political-legal. In each case, we do not claim to provide a complete

<sup>6</sup>See J. Shulman, "When the Price is Wrong - By Design," *Columbia Journal of World Business*, vol. 2, no. 3, May-June 1967, p. 69.



list, but rather to focus on those items which we consider to be more important. Our purpose here is to provide an overview.

### *Economic*

In discussing the economic challenges of multinational corporations, one critical factor must be kept in mind, namely, whatever autonomy the affiliates may claim to possess, the parent company, as shown above, keeps tight control of the financial linkages between it and its affiliates. With this factor in mind, we would stress two themes, those of growth and stability. Economic growth is affected by the capital and technology which is a major part of the package of direct foreign investment. To the extent that foreign affiliates reinvest their earnings in host countries, future investment will be determined within the framework of multinational corporations. The greater the level of direct foreign investment in a country and the more a country depends on such investment for future capital expansion, then the more economic growth will be influenced by financial decisions made by the parent of the multinational corporation. This means, in turn, that future investment decisions in individual countries will depend on how the parent company views its *global* prospects. This characteristic of the multinational corporation's behaviour is an important consideration for countries in which annual foreign investment is a significant percentage of annual total investment. An example of the type of development which requires watching is the fact that Canada's share of annual us direct foreign investment declined from 46 per cent in 1950 to 13 per cent in 1967, while there has been an increase in Western Europe's share from 19 to 51 per cent. As an aside at this point, it seems that an appropriate framework for analysing direct foreign investment is that proposed by Professor H. G. Johnson in his 1968 Wicksell Lecture,<sup>7</sup> in which he points to the development of a dynamic theory of comparative cost. An important part of such a theory would trace the way in which trade leads to investment, and this in turn requires an understanding of the product cycle concept.

The fact that foreign investment may fluctuate from year to year has implications for our second theme, stability, as well as for economic growth. Multinational corporations can affect several aspects of economic stability – monetary, fiscal, balance of payments and employment stability. Brief mention will be made of each of these. In the monetary area, the multinational corporation may be able to evade the intent of the host country's monetary policy through access to retained earnings in the affiliate and in the parent company, and through access to other sources of funds open to the parent. The host government's tax revenues and tariff

<sup>7</sup>"Comparative Cost and Commercial Policy Theory for a Developing World Economy," Stockholm: Almqvist & Wicksell, 1968.

revenues, where intra-company trade takes place, can be affected by the manipulation of transfer prices. The balance of payments in the host country can be affected by the flexibility which the multinational corporation has to transfer income from affiliate to parent, eg., the alternatives include dividend repatriation, transfer pricing, payment of royalties, license fees and fees for management contracts. It is in this area that most concern has been expressed both in Canada and in Europe as a result of the impact of the us balance of payments guideline policy. Lack of financial disclosure has frequently prevented host countries from knowing exactly what was going on in the foreign corporations within their borders.

Many of the foregoing examples of possible instability can obviously have a direct effect on employment. In this area, however, there is a particular problem facing a trade union when it bargains with an affiliate of a multinational corporation. The multinational corporation may have substantial bargaining power if it has the flexibility to switch production between affiliates in different countries and thus avert the impact of a strike in any one country. This fact was recognized in the recent strike of Ford in the UK when Prime Minister Wilson pointed out to the British workers that Ford might very well switch its production and future expansion to Ford operations in Germany. A further development worth watching is the extent to which multinational corporations undertake international specialization of production as opposed to the duplication of production operations in different countries. International specialization may appear to make economic sense to the parent company and the host country, but it also makes the multinational corporation vulnerable to the disruption of production in any one country.

Our treatment of the economic challenges of the multinational corporation has emphasized macro-economic aspects. Micro-economic aspects, concerning the performance of foreign-owned firms, have been skilfully researched by Professor A. E. Safarian.<sup>8</sup>

#### *Political-Legal*

The question of a political challenge to host countries from direct foreign investment is a part of the more general problem in international relations concerning the way in which transnational society can evolve while state sovereignties are maintained intact. The literature of international relations is relevant to an understanding of this problem. Transnational society is the term used by Professor H. Menderhausen to embrace all those ways in which social units of countries are linked by cultural, political, legal and economic ties; state sovereignty, on the other hand, refers to the protection of the collective objectives of individual states. The essence of transnational society is that "contact makes community,"

<sup>8</sup>*The Performance of Foreign-Owned Firms in Canada*, Montreal: Canadian-American Committee, 1969.



while the essence of the sovereign state is that "independence makes personality."<sup>9</sup> It takes no more than a glance at the stalled negotiations on the political evolution of the European Common Market to see what conflicts can arise between these two elements. Direct foreign investment poses similar problems for the nation-state. In the name of transnational society, in this case the freedom of movement of capital and trade between countries, the nation-state feels its sovereignty eroded by the existence and operations of multinational corporations which are the institutional conveyors of direct investment. The particular concern arises because of the way in which the laws and policies of the parent country can be transmitted to the affiliates in host countries. This is generally referred to as the issue of extra-territoriality. Serious conflicts have arisen when the laws and policies of the two countries have been in conflict, and the affiliate has found itself in the intolerable position of being subject to more than one jurisdiction. But the potential for conflict will always exist as long as there is an overlap of jurisdictions.

The areas of extra-territoriality most frequently mentioned are those of anti-trust, freedom to export, and balance of payments policies, because the us is the home of most of the world's multinational corporations and it is in these areas that the us government has chosen to act extra-territorially. However, there are other areas in which extra-territoriality may give rise to problems such as taxation and transfer pricing, where the parent government may attempt to influence the tax jurisdiction within which the multinational corporation takes its profits. This is especially important where the corporation is vertically integrated and sales take place between parent and affiliates in different countries, as is the case with the large international oil companies. Another extra-territorial situation may arise in the area of financial disclosure, when the affiliates may be required to submit documents to the parent government in connection with securities requirements or anti-trust proceedings.

Apart from extra-territoriality involving action initiated by the parent government, sovereignty is also felt to be affected by the way in which commercial decisions are made in multinational corporations. There is little doubt that most parent companies have an ethnocentric bias which tends to favour the parent country.<sup>10</sup> For example, when excess capacity and unemployment exists in parent and host country and there is an opportunity to expand production in one place or another, the parent country will tend to be favoured. However, the reality of the successful

<sup>9</sup>H. Menderhausen, *Transnational Society vs. State Sovereignty*, Rand Corporation, March 1968, p. 3806.

<sup>10</sup>See J. Polk, I. W. Meister and L. A. Veit, *US Production Abroad and the Balance of Payments*, New York: National Industrial Conference Board, 1966, p. 120; and J. N. Behrman, "The Multinational Enterprise and Nation States: The Shifting Balance of Power," paper given at conference held at the us Department of State, February 14, 1969.

functioning of any organization requires that there be a control centre which, in this instance, we have shown to be in the parent company. Thus, host countries will find that functions such as research and development will tend to be centralized in the parent, and that regardless of the existence of export control regulations, decisions to export will also largely be centralized in the parent company. These aspects of the multinational corporation are different from those involving actions by the parent government. The latter do involve questions of sovereignty while the former reflect the reality of how multinational corporations operate.

There is another significant issue concerning sovereignty, that of the interaction between international unions and multinational corporations. The trade unions recognize the power and flexibility of multinational firms.<sup>11</sup> Some union leaders have realized the need for the union associated with the subsidiary in any one host country to plan and coordinate their bargaining strategy with affiliated unions in other host countries, and particularly with the affiliate based in the country of the parent company. According to Thomas Sloan, vice-president of the International Chemical Workers' Union in Canada,

In Canada we are now attempting to coordinate our bargaining in both the us and Canada with the multinational companies operating on both sides of the border. ... We even have had to resort to strike action, but together we represented such a large portion of the company's operations, that we were able to exert the necessary economic strength in order to force the multinational companies to meet our demands.

I would like to indicate with these examples that although it is in fact very difficult and will perhaps even demand some relinquishing of autonomy of national unions, this is definitely worthwhile and I believe we have proven the point.<sup>12</sup>

In developing policies to deal with extra-territoriality, we feel that further analysis has to be undertaken in the following three areas.

1. Examine the actual ways in which the laws and policies of governments may conflict. For example, in the area of us balance of payments guidelines policies, the us government attempts to improve its own balance of payments, and, this occurs at the expense of other countries. This appears to be a zero-sum game or one of direct conflict. However, there exists a common interest as well, in that both countries will not want to pursue policies which will lead to the devaluation of currencies and the creation of instability in the international monetary system.

2. Examine the meaning of the concepts of sovereignty and independence as they apply to nation-states in the 1970s. The growth of international economic relations since World War II has been staggering. It

<sup>11</sup>See *Globe & Mail*, Toronto, April 4, 1970, p. B1.

<sup>12</sup>*I.C.F. Information*, International Federation of Chemical and General Workers' Unions, CIS 3/69, March 1969, pp. 25-6.

reflects the willingness with which countries have accepted a high degree of interdependence and consequently a reduction of sovereignty.

3. Examine the different concepts of jurisdiction which are used by nation-states. For example, the problems of extra-territoriality occur in Canada because a territorial concept of jurisdiction (Canada) is brought into conflict with a personal concept of jurisdiction (us) whereby the us government attempts to apply its laws to its citizens *whether located inside or outside the territorial limits of the us*. Distinguished legal scholars working under the auspices of the International Law Association are already working in this area.<sup>13</sup>

It is probably clear from these remarks that we feel that further progress in analysing problems of the multinational corporation and on developing governmental policies requires the assistance of scholars in political science, international relations and international law.

### 3. SOME POLICY ALTERNATIVES

We now come to outline what can be done about the problems posed. For purposes of discussion, it is helpful to divide the policy options into unilateral, bilateral and multilateral alternatives—what can be done by a host country on its own, by a host country with the parent country, and by all host and parent countries together? It should be noted that these alternatives are not mutually exclusive and that the problems should be dealt with on all three fronts. Each alternative tends to be appropriate to a particular set of problems.

The unilateral option involves ways in which the host country can improve the performance of *all* firms, both domestic and foreign-owned, through such measures as tariff changes, tax incentives, combines policy and the improvement of labour and management inputs. At the same time, the host country, on its own, can promote greater reliance on domestic, as opposed to foreign sources of financing, and thus promote Canadian entrepreneurship. We would hope that all such measures would be undertaken in the spirit of the further development of an international economy. That is to say, we would favour unilateral measures which were not protectionist. However, a country can decide what sectors of its economy are critical for non-economic reasons, and close these to foreign investment.

The bilateral option is suitable for dealing with parent-host country problems which are unique to the two countries. For example, in the us-Canadian context, the automotive agreement and defense production-sharing program may call for special attention by these two countries only.

<sup>13</sup>See International Law Association, *Report of 51st Conference, 1964* and *Report of 52nd Conference, 1966*.

It might be argued that the us-Canadian situation is unique in terms of both the geographic proximity of the two countries, and the level of American investment in Canada, so that special arrangements such as the Fulton-Rogers agreement in the field of anti-trust, and the Diefenbaker-Eisenhower agreement in the field of freedom to export are needed.<sup>14</sup> However, we would argue that these two topics are of sufficiently general concern that they can best be dealt with on a multilateral basis. The present ineffectiveness of these agreements would also argue in favour of taking a different approach.

It seems to us that the multilateral approach is best suited to dealing with problems of extra-territoriality (i.e., balance of payments, freedom to export, anti-trust, taxation, financial disclosure). There is, for example, a common interest among both parent and host countries, as evidenced by the existence of the GATT and the IMF, that instability in the international economic system should not occur as a result of the unilateral action of any one country. Therefore, multilateral agreement on the balance of payments implications of multinational corporations would seem to be a real possibility. Canada is not alone in wanting action to be taken on this score. Interviews conducted with officials in Europe, both in individual countries and in organizations such as the OECD and the EEC suggest to us that considerable support could be found for such a move. Support from international business could also be anticipated as long as business understands that what is being discussed is some way of relieving it of the intolerable situation which exists when it is subjected to conflicting demands by two or more governments.

Before developing such an agreement, it would perhaps be useful to examine the various organizations and agreements that exist in connection with the infrastructure for international trade, i.e., communication, transportation and finance. What, for example, has been the role of the International Air Transport Association and shipping conferences? How has agreement been reached on the sharing of radio waves and television channels? In another area, an examination might be made of the way in which the extra-territorial reach of the Federal Maritime Commission and the Civil Aeronautics Board of the United States has been counteracted by the combined actions of the group of affected countries.<sup>15</sup> The point is,

<sup>14</sup>Further details of these agreements can be found in *Canadian Parliamentary Debates*, July 11, 1958, p. 2142 and February 3, 1959, pp. 618-9; and in I. A. Litvak and C. J. Maule, "Conflict Resolution and Extraterritoriality," *Journal of Conflict Resolution*, vol. 13, no. 3, September 1969, p. 305.

<sup>15</sup>In 1961, the us Congress authorized the Federal Maritime Commission to approve or disapprove ocean freight conference agreements, especially in the case of dual-rate contracts. The implementation of this policy, which would require the production of documents located outside the us, was resisted successfully by the coordinated action of ten European countries and Japan.

In 1961 also, the Civil Aeronautics Board (can) of the us promulgated a regulation requiring any holder of a foreign air carrier permit to submit details of its current and

the multinational corporation is not an entirely unique phenomenon and nation-states can come to grips with it by studying institutions with similar characteristics.

future schedules for approval by the Board, and to produce certain traffic data relating, in particular, to the origin and destination of passengers. Foreign air carriers as a group opposed this regulation, such that by January 1968 it had not been carried into effect.

The Chandler dispute, in 1963, is another example of the cab's extra-territorial intervention, this time in connection with aviation rates set by the International Air Transport Association. In this case, the us government backed down completely when faced with the intervention by foreign governments on behalf of their national airlines, and in the face of a threat by the British government to seize us aircraft.

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

BRANCH PLANT ENTREPRENEURSHIP<sup>+1</sup>

and

MANAGING THE ENTREPRENEURIAL ENTERPRISE<sup>+2</sup>

by

I. A. LITVAK and C. J. MAULE

<sup>+1</sup> Reprinted from The Business Quarterly, Spring 1972, Vol.37, No.1.

<sup>+2</sup> Reprinted from The Business Quarterly, Summer 1972, Vol. 37, No.2.



# BRANCH PLANT ENTREPRENEURSHIP

The problems experienced by host countries associated with direct foreign investment have been subject to considerable economic analysis, but little attention has been paid to the effects which such investment has had on the development and use of indigenous human resources. However, host governments have expressed increasing concern over topics such as the brain drain, the dependence on foreign management and technology which undermines the scope for local entrepreneurship and the associated harmful effects on economic growth, the lack of sensitivity of foreign-owned firms to local labor practices and the vulnerability of domestic employment arising from the flexibility enjoyed by the multinational corporation to shift production between plants in different countries.

The purpose of this article is to examine the ways in which direct foreign investment affects entrepreneurship and human resource development. Our analysis is based on the U.S. — Canadian situation and emphasizes the effect of U.S. multinational corporations in the manufacturing sector on the development and use of professional manpower. The discussion is based on extensive studies we conducted of the organizational arrangements of U.S. multinational corporations and their subsidiaries in Canada.<sup>1</sup> However, the framework of analysis employed and some of the generalizations made will be applicable to other developed countries which host the affiliates of multinational corporations.

It is our contention that the scope for entrepreneurship enjoyed by the management of a Canadian subsidiary determines to an appreciable extent the numbers and the sophistication of the professional manpower employed, as well as their horizons for future development and utilization, and that this scope in turn will vary between different types of foreign subsidiaries.

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## THE NATURE OF ENTREPRENEURSHIP

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Professor A. H. Cole perceives entrepreneurship as, "... the purposeful activity (including an integrated

sequence of decisions) of an individual or group of associated individuals, undertaken to initiate, maintain, or aggrandize a profit oriented business unit for the production or distribution of economic goods and services."<sup>2</sup>

Since direct foreign investment, in the form of operating subsidiaries, is usually initiated and managed by a team of executives, our analysis of entrepreneurship will deal with the "multiple" (top management) rather than the "individual" entrepreneur. Cole describes the process of entrepreneurship as including innovation, management and adjustment to external conditions, which is directed at six areas of business activity:

- 1) The determination of the business objectives of the enterprise, and the change of those objectives as conditions require or made advantageous;
- 2) The development and maintenance of an organization, including efficient relations with subordinates and all employees;
- 3) The securing of adequate financial resources, the retention of them, and the nurture of good relations with existing and potential investors;
- 4) The acquisition of efficient technological equipment, and the revision of it as new machinery appears;
- 5) The development of a market for products, and the devising of new products to meet or anticipate consumer demands; and
- 6) The maintenance of good relations with public authorities and with society at large<sup>3</sup>.

Companies which experience dynamic economic growth are those in which all three processes of entrepreneurship are expressly encouraged by the senior executives and among their subordinates. Our studies of Canadian subsidiaries of U.S. companies indicate that the scope for entrepreneurship enjoyed by Canadian management tends to be limited by the "grants of authority" delegated to the subsidiaries by their parents, and by the fact that many of the critical business functions associated with the process of innovation in such areas as research and development, design engin-

engineering, and marketing planning and research tend to be conducted in the parent company. Moreover, because the critical decision-making areas associated with the entrepreneurial processes of management and adjustment to external conditions must conform to the expectation of the U.S. parent executives, who have the power to sanction deviations from expected behavior, the scope for Canadian entrepreneurship tends to be circumscribed.

The operational necessity on the part of Canadian executives of many subsidiaries of depending on their U.S. parent companies for technological and management support can have a castrating effect on the entrepreneurial outlook of such executives, and, thus, on the development and utilization of professional manpower in such companies. To illustrate this point, witness the following goal to be found in the long-range plan of a major Canadian subsidiary in the chemical industry:

"Business Objective 3. Exploit opportunities within Canada to market products developed by Company X (U.S.) and install economic facilities for their manufacture."

Company X has no research and development unit in Canada and can be contrasted to a competing U.S. subsidiary of similar size in the same industry, Company Y. This company presents its product goal somewhat differently, in the form of a product philosophy as follows:

"Generally we plan to lean heavily on Company Y's (U.S.) technology to maintain a leadership position in terms of product properties, quality and variety. We expect more and more to see the product engineered to specific use requirements.

"... The progress of Company Y (U.S.) in recent introductions of (certain) products is being followed closely. Good market acceptance in the United States will be followed by sampling in Canada. Early attempts at Canadian production are planned but these products may require a major revision and/or new equipment, both for quality and volume."

It does not take much imagination to perceive the kind of research and development activity that would be conducted by Company Y's subsidiary in Canada, namely, product testing and modification. This activity may necessitate employing graduate engineers and scientists, but it is doubtful that their level of sophistication would have to be as high as that of their U.S. counterparts, since the process of innovation in new product or process development takes place in the parent company. Even if one were to assume that their level of technical sophistication were comparable, the more narrowly defined entrepreneurial role assigned to the Canadian subsidiary prevents Canadian scientists and engineers from fully realizing their professional potential, and in the long run limits their professional development. In the case of the Canadian subsidiary of Company X, technical support of a much less professional nature would be required since the "innovation" of the product and its "adjustment" for the Canadian market where appropriate, would be "managed" by the parent research and development unit.

Two points may now be made. First, the scope for entrepreneurial activity on the part of the Canadian subsidiary is largely defined by the "grants of authority" delegated its management by the parent company. This fact suggests that the scope for entrepreneurship in the U.S. company will be appreciably greater than in the Canadian subsidiary. Thus, the higher the level of direct foreign investment in a country, especially if it is dominant in the key growth sectors of the economy, the greater the likelihood that indigenous entrepreneurial drive will be limited. This will still be the case even if the level of educational sophistication and the socio-cultural attitudes of the nationals employed in the host country is comparable to those of the parent country. This is not to deny that direct foreign investment may provide job opportunities that otherwise might not exist. The fact is that the existence of such investment may not allow for those opportunities which reflect the educational, scientific and managerial



priorities of the host country.

The second point is that the scope for entrepreneurship differs between subsidiaries. This is obvious from the foregoing examples of competing U.S. chemical subsidiaries in Canada, and their product research and development programs. The reasons for the difference may be many; however, our studies of U.S. - Canadian business arrangements suggest that the critical reasons may be attributed to the corporate philosophy of the parent company toward its global business, and the positioning of the Canadian subsidiary in the company's organizational structure.

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#### CORPORATE PHILOSOPHIES

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In order to assess the differing impact of U.S. subsidiaries on Canadian professional manpower and entrepreneurship, the different organizational forms and behavior of large U.S. companies which have "gone international" must be examined.

The evolution of a U.S. domestic company into an international and multinational corporation often follows three distinct but overlapping stages of development. These stages may be perceived in terms of corporate philosophies which affect the formulation of the strategy and the structure of the company. While no two companies experience identical conditions, nor respond in a like fashion at differing stages of their international development, interviews with major companies in North America suggest that there are certain strategies and structural patterns which are commonly adopted by companies in each of these stages.

*Stage 1: Export Orientation* — the company views its overseas business as being of secondary importance to the realization of its corporate strategy. This philosophy results in highly centralized control of its international operations in the parent firm.

During this stage of development, foreign trade activity is usually conducted with a minimum change in corporate outlook and organizational structure. Exhibit 1 provides an illustration of such an organizational pattern. In this initial stage of development, our

studies showed that at the time the parent company established its first foreign subsidiary, often in Canada, it was not uncommon to find the senior "resident" executive of the Canadian affiliate reporting directly to the President or Chairman of the U.S. parent company. In some instances, the "resident" executive was a general manager or vice-president, while the president of the Canadian affiliate was a non-resident executive based in the parent company. In such cases, the parent company exhibited a very strong ethnocentric (parent country) bias.

The Canadian company was often a personal venture on the part of the President. The other worldwide activities were usually controlled and co-ordinated by the marketing unit in the parent company, through an export department. The organizational structure employed by such companies was similar to that of Exhibit 1 except for the fact that the Canadian affiliate did not fall within the jurisdiction of the export department as shown in Exhibit 2. It was treated as a separate unit which manufactured and marketed goods primarily for the Canadian market with some exports, largely to Commonwealth countries.

The degree of autonomy accorded the Canadian affiliate of a Stage 1 company is minimal, inasmuch as the activities of the senior Canadian functional executives are constantly guided, if not directed, by their senior U.S. counterparts. All research and development is centered in the parent company; major purchasing and investment decisions are taken by the U.S. executives, exporting initiative resides with the parent export department, and financial reporting is so closely supervised and controlled that many Canadian presidents are kept in the dark about their own company's performance. Financial data are transmitted by the senior Canadian financial officer to his U.S. counterpart who then simply consolidates these data into the U.S. company's financial statements. Canadian employees are often viewed and treated as employees of the U.S. company. To reinforce this fact, the board of directors of the U.S. parent company frequently

EXHIBIT 1

EXPORT ORIENTATION — FUNCTIONAL STRUCTURE

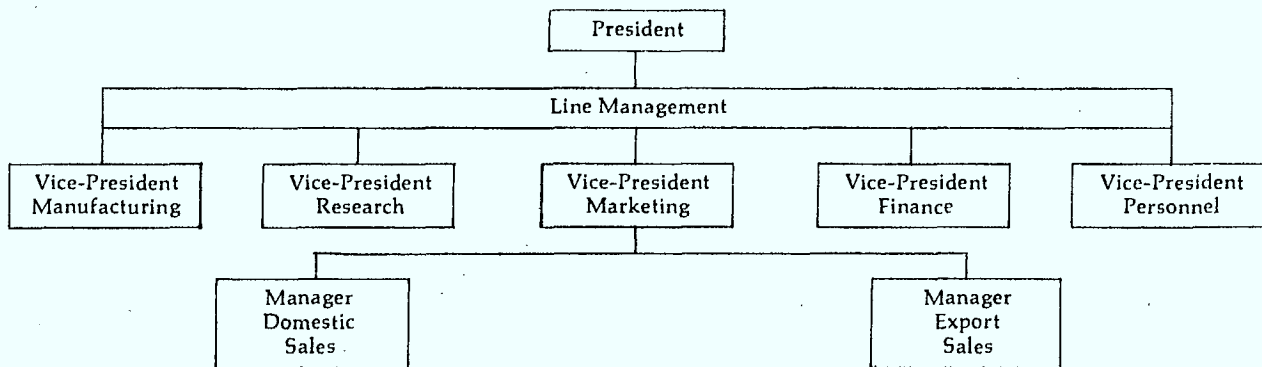
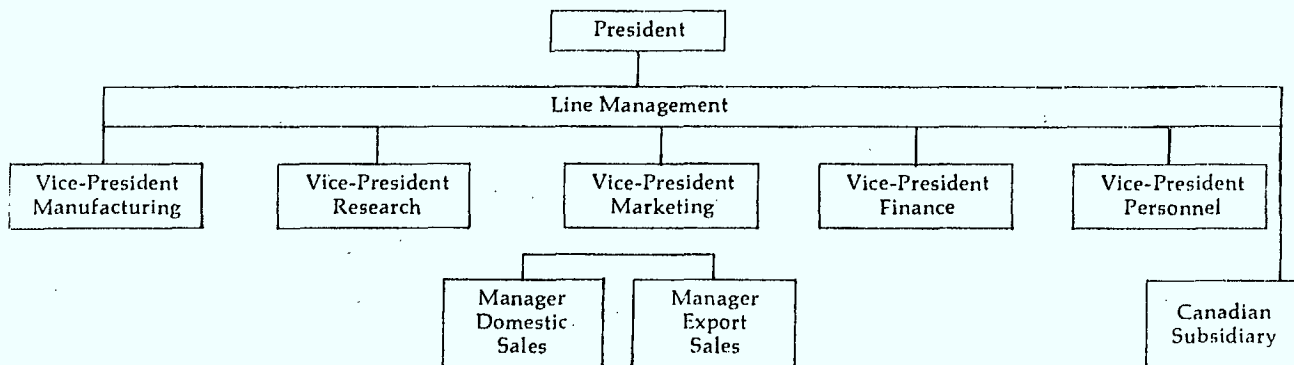


EXHIBIT 2

EXPORT ORIENTATION — FUNCTIONAL STRUCTURE



doubles as the board for the Canadian affiliate. It is only for public relations purposes that there is a Canadian president, because for all intents and purposes, the incorporation of the Canadian company is viewed merely as a front interposing a corporate shield between the U.S. and Canadian operations.

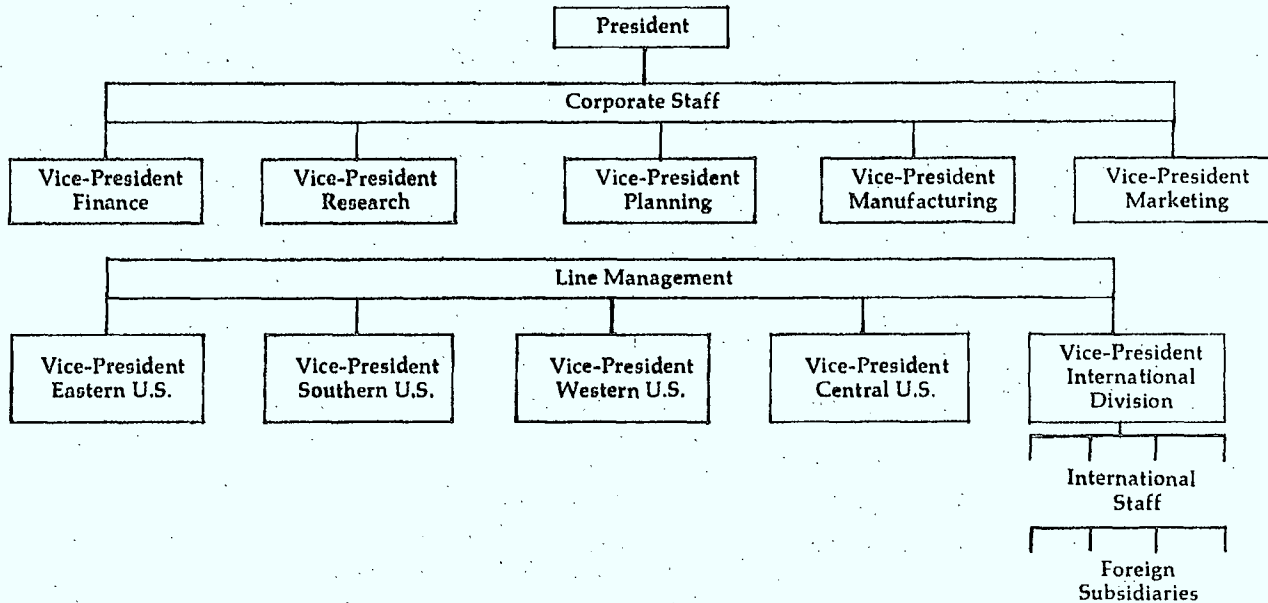
*Stage 2: International Orientation* — the company places greater emphasis on its international business in achieving its corporate strategy. It grants greater autonomy to its foreign affiliates, but retains a high degree of financial control over their operations. Typically, the subsidiaries report to a vice-president

in charge of the parent company's international division, or to the senior executive of an International Headquarters Company.

Exhibit 3 offers an example of such an organizational pattern structured on a geographic basis. Other companies may select organizational patterns structured on a product or functional basis. The criteria employed for deciding on the structural patterns are manifold. They include: size of company; nature and range of products; centralized versus decentralized management control orientation; historical experience of company; nature and extent of foreign investment hold-

EXHIBIT 3

## INTERNATIONAL ORIENTATION — GEOGRAPHIC STRUCTURE



ings; and, management personnel capabilities.

The actual autonomy of the Canadian affiliate need not be greatly increased when the parent company changes its orientation from domestic to international. Typically, one would have expected the Canadian affiliate to be grouped along with the company's other foreign affiliates, reporting to the head of the international division. In fact, this is not the case for many Canadian subsidiaries. The more common pattern is to exclude the Canadian subsidiary from the international division.<sup>4</sup> In the more progressive companies, the Canadian subsidiary is often located in a North American division, while in other cases, it is submerged into one of the domestic (U.S.) divisions, with the Canadian president reporting to a (U.S.) group vice-president, or else to the vice-president in charge of North American sales. U.S. parent management expects the Canadian affiliate to behave in much the same way as a U.S. regional unit, with the Canadian president occupying a

position comparable to that of the general manager of a U.S. regional unit. His title of President simply recognizes that Canada is a nation-state politically, and that the head of a company should have the title of president. The other foreign subsidiaries are controlled by the international division, and Canada is simply not viewed as being foreign. It was noted in the Harvard study of 187 U.S. multinational enterprises that Canadian subsidiaries have generally been managed as domestic affiliates by the executives of these enterprises.<sup>5</sup>

The benefits of an international orientation for the Canadian affiliate lies in the fact that there appears to be greater scope for injecting Canadian interests into the U.S. network of operations. Unlike the case of a Stage 1 subsidiary, a Stage 2 subsidiary usually has a Canadian "resident" president, a Canadian board of directors with a number of Canadians on it, and in some exceptional cases local equity participation. These

conditions have the effect of making parent management more sensitive to Canadian management aspirations. Further, the Canadian affiliate functions more like a regional profit center with responsibility for its operations assigned to the Canadian president. The reporting relationship between the other Canadian executives and their U.S. counterparts is one of managerial co-operation rather than command, but within defined limits. The president of the Canadian operations still works under a system of detailed "grants of authority", listing areas of discretion and decision requiring the approval of the parent company.

An example of this is the need for parent company approval of senior management appointments by the subsidiary. The reason for this is well illustrated in the following statement found in a manual issued to senior management of the subsidiaries of a large U.S. electrical appliance firm, including the Canadian subsidiary.

"It is critically important, . . . that the management of subsidiaries should conduct their operations in such a manner as to earn the wholehearted support and co-operation of personnel at the operating levels of

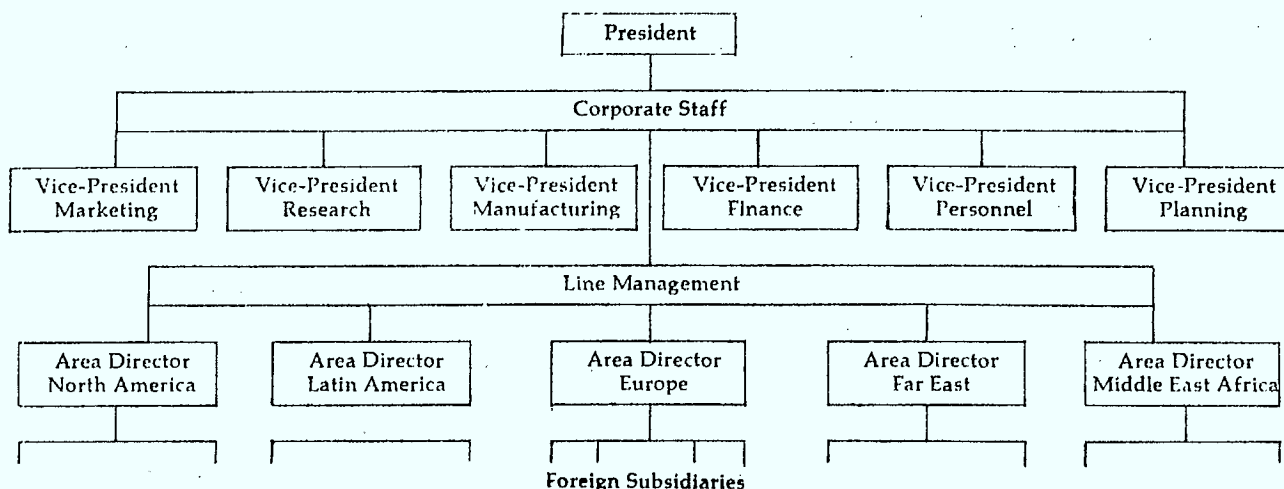
the parent Company departments. This requires a neat balance on the part of the subsidiary in directly adopting the maximum amount of the parent Company output of product designs, engineering approaches, manufacturing methods and marketing plans . . ."

Studies indicate that the orientation of top management "shifts from a preoccupation with domestic affairs to an international point of view . . . when foreign assets climb to twenty per cent or more of total corporate assets."<sup>4</sup> The contesting claims of domestic and foreign operations on corporate resources results in a situation in which the overseas division can no longer be managed as a separate part of the company. This is particularly evidenced in the case of large corporations and tends to promote the adoption of the third stage of internationalization.

*Stage 3: Multinational Orientation* — the company no longer distinguishes between domestic and international business. Domestic business is subordinated to and fully integrated with a global strategy. The head office management staff becomes multi-

EXHIBIT 4

## MULTINATIONAL ORIENTATION — GEOGRAPHIC STRUCTURE



national in outlook and responsibility. Such a company would be receptive to moving toward both international ownership and control.

Management which is committed to pursuing a multinational orientation will face the task of establishing an organizational structure which is capable of initiating, and responding to, activities on a world-wide basis. A major prerequisite for achieving this condition is the formation of staff groups at corporate headquarters who are skilled in international management, and whose responsibilities include domestic and foreign operations without making such a distinction. Operational authority, as in the case of companies with a domestic and international orientation, may be assigned on a functional, geographic or product basis. However, at this stage, the organizational structure must reflect a global strategy. The geographic and product patterns are the most commonly used, with the former often incorporating a regional basis of organization as shown in Exhibit 4.

It should be noted that management of such companies will assess profit opportunities and allocate company resources on a country-by-country basis, comparing the probable pay-offs to other opportunities throughout the network of operations. Further, the company will endeavour to promote a commonality of objectives in order to dissuade all company subsidiaries from becoming self-contained, autonomous sub-units. Corporate management will encourage such trends as international specialization of manufacturing; pooling of research and development efforts; international marketing planning; centralized and coordinated world-wide purchasing, distribution and exporting; and, executive mobility between the various subsidiaries of the corporation and central headquarters. The latter activity is designed to instill in all management, corporate and subsidiary, a total commitment to the global strategy regardless of national or other geo-cultural political considerations.

Few companies pursue a corporate philosophy that is akin to the multinational orientation. External pres-

ures such as nationalism, often channeled against direct foreign investment, make it difficult for most companies to see the wisdom, if not the practicality, of adopting a world-wide integrated approach to business.

In the few instances where U.S. companies are trying to adopt in full the Stage 3 orientation, the Canadian subsidiary's reporting relationship changes little from the one it had in the Stage 2 example. The Canadian subsidiary is still located in the North American division which becomes a geographic region of a Stage 3 corporation. Canada is perceived to be a part of the North American continental market, and because the size of the U.S. market dwarfs the Canadian market, the loci of decision making power tend to be located in the corporate offices of the North American division in the United States. The multinational orientation confers greater autonomy and, hence, scope for entrepreneurship on the part of other (non-Canadian) foreign subsidiaries. The major benefit for the Canadian subsidiary is associated with greater international specialization which may result in some research, development and innovation in a specific product category. This is particularly the case when the organizational structure of the multinational enterprise is based on product divisions as opposed to geographical areas.<sup>7</sup>

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#### SOME GENERALIZATIONS

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There can be little doubt that the level of direct foreign investment, particularly from the U.S., has an influence on the Canadian environment for entrepreneurship, and that differences in opportunity exist between subsidiaries which can be attributed to the corporate philosophies of parent companies. Exhibit 5 shows the three stages of internationalization and Cole's six important phases of purpose for any business, and thus for entrepreneurial (innovation, management and adjustment to external conditions) activity. For example, for the parent company

"... innovations may be of any sort, from the organization of a business unit itself — the launching of



an enterprise novel in product, place or form — to a new method of packaging a manufactured item. They may be innovations of technological equipment and productive processes, or they may be purely innovations of management.”<sup>8</sup>

However, in the case of a Canadian subsidiary operation, this capacity, especially its most important process, namely that of innovation, will be limited by the grants of authority delegated to Canadian management by the parent.

Turning to Exhibit 5, the scope for entrepreneurship is severely limited for a subsidiary of a parent company with an export orientation (Stage 1). If we look at the first phase of business activity (The determination of the business objectives of the enterprise . . .), our analysis of corporate philosophies indicates that these objectives are determined by parent management. Regardless of whether the senior executive officer of such a subsidiary is a resident or a non-resident,

the multiple entrepreneurial function is performed largely in the U.S. parent company.

If we go down the phases of business activity for a Stage 1 subsidiary, we find a common pattern which restricts the company from innovating, but permits the pursuit of the process of management and adjustment so long as the activities are consistent with parent management standards. In fact, any departures from the norm, would require prior approval from corporate headquarters. This has a significant effect on the type of professional manpower such a subsidiary would employ. For example, research and development is conducted in the parent company, and major adjustments to any new product would be handled by the engineers of the parent unit, such that the Canadian subsidiary would employ primarily technical personnel in a supporting role. Such persons would normally be non-university graduates. Should problems of a complex nature develop, the subsidiary would then request

EXHIBIT 5: SCOPE FOR ENTREPRENEURSHIP RELATIVE TO STAGE OF INTERNATIONALIZATION AND PHASES OF BUSINESS ACTIVITY

| Phases of Business Activity \ Corporate Philosophy  | Stage 1 Subsidiary | Stage 2 Subsidiary | Stage 3 Subsidiary |
|---|--------------------|--------------------|--------------------|
| 1. The determination of the business objectives of the enterprise, and the change of those objectives as conditions require or make advantageous. | M                  | M                  | J                  |
| 2. The development and maintenance of an organization, including efficient relations with subordinates and all employees.                         | I<br>N             | O<br>D             | I<br>G             |
| 3. The securing of adequate financial resources, the retention of them, and the nurture of good relations with existing and potential investors.  | I                  | E                  | N<br>I             |
| 4. The acquisition of efficient technological equipment, and the revision of it as new machinery appears.   | M                  | R                  | F<br>I             |
| 5. The development of a market for products, and the devising of new products to meet or anticipate consumer demands.                             | A                  | A<br>T             | C<br>A             |
| 6. The maintenance of good relations with public authorities and with society at large.   | L                  | E                  | N<br>T             |

from the parent assistance in the form of visiting engineers or scientists. In short, Canadian management would rely largely on the parent company for all major technology.

The scope for entrepreneurship broadens when we move from Stage 1 subsidiaries to Stage 2 (International Orientation) through to Stage 3 (Multinational Orientation) subsidiaries, with the numbers and level of sophistication of the professional manpower employed increasing correspondingly. This difference is a direct result of an increase in powers delegated in the form of "grants of authority" by the parent to the subsidiary.

Our interviews with present and former executives of U.S. subsidiaries in Canada suggest that a major problem in managing a U.S. subsidiary in Canada is that potential Canadian creativity is often not encouraged, and in fact may be obstructed. Specifically, the point made is that most innovations emanate from the parent company, and in the event that the innovation is conceived of in the Canadian subsidiary, it must be reported to the parent company. If a decision is then taken to develop the innovation, in many instances, the development takes place in the parent company. Even in those subsidiaries which enjoy appreciable autonomy, this situation tends to dissuade the potentially more creative personnel from conducting original experimentation. For some executives, the choice is obvious, namely, to move to the parent company; however, for those who are not interested in leaving Canada, this choice presents a dilemma. Many simply relate to the parent-subsidiary framework of operations. Others may move to another company, but a critical point to keep in mind here is that with the high degree of foreign ownership in key industries, the scope for innovation will be quite limited. The total impact of this phenomenon on Canadian development may be damning if the outlook, which is engendered in the minds of executives of subsidiaries, works against the development of the innovating potential of Canadians.<sup>9</sup>

Those foreign subsidiaries in Canada which do display entrepreneurial drive, such as Canadian General Electric<sup>10</sup> and Imperial Oil,<sup>11</sup> suggest that Canadian government policy aimed at promoting entrepreneurship will have to take into account the corporate philosophy of the foreign parent and the associated commercial autonomy granted to the Canadian subsidiary. By promoting entrepreneurship on the part of a select number of foreign subsidiaries, the Canadian government may also create a favourable demonstration effect on the part of Canadian-owned firms. END

#### FOOTNOTES

<sup>1</sup>See I. A. Litvak and C. J. Maule, "The Multinational Firm and Conflicting National Interests," *Journal of World Trade Law*, 3, 3 (May-June 1969), pp. 309-18; and I. A. Litvak, C. J. Maule and R. D. Robinson, *Dual Loyalty: Canadian-U.S. Business Arrangements* (Toronto, McGraw-Hill, 1971).

<sup>2</sup>*Business Enterprise in Its Social Setting* (Cambridge, Harvard University Press, 1959) p. 7.

<sup>3</sup>In *The Business System — Readings Vol. 1*, Eds. C. Walton and R. Eels (New York, MacMillan Co. 1967) pp. 399-400.

<sup>4</sup>For example with reference to the Barber-Greene Company, its Canadian wholly-owned subsidiary is operated as a branch factory of the domestic company (U.S.) and is not considered part of the international operations, E. B. Lovell, *The Changing Role of the International Executive*, Studies in Business Policy, No. 119 (New York, National Industrial Conference Board, Inc., 1966), p. 148.

<sup>5</sup>L. T. Wells Jr., "The Multinational Business Enterprise: What Kind of International Organization?" *International Organization*, Summer 1971, p. 450.

<sup>6</sup>W. M. Cannon, "The Expansion of American Corporations Abroad" in *International Enterprise* (New York, McKinsey and Co., 1962) p. 9.

<sup>7</sup>See Wells, *op. cit.*, pp. 453-457.

<sup>8</sup>Cole, "The Business System", *op. cit.*, pp. 400-1.

<sup>9</sup>A similar conclusion is reached with respect to developing countries by P. N. Rosenstein-Rodan, "Multinational Investment in the Framework of Latin American Integration", in Inter-American Development Bank, *Multinational Investment in the Economic Development and Integration of Latin America*, Bogota, Columbia, April 1968, pp. 25-6.

<sup>10</sup>J. Herbert Smith, "Canadian Independence and the U.S. Subsidiary", an address to the Canadian Club, Toronto, Nov. 8, 1971.

<sup>11</sup>Litvak, Maule and Robinson, *op. cit.*, ch. 9.

## MANAGING THE ENTREPRE-

In recent years politicians, businessmen and government bureaucrats have exhorted Canadians to become more entrepreneurially-oriented, particularly in high technology areas of business. To the non-socialist nationalist, encouraging entrepreneurship is a way of fighting the U.S. economic takeover of Canada. For the businessmen, the promotion of entrepreneurship is a reinforcement of the principles of free enterprise, and a call to halt the drift toward a welfare state. From the perspective of the politician and bureaucrat, Canada's future economic well-being and independence is going to be greatly affected by the entrepreneurial drive of its people. This rationale underlies the promotion of some of the critical government incentive programs which are aimed at stimulating a high technology industrial base in Canada.

The purpose of this article is to provide some empirical data about the factors which advance and obstruct technological entrepreneurship in Canada, with a view to determining the role which the Canadian government might play.

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### THE TECHNOLOGICAL ENTREPRENEUR

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Technological entrepreneurship has been described as follows:

"The firm is started by two founders, both of whom are in the middle thirties. One usually can be described as the driving force. He conceives the idea and enlists the other founder. They come from the same established organization, which is where they got to know each other. Either both are in engineering development or one is in engineering and the other is a product manager or in marketing. Often, they have achieved significant prior success, with titles such as Section Head, or Director of Engineering, being common."

The population examined in this study consists of forty-seven small, newly-established ventures initiated by technologically-oriented entrepreneurs, more than half of whom conformed closely to the above description. The sample selected was based on judgment and

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# NEURIAL ENTERPRISE

I. A. LITVAK and C. J. MAULE

the availability of information. Every effort was made to ensure that the interviewees were technological entrepreneurs involved in the formation of new firms. With few exceptions, the firms were small; less than ten % of the firms had annual sales in excess of five million dollars. All 47 firms, involving 96 entrepreneurs, were interviewed in 1971. The location of the newly-established firms were as follows: Quebec (17%); Ontario (40%); Prairies (26%); and B.C. (17%).

A major finding of our study is that only 15% of these ventures were commercially successful, another 30% appeared to have some chance of becoming successful, while the remaining 55% were either failing or had failed. It is our purpose to highlight the reasons for the difficulties experienced by these firms.

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## MANAGERIAL CAPABILITIES

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Eighty per cent of the 96 entrepreneurs who established new ventures possessed a technical background which usually included formal education and on-the-job experience. About 64% of the entrepreneurs possessed post-secondary training. It was noted that the first ventures established by the entrepreneurs were generally in those lines of business in which they had gained their on-the-job experience, and in areas in which they tended to possess their greatest degree of formal training. It was therefore not surprising that the technical capabilities of many of these newly-established firms were of a satisfactory calibre, at least at the outset.

The major reason for failure can be attributed to the obvious lack of general management expertise on the part of these firms. While the entrepreneur's technical capabilities may have enabled him to promote the formation of a company, it was seldom a sufficient condition to ensure the profitable performance of a newly-established venture.

Only a few of the entrepreneurs possessed general management expertise comparable to their technical skills. This fact may be attributed to their lack of a

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formal business education, coupled with work experience which tended to be in the technical area. In those instances where other management job responsibilities were included in their previous positions, they were rarely of a senior decision-making type. In brief, most of the entrepreneurs were ill-prepared to organize and

manage a newly-established venture. Their level of competence in such management areas as marketing, finance, personnel and even manufacturing was sadly lacking.

This general management capability problem was further compounded because the entrepreneurs tended to resist giving up any control over their corporate operations and preferred to operate in the role of owner-managers. Instead of forming a professional management group to oversee the operations of the firms, the entrepreneurs tended to do everything and be everything to everybody. In a number of cases where control was given up, the timing was too late to introduce the necessary corrective action to salvage the venture. Reticence to share management control, and the downgrading of the non-technical management areas of expertise also resulted in the hiring of personnel whose financial and marketing expertise left a lot to be desired. The non-technical employee and/or partner was no match for the entrepreneur either in sophistication or drive. On the other hand, entrepreneurs who did hire competent personnel in the non-technical areas, often did so on a part-time basis, payment for which might have included a modest salary and stock option. Accountants, lawyers and management consultants were the professional types usually included in such an arrangement. However, the participation of part-time experts in the initial stages of new venture operation in a competitive market can be equally unsatisfactory.

This concern over control and the initial downgrading of the non-technical areas of management by the entrepreneurs often effected a metamorphosis on his part by turning him into an "amateur" general manager, which in turn undermined the potential profit base of the newly-established venture. For example, technological entrepreneurs on forming a small company may find themselves so preoccupied with raising capital, generating market opportunities, training personnel and performing other administrative duties, that they are unable to devote the required effort to

managing the commercialization of the innovation. Unwillingness to delegate control even in the technical area, or an inability to impart the technical know-how to one's subordinates often led to unnecessary complications and delays which had the effect of undermining the total operations. Further, the very drive and enthusiasm which led to the formation of the enterprise, namely the entrepreneur's technical innovative skills, became partially dissipated when he expanded his activities into areas in which he had limited competence.

This lack of general management sophistication, especially in such areas as finance and marketing, have undermined the potential success of many operationally sound projects. Inability to identify and tap existing sources of venture capital, and poor selection of distributive arrangements are but two of the reasons which can be traced to the foregoing shortcoming. When the entrepreneur experiences this state of affairs, usually because of his own management myopia, he becomes frustrated and despondent. These are the pre-conditions which often lead to the abandonment of the project.

Illustrative of this general lack of management expertise, is the absence of any attempt on the part of most of these entrepreneurs to establish a set of clear-cut objectives for their firm. Consequently, planning procedures, operational guidelines and contingency plans are rarely evident in the management of these companies. First attempts at stating company objectives, surveying market possibilities, and assessing fully the commercial feasibility of the product or process often occurs when the entrepreneur applies for financial assistance either from business or government.

Regardless of the managerial sophistication of the entrepreneurs, many of them, who were involved in starting up small firms, incorporated two companies. One company was assigned the responsibility of doing the research and development work, and holding the patents where applicable. This company was usually

the exclusive domain of the entrepreneur. Outsiders would rarely be allowed to obtain equity participation in this firm. A second firm, which was controlled by the first, would be assigned the manufacturing and marketing task of the innovation. This firm usually served as the vehicle through which the entrepreneurs would try to raise debt and equity financing. Moreover, it was in this company that the entrepreneur would allow for employee equity participation. In this manner, a spirit of personal participation was engendered on the part of key employees, and served as a way of compensating them for their lower salaries. Effective control of the manufacturing and marketing firm was retained by the entrepreneur through the financial and research and development linkages between the two companies. In addition, there were tax considerations for having two separately incorporated companies.

A further point to note is that approximately 30% of the entrepreneurs were simultaneously involved in promoting a number of projects through a variety of small companies. Failure in one company seldom dissuaded the entrepreneur from promoting other ventures. It should be noted that the failure of a firm need not result in its physical disappearance, but merely in a change of ownership, or the pursuit of a new project. In addition, the closing of business firms is not always indicative of unsuccessful operation. It may be connected with events in the personal lives of the owners, particularly in the case of small operations where the fate of the business is linked closely with the lives of individual owners and their families.

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#### FINANCING THE PROJECT

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The need for capital funds was one of the most challenging problems facing the entrepreneur. Thirty-five per cent of the entrepreneurs interviewed stated that their company's capital structure, at the time of incorporation, consisted largely of their own cash and savings, which in some instances, was barely sufficient to cover the expenses of incorporation. In addition to the

entrepreneurs' savings, other sources of initial capital investment included family, friends, financial institutions, suppliers, former employers and prospective customers.

The relationship of cash, stock and credit in running a business was only vaguely understood. These entrepreneurs had invested their total savings at the outset, and as problems arose during the commercialization of their project, many of them were in the unenviable position of not having reserves to draw on to tide them over their difficulties. Many of them had difficulty in distinguishing between their business and personal finances.

While the most obvious source of capital is the venture capital firm, 65% of the entrepreneurs expressed reservations about approaching such groups. The following reasons were offered: venture capital firms tend to want to assume equity control of the firm in which it invests; venture capital firms insist on appointing their own company executives on the Board of Directors of the firm, and may go so far as to wrest complete control from the entrepreneur by having their own man assume the responsibility of chief executive officer; and, venture capital firms who have acquired effective control of the entrepreneur's company tend to prevent the entrepreneur from raising additional capital through equity participation for fear of weakening their control.

This preoccupation with the issue of control appears to be the critical factor underlying the resistance of entrepreneurs against utilizing the services of venture capital groups. Even in those instances where entrepreneurs admitted that these groups were in a position to extend both capital and much needed management assistance, they, nonetheless, preferred to struggle on on their own, knowing fully well that the chances of success might be slim. The reasons for this attitude may be understood in the context of why these persons became entrepreneurs. Two critical considerations prevailed. First, there was a desire to produce something through one's own efforts and to achieve both per-

sonal satisfaction and public recognition. This drive can be triggered off either through positive or negative experiences. For example, a positive factor might be a father's background as a successful self-made businessman. A negative factor might result from frustration experienced through employment in a company which is not willing to recognize the prospective entrepreneur's contributions or proposed project idea for commercialization.<sup>2</sup> Second, there was the desire to be one's own boss. In the case of at least 20% of the entrepreneurs, fear, insecurity and inadequacy in their previous jobs were critical reasons offered, for "going on one's own". These attitudes included fear of losing one's job, the need to supplement present income, ensuring activity during retirement, and creating a better future for one's children.

All 47 firms were recipients of some governmental assistance program for research and development. We estimate that 40% of the firms would not have been able to continue their project development program without government assistance. Another 30% of the firms probably could have commercialized their projects without government assistance. The attitude of this group of firms was "if the money is available from the government, why not take advantage of it?". As a Canadian venture capitalist noted, "Government money . . . we will consider as 'gravy'".<sup>3</sup>

It was clear from our interviews that in 25% of the cases knowledge of government incentive programs had been obtained by chance — as a result of meeting a government official, politician or fellow businessman, or noticing an article in a newspaper or trade magazine. The point is not that the programs were necessarily publicized inadequately, but that the small entrepreneur is frequently both unaware of his environmental setting, and does not devote the time to examining what sources of financing, both public and private, are available to him. His main institutional financial contact tends to be his local bank, while other sources of financing were shown to be shareholder loans, where the shareholders are often friends, sup-

pliers and customers. However, the Canadian banking system was harshly criticized by most of the interviewees for being overly conservative, and commercially naive in its assessment of business propositions. One entrepreneur summed it up as follows: "If I could satisfy the criteria for getting a loan from my bank, I would not have to ask for one".

Most of the entrepreneurs felt that it would be easier for them to raise venture capital from sources in the U.S. than in Canada, especially for amounts in the \$300,000 to \$500,000 range. In some instances, this view was based on experience, i.e. hard offers of cash from the U.S., and in some cases it reflected an impression of the environment.

There was a marked difference between Canadian-born and immigrant entrepreneurs in their perception of the environment for entrepreneurship in Canada. Approximately 50% of the entrepreneurs studied were immigrants to Canada mainly from the U.K. and Europe. This group tended to be more committed to their venture, more enthusiastic and less critical of the Canadian environment than the native-born entrepreneur. The latter group tended to view the U.S. scene as being more favorable to the entrepreneur than the Canadian setting, while the former would compare the Canadian environment to the more restrictive situation abroad, usually in his native country. The foreign-born entrepreneur noted the ease with which one could establish a business in Canada, the greater availability of capital in Canada than at home, and the greater social mobility which was reflected in the individual being judged in Canada on his performance, rather than his background.<sup>4</sup>

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#### MARKETING

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The marketing performance of the entrepreneurs was weak, and was a major factor for the apparent high mortality rate of the projects. Most of the entrepreneurs were unable to see the linkage between product innovation and marketing innovation, i.e. that techni-



cal innovation through product modification could be successful only if the benefits were readily perceived by the intended users.

Most of the new product development was carried out and implemented before any attempt was made to assess the market potential and the costs of penetrating the market. Overestimating demand, underestimating competition, ignoring the need to invest in promotion, selection of inefficient and costly distributors, overextension of credit through consignment selling, understaffed sales organization, inadequate warehousing facilities and unreliable delivery and service support were some of the reasons deduced for the problems encountered by the entrepreneurs. It was estimated that only one out of five firms had a satisfactory marketing organization. At least 85% of the firms introduced their innovation into a highly or moderately competitive market. In the case of adaptive innovations, the market was almost always highly competitive.

The point to be made is that the love that the entrepreneur has for his product innovation often blinds him from perceiving his real opportunities and the state of market competition. An adaptive product innovation in competition with the giants of the industry is seldom a formula for long term success. About 35% of the innovations studied appeared to have no effective protection either because the invention was questionable, or it was not worth the investment, or because the protection derived from a patent was usually more than off-set by the information disclosed at the time of application. In general, the entrepreneur had little sophistication in the use of patent protection.

In addition to these problems, the limited size of the Canadian market forced many of the entrepreneurs to extend their marketing horizons at least to the U.S. market where they were even less well-equipped to compete. Only 19% of the firms viewed their products as being sold solely in the Canadian market. For 10% of the firms, the export markets predominated, while for the remaining 71%, sales would have to be made

in both the domestic and foreign markets. It was noticeable, therefore, that these firms were very much aware of the limitations of the size of the Canadian market, the distance separating the centers of population, and the international environment in which they operated.

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#### ROLE OF GOVERNMENT

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The view expressed most frequently by the commercially successful entrepreneurs who had received financial support from the government was that the advice and assistance received from government officials had been most valuable to them. From less successful entrepreneurs, there was less satisfaction about the role of the government and about the environment in general. Amongst this second group the complaints most frequently heard were; that the government did not provide assistance with respect to the marketing of the product or process; that the government was reluctant to provide the additional financing after the first loan or grant had been made, and it could be shown that the project stood a good chance of success with some additional financing; that the government would not use its purchasing policies to promote the sales of products which government financing had assisted; and that, in general, other federal government departments and provincial governments were not at all helpful in assisting an entrepreneur who had received some federal government assistance.

Knowledge about government assistance programs for research and development varied enormously among the entrepreneurs. About one in four mentioned that they had heard about the programs by chance. It is probable that information about the programs declines as one moves away from central Canada, both east and west. Such imperfections in the knowledge which entrepreneurs have about their environment exists in other areas as well, as has been shown. In fact, as much, if not more, is known about U.S. as about Canadian sources of venture capital.

There are a number of policy issues which arise out

of these comments on the role of the government in assisting entrepreneurship. One of the more fundamental questions to be considered is, under what conditions should the government promote research and development and entrepreneurship in Canada? We do not intend to discuss the theoretical and empirical relationship which links research and development to economic growth and other indicators of economic progress.<sup>5</sup> Rather, we will assume that such a relationship is accepted, and that the question for the policy-maker is how the government can promote this relationship.

In order to examine this question, we will deal with two areas, first, the ways in which entrepreneurship can be related to the industrial goals of Canada, and second, the ways in which the government can assist in promoting entrepreneurship.

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#### INDUSTRIAL STRATEGY

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One starting point for such a discussion is the identification of the industrial strategy (goals and means) of the country. From our observations, it appears that there is no clear and coherent understanding, either among businessmen or government officials, of what the goals of industrial policy are in Canada. It is known that the government is attempting to promote manufacturing industries in general, as well as other sectors of the economy, but within the manufacturing sector, it is not known which industries are the prime targets for promotion. Our initial point here is that the many programs of industrial development promoted by different federal government departments (and provincial governments) do not necessarily complement each other and may even offset each other. From the businessman's point of view, he may find himself assisted by one department only to appear to be thwarted by another.

If one considers only those government programs, which are aimed at promoting research and development and entrepreneurship, it appears to us that an attempt to concentrate efforts on promoting various

areas of technology might prove to be a more effective use of the limited resources available.

The goals of an industrial policy will obviously result from political decisions and it is here that the Department of Industry, Trade and Commerce, with its first hand knowledge of different industry sectors, can provide an important input. Specifically, there is a need to engage in some form of technical-economic forecasting which will permit the selection of projects which will have a substantial chance of success because they meet an identifiable need. Like other commentators, our observations are that most innovations which fail, do so due to an inability to establish a market, either for technical or for economic reasons.

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#### PUBLIC ENTREPRENEURSHIP

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The second area for discussion is the type of role which the government should play in promoting entrepreneurship. This role can include the undertaking by government of research and development, the financial support of private research and development, and the commercialization of innovation by a government-owned firm or by a private firm.

Since the government already provides financial support for research and development by private firms, it is in fact acting as a provider of venture capital. The question then arises whether government is so organized that it can effectively fulfill a role of a venture capitalist.

Private venture capitalists, both in Canada and the U.S., note the following;<sup>6</sup> frequently a project has to receive a second injection of capital and usually under less attractive conditions than the first was made; only a small proportion of the total projects funded are successful so that the return on the successful ones has to be substantial; a great deal of time and effort is spent on examining projects on a systematic basis, that is to say, a team of researchers working closely together will evaluate a proposal; and venture capitalists work very closely with the funded companies. For

example, they may provide management services, monitor the company's activities on a regular basis and have a seat on the Board of Directors.

Thus, the characteristics of venture capitalists include the following: a willingness to accept losses and to make large returns on a few successful projects; a willingness to provide additional financing when a project has not achieved its original objectives; an insistence on becoming intimately involved with the management of the company; and a set-up which permits a team approach to the evaluation of a project.

There are obviously a number of ways in which a government organization is less suited to engaging in venture-capital activities as outlined above, than is a privately-owned firm which specializes in this role. First, the government's sources of funds are public funds provided largely by taxation and borrowing. The public may find it difficult to accept the use of such funds for risky ventures, and thus there may be reluctance, for political reasons, for government to fulfill effectively the venture-capital role. The private venture capitalist's sources of funds are provided by persons who accept and want their funds to be used for such risk-taking activities. In addition, a government organization which achieves a very high return on an investment would tend to be strongly criticized by business interests, because they would not perceive the government in the role of a venture capitalist.

Second, a civil servant's career performance tends to be measured by factors which reveal the careful and prudent use of public funds. Having a one-in-ten success record, as is the case for private venture capitalists, and having to make a second loan when the first has not achieved its intended objectives, is hardly consistent with the public image of a responsible civil servant.

Third, close surveillance of a firm's operation can of course be taken by a government department, but few departments are equipped to provide management services, and appointing a government official to a board of directors would be considered the business

equivalent of the government invading the "board-rooms of the nation".

Finally, evaluation of projects requires a team effort. While a private venture capitalist specializes in providing this service, government departments tend to use, for evaluation purposes, individuals and groups of officials who have other administrative responsibilities, and thus who do not have the same amount of time available to concentrate on project evaluations, and who may lack the required operational expertise.

The foregoing remarks are consistent with our observations of firms in the following areas. First, there was a reluctance of government to provide a second injection of capital. Second, a number of firms might have completed their projects if there had been some management assistance provided. And third, most of the projects which received support fell into the category of adaptive innovation.

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#### RECOMMENDATIONS

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From the foregoing examination of the experiences of technological entrepreneurs and the role played by the government, consideration should be given to developing the following government policies and programs.

1. A statement of the goals of an industrial policy with emphasis on those sectors and regions which will receive special treatment for the purpose of promoting Canadian entrepreneurship.
2. An attempt must be made to rationalize the many incentive programs within and between government departments in order to make a more effective use of public resources. The role of the Canada Development Corporation as a venture capital firm must be clarified.
3. The design of special management education programs for entrepreneurs, particularly those involved in the start-up of new enterprises.
4. The promotion of stronger ties between entrepreneurs and venture capital and management consulting firms. One method of achieving this objective might be to contract out to private firms



the evaluation of applicants for government incentive programs which is presently done in-house.

5. The promotion of greater awareness about entrepreneurship on the part of universities, particularly in the Faculties of Engineering and Administration.
6. The development of a more effective public information program about the availability of government incentive programs for entrepreneurs. END

#### FOOTNOTES

<sup>1</sup> A. C. Cooper, "The Palo Alto Experience", *Industrial Research*, May 1970, pp. 58-60.

<sup>2</sup> For a detailed discussion of negative factors, see A. C. Cooper, *Op. Cit.*

<sup>3</sup> A. Grieve, "Venture Capital Sources and the Canadian

Entrepreneur", *The Business Quarterly*, Vol. 37 (Spring, 1972), pp. 55-56.

<sup>4</sup> For an interesting discussion of the differences in perception see I. H. McLeod, "Can Canadians be Successful Entrepreneurs", *The Business Quarterly*, Vol. 37 (Spring, 1972), pp. 29-36.

<sup>5</sup> For general discussion, see N. H. Lithwick, *Canada's Science Policy*, (Toronto, Methuen, 1969).

<sup>6</sup> For example, see *Venture Capital*, Report of Conference held at the School of Business, University of Toronto, September 28 and 29, 1970; and "The Golden Equation of Venture Capital", *Dun's Review*, September 1969, pp. 43 to 45.

Two annotated bibliographies on the subject area are:

<sup>1</sup> *The Entrepreneur and New Enterprise Formation*, published by the Center for Venture Management, Milwaukee, Wisconsin, Fall 1970.

<sup>2</sup> R. V. Davies, *Success and Failure Factors of Small Business*, Ottawa, Department of Manpower and Immigration, September, 1967.

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

SELECTING EXPORT MARKETS<sup>+</sup>

by

O. MARY HILL

<sup>+</sup> From: How to Win World Markets, published by Department of Trade and Commerce, (Ottawa) 1967, pp.7 - 14.

## SELECTING EXPORT MARKETS \*

By O. Mary Hill

JOHN SMITH, a Canadian manufacturer, has been in business for about fifteen years. He is turning out a good product, it is selling well in Canada, and he would like to extend his plant and step up production. To do this, he needs more customers. He has an idea. Why not look for these customers in foreign countries as well as in Canada? Actually, Mr. Smith is taking the first step toward becoming an effective exporter - because exporting begins with a state of mind. It's not a casual business; a businessman should enter upon an export campaign with energy and determination - and with the intention of making it last. The Canadian who views foreign markets as a place to get rid of occasional surpluses, the in-and-outer, makes no enduring impression. Worse, he damages Canada's reputation as an international trader.

A Canadian businessman usually can't and won't turn into a successful exporter within weeks or perhaps months. It may take much longer. Veteran export managers believe that it takes a minimum of five years to get solidly entrenched in foreign markets. But the time and care taken in choosing the right place or places for an initial export venture can minimize the risks and make ultimate success quicker and more certain.

Exporting begins with a state of mind - a state of mind that must be reflected in top management. In other words, management must have an export complex and must be persuaded that it is wise and will be profitable to diversify the company's markets. It must see that export orders always receive the same attention as domestic orders; that money is set aside for travel and promotion; that its knowledge of foreign markets is kept up to date. It may even consider allocating a certain amount of output to export and then prepare to go out and sell it.

Once he has resolved to try his luck in foreign markets, the potential exporter should turn his attention to his product. He should try answering these questions as a start:

\*From: How to Win World Markets, published by Department of Trade and Commerce, (Ottawa) 1967, pp. 7-14.

- Is there something unique about my product?
- Could it be adapted if necessary to meet differing overseas tastes or needs? (A chain saw company had to provide a special clutch for saws in use in humid North Borneo)
- Have I, or could I provide, enough production to serve both Canadian and foreign buyers efficiently?
- Would I need to supply service and would this be a problem?
- Would I have to have sales literature or service manuals printed in a foreign language or languages?
- Would the shipping costs be high?

The answers to these will have a direct bearing on the selection of markets and on export strategy. If the product is basically similar to something already made extensively in other countries, chances of selling it abroad are slim. If production delays make it difficult to honour delivery dates, overseas customers will soon drift away. If shipping costs are apt to be high, it is best to investigate nearby markets first. If the product needs servicing, this will affect distribution arrangements overseas. If adapting it might be difficult, avoid the more exotic markets.

At this point, the exporter needs to look at potential markets -- and he can start looking at them right at his desk or at a library table. Market research can begin effectively with some digging for facts -- facts on a number of markets to be compared and appraised. Here are some suggestions for starting on this job.

1. Examine the Canadian export statistics put out by the Dominion Bureau of Statistics, particularly the "Exports by Commodities" series. (For information about how to obtain these, see the bibliography.) Find out whether a product similar to yours is being sold abroad and where. A word of warning: don't look at the figures for one year only because they may be misleading; three years will give you a better picture. And look at the full range of the products in your field and not at just one or two.

2. Take a look at the statistics put out by some other countries, such as the United States and Britain. These are not difficult to obtain; the Embassy or one of the Consulates of the country here in Canada or a good library should be able to help. If the researcher finds that the United States is selling a product similar to his in a number of countries, perhaps he can too. The same is true of the British statistics. In the wider field, the United Nations Yearbook of International Trade Statistics gives imports and exports by unit value for 132 countries and although the categories may be too broad, the figures may have some value.

## SEVEN KEYS TO SELECTION

In general, in selecting markets keep these points in mind:

- . Concentrate on one or two markets to start; don't spread yourself too thin.
- . Don't overlook the smaller, less obvious and possibly less competitive markets. (One refrigerator manufacturer made sales in Fiji and New Guinea.)
- . Plan to spend time and money visiting foreign markets. These visits, say a veteran, "break down exporting difficulties into practical problems you can deal with"
- . Keep within your capacity to service customers; don't go after foreign orders that you can't fill.
- . Make certain at the start that your export business is going to be profitable.
- . Find a need and fill it; this ensures success.
- . Stay away from markets in which import restrictions or exchange controls will restrict your scope.

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3. Talk with some experienced exporters, preferably in fields closely akin to yours but not directly competitive. Many of the larger companies are willing to share their experience with their smaller confreres.

4. Ask the shipping companies in your area to give you some idea of the shipping charges to various markets. Check on other ways of shipping if they seem feasible, such as trucking or air freight - or even parcel post.

5. Make good use of your trade association and/or the Canadian Export Association; you may be able to obtain some market information from other members who have been travelling abroad. Through the association, you may also have a chance to take part in international conferences - an excellent way to make foreign contacts and to get a glimpse of conditions in other countries.

6. Remember that the foreign or international departments of the chartered banks have a good deal of information, printed and otherwise, on foreign countries and will be glad to help you.

7. Examine trade directories from various countries to get a line on prospective customers, or study the yellow pages of foreign telephone books.

Some businessmen feel that they cannot advance even this far in plans for exporting without expert help. Help is close at hand -- as close as a regional office of the Department of Trade and Commerce (St. John's, Halifax, Montreal, Winnipeg, Edmonton, and Vancouver) or the head office in Ottawa, the provincial departments of trade and industry, and various associations.

In the Department of Trade and Commerce in Ottawa, a Commodity Officer familiar with the exporter's field can help him assess his products in terms of export potential and an Area Trade Officer can brief him on conditions in particular regions and on the terms of access to various markets. (That phrase, "terms of access" covers many important things -- such as import duties, restrictions on imports or on foreign exchange, preference arrangements, and so on.)

These officials can also get advice for him from other officers of the Department on other problems, such as export or import permits if these are required, shipping services, or the need for the product to comply with health or other regulations. And they can put the businessman in touch with the Canadian Trade Commissioners who serve in 47 different countries and who can provide further information on markets.

The Trade Commissioner can take on the research job where the potential exporter, having completed his initial investigation and made contacts here in Canada, leaves off. But first the exporter must decide which markets, in his judgment, are worth studying further. Then write to the Trade Commissioner in each, enlisting his help in doing some market research. Don't simply write and say: "I make refrigerators. Can I sell them in your territory competitively? How big a market is it?" The letter must include, among other things (and using refrigerators as an example):

- (1) Sizes of refrigerators made.
- (2) Prices at which they could be offered. (Prices may not be firm at this stage but they should be approximate.)
- (3) How much production can be set aside for export.
- (4) Description of the product, accompanied by a brochure, small folder or pictures.
- (5) Method of selling favoured -- by commission agent, by a distributor who will maintain stocks, direct to large or chain stores, etc.



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(6) Type of customers to whom the firm sells in Canada - such as department stores, retail stores, wholesalers, institutions, etc.

The exporter of a food product would do well to send the Trade Commissioner labels from cans, cartons or bottles; the man who is selling a highly technical product should dispatch catalogues or perhaps service manuals. Send actual samples when this is practicable.

It is often unwise to assume on the basis of sketchy information that certain markets have no potential; check the point. A Canadian manufacturer of heating equipment discovered to his surprise that he could sell in Jordan because, although the days are hot, the nights are cool. He is also selling in Venezuela, where his equipment is used not to heat houses but to dry coffee beans.

When he has received from the Canadian businessman the information that he needs, the Trade Commissioner can prepare a preliminary market report. This report may cover a number of factors and their importance will vary with the product and with the market being studied. If the exporter wants to sell table lamps, he will need to know the voltage and frequency used, the type of plug employed, and what electrical standards the product will have to meet. If he sells food products, standards of a different sort will concern him and so will labelling regulations. Some of the general information that the Trade Commissioner customarily includes in a preliminary market report is given in the accompanying box feature; it can also serve as a check-list on market information needed.

Once the exporter has obtained this market information from a number of Trade Commissioner posts, he can compare it and make an initial selection of possible markets. Then, using current data on shipping costs, import duties, insurance charges, commission rates usually paid to agents, etc., he can set to work calculating c.i.f. prices for various markets, first in Canadian currency and then, if necessary, in the currency of the various countries, such as sterling or U.S. dollars. This calculation should answer the question: "Can I sell abroad at a profit?"

The exporter may find, following further correspondence with the Trade Commissioner, that his price is in line with the competition, that the import duty is not too high, and that it should be possible to interest a good agent in his product. But, the Trade Commissioner may add, the product itself will need a bit of redesigning to appeal to French, Mexican or Lebanese buyers, and it will need to be more strongly packed to stand up to rough handling en route. This is the cue to start working on these problems. A Canadian manufacturer of heating equipment found, for example, that for German customers he must put a peephole in the burner casing and have the oil lines chromium-plated. If the drawback is a too high price, the exporter must sharpen his pencil and work on how much this initial price can be shaved.



## How The Trade Commissioner Assesses Sales Prospects

IN reporting on the sales prospects for a Canadian product in a market, Trade Commissioners consider the following points:

### Basic Factors

1. Area of a country, distances, terrain, climate, and other geographical factors that may influence the market for the product.
2. Size, distribution and concentration of population.
3. Level of income; distribution of income.
4. Natural resources (limited, potentially wealthy); importance of staple products in earning income.
5. Extent and stage of industrial development; plans for further development.
6. Present economic situation, trade balance, credit standing, availability of foreign exchange.

### Access to Market

1. Import restrictions, such as licensing or quotas.
2. Rates of customs duties; whether Canadian goods receive preferential or M.F.N. treatment.
3. Method of calculating value of product for duty purposes.
4. Marking and labelling regulations; need for health certificates for animal, plant and fisheries products, etc.
5. Currency and convertibility; any controls on remittances.
6. Bilateral trade or barter agreements that favour imports from particular sources.

### Market Potential

1. Current and potential demand.
2. Domestic production of product or one closely related.
3. Statistics on imports by volume, value and country of origin. Are these increasing or decreasing?

4. Dominant price and quality ranges of imported and domestic product; range with the largest current and potential sales.

5. Prices at the importer, wholesale and retail levels.

6. Control of market by traditional suppliers; acceptability of new products.

#### Market Requirements

1. System of measurement used - metric, English, etc.

2. Preferred basis of price quotation - c.i.f., f.o.b., etc.

3. Terms of payment considered normal - sight draft, letter of credit. If credit is necessary, the standard terms.

4. Preferences in styling, quality, etc., because of national characteristics or interests which differ widely from the Canadian.

5. Need for special packaging because of climate, shipping conditions, government regulations, or local tastes or prejudices.

#### Distribution

1. The normal importer of the product - manufacturer, commission agent, merchant, other. Markups or commissions expected in each instance.

2. Normal distribution patterns.

3. Should one firm have the exclusive agency for the whole market or would a number of representatives in various locations be preferable?

4. Do importers normally carry large stocks to supply the trade or are frequent small shipments common?

5. Will the representative expect advertising support?

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It is a sound idea not to try selling in too many markets to start with. Follow the advice of a Canadian textile manufacturer who says, "Our company has discovered that it is best to begin in a small way, become established in one or two areas, and then spread out." A Trade Commissioner put it more picturesquely: "Don't shoot a number of arrows in various directions on the theory that one of them may find the target. They may all miss."

Sometimes market research has a negative value: it can tell a firm what markets to avoid, or those in which the chances of success are at best marginal. In general, avoid a market if:

- The product is not likely to appeal to consumer tastes there.
- It will need more adaptation than the demand warrants, or more than the manufacturer is willing to undertake.
- Import restrictions and/or high tariffs restrict or practically eliminate the demand.
- Shipping costs will be prohibitive.
- Too much will have to be spent on putting out sales literature or catalogues in another language or languages. (This applies to highly technical products.)

The Trade Commissioner can and will be the exporter's eyes and ears in a foreign country but he cannot sell his product for him. He can tell him many things about a market but to understand it fully, the exporter must become the "man on the spot." Three or four days spent in Jamaica, for example, give a businessman the feel, the atmosphere, of the Jamaican market that he can acquire in no other way. He can talk with prospective agents, visit potential customers, study at firsthand methods of selling.

One export manager says: "You yourself know your business best and what you have to offer. A personal visit is the best way to estimate whether a certain market is a good one for you." (He adds that his firm has never failed to get back in sales the money spent on foreign travel.)

How long the whole process of preliminary market research will take depends upon a number of things. One is the product that you want to sell. It is much easier to assess the demand for nylon stockings than for complicated electronic equipment. A Canadian company in the electronics field recently spent two years studying and evaluating various markets. But once it chose the countries in which to launch an export campaign, contracts came its way quickly. Large firms who require and can pay for a really professional and detailed market research job can employ organizations like the Economist Intelligence Unit or (for Western Europe) Continart A.G.

One excellent way that a firm can pretest a market, particularly in the United States or in Europe, is by exhibiting in one or more trade fairs, either on its own or in a section sponsored by the Department of Trade and Commerce. At a trade fair the exhibitor can study the reaction to his product, stack it up against the products of competing firms, come into contact with prospective customers or with prospective agents, and in general get a "cram course" in that market.

A Montreal manufacturer of top-flight athletic footwear has made most of his contacts and does nearly all of his selling in his main market, the United States, by taking part each winter in the huge National Sporting Goods Show in Chicago. There he meets buyers from the big U.S. department stores and he needs no other outlet. Specialized trade fairs can be equally useful in selling a highly technical product because they provide the exhibitor with a pre-selected group of potential customers who talk his language, technically speaking.

Trade missions, sponsored usually by the Department of Trade and Commerce or by one of the provincial departments of trade, can also be an effective way of finding out about a market quickly and simply.

Small firms, faced with the problem of choosing markets and then learning what one export manager calls the "commercial footwork," may feel that export trade is just too complicated. This is a fallacy; many small-sized Canadian companies are doing plenty of export business. They prove the truth of the observation made by a Vancouver businessman, "The little guys can run under the feet of the big guys." Sometimes smallness is a positive advantage: the small business can make decisions and changes more quickly and this flexibility is an asset in exporting.

One case history may serve to emphasize and illustrate the points made in this article. It concerns the U.S. market, where tariff questions and valuation are especially important, but it details a method of approach valid in nearly all markets. A Canadian confectionery manufacturer sets out his experience this way:

"We began our serious investigations into the U.S. market in the late spring of 1962, about eight months before our first shipment and about six months before our first export production run.

"The problem was broken down and plans were laid more or less, but not necessarily, in the following order:

1. Decide on what domestic lines to export.
2. Determine United States selling price. Generally speaking, both the prices and weights of export bars were determined by competition in the United States.

3. Estimate gross and net profit on each line, taking into consideration such items as rate of duty, value for duty, elimination of federal sales tax, estimated freight charges to various areas in the United States, plus many other factors.
4. Check possibility of United States registration of Canadian product names if not already done.
5. Check Food and Drug Regulations regarding formulas, product names, etc. This entailed numerous visits to Washington and sending samples of products to Food and Drug Administration, Washington, for analysis and approval.
6. Where necessary, change designs of labels, formulas and possibly product names to meet United States Food and Drug and other regulations.
7. Investigate United States Customs Regulations for the purpose of obtaining a written ruling from the Treasury Department -- Bureau of Customs, as to tariff classification and basis for valuation of our various products for duty purposes. This required visits to the office of the appraiser, Bureau of Customs, Buffalo, N.Y., and to Washington -- as well as much written and telephone correspondence.
8. Study Canadian duty drawback regulations and establish internal procedure for claiming drawback if applicable. Drawback can mean the difference between profit or loss in some lines.
9. Determine policy re geographical distribution -- that is, whether on national or regional basis. This required a thorough study of freight rates, type of carriers available, climatic conditions as our product is perishable, as well as some study of state and federal regulations.
10. Determine method of distribution -- in our case at the moment, franchised wholesalers. Seek out and appoint distributors."

And the result? To quote, "Our first year's business exceeded expectations and we see no reason .... why our longer term expectations should not also be fulfilled."

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

INTERNATIONAL BUSINESS: WHAT IS THE BEST STRATEGY?<sup>+</sup>

by

M. Y. YOSHINO

<sup>+</sup> From: The Business Quarterly, Fall, 1966, pp. 46 - 55.



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INTERNATIONAL BUSINESS: WHAT IS THE BEST STRATEGY?\*

By M. Y. Yoshino

ONE OF THE MOST significant business trends today in advanced industrial nations is an increasing internationalization of business activities. A number of major corporations throughout the world are now committed to full-scale, long-term participation in the intense, sophisticated rivalry of world enterprise. Far-sighted business executives no longer limit their horizons to opportunities in the domestic market; they have begun to evaluate alternative opportunities for development of their corporate resources on a global basis.

In the last decade, a basic change has occurred in the character of international business, which up to that time had been traditionally an export-import type of operation. An increasing number of firms are undertaking local manufacturing either through licensing arrangements or through direct investments. This development has created new opportunities as well as problems for top management. International business now accounts for an important share of the business of many large corporations throughout the world and requires the full-time attention of first-rate executives and staff. It can no longer be managed successfully by second-rate executives nor can it be treated as an adjunct by executives whose responsibilities lie elsewhere.

Recently I undertook a study to investigate the process whereby a firm evolves from a domestic organization, serving a relatively homogeneous home market, to an international corporation, serving a large number of diverse multinational and cultural markets. The study sought to examine the degree to which a firm's expansions into international markets are deliberately planned as an integral part of the firm's long-range corporate goals and strategy.

The main objectives of the study were to identify patterns and recurring problems in current practices in this area and to suggest some useful guidelines to those firms that are contemplating expansion overseas. Data were gathered through intensive interviews with executives of twenty-five major North American corporations with large international commitments. These firms represented the following industries: chemical, automobile, pharmaceutical, home appliance, electronics, food and farm equipment.

\*From: The Business Quarterly, Fall, 1966, pp. 46-55.



The study has revealed that:

- . In spite of much current interest in international business, an overall policy to guide a firm's entry into foreign markets has been generally lacking. The failure to develop long-range international objectives prior to moving overseas has resulted in many unsuccessful foreign ventures.
- . Decisions relating to entry into foreign markets are complicated by many variables, the counterparts of which are not found in decisions relating to entry into new domestic markets. These variables must be explicitly recognized and reflected in the firm's international business policy.

#### Consequences of Lack of Planning in Entering Foreign Markets

In the majority of firms studied, international business has evolved over a period of time without a deliberate policy guidance established by top management. Typically, a firm's foreign business began in the form of export sales in response to inquiries from distributors overseas. Export sales were traditionally handled by export managers, whose status in most organizations was nothing more than that of glorified shipping clerks. As the firm's foreign markets grew, it began to encounter difficulties in supplying these markets through export operations because of a variety of import restrictions imposed by the foreign governments. Management, faced with the alternatives of abandoning the market or undertaking local production, usually chose the latter course. In most cases, this decision was delayed as long as possible because of management's reluctance to make a large commitment overseas.

In some cases, the initial inducement for direct investment overseas came from a local distributor who saw the benefits of establishing a more permanent tie with the foreign firm in the form of a joint venture. Occasionally a local distributor may have been motivated by fear of losing the market if a competitor succeeded in persuading his foreign supplier to establish local production facilities first.

What are the consequences of a lack of over-all planning for entry into foreign markets? First, lack of planning usually leads to sub-optimum deployment of corporate resources overseas and a consequent loss of the potential benefits of multi-national operations. An important advantage of multinational business as contrasted with purely domestic operations is that it provides management with the broadest possible dimension of enterprise in which to take full advantage of worldwide investment opportunities that offer the highest returns.

However, this strength can be realized only when alternatives are systematically examined and compared on a global basis. For example:

Senior executives of a large pharmaceutical firm still held an opinion that foreign investment projects were inherently riskier than domestic ones. Thus they favoured domestic investment projects over their international counterparts. The firm's International Division was allocated every year a certain percentage of the total fund available for new investments, so that, according to one senior executive, "safer" domestic investments did not have to compete against "glamorous" but "riskier" international projects. Furthermore, International Division lacked a clear-cut policy to guide allocation of its fund between projects for expanding existing facilities and those for entering new markets. Thus, decisions concerning allocation of corporate resources within International Division were reached primarily through "negotiations" among various interest groups. One executive, having noted the inadequacy of this method, commented, "We take a great pride in being an international company, but we are far from achieving optimum allocation of our resources on a global basis."

Secondly, lack of planning indicates ignorance of timing as a critical element in achieving successful entry into foreign markets. Unless a firm can time its entry properly, there is a possibility that it will be excluded from certain promising markets permanently. The reason for this exclusion is that the first firm which undertakes local production can often negotiate with the host government for preferred treatments and special concessions, including a provision to make subsequent entry into the market by competitors extremely difficult, if not impossible.

Even without these negotiated benefits, the first entrant can often enjoy decided advantages over potential competitors because of the need for a long lead time to initiate a foreign venture and to build a viable position in the market. The following example is illuminating:

A manufacturer of industrial equipment had for a long time followed implicitly a policy of undertaking local production only when it was forced upon it by competitive pressure or actions of the host government. When the management became aware that the company was being squeezed out of some promising markets because of this policy, it reversed its position and began to seek actively opportunities for direct investment overseas. A senior executive of the firm noted that the company was experiencing considerable difficulties in regaining the lost ground because it was virtually locked out of some

markets due to governments' concessions granted to earlier entrants, while in others competition was too entrenched for the firm to develop a viable position.

The fact that a firm cannot simultaneously enter every promising market in the world creates a need for establishing a priority ranking to allow a systematic approach to develop these markets over a period of time.

Thirdly, lack of planning tends to restrict the flexibility of a firm's subsequent operations. For example, in some firms studied, earlier licensing agreements or exclusive distribution rights had seriously hampered their subsequent expansions overseas. Such firms have found it impossible to establish their own production facilities in certain markets to take advantage of rapidly growing opportunities because of exclusive licensing agreements made earlier without careful examination of their consequences. It is no comfort to the management of these firms to know that their licensees are developing a highly profitable business in these markets, while their own returns are limited to a small royalty.<sup>1</sup>

A large manufacturing firm had relied exclusively on licensing route to enter rapidly growing markets in the Western Europe and Japan because top management of the firm believed that licensing allowed the firm to enter foreign markets with minimum commitment of resources, while enjoying a guaranteed level of return. As the time went on, however, the management became aware that many licensees overseas had developed extremely profitable business based on the licensed know-how, while the licensor's participation was limited to only a negligible royalty. The management belatedly realized that direct investment route would have been much more suitable in entering these growth markets. The firm's position would have substantially improved, even under licensing agreements, had it insisted on equity participation rather than a straight royalty arrangement, in return for its technical know-how.

A related difficulty to lack of planning is the selection of partners, if the ownership of a contemplated venture is to be shared with local interests. If a firm undertakes direct investment as a result of continuing pressure from a particular local interest, such as a distributor or licensee, it becomes in a sense, a captive of that local group and loses the freedom to search for alternative candidates for partnership. Many firms have learned at considerable expense that a satisfactory relationship in one form of collaboration does not guarantee success under a different type of arrangement. For example, a distributor who has had outstanding success in export operations has not necessarily proved to be an effective partner in manufacturing ventures.

Finally, ill-planned market entry is likely to lead to numerous operating problems after the foreign venture gets under way. Lacking a policy to guide its move overseas, a firm may postpone the decision to enter a given market until the last moment, thereby creating further problems.

#### Host of Problems Face Management

Once a decision is made to enter a foreign market, management faces a host of complex problems: it must investigate the political climate, satisfy legal requirement, undertake complicated financial transactions, or negotiate with the local government. Being preoccupied with these problems, management is often tempted to postpone examination of such important considerations as cost structure, competitive strength, distribution program, product policy, and capital requirements of a new venture until the operations get under way. Frequently, management assumes that each of these problems can be resolved as it arises after the overseas venture is in operation. Unfortunately, this assumption has proved false on many occasions. For example:

A leading manufacturer of consumer durable goods became impressed with rapid postwar growth in the Japanese market and was anxious to beat its competitors in establishing its operations there. The firm hurriedly negotiated with a local firm to form a joint venture, sought successfully an approval of the Japanese Government and immediately began constructing a new plant. The management felt that once it established its foothold in the market it could then devote its attention to various operating problems. When the operations got underway, the management was surprised to learn that it faced serious operating problems resulting from stiff local competition, intricate web of business relationship governed by tradition and difficulties of breaking into the well entrenched distribution system. The management found it difficult to correct these problems and was forced simply to live with them. The performance of the subsidiary remained at a level substantially below what the parent company had expected it to be.

#### DEVELOPING A POLICY FOR INTERNATIONAL OPERATIONS

The foregoing considerations indicate an acute need for establishing a policy to guide a firm's entry into international markets. Given diverse and rapidly changing conditions overseas and the risks inherent in international ventures, this need cannot be overemphasized. The policy must clearly identify the firm's international goals and how these goals are to be achieved. How, then, can a firm formulate such a policy? What important considerations must a firm weigh prior to moving abroad? The most basic question that top management must consider can be stated simply, "Should the firm go 'international'?" Only when this



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question is satisfactorily answered is management ready to proceed to examine the "where," "when," and "how" aspects of entry into foreign markets. In view of the abundant opportunities existing in many foreign markets, such a question may seem irrelevant. However, it is important to recognize that attractiveness of market opportunities overseas varies widely among industries as well as among individual firms. There is also a wide variation in the abilities of individual firms to exploit foreign markets successfully. Not every firm can build successful operations abroad. Some are likely to find it more profitable to deploy their limited resources in more intensive development of familiar domestic markets than to make extensive commitments overseas. In evaluating the appropriateness of entry into foreign markets, a management should:

- (1) Assess opportunities in international markets for its products and technology as well as the potential risks associated with these opportunities.
- (2) Examine the degree to which the firm can develop potential opportunities abroad in the light of its own organizational and managerial competence.

In assessing the opportunities and threats posed by foreign markets, management is faced with a vast array of nations and societies. An accurate analysis is hampered by the unreliability, or total absence, of critical statistical information in many parts of the world. Management, being unfamiliar with conditions overseas, may find it difficult to understand the true implications and significance of whatever data are available. The task is further complicated by rapid changes occurring in economic and social environments throughout the world.

Despite these apparent difficulties, three alternative methods of making organized, objective country-by-country surveys of opportunities exist. One method is to require each domestic product division or group to identify opportunities overseas for its respective sphere of activities. This method is particularly useful for a firm whose operation consists of technically oriented product lines, where technical knowledge is essential in recognizing and assessing market opportunities. The limitations of this method are that domestic executives may be too pre-occupied with managing existing operations, or that they may lack familiarity with foreign market conditions.

Another method of surveying foreign markets is to organize a company-wide committee or task force for this specific purpose. The committee is usually headed by a senior executive and consists of men from various functional and product groups. This method makes it possible to provide coordinated direction and a company-wide view in identifying opportunities overseas.

Finally, it is possible to enlist the services of an outside consultant to undertake a survey. The advantages and limitations that are usually associated with employment of outside consultants apply equally well in this case.

If a well-directed search reveals promising potential markets overseas for the company's products and technology, management must then determine if the existing organization has the real or potential capacity to capitalize on these opportunities. Unfortunately, there is a widespread assumption that any sizable firm possesses the necessary skills for dealing with international business problems or that it can readily obtain the needed skills and resources. When the complexity of international business is understood, the fallacy of this assumption will be readily seen. In multi-national operations, the managerial task must be performed in diverse economic, cultural, political, technological and legal systems. Far-flung foreign affiliates must be continuously supported by the financial, technological, and human resources of the corporate headquarters. Time-consuming and often frustrating negotiations with foreign governmental officials must be conducted. Top management must also establish and maintain long-term collaborative relationships with foreign executives whose cultural backgrounds, ethical standards and value systems may differ substantially from their own view.<sup>2</sup>

In view of these complexities, it is well for management to examine objectively its own competence. Furthermore, risks inherent in international ventures must be clearly recognized. Since the ability and willingness to take risks varies widely among executives, management should carefully assess the degree of risk associated with opportunities abroad and determine if it is acceptable in terms of both the organizational goals and personal orientations of top management.

#### Developing an International Business Strategy

If a firm decides to "go international" based on the preceding analysis, management must develop a strategy to meet this objective. At the risk of oversimplification, I shall single out five major issues that top management must consider in formulating a strategy to achieve successful entry into foreign markets. These considerations are:

- 1) definition of the basic perimeter of the firm's international activities,
- 2) selection of markets,
- 3) alternative routes of entry into foreign markets,
- 4) alternative methods of market entry,
- 5) ownership policy of foreign ventures.

# 1. Definition of the Basic Perimeter

Each of the market opportunities identified by the initial survey must now be reviewed carefully to measure its relative attractiveness and risks. Thorough investigation of a foreign market is time-consuming and costly. Thus, before undertaking a comprehensive study of each potential market, the basic perimeter of the firm's international business must be clearly established by top management.

The two major steps discussed earlier - survey of opportunities and assessment of internal resources and competence - should provide useful guidelines in this attempt. In defining the character of the firm's international business, the following questions must be answered.

- Regional Specialization: Should the firm limit its international activities to certain geographic regions of the world? Or should it become truly global, as long as entry is justified by market opportunities?
- Time Span: Over what time period should the firm plan its strategies for foreign market entry? Can the firm effectively time-phase its entry into various markets? The decision is complicated by two basically conflicting pressures - rapidly changing conditions overseas, and the need for a long lead time to implement entry into a foreign market.
- Relative Extent of Foreign Commitments: Should the management impose some restrictions on the extent of commitments it is willing to consider in a given market? A project below a certain economic size is not worth undertaking, yet it may be wise to place some limit on the size of the firm's commitment in each market in order to diversify the risks.
- Degree of Operating Flexibility: To what extent is the management willing to adjust the firm's product designs or processing to differing requirements of foreign markets? To what extent is the management willing to deviate in its overseas ventures from the basic character of its domestic business?

Careful examination of each of these issues would considerably limit the scope of potential opportunities to be investigated in detail. For example, one firm included in this study concluded from a similar analysis that it should concentrate its initial overseas efforts in establishing itself firmly in the countries of the European Common Market. Another firm has discovered that opportunities for its products existed practically all over the world. To facilitate further analysis



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however, the firm divided those potential markets into three categories, according to levels of economic development and of political stability. The first group consisted of those markets that are found in industrial countries with stable political conditions. The second group included markets in underdeveloped but politically stable countries. The third group represented economically underdeveloped and politically unstable markets. The firm has subsequently decided to time-phase its approach to these markets by beginning with those in the first category. Meantime, the management is closely watching dynamic developments in markets of the second and third categories.

## 2. Selection of the Markets

In investigating the relative attractiveness of potential markets, four considerations are important:

- 1) the size of the market,
- 2) conditions and structure of a particular industry in each market,
- 3) the degree of risk associated with each,
- 4) the attitude and policy of the host government toward foreign ventures.

The procedure involved in estimating the potential size of a foreign market is basically the same as the one commonly followed in domestic operations, allowing for extra complications introduced by the absence of accurate data and rapid environmental changes.<sup>3</sup> Though the desired level of precision and accuracy may be difficult to achieve, it is usually possible to obtain useful benchmarks to allow meaningful comparisons among various alternatives.

Management must then analyze the environment in which a particular industry operates in each country. In entering a foreign market, a firm faces a new industrial constellation where competitive conditions are likely to differ from those found in the home market. Thus, a new entrant must carefully examine the limits within which it must operate in a particular industrial environment, and must identify the means of competition. Management can then assess the degree to which the firm as a new entrant can satisfy the requirements imposed by the adapted industrial environment and what strategy it should pursue to compete effectively with those domestic and foreign firms which already possess broad established bases of operations.<sup>4</sup>

The third variable to be examined is the degree of risk associated with each alternative market. Because of a wide diversity in environmental forces, the risk level is likely to differ substantially among various markets. Consequently, the attractiveness of a particular

market becomes meaningful only when the risk level is properly considered. Basically, risks in international operations can be classified into four categories - political, economic, operational, and ownership. Political risks range from minor bureaucratic harrassment to outright expropriation. Economic risks, though often difficult to separate from political risks, may take the form of unstable currency, a poor foreign exchange position, a galloping inflationary trend, or a shifting government economic policy.

Operational risks arise from certain inadequacies in indigenous technological and institutional systems and from the scarcity of essential resources needed for the smooth functioning of an industrial enterprise. Such risks include the absence of various forms of economic and financial institutions, of reliable sources of supply of raw materials, and of local managerial and technical talents.

In some countries ownership of a foreign venture must be shared with a local interest, which also has elements of risk. Though participation of local interests in a foreign venture decreases the political vulnerability of the enterprise, it results in dilution of control over key managerial decisions.

Some of the risks mentioned above, particularly those of a political nature, can be reduced substantially by deliberate action on the part of management. Here, the fourth consideration, the attitude of the host government toward foreign ventures must be examined. It is possible to reduce potential risks by negotiating for specific guarantees and concessions from the host government at the time of entry into the foreign market. Some governments are willing to grant special considerations to foreign firms if their activities are deemed beneficial to the welfare of the host country.

A more permanent way to reduce political and economic vulnerability is to so structure and manage a foreign venture that the long-term interest of the host country is integrated with that of the investing firm. In any case, the attitude of the host government toward foreign investments is the decisive factor. Thus, the government's real attitude as well as its proclaimed position toward foreign investment should be carefully studied.

Having considered these four elements in each of the potential markets, management can now assign a rough priority ranking to each one. By this means, the potential foreign markets may be surveyed in order of importance. However, this ranking must be adjusted by competitive conditions. The real or potential threat of actions by competitors in certain markets may force management to consider shifting the priority among the potential markets, whenever there is a danger that the first entrant into a specific foreign market can effectively block the subsequent entry of others.

### 3. Exploring Alternative Routes of Market Entry

When a market is selected for entry, management must decide how to enter this market most effectively. Basically, entry into a foreign market can be achieved by three alternatives - exporting, contractual arrangements and direct investment. An understanding of the advantages and potential hazards of each alternative and flexibility in using each are vital to the long-term success of an international business.

Traditionally, export has been used most frequently in reaching foreign markets. It involves less risk and a smaller managerial and financial commitment than either of the other two methods. Furthermore, for certain types of products where economy of scale is critical in the production process, an exporter may conceivably enjoy competitive advantages over local procedures despite transportation charges and tariffs.

Exporting, however, has several decided disadvantages. It is impossible to reach many parts of the world through the export route because of various import restrictions. The method is most vulnerable to restrictive measures if a competitor decides to undertake local production in a given market. In fact, under some circumstances, exporters may be completely frozen out of the market. Another disadvantage is that exporting offers limited potential for those products that require intensive marketing effort, product adaptation, promotions, and customer services.

A popular alternative to exporting is contractual arrangements of various types, such as licensing, contract manufacturing and management contract. While they cover a wide spectrum of activities, there is one common feature, that is the scope and coverage of a given arrangement is specified by a contract both in terms of time period and services rendered. Licensing allows a firm to enter a foreign market quickly, and to take advantage of the existing organization, managerial and technical personnel, and marketing organization of a licensee. As a rule, approval of the host government can be obtained much more quickly for licensing than for direct investment. Licensing also requires relatively little financial and managerial commitment from the licensor. Furthermore, it helps overcome that nationalistic barriers commonly raised against exporting operations.

Licensing, however, has several major limitations. Because of its contractual nature, licensing limits the time period during which a firm can operate in a given market. If a firm wants to renew licensing arrangements indefinitely, it should realize that a continued representation in a foreign market depends upon its ability to generate new technology. There is a potential danger that a licensee may become a strong competitor in the market when the agreement expires. Practical considerations often prevent a licensor from exercising control over production and marketing of licensed products. Perhaps the most serious limitation is that straight licensing, by its very nature, is not suited to long-term development of a foreign market.<sup>5</sup>

Manufacturing contract allows a firm to undertake local manufacturing by using existing facilities of a local firm through contractual agreements. There are some obvious advantages to this method of operations. The contracting firm can avoid a heavy investment in establishing its own manufacturing facilities. It also enables the firm to enter a foreign market quickly. For this reason, some firms have used it as a temporary measure, while their own plants are being constructed in the market. Moreover, unlike licensing where both production and marketing aspects are tied in a package, manufacturing contract allows the firm to undertake its own distribution in the country. In some cases, the contracting firm can negotiate an extremely attractive arrangement because a local firm may have excess capacity it is anxious to utilize or it can benefit from a greater scale of production. There are, however, several major disadvantages. The firm may find it difficult to locate a suitable manufacturer who is not only willing but also capable of manufacturing the firm's products under its specifications. Quality standard has been found particularly difficult to enforce. Furthermore, the firm may be reluctant to share its manufacturing know-how with a foreign firm.

Management contract makes it possible to capitalize on firm's managerial know-how by agreeing to provide a foreign venture with managerial talents. It enables the firm to obtain operating control of a venture without making large equity investment. Moreover, the contractual nature of this arrangement tends to ease local resentments which may otherwise result from an attempt to assume managerial control of a foreign venture through other means.

Management contract is frequently welcomed by a foreign firm as well as the government of the host country, inasmuch as it brings to the country managerial know-how, one of the most critical and scarce resources in most developing countries. Management contract can provide needed managerial support to a new venture until the local management is trained. From the point of view of a contracting firm, however, management contract has two main limitations. First, since managerial effectiveness depends, in part, upon local environments, there is no guarantee that managerial practices developed in one country can be applied in another with equal effectiveness.<sup>6</sup> Secondly, managerial talents are scarce in almost any parent corporation, thus providing a foreign firm with managerial support for a fixed fee may not be the best use of the firm's scarce resources.

The third method of entering a foreign market is by direct investment. While the specific nature of commitment may vary from simple assembly set-up to fully integrated manufacturing operations, the direct investment route enables a firm to combine its technical, managerial, and financial resources for a long-term development of a foreign market. Only in this way can profits be earned on the full range of operations involved, and full advantage be taken of the local wage and salary level. Furthermore, the firm can benefit from various



incentives made available by the host country. It must be recognized that the direct investment route requires an extensive commitment of corporate resources, thereby making the firm more vulnerable to economic and political risks. Furthermore, a long lead time and much development effort are usually required before the operations become profitable.

The suitability of each form of entry must be analyzed carefully in terms of the conditions of a particular market. There are, however, general guidelines in selecting a particular form of market entry. First, the three routes should be viewed as alternatives rather than a sequence of developments to be followed. Some firms pursue implicitly the practice of a step-by-step approach in developing a foreign market. They begin supplying a market through the export route first and consider local production only when export sales have reached a sufficient volume or when the market can no longer be supplied through exporting.

While this practice has the advantage of minimizing risks, it has often resulted in the loss of promising markets or in forfeiture of rapid growth opportunities. There is no reason why a firm should pursue the policy of a stage-by-stage development, when direct investment is justified right from the start by the local investment climate and the capacity and commitment of a particular firm. In fact, at times an early and large scale entry in the form of direct investment is the only way a firm can build a viable position in a foreign market. This is particularly true for those industries manufacturing capital intensive products.

Thus, if any firm confines itself, by default, to any one of the three routes, it is severely limiting its opportunities in a foreign market. There is, however, perceptibly inflexible attitude among the firms studied toward devising an appropriate entry strategy to meet the particular requirements of the market under consideration.

Secondly, these three routes of market entry are by no means mutually exclusive. Frequently they must be integrated to enable a firm to penetrate a foreign market. Such an integrated approach is particularly applicable for a diversified firm whose multiple product lines are likely to require different entry strategies. For example, a firm may follow the licensing route of entry for products with a limited or specialized market, or for products or processes expected to have a relatively short economic life. It can simultaneously establish a local base of production in the market for its major product lines. Furthermore, the firm can export certain types of products to the market to supplement the product lines of the local manufacturing or licensing operations.

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Another important consideration in choosing among alternative routes of market entry is to examine the firm's objectives with respect to a market under consideration. As has been pointed out earlier, the initial decision on the form of entry has far-reaching implications on subsequent operations in the market.

Finally, it is important to review periodically the suitability of a particular form of operation in a given market because changes in the operating climate and regulations governing the activity of foreign companies can rapidly alter the applicability of any one of the alternatives for a given company or a category of products.

#### 4. Evaluating Alternative Methods of Entry - Acquisition vs Initiating New Ventures

If a direct investment route is chosen, management has the choice of either initiating its own venture or acquiring an existing foreign concern. Some quite successful multinational firms rely almost exclusively on acquisition in entering foreign markets.

The proponents of acquisition claim that it allows timely entry into a market with relative ease. If a firm has to initiate its own venture, a year or two of intensive developmental effort is usually required before the affiliate becomes productive. Through acquisition, however, the investing firm can take advantage of managerial talents, technical resources, and the labor force of the acquired company, thus avoiding some of the major difficulties of starting a foreign venture. Qualified, experienced managers and technicians are extremely scarce overseas. The labor market for non-managerial personnel is becoming increasingly tight also in most highly industrialized countries, and in underdeveloped areas much initial investment is needed to train the indigenous labor force. An acquiring firm can also take over the existing distribution network and goodwill among distributors and ultimate customers cultivated by the acquired firm over a period of time. Acquisition also can reduce high risks usually associated with foreign ventures because an acquired firm possesses familiarity with the particular industrial environment and competitive conditions in the market.

The limitations of acquisition are as follows: First, the potential firms to be acquired may be non-existent or alternatives may be severely limited. Second, acquisition may arouse nationalistic resentment in the host country against the investing firm because the action may be interpreted as a local firm being taken over by a foreign interest. Aside from the emotional overtones connected with acquisition, some foreign governments that are anxious to obtain new manufacturing facilities and technology through foreign investment may take discriminatory actions against the firms choosing this manner of entry. Thus, a firm considering entry into foreign markets through acquisition is usually in a weaker position to negotiate with the host government than one planning to establish a new operation.

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Some of the frequently cited advantages of acquisition should be examined carefully. For example, the time-saving feature of acquisition is not universally applicable. Location and evaluation of potential candidates for acquisition are often time-consuming processes. Negotiations may extend over a long period of time.

Advantages associated with taking over an existing organization and managerial personnel are, in part, offset by the problems of integrating the acquired firm and its management personnel into the parent organization. The process of integration is complicated by basic differences in managerial philosophy and orientation arising from cultural and environmental variations, and the climate of insecurity found in most acquired firms. In choosing between the two alternative methods of undertaking direct investment, the general considerations presented here should be used as guidelines for careful analysis of each specific case.

#### 5. Determining Ownership Policy

In making direct investments overseas, management faces another important decision, that is, it must determine the firm's policy toward ownership of foreign ventures. The ownership pattern of a foreign venture can range from no equity (i.e. only a contractual relationship and/or debt financing), minority ownership, 50-50 split, majority to one hundred percent ownership. An investment firm can obtain equity participation in a foreign venture through a variety of ways, such as through contributions in cash, technical assistance, used equipment, brand names, managerial know-how, and stock of the investing firm. Combinations of any one of these alternatives is entirely possible. In fact, some of the most intricate financial arrangements are known to have been employed in acquiring equity in a new foreign venture.

Though the participation of local interest in foreign ventures is required in some countries such as India, Mexico and Japan, management has considerable flexibility in determining ownership patterns in other important markets, including those in the European Common Market.

There is a wide diversity in managerial attitudes toward ownership of foreign ventures. Some firms insist on, or at least prefer, complete ownership of their ventures, while others actively seek the participation of local interests in theirs. Although there are various ramifications to the ownership issue, the basic choice lies between total ownership and joint ventures. The advantages and limitations of each choice deserve careful attention.

The chief advantage of total ownership is that it assures a greater degree of managerial control over a foreign venture than is possible under a joint venture arrangement. The firm can enforce its own policy and standards in such key areas as financial management, product quality, selection of managerial personnel, and the disposition of profit. With total ownership, the basic conflicts of interests often found in joint ventures are avoided.



Under joint ownership, differences in managerial orientation and corporate objectives often cause disagreements over basic policy. Such disagreements may lead to vacillation and inability to develop a unified policy or to the emergence of a dominant partner. Joint ventures, particularly those with evenly divided ownership, are inherently difficult to manage. There is also a risk in associating with a local firm in a politically unstable country. When a political upheaval occurs, it is possible that the chosen partner may fall out of favour with a new government, thereby damaging the investing firm.

What then are the potential benefits of a joint venture? One important benefit is the reduction of risk. The arrangement allows a firm to enter a foreign market with a substantially smaller initial capital outlay than would be possible otherwise. Furthermore, by working with a local partner the investing company can realize a threefold benefit. First, it would acquire a staff that would otherwise take a long time to develop. Second, it would acquire knowledge of local business practices that could otherwise be obtained only by costly trial and error or time-consuming analyses. Finally, it would gain ready access to the government and business community. The investing firm can benefit from the local partner's carefully developed associations in such areas as government relations and banking connections. Thus, the system of joint ventures provides, at least in theory, an effective combination of the managerial and technological resources of the investing firm with the distinctive competence of the local partner. Moreover, joint ventures are likely to be favoured by the host government as well as by the industrial community in the host country.

If the firm chooses to pursue the policy of one hundred percent ownership of its foreign ventures, it must be aware that such a venture is likely to be vulnerable to pressures and resentments of various sorts in the host country. This is particularly true in developing nations, where the past record of Western enterprises has been far from impeccable. Thus, the firm must be prepared to reduce this vulnerability and conflicts by finding a mutuality of interest between the host country and the firm through deliberate managerial planning and actions.

There are several ways that a firm can effectively contribute to the interest of the host country other than by sharing ownership of an enterprise with indigenous interests. The investing firm can turn over a considerable share of management responsibility to local nationals; it can continuously support the venture by feeding new technical knowledge and discoveries; it can develop local managerial skills and reinvest savings in the host country.

If the firm chooses to pursue the joint venture route, it must determine with whom ownership is to be shared. The most common way to share ownership of a contemplated venture with an established local firm (or firms). In this case, choice of a local partner (or partners) becomes an extremely important decision. In evaluating a

potential partner firm, management should go far beyond examination of its financial, technical and managerial capacities. The investing firm should analyze the local firm's hidden commitments to other firms through banking connections, cartel arrangements, or family relations. Most importantly, the investing firm should understand clearly what objectives the local firm wants to pursue and what it expects out of the contemplated venture.

Another way to share ownership is to obtain a part of the equity in a new venture from the local capital market in the host country. For example, when Kaiser Motors established its venture in Argentina, it sold approximately a third of its equity to private investors in the country.<sup>8</sup> This method has an advantage of diffusing benefits derived from the venture directly among a wider segment of the population. A broader ownership participation also tends to reduce political vulnerability of a foreign venture. Moreover, it enables the investing firm to obtain operating control with relatively limited equity participation. There are some basic problems, however. Frictions may arise between the management and local stockholders because expectations of local stockholders may differ rather markedly from those of the management. More basically, this method is impractical in many countries where an adequate capital market is yet to be developed.

The concept of shared ownership can be carried to the ultimate form by offering local investors opportunities to buy equity in the parent firm, thus creating a truly internationally owned corporation. While this represents the idealized form of a true multinational corporation, there are a number of practical constraints to prevent immediate application of this concept to a significant degree.<sup>9</sup>

#### FOOTNOTES

<sup>1</sup>Michael Y. Yoshino, "Marketing Orientation in International Business," Business Topics, Vol. 13, No. 3, Summer 1965, p. 61.

<sup>2</sup>For illuminating discussion of intercultural administrative problems, see John Fayerweather, The Executive Overseas (Syracuse, N.Y.: Syracuse University Press, 1959) 182 p.

<sup>3</sup>Boyd, Frank, Massy and Zoheir, "Marketing Research in Emerging Economies," Journal of Marketing Research, Vol. 1, No. 4, pp. 20-23.

<sup>4</sup>Ralph Hodgson and Hugo Uytterhoeven, "Analyzing Foreign Opportunities," Harvard Business Review, Vol. 40, No. 2 (March-April, 1962) pp. 60-79.

<sup>5</sup>Charles Henry Lee, "How to Reach the Overseas Market by Licensing," Harvard Business Review, Vol. 36, No. 1, (January-February, 1958). pp 77-80.

<sup>6</sup>Richard N. Farmer and Barry M. Richman, Comparative Management and Economic Progress (Homewood, Illinois: Richard D. Irwin, Inc., 1965,) pp 1--24.

<sup>7</sup>Richard D. Robinson, International Business Policy, (New York: Holt, Rinehart and Winston, 1964) pp 99-145.

<sup>8</sup>John E. Ewing and Frank Meissner, International Business Management: Reading and Cases Belmont, California. Wadworth Publishing Co., 1964, p. 506.

<sup>9</sup>John Fayerweather, "LRP for International Operations," California Management Review, Vol. 3, No. 2, (Fall, 1960) p. 24.

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

THE SILENT LANGUAGE IN OVERSEAS BUSINESS<sup>+</sup>

by

EDWARD T. HALL

<sup>+</sup> From: Harvard Business Review, May-June, 1960, pp. 87-96.

## THE SILENT LANGUAGE IN OVERSEAS BUSINESS\*

By Edward T. Hall

With few exceptions, Americans are relative newcomers on the international business scene. Today, as in Mark Twain's time, we are all too often "innocents abroad," in an era when naiveté and blundering in foreign business dealings may have serious political repercussions.

When the American executive travels abroad to do business, he is frequently shocked to discover to what extent the many variables of foreign behavior and custom complicate his efforts. Although the American has recognized, certainly, that even the man next door has many minor traits which make him somewhat peculiar, for some reason he has failed to appreciate how different foreign businessmen and their practices will seem to him.

He should understand that the various peoples around the world have worked out and integrated into their subconscious literally thousands of behavior patterns that they take for granted in each other. Then, the stranger enters, and behaves differently from the local norm, he often quite unintentionally insults, annoys, or amuses the native with whom he is attempting to do business. For example:

-In the United States a corporation executive knows what is meant when a client lets a month go by before replying to a business proposal. On the other hand, he senses an eagerness to do business if he is immediately ushered into the client's office. In both instances, he is reacting to subtle cues in the timing of interaction, cues which he depends on to chart his course of action.

Abroad, however, all this changes. The American executive learns that the Latin Americans are casual about time and that if he waits an hour in the outer office before seeing the Deputy Minister of Finance, it does not necessarily mean he is not getting anywhere. There people are so important that nobody can bear to tear himself away; because of the resultant interruptions and conversational detours, everybody is constantly getting behind. What the American does not know is the point at which the waiting becomes significant.

In another instance, after travelling 7,000 miles an American

walks into the office of a highly recommended Arab businessman on whom he will have to depend completely. What he sees does not breed confidence. The office is reached by walking through a suspicious-looking coffeehouse in an old, dilapidated building situated in a crowded non-European section of town. The elevator, rising from dark, smelly corridors, is rickety and equally foul. When he gets to the office itself, he is shocked to find it small, crowded, and confused. Papers are stacked all over the desk and table tops—even scattered on the floor in irregular piles.

The Arab merchant he has come to see had met him at the airport the night before and sent his driver to the hotel this morning to pick him up. But now, after the American's rush, the Arab is tied up with something else. Even when they finally start talking business, there are constant interruptions. If the American is at all sensitive to his environment, everything around him signals, "What am I getting into?"

Before leaving home he was told that things would be different, but how different? The hotel is modern enough. The shops in the new part of town have many more American and European trade goods than he had anticipated. His first impression was that doing business in the Middle East would not present any new problems. Now he is beginning to have doubts. One minute everything looks familiar and he is on firm ground; the next, familiar landmarks are gone. His greatest problem is that so much assails his senses all at once that he does not know where to start looking for something that will tell him where he stands. He needs a frame of reference—a way of sorting out what is significant and relevant.

That is why it is so important for American businessmen to have a real understanding of the various social, cultural, and economic differences they will face when they attempt to do business in foreign countries. To help give some frame of reference, this article will map out a few areas of human activity that have largely been unstudied.

The topics I will discuss are certainly not presented as the last work on the subject, but they have proved to be highly reliable points at which to begin to gain an understanding of foreign cultures. While additional research will undoubtedly turn up other items just as relevant, at present I think the businessman can do well to begin by appreciating cultural differences in matters concerning the language of time, of space, of material possessions, of friendship patterns, and of agreements.

### LANGUAGE OF TIME

Everywhere in the world people use time to communicate with each other. There are different languages of time just as there are different spoken languages. The unspoken languages are informal; yet the rules governing their interpretation are surprisingly ironbound.

In the United States, a delay in answering a communication can result from a large volume of business causing the request to be postponed until the backlog is cleared away, from poor organization, or possibly from technical complexity requiring deep analysis. But if the person awaiting



the answer or decision rules out these reasons, then the delay means to him that the matter has low priority on the part of the other person-- lack of interest. On the other hand, a similar delay in a foreign country may mean something altogether different. Thus:

-In Ethiopia, the time required for a decision is directly proportional to its importance. This is so much the case that low-level bureaucrats there have a way of trying to elevate the prestige of their work by taking a long time to make up their minds. (Americans in that part of the world are innocently prone to downgrade their work in the local people's eyes by trying to speed things up.)

-In the Arab East, time does not generally include schedules as Americans know and use them. The time required to get something accomplished depends on the relationship. More important people get fast service from less important people, and conversely. Close relatives take absolute priority; nonrelatives are kept waiting.-

In the United States, giving a person a deadline is a way of indicating the degree of urgency or relative importance of the work. But in the Middle East, the American runs into a cultural trap the minute he opens his mouth. "Mr. Aziz will have to make up his mind in a hurry because my board meets next week and I have to have an answer by then," is taken as indicating the American is overly demanding and is exerting undue pressure. "I am going to Damascus tomorrow morning and will have to have my car tonight," is a sure way to get the mechanic to stop work, because to give another person a deadline in this part of the world is to be rude, pushy, and demanding.

An Arab's evasiveness as to when something is going to happen does not mean he does not want to do business; it only means he is avoiding unpleasantness and is side-stepping possible commitments which he takes more seriously than we do. For example:

-The Arabs themselves at times find it impossible to communicate even to each other that some processes cannot be hurried, and are controlled by built-in schedules. This is obvious enough to the Westerner but not to the Arab. A highly placed public official in Baghdad precipitated a bitter family dispute because his nephew, a biochemist, could not speed up the complete analysis of the uncle's blood. He accused the nephew of putting other less important people before him and of not caring. Nothing could sway the uncle, who could not grasp the fact that there is such a thing as an inherent schedule.-

With us the more important an event is, the further ahead we schedule it, which is why we find it insulting to be asked to a party at the last minute. In planning future events with Arabs, it pays to hold the lead time to a week or less because other factors may intervene or take precedence.



Again, time spent waiting in an American's outer office is a sure indicator of what one person thinks of another or how important he feels the other's business to be. This is so much the case that most Americans cannot help getting angry after waiting 30 minutes; one may even feel such a delay is an insult, and will walk out. In Latin America, on the other hand, one learns that it does not mean anything to wait in an outer office. An American businessman with years of experience in Mexico once told me, "You know, I have spent two hours cooling my heels in an executive's outer office. It took me a long time to keep my blood pressure down. Even now, I find it hard to convince myself they are still interested when they keep me waiting."

The Japanese handle time in ways which are almost inexplicable to the Western European and particularly the American. A delay of years with them does not mean that they have lost interest. It only means that they are building up to something. They have learned that Americans are vulnerable to long waits. One of them expressed it, "You Americans have one terrible weakness. If we make you wait long enough, you will agree to anything."

Indians of South Asia have an elastic view of time as compared to our own. Delays do not, therefore, have the same meaning to them. Nor does indefiniteness in pinpointing appointments mean that they are evasive. Two Americans meeting will say, "We should get together sometime," thereby setting a low priority on the meeting. The Indian who says, "Come over and see me, see me anytime," means just that.

Americans make a place at the table which may or may not mean a place made in the heart. But when the Indian makes a place in his time, it is yours to fill in every sense of the word if you realize that by so doing you have crossed a boundary and are now friends with him. The point of all this is that time communicates just as surely as do words and that the vocabulary of time is different around the world. The principle to be remembered is that time has different meanings in each country.

#### LANGUAGE OF SPACE

Like time, the language of space is different wherever one goes. The American businessman, familiar with the pattern of American corporate life, has no difficulty in appraising the relative importance of someone else, simply by noting the size of his office in relation to other offices around him:

-Our pattern calls for the president or the chairman of the board to have the biggest office. The executive vice president will have the next largest, and so on down the line until you end up in the "bull pen." More important offices are usually located at the corners of buildings and on the upper floors. Executive suites will be on the top floor. The relative

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rank of vice presidents will be reflected in where they are placed along "Executive Row."

The French, on the other hand, are much more likely to lay out space as a network of connecting points of influence, activity, or interest. The French supervisor will ordinarily be found in the middle of his subordinates where he can control them. -

Americans who are crowded will often feel that their status in the organization is suffering. As one would expect in the Arab world, the location of an office and its size constitute a poor index of the importance of the man who occupies it. What we experience as crowded, the Arab will often regard as spacious. The same is true in Spanish cultures. A Latin American official illustrated the Spanish view of this point while showing me around a plant. Opening the door to an 18-by-20-foot office in which seventeen clerks and their desks were placed, he said, "See, we have nice spacious offices. Lots of space for everyone."

The American will look at a Japanese room and remark how bare it is. Similarly, the Japanese look at our rooms and comment, "How bare!" Furniture in the American home tends to be placed along the walls (around the edge). Japanese have their charcoal pit where the family gathers in the middle of the room. The top floor of Japanese department stores is not reserved for the chief executive--it is the bargain roof!

In the Middle East and Latin America, the businessman is likely to feel left out in time and overcrowded in space. People get too close to him, lay their hands on him, and generally crowd his physical being. In Scandinavia and Germany, he feels more at home, but at the same time the people are a little cold and distant. It is space itself that conveys this feeling.

In the United States, because of our tendency to zone activities, nearness carries rights of familiarity so that the neighbor can borrow material possessions and invade time. This is not true in England. Propinquity entitles you to nothing. American Air Force personnel stationed there complain because they have to make an appointment for their children to play with the neighbor's child next door.

Conversation distance between two people is learned early in life by copying elders. Its controlling patterns operate almost totally unconsciously. In the United States, in contrast to many foreign countries, men avoid excessive touching. Regular business is conducted at distances such as 5 feet to 8 feet; highly personal business, 18 inches to 3 feet--not 2 or 3 inches.

In the United States, it is perfectly possible for an experienced executive to schedule the steps of negotiation in time and space so that most people feel comfortable about what is happening. Business transactions progress in stages from across the desk to beside the desk, to the coffee table,

then on to the conference table, the luncheon table, or the golf course, or even into the home--all according to a complex set of hidden rules which we obey instinctively.

Even in the United States, however, an executive may slip when he moves into new and unfamiliar realms, when dealing with a new group, doing business with a new company, or moving to a new place in the industrial hierarchy. In a new country the danger is magnified. For example, in India it is considered improper to discuss business in the home on social occasions. One never invites a business acquaintance to the home for the purpose of furthering business aims. That would be a violation of sacred hospitality rules.

### LANGUAGE OF THINGS

Americans are often contrasted with the rest of the world in terms of material possessions. We are accused of being materialistic, gadget-crazy. And, as a matter of fact, we have developed material things for some very interesting reasons. Lacking a fixed class system and having an extremely mobile population, Americans have become highly sensitive to how others make use of material possessions. We use everything from clothes to houses as a highly evolved and complex means of ascertaining each other's status. Ours is a rapidly shifting system in which both styles and people move up or down. For example:

-The Cadillac ad men feel that not only is it natural but quite insightful of them to show a picture of a Cadillac and a well-turned out gentleman in his early fifties opening the door. The caption underneath reads, "You already know a great deal about this man."

Following this same pattern, the head of a big union spends an excess of \$100,000 furnishing his office so that the president of United States Steel cannot look down on him. Good materials, large space, and the proper surroundings signify that the people who occupy the premises are solid citizens, that they are dependable and successful.-

The French, the English, and the Germans have entirely different way of using their material possessions. What stands for the height of dependability and respectability with the English would be old-fashioned and backward to us. The Japanese take pride in often inexpensive but tasteful arrangements that are used to produce the proper emotional setting.

Middle East businessmen look for something else--family, connections, friendship. They do not use the furnishings of their office as part of their status system; nor do they expect to impress a client by these means or to fool a banker into lending more money than he should. They like good things, too, but feel that they, as persons, should be known

and not judged solely by what the public sees.

One of the most common criticisms of American relations abroad, both commercial and governmental, is that we usually think in terms of material things. "Money talks," says the American, who goes on talking the language of money abroad, in the belief that money talks the same language all over the world. A common practice in the United States is to try to buy loyalty with high salaries. In foreign countries, this manoeuvre almost never works, for money and material possessions stand for something different there than they do in America.

#### LANGUAGE OF FRIENDSHIP

The American finds his friends next door and among those with whom he works. It has been noted that we take people up quickly and drop them just as quickly. Occasionally a friendship formed during schooldays will persist, but this is rare. For us there are few well-defined rules governing the obligations of friendship. It is difficult to say at which point our friendship gives way to business opportunism or pressure from above. In this we differ from many other people in the world. As a general rule in foreign countries friendships are not formed as quickly as in the United States but go much deeper, last longer, and involve real obligations. For example:

-It is important to stress that in the Middle East and Latin America your "friends" will not let you down. The fact that they personally are feeling the pinch is never an excuse for failing their friends. They are supposed to look out for your interests.-

Friends and family around the world represent a sort of social insurance that would be difficult to find in the United States. We do not use our friends to help us out in disaster as much as we do as a means of getting ahead—or, at least, of getting the job done. The United States systems work by means of a series of closely tabulated favours and obligations carefully doled out where they will do the most good. And the least that we expect in exchange for a favour is gratitude.

The opposite is the case in India, where the friend's role is to "sense" a person's need and do something about it. The idea of reciprocity as we know it is unheard of. An American in India will have difficulty if he attempts to follow American friendship patterns. He gains nothing by extending himself in behalf of others, least of all gratitude, because the Indian assumes that what he does for others he does for the good of his own psyche. He will find it impossible to make friends quickly and is unlikely to allow sufficient time for friendships to ripen. He will also note that as he gets to know people better, they may become more critical of him, a fact that he finds hard to take. What he does not know is that one sign of friendship in India is speaking one's mind.



## LANGUAGE OF AGREEMENTS

While it is important for American businessmen abroad to understand the symbolic meanings of friendship rules, time, space, and material possessions, it is just as important for executives to know the rules for negotiating agreements in various countries. Even if they cannot be expected to know the details of each nation's commercial legal practices, just the awareness of and the expectation of the existence of differences will eliminate much complication.

Actually no society can exist on a high commercial level without a highly developed working base on which agreements can rest. This base may be one or a combination of three types:

1. Rules that are spelled out technically as law or regulation.
2. Moral practices mutually agreed on and taught to the young as a set of principles.
3. Informal customs to which everyone conforms without being able to state the exact rules.

Some societies favour one, some another. Ours, particularly in the business world, lays heavy emphasis on the first variety. Few Americans will conduct any business nowadays without some written agreement or contract.

Varying from culture to culture will be the circumstances under which such rules apply. Americans consider that negotiations have more or less ceased when the contract is signed. With the Greeks, on the other hand, the contract is seen as a sort of way station on the route to negotiation that will cease only when the work is completed. The contract is nothing more than a charter for serious negotiations. In the Arab world, once a man's word is given in a particular kind of way, it is just as binding, if not more so, than most of our written contracts. The written contract, therefore, violates the Moslem's sensitivities and reflects on his honor. Unfortunately, the situation is now so hopelessly confused that neither system can be counted on to prevail consistently.

Informal patterns and unstated agreements often lead to untold difficulty in the cross-cultural situation. Take the case of the before-and-after patterns where there is a wide discrepancy between the American's expectations and those of the Arab:

-In the United States, when you engage a specialist such as a lawyer or a doctor, require any standard service, or even take a taxi, you make several assumptions: (a) the charge will be fair; (b) it will be in proportion to the services rendered; and (c) it will bear a close relationship to the "going rate."

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You wait until after the services are performed before asking what the tab will be. If the charge is too high in the light of the above assumptions, you feel you have been cheated. You can complain, or can say nothing, pay up, and take your business elsewhere the next time.

As one would expect in the Middle East, basic differences emerge which lead to difficulty if not understood. For instance, when taking a cab in Beirut it is well to know the going rate as a point around which to bargain and for settling the charge, which must be fixed before engaging the cab.

If you have not fixed the rate in advance, there is a complete change and an entirely different set of rules will apply. According to these rules, the going rate plays no part whatsoever. The whole relationship is altered. The sky is the limit, and the customer has no kick coming. I have seen taxi drivers shouting at the top of their lungs, waving their arms, following a redfaced American with his head pulled down between his shoulders, demanding for a two-pound ride ten Lebanese pounds which the American eventually had to pay.

It is difficult for the American to accommodate his frame of reference to the fact that what constitutes one thing to him, namely, a taxi ride, is to the Arab two very different operations involving two different sets of relationships and two sets of rules. The crucial factor is whether the bargaining is done at the beginning or the end of the ride! As a matter of fact, you cannot bargain at the end. What the driver asks for he is entitled to!

One of the greatest difficulties Americans have abroad stems from the fact that we often think we have a commitment when we do not. The second complication on this same topic is the other side of the coin, i.e., when others think we have agreed to things that we have not. Our own failure to recognize binding obligations, plus our custom of setting organizational goals ahead of everything else, has put us in hot water far too often.

People sometimes do not keep agreements with us because we do not keep agreements with them. As a general rule, the American treats the agreement as something he may eventually have to break. Here are two examples:

- Once while I was visiting an American post in Latin America, the Ambassador sent the Spanish version of a trade treaty down to his language officer with instructions to write in some "weasel words." To his dismay he was told, "There are no weasel words in Spanish."

A personnel officer of a large corporation in Iran made an agreement with local employees that American employees would not receive preferential treatment. When the first American employee arrived, it was learned quickly that in the United States he had been covered by a variety of health plans that were not available to Iranians. And this led to immediate protests from the Iranians which were never satisfied. The personnel

officer never really grasped the fact that he had violated an iron-bound contract. -

Certainly, this is the most important generalization to be drawn by American businessmen from this discussion of agreements: there are many times when we are vulnerable even when judged by our own standards. Many instances of actual sharp practices by American companies are well known abroad and are giving American business a bad name. The cure for such questionable behavior is simple. The companies concerned usually have it within their power to discharge offenders and to foster within their organization an atmosphere in which only honesty and fairness can thrive.

But the cure for ignorance of the social and legal rules which underlie business agreements is not so easy. This is because:

- The subject is complex.
- Little research has been conducted to determine the culturally different concepts of what is an agreement.
- The people of each country think that their own code is the only one, and that everything else is dishonest.
- Each code is different from our own; and the farther away one is travelling from Western Europe, the greater the difference is.

But the little that has already been learned about this subject indicates that as a problem it is not insoluble and will yield to research. Since it is probably one of the more relevant and immediately applicable areas of interest to modern business, it would certainly be advisable for companies with large foreign operations to sponsor some serious research in this vital field.

#### A CASE IN POINT

Thus far, I have been concerned with developing the five check points around which a real understanding of foreign cultures can begin. But the problems that arise from a faulty understanding of the silent language of foreign custom are human problems and perhaps can best be dramatized by an actual case.

A Latin American republic had decided to modernize one of its communication networks to the tune of several million dollars. Because of its reputation for quality and price, the inside track was quickly taken by American company "Y."

The company, having been sounded out informally, considered the size of the order and decided to bypass its regular Latin American representative and send instead its sales manager. The following describes what took place.

The sales manager arrived and checked in at the leading hotel.



He immediately had some difficulty pinning down just who it was he had to see about his business. After several days without results, he called at the American Embassy where he found that the commercial attaché had the up-to-the-minute information he needed. The commercial attaché listened to his story. Realizing that the sales manager had already made a number of mistakes, but figuring that the Latins were used to American blundering, the attaché reasoned that all was not lost. He informed the sales manager that the Minister of Communications was the key man and that whoever got the nod from him would get the contract. He also briefed the sales manager on methods of conducting business in Latin America and offered some pointers about dealing with the minister.

The attaché's advice ran somewhat as follows:

1. "You don't do business here the way you do in the States; it is necessary to spend much more time. You have to get to know your man and vice versa.
2. "You must meet with him several times before you talk business. I will tell you at what point you can bring up the subject. Take your cues from me. (Our American sales manager at this point made a few observations to himself about "cookie pushers" and wondered how many payrolls had been met by the commercial attaché).
3. "Take that price list and put it in your pocket. Don't get it out until I tell you to. Down here price is only one of the many things taken into account before closing a deal. In the United States, your past experience will prompt you to act according to a certain set of principles, but many of these principles will not work here. Every time you feel the urge to act or to say something, look at me. Suppress the urge and take your cues from me. This is very important.
4. "Down here people like to do business with men who are somebody. In order to be somebody, it is well to have written a book, to have lectured at a university, or to have developed your intellect in some way. The man you are going to see is a poet. He has published several volumes of poetry. Like many Latin Americans, he prizes poetry highly. You will find that he will spend a good deal of business time quoting his poetry to you, and he will take great pleasure in this.
5. "You will also note that the people here are very proud of their past and of the Spanish blood, but they are also exceedingly proud of their liberation from Spain and their independence. The fact that they are a democracy, that they are free, and also that they are no longer a colony is very, very important to them. They are warm and friendly and enthusiastic if they like you. If they don't, they are cold and withdrawn.
6. "And another thing, time down here means something different. It works in a different way. You know how it is back in the States when a

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certain type blurts out whatever is on his mind without waiting to see if the situation is right. He is considered an impatient bore and somewhat egocentric. Well, down here, you have to wait much, much longer, and I really mean much, much longer, before you can begin to talk about the reason for your visit.

7. There is another point I want to caution you about. At home, the man who sells takes the initiative. Here, they tell you when they are ready to do business. But, most of all, don't discuss price until you are asked and don't rush things."

### THE PITCH

The next day the commercial attaché introduced the sales manager to the Minister of Communications. First, there was a long wait in the outer office while people kept coming in and out. The sales manager looked at his watch, fidgeted, and finally asked whether the minister was really expecting him. The reply he received was scarcely reassuring, "Oh yes, he is expecting you but several things have come up that require his attention. Besides, one gets used to waiting down here." The sales manager irritably replied, "But doesn't he know I flew all the way down here from the United States to see him, and I have spent over a week already of my valuable time trying to find him?" "Yes, I know," was the answer, "but things just move much more slowly here."

At the end of about 30 minutes, the minister emerged from the office, greeted the commercial attaché with a 'doble abrazo', throwing his arms around him and patting him on the back as though they were long lost brothers. Now, turning and smiling, the minister extended his hand to the sales manager, who, by this time, was feeling rather miffed because he had been kept in the outer office so long.

After what seemed to be an all too short chat, the minister rose, suggesting a well-known café where they might meet for dinner the next evening. The sales manager expected, of course, that considering the nature of their business and the size of the order he might be taken to the Minister's home, not realizing that the Latin home is reserved for family and very close friends.

Until now, nothing at all had been said about the reason for the sales manager's visit, a fact which bothered him somewhat. The whole setup seemed wrong; neither did he like the idea of wasting another day in town. He told the home office before he left that he would be gone for a week or ten days at most, and made a mental note that he would clean this order up in three days and enjoy a few days in Acapulco or Mexico City. Now the week had already gone and he would be lucky if he made it home in ten days.

Voicing his misgivings to the commercial attaché, he wanted to know if the minister really meant business, and, if he did, why could they not get together and talk about it? The commercial attaché by now was be-

ginning to show the strain of constantly having to reassure the sales manager. Nevertheless, he tried again:

"What you don't realize is that part of the time we were waiting, the minister was rearranging a very tight schedule so that he could spend tomorrow night with you. You see, down here they don't delegate responsibility the way we do in the States. They exercise much tighter control than we do. As a consequence, this man spends up to 15 hours a day at his desk. It may not look like it to you, but I assure you he really means business. He wants to give your company the order; if you play your cards right, you will get it."

The next evening provided more of the same. Much conversation about food and music, about many people the sales manager had never heard of. They went to a night club, where the sales manager brightened up and began to think that he and the minister might have something in common after all. It bothered him, however, that the principal reason for his visit was not even alluded to tangentially. But every time he started to talk about electronics, the commercial attaché would nudge him and proceed to change the subject.

The next meeting was for morning coffee at a café. By now the sales manager was having difficulty hiding his impatience. To make matters worse, the minister had a mannerism which he did not like. When they talked, he was likely to put his hand on him; he would take hold of his arm and get so close that he almost "spat" in his face. As a consequence, the sales manager was kept busy trying to dodge and back up.

Following coffee, there was a walk in a nearby park. The minister expounded on the shrubs, the birds, and the beauties of nature, and at one spot he stopped to point at a statue and said: "There is a statue of the world's greatest hero, the liberator of mankind!" At this point, the worst happened, for the sales manager asked who the statue was of and, being given the name of a famous Latin American patriot, said, "I never heard of him," and walked on.

### THE FAILURE

It is quite clear from this that the sales manager did not get the order, which went to a Swedish concern. The American, moreover, was never able to see the minister again. Why did the minister feel the way he did? His reasoning went somewhat as follows:

"I like the American's equipment and it makes sense to deal with North Americans who are near us and whose price is right. But I could never be friends with this man. He is not my kind of human being and we have nothing in common. He is not 'simpatico'. If I can't be friends and he is not 'simpatico', I can't depend on him to treat me right. I tried everything, every conceivable situation, and only once did we seem to understand each other. If we could be friends, he would feel obligated to me and this obligation would give me some control. Without control, how do I know he will deliver what he says he will at the price he quotes?"

Of course, what the minister did not know was that the price was quite firm, and that quality control was a matter of company policy. He did not realize that the sales manager was a member of an organization, and that the man is always subordinate to the organization in the United States. Next year maybe the sales manager would not even be representing the company, but would be replaced. Further, if he wanted someone to depend on, his best bet would be to hire a good American lawyer to represent him and write a binding contract.

In this instance, both sides suffered. The American felt he was being slighted and put off, and did not see how there could possibly be any connection between poetry and doing business or why it should all take so long. He interpreted the delay as a form of polite brush-off. Even if things had gone differently and there had been a contract, it is doubtful that the minister would have trusted the contract as much as he would a man whom he considered his friend. Throughout Latin America, the law is made livable and contracts workable by having friends and relatives operating from the inside. Lacking a friend, someone who would look out for his interests, the minister did not want to take a chance. He stated this simply and directly.

#### CONCLUSION

The case just described has of necessity been oversimplified. The danger is that the reader will say, "Oh, I see. All you really have to do is be friends." At which point the expert will step in and and reply:

"Yes, of course, but what you don't realize is that in Latin America being a friend involves much more than it does in the United States and is an entirely different proposition. A friendship implies obligations. You go about it differently. It involves much more than being nice, visiting, and playing golf. You would not want to enter into friendship lightly."

The point is simply this. It takes years and years to develop a sound foundation for doing business in a given country. Much that is done seems silly or strange to the home office. Indeed, the most common error made by home offices, once they have found representatives who can get results, is failure to take their advice and allow sufficient time for representatives to develop the proper contacts.

The second most common error, if that is what it can be called, is ignorance of the secret and hidden language of foreign cultures. In this article I have tried to show how five key topics---time, space, material possessions, friendship patterns, and business agreements---offer a starting point from which companies can begin to acquire the understanding necessary to do business in foreign countries.

Our present knowledge is meager, and much more research is needed before the businessman of the future can go abroad fully equipped for his

work. Not only will he need to be well versed in the economics, law, and politics of the area, but he will have to understand, if not speak, the silent languages of other cultures.

## INTRODUCTORY MARKETING MANAGEMENT COURSE

### SUPPLEMENTARY READING

#### EXPORT

#### MARKETING GROUPS FOR SMALL AND MEDIUM SIZED FIRMS<sup>+</sup>

1. Adaption of Small and Medium-Sized Firms to Changing Market Conditions
2. Basic Considerations in Connection with the Establishment of Export Marketing Groups

<sup>+</sup> Published by: Organization for Economic Cooperation and Development. Paris, 1964.



## EXPORT

### MARKETING GROUPS FOR SMALL AND MEDIUM SIZED FIRMS\*

#### I.

#### ADAPTATION OF SMALL AND MEDIUM-SIZED FIRMS TO CHANGING MARKET CONDITIONS

##### 1. Changing production techniques and market conditions

Why has the problem of export co-operation become so urgent in recent years?

This question can best be answered by considering the changes in production and market conditions that have taken place in the last few decades.

The development in production techniques has made it possible to reduce unit costs in most industries. The new techniques, however, often requires long runs in production, thus necessitating large-scale investments for plant and equipment, the employment of highly qualified key personnel, the training of a labour force and an efficient organisation for production. All these requirements draw heavily on the financial resources of manufacturers, often at a time when they are also faced with large investments for marketing their products.

Development in market conditions requires changes in the marketing methods of manufacturers. Previously, they could feel fairly safe in their national and regional markets because they were protected by customs barriers, quantitative import restrictions, and advantages of locality, or because of special knowledge of the specific character, traditions and habits of the consumers. These circumstances made it possible for them to obtain satisfactory prices in spite of their low productive capacity and widespread production programmes.

Today, many of the national barriers have been broken down and European trade is enjoying increasing liberalisation. This development was fostered by O.E.E.C. (Organisation for European Economic Co-operation), continued for its twenty Member countries by O.E.C.D.,

\*Published by: Organization for Economic Cooperation and Development.  
Paris, 1964.

and carried on in the forms of Customs Unions by E.E.C. (European Economic Community) and E.F.T.A. (European Free Trade Association), where the dismantling of both tariff barriers and quantitative restrictions is accelerating. Under G.A.T.T. (General Agreement on Tariffs and Trade) efforts are being exerted on a somewhat broader basis to reduce tariffs.

Developments in transport and communication further diminish locational advantages, and up-to-date marketing methods make it possible to adapt products to the requirements of foreign consumers or vice versa. Perhaps, in a few years there will be no such things as a "protected home market". Even small and medium-sized firms who, for various reasons, had limited their business activities to their home markets will now have to consider exporting. Foreign competition, having taken away some of their traditional markets, might force them to do so in order to keep their sales.

Another factor of importance for market conditions is the concentration of the distributive trades in many countries. In time, a comparatively small number of large chains may dominate distribution of goods to the majority of end-consumers. This will strengthen the position of retailers and wholesalers vis-a-vis manufacturers.

On the other hand, some of these changes in market conditions open new export possibilities for manufacturers. Not only the removal of trade barriers, but also the rising standard of living in most countries implies an increased demand for goods. But in order to take advantage of these export possibilities manufacturers will have to adapt their products to the new markets and to intensify their marketing methods in accordance with the new conditions.

## 2. Export problems for small and medium-sized firms.

The expansion of sales, to foreign markets especially, raises problems for small and medium-sized firms. At times they may solve their marketing problems successfully because their size and structure endow them with favourable flexibility, which facilitates the adaptation of their products to foreign markets. Experience also shows that when incomes rise demand will be increasingly directed towards those high quality goods and specialities which are typical for production by small and medium-sized firms.

The establishment of an export marketing organisation requires large investments. The more the attitudes and behaviour of new customers differ from those of old ones, the more likely it is that the firm will have to resort to costly market research, product adaptation, and export promotion. As small and medium-sized firms are rarely able to establish export sales on an individual basis, especially as their range of products is often too limited to bear the heavy export marketing costs and they are therefore forced to sell their products together with those of other exporters.

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This combination of products can take place through independent middlemen in the home country, through financial integration, or through voluntary co-operation between small and medium-sized manufacturers in an export marketing group.

The most important types of middlemen in the export trade are export merchants, commission agents, and combination export-managers. The export merchant buys on his own account and finances all his export transactions. The marketing problems of manufacturers in this case will not be much greater than they are on the home market. The export agent sells in the name of, and for the account of, the manufacturer. His main function is to promote the export of the products, but normally he leaves all other export functions to the producer. The combination export manager, working for a number of manufacturers at the same time, generally performs all the export functions necessary and acts in the name of his various employers.

Export co-operation through financial integration may be effected by one firm taking over the control of other firms, or by combining two or more firms in such a way that they acquire capital interests in one another. Financial integration may provide a sound basis for enforcing a co-ordinated and rational export programme for the firms concerned. However, this solution of export marketing problems holds no attraction for the majority of small and medium-sized firms who want to remain financially independent. This independence can best be preserved when the combination of products and export efforts takes place within the frame of an export marketing group.

An export marketing group consists of two or more manufacturers who combine - to varying degrees - their export activities on a voluntary basis in order to strengthen their market positions abroad. The firms co-operating remain financially and legally independent. Export functions, carried out by the firms individually so far, are combined and centralised. This co-operation enables the members to perform better selling and promotion work at lower costs, with specialised personnel and to a more extensive degree. Functions, like market research, mass advertising and product development, often neglected by small and medium-sized firms because of lack of financial means, can be taken up and add to more effective marketing abroad. The combined assortments of export marketing groups facilitate furthermore the establishment of a more efficient distribution system and group sales force in the foreign markets than the firms are able to use individually.

Naturally, the centralising of the various export functions and the collective activities in advertising, selling and sales promotion of an export group necessitate not only a common interest and spirit among group members but a co-ordinated business policy as well. Therefore, the firms entering into such an export co-operation must be prepared to handle their export activities for the common good and

they must give up some of their individual freedom of action to make their venture successful within the group. The history of voluntary chains in distribution, organised on similar principles and for comparable purposes is a good example of how firms have succeeded in their co-operation by combining their strength. The methods they have applied in organising and carrying out their work should be studied and used as possible solutions to the problems export marketing groups are also faced with.

Export marketing groups are not new. In many cases such groups have worked successfully for years. On the other hand, many attempts have also failed. Unwillingness to co-operate has been one of the main causes of such failures, but also inadequate planning and organisation, faults in the structure and composition of groups, and many other facts have been conducive to these failures. Therefore a practical solution to these problems must be found if export co-operation is to be successful.

## II

# BASIC CONSIDERATIONS IN CONNECTION WITH THE ESTABLISHMENT OF EXPORT MARKETING GROUPS

## 1. Range of products

If manufacturers are to derive advantage from a co-ordination of their export functions, it is of major importance that their export co-operation should be properly planned. The production programme and markets of each individual firm must be analysed in detail before firms decide to co-operate in promoting their export sales.

The question of selecting the range of products to be marketed by the group is of paramount importance. The rational selection of the range of products greatly influences marketing efficiency and, consequently, export costs.

It may have considerable bearing on the proper selection of the range that the products are consumed together. This is exemplified by the Danish THETA<sup>1</sup> Group for marketing textile materials for interior decoration in the U.S.A., and the Belgian EPSILON Group for the exportation of textile machinery. In the latter case this point is so important that the group sometimes enters into co-operation with foreign manufacturers so as to be able to offer a complete range of machines to certain types of factories.

Sometimes, better export results are achieved when all products are sold through the same channels of distribution. This is the case where marketing efforts are mostly directed towards distributors and not towards end-consumers. This fact has been taken into consideration by the GAMMA Group in Belgium, which is endeavouring to select a range that can be sold through the same type of retail shops.

Since manufacturers co-operating in export promotion remain independent, their interests may clash when their products can be used readily as substitutes for one another. How much importance they should attach to this particular point depends on the extent of their export co-operation. If their co-operation includes only market information, advertising and service, the fact that the participating firms are offering rival products does not usually entail any adverse consequences. If, on the other hand, co-operation also includes a centralisation of order booking and distribution, then the actual allocation of orders to rival firms may entail difficulties. However, firms should consider the consequences before ceasing to co-operate on the grounds that their products can be substituted for one another. As tastes differ, consumers often wish to see a whole range of products

1. Greek letters are used to conceal the true names of marketing groups which have been mentioned in this report, all of which exist. See Annex 11.



before they decide to buy. It may, therefore, be an advantage to include in the same collection products appealing to different tastes.

The Danish THETA Group, already cited, serves as an example of excellent co-operation, even though several of the products of the co-operating firms may, to a certain extent, be used as substitutes for one another.

As a consequence of difficulties experienced in connection with the distribution of orders, manufacturers are frequently advised not to centralise the booking of orders and distribution when their products may be substituted for one another. In spite of this fact many such firms find it beneficial to perform these export functions on a joint basis.

The problem may be solved by excluding rival products from the joint range. The DELTA Group in Switzerland is an excellent example of how this can be done in practice. This solution does not prevent firms from marketing their full range of products in the local market, though it would naturally be advantageous if the specialisation of export sales could be reflected in production.

## 2. Some or different industries

Another major question is whether the export group is to be made up of firms in the same industry or in several different industries.

It is not possible to give a general answer to this question. The division into industries is generally based on products or raw materials used and does not necessarily provide an adequate basis for determining the scope of the export group. Sometimes, however, the division into industries is reflected in the wholesale and retail trades, the products of one industry being sold through the same channels of distribution. Export co-operation among firms in the same industry can therefore result in improved marketing possibilities. Furthermore, products of the same industry frequently differ so much from one another that rival firms may perform their export functions on a joint basis.

In several countries the channels of distribution carry products from several industries. This development is a result of the efforts to improve marketing efficiency by combining products that are bought together, cost approximately the same, are sold in different seasons, etc. A case in point is furnishings that are now being sold to an increasing extent from the same shop, whereas the products were formerly distributed through several different types of retail outlets.



Such a development may suggest the establishment of export groups consisting of firms in several different branches of industry. An adaptation to developments in the furnishings trade may result in export groups of furniture and textile manufacturers.

In the producer goods industry export groups are often established for the purpose of covering complementary requirements for products outside the individual range of one industry, e.g. complete equipment for hospitals. Such groups are frequently established 'ad hoc'. This does not prevent the firms concerned from distributing their products concurrently through wholesale and retail channels in the same markets, either alone or in co-operation with other firms.

In many cases, therefore, it is inadvisable for an export group to handle the products of one particular industry alone. The factors influencing the selection of products for a particular range will determine what branches of industry are to be included in the co-operation.

### 3. Fields of co-operation

An export group may be established for the sole purpose of procuring detailed market information, even though it is nowadays possible to obtain this from public institutions, trade organisations chambers of commerce, etc. It is, however, necessary to adapt these data to the particular interests of the manufacturers in the group. Moreover, such a desk - research may be the beginning of more extensive co-operation in future.

The advantages of co-operation become more apparent when a group undertakes field research on a joint basis. Such research is difficult and calls for larger investments which are easier to finance if undertaken jointly. Export market analyses are frequently supported financially by public authorities, provided a group of firms will benefit from them and itself contributes financially.

If co-operation includes sales promotion, the economic advantages become still more obvious. Advertising may well be undertaken collectively even though the participating firms continue individually to canvass their own customers.

If manufacturers do not want to restrict their co-operation to prestige advertising but to extend it to the promotion of individual products, such products should be advertised under a common name or brand which should also be used by the individual firms in their own sales propaganda on the packages, etc. Collective advertising can only be fully efficient however when group exports are centralised. This may include a central export office and the use of joint channels of distribution on the export markets. In fact, export co-operation will be much more economic and successful if products are sold and distributed through a joint export office. A thorough co-ordination and centralisation of all export functions thus becomes possible and enables firms to get a better return for their marketing costs. It is usually

advisable to locate the export office in the home market so as to facilitate the close co-operation between managers of member firms, but if a group concentrates on a single foreign market with a large turnover it may be expedient to establish the sales office in that market.

In order to derive full advantage from export co-operation, it is necessary to establish joint marketing channels in export markets as well. An export group is able to procure the best channels of distribution in the individual markets owing to the advantages presented by this type of co-operation to foreign distributors.

Normally, any export group should begin its life carefully with a selection of possible and, in the long run, desirable functions. Desk-research, collective advertising, and sales promotion form the basis for marketing groups abroad. Field-studies, branded goods policy, and product development might follow later when the co-operation has proved successful. A full marketing service should always be the goal when looking ahead as export groups must offer their members collectively the same competitive weapons as are available to the larger firms individually. In later stages, of course, the group can and should include other fields like buying, harmonisation of production and basic technical research, to name a few.<sup>1</sup>

#### 4. Number and types of markets

The proper choice of the market or the markets which the export group should consider entering is of major importance for the success of the co-operation. If the potential member firms of the group have not been active at all in exports, the choice is relatively simple as biased personal preferences will not influence the decision so easily. A thorough study of the potentials of promising markets has to be made and preference should be given to that market or partial market where satisfactory results can be achieved most economically.

Even the combined strength of twenty or thirty firms will not perform miracles. Activities have therefore to be restricted in the first stage to two or three foreign markets which should be homogeneous and similar to each other. This would prevent different marketing approaches, especially in sales promotion and advertising, which could prove very costly and would therefore quickly discourage the group. Furthermore, it would be advantageous if the markets were located in the same regional area, like the Benelux countries, the Scandinavian countries or Austria and Switzerland, for in the beginning it would not seem advisable to spend time and money on markets so geographically apart as, for instance, Northern France and Southern Italy.

<sup>1</sup>See for details Chapter IV, page 45 of this guide.

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It has to be assured also that the chosen market will offer equal opportunities for the products of all participating firms, particularly if assortments are heterogeneous, and that the same sales organisation and the same channels of distribution can be used. The choice of markets is therefore interdependent with the types of firms in the marketing group - and vice versa.

If potential group members have already been actively engaged in export marketing and have established sales, then the choice of market becomes more complex because these firms might want to.

- \* have those markets included, hoping thereby to strengthen their position with the help of the whole group even if this choice might prove disadvantageous for the rest, or
- \* have those markets excluded, as they are already well established there and are more interested in new market areas, while their prospective partners are especially interested in profiting from the experience gained by these firms.

Again, only a market survey can serve as a basis for the final decision in order to ensure that the best possible market chances for the majority of member firms shall be exploited. Firms which cannot agree to such a decision should be left out. It seems better to limit the number this way than to start off with compromises, which will hamper the commercial success of the marketing group.

Some existing export groups - like the DELTA Group in Switzerland - have tried to solve this important problem by constituting subgroups for those member firms who are only interested in certain markets and regions or in certain specified outlets like department stores or government buying. This certainly is a useful solution, but it seems doubtful whether such a choice is feasible at the beginning of the enterprise when too many complications may jeopardise the efficiency and success of the export activities. It should, therefore, be considered as a second stage when the spreading of activities to new markets is planned.

##### 5. International export co-operation

Export co-operation between smaller firms of different countries does not seem yet to be very common, but is obviously growing in importance. If the selection of partners is made carefully enough, not only is such co-operation as good as export marketing with firms of the same country, but it can bring even faster and more profitable results. The foreign partner already has his sales organisation established, knows the trade outlets and market conditions well,

and has established a reputation of his own which can be of great advantage to the manufacturer who enters into co-operation with the firm, but the risks involved are naturally greater than with manufacturers of their own country who are well-known to the firm. A close look has to be taken, therefore, at the following points which could mean failure or success in co-operating with the foreign partner or partners.

- \* position of firm in market (reputation, strength, channels used, market coverage),
- \* production facilities and capacity of the firm,
- \* liquidity, financial sources and management ability,
- \* marketing policies,
- \* assortment range.

The last item is especially important, as lack of harmonisation in assortments can easily lead to misunderstanding, unwanted competition with partners, overlapping of efforts and failure of the co-operation.

It is easier for manufacturers to co-operate if their products are complementary to each other. If their production programmes overlap they must endeavour to specialise in such a way that the individual product is manufactured in one factory only, with a resultant lowering of manufacturing costs. An Italian manufacturer of motor-scooters may, for instance, enter into co-operation with a Dutch manufacturer of bicycles and bicycle-trailers by selling the Dutch products through the same channels of distribution as the motor-scooters. In this way the marketing costs are distributed over a larger number of products, and the Dutch manufacturer derives advantage from a well-established marketing organisation on the Italian market. Similarly, the Dutch manufacturer includes the Italian motor-scooters in his marketing organisation and the Italian manufacturer derives a corresponding advantage in Holland.

This type of co-operation can be expanded to other countries in which two manufacturers wish to promote their export sales. By employing a joint marketing organisation they will be able to reduce the cost of market research, sales promotion and actual distribution.

Co-operating firms, of course, run the risk that one of the participants may take up the manufacture of the products of one of the others after sales in the product are rising. This risk is particularly serious in the case of international co-operation, as it may be difficult to take legal proceedings, but the risk may be reduced by arranging for the payment of substantial penalties in case the agreement is broken.



Firms in different countries may also work together in more restricted fields. A French, a German and a British shirt-maker may, for instance, co-operate on advertising their cotton shirts in preference to shirts made of synthetic fibres. Firms also frequently combine in arranging specialised international exhibitions. If co-operation is only to comprise a general publicity campaign, then it is of no consequence that the ranges of products be identical. Collective quotations for large contracts are also frequently submitted. Such contracts often comprise products that are not made by a single manufacturer alone, or are of a volume that exceeds the productive capacity of a single manufacturer. The Belgian GAMMA Group for textile machinery co-operate with manufacturers in other countries both as regards exhibitions and quotations for large contracts.

#### 6. How does one get started?

On examining what it is that makes manufacturers want to co-operate on exporting, the main reason usually found is marketing difficulties, often engendered by keener competition with imported goods. There is no doubt that, in many cases, manufacturers would have been better able to counter such competition if they had begun to co-operate at an earlier stage. The problem, however, is who should take the initiative in getting firms to co-operate in time on export functions?

When export co-operation is to be a voluntary effort, a proposal to this effect put forward by a potential member of the export group will probably meet with the best reception. If the initiator is a businessman who enjoys the respect and confidence of his trade, the idea of co-operation will stand a good chance of success. The French BETA Group and the Swiss DELTA Group were both started this way.

However, managers of small and medium-sized firms may feel that they will suffer loss of prestige if they take the initiative and call for export co-operation. Sometimes it is also difficult for them to realise soon enough that changed market conditions often necessitate marketing co-operation if they are to continue as independent firms.

It is therefore important to establish that, when a firm calls for export co-operation, it may be a sign of foresight and adaptability. Naturally, a firm that systematically analyzes, for example, consequence of the present market integration, is in a better position to take the initiative in promoting export co-operation than a firm that makes a similar proposal against a back ground of marketing difficulties.

Many firms are not aware of the advantages of export co-operation and information should therefore be supplied by trade associations and public export authorities. Most trade associations already help members by supplying market information and acting as

advisers on export questions. Consequently, they possess excellent qualifications for estimating the competitive position of the industry. On the basis of these estimates the association may initiate export co-operation between members. Such information should be distributed at meetings and courses of the trade associations, through publicity, and articles in periodicals and other papers.

Trade and other business associations may operate as the organisational centres of export groups. Such is the case with the French ALPHA Group, which comprises many small industrial firms. Even if one does not go that far, associations may often make their secretariat available for the drafting of articles of association and the execution of other formalities in connection with the establishment of a group. In some trade associations the secretariat carried out regular office work during the export group's initial period of operation.

In Belgium one of the largest trade associations makes both offices and staff available to members for permanent co-operation on important export functions. The trade association of textile manufacturers in Denmark helps to establish export co-operation by presenting basic information on markets where a joint export drive seems possible.

In several countries the public authorities regard export co-operation between small and medium-sized firms so essential that they have encouraged joint efforts in various ways, some examples of which are mentioned in Annex 1.

Firms or associations who have taken the initiative in starting export groups have done so because of marketing conditions necessitating active co-operation. Also, they have used results from market research, where such has been carried out, as well as figures from official statistics, to prove the necessity for a joint export drive. Proposals for co-operation should, furthermore, show the economic advantages and set out how it could be carried out.

Before the initial meeting, all special problems of co-operation should be discussed with the individual firms. It has proved to be useful if, at the initial meeting, a representative of an already existing export group be present to speak on his group's experience and to answer questions. However, the lead must come from one or two active men. They must provide the leadership especially necessary when a new organisation gets started. Many examples can be found in recent business where similar organisation succeeded because a few enthusiastic members carried their colleagues with them. Again, voluntary chains and retailer buying groups present valuable case material in this respect.



INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

STRATEGIC PLANNING FOR EXPORT MARKETING<sup>+</sup>

by

FRANKLIN R. ROOT

<sup>+</sup> International Textbook Co., 1966.

## Planning Export Pricing Strategy

Planning export pricing strategy is a difficult and troublesome job. Export management must make judgments on a broad variety of conditions and relationships which are known only imperfectly and with varying degrees of probability. But this does not mean that a systematic approach to export pricing is impossible or a waste of time. In this chapter we identify and explore questions which export management should pose and answer in planning its export pricing strategy for a target market—not with the intent of answering them in any definitive fashion but rather to suggest lines of reasoning which may prove useful in this planning area.<sup>1</sup>

One difficulty is the concept of price itself. To the economist, price is the exchange ratio between a good and money as determined by the interaction of supply and demand in the market. The pricing *system* is the allocating mechanism of the market economy.

To the conventional businessman, price is the money he gets from selling a product unit, and it determines the profitability of that product. The conventional businessman also knows his product has not one but several prices because of many kinds of

<sup>1</sup> Texts in export marketing have paid little or no attention to the formulation of export pricing policies. Instead they have treated the *mechanics* of export pricing such as the arithmetic computation of c.i.f. prices. In this chapter we reverse this situation, concentrating on export pricing strategy while ignoring price mechanics.

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discounts (functional, cash, seasonal, etc.) and frequent gaps between list prices and actual negotiated prices. To speak of *the* price of a good is an abstraction which, however justified, ignores the reality of plural prices.

The marketing executive sees price in still another way. To him, price is one of several elements of the marketing mix which he must work with to achieve his marketing goals. This conception of price is the most useful in planning export pricing strategy. Export planners should look at pricing as a marketing tool, as a means of reaching the sales potential or other objective in the target market. At the same time, export planners should draw on the insights afforded by the economist's approach to pricing, especially his treatment of demand and concepts of marginal revenue and cost.

### Determining the Base Price

A defensible starting point in planning export pricing strategy is the determination of the *base price*. This is the price that the *final buyer* pays for the product.<sup>2</sup> For a consumer good the base price is the retail price; for an industrial good, it is the price to the industrial user.

We call this final-buyer price the *base price* because it serves as the basis for the discount structure and the pricing strategy. In making this statement we are aware that many exporters do not care about the final-buyer price of their merchandise in foreign markets and may not even know it, and that it does not form the basis of their pricing policy. We intend to show that this view is mistaken, that the final-buyer price is of critical importance in the export marketing program.

The determination of the base price of a product, or product line, in the target market involves three logical steps: (1) estimating the relevant demand schedules of final buyers over the strategic planning period, i.e., the relationships between price

<sup>2</sup> Subsequent discussion may remind some readers of the procedure known as *retrograde pricing*. Our approach, however, is somewhat different: we view the base price as the starting point in planning export pricing strategy, not necessarily as the basis for an arithmetical calculation of export price.

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and sales volume; (2) estimating the incremental manufacturing and marketing costs to achieve various projected sales volumes; and (3) selecting the price (or sequence of prices) that offers the highest profit contribution, i.e., sales revenue net of incremental costs.

It is the job of market research to supply the data needed for estimating demand schedules. Export planners cannot hope to construct the economist's theoretical demand schedule relating sales volume to *all* possible prices, but they can often get enough information to make an informed judgment on the probable relation between prices and sales over a meaningful price range, particularly during the first phase of the planning period. This information may come from a variety of sources: past sales records (if the company has accumulated experience in the target market); competitors' pricing behavior; consumer surveys; surveys of the trade (retailers, industrial distributors, etc.), and the like. Most difficult is the projection of *shifts* in the demand schedule over the planning period. Here planners should consider, among other things, the probable life cycle of the product, a subject discussed when we come to pricing strategy.

In estimating the incremental costs of various projected sales volumes export planners need to include *all* marketing costs necessary to get the product into the hands of final buyers. This means that a *final* determination of the base price can be reached only after decisions have been taken on the rest of the marketing mix.<sup>3</sup> This is clearly so in the case of the channel of distribution. When export planners decide on a channel comprising independent agencies (distributors, agents, etc.) they should ascertain the margins required by those agencies to distribute the company's product. These margins are costs incurred in marketing to final buyers and enter, therefore, into a determination of the base price. On the other hand, planners should ignore fixed costs such as manufacturing and administrative overheads—they have no part to play in base price determination.<sup>4</sup>

<sup>3</sup> Decisions on other marketing mix elements affect not only marketing costs but also the over-all export marketing strategy and the role of pricing in that strategy.

<sup>4</sup> Of course, a company must cover both variable and fixed costs in the long run if it is to stay in business. But this fact has no logical bearing on pricing decisions made *after* a company has assumed fixed cost burdens.

### Planning Export Pricing Strategy

The third and final step in determining the base price involves a comparison of the profit contributions of the various projected sales-price combinations, and a choice of that combination which promises (after allowance for risk) the highest profit contribution over the planning period. Planners may choose two or more optimal combinations for different points in time when they expect demand shifts during the planning period that significantly alter demand price elasticities. How closely the highest profit contribution approaches the theoretical maximum depends

**Table 3**  
Determining the Base Price in Export Marketing - Illustration for the First Year

|   | Base Prices in Dollars |          |          |           |          |
|---|------------------------|----------|----------|-----------|----------|
|   | \$95                   | \$110    | \$125 *  | \$150     | \$175    |
| 1. Number of units sold.....                          | 500                    | 475      | 450      | 250       | 100      |
| 2. Sales revenue.....                                 | \$47,500               | \$52,250 | \$56,250 | \$37,500  | \$17,500 |
| 3. Incremental costs.....                             | \$40,750               | \$49,875 | \$50,625 | \$31,250  | \$13,750 |
| 4. Profit contribution.....                           | (\$ 1,250)             | \$ 2,375 | \$ 5,625 | \$ 6,250* | \$ 3,750 |
| 5. Profit contribution per unit sale.....             | (\$ 2.50)              | \$ 5.00  | \$12.50  | \$25.00   | \$37.50  |
| 6. Unit profit contribution as per cent of base price | (2.6)                  | 4.5      | 10.0     | 16.1      | 21.4     |

Note: ( ) represents a loss. Asterisk indicates highest profit contribution.

on the accuracy and completeness of the planners' information on projected costs and sales revenues.

Table 3 offers a simple illustration of the approach we have outlined for the determination of the base price.

In this example we assume incremental manufacturing costs are \$30 per unit, incremental marketing costs (including handling and freight charges) are \$20 per unit plus a distributor's margin calculated at 40 percent of the base selling price, and entry costs (tariff duty, etc.) are equal to 10 percent of the base selling price. Although these assumptions greatly simplify the costing job of export planners, they serve to indicate its character. Given these cost assumptions and our demand assumptions (item 1), the base price which returns the highest profit contribution is \$150. Note that a price of \$175 returns the highest profit contribution per unit sale, but its total profit contribution is not the highest because of a sharp decrease in the number of units sold.

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Table 3 shows only the first year of the strategic plan. When profit contributions are estimated for the remainder of the planning period, it may be found that \$150 is *not* the optimal price for the entire planning period. Another price, or a sequence of prices, may promise the highest profit contribution over the planning period.

Risk is another factor that may influence the determination of base price. Ordinarily, planners have varying degrees of confidence in their demand estimates for any one year and in their estimates for different years. Degrees of confidence may be expressed quantitatively by ascribing corresponding probability weights to demand estimates in any given year and by weighting early years more heavily than later ones. If we weighted each demand estimate in Table 3 with the degree of probability export planners felt about it, then another price (say, \$125) might offer the highest profit contribution.<sup>5</sup>

Once determined, the base price helps guide export management in planning the discount structure and the pricing strategy. But for several reasons the base price will seldom be the price finally recommended in the strategic plan.

Export objectives other than profit maximization may modify the profit contribution approach. These include pricing to get a target return on investment or a target market share, price stabilization, pricing to minimize risk of a big loss; pricing to deal with the "best" customers, and others.<sup>6</sup> Referring back to Table 3, a company wishing to maximize its market share would prefer a price of \$125 because it offers the biggest sales volume.

Considerations of pricing strategy may also lead to a departure from the base price. Should we use price as an active promotional tool or rely more on advertising, personal selling, and other marketing mix elements? Should we price above, below or

<sup>5</sup> For a good introduction to the use of probability weights in making business decisions see Robert Schlaifer, *Introduction to Statistics for Business Decisions* (New York: McGraw-Hill Book Company, Inc., 1961).

<sup>6</sup> For a fuller discussion of pricing objectives see Alfred R. Oxenfeldt, *Pricing for Marketing Executives* (San Francisco: Wadsworth Publishing Company, Inc., 1961) and Robert F. Lanzillotti, "Pricing Objectives in Large Companies," *American Economic Review*, December 1958, pp. 921-940.



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at the same level as competitors? When our product is new to the target market, should we enter with a high "skimming" price or a low price? Should we price to maximize the profit contribution of the product line taken as a whole, or the profit contribution of each item taken alone? These are some of the questions that enter into the formulation of pricing strategy. They suggest the complex nature of pricing and why determination of the base price is only the first step in planning export prices.

Pricing strategy also influences the discount structure by affecting the size of distributors' margins, and in other ways. Aside from this consideration, the fact that companies often use indirect channels involving independent middlemen to reach target consumers means their export prices are not final-buyer prices but intermediate prices. Furthermore, indirect channels may seriously weaken the exporter's control over the final-buyer price.<sup>7</sup>

None of these observations mitigates the value of the base price as a guide. When the base price is determined, export management can more readily assess the impact that decisions on discount structure and pricing strategy are likely to have on profit contributions.

Before taking up these further aspects of pricing, however, we want to make a brief comment on *cost-plus* (or full-cost) pricing because of its apparent appeal to export management.

Cost-plus pricing is pricing a product according to the following formula: cost of materials and labor *plus* allowance for manufacturing overhead *plus* selling expenses *plus* allowance for general overhead *plus* fixed profit margin *equals* price. This formula is attractive because of its simplicity and its seeming assurance that the company will make a profit on each unit sale. But cost-plus pricing has several drawbacks: (1) it completely ignores demand in the target market; (2) it ignores competition; (3) it uses an arbitrary allocation of overhead costs which are not affected by current sales; (4) it involves circular reasoning because price influences costs through its effect on sales volume; and (5) it offers no guidance to maximize profits or reach other profit goals.

<sup>7</sup> See Chapter 5.

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Full-cost pricing is frequently modified in practice to take account of demand and competitive conditions. This means that profit margins are varied among products, markets, customers, and different points of time.

... the selling price is most likely to be a compromise of some sort between the cost-plus profit which the seller would like to get and some different price which the buyer is willing to pay."

Even so, the effort to recover full costs on each unit sale easily leads to pricing that fails to maximize profit contributions. The proper use of cost in pricing is to measure the profit contributions of different projected prices.<sup>9</sup> Then export management can make reasonable decisions on discount structure and pricing strategy.

### Planning the Discount Structure

Management should plan the discount structure to agree with its over-all export strategy because it has a bearing on all elements of the marketing mix. Here we mention only some of the broad considerations in framing discount policy.

The most important discounts are *functional* discounts to channel members. These discounts serve two functions: (1) payment to channel members for their ordinary job as middlemen (selling, stocking, etc.), and (2) payment to encourage channel members to give extra promotional effort to the exporter's product. Export management should offer its channel members discounts that fully compensate them for the services management expects to get from them. This subject is taken up in Chapter 5.<sup>10</sup>

<sup>8</sup> E. Stewart Freeman, Budget Controller, Dennison Manufacturing Company in "Cost Accounting and Industrial Pricing," *Yearbook of the National Association of Cost Accountants* (New York: 1939), pp. 21-38.

<sup>9</sup> For a more thorough discussion of full-cost pricing see Joel Dean, *Managerial Economics* (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1951), pp. 444-457.

<sup>10</sup> Chapter 5 also touches on the question of controlling final-buyer prices when export management uses an indirect channel of distribution.

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*Quantity* discounts also have a promotional function. Export management needs to decide whether to give quantity discounts at all and, if so, the discount schedule. Management can gauge the influence of quantity discounts on profit contributions by investigating their effects on sales and the probable savings in transportation, handling and order costs. Pressure by buyers and competitive practice enter into this evaluation.

When *auxiliary services* are offered final buyers, a decision should be made on whether to cover their costs out of sales or whether to charge customers for each specific service. The latter policy may be implemented in the form of discounts, such as a lower price to an industrial user who takes delivery at the exporter's foreign branch outlet instead of at the user's place of business. In this and in other ways, discounts and allowances may help tailor services to the needs of each individual buyer.

*Cash* discounts are offered customers to accelerate payment, but they are less common in export marketing than in domestic marketing because of letter of credit and draft financing.

This short discussion of discount policy makes clear its dependence on product, channel, and promotion as well as pricing decisions—another confirmation of the need to plan export marketing strategy comprehensively, with full regard to all elements of the marketing mix.

### Special Factors in Export Pricing

In pricing its products export management must consider factors that are not present in the domestic market or not present to the same degree.

Import duties are the most notorious of these factors. Exporters of manufactured products encounter duties in all national markets, and they must allow for them in their pricing. We cannot discuss here the *ultimate* price effects of duties, a subject that international economists have explored in detail. Suffice it to say that a duty may be absorbed wholly by the exporter, wholly by the foreign consumer, or shared by both depending on market conditions. In any event, exporters can

#### Planning Export Pricing Strategy

seldom ignore duties as a cost of trading with foreign markets. Smuggling provides an exception to this rule, but we can not recommend it as an optimal export strategy.

In 1963 U.K. customs officers seized 32,000 watches. Most of these came from Switzerland, some manufactured purely for the smuggling trade. Watches are the favorite contraband (despite an EFTA duty of only 13.5 percent) because they have a high unit value, are easily carried (without straps), and find a ready market with a high retail mark-up. It is not without interest that the legitimate sales of watches in the United Kingdom have fallen from 9 million in 1939 to 5 million in 1963. Cameras and cigarettes are other commonly smuggled items.<sup>11</sup>

Exporters may also face non-tariff barriers in their target markets. These include customs "red tape," national preference laws or campaigns ("Buy American," "Buy British") and internal taxes that bear more heavily on imported products.

The Italian road tax is \$170 for a U.S. compact car, \$44 for a Volkswagen, and \$17 for a Fiat. The French government levies a \$60 surtax on a two-gallon container of grain spirits. The French also prohibit the advertising of grain liquors. (Grain spirits are not produced in France.)

Exporters may also have to cope with price controls, "unfair" pricing laws, labeling requirements, and other regulations in foreign markets which, although they do not discriminate against imports, are very different from their counterparts in the domestic market.

At times, these special factors may rule out an otherwise desirable pricing strategy such as selling in the target market at prices below those in the exporter's country (anti-dumping laws) or pricing below competition in the target market (unfair pricing laws). At other times, they may shut an exporter out of a market. The presence of special factors in no way qualifies the approach to strategic export pricing outlined in this chapter. But it does make the already complex job of pricing tougher for export management.

<sup>11</sup> *The Financial Times*, March 9, 1964, p. 9.

## Planning Export Pricing Strategy

### Export Pricing Strategies

Export pricing strategy is part of export marketing strategy; it is the use of price to achieve strategic goals in the target market. In planning export pricing strategy a determination of the base price gives management a starting point and a benchmark, but it is not the whole story.

Export planners need to consider many additional factors, including strategic goals, company resources, and the entire marketing mix. The possibility of tapping export sales potentials in more than one way, involving different mixtures of product, price, channels and promotion; varying degrees of knowledge and expectation about relevant conditions; the willingness and capacity to assume risks—all help generate a wide diversity of pricing strategies. All things considered, export planners must decide which pricing strategy is the *right one for them*.

The range of considerations entering pricing strategy is suggested by the following questions that export management needs to answer:

What should be the role of price in the over-all export marketing strategy? What degree of pricing discretion do we have in the target market? What pricing policy fits the brand image we want to create? Should we advertise price?

What is the probable life cycle of our product in the target market? What is the present stage of the cycle? How should we price over the cycle?

How should we price a product new to the target market?

Should we price above, below, or at the same level as competitors? Which competitors?

What is the probable reaction of competitors to our price? To price changes in the future?

Should we follow a stable price policy?

Should we price to get the highest profit contribution on the entire product line, or should we price each product sepa-

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rately? Should we have low "leader" prices? High prestige prices?

How many price lines should we have for each product?

Should we charge the same price to all customers? Who qualifies for functional and other discounts?

Should we try to control the final-buyer price? How?

How should we allow for flexibility in tactical, day-to-day pricing? Should we use price deals to introduce or promote our product in the target market?

We comment only on some salient points relating to these questions.

Whether price should be an active marketing tool or have only a passive function depends partly on the degree of pricing discretion at management's disposal. At one extreme, management may have little or no pricing discretion, and thus no pricing policy. This occurs when a product is sold under conditions of perfect competition—price is determined by the interaction of many buyers and sellers, and buyers have no preference (aside from price) for one seller's product over another. In these circumstances, the product is a "commodity" and the exporter must sell at the prevailing market price—or not sell at all. Raw materials, basic foodstuffs, and widely-produced, unbranded manufactures such as cotton textiles fall into the commodity classification.

At the other extreme, management usually has wide pricing discretion when its product is new to the market and has no competitive substitutes. The degree of pricing flexibility hinges on the degree of product differentiation. When consumers show a preference for an exporter's product because of its quality, style, performance or any other property (real or imagined) the exporter has some degree of pricing authority and the opportunity to develop an optimal pricing strategy. In our present discussion of pricing strategy we are talking, therefore, about products differentiated in some way. Even so, export manage-



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ment must judge the *degree* of its pricing discretion in the target market.<sup>12</sup>

The degree of pricing discretion determines management's *capacity* to use price as a marketing tool. But how *should* it be used? This question relates to the optimal marketing mix discussed in Chapter 1. What is called for is an assessment of the profit contribution offered by each and every part of the marketing mix so that management can plan a marketing mix with a maximum profit contribution.<sup>13</sup> Planners should insure that pricing strategy supports rather than weakens other parts of the export program. A low-price policy, for example, is likely to vitiate a quality product image which management wants to promote.<sup>14</sup>

Many manufactured products have a *life cycle*. The life cycle starts when a company introduces a product new to the market which is sharply differentiated from older products. In a word, the product is a *specialty*. At this stage the marketing job is mainly promotion and distribution—stimulating demand and making the product available to people. There is little or no price competition, giving management broad pricing discretion.

Few products can remain specialties indefinitely; sooner or later they are duplicated, or even improved, by other companies.<sup>15</sup>

Until last spring Wilkinson Sword was the sole producer of stainless steel razor blades, but since then every major manufacturer has entered the market. Ever-Ready Razor Products and Schick (both U.S. companies) brought out double-edged stainless steel blades for the U.K. market last May. Gillette—

<sup>12</sup> The analysis we have described to determine the base price also indicates the range of management's pricing discretion. This range is not fixed. Management may enlarge it through product adaptation and promotion.

<sup>13</sup> When the marketing mix is optimal its over-all profit contribution cannot be increased by re-allocating any of its elements—product, price, promotion, etc.

<sup>14</sup> Aware of this tie-up between price and quality image, Danish beer exporters are distressed when a fellow producer sells low-price beer in a foreign market.

<sup>15</sup> Works of art and handicraft articles like Persian rugs are among the few exceptions. Patents may delay imitation, but only for a time.

### Planning Export Pricing Strategy

the most dangerous competitor—did so this January. The stainless steel share of the whole razor blade market (about 15 percent in the days when Wilkinson Sword was unchallenged) will jump to at least half by the end of the year. Gillette is striking hard, planning to spend £750,000 on direct advertising this year. Wilkinson Sword still has the biggest share of stainless sales in the U.K., but even after its new factory is built it will not be able to meet demand.<sup>10</sup>

The original producer may seek to maintain his market position through promotion emphasizing the distinctiveness of his product. But as competitive pressures grow more intense and competitive products become more alike, he is forced to lower price. His pricing discretion is now much less; he must pay close attention to competitors. Still brand competition continues and brand preference remains a buying factor. The product is no longer a specialty; it has become a *standard product*.

As more companies enter the market, as competitive brands become more and more alike in appearance, function, and other properties the product approaches a *commodity* status. Here there is little brand preference among buyers; they buy mainly on a price basis. Price competition triumphs over brand competition. Companies place major emphasis on cutting manufacturing and marketing costs. Blanket coverage of the market is important.

Although companies are not usually successful in preventing a specialty from becoming a standard product, they are better able to forestall transition to a commodity. Skillful promotion can sustain brand preference (if not, brand insistence) even though competitive products are alike in objective terms. The case of Bayer aspirin, and brand preferences in gasoline are instructive in this regard. Product improvements and new packaging are also commonly used to stop a drift towards commodity status. Indeed, much of contemporary marketing may be viewed as a continuing effort to keep one's product from slipping to a commodity.

Export management should know what stage of the life cycle its product now occupies in the target market. Often it is at a

<sup>10</sup> *The Financial Times*, March 31, 1964, p. 9.

### Planning Export Pricing Strategy

point in the life cycle which precedes or follows its position in the home market.

In the United States nine-tenths of the households have at least one television set while in the EEC the fraction is one-third. U.S. manufacturers face an almost saturated market—black and white television sets threaten to become commodities. Thus the great emphasis on product improvements such as portable and colored sets. Television sets are at an earlier point of the life cycle in the EEC although they have pretty much moved out of the specialty phase. Similar remarks apply to many other kinds of household equipment: freezers, dishwashers, dryers, etc.

When an exporter's product is new to the target market (even though it may not be new to the home market) how should he price it in view of its probable life cycle? We can distinguish two basic strategies.

The first strategy is to enter the market with a high price to "skim" the cream of demand. Later when the specialty becomes a standard product, the price is lowered to maintain and increase sales. Price is cut further when, and if, the product becomes a commodity.

This *skimming-price* strategy is shown in Figure 4.<sup>17</sup> Here the exporter has introduced his new product to the target market at a high price (\$100). Sales expand at an increasing rate, but after about 18 months other companies (attracted by the high profit margin) enter the market with comparable products. Now the exporter faces a pricing decision. If he keeps the \$100 price, his sales will fall off rapidly although they will not entirely disappear because of the brand loyalty of some customers. The alternative is to cut price to a competitive level (\$75) and get a rising sales volume as the product builds up a mass market. If brand preferences can not be sustained by sellers, the product becomes a commodity. Once again, the exporter must cut price if he is to avoid a quick drop in sales.

The second basic strategy is to enter the target market with

<sup>17</sup> The writer is indebted to Joel Dean, "Pricing Policies for New Products," *Harvard Business Review*, November 1950, pp. 28-36 for the terms "skimming price" and "penetration price."

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a low price serving as a spearhead in order to penetrate the market as quickly as possible. Here the strategy is to build up a dominant market position in a short time. *Penetration pricing* may also keep out competitors because of low profit margins. In following this strategy the exporter wants to build up a mass demand for his product and prevent others from entering the

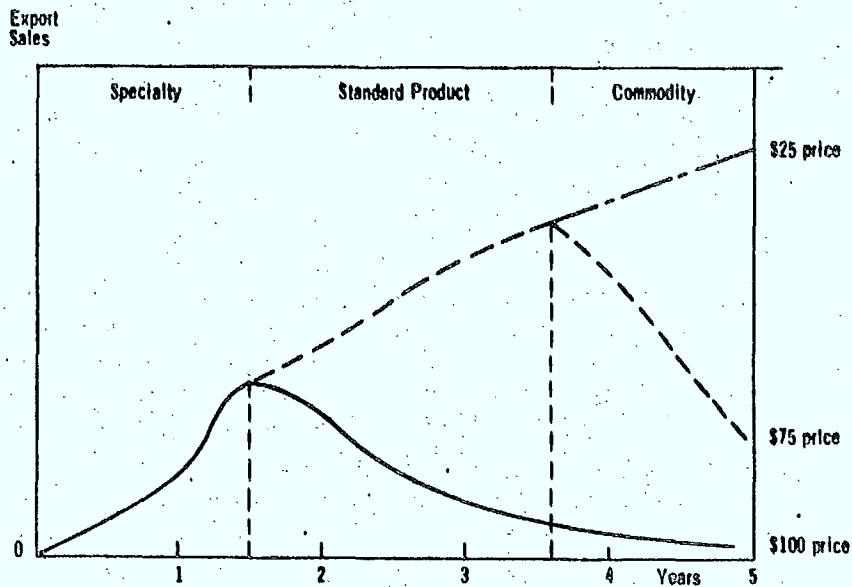


Figure 4. Export pricing over the product cycle: skimming-price strategy.

market. He expects his profits to come from volume sales rather than profit margins. He is interested in all the milk, not just the cream.

Which strategy is better? It depends on the company, the product and the market. Let us simply note that penetrating pricing is more daring than skimming pricing because it counts on a build-up of volume sales. For this reason alone, a small company with limited financial and production capacity would choose a skimming-price strategy.

When a company exports several products to a target market, management should decide whether to price so as to maximize the profit contribution of the entire line (full-line pricing).

### Planning Export Pricing Strategy

ing) or whether to price each product separately (single product pricing). The thinking behind full-line pricing is sound: it emphasizes the importance of maximizing the profit contribution of the entire export marketing program. It recognizes that an effort to maximize the profit contribution of each item in the line may not maximize the profit contribution of the entire line. In full-line pricing export management accepts the fact that under some market conditions not all products can be expected to make the same profit contribution. This clearly applies to new products still working to gain market acceptance, but it also applies to products which are valuable because they "round out" the line or give it prestige.

At the Frankfurt Automobile Show Daimler-Benz unveiled its new model 600, the Grand Mercedes, which will sell in the U.S. for about \$20,000 and the limousine model for about \$26,000. The new car is an effort to reestablish the super-luxury status of the prewar Grand Mercedes and thus enhance the prestige of the entire Mercedes line. Daimler-Benz does not expect its Model 600 to make money. The cost is being absorbed as a promotional expense for the smaller Mercedes models. Daimler-Benz expects to sell 8 to 10 cars a month in the U.S. during the first few years and then perhaps level off at 6 or 7 a month.<sup>18</sup>

On the other hand, in full-line pricing export management should not ignore the profit contribution of individual products. When a product has a negative profit contribution, expectations are poor, and it adds little to the rest of the product line, then management should drop it.

In pricing its products export management should always take into account the probable reactions of competitors in the target market. When the exporter has only a small market share, competitors are likely to ignore his initial price or subsequent price changes. But when his market share is sizeable and the number of competitors is small (oligopoly), then changes in his price are quickly matched by other sellers. In these circumstances export management may well decide to follow a stable

<sup>18</sup> "New Luxury on Wheels," *Business Week*, September 21, 1963, p. 38.

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price policy, relying on product adaptation, promotion and other non-price measures to achieve sales goals.

In closing this discussion of export pricing strategy we want to make clear the importance of tactical, short-run flexibility in pricing. All strategic pricing must leave room for tactical flexibility. It is most unwise to require operating management to keep to a specific price with no margin for negotiating with customer prospects, meeting short-run market developments, or countering sporadic competitive activity. The purpose of pricing strategy is to guide operating management in making daily pricing decisions—not to put management in a straight-jacket. Pricing strategy determines pricing goals and provides pricing benchmarks such as the basic price. In this way, export pricing strategy (like all export marketing strategy) offers the best protection against tactical victory bought at the cost of strategic defeat.



INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

A PRODUCT LIFE CYCLE FOR INTERNATIONAL TRADE?<sup>+</sup>

by

LOUIS T. WELLS JR.

# A Product Life Cycle for International Trade?\*

by Louis T. Wells, Jr.

The lowering of barriers to international trade has resulted in many opportunities for American companies to profit from exports. Clearly, the businessman needs ways of analyzing the potential exportability of his products and, equally important, tools for predicting which products are likely to be threatened by import competition.

Until recently, the manager was dependent on the explanations of trade offered by the classical and neo-classical economists. Their reasoning generally led to the conclusion that each country will concentrate on exporting those products which make the most use of the country's abundant production factors. The economic theory is elegant—it can be stated mathematically or geometrically and it can be manipulated to yield, under certain assumptions, answers to questions such as what is the value of free trade to

a country, or what are the costs and benefits of certain restrictions. So long as the problems posed are of very broad nature, the theory provides a useful way of analyzing them. However, when the theory is applied to the detailed problems

## The Trade Cycle Model

A new approach to international trade which appears most promising in aiding the business executive is closely related to the product life cycle concept in marketing. The model claims that many products go through a trade cycle,<sup>1</sup> during which the United States is initially an exporter, then loses its export markets and may finally become an importer of the product. Empirical studies of trade in synthetic materials,<sup>2</sup> electronic products,<sup>3</sup> office machinery,<sup>4</sup> consumer durables,<sup>5</sup>

\* Reprinted from the *Journal of Marketing* published by the American Marketing Association, Vol. 32 (July 1968). At the time this article was published, the author was an assistant professor at the Harvard University Graduate School of Business.

<sup>1</sup> For a more complete theoretical support of a similar model, see Raymond Vernon, "International Investment and International Trade in the Product Cycle," *Quarterly Journal of Economics*, Vol. LXXX (May, 1966), pp. 190-207.

<sup>2</sup> Gary C. Hufbauer, *Synthetic Materials and the Theory of International Trade* (Cambridge: Harvard University Press, 1966).

<sup>3</sup> Seev Hirsch, *Location of Industry and International Competitiveness* (Oxford: Clarendon Press, 1967).

<sup>4</sup> U. S. Senate, Interstate and Foreign Commerce Committee, *Hearings on Foreign Commerce*, 1960, pp. 130-139.

<sup>5</sup> Louis T. Wells, Jr., *Product Innovation and Directions of International Trade*, unpublished doctoral thesis (Harvard Business School, 1966).

and motion pictures<sup>4</sup> have demonstrated that these products follow a cycle of international trade similar to the one which the model describes.

According to the trade cycle concept, many products follow a pattern which could be divided into four stages:

Phase I: *U. S. export strength*

Phase II: *Foreign production starts*

Phase III: *Foreign production competitive in export markets*

Phase IV: *Import competition begins*

A brief look at the reasoning underlying each of these stages will give some clues which will help the businessman to identify the stage in which particular products may be. The concept can then be an aid in predicting the product trade performance to come and in understanding what actions the manager can take to modify the pattern for certain products and to profit from different stages of the cycle.

#### *Phase I: U.S. export strength*

What kinds of new products are likely to be introduced first in the United States? It can be assumed that American entrepreneurs have no particular monopoly on scientific know-how or on very basic technical ability. What they do have, however, is a great deal of knowledge about a very special market—one which is unique in having a large body of very high-income consumers. Products which satisfy the special demands of these

customers are especially likely to be introduced in the United States. Moreover, due to a monopoly position of the United States as a supplier of the new products which satisfy these unique demands, they offer the best opportunities for export.

Empirical studies have failed to show a very simple relationship between demand and invention. However, there can be little doubt that certain products are simply more likely to be developed in America. Automatic transmissions for automobiles promised to be pretty expensive additions to cars. If an inventor considers the chances of his brainchild's being purchased by consumers, a U. S. inventor would be more likely to pursue an automatic transmission than a European. The European inventor would more probably concern himself with ideas suitable to European demands. He might respond to high fuel taxes and taxes on engine displacement by developing engines which produce more horsepower per cubic inch. He might develop better handling suspensions in response to the road conditions. An inventor usually comes up with products suitable to his own market. It is even more likely that the final product development leading to commercial production will be achieved by an entrepreneur responding to his own national demand.

Even if an American is most likely to be the first to produce a high-income product, why does he not set up his first plant abroad where labor is cheaper? Certainly for many products the cost of materials and of capital is not sufficiently higher in Europe to offset the advantages offered by cheaper labor. Moreover, the

<sup>4</sup> Gordon K. Douglass, *Product Variation and Trade in Motion Pictures*, unpublished doctoral thesis (Department of Economics, Massachusetts Institute of Technology, 1963).

burden of tariffs and freight are light enough now for many items. And the uncertainties of manufacture abroad are diminishing as more American companies gain experience. There are, though, very rational reasons why the American entrepreneur might prefer to start manufacture at home.

At the early stages of a product's life, design is often in a constant state of flux. There is a real advantage which accrues to a manufacturer who is close to the market for his products so that he can rapidly translate demands for design changes into more suitable products. Moreover, these changes often require the availability of close communication with specialized suppliers. Hence, the instability of product design for new products argues for a location in the United States—near to the market and close to a wide range of specialized suppliers.<sup>7</sup> The entrepreneur is less likely to be concerned with small cost differences for very new products. The existence of a monopoly or the significant product differentiation at the early stage of the product life cycle reduces the importance of costs to the manufacturer. The multitude of designs and the lack of standard performance specifications make it very difficult for the consumer to compare prices. Also, in the early stage of the product life cycle the consumer is frequently not very concerned with price. Success comes to the manufacturer who can quickly adjust both his product design and marketing strategy to consumers' needs which are just beginning

to be well identified.

At this point, the American manufacturers have a virtual monopoly for the new product in the world market. Foreigners who want the good must order it from the United States. In fact, wealthy consumers abroad, foreigners with particular needs for the product, and Americans living abroad seem to hear about it very quickly. Unsolicited orders begin to appear from overseas. U. S. exports start to grow—initially from the trickle created by these early orders—to a steady stream as active export programs are established in the American firms.

#### *Phase II: Foreign production starts*

Incomes and product familiarity abroad increase, causing overseas markets eventually to become large enough that the product which once appealed primarily to the U. S. consumer has a broad appeal in the wealthier foreign countries. Not only does a potential foreign producer now have a market close-at-hand, but some of his costs will be lower than those of the U. S. producer. Imports from America have to bear duty and overseas freight charges—costs which local products will not carry. Moreover, the potential foreign producer may have to invest less in product development—the U. S. manufacturer has done part of it for him. Some measure of the size of his potential market has been demonstrated by the successful sale of imports. Favorable profit projections based on a demonstrated market and an ability to under-price imports will eventually induce an entrepreneur in a wealthy foreign market—usually first in Western Europe—to

<sup>7</sup> Same reference as footnote 3.

take the plunge and start serious manufacture. Of course, this manufacturer will, in some cases, be an American subsidiary which starts production abroad, realizing that if it does not, some other company will.

However, the calculations that yield favorable costs projections for competition with imports from the United States in the foreign producer's home market do not necessarily lead to the conclusion that the foreign producer will be a successful competitor in third markets. For many modern manufactured goods he is likely to be at a serious disadvantage due to the small size of his plant in a market where he also must bear the burdens of freight and tariffs. Scale-economies are so important for many products that the U. S. manufacturer, with his large plants supplying the American market, can still produce more cheaply than the early foreign producers who must manufacture on a significantly smaller scale.

During this second stage American exports still supply most of the world's markets. However, as foreign producers begin to manufacture, U. S. exports to certain markets will decline. The pattern will probably be a slowdown in the rate of growth of U. S. exports. The slowdown in the rate of growth of export of home dishwashers in the last few years as European manufacturers have begun production provides an example of a product in this phase of the cycle.

*Phase III: Foreign production competitive in export markets*

As the early foreign manufacturers become larger and more experienced

their costs should fall. They will begin to reap the advantages of scale economies previously available only to U. S. manufacturers. But, in addition, they will often have lower labor bills. Hence, their costs may be such that foreign products become competitive with American goods in third markets where goods from both countries have to carry similar freight and duty charges.

During this stage, U. S. producers will be protected from imports in their domestic market where they are not faced with duty and overseas transportation costs. However, foreign goods will gradually take over the markets abroad which were previously held by American exports. The rate of growth of U. S. exports will continue to decline. The success of European ranges and refrigerators in Latin America points out that these products are in this phase.

*Phase IV: Import competition begins*

As the foreign manufacturer reaches mass production based on his home and export markets, his lower labor rates and perhaps newer plant may enable him to produce at lower costs than an American manufacturer. His cost savings may be sufficient that he can pay ocean freight and American duty and still compete with the American in his own market. This stage will be reached earlier if the foreign producer begins to think in terms of marginal costs for export pricing. If he believes that he can sell above full costs in his home market and "dump" abroad to use up his excess capacity, he may very quickly undercut the U. S. producers pricing on full costs.

During this final stage, U. S. exports

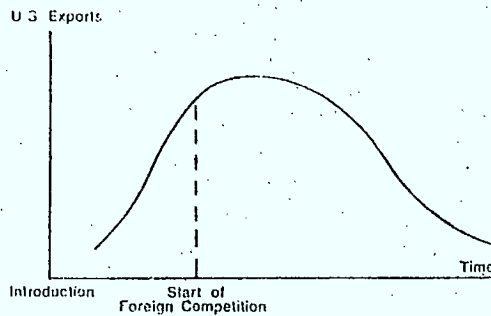


Figure 1. Export cycle

will be reduced to a trickle, supplying very special customers abroad, while import competition may become severe. The bicycle is a product which has been in this phase for some time.

#### *The Cycle*

Thus the cycle is complete—from the United States as a strong exporter to the stage where imports may capture a significant share of the American market. Figure 1 shows schematically the U. S. export performance for an hypothetical product.

The early foreign producers—usually Western Europeans—will face a cycle similar to that of the U. S. manufacturer. As still lower-income markets become large enough, producers in these countries will eventually become competitive—displacing the dominance of the early foreign manufacturers. The manufacture of products moves from country to country in what one author has called a "pecking order."<sup>8</sup>

So far, there are only relatively few examples of the less-developed countries'

becoming exporters of manufactured goods. The classic example is standardized textiles. Another interesting example is the export of certain standardized computer components from Argentina. However, the current growth rate of over 12 % per year for exports of manufacturers from less-developed countries may indicate that they will soon become an important factor for the American businessman.

### How Different Products Behave

Obviously, the export patterns are not identical for all products. Three variables were critical to the argument supporting the trade cycle concept: the uniqueness of the appeal of the product to the U. S. market, the reduction in unit costs as the scale of production increases, and the costs of tariffs and freight. Differences in these variables will be very important in determining how a particular product behaves as an export or import—and thus what the profit opportunities or threats will be.

#### *High-Income Products*

The advantage of the United States in export markets in certain products was said to be dependent on the uniqueness of the appeal of the product to the American consumer. The cycle would be more "stretched out" if this demand is particularly unique. For such products, the U. S. manufacturer will probably remain an exporter for a longer period of time and can postpone his fears of import competition.

It is possible to categorize some prod-

<sup>8</sup> Same reference as footnote 2.



ucts for which the U. S. demand is "unique":

*Luxury Function:* Certainly products which perform functions people are willing to do without until they are comparatively wealthy have a particularly large demand in the United States. Movie cameras and room air-conditioners come immediately to mind. In fact, a classification of consumer durables into luxury discretionary, and necessity shows a remarkable correlation with the U. S. export performance of the products. Exports increased 330 % over a ten-year period for the luxury products, compared to an almost 84 % increase for the discretionary items and only a 7 % increase for the necessity products. (See Table 1.)

*Expensive to Buy:* Products that cost significantly more than other products which perform similar functions appeal primarily to a high-income market. Electric knife sharpeners are an example of this type of product. A study by Time Marketing Service<sup>9</sup> showed that 21.5 % of households with incomes of over \$10,000 (where the heads were white collar, college educated) owned electric knife sharpeners. In contrast, only 11.6 % with incomes under \$10,000 owned them.

*Expensive to Own:* Similarly, products that are expensive to maintain or to operate compared to alternative products which perform similar functions are uniquely suited to a high-income market. The American automobile provides an example. The disadvantage of its high

fuel consumption more than offsets the advantages of more space and higher horsepower for most low-income foreign consumers.

*Labor Saving:* Products which save labor by substituting a relatively large amount of capital are particularly appealing to the American market. The high cost of labor, a function of high American incomes, makes it very attractive to buy items such as heavy road building equipment and computers which substitute capital for labor.

Of course, the businessman can influence the appeal of his products through his product policy. For example, he can build larger or smaller cars, automatic record players or simple ones.

#### *Scale Economies*

The trade cycle is also influenced by the amount of savings in cost, which can be achieved by increasing the scale of production. If a small plant is equally as efficient as a large one for a given product, a foreign producer will start to manufacture while his market is still relatively small. U. S. exports will not be as successful, and import competition will probably soon begin.

The effect of scale economies is well illustrated by the cases where a product goes through several stages of manufacture. In refrigerator production, for example, low costs can be reached in assembly operations at a much lower volume than in the manufacture of compressors. This difference shows up in the performance of U. S. exports for one period where exports of completed refrigerators fell drastically, but exports of

<sup>9</sup> Time Marketing Services, *Selective Mass Markets for Products and Services*, Time Marketing Information, Report No. 1305.

Table 1. Ratio of Value of 1962-1963 Exports to Value of 1952-1953 Exports

| <i>Necessity</i> |             | <i>Discretionary</i> |                                     | <i>Luxury</i>      |             |
|------------------|-------------|----------------------|-------------------------------------|--------------------|-------------|
| Refrigerators    | 0.47        | Automobiles          | 0.99                                | Movie Cameras      | 4.14        |
| Ranges           | 0.87        | Electric Clocks      | 1.04                                | Freezers           | 0.74        |
| Radios           | 1.42        | Still Cameras        | 4.66                                | Air Conditioners   | 3.59        |
| Irons            | 1.56        | Washers              | 1.35                                | Slide Projectors   | 4.66        |
| Televisions      | 1.04        | Vacuum Cleaners      | 1.78                                | Dishwashers        | 8.50        |
|                  |             | Mixers               | 1.25                                | Outboard Motors    | 4.18        |
|                  |             | Record Players       | 1.81                                | Recreational Boats | 4.40        |
|                  | <u>1.07</u> |                      | <u>1.84</u>                         |                    | <u>4.32</u> |
|                  |             |                      | F = 7.0 (Significant at 0.95 level) |                    |             |

Note: Adjustments for freezer exports to Canada and 1963 still camera exports raise significance to 0.99 level. Same reference as footnote 5.

Source: Classification of products from James Gately, Stephen Gudeman, and George Mosley, "Take-Off Phenomenon", unpublished paper submitted to Consumer Behavior Research Seminar (Harvard Business School, May 27, 1965). Export data from U.S. Department of Commerce, Bureau of the Census, FT 410 Reports.

compressors for inclusion in refrigerators assembled abroad held their own.

#### *Tariffs and Freight*

If tariffs or other trade barriers overseas are high for a particular product, foreign production is encouraged. Hence U. S. exports will receive early compensation from foreign production. Developing countries have frequently raised tariffs to encourage local production while their markets are still small. However, if the American tariff is high, it follows that the United States manufacturers need worry less about import competition.

High freight costs, usually for products which are heavy or bulky compared to their value, tend to discourage trade. Not only will foreign production occur earlier, but foreign competition is unlikely to become a serious threat in the U. S. market. In the extreme cases of very high transportation costs, trade never occurs, or occurs almost entirely along borders where a foreign source is closer

than a domestic one. For example, trade in gravel has never been significant because of transportation costs.

#### *Exceptions to the Cycle*

Not all products can be expected to follow the cyclical pattern described. The model says little about products which do not have a particularly strong demand in the United States. In addition, for some products the location of manufacture is tied to some particular natural resource—agricultural, to certain types of land; mining and initial processing, to areas containing the mineral. The manufacturing processes for some products such as the traditional handicraft goods have only slightly increasing returns to scale. Moreover, some products appear to remain sufficiently differentiated so that price discrepancies play only a slight role. For example, American cigarettes have continued to command a price-premium in Europe.

There are also manufactured goods

for which even the U. S. market is not large enough to allow significant scale economies. Such products tend to be produced in various locations close to market clusters, and no one area achieves a large cost advantage. Trade tends to be produced in quantity, bringing the cost down so that the product moves into the cycle under discussion.

High-performance sports cars and sail boats may be examples of this type product. Until recently, much of the production for such sports cars was located in various areas of Europe and was based on small production quantities. Recently both of these products have seen some large-scale manufacture in the U. S. and significant cost-reductions. General Motors led the way with mass manufacture of the Corvette. More American manufacturers will probably enter the high-performance sports car market and compete with the virtually hand-produced, expensive European sports cars.

### The Trade Cycle and Business Planning

Obviously, no simple model can explain the behavior of all products in international trade. However, the trade cycle model does appear to be useful for understanding trade patterns in a wide range of manufactured goods. Although no such model should be used by the businessman without a careful examination of individual products, it does provide some very useful hints as to which products might be exportable and which might suffer import competition.

The concept can give some clues as to the success of various product policies.

### *Market Segmentation*

The model provides some insights into the role which market segmentation can play in increasing exports and protecting against imports. Design modifications can be made for certain products which can change the appeal of the product to different kinds of customers and thus modify the trade cycle. In fact, the manufacturer often makes such changes for reasons unrelated to international trade but rather as a response to changes in the nature of his home market. As the American consumer becomes wealthier and more sophisticated, and as domestic competition becomes more severe, the manufacturer often makes his products more automatic, more powerful, more luxurious. The marketer may be trying to differentiate his product from those of his competitor, or he may simply be responding to the demands of a wealthier consumer. These changes may make the product more suited to the growing incomes of the American customer, but they will also affect its exportability. The item may become too expensive for the majority of foreign consumers, hastening competition from foreign-produced goods.

This gradual product sophistication may, however, provide some protection against imports in the United States. No doubt, the size and automatic features of the American automobile have had a special appeal to the high-income American market and have consequently held back the flow of imports. The product design has, however, had another effect: simpler, cheaper foreign cars have been

able to capture a part of the U. S. market more concerned with economy of operation and lack of style obsolescence than with luxury, fashion, and automatic features—second cars, student cars, etc.

The American automobile industry did not respond to imports by trying to produce a real economy car in competition with the Volkswagen and Renault, but rather produced a middle-range product (the compacts) which competed with Volvo and Peugeot, for example. The move was probably a wise one. No doubt, the producers of the economy cars abroad had reached cost savings from scale economies equivalent to anything the U. S. producers could hope to obtain. Moreover, they had lower labor costs. By choosing to attack the middle range, the American manufacturers chose a market where they could have a scale advantage for a time, until the higher-income segment of the European market was so large that middle-range cars would be more important. Perhaps the U. S. manufacturers simultaneously created a more exportable product for the future.

For products where design sophistication consists of adding special features to a basic model, export versions can be produced simply by eliminating some of the extras. Thus, some producers can extend the exportability of their products while simultaneously satisfying the more sophisticated needs of their home market.

The existence of segmented markets leads to Americans' exporting and importing the same product: exporting large automobiles to high-income consumers abroad while importing small, economy cars; exporting large refrigerators while importing small ones for campers and

summer homes. The relative competitiveness of the United States in 1965--66 in the higher-quality versions of a product stands out well in the case of home freezers of different sizes in Germany and in the United States. For each model the lowest-priced unit was chosen for comparison. The larger models were cheaper in the United States and the smaller models in Germany. American manufacturers did not yet need to worry about imports of large freezers, but they were already beginning to experience competition from smaller models.<sup>10</sup>

#### *Product Roll-Over and Foreign Investment*

Of course, the point is finally reached for many products where design changes can no longer make the American product competitive abroad or safe from imports. The U. S. firms may follow two strategies for survival: a continual product roll-over, shifting resources to new products more suited to the unique demands of the American market; and manufacturing abroad to take advantage of lower production costs and to save tariffs and transportation charges. The strategies are not mutually exclusive, but both require advanced planning and constant surveillance of the future of individual products and assessments of the company's capabilities.

#### **Conclusion**

Companies can no longer afford failure to analyze opportunities for profit offered

<sup>10</sup> Sears, Roebuck and Co. catalog (Fall and Winter, 1965) and Neckermann Catalog, No. 169 (September 1, 1965-March 1, 1966.)

by exports and the possible threats to their own market posed by imports. The trend of international events indicates an increased importance of trade to businessmen. In response to this changing environment, the manager must have a continuing program to analyze the future directions of international trade in his products so that he may plan early enough for appropriate policies. The product cycle model provides a useful tool in this analysis.

INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

SOCIETAL PRESSURES:

HOW BIG BUSINESS

PERCEIVES THEM

by

I.A. LITVAK and P.M. BANTING



# SOCIETAL PRESSURES: How Big Business Perceives Them

*"... there is a deep disorder in our society which comes not from the machinations of our enemies and from the adversities of the human condition but from within ourselves"<sup>1</sup>*

ISAIAH A. LITVAK    PETER M. BANTING



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It is increasingly apparent that Canadian companies will have to anticipate environmental pressures, both ecological and social in nature, to survive in the 1970's. Corporate profit objectives increasingly will become mere threshold requirements beyond which the company will satisfy to achieve the demands of societal pressures.<sup>2</sup>

In this research study it is shown that Canada's major industrial firms are product oriented rather than being sensitive to the environmental needs of their customers. These firms exhibit a high degree of sensitivity to governmental legislation affecting their operations, but little sensitivity to societal pressures having no legal sanction. The research indicates that possible reasons for environmental insensitivity are

- 1) Inadequate resources assigned to the task of monitoring areas of potential societal concern,
- 2) Poorly structured channels of communication to feed-back information that may be gathered,
- 3) Responsibility for receiving and analyzing intelligence reports assigned to other than those who should be most concerned — chief marketing executives,
- 4) Inability to implement effective strategy changes because of short-run profit commitment to entrenched interests.

These factors indicate why management of Canadian companies are inner-directed, thus unable to respond to immediate societal pressures, and only able to anticipate future issues as extrapolations of their current operational problems.

It is no wonder that a larger number of M.B.A. graduates eschew Canada's largest corporations in favor of jobs in government, positions in public service and non-profit organizations, and careers in education. Their vocational choices are merely another expression of youth's disenchantment with today's world of business and commerce.

Although our nation's youth at times are more vocal than other sectors of society, this disillusionment with current business practices is vastly more general and

widespread. One need only scan the daily newspaper to observe the multiplicity of issues, and divergent pressure groups demanding and lobbying not simply for recognition but more importantly for compliance with their demands. The issues are as far reaching as the quality of life, and as narrow as complete content disclosure on labels. The pressures not only emanate from well organized and broadly based groups such as Pollution Probe, but also are increasingly exerted in the specific complaints of individual housewives. Recent headlines reflect the growing concern:

"CHILD-SAFE CONTAINERS FOR DRUGS MAY SOON BECOME LAW"

"POP FIRMS MUST CUT CHEMICALS"

"PLEDGE TO FIGHT PHOSPHATE"

"UNSOLICITED CREDIT CARDS TARGET OF NEW ONTARIO AMENDMENTS"

"BAN URGED ON NO-REFUND BOTTLES"

In speeches to trade associations, the press, and stockholders meetings, corporate executives embellish their pronouncements of social responsibility with apparent heart-felt earnestness. For example, J. K. Grant, President of Nabisco Foods, addressing the Toronto Chapter of the American Marketing Association in March, 1970, stated:

"I think it's fair to predict that consumerism will strongly influence business in the years to come . . . Consumer-directed legislation, and our own inertia are stealing our initiative . . . If we want business as we know it to survive, we've got to realign our business practices, attitudes, and communication methods."

One would imagine that management of Canadian companies would not only be sensitive to these pressures, but also act in response to them. Yet their everyday actions exhibit a reluctance to practise what they preach, as the following headlines indicate:

"AEROSOL FIRMS OPPOSE LABEL REQUIRING EXPLODING BALL SYMBOL"

"COMPANIES ADMIT ACID STILL BEING DUMPED INTO LAKE"

This contradiction between altruistic pronouncements and myopic profit-maximizing behavior can be explained by examining the opposing forces within the marketing system.

#### THE STRUCTURE OF THE SYSTEM

The simplest system is a seller and a buyer, operating face to face, with equal bargaining power, and direct information exchange. Few systems today are so simple. Typically, ultimate consumers are removed by many exchange levels from the original manufacturer, market power is unequal, and incomplete information exists.<sup>3</sup>

Just as specialization in manufacturing provides production cost economies, so too specialization in distribution through many levels provides marketing cost economies.<sup>4</sup> However, specialization reduces consumers' product knowledge and producers' sensitivity to consumer needs. Inadequate information creates conflicts of interest which polarize with continuing opposing pressure. Exhibit 1 illustrates

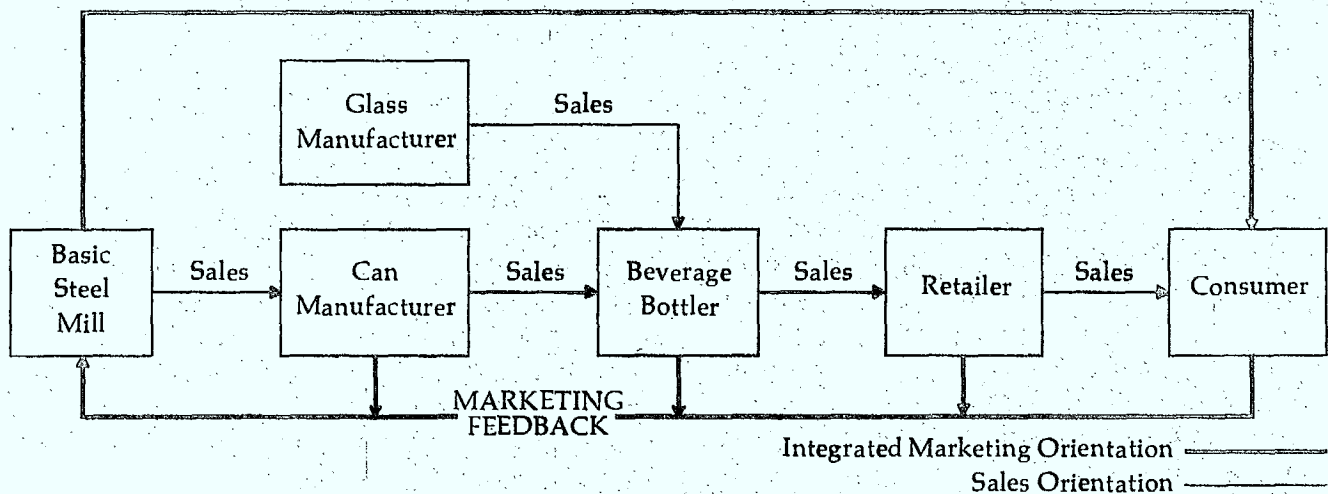
these factors as they relate to canned beverages, a "cause celebre" in the pollution controversy.

The basic steel producer, to expand his sales of tin plate steel sought a new market by promoting beverages in cans, where formerly they were only packaged in returnable bottles. His appeal to the consumer was storage convenience and disposability.

Resistance from glass producers stemmed from their desire for economic survival in undermined markets. Resistance from bottlers centred on their extensive fixed capital investment in machinery and equipment. These attitudes did not reflect commitment to consumer sovereignty;<sup>5</sup> rather they expressed the opposite: producer sovereignty. This resistance only delayed the successful introduction of canned beverages. Retailers supported canned beverages because they reduced handling cost, increased storage and display efficiency, and eliminated breakage and empty returns servicing. Consumers were willing to pay the higher price for this added convenience.

Glass manufacturers soon responded with a new non-returnable beverage bottle having similar convenience attributes. Beverage bottlers, too, overcame their

EXHIBIT 1  
THE BEVERAGE CONTAINER MARKET  
EXAMPLE



resistance, finding advantages in not having to handle, clean and sterilize returnables. Thus a new equilibrium prevailed in the marketing system.

Neither consumers, retailers, wholesalers, bottlers, manufacturers, nor governmental regulating agencies expressed concern over the pollution problem these two new containers might pose. The problem only became apparent after municipal agencies experienced severe difficulties in garbage disposal and litter management. Even at this crisis stage, manufacturers and retailers exhibited remarkable unconcern, claiming consumer sovereignty as justification for continuing their disposable container strategies. As alarm about pollution increased, the public, recognizing the dangers of disposable containers as environmental litter, lobbied for government regulation.

But disposable containers are only one element of the larger pollution problem, which is a symptom of a greater environmental crisis facing mankind. Professor Robert L. Heilbroner states that in a normal year

"... the United States alone 'produces' 142 million tons of smoke and fumes, 7 million junked car bodies, 20 million tons of waste paper, 48 billion used cans, 26 billion bottles and jars, 3 million tons of waste rock and mill tailings, 50 trillion gallons of hot water . . . All this imposes a cost to society — a cost that was once swept under the rug, but that is now beginning to show through the rug . . ."<sup>6</sup>

According to another recent report:

"The Canadian Society of Zoologists says bluntly: The very survival of mankind is at stake. U Thant, speaking for the United Nations, says the deadline is ten to fifteen years away."<sup>7</sup>

The prime objective of attack by environmentalists and ecologists, whether professional or amateur, is big business. Large manufacturing companies are held responsible for most of society's ills. For this reason, the authors in the Spring of 1970 surveyed the largest Canadian manufacturing firms to ascertain whether these attacks have affected the attitudes of big business.

#### THE STUDY OBJECTIVES

The authors attempted to examine how sensitive leading Canadian companies are to current social and political pressures;<sup>8</sup> and more precisely whether these pressures have induced them to appoint personnel to monitor and interpret social concerns so their firm can adjust and adapt its operations in a responsible fashion. The study investigated four questions.

- (1) Is organizational structure designed to be sensitive to societal pressures?
- (2) What level in the organization receives the impact of such pressures?
- (3) What types of pressure do the companies consider of critical importance?
- (4) In what direction does management expect pressures to be exerted in the future?

#### THE SAMPLE

*The Business Quarterly Industrials Classification*\* of the leading 283 public Canadian companies with more than five million dollars total book assets was chosen, because these, the largest Canadian companies, are the object of most societal pressures. A second reason for this selection was the expectation that these firms, possessing the largest resources, would be first to recognize such pressures, would have greatest financial capability for adjustment, and would be first to structure their organization to accommodate these demands.

Each firm was mailed a self-administered, pre-tested, 12-page questionnaire. One hundred usable returns (35 per cent of the total population) form the basis of the study. Fifty respondents manufacture industrial products, 35 manufacture consumer products, and 15 are non-manufacturing. Their major customers include consumers for 29, retailers for 26, wholesalers for 25, Government for 9, industrial users for 7; and utilities in four cases. Exhibits 2 and 3 provide additional classification data.

\*published in winter 1969 issue.



## 1. ORGANIZATION STRUCTURE

The questionnaire was directed to the presidents of the 283 Canadian industrial firms. Asked to identify their senior executive in charge of the company's marketing activity, fifty-five per cent indicated their senior "sales" executive. The sales function was dominant in 79% of the non-manufacturing firms, in

### EXHIBIT 2

#### CLASSIFICATION OF INDUSTRIES

| INDUSTRY  | RESPONDENTS |
|---|-------------|
| Chemicals and Chemical Products .....                                   | 3           |
| Clothing .....  | 1           |
| Electrical Products .....   | 8           |
| Foods and Beverages .....   | 14          |
| Furniture and Fixtures .....  | 1           |
| Knitting Mills .....  | 1           |
| Machinery (except electrical machinery) .....                           | 4           |
| Metal Fabricating (except machinery and transportation equipment) ..... | 5           |
| Non-metallic Mineral Products .....                                     | 3           |
| Paper and Allied Industries .....                                       | 10          |
| Petroleum and Coal Products .....                                       | 5           |
| Primary Metal .....   | 6           |
| Printing, Publishing and Allied Industries .....                        | 6           |
| Rubber .....  | 1           |
| Textiles .....  | 3           |
| Transportation Equipment .....  | 4           |
| Wood .....  | 3           |
| Construction .....  | 4           |
| Finance, Insurance and Real Estate .....                                | 1           |
| Forestry .....  | 1           |
| Mining .....  | 3           |
| Public Utility Operation .....  | 2           |
| Trade (retail or wholesale) .....                                       | 2           |
| Transportation, Storage and Communication ....                          | 10          |
| Other .....   | 8           |

NOTE: The total number of respondents is greater than 100 because several firms operate in more than one industry category.

60% of the industrial manufacturers, and in 36% of the consumer product firms. In the other firms, the marketing function was headed by a senior "marketing" executive.

To recognize the significance of these figures, it is important to understand the difference between a sales and a marketing orientation. A sales oriented firm is structured about a philosophy of promoting the company's product to its customers. The product is developed with prime emphasis on its technical features. Marketing research is primarily concerned with gauging market size, and solving sales and distribution problems, paying only lip-service to environmental influences shaping the customer's attitudes. In the marketing oriented firm, the philosophy is to determine the customer's total needs, and how these needs may be affected by environmental considerations. New products are developed with prime emphasis on customer requirements, and the marketing unit plays a dominant role in the firm's critical decision making areas. Great stress is placed on marketing research to assess customer motivations and to solve non-recurring environmental problems, as opposed to the functional problems associated with the movement and promotion of goods.

Of course, the senior executive's marketing title alone does not indicate that the marketing philosophy has pervaded the organization. Nor does the sales title

### EXHIBIT 3

#### SIZE OF FIRMS

| GROSS ANNUAL SALES              | NUMBER OF FIRMS |
|---------------------------------|-----------------|
| Under \$10 million .....        | 12              |
| \$10 - \$24.9 million .....     | 25              |
| \$25 - \$49.9 million .....     | 18              |
| \$50 - \$99.9 million .....     | 16              |
| \$100 - \$249.9 million .....   | 17              |
| \$250 - \$499.9 million .....   | 8               |
| \$500 - \$999.9 million .....   | 3               |
| More than \$1,000 million ..... | 1               |

mean that the firm is totally unresponsive to environmental considerations. However, it is a clue to the motivating force within the organization.<sup>9</sup>

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## 2. ORGANIZATIONAL SENSITIVITY

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Most crucial environmental pressures eventually are expressed through governmental legislation, mainly at the federal level. Thus any company which wishes to be fully conversant with developing controls and restrictions should be knowledgeable about current debates in parliament, and research studies being undertaken by Federal Departments and Universities. An example of the perils to private enterprise of not being "tuned in" is the recent cyclamate directive which caught soft drink manufacturers completely unprepared, to the extent that they were forced to destroy tens of thousands of dollars in finished goods diet drink inventories.<sup>10</sup> Moreover, social irresponsibility was indicated by their not anticipating the potential dangers of cyclamates, planning and developing substitute additives, and introducing them to the market before the government felt it necessary to institute a ban. A case in point is the statement by Coca-Cola's senior vice president in Toronto when asked to comment on the U.S. cyclamate ban.

"We are waiting for Health Minister John Munro's comments. Naturally we do not intend to sell anything that would be harmful to consumers and we will be guided by what our own health minister says . . . I think our government here is playing it coolly and a bit more dispassionately than the U.S. . . . We do a lot of our own research in this area . . . The evidence as indicated applies to rats and massive doses."<sup>11</sup>

The current performance of detergent manufacturers is equally myopic on the question of phosphates, where, like the diet pop manufacturers, they are being forced to act in the interest of consumers by government decree. Indeed it is quite likely that within a few years they will be faced with another similar situation regarding enzyme additives, and most likely will be

equally insensitive and unprepared. These examples point to the glaring fact that manufacturers are not sufficiently empathetic to the environment to have people in their organization who would be concerned with the public good and screen both products and processes for harmful side-effects and their impact on the quality of life.

Only 12 of the 100 respondents employ a person whose chief responsibility is to analyze governmental legislation and environmental pressures which might affect their marketing activities. Nine are manufacturers of industrial products and their concern has little to do with marketing per se or consumerism. The bulk of their time is spent on taxation, tariffs, and customs.

Sixty-nine of the 100 companies show some concern over government and other pressures by collecting data from secondary sources. The individuals responsible for this task conduct it as a minor aspect of their responsibilities. The recipients of this information occupy senior management positions, 69 per cent being company presidents. Only 10 per cent are directly involved in sales and marketing. The chief secondary sources of information they use include: trade association bulletins, publications of chambers of commerce and boards of trade, the public press, trade publications and subscription services. Government sources, including both direct personal contact and publications, play a relatively small role.

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## 3. CRITICAL PRESSURES

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A major objective of the study was to ascertain the types of governmental legislation and pressures which the respondents perceive as having the greatest impact on their companies' marketing activities. To provide a frame of reference for respondents, the authors constructed a matrix and examples of possible pressures shown in Exhibit 4. In following sections of the questionnaire, respondents were asked to list and elaborate upon the most significant influences affecting their particular company's marketing activities.



# FEDERAL LEGISLATION AND OTHER PRESSURES

Respondents indicated that federal legislation and pressures have the greatest impact on their marketing activities. Laws influencing product and price decision making areas received the largest number of mentions. In the product area, safety standards, regulations affecting foreign trade, and weights and measures were dominant. In price, regulations concerning foreign trade, the Combines Act, and tax laws were predom-

inant issues. Federal pressures were seen as being critical only in the pricing area, mainly through Prices and Incomes Guidelines. The Department of Consumer and Corporate Affairs and the issue of pollution received less than one per cent of the mentions under the product heading.

The other three marketing areas, distribution, advertising, and personal selling, received less than half the mentions about federal laws, and only a small fraction of responses under federal pressures without

## EXHIBIT 4

| Marketing Areas \ Influences     | Federal Legislation                         | Federal Pressure Without Legal Sanction | Provincial Legislation         | Municipal Legislation | Consumer or Industrial User Pressures | Pressure from Other Groups               |
|----------------------------------|---|---|--------------------------------|-----------------------|---------------------------------------|--|
| A. Product                       | Patents and Trade-marks                     | Uniform Package Size & Weights          | Pollution Control              | Safety Standards      | Private Legal Suits                   | Industry Association (Product Standards) |
| B. Price                         | Combines Act                                | Price & Income Guidelines               | Transportation Rate Regulation |                       | Buyers' Associations                  | Co-ops                                   |
| C. Advertising & Sales Promotion | Food & Drug Act<br>Combines Act             | Truth in Advertising Movement           | Copy Content Rules             | Bill-board Location   | Trading Stamp Controversy             | Canadian Code of Advertising Standards   |
| D. Personal Selling              | Bills of Sales Act<br>Conditional Sales Act | Protection of Privacy                   | Licensing Salesmen             |                       |                                       | Better Business Bureau                   |
| E. Distribution                  | Discriminatory Discounts                    | Exorbitant Margins                      | Licensing Carriers             | Store Hours           | Picketing Stores                      |  |

legal sanction. Transportation rules were cited most often in the distribution area, while the Combines Investigation Act received the greatest mention under advertising. The White Paper on Taxation received some mention under the personal selling heading, and the Department of Consumer and Corporate Affairs was also minimally acknowledged in the advertising area.

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#### PROVINCIAL LEGISLATION

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While the product area was dominant in responses about provincial laws and pressures, distribution assumed equal weight with price. The most often cited issue in the product area was pollution, particularly by manufacturers of industrial products. In the price category, taxation and transportation regulations were equally dominant, while the distribution area was exclusively dominated by transportation laws. Hardly any mention was made about laws affecting advertising and personal selling.

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#### MUNICIPAL LEGISLATION

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Laws affecting the product area were again dominant in the municipal side of legislation. However, distribution laws assumed greater importance than legislation affecting price. Safety standards and pollution represented the majority of mentions under the product category, transportation laws dominated the distribution area, and zoning laws were mentioned as affecting the price and advertising areas.

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#### PRESSURES FROM CUSTOMERS AND OTHER GROUPS

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Out of 229 mentions, price received 67, product had 63, advertising 34, personal selling 33, and distribution 32. Actions of competitors were singled out as the strongest pressure on price, while consumer groups and cooperatives had secondary impact. Industry associations and customers were seen to exert most of the pressures in the product category. Pressures in the other three categories stemmed from a widely dispersed

number of sources including competitors, customers, cooperatives, trade unions, and purchasing agents. There was no pattern to the diversity of issues stimulating these pressures. Most centred on complaints about product quality, service, delivery, product specifications, and general criticism of company promotional activities.

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#### 4. MANAGEMENT EXPECTATIONS

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Of the 100 respondents, only 25 commented on the future directions they expect societal pressures to take. There was unanimous agreement that increasingly restrictive government regulation of and involvement in industry at both federal and provincial levels could be expected. According to the vice president of marketing for one of the largest petroleum companies in Canada:

"There is no doubt in our minds that the present trend to more, rather than less, legislative and other pressures on business will continue: Witness the recent establishment of Federal and Provincial Consumer Affairs Departments, and the Economic Council of Canada's 'Interim Report on Competition Policy.

"There is a greater awareness and concern by society for the rights of the individual. Corporations must learn that it is not enough to please their customers, they must be acceptable corporate citizens in all respects."

Contrary to the preceding viewpoint, most comments from respondents suggest that these pressures will stimulate a negative response from business, as was shown by the earlier beverage container illustration. They pose a threat to established methods of doing business, imperil profits by forcing increasing expenditures on new capital equipment, and may undermine what companies see as long-enduring profitable markets. A response typifying this reaction was offered by the divisional sales manager of a multi-product industrial manufacturer with sales in the \$100-\$250 million range:

"I see no reversal of the trend toward more participation by various levels of government in business.

"Business has no recourse but to provide more manpower resources to watch over, administer and oppose certain regulations, a costly process."

The majority of respondents expressed concerns that are based on extrapolations of current issues such as: disproportionate taxation and a fear of the White Paper; unilateral tariff reductions and ineffective anti-dumping legislation; increased operating costs resulting from legislation, rising wage demands and interest rates; lack of uniformity and no co-ordination of legislation among all governmental levels.

#### CONCLUSION

The problems of the quality of life do not stem exclusively from big business myopia. As was shown in the beverage container example, equal blame must be shouldered by the public at large, and by government. But because these problems arise from the activities of business, large companies will continue to bear the brunt of criticism.

It is increasingly apparent that imperfections in our free enterprise system, including the difficulties of

exercising consumer sovereignty, have precipitated our current dilemma. The consumer can only choose from the range of goods and services offered to him in the market place. This range does not include a choice or tradeoff between alternatives of physical and social environmental qualities. For example, a consumer may choose amongst styles, shapes, colours and sizes of automobiles; but has insufficient information about the negative costs to society of his purchase decision. Furthermore, at present he does not have the alternative choice of a noiseless or effluentless automobile.

Historically, it has been the role of the government to introduce corrective measures through legislation to protect the individual from the excesses of an imperfect free enterprise system. This inevitably creates conflict between business and government. The severity of such conflict depends on the degree of enlightenment exhibited by all concerned participants.

But more important than whether business can avoid being usurped by government is the question of direction.

"If men really believed they controlled their destiny, they would not talk of what the future would bring: instead they would debate the kind of future they wanted."<sup>12</sup>

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INTRODUCTORY MARKETING MANAGEMENT COURSE

SUPPLEMENTARY READING

A CONCEPTUAL FRAMEWORK FOR  
INTERNATIONAL BUSINESS ARRANGEMENT

by

I.A. LITVAK and P.M. BANTING

# A Conceptual Framework For International Business Arrangement

ISAIAH A. LITVAK AND PETER M. BANTING\*

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The more unstable a foreign environment is, the more difficult it becomes for the international firm to establish and maintain control over its marketing arrangements in foreign countries. This is particularly the case in developing economies. Therefore, it becomes vital for the international marketer not only to evaluate those environmental elements which impinge upon his pattern of foreign involvement, but also to structure feedback systems which will enable him to minimize external threats to his firm's development in foreign countries. This paper presents a classification system which permits the international marketer to determine the marketing arrangement best suited for the foreign country, and the vulnerability of the firm's international structure to change.

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Most comparative studies to date have been descriptive and general rather than analytical and specific. In the words of an eminent marketing authority, Professor Reavis Cox:

"Much of the literature of comparative marketing combines observations by perceptive travellers with the results of inquiries among a few informed people and a survey of the easily available published materials. Most of it, however, does not dig very far beneath the surface. Someone takes a quick look in the course of a short trip made for some other purpose and reports back on what he has seen. He makes no systematic or thorough search for data that would be available if he had time to seek them out. He gathers no new materials through extensive field work."<sup>1</sup>

This absence of information, particularly in the case of the marketing middleman, is a serious omission because he has been and will continue to be a key factor in the stimulation of foreign investment, and the formation of international business arrangements.

Few companies when going international initiate their activities by establishing manufacturing facilities in the foreign country. They are more likely to take

a cautious approach, where the risks associated with heavy investments may be minimized. Rather than having wholly-owned distributive arrangements, they tend to employ the services of an established resident agent or merchant middleman. This first distributive arrangement is rarely the ideal. Pressures within the foreign environment, together with the company's desire to optimize its foreign market potential result in continual re-evaluation and reorganization of its international marketing arrangements. Because utilizing the manufacturers' agent is the most simple and least costly method of probing the foreign market for both small and large companies, and because the manufacturers' agent is frequently superseded by other middlemen, this article will focus on the agent as the starting point in the evolution of international business arrangements. A classification system will be formulated for evaluating the marketing middleman's vulnerability to change when he is employed by the foreign principals, and the relation will be shown between country-type and the direction in which the marketing-oriented middleman is most likely to adapt.

Much of the empirical data was obtained from personal interviews conducted by the authors with manufacturers' agents, merchant middlemen, and manufacturers in the United States, Canada, and South Africa, and from a questionnaire sent to manufacturers' agents associations.<sup>2</sup>

<sup>1</sup> Reavis Cox, "The Search for Universals in Comparative Studies of Domestic Marketing Systems," *Proceedings of American Marketing Association Fall Conference, September, 1965*, p. 145

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<sup>2</sup> The authors are indebted to the Canadian Department of Labour, under whose commission part of the research was done, and to Dr. Andre van der Merwe, Graduate School of Business, University of Cape Town, for his assistance in South Africa.



## THE FINDINGS HIGHLIGHTED

The data collected suggest that there are certain strategic factors that have affected the development of distributive arrangements, particularly during the post-war era. These factors include nature of the product, concentration of customers, intensity of competition, resources of the middleman, market potential, degree of industrialization, cultural, lingual and geographical distance, legislation, and degree of political stability. Alone or in combination, they influence the way the distributive arrangement evolves and the middleman's role in international business arrangements.

The results of the study indicate that in both domestic and foreign markets the marketing middleman is more likely to evolve from being a pure agent:

- a) the greater his resources are,
- b) the more complex the product is,
- c) the greater the market potential and regional concentration of customers are, and
- d) the more competitive the market is.

The findings further indicate that the manufacturers' agent will more likely be utilized to both probe the market and participate in international business arrangements:

- a) the greater the degree of political instability that exists in his country,
- b) the greater the distance between his country and that of his principal in miles, language, and culture, and
- c) the greater the proliferation of rules and regulations governing foreign investment in either the agent's or his principal's country.

## SIGNIFICANT ENVIRONMENTAL FACTORS

These findings apply equally to the United States, Canada, South Africa, and other countries. Nonetheless, there are certain differences in the way the agent has developed from one country to another. Upon closer scrutiny, it may be seen that the rate at which an agent has developed in any one country, and the direction of his evolution within that country, are the result of the environment within which he operates. These differences are most apparent in agents who represent foreign principals. For example, numerous agents in South Africa and Mexico tend to evolve into manufacturers, while in Canada and the United States they tend to become merchant wholesalers.

The following paragraphs will first develop a classification system indicating the likelihood of an agent being vulnerable to such evolutionary environmental influences, then propose a theoretical framework which shows what institutional character the adaptable agent will be most likely to assume.

## THE "HOT-COLD" COUNTRY CLASSIFICATION

Countries may be viewed as lying along a temperature gradient. "Hot" countries are those in which the environmental forces irresistibly push the agent toward new institutional structures. If he does not adapt,

he finds he no longer has any principals to represent, or competitors have taken most of his business away. In other words, the environment is "too hot" for his continued existence as a pure agent.

At the other end of the gradient, the manufacturers' agent finds few threats to his continuation as a pure agent. His principal is more inclined to let the agent handle his accounts as he sees fit, and competitive pressures toward institutional change are less dynamic. This is the comfortably "cold" country.

The factors which lead to a country being classified as "hot," "moderate," "cold," or somewhere in between are defined as follows:

- 1) Political Stability—a system of government which permits representation of the major segments of its society, enjoys the confidence of its people, generates conditions for continuity of business operations, and is sympathetic to private enterprise. A "hot" factor when stability is high.
- 2) Market Opportunity—a sufficient number of customers with incompletely satisfied needs and the necessary resources with which to satisfy those needs for the product or service in question. A "hot" factor when opportunity is high.
- 3) Economic Development and Performance—the level of a country's economic growth, efficiency, equity and stability, which shape the environment for private enterprise. Applying Rostow's classification<sup>3</sup> within the context of this definition, levels could be grouped as follows:

Low—the traditional society, the pre-conditions for take-off, and the take-off. A "cold" factor.

Medium—the drive to maturity. A "moderate" factor.

High—the age of high mass-consumption. A "hot" factor.

- 4) Cultural Unity—the values, goals, attitudes, social relationships and interactions between distinct segments within a country's people in terms of shared heritage, unassailed by competing groups. A "hot" factor when unity is high.
- 5) Legal Barriers—a proliferation of public measures in the form of laws and regulations which either deliberately or unintentionally restrict or discourage existing business activities and the future environment for private enterprise. A "cold" factor when barriers are high.
- 6) Physiographic Barriers—the obstacles to the development of efficient business operations created by the physical landscape or land forms of the country. A "cold" factor when barriers are high, and infrastructure is weak.
- 7) Geo-Cultural Distance—barriers created by geographical separation, cultural disparities between countries and problems of communication resulting from differences in social perspectives, attitudes and language. A "cold" factor when distance is high.

<sup>3</sup>For a detailed description of Rostow's classification, see W. W. Rostow, *The Stages of Economic Growth* (Cambridge, Mass., Cambridge University Press, 1960).



3

| Degree of Environmental Characteristics       | HOT Country | MODERATE Country | COLD Country |
|---|-------------|------------------|--------------|
| Political Stability<br>H - L                  | High        | Medium           | Low          |
| Market Opportunity<br>H - L                   | High        | Medium           | Low          |
| Economic Development and Performance<br>H - L | High        | Medium           | Low          |
| Cultural Unity<br>H - L                       | High        | Medium           | Low          |
| Legal Barriers<br>L - H                       | Low         | Medium           | High         |
| Physiographic Barriers<br>L - H               | Low         | Medium           | High         |
| Geo-Cultural Distance<br>L - H                | Low         | Medium           | High         |

EXHIBIT A  
THE COUNTRY TEMPERATURE GRADIENT  
A CLASSIFICATION SYSTEM OF ENVIRONMENTAL CHARACTERISTICS

The matrix configuration of this temperature gradient classification is shown in Exhibit A.

Thus, for example, an agent in Canada who represents a United States manufacturer would find his country classified as follows:

Political Stability . . . . high (a hot factor)  
 Market Opportunity . . high (a hot factor)  
 Economic Development  
 and Performance . . . . high (a hot factor)  
 Cultural  
 Unity . . . . . medium (a moderate factor)  
 Legal Barriers . . . . . low (a hot factor)  
 Physiographic  
 Barriers . . medium (a moderate factor)  
 Geo-cultural  
 Distance . . . . . low (a hot factor)

Since we find five "hot" and two "moderate" factors, we conclude that Canada is a relatively "hot" country under this classification system, and the manufacturers' agent probably will be forced to evolve as a marketing institution.

There are several reasons for likely evolution of the distributive arrangement away from simple agency representation. In a "hot" country, such as Canada, the foreign principal will experience a set of conditions conducive to foreign investment. The market potential for his product-mix is excellent. Few restrictions are imposed on direct injection of foreign capital and managerial skills. The government in power has shown its willingness to permit foreign-owned and controlled companies to repatriate part of their earnings. The government does not discriminate against foreign-owned firms in favor of domestic companies. In short, the U. S. company would perceive opportunities for greater profits through increased control over its distributive system in Canada, while the risks of its greater involvement would be minimal.

On the other hand, an agent in South Africa who represents a United States manufacturer would find his country classified as follows:

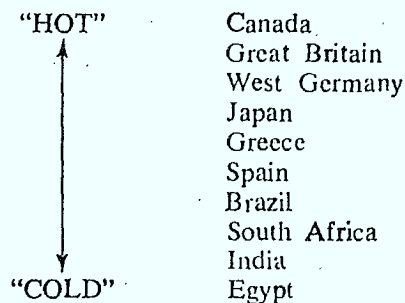
Political Stability . . . . low (a cold factor)  
 Market  
 Opportunity . medium (a moderate factor)  
 Economic Development and  
 Performance . medium (a moderate factor)  
 Cultural Unity . . . . . low (a cold factor)  
 Legal Barriers . medium (a moderate factor)  
 Physiographic  
 Barriers . . . . . high (a cold factor)  
 Geo-cultural  
 Distance . . . . . high (a cold factor)

It can be seen that this classification with four "cold" factors and three "moderate" factors, represents South Africa as quite a "cold" country, and thus the agent is less vulnerable to being forced to evolve.

In this situation, the U.S. firm foresees high risks in committing capital investments to South Africa. While the governmental attitude toward foreign investment is not negative, latent unrest among the populace, uneven distribution of personal income, and the so-

cial policies practised by the government act as obstacles because they portend possible social upheaval and commercial uncertainty.

Charts for several countries illustrate further the application of this classification system (see Exhibit B). These countries could then be ranked, when viewed as agent outlets for a U. S. based manufacturer, on a gradient ranging from "hot" to "cold" as follows:



#### ADDING PRECISION TO THE MODEL

It should be noted that such ratings of countries will change over time. The changes may result from factors both internal and external to the country, necessitating continual surveillance and possible revision of the country's classification. For example, within a country a change in government may bring about a dramatic shift in its policy toward foreign business involvement. In the international business sphere, regional economic realignments, new resource developments, economic assistance programs, and international financial movements may force a re-examination of the country's rank. Within the foreign principal's own country, such phenomena as guidelines for foreign investment, restrictive trade practice rulings, and shifts in the political climate may have a similar effect on the country's evaluation. Of no less importance are the results of changes in the objectives and resources of the principal.

It is widely recognized that within a country the environmental elements tend to develop along parallel lines as the country matures. Thus, it is the exception when one environmental element predominates to such an extent that it negates the other environmental factors in placing a country along the temperature gradient. For example, the possibility exists that a country at either end of the distribution channel may institute a policy which completely precludes foreign commercial involvement, e.g. application of the U.S. "Trading with the Enemy Act" against Communist China, or severely hampers involvement, e.g. other communist countries.

Further, countries ranked according to the temperature gradient classification system are approximately positioned. Although several countries may exhibit an identical classification mix, finer calibration of their relative position is dependent upon additional subjective weights. Rarely will two firms give identical rating to the same country. One manufacturer may be in a far better position to establish a strong buyer franchise, and thus view the foreign country as relatively "warmer", than another manufacturer who

EXHIBIT B

APPLICATION OF THE CLASSIFICATION SYSTEM

| Environmental Characteristics        | CANADA |   |      | GT. BRITAIN |   |      | W. GERMANY |   |      | JAPAN |   |      | GREECE |   |      |
|--------------------------------------|--------|---|------|-------------|---|------|------------|---|------|-------|---|------|--------|---|------|
|                                      | Hot    |   | Cold | Hot         |   | Cold | Hot        |   | Cold | Hot   |   | Cold | Hot    |   | Cold |
| Political Stability                  | H      |   |      | H           |   |      | H          |   |      | H     |   |      |        |   | L    |
| Market Opportunity                   | H      |   |      |             | M |      | H          |   |      | H     |   |      |        | M |      |
| Economic Development and Performance | H      |   |      |             | M |      | H          |   |      | H     |   |      |        | M |      |
| Cultural Unity                       |        | M |      | H           |   |      | H          |   |      | H     |   |      |        | M |      |
| Legal Barriers                       | L      |   |      | L           |   |      |            | M |      |       |   | H    | L      |   |      |
| Physiographic Barriers               |        | M |      | L           |   |      | L          |   |      |       | M |      |        | M |      |
| Geo-Cultural Distance                | L      |   |      | L           |   |      |            | M |      |       |   | H    |        |   | H    |

|                                      | SPAIN |   |      | BRAZIL |   |      | S. AFRICA |   |      | INDIA |   |      | EGYPT |   |      |
|--------------------------------------|-------|---|------|--------|---|------|-----------|---|------|-------|---|------|-------|---|------|
|                                      | Hot   |   | Cold | Hot    |   | Cold | Hot       |   | Cold | Hot   |   | Cold | Hot   |   | Cold |
| Political Stability                  |       |   | L    |        |   | L    |           |   | L    |       | M |      |       |   | L    |
| Market Opportunity                   |       | M |      |        | M |      |           | M |      |       | M |      |       |   | L    |
| Economic Development and Performance |       | M |      |        |   | L    |           | M |      |       |   | L    |       |   | L    |
| Cultural Unity                       |       | M |      |        | M |      |           |   | L    |       | M |      |       | M |      |
| Legal Barriers                       |       | M |      |        |   | H    |           | M |      |       |   | H    |       |   | H    |
| Physiographic Barriers               |       |   | H    |        |   | H    |           |   | H    |       |   | H    |       |   | H    |
| Geo-Cultural Distance                |       |   | H    |        |   | H    |           |   | H    |       |   | H    |       |   | H    |

does not enjoy a similar advantage. On the other hand, a manufacturer's greater international business sophistication may lead him to evaluate a country as being relatively "cooler" than his less experienced counterpart would evaluate it.

Product characteristics may warrant similar adjustments in the classification of a country. For example, for a highly technical and costly product, the country might be rated much "warmer" in the gradient than for a simple, inexpensive product.

### INTERNATIONAL BUSINESS ARRANGEMENTS

The temperature gradient shows how susceptible an agent might be to evolutionary influences. But, it serves a further purpose. When superimposed upon the various types of business enterprise which may be used in a particular environment, it also predicts the type of institutional structure into which the manufacturers' agency is most likely to evolve. (See Exhibit C.)

The degree of control which a principal can exercise in a foreign market is related to the "temperature" classification of the country.

In a "hot" country, by definition, the environmental elements force the agent to evolve. His very survival hinges upon his ability to adapt to changing market conditions, and expectations of his principal. In fact, this is true of all marketing middlemen. Thus, in such an environment, the foreign principal can exercise maximum control over the evolutionary process. He may establish a branch sales office, a branch plant assembly operation, or a wholly-owned manufacturing subsidiary. It is then within his discretion whether to retain the agent in a different capacity such as sales manager, salesman, branch manager, or distributive contact with the trade. On the other hand, he may choose to sever all ties with his former agent.

The foregoing situation is in fact the case experienced by Canadian agents representing American principals. Many of the present giants in Canadian industry originally employed agents to probe the Canadian market at the turn of the century. As the country developed, it rapidly moved up the temperature gradient from "cold" to extremely "hot" and, as a consequence, foreign principals by-passed Canadian agents. Thus today, more than one half of the manufacturing sector of the Canadian economy is controlled by non-residents, of which more than three-quarters is in the hands of American firms.

Modifying the exclusion of the Canadian agent has been the size of the foreign principal. While large principals have completely by-passed Canadian agents by establishing wholly-owned Canadian subsidiaries, smaller principals have established sales branches and assembly plants, and in many instances, have absorbed the agent into their sales organization.

The case is completely reversed in a "cold" country where the agent is least susceptible to evolution. Here the agent shapes his own evolutionary process. If he does not wish to change, he may continue as a pure agent unassailed by the influence of his foreign principal. On the other hand, if internal conditions

such as competition, the agent's financial and managerial resources, and market expectations exert pressure upon his functioning as an institution, he is most likely to adapt by establishing his own manufacturing operation, entering into a licensing arrangement, participating in a joint venture arrangement, or becoming a merchant wholesaler. In any case, he retains maximum control over the way in which he evolves and it is extremely difficult for the foreign manufacturer to exercise any significant power in the relationship.

Egypt provides an illustration of this condition:

"The machinery used to sell foreign goods has usually followed one of two forms: (1) selling through exclusive agents or representatives, and (2) selling through the manufacturers' own branches. Manufacturers own branches have dwindled in importance as a result of import restrictions and exchange control. The exclusive agent is now the basic importing institution. He is the authorized representative of the foreign manufacturer and is responsible for selling and distributing the goods throughout Egypt."

In fact, the foreign principal is virtually excluded from probing the market except through agents.

In South Africa, although foreign principals are not restricted from operating in the domestic market by such stringent legal barriers, the economy is still "relatively cold" and the internal market conditions exert evolutionary pressure upon the pure agent as an institution. Thus, when the marketing-oriented agent changes his institutional role, he does this because he so chooses. Consequently, he may actively negotiate joint venture and licensing agreements with his foreign principals or decide to engage in manufacturing on his own.

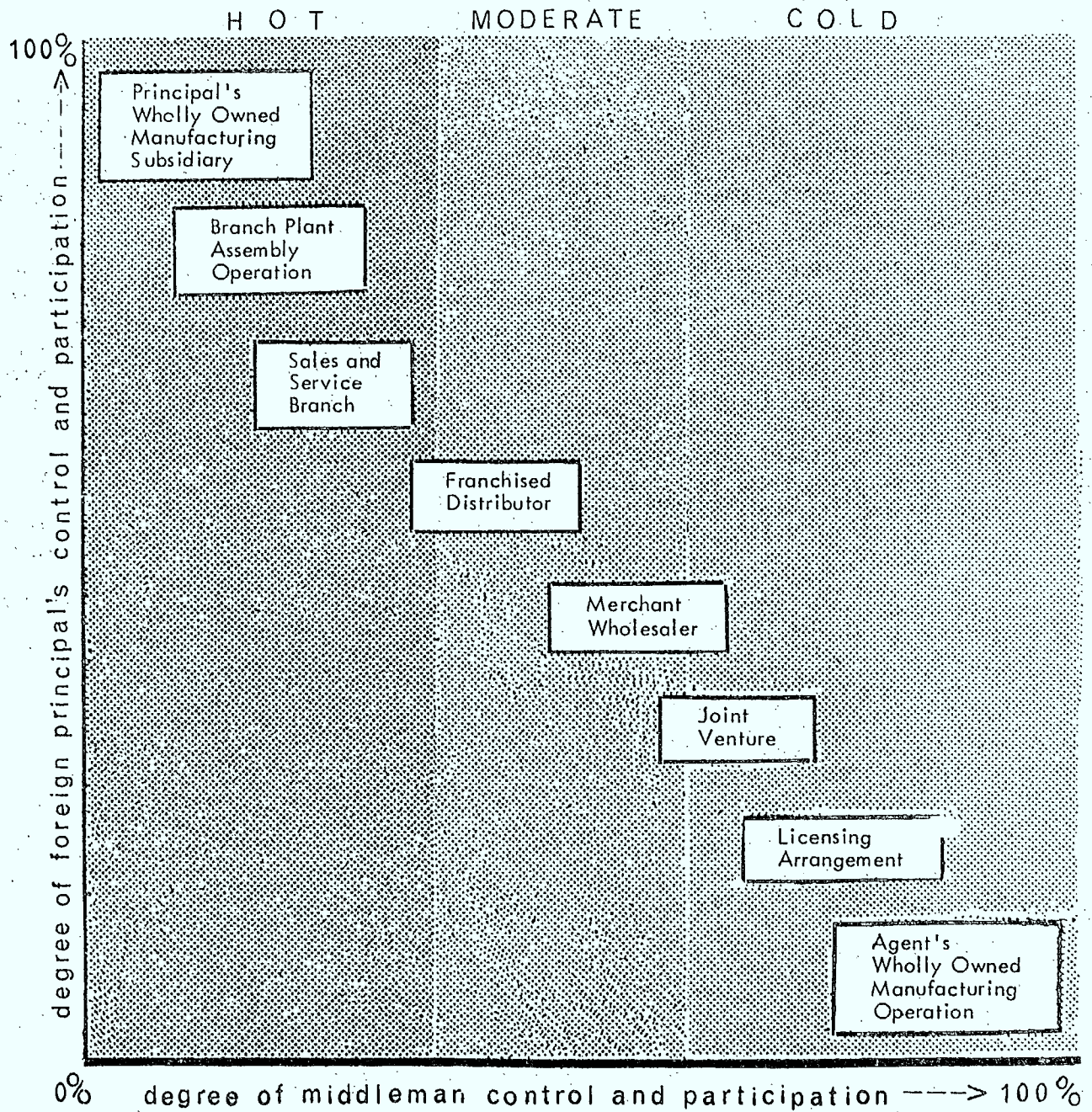
Foreign principals frequently may wish to enter such relatively "cold" countries as South Africa and Brazil, but are unwilling to experience the risks attendant to the country's "coldness." Thus, a foreign principal may seek out and initiate an arrangement with the agent, but does so in a situation where his control over the foreign operation is severely limited due to the agent's superior bargaining power over the negotiatory process. The following illustrations are examples of actual situations encountered in the South African market:

- 1) Certain agents in machinery and automobile distribution have recently decided to become assemblers or manufacturers on their own account through licensing agreements with their former principals.
- 2) In the cosmetics, hosiery, household appliances, and in consumer and industrial chemical fields, various agents have initiated their own manufacturing operations, some to the exclusion of their original principals, and others in partnership with them in the form of joint ventures. This new institutional arrangement has not prevented the South African entrepreneur



EXHIBIT C

INSTITUTIONAL STRUCTURE GRADIENT  
FOR INTERNATIONAL BUSINESS ARRANGEMENTS



from continuing in his capacity as an agent for other foreign manufacturers in non-competitive fields.

- 3) Some foreign manufacturers working through agents with limited resources have agreed to grant franchises to other South African entrepreneurs on the condition that the agent be retained in his capacity as a necessary distributive link. The most recent example has involved an agreement between an American foundation wear manufacturer, a South African clothing manufacturer and the manufacturers' agent.

Those countries lying in the moderate range of the temperature gradient exhibit an environmental setting wherein the pressures between agent and principal provide neither with absolute control. Thus, under pressure from his foreign principal, the agent may be persuaded to assume additional functions, but he retains sufficient flexibility to decide the course of his evolution. At the same time, he is still subject to domestic environmental pressures which in many instances have forced him to evolve into a merchant middleman in the capacity of either a merchant wholesaler, or a franchised distributor.

### IMPLICATIONS

The theory proposed here has been developed to explain and predict the way in which distributive arrangements evolve over time within different environmental settings. To do this, it isolated the key environmental elements which make the manufacturers' agent vulnerable to change, and dictate the institutional direction of his evolution.

Today, firms in the United States are becoming increasingly aware that their very survival will depend on their business success in foreign markets.

Whether the company is currently using any particular type of marketing middleman, or is planning to establish a new distributive arrangement, the conceptual framework is sufficiently flexible to predict the most favorable intermediary to employ, and what is likely to happen to that distributive arrangement. For example, in establishing a new distributive relationship, the company is better able to select the most effective intermediary and to determine whether it is necessary to build flexibility for change into the relationship.

On the other hand, a firm, already operating in, say, a "hot" country, with heavily committed investments, may be guided by this concept to relinquish control if the environment becomes "cooler." Without this guidance, the company may find control wrested away at a high cost both financially and in terms of continuing goodwill. This information is critical to any company's attempt to plan its international operations effectively in a highly competitive and volatile world market. Moreover, because of the need to continually audit the firm's commitments in a rapidly changing multinational environment, the necessity of having operational concepts is intensified.

The temperature gradient theory is useful to those marketers who are either intending to explore foreign markets, or are already engaged in international business. It suggests:

- a) the favorability of foreign markets, and the ease with which their opportunities may be realized,
- b) the degree of control the foreign principal can exercise over his distributive arrangements, and
- c) the degree of control the foreign principal can anticipate in the planning and development of his own operations in the foreign country.