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Planning your Global Strategy

Carol Sánchez and Steve Goldberg

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Sound planning and due diligence are important for both domestic and international strategic initiatives. However, in an international setting there are additional cultural, legal, and logistical considerations. In this article, we discuss considerations before doing business internationally. We address how a company knows it's ready to go international, special expertise required to go international, how to obtain that expertise, factors that should be considered in choosing a foreign market, finding an overseas partner, legal and tax issues considerations and, finally, how to get paid.

When is a Company Ready to go International

To succeed internationally, managers *should* know *why* they are selling internationally, *how* their product compares with competitors' products, *what* transactions are involved in selling internationally, and *who* they can consult, contract or hire to provide needed specialized expertise. A Chinese consultant who prepares U.S. clients to enter into agreements with Chinese partners urges due diligence with potential Chinese companies, to learn if they are solvent, if they can produce and/or pay on time, if they work with competitors, if they will respect intellectual property, etc. She reflects that often after U.S. managers' first visit China, they return with a signed contract. "I ask them, 'did you look at their balance sheet? Did you talk to their competitors? Did you talk to their customers?' And they say, 'no, how could we do that? We were the Chinese's guests. They entertained us graciously, they spoke perfect English, and they understood us. And wouldn't it be culturally inappropriate to ask those questions?'" She then helps her American clients pick up the pieces when performance on the contract fails.

The problem is not that the American company owners are insensitive to Chinese culture. The problem is that they acted knowing dangerously little about the culture, institutions and practices that govern business in China. Wining and dining do not substitute for due diligence. Sensitivity is not knowledge, and blind trust is no way to do business in any market -- especially not in unfamiliar international markets.

In these tough economic times, US manufacturers are searching for alternative ways to increase sales and spread fixed costs over a larger volume of products. At some point managers of medium-sized firms should consider selling internationally. But how does a medium-sized firm successfully sell products internationally? Isn't exporting a complicated and highly technical process? Doesn't a manager need to have intimate experience in foreign markets to sell successfully?

Selling internationally is different from selling domestically. First, less information is available about international markets, competitors, and financial stability of international customers. Second, international business involves many specialized transactions. Third, cultural and institutional differences affect the way business is done in other countries, and managers must be aware that they exist. But help is available, and managers don't have to be *experts* in that country or in those transactions to do business successfully.

Why do business internationally?

Exhibit 1 identifies four major reasons to expand business activity internationally. Medium-sized companies frequently want to export their current capacity and capabilities abroad. Exporting allows them access to new, often large, markets, mitigate domestic competition by selling in greater volumes, and achieve global brand awareness. A company might import products or components to keep manufacturing costs down. Customers or competition may force a company to

manufacture abroad. After experience with exporting, a company may want to be closer to its customers and distribution networks.

When is a company ready to sell internationally?

Exhibit 2 identifies conditions that should be met before embarking on international activity. A company is ready to expand sales internationally when management is committed to doing so. Management commitment means resources, which includes money, personnel and time. The entire company must be committed so that the shipping department, and every other department, gives priority to the new, international part of the business. Committing financial resources includes realistically assessing risk and return. Personnel must be developed or hired with international expertise. Commitment may include having the patience (and resources) to overcome weak or false starts.

Managers must understand their product's domestic strategy before they can design an international strategy. What makes your company successful in its current market? Why do your customers need your product? Do you compete on price, quality, customer service, brand image, or technology? How do you distribute – is it through agents, distributors or directly to end-users? At what point in the value chain – R&D, sourcing, manufacturing, marketing and sales, customer service – is your company providing the most value? What are you outsourcing? What makes firms in your industry profitable?

Knowing the answer to these questions will help you determine in which foreign markets you are likely to succeed and what functions might have to be replicated. In the US, your customers' buying power may be high because there are many competitive products among which customers can choose. In Mexico, customer buying power may still be high, but only because there are fewer

customers who can afford your product or there isn't a perceived need for the product yet. Being aware of differences in buyer behavior is important to your success.

Adequate cash flow is required for necessary flexibility and, thus, potential success of an international project. To move forward, a company should have adequate cash flow to cover identified worst case contingencies. Generally speaking, the more directly involved your company is in the international sale, the more money you will need. If you decide to export using an agent or distributor, your costs will be less, but so will your return. Also, adequate production capacity must be available to support international sales.

International Expertise

Exhibit 3 identifies considerations in obtaining international expertise. If you are exporting or importing, you need to know what international business transactions or activities take place, such as packing, shipping, obtaining export licenses, customs procedures, and INCOTERMS¹ (www.iccwbo.org/index_incoterms.asp). But particularly if you are just starting, you don't need to know how to do these things yourself. You can – and should -- contract or outsource expertise to provide services.

Choosing a freight forwarder is an important decision. Freight forwarders shepherd shipments from factory to customers. Their services include booking containers and transportation, scheduling, export and import documentation, inspections, insurance, warehousing, packing, loading, tracking, and follow-up claims, if necessary. The freight forwarder is your agent. Your company is directly responsible for any mistakes he or she might make. Choose a freight forwarder with a track record of expertise, financial strength, solid customer and bank references, and comprehensive services. Good

¹ Incoterms are standard trade definitions devised and published by the International Chamber of Commerce most commonly used in international sales contracts.

freight forwarders tend to be large, and the most experienced serve multinational firms with foreign subsidiaries. Some are specialists in an industry; others are generalists.

Carefully determine whether your product requires modification to meet your target market's technical requirements as well as local tastes. To sell in Europe, your product may need to meet the criteria set by the CE Mark. There may be local health and safety regulations. Your one-inch fastener might require a change to a 2.5 cm fastener. Your 8-oz bottle may need retrofitting to a 250-ml bottle.

When doing business internationally, not only are there language and money differences, but also significant differences in people's attitudes and behaviors regarding time, authority, risk, status, social groups, family – among other things. Attitudes and behaviors transcend social niceties: they affect business transactions too. For example, a decision on a purchase order may require the authorization of several managers of the German firm instead of just one in the US, because companies in Germany may be more centralized than US companies. If you tend to delegate broad responsibilities to your subordinates, you may have difficulty being understood by some Southeast Asian workers, who are used to receiving specific, detailed instructions from supervisors and are not used to having extensive decision-making authority. If you prefer a first-name basis with your employees, you may embarrass your Mexican work force by asking them to call you "Bill." They are accustomed to addressing authority figures with formal titles.

Understanding differences in culture and values contribute to international business success. (For more information on cultural differences, see Hofstede, 2001.) Mexican workers tend to accept the authority of others more than US workers do. Portuguese are more risk-averse, and may be uncomfortable with the introduction of new work systems or procedures as compared with North Americans who have a much higher tolerance for change and risk-taking in the workplace. The United States culture emphasizes values such as competition, professional status, power and material rewards.

Swedish workers tend to place more value affiliations, family and quality of life. So, your compensation and reward system for Swedish workers may look very different than the one you design for US workers.

Understanding cultural differences helps you trust and be trustworthy when you do business in other countries. Business behavior should err on the side of formality. You can read books about proper etiquette in foreign countries, but if you speak, dress, act and behave in your most formal and polite mode -- as opposed to your informal mode -- you are more likely to be successful. You should read about the country and the culture where you will do business. Never assume you know everything. On the contrary, recognize that the more you know about a culture, the more there is to learn about it.

Having said that, be true to your company and its culture. Respecting the host culture doesn't mean forgetting your own. If your job is to do due diligence about a potential partner, or to investigate the terms of a sales contract, then do your research thoroughly. As mentioned earlier, don't be so fearful of being culturally insensitive that you fail to do what good business practice dictates.

In Which Foreign Markets?

The only reason to sell in another country is because the country and its buyers have a risk and return profile that fit your company's strategy and product. Managers often decide to sell in a foreign country for poor reasons such as being impressed in a personal conversation, liking the climate or lifestyle in a country, or selling overseas because everyone else is doing it.

Carefully analyze any country of interest. Go to a library or go on line and search the US Department of Commerce's National Trade Data Bank (www.stat-usa.gov/tradtest.nsf) for current reports on the country's political, legal and economic environments. Determine critical factors for success. Exhibit 4 lists some factors that might be critical for your company's success. Is the currency

stable? Is the government stable? Are elections likely to affect your business? Is contract law well-developed? Consider the country's natural, human and physical infrastructure. Is there sufficient energy to run your factory, or ports and harbors to receive your goods? Are there skilled people, at what wage level, and how old are they? Are there adequate roads, airline service, phone systems and internet access? Finally, research the cultural and institutional environment. How large is the potential market after considering competition? Would the country generally be accepting of your company and its product?

Know your product and competition in your domestic market. In the US, your product may face significant competition. Your strategy might be to provide it at the lowest cost. But in Mexico, your product may be new or you may be able to add attributes to it that differentiate it from your competition. Customers may be willing to pay more for it because it is unique. Your market may be smaller because fewer customers have disposable income to buy your product, but you may have a first mover advantage that sets you apart from competition.

Discovering industry trends and competitive behavior in your new market may be difficult. Competitive information about your industry in other countries is often difficult to get. The US Department of Commerce (www.stat-usa.gov/tradtest.nsf) has staff in most countries whose job is to obtain and document business information for the benefit of US companies. They research industries and write reports on the business climate, trade leads and products sought by foreign companies and governments.

US trade shows industry can be a valuable source of trade leads. Foreign buyers attend because they know that in the US there is a wide variety of sellers who supply high quality goods at great value -- given the current low price of the US dollar. Proactively seek out foreign visitors at trade shows. Gather as much information as you can about their country, their market, and competition.

Trade barriers range from direct taxes such as tariffs to indirect constraints such as increased paperwork and documentation. Since the establishment of the World Trade Organization (WTO), the global trend has been reduced trade barriers especially among the 148 WTO member countries. But barriers do exist, and you should examine whether tariff or non-tariff barriers have the potential to derail your international project.

Exporters and importers consult the Harmonized Tariff Schedule of the United States (HTSUSA) to properly classify their merchandise. Within the HTSUSA, the export classification system is called Schedule B (<http://www.census.gov/foreign-trade/schedules/b/>). The import side is called the Harmonized Tariff Schedule of the United States Annotated (HTSA) (<http://www.usitc.gov/tata/hts/other/dataweb/>). Search by product name, and find the associated HTS number. Then consult the category in U.S. trade documents (General, Special or Statutory) to determine whether or not U.S. import duties will be levied if you import a product from China. General duty rates are for most favored nations or WTO members. Special rates are for nations that enjoy regional or other agreements (such as NAFTA, or Israel). Higher, statutory rates and special licenses are required for goods from countries with which the US has poor relations such as Cuba, Iran, Libya and North Korea. If you wish to export your product to Brazil, for example, consult Brazilian tariff information to see if they will charge duties. For a general idea of foreign tariff levels, read the U.S. Department of Commerce's Country Commercial Guides for your target country (<http://www.buyusa.gov/home/>). Governments may also levy transaction fees, excise taxes and value added taxes. Your freight forwarder will calculate these fees, but be aware they exist.

Non-tariff barriers include quotas, or government-imposed limits on the quantity of goods, and standards, such as environmental rules, labeling, testing requirements or product specifications. US Food and Drug approvals, the ISO 9000 + standard and the European Union's CE Mark are examples

of standards, as is the French requirement that all products sold in France be labeled in French. There may be other non-tariff barriers. Discuss with your banker, freight forwarder and other service providers to determine if they apply to your product.

How do I find a partner?

We consider two indirect market entry approaches to selling into a new market (see Exhibit 5). The first is by using an export management company (EMC) and the second is by using what export expert Jim Foley calls the “piggyback partner” (1999). Both have advantages. Using an EMC is akin to contracting out your international sales. EMCs contact foreign distributors on your behalf to represent you in that market. The EMC is an extra step in the sales chain, but often you know which distribution channel they have appointed to represent you. At some point you may make direct contacts in the foreign market. However, EMCs may keep their network hidden from you, to increase your dependence on them and avoid the likelihood that you sell on your own. To find EMCs, ask your industry associations, search trade journals, visit your local trade center, visit the US Department of Commerce Commercial Service, and surf useful websites (www.myexports.com) for the US Exporter’s Yellow Pages and www.fita.org for the Federation of International Trade Associations.

The piggyback partner is much less likely to reveal his distribution network to you, which makes it more difficult to sell on your own at a later date. Jim Foley (1999) recalls a client who wanted to sell truck parts in China. He found a fit with a piggyback partner, a leading truck manufacturer who owned a subsidiary in China. But if the partnership were to end, the truck parts maker would not be able to sell directly to the Chinese subsidiary. To sell anything at all he would need a new partner. But the piggyback strategy can work in many situations. You can find a piggyback partner by networking with customers, at trade shows, and through your trade associations.

Screening them before you hire them is critical, because they end up with significant control. You want to be sure your partner will represent your product in a way that is acceptable to you. For example, they may not sell your product under your name, and instead sell it under their own or with a private label.

If you prefer to be directly involved in selling your product overseas, you may choose to contract with a sales agent. Sales agents represent your products in the market but do not take legal title. The agent arranges the sale. The manufacturer ships the product, invoices and collects from the buyer directly. The manufacturer pays the agent a commission. This arrangement provides greater risk and greater control. The manufacturer assumes the risk of being paid, no overseas inventory is held by the agent, and the manufacturer (often via his freight forwarder) is responsible for conducting all import transactions. In some countries, the agent may be considered as an employee of your company. The manufacturer is directly involved in the sales process, knows his customers, can restrict sales, sets price, and, thus, gets greater feedback from buyers.

Distributors take orders directly from customers, place orders on the manufacturer, take title to goods, inventory goods locally, market them, sell them, collect from customers and pay the manufacturer. Distributors may market your product more aggressively than an agent, and provide after-sales support. Since they take title of the product, they may know import procedures and move goods efficiently. On the other hand, distributors, have higher costs of operation, thus, markup the price of product. When you choose your distributor, be sure to negotiate pricing issues in advance.

There are considerations in choosing between an agent and a distributor. A distributor arrangement tends to reduce risk but also reduces control over product. If it is best shipped in full container loads, you may need a distributor who can assume and manage inventory, as opposed to an

agent who handles specific, individual orders. If your products are smaller, lighter, and have a high per unit value, shipping individual orders and using an agent may work better.

If possible, visit your potential new market before you enter into any agreement. Meet candidates before you choose your agent or distributor. Know how your product will be sold, through which distribution channels, and what is your competition. Personally visiting a new market gives you insights on how people live, how people and organizations buy things, and the way business operates. It's difficult to obtain those insights from secondary research.

Legal, Tax and Accounting Issues

Law is not practiced the same way all over the world. In common law countries, such as the UK, the US, India and most former British colonies, law is based on tradition, precedent and custom. Courts interpret and may overturn laws. In civil law countries, such as Japan and countries in Continental Europe and South America, law is organized into detailed sets of codes. These laws are rarely revised and courts rarely interpret them. Everything is spelled out in the code. For example, contracts written in civil law countries tend to be shorter because codified law incorporates all of the issues of concern in a contract. Contracts in common law countries are longer because they tend to cover contingencies that might not be covered by existing law. How specific or general your contract has implications for you and your business, and it's important to recognize the difference.

Some US laws govern US companies doing business overseas. The Foreign Corrupt Practices Act (FCPA) and embargo laws prohibit US companies from doing certain things when they participate in international business. The FCPA forbids US companies from bribing foreign officials to obtain or keep business. Embargoes forbid companies from selling to restricted countries such as Cuba and North Korea. Export controls prohibit the sale of certain products, such as chemical and biological

materials that could be used in weapons manufacture. The US Department of Treasury's Office of Foreign Assets Control has a list of Specially Designated Nationals, or individuals with whom it is forbidden by law to do business. This has become particularly critical since 9/11. If you violate these laws, whether you know about them or not, you and/or your company may be prosecuted.

It is challenging to protect your intellectual property when you sell overseas. US law protects your intellectual property only in US territory. It may be necessary to obtain patents for products in some or all of the countries in which you do business. There are a growing number of multilateral patent agreements that allow you to file in one country and obtain protection in another or a region. Nevertheless, intellectual property law is complex and you should seek help from a legal expert.

Value added tax (VAT) is a local law that exists in most foreign countries. It is similar to our local and state sales tax but is collected at the federal level at point of entry when goods are cleared through customs. VAT rates can be as high as 20% in some countries. It often represents a larger percentage of government revenue than personal or corporate taxes. Consumers eventually pay, as sellers roll the VAT into the purchase price. The importer usually pays VAT up front, but this depends on how the export terms were set up between you, the exporter, and the buyer, the importer. If the terms of the sale are such that all freight, duty, and customs expenses are paid by the seller (called DDP in INCOTERMS), the US exporter may have to pay VAT up front. Make sure the price you charge your foreign buyer reflects the terms of sale.

There are tax incentives for US exporters. One of them is called duty drawback. If exported products contain components or raw materials that were imported into the US, you may be able to obtain a refund on import duties paid. Obtaining duty drawback is complicated and requires complex documentation. Work closely with your freight forwarder and tax accountant to pursue duty drawback.

Until October 2004, the most important tax incentive for US companies was the Foreign Sales Corporation (FSC). Under certain conditions, for certain products, and by setting up a new company in a qualifying country such as the US Virgin Islands, FSCs allowed US companies to reduce the effective rate of tax on their export sales by about 5%. But in October 2004, the FSC law was repealed by the US Congress, largely due to the WTO ruling that the FSC program was a de facto export subsidy that violated international trade rules

Payment Terms

All business has risk, but international business has added risk that is not necessarily mitigated by the US's solid financial institutions, common currency and a legal system that protects property rights. Getting a credit report from a foreign buyer can be difficult, and currency fluctuations increase an exporter's worries. There are three fundamental types of risk: credit risk, political risk and foreign exchange risk. Credit risk refers to the possibility that your customer will be unable to pay when payment is due. Political risk addresses the likelihood that government action restricts your ability to do business or collect payments. To mitigate these risks, select payment terms based on your assessment of your customer's credit risk and the environment's political risk. The higher the risk, the more you need to use secured payment terms.

Exchange risk is the probability that the exchange rate between the seller's and buyer's currency will unexpectedly change resulting in a loss for one of the parties. A common technique for hedging exchange risk is through a forward exchange contract. As the seller, on the date of the sale, you could enter into a contract with a bank to exchange the amount of foreign currency that you expect to receive at a given future date, say, 60 days out, for dollars at the 60 day forward rate. The forward contract is a binding agreement to deliver a fixed amount of one currency in return for a fixed amount

of another currency at a future date. Consult with your international banker to learn about other risk-reducing options.

After assessing risk, payment terms are agreed to with the customer. A competitive market may reduce negotiating power. Risk is minimized with either payment in advance or an irrevocable letter of credit from a U.S. bank. Buyers usually transact advance payment using a bank-to-bank wire transfer for a flat fee of about \$50-\$100 per transaction. Work with your banker to design the best way for you to be paid in advance.

An irrevocable letter of credit (L/C) lowers the risk to both sellers and buyers because if there is no shipment, there is no payment. Once the documents verifying shipment are presented to the bank – called a sight draft – the buyer's bank releases payment on the L/C to the seller's bank. Longer terms can be negotiated. Letters of credit are secure, but they are complicated and they can be expensive as the cost is related to the value of the transaction. Consult with your banker to design the most secure L/C given the level of risk you are willing to absorb.

An open account raises the seller's risk and lowers the buyer's risk. The seller ships without having to wait for a wire transfer or a L/C, and the buyer receives the goods immediately. Open accounts are quite common. But exporters who use them do so only after significant experience with a buyer, after a number of transactions with advance payment or L/C, or by adding credit insurance to the payment package to protect themselves against customer default.

Whatever payment method you choose, it should reflect your tolerance for risk and your desire to be competitive. The best payment method will depend on level of political risk in that country, credit worthiness of the customer, relationship between seller and buyer, how competitive your product is in the market, how large and how frequent your shipments are, and how much risk you are willing to

assume. The less risk assumed by the seller, the more risk the buyer assumes and potentially the less competitive are the seller's offerings.

Conclusion

There are potentially significant rewards to be obtained from entering foreign markets. Managers should carefully consider a number of factors to assess the risk and reward trade-off before making the decision to internationalize operations. Hopefully, we have provided a framework and some insight in deciding the why, when, which, and how of entering foreign markets.

Exhibit 1

Reasons to Go International

- Access new or large markets
- Mitigate domestic competition
- Get global brand awareness
- Lower production costs

Exhibit 2

A company is ready to sell internationally:

- When management is committed to doing so
- When you know your product and your competition
- When you have sufficient cash flow
- When you have production & sales capability

Exhibit 3

What International Expertise Do I Need?

- Legal advice on contracts
- Banking advice on payments and currency exchange
- Freight Forwarder advice on tariffs, shipment terms, title, insurance
- Accounting advice on taxation
 - Know when to hire, develop, or outsource it!
- Do I standardize or adapt my product?
- Cultural and institutional differences

Exhibit 4

Considerations in Deciding Where to Sell

- Political, economic and currency risk.
 - Legal and regulatory environment.
 - Size and tastes of market.
 - Natural and human resources, infrastructure

- Your product's strategic fit and local competition
- Industry trends, competitor behavior
- Tariffs, trade barriers
- Trade leads, trade shows

Exhibit 5

Finding a Partner

- Indirect market entry
 - Export management companies
 - “Piggyback” partners.
- Direct market entry
 - Sales agents
 - Distributors
- Travel if you can

Exhibit 6

What legal, tax and accounting issues should I be aware of?

- Local legal differences
 - Common law versus civil law
 - Intellectual property law, value-added tax
- US Law
 - FCPA, embargoes, export controls, Homeland Security
- Let a tax expert handle most tax and accounting issues

Exhibit 7

Payment Considerations

- Credit, political, foreign exchange risk
- Payment options:
 - Advance payment
 - Letters of credit
 - Open account + credit insurance

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