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Conference Paper

Internationalization, competition and transfer of knowledge: And the efforts by companies in BRIC countries to enter markets in USA and Europe

53rd Congress of the European Regional Science Association: "Regional Integration: Europe, the Mediterranean and the World Economy", 27-31 August 2013, Palermo, Italy

Provided in Cooperation with:

European Regional Science Association (ERSA)

Suggested Citation: Westernen, Knut Ingar (2013) : Internationalization, competition and transfer of knowledge: And the efforts by companies in BRIC countries to enter markets in USA and Europe, 53rd Congress of the European Regional Science Association: "Regional Integration: Europe, the Mediterranean and the World Economy", 27-31 August 2013, Palermo, Italy, European Regional Science Association (ERSA), Louvain-la-Neuve

This Version is available at:

<https://hdl.handle.net/10419/123860>

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Internationalization, Competition and Transfer of Knowledge - and the Efforts by Companies in BRIC Countries to Enter Markets in USA and Europe.

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Abstract

Internationalization and competition now cuts across national borders, a firm's position in one country is no longer independent from its position in other countries. This has at least two implications, it is an advantage for the firm to be present in several major growth markets. It is also desirable integrate its activities on a worldwide scale, in order to exploit and coordinate linkages between these different locations. Competition also cuts across sector boundaries and market segments: This growing complexity of competition has changed the determinants of firm organization and growth, as well as the determinants of location. No firm, not even a dominant market leader, can generate all the different capabilities internally that are necessary to cope with the requirements of global competition. In this paper we will use the Brazilian company JBS' acquisition of the US company Pilgrim's Pride at the end of 2009 as an example to look further into the questions raised above.

Keywords: Internationalization, Competition, Transfer of Knowledge, Poultry.

Paper to be presented at 53rd ERSa Congress, 27-31 August, 2013, Palermo, Italy.

1 Introduction

International trade has been going on for hundreds of years, but it was only after the conditions for free trade were improved from the 1960's and onwards that international trade was a common phenomenon for a large number of firms in most countries of the world. Previously, international trade was characterized by high transport costs and the risk of participating in international operations for many companies was high, but on the other hand the possibilities for making large profits were also present. From the sail ship era through World War II we saw that skilled trade companies could make high profits if they had well developed knowledge about the culture, language, institutions, and how the market systems worked in the countries they were dealing with, and combined this with a strong competitive and financial situation in the country from which they operated. The two major structural changes we have seen in international trade occurring over the past 40 years is that companies now have far less risk to participate in international operations and transportation costs compared to the cost of the actual traded goods has dropped substantially.

Globalization is often defined in economic and commercial sense as a global network of economic processes between companies, institutions and governments in different countries. Furthermore, we talk about the internationalization of companies and it is often defined as international networks between companies in different countries. The use and understanding of the concepts we find in the literature, such as Dunning (2008), show the interpretation that globalization is often understood as more general economic/political processes compared to economic internationalization which is linked more directly to the exchange of goods between companies in different countries. Today, one can see that there is a high percentage of goods and services available on the world market. Furthermore, many companies whether they are internationalized or not, compare themselves with competitiveness and cost structure similar to other companies on the international arena. A multinational company, MNE, (Multinational Enterprise) is defined as a company that operates in two or more countries.

In this chapter we will first focus on explanations why companies want to establish operations outside the borders of their own country. In the literature about internationalization after 1960 we have seen two main theories or two key approaches to explain companies' international participation:

(1) "The Eclectic Paradigm of International Production". This is mainly related to the economist John H. Dunning, and will be called Dunning's model, Dunning (2008).

The second model is:

"The Uppsala Model of Internationalization", which will be called the Uppsala model, Johanson and Vahlne (1990). In this paper we will pay special attention to the role, development and dissemination of knowledge in both models.

The traditional internationalization processes we have seen after World War II have been characterized by looking at resourceful businesses in economically strong countries like the USA and Canada, countries in Western Europe and the Soviet Union/Russia. The transfer of knowledge from resourceful companies in the developed western world has often been modest to the recipient country and profit considerations have played a major role. An interesting structural change we have seen in relation to internationalization processes over the last 10-20 years is that companies from newly industrialized countries with growing economies like China and Brazil (often called BRIC countries, which is Brazil, Russia, India and China) have now conducted similar processes in relation to companies in Western Europe and the USA. An important part of the fundamental discussion in this chapter will be on strategies for when knowledge transfer actually is changing and how companies in BRIC countries use knowledge to develop competitiveness. This will also be discussed in relation to an empirical example at the end of this chapter.

2 Explanations of Globalization and Internationalization

2.1 Definitions and Concepts

When analyzing the characteristics of the multinational company an often used definition is given by Dunning (2008) where he says:

"A multinational or transnational enterprise is an enterprise that engages in foreign direct investments (FDI) and holds or controls value-adding activities in more than one country".

The process one often studies when a company is taking part in internationalization is that the company acquires companies in other countries fully or partially. Another criterion that is often used to assess whether internationalization goes on, is how much the value of

production for internationalized companies grows in relation to the actual production of national companies in the country. It is in this context interesting not only to look at production growth in volume, but also the number of employees who are related to internationalized production. It is also interesting to look at the activities in research and development that internationalized firms contribute both to develop their own competitiveness and what kind of spread effects to other companies both at home and internationally take place.

Starting in the 1960's there has been a discussion about the extent to which internationalized companies make profits in the country where they establish operations and take these profits back to the country where the company has its headquarters. This discussion accelerated through the 1960's and 1970's, in relation to critical analysis of this phenomenon, for example done by Baran and Sweezy (1965) in their famous book "Monopoly Capital". It has throughout the post-war period been a debate about the exploitation of poor countries, in the light of how and to what extent internationalization is a driver of this phenomenon.

It is important to use the concepts correctly in the sense that an increase in export between two countries does not necessarily have to be reflected by a corresponding increase in the internationalized production. A distinction is often made between direct and indirect exports in the sense that direct export occurs from the company in one country to recipients in the other country when it is not taken care of by commercial agents or other intermediaries. The indirect exports are first based on the company's production, but then transferred totally or in part to agents, distribution companies or providers before the product enters the market in the country it is sent to. To what extent internationalized firms contribute to increased exports from the country they are internationalized to vary, but often it is the case that the internationalized company send goods back to the parent company in the country of origin. But it may also be that the internationalized company establishes new activities in a country to sell their products domestically which reduce the export from the supplier in the originating country. This is a widespread phenomenon in the automotive industry with examples like Toyota that established factories in the United States, and U.S. car manufacturers that established themselves in Japan. Statistically, this reduces export volumes. In the 1960s and 1970s, we saw many several examples of American companies that started up commodity production in other countries, or bought companies and this increased export of goods back to

the United States, which is statistically an increase in export volumes globally.

A central concept in the discussion about internationalization is foreign direct investment, FDI. We have seen many examples of different strategies for how a company can improve its market position and competitiveness in another country. One way to do this is to invest in the new country while other strategies can be building up alliances with companies in other countries or establish contracts for licensed production. There is a perception among most economists that foreign direct investment (FDI) is an important part of growing globalization.

Dunning (2008) defines FDI:

"FDI consists of a package of assets and intermediate products such as capital, technology, management skills, access to market and entrepreneurship."

It is important to be aware that FDI is more than just for a company to spend money in another; this is normally a process where integration of activities between companies is one of the keys for success. Another issue discussed is how much control the parent company must have when conducting a FDI for this to be considered as a substantial investment abroad. This brings up the discussion about the differences between active and passive industrial owners. Normally it is the case that the parent company must have more than 10% of the capital of the new company in the new country which is looked at as a minimum to have real influence because of the FDI. On the other hand, we also talked about passive industrial owners (such as the Norwegian Oil Fund) where the strategy of the financial investment is to receive returns, but to exercise shareholder rights is not the primary purpose.

2.2 Dunning's Model

The first explanations that have been widely put forward to say what the factors behind internationalization are, was given by Professor John H. Dunning in the 1980s and have developed further since. Dunning uses the term "eclectic paradigm" and he does so because his approach to internationalization is to look at it as (Dunning (2001)):

"A conglomeration of various (eclectic) factors which are melted into a paradigm rather than a proper theory."

It is precisely this understanding of the word "eclectic" that is found in the Oxford Online Dictionary where the definition is:

"Eclectic: Not following any system, philosophy or theory, but selecting and using what are considered to be the best elements .

The factors Dunning chose as the best elements to explain internationalization are:

1. Benefits justified by ownership
2. Benefits justified by localization
3. Benefits justified by internationalization incentives

This is often called Dunning's OLI explanation of internationalization (Dunning (2001)) where:

O = Ownership,

L = Location

I = internationalization incentives

Dunning uses and applies his theory at the company level and one of his main conclusions is that multinational companies choose their internationalization strategy based on the OLI advantages the company can achieve.

Ownership

Dunning argues that there are clear advantages to owning a company or organization completely or partially in the country where the parent company wants to establish operations like exporting. Dunning has three main arguments why ownership in the recipient country is beneficial, and the first is that by being established, it is easier to gain information about the market situation and thereby other competing firms. The other main argument is that the parent company has easier access to the specific resources of the country and this is especially important for labor, raw materials, capital and technology. The third argument is that ownership is advantageous because it gives insights to culture and attitudes to management.

Localization

There is no doubt that localization plays a role and localization in the country which is the recipient of the goods is advantageous because you can access resources and communication infrastructure in a more efficient way. Furthermore, it is also true that localization can give access to special initiatives and policies by national and regional governments.

In his attempt to explain internationalization Dunning says it is very important to look at how the three factors (OLI) interact. It has been argued that what Dunning calls the benefits of internationalization incentives is more or less the same argument that he puts forward when he argues about ownership and localization. The main expression Dunning gives in relation to the I-factor is (Dunning (2001)): "a wish to reduce transaction or information costs, buyer ignorance or uncertainty."

In summary, one can say that Dunning tries to explain that a company will start up with direct investments abroad when arguments looked at in the light of the three OLI components are large enough. Dunning's theory has been criticized by many like Perlitz (2004) who says that at least two more elements should be added to the OLI factors and that is the companies' overall strategy and its financial strength. Other critical arguments to Dunning's theory are that that it is statistically difficult to verify. The way Dunning tries to explain internationalization is difficult to operationalize, especially it is difficult to establish a data collection system so that the OLI components can be tested. It is also argued that Dunning highlights the factors he finds that explain internationalization in the best way, but that he has to a modest degree analyzed the processes that underlie this development.

2.3 The Uppsala Model of Internationalization

The Uppsala model was developed by Johanson and Vahlne in the 70's and is documented by Johanson and Vahlne (1990). This model to explain why internationalization takes place is partly based on the theories of Cyert and March (1963) and it also has elements from Penrose's theory of business development, Penrose (1959). The empirical basis for the model is that the two above mentioned scientists were employed at the University of Uppsala and they studied internationalization in four Swedish companies, Sandvik, Atlas Copco, Facit and Volvo. The key focus of this study was how these Swedish companies gradually built up their companies to be able to enter into international markets. The Uppsala model can be viewed as a theory in which the central issue is how companies learn in new markets in the countries where they establish activities. The central element of the theory is that internationalization takes place and evolves based on how capable companies are to gain knowledge about all the conditions that face them in the new country.

The Uppsala model emphasizes that the internationalization of a company is a corporate development and occurs gradually. The typical story of a company is that it at first operates in the domestic market and gradually gains financial strength and competitiveness. With a strong platform in the home market the company manages to start exporting to other countries and this normally begins by establishing alliances with other companies in the new country. Then developments happen continuously so that the parent company more and more gains control and often ends up by doing foreign direct investments. Another feature of the Uppsala model is that internationalization normally first takes place in neighboring countries with a relatively similar culture and market conditions. Then the company moves to more distant and different countries and the success of this depends on how able the company is to learn and to capitalize these learning processes into profits.

The Uppsala model has also been criticized, see Kutshker and Schmid (2006), using some of the same criticism as the Dunning model, namely that it is difficult to test empirically. The Uppsala model is maybe even more problematic to test than the Dunning model since it is difficult to find actual indicators of what corporate learning is about and how the company internalizes learning processes. The Uppsala model is also criticized from the point of view that learning processes are important but it is also important to assess the resources the company has both for learning and being able to compete in foreign markets in general. Companies that have strategies for internationalization must have financial resources to take some losses and restructure if the conditions in the new country change.

Another factor that is of importance when looking at how internationalization takes place is the behavior of the institutions in the country where a company wants to establish new operations. We have in recent years seen examples from China that institutions and rules about market conditions set up by institutions can be quite unpredictable and this provides unique challenges in terms of internationalization.

A comparison of Dunning's model to the Uppsala model, shows that the Uppsala model is based on assumptions about the behavior of companies while Dunning's model is formulated in the way that it chooses the factors considered most reliable for explaining internationalization. One can say that Dunning's model seems to have no other behavior built into it than the more general assumptions that companies seek to maximize profits. In relation

to timing the Uppsala model is a process-oriented way of analyzing while Dunning's model only argues that the OLI factors are all important. Another feature is that the models have a different attitude to the domestic market. The Uppsala model argues that strength and resources are important to build up in the domestic market before the company can go abroad, while Dunning is not taking this argument explicitly into account.

The Uppsala model has a clear point of view that corporate behavior is an important incentive to avoid uncertainty and that this is an important driver behind internationalization.

Comments to the Dunning model (Kutchker and Schmid (2006)) argue that assumptions built into this model about rational behavior are more or less like what we find in neoclassical business firm theory while the Uppsala model is more directed towards a resource-based theory of the firm.

3 Different Aspects of Globalization

3.1 Globalization in a Critical Perspective

Globalization involves historical changes and factors that are of importance include:

- The interplay between market forces
- Political government intervention
- The importance of culture and tradition combined with conditions at the local level

From a critical point of view, one can question the positivist distinction between facts and values when trying to figure out what this globalization is about. Even in a critical perspective there is no reason to completely reject all forms of research based on a positivist tradition which is based on traditional data collection about states and changes taking place with respect to production volumes, number of employees, turnover and other indicators.

Furthermore, it is interesting to analyze the process lying behind the construction of new concepts that are used in communities when new companies are established in another country utilizing new raw materials, new technologies and new forms of leadership. It is also interesting to look at the stories (narratives) that are told about actual processes of change that occur when internationalization takes place. It is also interesting to see how these changes from internationalization change and develop society's institutions in those places where new production is taking place or where new imported goods are utilized. If we try to reconstruct how internationalization took place and the impact it had, one can for example refer to

Gramsci (1971; 2000) where he argues that we must combine elements from different forms of understanding, not only on the basis of changes in production conditions but also to how people who live there relate to changing conditions. This brings forth a new type of understanding which is what Gramsci calls "common sense propositions."

When we do such an analysis of changes internationalization brings about the selection of time horizon is important. The more general question is the following, when did internationalization actually begin, was it the Chinese export via the Silk Road that began more than 2000 years ago, was it the sail ship's trade with spices and other valuable goods, or was it after trade barriers largely disappeared in 1960 - 70's and strong developed countries like the U.S. and countries in West Europe took to a greater extent control over raw materials and other resource-based commodities? The conclusion so far is that by analyzing globalization one has to be aware of how values change in societies and do this within a historical framework.

An example to illustrate how globalization contributes to the construction of new concepts and how the narratives alter perception and knowledge formation can be the following. In China, we have the last 10 years seen the establishment of department store chains like Wall-Mart (US-owned) and Carrefour (French/Spanish-owned) in many major cities. These chains have contributed to the creation and development of new concepts, such as what to put in the concept of price. Previously in China this was a concept based on cost of production but where there was an important aspect of negotiation. The foreign-owned new chains have a different understanding of what a price is – the fixed price concept. This means that stories about buying behavior have changed content as narratives. Earlier stories from Chinese-owned and Chinese culturally oriented stores had an important part about how good you were to negotiate a low price. In the new foreign-owned department stores storytelling (narratives) is about how skilled you were to find an item with a low fixed price "on sale". The point here is that if you want to study knowledge transfer before and after the internationalized development has taken place there is a great possibility that the positivist assumption of a distinction between subject and object will not help you to see how the learning processes take place since "Common sense", as Gramsci called it, has changed.

3.2 Dimensions of Globalization

As explained in the previous section, globalization can be seen from many dimensions and in this chapter we will discuss some like:

- Trading
- Foreign Direct Investment
- Short-term capital movements
- Knowledge
- Employment and processes behind changes in employment

There has been much discussion about one factor mentioned above and that is creation, storing and transfer of knowledge. The World Bank states in a report (World Bank 1999) that the transfer of knowledge has been one of the strongest forces for change in markets as a part of an internationalization process in recent years and this process is expected to continue.

The globalization of knowledge does not only involve knowledge about markets, technology and production, but also knowledge about society and cultural aspects, especially the part of community activities that are made within institutions. We will discuss this issue further in the empirical example where we give a brief discussion of China's accession to globalization processes. The interesting issue is the importance institutions have received as a part of the processes of globalization. We can see that this development has worked in both ways, some institutional developments have stimulated trade and globalization, and some have worked in the contrary direction. When we use the term institution in this context it is important to look at international institutions, to national and to regional institutions. International organizations like the WTO serve as important forums for negotiations and contacts between countries, but also as forums for addressing problems and in some cases this leads to constraints through trade barriers. National institutions are often related to trade policy measures and governments have in recent years also started using regional institutions, particularly those that organize various grants and support schemes to develop incentive systems of importance for national as well as for companies moving in from other countries.

Trade

Most studies conclude that there is a positive relationship between trade and growth, even though there also have been some studies that are critical to this. The more general argument as asserted by Leif Johansen already around 1970, was that more open systems of trade and

the removal of tariff barriers and other trade barriers would more easily contribute to economic crises and also have some effect that they were spreading faster than they otherwise would have done. We also got during the 1970s, see Baran and Sweezy (1970) and Amin (1970), an analysis from a Marxist/critical perspective where it was argued that trade and strong companies in developed western countries encouraged internationalization because that led to exploitation of the poorer developing countries. We have on a regular basis since 1970 seen similar effects documented, see Western 2012, which is a study of how US-based pharmaceutical companies collect huge profits by establishing daughter companies in Puerto Rico to take advantage of lower costs of labor.

An important and interesting discussion has come in the last ten to twenty years and one case is presented at the end of this chapter. This is about how companies in newly industrialized countries (BRIC countries) now have taken the role as leading strong dominating firms when establishing and/or buying companies in the U.S. and Western Europe as a part of an internationalization process. We see this happening in some production sectors; where strong companies originated in BRIC countries buy up industrial enterprises. The example at the end of this chapter is a major food producer in Brazil (JBS) who has bought one of USA's largest companies in the food industry processing of white meat (poultry) and thus they have established both significant market power in the U.S.A. and they also take out considerable profits from the U.S. to Brazil.

Labor

There is no doubt that increased internationalization has contributed to larger movements of labor between countries than we would otherwise have had. This aspect of globalization is very interesting, but there is relatively little research done and few empirical results about the impact this has had for the country that undertakes FDI and for the country where production takes place. Another aspect of globalization and labor movements is that when companies from Western countries are entering fast-growing developing countries they take with them at least to some extent the sender country's culture and rules. This may both have positive and negative effects; some of the positive effects can be seen in Kenya's production of flowers where this production has been professionalized with regard to logistics which is one main source of profitability.

There has been a discussion about how such internationalization processes leads to an improvement or worsening of the working conditions in the country where the investments take place and there is no general answer here. There is no doubt that one driver behind globalization still is to exploit lower wages in the country where the production activities are established.

Foreign Direct Investments

As explained in previous chapters foreign direct investments (FDI), are a focal point in the discussion of internationalization. Numbers show that FDI has increased steadily if we take a longer period of time into consideration while short-term changes largely are related to cyclical movements we have seen in recent years, this particularly appears in the crisis in 2008-2009.

Short-term capital transactions

The last 20 years we have seen a steady liberalization of the system of short-term capital flows and this has probably been one of the most controversial aspects of globalization. The International Monetary Fund (IMF) has recently warned that the liberalization of short-term capital flows have gone too far. There is no doubt that businesses and financial institutions in good times have been able to move large amounts of money as a part of short time international capital transactions. This is seen as one of the important causes of the crisis and the severity of the crisis we had that started in 2008, Stieglitz (2010). It is therefore almost ironic that in 2011 and 2012 we have seen statements from U.S. financial and business organizations where it has argued for stronger control over short-time capital flows, one example fueling these arguments has been the relatively large profits companies like JBS have taken from the U.S. and home to Brazil.

4 Internationalization at the company level

4.1 Introduction

Internationalization at the company level can be defined as the development of networks of business relations between the company in the country where it was originally established to businesses and markets in other countries, where the focal point is that the parent company has influence on management through ownership, through contract or otherwise. It has almost

been a mantra in strategic thinking about businesses in general that they must develop international relations at least by comparing their own operations with how companies in other countries do, or develop actual relationships with companies in other countries so they get familiar with market conditions, technology, organization, institutions and other important factors.

It is difficult to point at a theory that has general acceptance about which forces are the most important for globalization at the firm level, a discussion is given by many, for example, Yip (1989). The key words under shows that a company's potential for globalization can be seen in relation to the following:

- Market development
- Cost drivers
- Institutions / government interventions

4.2 The company's competitive situation

The factors that affect a company's potential for internationalization is also normally an important part of the more general basis for the development of the competitiveness of the company. It is interesting to look more in detail at which factors play a role for companies in their internationalization processes in relation to the points mentioned above. When it comes to market development it is an important decision for how the internationalization of production shall look. The question is if the company wants to establish a company in the new country to sell the products there, or if they want to establish a company in one new country to proceed with export to other countries or markets.

When it comes to cost drivers it is especially the cost of labor and access to local resources that are the key arguments for the company's decision. Also, public policy and other institutional factors in the new country are important. The new country can have trade agreements with other countries, which makes it cheaper to export to countries and also avoid technical barriers to trade and other regulations. Furthermore, it may be so that the country has established economic / political incentives that affect the cost structure in a positive direction. It is interesting to see how Porter develops his theories of competitiveness of companies from the book published in 1980 and continuing throughout the 1980's, Porter (1980; 1991). In Porter's analysis from the 1990's we see internationalization as an integrated

part of other perspectives to enhance corporate competitiveness and development of knowledge and competence.

When you look at market developments from around the year 2000 we see many internationalization processes in manufacturing industries characterized by medium or high levels of technology and examples are: IT / Computers, automotive industry, and pharmaceutical industry. Another group of companies/sectors where we saw internationalization develop was more resource-intensive activities such as mining and textiles where the key was to exploit cheap labor, see World Economic Report (2001).

A new tendency we have seen starting around the year 2000 and still continuing is in the processing industries and retail trade. When we look at three major international corporations such as Carrefour, Wall Mart and Tesco these corporations have established and developed in newly industrialized countries such as China and Brazil. Important factors behind the success of retail chains in BRIC countries are:

- Adaptation of management, strategy, and knowledge skills in the country where they establish and combining this with the company's own core competences
- Financial resources
- Detailed knowledge about markets, buying habits and other key dimensions of the amount
- The importance of combining the supply of local goods with the company's own product lines

As a manager of Carrefour in Brazil said, Gulati (2008):

"We need both high quality fresh tomatoes purchased from local producers together with our own canned crushed tomatoes produced in Western Europe and shipped to Brazil."

We have documentation that shows that the newly established international retail chains in BRIC countries now are to a large degree based on utilizing knowledge including inventory management, IT use, professionalism in management and development of knowledge among the employees. This, combined with the fall in transportation costs we have seen in the last 20 years makes several brands still manufactured in Western Europe and transported around the world profitable; examples are the trade of Heinz. Other international brands like Coca Cola

are produced locally, but with very strict control and monitoring. This is, of course, not an argument against further globalization of production by more advanced technologically oriented activities like IT and pharmaceuticals, but just shows the enormous influence of the fall in transportation costs.

5 Globalization and Internationalization from Companies in BRIC Countries to Developed European Countries and USA.

The points of view on the BRICS countries that follow in this section apply primarily to China, Brazil and India. Russia has a different development when it comes to international trade, here we must take into consideration that Russia has inherited a lot from the old Soviet regime.

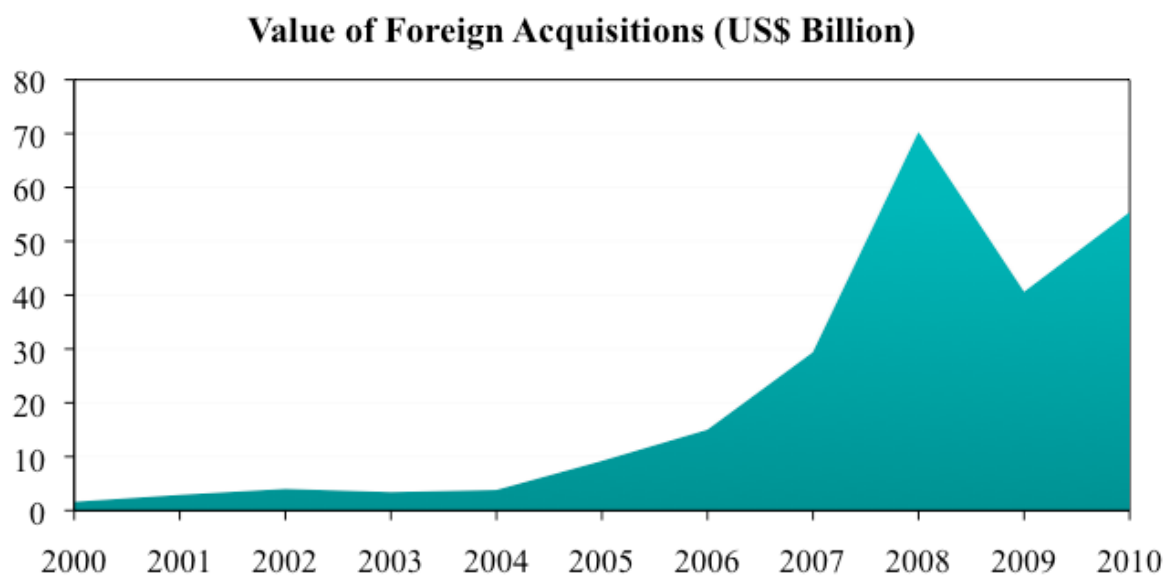
China, India and Brazil had from the 1990s and up to 2000 gained special competitive advantages in some sectors largely based on relatively low production costs and low to medium skilled labor. These products were for a large part first produced for the home market, but the countries established export production from sectors like textile, clothing, footwear, metal and plastic products and consumer electronics. Also through the same period we experienced a rapid development in education in these countries and this also played a part to provide a basis for production using medium level technology and in some cases advanced technology combined with educated labor. Around year 2000 the following points could characterize the level of development in the three countries:

1. The companies have gradually been able to make use of technology at the medium and high level, to a large degree combined with low cost production.
2. The companies have learned to adapt the products to the market behavior of the receiving countries in the sense that they have to offer goods and services of high quality and based on customer needs. Especially for China, this was a big transition.
3. Firms became able to adapt both to markets with large production volumes and in niche markets with relatively low production volume, but with low unit costs.

Around year 2000 we saw the emergence of a new trend in the sense that companies in BRIC countries steadily increased their investments in businesses in other countries like USA, Canada and many countries in Western Europe. In China we saw simultaneously a change in

the political leadership's attitude to international trade which resulted in the slogan "Go Global". In 2000/2001, China became a member of the World Trade Organization, which gradually changed trade policies and institutional behavior; statistics for China's FDI are presented in Table 1. The economic initiatives of the three countries have been very different, mainly because of China's tight political control over the economy while India and Brazil on the other hand, had a tradition of a more market-oriented economic system, more similar to countries in Western European and U.S.

Figure 1: Value of China's Foreign Acquisitions



Source: Thompson Reuters.

The developments and changes in Chinese policies for internationalization can be divided into three phases.

Phase 1: Go Global policy from about 2000.

China had only modestly allowed businesses to establish themselves in Europe before year 2000, the exception was state-owned firms that bought smaller stakes in companies in the energy and resource sector, mainly with a view to ensure access to raw materials to meet China's national demand. After year 2000 we saw the Go Global policy and three examples to characterize this are the following. In 2004 Shanghai Automotive Industrial Corporation (SAIC) bought 49% of the company Ssangyong Motors in South Korea. SAIC was when one

of China's largest and long-established car manufacturers and had already some experience of cooperation with Volkswagen and GM since the 1980s. SAIC's efforts to develop Ssangyong was not successful mainly because of two reasons. The first was the cultural differences and the problems that raised and the other problem was the global recession starting 2008 that made the demand for cars fall significantly.

The next example was the Chinese company D'Long Group's acquisition of the company Murray Inc. in USA. D'Long Group was a large company with production in many segments including smaller engines and equipment such as lawn mowers and other equipment for recreational activities. It was also within this segment that Murray Inc. had its production. What happened was that the production in China within the framework of the D'Long Group acquired patents, technology and used the brand of Murray Inc. The strategy was to use this to produce similar equipment, but at substantially lower prices than the market was in the United States. This strategy did not succeed mainly because the machines produced in China had too low quality and failed to meet changes in demand.

A third example was when one of China's largest electronics manufacturers TCL in 2004 bought the French consumer electronics company, Thompson. The strategy here was also that one should use TCL's factories in China and achieve lower costs while the marketing of the electronic products in Europe should use the Thompson name. This strategy also failed and production ended.

The logic behind the first wave was utilizing Chinese production capacity with low cost and reasonably trained personnel and combine this with innovative technology from U.S. and Western Europe. The market strategy was then to buy the rights to the brand and use the distribution channels that the companies outside China already had established. Many of these projects failed or were significantly restructured because of a lack of understanding about management and marketing from the Chinese side. Another motive for the Chinese to develop such policy and business relationships was to get an innovative stimulus for further development of the products, but this was also in many cases not successful because of the lack of understanding from the Chinese side what an innovative process from the US/Western European point of view was about. On the other hand one can also point out some success stories from the "Go Global" period and these are primarily in areas where differences in

labor costs are very large and the necessity of changes in market behavior and innovative development were modest.

Phase 2:

The second wave kicks in from about 2007 / 2008, while we also see the effects of the global economic crisis. The focus is now being directed towards companies where the resource aspect is central, i.e. mining, oil and energy and to some extent agricultural production. Cooperation with and acquisitions of such companies gave less cultural and managerial problems and China could take advantage of the educational developments that had taken place and enter with its "army of engineers" that was technologically educated personnel who to a large extent had worked in equivalent activities in China

Phase 3:

The third wave beginning around year 2008 is still evolving and the central issue here is that Chinese companies buy or enter into binding agreements/contracts on the ownership side with companies that have technology and research and development departments of interest for the Chinese mother company. This strategy differs from the first phase because of its emphasis on technology transfer and cooperation on research and development since the Chinese now take home, learn and test the technology in its own production before starting on the world market. An example of this is the Chinese manufacturer of aircraft and aircraft components XAC that in 2009 bought about 90% of the shares in Fischer Advanced Composite Components (FACC) which is a company established in Austria that delivers advanced parts for the aerospace industry such as Airbus and Boeing. The strategy from the Chinese side here is that FACC continues to produce and develop in the markets where they already are established without the new Chinese ownership demanding changes in this. What the Chinese do is to learn from and copy what the company does and establish and develop production facilities in China based on this. There are other examples in the electronics sector where Chinese companies use the same strategy buying significant portions of companies and using this for technology imports but leaving the USA/European firm to develop in the original markets without making major changes in relation to the company's original strategy.

One can say that a reasonable parallel logic we can find behind the acquisition of Chinese interests of Volvo in 2010 is to integrate Volvo's technology, designs and know-how in new

manufacturing activities in China primarily for production, at least initially, for the Chinese domestic market. The same logic is also behind the Chinese takeover of a French producer of additives for animal feed (Adiseo group) where the use of technology and patents from the French firm is used for developing products for the Chinese domestic market and thereby meet competition from exporters from USA and Europe. Another example is the Chinese takeover of Australia's leading manufacturer of products from Polyetylen, Ueno with the same purpose, to develop products for the whole market and meet import competition.

Summary

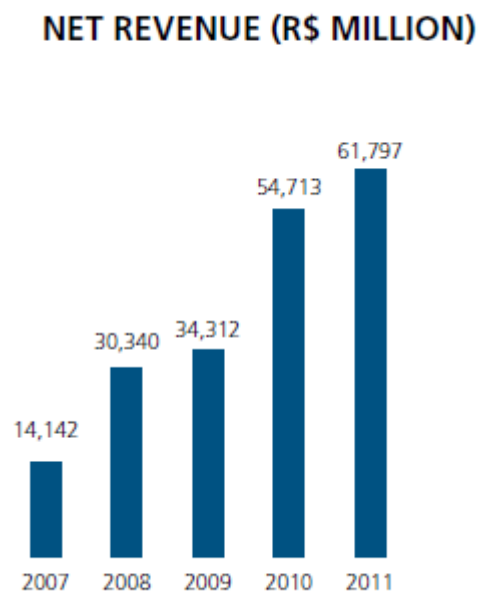
We have seen a development in what can be looked at as three waves or phases of strategies that have been behind the Chinese policies for globalization of corporations. In the first phase, one can say that the Chinese used established firms in the West as a springboard for increased sales and increased exports to Western markets, and hopefully at the same time took advantage of Chinese production activities. This proved in many cases to be not successful and in the second phase the Chinese concentrated on energy and natural resources. Here, China was already well established with both a knowledge level and home production for the domestic market so they were able to understand and adapt knowledge and technologies for production. This is the reason why the second phase went reasonably well. The third phase has a strategy that the Chinese hope to ensure access to technology, patents and innovative capacity, but under the clear strategy that the foreign company is developing and competing in their original and normal markets, at least the first years. The idea here is that China gradually learn from this and take home all or part of the technology and use and develop this first for the home market. Since China and the Chinese economy is to a large extent centrally directed and under political control it is difficult to see corresponding phases in Brazil and India. It is not difficult to find examples of the push for globalization from logics that we can relate to the developments from China, but with the big difference that the developments in Brazil and India to a much larger degree have to adapt to normal market conditions.

6 Case Study: How the Brazilian food group JBS has done internationalization in the production of white meat.

One of the largest companies in the food industry in Brazil is called JBS and has its headquarters in Sao Paolo, Brazil. Figure 2 below shows the net revenue from sales in the period 2007-2011. The development has gone from a net revenue of about 14 billion R\$ in

2007 to 61,797 in 2011. (R\$: Brazilian real, where one USD equals about 2 R\$). The figure shows that the group has had a tremendous growth from 2007 to 2011 and this growth is partly a result of an acquisition strategy internationally and a growth in the domestic market in Brazil.

Figure 2: Net revenue from sales JBS.

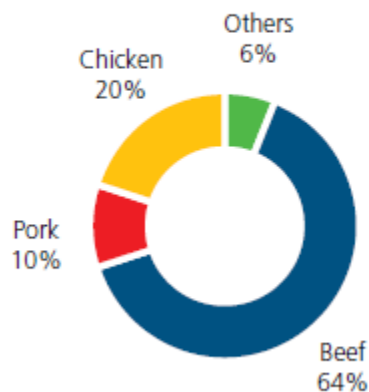


Source: JBS, Annual Report 2011.

Figure 3 is taken from JBS's annual report for 2010 and tells about the different manufacturing activities that the JBS company is engaged in. The main products are the production and processing of beef, white meat (chicken / broiler) and production and processing of pork, sheep and leather products.

Figure 3: Total net revenues by segment for JBS.

TOTAL NET REVENUES BY SEGMENT



Source: JBS: Annual Report 2010.

The company JBS started as a local slaughterhouse in 1953 and grew until 2005 primarily by producing beef for the domestic market in Brazil. The first major international expansion came in 2005 when JBS bought Swift Armour Company which was Argentina's largest producer of beef and also a large exporter of beef to the world market. In 2007, JBS bought Swift Company which is now one of USA's largest producers of beef and they also bought companies in Australia. In 2008, JBS had international operations divided among 21 companies in Brazil, 7 in Argentina, 12 in the U.S. and 8 in Australia. In 2008, JBS was the third largest company in the production of beef in the United States and when all beef production is looked at all together, the largest single producer in the world. At the end of 2007/2008 JBS bought 50% of the company INALCA which is Italy's largest company for the production of beef and a leading exporter to several other European markets. In 2009, JBS bought the Brazilian-owned group Vertim which is the second largest food group in beef and one of the largest exporters of such products to Latin America. Up until 2009, JBS also conducted several other smaller acquisitions in U.S.A. of companies that manufacture equipment for packaging of beef, for chemicals, and IT companies that specialize in management of industrial activities. The acquisition of Vertim has led to JBS having a large range of food products for the domestic market in Brazil and other countries in South America mainly Mercosul countries. These products include milk, other dairy products, other food products, biodiesel, petrochemical products, hygiene products, canned food, and a number of other related products.

The key strategic decision JBS made at the end of 2009 was the acquisition of 64% of the shares in the US-owned company Pilgrim's Pride Corporation (PPC), which established the company as heavily involved in the market for production of white meat in the USA. Previous acquisitions of companies by JBS had to a large extent been within segments where the company before had years of tradition, knowledge and experience, the beef sector. The purchase of PPC by JBS in 2009/10 implied that the company became the second-largest producer of chicken in the world with companies in the United States, Mexico and Puerto Rico, with a daily slaughtering capacity of 7.6 million chickens. This acquisition was performed financially in cooperation with the Brazilian Development Bank (BNDES).

The acquisition of PPC led to a development that 2010 became a difficult year for the JBS with a net loss of R\$ 300 million. The main reason for these financial problems was the cost of integrating PPC and the Vertim group into JBS. Nevertheless, it appears that JBS came through 2010 reasonably well and the developments in 2011 showed an improvement of the financial situation. In 2012, it is expected that the group will have a result on the positive side as far as net earnings are concerned. The important and interesting issue here is that the Brazilian development bank BNDES has actively contributed to an improved financial situation for JBS in the way that BNDES has converted a significant portion of the debts of JBS to shares. The basis for the acquisition of Pilgrim's Pride was that BNDES's financial contribution was to issue convertible bonds, which meant that the BNDES took a substantial part of the risk for the entire financial operation. By converting bonds into shares in JBS the situation of ownership is now that the original family, Baptista, owns about 47% of the shares, BNDES 31% and others about 22%.

Two main reasons that the situation is improving for the combined JBS/Pilgrim's Pride operation in the USA is that the manufacturer is big enough to have market power in relation to the major supermarket chains in the sense that they can provide large quantities at relatively low prices, but at the same time the chains know that there is a limit to how hard they can push price levels before the manufacturers find other sales channels. The other main point is that there seems to be a slight increase in the demand in the U.S. market for white meat. Pilgrim's Pride is also a major exporter of poultry from the United States and particularly there has been growth in the export to the Chinese market.

A closer look into the JBS acquisition strategy of Pilgrim's Pride reveals the following categories:

1. Strategy
2. Development of competitive situation
3. Site conditions
4. Financial resources

When JBS started negotiations to take over Pilgrim's Pride, the Pilgrim's Pride Company was close to being declared bankrupt in the United States. To what extent the company was technically bankrupt was never fully clarified, but JBS paid a total \$ 2.8 billion for the company, and included in this was the takeover of PPC debt. What happened then was that the owners of PPC got a 36% stake in the separated part of the U.S. Company and this stake was valued at \$ 450 million. An important part of the acquisition of PPC in relation to JBS's overall strategy was that this should strengthen JBS significantly in the U.S., but also strengthen JBS exports to Russia, the Middle East and China. From the U.S. side the takeover of Pilgrim's Pride by JBS was handled by the U.S. antitrust authorities and the result was that such a takeover would not change competition substantially in the United States because the production of white meat at PPC was assumed to be kept in volume approximately unchanged with the new owners from Brazil. On the other hand, the situation was problematic for PPC in December 2009 since the company had about \$ 2 billion in debt mainly to producers of feed and other related products so a complete bankruptcy of PPC would likely lead to further bankruptcies for feed suppliers and other producers in the U.S.

One factor behind the financially improved situation in 2012 is that PPC has imported feed produced in Brazil which has proved to be cheaper than the U.S. based production of feed. This shows another interesting strategic element, which the company now has better options for buying feed and can take advantage of competition between U.S. produced feed and feed produced in Brazil.

Another interesting feature of the company is that it now can change the product assortment in a fast way to meet changes in demand. What has happened in the United States in the beginning of 2012 is a relatively sharp increase in prices for all parts of the chicken apart from white breast meat. With the size of the PPC Group in production capacity they have

possibilities to change production relative to changes in demand and differentiate between which part of the chicken goes for export and for the domestic market.

When it comes to strategy in relation to sales channels, the new JBS Pilgrim's Pride Company continues to use the Wall-Mart Group in the United States as one of the main distributors of chicken products. This means that Wall-Mart on a national basis sells large quantities of chicken meat. But Wall-Mart is also aware of the fact that there is a limit for price in the negotiations with PPC because PPC is so big that it can change sales channels in a way that this will be a strong competitor to Wall-Mart. Moreover, the Pilgrims Pride brand is a well-established part of Wall-Mart's branding and the cost of not continuing this is high.

Another win-win situation for both PPC and Wall-Mart is the foreign establishments of Wall-Mart outside the U.S., especially in China. JBS already had experience from other types of markets than the U.S. and how to react to changes in culture and other relationships. As a sum up, JBS commented on the merger and development of PPC on its website in the following way:

"This transformation brings forth a goal of more effective working capital management and improved cost structure and a more profitable sales mix. Pilgrim's Pride is also changing its pricing strategy creating less dependence on one-year fixed price contracts and a more reflection of markets. "

Another interesting feature about the new company structure is that it is possible to develop a stronger long-term capital strategy compared to what Pilgrim's Pride could do as a wholly owned U.S. company. This is because the Brazilian investment bank can enter in with convertible bonds when necessary. Thus, it appears that Brazilian state capitalism actually helped to improve and reorganize the company's position in the U.S. relative to other producers of poultry in the United States. What also happened is that the markets for red meat where JBS was involved have shown reasonably good performance so that the whole group altogether has an improved financial situation.

The latest development of strategy from JBS (looking at this from the end of 2012) is that the company has acquired the Brazilian producer of white meat Doux Frangosul. This is one of the major manufacturers of chicken meat, mainly to the Brazilian domestic market. The

interesting thing here is that the JBS Group first established itself in the U.S. market for white meat and then the next step was the entry into the domestic market in Brazil. The argument for doing it this way that came from JBS as stated in the Wall Street Journal, 7 May 2012 where JBS argues that they now can use technology and knowledge from the United States and take this back and develop this for the rather fierce competition there is for white meat in Brazil.

On the world market for export of white meat the situation is that both Pilgrim's Pride and Wall-Mart export chicken to China. The total imports of poultry from the U.S. to China have risen considerably from about 370,000 tons in 2005 to nearly 800,000 tons in 2009. Because of this, China raised an anti-dumping claim to American suppliers in 2010. It was certainly both commercial but also political reasons for this since President Obama in September 2009 put an additional tariff of 35% on imports of tires from China to the U.S. In 2010, as a result of the anti-dumping claim Chinese authorities announced that they put an extra toll on imports of white meat from 35 major US-based companies, but with large individual differences in how the companies were treated. Pilgrim's Pride was imposed a toll of 80.5% while one of Pilgrim's Pride's largest and most important competitors in the U.S., Tyson Foods, was imposed a toll of 43.1%, the average toll imposed U.S. manufacturers was 64.5%, Lee (2011).

There has been an analysis of the effects of this and it is estimated price elasticities in the Chinese market. The results of these analyses show that Chinese consumers have to carry between 50% and 80% of the cost of the penalty taxes since this has led to a significant increase in prices for white meat in Chinese consumer markets. The interesting and almost ironic fact here is that there is a BRIC country, China, which imposes taxes on products manufactured in the USA, but where ownership and management has the foundation in another BRIC country, Brazil.

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