Establishing an Offshore Operation

Approach the problem with flexibility and consider the alternatives outlined here to increase chances of success

BY THOMAS P. COLLIER*

Quite apart from the actual physical location of a proposed overseas plant, it is recommended that a flexible approach to the problem of establishing an offshore manufacturing operation will increase the chances for ultimate success. One should consider the advisability of a a) contract manufacturing arrangement; b) joint-venture manufacturing arrangement with local people, and c) wholly-owned manufacturing plant. These three possibilities will be discussed briefly.

CONTRACT MANUFACTURING

To be competitive in the foreign market, you may require a local source of production. In areas where skills or sources of supply are available, or to conserve investment expenses, a contract manufacturing operation frequently is a sound choice. It is also an inexpensive way to prove the feasibility of offshore manufacturing which, if valid, can lead to a joint venture or wholly-owned manufacturing operation, depending on the circumstances.

A contract manufacturing operation also has certain advantages when used overseas. It permits you to use your existing sales network more effectively. If you don't have an existing sales network (distributors, dealers, etc.) you probably won't consider a contract manufacturing operation.

JOINT-VENTURE MANUFACTURING

In many countries of the world, particularly in India, Brazil and Mexico, governments have made it virtually mandatory for American investors to take in local partners in any new technological manufacturing venture in their country. When such an attitude prevails, one is well advised to consider the merits of some form of joint venture. There are, of course, ways and means, quite legal, by which actual control can be placed in the hands of the American manufacturer.

The most important single ingredient in the success of a joint-venture manufacturing operation, whether it is in Europe or elsewhere, is the selection of the foreign partner. It is important that the American and foreign partner are in complete agreement and harmony as to the goals and objectives of the corporation as well as the fiscal and personnel management of the joint-venture enterprise. Americans tend to reinvest profits, establish written goals and objectives, long-range plans, position guides for key personnel, employ excellent personnel director and demand and expect hard work, diligent performance, regular work hours for top management, employee training and benefits, etc. The foreign partner does not always share these viewpoints.

If, after study, a particular country is selected and stands out above all others for good business reasons, then it behooves management to seriously consider the advisability of a joint-venture operation with those nationals. With diligence, talent and effort, good partners can be found.

WHOLLY-OWNED MANUFACTURING OPERATIONS

In this writer's view, the most effective way to penetrate the major industrial markets of the world is through a wholly-owned manufacturing/marketing operation. Obviously, this will have to be consistent with the foreign government's policy regarding wholly-owned foreign enterprises. In certain industry sectors which are considered sensitive or defense oriented, it may not be possible to fully own a foreign manufacturing operation. Any corporation considering an offshore manufacturing plant must be prepared to spend a considerable amount of time, money and talent to locate the most advantageous site after much consultation with the foreign government authorities concerned with the permission to establish a manufacturing plant. There is a critical need for the American corporation to have an enlightened and experienced back-stopping group at the home office in the United States to see the manufacturing project through from conception to turning out the finished product.

Corporate managers in the U.S.A. must make certain that they have available their best talent in manufacturing, engineering, marketing, financial, personnel and management involved from conception to completion of the foreign production facility.

One must have the talent to pick the right kind of people to organize and run the foreign operation and to be able to let the operation run autonomously as long as certain over-all corporate policies and goals are being met. For the newcomer company in the international field, this is not always easy since there is the normal tendency of trying to "second guess" the over-

*Thomas Collier and Associates, Los Angeles, CA.

seas operation and to make it into a selfsame image as a similiar U.S.A. operations (and this spells "trouble").

If the wholly-owned plant is not under the control of a manager of international operations, but instead is incorporated within the domestic division that normally handles the product line, then it is vitally important that there be a very close liaison between the heads of manufacturing, engineering, marketing and finance on the part of the U.S.A. and the offshore operations.

There should be a complete and free interchange with the respective functional officer in the U.S.A. having an equal responsibility for the successful operation of his counterpart activity in the offshore plant. In any case, there must be a single authority on the U.S.A. management team who assumes overall responsibility for the successful operation of the offshore plant.

There are many attractions for the American investor in selected European countries because of tax and other finanacial incentives which are offered. France, England, Northern Ireland, Southern Ireland (Eire), Scotland, Italy, etc. offer a number of benefits to attract the American manufacturer. In Europe one can generally find the availability of factory-trained and easily trainable labor. There is a new generation of European managerial and technical people with outstanding educational background who are a real plus for the American enterprise setting up manufacturing in Europe.

GENERAL OBSERVATIONS

With the exception of "sensitive" industries/products in certain countries, it is relatively simple for an American company to set up its own wholly-owned European operation. Contract manufacturing firms are readily available in most of the European countries.

Skilled and experienced middle and top management is also available as is other skilled manpower with the possible exception of Germany, Sweden and Holland where there is a shortage of good available manpower.

However, for a price one can generally get competent managerial talent. (It should be pointed out that it is not simple, quick or easy to find, organize and train a good marketing organization.) The exceptionally good schools of higher education in France have developed outstanding managerial and technical executives in the last 20 years.

Europe, of course, provides a stability of government, currency and laws not usually found outside the United States, Canada, Japan, Australia, New Zealand and perhaps the Republic of South Africa. Moreover, the European markets in themselves offer an excellent potential for the successful and competitive American product. Most firms set up in Europe to supply the European and other traditional export markets.

Inflation, with its increased cost of labor, raw materials, transportation and social benefits, is showing its effect in rising manufacturing costs in Europe. There is no indication that these costs will come down before they go up. Therefore, the more products that are manufactured in a plant and the more markets that can be served by that plant, the greater are the chances for its success.

Most European governments are sensitive to the need to export and, hence, in any negotiations with government entities, the subject of new jobs and of exports back to the United States and elsewhere should be emphasized. Government financial incentives and other tax considerations are often given to the American manufacturer who skillfully uses these trump cards.

Incentives

Perhaps it would be well to give an example of some of the financial and other incentives being offered by one of the world's largest and most dynamic countries. In order to attract foreign investment in France, the French government has greatly increased the possibilities for obtaining financial aid and tax relief.

It is possible to negotiate with the French government authorities for cash grants up to 25% of the foreign investor's total cost of establishing his operation in a priority area. It should be pointed out that there are no discriminations made as to the nationality of the investor in any of these priority areas. Equal and fair treatment is given to a French firm, an American firm, or any other nationality that is contemplating initiating or expanding an existing operation in one of these priority areas.

Again, referring to the priority areas of France, there are other forms of assistance in addition to the case grants. For example, the foreign manufacturer can receive accelerated depreciation; employee training subsidies; and under certain conditions exemption from local taxes. Some new or enlarging existing enterprises in the priority areas may be entirely or partly exempted from local business taxes up to a period of five years.

In September 1978, the French Government established a $680 million fund to assist certain industries. This special Industrial Reconversion Fund is devoted one-half to subsidies and one-half to loans. A firm, French or foreign, with a substantial project in the target areas can obtain up to 25% direct cash grant and up to 25% unsecured state loan at very low interest rates.

The waivers on taxation, employee training subsidies, accelerated depreciation and other local benefits might add another 20%, thus making it possible for almost 70% of the initial investment to be offset by these grants, loans and other incentives.

Thus, it is very important for the American enterprise contemplating setting up or enlarging an existing manufacturing operation in Europe to look carefully at the substantial host government financial and other incentives that are available to those corporations that are willing to do their "homework."