Hints on Setting Up Overseas

Thorough, detailed examination of all factors is necessary in deciding best opportunity for you

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There is no off-the-shelf, quick-and-easy way to consummate successfully any one type of offshore manufacturing operation. There is no standard contract that applies to all cases, let alone most international agreements. People — hence corporations — are different. Corporate philosophies, policies and products are different.

Apart from the actual physical location of a proposed overseas plant, a flexible approach to the problem will increase the chances for ultimate success. One should consider the advisability of (a) license/manufacturing arrangement; (b) a joint-venture manufacturing arrangement with a local firm; (c) wholly-owned manufacturing plant. I shall briefly discuss these three possibilities before getting into plant location. (Overseas contract-manufacturing arrangement and franchising have also been successfully used by companies where they fit the product line or mode of operation. Also, I have purposely omitted reference to acquisitions, which frequently are used for quick market-entry.)

LICENSING

Many large companies went the licensing route on their initial foray into the overseas marketplace. Today it is usually the smaller company with limited financial resources, few or inexperienced international executives, or a desire for limited involvement in foreign business

CONTRACT MANUFACTURING

In areas where the skills and sources of supply are available, or to conserve investment expenses, a contract manufacturing operation may be a good choice. It is also an inexpensive way to prove the marketability of the product. If the product proves profitable, the operation may be converted into a joint venture or a wholly-owned enterprise, depending on the circumstances. Regarding contract manufacturing, the assumption is made that you already have or can quickly establish a marketing and distribution network.

In many countries of the world, for example Mexico, India, etc., governments make it virtually mandatory for foreign manufacturers to take in local partners in new ventures. Where such attitudes prevail, one is well advised to consider the merits of this form of joint-venture production. There are, of course, ways and means in which actual control can be placed in the hands of the foreign investor. For example, there are attorneys in Mexico who are skilled in establishing joint-venture operations between foreign investors and Mexican nationals who can protect the foreign investor's best interests.

The most important ingredient in the success of joint-venture manufacturing operations, is the selection of a local partner. It is important that the foreign and the local partner be in complete agreement and harmony as to the goals, objectives, and policies of the joint corporation as well as fiscal matters, personnel, and labor relations of the joint-venture enterprise. Foreigners, and in particular Americans, tend to reinvest profits in the early years, establish written goals and objectives, require long-range planning, have position guides for key personnel, employ excellent industrial and personnel directors, demand hard work, diligent performance, regular work hours for top management, and provide excellent modern equipment and work facilities, etc. The local partner does not always share these viewpoints, let alone understand or even condone these policies and practices.

If, after a thorough and professional study, the country is selected, it behooves management to consider the advisability of a joint-venture operation with local nationals. With diligence and effort, good partners can be found, and the same applies to competent local attorneys, consultants, and accountants.

WHOLLY-OWNED MANUFACTURING OPERATIONS

Assume that wholly-owned manufacturing operations are consistent with your corporate and foreign government policy. Moreover, assume you are prepared to go the whole way with sufficient capital and with an enlightened "back-stopping" group at the home office. Assume you are willing to spend long hours and much money and effort to properly set up the manufacturing, engineering, marketing, financial, personnel, and management policies to operate properly abroad.

Wholly-owned operations may be the practical way to control one's own destiny in a foreign environment. Setting up a wholly-owned manufacturing and marketing operation is very much like undertaking a similar program in one's home country. However, one must have special experience and talent to pick the right kind of people in the home office and overseas to

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organize, supervise, and control the operations. There is a requirement to be able to let the foreign operation run autonomously as long as certain overall home office corporate policies and objectives are being followed. For the newcomer to the international field, this is not always easy. There is the normal tendency of home office management trying to "second-guess" the overseas operation and to make it into a self-same image as a similar home country operation — and this spells trouble!

If the wholly-owned foreign 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, you must expect problems. 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 home office and offshore operation. There should be a complete and free interchange between the respective functional officers in the home office and overseas. In any case, there must be *one single authority* over the home office management team who assumes overall responsibility for the successful operation of the offshore plant.

LATIN AMERICAN VS. WESTERN EUROPE

The nearness of Latin America, with its sources of low-cost labor (and some raw materials), makes it attractive to United States firms. Also, in certain Latin American countries, including several of the islands in the Caribbean, there are tax-haven countries, free ports and free-trade zones which are also an aid to manufacturing and/or assembling on a low-cost basis. Wage rates in many Latin American countries are considerably below those of most of the Western European countries. But it should also be pointed out that the level of skills and productivity is proportionately lower in Latin America than in Europe (or even in some Far East countries like South Korea, Taiwan, Hong Kong, etc.).

In most of Latin America, there is a shortage of skilled and highly-trained workmen, technicians, and machine tool operators. There is also a scarcity of professionally trained middle and top management.

There may be enormous transportation problems between the U.S.A. and certain Latin American ports. For some of the countries, steamship service is erratic and costly, not to mention pilferage, poor harbors, handling and warehouse conditions in many of the Central American, Caribbean and South American port cities.

If one can use rail or truck transportation such as is possible from the United States and Canada to Mexico, then this gives added weight to that country as a possible manufacturing source. In the case of ocean shipments between the U.S.A. and selected Latin American countries, the competition is much less keen than across the Atlantic. Hence the service tends to be on the inferior side and the costs of transportation and insurance continually rise. Transportation to, within, and out of Latin America requires serious consideration, when and where applicable. On the other hand, air transportation is relatively good; competitition is expanding; and steamship service and local port conditions are improving.

Government Stability

The stability of the governments of Latin America is something one must always study very carefully. Where governments change rather easily and frequently due to politics and revolution, it can have its effects on the foreign companies in these countries. Wholly-owned foreign companies are frequently the target for much abuse if not destruction when these uprisings occur. Exappropriation must always be considered by the foreign investor with wholly-owned plants in the more troublesome countries.

When governments change in certain Latin American nations, import permits as well as export permits are slowed if not stopped altogether for a period of time. This can wreak havoc on manufacturers who must import needed items. The export of currency including remission of dividends or royalties can be slowed or stopped at the whim of the government. All of these things have happened repeatedly in Latin America. Until recently, Mexico has been the most stable of all Latin American countries with a freely convertible currency and has striven for a reasonably sound fiscal policy. It has an abundance of raw materials, natural resources, and vast resources of oil and natural gas. It is also aided by its close proximity to the United States. Its economy is well intertwined with that of the United States.

Social security legislation and practices in Latin America (and in many European countries) reach to amazing heights. Therefore, one must look at the hourly wage as only one important factor in the costing of the product.

Social Benefits

Frequently, the social benefits paid to the worker can amount to as much as or more than his actual salary. Profit sharing with the workers, union problems, and the various types of actual and hidden taxes should be carefully explored before going into a Latin American country. Of course, this also holds true in Europe and elsewhere.

A principal advantage of Latin America for the foreign investor is that Latin America can be an excellent source of raw materials. The agricultural and extractive industries of Latin America offer great opportunities for further and continued exploitation. The other advantage to the foreign investor is the possibility for local production to satisfy a large and growing internal market where profits can be substantial by foreign standards. Other than Mexico, Brazil and Puerto Rico, one does not normally think of setting up manufacturing operations in Latin American countries to supply the parent company and/or the American market. There are some exceptions to this rule, but not many. There are a number of incentives and inducements offered to foreign manufacturers. Be sure your application is well prepared, accurate and properly presented.

There are many attractions for the foreign investor in selected European countries because of tax and other incentives. Northern and Southern Ireland (Eire), England, Wales, Scotland, Benelux, Italy, Spain and even areas of the dynamic and prosperous countries of France and Germany offer a number of substantial incentives to lure the foreign manufacturer. In Europe one can generally find the availability of factory-trained and easily trainable labor. For example, European tradition of economic stability, pride in workmanship, well educated and trained middle and top management, good productivity, and a balanced infrastructure have attracted hundreds of foreign firms to locate in Europe.

Incentives

New, modern government-built plants have low rents and outright cash grants on the purchase of new machinery and equipment, training grants, and other assistance. Some European countries have a very relaxed Free Port arrangement which virtually permits you to declare your own plant a Free Port and import and export required raw materials and products without the payment of duty, taxes, etc. But don't let the incentives blind your judgment as to the viability of your new plant!

Most of Europe provides a stability of government, currency and laws not usually found outside of the United States, Canada, Australia, New Zealand and perhaps Japan. Moreover, the European markets in themselves offer an excellent potential for most successful and competitive foreign products. Most firms set up in Europe to supply the European and other export markets. However, in recent years a number of manufacturing facilities have been established in Europe and Asia to supply components or products for the American market.

Inflation and the escalating costs of labor, raw materials, transportation, taxes, unionism and social benefits are showing their effect in rising manufacturing costs in Europe. There is no indication that these costs will come down to where they were even a few years ago. Therefore, the more volume that is produced in a plant and the more markets that can be served by that plant, the greater are the chances for sustained profits.

Virtually every European and Latin American government is sensitive to the need for increased employment and exports and, hence, in any negotiation the subject of exports back to the home country and elsewhere should be emphasized. Government incentives and other considerations are often given to the foreign manufacturer who skillfully uses this trump card. When advanced technology is being brought in to the host country, it is an obvious means to obtain additional benefits from the host government.

FAR EAST

(Case Study): In the late 1950's when I was President of Motorola Overseas Corporation, we were faced with formidable competition from Japan. It seemed to indicate that Japanese manufacturers could conceivably eliminate Motorola from the home entertainment business. We established a positive policy which saved our American market. It also made Motorola more money and customers than we ever thought possible in the consumer electronics market. We decided we could buy from Japan and elsewhere the same kind of component parts, kits of parts, or finished products from the same suppliers as our Japanese competition. Our judgment later proved to be sound, valid and very profitable!

Motorola set up a purchasing and inspection operation in Japan. Initially we bought finished products made to rigid Motorola specifications and bearing the Motorola name. Later kits of parts and, finally, after some three or four years, just essential components were imported. These products were merchandised on a national scale using Motorola's sales and service organizations. Motorola easily outsold Japanese competition. In fact, the new miniature transistor radios carried the whole Motorola consumer product line into many new accounts. In many low-cost production areas of the Far East, it may be possible for you to consider the strategy, "If you can't lick 'em, join 'em!"

SUMMARY

1. A licensing arrangement may provide the manufacturer with a quick entry into the overseas marketplace with a minimal financial and personnel involvement. Care must be taken that one is not creating a formidable competitor, not only in the foreign marketplace but also in the home country as well. As a cautionary note, please remember that once know-how is disclosed, it is very difficult to "undisclose" it.
2. If you are willing to consider a joint venture, and in many situations I urge you to do so, it would appear that this arrangement can be more advantageous, especially in most of the "developing" countries.
3. Look carefully at the incentives being offered to attract new manufacturers to certain foreign markets. However, it is foolhardy to be obsessed with or mesmerized by these "giveaways." If there isn't a sufficient local market to satisfy your new plant's productive capacity, you may be inviting trouble!

As regards establishing your own wholly-owned overseas manufacturing plant, I would like to add a note of caution. I am aware of many horror stories. A suprising number of foreign companies have had the unhappy experience of planning on exporting a large proportion of production only to find for political or other reasons that it was not possible. With export sales cut off and an insufficient local market, the company/plant will quickly become unprofitable. Those so-called wonderful and attractive incentives which the host government makes available can become meaningless, especially if the company fails! Therefore: There is no substitute for doing a thorough, detailed, painstaking and professional study *before* investing and/or expanding overseas.