Transcription Lesson 1: Non-equity modes

SLIDE 1

How do small and medium enterprises (or SMEs) become international businesses?

With less than 250 employees, SMEs have fewer resources than large organisations. It's not as easy as buying another company in a foreign location. International business also means higher transaction costs and increased risks – requiring entrepreneurs who are leaders at identifying opportunities and taking decisions to exploit them. SMEs will often experience most challenges at the early stages of internationalisation, including getting to grips with basic transactions and developing the skills, know-how, experience and resources for successful cross-border operations.

So, how DO companies progress from these first steps to the higher levels of international business?

SLIDE 2

We can look at two sides. The first? SELLING the organization's value proposition to foreign markets. A company that sells PRODUCTS or GOODs can choose exporting. This is an effective entry strategy for SMEs who are exploring foreign markets. It's a low-cost, low-risk option compared to other strategies, requiring much less investment in that market. It's also useful for larger companies who are testing the waters.

If an organisation doesn't yet have the capabilities or know-how to export directly itself, and it wants quick access to new markets, it can choose to use either an intermediary based in its home country, or one based in the foreign market. A home-based intermediary would include an export management company – an independent company that handles the necessary documentation, finds buyers for the export, and takes title of the goods for direct export. In return, it charges a fee or commission for its services.

Intermediaries based in foreign markets, on the other hand, include local distributors or sales agents. Distributors are foreign intermediaries who represent the SME in the foreign market. Often, distributors represent many other companies, acting as the "face" of the company in that country, selling products, providing customer service, and receiving payments. In many cases, these distributors take title to the goods and then resell them. Distributors know the local market and are a cost-effective way to enter that market, but they do sell many competing products and the SME might lose the opportunity to establish their brand.

Next, with globalisation and technological revolutions comes the rise of the services sector. Think of the last concert you attended where an international artist performed. That musician supplied their entertainment service across borders. Netflix is a fantastic example of a service that uses the internet to deliver streaming

References: Peng, MW & Meyer, KE. 2019. *International business*. 3rd ed. Andover, United Kingdom: Cengage Learning.

entertainment. Right now, you and your peers in many different countries are engaging in digital learning. What about global travel – like airlines and cruise lines?

In fact, global travel services facilitate another type of international service – servicing residents FROM foreign markets. Hotels and AirBnBs service the foreign residents that arrive from around the globe, checking in after having booked online from another country. Some universities are so prestigious, that people travel from around the world to attend them. And I. am sure you have heard of "surgery safaris"?

Then, organisations can sell a combination of goods, services and rights. Restaurants are great examples businesses that use franchising to grow internationally. Ocean Basket is one South African success story. Licensing is common in royalty-based fields like music. Turnkey projects are common in construction work, where everything is built and the key is handed over. BOT contracts are similar, but because of their complexity, the company is often required to stay on to help run things while the foreign customer learns the ropes. Lastly, management contracts allow an organisation to sell its expertise at running a business to a foreign company.

SLIDE 3

So, that's the seller side of the non-equity modes, but what about the buyer side? In this case, the coin is flipped, and the SME buys in the product, service or combination package.

Like exports, goods can be imported directly for use in the SMEs domestic operations. Or the SME might use an intermediary to purchase these goods via indirect imports. Subcontracting of manufacturing will provide the organisation with a component product made in a foreign land – possibly at less cost. An example might be a manufacturing facility in Spain that creates a specific part for a BMW car.

(CLICK) A similar concept on the service side of the buyer market is business process outsourcing. Your company can choose to contract a foreign organization to perform a key business operation – like call centres. Chances are good that, when you are calling the call centre of a major corporation in the USA, you might end up speaking with someone in India! It is the LABOUR that is being subcontracted. Hiring foreign consultants is another imported service – sometimes the expertise you need for your business may only be in the hands of a few throughout the world.

Lastly, like a franchisor or licensor can export their business concepts overseas, an entrepreneur can BUY the rights to use these franchising and licensing concepts. It lessens the their risk… the business model has already been proven a success! One can also outsource a company's design or development work through R&D contracts – accessing those locations around the world with the most innovative capabilities to jump ahead in their own markets. And lastly, we see subcontracting coming into play, but this time in combining services, goods, and rights to perform an entire portion of a VALUE CHAIN. Everything, therefore, must be done to the exact specifications of the contracting company – and this is a very popular approach in the retail fashion industry.

References: Peng, MW & Meyer, KE. 2019. *International business*. 3rd ed. Andover, United Kingdom: Cengage Learning.

SLIDE 4

And there you have it. Using these modes of internationalisation makes it much less risky for a company to engage in international business as they don't make any direct investment – like building operations – in a foreign country. This lack of direct investment makes these NON-EQUITY modes. However, a truly global company has invested in opening branches and offices in many countries, and their products or services are distributed worldwide. These companies OWN EQUITY in that foreign location – and this is called foreign direct investment (or FDI). CLICK

SLIDE 5

I am telling you this because I want you to remember the four types of business that operate across geographic borders. If an organisation were to use ONLY non-equity modes, which one of the four would it be?

That's right – they will remain an international business, using the home replication or EXPORT strategy.

The other three – global, multinational, and transnational – are the Coca Cola and McDonald's of the world, who DO make foreign direct investment in another country, but can ALSO COMBINE their EQUITY modes of global operations with the non-equity modes of international business. SMEs who are aiming to become the next big thing in global trade need to think ahead, planning for a strategy from the beginning that will support their global operations in the future.

References: Peng, MW & Meyer, KE. 2019. *International business*. 3rd ed. Andover, United Kingdom: Cengage Learning.