

Chapter 4

Motives for Internationalisation

The aim of this Chapter is to clarify that internationalisation is not in all cases simply driven by the desire to enhance sales but that the motives for internationalisation can be manifold, with major consequences for market entry strategies, the coordination of international subsidiaries, country selection, organisation, etc.

Heterogeneous Strategic Objectives for Internationalisation

Internationalisation into specific foreign countries, whether it is via exporting or importing, via international contracts or foreign direct investment, is always driven by certain motives of the MNC. In this regard, it can be assumed that the strategic conduct of a company in a particular country is always shaped by its strategic objectives with regard to this country, as an important part of the intended strategy.

However, the literature on internationalisation often does not differentiate between the respective objectives but rather it is assumed, often only implicitly, that sales-oriented objectives are the most relevant. The term *market entry strategy* which is often used for the foreign operation mode clearly indicates this assumption. Traditional concepts and studies on internationalisation (e.g. the theory of monopolistic advantage by Hymer (1960)) often assumed that the international activities of companies only give them the benefit of a broader exploitation of company-specific advantages. Very different objectives of internationalisation can be given, however. As has already been stated in the international *product lifecycle theory* by Vernon (1966), the *production cost advantages* of a foreign market might be an important reason for relocating production to foreign countries even if the primary sales focus is still on the home country.

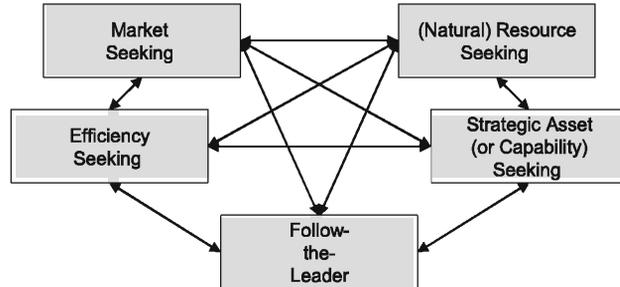
In the perspective of the MNC as a “differentiated network”, as discussed in Chapter 1, different subsidiaries are assigned different tasks and roles, and heterogeneous location advantages of the different foreign subsidiaries are exploited. This perspective clearly illustrates the *multi-facetedness of the motives* for being active in foreign countries.

*Sales Objective
Traditionally in
the Focus*

The *five motives* shown in Figure 4.1 can be distinguished as the most relevant objectives of internationalisation (e.g. Dunning 1988; Shan 1991, p. 562; Morschett 2007, pp. 310-320; Dunning/Lundan 2008, pp. 67-77).

Figure 4.1

Alternative Motives for Internationalisation



Market Seeking

The *primary motive* for starting activities in a foreign country is frequently the *access to new markets* and the sales potential offered by foreign markets. In particular when the home market is saturated, as is more and more often the case for the industrialised countries of Western Europe, the USA or Japan, company growth can be maintained by international sales.

Orientation on the Sales Side

If market seeking is the motive for internationalising, foreign countries are chosen by the sales potential they offer for the company. Country characteristics that are used as *selection criteria* in this case include, for example:

- market size
- market growth
- presence of attractive customer segments and
- demand for the products or services of the company.

International market-seeking objectives are not necessarily associated with foreign production but may also be reached by home-country production that is being exported to the foreign market. While *exporting* can be used to exploit excess production capacity in the home country, and it is usually less risky and can be carried out with lower initial investment, FDI in the target market can help to circumvent trade barriers, reduce logistics costs and

develop a better understanding of the market. These aspects are discussed in more detail in Chapter 16 (“International Production & Sourcing”).

Given that access to a foreign market is not always easy and the market knowledge of a foreign company is usually lower than that of a local company, first market entries are often realised via *cooperative arrangements* with local companies (Erramilli/Rao 1990, p. 146). Those local companies provide the company with the necessary knowledge about the market, with access to distribution channels and with other local relations.

However, considering the high relevance of customer relations, it can be observed on a national and on an international level in recent years that companies tend to exert a *tighter control* over their foreign sales activities and are willing to use a higher level of ownership of these activities to provide the necessary coordination (Zentes/Neidhart 2006). *Internalisation* of the foreign marketing activities, i.e., vertical integration, and a full-ownership strategy instead of cooperative arrangements, are often the consequence. The reason can be seen in the fact that a foreign subsidiary acts as a “*gate keeper*” to the local market which gives it a specific power versus the company in the home country, in particular when it is controlling distribution channels, marketing activities, etc. *Relationship marketing* is becoming more important in many industries – i.e., the establishment, maintenance and enhancement of long-term relationships with customers (Zentes/Morschett/Schramm-Klein 2007, pp. 231-252) – and the customer relationship is becoming a critical asset for a company. Hence a very close and unrestricted information flow between the foreign market and the headquarters in the home country and very quick and flexible reactions become necessary.

This dynamic development, which is shaped by a low level of market knowledge in early phases of market entry (and, thus, often cooperative entry modes to facilitate the market entry), and by increasing market knowledge over time and the wish to exert a stronger control over the activities (and in consequence a preference for full ownership of the subsidiary), is theoretically explained by the “*internationalisation stages models*”, which are discussed in more detail in Chapter 12.

Follow-the-Customer

With the market-seeking motive, sales in the foreign market are in focus. Usually, customers in the foreign country are consumers or companies resident in the host country. In business-to-business markets, however, customers in the foreign country might also be companies from the home country who have internationalised to this country. For instance, a Swiss company might sell in China to the Chinese subsidiary of another Swiss MNC.

*Cooperative
Operation Modes
to Improve
Market Access*

*Vertical
Integration*

*Dynamic
Changes in
Operation Modes*

*Piggybacking
of Service
Companies*

For service companies in particular it is very common to enter a foreign market as a consequence of the internationalisation of one of their main customers (so-called “*piggybacking*”). This “follow-the-customer” motive is often seen as the most relevant reason for service companies to internationalise. Following a customer overseas might be necessary to *protect existing sales* levels (if the customer relocates parts of its home country production abroad) or it can be an opportunity to enhance sales if the customer increases its production with the new foreign facility. Existing business relationships, e.g. for professional services like business consulting, advertising agencies and auditing companies, are ensured and deepened by accompanying important clients into the foreign market (Erramilli/Rao 1990, p. 141; Cardone-Riportella et al. 2003, p. 384).

*Competitive
Advantage
through Customer
Knowledge*

While this motive may be seen as a *subdimension of market-seeking*, it makes a major difference whether the customer base of the company in the host country consists mainly of local customers or mainly of customers from the company’s home country. In the follow-the-customer situation, the company has a strong advantage because the uncertainty of entering the foreign market is much lower. An important customer is already secured prior to the market entry and the demand behaviour of this customer is already known to the MNC from the home country. The “*liability of foreignness*”, i.e., the often-stated competitive disadvantages compared with local companies due to less market knowledge, is reversed in this situation since the MNC already has accumulated knowledge and information about this customer (Erramilli/Rao 1990, p. 143).

However, following-the-customer also leads to *major interdependencies* of the international activities. Since a dominant reason for following the client is also to deepen the business relationship with this customer in the home country (Cardone-Riportella et al. 2003, p. 385), it is important that the marketing offer and the quality level of the company in the host country mirrors the offer in the home country. The strong interdependence makes centralised coordination necessary, since decisions by the MNC’s headquarters must also be implemented in the foreign market. On the other hand, *centralised coordination* also becomes easier, since the headquarters might even have better information available on this customer and on its company’s objectives than the specific foreign sales unit (Mößlang 1995, p. 220).

*Manufacturers
Following-the-
Customer*

While the literature assigns this objective mainly to service companies, it seems obvious that the motive can be very *relevant for manufacturing companies* as well. Industrial supplier relations are sometimes very similar and closely linked to specific customers (Ferdows 1989, p. 7; Zentes/Swoboda/Morschett 2004, p. 394). If, for instance, a large German car manufacturer establishes production facilities in Eastern Europe, this forces suppliers to consider internationalisation to these countries as well. The same phenome-

non was observed when Japanese car manufacturers established their first production facilities in the USA in the 1980s and 1990s. Consequently, more than 500 automotive suppliers from Japan established production facilities in the USA in their wake (Dunning/Lundan 2008, p. 70).

Bridgehead

In connection with the market-seeking objective in particular, the activities in a specific country can also be motivated by the opportunity to establish a bridgehead for *entering adjacent foreign countries* immediately or at a later stage.

In this case, besides the activities in the host country, the company intends to identify market opportunities in other countries that are easier to enter from this bridgehead. For example, Hong Kong used to be a bridgehead for many companies to enter the attractive Chinese market, and Austria is often used by Western companies as an entry point into Eastern Europe. For example, *McDonald's*, *Aldi* and *Rewe* used their activities in Austria to enter Eastern European markets. Often, after the establishment of activities in the neighbouring countries, the bridgehead serves as a regional headquarters.

Resource Seeking

Foreign activities can also be taken up with the objective of giving the MNC access to relevant resources and securing this access to resources, such as natural resources, but also to specific components from foreign suppliers, to certain topographical sites (like agricultural land, harbours, etc.) (see Rugman/Verbeke 2001, p. 158). Companies in the *primary sector* and companies that are strongly dependent on natural resources, like oil companies, tyre producers and chemical companies, were very early internationalisers, with the aim of securing the necessary inputs for their companies (Bartlett/Ghoshal 2000, p. 5).

Country characteristics that are used as *selection criteria* in this case include primarily

- availability of important resources,
- cost of resources in the country,
- allocation of resources in the country, e.g. the extent to which the resources are controlled by a few organisations or by many.

The resource-seeking motive is closely linked to *cooperative operation modes* (Morschett/Schramm-Klein/Swoboda 2008). The main reason can be seen in

Foreign Country as Bridgehead for Further Internationalisation

Orientation on the Supply Side

Partnership Strategies

the *first-mover advantage of local companies* with regard to local resource access (Hennart/Larimo 1998, p. 524). Local companies have often secured access to important natural resources very early, often decades ago, and major natural resources are often at least partially controlled by the host government (e.g. in Russia). So while *acquisition* might be an option theoretically, often legal restrictions hinder this operation mode. A foreign company that wants to get resources thus often needs to partner with local companies to be able to gain access to their networks, their government relations, their know-how, etc.

It is also plausible that foreign subsidiaries which are mainly established to gain access to resources in a foreign country intend to embed themselves tightly in the local environment, to tighten the relationships that they have established with the help of a cooperation partner and to enhance the security of supply of the critical resources. The company often has to adapt to processes and routines in the host country.

Resource-seeking is simultaneously linked to strong interdependence with the rest of the MNC, since the goods and resources that are acquired in the foreign market are either directly delivered to other organisational units of the MNC, e.g. a factory in the home country, or are further processed in the host country by the foreign subsidiary, to be subsequently delivered to foreign countries, at least partly. Resource-seeking thus usually leads to *one-directional, sequential flows of material* from the foreign subsidiary to the rest of the MNC.

Efficiency Seeking

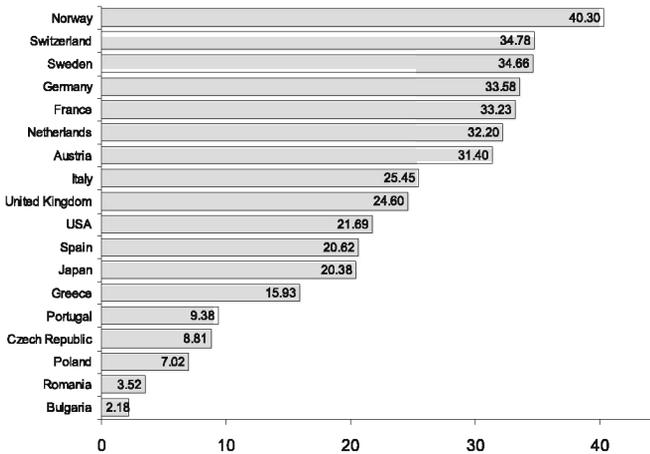
Orientation on Production Efficiency

Another major motive for internationalisation can be efficiency seeking, i.e., the quest for the *improvement of the overall cost efficiency* of the MNC. If this is a motive, then the foreign subsidiary is often part of an *internationally configured network* of production activities. The intention is to exploit specific location advantages for specific activities and design a production network that rationalises the production processes (Rugman/Verbeke 2001, p. 159). The foreign subsidiary is then often responsible for manufacturing components or final goods that are delivered to the parent company or peer subsidiaries in cross-border production processes (Martinez/Ricks 1989, p. 469). In services, the *outsourcing and offshoring* of call-centre activities to Ireland, or of IT services to India, are typical examples of efficiency seeking (see Chapter 13 for a discussion of these phenomena).

Efficiency-seeking activities can either try to exploit *differences in factor costs* (i.e., between rather heterogeneous countries) or be designed to enhance *economies of scale by bundling production* (i.e., between broadly similar economies) (Dunning/Lundan 2008, p. 72).

Labour Cost in Manufacturing in Selected Countries (in EUR per hour 2008)

Figure 4.2



Source: Schröder 2009.

Characteristics that are used to *select* a foreign country as a *location* in the case of efficiency seeking include, for example:

- production costs in the country, which differ tremendously (see Figure 4.2)
- distance to relevant markets (as an influence on logistics costs)
- possibilities to integrate the production process in the company's overall cross-border production processes
- the availability of good and efficient suppliers.

The possibility of integrating the production processes across borders is obviously improved by reduced tariff and non-tariff barriers between countries and this is why efficiency-seeking internationalisation often occurs in regionally integrated markets (Dunning/Lundan 2008, p. 72), such as the EU or NAFTA (see Chapter 5).

If the subsidiary is producing components in a vertical supply relationship with other organisations within the MNC, then *tight coordination* is necessary to integrate the production processes in the MNC (e.g. Gupta/Govindarajan 1991). Thus, foreign subsidiaries that are mainly established as production sites for the MNC often have a rather low level of autonomy and a degree of central coordination (Young/Tavares 2004). Since their structures and proc-

*Miniature
Replicas and
Product
Mandates*

esses are often similar to the parent company, they are sometimes called “miniature replicas” (White/Poynter 1984, p. 60; see Chapter 3). On the other hand, efficiency advantages in the host country can also be exploited by having the subsidiary carrying out full value chains and assigning it a “product mandate” which gives it full (regional or worldwide) responsibility for one or several products. In this case they might be able to establish specialised resources and a high level of competence which promotes their autonomy. In any case, a certain level of coordination of this subsidiary remains necessary due to the high interdependence with the rest of the MNC (Young/Tavares 2004, p. 221).

If the internationalisation is mainly due to efficiency motives, *cooperative arrangements* are sometimes chosen as the operation mode (Morschett 2007, p. 515). Manufacturing in the host country – at least compared with pure sales activities – is linked to very high capital cost and consequently a *risky engagement*. Sharing large investments and high risks with a local partner is a frequent motive for cooperative strategies. Local partners can also contribute to economies of scale in production (Heshmati 2003; Kutschker/Schmid 2008, p. 890).

Outsourcing Internationally

Alternatively, seeking cost efficiency might also lead to *outsourcing*. In particular, cost reasons are often seen to influence the “make-or-buy-decision”. Arguments for outsourcing include flexibility, reduced investment of own resources, specialised know-how, economies of scale and economies of scope (Aharoni 2000, p. 17). This is discussed in more detail in Chapter 13. As an example, outsourcing production to a contract manufacturer might give a company access to a very cost-efficient international production network with high flexibility (Morschett 2005), and thus, give it the opportunity to fulfil the efficiency-seeking motive by using the configuration of the contract manufacturer without own international FDI.

Strategic Asset Seeking

Besides the motive of accessing natural resources, components or other similar inputs, a motive of the company might be *access to local knowledge*, capabilities, technological resources, and innovations. The “strategic asset seeking” motive is based on the idea that an international presence of the MNC gives it a major information advantage over other companies that is grounded in the “scanning and learning potential” of the company network (Bartlett/Ghoshal 2000, p. 8). Research institutions, but also suppliers, customers or competitors, can be important sources of technological knowledge (Ferdows 1989, p. 6). For example, it is often argued that access to specific knowledge and capabilities in the host country is an important reason for direct investment in the USA (see Randøy/Li 1998, p. 91). Related to the

motive of strategic asset seeking is the idea that the superiority of differentiated MNC networks is often attributed to the *enhanced innovation capability* of such networks (Ghoshal/Bartlett 1988; Bartlett/Ghoshal 1989).

If strategic asset seeking is a major motive for internationalisation, the country characteristics that are used as *selection criteria* include, for example:

- innovativeness
- sophistication of demand
- availability of related and supporting industries
- presence of innovation clusters in the relevant industry.

While obviously a company has to consider the innovation capacity of a potential host country in its specific industry, some general evaluations can be drawn from secondary sources like the World Competitiveness Report (see Table 4.1).

Orientation on Know-how

Innovativeness of Countries from the World Competitiveness Report 2009-2010

Table 4.1

Country	Rank	Innovativeness Score	Country	Rank	Innovativeness Score
United States	1	5.77	Korea, Rep.	11	4.84
Switzerland	2	5.56	Canada	12	4.80
Finland	3	5.53	Netherland	13	4.79
Japan	4	5.51	Belgium	14	4.62
Sweden	5	5.39	United Kingdom	15	4.60
Taiwan	6	5.28	Iceland	16	4.55
Germany	7	5.11	Norway	17	4.53
Singapore	8	5.09	France	18	4.50
Israel	9	5.06	Austria	19	4.46
Denmark	10	5.04	Australia	20	4.43

Source: Schwab/Sala-i-Martin/Greenhill 2009, p. 20.

Innovativeness (and, related to that, an adequate location for MNCs seeking strategic assets) requires an environment that is conducive to innovative activity, supported by both the public and the private sectors. In particular, this means sufficient investment in research and development, especially by private, high-quality scientific research institutions, collaboration in research between universities and industry, and protection of intellectual property (Sala-i-Martin et al. 2009, p. 7).

*USA and
Switzerland as
Leading Innovative
Nations*

The leading countries for innovativeness are the USA and Switzerland. The Competitiveness Report comments, along with other dimensions of competitiveness: "Switzerland overtakes the United States this year as the world's most competitive economy [...] Switzerland's economy continues to be characterized by an excellent capacity for innovation and a very sophisticated business culture [...] The country is characterized by high spending on R&D. Switzerland's scientific research institutions are among the world's best, and the strong collaboration between the academic and business sectors ensures that much of this research is translated into marketable products and processes, reinforced by strong intellectual property protection. This strong innovative capacity is captured by the high rate of patenting" (Sala-i-Martin et al. 2009, p. 21). Innovativeness is often linked to the presence of *regional innovation clusters*, which are discussed in more detail in Chapter 6.

*Innovation and
Coordination*

If the foreign activity is mainly targeted towards gaining know-how and access to strategic assets, this has clear implications for the *headquarters-subsidiary relationship*. For example, a very high level of centralisation has been shown to reduce motivation and creativity and thus to exert a negative influence on the innovation capability of a foreign subsidiary (Gates/Egelhoff 1986; Egelhoff 1988). However, there has to be a close link between the foreign subsidiary and the rest of the MNC, because internal communication flows (horizontal with other subsidiaries and vertical with the headquarters) are major determinants of the innovation capacity of an organisation (Nohria/Ghoshal 1997, p. 39). In particular, it is important that the foreign subsidiary in this case has not only the necessary capability to generate new knowledge, but also the necessary motivation to share this knowledge with the rest of the MNC (Nohria/Ghoshal 1997). Normative integration via a strong organisational culture has been shown to be an efficient coordination instrument which motivates and facilitates two-directional knowledge flows (see Chapter 10).

*Cooperation to
Acquire
Knowledge*

If the access to local knowledge is a primary motive for foreign activities, cooperative arrangements are often beneficial. To acquire knowledge, a *strong embeddedness* in the local environment is necessary, *local relationships* are required and a close and trustful contact with local institutions (Fisch 2001, p. 135; Morschett 2007, p. 318). Local cooperation partners, as in a *joint venture*, can support access to the necessary knowledge sources. An alternative operation mode to gain rapid access to local knowledge in foreign markets is the acquisition of a foreign competitor, including the knowledge base that is accumulated in its patents and, in particular, in its employees. In both cases, *market imperfections* in the market for knowledge can be seen as reasons for the (partial) internalisation (Williamson 1985).

Since the innovation potential is closely related to the R&D activities of the company, this aspect is discussed in more detail in Chapter 17 (“International Research & Development”).

Follow-the-Leader

As early as 1973, Knickerbocker argued that companies tend to behave similarly in an oligopolistic industry situation with the objective of maintaining stability and avoiding major changes in the competitive structure. Thus, internationalisation might occur as an *oligopolistic reaction* to a competitor’s move to a foreign country (Cardone-Riportella et al. 2003, p. 390). This can influence the internationalisation decision in general as well as the selection of specific foreign countries.

This strategy-based consideration becomes more relevant with increasing levels of internationalisation of the relevant competitors and with increasing competition concentration. In this situation, international activities in particular countries can also represent an *exchange of threats* between competitors (Graham 1978; Malhotra/Agarwal/Ulgado 2004, p. 4). If the same companies compete in several countries, a MNC can use its portfolio of foreign activities in a strategically coordinated manner. For example, it can use its strength in the USA to attack a competitor there who attacked it in a European market. This strategic flexibility is particularly relevant in highly globalised industries. It can be linked to any of the four motives mentioned above. For instance, it might be necessary to have access to a specific resource, access to a specific market, or a specific access to strategic assets and know-how to react to a competitor’s action.

*Exchange
of Threats*

Bundles of Motives

While often one of the five motives above is the dominant reason for activities in a particular country, they seldom exist in isolation. Generally, companies pursue a bundle of objectives simultaneously (Shan 1991, p. 562). As with any bundle of objectives, it has to be investigated whether they are concurrent or complementary. Sometimes, a MNC might have to accept a trade-off between different location characteristics that are favourable for one motive but less favourable concerning another motive.

In any case, combinations of the five aspects mentioned are very common. For example, a company might be primarily market seeking, but to address the demand in a specific country it must relocate parts of its production process into this country to enhance the production efficiency with regard to this sales market. Another company might need a local presence in a country

to gain access to relevant strategic assets which are necessary to develop an innovative product for this country market. Thus, the country characteristics that lead to a selection of a specific foreign country for company activities should be considered in combination.

Conclusion and Outlook

The motives of a company in entering a foreign country are not necessarily focused solely on expanding its markets. Moreover, the motivation is often not one-dimensional but multifaceted. Since the motives of the company for undertaking activities in a specific country are a major part of its strategy, however, other major parts of the strategy, the organisational behaviour, the company structure, etc., have to be aligned to these motives. This shows the necessity to differentiate, for example, the headquarters-subsidiary relationship according to the dominant motive for internationalisation.

In the last few decades, dynamic shifts have occurred in the principal motives for entering foreign countries. For example, China was long seen mainly as a country for cheap production, while now it is increasingly entered by companies as an attractive market. Eastern Europe opened and simultaneously became attractive as a market and for efficiency seeking. With the perceived increasing scarcity of some natural resources, like oil and gas, some countries (e.g. Russia) have become crucial for the long-term access to this necessary supply. Linked to the development of prices for natural resources, the same countries are also becoming more attractive as markets. Strategic assets can no longer be found exclusively in the USA or in Europe. For example, Korea has become one of the innovation centres of the world in consumer electronics, like TVs. Conversely, MNCs from emerging countries like China are more and more often seen to internationalise to industrialised countries to gain access to know-how. Moreover, with internationalisation in many foreign countries, the follow-the-customer trend has accelerated over the last decades (Dunning/Lundan 2008, p. 70).

Further Reading

DUNNING, J.; LUNDAN, S. (2008): *Multinational Enterprises and the Global Economy*, 2nd ed., Cheltenham, UK, Edward Elgar Publishing, pp. 67-77.

Case Study: British Petroleum¹

Profile, History, and Status Quo

In 1901 the English entrepreneur W. D'Arcy acquired an exclusive right to search for oil in south-west Persia (modern Iran). After years of unsuccessful searching, on the morning of 26 May 1908, the chief explorer G. Reynolds could announce in a telegram sent to D'Arcy, who was about to go bankrupt, an immense oil discovery. The *Anglo-Persian Oil Company* started business within a year and would become *British Petroleum (BP)* in 1954. After several years constructing its refinery complex and a cross-country pipeline, the *Anglo-Persian* project almost went bankrupt again due to a lack of customers and established competitors. Fortunately, Winston Churchill, then First Lord of the Admiralty, understanding the strategic relevance of the project and the imminent need for oil, convinced the British government to become a major shareholder in 1914 – the end of the company's persistent cash crisis.

The brand “BP” was originally created by a German company to market its products in Britain, but at the time of the First World War, its assets – the distribution network – were confiscated and sold to the *Anglo-Persian Oil Company*. With the rise of the automobile, *Anglo-Persian* expanded its business to the mainland of Europe and the USA in the 1920s and 1930s, thus, the number of BP-labelled petrol pumps or service stations increased from 69 in 1921 to more than 6,000 in 1925. During the Second World War, the economic growth on the European continent ended and the military-related BP petrol was consolidated with other brands to a single petrol for sale in the UK. Since the capacity of the *Abadan* refinery in Iran (Persia changed its name in 1935, and the company changed its name accordingly) was limited and many of the company's oil tankers were attacked on their way from Iran to Britain, the *Anglo-Iranian* tried to find oil on British territory after being requested to do so by the government. The company was finally successful in an area near Nottingham, England.

In the post-war era, *Anglo-Iranian* invested mainly in refineries and new marketing efforts in Europe. It took the company several years to find new large oil reservoirs – in 1969 on the Prudhoe Bay in Alaska and in 1970 offshore in the middle of the North Sea. Those discoveries were crucial to the survival of BP because almost every oil-rich nation in the Middle East, including Iran where the company once concentrated its complete strategy, was about to nationalise its resources. Hence, BP learnt its strategy lesson for the future and became in addition fully privatised in 1987.

*First Oil
Discovery of
Anglo-Persian*

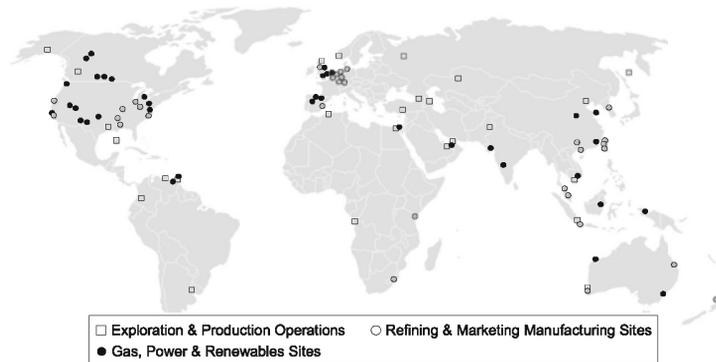
Rise of BP Brand

1 Sources used for this case study include various annual reports, press releases, the web site <http://www.bp.com> as well as explicitly cited sources.

Status Quo of BP

Nowadays, incorporated as *BP plc*, the company has grown into one of the largest vertically integrated energy groups in the world. It not only delivers oil, petrol and gas but also provides a large range of diverse products, from lubricants and chemicals to various types of low-carbon energy. 80,300 employees worldwide in over 100 countries generated sales of 239 billion USD in 2009. The EBIT was about 26 billion USD. Today, *BP* is the second largest British company with exploration, production, refining and sales operations worldwide (Figure 4.3).

Figure 4.3

BP's Worldwide Operations

Source: www.bp.com.

*BP's Extensive Value Chain***BP's Motives for Internationalisation**

BP operates in exploration and extraction of crude oil and gas, but also conducts transportation and construction. Furthermore, the company's activities involve selling the refined petrol through about 24,100 service stations at present. In addition, *BP* invests sustainably within its third segment, especially in its *BP Alternative Energy* unit. Thus, on the one hand the company performs *downstream* activities like refining crude oil to petroleum-based products in its 19 refineries. These activities include marketing and distribution, too. On the other hand, *BP* pursues *upstream* operations through exploration of natural resources. Thus, *BP's* business encompasses the main activities of the *value chain* to achieve a competitive advantage through a focused superior performance.

BP – being a multinational company – operates as a differentiated network and has strongly heterogeneous motives and objectives to operate in the

respective host country. In this case study BP's motives for going abroad are elaborated according to its major business segments.

Upstream - Exploration and Production

The oil industry is a very good example of how intended sales are not the only motive for a company to go international with its business. Instead, in the case of BP, discoveries of natural resources are the primary objective. Today, the proved oil reserves of 1,333 thousand million barrels (as of 2009) are spread around the world (with a dominant part in the Middle East) as Figure 4.4. displays. Actually, finding and sourcing oil in Persia was the precondition for the start-up in London and the success in the subsequent years. Hence, the focus to market the products was on Britain, the domestic market, in the first place. As stated in the introduction, during the Second World War there was a successful attempt to detect oil on British soil, to become more independent of Iranian oil. Additionally, in 1970, a BP crew found the giant *Forties field* offshore in the North Sea, which could deliver 400,000 barrels crude oil per day. Just before that, the company was lucky in finding the largest oil reservoirs ever detected in North America.

Those discoveries turned out to be the salvation of BP during the emerging conflicts in the Middle East in the 1950s. Almost every oil-rich country there, including Iran, was about to nationalise its resources and the associated industries. BP at that time still concentrated almost its complete supply strategy on the Middle East, while anti-British sentiment there escalated. After the last expatriates were forced to leave the country, the refinery was shut. As a reaction to nationalisation in Iran, governments around the globe imposed a conjunct pressure to boycott oil (which was still possible at that time) and hence, damaged Iran's economy tremendously. As a consequence of this, the Iranian government had to accept a new consortium of companies, including *Standard Oil of Indiana (Amoco)* and *Anglo-Iranian*. The latter held a stake of 40 % and shortly after, its name was changed to *The British Petroleum Company (BP)*.

One can see that the country risks that accompany doing business in unstable political regions can even lead to state expropriation. This was likewise the case in the early 1970s when Gaddafi came to power through a military coup in Libya and nationalised BP's oil operation. To this day BP has similar struggles, e.g. with its Russian joint venture *TNK-BP*. Here the Russian shareholders have tried to take control of the company and hence over the investment and dividend decisions as well. Thus, as there are still resource-intensive countries with local companies which are quite often controlled by the government, BP needs to pursue strategic co-operative arrangements with those local partners. Hence, the company works closely with govern-

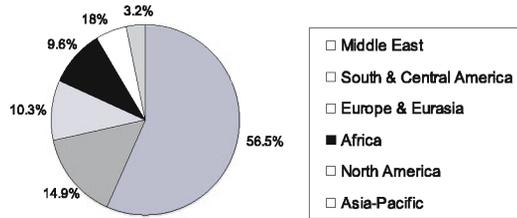
*International
Sourcing*

Country Risks

ment representatives and national oil companies which often have a first-mover advantage. Another mutual benefit of the collaboration is that the huge investment risks (with very late pay-offs) which are often associated with those kinds of projects can be shared.

Figure 4.4

Proved Oil Reserves Worldwide as of 31 December 2009



Source: BP 2010.

New Essential Oil Discoveries

The necessity to internationalise to countries where the relevant resources are available shows how strongly companies in the primary sector depend on having access to natural resources. That is why, as mentioned above, *BP* was very fortunate with the detection of the two major oil fields offshore of Scotland and in Alaska after the company had been unsuccessful in discovering additional crude oil in Malta, Australia and Papua New Guinea in the 1960s, and during its long search in the UK. Since *BP* had no infrastructure in the USA, it acquired a 25 % stake of *Standard Oil of Ohio (Sohio)* to get access to *Sohio's* refining capacities and its distribution system.

Reserves Replacement

Thus, the company eventually became quite independent of Middle Eastern crude oil, its former sole resource. Therefore, the replacement of the mentioned reserves is an important strategic outlook figure in the annual reports. In 2009 *BP* replaced more than 100 % of its reported reserves for the seventeenth year in a row. Recently, *BP* has made extensive discoveries in Angola and Egypt and has gained access to new huge oil and gas fields in Iraq, Indonesia and Egypt. Furthermore, the company is exploring the ultra deep-water off the Gulf of Mexico, where, at the time of the writing of this book, a dramatic catastrophe occurred. An explosion on a drilling rig caused an oil spill that is estimated to be up to 60,000 barrels per day. While this incident will certainly influence the future of *BP*, at least in the exploration, the effects are not clear at all at the time of the writing and will therefore not be considered in the remainder of this case study.

Summing up, the key strategy within the *upstream* activities comprises BP's focus on very prolific resource basins globally and its extension through further findings and successful exploration to sustain production of at least 4 million barrels per day by 2020.

Midstream - Bridge to more Efficiency

Technological progress has always been an important driver for *British Petroleum* – especially for oil exploration, transportation and refining. For example, to extract the crude oil from the *Forties Field*, BP's engineers had to construct production platforms able to withstand the rough waters of the North Sea in every season. BP plant can operate in water depths up to 1,450 metres with its innovative deepwater technology. In addition, BP is the operator and largest shareholder of the 1,768-kilometre *Baku-Tbilisi-Ceyhan* pipeline (BTC) from Azerbaijan at the oil-rich Caspian Sea through Georgia to a terminal at the Turkish coast. The BTC pipeline, which could also be considered as a *midstream* activity, was a challenging engineering project justified by the aim of bypassing the politically unstable territories of Russia and Iran – a cost-efficient logistic to the Western markets. Moreover, the company has acceded to a promising joint venture to explore Canadian oil sands and also uses new technology to enhance production from current fields which would otherwise suffer from a decline in production.

Even in its early days, BP used the advantage of location by constructing its first high-technology refinery complex in Persia, which was connected with the oil-well through a sophisticated pipeline more than 200 kilometres long. Rationalisation is still an objective today when operating abroad and hence, cost advantages can be utilised. Thus, another company's motive to go international with both its production and transport business arises from a more profitable operation prospect. In doing so, subsidiaries are often responsible for manufacturing more efficient components, which is additionally the case with its refining of crude oil. BP utilises cross-border product and process specialisation and takes advantage of different factor endowments and market structures.

Downstream - Refining and Marketing

BP not only concentrates on finding and extracting oil and gas, but also on extending its business down the *value chain* to the consumer. Thus, BP's product, refining, distribution and service departments can be found within this segment. As stated above, with technological changes, the demand for petrol increased year by year and, within five years, *Anglo-Persian* could call over 6,000 service stations its own by 1925. Those BP-labelled petrol pumps

*Technology as
BP's Driver*

*Efficient
Operations*

*BP's Complex
Value Chain*

appeared not only in Britain, but also in continental Europe, accompanied by an increase in marketing efforts, including advertisements in magazines. Thus, in those countries, *BP* was mainly pursuing the “classic” motive for a company’s internationalisation efforts, i.e., looking for *new sales markets*.

After the Second World War, *BP* invested in new marketing efforts in Scandinavia, the Netherlands and Switzerland and even sold petrol to New Zealand. Moreover within what is today its second major business segment, new investments in refineries in Germany, but also in France and Italy have followed. Today, *BP* is *one of the leading companies* in refining petrol and hydrocarbon products in Europe, the USA and Australia. Its total refining capacity comprised about 2,700 thousand barrels a day in 2007. The company serves millions of customers every day with about 24,100 service stations around the globe at present.

Merger & Acquisitions

To achieve this, *BP* sought several big M&As. In 1987 the company acquired the remaining shares of *Sohio*, an American oil company with refineries and a service station network, which was incorporated into *BP America*. In 1998 *BP* merged with *Amoco* to deal with the tough competition by combining their global operations and hence, the largest producer of oil and gas in the USA was formed. Soon, *Amoco*’s service stations were re-branded as *BP*. Furthermore in 2000, *BP* was joined by *ARCO*, an American oil company with a large network of pipelines, chemical plants, refineries and over 900 outlets trading as “*ampm*”. Thereafter, all the service stations of the *BP Group* on the west side of the Rocky Mountains were branded as *ARCO*.

Figure 4.5

BP Brands



Source: www.bp.com.

Castrol, a producer of lubricants especially for automotive and aeroplane engines, was bought in 1966 by the *Burmah Oil Company*, which joined the *BP Group* in 2000. The operations of *Burmah Oil* were incorporated within the group, while the famous lubricant brand *Castrol* was retained. *Aral*, with its very modern service station network, became part of the *BP Group* in 2002 and *BP* decided to keep the *Aral* brand. The 630 German *BP* stations were rebranded with the familiar *Aral* blue and white.

New Markets

With these main brands, it is obvious that *BP* concentrates most of its activities on Europe and the USA. The company is also looking for new markets, however, and was planning to build and operate around 1,000 retail stations in China by 2007 with its partners *Sinopec* and *Petrochina*. All in all, *BP* is very active in China as the leading importer of liquefied petroleum gas (LPG), being the only foreign company involved in the aviation fuels market and a seller of lubricants, etc. In addition, *BP* is very active with its *Aromatics & Acetyls* unit within the marketing segment in China.

With the new millennium, two major challenges for humanity appeared. On the one hand, there has been a dramatic rise in the prices of oil and gas, followed by a sharp drop in prices. However, in the medium term, prices are expected to continue to rise. On the other hand, scientists from all over the world warn about the threat to the earth through climate change. *BP* feels responsible for addressing the challenges of reducing carbon in the atmosphere by establishing a third major business segment: *Gas, Power and Renewables*. Through its *Alternative Energy* unit, the company invests heavily in low-carbon energy sources, including wind farms, solar energy and hydrogen energy, to be well prepared for the future. For example, *BP* has developed three wind-farm projects in the USA (Colorado and Texas) and in India, and it plans to extend its wind capacity from 370 MW in 2007 to more than 1,000 MW by the end of 2008. Hereby, the company seeks competitive strength in an unfamiliar market to augment its global product portfolio. It is important to have access to local (technological) knowledge due to multinational engagements in terms of foreign direct investments like acquisitions or partnerships.

New Assets and Know-How

Therefore, *BP* also has its own research facilities to enlarge innovative abilities and to gain an edge on information. For example, Germany has a very advanced solar industry, therefore *BP* signed a co-operation agreement with an institute on the spot, the *Institute of Crystal Growth (IKZ)*. The same is the case with universities and research institutes in the USA, e.g. the *California Institute of Technology*. Through the merger with *Amoco*, *BP* also gained access to an American solar power company. Now, *BP* has become a leader in the solar power industry and is about to more than triple its cell production due to further expansion in the USA, Spain and India by 2008. Moreover, the company runs several laboratories worldwide to foster its research, not only in alternative energy but also within its whole product portfolio. For example, in 2006 the company founded the *Energy Biosciences Institute (EBI)* for the development of petroleum substitutes.

Research Activities

BP's key strategy concentrates on better performance within the *Refining & Marketing* segment, with more efficient operations for an increased output of its key refining facilities and chemical plants, hence margin capture. In particular, with its service stations, the company covers the entire value chain.

In the *Alternative Energy* segment, *BP* pursues a growing equity value by investing in low carbon technologies for long-term strategic growth. Thus, *BP* has become an organisation which embodies energy in all its dynamic forms.

Summary and Outlook

Since 1989, *BP* has been pursuing a strategy for a long-term sustainable *upstream* business in order to extract a cumulative amount of low cost oil and gas from the fields, year by year and, thus, to achieve an impressive through-cycle return (see Datamonitor 2008a, p. 5). To do so, having access to resources is essential to stay competitive.

Within its *downstream* activities, over the years *BP* has created a diverse product portfolio – even down to petrol stations – which is marketed worldwide and balances the company's risks. With its new *Alternative Energy* unit, *BP* founded an auspicious business which will support humanity to bear the upcoming climate change. The large and geographically diverse project portfolio is thus likely to grant a good long-term production outlook.

The reason for *BP's* wide geographical spread resides in its utilisation of most of the value chain due to global advantages. Therefore, the company has different motives for internationalising its activities at the particular chain link. Thus, the core managing board identifies opportunities in challenging markets for the *BP Group* to grow both upstream and downstream.

In Spring 2010, the mentioned catastrophe on an offshore oil platform in the Gulf of Mexico spilled millions of litres of oil into the ocean and on the shores of the USA. This environmental disaster was a top priority not only for *BP* but even for the US president. Crisis management by *BP* was highly criticised and most severe, the leak could not be closed for months. At the time of the writing of this book, it is expected that the spill could ultimately cost *BP* tens of billions of dollars. The full effect of this crisis on the company, its existence but certainly the further exploitation of oil reserves, in particular offshore in the USA, remains to be seen.

Questions

1. Explain the main motives for going international with a company's business. In a second step, apply those objectives by focusing on *BP* in detail.
2. In 2003 the joint venture *TNK-BP* was formed, which is an example of all the associated challenges within the petroleum industry in a politically unstable country. Describe and analyse the recent struggles *BP* is experi-

encing in its Russian engagement. Furthermore, this merger is a good example of certain motives of *BP* to internationalise. Demonstrate the strategic ideas behind the partnership.

3. Climate change is the challenge of the new millennium, not only for humankind but also for *BP*. Identify how the company is dealing with this situation, particularly by focusing on its international new business arrangements. Furthermore, elaborate accompanying motives for those international operations.

Hints

1. Media articles about the struggle within TNK-BP can be found, inter alia, at www.ft.com.
2. Concentrate particularly on *BP's Alternative Energy* unit. Its website will reveal additional information.