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Firm Strategies for Accessing Foreign Markets and The Role of Government Policy*

Working Paper 5/94

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I. Introduction

Food firms are increasingly focusing on foreign markets as the source of growth. A major reason is the lack of market growth in home countries compared to the rapidly growing economies of Asia and South America. Eastern Europe and the former Soviet Union also are seen as at least potential growth markets. In addition, trade liberalization, especially in North America and Europe, has facilitated rationalization of production within regions.

Firms utilize a number of modes or strategies for accessing foreign markets. They can use exports or local production and the latter can be achieved with licenses, joint ventures or their own affiliates. Of these alternatives, production by affiliates is by far the most dominant. In 1990, international commerce in processed food products totalled at least $1.5 trillion U.S. and of this total roughly 1 trillion was sold by foreign-owned affiliates, $325 billion was exports and the balance was by licences and joint ventures (Henderson and Handy,1994).

The importance of sales by foreign affiliates compared to exports also is illustrated by data for the U.S.[1] In 1992, sales by U.S. affiliates abroad totalled $88 billion while U.S. processed food exports were about one quarter of this amount. Also, foreign affiliate sales are becoming more important; over the 1988-92 period they increased 47 percent compared to a 44 percent increase for exports.

In addition, data from a sample of 38 large U.S. food processors indicate that in 1992, 30 percent of their total sales were accounted for by sales from their foreign affiliates, up from 26 percent in 1988 (USDA, Economic Research Service). For these firms, foreign affiliate sales were 10 times greater than exports. Over the 1988-92 period, however, their exports increased by 93 percent whereas sales by their foreign affiliates increased 45 percent.

While there is a large and growing data base on the dollar volume of exports and sales from foreign direct investment at both the industry and firm level of aggregation, there is very little empirical analysis of the factors motivating food manufacturing firms to select alternative modes to penetrate foreign markets.[2]

The objectives of this paper are (1) to explore the motives underlying firm strategies for accessing foreign markets, (2) to identify the major factors influencing the choice of exports, licensing agreements, joint ventures and ownership of production affiliates and (3) to discuss both the influence of government policies on firm strategies for accessing foreign markets and the implications of the findings for policy development.

The procedure followed in this study was to conduct personal interviews (mostly in the fall of 1993) with senior management of multinational food manufacturing firms operating in the U.S. and Canada. In some cases, the persons interviewed were located in the Canadian subsidiary. The firms were selected based on prior knowledge of the international operations. We strove for diversity in both size and scope of international operations, product type, and product diversity. Our attempts were somewhat restricted due to the unwillingness of a few firms to participate. We employed a relatively free discussion format for our interviews, using broad questions; some interviews yielded a more

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[1]Data on U.S. foreign affiliate sales and exports are from the U.S. Bureau of Economic Analysis and U.S. Bureau of Census, respectively.

[2]Examples of such studies are Handy and Henderson (1994) and Henderson *et al* (1993).

comprehensive and detailed view of firm activities than others. References in this paper to numbers of firms providing a specific answer thus should be interpreted as only a rough indicator of importance. Supplementary information from annual reports and secondary sources were used, as necessary, to obtain a comprehensive view of a firm's international activities.

The following sections briefly summarize the theories of foreign direct investment, the characteristics of the firms interviewed, the choice of location for production, production strategies, the influence of public policy and the implications for policy developments.

II. Theories of Foreign Direct Investment[3]

A large and growing body of literature has explored the motivation for foreign direct investment. Dunning's (1979,1980) "eclectic" approach is the most prominent "family" of theories within the literature. The eclectic theory synthesizes a number of loosely derived paradigms drawn from industrial organization, neoclassical trade theory, and the theory of the firm. Dunning and Norman (1985) suggest that the extent of a firm's international involvement depends on the presence, or lack thereof, of ownership, locational and internalization advantages.

Ownership advantages manifest themselves as mobile, intangible assets exclusive to the firm. Examples are product quality, technology, marketing expertise, or property rights such as trademarks or formulae.

Location advantages refer to the environment in which the firm operates. They may take the form of consumer needs and tastes, market structure, location specific resources, differences in factor prices, and government policy such as tariff and non–tariff barriers or restrictions on foreign direct investment.

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[3]Definitions of terms used in this report:

Foreign Direct Investment (FDI) - Secondary data are based on the definition of FDI as the ownership of assets by a foreign firm for the purpose of "controlling" the use of those assets. The Department of Commerce and Statistics Canada define foreign investment as direct when a foreign firm has a stake of about 10 percent or more in a host country operation and no other firm has as large a share. Publically-traded firms usually adopt a 20 percent criterion for accounting purposes in their annual reports. The percentage participation, though arbitrary, is intended to reflect the notion that a large stockholder will normally have a strong say in the operations of a firm even if that stockholder does not have a majority stake, i.e., at least 50 percent. In fact, most foreign direct investment in the food industry appears to fall into the category of majority-owned.

Except for references to such data, this paper uses the term FDI interchangeably with "ownership" and "foreign affiliate", by which we would typically mean majority ownership. We use the term "full ownership" to emphasize 100% equity ownership and control.

Joint Venture - In this paper, a joint venture means shared ownership and shared active management of an enterprise. This distinguishes it from FDI. Although the relative shares can vary, the implication is that in most cases responsibility is roughly 50/50 (some firms want to have at least 51%).

We have avoided reference to alliances. This term was found to be too difficult to distinguish from either arm's length relationships among firms or joint ventures. In a few cases, firms referred to co-pack arrangements but we have not included them in this paper.

Internalization advantages occur if there exists an advantage in administering international transactions within the firm, rather than through external markets. Internalizable ownership advantages can range from the possession of property rights, say trademarks, that cannot be fully appropriated through arm's length exports, to advantages that are external to any one activity but internal to the firm. The latter are associated with transaction-cost economizing; these economies can be realized when operations in different countries within the same multinational share services, information, transportation, warehousing, and purchasing and financing, etc. The broader the boundaries of a multinational, the greater these economies can be.

All three advantages must be present in order for a firm to engage in FDI. Thus a firm will undertake FDI when its internalizable firm-specific advantages outweigh any disadvantages associated with operating in the foreign market and on balance the host country possesses a locational advantage for the firm.

Unlike other theories, including those concerned with oligopolistic reactions,[4] the eclectic approach focuses on the importance of firm, industry, and country characteristics in determining foreign direct investment. Most important for our purposes, the structure of the eclectic paradigm allows for an analysis of a firm's international involvement along a continuum from the arm's length transactions involved in exporting, through contract transactions, such as licensing, to internal transactions within a firm, such as foreign direct investment. As such, it provides a comprehensive framework for evaluating firms' choices between alternative methods of supplying foreign markets.

III. Characteristics of Firms Interviewed

Seventeen firms are included in our study. The majority of the firms are U.S. multinationals involved in the production of food; multinational firms from Canada, the United Kingdom, and Switzerland are also included.

The firms are nearly all relatively large and operate primarily in North America and Europe. The median level of 1992 sales was $5.9 billion. Five firms had sales greater than $10 billion; five firms had sales between $5 and $7 billion; another five firms had sales between $1 and $4 billion; and two firms had sales below $1 billion. North America is the largest source of revenue for thirteen firms and the second largest source for the remaining firms. Europe is the largest source of revenue for four firms and the second largest source for seven firms. Other regions of operation include Latin America and the Pacific Rim. Relative to their worldwide operations, most firms have limited exposure in the Middle East and Africa.

Food processing is the primary activity for fifteen of the seventeen firms. All the firms produce goods for retail consumption. Five firms also supply goods for further manufacture, and at least five others supply goods to the food service sector.

Two firms' primary activity is food retailing, but they are also involved in food processing. One firm focuses its production on goods for sale at its retail stores. The other firm operates its retailing and processing activities independently of one another. Their processing operations compete with other food processors for supply of the retail business.

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[4]The "family" of oligopolistic reaction theories proposes that oligopolistic firms undertake international production, at least in part, in order to counter, check or forestall moves by rival oligopolists (Graham, 1985).

All the firms produce more than one product, but the degree of diversity varies. Several firms produce closely related goods or goods of a certain form (e.g. frozen food) while others produce a wide array of goods in many forms. The degree of processing required for each good also varies both within and between firms. Several firms are involved in refining raw agricultural inputs, while others produce highly processed goods with little raw input. Some firms produced goods of both types.

Each firm possesses intangible assets related to either marketing or technical skills and knowledge. Firms' viewed their investments in developing and marketing a product of consistent quality and the knowledge associated with these activities as a competitive advantage. In some cases, these skills are associated with the extension of a single global brand, but frequently firms used their skills to support different brand names in various markets. A few firms viewed their knowledge of production processes or sourcing abilities as important competitive advantages. For example, one firm discussed the importance of the unique "proprietary skills" it has developed running low margin businesses such as feed mills and flour milling.

Foreign sales were above fifty percent of total sales for six firms in the sample, between thirty and fifty percent for seven firms and less than thirty percent for four firms. All the firms, except one, use a variety of methods to provide goods outside their home country. One firm supplies foreign markets only through exports, but has owned foreign operations in the past.

Foreign affiliates account for the highest proportion of sales outside the home country for fifteen firms. Joint ventures account for the largest source of revenue for one firm and are the second largest source of revenue for at least four firms.

All seventeen firms use exports to access markets outside their home country. However export propensities are typically small: exports are less than four percent of home country sales for eleven firms, while five firms have exports between four and ten percent of sales. One firm is a clear exception with exports accounting for about fifty percent of total sales.

Licenses account for a small proportion of firms' sales. Only one firm has a strong commitment to their use worldwide. Others limit the use of licenses to geographic areas or to technology. At the time of our interviews, four firms were not participating in licensing agreements.

In the following description of firms' strategies for accessing foreign markets, we distinguish between two related sets of choices available to the firm: 1) the choice of production location and 2) the form of the production arrangement. The former involves the choice between location inside or outside the home country while the latter involves the choice among licensing, joint ventures, or foreign affiliates for production outside the home country. Although firms may make these choices simultaneously, the factors motivating firms' choices, or their relative importance, vary. Treating the two choices independently allows for explicit recognition of either the difference in motivating factors or their relative importance for each choice.

IV. The Location of Production

The choice of production location in the food industry arises largely as a consequence of firms' decisions to serve markets outside their home country. Either implicitly or explicitly firms discussed their increasing emphasis on sales expansion in international markets. Three firms possessed a specific target for sales outside their home country, but most firms did not target a specific share of total sales for their international operations. In addition, several companies stated that they recently developed new, more focused and formal procedures for identifying and ranking the most promising foreign markets for entry. One firm has developed an "index of attractiveness" to rate potential foreign markets. It uses over 20 separate factors associated with the economic and political environment as well as more specific product market characteristics.

The most frequent reason given for the increasing emphasis on international business was slow growth in the home country market that hindered firms' ability to meet overall growth objectives. Firms believed that slow population growth, production in mature market segments and high domestic market shares contribute to lower growth potential in the home market.

Other reasons given by firms for expanding into foreign markets were the desire to spread risks through geographic diversification and to exploit brand and technology related intangible assets. The use of these assets in foreign markets also can effectively lower their cost in serving the home market as a result of economies of size and scope.

Once a firm expands the supply of its product beyond home country borders, it may choose among three supply options: 1) Produce in the home country and export to the target market; 2) Produce in the new market for local consumption through a licensing agreement, joint venture, or foreign affiliate; and 3) Produce in a market other than the home country through a licensing agreement, joint venture, or foreign affiliate and export to the target market. The interviewed firms exercised these options to varying degrees; only one firm used a single option, exports, at the time of the interview.

In this section of the paper, we describe the factors viewed by firms in our interviews as important to their choice of production location. The primary factors influencing their production location decisions include: a) the need to customize their product for individual markets and control its quality, presentation, and delivery within the market; b) economies of scale; c) delivery cost relative to the unit value of the product; d) input requirements; and e) the level of risk associated with the target market. Government policy can also affect production location decisions, but for most of the firms interviewed it apparently is not often a primary factor. Section VI discusses the role of government policy in detail.

In general, factors that make production in the home country an unattractive option for supplying a foreign market favour the alternative option: production outside the home country. For ease of exposition, the description below focuses primarily on the choice between exporting production in the home country and production in the target market.

Customizing Products and Control

Most of the firms interviewed expend a considerable amount of effort investing, building, and exploiting brand names. As the brands represent a key intangible asset, firms have an interest in maintaining the quality and reputation of their brands. To maintain and hopefully improve upon this asset, firms must be certain that their products meet the needs of customers, possess a consistent level of quality, and reach the targeted consumer in a timely manner. Successful exploitation of brand names in the target market may not require local production, but several of the firms interviewed seemed to suggest that it is a prerequisite for their success.

For many products, consumer tastes and preferences differ to some degree among countries. Twelve firms discussed the importance of tailoring their products or product lines to the consumers' needs and preferences in the target market. Six of these firms felt that success in target markets hinges on local production and, in some cases, indigenous management. According to these firms, local production allows for a better understanding of the culture, tastes, and preferences of the target market. The other firms, however, said that local production is not necessary for this purpose. A few noted that switching production runs to accommodate different formulations tailored to target market tastes, and meeting differences in labelling and packaging requirements is not a problem in modern plants and this allows a plant in one country (either at home or abroad) to serve markets in other countries.

Local production may have the additional benefit of providing more control over the distribution of the product. Five of the six firms that did not think local production was necessary to tailor products to local demand nevertheless maintained distribution facilities or distribution joint ventures in the target market. The purpose was to allow for greater assurance of product delivery and control over presentation of the product to the customer.

Brand name may be less important for firms involved in ingredient supply, but maintaining the reputation of their product and assurance of product delivery may be of equal importance. The success of ingredient suppliers depends on their quick response to customer needs and a close interaction with customers. Four of the five firms involved in ingredient supply indicated that they found it necessary to locate production close to their industrial customers in order to provide the service demanded. As customers move outside the home market, ingredient suppliers follow in order to maintain a close working relationship. In fact, one of the interviewed firms is required by contract to produce in the country of the customer.

Economies of Scale

Achieving and exploiting economies of scale is important to these firms with respect to production both inside and outside the home country. To the extent that firms are able to exploit economies of scale in the home country through export and unable to achieve economies of scale in the target market, they favour production in the home country. Thirteen firms remarked on the importance of economies of scale. Their comments provide insight on the relative importance of economies of scale in their production location decisions.

(a) Economies of Scale in the Home Country

Seven firms indicated that economies of scale play an important role in the export of goods from the home country. Only two firms, however, use export as the sole method of supplying a product to markets outside the home country. In both cases, the firms are small relative to the other firms interviewed. One of the firms produces relatively homogenous products and currently has no foreign plants. The other firm produces a variety of goods and owns foreign plants, but chooses to use only home production for one product because of cost efficiencies. This firm possesses only a relatively small share of the global market for the product and faces a well established competitor entrenched in the target markets. For four of the seven firms, economies of scale as a primary factor in export from the home country is limited to specific products and/or geographic areas.

In general, it appears that exports are one way to exploit economies of scale in the home country, but that firms limit export of their product(s) primarily to nearby markets. For markets located further from the home country, firms generally prefer to supply the markets through foreign production. Firms also pursue a mixed supply strategy, exporting some products from the home country and opting for local production of other products. This indicates that export due to cost efficiencies associated with economies of scale may be specific to the product as well as to the geographic area.

(b) Economies of Scale in the Target Market

The ability to achieve economies of scale in the target market was cited by six firms as a critical factor in determining whether foreign production or exports will occur. Factors that make target markets too small for local production are not limited to population. Several firms noted that the level of per capita income is equally as important as population. For example, a producer of frozen and prepared foods remarked that disposable income within a market has to be high enough to make their products affordable. A few firms noted the importance of the level of competition they face within the market and its impact on their ability to obtain a market share large enough to warrant local production.

Exports to markets that are too small to support local production may in time become large enough to warrant it. As discussed above, firms actively pursue growing markets. Ten firms explicitly said that they view exports as a first step in a progression that leads to local production in foreign markets. As the potential market for their product grows, economies of scale are one reason that foreign production becomes more feasible for firms.

Another possible indication of the importance of economies of scale and size of the target market is the movement toward regional markets. Seven firms in our sample have taken a regional approach in their production decisions, centralizing production within one country and exporting within the region or centralizing product management within a region. For diversified firms, this may result in plants in more than one country in a given region with each plant specializing in a product or product line.

Delivery Costs

Freight and other costs associated with the delivery of a product to the target market reduce the benefits gained from economies of scale in the home country and could favour the location of production in or close to the market served. Ten firms mentioned these costs as a factor in their decision to export or locate their production abroad. Five of these firms discussed the importance of delivery or freight costs in terms of their level relative to the unit value of their product as opposed to delivery cost alone. At least two of the ten discussed the tradeoff between production costs and delivery costs as a decisive factor in choosing between exports from the home country and foreign production. These firms said that because of the low unit value of some of their products at the point of sale, freight costs prohibit their export.

Delivery costs are not equally important to all the firms. Sufficiently low production costs in the home country may allow for export despite the presence of high delivery costs. In addition, two firms indicated that freight costs are not important in their decision to supply foreign markets. These two firms, however, ship their products in bulk form. The ten firms above ship goods packaged in their final form; consequently, they cannot take advantage of the lower bulk rates.

Delivery costs relative to product value may be the most important factor in the choice between home country production and production in a third country for export to the target market. As discussed above, high delivery costs make it beneficial for firms to locate close to the market served. If they choose not to locate in the market itself, their best alternative is to use a source of supply closest to the market. In many cases, this results in supply from an affiliate outside the home country.

While this discussion might imply that physical distance to the market served and delivery costs are positively correlated, our interviews with firms indicate that this is not always true. More than one North American firm spoke of the freight cost advantage of low backhaul rates to Asia.

Raw Material and Other Input Requirements

Eight firms indicated that raw material requirements affect their choice of production location. Six of them remarked that the lack of suitable or affordable raw agricultural inputs in the target market can limit local production. As these firms enter new markets, production tends to occur in areas suitable for production of the raw agricultural input.

If production of the raw input is untenable, the firm exports to the target market. The exports may consist of either a finished or semi–processed good. In one case, a firm exports a semi–processed product to a plant in the target market because desert conditions prohibit growth of the raw input.

Three firms locate production outside their home country due to a lack of suitable conditions for production of raw agricultural inputs in the home market. For these firms, the host country's comparative advantage in the raw agricultural input, rather than the desire to serve new markets, dictates the choice of production location for their product. In all three cases, firms locate production close to the source of the raw agricultural input.

The limits placed on the location of production seem to be both product and firm specific. One firm that produces both goods with high and low proportions of raw agricultural inputs discussed the limitation on production location only with respect to the product with a high proportion of raw agricultural inputs. In general, most firms that discussed this limitation on production made reference to this type of good. Interviews with three other firms, however, suggest that not all firms producing goods with a high proportion of raw input limit production to areas suitable for the growing the agricultural input. These firms, faced with increasing raw input costs merely switched to importing a semi–processed form of the raw ingredient from other markets.

Because ingredient costs account for the majority of the production costs incurred by the firms, other input requirements, including labor, have little impact on the choice of plant location. Only one firm shifted production outside the home country due solely to labor cost. This firm represents an exception because of its involvement in harvesting the agricultural input, a labor intensive task.

Risk

Several firms noted that exports entail less risk than a commitment to local production in a foreign market. In countries marked by political instability or markets with poor infrastructure, local production is less favoured. Experience in international markets, however, may reduce the risk associated with a market. For example, one firm noted that, contrary to prevailing thought in the industry, it does not view the risks in Latin America, and Brazil in particular, as substantial enough to forego investment. Its considerable experience in Latin America reduces the risks involved.

Conclusion

The description of the foreign activities of the firms in our sample in Section III indicates that most foreign sales of food firms are not made from their home country. The preceding description suggests that a number of factors, alone and in combination, may determine the choice between exports and production in the target country. Two overriding factors for locating production outside the home country exist: 1) the need to tailor products to distinct cultures and tastes, building or maintaining brand reputation and providing the necessary level of service to customers; and 2) low unit value of products at the point of sale relative to delivery costs. Though important to three firms, a less prevalent factor for firms in our study was the home country's inability to produce the raw agricultural input.

Four factors were considered important for choosing to produce within the home country rather than abroad: 1) a target market too small to support local production; 2) a firm's desire to limit its exposure to risk in the target market; 3) difficulty in producing the raw agricultural inputs in the target market; and 4) economies of scale in the home country. As discussed above, delivery costs place limits, in some cases, on the last of these factors. As a result, they may best explain exports within regions, rather than worldwide.

The focus on production in the home country versus production in the target market obscures, to some extent, the roles of both options in firms' strategies for successful entry in new markets. Though all firms interviewed export from the home country as an end, they also use exports in their initial forays into foreign markets. If the target market can support local production, they might proceed from exports to production within the market.

The progression from export to local production in the target market does not necessarily begin in the home country. The interviewed firms generally seek to supply new markets from the most cost efficient source. This is true as an initial step in entering a country as well as on an on-going basis. As discussed above, delivery costs may make export from the home country prohibitive and favour a source of production located close to the market served. In a similar manner, other cost considerations may favour supply of a new market from other than the home country. Firms indicated that they choose to supply markets from the lowest cost source, including both production and delivery costs. Home country production is favoured only to the extent that it meets the low cost criterion.

A related question which has provoked considerable debate is whether FDI and exporting are complementary or substitute activities. Root (1982) argued that exporting and FDI are complementary while Caves (1982) hypothesized that exporting and FDI are substitutes, especially when export propensity reaches a particular threshold level. The evidence from firms surveyed for this study plus secondary data from the ERS firm-level data base suggests that FDI and exporting are complementary in the aggregate. That is, for most firms, export propensity does not decline as sales from foreign affiliates and joint ventures increase. But for many product-specific and country-specific situations, FDI clearly substitutes for exports. Apparently, as a firm's penetration of foreign markets expands, new export opportunities emerge to compensate for exports replaced by licensing, joint ventures, and foreign affiliates.

In any case, the entry process into new markets frequently does not end with the decision to produce locally rather than export into the target market. Rather, the decision to produce in the target market often begins a journey involving choices along a continuum of production arrangements until the firm attains its desired long-term mode of production. The following section describes firms' views of alternative production arrangements in target markets and the factors important to the choice among them.

V. Production Arrangements in the Host Country

Licensing agreements, joint ventures and affiliates are the three principal production arrangements used in foreign countries.[5] Each of these methods can be used in the short term, that is, as a method of entry, and in the long term. This section examines the factors influencing these choices.

As indicated in earlier sections, information from both secondary data and the firms interviewed indicates that for both purposes, ownership is in most cases the preferred option and licenses the least preferred. In particular, foreign direct investment is the dominant form of supply for fifteen of the seventeen firms interviewed and ten expressly stated that full ownership is the most preferred option.

In addition, firms interviewed indicated that, while they used various methods to enter a country, in many cases their ultimate goal was ownership. In other words, if a foreign affiliate was not chosen at the outset they would "progress" along the continuum from exports, through to licensing and joint ventures, toward full ownership. However, a variety of patterns of progression along this continuum is observed. For instance, at least a few firms interviewed have progressed from arm's length exporting to licensing, several have moved from exporting into a joint venture and/or ownership arrangement, at least half have used licensing as a step toward joint venture or ownership, and almost half have used joint ventures as a prelude to full ownership.[6]

Overall, we identify several factors affecting firms' choices between these three production arrangements: a) control over intangible assets; b) risk; c) the desire or ability to overcome entry barriers; d) the desire to capture "synergies" by entering a foreign market with another firm; and e) government policies. The tradeoff between control and risk is often an important consideration for the firms, while the other factors also can play deciding roles. The relative importance of these

[5]We focus on production arrangements whose primary purpose is to serve foreign markets with foodstuffs, mainly consumer-ready products. Only one firm interviewed undertakes joint ventures for the purpose of sourcing raw agricultural product from foreign countries as a strategic program that allows it to achieve a high degree of vertical coordination. None of the firms seems to undertake licensing for the sole purpose of sourcing raw product. Some firms use foreign affiliates to source as discussed in the previous section and most source globally at arm's length; however direct investment for the purpose of sourcing only is not common in the sample.

[6]The degree of flexibility afforded licensors and joint venture partners to end an agreement or have it evolve into a more preferred arrangement would have to be negotiated.

determinants is influenced by characteristics of the product, the host country including the structure of the market, and the firm.[7]

To the extent that government policies affect the level of risk in a country, they can play a role in firms' decisions with respect to the mode of entry and longer term production. Furthermore, firms may be limited to certain levels of equity participation in countries which have fairly restrictive foreign investment rules; this is more common in less developed countries than industrialized ones. In most cases, however, government policies did not appear to be a major determinant of the choice of production arrangement for the firms interviewed. Government policy is discussed further in the following section; in this section we focus on the other factors affecting firms' choices listed above.

Control over Intangible Assets

As discussed in the previous section, the desire to maintain control over intangible assets is a key factor in the decision about whether to serve a foreign country with exports or local production. This desire for control also was evident in the comments made by firms on the relative merits of licences, joint ventures and full ownership as means of producing locally.

The degree of control over day-to-day and longer term decisions increases as one moves from licenses (arm's length contracts) to joint ventures to ownership. Indeed, the majority of firms interviewed said that their preference for full ownership is most influenced by the desire to have complete control over the management of production, marketing and distribution. To varying degrees they expressed a reluctance to hand over or share control of such firm–specific intangible assets in a licensing or joint venture arrangement. Those intangibles or ownership advantages most pertinent to our sample and multinational food firms in general are the reputation and quality of branded products, process technologies, commodity trading, customer service, and skills related to marketing and market development. The ability to manage and develop brand name products with consistently high quality appears to be one of the most important advantages belonging to many firms in the sample.

Control over technology in licensing or joint venture arrangements did not appear to be a concern to most of the firms interviewed. One firm expressly stated it would prefer to use foreign direct investment instead of a licensing or joint venture agreement because of the concern for protection of technology in its ingredient business. Although this firm indeed licenses technical assistance in a number of countries, apparently, it chooses not to patent its technology and questions the enforceability of this kind of document. Another firm commented that it is reluctant to share its technology in a licensing or joint venture agreement. Overall, however, the firms did not express great concern over problems of dissipation of technical expertise or disclosure of production technology.

In choosing licensing instead of a production arrangement involving at least some degree of equity participation, firms would normally forsake the greatest amount of control over intangibles. Indeed, a few firms remarked that licensing is chosen only as a last resort and another commented that it would prefer to export than use licensing if it could not obtain full ownership. While the latter comment runs counter to the paradigm of progression along a continuum, it highlights the importance of control as a factor influencing choice of mode and the apparent lack of control

[7]At least for the longer term, firm preferences are no doubt related to relative profitability. One firm remarked that it dislikes licensing because it is less profitable than other modes and another firm had at one time considered licensing a good source of revenue but now does not seek licenses for this purpose *per se*.

provided by licenses over at least some activities. In this vein, one firm in the sample withdrew from a licensing arrangement partly because the licensee had been unsuccessful in marketing and developing its products; this firm now exports to the country from a foreign affiliate established in the same geographic region and at least in this case has better control over marketing and distribution as well as production.

More than a few firms expressly stated that joint ventures, which offer more control over daily affairs and the strategic development of company products than licensing, are a favoured second to affiliate ownership. Some firms noted that they expend significant resources in aggressively seeking well suited joint venture partners. A preference for at least a 50 percent share in a jointly–owned operation seems to prevail among the firms, presumably with the aim of being able to exercise a somewhat greater amount of control in the partnership. Firms expressed concerns about balance of power and sharing of returns with joint ventures as well as difficulty in management unless there is a clear convergence of interests. These kinds of conflicts thus may be factors in the failure or short–term nature of some joint ventures.

Regardless of the mode used to supply a foreign market, firms often will want to own the distribution system or at least have a joint venture with a distributor, with the goal to have more control over brand development, product quality and physical distribution. One firm made the point that it is important to build up retail distribution even before building or acquiring a plant. Few firms in our sample seem to have used licensing for the sole purpose of distributing product in a foreign country; almost all licensing agreements appear to have included distribution as well as production. On the other hand, most joint ventures in our sample appear to be for production only, a few for both production and distribution and several for distribution only. Firms also may set up local or regional offices in foreign countries in order to ensure that products are adequately tailored to local tastes and so that customer service and marketing can be performed more effectively.

Risk

Many of the risks associated with supplying foreign markets are similar to those incurred by firms in their domestic markets. In the case of foreign markets, however, firms noted that risks can be increased because of relatively poor knowledge of markets and ways of doing business especially in countries with different cultures. In some cases risks also can be greater because of a less well developed infrastructure, an unreliable workforce or political instability. In addition, fluctuating exchange rates can be a source of uncertainty that must be managed.

After exports, the mode of supplying a country with the least financial risk would be licensing followed by joint ventures through to wholly–owned affiliates. As indicated above, the risk of losing or failing to fully capture the benefits of intangible assets varies inversely with this progression of modes. Thus there is a tradeoff between control and these risks. Licensing and joint ventures can be useful strategies in terms of lowering financial risk while establishing a market presence and consumer acceptance and gaining access to foreign distribution. Some firms in the sample have greater international experience than others and in this way appear to be less vulnerable to various risks; as a result, all else equal, these firms may be more apt to choose direct investment to access foreign markets.

Synergies

Synergies are created when two firms combine their mutually beneficial ownership advantages and both become better off because of this effort. Benefits from synergies are identified in the foreign operations of several interviewed firms serving foreign markets with joint ventures and appear to be an important secondary motivating factor for joint ventures. In a few cases benefits from synergies are associated with one firm exporting product from a home or nearby country to the host country where the product is distributed by another firm. Typically, however, production takes place in the host country.

Among the firms interviewed, synergies are largely characterized by one firm offering skills related to production and the other firm contributing knowledge of foreign markets and access to a foreign distribution system. The firm offering production knowledge seems to most often provide the brand recognition as well, however this is not necessarily the case and indeed the product may be cross–branded. One firm also commented that it uses joint ventures in situations where it lacks skill to produce high value products; this firm would bring to a joint venture its skills related to commodity trading and upstream processing.

Benefits from synergies seem to be most often associated with joint ventures in countries with relatively high risks related to lack of market knowledge, poor infrastructure and an unstable policy environment. However, there are examples among the firms interviewed of joint ventures being used to better serve potential growth markets in relatively stable and culturally familiar countries. These joint ventures typically occur between relatively large, well established firms and may tend to be longer term arrangements, possibly due to a relatively high capital commitment by the partners and a greater dependency on each other's contribution.

Synergies gained from a joint venture can apply in the longer term as well as in the short term. Long–term joint ventures appear to be more common in our sample than on–going licensing agreements. This may be due to both the greater control over firm–specific advantages and greater synergies offered by the former.

Entry Barriers

Entry barriers[8] as a factor in the choice between production arrangements in foreign markets was discussed in only a few instances. One firm commented that market competition in the host country caused it to switch to licensing foreign production instead of owning a foreign affiliate. Two firms stated they had attempted to enter a foreign market using a joint venture but decided not to pursue the effort because of an entrenched incumbent(s). One firm entered a joint venture with a fellow large, established multinational in order to be able to compete in both production and distribution with an entrenched incumbent.

These examples and general observations of the sample firms lead us to believe that market related entry barriers likely discourage firms from entering markets with foreign affiliates rather than a method that involves less investment risk. In fact, they may discourage firms from entering foreign

[8]Entry barriers are broadly defined here to be anything that decreases firms' likelihood, scope or speed of entering potential markets.

markets at all; the ability of a firm to capture a certain amount of market share is apparently an important factor when firms decide whether entry into a country has the potential to be worthwhile.

While cost may act as a barrier to entry, availability of capital funds generally does not appear to restrict the firms interviewed from ultimately achieving a goal of full ownership in production or distribution.[9] Exceptions to this among our sample firms appear more likely the smaller the firm. One firm remarked, however, that costs associated with distribution are often greater than those associated with manufacturing and there is a general impression that there are often difficulties in accessing and establishing foreign distribution. Formidable cost requirements, the existence of an entrenched incumbent and the desire to avoid duplicating an existing distribution system appear to be important motivations for joint ventures.

Entry barriers might motivate firms to choose licensing and joint venture agreements in the first place and are possibly reasons for maintaining these arrangements in the longer term. In particular, an important motivation for longer term licensing agreements appears to be entry barriers because they allow firms to take advantage of existing businesses and facilities in foreign markets.[10] For instance, in the soft drink industry territorial licensing has become commonplace and many local franchises are now owned by a few dominant firms. As indicated earlier, however, long-term joint ventures often offer more control and greater synergies and were more common in our sample of firms.

Conclusion

This section describes firms' views of alternative production arrangements in target markets and the factors important to firms' choice among them. It is believed that all firms in the sample have a strong preference to supply foreign markets using direct investment. The primary motivating factor for ultimately choosing direct investment is the desire to maintain control over firm–specific intangible assets. It would appear that the most important intangible to firms in our sample and in the food industry as a whole is the reputation and quality of branded products. Other important intangibles to firms in the sample are process technology, customer service, and marketing.

While control over intangible assets is important to multinational food companies, other factors associated with establishing local production abroad must be taken into account. Firms weigh the risks associated with making a large capital commitment in a foreign affiliate with the benefit of maintaining full control over firm–specific advantages. Consideration of risk becomes more important the more unfamiliar the market and the more unstable the politics and policy environment of a country.

[9]A few firms emphasized that efficient use of capital dictates worldwide distribution of company resources.

[10]While there are exceptions, long-term licensing agreements in our sample appear to mostly involve the production and distribution of branded beverage and confectionery products. In the food industry, most licensed confectionery products are chocolate based candy and require milk for production, so that licensors of such products rely on domestic milk sources of the licensee to ensure a fresher confectionery product (Thomas, 1994). By licensing rather than exporting beverages, transportation costs of shipping water and containers are avoided. For soft drinks, the geographic development of the industry also has been influenced by a returnable bottle policy which strongly favours local bottling. However, these factors are relevant to the decision of where to produce rather than the business arrangement used.

Licensing or joint venture agreements may be chosen instead of direct investment in situations where market and political risks are high and if a firm has little experience in managing risks in foreign countries. Licensing intrinsically involves less financial risk than joint ventures. However, joint ventures offer greater control over intangibles as well as synergistic benefits associated with the contributions of both partners. Overall, the interviewed firms typically prefer joint ventures to licensing agreements as a means of accessing foreign markets.

Both licensing and joint venture agreements, however, give firms the opportunity to develop a market presence and gain consumer acceptance for their products over a period of time. They can be a cost effective means to obtain local knowledge of the production and marketing systems and access to processing and distribution systems.

A variety of entry barriers can influence the mode of production chosen, either for the short–term or long–term. For example, the existence of an entrenched local incumbent can motivate firms to enter foreign markets using licensing and joint ventures instead of direct investment or could even discourage entry.

While internalization advantages of ownership (see Section II) were not explicitly discussed in the interviews in terms of a determinant of full or partial ownership and have not been discussed as such in this Section, it is evident that a number of firms in the sample take advantage of these synergies. In particular, for several firms we observe that parents and foreign affiliates share and trade goods and services such as agricultural inputs, final consumer products, research and development, distribution networks, and a wide variety of skills and knowledge.

VI. Influence of Government Policies on Firm Strategies

Trade policies, foreign direct investment policies and a range of domestic policies might be expected to influence decisions about which countries to enter and whether to do so with exports or local production. They also could influence the choice of business arrangement used for production in the host country. In addition, changes in policies might be expected to be one factor leading to change in these decisions, including disinvestment.

In only a few circumstances did firms interviewed specifically identify public policies as the decisive factor with respect to which countries to enter or the mode of entry. However, policies may have a greater effect than this implies. Most firms indicated that government policies were a factor in location decisions. In addition, firms emphasized the role of costs in location decisions and to the extent that policies influence costs they would influence these decisions.[11]

[11]For example, at least three firms did not appear to distinguish between freight costs and costs due to trade barriers in their discussion of delivery costs as a factor affecting location decisions.

Trade Policies

In discussing policy influences, only two firms specifically said that they chose production in the target market rather than exports because of trade barriers. One firm moved from exporting to licensing in order to avoid high tariffs in the Philippines. The other firm mentioned that high tariffs on their products in Europe may favour production in the European market. They did not specify if this had, indeed, been a motivation for shifting their production to Europe.

Although tariffs are not often a key factor affecting where plants are located, they can influence where individual products/product lines are produced. Thus, tariffs were considered a deterrent to exports by about a third of the firms in terms of exceptionally high levels (e.g. EC, Japan) relative to product value. A few firms noted the negative influence on competitiveness of tariffs on inputs such as Canada's packaging tariffs before the FTA.

Non-tariff barriers play a more important role than tariffs. Quantitative import restrictions such as those associated with Canada's supply managed dairy and poultry sectors and the U.S. sugar and peanut programs were cited by several firms as at least influencing the location of production for these products. Import restrictions for supply managed products obviously inhibit trade but they, or at least their associated domestic market restrictions, also could have a negative influence on investment. For example, one or two firms indicated they were not interested in operating in restricted markets and several Canadian subsidiaries noted the higher costs associated with producing a range of products due to supply management. The U.S. sugar and peanut programs likewise add to processing costs in the U.S. and favour imports of any products which are not subject to import controls containing these ingredients.

The use of technical regulations (regulations governing health and safety, product quality, labelling, etc.) as non-tariff barriers was a more general concern. They were mentioned by about half the firms as a factor limiting exports of some product. Technical regulations that were cited as having the effect of reducing trade included Canada's standard container size regulations, the difference in red dyes allowed by Canada and the U.S., and different regulatory standards for colours and flavours among countries in Europe. Labelling regulations were identified by some firms as at least an added cost whereas others considered them to be little problem. In addition, concerns related to the enforcement of technical regulations, including difficulties crossing borders were expressed, especially with respect to Canada-U.S. trade in meat. Canadian firms were concerned that the lack of border enforcement of Canada's labelling regulations gave imports an unfair advantage.

On the other hand, export subsidies can facilitate exports. A few firms mentioned the U.S. Export Enhancement Program (EEP). One noted that it was a key factor in its exports of a product to Japan while a couple of Canadian based firms were concerned with the adverse effect of EEP and EU export subsidies on their efforts to export to third countries. Export development programs such as the U.S. Market Promotion Program (MPP) also were cited in this regard. However, these examples do not imply that without government support these firms would have used some other mode of entry.

The influence of trade policies on firm strategies also is indicated by firms' views on the role of trade liberalization. The most common reaction to FTA/NAFTA was that it would reinforce the move to regional plants, specialization of plants and more integrated management structures. This view of increased regionalization was expressed in some form by about sixty percent of the firms. It is evident in firm restructuring with less efficient plants being closed and their markets served with imports and/or by other plants, perhaps upgraded for the purpose. With respect to management, there is a tendency for head offices to organize on a geographic (e.g. North American division) or product line basis rather than a country basis. The general view was that these changes were taking place anyway as a result of pressures to improve efficiency but have been accelerated by the FTA. Even then, the effect was perhaps less the actual reduction in barriers as the increased awareness they created of the opportunities to rationalize production and markets, especially in a recessionary period.

At the same time, a few Canadian managers were concerned that the FTA has been less effective than was anticipated in reducing border irritants and producing a "level playing field."

While these comments also apply to some degree to trade and investment with Mexico, the implications of NAFTA appear to be less clear. The anticipated growth in the Mexican economy is seen as a positive factor for trade or investment. As discussed above, the advantages and disadvantages of producing in Mexico are still being assessed by most firms and distribution is an added challenge.

Although GATT was not discussed in much detail, a few firms anticipated that it would be beneficial in opening up markets. Similarly, a couple of firms noted that EC '92 will make trade among European Union countries easier and reduce the number of companies.

Foreign Investment Policies

While virtually all countries regulate foreign direct investment to some degree, this topic was mentioned by only a few firms. For example, India and Mexico were cited as more attractive locations since relatively stringent rules of this type have been relaxed.

Domestic Agri-Food Policies

Agri-food policies that could influence trade and investment decisions include market regulation, technical regulations and market and income support programs. As discussed above, these policies often have associated trade policy implications, but this section focuses more on their effect on the competitiveness of local production. A policy which increases costs in the target country relative to the home country favours the use of exports, other things equal, whereas policies which reduce costs favour production in that country. While twelve firms made comments on agri-food policies, in only one or two cases did they appear to be the major factor in whether to invest or disinvest in a country. As in the case of trade policy, however, they are more important for decisions on individual products.

Discussion of the influence of market regulation on competitiveness of production was largely centered on Canada's marketing boards and supply management system for poultry and dairy, and the U.S. peanut and sugar program. In both cases, the effect was to make production in the respective countries less competitive. While the effect on domestic production is largely offset by import restrictions, processors of products using ingredients based on these commodities are less protected. Also, the higher cost structure limits exports from each country. A couple of firms also indicated a lack of interest in entering actually or potentially regulated markets.

In addition to their use as NTB's, the effect of technical regulation and enforcement procedures on domestic cost competitiveness was a concern. For example, it was claimed that Canada has tougher meat plant inspection than the U.S. and that Canada allows imports of products not meeting its labelling regulations. Differences in pesticide regulations that lead to cost differences and the fragmentation of Canada's already small market by interprovincial trade barriers also were mentioned.

On the other hand, regulations can be helpful in assuring competitive products meet stated ingredient claims. One firm noted the advantage and even necessity of being on the Hazard Analysis Critical Control Point (HACCP) meat inspection system in supplying a food service customer.

With respect to support programs, the main concern was with the European Union's subsidies and their effect on a firm's ability to export there and to third countries. One firm noted that canola production in the U.S. is limited partly because this crop is not eligible for support programs and this contributed to disinvestment in its U.S. facility. One firm suggested that U.S. support programs were more effective and GATT-proof than Canada's.

Other Domestic Policies

For the most part, industrial, social and environmental policies did not appear to be important determinants of investment decisions. A few firms mentioned that labour legislation and environmental regulation could influence plant location decisions.

Taxes were not identified as an important determinant of investment. The effect of exchange rates or fluctuations in them on the profitability of international activities was noted but did not appear to be a significant factor in firm decisions about countries or method of access. A few firms suggested that economic or political instability are a concern in deciding which countries to enter, especially with investment. Increased interest in investing in countries such as Mexico, India and China and Eastern Europe was linked to political and/or legislative changes more favourable to foreign investment.

VII. Implications for Public Policies

A broad goal of public policy is to improve economic welfare. In many cases trade can contribute to this goal by allowing countries to gain from comparative advantage, economies of scale and increased competition. Foreign direct investment, joint ventures and licenses likewise can contribute to this goal. In fact, foreign production can be considered as the vehicle for the export of a firm's intangible assets (e.g. management and technical expertise, product quality, brand names). As well, it can facilitate trade in goods and services by reducing transactions costs (e.g. intra-firm trade).

While in principle most if not all countries could be better off with a world economy more fully integrated by trade and foreign production, changes in production and consumption patterns would result. Within countries this gives rise to pressures to encourage integration from those who believe they would benefit and pressures to discourage it from those who perceive losses or at least the need to change. As a result, we find a mixture of policy thrusts: trade liberalization and continuing erection of non-tariff barriers to trade; encouragement of FDI by some (potential) host countries and restrictive regulation of FDI by others.

The strategies firms use or would like to use to participate in foreign markets thus give rise to a number of policy issues. The comments of firms interviewed on the influence of policies are summarized in the previous section. This section looks at a few of the policy issues and implications flowing from that section and earlier sections describing firm organization, goals and strategies.

Trade Liberalization

Trade liberalization, to the degree that it in fact takes place, clearly facilitates exports. At least in the short term, it favours exports over production abroad. However, although tariff and non-tariff barriers to exports as motives for foreign production were given in a few cases, their overall significance did not emerge as a major determinant. The decision to enter a foreign country is more a function of the expected market potential. Trade barriers could prevent using exports as an initial step and thus increase the cost and risk of entry (although they also could increase the rewards) while investment rules could impede the use of ownership.[12]

At the same time, trade liberalization is one of the factors favouring a more regional view of markets and how to serve them. In this respect, trade liberalization is influencing both trade and foreign production.

One issue is how to effectively implement trade agreements. Border harassment, the threat of countervailing duties and so on directly or indirectly hinder trade and investment. Examples cited by firms interviewed include vigorous U.S. border inspection of meat products and uncertainty about possible changes to sugar-content regulations. The uncertainties created by these actions have their greatest effect when firms are making investment decisions.

Foreign Production: Home Country

From the point-of-view of the home country, foreign production by its firms has positive economic effects because it allows them to earn income on the "export" of certain intangible assets. As indicated earlier, the use of its management and technical expertise in this way would help to reduce costs in both the home and host country (through economies of size). Also, to the extent it led to intra-firm trade the home country would achieve benefits. On the other hand to the degree that foreign production substituted for exports, the home country would lose the associated economic activity. However, as briefly indicated in the conclusion to Section IV, while production in other countries replaces exports by a firm, this may be offset by new export opportunities as the firm expands into new global markets.

We are not aware of many policies designed to favour outward foreign production although numerous if not all countries have policies to stimulate exports.[13] Export market development programs range from subsidies to market intelligence and local services by embassies. Some (e.g. export subsidies) clearly favour exports over foreign production. Given the use of exports as a first stage of entry and the importance of foreign market information to investment decisions, they also could indirectly facilitate foreign production.

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[12]As noted by Graham and Krugman (1991, p. 49), trade protection favours foreign investment only if it gives foreign owned firms an advantage over domestic firms. In other words, while trade protection may discourage imports, a foreign firm will enter a country only if it can successfully compete with local producers.

[13]Assistance in the form of information and so on is provided. Also, the U.S.-Mexico Maquiladora program facilitates production by U.S. companies in Mexico. Furthermore, Steven Globerman (1994) cites a book by Dunning (1993) as support for saying "... governments have traditionally tended to favour and, indeed, in many cases to promote direct investment abroad".

Foreign Production: Host Country

From the point-of-view of the (potential) host country, foreign production also is seen as a mixed blessing.[14] On the one hand, the host country benefits from the management, technical and marketing expertise of the firm, the infusion of investment capital, greater specialization in the economy and increased competition. These benefits accrue to the specific sector and also more generally to the degree that the skills, etc. spillover into other sectors.

The concerns raised in host countries by FDI are both economic and political: affiliates of foreign firms might have a higher propensity to import and this could lower the demand for domestic production; they might keep the higher skilled jobs, research and development activities, etc. at home, effectively replacing or retarding development of these skills in the host country; they could use transfer pricing to avoid taxes; they take profits outside the country; they increase the costs to the economy of policies such as tariffs and subsidies to the degree benefits get transferred out of the country; they may be more able than domestic firms to influence policies in areas such as the environment and labour; and so on.

In their review of inward FDI to the U.S., Graham and Krugman found little basis for most of these concerns. Their importance could differ, however, by country and industry. For example, in Canada, foreign affiliates in the food and beverage industry appear to have higher propensities to import and lower propensities to export than domestic firms (Vaughan,1994). Their higher propensities to import, however, are likely substantially more than offset by their local production which largely substitutes for imports. On the other hand, in a country like Canada, which has a high proportion of foreign owned firms, and views exports as the primary source of industry growth, a multinational firm's strategy which limited its affiliates to serve only the host country would frustrate that country's export goals. The impression from the firm interviews is that the practice of limiting affiliate mandates to the host country market is being replaced by or at least modified by a strategy of producing in the most cost effective location without regard to national boundaries.

The only other one of these concerns discussed with firms in this study was the location of research and development activities. In most cases, these activities were considered to be a headquarters function, either to maintain control or as an historical fact. However, several of the firms interviewed have research centres in other countries or at least have research done on contract in other countries. In these cases, the specific R&D activities that were placed in a country were said to be related to specialization of production, local demand, etc.

Domestic Policies

The increased emphasis on cost competitiveness has implications for domestic policies - market regulation, technical regulation, taxes, and so on - which increase costs. Many factors affect costs and firm decisions. However, other things equal, countries which can effectively meet internal policy goals at the least cost to industry will be best able to attract and retain investment. As indicated in the previous section, these kinds of concerns were raised by a number of firms. A corollary of this observation is the issue of financial incentives of one kind or another to encourage firms to locate

[14]The benefits and costs of FDI are discussed with respect to the U.S. economy in Graham and Krugman (Chap. 3).

in a country or a specific location in the country. In most cases, however, domestic policies would need to have a substantial impact on competitiveness in order to influence location decisions.

Multilateral Policies

The increased interdependencies of economies through trade and FDI, along with the increasing "stateless" nature of multinational firms, has stimulated interest in the need for more international cooperation in areas such as competition policy and tax policy. One difficulty, however, is that policies which would be optimal for home countries, host countries and the world are not identical (Caves, 1982, p. 298). While the GATT includes rules for FDI (e.g. access and national treatment), a more broadly based multilateral accord including a dispute settlement mechanism has been proposed (Graham and Krugman, p. 92).

VIII. Summary and Conclusions

The international activities of food and beverage firms include trade and production in foreign countries. Of these, production abroad is by far the largest. On a global basis, production by foreign affiliates, joint ventures and other means is some 4-5 times greater in value than exports while 38 large U.S. based food processors have sales by foreign affiliates about ten times the value of their exports from the U.S.

The purpose of the study reported in this paper was to better understand the motives of firms and the factors influencing their decisions about the method of serving foreign markets, including the role of public policies. The methods examined were exports, licenses, joint ventures and foreign affiliates.

Information was obtained from interviews in the U.S. and Canada with seventeen firms. The firms were selected to cover a range of nationalities, sizes, products and international activities.

Among the theories that seek to explain foreign direct investment (FDI), the eclectic theory of Dunning is the most prominent. It explains a firm's choices among exports, licences, joint ventures and foreign affiliates in terms of its ability to capitalize on internalizable, firm-specific advantages and the locational advantages of individual countries. The results of this study are consistent with this theory.

The main reason for expanding into international markets given by the firms interviewed was the slow growth of domestic markets. Other reasons included the desire to spread risks through geographic diversification and the desire to exploit intangible assets such as brands, production and marketing expertise, and technology.

This paper divides the decision to participate in international markets into two stages. The first is whether to use exports or to produce in the target country (local production). The second is which business arrangement to use - license, joint venture or foreign affiliate - given a decision to produce in the host country.

The key factors favouring production in the target country are (1) the need to tailor products to the market, develop and maintain the brand and provide service, and (2) a low unit value of product relative to the delivery cost of exports. At the same time, four factors favour production in the home country: (1) a small target market, (2) the desire to reduce risk, (3) an inadequate supply of agricultural inputs in the target market, and (4) economies of scale in the home market. In some cases, the most economical source for supplying the target market is a facility in a nearby market.

While exports and production in the host country are substitutes for each other in many product-specific and country-specific situations, firm-level data indicate that in the aggregate they are complementary. The propensity to export for most firms does not decline as sales from foreign affiliates and joint ventures increase.

If the decision is to produce in the target market, there are four key factors influencing the choice between licences, joint ventures and ownership: (1) the degree of control over intangible assets, (2) risk, (3) entry barriers and (4) synergies provided by entry with another firm.

Both secondary data and the responses of firms interviewed indicate that the most common and usually the most preferred method of supply on an ongoing basis is ownership. Licenses are typically the least preferred. In particular, while a major goal of firms is to maintain control over production and marketing to protect and fully utilize intangible assets, and this is best achieved by ownership, they also want to reduce investment risk. This can lead to entry with licences or joint ventures, other things equal. These options also provide access to firms with local production capacity, knowledge and skills, especially important in countries with different cultures. In addition, local firms can provide access to a distribution system. In general, developing or gaining access to an effective distribution system is a key element in supplying foreign markets.

Given the preference for ownership control in the long term and the less risky nature of other arrangements in the short term, it is not surprising that firm strategies for supplying foreign markets often entail a "progression" along the continuum of exports, licences, joint ventures and full ownership. The progression could start and stop at any of these points depending on the relative importance of the factors identified above in the specific situation. In other words, the relative importance of control, risk, synergies and so on depend on characteristics of the firm, the product, the market and the country.

Public policies also influence firm strategies for supplying foreign markets. They include tariff and non-tariff barriers, export programs, subsidies, trade agreements and regulations governing foreign direct investment. They also include the influence of domestic sectoral, horizontal and macro-economic policies on competitiveness and the "policy environment". The comments of firms interviewed, however, indicate that public policies are the key factor only in somewhat exceptional circumstances. Examples would be the high tariffs into the Japanese market, Canada's supply management system for dairy and poultry in terms of its quantitative import controls and effect on competitiveness, and the U.S. sugar and peanut programs.

In addition, trade agreements such as the Canada-U.S. Free Trade Agreement were seen by the firms as facilitating and stimulating closer integration of Canada and U.S. production but they believed that such integration was increasing in any case due to competitive pressures. This integration is in the form of rationalizing plants and the production of specific products between countries and in the management structure of firms.

The growing global integration of national economies and industries such as the food industry, however, does raise a range of issues for public policy. They include:

- the need to improve the implementation of trade agreements in order to reduce uncertainties of market access.

- the suitability of programs to expand exports given that exports often lead to foreign investment and, in any case, local production is by far the more important and favoured (by firms) form of participation in foreign markets.

- the effect of sectoral policies such as market regulation, technical regulation, support programs and research programs on the international competitiveness of a country hoping to attract foreign investment and expand exports.

- likewise, the role of horizontal policies (labour, competition, environment) and macro economic policies (taxes, exchange rates) in creating an economic environment favourable to foreign investment in terms of costs, economic growth and stability.

- the need for closer coordination among nations in policy areas such as technical food regulation (food safety, labelling and packaging), labour, environment and competition.

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