Global Business & Development Law Journal

Volume 7
Issue 1 *Symposium: Doing Business in Central and Eastern Europe*

Article 10

1-1-1994

# Book Review

University of the Pacific, McGeorge School of Law

# When Businesses Cross International Borders—Strategic Alliances and Their Alternatives

By Harvey S. James, Jr. and Murray Weidenbaum, Praeger Publishers, 1993

Reviewed by W. Eric McElwain*

Much has been written about the globalization of business and commerce, but the average informed business lawyer may have only vague notions about the implications of this trend on the ways that his clients do business. While average lawyers may understand the rise of regional trade blocs in North America, Europe, and Asia and the explosive increase in cross-border commerce, they may know little about the myriad of responses available to businesses in meeting the challenges of global competition. In just over 100 pages, Harvey S. James, Jr. and Murray Weidenbaum systematically describe each of the many ways, together with its advantages and disadvantages, that a business can internationalize itself in order to expand its markets and to remain competitive.

The authors contend that during the next decade, even the growth of regional markets will be overwhelmed by the need for businesses to become truly global.[1] In this book, they describe four general methods by which companies can compete at the global level: (1) marketing abroad directly; (2) cooperating contractually with foreign companies; (3) owning their own facilities abroad; and (4) forming strategic alliances, with or without equity investment. Chapter by chapter, James and Weidenbaum discuss the specific methods of doing business within each of these four general categories, and they describe the situations in which a particular response may not necessarily be appropriate as well as mentioning the inherent risks that attend each method.

The most common strategy for penetrating foreign markets, according to James and Weidenbaum, is direct exporting, a method which allows a company to retain full control of its product, but also subjects it to any trade barriers that the importing country may have erected to protect its domestic producers.[2]

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1. HARVEY S. JAMES, JR. & MURRAY WEIDENBAUM, WHEN BUSINESSES CROSS INTERNATIONAL BORDERS—STRATEGIC ALLIANCES AND THEIR ALTERNATIVES 6 (1993).

2. JAMES & WEIDENBAUM, *supra* note 1, at 19.

Designing and building turnkey[3] operations which are then turned over to the local producer is another method of marketing directly abroad. By maintaining full control in its home country, however, a company has less ability to respond to the local variations and fluctuations in markets from one country to another.

Many companies are unable or unwilling to make the large financial or technical commitments necessary to establish either direct exporting links or wholly owned foreign subsidiaries. For such companies, cooperative contractual agreements with foreign firms may be the best way to gain access to foreign markets.[4] The most prevalent form of cooperative contract is licensing, by which the licensor sells a limited right to produce and market a product (usually in a given geographical area) in return for royalty payments. A variation of licensing is franchising, whereby an entire business system or service is licensed to an independent licensee. While licensing can generate income without risking significant amounts of capital (which is especially advantageous to smaller or less liquid companies),[5] it creates the problems of loss of control and accountability. Even with strong quality or procedural controls in the contract, enforcement may be a problem and might lead to the licensee eventually using the acquired technology to compete with the licensor. On the other hand, licensing can be useful where the local political climate discourages or prohibits control or ownership of local businesses by nonnationals.

For companies willing and able to invest substantial capital resources, building or buying (through a merger or acquisition) production and distribution facilities abroad remains a popular method of establishing a foreign presence.[6] This gives the company maximum control and flexibility over its operations, avoids any import restrictions in the host country, and allows the company to keep all the profits from the foreign sales. On the other hand, in addition to the large investment required, the company may have to contend with an unfamiliar market, with an adverse political climate, with differing employment and labor practices, or with local laws prohibiting outright foreign ownership of businesses. This explains why the largest share by far of direct foreign investment by U.S. companies has gone to foreign affiliates in the relatively low-risk countries of the European Union (formerly the European Community).

Strategic alliances without equity investment have been a growing form of international expansion for businesses because they allow firms to share the risks of an uncertain marketplace by jointly pursuing common objectives.[7] In these

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3. "Turnkey" refers to a facility, operation, or product finished by the creator in a state suitable for immediate use in the normal manner. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 1274-75 (Merriam-Webster, Inc., 10th ed. 1993).

4. JAMES & WEIDENBAUM, *supra* note 1, at 28.

5. Licensing can be a tool to learn more about a particular foreign market in order to determine whether the market justifies a more substantial capital investment. *Id.* at 33.

6. *Id.* at 48.

7. *Id.* at 61.

alliances, companies maintain their own identities while pooling their resources. Companies may form such alliances for multiple purposes, or they may do so for very limited, specific reasons and still remain competitors in other areas. In countries with relatively open economies, direct investment remains the dominant form of business expansion, but in more closed markets, tie-ins with local firms may be the only practical way to enter a new national market.

Companies may form strategic alliances to share research and development or to jointly pursue production and marketing. Increasingly, the alliances are looking to share the risk and expense of developing new products with sophisticated technology, which is then shared, although alliances between competitors is extremely delicate and difficult.[8]

Much of the investment made by Western businesses in the new markets of Eastern Europe and the former Soviet Union has been through strategic alliances with equity investment, such as joint ventures with local companies. These have been used to gain entry to markets closed by governmental regulations or other artificial barriers.[9] On the other hand, such alliances often produce lower profits than direct ownership, and issues of control of the venture may emerge.

The challenges of a global economy have given rise to an increasing number of ways to meet them. Each of these ways has its advantages and disadvantages. In this book, James and Weidenbaum concisely go through the various options and discuss the situations in which one response or another is more appropriate. They point out, however, that the decision to globalize has far reaching consequences.[10] To remain competitive, the truly global firm must be willing to enter into a variety of international business ventures. Such a firm may cross borders to the point of appearing stateless and yet may be firmly entrenched in local economies. The conclusion of the authors is that globally oriented firms will be more effective in competing at the world level than enterprises that are limited to a single geographic market.[11]

Lawyers sometimes focus only on the problem presented to them without investigating the business decision behind it. The international practitioner can be more effective if there is an understanding of the variety of business options that are available to a company looking to expand internationally. This book outlines these options in an organized and logical manner and can serve as a good primer for the practitioner who wants to understand the larger context in which businesses must operate. The phenomenon of globalization means that it is not

8. Between 1987 and 1989, McDonnell Douglas and Airbus Industries negotiated in an attempt to pursue joint aircraft development. The negotiations were ultimately unsuccessful, and they have since been head-to-head competitors. *Id.* at 81.

9. In Hungary, General Motors owns two-thirds of automobile producer Raba, and General Electric owns three-fourths of light bulb producer Tungsram. *Id.* at 84.

10. Fully half of Xerox's employees are located outside the United States, while General Electric derives one-third of its profits from international activities. *Id.* at 103.

11. *Id.* at 109.

enough for a lawyer just to advise his clients on narrow legal issues. The practitioner will be far more effective by being at least conversant in the various business strategies that are available to a company as it expands beyond its own national borders.

# Entrepôt Capitalism: Foreign Investment and the American Dream in the Twentieth Century

By Charles R. Geisst, Praeger Publishers, 1992

Reviewed by Eric J. Coffill*

The United States in the twentieth century has been a magnet for foreign capital and achieving the American Dream has always depended to some extent upon that financial presence. But the type and structure of that capital has not remained static. What began in the nineteenth century as traditional foreign investment in traditional industries, such as bonds and stock of railroads and mining companies, began to change after World War I. That change resulted in U.S. financial markets being used by foreigners to raise long term capital, much of which then freely left and reentered the country because of a lack of restrictions. It was through such use of these U.S. financial markets that the United States became an entrepôt,[1] or trade intermediary.

Charles R. Geisst in his book, *Entrepôt Capitalism: Foreign Investment and the American Dream in the Twentieth Century*, has written the first history on the subject of foreign investment in the United States since 1920. The book is intended as a companion to the author's 1990 work, *Visionary Capitalism: Financial Markets and the American Dream in the Twentieth Century*. Rather than a topical approach, Geisst has wisely chosen to address the subject on a chronological basis which begins with the United States emerging victorious from World War I and essentially ends with the period surrounding the precipitous fall of the stock market in October 1987.

Geisst tracks the flow of foreign investment[2] in the United States through a series of historical starts and stops during this period. Following the end of World War I, foreign capital "in search of a safe home and a decent return" flowed to

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1. "Entrepôt" is defined as a "place where goods from abroad may be deposited, and from whence they may be withdrawn for exportation to another country, without paying a duty." BLACK'S LAW DICTIONARY 532-33 (6th ed. 1990).

2. "Foreign investment" is used to mean only the flow of *private* capital across national borders. Government flows of capital are excluded.

the United States. U.S. prosperity, a favorable foreign exchange environment, low interest rates, aggressive U.S. commercial and investment bankers, and a lack of regulation all contributed to the country's role as an entrepôt during the 1920s. Following the stock market crash of 1929 and the resultant Great Depression, the new U.S. role as entrepôt came to an abrupt halt as capital suddenly became scarce. However, by the end of the 1930s, the deterioration of the European political climate and the anticipation of war drove capital, once again, to the United States in search of safety. The United States' entry into World War II, for multiple reasons, resulted in disincentives for foreign investment.

The thirty years following World War II, marked notably by the absence of a global war, produced the greatest monetary stability of the century. As Europe began to rebuild and the foreign exchange markets reopened for trading, foreign investment once again flowed into the United States. Yet the effects of the war were still being felt, and the United States was in a better position to invest abroad than vice versa. Foreign markets thus became increasingly attractive and capital outflow exceeded inflow. This led to U.S. government controls to attempt to minimize or solve what had become, by the 1960s, a balance of payments problem. Foreign investment in the U.S. then began a new era. After 1972, based upon the U.S. decision to devalue the dollar and end the Bretton Woods system of fixed parity exchange rates, foreign direct investment began to increase substantially as the dollar weakened on the foreign exchange markets. Concurrent to some degree, the emergence of the Eurobond and Eurodollar markets in the 1960s obviated the need for foreigners to rely upon U.S. monetary facilities for U.S. investments, thus providing a substantial boost to the development of the entrepôt market outside the United States.

Geisst posits that the benefits of direct foreign investment in the United States are constantly overlooked in favor of political or xenophobic considerations, especially during the 1980s. He argues U.S. industry and consumers have benefitted from increased foreign investment on two counts. First, the opening of foreign manufacturing and banking facilities in the United States forced U.S. businesses to confront their shortfalls and resulted in increased quality of U.S. manufacturing and improved financial products and services. Second, foreign portfolio investment favorably affected U.S. interest rates since the second half of the 1980s, in part by helping fund the budget deficit by foreign investment in Treasury bonds.

Geisst's book is hardly light reading and at times reads more like a text on U.S. economic history or international finance than a study of foreign investment. But this is understandable because foreign investment and entrepôt capitalism are largely tied at all times to the comparative attractiveness of the U.S. market. This requires the topic be placed in a global perspective. His use of foreign investment data is effective, but conditioned upon an explanation as to how statistical problems with that data during this period cause some degree of concern as to its comparative value. A notable omission, although hardly a fatal one, is the author's minimal discussion of the role (if any) of tax incentives or disincentives in the foreign investment decision-making process. The book is not for neophytes, who may soon find themselves puzzled by fleeting references to the likes of Bretton Woods, Regulation Q, and LIBOR. But notwithstanding these relatively minor criticisms, the book is to be recommended to those seeking a succinct (i.e., 154 pages) source of reference information or a general education regarding the sources, structure, and influence of foreign investment and entrepôt capitalism in the United States since the 1920s.

# International Joint Ventures: Soviet and Western Perspectives

Edited by A.B. Sherr et al., Quorum Books, 1991

By Brian L. Zimbler*

When *International Joint Ventures: Soviet and Western Perspectives* was completed in 1990, the Soviet Union was still intact and Soviet-Western joint ventures provoked great interest. The book's nineteen chapters assess joint ventures from different economic and legal perspectives, but virtually all exhibit some of the shared assumptions and enthusiasm of the moment. With the luxury of hindsight, the weaknesses of many of these assumptions are now evident. Still, this book cannot be simply dismissed as out-of-date. Rather, it provides a fascinating snapshot of Western and Soviet perspectives and expectations in 1990.

The underlying theme of the book is rather simple: it compares Western and Soviet views on prospects for foreign investment in the Soviet Union. The emphasis is on "joint ventures," the main legal form for foreign investments in the Soviet Union at that time. Unfortunately, this focus limits the work's usefulness for today's practitioners. Many of the Soviet laws described are no longer in force, having been superseded by the national laws of the fifteen new countries that succeeded the former Soviet Republics. In the Russian Federation, for example, Soviet joint venture laws adopted between 1987 and 1991 were replaced by new Russian corporate and civil laws. New Republic-level legislation on basic property, corporate, commercial, and civil law subjects began emerging in late 1990 and 1991, apparently too late for consideration by any of the authors.

Unfortunately, the contrast displayed between the views of Soviet and Western authors is not particularly dramatic. The Soviet authors' chapters are primarily descriptive in nature, avoiding deeply critical or piercing analysis. For example, the chapter by Ranenko and Yakovleva on "Conditions for Creating a Favorable Investment Climate in the Soviet Union," provides a rather thin summary of joint venture projects through 1990 and merely concludes that a "greater effort" is needed to improve the investment climate. No magic solutions are offered. The chapter by Doronin is more interesting, arguing that the success

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of Soviet foreign trade and investment policies will depend on the degree of transition to a market economy.

The contributions of the Western authors (all British or American) vary in quality, but at their best are somewhat more insightful. The chapter by Stubbs lays useful groundwork by comparing Soviet and Western concepts of risk and return. It explains the difficulties of grafting Western-oriented business structures onto the Soviet economy, where managers had not previously applied Western notions of profit.

The chapter by Hanson on "The Internationalization of the Soviet Economy" is especially perceptive, and perhaps the highlight of the book. It focuses on the key obstacles to success in Soviet foreign trade policies. Essentially, without facing market forces, individual enterprises cannot make rational import and export decisions. A lack of profit-driven incentives discourages exports, while isolation from world market prices and exchange rates perversely encourages imports. Hanson concludes that absent substantial market reform, neither joint ventures nor other foreign investments can really help develop a stronger, export-driven Soviet economy.

Unlike Hanson, some of the other authors express the rather naive belief that joint ventures will make important contributions to Soviet economic development and market reforms. These beliefs were largely a product of their time. Four years later, such feelings have generally been replaced by widespread disillusionment among both Western and former Soviet analysts. The Westerners generally feel that joint ventures face enormous obstacles and are not likely to build successful businesses under current economic and political conditions. The former Soviets distrust and dislike Western investors, whom they consider much too cautious and demanding. They blame the West for a surfeit of empty promises of support, and a lack of substantial investments.

Still, a few authors provide advice which remains timely and useful for Western businesses. The chapter by Gotbaum on personnel and labor issues could easily have been written in 1994: There are still bouts of jealousy over joint venture employees' salaries, cultural clashes between Western and Soviet management approaches, and stark contrasts between conditions in the state and private labor markets. The chapter by Butler nicely anticipates several important trends, including the rise of regional and local legislation, nondiscriminatory "national" treatment for foreign and domestic investors alike, and the hamstringing of joint ventures by new export licensing requirements and regulatory controls.

Taking a comparative tack, author Morton compares the Soviet and Chinese approaches to foreign investment, although the discussion is ultimately rather superficial. He identifies basic similarities and differences in these giant economies and their approaches to market reforms. However, Morton does not begin to anticipate or explain the dramatic differences in economic performance which the two countries exhibited after 1990, as the Chinese economy soared while the Soviet one crumbled. Like some of the other authors, he also appears unduly impressed by several aspects of perestroika which turned out to be transitory, such as the phenomenon of producer cooperatives.

Despite differences in their perspectives and approaches, virtually all of the authors share certain key assumptions. None foresaw the coming dissolution of the Soviet Union or the ensuing political and economic chaos. Most express some optimism that Soviet economic reforms can be maintained and strengthened, and that foreign investments can and should play a key role in this process. All appear to agree that Western-style economic models and market behavior should be incorporated into the Soviet economy, although it might have been more interesting if the editors had invited an opponent of reforms to challenge this pro-Western position. However, the concluding chapter by Sherr is at least honest about the implications of such a pro-reform agenda, and sets out the likely benefits for Western goals and interests.

Overall, the book provides a useful frame of reference for analyzing the rapid changes in the former Soviet Union. Perhaps the editors should compile a second, companion volume, focusing on the prospects for joint ventures and foreign investments in 1994. By comparing the somewhat naive expectations of 1990 with the often hard realities of 1994, it may be possible to obtain some truly useful policy prescriptions for the future.