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School of Business
International Marketing
AC40A8000 Bachelor's Thesis

Internationalization of an SME through FDI as mode of entry

- Case Real Estate Company -

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1 Introduction

1.1 Background of the study

In a World becoming ever smaller, many companies face the reality of internationalization in order to be profitable and to exist. Before moving operations abroad was the privilege of large-scale enterprises. Nowadays smaller and smaller companies are able and forced to look for foreign markets while the foreign competitors enter their home markets. For the last 50 years that internationalization has been studied the focus on has been moving from company related attributes towards environment-related attributes and from large companies towards small- and medium sized companies. The new area of study is called international entrepreneurship.

The idea for this topic and for the case came about a year ago, when I became more and more interested in doing business BRIC countries and especially in Brazil. The case company is a small real estate investment company that operates in Finland and in São Paulo area Brazil, where the company has had operations for about two years. Working has an entrepreneur in an own company has always been more fascinating option than working for some else. As one of the BRIC-countries and one of the hotspots of today’s business world and with the speed of growth of its economy only second to China, Brazil makes an extremely interesting market to be involved in.

1.2 Research questions

The goal of this work is to get an idea what are the main issues that have to be in order for a successful internationalization, while giving the reader a small insight of the Brazilian market in general. It is also notable that the case company does not go by the most common internationalization models, for it is neither a production company nor a service company.

RQ1: How does the internationalization process of a micro enterprise occur?

RQ2: What kind of driving forces there are to internationalize, how does the decision internationalize occur in the case context and can be put into more universal pattern?

RQ3: Compare pros and cons of different entry modes for an SME entering Brazil

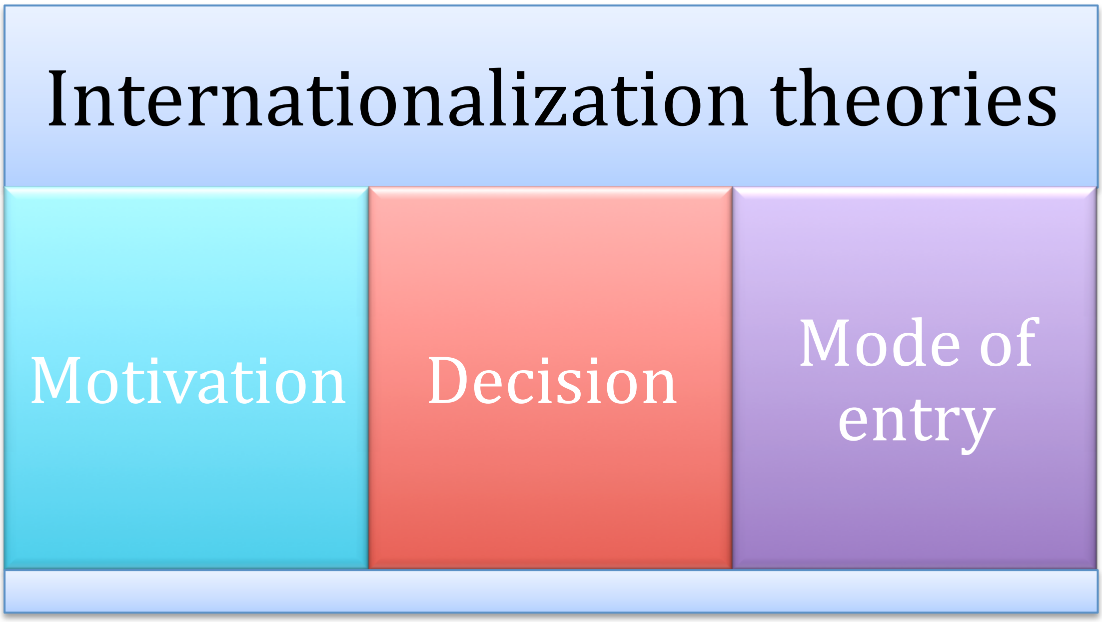
1.3 Research methodology

This study is mainly done as a desktop research by using scientific articles and different textbooks for the theoretical part. The empirical part was made using different Internet and organizational resources while an interview was made for the empirical part concerning the case company. The interview was done by using theme interview method. The theme interview method means that topics are made in beforehand while specific questions are not made. The interviewer may have a list of themes and topics but not a direct list of questions. The interviewed has the possibility to add his opinions to the interview. (Eskola & Suoranta, 1998, pp 86)

1.4 The structure of the study

This study consist of two important focus areas of international business: In the first section the most common theories of internationalization are being dealt excluding the ones that do not support the case company or do not give background to later theories. The second focus point emphasizes on the internationalization process of an SME.

1.5 Theoretical framework



1.6 Literature review on internationalization theories

There is a lot of written material and theories about the internationalization processes and none of them are universal. Most of the known internationalization theories have been developed as an outcome of internationalization activities of multinational enterprises (MNEs). Still it is important to discuss these theories to give background for internationalization of small- and medium sized enterprises (SMEs) or so-called international entrepreneurship. The transaction cost analysis (TCA) model, the innovation-based models (I-models) and the born globals have been left out of this study, for they do not provide any beneficial framework towards the case company. The model and process of each company is somewhat unique and rarely goes exactly according to the theories.

1.6.1 The Penrosian approach

Internationalization processes have been studied from the turn of the 1960’s. In 1959 internationalization was discussed in the book: *The Theory of the Growth of the firm* by Edith Penrose and later in an article *The core competence and corporation* by Prahalad and Hamel in 1990, core competences were more accurately defined. This so-called traditional market approach concentrates on the company’s core competences and how they act as decisive factors whenever moving abroad.

1.6.2 The OLI-Paradigm

The OLI (Ownership, Location, Internalization) paradigm also known as the eclectic approach by Dunning (1988) tries to explain the different forms of international production and the selection of the target country. The point is that it is more likely to invest into a country that has advantages in all three factors mentioned above. The ownership advantages consist of different kinds of advantages when a company is investing abroad of a specific production facility or company is owned by a foreign company. The ownership advantages arise from intangible assets such as innovations, patents or experience. The location advantages concern advantages that add competitive advantage in terms of location of production, resources, energy or market. The internalization advantages mean that it has to be more profitable for the company to run all the operations it is running by itself instead of outsourcing them. (Dunning, 1988)

1.6.3 The U-Models

One of the best-known models of internationalization is the Uppsala model, also known as the U-models. The U-model was developed in the 1970’s in University of Uppsala, Sweden on the basis of the articles *The internationalization of the firm: Four Swedish Cases* by Johanson and Wiedersheim-Paul in 1975 and the article *The Internationalization Process of the Firm: Model of Knowledge Development and Increasing Foreign Market Commitments* by Johanson and Vahlne in 1977. The U-model relies on the assumption that internationalization is being seen as a natural growth model where a company slowly but surely enters the markets that are the closest and/or that have the closest psychic distance. The model goes through four stages: in stage 1 there are no regular export activities, in stage 2 there is an independent exporter, in stage 3 a foreign subsidiary is established and in stage 4 foreign production takes place. The U-model is very common and simple model, but it has faced a lot of criticism for it is too deterministic only reflects the reality of big production companies. (Hollensen, 2007, pp 64-65)

1.6.4 The Network Model

A more recent internationalization model is called the network model. It is mostly handwriting of Johanson and Mattson. It is presented in a book *Strategies in Global Competition* by Hood and Vahlne. It differs from other models of internationalization, for in other models the market is the determining factor that causes companies to expand their operations. They don't take the relations between companies in account. The network model has been developed from the perspective that autonomous actors are tied together in relationships based on their technical, economic, legal and most importantly personal ties. The basic idea is that a single company is dependent on the resources of other companies and gets access to these resources through their networks. The networks can be used as bridges to enter other networks and markets. Usually entering a network speeds up the pace of internationalization and setting up own subsidiaries abroad. According to this model the internationalizing company seeks to minimize the need for knowledge development, minimize the need for adjustment and exploit established network positions. (Johanson and Mattsson, 1993; Hollensen, 2007, pp 70-72)

It is said that there are four situations in the network model: The early starter, the lonely international, the late starter and the international among others

		Degree of the internationalization of the market	
		Low	**High**
Degree of the internationalization of the firm	**Low**	The early starter	The late starter
	High	The lonely international	The international among others

(Table 1)

The early starter is a company's domestic competitors, customers, suppliers and other companies have few or none international operations or important international relationships. This kind of company is said to go by the Uppsala model; slowly but surely spreading the surrounding markets, first by agents and later establishing subsidiaries. (Hollensen, 2007, pp 72)

The lonely international has relationships with companies in foreign countries. It can manage in the international environment and different cultures. The initiative for further internationalization is self-driven rather than following others. In fact lonely internationals often attract many followers to come along to the international markets. (Hollensen, 2007, pp 72-73)

The late starter is a company whose customers and competitors have already internationalized. In cases of late starters there has to be a differentiation made while discussing SMEs and LSEs. SMEs have to be more specialized when going abroad if they wish to offer something for the international market and stay alive where there is more competition. LSEs that have become large in domestic market find it harder to focus on a niche market. A joint venture can be a good possibility for a LSE if it wishes to enter foreign niche market. The downside for a late starter is that it doesn't have as good market knowledge and contacts as the competitors do. (Hollensen, 2007, pp 73)

In the international among other situation the company and its competitors are highly internationalized. The company can act as a network bridge between networks. The international among others may use its production capacity and resources in one market to use them on the other market. (Hollensen, 2007, pp 74)

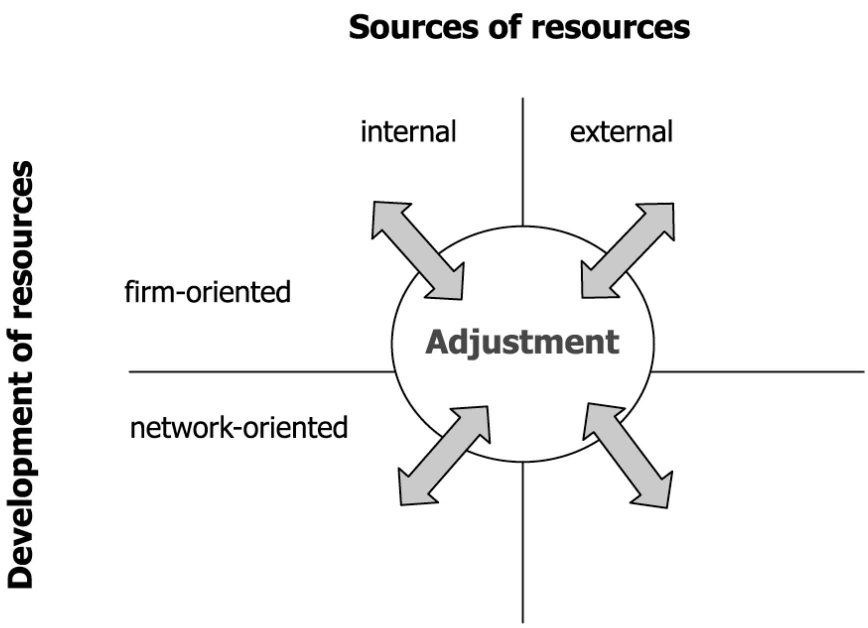
1.7 The Internationalization of SMEs

Internationalization of SMEs has become more and more hot topic within the last years. It was brought in to closer perspective in an award-winning article: *Toward a theory of international new ventures* (1993) by Oviatt and McDougall. In the article are listed four types of four types of elements that make a sustainable international new venture: Internalization of some transactions, alternative governance structures, foreign location advantage and unique resources. In the article *SME internationalization research: past, present, and future* by Ruzzier et al. (2006) the interest towards SMEs has developed in particular in those countries that suffer balance of payment deficits by boosting the international activeness of SMEs to create MNEs of the future. Globalization has also driven the SMEs to look further than the domestic market. It also represents models that have been studied to give further understanding about SME internationalization models. Accordint to Ruzzier et al. the resource-based model by Ahokangas (1998) has been has been the best model to describe the internationalization of SME alongside the network-model discussed above. The research on international entrepreneurship still lacks a model that can describe the phenomenon universally.

1.7.1 The Resource Based Model

Resource-based perspective has emerged from the Penrosian models of internationalization mentioned earlier. The resource-based model focuses on the hard-to-copy competitive advantage a firm possesses, that are not only physical but also intangible knowledge-based. Identifying these resources is difficult and debate between scholars determining the characteristics of these resources goes on. (Ruzzier et al. 2006) According to Ahokangas (1998) cited in Ruzzier et al. SMEs are dependent on the development potential of key external and internal resources that can be developed and adjusted in and within the firms. There are two defining dimensions in this model: the origin of the resources and the development of the resources – firm-oriented (inward) and network-oriented (outward). Four possible outcomes occur from these dimensions:

1. Internal resources in a firm-oriented mode
2. External resources in a firm-oriented mode
3. Internal resources in a network oriented mode
4. External resources in network oriented mode



Source: Ahokangas (1998)

Picture 1

According to Ahokangas the modes of the resource adjustment are about control over the critical resource stocks and interdependence between these resource stocks. The internal firm-oriented adjustment can be seen as the firm's own development strategy that is learnt through trial and error by entering the foreign environment and learnt without external aid. The second mode of adjustment represents relationships with various external organizations such as expert organizations, research institutions or universities. The third mode involves development activities that are traditionally associated with co-operation with such partners that share common interest to develop these resources together such as inter-firm alliances in after-sales services. The external network-oriented adjustment mode is about more developed case where the control over firm's resources are shared. This can be seen occurring in cases of mergers and joint ventures. (Ruzzier et al. 2006)

1.7.2 International entrepreneurship

International entrepreneurship has been increasingly in the spotlight when governments and scholars have noted that globalization drives and enables ever-smaller companies to expansion beyond their home country's borders in hope for better sales and markets. (Hollensen, 2007, 74-76) A lot of research has been made considering international entrepreneurship, but the scholars have neither found a single definition nor unified pattern model that explains how international entrepreneurs act and what drives the internationalization process further. The research of international entrepreneurship has divided into two paths the SMEs moving across borders and multicountry research teams to study entrepreneurial issues in multi-cultural environment. (McDougall et al. 2000) In this study the moving across borders is being focused. Studies by Manolova et al. (2002) indicate that the entrepreneurs' personal competences and earlier international experience play significant role in the step abroad. Manolova et al. find in their study that the entrepreneurial internationalization is not about statistics but about perceptions that the manager/owner sees a possibility in internationalization and is willing to take a risk in achieving it. Like mentioned above, the SME is not able to compete head to head with large scale enterprises so it must have unique resources or networks and the management has to be able in strategic thinking to plan the internationalization process in order to be successful. (Hollensen, 2007, pp 76-77; Hitt et al. 2001)

2 Internationalization of The Firm

2.1 Motives for internationalization

According to the classical macroeconomic theory of investments suggests that the main motive for foreign investments is that the company is trying to maximize its profits. On the basis of this theory whenever someone holds extra capital, it invests it there wherever it is needed and where it provides the best profit. The same goes with labor force. According to this theory countries that have excess labor would experience massive outflow of labor and the countries with excess capital would experience heavy outflow of capital and the whole world economy would be in balance at some point. (Tiusanen, 2010)

Usually behind most internationalization decisions there is the idea of gaining more profit or growth, but there many other reasons that go far beyond the seek for profit. The motives for internationalization can be categorized in two main categories –proactive and reactive. (Hollensen, 2007, pp 43)

Proactive motivators come from the firms' own desire to expand its activities beyond borders. The key motive usually is profit. The company seeks new opportunities to make bigger profits and growth. Seeking profit is a good explanation for internationalization in general, but it does not provide the whole answer why a specific market is chosen. Usually the need to go to a certain market comes from emotional issues. The management has just decided that they want to enter a certain market. (Aharoni, 66) In many cases there can be some information of foreign opportunities that promise bigger profits. Economies of scale are many times also a good reason to expand abroad. Today almost all big companies have production facilities in countries where it is cheap to produce. (Hollensen 2007, pp 43)

Internationalization can also be a reactive outcome. Sometimes the competitive pressure in local market becomes too big or the local market is too small or saturated that the possibility to produce and sell is not profitable. In some cases the psychic distance of a foreign country is so small that internationalization is not even thought of, such as German companies expanding to Austria, or British selling to Australia.

2.2 Internationalization triggers

The final decision whether or not to move to a certain market does not arise from the analytical data that is available to the company. The initiators to internationalization and market entry come from the motives mentioned before and usually some of the following reasons:

- “An offer that cannot be refused.” An outside proposal that is so tempting that it almost sounds too good to be true and cannot be ignored. It can come from a partner, foreign government customer etc.
- Fear of market loss
- The “band wagon effect”: others are succeeding in the same area of business. Can be thought of like the California gold rush.
- Strong competition from abroad in the home market.

(Aharoni, 66)

2.3 Business climate

Whenever a company considers investing to a foreign market, there must be proper done some proper investigations concerning the target market. The business climate has to be suitable for foreign investments when entering a market. A certain business climate can be suitable for some industries and not suitable for others. Business climate consists of business and income tax levels, workforce availability, energy costs, market size, quality of services, costs of living, quality of life, environmental regulation, permitting, licensing and other regulations, real estate costs and availability, infrastructure, access to finance and capital and other incentives. (IEDC)

2.4 Political risk

Political risk rises from the concern of the political stability of the target country. There is no country that hasn't got a political risk, but the range of risk varies a lot between countries.

There can be seen three major kinds of political risks. The first one is called *general instability risk* or more commonly *ownership risk* and it concerns the ownership of the company. In some of the most extreme cases the host country has taken over the operations and the equity of the investing company. These expropriations can be somewhat different. When talking about *nationalization*, the host government transfers the foreign owned property to itself. In *Intervention* a local government or a private group supported by the government seizes the power in the company. In *Requisition* the company is taken over by the government, usually by the military in response to an emergency situation and usually returned to owners when the situation no longer demands it. There can also be *coerced sale* where the local government forces the investor to sell its share. Other kind of coercion can occur when the terms of the contract have to be renegotiated. Taken to extreme, in *contract revocation* the local government unilaterally terminates the contract with the investor. (Bradley, 2002, pp 133; Hollensen, 2007, pp 189)

The second kind of political risk is called *operations risk*. It refers to the interference with the ongoing operations of the firm, such as inputs, outputs, size, expected cash flows, ROI and so on. (Bradley 2002, pp 133; Hollensen, 2007, 189)

The final political risk is *transfer risk*; it can be encountered when transferring capital between different countries. This is good to be taken in consideration in companies that pay periodic dividends and other payments overseas. The changes in currency regimes may result entirely different profit depending on the current value of dollar or other currency. (Bradley 2002, pp 133-134; Hollensen, 2007, pp 189)

Other kinds of political risks can also occur and are not necessarily issued by the government. Following protectionist issues can also be taken under the account of political risk:

- *Import restrictions* mean that import of certain kind of goods or raw materials is restricted in order to protect the local production.
- *Local-content laws* force foreign companies to purchase local raw materials if they want to sell their products within the within the market.
- *Exchange controls* can limit the amount of local currency exchanged to foreign currencies or being taken out of the country.
- *Market control* occurs when a government of a country tries to prevent foreign companies from competing in certain markets
- *Price control* happens when prices are artificially determined for essential products that control considerable public interest, such as pharmaceuticals, petrol etc.
- *Tax control* is a political risk when it concerns controlling foreign investments. There have been many cases that the taxes have been risen unexpectedly for foreigners
- *Labor restrictions*. In many countries the labor unions have a word or two to say, when it comes to passing laws that concerns wages, working hours and such. These can be costly to business. If their terms are not met, there can be a strike.

(Root, 1994)

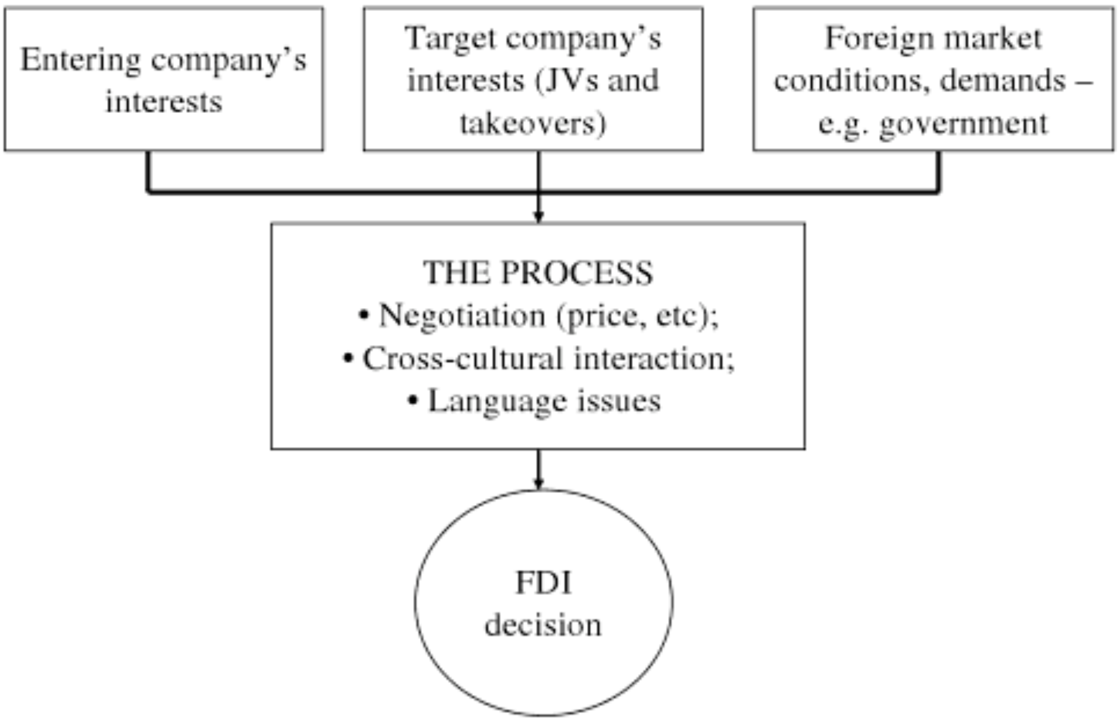
3 Foreign Direct Investment (FDI)

In this work the focus is entirely on foreign direct investment. Other entry modes will not be taken in consideration. In this section definition of FDIs, motives for FDIs and choice of FDIs are discussed.

3.1 Definition

When a company chooses FDI as mode of entry, it acquires minimum of 10% of voting power in a foreign enterprise, it participates in a joint venture or in the most extreme cases it invests in a wholly owned subsidiary by purchasing an existing company or establishing a new company from the scratch. (Tiusanen 2010; Hollensen 2007; FDIs in China)

3.2 FDI decision making process



Picture 2

The FDI decision process is rarely a straightforward action. The decision to use a particular form of FDI is usually unfold through a long period of time. Usually small pieces of information for and against, affecting the final decision are gathered from various sources from a chain of events that perhaps are not even related to the actual FDI process. (Aharoni, 1966; Larimo, 1995; Welch et al. 2007, 323) There can be various elements that precede the final FDI decision. The company usually is somewhat internationalized already and FDI is seen as a natural continuum of the company’s actions or a change may occur in target country’s policies or environment that make it tempting to invest directly. In the last-mentioned cases, the company must take swift actions in order to get to the foreign market before competitors do. There have been such cases that the investment decision has been made within the 24 hours of the first impulse. (Calof, 1993) There can also be such case that a proposal for acquisition of a company may come suddenly and ready-made package for relatively easy implementation of the FDI process and/or there is not much time to decide before someone makes the acquisition. Anyhow the spectrum of time that the decision takes place, may vary a lot from instant response for the first impulse or it can take years of groundwork and comparison of alternative options. (Welch et al. 2007, 322-323)

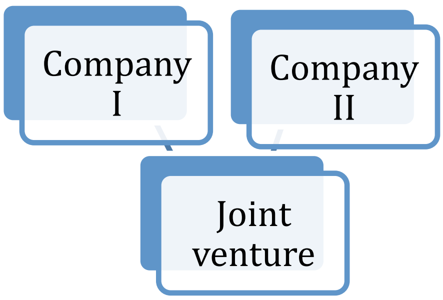
3.3 Forms of FDI

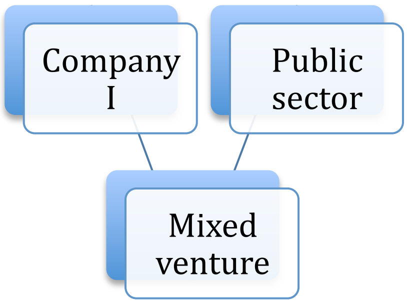
3.3.1 Joint ventures

Joint ventures are quite commonly used in international business operations. Joint venture can mean either joint contractual venture or joint equity venture.

A joint contractual venture refers to cooperation for certain purpose between partners for a certain period of time, without sharing capital. This can be seen as contract for cooperation and is often called as strategic alliance. (Luostarinen & Welch, 1990, pp 158; Hollensen, 2007 339)

A joint equity venture refers to a company established by two or more partner and have all put assets in to the company and share equity and risk. Partners seek for a long-term partnership and profit. In some cases one or more of the partners is public sector. When that happens we are talking about mixed ventures. (Luostarinen & Welch, 1990, pp 159; Tiusanen)





3.3.2 Advantages and disadvantages of joint ventures

Joint venture is many times a preferable method of entry to foreign markets. It offers many benefits that other form of FDI lack. For a foreign investor, it is advantageous to spend less money on a single venture and in many cases the access to capital is very limited in foreign country. At the same time there can be made more investments in human capital and the total price that money is put in, is far less than acquiring the whole company. While the amount of capital is less than in acquisition so are the risks. First of all, the political risk is much lower because the venture is seen as a local company. Commercial risk is also smaller simply because less capital is invested and lost in case of bankruptcy, so are the exchange risks. It is also good to have a local image on the company, so the attitudes and fears of “foreign takeover” do not occur. A local partner also usually opens many doors that would otherwise stay shut. Also local knowledge is usually worth more than gold. It takes a lot of time to get to know the local field by oneself. And in some cases a foreigner cannot own a company or be in its board, unless there is not a local person involved.

Joint venture has also its own downsides. First of all, the partners may have totally different objectives; this situation is likely to cause some difficulties when doing business. Sharing the company means sharing the profit. There can also be problems occurring if the partners have different purchasing strategy, sudden over pricing or transfer pricing may occur. Problems can also come by in personnel strategy; nepotism is possible to occur. In cases of mixed ventures, the new election or change in power in some other way can turn the whole venture up side down, or the local government works on the basis of political decision making, not by making business. In some cases the problem can be that, even though the local partner is a private partner, it may be affiliated strongly to certain political party or organization and will cause problems such as boycotting from the opposing party supporters. Different kinds of financing problems can also occur such as the other part lacking needed capital or the other part wanting to invest more and other wanting to cash in. Dead-end street is a situation where two partners hold a 50-50 share and when they disagree on some issues, pretty much nothing happens until other one gives in. Some cases there may be legal issues that cause problems, such as minority shareholder protection that can prevent the company from developing or the foreign investor may lose some tax advantages in its home country.
(Luostarinen & Welch, 1990, pp 158-161; Hollensen, 2007, pp 339-349)

3.4 Wholly owned subsidiaries

3.4.1 Mergers and acquisitions

Acquisition offers a swift entry and often access to distribution channels, existing customer base and sometimes even recognized brands in the target market. When using “brownfield investment as an entry mode, a foreign company either merges in to a company in the target market or buys a dominant share of a target company. Usually 51% share is considered as enough control over the company. (Luostarinen & Welch 1990, pp 164; Hollensen, 2007, pp 364; Tiusanen 2010)

Acquisition can be either horizontal when acquiring firm is purchasing a similar kind of company, for instance a brewery buying another brewery, vertical when the acquired firm becomes a supplier or a customer for the mother company, concentric when the acquired has the same market and different technology or vice versa. The acquisition can also be conglomerate when the acquired firm is in entirely different industry than the mother company. (Hollensen, 2007, pp 364)

Acquisition is a swift way to enter new market. It offers a quick access to distribution channels, personnel, experienced managers, local knowledge and contacts; also local familiar brands can be beneficial.

There are some risks related to acquisition as well. There is a risk that the locals start boycotting the foreign company and refuse to buy anything from the company, clash of cultures can also occur when the foreign management takes over the company and one major disadvantage of acquisition is that it usually is very expensive to buy a ready company. (Luostarinen & Welch, 1990, pp 165; Hollensen, 2007, pp 368)

3.4.2 Greenfield Investment

Greenfield investment has nothing to do with green fields, it rather means establishing an entirely new outlet to a foreign country. It is the most extreme FDI. It offers the mother company a complete control over its subsidiary, but it is the most expensive and offers the slowest entry to the markets. The greatest benefit of it is that it allows the company to fully decide what kind of company it will be and for instance how the production facilities are equipped. Greenfield investment is wise to be taken in consideration when a company’s technology is either cutting edge and not to be given to outsiders or no one else can handle the technology properly or the production process is unique. Sometimes local public sector offers different kinds of incentives for foreigners to establishing new companies. In some industries such as mining and timber, the proximity to raw materials can be a good reason to establish an outlet there, for example the Finnish paper companies that have pulp and paper mills in Brazil. (Tiusanen 2010, Luostarinen & Welch, 1990, pp 165-166; Hollensen, 368)

4 Federative Republic of Brazil

Federative republic of Brazil (*República Federativa do Brasil*) is the largest country in South-America and the world's largest country in the tropics. Its area covers over 8500km^2, an area bigger than entire Europe, excluding Russia. Brazil has common border with every other South-American country except with Chile and Ecuador. Brazil consists of 26 states and *Distrio Federal*, in which the nation's capital, *Brasília* is located. In the southeastern part of the country are located business cities of São Paulo, Rio de Janeiro and Belo Horizonte. Two thirds of Brazilians live in this region. (Ojala, 2004, pp 9; CIA, 10)

First Portuguese settlers set their foot on Brazilian coast in 1500. This meant a Portuguese rule for over three centuries. In 1822 Brazil gained its independence peacefully, maintaining a monarchical system until the abolishment of slavery in 1888 and military's proclamation of a republic in 1889. After this Brazil was politically dominated by local coffee exporter until populist leader Getulio Vargas seized power in 1930. After half a century that Brazil had underwent with populist and military government, it's power peacefully ceded to civilian leaders. (CIA, 2010)

Brazil's currency is Real. One Brazilian Real is approximately 0.42 Euros (28.10.2010, Google). The Brazilian economy is among the ten largest economies in the world. It is well known for its massive mining industry. It is a producer of various minerals and raw materials. Brazil's other major industries are steel, automobiles, planes, and electronics. It is the world's biggest producer of coffee, oranges and manioc and a major producer of beef, beans and soy. (CIA, 2010)

Though Brazil is considered to be extremely wealthy country with a labor force of over 100 million and in the future it will be even wealthier, when they get their hands on one of the world's largest underwater oil discoveries, that were found a few years ago. (Uusi Suomi, 15.4.2008) The wealth in Brazil is shared extremely unequally the differences in income are huge and due to this the shack villages in the edges of biggest cities have grown from year to year and the conditions there have gone from bad to worse. (Ojala, 2004 pp 16-17; Finpro)

The population estimate in 2010 was 201,1 million inhabitants and therefore it is considered as the fifth most populous country in the world and the most populous country in South-America. The most common ethnic groups are European origin, mulattoes, black and other such as Japanese, Arabs and Indians. People of European origin are from Portugal, Italy, Germany, Russia, Spain and Poland. Rapid growth of population and urbanization has lead to many social problems. When walking the streets of any major city in Brazil and not bumping into any beggars or street children seems impossible. Like most developing countries, the majority of Brazil's inhabitants are under 30-years old. (CIA, 09; Ojala, 2004, pp 10-11; Finpro, 2010)

4.1 Business climate in Brazil

	2006	2007	2008	2009	2010	2011e
Change in GDP %	3,9	5,6	5,1	-0,2	6,3	4,5
GDP (Billion USD)	1088,9	1366,3	1637,9	1573,4	1908,3	1996,0
GDP/Capita (USD)	5830	7220	8540	8090	9690	10020
Investments in fixed assets (%-change)	9,8	13,4	13,7	-10,0	13,0	8,5
Change in industrial production (%)	2,9	5,9	2,9	-7,3	8,0	4,8
Unemployment rate (%)	10,0	9,3	7,9	8,1	7,1	7,1
Balance of payments (Billion USD)	13,6	1,6	-28,2	-24,3	-52,8	-64,0
Balance of payments % of GDP	1,3	0,1	-1,7	-1,5	-2,8	-3,2
Change in consumer prices (%)	4,2	3,6	5,7	4,9	5,5	4,7
Exchange rate BRL/1 USD	2,18	1,95	1,83	2,0	1,80	1,86

The economic growth of Brazil has returned to the level it was before the financial crisis. In 2009 the economy came down slightly, but the estimates for this years growth go between 6 and 7,5%. The moderately good recovery of Brazil was based alongside by good macroeconomic situation on stable banking sector and strict regulation of the fiscal sector.

The strong recovery policy kept the consumption in running also. The growth views seem bright in the future also due to lately found gas and oil deposits on the Brazilian coast, investments have also been made in major sports events such as the FIFA World Cup in 2014 and 2016 Summer Olympics in Rio de Janeiro. (Finpro, 2010)

The service sector takes a 67% share of the gross domestic product. The share of industrial activities is slightly below 26% and the agriculture takes a 6% share of the overall GDP (Finpro, 2010)

The inflation rate has been around 6%. The inflation forecasts have been well over the 4,5% inflation goal set by the government. Inflation control has been one of the most important agenda in the last years. (Finpro, 2010)

The Balance of payments has suffered deficits since 2008. In 2010 the deficits have been approximately 52 billion USD. According to the EIU calculations the deficits can reach 64 billion USD in 2011. The deficits are not the main concern of Brazilian officials for it is seen only as temporary because of the future income. (Finpro, 2010)

The budget deficit has been a problem for a while in Brazil. At worst it has been around 10% of the total GDP. The imbalance has been the result of public sector debts and spending to salaries and pensions of government officials. Now a tight monetary- and fiscal policy takes place within the country. The overall economy has become more stable and many social renovations have been made and poverty has been reduced. Between years 2002 and 2008, 19 million people have got out of the two lowest consumption groups. (Finpro 2010; Della Librera 2010)

In 2010 Brazilian labor force consists of 103,6 million people; meaning 1,9% yearly increase. The average unemployment percentage has been around 7%. In 2009 1,7 million new jobs were created, of which 210,000 were in the construction industry. Still in many cases the education level of the workforce does not meet the higher demands of the work. The average working costs in 2010 were approximately 5,9 USD per hour. The working hours should not exceed 8 hours per day and 44 hours per week. Brazil has minimum wage laws that have set the current minimum wage to about 180 USD. (Finpro, 2010; PWC, 2010)

4.2 Foreign trade

Brazilian export rate has come up very much in recent years, but faced a slump of 40 million USD in 2009. By 2010 the foreign trade was recovered decently and the exports came up by 27% that can be explained by the price development of raw materials. Meanwhile the import rate came up by 50% and is expected to continue to go on with the current trend. (Finpro, 2010)

Brazil's most important exports are industrial goods (46,8%), primary products (36,9%), semi-finished products (13,7%) and other goods (2,6). The most important imports are machinery and components (48,1%), capital goods (20,7%), consumer goods (13%), and crude oil and petroleum products (18,2%). Brazil is a founding member of Mercosur. (Finpro, 2010)

4.3 FDIs in Brazil

Since the beginning of the 1990's the FDI inflow to Brazil grew rapidly. This was due to the governments privatization program that led to huge increase in stock market investments and FDI. Nowadays the government has changed its policies towards favoring FDIs. According to A.T. Kearney's FDI confidence index, Brazil is seen as the 4th best place to invest in after China, USA and India. (Finpro, 2010; A.T Kearney, 2010)

The total amount of foreign FDI in Brazil was 319 billion USD in 2009. The forecast for the year 2010 was 349 billion USD, of which the majority has been centered to the steel industry, service industries and car- and machine manufacturing. There has also been increase in telecommunications-, energy- and financial sectors. USA is the largest single investor with almost half of the overall FDI. It is followed by Spain with 25% of the overall FDI. Other Significant investors are Netherlands, France and Japan. (Finpro, 2010)

Brazil's biggest attractions to investors are the huge domestic market and competitive production environment in Latin America. Majority of the export related FDI are in the steel industry and the pulp and paper industry. (Finpro, 2010)

Downsides and difficulties in investing Brazil are said to be the hard-to-follow bureaucracy and taxation (For further information concerning taxation, see *Deloitte International Tax and business Guide: Brazil 2010*). Especially import taxes are high and make goods that are manufactured outside Brazil relatively expensive when comparing to other countries. This has also resulted many companies using FDI as mode of operation. (Deloitte, 2010; Finpro, 2010)

Difficulties for Finnish companies can be said to be the lack of knowledge of the country and culture. It is to be noted that Brazil is not a cheap labor country. The salaries can be reasonably high and social payments have to be paid on top of them. The salaries of skilled executives can be even higher than in Finland. Personal relationships play a crucial role in doing business in Brazil. Getting to form these relationships without knowing Portuguese is very difficult because getting without it, getting to know the culture and customs is hard. For instance person saying “yes” can mean “maybe” or “no” and it is important to tell the difference. Local presence is crucial; a phone number in Finland is not enough to support activities there. For SMEs this is a big challenge because while making sales efforts there, the aftermarket services should also be thought through. (Deloitte; Finpro, 2010; Ripatti, 2010)

4.4 Finnish FDIs in Brazil

Finnish companies started making their FDIs mostly in the beginning of 1990's, a handful of companies had operated there before, such as Valmet. (Larimo) Telecommunications sector has been the most interesting one for Finnish companies. The total revenues of Finnish companies in 2008 was approximately 2,7 billion Euros, about four times the amount of Finnish exports. Finnish companies have approximately 20 000 employees in Brazil.

The most important industries and companies in Brazil are:

- The forest cluster: Ahlström, Stora Enso, Metso Power, Metso Paperi, Ponsse, Pöyry, Sav-cor Forest, Savcor Process
- Mining industry Larox Group, Metso Minerals, Outotec, Tamfelt), energia (Wärtsilä, Metso Power, Pöyry, Metso Automation
- Telecommunications companies: Elcotec, Metso Automation, Nokia, Nokia Siemens, PKC Group, Salcomp, Tecnotree
- Other significant companies in Brazil are Dynea, Eltete TPM, Huhtamäki, Kemira, Nordea, Cargotec, Planmeca Group, Glaston Group, CPS Color and Outokumpu.
- Also many foreign-owned companies that have production facilities in Finland have activities in Brazil are Valtra, Rapala, Tellabs, Andritz

(Finpro, 2010)

5 Case company

The case company PB is a real estate investment company that has operated in Finland for a couple of decades. PB operates currently in São Paulo state in Brazil.

5.1 History

PB and its mother company P Oy and are run by a Finnish entrepreneur, who in this study is called L. Neither of the companies have any hired personnel, so they can be described as micro enterprises. Previously before becoming a private entrepreneur, L had worked at a Finnish company that was previously known as a shipbuilding company H. While working there L held the position of investment manager and was responsible other investments such as real estate, that H had and were not associated directly with the company's core business, which was shipbuilding at the time. In the turn of 1990's H had established a joint real estate management company with in Portugal, to manage the real estate projects. While working in Portugal, L met Brazilian S, who was nominated as a managing director of the company.

P was originally found in 1978, but it remained as a shell company for many years and the current entrepreneur. L bought the company in the beginning of 1980's. The actual operations began in the beginning of 1990's, when L decided to be a private entrepreneur, after having spent somewhat ten years in the real estate business. He had been working on different kinds of real estate projects in Finland and in Portugal, where he met his current associate, S in Brazil.

At first time P started investing in apartments and blocks of flats in Helsinki area. The basic idea was as simple as buy low, sell high. No major investments or renovations were made to the actual apartments. The operations went well and grew over time. Investments were made in other cities in Finland also, such as Kotka and Imatra. In the beginning of the new millennium, P established a joint venture with the Port of Hamina. The company invested in warehouses and cargo terminals for LG and DHL. The subsidiary also owns the gate building in Port of Hamina, which has about 8500 square meters of floor space.

The Finnish market was overall good and the profits were acceptable until the mid 2000's when foreign real estate investment companies and funds entered the Finnish market. Their entry raised the overall price level and profits became lower. This resulted that it was really difficult to find anything to buy for a reasonable price. There seems to be some light in the end of the tunnel, because majority of the foreign investors have withdrawn from the market due to the financial crisis. Now after couple of years L says that the prices and profits are now settling to more acceptable level again. (L 2010)

5.2 Entry

The idea to establish a company with S in Brazil had been in mind for many years. It just took some time to find something that would be reasonable to do together. In the turn of 2008 S came up with an old industrial laundry building in the city of Valinhos, Sao Paulo. The property consisted of the building itself and four hectares of land. A local family had been running the laundry, but they had decided to quit their business and to sell the property. A reasonable price was negotiated with the former owners and when that was done, PB was established and the property was bought. The company appealed a change in the zoning and tore down the laundry. P got a permission to build 320 apartments to the area. It did not take a long time from the permission, that a big American real estate company Hines contacted P in order to buy the area. Price was seen to be right and the property was sold. (L 2010)

L and S had no particular strategy was made to the market entry. The entry itself was so swift that planning a strategy would have even crossed their minds. The associates went in with Greenfield investment, of which S owns 20%, the P mother company owns 40% and L's other company A owns 40%. Establishing a company in Brazil is a necessity. It is almost impossible for a foreign company to have operations in the country. Import taxes and local legislation make FDI almost the only reasonable mode of entry to Brazilian market. According to L, the biggest challenge in establishing a company on the other side of the world was to get to know all the basic rules of the market; this required a lot of homework regarding local legislation and taxation, in order to be able to plan the funding of the company and how the interests and dividends are being dealt by Finnish and Brazilian officials.

PB has not used any outside funding resources neither from Finland nor from Brazil. It is yet too see whether P will apply funding from Finnfund or Finnparnership, who admit funds for international Finnish companies operating in developing markets.

5.3 Why Brazil

Besides that L had an old friend in Brazil, the change in Brazil's situation had a great influence on the possibilities and the decision to enter. Before it had been almost impossible middle class Brazilian to get loans for proper housing, because of extremely high interest rates and loan guarantees. President Luiz Inácio Lula da Silva established interest support program for homebuyers and obligated banks to lend 40% of their overall lending to homebuyers or building houses. In case a bank refused to put 40% of its lending to these kinds of projects, the remainder capital had to be deposited to the central bank with zero interest. This allowed many people, who had previously been unable to buy a house, to do so. Also a program called "Minha Casa, Minha Vida" was established for the poorest part of the population to get proper housing. There is also a huge shortage of well-built houses in Brazil; Sao Paulo state alone lacks around 3,7 million new houses and apartments. The overall economy is also developing. Oil has been found in the ocean and all sorts of other minerals are also found, so the situation is entirely different than what it was in the beginning of 2000's. Therefore it is extremely hard to see any political or market risks involved. L admits that there is always risk related, but in this case the only risk he can see, which is very unlikely, would be the costs of construction to come rapidly up. Still the margins are quite good, so the prices should rise a lot.

Main drivers to enter the Brazilian market were the current market situation, contact with S, who has been working in the Brazilian real estate market and knows the market quite well; and the decline of the Finnish real estate market.

The triggering force was the opportunity to buy the laundry facility. When the proposition came and it seemed to be a reasonable investment, L decided to take the step further and go for it. After the decision was made, L contacted PriceWaterhouseCoopers to get information concerning the Brazilian market and especially the treaties concerning taxation between Brazil and Finland.

Brazilian government has been very pleased to have FDI inflow to Brazilian market, since spring 2010 the government has put restrictions to foreign invests because the money is flowing in from doors and windows so to speak. The government added 1,5% investments tax on foreign stock market investments. The foreign investments tax does not concern FDIs that are being done. Other limitation to foreign investments is that a person who does not live in Brazil cannot be a board member of a Brazilian company. This means also that L is not able to be an official board member of PB unless he moves to Brazil.

5.4 Current projects

Currently PB is working on multiple projects with a local construction company called V. In Valinhos, Sao Paulo there is a block of flats “Infinito” of 68 apartments and 18 floors. In October 2010 PB and V got all the permits in order and were given the green light to start selling the apartments. The companies had done marketing efforts in beforehand and had announced that on 22 October, 9 am they will start selling the apartments that were going to be built. By 10 am, all of the 68 apartments were sold. The construction will begin in January 2011.

Other projects are two blocks of flats that will have 162 apartments altogether in Santos, SP and a residential area “Vita Verdi” in Valinhos, SP with approximately 7 hectares of land and 92 houses will be built there and the houses can be bought from February 2011. Things look bright for this area also, because according to a market research V has made, every house would have 82 buyers.

V is currently PB’s only partner in Brazil. The companies started cooperating together when P had acquired the land for the Vita Verdi project and V contacted PB in terms of cooperation. Cooperation is beneficiary to both parts. The greatest benefit is that the both companies can take part in more projects than they otherwise could. If PB would work solo and used whatever construction company available, the possible investments would be quite rare and the risks would also be higher. V has approximately 40 years of experience in constructing business in the area, so they know quite well all the local costs and how to build houses well. PB on other hand has the kind of know-how that V lacks, for example certain relationships and prospecting the market. Currently the only obligation companies have with each other is a bilateral contract of cooperation in case the other one finds a property or a good investment, the possibility has to be offered for the other one to join in, in terms of "gentleman's agreement".

5.5 Future plans

V has offered PB a 50/50 share of the company. L says that if PB will accept the proposal, it would mean many common projects and the company would be developed in the direction that the goal would be to go public some day. L says that PB will remain and focus on the real estate business, but it has been in mind to help other Finnish industrial companies to set up their production facilities in Brazil and to kick start their production while PB would become partner in such ventures. This is due to the high import taxes in Brazil so exporting from Finland, for instance is very expensive.

6 Attributes and know-how of an international entrepreneur

L states that in order to be able to manage and be successful in international market the entrepreneur has to have few attributes that many people lack:

- Knowing the business in the domestic market extremely well.
- To have mindset of an explorer
- To understand that while in Rome, do it like the Romans do – A dire mistake is made if the entrepreneur sees himself/herself as a teacher for others
- Finding trustworthy partners and to accept the fact that they rarely think like the ones in the home country
- To accept the fact that the results can take a lot of time and effort. There is no shortcut to happiness
- If the entrepreneur has experience from more developed market than the current one is, it can be "easy" to work in a market that is not as developed – every business sector has a certain path how it develops. It is easier to work if the entrepreneur knows what is coming

(L 2010)

7 Discussion and conclusions

In this section the research questions are being discussed in context of the case company. The research questions are being discussed in the numerical order from 1 to 3 and conclusions are presented in the end of each research question.

7.1 Research question 1

How does the internationalization process of a micro enterprise occur?

Different kinds of theories that explain internationalization of companies have been studied since the 1950's. Starting from the Penrosian tradition and going through different models such as Uppsala model and OLI-paradigm, network model and the resource based model to the newly developed study of international entrepreneurship. Many of the models have been valid in their time, but more and more of them have become outdated, for their focus is rather in the firm itself and not in the rapid, ever-changing environment that surrounds them.

The network model is the first one that had a different emphasis on internationalization than its predecessors. It was developed in terms of industrial networks but it gives a better understanding of the interdependencies between different companies, their stakeholders, governments and the most importantly the people who act within them.

For PB the networks have been the only possibility for the company even to exist. PB is a micro enterprise with no hired employees and the only possibility to survive in the field, is to have a vast network of different kinds of contacts in various areas of business in home country and especially when even considering internationalization. When entering an entirely new country the most important part in entry is to become a part of the network.

The network model explains how companies internationalize through networks, but is not provide an answer "why". The resource-based model gives a better explanation for this. It can be said to be a combination of the network model and the Penrosian approach of core competences. It relies on the networks but it also explains why some entrepreneurs get to become a part of the network and some are left out. It all relies on the SMEs unique resources that the partners can benefit from. These resources can be adjusted to fit the needs of partners better. Interdependencies tie the partners and networks together.

In PB's case the resources that are wanted by its partners an from which they can benefit from are experience in the business, finance and maybe in the future, contacts in the Finnish market, who want to set up their own subsidiaries in Brazil.

All in all the resource based theory is currently the best theory there is to explain why internationalization of SMEs happen but it does not cover all of the topics that are discussed in terms of "international entrepreneurship", a lot of research is to be done.

7.2 Research question 2

What kind of driving forces there are to internationalize, how does the decision internationalize occur in the case context and can be put into more universal pattern?

As discussed in the theory section the driving forces emerge from the local environment as push-factor or from external environment as pull-factor. In PB case the push factors were higher prices and lower margins as the international investors entered the market. New opportunities had to be discovered from abroad. Luckily at the same time the market in Brazil became more and more tempting and worked as a pull-factor when almost all the pieces seemed to fit in place for trying to succeed abroad.

Still the statistics do not offer the complete answer for the internationalization decision. Earlier mentioned that the decision to go international may take many years or it can be done in a really short period of time. Many factors are usually been taken in consideration but there sure shots with 100% certainty. The final driver is the entrepreneurial/managerial intuition that launches the process when the manager/entrepreneur has a "good feeling" and is willing to take the risk to enter foreign market.

In PB's case the idea of internationalization had been in mind for many years, but the final trigger occurred quite suddenly. When the opportunity emerged to purchase the property in Brazil the decision was quite fast without further hesitation. The further investigation was made afterwards.

In this context it seems that the managerial urge is the strongest motivator and trigger as have previously been stated.

7.3 Research question 3

Compare pros and cons of different entry modes for an SME entering Brazil

The Brazilian market has been ever more tempting for many international companies for the last two decades. Due to Brazil's protectionist measures of having high import taxation in order to support the domestic production and inflow of FDI, licensing and wholly owned subsidiaries can be seen as the best alternative for a market entry, as long as the production is made inside Brazilian borders. For a small company, exporting can be too costly alternative and local substitutes usually found with lower prices.

The Brazilian legislation and incentives favor the use of FDI, but it is left for the entering company to decide which form of FDI to use, depending on its expertise to act in the market and the knowledge of the market. In most cases, it is more than advisable to have a local partner to get in to the market and to work there. If local partner is not present, the company must have its own employee living in Brazil permanently in order to be able to exist.

For P the only alternative to internationalize in general is FDI. P is an investment company and does not produce any products or offer any services or direct employment in general.

8 Summary

In last 50 years the internationalization processes of firms have changed a lot due to the globalization alongside with the business models of companies. The theories explaining the phenomenon of internationalization have also made huge steps forward alongside with the changing environment. The study of international entrepreneurship still lacks a model that can explain the internationalization of SMEs altogether. Further study is being made as we speak to develop new models.

The internationalization process of an SME can have a lot of variation according to the company's business sector. Still few basic assumptions can be made that in order for an SME to internationalize successfully it has to recognize its own primary resources and to be able to use them effectively within business networks while recognizing what resources it lacks and to try to compensate these lacks by finding suitable partners who have these resources. In order to do this, the SME must be able to obtain knowledge concerning markets and partners.

In order to internationalize to Brazil the best choice is to go for the FDI for it is supported by the legislation and seems the only reasonable one in order to be competitive within the market.

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