

The International Expansion of Marcopolo (A): Adventures in China

Abstract

This case describes the initial steps in China of Marcopolo, the largest Brazilian manufacturer of bus bodies, and the challenges faced by the firm. Central issues in this case are: (a) the change in the nature of the firm's internationalization process as it moved from psychically-close markets to a psychically-distant market; (b) the risks faced in the internationalization process; (c) the advantages and disadvantages associated with different entry modes in China; (d) the need to develop experiential knowledge in the Chinese market. The case can be used in international business, international marketing and emerging market courses.

Introduction

The management of Marcopolo, a Brazilian manufacturer of bodies for bus chassis, was weighing up the opportunities in the Chinese market in 2005. Marcopolo was the leader in the Brazilian bus body market, with a 47% market share. The firm was also a leading manufacturer worldwide, with a global share estimated at between six and seven percent. The company exported to over 80 countries on all continents, and had factories in Portugal, Argentina, Mexico, Colombia and South Africa, as well as commercial offices abroad and a licensing agreement in China. With sales estimated at 1.6 billion reais in 2004, and total annual production of approximately 16,000 units, about 45% of the units produced were sold in the international market and 55% in the domestic market, thus positioning the firm among Brazilian companies with a high degree of internationalization.

Marcopolo's effort to expand into China was part of the company's ambitious strategy to penetrate key emerging markets. Countries such as India, Russia, Indonesia, Malaysia and Japan were also part of this strategic plan. Although China was seen as a challenge, due to the perception that the country is closed and complex, within Marcopolo it was believed that establishing a presence in that market was imperative. As noted Marcopolo vice president, José Martins,

“Half the world's population is concentrated in that part of the Far East (China, India, Indonesia, Thailand, Malaysia, Philippines, Burma, Singapore etc.). And it's the half of the world population that uses buses; we, on the other hand, are closer to the area where buses are not used, which is the case with United States and Europe.”

In 2000, the company had signed a licensing agreement with Iveco, a chassis manufacturer belonging to the Italian group Fiat, which had a joint venture with a Chinese state company, the Changzhou Bus Company (CBC). This contract would continue until 2007, when Marcopolo would be free to set up its own direction in China. Several alternatives were available to the firm, including the construction of a body assembly plant or a components plant in association with local or multinational companies. Regardless of the decision, company management believed it would be necessary to establish a

partnership and develop relationships in the local market. In anticipation of this move, the company had established a sales office in order to acquire direct knowledge of the local market and develop links. However, it was still necessary to define a strategy for the future mode of operation in China.

The Global Bus Body Industry

It was estimated that the global bus industry produced a total of 221,000 buses in 2003 and 241,000 in 2004, an increase of 9.3%.¹ Exhibit 1 shows the world production of buses by major producing countries from 2002 to 2004. In 2004 the main manufacturers in terms of the number of units were Hyundai (South Korea), Tata (India), Daimler Chrysler (Germany) and Toyota (Japan). Exhibit 2 lists the world's leading manufacturers of complete buses.

INSERT EXHIBITS 1 AND 2 HERE

There are two types of companies operating in the industry: the integrated producers, which manufacture bodies, chassis and engines, and the body producers, which produce the bodies to be later assembled onto the chassis/engine. Therefore, the expansion of body manufacturers depends on integrated producers, since the former occupy an intermediate position in the supply chain. In general, the customer provides the chassis and engine on which the body is mounted; however, in some cases a joint venture is established in which the integrated producer manufactures the chassis and engine, and uses an outsourced body to assemble the final product. Bus bodies can be exported in several ways: CBU (Completely Built Up), i.e., the fully assembled bus; PKD (Partially Knocked Down), where the assembled body is exported; MKD (Medium Knocked Down), in which the body is exported in modules; and CKD (Completely Knocked Down), in which the body is completely disassembled and shipped to a local partner in kits.

The emergence and growth of the Brazilian bus body market occurred between 1956 and 1961 under President Kubitschek, whose policy of “fifty years of progress in five” led to stimulus of the development of Brazil's automobile industry and made possible Brazilian market dominance of bus bodies by national companies. Another driving factor of the local industry was the setting up of chassis manufacturers in the country: Mercedes-Benz (DaimlerChrysler) in 1953-1954, Scania in 1958-1959, and Volvo in 1969. Exhibit 3 shows the evolution of the Brazilian bus body market from 1990 to 2005.

INSERT EXHIBIT 3 HERE

The main domestic producers of bus bodies were Marcopolo, Induscar, Comil, and Busscar (Exhibit 4). These companies have developed competitive advantages that were barriers to potential new foreign entrants. Such advantages include knowledge of the specificities of the Brazilian market and product customization to such specificities, such as the precarious road surface conditions and overall lack of road maintenance. Having dominated the domestic market, the bus body firms, and Marcopolo in particular, set off in a second stage to conquer foreign markets.

The Firm

Marcopolo was founded in 1949 as Nicola & Cia Ltda in the city of Caxias do Sul, Brazil, to manufacture bus bodies. The company defined its mission thusly:

“... to deliver solutions, goods and services for the satisfaction of customers and users, with technology and performance, and to adequately compensate investment, working to foster public transport of passengers and contributing to improving the quality of life of employees and society.”

At its inception, the company had eight partners and just fifteen employees. The partners were workers, with areas of expertise that while different, were all required for the production of bus bodies. In 1950, Paulo Bellini – who would later become principal shareholder and company president – joined the firm as partner and to head warehouse and accounting.

At that time, bus body production was done totally by hand. Since bus chassis per se did not exist, it was necessary to cut and weld truck chassis to the desired size. The process was extremely laborious and time consuming. It was not until 1953 that Marcopolo began producing the first steel structures, a landmark in the bus body industry in Brazil. These metal structures had the great advantage of reducing the weight of the vehicles. The new structures, combined with the emergence of special chassis for buses, reduced manufacturing time.

In 1954, while starting to build a new factory, the company changed its name to Carrocerias Nicola S/A. The construction of the new unit was completed in 1957, the same year the company began producing buses using Brazilian chassis. In 1959, at the time of its tenth anniversary, total production amounted to 600 bodies. By the early 1960s, the company signed the first export contract. The modernization of production processes and the implementation of training programs made possible a considerable increase in output, with the number of bodies manufactured doubling by the end of the decade.

The Marcopolo, a bus model manufactured in 1968 and named in honor of the Venetian navigator, was an advanced design based on modern production techniques. So great was the success of its launch at the VI Automobile Showroom, in São Paulo, that the company decided to adopt the name, and in 1971, changed its corporate name to Marcopolo Carrocerias e Ônibus². It was also during this time that Marcopolo began exporting CKD (Completely Knocked Down) units, in parallel with the supply of technology to Venezuela. In 1978, the company began trading on the Sao Paulo Stock Exchange.

In 1981, Marcopolo inaugurated an additional factory, which eventually came to centralize bus production. At the time, total exports were worth 39 million dollars; however, the economic crisis of the 1980s – the “lost decade” – strongly impacted the company, which was forced to cut bus production. In 1986, the company began implementing Japanese

management and production techniques at its plants. That same year, Marcopolo set up a fiberglass components factory , which became a wholly owned subsidiary called MVC Componentes Plásticos Ltda. Initially, the factory produced plastic parts and components for the exclusive use of Marcopolo, in accordance with the company's strategy to ensure its own innovative technology. But over time, the plant began to produce and supply a wide range of products for various industries, such as components for cars, trucks and buses, spare parts for aircraft, telephone booths, etc.

In 2004, Marcopolo recorded consolidated net revenues of 1.6 billion reais and built 15,938 bodies; by July 2005, the company recorded a net income of 968 million reais and built 9,484 bodies. Of this output, 7,054 units were sold on the international market in 2004 and 5,116 units by July 2005. Data on production, revenue and earnings of Marcopolo are presented in Exhibits 5-11.

INSERT EXHIBITS 5 TO 11 ABOUT HERE

In 2005, Marcopolo had three bus production units in Brazil: Marcopolo Ana Rech (city buses and long-distance coaches); Marcopolo Planalto (minibuses and light commercial vehicles); and Ciferal Indústria de Ônibus Ltda (city buses), acquired in 1999. In addition, the subsidiary MVC Componentes Plásticos Ltda served the automotive, rail and communications industries, among others, with five plants, four in Brazil and one in Mexico. The firm exported to all continents, and had factories and commercial offices abroad (Exhibit 12). In 2005, the firm had approximately 8,300 employees in Brazil and 2,350 abroad (Exhibit 13).

INSERT EXHIBITS 12 AND 13 ABOUT HERE

Corporate Structure and Management Team

Marcopolo was a publicly traded corporation with shares traded on the Sao Paulo stock exchange (Bovespa). In 2005, the company was controlled by three major shareholders, who together held 65% of the voting capital: Paulo Bellini, Chairman of the Board of Directors and president of the company, who owned directly or through a holding company 36% of the voting shares; José Antonio Fernandes Martins, Vice President and member of the Board of Directors, who controlled directly or through a holding company just over 15% of voting capital, and Valter Antonio Gomes Pinto, a company officer with 14%.

Bellini, Martins and Pinto, the main voting shareholders in 2005, joined the company a few years after its foundation: Bellini in 1950, Pinto in 1964 and Martins in 1966. Between 1964 and 1968 Bellini was CEO and in 1969 became president and the major shareholder of Marcopolo, having acquired the shares of the Nicola brothers, who left the company in 1967. From 1970, José Martins, Valter Pinto and Raul Tessari became part of the company's executive management. In the words of president Bellini,

“I remember the importance of the invitations extended to Martins and Valter and, later on, to Tessari, to join the

management team. The management team formed led to the opening of new horizons towards a modern and strategic management, a factor of key importance for the development and consolidation of the company... ”³

The Internationalization Process

The internationalization process of Marcopolo can be divided into three distinct, albeit complementary and overlapping, phases: exports, inward internationalization, direct foreign investment and licensing.

Exports

The first phase, characterized by exports, started in 1961 when an export contract with a bus company in Uruguay was signed. Exports were part of a deliberate strategy to achieve economies of scale and protection against market oscillations and possible stagnation in the Brazilian domestic market.

In 1964, with the stimulus given to exports by the military government, several companies from Caxias do Sul formed a consortium to provide specialized support to the member firms. However, realizing that its products had a high potential for acceptance in the South American market, compared to European products, Marcopolo soon created its own export department.

At the time, the South American market was supplied with coaches from Europe, which were very expensive: firstly because the product volume and the distance between Europe and South America entailed high shipping costs; secondly because bus production required much hand finishing and labor was more expensive in Europe; and thirdly because the European product was designed to run on European roads, which were different from South American roads, particularly with regard to the quality of surface and overall conservation. Another aspect that was favorable for Brazilian exports, particularly to neighboring countries such as Uruguay, was the fact that the product could be delivered to the customer “running,” thereby avoiding the high freight costs that made the European product more costly. Another favorable factor was the development of the chassis industry in Brazil.

The next step was to search for exclusive representatives in the major markets of South America. The entry mode based on local representatives was justified by the proximity to customers and lower commissions than in the case of resellers and dealers. All after-sales service was provided directly by the company. Early export markets included Paraguay, Chile, Peru, Bolivia, Ecuador, and Venezuela. Despite several attempts, the Argentine market remained closed until 1992, when Mercosur was created; the Colombian market – also protected – was only conquered through direct investment in the early 2000s.

DaimlerChrysler, which also exported buses, used dealers earning a commission of approximately 20% to cover the costs of parts inventories, provision of technical assistance, etc. Marcopolo, in turn, paid sales representatives on a commissions-only basis, of 5% to 10%. All after-sales service was provided directly by the company, permitting closer

contact with the customer. All Marcopolo representatives were exclusive, to the point that representation of even non-competing lines was prohibited. The only exception was Chile, where the representative chosen by the company already had other business of this type, but had demonstrated its ability to manage both representations. The company used international fairs to prospect for new customers and markets and increase participation in international tenders. Since the beginning of its export business, Marcopolo had attended several international trade shows and had received numerous awards for products displayed.

Marcopolo made its first exports to the U.S. market in 1988, with Stewart & Stevenson being chosen as the exclusive U.S. distributor. Following the specifications suggested by Stewart & Stevenson, Marcopolo produced and exported, exclusively to the U.S. market, the first units of the S&S Shuttlebus, which were very well received. The models were designed to capture the market for hotel-airport shuttle transport and for small groups of tourists.

In 1992, exports began to Mexico with a joint venture for bus assembly with a Mexican chassis manufacturer. After 1994, the Mexican crisis and the ensuing drop in orders from that market forced the firm's management to seek orders in the U.S. market. Thus, limited numbers of coaches were exported to the United States until the dissolution of this joint venture, when exports came to a halt. In 2005, given that Mexico was part of the North American Free Trade Agreement (NAFTA), and thanks to an alliance with DaimlerChrysler, a strong performer with extensive experience in the U.S. market, the Marcopolo management came to believe that the company was positioned quite favorably to resume exports to the United States. However, the executives believed the company needed to be cautious with regard to these exports in light of certain peculiarities of the U.S. market, such as the power of the "Buy American" campaign, which emphasized that American consumers should buy American products, and the financial impact of product liabilities, which held producers responsible for accidents involving their products.

The company also exported to Africa, first to Angola and Mozambique (Portuguese-speaking countries), and to Nigeria, in CKD form. With the end of apartheid and given its scale and strong influence on the African continent, South Africa emerged as a very interesting market. There, buses were imported from Europe, and though of good quality, such buses were expensive and not compatible with local road conditions. After analyzing the market and establishing two representatives, exports started in 1995. In 2005, the company exported to over eighty countries and exports as a percentage of total sales exceeded 50%.

Inward internationalization

The second movement was marked by inward internationalization, in which the company sought and acquired from abroad, production techniques, technology, and standards. This movement was initiated through concomitant visits to Japan during the 1980s, the opening of a sales office in the U.S., the opening and operation of a plant in Portugal, and

export operations.

The visits to the Japanese factories, to observe and learn production techniques and philosophy – a process that became known internally as “Japanization” – were initiated in 1986 by the company president, Bellini, and the chief industrial officer. During this first trip, the two visited thirteen companies and were extremely impressed with the cleanliness of factories, the organization of manufacturing cells and the team spirit of the staff. In 1987, a second trip was made by eight other company leaders, among them the vice-president, José Martins. The knowledge thus gained and through courses taught by experts gave rise to the *Marcopolo System*, “a set of techniques for producing quality in a good working environment by satisfied workers.” The basic principles within this process were the SUMAM (suggestions for improving the Marcopolo environment) philosophy and the SIMPS (Integrated Marcopolo System of Production Solidarity) tenets. The objectives of the SUMAM philosophy were to improve the location and working conditions, based on application of the 5S methodology to production employee behavior: Seiri (Organization), Seiton (Order), Seisu (Cleaning), Seiketsu (Conservation) and Shisuke (Obedience). The improvement process was done by the formation of spontaneous small groups, where members were united by affinity in order to identify problems and find solutions. The SIMPS system sought to motivate work, optimize the flow of materials, prevent waste and reduce process times, combining kanban with just-in-time production.

Acquiring knowledge in the U.S. market was encouraged by access to the American Department of Transportation (DOT) standards that, due to their demanding requirements, served as parameters for the automotive industry in several international markets. The process of adoption of the DOT standards came to be known at the company as “Dee-Oh-Tee-ization.”

Marcopolo's entry in Portugal took place after an appraisal study of the European Common Market – a market that the company was already exporting to, but one where it wanted to establish a more effective presence. Such a presence would enable it to access the technologies and adopt standards for bus production in accordance with the Economic Commission for European Standards. Marcopolo identified Portugal as the gateway to that market and acquired a majority stake in a small local manufacturer. As a result of the acquisition, the company gained access to technologies such as mechanical components for double-decker buses and the production of low-floor buses. This access gave Marcopolo the strength needed to pressure Brazilian chassis manufacturers to modernize. Other technologies brought by the company were refrigeration (bars, refrigerators), TV, heating, and so on. Via this process, the company accelerated the development of its suppliers in Brazil so they could manufacture such components domestically. Many times, in efforts to consolidate the domestic market and qualify for export Marcopolo brought together the European manufacturer and the national supplier so that they would partner and enter into a production partnership to supply the company. The heating technology, for

example, was of great importance for Marcopolo to sell buses to Chile, which, with ambient temperatures as low as -20°C, needed a very efficient heating system.

In addition to the ECE and DOT standards, the company also identified that, to meet the demands of various foreign markets, it was necessary to seek ISO certifications. Thus Marcopolo obtained ISO 9002 certification in 1996 and ISO 9001 in 1997—both through the Det Norske Veritas classification society. It also received ISO 14000 certification relating to the preservation of the environment.

Foreign Direct Investment

The third movement was foreign direct investment. This movement was permeated by strategic alliances, in the form of joint ventures and partnerships. There were multiple drivers for the increase of the company's international operations via physical facilities. On the one hand, there was top management's desire to take the firm into other markets: “exports were going well, but Marcopolo wanted to go further;” on the other, several important strategic issues became aligned. The first was the growth potential of the company when only international operations through exports and domestic market growth were taken into account. With a leadership position in the Brazilian market, fiercely disputed with other reputable competitors, market share gains appeared more costly than international expansion. However, further expansion to certain international markets was hampered by with freight costs that were, in some cases, prohibitive. In addition, the stage of evolution of some of the international markets and the company's own strategy suggested the need to be closer to customers: such proximity would allow for integration of various processes, economies of scale, and cost reductions, as well as access to technologies and know-how that the company had still not mastered. Nevertheless, management envisioned that any decision regarding foreign direct investment should include core competencies to generate competitive advantage, such as competitive processes, market knowledge, adaptability, learning ability, and quick response to demand.

The company's mode of operation varied widely depending on the specific country. In countries where prevailing market prices were higher, the company could choose to continue exporting the completely built unit (CBU). In more price-sensitive markets, however, it had to try and pare down the cost of exporting as much as possible, exporting the product as PKD, MKD, or CKD. As a final alternative, the company could choose to produce buses and components in the foreign market.

One of the major constraints faced by Marcopolo to produce buses in foreign markets was the availability of local suppliers. For the company to use local suppliers, it was important that the latter could work with standards of quality and reliability demanded by Marcopolo. However, such partnerships took time to build, so Marcopolo started operations by exporting its own components (CKD); later, as relationships with local providers matured, the company's end product came to include increasingly more local content.

According to the vice president, José Martins, tax incentives of the governments of target countries also exerted influence on how the company operated, first, by fostering assembly in the country through joint ventures with domestic firms:

“Suppose for example the tax to import a complete bus is 25%; the government then calls and says, 'Listen, if you build this bus here, I can lower the tax to 12%.' So, your level of competitiveness increases and you can begin to study the possibility of sending the bus as CKD or MKD. For this, we have to find a plant that already operates in that country and make technology agreements, where you send the disassembled parts and assemble them there.”

Then, leveraging the nationalization of the product:

“So then the government calls the company and says, ‘Guys, I need to generate more jobs in my country. So – these CKD pieces you’re doing – let’s implement a nationalization program. If you do, I’ll give you more incentives: I’ll lower the tax on CKD from 12% to 2.5% or 3%.’ You then become more competitive and begin to develop local manufacturing, based on local content.”

The study for selection of the markets for direct investment took into account such factors as (i) the intensity of export activity for that marketplace; (ii) export costs in comparison with the deployment of a local operation; (iii) geographical distance; (iv) affinity in terms of language and culture; (v) the degree of technological development of the country and its industrial vocation (availability of raw materials and basic industrial products); (vi) strategic positioning in relation to other potential markets; (vii) local government policies; (viii) the existence and nature of local competitors; (ix) availability of potential suppliers. Overall, emerging markets were favored, since buses are a means of transport more affordable and accessible to meet the masses, particularly low-income populations.

The first foreign direct investment was made in 1990, in Coimbra, Portugal, in association with the Portuguese group Evicar. The main objective of entry in Portugal was to establish a strategic presence in the European market, dubbed by the company's executive management as "bus Mecca." The European market was seen by management as complex and competitive, with high value-added products and, most importantly, advanced technology. It was therefore extremely advantageous for Marcopolo to be present – not only to learn, but also to seize opportunities as they presented themselves. Marcopolo acquired 76% of the operations and also assumed administrative control of Evicar. The Portuguese partner was also a dealer of a Dutch chassis factory, being responsible for supplying chassis and sales. Although the plant located in the city of Coimbra was small, it acted as a radar, feeling out the market, seeking information, and making its presence felt. In terms of volume the company was not strong in this market, producing only about 20 units per month, but quality was compatible with the European market. Through this operation, Marcopolo became closer to the North European and North African markets. In 1992, Marcopolo acquired full control of the operation, with the Portuguese partner continuing as the

chassis supplier.

Even producing buses to EEC standards, Marcopolo had two substantial cost advantages compared to European manufacturers. First, while buses produced in Europe were still virtually hand built, Marcopolo had a sophisticated yet low cost production system; secondly, European labor costs were five to eight times higher than in Brazil, from where most of the parts originated. However, the European market was mature, and therefore difficult to penetrate. Thus, management believed that at least another five years of operation would be required for Marcopolo to become truly competitive in the European market. The Portugal unit was thus viewed as the seed for future initiatives in Europe.

In Mexico, Marcopolo had a joint venture with a local partner, Dina Autobuses, since 1992. Despite being, until then, a bus manufacturer and the largest manufacturer of trucks in Mexico, the Mexican partner had been privatized in 1991 and had outdated products. Within this partnership, Dina supplied chassis and Marcopolo the bodies. The company exported 400 complete buses and 3500 CKD units; it also transferred technology, assembly techniques, parts and components. Although the initial partnership term was for 10 years, early problems started to appear. The alliance began experiencing difficulties in 1994 with the Mexican crisis, and this exacerbated the misalignment—already being felt—between the two strategic partners. In 1997 the alliance was dissolved, and Marcopolo started up a sole venture, Polomex, in the city of Aguas Calientes. In 1998, DaimlerChrysler entered into a strategic alliance with Marcopolo, acquiring 26% of the shares of Polomex and assuming control of the commercial area. The Aguas Calientes factory was closed, with operations moving to Monterey, where DaimlerChrysler already operated.

The next market for direct investment was Argentina. From the early 1990s, the Argentine market had attracted Marcopolo's attention, since, with the creation of Mercosur in 1992, Argentina accounted for a significant part of the company's exports. The geographical proximity of Argentina, as well as cultural similarities with Brazil, contributed to make this market all the more attractive. The local competition was composed of local producers with a limited range of products, which gave Marcopolo the opportunity to operate freely in segments not yet occupied by the competition.

However, barrier and non-barrier tariffs imposed on company exports meant that some products, even if of better quality, were not as competitive as those produced locally. The main non-barrier tariff was related to freight. With respect to coaches, exportation was not a problem since the cost of transport—the product was delivered running—represented a small percentage of the total cost of the coach. However, in the case of coaches, the cost of transportation accounted for much higher percentage of the total value of the product, thereby rendering competition in the Argentine market non-viable since the final price of the Marcopolo coach was well above that of the competition. It was to address this problem that the idea arose of establishing a manufacturing plant in Argentina.

Thus, in 1997, Marcopolo bought at auction a defunct factory located in the city of Rio Cuarto, in Córdoba

province. Although the company had identified the need to establish itself in Argentina, the plant investment was made in a more opportunistic than deliberate fashion: the conditions for closing the deal were extremely favorable given the location and price. The factory was acquired for a price considered “quite reasonable” and with four years of financing, at a time when there was parity between the real and the dollar. The location of the factory was quite favorable because, first, there was a high concentration of automotive industry in Cordoba; secondly, it was outside of the greater Buenos Aires area, which meant greater incentives such as low labor related taxes; finally, this location was convenient in terms of exporting to the other Mercosur countries and Chile. Thus was founded Marcopolo Latinoamerica.

The installed capacity in Argentina was 1250 buses and minibuses per year. However, the economic crisis that has stricken the country since 2002 caused several problems for the company, defaults for example; indeed, finding clients with real ability to pay for their products had become a challenge. This forced Marcopolo to sharply curb operations in the country, leaving the plant in a state of virtual hibernation. However, the subsequent recovery of the Argentine economy enabled Marcopolo to see resuming its operations in that market for 2006. According to the company's executive management, the reopening of the factory was the right thing to do if only because of the need to supply the Mercosul markets with city buses. Even so, the reopening would not be immediate because the company had to get the timing right and ascertain operational capacity.

With the entry into the Argentine market, Marcopolo came to cover the entire Mercosur region; and with the entry into Mexico, the company gained access to Central America and to potential markets to the north. This left a vacuum in northern South America, i.e., Colombia, Venezuela, Peru, Ecuador and Panama. In order to address this gap, and due to the strategic location of Bogotá, Colombia, a production unit was opened in that city. This particular plant, Superpolo, was set up by establishing a joint venture with Fanalca, a local bus manufacturer. Another strong attraction of the Colombian market was TransMilenio, a government project to promote urbanization. The project was part of the National Plan for Transportation (considered by the company as one of the best in the world) which required 20 to 40 buses to be produced monthly. Superpolo, which had capacity to produce 2,000 buses a year, began operations in December 2001, producing city, intercity and mini-buses. Marcopolo supplied the assembly technology, CKD buses and the components for articulated, mini and micro-buses. By 2005, the buses built at this unit were already 40% local content.

Just before starting the operation in Colombia at the end of 2000, Marcopolo also made a direct investment in South Africa, a country that it was already exporting to. The company acquired the Volvo plant in Johannesburg, thereby founding Marcopolo South Africa, which began operations in 2001 with a production capacity of 700 bodies per year. This plant enabled the company to service the southern half of Africa. In this market, Marcopolo worked via partnerships with major chassis manufacturers, such as Volvo and Scania. The interstate coaches were exported to that location complete or in

PKD, and the city buses were exported as MKD and CKD.

In addition to the overseas production subsidiaries, Marcopolo also opened sales offices. In 2005, Latin American offices in Colombia, Peru and Mexico were supporting operations in those countries. Other offices were opened in the UAE, USA and China. Examples of products made by Marcopolo appear in Exhibit 14.

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Licensing

Marcopolo's first experience with licensing was in Venezuela in 1971, when the company signed a body assembly contract with Ensamblaje Superior C.A. The contract involved licensing and technical assistance. A few years later, in 1974, a contract was signed with Ghana-based Mark Coffie Engineering Ltd., for building the Marcopolo Junior microbus from CKD.

Entry into China

The possibility of entering China began to be aired at Marcopolo in the mid-1990s, although at the time, the matter failed to garner much attention within the company. However, once the importance of this movement gained recognition and the company decided to enter the Chinese market, implementation became the next concern.

The process of surveying the market began in 1997 with a visit by the company's president, Bellini. Up until then, the company had no connection with China, even as an exporter. Later on, the project was handled by Paulo Guarese, Executive Manager of Special Projects. The process of prospecting included research, travel, process mapping, and, later, discussions based on information gained from the company's various departments (export, corporate, international business, human resources, etc). Overall, the process took about two years. The company had to rely on several sources, including major chassis companies, such as Scania, Volvo, and DaimlerChrysler, several global international suppliers, and chambers of commerce.

Entry Mode

The opportunity to enter the Chinese market came through Iveco, an Italian chassis builder belonging to the Fiat group. Iveco had started its operations in China in the city of Nanjing fifteen years earlier, through a joint venture with Yuejin Automobile Group. Thus was founded the Nanjing-Iveco Automobile Company Ltd. (Naveco), tasked with building the Iveco Daily, a multi-purpose commercial van, for transporting cargo or passengers. The success of the Daily, combined with the country's growing transportation needs, spurred Iveco's interest in bus manufacturing. The city government of Nanjing then introduced Naveco to the Changzhou Bus Company (CBC), a Chinese producer of city buses with annual sales of 4,000 units. Thus in 1999 began the process of setting up a joint venture, and CBC-Iveco was created in 2000. However, it became clear during the process that a technological upgrade was still needed in body manufacturing; Iveco then

embarked on a search for partners who could provide such technology.

Iveco invited Marcopolo to participate in a licensing agreement, which would involve a package of technology, technical knowhow and the installation of a factory to produce bodies. Marcopolo also undertook to perform technical assistance, staff training, and teaching of operating procedures, both to the Italians and the Chinese.

By that time, Marcopolo had already identified the Chinese market as a strategic one. Thus, even though it was the first time in Marcopolo's 55-year history that the company was signing an agreement to license technology to a competitor – Iveco competed with Marcopolo in the European market via coachbuilder Irisar – this opportunity was seen as of great importance. According to Paulo Guarese, the company considered the deal a victory in that it demonstrated flexibility and adaptability to work with many diverse forms of internationalization. In 2000, shortly after the consolidation of CBC-Iveco, a licensing agreement lasting until 2007 was signed between Iveco and Marcopolo; then in 2001, the Chinese government granted the required business operating license to launch operations.

Within the contract, Marcopolo should develop three bus projects for Iveco: a microbus, a city bus and a long distance coach. These projects did not involve entirely new products, but rather adaptations for the Chinese market of existing Marcopolo products.

Choice of Location in China

Among the measures taken by the Chinese government to spur national development was the creation of 53 industrial districts. These districts, with populations ranging from 300,000 to 1,000,000 inhabitants, were based on central government directives; however, each one established its own tax policy giving investors a variety of incentives. The districts took care of their investors, helping them with contracts, selection of the best lots, favorable conditions, etc. Marcopolo's decision to open offices in Changzhou was taken due to incentives as well as the presence of Iveco.

Another important step taken by the company was the sister-city relationship established between Changzhou and Caxias do Sul. This process was implemented through the city hall of the respective cities and included exchange activities whereby Brazilian politicians visited the city of Changzhou and Chinese politicians came to Brazil. The protocol in Brazil included introducing the visitors to the Chambers of Commerce, Industry and Science, the Universities, and to Caxias do Sul government representatives. According to Guarese,

“This came to be seen as a major step forward, because everything in China begins with the political relationship. Everything starts with the top layer, which consists of politicians, and then radiates throughout the pyramid... The doors are now wide open in China for us to get to work.”

Characteristics of the Chinese Market

The Chinese market, given its size, was considered extremely attractive. Despite the poor highway infrastructure,

government policies in the transportation sector prioritized road transportation. The number of privatized highways was growing, and these offered improved highway conditions, particularly on the east coast. Despite the rapid growth of passenger cars in China (a 75% jump in the number of cars in circulation in 2003), there were only still only 15 cars per 1000 inhabitants. For purposes of comparison, in the United States this ratio was 700 per 1000.

According to the company's executive management, the country could be divided into traditional China and modern China, which meant that there were two distinct markets: one popular and one up-market. The first market was not too concerned with quality, or even the authenticity of the products: the concern here was with the price. Therefore, products in that market were low priced, low value and low quality; in many cases, products were pirated imitations of other more expensive products. The second market was more demanding; it sought after products with high added value and was less concerned with price. Exhibit 15 shows the evolution of bus production in China between 1999 and 2004 compared with Brazil and Russia.

INSERT EXHIBIT 15 HERE

Inequality in China was pronounced, and was especially apparent between the east coast, home to modern China, and the interior—the west—where traditional China persisted. Even with all the inequality, the Chinese market was extremely important: with a demand of 70,000 buses a year, it constituted the biggest bus market in the world. Moreover, with its high rates of economic growth (Exhibit 16), China—especially the east coast—had modernized rapidly. The creation of industrial districts and the country's entry to the WTO attracted large number of investors; hence the need to improve infrastructure by building highways and bridges, which in turn transformed transport inter-village transport into highway transport, driving a strong demand for coaches. The modernization of urban centers also required forms of transport that were more efficient, not only in terms of the buses per se, but also in terms of implementing integrated transport systems. Exhibit 17 presents information on passenger traffic from 1999 to 2004.

INSERT EXHIBITS 16 AND 17 ABOUT HERE

Brazilian Firms in China

Most Brazilian firms were not yet operating in China. In fact, a little over one thousand Brazilian industrial firms exported to China in 2005. Nevertheless, foreign trade between Brazil and China had grown substantially during the past five years (Exhibit 18), even if most Brazilian exports were commodity-based. Only a small proportion of total exports from Brazil were of parts and vehicles (Exhibit 19). In terms of foreign direct investment, there were less than ten Brazilian firms with industrial plants in China.

INSERT EXHIBITS 18 AND 19 HERE

Competition in the Chinese Market

The huge demand from China had attracted many large companies. Some of the largest producers of buses were already in China; these included DaimlerChrysler, through Yaxing-Benz (a joint venture between the Chinese Yangzhou Yaxing) and Volvo, which partnered with Sunwin. DaimlerChrysler became the global benchmark in bus technology with the EvoBus ('Evolution' + 'Bus'). In certain markets, including Mexico, DaimlerChrysler worked as a partner of Marcopolo; however, in other markets, such as China, the company constituted a strong competitor.

The Chinese companies themselves were also a strong presence in the market; in 2005, in Marcopolo's judgment, they were already well prepared. According to Marcopolo's Executive Management, there were 15 large bus factories—of which eight or nine should survive—and about 27 minibus plants. The vast majority of these factories did not need foreign technology, given that they had “a beautiful design, an excellent product, and average to above-average quality,” i.e., the ability to offer products that met market expectations.

Piracy and Patent Infringement

One of the biggest problems for foreign investors in China was piracy and patent infringement. There were fears that the investor might be copied immediately, thereby losing the competitive advantages conferred by the intellectual property of their technology. There was pressure from foreign governments and foreign investors on the Chinese government so that actions be taken to reduce piracy, such as the creation of national agencies for the protection of intellectual property. One of the biggest complaints of the international community concerned the fact that Chinese laws were not structured to act efficiently and effectively.

According to the company's executive management, certain strategies and preventive measures could be taken to curtail the risk of being imitated, or to limit the losses, in the event of having been copied. The first protection measure was part of company strategy, i.e., developing and producing internally the strategic technology content. Marcopolo concentrated the company's innovation process (which required a team of over 500 employees in engineering) in Brazil. The production of these strategic components was also done vertically rather than outsourcing these types of tasks. In the words of the vice president, José Martins:

“An important point that made Marcopolo's internationalization possible was precisely the strategic decision to develop vertically. Marcopolo manufactures everything: seats, windows, toilets, plastic components, fiber glass, air conditioning -- everything. We make everything.”

A second strategy would be to enter the market with high-tech products, which would be difficult to replicate. The problem here would be that the high cost of these products would not allow their commercialization in the Chinese market. Another option was to stay one step ahead, that is, enter the market with average technology gradually but then gradually

increase: “you're getting copied, but then you always roll out a better technology to compete, until, at some point, the copiers to give up.” The difficulties in this case concerned two aspects: first, there were no assurances as to the withdrawal of the copiers; second, this strategy might be effective when it came to protecting the competitive advantages of the investors and the owners of the technology -- but society as a whole would lose, being relegated to using outdated technology.

Another defensive measure adopted by some firms present in the Chinese market was to simply hire the copiers. “It's the old strategy—if you can't beat them, join them,” commented Guarese. Thus, some companies would hire their own imitators, outsourcing production to them and doing only end quality control. This did not end the problem, but it did entail fewer losses and gave the company a certain level of control.

Despite all these measures, the problem of piracy in China was very serious and had no easy solution because “copying is something that is very well rooted in Chinese culture.” According to the executive Paulo Guarese, in China there already existed pirated Marcopolo products, including the original brand.

Alternatives in China

Due to restrictions imposed by the licensing agreement with Iveco, which prevented Marcopolo from entering the Chinese market with its products before 2007 (either through exports or through local production) the company began to seek ways to establish a deeper relationship with the market without any breach of contract.

Given the need to establish connections with the market, the company opened the Marcopolo Changzhou Office (MSO), a commercial office with the goals of (i) building the company's relationship with the consumer market, (ii) understanding the local supply system, and (iii), understanding the country's political environment and establishing relationships, because, in Guarese's words, “everything in China begins with the political relationship.” The office gave the Marcopolo team the opportunity to enhance its level of understanding of the country as a whole, and through the information and knowledge gained, the company sought in 2005 to sketch out its future in China.

A second measure to address the restrictions imposed by the Iveco contract was the development of a project to build a components factory. This project would engender several advantages. The company would not only have the opportunity to work directly in the Chinese market, but would also have access to Chinese manpower and raw materials. Thus, components could be produced in China at lower cost and then transferred to its other units in Brazil and elsewhere. In addition, the company intended to act as a supplier of components for the CBC-Iveco venture.

This plant would be built through a joint venture between Marcopolo and another CBC group company that also owned businesses in the area of components. In this partnership, Marcopolo would have a dominant role, with a 75% interest, the CBC Group company retaining a 25% share. To implement this alternative, Marcopolo would have to start

almost immediately the components factory, and, by 2007, at the end of the contract, would be sufficiently strong to build bodies.

However, problems in negotiations with the potential partner caused Marcopolo's management to explore other alternatives. Management came to the conclusion that it would be more appropriate to reverse the steps, that is, instead of starting with the production of components and then bodies, the company would start with bodies and follow afterwards with the components. In the words of José Martins: "We thought that if we had a parts factory, we would sell parts to everyone. It was a logical approach—perfectly logical—but in reality, our partner was wrong."

By 2005, it was clear to Marcopolo managers that, in order not to be left behind in the competitive process, it would be necessary to produce bodies in the Chinese market as soon as possible. The first reason for this imperative was the fierce competition between the international and Chinese companies within the Chinese market. The second was related to the very nature of global competition. Many corporations were seeking to optimize production processes based on global sourcing strategies. China, like other Southeast Asian countries, offered competitive advantages, especially as concerned the cost of labor, making it highly attractive place to companies wishing to adopt this strategy. In the view of senior management, it would be necessary to optimize production processes through a global sourcing strategy, for which the role of China was key. As vice-president José Martins noted,

"First you start to export the CBU (Completely Built Up). Then you begin to export the CKD (Completely Knocked Down). The next step is local content. Local content refers to the progressive nationalization you present to the government in order to obtain favorable import tax treatment. With local content in place, you can proceed to the last step, which is global sourcing... I cannot have one seat factory in Caxias, one in China, another in India, and another in Mexico... And I can't export seats from Brazil, because China has a better price... Out of this entire world map you have in your hands, who can make the seat the cheapest? Is it China? Then you close all your seat factories and China starts supplying all your bus factories."

However, the company needed to solve two major problems. The first concerned the restrictions imposed by the licensing agreement with Iveco, whose term extended through 2007; the second referred to the entry mode to be adopted by Marcopolo in China once it was acting independently.

Regarding the first problem, Marcopolo had the option to negotiate an early expiry of the contract, given that the CBC-Iveco transaction was already fully implemented and operational, and Marcopolo's role had become restricted to that of technical advisory. Another aspect that increased this possibility was the fact that not only had the CBC group caused problems for Marcopolo in relation to the components plant, but Iveco itself was at odds with the partner, and the buses designed by Marcopolo for CBC-Iveco had still not got off the drawing board. Another option would be, since the company

had a wide range of products (buses, light commercial vehicles etc.), to develop and market products that did not compete directly with those of CBC-Iveco.

As to the form of action, Marcopolo had three main alternatives. The first two took into account the need for the firm to work with chassis producers, while the third envisioned a more independent stance.

The first option would be to establish a joint venture with multinational companies—chassis manufacturers such as Volvo, Scania or DaimlerChrysler; from the standpoint of Marcopolo, this would not be a bad idea given the company's prior positive experiences with joint ventures with these companies. However, a strategic alliance with a foreign partner could generate problems in terms of market penetration, given that these partners might not have the necessary local knowledge and *guanxi*.

A second option would be to establish a joint venture with a Chinese partner, e.g., a chassis builder such as Dongfeng Motor Company. That would partly address the *guanxi* problem; but, according to the company's executive management, regional protectionism was present in the Chinese market which meant that some products simply were not accepted in certain places. Thus, if the company were to patronize one particular chassis supplier, it would be practically excluded from certain regions.

This led to company managers to the third and perhaps most desirable of alternatives, which would be to maintain flexibility and work with all types of chassis. Regardless, Marcopolo still had to set up a joint venture—in this case a horizontal one with a Chinese truck body builder—because the law still did not allow a foreign body builder to act in the country as a sole venture. This association would also address the difficulty of thriving independently in the Chinese market, because, regardless of the available capital / management / technology, it had to be the Chinese partner that established the necessary links with the market.

Thus, having studied the alternatives with respect to the Iveco contract and regardless of the product line to be developed and marketed at the beginning of operations, Marcopolo was now engaging in talks with potential partners. According to the company's executive management, three provinces had been identified as possible locations for the company to deploy, and, in all three, the company had received government permission to set up operations. However, only two presented potential partners of interest to the company. It was precisely negotiating with the partners that was the most difficult stage: the process was extremely slow and required much patience. In the numerous meetings involving different people and structures the future partner would assess the foreigner's potential and check the consistency of his discourse. Paulo Guarese explained that credibility and consistency—combined with *guanxi*—were the determining factors in these negotiations. But management continued to see China as a milestone in its international development; as José Martins put it,

"When we have China figured out, our potential partner will be a sure thing. So that's what we're hoping for,

because China may be the main point of our internationalization.”

Exhibit 1 – World Production of Buses – Selected Countries (units)

Country	Production of Buses - units			% Change	
	2002	2003	2004	2002/2003	2003/2004
China	n.a.	66,700	78,712	n.a.	18%
United States	22,987	27,943	29,033	18%	4%
Brazil	22,826	26,990	28,738	18%	6%
Russia	15,829	17,224	18,760	9%	9%
Turkey	n.a.	10,967	14,742	n.a.	34%
South Korea	18,128	16,354	14,000	-10%	-14%
Japan	11,141	11,406	12,286	2%	8%
Germany	9,745	10,423	9,984	7%	-4%
Sweden	n.a.	2,850	2,915	n.a.	-4%
France	2,589	2,393	2,992	-8%	25%
Italy	2,597	2,850	2,915	10%	2%
Egypt	3,052	2,367	2,780	-28%	17%

Source: OICA; n.a. = not available

Exhibit 2 – Ranking of World Production of Buses and Coaches* by Manufacturer

Ranking	Manufacturer	2004 - units
1	Hyundai - Kia	113,237
2	Tata	59,301
3	Daimler-Chrysler	47,045
4	Toyota	38,015
5	Fiat-Iveco-Irisbus	31,188
6	Navistar	15,762
7	Anhui-Jianghuai Auto	12,077
8	GM-Daewoo	10,785

Source: OICA; *includes passenger vehicles with eight or more seats

Exhibit 3 – Brazilian Production of Bus Bodies

Year	Domestic Market		International Market		Total units
	units	%	units	%	
1990	8,480	91.7	766	8.3	9,246
1991	14,203	92.6	1,141	7.4	15,344
1992	14,784	82.9	3,046	17.1	17,830
1993	10,355	78.0	2,919	22.0	13,274
1994	9,401	74.5	3,224	25.5	12,265
1995	14,401	81.7	3,224	18.3	17,625
1996	16,379	88.5	2,119	11.5	18,498
1997	14,775	80.5	3,614	19.5	18,389
1998	15,883	82.3	3,408	17.7	19,291
1999	10,333	80.5	2,488	19.4	12,821
2000	13,267	73.3	4,832	26.6	18,099
2001	15,561	71.7	6,119	28.2	21,680
2002	15,299	70.2	6,488	29.7	21,787
2003	14,368	67.1	7,013	32.8	21,381
2004	15,826	64.1	8,850	35.9	24,676
2005*	7,931	55.5	6,365	44.5	14,296

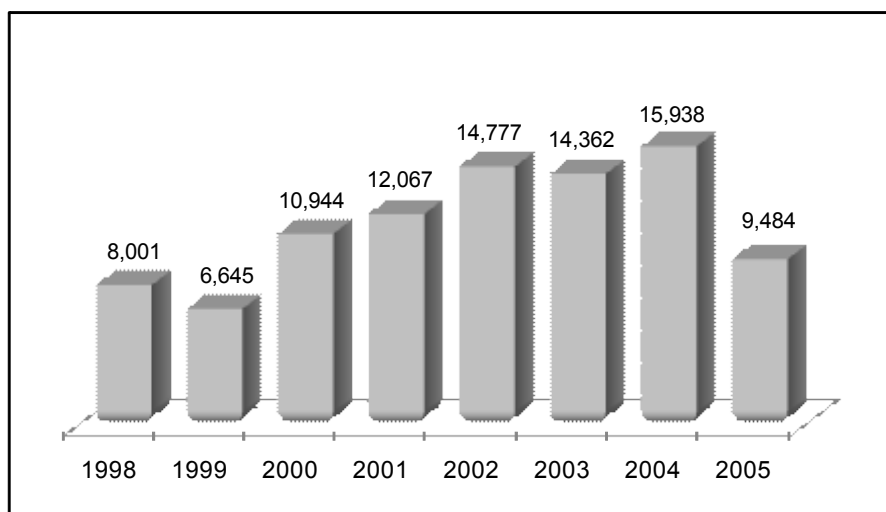
Source: Marcopolo; *2005 production: January-July only

Exhibit 4 – Ranking of Brazilian Production of Bus Bodies by Manufacturer

Ranking	Manufacturer	Year of Foundation	Production 2004 - units
1	Marcopolo/Ciferal	1949	11,591
2	Induscar	1946	5,692
3	Comil	1985	2,200
4	Busscar	1946	1,707
5	Irizar	1998	491

Source: Fabus

Exhibit 5 – World Production of Marcopolo (units)



Source: Marcopolo

Note: 2005 production: January-July only.

Exhibit 6 – Bus Body Production in Brazil: Marcopolo market share (%)

Products	2005*	2004	2003	2002	2001	2000	1999	1998
Interstate	46.0	56.5	64.9	64.9	50.7	45.8	44.6	51.8
Urban	50.2	48.6	44.9	46.5	43.3	46.1	41.0	31.6
Microbuses	29.1	35.7	38.5	40.9	45.9	45.9	54.7	59.5
Minibuses	27.5	22.1	31.7	43.8	34.7	-	-	-
TOTAL	45.5	47.0	47.0	49.8	45.3	46.0	43.4	38.7

Source: Marcopolo
*through July 2005

Exhibit 7 – Marcopolo Production by Country (units)

Country	2005*	2004	2003	2002	2001
Domestic Production					
Marcopolo:	4,470	8,504	8,314	8,749	7,391
Ciferal	1,783	3,085	2,368	2,630	2,261
Total Brazil	6,253	11,589	10,682	11,379	9,652
Foreign Production					
Mexico	1,794	2,102	1,687	1,964	1,423
Portugal	146	176	119	96	112
Argentina	-	-	-	-	-
South Africa	152	406	399	204	120
Colombia	1,139	1,665	1,475	1,134	375
Total Foreign	3,231	4,349	3,680	3,398	2,415
TOTAL	9,484	15,938	14,362	14,777	12,067

Source: Marcopolo *through July 2005

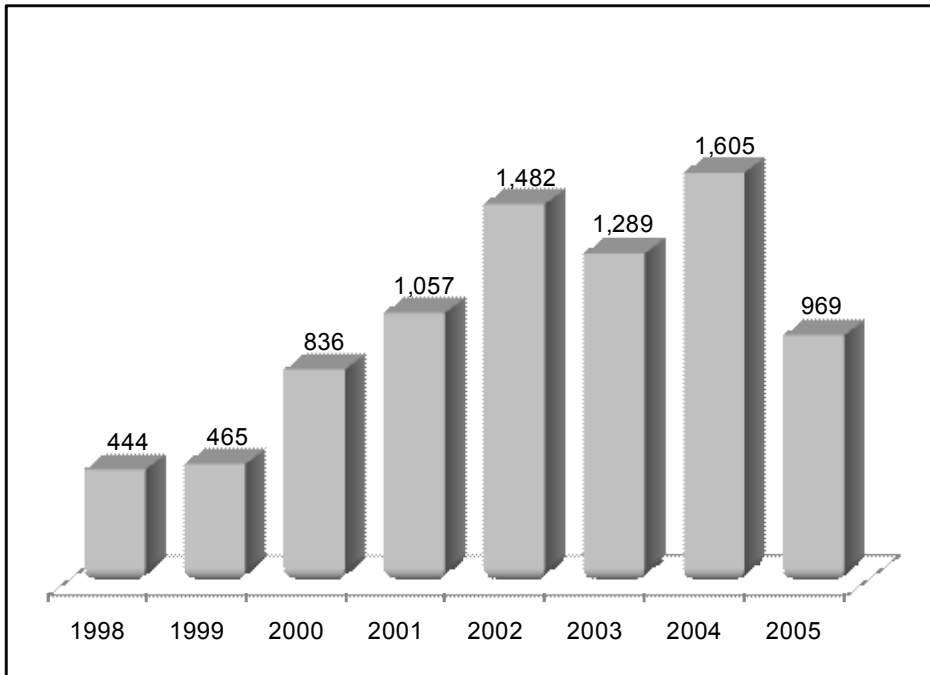
Exhibit 8 – Marcopolo World Production by Product (units)

Products	2005*			2004			2003		
	DM	IM	TOTAL	DM	IM	TOTAL	DM	IM	TOTAL
Interstate	831	1,115	1,946	1,608	2,065	3,673	1,352	1,654	3,006
Urban	1,701	2,329	4,030	3,451	2,567	6,018	2,586	2,209	4,795
Microbuses	208	1,030	1,238	1,115	1,491	2,606	1,399	1,104	2,503
Minibuses	87	357	444	217	436	653	452	558	1,010
Subtotal	2,827	4,831	7,658	6,391	6,559	12,950	5,789	5,525	11,314
Vans/Volare	1,541	285	1,826	2,493	495	2,988	2,903	145	3,048
TOTAL	4,368	5,116	9,484	8,884	7,054	15,938	8,692	5,670	14,362

Source: Marcopolo
*through July 2005

DM = Domestic Market; IM = International Market

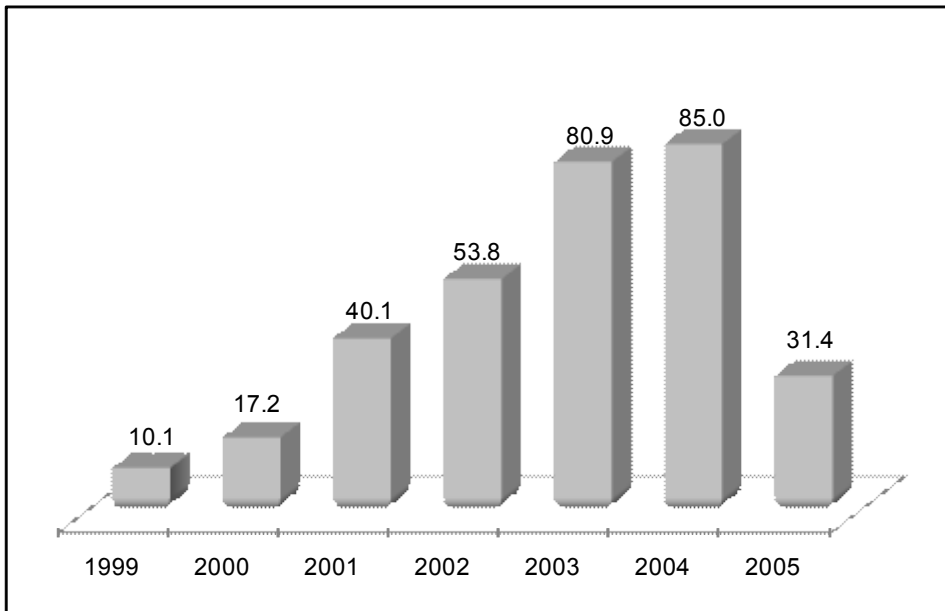
Exhibit 9 – Marcopolo Net Income by Year (million BRL)



Source: Marcopolo

Note: 2005 data is January-July only.

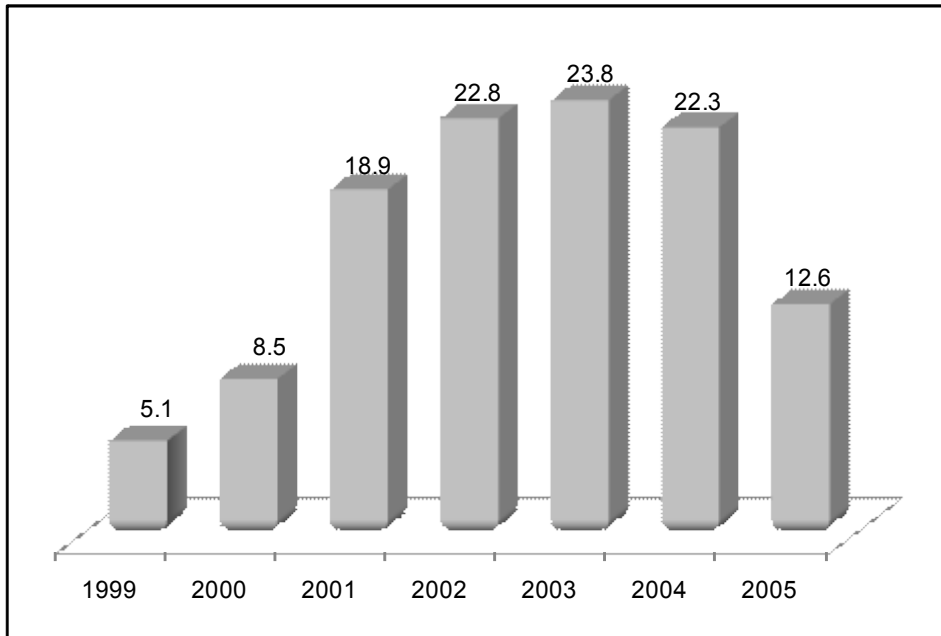
Exhibit 10 – Marcopolo Net Profit by Year (million BRL)



Source: Marcopolo:

Note: 2005 data is January-July only

Exhibit 11 – Marcopolo Annual Return on Equity (ROE) – (%)



Source: Marcopolo:

Note: 2005 data is January-July only

Exhibit 12 – Countries Served by Marcopolo through 2005

EXPORTING	
<p>EUROPE:</p> <ol style="list-style-type: none"> 1. England 2. Belgium 3. Netherlands 4. France 5. Germany 6. Spain 7. Portugal 8. Italy 9. Greece 10. Iceland <p>ASIA:</p> <ol style="list-style-type: none"> 11. Oman 12. Taiwan 13. Iraq 14. Hong Kong 15. Kuwait 16. Singapore 17. Pakistan 18. Saudi Arabia 19. United Arab Emirates 20. China 21. Syria 22. Bahrain 23. Japan <p>AFRICA:</p> <ol style="list-style-type: none"> 24. Lesotho 25. Swaziland 	<ol style="list-style-type: none"> 43. Tanzania 44. Malawi 45. Mozambique 46. Zimbabwe 47. Botswana 48. Rwanda <p>South Africa</p> <p>NORTH AMERICA, CENTRAL AMERICA AND THE CARIBBEAN:</p> <ol style="list-style-type: none"> 49. USA 50. Canada 51. Mexico 52. Dominican Republic 53. Bahamas 54. San Martin 55. Curacao 56. Aruba 57. Trinidad and Tobago 58. Guadalupe 59. Martinique 60. Barbados 61. Cuba 62. Jamaica 63. Belize 64. Guatemala 65. El Salvador 66. Costa Rica 67. Honduras 68. Nicaragua

26. Libya 27. Morocco 28. Egypt 29. Eritrea 30. Ethiopia 31. Mauritania 32. Ivory Coast 33. Ghana 34. Nigeria 35. Cameroon 36. Democratic Republic of the Congo 37. Republic of the Congo 38. Uganda 39. Kenya 40. Zaire 41. Angola 42. Zambia	69. Panama SOUTH AMERICA 70. Argentina 71. Uruguay 72. Paraguay 73. Chile 74. Bolivia 75. Peru 76. Ecuador 77. Colombia 78. Venezuela 79. Guyana 80. Suriname 81. French Guyana OCEANIA 82. Tahiti 83. New Caledonia
PLANTS	
Brazil (4) Mexico Colombia	Argentina Portugal South Africa
COMMERCIAL OFFICES	
Brazil (4) USA Mexico Colombia	Peru Arab Emirates China
LICENSING	China

Source: Marcopolo

Exhibit 13 – Marcopolo Workforce, by Year / Location

	2005*	2004	2003	2002	2001	2000
Parent company	5,511	5,457	4,969	5,055	4,541	4,253
Other companies in Brazil	2,819	2,854	2,428	2,092	1,890	1,838
Companies in other countries	2,350	2,256	1,982	1,711	1,245	568
TOTAL	10,680	10,567	9,379	8,858	7,676	6,659
Turnover (%)	1.18	0.84	0.77	0.77	0.63	0.69

Source: Marcopolo

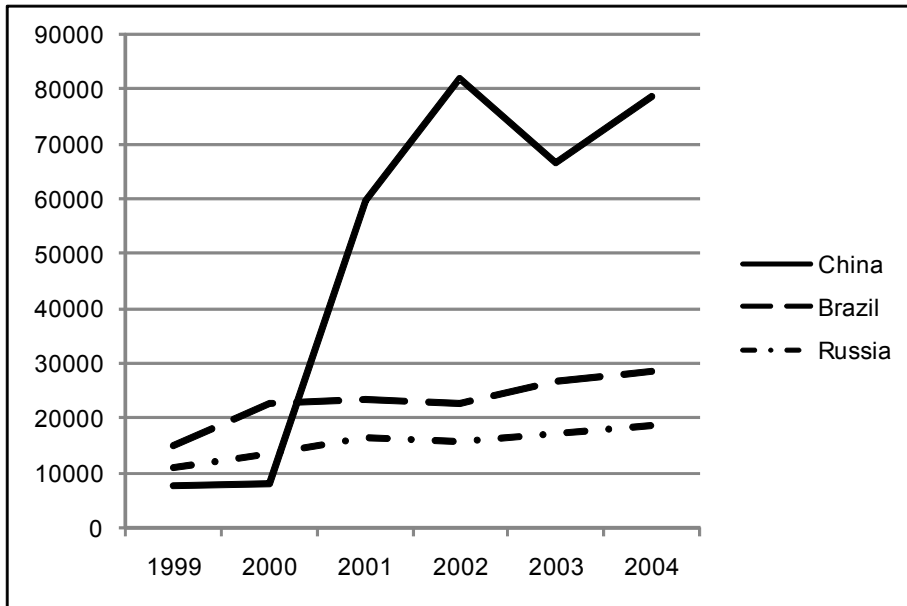
*through July 2005

Exhibit 14 – Example of Products Manufactured by Marcopolo



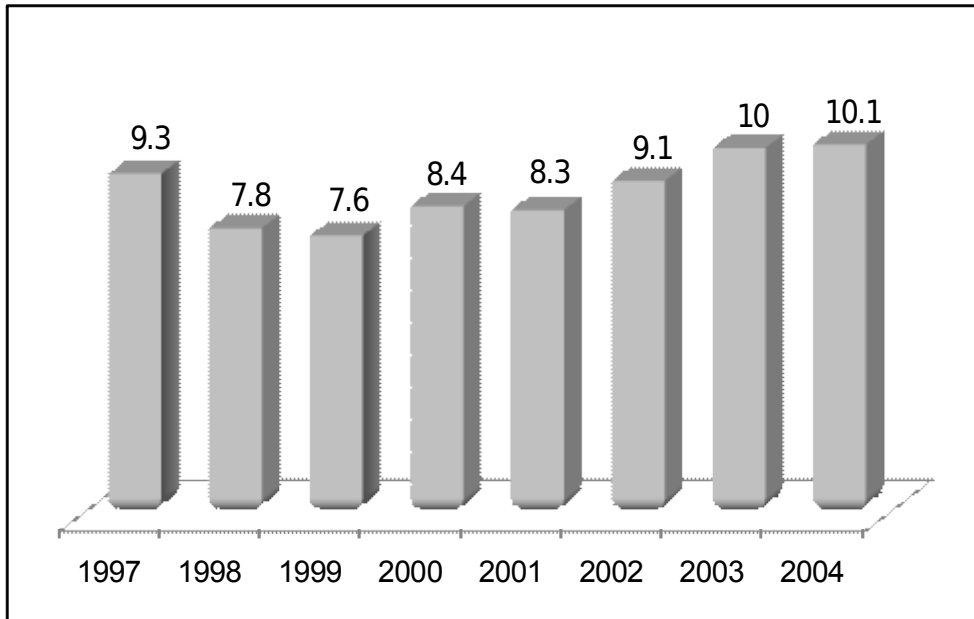
Source: Marcopolo

Exhibit 15 – Production of Buses: China, Brazil and Russia (units)



Source: OICA

Exhibit 16 – China PIB: Yearly Growth (%)



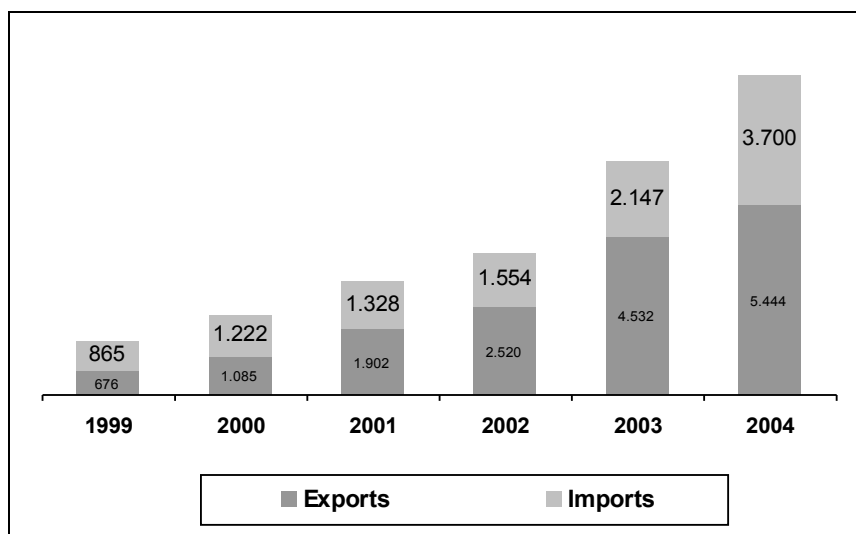
Source: Economist Intelligence Unit

Exhibit 17 – Passenger Traffic by Year and Mode of Transportation (10,000 passengers)

Year	Total	Railways	Highways	Waterways	Civil Aviation
1999	1,394,413	100,164	1,269,004	19,151	6,094
2000	1,478,573	105,073	1,347,392	19,386	6,722
2001	1,534,122	105,155	1,402,798	18,645	7,524
2002	1,608,150	105,606	1,475,257	18,693	8,594
2003	1,587,497	97,260	1,464,335	17,142	8,759
2004	1,767,453	111,764	1,624,526	19,040	12,123

Source: China Statistical Yearbook, 2005

Exhibit 18 – Foreign Trade between Brazil and China (1999-2004) - (US\$ million)



Source: Conselho Empresarial Brazil-China

Exhibit 19 – Brazilian Exports of Vehicles and Parts to China (US\$ millions)

Exports	1997	1998	1999	2000	2001	2002	2003
Parts and other vehicles	23.5	13.1	5.0	47.9	144.4	116.4	324.5
Automotive vehicles	0	0	0	2.3	86.2	33.7	16.8

Source: IPEA/Funcex, based on Secex data.

Endnotes:

¹ The data, supplied by OICA (The International Organization of Motor Vehicle Manufacturers), is not complete since not all countries and manufacturers report their production. Nevertheless, it is estimated that these manufacturers represent more than 90-95% of world production.

² It was only in 1992 that the company again changed its corporate name and adopted the current name “Marcopolo S.A.”

³ *Marcopolo: meio século de uma história*. Caxias do Sul, Conceitual, 1999, p. 9.

Teaching Note

The International Expansion of Marcopolo (A): Adventures In China

Case Objectives

This case aims to provide students with an opportunity to discuss the internationalization process of a very successful Brazilian firm and the specificities of entering a psychically-distant market, China. Instructors can pursue the following specific objectives:

- analyze the several steps of a gradual internationalization process of an emerging economy firm;
- discuss how different internationalization theories may explain the internationalization patterns of an emerging economy firm;
- illustrate the changes in the international trajectory of a firm;
- evaluate the challenges associated to entering the Chinese market;
- discuss advantages and disadvantages of different entry modes in China;
- suggest possible strategies for the continuing internationalization of an emerging economy firm aspiring to achieve global relevance.

Case Synopsis

This case describes the initial steps in China of Marcopolo, the largest Brazilian manufacturer of bus bodies, and the challenges faced by the firm as it enters a psychically-distant market. Marcopolo, founded in 1949, was already a large exporter of bus bodies and had plants in Portugal, Colombia, Mexico, Argentina and South Africa when it entered the Chinese market by means of a licensing agreement. It had at the time between 6 and 7 percent of the global market of bus bodies.

Until its entry in China, Marcopolo exports had not reached the largest markets of Asia and Eastern Europe, due to high freight costs. However, top management believed that to move further – beyond the present markets in the

Americas, Western Europe and Africa – was a strategic imperative for company growth. Asia and Eastern Europe were the largest bus markets in the world, and the leading bus assemblers and bus body manufacturers were already operating there.

The licensing contract signed by Marcopolo in 2000 with Iveco-CBC, a joint-venture between an Italian firm and a Chinese state company, did not permit Marcopolo to have its own plant or to export to China until 2007. However, by 2005 the time came that the company had to make a decision on whether to continue with the licensing agreement or to invest in a plant in China. Several alternatives are examined.

Central issues in this case are: (a) the change in the nature of the firm's internationalization process as it moved from psychically-close markets to a psychically-distant market; (b) the risks faced in the internationalization process; (c) the advantages and disadvantages associated with different entry modes in China; (d) the need to develop experiential knowledge in the Chinese market.

Intended Use

We suggest this case be used in international business and international marketing courses, as well as courses on emerging markets. It portrays the trajectory of a Brazilian entrepreneurial firm from foundation to international expansion, to become a significant player in global markets. The entry in China provides an opportunity to discuss the specific move in the context of the international trajectory of the firm.

The case has been used in graduate programs (regular MBA and Executive MBA). It was also used in shorter training programs with executives from a development bank, a government agency dedicated to promote entrepreneurship, and several firms undergoing internationalization.

Suggested Questions for Class Discussion

The following questions are suggested:

1. How was Brazil able to develop a highly innovative bus body industry?
2. What are the characteristics of the bus industry? What are the characteristics of the bus body industry? To what extent do these characteristics impact the internationalization process of a large bus body manufacturer?
3. What are the country-specific advantages of Brazilian bus body manufacturers?
4. How did Marcopolo build firm-specific advantages? To what extent may these advantages be transferred to other markets abroad?
5. What were the motivations of Marcopolo's managers to go abroad? How did these motivations change over time?
6. How did Marcopolo's management select new foreign markets? Did it seem to be a rational choice or could other factors explain their choices?

7. To what extent does the internationalization process examined in this case follow the predictions of traditional theories of internationalization?
8. Why did Marcopolo's management perceive the entry in China as a mandatory strategic move? Do you agree with them?
9. How did Marcopolo acquire knowledge about China?
10. What risks were perceived by managers?
11. Marcopolo's initial entry mode in China was by means of a licensing agreement. What are the advantages and disadvantages of this entry mode compared to others?
12. How should Marcopolo proceed in its internationalization process in China?

Case Analysis

Depending on how the case is intended to use, some issues may or may not be raised by the instructor. Nevertheless, this analysis covers a broad set of issues that might be considered.

Q1 – How was Brazil able to develop a highly innovative bus body industry?

Brazil has been long known as “the sleeping giant,” because of its fantastic natural resources but recurrent economic crises. In spite of this, the country has had several important periods of growth in its recent history, which established the bases for its recent development. One of these periods was the 1950s, especially during the presidency of Juscelino Kubitschek de Oliveira (1956-1961), popularly known as JK. JK had great ambitions for the country, and an audacious five-year plan. The plan focused on five major issues: energy, transportation, heavy industries, food and education. He was also responsible for the building of a new capital in Central Brazil in order to push the development of the country—thus far restricted to coastal areas—into the interior. The development of a road-based transportation infrastructure that crossed the country was one of his government's major achievements. Also, the successful development of the motor vehicle industry (cars, trucks and buses) in Brazil can be credited to his government. In spite of his achievements, his government substantially increased national debt, which was one of the seeds of inflation in the following years.

JK's government created the basic conditions for the development of the bus industry in Brazil, and within it, the bus bodies segment. Although some of these firms were created in the late 1940s, before such events took place, they benefitted from government policies that not only protected them from foreign competition, but also provided several mechanisms of financing and subsidies that were not previously available. Firms additionally benefitted from the investments in Brazil made by several international bus assemblers.

Thus government protection, incentives, subsidies, and a planned intervention in the economy to develop the transportation industry and infrastructure set the foundations to create a strong bus body industry in Brazil (Exhibit 3).

Q2 – What are the characteristics of the bus industry? And what are the characteristics of the bus body industry? To

what extent do these characteristics impact the internationalization process of a large bus body manufacturer?

The Brazilian bus body industry is an oligopoly, with only a handful of firms (Exhibit 4). Marcopolo is the market leader, with close to 50% market share. Barriers to new entrants in the industry are scale, knowhow, and brand identity. Buying power is high; however, firms in the industry are typically not tied to one specific assembler, but rather serve several assemblers in Brazil and many foreign countries, too. Firms tend to be vertically integrated in terms of their major components. However, Marcopolo developed a very competent group of suppliers for noncritical components. There is a high level of rivalry among firms in the industry.

All the companies' headquarters are located in the South or Southeast of Brazil, an area that received a large influx of immigration, especially Italian, German, Austrian and Slavic. Accordingly, the majority of the group that founded Marcopolo was of Italian origin, as was Bellini, too, the president and the main strategist of the group. Induscar was founded by an Italian immigrant, Comil, by members of two Italian-origin families and Busscar by Swedish immigrants. Italy was well known for the construction of bus bodies, and it was still an important player in 2005 (see Exhibits 1 and 2). Thus, these firms benefitted from their location within Brazil and their European heritage in terms of design and knowhow.

The bus industry is in the process of becoming a global industry. Local players in emerging economies develop joint ventures and strategic alliances with global players. Bus body manufacturers are also engaging in alliances with chassis manufacturers.

Buses are an increasingly used mode of transportation in developing markets, as they substitute more rudimentary forms of transportation. However, assemblers face stagnant or decreasing demand in developed markets, where other forms of transportation are preferred (cars and metro in urban areas; cars, trains and airplanes in intercity and interstate transportation). Therefore, the main markets are in Asia and Eastern Europe.

Customer preferences vary depending on the market. In developing countries, customers value quality, style, comfort; in developed markets, price and resistance to bad road conditions are more relevant. In spite of this, emerging economies also have segments that yearn for quality, style and comfort.

While brand is not an important consideration for the final user, assemblers do consider company reputation and the capacity to manufacture and deliver the product. The Marcopolo brand name does not connote a Brazilian manufacturer and might instead be assumed to be an international product by those that do not know the company.

Q3 – What are the country-specific advantages of Brazilian bus body manufacturers?

Q4 – How did Marcopolo build firm-specific advantages? To what extent may these advantages be transferred to other markets abroad?)

The following table summarizes the two types of advantages that Marcopolo had to start its internationalization process.

Country-specific Advantages (Brazil)
Firm-specific Advantages (Marcopolo)
1. Bad road conditions and poor maintenance.
1. Know-how to deal with bad road conditions.
2. Less-developed country, with a large domestic market; high percent of population belonging to low and low-middle class, with strong use of buses.
2. Scale
3. Low labor costs.
3. Corporate Reputation
4. Product delivered by road to neighboring countries (Mercosur).
4. Lower price compared to competitors from developed countries.

To what extent are these advantages transferrable to other countries?

- Country-specific advantages 1, 2 and 3 are only transferable by means of exporting.
- Country-specific advantage 4 is only available for neighboring countries of Cone Sur.
- Firm-specific advantage 1 is valid for exporting, licensing, or direct investment in countries with similar conditions.
- Firm-specific advantage 2 only applies for exporting to other countries.
- Firm-specific advantage 3 is important in terms of establishing partnerships and joint-ventures in foreign countries, whatever the entry mode chosen by the firm.
- Firm-specific advantage 4 depends on exchange rates.

The advantages listed before depends on which is the competitor with whom the comparison is made. Local firms in emerging markets may have developed similar advantages (e.g. Chinese firms).

There are also country-specific disadvantages. For example, the location of Brazil in South America creates a disadvantage in terms of costs of freight in relation to several markets.

Q5 – What were the motivations of Marcopolo’s managers to go abroad? How did these motivations change over time?

The initial motives that forced Marcopolo to search for international markets are obvious. This is a typical case of market-seeking internationalization (Dunning et al, 1997):

- The company had achieved high market share in the domestic market. Besides government controls to prevent abuse of economic power by large-share firms, the cost of gaining additional share tends to be higher when a company already has a large market share of that market. It is often easier to gain share in new markets.

However, as the internationalization process developed, other motives, such as efficiency-seeking and strategic asset-seeking (Dunning et al, 1997) also appeared:

- Top management saw internationalization as a deliberate strategy to obtain gains in scale, to protect against potential exchange rate problems and stagnation in the domestic market.
- A third motivation that appears in this case is the access to technology and know-how, which seem to have inspired several movements to expand inward.
- There was also the intention to reach more geographically distant markets to overcome disadvantages due to

freight costs to markets outside South America.

- Finally, there was an understanding that internationalization would lead to greater customer proximity in order to offer better after-sale service.

Q6 - How did Marcopolo's management select new foreign markets? Did it seem to be a rational choice or could other factors explain their choices?

The following criteria were used when selecting a new international market for foreign direct investment:

- High export intensity to that market
- Costs of operating in the country should be lower than exporting
- Geographically distant market
- Affinity with the country (culture, language, and business practices)
- Degree of technological development compatible with Brazil's
- Availability of raw materials and components
- Location close other potential markets
- Local government policies favoring FDI
- Few and weak competitors
- Availability of potential suppliers.

In addition, there was a preference to enter emerging markets, because of their higher potential, and because Marcopolo's knowhow to build products that could handle bad road conditions was a competitive advantage.

(Q7 – To what extent does the internationalization process examined in this case follow the predictions of traditional theories of internationalization?)

The first part of Marcopolo's internationalization process followed the predictions of the Uppsala Internationalization Process Model. It is essentially a gradual, stepwise process to geographically- and psychically-close markets (Johanson and Vahlne, 1977). The following table summarizes the timeline of Marcopolo's internationalization.

YearEvent1961First export agreement to Uruguay1964Export marketing group.Export department.Exclusive representatives in the most important South American markets, to offer after-sales service.1986Technology transfer from Japan (*inward* internationalization) 1988Entry in the U.S. market with its own exclusive distributor 1990FDI in Portugal in association with a local private group in order to have access to Northern African markets. 1992FDI in Mexico by means of a joint venture with a state firm, Dina Autobuses, until 1997, to get access to the Mexican and the U.S. market.1997The Mexican operation turns into a sole venture.1997FDI in Argentina by acquisition of a local company. 1998The Mexican operation becomes a joint venture with DaimlerChrysler2000FDI in South Africa to access the south part of the African continent. 2001FDI in Colombia by means of a joint venture with a local firm, to reach the Northern part of South America and the Caribbean.2002Operations in Argentina are interrupted with the Argentinean crisis. The choice of markets follows the logic of psychic distance (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). The concentration of operations in Latin America in the first steps of internationalization is a strategy often followed by firms from the region (see, for example, Robles, 2000; Martínez et al., 2004). In fact, Rugman (2005) showed that most MNEs, even those from developed countries, tend to concentrate their operations in their regions of origin.

Besides the logic of psychic distance, however, there is also a strategic plan behind the decisions taken by Marcopolo's management. Production facilities were established in countries that permitted to cover regional markets not easily accessible from Brazil, because of freight costs or because they were protected markets. Whether this is an emergent strategy or whether it was deliberate since the beginning is impossible to determine.

Nevertheless, the move to China shows a disruption in Marcopolo's internationalization process. Although it had a few experiences of licensing before, it never licensed a major competitor, such as Iveco, a member of the Italian group Fiat. In addition, Marcopolo did not have previous experiences with China, since it did not export to China. Also, most of the criteria for market selection did not seem to be used by management when taking the decision to enter China. Therefore, the entry in China represents a rupture in the international trajectory of the firm. It seems that the firm, from that point on, does not follow fully the steps envisaged by Uppsala scholars, as in the previous stages of internationalization.

Q8 – Why did Marcopolo's management perceive the entry in China as a mandatory strategic move? Do you agree with them?

Several motivations can be identified in the Marcopolo case:

- Market-seeking – The entry in China had as its main goal to reach an extraordinarily large market, which was expanding rapidly. As Martins, the vice-president, mentioned, Asia was the largest market for buses. Therefore, the main motivation for Marcopolo's entry in China was not low labor costs – an efficiency-seeking

motive – but rather market-seeking.

- Bandwagon effect? – It also seems that there was a pressure from competitors' moves. In fact, Marcopolo was a late entrant in the Chinese market; the largest global assemblers were already there (such as DaimlerChrysler and Volvo, both with joint ventures), and there was a large number of domestic competitors, most of them with average to high quality.
- Global Sourcing – The concept of global sourcing seemed to come later to Marcopolo's top management. The firm had a tradition of vertical integration and concentration of production in its Brazilian plants, which is quite common among manufacturers in Brazil. The idea of producing components in lower-cost countries and of developing a global supply chain seemed to be new to the firm's management.

(Q9 – How did Marcopolo acquire knowledge about China?)

The following table presents the sequence of steps followed by Marcopolo to gain knowledge about the Chinese market.

YearEvent1995Management starts to consider China as a potential target for FDI1997CEO Paulo Bellini visits China19971999Paulo Guarese, Executive Manager for Special Projects, is in charge of studying the Chinese market; research, trips to China and discussions within the firm.

2000A license agreement is signed with Iveco – CBC.

There are essentially two types of market knowledge: objective knowledge and experiential knowledge (Johanson and Vahlne, 1977; Penrose, 1959). Most of the knowledge acquired by Marcopolo before entering the Chinese market was of an objective nature. Experiential learning in China followed market entry. After licensing Iveco-CBC and already planning for a future FDI in China, Marcopolo established a commercial office in Changzhou with the intention than to gain experiential knowledge of the local market and to establish relationships and guanxi. While the office supported the activities of technology transfer and technical assistance, it also permitted Marcopolo to develop its own links with Chinese officials.

(Q10 – What risks were perceived by managers?)

The decision to enter the Chinese market and the decision to sign a licensing agreement cannot be explained by the Uppsala model. To the contrary, economic theories are more useful to gaining an understanding regarding this move. Transaction costs analysis (e.g. Williamson, 1983) suggests that two types of variables play a role in the decision as to whether to invest in a foreign market or not: environmental variables (complexity and uncertainty) and behavioral variables (opportunism and bounded rationality).

- Complexity refers to elements in the environment that are not easily understood. Accordingly, in the case of Marcopolo, the Chinese environment was perceived by managers as highly complex (including the legal and

the political systems and cultural aspects).

- Uncertainty relates to the lack of knowledge about the consequences of possible actions. Marcopolo managers lacked experiential knowledge about the market and were perfectly aware of the need to develop relationships and guanxi. Iveco was already experienced with operations in China; the company had entered the Chinese market in 1985, fifteen years before signing the licensing agreement with Marcopolo. Therefore, a licensing agreement with Iveco reduced the perceived uncertainty of the environment.
- Opportunism refers to “a lack of candor or honesty in transactions” (Williamson, 1983, p.9). The perceived risk of opportunistic behavior is augmented when dealing with partners from a different culture. Marcopolo’s management perceived piracy and opportunistic behavior of a potential Chinese partner as the most important risk faced by the firm in China. The deal with Iveco reduced the perceived risk of opportunistic behavior because Marcopolo knew Iveco’s operations in Brazil and the firm’s culture. Iveco, a subsidiary of the Fiat group, with headquarters in Turin, Northern Italy, had a large operation in Brazil where it produced trucks, buses and light commercial vehicles. Fiat itself was one of the market leaders in the Brazilian automobile market. Therefore, there was a lot at stake for these firms not to behave honestly with a large Brazilian firm. In addition, Marcopolo’s cultural origins are Italian, and the city where the firm has its headquarters, Caxias do Sul, in Brazil, was founded by Italian immigrants. The Italian culture was therefore very familiar to Marcopolo’s managers. Therefore, managers felt they could trust Iveco.
- Bounded rationality implies limits in managers’ ability to perceive alternatives and to anticipate future events. When bounded rationality is combined with uncertainty and complexity, managers tend to be more cautious and to prefer alternatives that offer less risk (Williamson, 1983). In the case of Marcopolo, the alternative of a sole venture (less risky) was not available because of government restrictions. A joint-venture with a Chinese company seemed more risky than a licensing agreement with an Italian firm from a similar cultural background. This is why the Iveco offer seemed very attractive to Marcopolo’s top managers. Also, the negotiation was between Marcopolo and Iveco, and not with the Chinese partner.

Q11 – Marcopolo’s initial entry mode in China was by means of a licensing agreement. What are the advantages and disadvantages of this entry mode compared to others?

As to the licensing agreement itself, there are other relevant aspects to consider:

- It is not clear to what extent Marcopolo took the necessary actions to prevent opportunistic behavior from its partners. Rugman (2005) argues that it is especially difficult for a firm to use contracts as a means of self-protection in a licensing agreement.
- The licensing agreement between Marcopolo and Iveco-CBC included training and technical assistance. These

conditions meant that Marcopolo had to transfer tacit knowledge to the partners. This is not the case when a firm enters a foreign market with FDI.

- In addition, by 2005, China was still seen as the “land of piracy”, with insufficient protection to intellectual property. There was a high probability that licensing agreements with foreign firms not to be respected.

The following table summarizes the advantages and disadvantages of the licensing agreement:

Advantages	Disadvantages
Opportunity to learn about the market before making further resource commitments	Slow entry in the Chinese market
Time to develop relationships and build guanxi	Risk of opportunistic behavior by one of the partners (Iveco, CBC)
Opportunity to know competitors, especially local competitors.	Lack of control over the operation.

Alternative Strategies in China

Q12 – How should Marcopolo proceed in its internationalization process in China?

Once Marcopolo's contractual obligations with Iveco-CBC have been fulfilled, the company should implement a new business strategy in the Chinese market. The option of acting alone, through a sole venture, was not yet possible since (i) operation by a foreign company in the auto body industry was not permitted and (ii) the Chinese Government had not given any signs that this rule would change in the near future. Thus, at the time the assumption was that operating in China could only happen by means of a joint venture. As a result and as outlined in the case, Marcopolo had the following remaining options:

1. A factory in partnership with CBC Group

The initial idea was to establish a components factory to supply the CBC group, whereby Marcopolo would be the major stakeholder, with 75%, and the CBC Group would be a minority participant with 25%. The plant would later manufacture bodywork, with the end of the Iveco-CBC contract in 2007. However, soon thereafter the Marcopolo management came to the conclusion that it had chosen the 'wrong partner.' Iveco itself was disagreeing with the Chinese partner and the plans to manufacture buses for Iveco-CBC had thus far failed to get off the drawing board. As such, this alternative can be ruled out since the experience was all but positive.

2. Partnership with the MNE chassis builder

Another possibility would be to partner with a multinational chassis builder. This type of joint venture has the advantage of resulting in a quasi-vertical integration, without the need for major investments in fixed costs. Another positive aspect of this option was the fact that Marcopolo already had experience with this type of partnership. However, the potential partners had either already entered the market in joint ventures with other coachbuilders (Chinese, for the most part), or were not anticipating entering this market. Furthermore, a joint venture with a multinational that did not as yet operate in China would you need a Chinese partner (i) to meet government requirements and (ii) for purposes of guanxi. Penetration of the market by a late entrant would not, however, be easy.

3. Partnership with a Chinese chassis builder

Another possibility suggested was to seek a partnership with a Chinese chassis builder that had already reached an appropriate level of quality in order to form a joint venture; under this scenario, the partner would handle chassis manufacturing and Marcopolo would handle the bodywork. The main advantage of this alternative, in addition to the advantages afforded by a joint venture, as indicated above, was that the Chinese partner would already have guanxi and would know the market. The disadvantages were with respect to (i) the potentially opportunistic behavior of the partner, (ii) the difficulties in dealing on a daily basis with a company from a culture so different from the Brazilian, and (iii) regional protectionism, were the company to stick to a specific vendor.

4. Horizontal partnership with a Chinese body manufacturer

Another alternative was to develop a partnership with a Chinese chassis manufacturer. The main advantages of this type of joint venture are the creation of economies of scale and an acceleration in the learning curve that would result from the sharing of each partner's specific skills. This strategy would address the problem of the legal requirements in relation to a foreign company operating in China and would enable the company to retain the flexibility to work with any type of chassis. Finally, taking into account the quality of the chosen partner, such an alliance would solve the problem of connection to the market via guanxi. Marcopolo had, however, thus far failed to identify a possible partner. Also remaining were problems related to the potential opportunistic behavior of the partner and difficulties in dealing with a culture so different yet in so close a relationship, where transfer of technology and know-how would be inevitable. Also unclear was whether it would be possible to supply coachbuilders located in other districts or regions of China or whether the problem of regional protectionism would remain.

5. Leaving China

There were still many other markets to explore in Asia that did not present the same degree of complexity or the same level of uncertainty (especially with regard to laws and the legal system) as did China, and where Marcopolo could establish an operations base. Marcopolo faced the dilemma of being a late entrant and high costs to enter the Chinese market.

Epilogue to the Case

The Iveco-CBC joint venture was unsuccessful, and Iveco lost millions of dollars. The products never got off the production line. Marcopolo, however, did not lose any money because it had already received its part of the deal (12.5 million dollars). Marcopolo later opened a subsidiary in China to manufacture components (Marcopolo Autoparts & Components). The goal was to have a presence in China, not to make money per se. In addition, Marcopolo started a joint venture in India with the Tata Group, which became very successful.

Vice-President Martins explained how the Chinese licensing experience ended, in a speech to an Executive MBA class in 2007:

“The business failed to prosper. A quarrel between the Italians and the Chinese began. They accused the Chinese CEO of absconding with US \$20 million. We learned that he had begun lending money to family and friends: 500,000 dollars here, 1,000,000 dollars there. The money evaporated. Thus ended the joint venture. Soon thereafter we began negotiating a contract with another Chinese company to manufacture of minibuses and high-deckers. Negotiating the contract took two years; the Chinese are in no hurry: for them, a second, a minute, ten years, a century—it's all the same thing. They have 6,000 years of history, so they don't rush. After the deal closed, the Government changed the rules for the industry: the minimum investment for the automotive industry was no longer 50 million dollars, it was 100 million. We intended to invest 38 million. With US \$100 million we could build three factories equal to that. Then we ended the negotiations. We started MAC (Marcopolo Autoparts & Components) to produce components, assemble prototypes, and keep an eye on China to see how things would develop. We did this because the Chinese are aggressive competitors. They pay their employees very little; there are no social benefits; and their costs are very low. You can't say that the Chinese mask costs: they have costs that are 30% below the others. That's just the stark reality. And they are evolving, technologically speaking. China is the world's largest market. So while they manufacture 70,000 buses, they have over 50 manufacturers. So having a factory in China to sell in China is suicide because the returns are insignificant: profits are low or non-existent. Going forward, if we were to open a factory in China, it would be for export—and not to sell in the Chinese market.”

Other Relevant Information

This case is followed by a second case “The international expansion of Marcopolo (B): Manufacturing in the ‘Other Side of the World”, which discusses Marcopolo’s internationalization until early 2011. The second case has also been submitted to the Balas Conference.

The authors had no previous relationship with the firm. The two cases are based on several interviews conducted with members of the firm’s management team from 2004 to 2010 and secondary data from several sources.

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