

## **Why International Ventures Fail: Malpractices That Are Ignored in the External Environment Assessment**

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*Many businesses that try to obtain competitive advantages through unique resources of other countries or just want to enter a new foreign market fail, even though they follow sophisticated planning procedures and take the decisions that are based on a thorough assessment of a local external environment. This paper tests the hypothesis that there are more factors to consider than regular approaches propose – malpractices that are used in target countries, their types and scale of utilization. The initial qualitative stage of the research, in frames of which 22 representatives of business and government agencies have been interviewed, revealed 5 malpractices that can cause failure of a company that enters a foreign market.*

**Field of Research:** International business, Strategic management.

### **1. Introduction**

Many companies, that either reach a certain stage of maturity, or specifics of their area of operation dictate that, attempt to internationalize their activities. The internationalization process can take many forms: it can be exporting or licensing, franchising or contract manufacturing, direct investment or strategic alliances, owned subsidiaries or portfolio investments (Ajami, Cool & Goddard, 2006). Both the business practice and the book knowledge recommend in such cases the similar approaches to the external environment assessment that can have some differences, but still are very close.

These approaches can be seen either in the internal standards of business planning that are used by companies in planning and decision-making processes, or in books and articles dedicated to the problems of marketing, strategic management, international business and risk management (discussed in the Literature review section).

However, the business practice shows countless examples of unsuccessful attempts to enter an international market, though businessmen followed the existing formats of the external environment assessment. Therefore, the research problem under consideration was in existence of factors that can cause a failure to realize a formally correct procedure of entering a foreign market. The major research assumption was that among these factors there were malpractices - unconventional actions or phenomena that are not generally accepted business practices (and thus they generally are not included into the regular analysis framework). The motivation behind the research was to reveal such

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malpractices, systemize and classify them, understand to which extent they are used in business life and thereby make a contribution to the body of knowledge in this field.

The paper is organized in traditional form: Literature Review section gives an overview of sources on the studied subject, the four-phase research strategy is described in the Methodology section (the paper presents the results of the first phase), the major research results are provided in the appropriate section and are represented with summaries of five cases that had been described by survey respondents, Conclusion summarizes the outcomes of the research and provides limitations of the study.

### 2. Literature Review

A quick overview of monographs and textbooks dedicated to the business planning shows that the most common approach is to implement in the frames of the external environment assessment some formalized techniques (like PEST- or SWOT-analysis), or to analyze the external environment's major components with a help of a limited number of criteria (e.g. Ajami, Cool & Goddard (2006), Blackwell (2004), Friend and Zehle (2004), Paley (2004) and some others).

The works dedicated to strategic management or international competition (e.g. Ansoff (2007), Coate (2005), David (2011), Mourdoukoutas (2006), Porter, M.E. (2008), Sadler, P. (1993), as well as many others) and the marketing-centered works (e.g. Caslione and Thomas (2000), Curry (2008), Moutinho and Chien (2007) and some others) propose a similar approach - a set of analytical instruments and a limited number of formalized criteria.

The above mentioned schemes of analysis look convincing and quite solid, but it appears that some factors that can determine the important decision of entering a new country market or establishing of production facilities abroad usually are not paid enough attention. In most cases (both in real-life planning routine and in monographs or textbooks) these factors are completely overlooked and only in some cases these factors receive a light and quite formal coverage. Brown and Gutterman (2003) specify that an international business plan should contain a section called "Special Topics", which describes some important matters – risks and local regulatory procedures. The risks description includes a possibility of political changes that can affect the business, risks of theft, product liability claims and similar. The risk of property expropriation just mentioned and not explained in details. The regulatory matters are also discussed in brief and only with the assumption that officials use them in a proper way.

Some authors admit the importance of local administrative, political and legal systems, as well as cultural peculiarities in the analysis of external environment (Feldman and Santangelo, 2008). However, the first three factors are described from the perspective of fair usage of the existing regulations and the cultural aspect is covered from the point of view of cross-cultural communications, codes of behavior and establishing relations of trust between the international partners. However, some attention is dedicated to risks and vulnerability of these relations.

Carté and Fox (2008) discuss some culture-specific malpractices (like nepotism, very flexible ethical principles and even bribery) that can be considered as inappropriate in the civilized business world, but their area of expertise is rather cross-cultural

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communications and not strategy or business planning. In these terms their input into the discussion is limited.

Some contribution is also made by Luo (2002), who thoroughly studies the implementation of such malpractices as direct corruption and usage of the personal networking as an advantage in a competitive rivalry in an emerging market. He also studies the peculiarities of the regulatory environment and dealing with emerging market's governments and provides several case studies describing the actions of several multinational companies in China, Mexico, Brazil and Russia. Though, these important topics are covered, his approach is more ethical and not business-centered.

As expected, the standard external environment assessment procedures and publications in the studied subject area lack the overview and analysis of some factors that are usually called "malpractices" – unconventional actions or phenomena that are not generally accepted business practices.

### 3. Methodology

Though, Denzin & Lincoln (2008) note that qualitative methods are frequently perceived as giving marginal input into contemporary knowledge it was decided that research would be conducted in several phases and would use mixed methodology. First phases would use qualitative methods and would be aimed on verifying the existence of the malpractices phenomena and then on the attempt to reveal as many malpractices, as possible. Malpractices then would be systemized and classified. Further, the research would concentrate on quantitative analysis of malpractices' usage in one selected country and comparative analysis of malpractices' usage in several countries. The developed research approach was logically divided into four phases:

**Phase 1: Initial testing.** At this phase the hypotheses was verified with a set of semi structured interviews that according to Creswell & Clark (2007) is a good instrument for this task, which has no special quantitative requirements to the sample size in frames of the selected research strategy (thus, it was decided to limit the initial testing with 20-22 interviews). The purposeful sampling procedure was used: the respondents were selected from the population of entrepreneurs (that were known to participate in international operations) and state officials (that were responsible for taking decisions that can affect business activities). The research was focused on the acquisitions of evidences that malpractices existed and could be encountered. This paper describes the results of Phase 1.

**Phase 2: Database expansion.** The phase will be focused on increasing the number of revealed, described and systemized practices. It will also rely on the semi structured interviews and will provide a framework for further quantitative studies. It is planned to increase the number of interviews to 130-150 and to achieve better geographical coverage.

**Phase 3: Sample quantitative study.** A country will be selected for conducting a research of malpractices usage. The aim of the research will be to study the phenomena under consideration in terms of which malpractices are the most frequently used, motivational and ethical aspects, industry localization of malpractices, correlation between size of business and malpractices being used, etc. The detailed strategy for

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this phase will be developed later on, though the prevalence of quantitative methods in this case is obvious.

**Phase 4: Global comparative study.** The research will be focused on regional differences in malpractices implementation.

For the Phase 1 the following hypotheses had been formulated:

H1. The existing approaches to the external environment assessment don't cover some important aspects. Among them can be application of malpractices in foreign countries that are selected for expansion.

H2. These malpractices are widely used, not only in relations between business and authorities, but also in the business-business relations.

The general intent of this first phase was to confirm the existence and usage of malpractices in business that would allow later to systemize and classify them and then to carry out quantitative studies that will give a clear picture of the nature and regional peculiarities of malpractice broadening in this way the body of knowledge.

As it was planned, in frames of the research's Phase 1 a series of semi structured interviews with 22 respondents had been carried out. Twelve of them represented the business community, while other ten represented governing authorities of different level (municipal, regional and federal). Ten respondents represented Russian Federation, two – USA, two – Kazakhstan, two – India, two – Algeria, one – Pakistan, one – Morocco, one – Vietnam and one – Ukraine. In the frames of these informal interviews the respondents were asked to provide stories (that were not older than 10 years) about failures of foreign businesses that tried to enter the market of their home country, or about their personal experience of such attempts. The interviews had been conducted in the first half of 2011. The stories obtained out of these interviews were systemized and presented in the form of mini-cases in the Research Results section of the paper.

## 4. Research Results

A qualitative survey in the form of semi structured interviews revealed five cases of malpractices implementation. All respondents shared their experiences of malpractices usage. As the stories had much in common, it was decided to generalize them into five cases. Below we provide a brief description of these five cases - five stories of how a business-project can go not as planned, as a result of neglecting the broader and in-depth study of the external environment of the target country.

**1. "A Ghost city".** Let us imagine that a company operating in the field of manufacturing a good that is very sophisticated in its nature (say, cranes, or elevators, or even automobiles) is trying to evaluate all the pros and cons of establishing their own production facilities in a new country. In accordance with the above mentioned procedures, the preliminary business-plan has been prepared, all the regular factors of the local external environment have been studied, as well as other routine procedures were carried out. Now, the time comes for a field trip in order to clear the last details and look for a local logistics company that will handle the constant flow of parts and components that are planned to be transported to the new production site from other countries. The company reasonably wants to find a logistics expert with its own

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container terminal, which will ensure the speed and accuracy in delivery, safety of the containers and the proper rate of control of the supply process.

As a result of the selection process the two logistics companies are short-listed. One of them admits the absence of the container terminal in its ownership. When another company is asked about the same matter, the inquiring party receives a positive response. The manufacturer's request to have a look at the terminal's site after a short pause gets an invitation for the next day to have a visit to "one of our sites, we haven't decided, which of them". The next day the manufacturer's representatives are picked from the hotel and are brought not to the best container terminal in the world, but still to a satisfactory facility. They are escorted to the director's office, get acquainted with the site's director, receive a very warm welcome and finally have a walk along the territory. What they have seen seems enough to make the decision.

A year and a half later, with the start of production process the manufacturer experiences constant problems with logistics and after another half a year finally understands that the logistics company that has been chosen doesn't have the required facility at its disposal. The manufacturer carries out another selection procedure and finds another logistics partner, but additional costs that resulted from the logistic problems and violation of the due dates for several manufacturer's contracts seriously affected the overall economic effectiveness of the project.

Why and how could this happen? Actually, the selected logistics company didn't have its own container facilities. The resource they did have was the friendship of the director of the container terminal, which belonged to another company. This person was not satisfied with his remuneration and was thinking of leaving the company, so he happily accepted an opportunity to show the terminal he was managing (for a small fee) and pretend it belonged to the logistics company that was later selected by the manufacturer.

Such scheme is used in different forms and normally doesn't even have any hostile intentions as its basis. The possible future partner tries to do its best in order to ensure the cooperation with a big client. In the given case the idea of the logistics company management was to pretend that the company has its own container facilities, to convince the manufacturer to sign a cooperation agreement and while the manufacturer's production facilities were under construction to purchase (or probably to build their own) a container terminal.

**2. "Evil personnel"**. Once again a manufacturing company is looking for an opportunity to place a production facility in a new geographic region. From several countries under consideration the choice is made for a country with a socialist past, quite qualified labor force that still costs much less than the labor force in the neighbor-countries. The field mission organized prior to the final selection confirmed that from the point of view of the labor force's costs/labor quality ratio the selected country is above the comparison.

After half a year from the moment of putting the production facility into operation the management in the manufacturer's headquarters realizes that the costs of lost materials, damaged instruments and equipment, even the consumption of paper and other office merchandise were extremely high exceeding the planned figures by several times. Several auditors that were sent to the production site reported that the practice of

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stealing everything that can be stolen is widely spread among both the office employees and the labor force.

What was the reason for such an “evil” behavior of the employees? The level of salaries they received was just slightly above the average for this country, so that was definitely not the issue of motivation.

Further research revealed that shocking transition from socialist economy (with low levels of salaries, but fixed prices) to capitalist economy (when salaries grew slower than the prices and business didn't know anything about the social responsibility) resulted in evolving the defensive mechanism by employees– they were compensating the perceived low level of salaries by stealing. The motivation program and general salary increase were introduced and it cut the excessive consumption of materials, instruments and office merchandise to normal figures. However, after this the labor cost reached the average value for the geographic region.

**3. “We just care for your employees!”.** Let us assume that the manufacturer went through all the preliminary stages, managed to overcome all the problems of starting the production process and distribution in a new external environment and all the processes seem to be running as they were specified. After several months of production facilities functioning they become a subject of constant inspections from the side of numerous local controlling authorities. One after another, the production site and the office of the manufacturer are visited by representatives of fire inspection, engineering inspection, medical-sanitation inspection, labor inspection, tax inspection and several others. Every visit finishes in the same way – the inspecting authority fines the manufacturer for violating several sections of the appropriate instructions. Arguments that the same inspections approved and sanctioned the design projects of production facilities and office are not accepted. The manufacturer tries to settle things down in the frames of non-court appeal against the fines, but the appeals are rejected. Then the manufacturer tries to cancel the fines through court decision, but loses all the cases. After that there is no other option, but to pay the fines.

After another quarter the visits of all the controlling inspections repeat with similar results - unfair fines, no chance to defend the company's opinion, payment of the fines. The situation continues in all the next quarters leading to constant additional costs that were not calculated in the initial feasibility study of the project.

The practice discussed above has a simple nature. The constant visits of different inspections armed with difficult to understand instructions and manuals that contradict with each other and leave enough space for a subjective judgments were nothing more, but attempts of extortion. The situation was even worse, because the members of inspections were doing this not on their own, but with the cover of their superior management. The superior management in turn had a full support from the court employees and judges. Such institutionalized corruption forces the victims to pay a “fee” personally to the inspections that allows decreasing the costs. The “fee” is then distributed between the members of the inspecting team, their supervisors and court employees and judges.

The existence of such a practice hadn't been revealed at the planning stage. If it was, the top management of the manufacturer could consider entering another market and placing the production facility in another country.

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**4. Customs say “Yes”, customs say “No”.** Let us have a look at our manufacturer again. As in previous cases, all the preliminary planning stages have been passed, a decision has been taken to place the production facility in the specified country.

During the initial stage of the project when the production facility was put into operation the manufacturer had only some minor problems with customs in a form of delays with the document processing, but they were speedily solved after the manufacturer's representatives explained the customs officer that a new production facility will bring the new jobs to the region and will make the local life better in a lot of other ways.

A lot of problems have arisen with the launch of the production process. As parts, components and other materials that are used in the manufacturing process are brought to the country from abroad, all of them have to pass through the process of custom clearance. And every time a new shipment arrives at the border the customs either “loses” the documents, or needs to check every container for contraband, or calculate the customs value of the components in a way to maximize the customs dues.

This time the explanations about the importance of the production facility to the citizens of the country don't work. Every time the manufacturer is told that nothing can be done, that this or that action is done in accordance with the internal regulations and the laws of the country. As a result, the manufacturer bears financial losses for the violation of the contracts' due dates, usage of the customs warehouses, additional fines and similar.

Once again, such behavior of the customs officers can be explained as an attempt of extortion. When the officers understand that the construction of production facilities will cause a constant flow of components through the customs, they give the green light to all the shipments of equipment required for the production site and when the possible transaction costs of moving the plant to another location rise, they switch on the red light and start to cause trouble hoping to get a bribe from the manufacturer.

**5. You have built an exemplary business!** Let us again return to the example of the manufacturing company. It has passed all the hardships: troubles with an unreliable logistics partner, invasion of the inspecting authorities, troubles with customs and strange behavior of the personnel. All business processes are fine-tuned, the client base is built, the sales are growing – in other words, the business prospers.

At a reception at the mayor's office the manufacturer's local director is acquainted with a very successful local businessman. During the informal conversation the latter expresses his admiration on the success of the manufacture's business, telling that he knows how it is difficult to run a business in his country. At the end of the conversation the businessman invites the director for a dinner.

During the dinner they discuss all the barriers that make the life of any company, especially the foreign one, so difficult in the country and in the end of the meeting the businessman offers some minor investments and his services in solving “delicate” problems with state authorities and inspections in exchange for a 10-percent participation in the manufacturer's local business.

The director reports about this strange proposal to the manufacturer's headquarters and receives a decisive rejection. The local businessman being informed about the decision expresses his regrets and promises to return to this proposal in several months. The

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next several months the manufacturer encounters the same problems that he had before, but on a much wider scale. Then the local businessman approaches the manufacturer's representatives and once again proposes to solve all the problems, but this time for the 20-percent share in the local business. This "generous" proposal is rejected again. After that the intensiveness of inspections doubles, at the apartments of one of the manufacturer's leading local managers drugs are found and he is arrested, the manufacturer's warehouse is put on fire. The extreme pressure continues until the manufacturer agrees to sell his local business completely to this businessman at a very low price, as there are no other contenders for it.

The situation described above is an example of a direct attempt to expropriate business. In case the manufacturer agrees for the first proposal, the business can be taken from him even with lesser efforts, as the "partner" tries to place his own trusted personnel into the business. Usually, such full-scale war ends either with death of the successful business (if a foreign businessman fights to the end), or in the way described above. Local "businessmen" are in advantageous position, as they are free from the generally accepted ethics principles and have established binds with corrupted authorities.

The results of the first phase of the research allow us to make the following conclusions:

1. The evidences in favor of the first hypothesis had been found – the described cases provide examples of malpractices that are not taken into the account during regular external environment assessment.
2. Though, we cannot provide evidences that can describe the extent to which the revealed malpractices are used, the provided cases describe interaction not only in the "business – state institutions" interrelations, but also in the "business – business" and "business – employees" pairs that proves the second hypothesis of the first phase of the research.
3. Some approaches to systematization and classification of malpractices are already obvious after the realization of the first phase – malpractices can be classified and grouped by (with respect to):
  - *object*: what is the object of the malpractice - another business, government body, institution;
  - *subject*: *who is the person* (institution) that initiates the malpractice;
  - *participation of a third party* (intermediary): involvement in a malpractice of a party other than subject and object
  - *direction of impact* (internal or external): what is affected by a malpractice – business itself, some other business or institution outside it.
4. The described cases compels us to study the subject not only from the quite narrow international business point of view, but to study it in the broader context of ethics and sociologic studies of corruption making in this way an additional contribution to the appropriate areas of knowledge.
5. All the described cases illustrate the drawbacks of the existing approaches to the external environment assessment. It is absolutely clear that in order to overcome them the regular formal study of the external environment when making decision of entering a foreign market in this or that form should be extended with:

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- Comprehensive study of historical background – the presence of social cataclysms in the closest past of the country can be a cause of wide spread of malpractices.
- Comprehensive study of cultural traditions from the ethical standards point of view, as some authors (e.g. Carté and Fox, 2008) believe that adoption of wider ethical standards is the cause for approval of some malpractices.
- Thorough scouting trip – that will allow not only to get a quantitative information for the business planning procedures, but rather qualitative information on how hard it will be to implement the developed business plan.
- Establishing contacts with local expatriate community representatives – it will also help to acquire qualitative information on the country under consideration.
- Thorough study of all documents provided by a potential local partner (in case of any hesitations it is advised to inquire about the company at local chamber of commerce and law enforcement agencies) – it can save the company from entering into the relations with an inappropriate partner.

## 5. Conclusion

Hypotheses formulated for the first phase of research were confirmed – malpractices exist, they can be witnessed in “business – state institutions”, “business – business” and “business –employees” interrelations. This forms a good basis for the next phases of research.

To summarize the immediate application for business, though, many authors believe that trust resting on such corner stones as reliability, integrity and fairness (Zaheer, McEvily & Perrone, 1998), or probability that partner will follow the commitments (Anderson and Weitz, 1989), or willingness to trust each other (Aulakh, Kotabe & Sahay, 1996), we believe that the initial planning phase of any international endeavor should be completely free from trust. The cautious approach and double-checking of everything can be the factor that will ensure the appropriate selection of a new market or a place for new production facilities and thus will guarantee the long-term success.

As per limitations, the first phase of research can be characterized by a quite limited scale of study due to its purpose – we cannot say at the moment that the above mentioned are the major malpractices, or that we formulated their full list. It was an exploratory initial stage with the goal to confirm the existence of phenomenon, its results will be widened by further studies described in the methodology section of this paper.

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