Motives for offshoring

A qualitative case study of three Swedish companies

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Abstract

This thesis will analyze what companies main motives have been regarding their decision to offshore; either their whole production or only parts of it. The emphasis will be put on the following motives: enter new markets, cost-efficiency and closeness to markets, since they are the most commonly used in the literature. To be able to answer our purpose we have chosen to use a qualitative method by interviewing three companies within Jönköpings County, namely; Becker-Acroma, Sapa Profiles AB and Nefab.

The basic structure of the world economic map consisted of a core and a periphery, where the raw materials were provided by the periphery to the core, which in turn produced the final consumption goods. However, trade patterns have changed and the international structure of today’s business environment combined with advanced communication systems has created an environment where offshore markets have become more accessible.

After conducting the qualitative research, we have seen that the motive for offshoring differs in the long- and short run. A general pattern is evident in the short run as the interviewed companies have offshored, in order to follow their customers as they have moved their production abroad. The reason why companies follow their customer is in order to supply them more efficiently at the foreign market, rather than exporting the goods from Sweden. However, in the long run cost-efficiency becomes more important for a company, since the investigated companies will not stay in a market that does not generate any profit.
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Sammanfattning


Den ekonomiska strukturen i världen har under många år bestått av ”en periferi” och ”ett centrum”, där periferin förser centrum med råvaror som efter att bearbetats till färdiga produkter förs ut till konsumenterna. Till följd av avancerade kommunikationssystem och ökad globalisering har vi dock i dagens läge en mer sammansatt struktur som ger större utrymme för utlandsetableringar än tidigare.

Efter att ha utfört den kvalitativa undersökningen har vi sett att anledningen till utlandsetableringar varierar beroende på om man ser det ur ett långt- eller kortssiktigt perspektiv. Ur det kortsiktiga perspektivet kan vi fastslå att motivet har varit att följa efter företagets kunder då dessa har valt att etablera sig utomlands. Anledningen till att företagen väljer att följa sina kunder, har varit att även efter flytten kunna förse dem med varor och tjänster på ett mer effektivt sätt, vilket inte hade varit möjligt att göra från Sverige i form av export på grund av för höga transport- och andra interaktionskostnader. I det långsiktiga perspektivet har det visat sig att kostnadseffektivisering har fått ökad betydelse, då företagen inte stannar i en marknad som inte genererar vinst.
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1 INTRODUCTION

The main aim of this chapter is to first present the background about the chosen subject and establish the purpose of the thesis.

1.1 Background

Every era has a special word or phrase that it will be know for in the years to follow, the buzzword for the end of the second millennium was globalization. The explosion of globalization started in the beginning of the 1990s, since the number of books and academic papers with the words “global” or “globalization” had increased dramatically compared to the 1980s. Nevertheless, ever since the second millennium there has been an extraordinary increase in the number of globalization headings, the number has reached up to several hundred a year. The worldwide recognition that something fundamental is occurring in the world economy is a result of the sudden increase of awareness in globalization (Dicken, 2003).

For a very long time the basic structure of the world economic map consisted of a core and a periphery. The periphery provided the core with raw materials, which in turn produced manufactured goods that was shipped back to the periphery for consumption. However, the trade patterns of the world have changed a great deal and a more complex economic structure with new economies have emerged, while some core economies has experienced a decline to semi-peripheral status. The primary driving force of the new economic structure is considered to be the multinational corporation of our time, as they have a major influence on the global economy through their decisions to invest or not to invest (ibid).

The international structure of today’s business environment combined with advanced communication systems has created an environment where offshore markets become more accessible. These in turn makes it possible for companies’ to take advantage of low cost opportunities provided in other countries (Rutherford & Mobley, 2004). A recent example of this trend, can bee seen from the Swedish home appliance company Electrolux. They decided to close their production facility in Germany and move the production to a low-cost country, a decision which implied that approximately 1750 workers would be laid off. The company’s main reason was to become cost efficient, since the production in Germany was no longer profitable and their goods could not compete in the global market, (SVD 2005, 13 dec).

1.2 Purpose

The purpose of this thesis it to analyze, with respect to the chosen companies, what their main motives have been regarding their decision to go offshore; either with the whole production or only parts of it. The thesis will emphasize the following motives; enter new markets, cost-efficiency and closeness to market, since they are the most commonly used in the literature.
1.3 Method and delimitation
The method used in this thesis differs from the standard approach in empirical economies, which is to rely on statistical inferences. Subsequently, the empirical study is rather based upon interviews with a small set of chosen companies. The interviews where made personally at the headquarters, with individuals that have insight in the firms global operations. Moreover, the thesis will concentrate on companies from Jönköping’s county, namely; Becker-Acroma, Sapa Profiles AB and Nefab. In order to get a deeper understanding, we have chosen companies that are not similar in the sense that they all operate in different industries. However, the one thing that they all have in common is that they are manufacturing companies. It is important to keep in mind that the motives for offshoring are from the chosen companies’ point of view. Even thought companies such as IKEA has played a crucial part in the offshoring decisions of the interviewed companies, this thesis does not take into account IKEA’s nor the other companies offshoring decisions.

1.4 Previous research
When discussing globalization and production networks in general, Dicken’s book “Global shift: reshaping the global economic map in the 21st century” is an exceptional source of information. As he explains that the decomposition of the production chain is a result of the growing globalization of FDI, production and trade. Furthermore, outsourcing and offshoring has been defined by various author, however the definition used in this paper is the one given by Sako (2005) in her article “Outsourcing and offshoring: Key Trends and Issues”. She has put emphasis on two questions one regarding the location and the other about the boundary of the company, which she has illustrated in a figure.

Markusen (1998) is a pioneer in the study of Multinational Corporations (MNC). These companies are considered to be the main driving force for both globalization and offshoring. In his articles “Multinational Firms, Location and Trade” and “The Boundaries of Multinational Enterprises and the Theory of International Trade” he gives explanations for the reasons why and how a company develop into being a multinational corporation. When mentioning MNC’s, the next natural step becomes to bring up Foreign Direct Investment (FDI) due to the fact that FDI is conducted by MNC’s. The research on FDI is extremely broad. An important source is the International Monetary Fund (IMF) as they have given a definition of FDI and made several studies on the subject. In addition, an important contribution to the subject has been made by Ekholm, Forslid and Markusen (2003) as they have made a study on export-platform FDI. This form of FDI implies that: multinational firms invest and have production in a host country, where as the majority of their output are sold in a third market instead of the parent or host-country markets.
1.5 Outline

The outline of the thesis is divided into four parts. The thesis starts with a theoretical framework which provides the reader with relevant information on the subject, such as, defining the difference between offshoring and outsourcing, locations decisions of firms, and offshoring strategies. The following chapter presents the empirical study, where the results from the interviews are given. The empirical part is then analyzed in the next chapter, which is finalized by a conclusion.
2 THEORETICAL FRAMEWORK

This chapter entails the essential theories needed in order to analyze the empirical subject.

2.1 Production networks of firms

According to Dicken (2003) there are several ways of organizing the production network of firms. Globally concentrated production is the simplest form of production, because it is concentrated in a single location and the final products are then exported to the global market. Another form, called host-market production, differs from the previous one in the sense that the products are sold within the domestic market and no exports occur. In other words, the individual plant size is limited by the domestic market. However, a different production organisation has become more important the last few decades, because it involves production processes across national boundaries. Nevertheless, as trade is taking a global shape, the production process of companies is experiencing new opportunities, implying that production activities such as manufacturing and services can now be produced domestically or abroad. The relative low costs for unskilled labor in developing countries naturally entail that production that requires high amount of unskilled labor, such as gathering of components and other monotonous jobs are moving abroad (Dicken, 2003). An exceptional example of the above can be given by the Barbie doll case, where different parts of the doll are produced in different countries. The raw materials for the Barbie are purchased from Taiwan and Japan; the gathering of different parts of the doll used to be located in those countries but has now been relocated to low cost countries such as Indonesia, Malaysia, and China. The shape of the doll and decoration such as paint comes from the US, and China is providing the cotton cloth used for dresses (Feenstra, 1998). The process discussed above is illustrated with the help of figure 2.1.

![Figure 2.1: Slicing up the production chain- the case of the Barbie doll](Source: Own adaption of Feenstra (1998).)
Furthermore, the production chain is correlated by a network, which brings the “actors” or the “agents” (firms, states, individual, social groups, etc.) together in order to create relational structures at various geographical and organizational levels. A production process consists of a core that in turn consists of a set of operations linked by a series of transactions between one element and the next. The processes of transforming inputs into final goods that can be distributed and consumed are a two-way operation. It consists of a stream of semi-finished goods, materials, and finished items ready for consumption that goes in one direction and a stream of information (customer demand) and money (payments of goods and services) that goes in the other direction. In addition, the individual elements in the production chain are dependent on different technological inputs. Also, every single production chain is a part of a financial system that supplies the necessary investment and operating capital, and each chain of production must be coordinated, regulated and controlled. The variety of inputs, especially services, is very important in order for these processes to function (Dicken, 2003)

2.2 Offshoring and outsourcing

It is of great importance to distinguish and explain the two closely related terms “offshoring” and “outsourcing”. Offshoring as a part of the production chain can be defined as being an activity inside the company that will be carried out somewhere else, whereas outsourcing is defined as an activity that will be carried out by someone else (Venkatraman, 2004).

According to Sako (2005), every company is required to decide upon two questions, one regarding the location of the company’s activities and the other about whether to buy the input or produce it themselves. The figure below presents a simplified illustration of when companies offshore or outsource their activities.

![Location Decision Diagram](image)

**Figure 2.2**: Definition of offshoring and outsourcing
Adapted from: Sako (2005).
Sako (2005) states that offshoring arise when a company decides to move their production abroad (from domestic to overseas). Outsourcing, on the other hand, engage in a higher amount of specialisation as companies tend to move from sourcing inputs internally to sourcing them through separately owned suppliers (insource to outsource). As figure 2.2 further indicates, a firm can engage in offshoring in three different manners:

1) When a firm already have some degree of outsourcing (arrow 1), but decides to move from a domestic to a foreign supplier (arrow 2).
2) When a firm decides to simultaneously outsource and offshore to a foreign supplier (arrow 3).
3) Arrow 4 indicates a captive offshoring, which is when a firm may source to overseas locations by establishing a foreign affiliate. When a company then decides to move the source from an overseas affiliate to a foreign owned supplier (arrow 5), it is involved with offshoring.

The last type of offshoring explained above is sometimes called “offshore outsourcing”, but offshoring does not necessarily involve outsourcing (ibid). What distinguishes the phenomena of outsourcing and offshoring is that outsourcing involves the delegation of a process to a third-party merchant, while offshoring can involve the delegation of a process to a third-party merchant or stay internal (Venkatraman, 2004).

### 2.2.1 Multinational firms

According to general trade theory there are two motives for why companies decide to become multinationals firms. The motives are to provide a foreign market more profitably at that location and to benefit from lower-cost inputs offered by the foreign market (Brakman, Garretsen and van Marrewijk, 2001). In addition, there is no interest for a multinational firm to enter a foreign market, if that firm is identical to the companies in the market, because it will not generate any profit. The reason is; for a firm to cover its added costs (for example communication, transport costs, barriers to language) associated with doing business in another country; the firm must gain some advantages, such as superior technology, lower labour or transaction costs (Markusen, 1995). Furthermore, as the distance (between company and customer) increases, the more likely it is to relocate production facilities to the host country and to replace exports with FDI (Mervelede and Schoors, 2004).

According to Markusen (1998), there are some characteristics associated with multinational firms, namely:

1) Multinationals are often associated with high ratios of R&D relative to sales.
2) A large percentage of their workforce consists of people that contain scientific and technical skills.
3) Multinationals have a propensity to hold a high amount of intangible assets, which can be calculated as the market value minus the tangible assets such as machinery.
4) They are sometimes associated with new and/or technologically advanced products.
5) Multinational firms are negatively associated with plant-level scale economies
6) They are associated with customer proximity, implying that the company’s products are customized for the customer’s specific preferences.

In theory, it has been argued that Multinational Enterprises (MNEs) have played a central role in globalization as they expand their corporate networks beyond national boundaries, through establishing production facilities in foreign countries. In addition, intra-firm trade often reflects these foreign production activities as the factors of production are transferred from one country to another (Bonturi & Fukasaku, 1993). More precisely this type of international trade refers to trade between two or more units under common MNC ownership (Ivarsson & Johnsson, 2000).

Furthermore, there are other types of international trade, for example intra-industry trade, which means the exchange of comparable goods within the same product category. If for example France is a car exporter to the US, and if US-built cars are exported to France, the two countries are involved in intra-industry trade. Generally, intra-industry trade is about product differentiation and it does not necessarily involve intra-firm trade (Bonturi & Fukasaku, 1993). When looking at the total trade of countries, the ratio of intra-industry trade is relatively high, meaning that parent corporations rather export to their own affiliates. The situation emerges as a part of the corporation’s global strategy, once foreign investments have been made (OECD, 2005).

2.2.2 Location decision and FDI

International trade flows has over the last decades increased enormously, and has been linked to the surge in the performances of multinational firms. Such activity can be measured by foreign direct investments (FDI), and it can either be considered as a flow or a stock. The international monetary found (IMF) defines FDI as “the acquisition, by an entity resident in one country, of a lasting interest in an entity resident in another country” (Bowen, Hollander and Viaene, 1998).

In order for a firm to produce in a foreign market rather than to export their products, the foreign market must offer location advantages, such as reduced tariff costs, quotas, transportation costs, and cheap factor prices (Markusen, 1995). The empirical model that supports this theory is the proximity-concentration hypothesis, which states that there is a greater possibility for firms to develop their production horizontally across borders. The horizontally integrated multinationals have a tendency to locate in countries where factor prices (such as labour and capital) are cheaper than in their home country (Brainard, 1997). This is further supported by Markusen (1995), as he states that horizontal FDI seems to be the most frequently used form of FDI because the outputs of the foreign production affiliates are sold locally. Even though cheap factor prices play a crucial part in the location decision, closeness to customers have shown to be equally important. The second theory, called factor proportion hypothesis, which originates from traditional trade theory states that firms engage in production vertically across countries in order to take advantage of factor price differences associated with different relative factor supplies (Brainard, 1997).
There is yet another form of FDI, called Export-platform FDI and it refers to: when multinational firms invest and have production in a host country, where as the majority of their output is sold in a third market instead of the parent or host-country markets. This type of FDI contains elements of both horizontal- and vertical investments. When firms engage in export-platform FDI they usually provide an integrating market with a branch through horizontal investments, but their choice of location is cost-dependent through vertical investments. In other words, an outside firm chooses a low-cost location within a free-trade area to serve the whole free-trade area. An example of this can be a European firm that produces in Mexico in order to supply the integrated North American market. Furthermore, export-platform FDI is usually characterized by low host-country trade barriers and discouraged by large host-country markets (Ekholm, Forslid & Markusen, 2003).

In the same study 34 US multinational firms and their foreign affiliates were analyzed. The sales by foreign affiliates were split into local sales in the host market, export sales back to the US, and export sales to a third market. The countries that had the highest percentage of sales going to a third market were Ireland, Belgium and Holland, in addition, they had a very small amount of sales going back to the US. In countries like Singapore, Hong Kong and Malaysia, the output was mainly exported rather than sold locally, but there is a balance between sales to a third market and sales back to the US. The majority of the sales of US Affiliates in Mexico and Canada naturally go back to US because they are already in a free-trade area due to the North American Free-Trade agreement (NAFTA). Figure 2.3 is a simple illustration of the theory discussed in the previous sections.

**Figure 2.3:** Offshore outsourcing, vertical FDI, and intra-firm trade. Adapted from: Marchant & Kumar (2005).
2.2.3 Scale economies

According to Brakman, Garretsen, van Marrewijk (2001) “Economies of scale” is defined as; when a company faces the situation of when an increase in the level of output produced results in a decrease in the average cost per unit of output. The average cost (AC) curve is downward sloping as shown by the figure below.

![Average cost curve](image)

**Figure 2.4**: Average cost curve
Source: Brakman, Garretsen, van Marrewijk (2001)

Two distinctions can be made in order to better understand the shape of the average cost curve and they are: internal and external economies of scale. Internal economies of scale are associated with an increase of firm-level production. The more output a company has, the more it can benefit from scale economies, in addition, the company can obtain a higher cost advantage compared to smaller firms. Furthermore, internal economies of scale are consistent with imperfect competition as it implies market power for the firm in question. In the case of external economies of scale, the decrease in the average cost curve refers to the increase in output for the whole industry and not for a single firm (ibid).

Industrial production efficiency is achieved by dividing the production process into different stages. Baring this in mind, each firm will specialize in each stage of the production process. The division of production is positively related to the size of the market, meaning that as size of the market grows the division of the production becomes greater. The theory of scale economies has expanded to include two new approaches namely national and international economies of scale. Scale economies is said to be international, if the transportation of a product is easy, because then it is more favorable to concentrate production in a single country. When the division of production is forced to be located in several countries, due to high trade barriers and transport cost, the scale economies are national (Bowen, Hollander, Viaene 1998).
2.3 Offshoring strategies

When companies offshore, they have to take a decision based upon two diverse but extremely related questions under consideration, regarding what type of offshoring strategy they should implemented. The first question a company is required to answer is; whether or not to have an equity or non-equity based approach. The difference between these two, lies in the fact that equity based approach is dependent on exporting through licensing and agents, while non-equity is when the home activity is partly or completely owned. Secondly, if and when a company decides to choose an equity based entry approach, they then have to determine weather to operate by setting up an entirely new plant (Greenfield) or through Acquisition by obtaining an existing local firm (Harzing, 2002).

2.3.1 Mergers and Acquisitions

When firms existing assets are relocated from domestic companies to foreign companies, we are referring to the terms: Mergers and Acquisitions, this is the principal form of FDI. Cross-border merger is when firms from various countries combine their assets and operations to create a new legal unit. Cross-border acquisition refers to a situation where a domestic company becomes a foreign-owned affiliate by relocating the control of assets and operations (Wikipedia). These types of M&A’s are extensively used by companies to strengthen and expand their market position; furthermore companies seek to increase their resources such as intangible assets (Kang, Johansson 2000).

Furthermore, according to a report released by ITPS\textsuperscript{1}, the most common reason for Swedish firms to establish abroad has shown to be to gain market power though acquisitions of firms in the same industry, and to get closer to unexploited markets abroad.

2.3.2 Greenfield

When a direct investment results in either a new plant or an extension of an already existing plant it is called Greenfield investment. Furthermore, it is a form of foreign direct investment (FDI) that has a tendency to generate both new jobs and production facilities, in the host country. In addition, they help transfer technology and know-how, and can lead to linkages to the global marketplace. On the other hand, there are some downsides to Greenfield investments as well, namely that profits made by these foreign companies do not stay in the host country, but rather go back to the home country. If these companies where local the profits made would generate both growth and increase the domestic economy. Another drawback is that local firms are crowded out, since multinational companies are producing goods at a lower cost (as a result of advanced technology and efficient processes) (Wikipedia).

\textsuperscript{1} The Swedish Institute for Growth Policy Studies
3 EMPIRICAL STUDY

This chapter describes the empirical studies based on interviews made with three companies’ located within Jönköping County.

3.1 Becker Acroma

3.1.1 Company background and motives for offshoring

AB Wilh Becker is the parent company of a Group, which is divided into four subdivisions, one of them being Becker Acroma. Even though AB Wilh Becker has the overall responsibility for accounting, information and finance, Becker Acroma is operating with a degree of autonomy, since it is a profit centre of its own. Becker Acroma produces paint, varnish and lacquers for the wood industry, including home and office furniture’s. Their largest customer is IKEA, whom they sell to through subcontractors. Furthermore, Becker Acroma never sells to a customer who purchases for less than SEK 1 million, indicating that they only sell to industries and not private customer (Becker Acroma).

In the early 1960’s several companies within the furniture industry, such as IKEA, moved their production to Poland due to cheaper labour costs, and ever since the production has moved further east to countries such as Thailand, Vietnam and China. Becker Acroma’s main motive for offshoring was to follow already existing customers, such as IKEA and other European companies, as they moved their production further east. Becker Acroma operates under the principle; “the-best-solution-partner” and in order to fulfill this purpose they have to be close to the customer. Furthermore, to be a best-solution-partner requires not only flexibility and quickness that arise from being close to the customer, but also to be able to offer low costs. Becker Acroma would for example not be able to operate under European costs and think they will gain market shares in China; instead they need to offer costs appropriate for the Chinese market, which can only be achieved by producing in China. Even though, closeness to customers is a primary reason for offshoring, the final outcome is always to benefit and generate profit from the offshoring decision. Becker Acroma is not entering a market out of goodwill, because in the long run their final goal is to earn money.

3.1.2 Offshoring Strategies

It is difficult for any company to grow organically, which is why it is necessary to either merge or purchase another firm in order to grow. This was the case for Becker Acroma, when they made their most important acquisition in 1996 by purchasing Klintens AB, which entitled them to double their production units. Through this acquisition they accessed markets in other part of the world, such as south Europe, North America, and some parts of Sweden as well. Prior to the acquisition of Klintens AB, Becker Acroma was mainly concentrated in Eastern Europe and the Nordic countries.

2 The information for Becker-Acroma was conducted through an interview made with the production director at the headquarters in Bellö.
As the market is disappearing from Europe to Asia, most importantly to China, and Becker Acroma wanted to be part of this expansion they decided to build their own production facilities there. Even though Becker has been in China for approximately 12-13 years, it was only recently they decided to start up their own construction. Since Becker Acroma wants to avoid being put with tremendous debts, they have avoided acquisitions of local firms, even though it is the best way to gain market shares. The initial intention of building facilities in China was not to sell for the Chinese market, but rather to supply their customer, for example IKEA. However, they saw potential to expend their sales to include not only their existing customers, but also the Chinese market, because there was a local demand for their products.

The strategy used by Becker Acroma differs from many other companies in the sense that they first hire labour, then evaluate potential customer, and finally they build a production facility, while other companies start from the other end. Becker Acroma is involved in export-platform FDI, since they have facilities that provide a third market such as Canada to the US, Italy to China. However, export-platform FDI usually seek the lowest costs, and this may not be the case for our company. Yet another Greenfield investment is in progress in USA, since they prefer US-made products rather than exported products from Canada. Becker Acroma has two new facilities under construction in Vietnam and Thailand, since these markets are growing, especially Vietnam. The downside to the use this type of offshoring strategy is to find the appropriate labour that is keen to learn the techniques used by Becker Acroma and to quickly implement it, in order to start producing and for the company to grow and generate profits. To summarise, Becker Acroma has grown through both Greenfield investments and acquisitions of other firms.

3.1.3 Location decision

The decision on where to locate their production facilities depends greatly on where their customers are based. Before building their own facilities, Becker Acroma had sales offices that were closely located to their most important customers. This gave them an insight to the local market as well as knowledge about the existing demand. Furthermore, as for China, the production facility was build in Qingdao, which is a region where there is a lot of European production and the reason for why Becker Acroma ended up there.

Labour intensive products have been offshored to, for example China where the labour costs are still low compared to Sweden. On the other hand, capital intensive products that require high technology and less labour are still based in Sweden. When a company such as Becker Acroma operates worldwide, it is given that some countries and markets will profit more compared to others. However, Becker Acroma does not continue their operation in a market that will not generate profit in the long run.
3.1.4 Positive/Negative effects of offshoring and future aspects
Through offshoring Becker Acroma is represented in large parts of the world, which enables them to satisfy their customers’ needs easily, wherever the customer is located. This is done through the implementation of their own experts, technicians, storages and production units, which is the strength of the company. The negative aspect from offshoring is that it drags a lot of resources from Sweden, such as lost time due to trips back and forth.

As for the future, Becker Acroma will continue expanding their business and their future targets are Thailand and Vietnam. However, they will continue their expansion into different parts of already existing markets such as Russia. On the other hand, everything is not moving to other countries, a lot of products are still produced in Sweden and it is extremely important to have a safe home-market, which Becker Acroma certainly has.

3.1.5 Summary
To conclude the Becker Acroma interview, it is evident that the main motives for offshoring have been to follow already existing customers, although at the later stages of the offshoring process, costs gained increased importance. The strategies used in order to supply the customers at the foreign market have shown to be a mixture of Greenfield investments and Acquisitions. Their choice of location has basically followed the same path as the industry’s, starting with Poland in the early 1960s and then moving further east to China, Thailand, and Vietnam.

3.2 Sapa Profiles AB
3.2.1 Company background and motives for offshoring
Sapa Profiles AB Sweden, which also includes China and Lithuania, is part of the Sapa Group. Sapa Profiles market and produce aluminum profiles, as well as systems, components and products made of aluminum profiles. The company has 11 production facilities around the world and their turnover was SEK 14 billion, in 2005 and their labour force consisted of approximately 8200 workers. Volvo, Scania and IKEA, are some of their largest customers. Sapa Profiles operates under three different business segments, explicitly; telecom, automotive and mass transportation. The company is always a subcontractor, indicating that they do not have their own products (Sapa Profiles).

The main motives for Sapa Profiles to offshore have been to enter new markets, get closer to new customers, and follow already existing customers. However, even though closeness to other markets was crucial at the early stages of offshoring, cost efficiency and access to skilled labour has gain equal importance for Sapa Profiles today.

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3 The information for Sapa Profiles AB was conducted through an interview made with the fabrication manager, at the headquarters in Vetlanda.
3.2.2 Offshoring strategies

All investments are financed by the Group, since the Sapa Profiles send the proposals to them and they then decided whether or not to offshore. Acquisitions have been a part of Sapa Profiles offshoring strategy since they started. The acquisitions are made at the group level, with the intention to enter new markets, indicating that Sapa Profiles is not a part of the decision process. They also have Greenfield investments in China and Lithuania, which are markets where Sapa has key customers, such as IKEA and Volvo. The Group recently acquired a Belgian company, which entitled them with labour competence and other useful resources.

The part of the production that is offshored is the labour intensive one, for example processing due to the fact that it does not require many investments and that the work competence can be found abroad, compared to building a press-machine.

What Sapa Profiles produce in Asia stays there or is shipped to North America, nothing is brought back to Sweden. The Swedish market is provided by goods produced in Sweden or sometimes even from Europe. In addition, it would be very costly if Sapa Profiles was to produce in Sweden and then transport the goods to China, by producing at the foreign market they can be more competitive through cost efficiency.

3.2.3 Location decisions

The main reason on where to be located is extremely dependent on where their customers are located. For example, if they would produce in Sweden and then send to China to Ericsson it would be very expensive and non profitable in the long run, in other words Sapa has basically followed their customers.

3.2.4 Positive/Negative effects of offshoring and future aspects

Through offshoring Sapa Profiles has been able to get closer to customers, and this in turn has led to comparative advantages against their competitors. The advantage of having a work force that can easily be moved around and established in different places is what generates business, even in Sweden. However, there are always negative aspects for offshoring, for example it is extremely difficult to deal with complicated foreign laws and sometimes even culture can serve as a barrier for trade. In order to conduct business in foreign countries, it is extremely important to have the right personal contacts and people who know what to ask, because it is not always that obvious where and whom to ask.

As for the future Sapa Profile does not have any specific markets they seek to enter, however they would like to continue growing. In China for example, they would like to grow toward other markets and then to bigger and more global customers.
3.2.5 Summary

The main offshoring reasons for Sapa Profile have been to enter new markets, get closer to new and already existing customers. Nevertheless, cost-efficiency is equally important as the above mentioned motives. Similarly to Becker Acroma, Sapa Profiles AB also applies Greenfield investments and acquisitions. However, the form of offshoring strategy differs depending on the type of the market. The decision on where to locate production units depends on where the company’s customers are based.

3.3 Nefab

3.3.1 Company background and motives for offshoring

Nefab is a producer of complete packaging solutions to international industrial groups, where the primary customers are within telecom and automotive industries. The company is represented in more than 35 countries, over four continents, with production sites in 11 countries. In 2005, the invoiced sales accounted to more than SEK 1.5 billion (Nefab).

Nefab’s vision is to be “the Global Partner for Complete Packaging Solutions”. It basically means to follow the customers as they move their production abroad, in order to provide them with the same range of products and services. Nefab has a competitive advantage over other firms in the same business, as they are the only company that offers packaging solutions at the global level. Nefab has stayed in markets even though it has not generated any profit for several years, which proves that customer intimacy goes before profit, at least in the short run. For example, Nefab was the first subcontractor for Ericsson when they moved their production to China in 1997, which once again strengthen their vision in being the global partner.

3.3.2 Offshoring strategies

According to Nefab, the goal of growing organically is to grow faster than the underlying market, by three different approaches. They can enter new geographical markets and industrial segments, follow their multinational customers as they expand geographically, and offer a broader variety of products and services. Even though growth organically is a difficult task to accomplish, Nefab was successful with this until the end of the 90’s. Nevertheless, Nefab has been forced to change their strategy because of the increase competition due to the growing globalization. As a result of this, they now conduct two offshoring strategies, depending on what type of market they are in. When entering an emerging market such as China, India and Eastern Europe they try to grow organically. However, in already established markets such as North America and Western Europe acquisitions is a requirement, because of the high level of competition.

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4 The information for Nefab was conducted through an interview made with the director of sales and marketing, at the headquarters in Jönköping.
Nefab has built production units in Estonia and Slovakia, however the intention was not to provide local markets, because of the insufficient level of demand, but rather to provide other European markets. The reason why the production is located in these countries is due to low labour costs. This differs from the production facility in China, in the sense that there are no exports to other Asian countries, they only produce for the local market.

When evaluating a potential market, Nefab first start by developing a sales market in that country before a production facility is built. The current hot spot for Nefab is India, as they 2 years ago started to evaluate the Indian market and potential customers. After the evaluation process, they realised that the demand was high enough to start a production facility there.

The Greenfield investments and Acquisitions are financed through a mix of both equity and loans. Their policy is to have at least 30 % of equity in the foreign affiliates.

3.3.3 Location decisions
The decision on where to locate the production facilities, is as already mentioned, greatly dependent on where the customers are based but also where the costs are low. For example, the production unit in India will be located in Delhi due to the fact that many customers and suppliers already located in that area. In addition, Nefab locates the labour intensive production in low-cost countries, as in the case of Estonia and Slovakia, but the capital intensive production is still located in Sweden.

3.3.4 Positive/Negative effects of offshoring and future aspects
The positive effect of offshoring is that it entitled us to achieve our vision, namely: “the Global Partner for Complete Packaging Solutions”. There is always a risk associated with offshoring, a risk with sales, organisation, and cultural differences. However, Nefab states that they have been very successful with their offshoring decisions and have managed to avoid all the risks mentioned above. As for the future, Nefab will continue expanding and as they see great growth potentiality. A market which is a potential target for the near future is Mexico, since it is a very interesting growth market. Furthermore, expansions will be achieved through building new production units in China and through acquisitions in Western Europe.

3.3.5 Summary
Nefab’s primarily reason for offshoring has been to follow their customers. Their offshoring strategies differ depending on the type of market they choose to operate in, when entering an emerging market such as China and India they try to grow organically. However, in already established markets such as North America and Western Europe acquisitions is a requirement, because of the high level of competition. Nefab locate their production facilities close to where their customers are based but also where the costs are low.
4 ANALYSIS

The data presented from the case study will be analyzed by comparing it to the theory.

A common feature for the analysed companies is that they all supply major companies such as IKEA, which have moved their production abroad. A company can not operate under European costs and assume that they could gain market shares in for example China, where the labour costs are low. In order to supply major customers efficiently a company must apply local costs, which can be achieved by producing in that country, which able them to avoid trade costs such as transportation costs and barriers to trade. This implies that the condition for horizontal integration is fulfilled (Markusen, 1998). This is why the interviewed companies have chosen to follow their major customers, which is true, at least in the short run. However, in the long run cost efficiency gains greater importance, since it is not profitable to stay in a market that does not generate any profit. In addition, other reasons for offshoring have through the interviews shown to be closeness to new customers and market expansion.

When analysing the three companies, it is evident that the companies have experienced a greater production division. This must be an indication of: (1) an advancement of the communication systems, which in turn has led to easier transportation possibilities (2) an increase of the market size. This supports the theory of international economies of scale presented in the theoretical framework. This theory is an expansion of the general theory of scale economies, and it state; if transportation of a product is easy, then the division of production is not necessarily concentrated in a single country. Furthermore, the production division is positively related to the size of the market.

4.1 Location decisions and FDI

According to Markusen (1995) a foreign market must offer location advantages, such as transportation costs, cheap factor prices etc. These are the reasons for why a firm chooses to produce in a foreign market rather than exporting their products. There is an empirical model that supports this theory, namely the proximity-concentration hypothesis, which states that there is a greater possibility for firms to develop their production horizontally across borders in order to take advantage of low factor prices.

The discussion above has shown to be true for all the interviewed companies. Starting with Becker Acroma it is evident that they have followed major customers such as IKEA, as they have offshored to low cost countries. By following major customers, Becker Acroma have been able to supply their customers at lower costs due to location advantage, in terms of cheaper factor prices and decreased transportation costs. Sapa Profiles and Nefab have used the same investment strategy as Becker Acroma, since they have invested horizontally across countries and taken advantage of low factor prices. More specifically, this is achieved by locating labour intensive production in low cost countries such as China while the capital intensive production is kept in Sweden, which has been implemented by all three companies. The capital intensive production is kept in Sweden because it requires more investments and skilled labour (which is more difficult to find abroad) compared to labour intensive production that only requires access to cheap labour.
Brainard (1997) states that firms engage in production vertically across countries in order to take advantage of factor price differences associated with different relative factor supplies. This implies that firms export a lot of their production produced in the host country to the home country (Markusen, 1998). Out of the three companies, only Sapa Profiles is involved in vertical FDI as some of the products produced in their European facilities are brought back to provide the Swedish market. Which supports the fact that horizontal FDI is used more commonly compared to vertical (Markusen, 1998).

Export-platform FDI is another form of investment strategy, where firms invests and have production in a host country, but the majority of their output is sold in a third market instead of the parent or host-country markets (Ekholm, Forslid & Markusen, 2003).

All three companies have shown indications of using this type of investment strategy. Through the interview it was evident that Nefab had the most obvious form of export-platform FDI. Since Nefab have production facilities in Estonia and Slovakia, which was build with the intention to provide the European market rather than the local market. The rationale behind the chosen countries was primarily driven by low labour costs. This is in line with the theory stating that: an outside firm chooses a low-cost location within a free-trade area to serve the whole free-trade area (Ekholm, Forslid & Markusen, 2003). However, the issue concerning the free-trade area is only applicable for Nefab and not the other two companies. For the case of Becker Acroma, the use of this investment strategy was not explicitly stated compared to Nefab. However, Becker Acroma has production facilities in Canada that provides the US market. In addition, they have facilities in Italy which provides the Chinese market. In these cases it is ambiguous whether the driving force was low costs, because it is not in line with the theory due to the fact that China has lower costs compared to Italy. If Becker Acroma would strive for lower costs and try to supply the US market, then the obvious country would be Mexico and not Canada due to lower labour costs. However, the demand for the company’s products may be higher in Canada and that is why they are located there, but this fact remains uncertain. Sapa Profiles has plants in Asia that supplies the local market, which sometimes also provides the North American market, however nothing is brought back to Sweden. This is not fully integrated with export-platform FDI, since some of the products actually stay in the host country. The fact that Sapa Profiles is providing a third market and nothing is brought back to Sweden, we have drawn the conclusion that it is some form of export-platform FDI.
4.2 Offshoring strategies

We have narrowed down our offshoring strategies to only include three, explicitly; mergers, acquisitions, and Greenfield investments. All three companies have chosen to use an equity based approach, meaning that the companies have either build an entirely new plant (Greenfield) or by obtaining an existing local firm through acquisition (Harzing, 2002). This further implies that all three companies have used a mixture of Greenfield investments and acquisitions, which has entitled them to grow and gain market shares in offshore countries and to get closer to customers.

Through the acquisition of Klintens AB, Becker Acroma experienced their biggest break through into the global market. The acquisition gave them access to foreign markets such as south Europe, North America, and some parts of Sweden. Prior to the acquisition of Klintens AB, Becker was mainly concentrated in Eastern Europe and the Nordic countries. Becker Acroma is aware of the fact that acquisitions of local firms is the optimal approach with the aim of gaining market shares, they have however chosen to use Greenfield investments instead in order to avoid debts and maintain liquidity. Prior to the actual construction of the production unit, Becker Acroma implement some steps, such as: evaluation of potential customer and hiring of labour. Sapa Profiles have used acquisition ever since they started, with the intension to enter new markets. Furthermore, Greenfield investments have been made in low-cost countries, such as China and Lithuania, where key customers such as IKEA and Volvo are based. We believe that acquisitions were not necessary in countries where Sapa Profiles have their key customers, because they already had significantly high market shares in those countries. However, Greenfield became crucial because they needed a production plant to provide their major customers. Through acquisitions Sapa Profiles have gain labour competence and other useful resources; we consider this to be of essential matter for a company to grow. Nefab conducts two offshoring strategies depending on what type of markets they are in. In emerging markets, such as China they prefer to grow organically, in contrast to already established markets where acquisitions are a necessity. Similar to Becker Acroma, Nefab never enters a country without developing a sales market, which they do by evaluating potential customers.
5 CONCLUSIONS

In this chapter the purpose of the thesis is answered and the conclusions of the case study are presented.

The purpose of this thesis was to:

“...analyze, with respect to the chosen companies, what their main motives have been regarding their decision to go offshore; either with the whole production or only parts of it...”

The emphasis was put on the following motives:

“...enter new markets, cost-efficiency and closeness to market...”

Prior to the interviews, our assumption was that the main motive for companies to offshore was: cost efficiency. Which indicates that parts of the production is located in low-cost countries in order to become more cost-efficient (low labour countries); which is supported by several authors, such as Brainard (1997) and Markusen (1998). However, the results of our interviews showed that the main reason for offshoring was to follow major customers in order to efficiently supply them at the foreign market. This is an indication of the idea that closeness to customers is equally important as cheap factor prices (Markusen, 1995).

By conducting the interviews it has become clear that even though the investigated companies are not operating in the same industry, they have shown to be very similar to each other, in their decisions to offshore. The motive for offshoring has shown to be greatly dependent on which industry a company operates in. For example, when IKEA decided to move abroad, Becker-Acroma faced no other option than to follow them, since they are a supplier for the furniture industry. Taking the above into consideration, the authors believe that a company is more or less forced to move towards the same direction as the industry.

It has been evident that the primary reason for all three companies motive for offshoring has been to follow their major customers. In addition, the relocation of production to a foreign country has shown not to be cost-driven in the short-run, but rather to get closer to the company’s already existing customer and to gain new customers. The companies were willing to stay in a market, even though it did not generate any profit in the short run, which further strengthens the companies’ short-run motive. However, a long run determinant for companies to stay in a market is to earn profit, implying that cost-efficiency gains more importance.
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Appendix: Interview questions

1. Hur är försäljningsmarknaden fördelad? Vilka är kunderna?

2. Vad är företagets huvudsakliga aktivitet här i Vetlanda och i den utländska marknaden?

3. Är företaget självständigt eller en del av en koncern?


5. Hur gick ni tillväga för att utvärdera eventuella leverantörer, i form av planering och organisation?


7. Vilka andra länder investerar (har ni produktion i) Ni i?

8. Hur ser fördelningen av de anställda ut? Både i Sverige och i utlandet? (Varför så många anställda just i det landet?)

9. Vilken del av produktionen/företaget har ni valt att etablera utomlands? Vad var det som låg till grund för ert beslut att utlocalisera just den biten?

10. Har det skett någon förändring på den Svenska marknaden efter utlandsetableringen? (Både vad det gäller företaget och kunderna?)

11. Har det skett någon prissänkning för de svenska konsumenterna? Finns det en fördel för konsumenter så som lägre priser till följd av lokalisering utomlands? Eller är det bara företaget som tjänar på det?

12. Har det funnits kulturella hinder som ni har varit tvungna att övervinna? Hur har ni gällt tillväga för att handskas med dessa skillnader?


15. Vilka transport- och transaktionskostnader har Ni? Har dessa kostnader minskat till följd av etableringen utomlands?

16. Vertikal integration. Har ni köpt upp leverantörer för att kunna få mer kontroll över produktionen?

17. Hur skulle Ni med egna ord definiera begreppet ”offshoring”?
18. Vad har enligt er mening varit positivt/negativt med offshoring? Vad är era planer inför framtiden?