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**Teaching Note**

**ESC: Firm Growth Through Internationalization**

**Synopsis**

This case examines “ESC,” a Dutch designer and installer of Process Monitoring and Control (PMC) systems that are used to control factories and manufacturing processes. The case traces the development of the firm since its launch in 1972 through various stages of growth and development. ESC was founded by an entrepreneur, Jan Wilders, and under his, and now his daughter’s, leadership, the company has become a major European designer and installer of PMC systems for customers across Eastern and Western Europe.

The case is based on more than 60 interviews with the founder and senior managers; one of the authors was a member of the firm’s supervisory board for 10 years, with a further five years as consultant.

**Teaching objectives**

The case allows the instructor to deal with issues such as the growth and internationalization of a service firm, the role of networks, partners and partnership formation, the liabilities of foreignness, and how firms acquire market entry knowledge and develop in the internationalization process. By describing the challenges faced in internationalization in practice, and by demonstrating the immense uncertainties involved, it gives a very realistic exploration of the meaning of these concepts as they are faced by practising managers. This practical realism is highlighted by the clear question posed in the case: should ESC prioritize Germany or China for growth, and if so, how should it internationalize there?

This case was prepared by Simon Harris, Professor of International Strategy at the University of Edinburgh, and Margaret Fletcher, Lecturer in the Adam Smith Business School at the University of Glasgow, for the sole purpose of aiding classroom instructions in the use of “ESC: Firm Growth Through Internationalization” teaching case. It provides analysis and questions that are intended to present alternative approaches to deepening students’ comprehension of business issues and energizing classroom discussion. The case is developed solely as the basis for class discussion and not as endorsement, source of primary data, or illustrations of effective or ineffective management.

**Teaching approach**

The case is suitable for courses in international business and international entrepreneurship. The case can be employed in a number of ways:

First, it can be used for discussion in class to illustrate theory on internationalization and international entrepreneurship processes.

Second, it can be used after theory has been presented as a means of applying and understanding the theory, taking theory as the main focus.

Third, a “flip-based teaching” approach may be taken where the case is used as a precursor, important aspects are discussed on the basis of the case and theory emerges from the discussion of the various points.

Fourth, because it examines and addresses so many of the core elements involved in internationalization and international entrepreneurship, it has often been used as a case on which an examination paper or an assignment paper is based.

**Teaching Plan**

To introduce the case, the instructor can make a few comments about the firm’s start-up process, expansion and internationalization in Europe, the founding entrepreneur leaving his employment in a large US-based electronic manufacturing MNE (called US-Tronics), having spotted a need for process manufacturing system control. The new firm started by providing services locally, then expanded to the whole of the Netherlands and to neighbouring Belgium, then to other European countries.

The plan could then be to introduce the fact that at the time of the case study the firm had to decide whether to internationalize further to China, or whether to grow into the large but mature neighbouring market of Germany. The decision concerning which markets to enter and develop was not clear to the management and caused great discussion and debate within the firm.

A teaching plan can then be framed around a discussion of each of the main areas that the case addresses for learning detailed below.

**The challenges of localization that a service firm faces when trying to achieve international market entry and expansion**

*Questions:*

1. What were the potential customers looking for in a supplier?

2. How could ESC assure them that they could offer this?

3. Why is it important and valuable to operate internationally in this industry?

4. Why is it important to be very local in operating in a territory?

Depending on the length of the class, a useful starting point is to consider, in the context of this international service company, Bartlett and Ghoshal’s needs for national responsiveness and for globalization. There are parallels here with international consultancy companies, who need to offer global-level capabilities and competences, but deliver these locally to customers within different territories. The firm needs to be “GLOCAL” in a particular way. Production is local, as with most service companies, but the knowledge development and coordination is centralized, and the control of service quality is highly controlled from the centre in order to preserve corporate reputation, on which all these businesses rely.

The challenge is then to find high-quality local staff who will be trained and will engage in learning and knowledge-sharing on a global basis. In this case, this is actuated through regular training sessions at HQ, in staff exchanges to help work on projects in different countries, and through a culture of sharing knowledge at work, in which open morning meetings and the canteen is central.

*A Schema of the issues of Globalization and National Responsiveness based on the ideas of Bartlett and Ghoshal*



*Answers to the questions for students:*

1. What potential customers were looking for in a supplier: local relationships that they could trust to do work and on which they could rely, shared business cultures, deep knowledge of their factory systems, but, essentially, the ability to access and employ world-class technical skills.

2. How ESC could assure them that they could offer this: having a local and international reputation, being well-connected with local networks, showing world-class technical ability.

3. Why it is important and valuable to operate internationally: manufacturing and manufacturing technology is globalized; all potential customers need to have world-class technologies if they are to be competitive.

4. Why it is important to be very local in operating in a territory: as a service firm, ESC will be doing nearly all the work in the customer’s own premises. ESC’s history shows that it is not possible to service customers from afar.

**The importance of network relationships in achieving market presence**

*Questions:*

5. What role did strong personal relationships play in the international development of ESC?

6. Why did these relationships enable access to markets?

7. What role did wider network positions, such as on industry bodies, play in the international development of ESC?

8. What does ESC’s contrasting development in Germany and the UK have to say regarding ESC’s model for international market entry?

IMP and network research has long highlighted the importance of personal and network relationships in the internationalization process. Transactions-cost research highlights personal relationships as an insulation from the risk of opportunism, which is well illustrated by ESC’s contractual but not personal-partnership relationship in Germany. By contrast, strong interpersonal trust meant that ESC and Haan’s companies could embark on a collaboration which, without the deep personal relationship between Jan and Haan, would have exposed each party to massive risk of opportunism.

Network relationships bring a great deal to help the internationalization process:

(a) They bring knowledge: on local markets, on how to do business locally, and on how to manage and work with local regulations, norms and cognitions/cultures.

 (b) They bring opportunities, which come from local knowledge combined with local personal relationships. Local network relationships require the knowledge and trust of the firm that is seeking expansion as well as of potential customers in the territory.

 (c) They bring local presence: this includes experiential knowledge about how to do things locally (not just what things are), such as how to find and access partners, suppliers, distributors, employees, and advisers. Local presence also brings actual introductions to other customers and potential partners. These “introducers” carry a reputation and trust with them that newly entered firms may not have.

(d) They bring internationalization knowledge: trusted local partners who know both the internationalizing firm and the local market well can help with the management of the internationalizing firm’s own development and an internationalization strategy that fits both the firm’s capabilities and local conditions.

(e) They can bring actual practical assistance on the ground, which may otherwise be costly and difficult to organize.

*Answers to the questions for students:*

5. The role that strong personal relationships played in the international development of ESC: Jan’s strong personal relationship with Haan enabled a significant market entry into the UK, ESC’s first step into the international market, which would have been impossible without it. Haan provided ALL the elements noted above. The Italian relationship was newer, but developed quickly into a strong personal relationship (since the strength of relationships is not necessarily associated with time). The strength of this relationship both enabled further international expansion and helped develop deep internationalization knowledge.

6. Why these relationships enabled access to markets: the relationship firms were strongly embedded in the local markets, so knew them well and could operate as local businesses, which did not face the liabilities of foreignness that ESC would have faced. The mutual interest between ESC and the partner companies could be fulfilled rapidly with less fear of the risk of opportunism. The parties trusted each other and were able to do things, such as staff exchange and learning, which would have been impossible otherwise.

7. The role that wider network positions, such as on industry bodies, played in the international development of ESC: Jan’s position on Dutch and European industry bodies meant that ESC’s reputation went much further than its physical presence. This fostered international opportunities by enabling unsolicited enquiries from other countries (e.g., the visit from the Italian entrepreneur) and meant that market entry, once begun, was much easier.

8. What ESC’s contrasting development in Germany and the UK has to say regarding ESC’s model for international market entry: The German expansion was undertaken through a contractual relationship secured by law rather than through personal trust and a network of local relationships. In Germany, ESC suffered the risk of opportunism in full. The UK and Italian expansions did not suffer from these risks. This indicates that ESC should develop by means of local relationships and gradual learning. We can see a firm specific model of local partnering on a particular contract or contracts, the partners’ engineers being trained by ESC to ensure technical skills, staff exchanges to ensure international quality, and an evolution if this works from contractual arrangements to joint ventures and ultimately to full Foreign Direct Investment. This model seems to work well for ESC and minimizes risk. This is a model of gradual increase in local commitment to internationalization that points to the Uppsala process.

**The role of market and general internationalization knowledge and learning in a firm’s approach to internationalization**

*Questions:*

9. What local market knowledge did ESC need in any territory that it was internationalizing into?

10. What particular local skills and capabilities did it need if it was to operate effectively in a new territory?

11. What knowledge did ESC need to have regarding those that were working on its behalf in any territory?

12. What ESC-specific internationalization knowledge has ESC learned through its experiences?

Johanson and Vahlne’s (1979) “Uppsala model” is a model of learning in internationalization that is based on Cyert and March’s (1969) behavioural theory of the firm. It recognizes that liability of foreignness arising from lack of knowledge can usually be addressed only through learning, and as the tacit knowledge involved in this learning is mainly experiential, this learning happens with the development of activities in the territory, which Johanson and Vahlne call “commitment.” This is represented in the model shown below, in which firms go through a sequential process of functional migration based on a firm’s “… gradual acquisition, integration and use of knowledge about foreign markets and operations, and on its successively increasing commitment to foreign markets.”

**The experiential learning process in Johanson & Vahlne’s (1979) internationalization model**



Subsequent research has highlighted different types of knowledge involved in this learning. Market-entry knowledge, the focus of Johanson and Vahlne’s original model, is the local knowledge about working within the territory. Technological knowledge is needed to achieve a viable long-term presence in international markets. Internationalization knowledge is firm-specific knowledge which concerns how the firm can internationalize.

*Answers to the questions for students:*

9. The importance of local market knowledge that ESC would need in any territory that it was internationalizing into. This is: the market-entry knowledge; concerned local regulations and norms; local norms for doing business; and everyday business culture. It would also be required to know who could be trusted to collaborate on practices, and how to go about finding customers and partners.

10. ESC needed two types of skills and capabilities to operate effectively in a new territory. First, it needed to interact very well with potential and actual customers in the territory by having local people interacting with them regularly and getting to know them and their businesses very well. Second, it needed their local operators to be able to show world-class knowledge and abilities.

11. The knowledge that ESC needed to have regarding those that were working on its behalf in any territory was that they would do reliable and high-quality work with each customer so that ESC’s reputation, on which its future as an international company relied, would not be threatened.

12. ESC has learned important firm-specific internationalization knowledge through its experiences. (a) It has learned that the liabilities of foreignness are immense, encompassing language, culture, local business practices and the need to be locally established. (b) It has learned that contracts do not work if they are based only on legal agreements and not on deep trust founded on personal knowledge of the other party. (c) It has also learned that the right customers and partners can be extremely helpful in assisting ESC to establish operations in new countries.

**Where should ESC prioritize for development, Germany or China, and how should it achieve market entry in these territories?**

*Discussion:*

There is not necessarily a right answer to this question. It was one of the longest-running and most difficult arguments within the management team, and ultimately, there was no real consensus. The final decision that was made may not have been the right one: we will have to wait 10 or more years to know. It is possible to summarize the advantages and disadvantages on a table, and this could well become a class exercise, perhaps with different teams completing different cells.

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| --- | --- | --- |
|  | **Advantages** | **Disadvantages** |
| **Germany** | Business and cultural differences are limited and ESC has experience of working thereGerman companies are requesting that ESC works there  | Cannot find a potential partner to follow the ESC internationalization model: ESC will have to find another way, which may carry riskHas a record of failure in the territory |
| **China** | China is the territory with the greatest manufacturing growth and potentialEstablished customers are already asking ESC if they can work there: ESC may lose them if it doesn’t grow there | Massive liabilities of foreignness, with considerable cultural and normative differencesNo experience of working outside Europe, or of being able to identify people to trust |

The greatest difficulty in both territories was to be finding potential partners with whom the ESC internationalization model could be pursued. In Germany this was because they didn’t exist. In China it was because the cultural differences meant that it would be difficult to establish trust with one. The risks in both territories would therefore be great, and this risk would be lessened by not being in a hurry.

ESC had always found it easier to follow its customers and to work alongside them, and over the years the size of its customer base and the strength of its relationship with them had grown. The strategy would follow this great resource, and because the progress would be governed by experience, and without taking large risks, it was decided to enter both markets over the years 2012 to 2020.

In Germany, entry would have to be through Foreign Direct Investment, by establishing, ultimately, three branch offices in the territory. Progress, however, would be governed by the customer who was prepared to take the risk with ESC. A long-established customer — a family-owned global electronic product and domestic appliance manufacturer for whom ESC had worked with for many years — helped with a contract that very soon led to the establishment of an operation in the very west of Germany. A German national, who had previously worked for a consulting engineering company, was appointed to head it up, and he recruited engineers from US-Tronics.

In China, the plan was to see if an internationalizing European customer would help ESC to find local partners in China with whom the ESC internationalization model could be pursued. To date, little progress has been made, though it has not been for want of trying, with a team of three actively developing discussions with existing customers. One customer was keen to progress, but they failed to find a local operator to work with, and for speed it placed the contract with US-Tronics.

**Suggested readings**

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