Internationalization by Creating a Strategic Alliance with Distribution Partners

Bachelor's Thesis

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Abstract

This bachelor's thesis studies how a company that is a manufacturer and supplier of its own products can bring these products to foreign markets by creating supplier partnerships with independent distributors in the form of a strategic alliance. There are many forms of co-operative internationalization, but in strategic alliances both parties work together towards a common goal and companies can tap into some of the advantages of vertically integrated systems while retaining their independence. Supplier partnerships can be very profitable for both the manufacturer and its distributors if they are together able to reach markets, customers, and efficiencies otherwise unattainable on their own.

A manufacturer that supplies its products to local distribution partners can gain several advantages through being able to utilize its partners capabilities and resources. It has been proven that having a local partner company can help foreign companies immensely in successfully entering an unfamiliar market, and it can sometimes even be a near requirement. The local distributors have irreplaceable knowledge, contacts, and experience in the market, ---(cut?) and by co-operating, a manufacturer can right away obtain vital information that takes years of experience in the country to gain. Manufacturers can also lessen the risks and costs involved in investing to foreign markets by using local distributors' established logistics operations, instead of creating their own subsidiaries from scratch.

The capabilities and compatibility of the partners is a crucial factor for the alliance to thrive. It is better for companies to be able to focus on the things that they do best and not to try and cover for all the areas by themselves. This is why partners need to possess the capabilities a manufacturer is lacking in but needs for entering the foreign market. Another side to the compatibility is to have aligned long-term goals because this will lead to mutually beneficial decisions and neither has incentives for selfish decisions that harm the other.

There exists a trade-off between having a partner with maximum capabilities or having a partner that is motivated to help the manufacturer in conquering the markets. The more powerful a distributor is, the more it wants to control all the different suppliers and to keep them in a stable competition between themselves. A smaller but ambitious distributor is more likely willing to exclusively serve one manufacturer to the best of its capabilities.

Choosing the right markets also is a decisive success factor. A manufacturer should consider the size of the potential market for its products, the competition in the industry, and the specific difficulties in entering a certain market, such as legislation and both cultural and geographical distance.

For partnerships to succeed in the modern global economy, manufacturers need to work closely together with their distributors while sharing information and properly committing to invest and help each other. Both need to fully understand themselves, their partners, the customers, and the products.

Keywords distributor, strategic alliance, supplier partnership, market entry

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1. Introduction

Cooperative internationalization with its various forms is a long-time phenomenon and its strategies have become increasingly popular due to globalization. Expanding a business to foreign markets still requires more than just a good business plan and a product. It also needs avenues for getting the merchandise to the right place at the right time. With the help of a distribution partner, a firm is better able to achieve international expansion otherwise unattainable. Allying with a partner that has established distribution channels can benefit both organizations. (Sarkar et al., 1999; Tyler, 2015). Creating close cooperative partnerships between manufacturers and distributors where both work to improve the flow of merchandise and information in the distribution channel system can be profitable for all parties involved (Buzzell and Ortmeyer, 1995).

Entering new foreign markets makes the company face many different competitive dynamics and new kinds of risks and challenges, both commercial and legal alike. Typically, goods can be brought to international markets by one of three classic ways: direct sales, marketing through an agent, or sales through a distributor. International distributors play a big role in the modern economic environment in keeping the supply chain between users and manufacturers running smoothly (Bisi, 2018; Vigdor, 2017).

There are several different types of cooperative internationalization, such as joint ventures, export consortiums, strategic alliances, and foreign distributors (Camisón and Villar, 2009). Strategic alliances are a form of cooperation where two or more companies undertake a common project while remaining independent organizations (Kenton, 2020). Distributors are suppliers' first point of contact for reaching prospective customers of the supplier's products. The distributors rarely sell the products directly to end users. Instead, they usually acquire very large amounts of the product and sell them in bulk to wholesale representatives who then sell the products to retailers. Sometimes distributors sell directly to retailers, who sell the products to customers. Since the distributors in foreign countries are the usual – and perhaps the only – direct points of contact for companies looking to internationalize, suppliers often form partnerships with them specifically (Cole, 2019).

My aim in this bachelor's thesis is to study how supplier partnerships are created, when a firm is looking to internationalize and start business operations in new foreign markets by creating a strategic alliance with distribution partners abroad. I wish to shed light on the whole process of creating a mutually beneficial partnership. Therefore, my research question is: "*How do manufacturers internationalize by creating a strategic alliance with distribution partners?"*

I must set several requirements to the companies I will be talking about in this text to set clear boundaries. The research is done regarding companies that are a manufacturer and supplier of one or several finished physical products which they are already selling at least in their domestic market. The company believes the products to be compatible and have demand in foreign markets as well. The firm is looking to internationalize, but without an existing customer base and sufficient knowledge on the target markets, entering unfamiliar markets will be difficult and many factors bring uncertainty. The company has then decided to internationalize by partnering with distributors abroad, instead of attempting to do everything on its own through foreign direct investments or different forms of cooperation.

I chose this subject because I am inspired by Finnish companies that have reached the global markets and are able to influence things in an international scale. Finnish technology, machinery, and expertise are generally held in high regard, and so I wish to one day be a part of bringing these innovations from my home country to different parts of the world.

I have structured my thesis as follows. I will first study the reasons and incentives behind manufacturers choosing to create international supplier partnerships with distribution partners, and then the requirements for them to do so. Then I will explain how manufacturers and distributors create and develop successful strategic alliances together. Lastly, to add empirical information to my research and to compare it to the literature of this subject, I interviewed Anna Erkkilä, who currently is a senior consultant for NIRAS Finland, and who has 20 years of experience in advising SMEs on how to develop their international businesses. The interview was held in Finnish and recorded.

2. Strategic alliances with distributors: Reasons and requirements

2.1 Reasons behind internationalizing through supplier partnerships

Since an individual firm seldom possesses the resources and capabilities to expand into global markets, strategic alliances have more often become a competitive requirement for facilitating their ambitions to internationalize. (Ariño and de la Torre, 1998; Bisi, 2018). D'alimonte (2014) claims, that strategic global business alliances are an effective way to enter foreign markets. A partner could provide established distribution channels and marketing systems, a ready customer base, as well as insights and knowledge of the markets they operate in. An experienced distributor is also able to advise the supplier on how to move products to the market faster, and how to modify their products to answer the local market preferences and regulations, which in turn makes the product more likely to be sold (D'alimonte, 2014). Distributors are the ones in contact with customers, so the producer is dependent on the customer information gotten from the distributors. Therefore, the distributors should be required to give exact and relevant data on the markets and financial performance (Arnold, 2000).

Most markets are nationally regulated and largely controlled by networks of the local intermediaries. Corporations know, that by themselves they are unable to master local business practices, meet regulatory requirements, recruit and manage the local staff, or be introduced to potential buyers, which is why they turn to local distributors. A company can benefit from acquiring expertise and knowledge of a market by hiring local distributors, while being able to minimize risks by investing quite little compared to an acquisition. Although, by doing so a company cedes much more control over strategic marketing decisions to its local partners, than it would need to in its home market (Arnold, 2000). Another common reason for forming a strategic alliance is to gain access to another firm's innovations without having to invest in research and development (R & D), which also makes this strategy more cost-effective (Raja, n.d.).

When a firm does not hold all the key factors for internationalizing, it needs to find alternate ways to cover for its deficiencies. A firm can gain access to a capability which it is lacking in through a partner firm abroad. This way distributors operating in foreign markets can as a partner help a firm exploit its internationally transferable capabilities (Kogut, 1988). Strategic alliances can create a relatively quick path to growth. By allying with companies that have services complementary to itself, the supplier can add new business capabilities while remaining independent (Tyler, 2015).

The Institute for Supply Management defines the term supplier partnership as "A commitment over an extended time to work together to the mutual benefit of both parties, sharing relevant information and the risks and rewards of the relationship" (Jusko, 2011). The core of supplier partnerships is to agree on common "objectives, policies, and procedures for ordering and physical distribution of the supplier's products" (Buzzell and Ortmeyer, 1995). From these definitions we can understand that in partnerships it is important for both parties to be working towards a common goal. Creating a mutually agreed contract where helping the other party helps the manufacturer grow its own revenues, will lead to neither one having their own agenda or making decisions detrimental to the other party. These kinds of partnerships can produce some of the efficiency benefits of vertically integrated organizations but without being under the same ownership (Buzzell and Ortmeyer, 1995).

Forming a strategic alliance with a distribution partner supports an aggressive growth strategy. The benefits of partnering with distributors include shared risk, access to markets and resources, speed to market, cost savings, and economies of scale. Finding distribution channels that allow a firm to accomplish its international business plans involves developing deep strategic alliances with the right distributing partners (Tyler, 2015).

The shared risk in partnering is most commonly seen in R & D. The ever-increasing R & D costs combined with the speed of global innovating means that products can quickly become obsolete and the risks of in R & D investments increases. Sharing the costs and facilities of R & D produces good value for the invested resources, while the process can be sped up by mutually contributing knowledge. Risk can also be shared in other activities for example in transportation systems and joint marketing. Doing so will not only spread out the risk associated to new ventures, but it also helps maximize returns for both parties and reinforces them. Thus, risk and cost sharing might allow an internationalization attempt without staking too much (D'alimonte, 2014).

Here is a collection of examples what different sources say about the specific things a company could gain from a distribution partner:

A good distributor can improve response times, expand a company's reach, create added value, and collect vital information from the customer interface (Bisi, 2018).

What the distribution partner could bring to the table is added product value, better access to markets, enhanced operations, better technological capabilities, strengthened strategic growth, improved organizational skills, and bolstered financial strength (Raja, n.d.).

A local partner can help with translating documents, converting from imperial measures to the metric system, adjusting to the local power grid and supply voltage, and complying with packaging regulations (D'alimonte, 2014).

From the examples above we can see that there are plenty of different ways for distributors to help a manufacturer. In a nutshell, they can provide expertise, additional value, and help overcome specific market related obstacles.

Companies quite often work together in distribution or marketing to get the better of their competition. Founding a well-planned strategic alliance can grant a head start to a market, or even impede competitors from starting their operations there. (D'alimonte, 2014) Entering into an alliance with an influential partner can diminish the market power of competitors. However, when forming an alliance companies should be careful not to create cartels or to breach the local anti-competition laws (D'alimonte, 2014).

A harsh downside of strategic alliances is having to share the intangible resources of the company, which play a key role for firms to obtain a competitive advantage over their competitors and potential partners. The risk of leaking information to an outsider is especially high, if a distributor also serves any of the manufacturer's competitors. There are also other factors that lessen the need of partnerships for a manufacturer, such as the learning curve of international growth. (Camisón and Villar, 2009). This is due to the firm becoming more competent and less reliant on others in initializing international commerce. If a firm already possesses the capabilities and resources to internationalize on its own, by doing so the firm does not need to share its tacit knowledge. Additionally, companies already experienced in supplier-customer relationships with multinational enterprises operating in their domestic market cold possibly leverage those relationships for acquiring new customers and expanding abroad. (Bradley et al., 2005; Raja, n.d.)

2.2 The requirements for internationalizing with a partner

Several requirements need to be met, for a company to be able to succeed in initiating an international cooperative operation. The more capable and cooperative both the parties are, the better their chances of success. If a firm is aiming at international expansion, it is necessary for it to have internationally transferable capabilities and a usable product. The managers must reflect on how far the company already is in its internationalization process to be able to decide on the optimal ways of growing in foreign markets. The assets abroad, acquired knowledge about the foreign market and the firm's competitive strengths are what determine the need for cooperation to exploit or complement the company's position in the markets abroad when internationalizing. It is also very relevant to assess the maturity of the firm itself. If the operations, supply chains and processes are not well organized or thought out domestically, you can't expect the firm to be able to create a similar working business model in a foreign country (Camisón and Villar, 2009).

Having internationally transferable capabilities is a positive predictor for the inclination to internationalize by cooperating. However, the more experienced the company is abroad the less it has propensity for international growth through alliances. Evidently accumulated capabilities that can be applied internationally do not alone determine a company's strategy for international growth (Camisón and Villar, 2009). Complementarity is another factor, that positively predicts whether firms are likely to enter cooperative arrangements (Nielsen, 2003). Camisón and Villar (2009) point out, that while the firm-specific factors enable cooperation, it is the environmental factors that create the need for it. Even if the environment is not creating direct pressure for cooperative internationalization, just presenting the opportune situation might be enough for the firm to pursue this strategy.

3. Creating successful supplier partnerships

3.1 Choosing foreign markets

Foreign market selection is strategically a critical decision and a key success factor in a company's attempt at internationalization. After making the decision to internationalize by cooperating with a local distributor, the first step is to identify two or three countries that would be suitable for the products (Myers, 2010). This decision is done based on whether the potential end users abroad would see the products as useful, how big the potential market is, how hard the competition is and how difficult would entering the market be. Things that also affect choosing the country are local legislation, common language of communication, and the target country's logistics performance (Schu and Morschett 2017).

A good example of a relatively easy foreign market entry is a German company going to Austria. They both speak German, have a low cultural distance, are geographically close so the products cross the border easily, and they have similar incomes per capita. In addition, partly due to both being a part of the European Union the countries' laws and economic systems are similar, they use the same euro currency, and German products have a reputation of quality and reliability in Austria (Schu and Morschett 2017). China on the other hand is a country notorious for letting domestic companies copy western products and sell them in China or even start exporting, without any ramifications regarding patent or copyright issues. This makes it riskier to bring your product there, since the law institutions do not protect foreign firms in this matter. China has also been in a harsh trade war with the Trump administration, which negatively affects not only the exporting of U.S. products there but also the image of U.S. companies, since they might be seen as opponents by the Chinese people (Koty and Wong, 2020; Lubrano, 2019). Depending on the country, government policies and regulations can be beneficial or extremely harmful (Schu and Morschett 2017).

Partnering with a local company can be useful when a company needs to overcome market entry barriers created by either market conditions or government policies. (D'alimonte, 2014). In Japan for instance, companies are often times reluctant to do business with foreign companies, because in Japan business is done on the basis of personal relations and trust as opposed to an institution-based view. A firm might very well need to cooperate with local a distributor to succeed in Japan, as collaborating with a domestic company has been proven useful and a near necessity for a new foreign company when entering the Japanese market (Andom and Joxelius, 2012).

Two decisive factors for choosing a country seem to be the realistic estimated demand and how arduous it is to establish a business there for a company from your country. The potential demand is affected by the size of your targeted market segment and the level of competition. The difficulty of market entry is affected by various factors, but the biggest deterrents can be the laws, regulations, and the competition in the industry. Tariffs and taxation are also relevant things to consider (Schu and Morschett 2017; Andom and Joxelius, 2012).

To have a better picture of the competitive situation in a potential market, one can use the Porter's Five Forces Framework, which is a method for analyzing the competitive environment and therefore the attractiveness of an industry, although it has its limits like only producing a list of factors that can affect a firm without putting them in a ranked order (Scott, 2020).

Distance between countries is not as big of an issue as it used to be a couple of decades ago due to efficient communication networks and the ability to move people and goods around the world with speed and reliability in an ever-improving manner (Ghemawat, 2007). This said, the internet neither removes the borders between countries nor the need for learning, gaining experience, and adapting to the conditions of the local market (Schu and Morschett, 2017). Even with the internet, cultural and geographic distance remain significant factors in the when choosing countries to enter, perhaps even to an unreasonable extent because of biased

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thinking (Baaij and Slangen, 2013). Geographical distance between a new target country and the existing country portfolio can be relevant for the distributor, because countries where operations have already been established can be used as logistics hubs from which nearby countries could be more easily served than from the home country. Thus, the added geographical distance between a country with already established operations and a target country have a negative effect on the propensity to choose a specific country (Schu and Morschett, 2017).

3.2 Choosing distribution partners

The next step after deciding on a country to enter is to find a compatible partner that could provide the capabilities that the internationalizing company needs for it to reach its target markets. In order to pick the right partner and to build an efficient alliance, the manufacturer should analyze its customers, products, and geography to determine where distributors could bring added value. The manufacturer should also collect information from separate teams within the company as well as external sources, to gather insights from different perspectives. As an example, the manufacturer could go straight to end customers and ask whether a distributor is able to answer all relevant questions regarding the product, or it could seek consultancy from local industry experts about regional demand trends. The manufacturer should then choose the distributor with the expertise and strengths most aligned with what is needed (Batra et al., 2016).

From the distributors' point of view, it is possible that the new product would be a substitute (a product that could serve as a replacement) or a complement (a product that brings added value when together) for a product already in their selection. Having two complementing products sold in the same place would boost the sales of both of them but bringing a substitute product would lead to the distributors to partially cannibalizing the sales of their old products. Acquiring a substitute product might still be a good thing to do if their new product leads to an increase in sales overall. Any amount of increased market share is gained at the expense of the competitors, and this might help preventing the competitors of the distributor from obtaining the products to their selection (Atasu et al., 2010).

To ensure an objective and accurate decision, a manufacturer should assess all considered distributors on a market-by-market basis by use of three core criteria. The first criterion is customer relationships, which evaluates the distributors' local market share compared to the competitors, how well they are positioned to reach the majority of the market, and their growth over the last few years. The second criterion, product knowledge, assesses whether the local customers see a distributor as a leader or a follower in its category, and if it can provide competent technical support for both the current and the expected future portfolios. The third criterion is sales capabilities. It analyses whether the manufacturer has achieved good sales in the market region, and whether the distributor is capable of providing the targeted customer outreach and high-quality relationship management. Additionally, the manufacturers should assess the ability to serve customers swiftly and efficiently while minimizing the possibility of supply disruption (Batra et al., 2016).

Looking solely at the criteria above, one might only consider the capabilities of the distributor, and forget about considering its motives and strategy. This can lead to a situation described by Arnold (2000), where in many cases a manufacturer ends up with the company that has the strongest position among the local distributor in the current status quo. The issue is that it also serves a couple of the manufacturer's major competitors. Even when these distributors certainly have a large clientele, they also want to control the product category, keep the competing suppliers in balance, and maintain market structure. On the other hand, a new company entering a foreign country with hopes of obtaining as big of a part of the market as possible, essentially wants to change the market structure. After some time, this arrangement is likely to deliver a sales plateau, and the manufacturer will struggle to grow its market share. Being market-led and assessing what customers want from their supplier (the distributing company) instead of doing the strongest distributor's bidding will oftentimes result in choosing a better distributor, due to a more thorough analysis of potential partners (Arnold, 2000).

A manufacturer should prefer distributors that are capable and willing to develop markets, instead of ones with a handful of ready customer contacts. The nature of the relationship with the distributor should be aligned with the manufacturer's long-term goals. This way the distributor's role is to help implement the manufacturer's marketing strategy, rather than being a local marketing department (Arnold, 2000).

One manufacturer took a closer look at the four distributors it was working with at the time, examining the abovementioned criteria of customer relationships, product knowledge, and sales capabilities. The analysis revealed the distributors to be often lacking in some capabilities or knowledge on particular products. To address these shortcomings, the manufacturer dramatically expanded its network to consist of 35 distributors, that when combined had all the necessary skills. The change of strategy was worthwhile, as distribution revenues increased by 12% within a year (Batra et al., 2016).

According to D'alimonte (2014) when companies cooperate, they often share highly valuable skills that are not for sale. It is typical for one partner to possess the technological know-how along with the ability to keep up with the rapid technological development in its field. What this partner needs from a partnership is capital, extensive distribution systems, marketing skills, service networks, and credibility in the target market. The partners exchange key capabilities in the partnership to gain new expertise. Firms with complementary skills are able to rely on each other's skill sets instead of dedicating resources and time on developing something that has already been done (D'alimonte, 2014).

There can be hundreds of possible distribution partners to choose from, which can be overwhelming (Bisi, 2018). Particularly firms with little experience and few contacts in the target market can have a hard time finding the right distributors. Potential distributors can be found by searching online marketplaces, networking, participating in a local trade show, getting consultancy, a marketing agency, or a trade association of the manufacturer's industry. Contacting top consultancy firms is a very common tactic since they already know trusted distributors abroad. They can also make a short list of the best suited partners and give their profiles, based on the given market entry strategy (Bisi, 2018).

Having expertise from multiple fields is requisite in international business projects, even when traditionally firms try to develop and hold all the necessary capabilities in-house. As complexity increases in technology and the governance structures of corporations, they are realizing that not everything should be done by one company. This results to a strategy of companies focusing only on the core parts of their business (D'alimonte, 2014).

Once a manufacturer has identified a distributor that fills the requirements, it should talk to other companies it represents to see how the relationships are working. It is also recommended to visit the distributor because developing personal relationships help business partnerships prosper. The importance of this is highlighted in cultures where people must be acquainted on a personal level to do business together. Travelling to the site also allows a more accurate assessment of the distributor's capacity and facilities (Myers, 2010).

3.3 Making supplier partnerships successful

After finding a suitable partner candidate, the supplier needs to "sell" the idea of creating an international strategic alliance and cooperation. The candidate company must see realizable value in the partnership, to even start considering the offer. Even if the cooperation seems profitable for the desired partner, they also need to consider the lost opportunity cost of investing their time and resources in the cooperation. If the possible partner believes it can make a better return on its investment with a different partner or in another market, or if they can create similar (or even a slightly smaller) profits but with a significantly lower risk, they will likely turn down the offer (Li, 2014).

It is critical to understand the business culture of the country to present the cooperation proposal in the correct manner and to not offend the other party. Having consulting help might be necessary if the business cultures are not very close to each other or if for example there is a language barrier. Even if the distributor speaks fluent English, creating a one-page selling sheet in the distributor's own language might be a good idea. Reading about the products in their native tongue will resonate more with the distributor and this also shows respect for other people's cultures (Myers, 2010).

Myers (2010) suggests that once the initial order with the distributor has been done successfully, the manufacturer will probably want repeat orders from its distributor. These will not just happen automatically without the manufacturer giving the support that the distributor needs to market the products. Building on the relationship will help and motivate the partner to sell the products. By maintaining regular communication and being proactive, the manufacturer can find out how things are going and how they could further help the distributor in creating sales. Above all, it needs to be made sure that the distributor fully understands how the products work. Additionally, it would do good for the distributor to know the strengths, weaknesses, and the complementary goods of the products. A manufacturer might also want to point out the reasons why a customer would choose the products over the competing options. (Myers, 2010).

Arnold (2000) portrays a common issue that arises when an established multinational company appoints a local distributor to a new market. At first, sales and revenues take off and the market entry seems to have been a good move. But after a while, sales start to stagnate. Alarmed, the company tries to discover the cause. The managers soon settle on what seems to be the primary obstacle for sustaining growth: their local distribution partner that had a flying start is now running out of methods for growth and starts to underperform. The pattern gets repeated time and time again as the enterprise expands to new markets. The executives then decide to make major changes by reacquiring the distribution rights and creating a new subsidiary, or in some cases buying the local distributor. Transitioning from indirect to direct sales can easily be expensive and disruptive and it might also create new issues. A few years later the company discovers to have an inefficient network of national distributors. Summed up, the local distributors are needed for market entry, but the manufacturer believes that owned subsidiaries perform better as they are under ownership (Arnold, 2000).

Most managers will see the fault in how the local distributors conduct their business. When asked what went wrong, their answer will typically be at least one of three things. First, *"The distributor didn't know how to grow the market".* In the beginning, distributors make easy sales with the manufacturers core products to the existing customer base. When the distributor moves on to the rest of the products or new market segments, the distributor does not seem to be competent enough. Second, *"The distributors didn't invest in business growth".* Even after encouraging investments, multinational managers think the distributors invested too little. Last, *"The distributor just wasn't ambitious enough".* Many managers believe that the typical distributor does not seek to dominate the market, but instead to have a midsize profitable business which it still can personally control (Arnold, 2000).

The local distributors on the other hand often have a starkly different view on why the relationships do not work in the long run. They will give reasons like not receiving enough support for growing the business, the impossible was expected from them, and that the partner's politics were too complicated. As a consequence of pointing fingers at each other, both parties overlook a repeatedly emerging point; neither party does sufficient investments in strategic marketing nor developing the business to reach the rest of the markets. Heavily committing to an unfamiliar market with independent distributors represents a risk unacceptable for many, and yet, multinational corporations have discovered that committing resources early to support the distributors operations leads to enhanced relationships and business performance. Corporations understandably want to keep risk to a minimum when entering new markets, but if this leads to a subsequent lack of investments and managerial attention, it can have a harsh effect on performance (Arnold, 2000).

The key to keep on growing after the business moves away from the distributors main customer base is to recognize the predictable phases of international distribution. Instead of looking for a distributor that has a ready market to serve, the manufacturer should seek one with a good "company fit", meaning they have a company culture and strategy compatible to the corporation's own (Arnold, 2000).

Companies should come up with appropriate incentives in order to encourage distributors to turn their attention to chosen products, market segments, and regions. To encourage focusing on a target area, the manufacturer could decide to compensate the distributors only when they increase their sales in the carefully chosen product category or region. As an example, focusing on underserved regions and customer segments will more probably result in increased returns, than supercharging pre-existing efforts in a major market, where the products' sales may already be nearing their saturation points. The incentive system should not be made in a way that would penalize distributors. Instead, the focus should be on creating incentives that would guide distributors with reprioritizing their focus and identifying possible regions and customer segments that do not yet receive adequate attention and coverage. This tactic is beneficial for both parties, as manufacturers will more likely reach their sales targets across the entire range of products, and distributors will understand how to increase their compensation (Batra et al., 2016).

While distribution channels are crucial for most manufacturers, distribution relationships are subject to some inherent problems. Suppliers can mitigate many these problems by developing a complete understanding on each of their products and their customers' needs. It is also necessary to understand the distributors' capabilities, incentives, and the support they require to succeed. Batra et al., (2016) mention four major areas of concern that might impede the efficient use of distributors. First, *a lack of customer insights:* Manufacturers might not use distributors as efficiently as possible, because they do not understand their customers in a detailed manner, including their varying needs for specific projects or regions. Second, *a short-sighted view of the distributor relationship:* Being inexperienced in distributor operations can lead to the manufacturer to fail in providing the appropriate support or incentives. Too often do they try to decrease the distributors' margins – a move that could set even loyal partners at odds. Third*, insufficient product insights:* When companies decide their distribution policies on the portfolio level, the accuracy of pricing and design modifications will suffer. The heterogeneity within the portfolio or customer base will lead superficial decisions to lose value. Last, *intermittent attention:* Problems may occur even in initially working distribution strategies if manufacturers fail to periodically re-evaluate them. Distributors' capabilities are constantly evolving and additionally, a needs and preferences of customer's change all the time (Batra et al., 2016).

Manufacturers could as first step to improve the relationships with their distributors, create an extensive fact base. This would contain detailed information and market data about individual products. Looking at spreadsheets is not enough on its own though. Different in-house divisions and teams have important knowledge on specific areas and recommended strategies for specific products and customers, since they work closer to the customer interface than the management (Batra et al., 2016).

It is rare for a supply chain strategy to reach its potential to the fullest without the CEO setting the tone. The same holds true for collaborating with external partners. An atmosphere of real collaboration is important, because sometimes distributors might wrongly see partnerships as a way for them to try to get better terms from of the supplier – price concessions for instance – without returning the favor. Merely sharing information and not having joint decision-making tends to create expectations for performance improvements, but without significant results. Just like relationships between people, partnerships between suppliers and distributors require time and effort. Both parties might need to regularly evaluate each other and the relationship so that issues are solved, and the partners stay on track (Jusko, 2011).

For a manufacturer to improve the interactions with its distributors Batra et a., (2016) suggest abiding by the following factors:

- *An emphasis on capability building.* Sales representatives deal with various different brands and products including ones that might not be so familiar to them, so they are appreciative towards manufacturers who assist in building their knowledge and capabilities. Ideally, manufacturers will provide training in-person so that the sales representatives can then apply their skills in the work environment.
- *Availability of frontline coaching.* An easy way to lose customers is to appear slow and bad at responding to questions and requests. One way a manufacturer can help distributors in providing rapid answers is by placing their own employees on site with the distributors to work together with local sales representatives. Manufacturers might even put together small teams for the task of supporting distributors in specific regions.
- *Strong supporting materials.* Manufacturers should produce comprehensive and easily accessible support materials. Case studies and white papers describing how a distributor can provide complete solutions are particularly important.

- *Clear expectations.* Service-level agreements should contain clearly stated expectations. Manufacturers should also be clear about providing benefits that the distributor will receive for good performance.
- *Appropriate organizational and IT systems.* Re-examining its organizational structure can help a manufacturer to determine how distributor relationships can be improved. For instance, creating new roles or hiring more staff might be necessary to manage the growing distribution channel. IT systems should be user-friendly for distributors and end users, and they need to be capable of handling transactions in large volumes.
- *A willingness to assist with marketing.* Marketing efforts are carried out best when both parties are involved, with the distributors interacting with customers, and the manufacturer stimulating general demand through a variety of measures. The manufacturers actions are to support the distributors and not circumvent them by leading customers to alternate places to complete their purchases.

By providing distributors with a combination of the types of support discussed above, a manufacturer can considerably improve their gross margins, meanwhile distributors can also receive higher revenues due to sales efforts becoming more effective. Manufacturers with most success consider what exact capabilities they need from a partnership, which distributor can best provide these, and how can both parties benefit from the arrangements. Thus can be observed, that efforts in a supplier partnership go far beyond simply agreeing on the terms and conditions, and compensating the distributors (Batra et a., 2016).

3.4 Negotiating the terms of the contract

Utmost attention and careful thought should be given to the numerous factors of a partnership before a contractual agreement is made between a supplier and a distributor. This can help in fending off controversial occurrences between the parties, regarding any aspect of the partnership and when being confronted with day-to-day situations. Vigdor (2017) brings up 10 “golden rules” for engaging with a distributor, which is a guideline for things to consider when creating a supplier partnership:

1. *Exclusivity.* Should a distributor be given exclusive rights, or should the rights be granted to several partners simultaneously? Is the distributor allowed to sell products similar to the supplier's?
2. *Minimum purchases as a condition for retaining the distribution right.* The distributor needs to reach a minimum target during a set time period. If it the distributors lacking performance lead to loss of market for the supplier, it could then terminate the exclusivity or even the entire contract with the supplier ahead of the predetermined date.
3. *Identity of the distributor and definition of obligations.* What is the distributor's role in the supply chain and what are they responsible of? According to Batra et al., (2016) the supplier will need to choose whether the distributors are to be used for fulfillment, creating demand, or both. The role depends on the capabilities of each partner, whether the distributor is a link to a larger distributor chain, and its performance in the past. Some of the things that a supplier may demand from its distributor are arranging the regulatory permits for commercializing the products in the chosen market, developing a marketing system, advertising the merchandise, employing the personnel, technical and customer support, a warranty and repair system, etc. Establishing these terms and conditions is often a strong indication of the distributor's character, intentions, and its willingness to be committed in a long-term partnership.
4. *Price of the products, payment terms, and shipping.* Normally the price per product is based on the catalog price of each product individually. However, the price might be changed due to factors such as the scale of purchases, discounts in order to penetrate the market or a change in raw material prices. There must be a thought-out price change mechanism provided in the agreement. Also the payment terms can change depending on whether it is a first, significant, or regular purchase by a long-standing partner with no late payment history.
5. *Protecting the intellectual property rights of the products.* Other than in special cases it must be verified that the intellectual property rights regarding the product strictly remain the property of the manufacturer. The distribution rights and the licenses granted by the

manufacturer to distributors and customers for using the products are to be described with requisite accuracy.

6. *Warranty and product liability.* When there is a defective product, the company providing the warranty will have to replace or repair the product which can be financially significant for either party. Product liability is the manufacturer's obligation to compensate any harm to a person or property caused by the use of the product.
7. *Period of engagement and termination.* It is essential to determine a set period for the companies' interaction, and to clearly define a mechanism for the renewal or termination of the agreement. A conversation about renewing or terminating the contract when the current agreement ends should also be held actively enough, so that the companies can react and plan for the future.
8. *Limitation of liability and compensation in the event of termination.* It is a general rule that a breach of contract entitles the harmed party to be compensated for the damage it was caused (if any). The limitations can include or exclude for example indirect damage and consequences. Sometimes the distributor may argue that even if the agreement is ended in its intended date without a breach of contract, the distributor is caused damage from terminating the agreement. This is due to the investments done by the distributor to build a relevant market throughout the term of the agreement, and in such case they demand for compensation.
9. *Dispute resolution mechanism, jurisdiction and governing law.* Whether the product is perceived to belong to a foreign or a domestic company, and whether the laws of the supplier's or the distributor's country are followed in disputes, can make a massive difference.
10. *Why is a written agreement necessary?* In the light of all the things discussed above, it is quite evident that a binding written agreement between the parties is needed. In the absence of a written agreement regarding a certain situation, solving it will be conducted according to the applicable laws. All of these rules combined will clarify the roles, give legal protection, and reduce the amount of disputes for each partner. These rules and the

intentions of the parties of course deviate in specific cases, due to the complex aspects of the relationships between suppliers and distributors. (Vigdor, 2017).

3.5 Interview of Anna Erkkilä

The results of the interview were quite similar to my main findings from the academic literature on this subject. Erkkilä emphasizes the importance of carefully pre-determining the criteria, that will be the basis of choosing the distribution partners. Understanding what kind of a role the distributors should have in the partnership will help in setting clear requirements for the capabilities the distributor should have. A thorough background check should be done on the possible partners, to see that there is nothing of concern about the business financially or ethically.

As mentioned before by Vigdor (2017), having a written contract that satisfies both parties is vital. Erkkilä adds, that requiring detailed terms should not be regarded as a sign of distrust between parties, but instead as aligning the companies' strategies to better achieve a win-win situation. Determining a revenue share model is always one of the most important parts of a contract. A model that fits all situations does not exist, but by understanding how the revenue streams and costs are structured, the partners can come to a fair agreement. To do this, Erkkilä suggests using the Business Model Canvas, that is used for mapping out and visualizing an existing business model. The way of sharing the revenues will affect the incentives of the distributor to sell the product as much as possible. As an example, if the distributor earns a certain percentage of every product sold and a fixed retainer fee is paid every month, it is less motivated to promote the new product, since they receive a good sum of money from the manufacturer anyway.

One reason not to start a partnership is that distributors will take their cut of the revenues, which can be avoided by creating owned subsidiaries. This will also remove the need to negotiate contracts with outsiders. Additionally, if the distribution partner is substantially larger than the internationalizing company, it might not prioritize the cooperation with the partnership. The manufacturer wants to have a distributor, which has good capabilities, but which will also regard the shared project as important (Erkkilä, 2020).

Erkkilä points out, that when a company does a market entry, it should be considered as an investment. The manufacturer should be prepared to put resources in an operation that will take some time before starting to create sales revenues let alone proper growth, because establishing a new business takes time and resources.

4. Summary and conclusions

This thesis has delved into the subject of internationalizing by cooperating with local distribution partners and creating strategic alliances with them. I began with examining the reasons for internationalizing in this specific way and explained what kind of companies this approach is suitable for. I then studied the methods and theory of choosing the right partners and how to build successful supplier partnerships in the context of a strategic alliance, in order to describe the entire process that a manufacturer goes through. Next, my interview with Anna Erkkilä helped in bringing an experienced expert's point of view. And finally, by summarizing my findings I can draw conclusions on what seem to be not only the generally accepted criteria, but also the contradictive viewpoints for creating mutually prosperous partnerships in foreign markets.

I summarize my findings as follows. Companies can achieve expansion otherwise unattainable when partnering with distributors (Sarkar et al., 1999). This is because local distributors have already established operations and experience, and they are far more knowledgeable of the local market. A manufacturer on its own is not able to gain a local distributor's capabilities without acquisition or cooperation (D'alimonte, 2014). Another reason for choosing to internationalize specifically by the way of partnering with a distributor is lowered risk and costs (Jusko, 2011 and Arnold, 2000). It is widely understood in the modern global economy, that for manufacturers and distributors to really achieve the potential benefits from their partnerships, they need to work closely together to achieve common goals, be compatible with each other, and actively support their partners (Buzzell and Ortmeyer, 1995; Batra et a., 2016; Myers, 2010).

Having common long-term goals in a partnership will discourage selfish decisions and motivate the parties to do their personal decisions in a way that is aligned with their partner's strategy (Buzzell and Ortmeyer, 1995). A company should not try to do everything by themselves, but rather focus on the activities where it can create value better than others – its core competencies. Having partners that are capable in the areas that the manufacturer needs but also lacks, will allow it to focus on what it does best (D'alimonte, 2014; Batra et al., 2016). For these reasons, choosing the right partners is already by itself a strong indicator for a successful partnership.

By committing to invest resources to support their partners and by openly sharing relevant information and insights with each other leads partnerships to perform better. Once a company has tested a market, they nearly without exception commit to the market even further. The risk of entering a foreign market needs to be minimized beforehand by properly analyzing and then choosing the right markets and partners. This way a manufacturer can then more confidently commit and invest in the new market and choose its distributors (Arnold, 2000). Thus, the outcome of this thesis is that manufacturers looking to internationalize can achieve far more when partnering with distributors abroad. The conclusion from this is that when a manufacturer has decided to internationalize through this strategy, they are to first choose their partners wisely, and then properly commit to developing their businesses in tight cooperation together.

There are two trade-offs I discovered from the literature. First, the more capable and powerful a distributor is, the less motivated it is to commit to a close partnership with just one company. An oligopolistic distributor will rather have many brands in its selection and not limit itself to just one company, because this grants more control and helps it serve a more diverse customer base. The second trade-off is that manufacturers want to avoid risk, but they need to invest sufficient resources for the partnerships to excel. Empirical studies show, that minimizing risks should be done in the phase of choosing markets and partners, after which the manufacturer should commit to aggressively building their operations and partnerships. Literature regarding both these trade-offs was sometimes one sided and overlooked the other side of the equation. Being aware of these trade-offs gives a better idea of the whole picture and helps in choosing the right distributors.

Some limitations in this thesis include that the business cultures and legal practices are different in every country around the world, which means that there is no universal advice or concept that can be applied to every situation. Companies also come in different shapes and sizes, which again creates different scenarios. Another major limitation was that my research addressed solely physical products because intangible products such as software programs and applications are sold in a very different manner. In addition, the research material I have used is mostly based on literature from the U.S.A. and Europe. I have also excluded research on online retailers that play a big part in the modern distribution channels.

Further research could be done regarding the balance of power between the manufacturers and distributors, and how this affects the decision making and the roles of the partners. It would also be interesting to expand the research to better address the rapidly rising Asian and African economies.

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