An Exploratory Approach to the Internationalization of German Family Firms to Latin America: Current Situation and Future Opportunities

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Johannes Ritz, M.A., MIB
Email: Johannes.Ritz@munich-business-school.de

Prof. Dr. Marc-Michael Bergfeld
Email: Marc-Michael.Bergfeld@munich-business-school.de

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Abstract:

This paper aims to analyze the internationalization efforts of German family firms to Latin America. It tries to shed some light on the current situation, the internationalization paths and financing options as well as the future opportunities for these firms in this region. This is especially important from a practice perspective, given the actual macroeconomic situation with an ongoing European crisis which puts pressure especially on German family firms which highly rely on exports to European countries to diversify their markets. On the other side the steady growth and increasing stability in Latin America presents interesting opportunities for expansion.

It could be shown that so far only very few German family firms exploit the opportunities in Latin American markets. Those who do generally follow a stage model of internationalization and use exporting and local representatives for market entry. Hereby there are strong indications that family-family relationships play a special role in this process, even more so the relationships between the German family and a local family of German heritage. It could be concluded that there are interesting opportunities German family firms could exploit and that using local partners of the same cultural background might be able to facilitate the process.
Introduction:

Today family firms operate in a new, changed global context. Global integration of industries is continuing to increase and makes competing on the global markets more complex, difficult and challenging. (see Ernst & Young Global Limited, 2012) The digital revolution also deeply affects the way business is done as the world has become more and more interconnected. This development has radically changed communication behavior, torn down barriers to doing business across international borders and created new, emerging industries. These changes present many opportunities for the internationalization of family firms (Fernández & Nieto, 2006); (Tsang, 2002); (Zahra, 2003) (George & Zahra, 2005); (Westhead & Howorth, 2007). However they also present challenges especially for traditional companies and industries. (World Economic Forum and INSEAD, 2012) The rise of emerging economies, like the so called BRIC countries or other “frontier markets”, threatens the competitive position of the traditionally leading economies in Europe and the United States. (King, 2010) On the company level this trend results in a faster changing environment and often dramatically increased competition from emerging market companies. (Ernst & Young Global Limited, 2010)

This new global context puts increased pressure on family firms to internationalize as a step to staying competitive in the new global market environment. Consequently, it can be seen that the main drivers for internationalization are growth, limited domestic markets and knowledge related reasons. (OECD Working Party on SMEs and Entrepreneurship, 2009)

As family firms in many of the industrialized countries, especially in Germany, are the backbone of the national economy it is important also from a macroeconomic view that they stay competitive. In Germany 92% of all companies are family controlled. These companies count for 60% of all people employed and 51% of revenues generated. (Zentrum für Europäische Wirtschaftsforschung GmbH und Institut für Mittelstandsfororschung, 2011) For Germany as a recognized export nation the percentage of firms that are serving international markets is about 12% while about 3% are active in foreign direct investment activities. (Wallau, 2006) Furthermore the German export structure still depends heavily on the neighboring EU countries, with 92% of mid-sized German companies exporting to at least one
western European market, realizing a 47% of their total export revenues in 2011 in this region (KFW Economic Research, 2012)

Hence, as a result of the European crisis, German exports to European countries have developed much slower that to other regions (Broyer, Petersen, & Dr. Schneider, 2012) putting an increased pressure on firms to diversify their export markets. Latin America, on the other hand, has shown overall very resilient and steadily, over average growing economy and historically low unemployment rates in the recent years. (The World Bank, 2012) However, the region has been somewhat ignored by the German industry and politics in the past. (Auswärtiges Amt, 2012) Looking at the overall export statistics for Germany confirms this judgment as Latin America just received 2% of the total German exports in 2011. (Statistisches Bundesamt, 2012)

This situation requires looking deeper into the actual situation of German family firms in Latin America and the future opportunities that might be exploited in the quest for diversification of export markets. Analyzing the current situation also might generate knowledge that can be beneficial for family firms that want to internationalize to Latin American markets.

Therefore, the present paper aims to make a first step into filling the research gap about the activities of German Family Firms in Latin America. It examines the actual situation and aims to answer the questions of what internationalization paths and financing options are used by family firms that are already active in Latin America. Also, it tries to identify the future opportunities for German family firms in the region and possible steps to accelerate their internationalization efforts towards Latin America. Looking closer into the situation of German family firms in Latin America can also contribute to the broader debate about the process of how family firms go about their internationalization efforts.
Literature Review:

The process of internationalization of companies in general has drawn a lot of attention of researchers for several decades and has been examined in different perspectives. (e.g. (Johanson & Vahlne, 1977) (Johanson & Vahlne, 2009); (Dunning, 1988); (Dunning & Lundan, 2008); (Schmid, 2007)) But still comparably little research has been conducted on the internationalization of family firms. (Pukall & Calabrò, 2014); (Kontinen & Ojala, 2010)

However, this emerging sub-field of research on family firms currently is gaining traction as there are more studies conducted and articles published in the recent years. (Calabró, Torchia, Pukall, & Mussolino, 2012); (Arregle, Naldi, Nordqvist, & Hitt, 2012); (Sciascia, Mazzola, Astrachan, & Pieper, 2012b) As Pukall and Calabró (2014) categorize in their recent review article on research on family firm internationalization the four topics studied the most so far are family firm heterogeneity, internationalization processes, relational/network aspects, as well as resources and capabilities. (Pukall & Calabrò, 2014)

In the first category of family firm heterogeneity researchers mainly focus on the positive or negative effects of different degrees of family ownership on internationalization. Main findings are that 100% family ownership has a negative impact on the internationalization (Bhaumik, Driffield, & Pal, 2010); (Sciascia, Mazzola, Astrachan, & Pieper, 2012b) However, outside minority shareholders can turn this effect to neutral, if not positive. (Fernández & Nieto, 2005); Sciascia et. al. (2012b) therefore suggest a curvilinear relationship between ownership and internationalization meaning that family ownership at moderate levels leads to higher levels of internationalization. Also there are studies that confirm that external influences in the governance structure of family firms increases their internationalization. (Arregle, Naldi, Nordqvist, & Hitt, 2012) (Calabró, Torchia, Pukall, & Mussolino, 2012); (Naldi & Nordqvist, 2009) In the category of internationalization processes research focuses on the pathways and pace of internationalization and the influence of generational change. Main findings are, for example, that family firms generally tend to internationalize slower than non-family firms, following the Uppsala Stage Model. (Claver, Rienda, & Quer, 2007); (Kontinen & Ojala, 2010); (Olivares-Mesa & Cabrera-Suárez, 2006) However, incoming owner generations can accelerate the internationalization efforts. (Bell, McNaughton, & Young, 2001); (Bell,
McNaughton, Young, & Crick, 2003); (Graves & Thomas, 2008). With regards to the Relational/Network Perspectives studies suggest that family firms can compensate their weaknesses with regards to internationalization using family-specific resources like trust, altruism, and social capital (Calabrò & Mussolino, 2011); (Segaro, 2010); (Zahra, 2003) Another study suggests that through network relationships even lacking financial resources and competence can be acquired. (Wright, Filatotchev, Hoskisson, & Peng, 2005)

Concerning the Resources and Capabilities View studies suggest that family firms generally have fewer financial resources available than non-family firms (Graves & Thomas, 2008) and lack managerial capabilities and internationalization knowledge within the family, both of which factors negatively affect internationalization. (Graves & Thomas, 2008); (Okoroafo, 1999)

Within the field of studies on family firm internationalization there have been numerous studies focusing on one country, for example Spain (Pukall & Calabrò, 2014) and only few studies with a multi-country focus (Carr & Bateman, 2009); (Casillas, Moreno, & Acedo, 2010); (Yang, 2012) However, so far there has been little work concerning the internationalization of German family firms or the so called “Mittelstand” (Wolf, 2011); (Wallau, 2006); (Industrie- und Handelskammer im mittleren Ruhrgebiet zu Bochum, 2010) and no particular study has been specifically investigating its participation in Latin America.

Therefore, the present paper also is a first step to answer calls for more studies in different country contexts, addressing specifically German family firms. (Naldi & Nordqvist, 2009)

The present paper relies on stage model theory (Johanson & Vahlne, 2009); (Johanson & Vahlne, 1977) when examining the internationalization paths of German family firms and draws on concepts of the resource based view (Wernerfelt, 1984); (Peteraf, 1993) as well as the capabilities and knowledge-based view (source) when analyzing the relationships with local partners in the internationalization process.
Methodology and sample:

As there is little hard data available on the firm level of the activities of German (family) firms in Latin America (Ritz, 2010) and the nature of the presented research was highly exploratory, the methodology used to gather data were expert interviews.

To get a broad overview of the topic the experts of choice were the heads of the commercial departments of the German Chambers of Commerce (Aussenhandelskammern) in the region. The interviewed heads of the services departments called “DEInternational” were chosen due to their specific insights into the activities of German firms in their local markets as they are in charge of supporting the market entry of German firms with services that range from market information through to individualized market entry consulting and the development of appropriate strategies. Therefore they generally have a very good overview of the activities of German firms in their local markets.

During January 2013 11 interviews were conducted with the heads of the service departments from the Chambers in Bolivia, Brazil (Porto Alegre Office), Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela and the Regional Chamber for Central America in Guatemala. Thereby, the sample covers almost all of Latin America, missing only Argentina as country with a German Chamber of Commerce Office. The interviews were semi-structured using the questionnaire in Appendix 1 and conducted in German. They were done by phone and lasted between 30 and 45 minutes each. The findings from the interviews were complemented through secondary data from various sources.
Results:

Regarding the analysis of the actual situation conducted, one main conclusion is that there actually exists very little specific knowledge about the activities of German Family Firms in Latin America. The experts interviewed confirmed that in most cases the vast majority of German Firms represented in Latin American countries are family firms. However, there are no exact statistics to confirm that fact and some mentioned that they never even had thought about this topic. Even for German companies in general there is little data available. The most exact numbers that the interviewed experts could provide were for German companies represented by a local sales agent and for German subsidiaries. They range from 80 up to 1200 local companies representing German firms, depending on the market. In the case of German subsidiaries the range goes from 3 for Bolivia up to 1000 for Mexico. Given the nature of the data provided by the experts, it is clear that this is not very exact information. However, comparing it with the number of German Family Firms as a whole of slightly more than 3 million firms (Haunschild & Wolter, 2010) it can give a first orientation. Only a very small percentage of all German Family Firms are involved in Latin America with a representation or own subsidiary. This fact can be confirmed when looking at the overall export statistics for the German Mittelstand: Latin America comes in on the last place with only 18% of total exports. (KFW Economic Research, 2012) Looking at this underrepresentation of German Family Firms in the region compared to the favorable macroeconomic environment, with above average growth rates (The World Bank, 2012), it becomes clear that there is a big potential for further engagement and investment of German Family Firms in the region. The interviewed experts confirm this, especially for a number of specific industries in their markets, where the market potential is significant and German Family Firms have specific competences. These are for example: Renewable Energy, Mining, Health and Pharmaceutical, Infrastructure, Automotive, Food processing, etc., as can be seen in the following chart:
Table 1: Industries with potential for German Family Firms

<table>
<thead>
<tr>
<th>Industries</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Renewable) Energy</td>
<td>78%</td>
</tr>
<tr>
<td>Natural Resources (Processing) and Agriculture</td>
<td>56%</td>
</tr>
<tr>
<td>Mining and Oil Industry</td>
<td>44%</td>
</tr>
<tr>
<td>Health Technologies (Pharma, Med Tech)</td>
<td>44%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>33%</td>
</tr>
<tr>
<td>Automotive Industry</td>
<td>33%</td>
</tr>
<tr>
<td>Food Industry</td>
<td>33%</td>
</tr>
<tr>
<td>Construction</td>
<td>33%</td>
</tr>
</tbody>
</table>

Note: Percentage of experts who mentioned this industry as particularly interesting for German Family Firms in their country.

Regarding the Internationalization Paths undertaken by German Family Firms, the interviewed experts confirmed in the vast majority a specific pattern. The usual process starts with direct exports to a country, which later lead to the establishment of a local sales representative. These local representatives are in majority local family firms. Often, they look for foreign companies to represent. In this context it was highlighted that in many cases those entrepreneurs are German expats or have German heritage. It also is common for German companies to actively look for local representatives. However, this normally only happens after a significant volume of sales through exporting without a specific representative is reached.

In a third step, if the market environment is favorable, a local subsidiary is established. This often, but not always involves the former representative and sometimes takes the form of a joint venture. There are also cases of a dual structure, where the local representative keeps the sales part and an additional subsidiary is established by the German mother company for services, marketing and control purposes. So as we can see in graph 1 the traditional stage model is confirmed also for German family firms going to Latin America. The last point explored in the expert interview was the financing options used by German Family Firms for their activities in Latin America, as financial resources are one of the known limitations to internationalization (OECD Working Party on SMEs and Entrepreneurship, 2009).
Hereby it could be confirmed that the majority of firms uses funding out of Germany. Mostly equity from the mother firm but also external funding sources. In this context especially credits by the German Development Banks KFW and DEG play an important role. However there are also examples for the involvement of local funding, especially when it comes to a joint venture between the German Family Firm and a local partner, in most cases the former local representative. There also have been reported few cases of local financing through government programs (Chile) and local debt financing.

**Graph 1: Commented Stage Model**

- **Export**: Demand driven, when orders happen to come in.
- **Local Sales Agent**: Mostly local family firms – often German expatriates.
- **Sales Subsidiary**: Often joint venture with former sales agent.
- **Full Subsidiary**: Sometimes buyout of former sales agent.
**Discussion:**

Considering the results of the analysis about the internationalization paths it can be stated that they currently confirm the traditional stage models (Johanson & Vahlne, 1977) (Johanson & Vahlne, 2009). It can clearly be seen that German Family Firms use a risk minimizing strategy, starting out with exports and only eventually getting to the step of foreign direct investment. This process is time consuming and also involves a lot of risk without a proper local network from the start. One interesting finding in this context is that the local representative in many cases is of German heritage. The effect of this structure is a reduction of the cultural distance and it would be very interesting to confirm if using local partners with the same cultural heritage can help to accelerate internationalization or even jump stages in the traditional stage model as we suggest in the following graph 2:

**Graph 2: Jumping stages?**

Concerning the resource-based perspective and the need for key resources to internationalize successfully it gets clear that German family firms rely on local partners to provide knowledge and market access. However, regarding financial resources the findings indicate that in most cases funding from the German headquarter is used which is in line with the argument that family firms are concerned with giving up control. However there have been reported cases of the use of local financing options which in the correct setting might be able to overcome the barrier to internationalization of a lack of financial resources without giving up too much control.
Limitations of research:
The present paper is of exploratory nature and presented the analysis is based on expert interviews with representatives of one type of organization, namely the German Chambers of Commerce. Therefore, the results could be biased and should be interpreted with care. Also, the study lacks reliable numbers with regards to for example how many German family firms are active in Latin America. To confirm the suggested results further and broader empirical studies will be necessary.

Implications and further research:
In the context of further research some of the findings with regards to the internationalization process are especially interesting and deserve future attention. In the first place, it can be recommended to further explore the role of local sales agents in the process of family firms’ internationalization, as they clearly play an important function. Especially the fact that in a great majority the local sales agents are family firms itself deserves further attention with regards to the family-family relationship and what role it plays in the process. Secondly, the phenomenon of the local representative of a German Family Firms being a German Expatriate or descendent of Germans is an interesting result which should be examined further, especially to confirm if this reduction in cultural distance can be used to jump stages in the internationalization process. Furthermore, the results concerning the forms of how German family firms finance their expansion to Latin America suggest that it might be beneficial to investigate additional, external options to finance the necessary investment to facilitate internationalization. Especially the role of local funds or partners seems to be relevant. Given the clear underrepresentation of German family firms in Latin America versus the huge market potential it could be beneficial to explore options to enhance the opportunity recognition process within German family firms so that they are better able to identify and exploit the market potential present in the region. So based on these results there can be identified several directions for further research as can be seen in the following graph:
With regards to other implications for practice, it can clearly be recommended that German family firms increase their attention and efforts with regards to the markets in Latin America. This is even more valid for the identified industries mentioned above. Doing so it might be valid to systematically search for suitable local partners (e.g. business families with German heritage) to help accelerate the internationalization process by providing market access, knowledge and financial resources.
References:


Ernst & Young Global Limited. (2010). *Business redefined: A look at the global trends that are changing the world of business*.


Appendix A: Questionnaire used for Interviews (in German):

Umfrage für die AHKs in Lateinamerika – Internationalisierung von dt. Familienunternehmen:

1. Welches sind die Zukunftsindustrien/Märkte in Ihrem Land für die nächsten 5-10 Jahre?

2. Wo sehen Sie besondere Chancen für deutsche Unternehmen bzw. welche „typisch“ deutschen Unternehmen oder Technologien fehlen?

3. Wie viele deutsche Unternehmen sind vor Ort mit Produkten oder Marken präsent? Wie viele sind mit einer Vertretung aktiv? Gibt es eine Liste?

4. Wie viele davon sind mit Direktinvestitionen bzw. eigenem Standort vertreten?

5. Wie viele bzw. welche Unternehmen davon sind deutsche Familienunternehmen?

6. Kennen Sie Beispiele dafür, wie die Unternehmen vor Ort Fuß gefasst haben?

7. Kennen Sie Beispiele für Unternehmen die Ihre Investition mit externem Beteiligungskapital finanziert haben? Evtl. sogar mit einem lokalen Investor?

8. Welche Finanzierungsformen nutzen die Unternehmen sonst für Ihre lokalen Investitionen?
## Appendix B: List of Interview Partners:

<table>
<thead>
<tr>
<th>Country</th>
<th>Interview Partner AHK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>Javier Moeller</td>
</tr>
<tr>
<td>Brasil - Porto Alegre</td>
<td>Dietmar Sukop</td>
</tr>
<tr>
<td>Central America</td>
<td>María Olga Brauns</td>
</tr>
<tr>
<td>Chile</td>
<td>Antje Wandelt</td>
</tr>
<tr>
<td>Colombia</td>
<td>Alexander Steinberg</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Ulrike Stieler</td>
</tr>
<tr>
<td>Mexico</td>
<td>Andreas Müller</td>
</tr>
<tr>
<td>Paraguay</td>
<td>Antonella Cabral</td>
</tr>
<tr>
<td>Peru</td>
<td>Dr. Jan Patrick Häntsche</td>
</tr>
<tr>
<td>Uruguay</td>
<td>Claudia Weber</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Ana Chenche</td>
</tr>
</tbody>
</table>