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Internationalization dilemma for Brazilian firms: China vs. the Greater Mercosur region

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Abstract

Purpose

The purpose of this paper is to explore, using the conceptual frameworks of psychic distance and resource-based view, how Brazilian firms resolve strategic dilemma. Brazilian firms face a strategic dilemma about whether to diversify and exploit the rapidly growing markets of China or to protect and expand the established markets of the Greater Mercosur region. The strategic responses of Brazilian business to business firms are examined within the context of internationalization decisions.

Design/methodology/approach

The paper takes a qualitative approach to study the decisions taken by Brazilian firms to deal with the strategic dilemma arising from competitive developments in domestic and regional markets.

Findings

Findings support four hypotheses based on the psychic distance and resource-based view frameworks. However, the fifth hypothesis that trust would be an impediment for establishing business in China for Brazilian firms was not supported. Trust did not appear as a concern for Brazilian businesses.

Practical implications

Two practical implications can be drawn from the findings. First, Brazilian firms have to consider whether they have made themselves vulnerable to attacks from Chinese firms in the Greater Mercosur region by not aggressively entering the Chinese markets. Second, they also have to understand whether their lack of strong presence in the Chinese markets has resulted not only in lost opportunities but also in making it difficult for them to enter the market later.

Originality/value

The paper takes a multi-theoretical approach to provide insights into the international business expansion decisions of firms in a major economy in the Greater Mercosur region. It contributes to the growing literature on firms in emerging economies. By adopting a qualitative approach to study the research questions, the paper provides insights into the behaviors of firms confronting strategic tradeoffs.

Keywords

Emerging economies, Resource-based view, Psychic distance, International expansion, Mercosur

Brazilian firms confront a major strategic challenge due to several developments that have transformed their competitive landscape. Chief among these developments are those linked with China and the Greater Mercosur region. As China has grown into the world's second largest economy, it presents both opportunities and threats for Brazilian manufacturing firms. The opportunities result from the large and growing Chinese markets that Brazilian firms can potentially exploit, the threats from increasing involvement of Chinese firms not only in Brazil but also in neighboring regional markets where Brazilian firms have historically been key players. For Brazilian firms, these developments pose a strategic dilemma – how to respond to this new competitive milieu. That is, whether to commit strategic resources to exploit the growing opportunities in Chinese markets or to maintain and grow the traditional markets in the Greater Mercosur region or to do both. As this strategic dilemma is relatively new, the main goal of this paper is to understand how organizational resources, competencies and psychic distance, moderated by market inducements and market risks, impact the resolution of the strategic dilemma for Brazilian business to business (B2B) firms.

The paper is divided into four sections. To contextualize the research questions, the first section examines issues related to regional trade, recent competitive developments and Chinese involvement in the Greater Mercosur regional markets. The second section reviews the literature, discusses the conceptual frameworks that guided the formulation of interview questions and presents the hypotheses. The third section covers issues related to sampling, analysis and findings. The fourth section discusses theoretical and strategic implications, followed by suggestions for future research.

The Greater Mercosur region and China

At the macro level, regional and bilateral trade agreements attempt to strengthen economic ties between neighboring countries by increasing intra-regional trade. The intensification of intra-regional trade resulting from these agreements has been attributed to regional comparative advantages that flow from economic integration, political commitment and market proximity (Macdissi, 2004). Recent data from Latin America show that trade agreements have been instrumental in motivating Latin American firms to increase their business involvement in regional markets. Furthermore, market potential and geographical and cultural proximity have driven the expansion of regional business. And reduced trade and investment barriers have lowered the cost of entering the markets.

The integrated regional markets of Latin America provide favorable market conditions for regional firms and encourage them not only to export products but also to manufacture them regionally. Brazilian firms have taken advantage of these developments and expanded their business regionally. Belonging to the largest regional economy, they have successfully leveraged their size and competencies to establish and enhance their presence in the Greater Mercosur regional markets. As a regional trading bloc, Mercosur was founded in 1991 by Argentina, Brazil, Paraguay and Uruguay. In 2012, Venezuela joined the group as its fifth full member. In the Greater Mercosur regional markets, associate members such as Bolivia, Chile, Columbia, Ecuador and Peru are also included. In the early 1990s, Brazil's share of total exports to the Greater Mercosur region was slightly over 7 per cent. In 2011, the share increased to 16.5 per cent.

Although Brazil has a long history of trade relations with neighboring countries, its overall trade now is higher with China than with the Greater Mercosur regional markets (see Table I for comparative trade data). Just a little over a decade ago, Brazil's exports to and imports from China were negligible at best. Today, however, the two countries are major trading partners. Consider the following. Brazil's exports to China in 1990 were a little over 1 per cent of its total exports; in 2011, the share increased to more than 17 per cent. While Brazil's exports to China have increased significantly, what is noteworthy about these exports is that they consist mostly of raw materials such as iron ore, soybeans and petroleum. One of the reasons for this is that imports of processed goods into China carry higher tariffs (Anderlini and Pearson, 2011). In contrast to Brazil's exports to China, which consist mainly of commodities, its imports from China are mostly of finished products, many of them goods that Brazil cannot make as cheaply as China because of higher domestic wages (Wessel and Prada, 2011).

Within Brazil, the heavy reliance on exporting commodities to China is coming under greater scrutiny. Among Brazilian firms, there is now a growing realization of the need to shift attention to exporting high value-added products to China. Economists also agree that such diversification would make the economy less vulnerable to the shocks of commodity markets (Anderlini and Pearson, 2011). The Brazilian Government also recognizes the value of product diversification and has negotiated with Chinese officials for the removal of trade barriers within China for finished and processed goods from Brazil. While the national goal of increasing exports of finished products to China is understandable, Brazilian firms find themselves in a strategic dilemma about whether to diversify and exploit the rapidly growing markets of China or to concentrate efforts in protecting and expanding the established markets of the Greater Mercosur region. The dilemma is further compounded by the fact that Chinese firms have recently begun their forays into the Greater Mercosur regional markets where Brazilian firms have held strong positions and maintained good business relations.

The Greater Mercosur region represents a large and growing market for Chinese firms and its attractiveness is not lost on them. In recent years, they have increased their commitment to the Greater Mercosur region and enhanced their presence. Exports from China to the Greater Mercosur markets have been increasing steadily. In the early 1990s, China's exports to the Greater Mercosur region were less than 1 per cent of its total; by 2011, the share increased to over 3.9 per cent, amounting to more than \$73 billion. During the past decade, China has

also successfully penetrated different countries, such as Argentina, Chile, Colombia, Peru, and Venezuela, where Brazil has historically been a major player. China is now a significant economic presence in the Greater Mercosur region, and its involvement is expected to increase further in the future.

Brazilian firms view the increasing Chinese involvement in their domestic markets and in regional markets as a major competitive threat. Alessandro Teixeira, the executive secretary of Foreign Trade Ministry, indicated that the cost advantage of Chinese products poses problems for Brazil and other countries and that, as a result, some sectors would lose their competitiveness (Platonow, 2011). In some business-to-consumer sectors, Brazilian executives have reported that the Chinese entry into Brazilian markets with products such as shoes, plastics, electronics and cutlery pose a major competitive threat. Furthermore, they expect that Chinese firms will not only capture a large share of the market with their low-priced products but will also move into selling high value-added products (Akhter and Barcellos, 2011).

The evolution of competitive situations in the Greater Mercosur regional markets has strategic implications for Brazilian firms, as they confront the challenging issue of expanding their business internationally and responding to emerging competitive pressures internally and regionally. These competitive developments pose different strategic choices to Brazilian firms. There is thus a need to understand how these firms view these competitive developments and respond to them strategically. Peng (2001, p. 809) suggests that as emerging economies become the new battleground for international business competition, researchers need to “pay careful attention to the institutional context in which IB activities take place”. Moreover, Fastoso and Whitelock (2011) have also encouraged business scholars to undertake studies that focus on Latin America. This study is a response to the calls for studies on emerging economies and Latin America.

Literature review

Different theories have been proposed to explain the internationalizing behavior of firms. Some of the earlier ones are the industrial organization theory (Hymer, 1960; Kindleberger, 1969) and the transaction cost analysis (Williamson, 1971). The industrial organization theory is based on the premise that firms take advantage of both product and factor market imperfections to internationalize their operations, as in a perfect market, they will not have any incentive to expand internationally. The transaction cost analysis, on the other hand, considers the impact of asset specificity and environmental uncertainty on the firm’s decision to either internalize operations or use markets when expanding internationally.

Both industrial organization theory and transaction cost analysis view the concept of internationalization through the lens of international production. As such, they have been seen as providing a limited perspective on internationalization. Nonetheless, because of their grounding in economic cost and benefit analysis, they laid the foundation for subsequent conceptual developments to explain international expansion of firms. These later developments broadened the scope of internationalization by including other modes of foreign market entry, as well as considering the impact of market- and nonmarket-related variables on internationalization decisions. Among these conceptualizations were the psychic distance model and the resource-based view of the firm (Johanson and Vahlne, 1977; Barney, 1991; Wernerfelt, 1984; Peng, 2001).

Psychic distance, defined as the distance between the home market and a foreign market and resulting from the perception of both cultural and business differences (Evans and Mavondo, 2002), has been shown to play a significant role in a firm’s decision to internationalize. When firms evaluate markets for international expansion, the acquisition of market-related information becomes essential. Such information, however, is not easy to acquire because psychic distance can prevent or disturb the flow of information (Vahlne and Wiedersheim-Paul, 1973). The lack of relevant information makes learning difficult and heightens the sense of uncertainty about the market (O’Grady and Lane, 1996). Besides the lack of relevant information, there are also other factors that

“hinder companies’ learning process about an international environment” (Nordstrom and Vahlne, 1994). These factors include not only cultural factors but also institutional, political, economic and administrative factors. Recent research shows that these factors remain salient in influencing internationalization decisions in today’s global economy (Ghemawat, 2007).

An essential aspect of B2B relationships is trust, defined as the belief that the business partner will be honest, fair and reliable (Anderson and Weitz, 1989; Morgan and Hunt, 1994). Trust becomes salient in dyadic relationships because “many aspects of relations between customers and suppliers cannot be formalized or based on legal criteria” alone, but instead “have to be based on mutual trust” (Ford, 1984, p. 18). Trust has been identified as an integral component of psychic distance (Hallen and Wiedersheim-Paul, 1984) and trusting others becomes easier if one can relate to them (Conway and Swift, 2000). When the perception of psychic distance increases, building new relationships becomes challenging because of the many psychological and social hurdles. These hurdles also deter firms from increasing commitments to the markets. Conway and Swift (2000) show the role that trust plays at different stages of international relationship building, beginning with initial interactions and ending with mature relationships. Trust becomes vital for maintaining successful relationships and a precondition for increased commitment (Miettila and Moller, 1990).

The comparative psychic distance between Brazilian firms and firms in the Mercosur region is less than the perceived distance between Brazilian and Chinese firms (Cyrino *et al.*, 2010). Brazilian firms would thus feel it to be relatively easier to navigate the regional markets for establishing and consolidating business. For these firms, the cost of operations and perceived entry barriers in the regional markets will be lower, which will encourage them to enter and build these markets. In contrast, as Chinese markets would be perceived as psychically distant, firms would hesitate from increasing involvement in these markets, with trust playing the role of an inhibiting factor.

The resource-based view suggests that firms are able to internationalize successfully when the resources they possess enable them to present a value proposition to customers that competitors cannot easily match (Barney, 1991; Wernerfelt, 1984). The goals of such resources are to enhance customer value and provide firms with a competitive advantage. As such, these resources should not be strategically equivalent, as it would allow rivals to cancel the focal firm’s advantages (Rodriguez and Rodriguez, 2005).

The two types of market-based resources or assets that can impact internationalization decisions are relational and intellectual assets (Srivastava *et al.*, 2001). Relational assets are relations that firms build over time with external stakeholders and are based on factors such as trust and reputation. Intellectual assets are internal to the firm and reflect the knowledge that the firm possesses about its competitive environment (Srivastava *et al.*, 2001). Firms employ these differentiating resources in production technology to gain cost advantages or in brand equity to acquire pricing power. For Brazilian firms, it can be hypothesized that the market-based resources they possess *vis-à-vis* Chinese competitors and with respect to the Chinese and regional markets will impact the resolution of the strategic dilemma of whether to enter and expand into China or to further consolidate market positions in the Greater Mercosur region or to do both.

The theoretical frameworks discussed above provided a more inclusive basis for examining the internationalizing behavior of Brazilian firms. Axinn and Matthyssens (2002) support the reliance on multiple theories. After reviewing the different theories, they noted that no one theory is able to capture and explain the complexity of the internationalizing behavior of firms. Whitelock (2002, p. 346) also noted that a model that incorporates “the key elements of each approach may present a more realistic and comprehensive picture of entry decisions”. Therefore, a multi-theoretical approach was used to address the research questions posed in this study.

Conceptual model

Based on the theoretical frameworks discussed above, a conceptual model was developed to form expectations of strategic behaviors of Brazilian firms and to formulate interview questions. As expansion into international markets involves making decisions related to intelligence gathering, product offerings, capacity building, responding to competitors' strategies and customers' responses; the scope of the internationalization decision was extended to include these strategic activities. In addition, internationalization decision was conceptualized to include decisions to enter a new market as well as to consolidate market positions in existing international markets (Figure 1).

The complexity of the internationalization decision arises from the tradeoffs that surface during the decision-making process. The tradeoffs become necessary because of uncertainties in the marketplace and internal resource constraints that limit the firm's ability to pursue multiple strategies concurrently. Firms do not know for sure how customers will respond to their offerings or whether their partners will behave opportunistically. Firms also face uncertainties about competitors' strategies and market developments that can create risks and opportunities. The tradeoffs reflect the strategic choices and are influenced by factors such as resources, competencies, market attractiveness, opportunities and threats and perceived psychic distance (Turnbull and Ellwood, 1986; Root, 1987).

In the proposed model, a firm's decision to enter a new market or to increase involvement in existing markets is influenced by resources and competencies and psychic distance. The model also shows that market-related inducements and risks moderate the decision to internationalize. Market-related inducements are environmental and competitive conditions specific to a country market that make the market attractive for entry and show potential for higher profits. On the other hand, market-related risks are environmental and competitive conditions specific to a country market that increase the likelihood of loss. Thus, the proposed model shows the impact of internal organizational conditions, executives' perception and external market situations on the internationalization decision of Brazilian firms. By including the moderating impact of market inducements and market risks, the proposed model brings the element of contingency into the equation and the various tradeoffs that form the normal experiences of businesses. The tradeoffs that firms make reflect their judgment of risks and inducements in the marketplace.

Following the suggestion of Voss *et al.* (2002), we formed tentative expectations of findings based on the conceptual model presented in Figure 1. These are expressed in the following propositions as they relate to the Brazilian B2B firms:

- Brazilian firms will consider regional markets more attractive because of psychic distance.
- Brazilian firms will consolidate their position in domestic and regional markets because of market attractiveness and because of competitive threats from Chinese firms in these markets.
- Brazilian firms will not commit huge resources to Chinese markets because of the information gap.
- Brazilian firms will not enter Chinese markets aggressively because of resource constraints and market uncertainty.
- Brazilian firms will find that psychic distance between Brazil and China will make trust an inhibiting factor for establishing business in China.

Method

The paper takes a qualitative approach to study the decisions taken by Brazilian firms to deal with the strategic dilemma arising from competitive developments in domestic and regional markets. The approach is recommended when the research goal is to gain deeper insights into a phenomenon for theory development

and subsequent empirical test of hypotheses through quantitative methods. The recent market-related changes have prompted many business scholars to recommend the adoption of a qualitative approach for theory building rather than theory verification (Axinn and Matthyssens, 2002; Leonidou and Katsikeas, 1996).

Among the different methods in qualitative research, case studies are considered appropriate when the phenomenon under study is not well defined (Yin, 1994). In this situation, in-depth personal interview, as a constituent of case studies, is considered an effective method to approach the research questions of why, how and when (Yin, 1994). As research on Latin American firms, especially Brazilian firms, is at a formative stage, a qualitative approach is expected to shed light on some of the findings reported in existing empirical studies and lead to a better understanding of the internationalization process of firms in emerging economies. However, it should be noted that qualitative research is generally difficult to conduct because access to executives, as international business researchers know, is not easy to obtain. Executives are generally reluctant to grant interviews and discuss strategies. This results in a smaller sample. Nonetheless, one of the advantages of qualitative methods is that they enable researchers to gain a deeper understanding of the phenomenon if access to even a small number of decision-makers can be obtained. Ellis (2000, p. 463) has noted the importance of qualitative research and the need for further foreign market expansion studies which are “based on in-depth interviews.”

Sampling

As Brazil is primarily a commodities exporting country, sampling became an issue because the unit of analysis for this study was firms that were currently exporting finished products. Along with sampling exporters of finished products, we were also interested in examining companies that were exporting or could potentially export to China. We obtained a list of companies published by the Ministry of Industry and Foreign Trade in Brazil, www.desenvolvimento.gov.br, which showed that there were 2,444 Brazilian companies that exported to China from January to December 2010. From this set, we selected 812 companies located in Sao Paulo, the richest state of Brazil, which accounts for about 33 per cent of Brazil's gross domestic product and where most of the industries are located.

Exports of these 812 companies ranged from less than US\$1 million to over US\$50 million per year. Companies that exported between US\$10 and US\$50 million were mostly commodities exporters or were trading companies or subsidiaries of multinationals located in Brazil. We excluded these companies and also companies which did not have an Internet site, as companies without Internet sites are difficult to contact and reach for interviews. Then, we concentrated our efforts in the state of Sao Paulo, specifically Greater Sao Paulo, and from the reduced list compiled a list of 19 companies that exported manufactured products. We chose São Paulo because the state exports approximately 50 per cent of total Brazilian exports of manufactured products. We called the managers or export directors of these companies to arrange for an interview and also to find out whether they exported to China, and, if they did, whether they exported finished products. From this list of 19 companies, 7 companies in the B2B sectors met our criteria of exporting finished products and agreed to be interviewed (see Table II for company related data). It is important to note that some companies, which were listed by the MDIC (Ministry of Industry and Foreign Trade) database as exporters of manufactured products, in fact, exported only primary products. The telephone calls we made provided us with information about the type of products the companies exported.

Interviews

A one-on-one in-depth interview with managers and export directors was conducted to collect data. The interviews followed a protocol to maintain consistency in the data collection procedure and improve reliability (Yin, 1994; McCracken, 1988). Before beginning the interview, a brief introduction about the goals of the research and affiliations of researchers was made. The interviewees were informed that the research was

conducted jointly at two universities, one in Brazil and the other in the USA. Following this introduction, the interview was conducted using a questionnaire with a specific set of questions. In the interview, a semi-structured format was followed, which is conducive to clarifying questions and seeking clarifications on responses if needed. In this approach, the interviewer is able to obtain more information and manage the interview process more effectively (Alam, 2005). Each interview lasted for about 90 minutes.

Data

Responses were obtained on different aspects of the internationalization process and included the following:

- number of years of exporting experience, domestic and regional competitive developments, main export markets and products exported;
- initiatives regarding the Chinese market, information gap about the Chinese markets and level of trust in dealing with Chinese intermediaries and customers;
- strategic focus of the company involving market orientation, market selection, market development, product standardization and customization and diversification.

Before the interview commenced, the interviewees were assured that the results will be reported anonymously in academic journals. As such, in presenting the findings below, the identity of firms is not revealed.

Findings

P1. Psychic distance and the Greater Mercosur regional markets.

Brazilian firms showed an overwhelming preference for the Greater Mercosur regional markets. Geographic and cultural proximity and the economics of shipping products shorter distances were decisive in this preference. Although the firms recognized the attractiveness of Chinese markets, they remained focused on the Greater Mercosur regional markets. China was “not a priority” (Firm A). Between China and the Greater Mercosur region, the commitment was to the “Latin American market”, where the firm had a “very solid and consolidated presence”, while keeping the “Chinese market in thought” (Firm B). The view was that if Brazilian firms “could not succeed in the neighborhood, it would be difficult for them to succeed in far-away markets” (Firm A). As one executive opined, the “focus is here, in Brazil” (Firm C). Although China was perceived as a major market, Brazilian firms did not have a strong presence there. The view was that South American economies were performing very well and thus were deserving of continuous attention. Brazilian firms also felt that they were well known in Latin America where they had already established sustainable businesses.

Regional emphasis was also the result of perceived opportunities. For one of the firms, the regional market was “much bigger than the market in China” and the goal therefore was to “meet the demands of the Mercosur and Central America markets” (Firm E). High economic growth and better prospects in Mexico, Venezuela, Colombia, Peru and other Latin American countries were seen as promising. Even for firms with specialized technology and with good potential in China, the Greater Mercosur markets represented a viable opportunity right away, which could not be disregarded. One executive indicated that he was “more concerned with customers in Latin America than those in China” (Firm G). The firms admitted the potential of the Chinese market, but acknowledged that it was easier to transfer high costs to Latin American markets than to the Chinese market. Furthermore, while China represented a huge market, it was also emerging as a competitive threat in Brazil and in regional markets:

P2. Chinese threats and regional business consolidation.

The entry of Chinese firms in Brazil and the Greater Mercosur region was viewed as a major strategic threat. Low-priced Chinese products had entered the markets and were seen as contributing to the

“deindustrialization” of Brazil, and the perception was that if the process continued, the “future generation will be destined to sell only commodities” (Firm E). Brazilian firms found it difficult to compete on price against Chinese products due to the high cost of production in Brazil. As one executive mentioned, while the Chinese firms enjoyed “a cost advantage” (Firm F), higher domestic wages made Brazilian firms less price competitive. The view was also that Chinese firms copied products and produced them in bulk to get a cost advantage.

Domestically, competitive pressures on Brazilian firms increased as Chinese firms were moving in to meet local demand. One of the executives considered “China as a threat” (Firm D). Chinese firms were seen as major competitors who enjoyed a price advantage and who lately had also improved the quality of their products. The feeling was that China was “going to swallow the world” as a result of the increasing competitiveness of its firms (Firm A). The greatest concern, therefore, was about the “Chinese invasion” (Firm C). The entry of Chinese firms in Brazil and regional markets had an adverse impact on local firms. One of the executives indicated that he had seen the “death of the electronics companies” in Brazil as most of the products sold in Brazil carried the “Made in China” label (Firm G). In view of these competitive developments, the firms wanted to further consolidate regional market positions before expanding into China:

P3. Information gap and expansion into Chinese markets.

In general, firms did not have reliable information about the Chinese business environment. They did not know much about customers or competitors and also lacked information about markets, distribution channels, tariffs and import duties. With limited information about the size of the Chinese market, it was difficult for them to forecast market reactions regarding product acceptance and purchase volume. One of the firms had no specific information either about customers or competitors and mentioned that it “knew nothing about the Chinese market”, as it had not conducted a formal study of the market (Firm A). Another firm did not have sufficient information about distribution costs, tariffs and import duties (Firm C). One of the firms obtained information about the Chinese market from a website for a monthly fee. It felt that markets for its products in China “involved large volumes”, and the information it gathered on China was “crude” (Firm B).

The firms lacked an organized effort to gain market knowledge. However, for one firm obtaining information about the Chinese market was not perceived as difficult, as most of its customers in China were multinationals. But, for this firm also, information about competitors and costs was lacking (Firm D). China was seen as an opportunity, but not as a market where the firms could aggressively expand business. One of the firms worked with a representative, but he spoke “neither Portuguese nor English” and therefore a translator was needed (Firm E). For this firm, the major issue was market knowledge, not knowing whether it would be able to sell “1 million or 50 million or whatever” (Firm E). Another firm said that “there is always the language problem” in China (Firm F). The information gap between what the firms needed and what they possessed was generally seen as a limiting factor for market expansion:

P4. Resources and competencies and expansion into Chinese markets.

The Chinese markets were perceived as being attractive because of high demand. However, Brazilian executives felt that to sell in China they would have to deal with the question of volume as they currently did not have sufficient capacity to meet demand. From one firm, for example, the Chinese wanted to import over 80 per cent of its total production (Firm B). Expansion into China meant that Brazilian firms would need to commit resources to develop competencies and increase volume. One of the firms mentioned that it neither had “organizational structure” nor “human resources” to focus on China (Firm A) and another said that “volume is the thing that frightens us a little” (Firm E). Furthermore, increasing exports to China was difficult because Chinese competitors enjoyed a price advantage due to “currency” advantage and “government subsidies” and “low cost” from economies of scale (Firm C). Chinese firms could also sell finished products at the same price as the firm charged for its raw materials, but Chinese firms were not ahead in technology – they got their advantage from

volume (Firm C). For Brazilian firms, the dilemma was a lack of capacity and not being able to achieve economies of scale and become price competitive. Another factor that hindered expansion into Chinese markets was the desire to sell standardized products with standardized packaging. One firm had developed an English language catalog for its products that it used in every export market and did not have “any specific promotional materials” for China (Firm D).

Brazilian firms recognized that the strategy they needed to succeed in China was to sell differentiated products with added value. Another significant factor needed for success was to overcome the liability of limited product lines (Firm D). The firms realized that in China they would need to sell “value-added products – higher volumes but at low prices” and enter the “market very slowly” because of problems with “financial capacity” (Firm B). The strategic choice was clear. There was a competitive need to enter and strengthen presence in Chinese markets. However, competing in these markets was difficult because of the low costs that Chinese firms enjoyed. Brazilian firms felt that this was due to the subsidies Chinese firms received and the low taxes they paid. In contrast, they felt that the tax burden in Brazil was too high, which made competing on price difficult. Furthermore, the firms found that undervalued Chinese currency also had an adverse impact on the competitiveness of Brazilian products.

Firms used different strategies to overcome the limitations of resource constraints. One of the firms aimed at establishing a joint venture with a Chinese company so it could source specific products and export others (Firm D). Another firm was hiring new export experts with the purpose of identifying new business opportunities and increasing sales to China. The company was focused on growth with an emphasis on looking for new market opportunities. Another firm, however, adapted its products to meet Chinese demands. And another wanted to avoid price competition with the Chinese by focusing on “research, technology and innovation” (Firm F). Another firm pursued the strategy of radical innovation with the goal of becoming a standard against which products of other companies are compared. It emphasized product differentiation and wanted to achieve its competitive advantage by being ahead of “competition in terms of innovation” (Firm G):

P5. Psychic distance and trust of Chinese businesses.

For most firms, contrary to what was hypothesized, trust was not a factor, especially with respect to whether they would get paid for products exported. Brazilian firms got paid punctually and did not have any issues in receiving payments. Language was perceived to be more of a problem than trust. Considering the psychic distance between Brazil and China, the findings related to trust were unexpected. One executive indicated, he “did not have any problems with the Chinese” (Firm G) and another said that he had “no complaints about them” (Firm A). The Chinese partners did everything they said they would do (Firm D). The firms did not have any bad experiences in dealing with Chinese firms (Firm C). The Chinese firms “always fulfilled the promises they made” (Firm B) and never gave any reason to Brazilian firms “not to trust them” (Firm F). For one firm, trust was not a factor as it sold products to a distributor and got paid on time; however, it did not know who the final customers were and what price they paid for the products (Firm E). Brazilian firms tried to develop commercial relationships for which differences in business culture were not considered critical dimensions for success. Chinese firms conducted business as business, but they did not like to deal with documentary payment methods, such as a letter of credit. For one firm, (Firm B), trust was not an issue, but it surfaced as a concern when discussions focused on strategies about product use and market potential; and the executive acknowledged that when it comes to strategy, people sometimes do not “tell the truth about their business.”

Discussion

Findings from this study provide insights into strategic behaviors of firms. The international business expansion decisions of Brazilian B2B firms parallel the trajectory hypothesized by the psychic distance model. The firms expanded into regional markets due to the perception of closeness and greater market opportunities. Similar

findings were reported by Cyrino *et al.* (2010). The regional expansion was also facilitated by the quality advantage that Brazilian firms enjoyed. Furthermore, supplying components and parts to firms within regional markets was more economical than setting up business outside the region. The Brazilian firms expanded their operations regionally, and this is where they currently wish to retain their focus and maintain their strong position. For these firms, protection of domestic and regional markets is a priority before venturing out into the Chinese markets that are highly competitive and where perceived uncertainties are high. Their strategic focus on the region acknowledges both organizational and external realities.

Compared to the Greater Mercosur regional markets, Chinese markets present several challenges to Brazilian B2B firms. The markets in China are large, but the firms there enjoy a cost advantage. Their cost advantage comes from the economies of scale that result from higher production due to the rising domestic demand and expanding international markets. Higher production and knowledge gained from meeting international demand have also contributed to the enhancement of the technical skills of Chinese firms in developing products that Brazilian firms cannot easily match. For Brazilian firms wanting to export B2B products to China, these market conditions present major hurdles, in addition to the hurdle of not being cost competitive. The cost disadvantage of Brazilian firms arose from capacity constraints and a domestic environment that extracted high wages and high tax. Thus, although Brazilian B2B firms could have expanded business into China, the overall market situation there was not conducive for such expansion.

For Brazilian firms, trust did not appear as a significant factor in conducting business with Chinese firms. One explanation for this outcome, even though psychic distance would hypothesize the salience of trust in this relation, is that the level of involvement of Brazilian firms in China was primarily at the transactional level. At this level, exporting firms were mostly concerned about receiving payments for products exported, and they experienced no difficulties with this. Chinese firms fulfilled their obligations and made payments on time, and Brazilian firms trusted them.

The strategic choices of Brazilian firms were influenced by internal resource constraints and competitive situations in regional and Chinese markets, supporting the resource-based view of firms. Brazilian firms lacked both capacity and cost advantage. Furthermore, the entry of cost-competitive Chinese firms into Brazilian and regional markets posed competitive threats for Brazilian firms that needed to be countered. Thus, given the choice between expanding business into China or consolidating business in regional markets, Brazilian firms opted for the latter, but acknowledged that they need to enter and expand into Chinese markets. To achieve this, they are taking steps to add value to their product offerings and become cost competitive.

Findings support the role of information in export expansion. Brazilian firms did not have market-related information which can best be obtained in the “field” and not “through officially established information services, whether public or private” (Denis and Depelteau, 1985). The lack of relevant informational and intellectual assets created uncertainty about Chinese markets for Brazilian firms, inhibiting business expansion.

While expanding into China remains a strategic goal of Brazilian B2B firms, it is overshadowed by the desire to protect and consolidate local and regional markets due to competitive developments. For Brazilian firms, international expansion for expansion sake did not seem to be a feasible strategy, when the need to stay in established markets and protect them from external competitive threats was pressing.

Two strategic implications can be drawn from the strategic choices of Brazilian firms. First, as Brazilian firms have been cautious about expanding into China, it could be argued that they will be losing out on emerging opportunities and that if they decide later on to increase their involvement in China, it might be too late. While the argument has some validity, it could be said that the strategic orientation of Brazilian firms to focus on the Greater Mercosur region is understandable because of their cost situation *vis-à-vis* Chinese firms and also

because of the uncertainties in Chinese markets. Second, it could be argued that by not expanding into Chinese markets, Brazilian firms have made themselves vulnerable, especially because Chinese firms can now attack them in their own domestic and regional markets without the fear of reciprocal attacks from Brazilian firms in China. The argument could also be extended by saying that Chinese firms will recognize the advantage of this situation and pursue the Mercosur regional markets more aggressively, weakening the competitive position of Brazilian firms. For these arguments to hold, one would have to assume that Brazilian firms will not be able to execute market responsive strategies to maintain and gain competitive advantages in their domestic and regional markets.

The discussion above suggests that several issues can be explored to add to the growing body of literature on the strategic behaviors of firms in emerging economies. Research can explore how networked channels can create entry barriers for Chinese firms in Brazil and the Greater Mercosur region. The question arises because the long presence of Brazilian B2B firms in the regional markets can result in strengthening such relationships and form entry barriers. Furthermore, as Brazilian firms do not enjoy a cost advantage *vis-à-vis* Chinese firms and thus find themselves at a price disadvantage, what strategic options can they exploit to expand into the Chinese markets? In addition, how can Brazilian B2B firms develop niche positions in products and components to be able to compete regionally and globally against firms in emerging economies?

Figure 1. The conceptual model

Table I. (US\$ million)

Geographies	Categories	1990	2000	2011
China	Total Exports	62,091.0	249,294.0	1,899,280.0
China	Exports (fob) to Argentina	13.1	610.5	8,493.6
China	Exports (fob) to Bolivia	5.8	4.7	384.5
China	Exports (fob) to Chile	66.9	783.7	10,810.2
China	Exports (fob) to Colombia	2.8	156.1	5,831.2
China	Exports (fob) to Ecuador	2.4	74.9	2,222.2
China	Exports (fob) to Paraguay	10.2	24.9	452.3
China	Exports (fob) to Peru	16.6	144.4	4,650.1
China	Exports (fob) to Uruguay	5.7	243.1	1,999.0
China	Exports (fob) to Venezuela	13.2	256.6	6,513.8
China	Exports (fob) to Brazil	103.8	1,223.9	31,817.4
	Total	240.5	3,522.8	73,174.3
	% of Total	0.4	1.4	3.9
China	Total Imports	53,345.0	225,024.0	1,741,420.0
China	Imports (cif) from Argentina	310.6	929.3	6,280.4
China	Imports (cif) from Bolivia	0.0	10.7	274.4
China	Imports (cif) from Chile	36.7	1,337.6	20,575.6
China	Imports (cif) from Colombia	4.4	32.1	2,388.7
China	Imports (cif) from Ecuador	0.6	80.1	580.3
China	Imports (cif) from Paraguay	21.6	3.2	44.4
China	Imports (cif) from Peru	85.7	559.9	7,865.7
China	Imports (cif) from Uruguay	69.9	101.3	1,413.7
China	Imports (cif) from Venezuela	28.1	94.7	11,507.7
China	Imports (cif) from Brazil	509.3	1,620.3	52,647.9
	Total	1,066.9	4,769.2	103,578.8

	% of Total	2.0	2.1	5.9
Brazil	Total Exports	31,413.8	55,085.6	256,039.6
Brazil	Exports (fob) to Argentina	645.1	5,756.4	22,708.6
Brazil	Exports (fob) to Bolivia	182.0	336.5	1,511.5
Brazil	Exports (fob) to Chile	483.7	1,151.0	5,417.9
Brazil	Exports (fob) to Colombia	162.6	475.4	2,577.3
Brazil	Exports (fob) to Ecuador	126.1	123.1	933.1
Brazil	Exports (fob) to Paraguay	0.6	1.0	6.3
Brazil	Exports (fob) to Peru	146.2	326.0	2,262.8
Brazil	Exports (fob) to Uruguay	294.6	719.8	2,174.5
Brazil	Exports (fob) to Venezuela	267.6	693.7	4,591.7
	Total	2,308.5	9,582.9	42,183.7
	% of Total	7.3	17.4	16.5
Brazil	Exports (fob) to China	381.8	1,002.3	44,313.1
	% of Total	1.2	1.8	17.3
Brazil	Total Imports	22,522.2	55,783.3	226,241.6
Brazil	Imports (cif) from Argentina	1,502.1	6,786.7	16,907.8
Brazil	Imports (cif) from Bolivia	35.8	139.1	2,863.7
Brazil	Imports (cif) from Chile	520.7	966.1	4,592.9
Brazil	Imports (cif) from Colombia	34.1	411.8	1,383.5
Brazil	Imports (cif) from Ecuador	6.5	18.4	95.2
Brazil	Imports (cif) from Paraguay	332.1	348.3	716.0
Brazil	Imports (cif) from Peru	140.2	209.7	1,367.9
Brazil	Imports (cif) from Uruguay	588.9	596.5	1,753.5
Brazil	Imports (cif) from Venezuela	393.8	1,318.1	1,268.2
	Total	3,554.2	10,794.7	30,948.7
	% of Total	15.8	19.4	13.7
Brazil	Imports (cif) from China	201.8	1,211.6	32,791.0
	% of Total	0.9	2.2	14.5

Note: GMID; Euromonitor International

Table II. Firm information

Name	Type of company	Employees	Revenue (million)	Revenue % exported	Years exporting
Firm A	Abrasives for glass industry, for glass polishing	70	\$1.6	20	11-12
Firm B	Wax and wax emulsion	NA	\$48	10	10
Firm C	Steel for automobile, railway and textile industry; steel rolling	500	\$45	3	10
Firm D	Steel and rubber parts for automobile industry	290-300	\$15.76	4	20
Firm E	Automotive parts and electrical instruments	150-200	\$9.8	10	
Firm F	Automotive parts, lights switch and thermostatic valve	310	\$70	7.8	23
Firm G	Power electronics and semiconductors	450	\$120	50	

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