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NORA-SAKARI: A PROPOSED JV IN MALAYSIA (Revised)

R. Azimah Ainuddin prepared this case under the supervision of Professor Paul Beamish solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

On Monday, July 15, 2003 Zainal Hashim, vice-chairman of Nora Holdings Sdn Bhd[1] (Nora), arrived at his office about an hour earlier than usual. As he looked out the window at the city spreading below, he thought about the Friday evening reception which he had hosted at his home in Kuala Lumpur (KL), Malaysia, for a team of negotiators from Sakari Oy[2] (Sakari) of Finland. Nora was a leading supplier of telecommunications (telecom) equipment in Malaysia while Sakari, a Finnish conglomerate, was a leader in the manufacture of cellular phone sets and switching systems. The seven-member team from Sakari was in KL to negotiate with Nora the formation of a joint-venture (JV) between the two telecom companies.

This was the final negotiation which would determine whether a JV agreement would materialize. The negotiation had ended late Friday afternoon, having lasted for five consecutive days. The JV Company, if established, would be set up in Malaysia to manufacture and commission digital switching exchanges to meet the needs of the telecom industry in Malaysia and in neighbouring countries, particularly Indonesia and Thailand. While Nora would benefit from the JV in terms of technology transfer, the venture would pave the way for Sakari to acquire knowledge and gain access to the markets of South-east Asia.

[1] *Sdn Bhd is an abbreviation for Sendirian Berhad, which means private limited company in Malaysia.*
[2] *Oy is an abbreviation for Osakeyhtiot, which means private limited company in Finland.*

The Nora management was impressed by the Finnish capability in using high technology to enable Finland, a small country of only five million people, to have a fast-growing economy. Most successful Finnish companies were in the high-tech industries. For example, Kone was one of the world's three largest manufacturers of lifts, Vaisala was the world's major supplier of meteorological equipment, and Sakari was one of the leading telecom companies in Europe. It would be an invaluable opportunity for Nora to learn from the Finnish experience and emulate their success for Malaysia.

The opportunity emerged two and half years earlier when Peter Mattsson, president of Sakari's Asian regional office in Singapore, approached Zainal[3] to explore the possibility of forming a cooperative venture between Nora and Sakari. Mattsson said:

> While growth in the mobile telecommunications network is expected to be about 40 per cent a year in Asia in the next five years, growth in fixed networks would not be as fast, but the projects are much larger. A typical mobile network project amounts to a maximum of €50 million, but fixed network projects can be estimated in hundreds of millions. In Malaysia and Thailand, such latter projects are currently approaching contract stage. Thus it is imperative that Sakari establish its presence in this region to capture a share in the fixed network market.

The large potential for telecom facilities was also evidenced in the low telephone penetration rates for most South-east Asian countries. For example, in 1999, telephone penetration rates (measured by the number of telephone lines per 100 people) for Indonesia, Thailand, Malaysia and the Philippines ranged from three to 20 lines per 100 people compared to the rates in developed countries such as Canada, Finland, Germany, United States and Sweden where the rates exceeded 55 telephone lines per 100 people.

THE TELECOM INDUSTRY IN MALAYSIA

Telekom Malaysia Bhd (TMB), the national telecom company, was given the authority by the Malaysian government to develop the country's telecom infrastructure. With a paid-up capital of RM2.4 billion,[4] it was also given the mandate to provide telecom services that were on par with those available in developed countries.

[3] *The first name is used because the Malay name does not carry a family name. The first and/or middle names belong to the individual and the last name is his/her father's name.*
[4] *RM is Ringgit Malaysia, the Malaysian currency. As at December 31, 2002, US$1 = RM3.80.*

TMB announced that it would be investing in the digitalization of its networks to pave the way for offering services based on the ISDN (integrated services digitalized network) standard, and investing in international fibre optic cable networks to meet the needs of increased telecom traffic between Malaysia and the rest of the world. TMB would also facilitate the installation of more cellular telephone networks in view of the increased demand for the use of mobile phones among the business community in KL and in major towns.

As the nation's largest telecom company, TMB's operations were regulated through a 20-year licence issued by the Ministry of Energy, Telecommunications and Posts. In line with the government's Vision 2020 program which targeted Malaysia to become a developed nation by the year 2020, there was a strong need for the upgrading of the telecom infrastructure in the rural areas. TMB estimated that it would spend more than RM1 billion each year on the installation of fixed networks, of which 25 per cent would be allocated for the expansion of rural telecom. The objective was to increase the telephone penetration rate to over 50 per cent by the year 2005.

Although TMB had become a large national telecom company, it lacked the expertise and technology to undertake massive infrastructure projects. In most cases, the local telecom companies would be invited to submit their bids for a particular contract. It was also common for these local companies to form partnerships with large multinational corporations (MNCs), mainly for technological support. For example, Pernas-NEC, a JV company between Pernas Holdings and NEC, was one of the companies that had been successful in securing large telecom contracts from the Malaysian authorities.

NORA'S SEARCH FOR A JV PARTNER

In October 2002, TMB called for tenders to bid on a five-year project worth RM2 billion for installing digital switching exchanges in various parts of the country. The project also involved replacing analog circuit switches with digital switches. Digital switches enhanced transmission capabilities of telephone lines, increasing capacity to approximately two million bits per second compared to the 9,600 bits per second on analog circuits.

Nora was interested in securing a share of the RM2 billion contract from TMB and more importantly, in acquiring the knowledge in switching technology from its partnership with a telecom MNC. During the initial stages, when Nora first began to consider potential partners in the bid for this contract, telecom MNCs such as Siemens, Alcatel, and Fujitsu seemed appropriate candidates. Nora had previously entered into a five-year technical assistance agreement with Siemens to manufacture telephone handsets.

Nora also had the experience of a long-term working relationship with Japanese partners which would prove valuable should a JV be formed with Fujitsu. Alcatel was another potential partner, but the main concern at Nora was that the technical standards used in the French technology were not compatible with the British standards already adopted in Malaysia. NEC and Ericsson were not considered, as they were already involved with other local competitors and were the current suppliers of digital switching exchanges to TMB. Their five-year contracts were due to expire soon.

Subsequent to Zainal's meeting with Mattsson, he decided to consider Sakari as a serious potential partner. He was briefed about Sakari's SK33, a digital switching system that was based on an open architecture, which enabled the use of standard components, standard software development tools, and standard software languages. Unlike the switching exchanges developed by NEC and Ericsson which required the purchase of components developed by the parent companies, the SK33 used components that were freely available in the open market. The system was also modular, and its software could be upgraded to provide new services and could interface easily with new equipment in the network. This was the most attractive feature of the SK33 as it would lead to the development of new switching systems.

Mattsson had also convinced Zainal and other Nora managers that although Sakari was a relatively small player in fixed networks, these networks were easily adaptable, and could cater to large exchanges in the urban areas as well as small ones for rural needs. Apparently Sakari's smaller size, compared to that of some of the other MNCs, was an added strength because Sakari was prepared to work out customized products according to Nora's needs. Large telecom companies were alleged to be less willing to provide custom-made products. Instead, they tended to offer standard products that, in some aspects, were not consistent with the needs of the customer.

Prior to the July meeting, at least 20 meetings had been held either in KL or in Helsinki to establish relationships between the two companies. It was estimated that each side had invested not less than RM3 million in promoting the relationship. Mattsson and Ilkka Junttila, Sakari's representative in KL, were the key people in bringing the two companies together. (See Exhibits 1 and 2 for brief background information on Malaysia and Finland respectively.)

NORA HOLDINGS SDN BHD

The Company

Nora was one of the leading companies in the telecom industry in Malaysia. It was established in 1975 with a paid-up capital of RM2 million. Last year, the company

recorded a turnover of RM320 million. Nora Holdings consisted of 30 subsidiaries, including two public-listed companies: Multiphone Bhd, and Nora Telecommunications Bhd. Nora had 3,081 employees, of which 513 were categorized as managerial (including 244 engineers) and 2,568 as non-managerial (including 269 engineers and technicians).

The cable business

Since the inception of the company, Nora had secured two cable-laying projects. For the latter project worth RM500 million, Nora formed a JV with two Japanese companies, Sumitomo Electric Industries Ltd (held 10 per cent equity share) and Marubeni Corporation (held five per cent equity share). Japanese partners were chosen in view of the availability of a financial package that came together with the technological assistance needed by Nora. Nora also acquired a 63 per cent stake in a local cable-laying company, Selangor Cables Sdn Bhd.

The telephone business

Nora had become a household name in Malaysia as a telephone manufacturer. It started in 1980 when the company obtained a contract to supply telephone sets to the government-owned Telecom authority, TMB, which would distribute the sets to telephone subscribers on a rental basis. The contract, estimated at RM130 million, lasted for 15 years. In 1985 Nora secured licenses from Siemens and Nortel to manufacture telephone handsets and had subsequently developed Nora's own telephone sets — the N300S (single line), N300M (micro-computer controlled), and N300V (hands-free, voice-activated) models.

Upon expiry of the 15-year contract as a supplier of telephone sets to the TMB, Nora suffered a major setback when it lost a RM32 million contract to supply 600,000 N300S single line telephones. The contract was instead given to a Taiwanese manufacturer, Formula Electronics, which quoted a lower price of RM37 per handset compared to Nora's RM54. Subsequently, Nora was motivated to move towards the high end feature phone domestic market. The company sold about 3,000 sets of feature phones per month, capturing the high-end segment of the Malaysian market.

Nora had ventured into the export market with its feature phones, but industry observers predicted that Nora still had a long way to go as an exporter. The foreign markets were very competitive and many manufacturers already had well-established brands.

The payphone business

Nora's start-up in the payphone business had turned out to be one of the company's most profitable lines of business. Other than the cable-laying contract secured in 1980, Nora had a 15-year contract to install, operate and maintain payphones in the cities and major towns in Malaysia. In 1997, Nora started to manufacture card payphones under a license from GEC Plessey Telecommunications (GPT) of the United Kingdom. The agreement had also permitted Nora to sell the products to the neighbouring countries in South-east Asia as well as to eight other markets approved by GPT.

While the payphone revenues were estimated to be as high as RM60 million a year, a long-term and stable income stream for Nora, profit margins were only about 10 per cent because of the high investment and maintenance costs.

Other businesses

Nora was also the sole Malaysian distributor for Nortel's private automatic branch exchange (PABX) and NEC's mobile telephone sets. It was also an Apple computer distributor in Malaysia and Singapore. In addition, Nora was involved in: distributing radio-related equipment; supplying equipment to the broadcasting, meteorological, civil aviation, postal and power authorities; and manufacturing automotive parts (such as the suspension coil, springs, and piston) for the local automobile companies.

The Management

When Nora was established, Osman Jaafar, founder and chairman of Nora Holdings, managed the company with his wife, Nora Asyikin Yusof, and seven employees. Osman was known as a conservative businessman who did not like to dabble in acquisitions and mergers to make quick capital gains. He was formerly an electrical engineer who was trained in the United Kingdom and had held several senior positions at the national Telecom Department in Malaysia.

Osman subsequently recruited Zainal Hashim to fill in the position of deputy managing director at Nora. Zainal held a master's degree in microwave communications from a British university and had several years of working experience as a production engineer at Pernas-NEC Sdn Bhd, a manufacturer of transmission equipment. Zainal was later promoted to the position of managing director and six years later, the vice-chairman.

Industry analysts observed that Nora's success was attributed to the complementary roles, trust, and mutual understanding between Osman and Zainal.

While Osman "likes to fight for new business opportunities," Zainal preferred a low profile and concentrated on managing Nora's operations.

Industry observers also speculated that Osman, a former civil servant and an entrepreneur, was close to Malaysian politicians, notably the Prime Minister, while Zainal had been a close friend of the Finance Minister. Zainal disagreed with allegations that Nora had succeeded due to its close relationships with Malaysian politicians. However, he acknowledged that such perceptions in the industry had been beneficial to the company.

Osman and Zainal had an obsession for high-tech and made the development of research and development (R&D) skills and resources a priority in the company. About one per cent of Nora's earnings was ploughed back into R&D activities. Although this amount was considered small by international standards, Nora planned to increase it gradually to five to six per cent over the next two to three years. Zainal said:

> We believe in making improvements in small steps, similar to the Japanese *kaizen* principle. Over time, each small improvement could lead to a major creation. To be able to make improvements, we must learn from others. Thus we would borrow a technology from others, but eventually, we must be able to develop our own to sustain our competitiveness in the industry. As a matter of fact, Sakari's SK33 system was developed based on a technology it obtained from Alcatel.

To further enhance R&D activities at Nora, Nora Research Sdn Bhd (NRSB), a wholly-owned subsidiary, was formed, and its R&D department was absorbed into this new company. NRSB operated as an independent research company undertaking R&D activities for Nora as well as private clients in related fields. The company facilitated R&D activities with other companies as well as government organizations, research institutions, and universities. NRSB, with its staff of 40 technicians/engineers, would charge a fixed fee for basic research and a royalty for its products sold by clients.

Zainal was also active in instilling and promoting Islamic values among the Malay employees at Nora. He explained:

> Islam is a way of life and there is no such thing as Islamic management. The Islamic values, which must be reflected in the daily life of Muslims, would influence their behaviours as employers and employees. Our Malay managers, however, were often influenced by their western counterparts, who tend to stress knowledge and mental capability and often forget the effectiveness of the softer side of management which emphasizes relationships,

sincerity and consistency. I believe that one must always be sincere to be able to develop good working relationships.

SAKARI OY

Sakari was established in 1865 as a pulp and paper mill located about 200 kilometres northwest of Helsinki, the capital city of Finland. In the 1960s, Sakari started to expand into the rubber and cable industries when it merged with the Finnish Rubber Works and Finnish Cable Works. In 1973 Sakari's performance was badly affected by the oil crisis, as its businesses were largely energy-intensive.

However, in 1975, the company recovered when Aatos Olkkola took over as Sakari's president. He led Sakari into competitive businesses such as computers, consumer electronics, and cellular phones via a series of acquisitions, mergers and alliances. Companies involved in the acquisitions included: the consumer electronics division of Standard Elektrik Lorenz AG; the data systems division of L.M. Ericsson; Vantala, a Finnish manufacturer of colour televisions; and Luxury, a Swedish state-owned electronics and computer concern.

In 1979, a JV between Sakari and Vantala, Sakari-Vantala, was set up to develop and manufacture mobile telephones. Sakari-Vantala had captured about 14 per cent of the world's market share for mobile phones and held a 20 per cent market share in Europe for its mobile phone handsets. Outside Europe, a 50-50 JV was formed with Tandy Corporation which, to date, had made significant sales in the United States, Malaysia and Thailand.

Sakari first edged into the telecom market by selling switching systems licensed from France's Alcatel and by developing the software and systems to suit the needs of small Finnish phone companies. Sakari had avoided head-on competition with Siemens and Ericsson by not trying to enter the market for large telephone networks. Instead, Sakari had concentrated on developing dedicated telecom networks for large private users such as utility and railway companies. In Finland, Sakari held 40 per cent of the market for digital exchanges. Other competitors included Ericsson (34 per cent), Siemens (25 per cent), and Alcatel (one per cent).

Sakari was also a niche player in the global switching market. Its SK33 switches had sold well in countries such as Sri Lanka, United Arab Emirates, China and the Soviet Union. A derivative of the SK33 main exchange switch called the SK33XT was subsequently developed to be used in base stations for cellular networks and personal paging systems.

Sakari attributed its emphasis on R&D as its key success factor in the telecom industry. Strong in-house R&D in core competence areas enabled the company to develop technology platforms such as its SK33 system that were reliable, flexible,

widely compatible and economical. About 17 per cent of its annual sales revenue was invested into R&D and product development units in Finland, United Kingdom and France. Sakari's current strategy was to emphasize global operations in production and R&D. It planned to set up R&D centres in leading markets, including South-east Asia.

Sakari was still a small company by international standards (see Exhibit 3 for a list of the world's major telecom equipment suppliers). It lacked a strong marketing capability and had to rely on JVs such as the one with Tandy Corporation to enter the world market, particularly the United States. In its efforts to develop market position quickly, Sakari had to accept lower margins for its products, and often the Sakari name was not revealed on the product. In recent years, Sakari decided to emerge from its hiding place as a manufacturer's manufacturer and began marketing under the Sakari name.

In 1989 Mikko Koskinen took over as president of Sakari. Koskinen announced that telecommunications, computers, and consumer electronics would be maintained as Sakari's core business, and that he would continue Olkkola's efforts in expanding the company overseas. He believed that every European company needed global horizons to be able to meet global competition for future survival. To do so, he envisaged the setting up of alliances of varying duration, each designed for specific purposes. He said, "Sakari has become an interesting partner with which to cooperate on an equal footing in the areas of R&D, manufacturing and marketing."

The recession in Finland which began in 1990 led Sakari's group sales to decline substantially from FIM22 billion[5] in 1990 to FIM15 billion in 1991. The losses were attributed to two main factors: weak demand for Sakari's consumer electronic products, and trade with the Soviet Union which had come to almost a complete standstill. Consequently Sakari began divesting its less profitable companies within the basic industries (metal, rubber, and paper), as well as leaving the troubled European computer market with the sale of its computer subsidiary, Sakari Macro. The company's new strategy was to focus on three main areas: telecom systems and mobile phones in a global framework, consumer electronic products in Europe, and deliveries of cables and related technology. The company's divestment strategy led to a reduction of Sakari's employees from about 41,000 in 1989 to 29,000 in 1991. This series of major strategic moves was accompanied by major leadership succession. In June 1992, Koskinen retired as Sakari's President and was replaced by Visa Ketonen, formerly the President of Sakari Mobile Phones. Ketonen appointed Ossi Kuusisto as Sakari's vice-president.

[5]*FIM is Finnish Markka, the Finnish currency until January 1, 1999. Markka coins and notes were not withdrawn from circulation until January 1, 2002, when Finland fully converted to the Euro. As at December 31, 2000, US$1 = FIM6.31, and €1 = FIM5.95.*

After Ketonen took over control, the Finnish economy went through a rapid revival in 1993, followed by a new period of intense growth. Since the mid 1990s the Finnish growth had been bolstered by intense growth in telecommunications equipment manufacturing as a result of an exploding global telecommunications market. Sakari capitalized on this opportunity and played a major role in the Finnish telecommunications equipment manufacturing sector.

In 2001, Sakari was Finland's largest publicly-traded industrial company and derived the majority of its total sales from exports and overseas operations. Traditionally, the company's export sales were confined to other Scandinavian countries, Western Europe and the former Soviet Union. However, in recent years, the company made efforts and succeeded in globalizing and diversifying its operations to make the most of its high-tech capabilities. As a result, Sakari emerged as a more influential player in the international market and had gained international brand recognition. One of Sakari's strategies was to form JVs to enter new foreign markets.

THE NORA-SAKARI NEGOTIATION

Nora and Sakari had discussed the potential of forming a JV company in Malaysia for more than two years. Nora engineers were sent to Helsinki to assess the SK33 technology in terms of its compatibility with the Malaysian requirements, while Sakari managers travelled to KL mainly to assess both Nora's capability in manufacturing switching exchanges and the feasibility of gaining access to the Malaysian market.

In January 2003, Nora submitted its bid for TMB's RM2 billion contract to supply digital switching exchanges supporting four million telephone lines. Assuming the Nora-Sakari JV would materialize, Nora based its bid on supplying Sakari's digital switching technology. Nora competed with seven other companies short listed by TMB, all offering their partners' technology — Alcatel, Lucent, Fujitsu, Siemens, Ericsson, NEC, and Samsung. In early May, TMB announced five successful companies in the bid. They were companies using technology from Alcatel, Fujitsu, Ericsson, NEC, and Sakari. Each company was awarded one-fifth share of the RM2 billion contract and would be responsible for delivering 800,000 telephone lines over a period of five years. Industry observers were critical of TMB's decision to select Sakari and Alcatel. Sakari was perceived to be the least capable of supplying the necessary lines to meet TMB's requirements, as it was alleged to be a small company with little international exposure. Alcatel was criticized for having the potential of supplying an obsolete technology.

The May 21 Meeting

Following the successful bid and ignoring the criticisms against Sakari, Nora and Sakari held a major meeting in Helsinki on May 21 to finalize the formation of the JV. Zainal led Nora's five-member negotiation team which comprised Nora's general manager for corporate planning division, an accountant, two engineers, and Marina Mohamed, a lawyer. One of the engineers was Salleh Lindstrom who was of Swedish origin, a Muslim and had worked for Nora for almost 10 years.

Sakari's eight-member team was led by Kuusisto, Sakari's vice-president. His team comprised Junttila, Hussein Ghazi, Aziz Majid, three engineers, and Julia Ruola (a lawyer). Ghazi was Sakari's senior manager who was of Egyptian origin and also a Muslim who had worked for Sakari for more than 20 years while Aziz, a Malay, had been Sakari's manager for more than 12 years.

The meeting went on for several days. The main issue raised at the meeting was Nora's capability in penetrating the South-east Asian market. Other issues included Sakari's concerns over the efficiency of Malaysian workers in the JV in manufacturing the product, maintaining product quality and ensuring prompt deliveries.

Commenting on the series of negotiations with Sakari, Zainal said that this was the most difficult negotiation he had ever experienced. Zainal was Nora's most experienced negotiator and had single-handedly represented Nora in several major negotiations for the past 10 years. In the negotiation with Sakari, Zainal admitted making the mistake of approaching the negotiation applying the approach he often used when negotiating with his counterparts from companies based in North America or the United Kingdom. He said:

> Negotiators from the United States tend to be very open and often state their positions early and definitively. They are highly verbal and usually prepare well-planned presentations. They also often engage in small talk and 'joke around' with us at the end of a negotiation. In contrast, the Sakari negotiators tend to be very serious, reserved and 'cold.' They are also relatively less verbal and do not convey much through their facial expressions. As a result, it was difficult for us to determine whether they are really interested in the deal or not.

Zainal said that the negotiation on May 21 turned out to be particularly difficult when Sakari became interested in bidding a recently-announced tender for a major telecom contract in the United Kingdom. Internal politics within Sakari led to the formation of two opposing "camps." One "camp" held a strong belief that there would be very high growth in the Asia-Pacific region and that the JV company in Malaysia was seen as a hub to enter these markets. Although the Malaysian

government had liberalized its equity ownership restrictions and allowed the formation of wholly-owned subsidiaries, JVs were still an efficient way to enter the Malaysian market for a company that lacked local knowledge. This group was represented mostly by Sakari's managers positioned in Asia and engineers who had made several trips to Malaysia, which usually included visits to Nora's facilities. They also had the support of Sakari's vice-president, Kuusisto, who was involved in most of the meetings with Nora, particularly when Zainal was present. Kuusisto had also made efforts to be present at meetings held in KL. This group also argued that Nora had already obtained the contract in Malaysia whereas the chance of getting the U.K. contract was quite low in view of the intense competition prevailing in that market.

The "camp" not in favour of the Nora-Sakari JV believed that Sakari should focus its resources on entering the United Kingdom, which could be used as a hub to penetrate the European Union (EU) market. There was also the belief that Europe was closer to home, making management easier, and that problems arising from cultural differences would be minimized. This group was also particularly concerned that Nora had the potential of copying Sakari's technology and eventually becoming a strong regional competitor. Also, because the U.K. market was relatively "familiar" and Sakari has local knowledge, Sakari could set up a wholly-owned subsidiary instead of a JV company and consequently, avoid JV-related problems such as joint control, joint profits, and leakage of technology.

Zainal felt that the lack of full support from Sakari's management led to a difficult negotiation when new misgivings arose concerning Nora's capability to deliver its part of the deal. It was apparent that the group in favour of the Nora-Sakari JV was under pressure to further justify its proposal and provide counterarguments against the U.K. proposal. A Sakari manager explained, "We are tempted to pursue both proposals since each has its own strengths, but our current resources are very limited. Thus a choice has to made, and soon."

The July 8 Meeting

Another meeting to negotiate the JV agreement was scheduled for July 8. Sakari's eight-member team arrived in KL on Sunday afternoon of July 7, and was met at the airport by the key Nora managers involved in the negotiation. Kuusisto did not accompany the Sakari team at this meeting.

The negotiation started early Monday morning at Nora's headquarters and continued for the next five days, with each day's meeting ending late in the evening. Members of the Nora team were the same members who had attended the May 21 meeting in Finland, except Zainal, who did not participate. The Sakari team was also represented by the same members in attendance at the previous meeting plus a new member, Solail Pekkarinen, Sakari's senior accountant. Unfortunately, on the third day of the negotiation, the Nora team requested that

Sakari ask Pekkarinen to leave the negotiation. He was perceived as extremely arrogant and insensitive to the local culture, which tended to value modesty and diplomacy. Pekkarinen left for Helsinki the following morning.

Although Zainal had decided not to participate actively in the negotiations, he followed the process closely and was briefed by his negotiators regularly. Some of the issues which they complained were difficult to resolve had often led to heated arguments between the two negotiating teams. These included:

1. Equity Ownership

In previous meetings both companies agreed to form the JV company with a paid-up capital of RM5 million. However, they disagreed on the equity share proposed by each side. Sakari proposed an equity split in the JV company of 49 per cent for Sakari and 51 per cent for Nora. Nora, on the other hand, proposed a 30 per cent Sakari and 70 per cent Nora split. Nora's proposal was based on the common practice in Malaysia as a result of historical foreign equity regulations set by the Malaysian government that allowed a maximum of 30 per cent foreign equity ownership unless the company would export a certain percentage of its products. Though these regulations were liberalized by the Malaysian government effective from July, 1998 and new regulations had replaced the old ones, the 30-70 foreign-Malaysian ownership divide was still commonly observed.

Equity ownership became a major issue as it was associated with control over the JV company. Sakari was concerned about its ability to control the accessibility of its technology to Nora and about decisions concerning the activities of the JV as a whole. The lack of control was perceived by Sakari as an obstacle to protecting its interests. Nora also had similar concerns about its ability to exert control over the JV because it was intended as a key part of Nora's long-term strategy to develop its own digital switching exchanges and related high-tech products.

2. Technology Transfer

Sakari proposed to provide the JV company with the basic structure of the digital switch. The JV company would assemble the switching exchanges at the JV plant and subsequently install the exchanges in designated locations identified by TMB. By offering Nora only the basic structure of the switch, the core of Sakari's switching technology would still be well-protected.

On the other hand, Nora proposed that the basic structure of the switch be developed at the JV company in order to access the root of the switching technology. Based on Sakari's proposal, Nora felt that only the technical aspects in assembling and installing the exchanges would be obtained. This was perceived as

another "screw-driver" form of technology transfer while the core of the technology associated with making the switches would still be unknown.

3. Royalty Payment

Closely related to the issue of technology transfer was the payment of a royalty for the technology used in building the switches. Sakari proposed a royalty payment of five per cent of the JV gross sales while Nora proposed a payment of two per cent of net sales.

Nora considered the royalty rate of five per cent too high because it would affect Nora's financial situation as a whole. Financial simulations prepared by Nora's managers indicated that Nora's return on investment would be less than the desired 10 per cent if royalty rates exceeded three per cent of net sales. This was because Nora had already agreed to make large additional investments in support of the JV. Nora would invest in a building which would be rented to the JV company to accommodate an office and the switching plant. Nora would also invest in another plant which would supply the JV with surface mounted devices (SMD), one of the major components needed to build the switching exchanges.

An added argument raised by the Nora negotiators in support of a two per cent royalty was that Sakari would receive side benefits from the JV's access to Japanese technology used in the manufacture of the SMD components. Apparently the Japanese technology was more advanced than Sakari's present technology.

4. Expatriates' Salaries and Perks

To allay Sakari's concerns over Nora's level of efficiency, Nora suggested that Sakari provide the necessary training for the JV technical employees. Subsequently, Sakari had agreed to provide eight engineering experts for the JV company on two types of contracts, short-term and long-term. Experts employed on a short-term basis would be paid a daily rate of US$1260 plus travel/accommodation. The permanent experts would be paid a monthly salary of US$20,000. Three permanent experts would be attached to the JV company once it was established and the number would gradually be reduced to only one, after two years. Five experts would be available on a short-term basis to provide specific training needs for durations of not more than three months each year.

The Nora negotiation team was appalled at the exorbitant amount proposed by the Sakari negotiators. They were surprised that the Sakari team had not surveyed the industry rates, as the Japanese and other western negotiators would normally have done. Apparently Sakari had not taken into consideration the relatively low cost of living in Malaysia compared to Finland. In 2000, though the average monthly rent for a comfortable, unfurnished three-bedroom apartment was about the same (660

US$) in Helsinki and Kuala Lumpur, the cost of living was considerably lower in KL. The cost of living index (New York = 100) of basket of goods in major cities, excluding housing, for Malaysia was only 83.75, compared to 109.84 for Finland.[6]

In response to Sakari's proposal, Nora negotiators adopted an unusual "take-it or leave-it" stance. They deemed the following proposal reasonable in view of the comparisons made with other JVs which Nora had entered into with other foreign parties:

Permanent experts' monthly salary ranges to be paid by the JV company were as follows:

(1) Senior expert (seven to 10 years experience)….RM24,300–RM27,900
(2) Expert (four to six years experience)……. RM22,500–RM25,200
(3) Junior expert (two to three years experience)… RM20,700–RM23,400
(4) Any Malaysian income taxes payable would be added to the salaries.
(5) A car for personal use.
(6) Annual paid vacation of five weeks.
(7) Return flight tickets to home country once a year for the whole family of married persons and twice a year for singles according to Sakari's general scheme.
(8) Any expenses incurred during official travelling.

Temporary experts are persons invited by the JV company for various technical assistance tasks and would not be granted residence status. They would be paid the following fees:

(1) Senior expert……...…….RM1,350 per working day
(2) Expert……...……....RM1,170 per working day
(3) The JV company would not reimburse the following:
    - Flight tickets between Finland (or any other country) and Malaysia.
    - Hotel or any other form of accommodation.
    - Local transportation.

In defense of their proposed rates, Sakari's negotiators argued that the rates presented by Nora were too low. Sakari suggested that Nora's negotiators take into consideration the fact that Sakari would have to subsidize the difference between the experts' present salaries and the amount paid by the JV company. A large difference would require that large amounts of subsidy payments be made to the affected employees.

[6] *IMD & World Economic Forum. 2001. The World Competitiveness Report.*

5. Arbitration

Another major issue discussed in the negotiation was related to arbitration. While both parties agreed to an arbitration process in the event of future disputes, they disagreed on the location for dispute resolution. Because Nora would be the majority stakeholder in the JV company, Nora insisted that any arbitration should take place in KL. Sakari, however, insisted on Helsinki, following the norm commonly practised by the company.

At the end of the five-day negotiation, many issues could not be resolved. While Nora could agree on certain matters after consulting Zainal, the Sakari team, representing a large private company, had to refer contentious items to the company board before it could make any decision that went beyond the limits authorized by the board.

THE DECISION

Zainal sat down at his desk, read through the minutes of the negotiation thoroughly, and was disappointed that an agreement had not yet been reached. He was concerned about the commitment Nora had made to TMB when Nora was awarded the switching contract. Nora would be expected to fulfill the contract soon but had yet to find a partner to provide the switching technology. It was foreseeable that companies such as Siemens, Samsung and Lucent, which had failed in the bid, could still be potential partners. However, Zainal had also not rejected the possibility of a reconciliation with Sakari. He could start by contacting Kuusisto in Helsinki. But should he?

Exhibit 1

MALAYSIA: BACKGROUND INFORMATION

Malaysia is centrally located in South-east Asia. It consists of Peninsular Malaysia, bordered by Thailand in the north and Singapore in the south, and the states of Sabah and Sarawak on the island of Borneo. Malaysia has a total land area of about 330,000 square kilometres, of which 80 per cent is covered with tropical rainforest. Malaysia has an equatorial climate with high humidity and high daily temperatures of about 26 degrees Celsius throughout the year.

In 2000, Malaysia's population was 22 million, of which approximately nine million made up the country's labour force. The population is relatively young, with 42 per cent between the ages of 15 and 39 and only seven per cent above the age of 55. A Malaysian family has an average of four children and extended families are common. Kuala Lumpur, the capital city of Malaysia, has approximately 1.5 million inhabitants.

The population is multiracial; the largest ethnic group is the Bumiputeras (the Malays and other indigenous groups such as the Ibans in Sarawak and Kadazans in Sabah), followed by the Chinese and Indians. Bahasa Malaysia is the national language but English is widely used in business circles. Other major languages spoken included various Chinese dialects and Tamil.

Islam is the official religion but other religions (mainly Christianity, Buddhism and Hinduism) are widely practised. Official holidays are allocated for the celebration of Eid, Christmas, Chinese New Year and Deepavali. All Malays are Muslims, followers of the Islamic faith.

During the period of British rule, secularism was introduced to the country, which led to the separation of the Islamic religion from daily life. In the late 1970s and 1980s, realizing the negative impact of secularism on the life of the Muslims, several groups of devout Muslims undertook efforts to reverse the process, emphasizing a dynamic and progressive approach to Islam. As a result, changes were introduced to meet the daily needs of Muslims. Islamic banking and insurance facilities were introduced and prayer rooms were provided in government offices, private companies, factories, and even in shopping complexes.

Malaysia is a parliamentary democracy under a constitutional monarchy. The Yang DiPertuan Agung (the king) is the supreme head, and appoints the head of the ruling political party to be the prime minister. In 2000 the Barisan Nasional, a coalition of several political parties representing various ethnic groups, was the ruling political party in Malaysia. Its predominance had contributed not only to the political stability and economic progress of the country in the last two decades, but also to the fast recovery from the 1997 Asian economic crisis.

Exhibit 1 (continued)

The recession of the mid 1980s led to structural changes in the Malaysian economy which had been too dependent on primary commodities (rubber, tin, palm oil and timber) and had a very narrow export base. To promote the establishment of export-oriented industries, the government directed resources to the manufacturing sector, introduced generous incentives and relaxed foreign equity restrictions. In the meantime, heavy investments were made to modernize the country's infrastructure. These moves led to rapid economic growth in the late 1980s and early 1990s. The growth had been mostly driven by exports, particularly of electronics.

The Malaysian economy was hard hit by the 1997 Asian economic crisis. However, Malaysia was the fastest country to recover from the crisis after declining IMF assistance. It achieved this by pegging its currency to the USD, restricting outflow of money from the country, banning illegal overseas derivative trading of Malaysian securities and setting up asset management companies to facilitate the orderly recovery of bad loans. The real GDP growth rate in 1999 and 2000 were 5.4% and 8.6%, respectively (Table 1).

Malaysia was heavily affected by the global economic downturn and the slump in the IT sector in 2001 and 2002 due to its export-based economy. GDP in 2001 grew only 0.4% due to an 11% decrease in exports. A US $1.9 billion fiscal stimulus package helped the country ward off the worst of the recession and the GDP growth rate rebounded to 4.2% in 2002 (Table 1). A relatively small foreign debt and adequate foreign exchange reserves make a crisis similar to the 1997 one unlikely. Nevertheless, the economy remains vulnerable to a more protracted slowdown in the US and Japan, top export destinations and key sources of foreign investment.

In 2002, the manufacturing sector was the leading contributor to the economy, accounting for about 30 per cent of gross national product (GDP). Malaysia's major trading partners are United States, Singapore, Japan, China, Taiwan, Hong Kong and Korea.

Sources: Ernst & Young International. 1993. "Doing Business in Malaysia."
Other online sources.

TABLE 1: MALAYSIAN ECONOMIC PERFORMANCE
1999 to 2002

Economic Indicator	1999	2000	2001	2002
GDP per capita (US$)	3,596	3,680	3,678	3,814
Real GDP growth rate	5.4%	8.6%	0.4%	4.2%
Consumer price inflation	2.8%	1.6%	1.4%	1.8%
Unemployment rate	3.0%	3.0%	3.7%	3.5%

Source: IMD. Various years. "The World Competitiveness Report."

Exhibit 2

FINLAND: BACKGROUND INFORMATION

Finland is situated in the north-east of Europe, sharing borders with Sweden, Norway and the former Soviet Union. About 65 per cent of its area of 338,000 square kilometres is covered with forest, about 15 per cent lakes and about 10 per cent arable land. Finland has a temperate climate with four distinct seasons. In Helsinki, the capital city, July is the warmest month with average mid-day temperature of 21 degrees Celsius and January is the coldest month with average mid-day temperature of –3 degrees Celsius.

Finland is one of the most sparsely populated countries in Europe with a 2002 population of 5.2 million, 60 per cent of whom lived in the urban areas. Helsinki had a population of about 560,000 in 2002. Finland has a well-educated work force of about 2.3 million. About half of the work force are engaged in providing services, 30 per cent in manufacturing and construction, and eight per cent in agricultural production. The small size of the population has led to scarce and expensive labour. Thus Finland had to compete by exploiting its lead in high-tech industries.

Finland's official languages are Finnish and Swedish, although only six per cent of the population speaks Swedish. English is the most widely spoken foreign language. About 87 per cent of the Finns are Lutherans and about one per cent Finnish Orthodox.

Finland has been an independent republic since 1917, having previously been ruled by Sweden and Russia. A President is elected to a six-year term, and a 200-member, single-chamber parliament is elected every four years.

In 1991, the country experienced a bad recession triggered by a sudden drop in exports due to the collapse of the Soviet Union. During 1991-1993, the total output suffered a 10% contraction and unemployment rate reached almost 20%. Finnish Markka experienced a steep devaluation in 1991-1992, which gave Finland cost competitiveness in international market.

With this cost competitiveness and the recovery of Western export markets the Finnish economy underwent a rapid revival in 1993, followed by a new period of healthy growth. Since the mid 1990s the Finnish growth has mainly been bolstered by intense growth in telecommunications equipment manufacturing. The Finnish economy peaked in the year 2000 with a real GDP growth rate of 5.6% (Table 2).

Finland was one of the 11 countries that joined the Economic and Monetary Union (EMU) on January 1, 1999. Finland has been experiencing a rapidly increasing integration with Western Europe. Membership in the EMU provide the Finnish economy with an array of benefits, such as lower and stable interest rates, elimination of foreign currency risk within the Euro area, reduction of transaction costs of business and travel, and so forth. This provided Finland with a credibility that it lacked before accession and the Finnish economy has become more predictable. This will have a long-term positive effect on many facets of the economy.

Exhibit 2 (continued)

Finland's economic structure is based on private ownership and free enterprise. However, the production of alcoholic beverages and spirits is retained as a government monopoly. Finland's major trading partners are Sweden, Germany, the former Soviet Union and United Kingdom.

Finland's standard of living is among the highest in the world. The Finns have small families with one or two children per family. They have comfortable homes in the cities and one in every three families has countryside cottages near a lake where they retreat on weekends. Taxes are high, the social security system is efficient and poverty is virtually non-existent.

Until recently, the stable trading relationship with the former Soviet Union and other Scandinavian countries led to few interactions between the Finns and people in other parts of the world. The Finns are described as rather reserved, obstinate, and serious people. A Finn commented, "We do not engage easily in small talk with strangers. Furthermore, we have a strong love for nature and we have the tendency to be silent as we observe our surroundings. Unfortunately, others tend to view such behaviour as cold and serious." Visitors to Finland are often impressed by the efficient public transport system, the clean and beautiful city of Helsinki with orderly road networks, scenic parks and lakefronts, museums, cathedrals, and churches.

Sources: Ernst & Young International. 1993. "Doing Business in Finland."
Other online sources.

TABLE 2: FINNISH ECONOMIC PERFORMANCE
1999 to 2002

Economic Indicator	1999	2000	2001	2002
GDP per capita (US$)	24,430	23,430	23,295	25,303
Real GDP growth rate	3.7%	5.6%	0.4%	1.6%
Consumer price inflation	1.2%	3.3%	2.6%	1.6%
Unemployment	10.3%	9.6%	9.1%	9.1%

Source: IMD. Various years. "The World Competitiveness Report."

Exhibit 3

TEN MAJOR TELECOMMUNICATION EQUIPMENT VENDORS

Rank	Company	Country	1998 telecom equipment sales (US$ billions)
1	Lucent	USA	26.8
2	Ericsson	Sweden	21.5
3	Alcatel	France	20.9
4	Motorola	USA	20.5
5	Nortel	Canada	17.3
6	Siemens	Germany	16.8
7	Nokia	Finland	14.7
8	NEC	Japan	12.6
9	Cisco	USA	8.4
10	Hughes	USA	5.7

Source: International Telecommunication Union. 1999. Top 20 Telecommunication Equipment Vendors 1998. http://www.itu.int/ITU-D/ict/statistics/at_glance/Top2098.html.