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International Business and Management

Selecting the Entry Mode

Francesca Grippa

Northeastern University
College *of* Professional Studies

Outline

- Which markets to enter (**Where**)
- When to enter – Timing (**When**)
- Which **entry mo**de to use (**How**)
  - exporting
  - licensing or franchising
  - establishing a joint venture
  - establishing a new subsidiary
  - acquiring an established enterprise

Where?

Nation Profit Potential (in the long term) = f(....)...

- Economic incentives
- Political stability
- Wealth and market size (Economies of scale)
- Living standards
- Free market approach (government attitude and history)

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Timing of Entry

First mover <u>advantages</u>

- Establishing a strong brand name (e.g., VHS)
- Leveraging economies of scale and gain a cost advantage over latecomers
- Creating switching costs (for customers, distributors and suppliers)

Timing of Entry

First mover disadvantages

Pioneering costs to learn the new "rules of the game":

- the costs of business failure if the firm makes mistakes, due to its ignorance of the foreign environment
- the costs of promoting and establishing a product offering
- the cost of educating customers

KFC educated Chinese to fast food and McDonald's capitalized on that!

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Scale of Entry

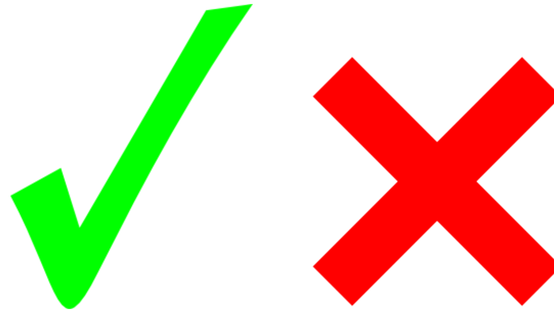
Large Scale Investment (e.g. ING in US in 2000):

- **signals** a **strategic commitment** to the market, to competitors, suppliers, government ("we will remain for the long run")
- **difficult to reverse** and **less resources** to invest in other countries (opportunity cost)

Small Scale Investment:

- A firm can collect info and learn about the foreign market (good if there is no pressure from competitors)
- A firm learns through hands-on experience in host countries, but this might prevent from capturing first mover advantages

Is there a right or wrong way to enter foreign markets?



Six Entry Modes (1 of 2)

1. Exporting	It is the first entry mode for many manufacturing firms (later, firms may switch to another mode)
2. Turnkey projects	The contractor handles all details of the project for a foreign client, including training personnel
3. Licensing	Granting the rights to intangible property to a foreign company for a specified time period, and in return, receives a royalty fee

Six Entry Modes (2 of 2)

4. Franchising

a specialized form of licensing in which the franchisor not only sells intangible property to the franchisee, but also insists that the franchisee agree to abide by strict rules as to how it does business (service firms)

5. Joint ventures

a firm that is jointly owned by two or more otherwise independent firms
most JVs are 50:50 partnerships

6. Wholly owned subsidiary

a firm owns 100 % of the stock
- set up a new operation
- M&A

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How to enter a foreign market? A Decision Model

- Choice of entry modes
  - Non-equity modes
    - Exports
      - Direct exports
      - Indirect exports
      - Others
    - Contractual agreements
      - Licensing/ franchising
      - Turnkey projects
      - R&D contracts
      - Co-marketing
  - Equity (FDI) modes
    - Joint ventures (JVs)
      - Minority JVs
      - 50/50 JVs
      - Majority JVs
    - Wholly owned subsidiaries (WOS)
      - Green-fields
      - Acquisitions
      - Others

Strategic alliances (within dotted area)

Source: Adapted from Y. Pan & D. Tse, 2000, The hierarchical model of market entry modes (p. 538), Journal of International Business Studies, 31, pp.535–554.

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Advantages and Disadvantages (1 of 2)

Entry Mode	Advantages	Disadvantages
Exporting	Ability to realize location and experience curve economies	High transport costs Trade barriers Problems with local marketing agents
Turnkey projects	Ability to earn returns in countries where FDI is restricted. Less risky than FDI in unstable regions..(short commitment)	Creating efficient competitors Lack of long-term market presence
Licensing	Low development costs and risks Fuji put up most of the required capital and paid 5% of revenues royalty fee to Xerox → plus JV Good if peripheral business (Coca Cola trademark to clothing manufacturers)	Lack of control over technology (RCA) → Cross licensing agreements to held each other hostage (Amgen-Kirin) Inability to engage in global strategic coordination

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Advantages and Disadvantages (2 of 2)

Entry Mode	Advantages	Disadvantages
Franchising	Low development costs and risks Stricter rules than Licensing McD.: control over menu, cooking methods, staffing policies, location	Lack of control over quality, unless create a subsidiary to control franchisee Inability to engage in global strategic coordination
Joint ventures	Access to local partner's knowledge Sharing development costs and risks Politically acceptable	Lack of control over technology (unless wall off) Conflicts over strategy and increasing bargaining power of one over time (as foreign firm learns more about mkt)
Wholly owned Subsidiaries (100% of the stock)	Protection of technology Ability to engage in global strategic coordination Ability to realize location and experience economies	High costs and risks Solution: SMALL SCALE enter through pilot projects and learn as you go (avoid losing brand image). Tesco / Fresh and Easy

Greenfield Investments or Acquisition?

Greenfield strategy

Better when the firm needs to transfer organizationally embedded competencies, skills, routines, and culture (McDonald's Franchising +Subsidiary)

Slower and riskier, but max control

M&A strategy

- Used by firms to compete with global competitors interested in expanding
- High Failure Rate →
  - *Over-payment*, Daimler-Chrysler 1998 to 2007
  - *Clash of organizational cultures* (German managers too autocratic and US managers overpaid! high turnover*)*
  - *Differences in national cultures*
  - *Inadequate pre-acquisition screening* (to pre-empt competitors, you end up buying a troubled organization)

Strategic Alliances

Cooperative agreements between potential or actual competitors (JV where firms have equity stakes or short-term contractual agreement to develop a new product)

\+ **Advantages**

- Facilitate entry into market (e.g. to create *guanxi with Chinese partners*)
- Share fixed costs (Boeing and Japanese firms for $8bil Investment B787).
- Bring together skills and assets that neither company has or can develop (Symbian: Nokia, Motorola, Matsushita, Siemens, Sony/Ericsson, Psion) → **coopetition**
- Establish industry technology standards. → Symbian

\- **Disadvantages**

- Competitors get easy access to technology and markets (US vs Japan)
- Careful to Trojan Horse…

How to make Alliances work?

1. **Carefully Selecting the Partner**
   - helps each other to achieve strategic goals
   - has the capabilities the other firm lacks
   - shares the firm's vision and culture
   - will not exploit the alliance for its own benefit (fair play)

2. **Build a strong Alliance Structure**
   - Wall-Off technology, which means make it difficult to transfer technology not meant to be transferred
   - have contractual safeguards against the risk of opportunism (cross-licensing agreements, e.g. Kirin-Amgen)

3. **Strengthening interpersonal relationships** between managers (build relational capital) and **Learning from each other**

Thanks for the attention