FOREIGN MARKET ENTRY STRATEGIES

Lecture Objectives

- Basic decisions for foreign market entry
- Advantages and disadvantages of each mode of market entry
- Theories of entry mode choice

Basic Decisions for Global Expansion

1. Which markets to enter
2. When to enter them and on what scale
3. Which entry mode to use

- The optimal mode varies by situation – what makes sense for one company might not make sense for another
- The decisions are not necessarily sequential

The where, the when, the how

Which Foreign Markets to Enter?

- It obviously depends on the objectives
  - Market seeking
  - Natural resource seeking
  - Efficiency seeking
  - Strategic assets seeking

Exploitation vs. Exploration

Can firms be ambidextrous?

When to Enter the Market?

- Early versus late entry: first-mover advantages and disadvantages

- Advantages
  - Brand name
  - Sales volume
  - Switching costs
- Disadvantages
  - Pioneering costs, evolving regulations

Source: Lieberman, M. & D. Montgomery, 1988. 'First-Mover Advantages', *Strategic Management Journal*, Vol. 9, Special Issue: Strategy Content Research, pp. 41-58.

What Scale of Entry?

- Level of resources firm can afford to commit

- Large scale entry & first mover advantages

- Risks associated with significant commitments
  - FDI sunk costs ⬆
  - Divestment difficulty ⬆
  - Strategic flexibility ⬇

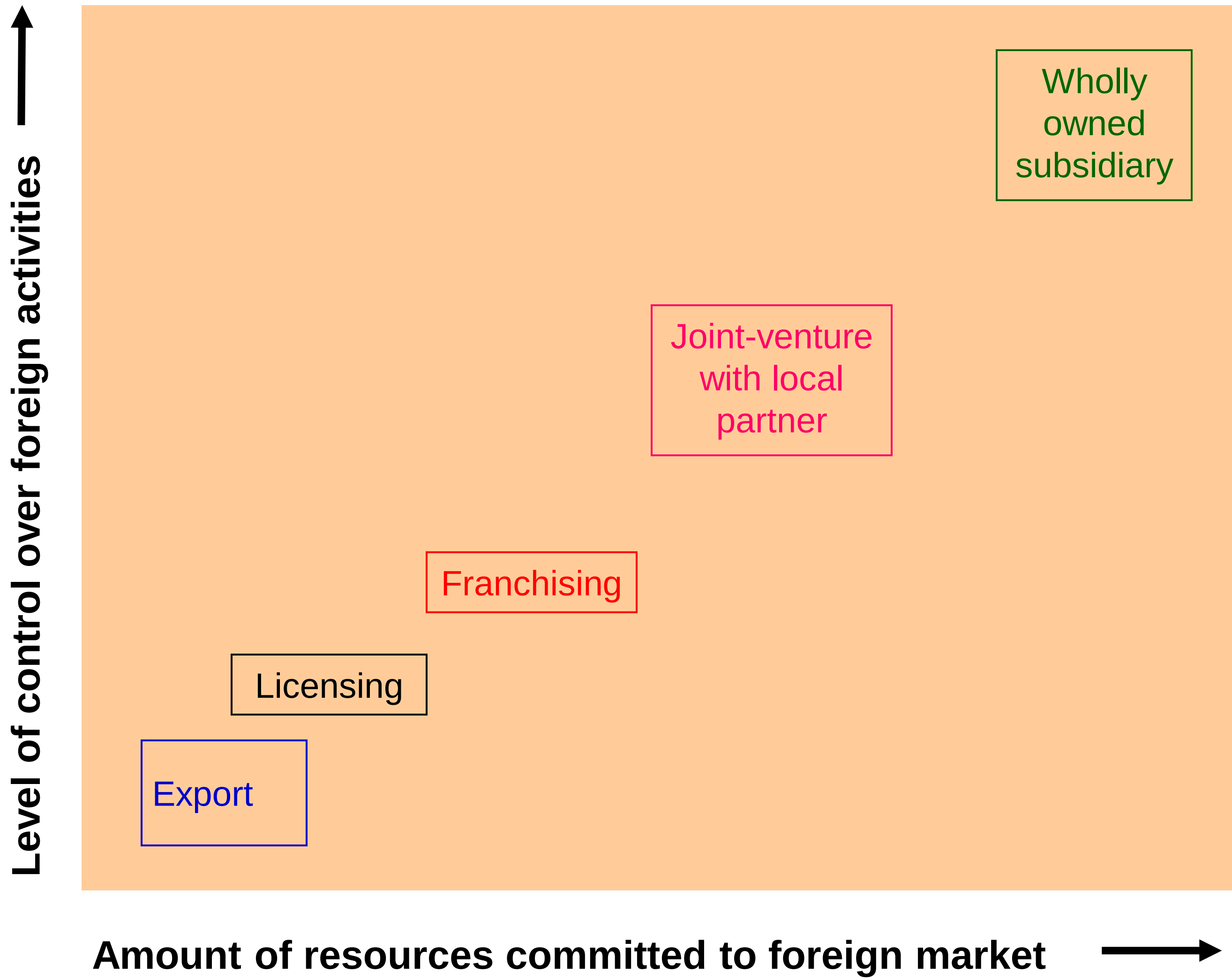
- Small-scale entry: learning process

Which Entry Mode to Use?

1. Foreign trade
   – Exporting
2. Contractual entry modes
   – Licensing
   – Franchising
3. Investment entry modes
   – Joint-venture (JV)
   – Wholly-owned subsidiary

- Firms *may* adjust entry mode in a gradual manner
  – Exporting → contractual mode → investment mode

Approaches to Foreign Market Entry



Source: Bartlett, C. A., S. Ghoshal & J. Birkinshaw, 2004. *Transnational Management, Text, Cases, and Readings in Cross-Border Management*.

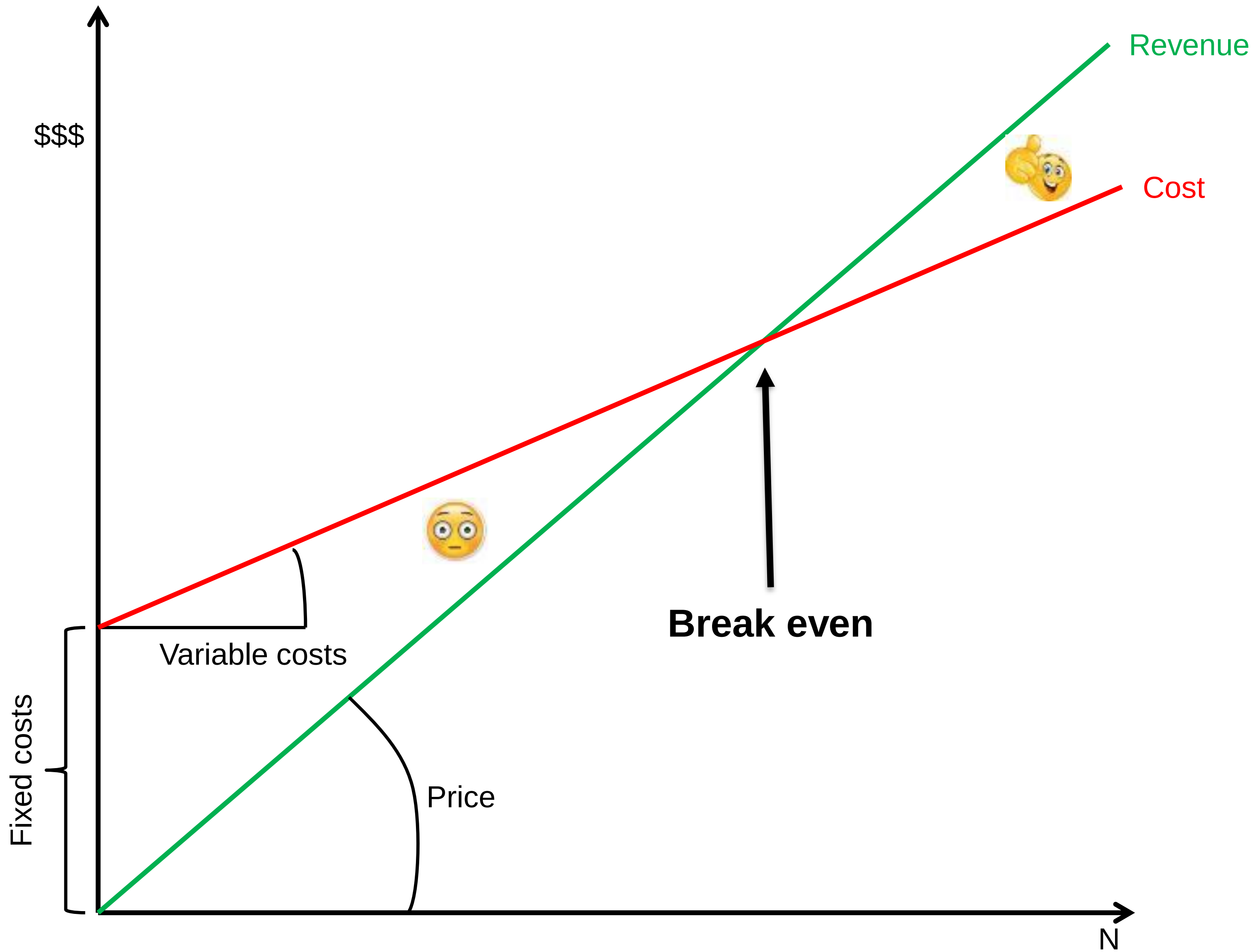
Exporting

- Manufacturing in a centralised location
  - High production control
  - Low marketing control

- Exporting's Pros:
  - it avoids the costs of establishing foreign manufacturing operations
  - it helps the firm achieve **experience curve** and location economies

- Exporting's Cons:
  - there may be lower-cost manufacturing locations
  - high transport costs and tariffs can make it uneconomical
  - agents in a foreign country may not act in exporter's best interest

The Economy of Scale



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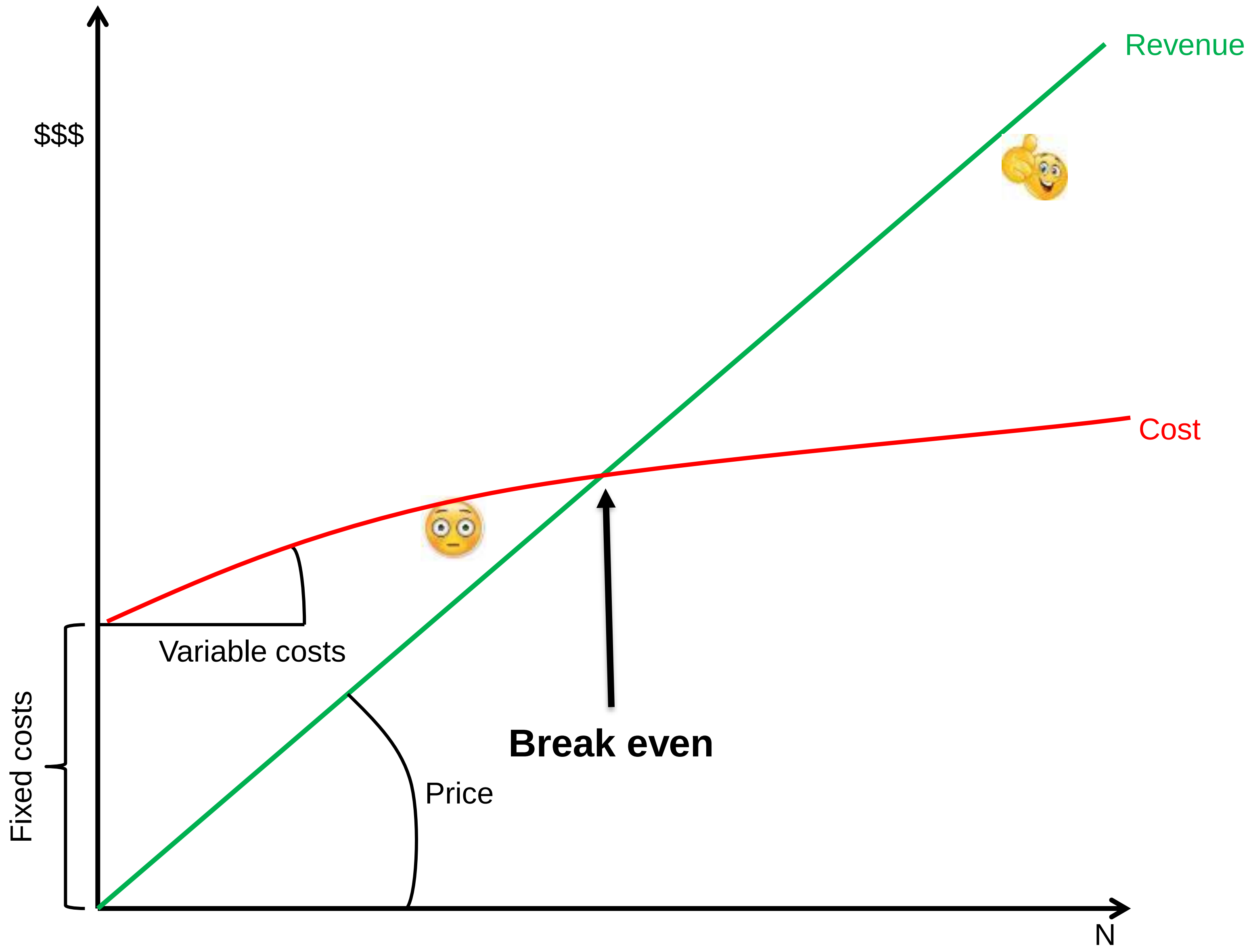
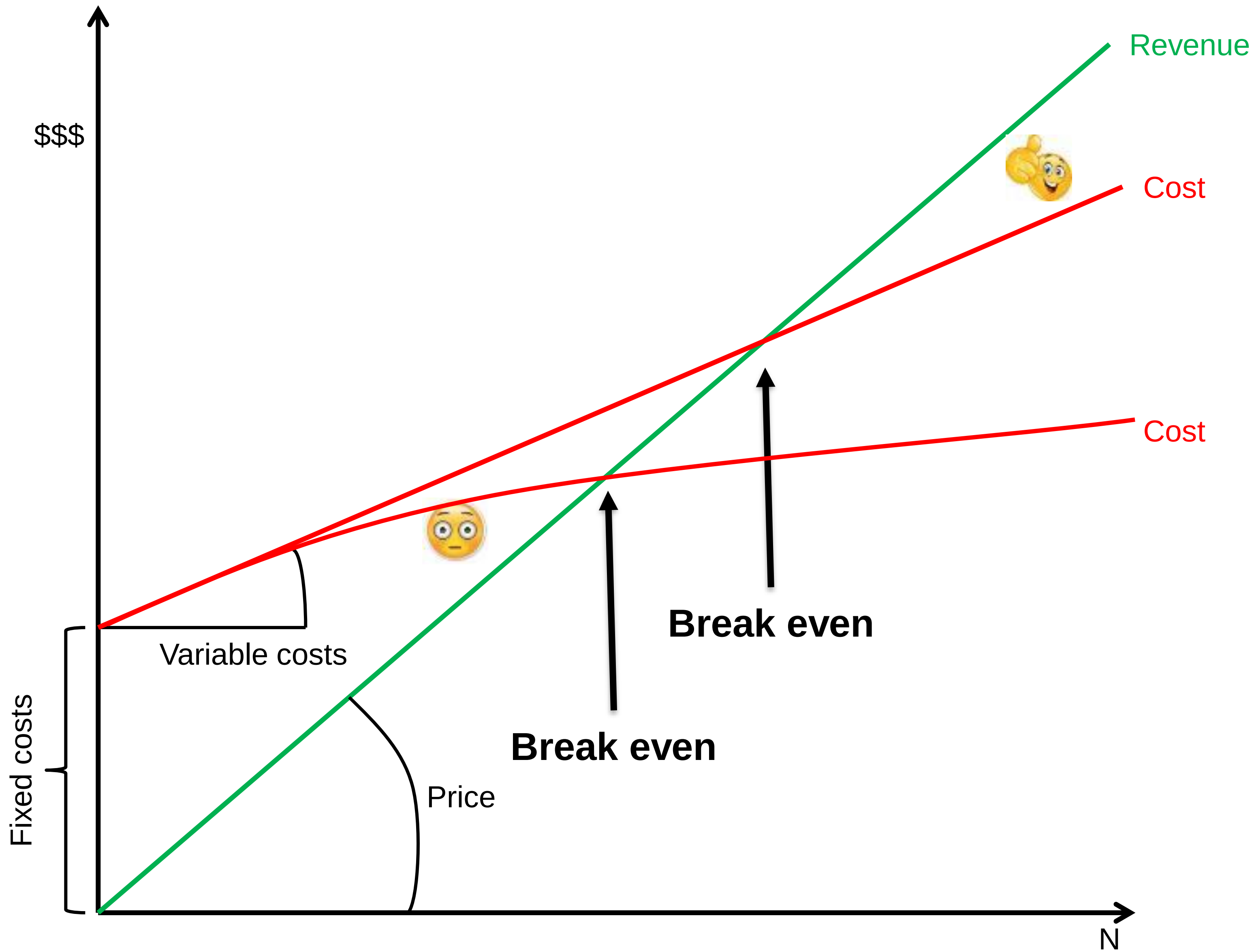


The Economy of Scale



Licensing

- A licensor grants the rights to **intangible property**
- A licensee pays a royalty fee

- Licensing's Pros:
  - the firm avoids development costs and risks associated with opening a foreign market
  - the firm avoids barriers to investment
  - the firm can capitalize on market opportunities without developing those business applications on its own
- Licensing's Cons:
  - the firm doesn't have full control
  - the firm's ability to coordinate strategic moves across countries is limited
  - proprietary (or intangible) assets could be lost
    - to reduce this risk, use cross-licensing agreements

Franchising

- **A specialized form of licensing** :
  - a package of commercial assets
  - in the form of a self-sufficient bundle of assets

- Franchising's Pros:
  - it avoids the costs and risks of opening up a foreign market
  - firms can quickly build a global presence

- Franchising's Cons:
  - difficult to achieve strategic coordination
  - difficult to monitor franchisee behavior

Joint-venture (JV)

- A firm that is jointly owned by two or more otherwise independent firms
  - E.g., 50:50 partnerships, technically limitless configurations
- Joint ventures' Pros:
  - a local partner's knowledge and know-how
  - sharing costs and risks of opening a foreign market
  - compliance with certain entry requirement of the host government
- Joint ventures' Cons:
  - the firm risks giving control of its technology to its partner
  - the firm may not have optimal efficiency
  - shared ownership can lead to conflicts and battles for control if goals and objectives differ or change over time

Wholly-owned Subsidiary

- Setting up new operation (Greenfield) or Merger & Acquisition (M&A)
  - 100% control by parent company

- Wholly owned subsidiaries' Pros:
  - high/full control over core competencies
  - enables strategic coordination across subsidiaries
  - internal operational efficiency

- Wholly owned subsidiaries' Cons:
  - the firm bears the full cost and risk of setting up overseas operations
  - regulatory and social discrimination

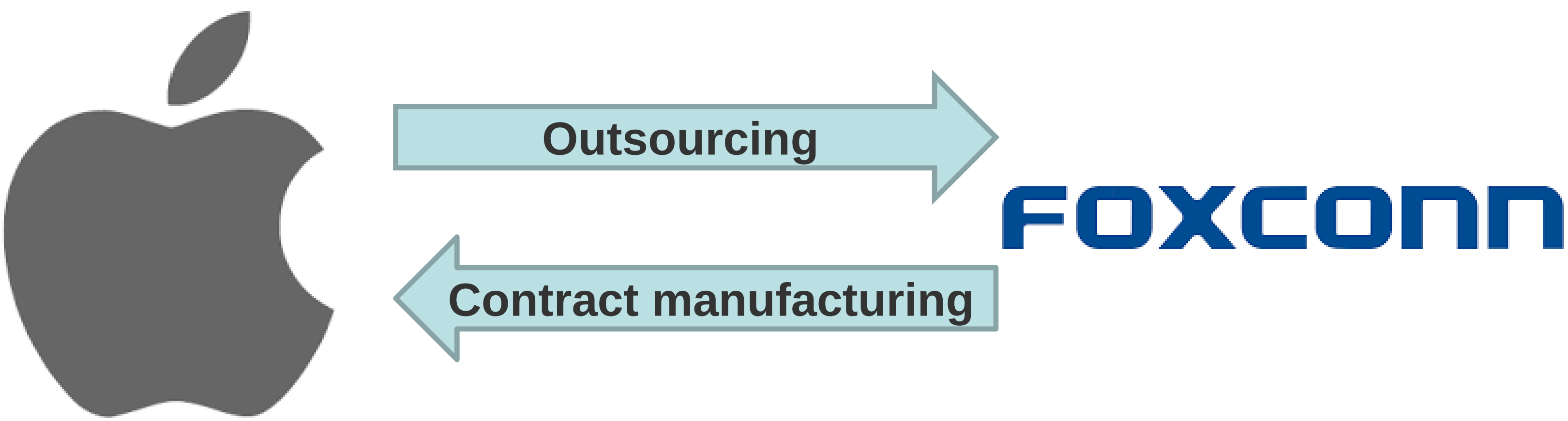
Merits of Different Entry Modes

Entry mode	Advantages	Disadvantages
Exporting	▪ Ability to realise location and experience-curve economies	▪ High transport costs ▪ Trade barriers ▪ Problems with local marketing agents
Licensing	▪ Low development costs and risks	▪ Inability to realise location and experience-curve economies ▪ Inability to engage in global strategic coordination ▪ Lack of control over technology
Franchising	▪ Low development costs and risks	▪ Inability to engage in global strategic coordination ▪ Lack of control over quality
Joint ventures	▪ Access to local partner's knowledge ▪ Shared development costs and risks ▪ Political dependency	▪ Inability to engage in global strategic coordination ▪ Inability to realise location and experience-curve economies ▪ Lack of control over technology
Wholly-owned subsidiaries	▪ Protection of technology ▪ Ability to engage in global strategic coordination ▪ Ability to realise location and experience-curve economies	▪ High costs and risks

Source: Hill, C., G. Jones & P. Galvin, 2004. *Strategic Management, An Integrated Approach*

Other specialized entry mode

- Management contracts
- Turnkey projects
- Contractual manufacturing



Collaboration modes

❑ Licensing ❑ Franchising ❑ Management contract	Non-equity / Contractual
❑ Equity joint venture ❑ Equity alliances	Equity

Strategic alliance

Strategic Alliances

	Existing Products	New Products
New Markets	To take existing products to foreign markets	To diversify into a new business
Existing Markets	To strengthen the existing business	To bring foreign products to local markets

Source: Beamish, P., A. Morrison, A. Inkpen & P. Rosenzweig, 2003. *International Management, Text & Cases.*

Greenfield or Acquisition?

1. A greenfield method – build
   - Capacity building (host country preference)
   - Transfer organizationally embedded competencies, skills, routines, and culture
   - Time consuming

2. An acquisition method – buy
   - Speedy
   - Cash-heavy (exposure to forex risks)
   - Learning advantages
   - Integration challenges
   - Competitive action (hostile acquisition)

Theories of foreign market entry

- Internationalization process model
  - Where, how, and when firms enter into foreign markets
- Transaction cost economics
  - Choice between market (trade/contract) and hierarchy (FDI)
- OLI (eclectic framework)
  - Theories of the multinational enterprises

Internationalization Process

- Foreign market knowledge is the key
- Knowledge level determines foreign market commitment level (both the level and the degree of commitment)
- Knowledge can be obtained through various learning processes
  - Experiential learning
  - Vicarious learning
  - Grafting
- The stage model rejected
- Insider-ship emphasized

Psychic distance

Uppsala university

Transaction cost economics

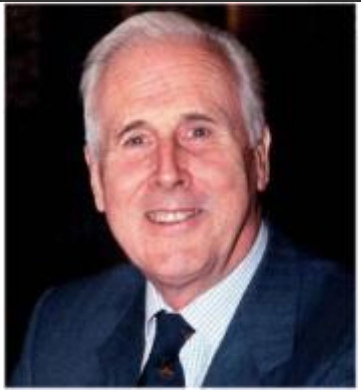
- What's the boundary of the firm?
- Economic activities can be organized at the arm's length (through market) or under a hierarchy
- Transaction partner opportunism!
- Transaction cost is high when
  - ***Uncertainty*** is high
  - Transaction is **frequent**
  - Asset **specificity** is high
- High transaction cost justifies hierarchy for better control of valuable assets
- Where is the good-will?

Oliver E. Williamson

Williamson in 2009

Eclectic framework of FDI

- Why do MNCs exist?
- In other words, why is trade not enough?
- Basically – the market is imperfect



John H. Dunning

- *I*nternalization advantage (transaction cost economy)
- *L*ocation advantage of foreign markets
- *O*wnership advantage to offset liability of foreignness

Strong OLI justifies FDI, hence the existence of MNCs

New perspectives for the new breed?

- Conventional
  - IPM
  - TCE
  - OLI

- Emerging
  - Spring-boarding
  - Linkage-leverage-learning (LLL)
  - Ambidexterity