# International Business 7e

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# Chapter 14

## Entry Strategy and Strategic Alliances

# Introduction

Firms expanding internationally must decide:

- which markets to enter
- when to enter them and on what scale
- which entry mode to use

Entry modes include:

- exporting
- licensing or franchising to a company in the host nation
- establishing a joint venture with a local company
- establishing a new wholly owned subsidiary
- acquiring an established enterprise

# Introduction

Several factors affect the choice of entry mode including:

- transport costs
- trade barriers
- political risks
- economic risks
- costs
- firm strategy

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

# Basic Entry Decisions

Firms entering foreign markets make three basic decisions:

1. which markets to enter
2. when to enter those markets
3. on what scale to enter those markets

# Which Foreign Markets?

- The choice of foreign markets will depend on their long run profit potential
- Favorable markets are politically stable developed and developing nations with free market systems and relatively low inflation rates and private sector debt
- Less desirable markets are politically unstable developing nations with mixed or command economies, or developing nations with excessive levels of borrowing
- Markets are also more attractive when the product in question is not widely available and satisfies an unmet need

# Timing Of Entry

- Once attractive markets are identified, the firm must consider the timing of entry
- Entry is early when the firm enters a foreign market before other foreign firms
- Entry is late when the firm enters the market after firms have already established themselves in the market

# Timing Of Entry

❖First mover advantages are the advantages associated with entering a market early

First mover advantages include:

❖the ability to pre-empt rivals and capture demand by establishing a strong brand name

❖the ability to build up sales volume in that country and ride down the experience curve ahead of rivals and gain a cost advantage over later entrants

❖the ability to create switching costs that tie customers into products or services making it difficult for later entrants to win business

# Timing Of Entry

❖First mover disadvantages are disadvantages associated with entering a foreign market before other international businesses

First mover disadvantages include:

❖pioneering costs - arise when the foreign business system is so different from that in a firm’s home market that the firm must devote considerable time, effort and expense to learning the rules of the game

Pioneering costs include:

❖the costs of business failure if the firm, due to its ignorance of the foreign environment, makes some major mistakes

❖ the costs of promoting and establishing a product offering, including the cost of educating customers

# Classroom Performance System

_______ refers to the time and effort spent learning the rules of a new market.

a) First mover advantages
b) Strategic commitments
c) Pioneering costs
d) Market entry costs

# Scale Of Entry And Strategic Commitments

- After choosing which market to enter and the timing of entry, firms need to decide on the scale of market entry
- Entering a foreign market on a significant scale is a major strategic commitment that changes the competitive playing field
- Firms that enter a market on a significant scale make a strategic commitment to the market (the decision has a long term impact and is difficult to reverse)
- Small-scale entry has the advantage of allowing a firm to learn about a foreign market while simultaneously limiting the firm's exposure to that market

# Summary

- There are no “right” decisions when deciding which markets to enter, and the timing and scale of entry, just decisions that are associated with different levels of risk and reward

# Entry Modes

These are six different ways to enter a foreign market:

1. exporting
2. turnkey projects
3. licensing
4. franchising
5. establishing joint ventures with a host country firm
6. setting up a new wholly owned subsidiary in the host country

❖Managers need to consider the advantages and disadvantages of each entry mode

# Exporting

- Exporting is a common first step in the international expansion process for many manufacturing firms
- Later, many firms switch to another mode to serve the foreign market

# Exporting

Exporting is attractive because:

- it avoids the costs of establishing local manufacturing operations
- it helps the firm achieve experience curve and location economies

Exporting is unattractive because:

- 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

# Turnkey Projects

- In a turnkey project, the contractor agrees to handle every detail of the project for a foreign client, including the training of operating personnel
- At completion of the contract, the foreign client is handed the "key" to a plant that is ready for full operation
- Turnkey projects are common in the chemical, pharmaceutical, petroleum refining, and metal refining industries

# Turnkey Projects

Turnkey projects are attractive because:

- ❖they are a way of earning economic returns from the know-how required to assemble and run a technologically complex process
- ❖they can be less risky than conventional FDI

Turnkey projects are unattractive because:

- ❖the firm that enters into a turnkey deal will have no long-term interest in the foreign country
- ❖the firm that enters into a turnkey project may create a competitor
- ❖if the firm's process technology is a source of competitive advantage, then selling this technology through a turnkey project is also selling competitive advantage to potential and/or actual competitors

# Licensing

- A licensing agreement is an arrangement whereby a licensor grants the rights to intangible property to another entity (the licensee) for a specified time period, and in return, the licensor receives a royalty fee from the licensee
- Intangible property includes patents, inventions, formulas, processes, designs, copyrights, and trademarks

# Licensing

Licensing is attractive because:

- the firm does not have to bear the development costs and risks associated with opening a foreign market
- the firm avoids barriers to investment
- firms with intangible property that might have business applications can capitalize on market opportunities without developing those applications itself

# Licensing

Licensing is unattractive because:

❖the firm doesn't have the tight control over manufacturing, marketing, and strategy required for realizing experience curve and location economies

❖it limits a firm's ability to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another

❖proprietary (or intangible) assets could be lost

❖One way of reducing this risk is through the use of cross-licensing agreements where a firm might license intangible property to a foreign partner, but requests that the foreign partner license some of its valuable know-how to the firm in addition to a royalty payment

# Franchising

- Franchising is basically 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
- Franchising is used primarily by service firms

# Franchising

Franchising is attractive because:

- Firms avoid many costs and risks of opening up a foreign market
- Firms can quickly build a global presence

Franchising is unattractive because:

- It may inhibit the firm's ability to take profits out of one country to support competitive attacks in another
- the geographic distance of the firm from its foreign franchisees can make poor quality difficult for the franchisor to detect

# Joint Ventures

- A joint venture is the establishment of a firm that is jointly owned by two or more otherwise independent firms
- Most joint ventures are 50:50 partnerships

# Joint Ventures

Joint ventures are attractive because:

❖they allow the firm to benefit from a local partner's knowledge of the host country's competitive conditions, culture, language, political systems, and business systems

❖the costs and risks of opening a foreign market are shared with the partner

❖When political considerations make joint ventures the only feasible entry mode

❖Joint ventures are unattractive because:

❖the firm risks giving control of its technology to its partner

❖the firm may not have the tight control over subsidiaries need to realize experience curve or location economies

❖shared ownership can lead to conflicts and battles for control if goals and objectives differ or change over time

# Wholly Owned Subsidiaries

- In a wholly owned subsidiary, the firm owns 100 percent of the stock

Firms can establish a wholly owned subsidiary in a foreign market:

- setting up a new operation in the host country
- acquiring an established firm in the host country

# Wholly Owned Subsidiaries

Wholly owned subsidiaries are attractive because:

- they reduce the risk of losing control over core competencies
- they give a firm the tight control over operations in different countries that is necessary for engaging in global strategic coordination
- they may be required in order to realize location and experience curve economies

Wholly owned subsidiaries are unattractive because:

- the firm bears the full cost and risk of setting up overseas operations

# Classroom Performance System

How do most firms begin their international expansion?

a) with a joint venture

b) with a wholly owned subsidiary

c) with licensing or franchising

d) with exporting

# Classroom Performance System

What is the main disadvantage of wholly owned subsidiaries?

a) they make it difficult to realize location and experience curve economies

b) the firm bears the full cost and risk of setting up overseas operations

c) they may inhibit the firm's ability to take profits out of one country to support competitive attacks in another

d) high transport costs and tariffs can make it uneconomical

# Selecting An Entry Mode

- All entry modes have advantages and disadvantages
- The optimal choice of entry mode involves trade-offs

# Selecting An Entry Mode

Table 14.1:

| Entry Mode | Advantages | Disadvantages |
|---|---|---|
| Exporting | Ability to realize location and experience curve economies | High transport costs<br>Trade barriers<br>Problems with local marketing agents |
| Turnkey contracts | Ability to earn returns from process technology skills in countries where FDI is restricted | Creating efficient competitors<br>Lack of long-term market presence |
| Licensing | Low development costs and risks | Lack of control over technology<br>Inability to realize location and experience curve economies<br>Inability to engage in global strategic coordination |
| Franchising | Low development costs and risks | Lack of control over quality<br>Inability to engage in global strategic coordination |
| Joint ventures | Access to local partner's knowledge<br>Sharing development costs and risks<br>Politically acceptable | Lack of control over technology<br>Inability to engage in global strategic coordination<br>Inability to realize location and experience economies |
| Wholly owned subsidiaries | Protection of technology<br>Ability to engage in global strategic coordination<br>Ability to realize location and experience economies | High costs and risks |

# Core Competencies And Entry Mode

- The optimal entry mode depends to some degree on the nature of a firm's core competencies
- When a firm's competitive advantage is based on proprietary technological know-how, the firm should avoid licensing and joint venture arrangements unless it believes its technological advantage is only transitory, or that it can establish its technology as the dominant design in the industry
- When a firm's competitive advantage is based on management know-how, the risk of losing control over the management skills is not high, and the benefits from getting greater use of brand names is significant

# Pressures For Cost Reductions And Entry Mode

- When pressure for cost reductions is high, firms are more likely to pursue some combination of exporting and wholly owned subsidiaries
- This will allow the firm to achieve location and scale economies as well as retain some degree of control over its worldwide product manufacturing and distribution
- So, firms pursuing global standardization or transnational strategies prefer wholly owned subsidiaries

# Classroom Performance System

If a firm wants the option of global strategic coordination, the firm should choose

a) franchising

b) joint ventures

c) licensing

d) a wholly owned subsidiary

# Greenfield Ventures Or Acquisitions

Firms can establish a wholly owned subsidiary in a country by:

❖Using a greenfield strategy - building a subsidiary from the ground up

❖Using an acquisition strategy

# Pros And Cons Of Acquisition

Acquisitions are attractive because:

- they are quick to execute
- they enable firms to preempt their competitors
- acquisitions may be less risky than greenfield ventures

# Pros And Cons Of Acquisition

Acquisitions can fail when:

- the acquiring firm overpays for the acquired firm
- the cultures of the acquiring and acquired firm clash
- attempts to realize synergies run into roadblocks and take much longer than forecast
- there is inadequate pre-acquisition screening

To avoid these problems, firms should:

- carefully screening the firm to be acquired
- move rapidly once the firm is acquired to implement an integration plan

# Pros And Cons Of Greenfield Ventures

- The main advantage of a greenfield venture is that it gives the firm a greater ability to build the kind of subsidiary company that it wants
- However, greenfield ventures are slower to establish
- Greenfield ventures are also risky

# Greenfield Or Acquisition?

- The choice between a greenfield investment and an acquisition depends on the situation confronting the firm
- Acquisition may be better when the market already has well-established competitors or when global competitors are interested in building a market presence
- A greenfield venture may be better when the firm needs to transfer organizationally embedded competencies, skills, routines, and culture

# Classroom Performance System

All of the following are advantages of acquisitions *except*

a) they are quicker to execute

b) it is easy to realize synergies by integrating the operations of the acquired entities

c) they enable firms to preempt their competitors

d) they may be less risky

# Strategic Alliances

- Strategic alliances refer to cooperative agreements between potential or actual competitors
- Strategic alliances range from formal joint ventures to short-term contractual agreements
- The number of strategic alliances has exploded in recent decades

# The Advantages Of Strategic Alliances

Strategic alliances:

- facilitate entry into a foreign market
- allow firms to share the fixed costs (and associated risks) of developing new products or processes
- bring together complementary skills and assets that neither partner could easily develop on its own
- can help a firm establish technological standards for the industry that will benefit the firm

# The Disadvantages Of Strategic Alliances

- Strategic alliances can give competitors low-cost routes to new technology and markets, but unless a firm is careful, it can give away more than it receives

# Making Alliances Work

The success of an alliance is a function of:

- partner selection
- alliance structure
- the manner in which the alliance is managed

# Making Alliances Work

A good partner:

- helps the firm achieve its strategic goals and has the capabilities the firm lacks and that it values
- shares the firm’s vision for the purpose of the alliance
- is unlikely to try to opportunistically exploit the alliance for its own ends: that it, to expropriate the firm’s technological know-how while giving away little in return

# Making Alliances Work

Once a partner has been selected, the alliance should be structured:

- to make it difficult to transfer technology not meant to be transferred
- with contractual safeguards written into the alliance agreement to guard against the risk of opportunism by a partner
- to allow for skills and technology swaps with equitable gains
- to minimize the risk of opportunism by an alliance partner

# Making Alliances Work

- After selecting the partner and structuring the alliance, the alliance must be managed
- Successfully managing an alliance requires managers from both companies to build interpersonal relationships
- A major determinant of how much a company gains from an alliance is its ability to learn from its alliance partners

# Classroom Performance System

Which of the following is *not* important to a successful strategic alliance?

a) establishing a 50:50 relationship with partner

b) creating strong interpersonal relationships

c) a shared vision

d) learning from the partner