Various Methods Of Entering Global Markets

Dr. Jack M. Wilson, Distinguished Professor of Higher Education, Emerging Technologies, and Innovation

© 2012 ff -Jack M. Wilson Distinguished Professor

Reasons for Going International

Remember: Reasons a company might go international include:

- Expand beyond a saturated domestic market
- Find new source of profits
- Add to your firm's competitive edge
- Diversify and grow your markets to hedge against economic crises
- Follow customers who are going abroad.

FACTORS THAT INFLUENCE THE MODE OF ENTRY DECISION PROCESS

An SME (small/medium enterprise) goes through successive decision making process that includes answering the following questions:

- Can our product be marketed abroad?
- What the key success factors for our products?
- Is secondary data available for those markets/products?
- What additional data is needed and how can we get it?
- Which of our products have the highest potential abroad?
- Which markets have the greatest potential for our products?
- Do we have excess production capacity?
- What are the characteristics of our target market?
- What are the international capabilities of the firm?

Internal Factors

- **Internal factors** have to do with the firm's resources, overall strategy, management mindset, time commitment and types of products or services considered for international markets.
- For most entrepreneurial firms, the key issues discussed during this initial stage of the decision process revolve around:
  - **Financial resources**—how much can we spend on international market expansion; should we borrow funds or use accumulated financial assets, are the potential rewards of this initiative worth the financial risks, etc.
  - **Human resources**—should we hire new staff or use existing personnel to lead the expansion effort; what would be the compensation for the new position, how would the new management role be defined, where would the position be located, etc.
  - **Type of product and/or service**—which of our products/services should we market internationally, how adaptable are they, what is required to make them ready for the target market, etc.
  - **Time horizons**—how much time can we dedicate to the international expansion effort, are we willing to accommodate longer receivables cycles, etc.
  - **Risk tolerance**—are we prepared to absorb the higher risks inherent in dealing with currency exchange rates, unfamiliar political, legal and market environments, economic cycles, etc.

External Factors

- Factors that affect the company's choice to enter a foreign market but are *independent* of management's decisions are called **external factors**.
- External factors fall under two categories:
  - target country factors and
  - domestic country factors.

- ***Target country factors*** that should be considered when choosing a mode of entry include:
  - **Market**—its size, competitive environment, marketing infrastructure, etc.
  - **Production conditions**—cost, quality and quantity of local materials and labor, to the transportation, communications, energy supply and other similar economic infrastructure components.
  - **Environmental conditions**—includes most of the political, economic, geographic and social factors that make one country more attractive for international commerce than another. Examples include government policies towards foreign trade, the overall rate of foreign investment, the gross national product, the diversification level of the local economy, the country's corruption ratings, and cultural and language barriers.

External Factors Contd.

- ***Domestic country factors*** also influence the foreign market entry mode.
  - For example, if a company has a **large enough domestic ma**rket, it can grow to a significant size before it chooses or needs to expand internationally.
    - A large domestic market can make some companies disinterested in expanding internationally due to the significant growth opportunities at home,
    - while a small domestic market would spur even small companies to seek international expansion sooner.
  - Other domestic country factors that would spur a company to seek international markets include competitive pressure at home, high domestic production costs, and favorable government policies towards exporting (tax incentives, trade support programs) for example.

  - The choices of market entry methods can differ significantly for **small and large** companies, depending on their capitalization, production capacity and marketing resources, among other issues.

Methods of Entry to International Markets

- **Exporting:** The most common and low-risk method of entering overseas markets, exporting is also the one requiring the least investment in financial, marketing and human resources and time. Because of its low commitment requirements, exporting is the preferred mode of entry of most small and entrepreneurial businesses. It is an especially well suited method for initial market tests due to the relative ease of pulling out of a market if it turns out to not be profitable.
  - **Indirect exporting-** when products are sold overseas by intermediaries who specialize in this activity from the home base.
  - **Direct exporting –**when products are distributed directly through agents and/or distributors in the target country. An alternative that falls under the direct exporting method is to export products to a direct branch or subsidiary of the company, which assumes that some form of direct investment in the target market has already been made.
  - We covered exporting in detail in the earlier section on Exporting

Selecting an Appropriate Distributor

As with all others forms of market entry, an entrepreneur who is considering exporting should do plenty of research and planning before committing to a market or a distributor. The following indicators should be used when selecting a distributor:

- Does the distributor have **established connections** in the targeted industries?
- Is the distributor **familiar with the type of products** manufactured by the company?
- Does the distributor have **experience** working with American companies?
- What are the distributor’s size, current product lineup and revenues?
- Will the distributor allow the company to conduct independent marketing and sales within the country?

Licensing

Another popular method for market entry is through **licensing**.

- **International licensing** is the process of transferring the rights to a firm's products to an overseas company for the purpose of producing or selling it there.
  - For a set royalty fee, the *licensor* allows the *licensee* to use its technology, trademark(s), patent(s) and other intellectual property in order to gain presence in the market(s) covered by the licensee.
- Licensing is an attractive mode of entry for many entrepreneurial firms because, like exporting, it involves **smaller upfront risks and expenditures**.
  - Since most of the costs of developing the licensed products have already been incurred, the royalties received often translate into direct profits for the licensor.
  - This form of market entry is most appropriate for countries that impose barriers to imports such as high tariffs and profit repatriation restrictions, and for mature products with relatively standardized production.
- Drawbacks: As with export partners, a firm considering licensing is advised to thoroughly research its potential licensees and their professionalism standards and to devise detailed legal contracts specifying the agreement's constraints, compensation rates, duration and other similar issues.
  - Such cautious approach is important especially for countries where the legal protection for intellectual property is weak or not strongly enforced by the government.
  - All too often, licensing companies have found themselves competing against their very licensees who have copied their know-how and entered the markets with little or no R&D expenses. High tech firms considering licensing should be especially wary of the dangers of technology expropriation.

Licensing Deals

- Donald Trump does most deals by licensing his name on projects

Franchising

- **International franchising** gives more control to the *franchisor* company over the *franchisee* who has licensed the company's trademarks, products and/or services, and production and/or operation processes.
  - Control is exerted through the franchise fee which can be expropriated if contracts are not adhered to, and elaborate contracts that govern the relationship between the franchisor and the franchisee/s.
  - On the flip side, the franchisor is also required to provide more materials, training and other forms of support to the franchisee.
  - A well functioning franchise provides a win-win arrangement for both parties:
    - the franchisor gets to expand into new markets with little or no risk and investment and
    - the franchisee gets a proven brand, marketing exposure, established client base and management expertise to help him or her succeed.

Contract Manufacturing

- The arrangement of using cheaper overseas labor for the production of finished goods or parts by following an established production process is called **contract manufacturing** or **outsourcing**.
- Contract manufacturing's growing popularity is due to the large savings it can produce in the financial and human resources areas of a business.
- Companies using this mode of entry benefit not only from lowering their production costs but also from an entry to a new market with small amounts of capital and with no ownership hassles.
- Some of the drawbacks of using outsourcing methods is the loss of control over the manufacturing process and the working conditions in the facilities, which can potentially lead to lower quality of the goods and/or human rights abuses and result in bad publicity and financial damages to the company's brand.
  - https://en.wikipedia.org/wiki/Contract_manufacturer

Top Ten Electronic Contract Manufacturers (2011)

1 Hon Hai Precision Industry (Foxconn) -- Tucheng City, Taiwan

2 Flextronics International Ltd. -- Singapore

3 Jabil Circuit -- St. Petersburg, FL

4 Celestica -- Toronto, Canada

5 Sanmina-SCI -- San Jose, CA

6 New Kinpo Group -- Taipei, Taiwan

7 Shenzhen Kaifa Technology -- Shenzhen, China

8 Benchmark Electronics -- Angleton, TX

9 Plexus -- Neenah, WI

10 Universal Scientific Industrial Co. Ltd. (USI) -- Nantou, Taiwan

- http://www.eetimes.com/document.asp?

FoxxConn factory in Zengzhou, China – making Apple iPhones

Turnkey Operations

- **Turnkey operations** typically involve the design, construction, equipment and, often, the initial personnel training of a large facility by a overseas company which then turns the key to the ready-to-run facility over to the purchaser.
- Most often the province of the largest specialized construction and manufacturing companies, turnkey operations projects are usually contracted out by governments for enormous projects such as the building of dams, oil refineries, airports, energy plants, etc.
  - Nevertheless, opportunities exist for the participation of smaller entrepreneurial firms as subcontractors for turnkey projects.
- Because of their extraordinary size and scope, many such projects require long-term commitment of personnel, financial reserves, supplies and other resources.

Management Contract

- Under a **management contract**, a company in one country can utilize the expertise, technology, or specialized services of a company from another country to run its business for a set time and fee or percentage of sales.
- This mode of entry is most widely used in the hotel and airline industries.
- While the management company is responsible for day-to-day operations, it cannot decide on ownership, financial, strategic or policies issues for the business.
- Such arrangement is suitable for companies that are interested in earning extra revenues abroad without getting entangled in long-term financial or legal obligations in the foreign market.

International Joint Ventures (IJVs)

- A form of foreign direct investment (FDI), **joint ventures** are created when two or more companies share ownership of a third commercial entity and collaborate in the production of its goods or services.
- IJVs are attractive to businesses because of the relative ease of market entry they offer, their shared risk, shared knowledge and expertise, and the potential for synergy and competitive advantage in the global marketplace.
- International joint ventures are formed for different reasons, the four main being:
  - to continue the **expansion** of an existing business,
  - to introduce the **company's products** to **new markets**,
  - to introduce **foreign products** to the company's **existing markets**,
  - to branch out into new business.
- See also: https://en.wikipedia.org/wiki/International_joint_venture

International Joint Ventures (IJVs) Contd.

IJVs can also take many different forms:

- Two or more companies from the same country form an alliance to enter another country
- An overseas company joins a local company to enter its domestic market
- Firms from two or more countries band together in a JV formed in a third country.
- A foreign private business and a government agree to join forces in a pursuit of mutual interests
- A foreign private firm enters into a JV with a government-owned firm to enter into a third national market.

Example: Jaguar (owned by Tata) and China's Chery Motors create a joint venture in 2012 to create new models for the Chinese market and manufacture them in a new factory.

Wholly Owned Subsidiaries

- As the most capital-intensive mode of entry, wholly (or fully) owned subsidiaries are usually considered viable only for large, internationally experienced corporations who can afford the great risks associated with ownership and operation of a business in a foreign country.
- Entering a market through a **fully owned subsidiary** involves buying an existing business (also called *brownfield strategy*) or building new facilities (also called *greenfield strategy*) in a new target country.
- While both of these scenarios allow companies to exercise maximum control over their operations and to decisively enter the target country's markets, they also expose the company to the **highest level of political, environmental, legal and financial risks**.
    - **(**http://www.investopedia.com/terms/w/whollyownedsubsidiary.asp)

Often the subsidiary structures can be complex

Ford Motor Company – U.S. parent company based in Dearborn, Michigan

Ford International Capital LLC –
First-tier subsidiary
(U.S. holding company located in Dearborn, Michigan, but registered in Delaware)

Blue Oval Holdings –
Second-tier subsidiary
(British holding company, located at the Ford UK head office in Brentwood, Essex, with five employees)

Ford Motor Company Limited –
Third-tier subsidiary
(the main British Ford company, with head office in Brentwood, with 10,500 employees)

Ford Component Sales Limited –
Fourth-tier subsidiary
(small British specialist component sales company at the UK Ford head office, with some 30 employees)

Transaction Cost Analysis

- Recent research suggests that using transaction cost analysis to select an international mode of entry actually improve their chances of selecting the most efficient method for their specific organization. The authors of the study recommend that SMEs evaluate three specific transaction cost criteria:
  - Level of investment required for each asset.
    - If no particular asset requires a large investment, non-equity modes such as licensing or franchising may be suitable for market entry.
    - If such entry requires a high level of specific-asset investment, equity modes of entry, such as IJVs or fully owned subsidiaries may be more appropriate.
  - Environmental factors of the target country.
    - A more stable and economically and politically secure country would be more inviting to an equity mode of entry, whereas a country where political or social turmoil and frequent economic crises would be suitable for non-equity modes of entry.
  - Status of internal control systems and processes.
    - A business that is built on strong internal culture and regulations would be more comfortable upholding them in their new markets by entering through equity modes.
    - On the other hand, a more open and flexible firm may be comfortable with relying on the controls of partners such as exporting agents or licensees.

Brouthers, Keith D. & Nakos, George. (2004). "SME Entry Mode Choice and Performance: A Transaction Cost Perspective," *Entrepreneurship: Theory and Practice*, 3: 229-247. - https://scholar.google.com/citations?user=gM5fX8QAAAAJ&hl=en