Entry Strategy and Strategic Alliances

What Are the Basic Decisions Firms Make When Expanding Globally?

- Firms expanding internationally must decide

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

What Influences the Choice of Entry Mode?

- 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

Which Foreign Markets Should Firms Enter?

- The choice of foreign markets will depend on their long-run profit potential
- Favorable markets
  - are politically stable
  - have free market systems
  - have relatively low inflation rates
  - have low private sector debt

Which Foreign Markets Should Firms Enter?

- Less desirable markets
  - are politically unstable
  - have mixed or command economies
  - have excessive levels of borrowing
- Markets are also more attractive when the product in question is not widely available and satisfies an unmet need

When Should a Firm Enter a Foreign Market?

- Once attractive markets are identified, the firm must consider the timing of entry

1. Entry is early when the firm enters a foreign market before other foreign firms
2. Entry is late when the firm enters the market after firms have already established themselves in the market

Why Enter a Foreign Market Early?

- First-mover advantages include
  - the ability to preempt rivals by establishing a strong brand name
  - the ability to build up sales volume 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

Why Enter a Foreign Market Late?

- First-mover disadvantages include
  - pioneering costs - arise when the foreign business system is so different from that in the home market that the firm must devote considerable time, effort and expense to learning the rules of the game
    - 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

On What Scale Should a Firm Enter Foreign Markets?

- After choosing which market to enter and the timing of entry, firms need to decide on the scale of market entry
  - 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

Is There a "Right" Way to Enter Foreign Markets?

- No, 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

How Can Firms Enter Foreign Markets?

- These are six different ways to enter a foreign market

1. Exporting – a common first step for many manufacturing firms
   - later, firms may switch to another mode
2. Turnkey projects - the contractor handles 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

How Can Firms Enter Foreign Markets?

3. Licensing - a licensor grants the rights to intangible property to the licensee for a specified time period, and in return, receives a royalty fee from the licensee
   - patents, inventions, formulas, processes, designs, copyrights, trademarks
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
   - used primarily by service firms

How Can Firms Enter Foreign Markets?

5. Joint ventures with a host country firm - a firm that is jointly owned by two or more otherwise independent firms
   - most joint ventures are 50–50 partnerships
6. Wholly owned subsidiary - the firm owns 100 percent of the stock
   - set up a new operation
   - acquire an established firm

Why Choose 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

Why Choose a Turnkey Arrangement?

- 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 has no long-term interest in the foreign country
  - the firm 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

Why Choose Licensing?

- Licensing is attractive because
  - 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 applications itself
- Licensing is unattractive because
  - the firm doesn't have the tight control required for realizing experience curve and location economies
  - 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

Why Choose Franchising?

- Franchising is attractive because
  - it avoids the costs and risks of opening up a foreign market
  - firms can quickly build a global presence
- Franchising is unattractive because
  - it inhibits 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 franchisees can make it difficult to detect poor quality

Why Choose Joint Ventures?

- Joint ventures are attractive because
  - firms benefit from a local partner's knowledge of the local market, culture, language, political systems, and business systems
  - the costs and risks of opening a foreign market are shared
  - they satisfy political considerations for market entry

Why Choose Joint Ventures?

- Joint ventures are unattractive because
  - the firm risks giving control of its technology to its partner
  - the firm may not have the tight control 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

Why Choose a Wholly Owned Subsidiary?

- Wholly owned subsidiaries are attractive because
  - they reduce the risk of losing control over core competencies
  - they give a firm the tight control in different countries necessary for 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

Which Entry Mode Is Best?

Advantages and Disadvantages of Entry Modes

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

How Do Core Competencies Influence Entry Mode?

- The optimal entry mode depends on the nature of a firm's core competencies
- When competitive advantage is based on proprietary technological know-how
  - avoid licensing and joint ventures unless the technological advantage is only transitory, or can be established as the dominant design
- When 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

How Do Pressures for Cost Reductions Influence Entry Mode?

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

Which Is Better – Greenfield or Acquisition?

- The choice depends on the situation confronting the firm

1. A greenfield strategy - build a subsidiary from the ground up
    - a greenfield venture may be better when the firm needs to transfer organizationally embedded competencies, skills, routines, and culture

Which Is Better – Greenfield or Acquisition?

2. An acquisition strategy – acquire an existing company
   - acquisition may be better when there are well-established competitors or global competitors interested in expanding

- The volume of cross-border acquisitions has been rising for the last two decades

Why Choose Acquisition?

- Acquisitions are attractive because
  - they are quick to execute
  - they enable firms to preempt their competitors
  - they may be less risky than greenfield ventures
- Acquisitions can fail when
  - the acquiring firm overpays for the acquired firm
  - the cultures of the acquiring and acquired firm clash
  - anticipated synergies are slow and difficult to achieve
  - there is inadequate pre-acquisition screening
- To avoid these problems, firms should
  - carefully screen the firm to be acquired
  - move rapidly to implement an integration plan

Why Choose Greenfield?

- 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
- But, greenfield ventures are slower to establish
- Greenfield ventures are also risky

What Are Strategic Alliances?

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

Why Choose Strategic Alliances?

- Strategic alliances are attractive because they
  - facilitate entry into a foreign market
  - allow firms to share the fixed costs and risks of developing new products or processes
  - bring together complementary skills and assets that neither partner could easily develop on its own
  - help a firm establish technological standards for the industry that will benefit the firm
- But, the firm needs to be careful not to give away more than it receives

What Makes Strategic Alliances Successful?

- The success of an alliance is a function of

1. Partner selection

- 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
  - will not exploit the alliance for its own ends

What Makes Strategic Alliances Successful?

2. Alliance structure

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

What Makes Strategic Alliances Successful?

3. The manner in which the alliance is managed

- Requires
  - interpersonal relationships between managers
    - cultural sensitivity is important
  - learning from alliance partners
    - knowledge must then be diffused through the organization