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STRATEGIC OPTIONS FOR ENTRY INTO INTERNATIONAL MARKETS

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Strategic Options For Entry Into International Markets

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1. Introduction

An increasing number of firms both in the advanced economies, the Newly Industrialized Countries (NICs) and deregulating and liberalizing economies like India are realizing the need for a broader perspective in developing their strategic plans than they have been hitherto used to. They have been increasingly facing competition in their home markets from firms originating in other countries. Another important development is that many firms in the US, Japan, Europe and some other countries are generating an increasing proportion of their annual sales from international markets. Firms like Exxon, IBM, Colgate-Palmolive, CPC International, Unilever, Philips and Nestle draw more than 60 per cent of their annual sales turnover from international markets *(Vernon-Wortzel and Wortzel, p.vii; Douglas and Craig, p.3)*.

The firms referred to in the foregoing paragraphs are large and very well known names in their respective industries but it seems that the trend towards globalization is no longer restricted to large corporations. Even smaller firms in western economies as well as developing countries like India are increasingly looking at international markets for achieving their growth and other strategic objectives. In the Indian context several medium sized firms have established sales offices and manufacturing operations in other countries. A few examples are; Arvind Mills in the textile industry; Ranbaxy in pharmaceuticals; United Phosphorous in agrochemicals; the Taj and Oberoi Group in hotels; and the A.V. Birla Group of companies in viscose and polyester

fibre *(Chaudhuri, et.al, 1996). Douglas and Craig (pp.3-4)* provide evidence of mid-size manufacturing companies with sales between US $ 200 million to US $ 1 billion operating in industries like precision instruments, medical equipment or computer peripherals, which cater to niche markets worldwide.

Though the forces in favour of globalization of industries are strong there are also pressures on firms to adapt themselves to local or regional conditions because of the host governments' regulations, local customer preferences or local competitive conditions. Despite the fact that governments face pressure from large and powerful companies for according them protection as is happening in India today it is highly unlikely that the process of globalization would be rolled back though its speed may vary from time to time depending on the configuration of forces against or in favour of rapid integration with the global economy.

It is our belief that the process of globalization is here to stay and hence increasingly firms in the western developed economies, including US, Canada and Western Europe, Japan, South Korea, the NICs and liberalizing countries like India would have to provide a global perspective to their strategic planning process.

This chapter is devoted to exploring the extant literature on modes adopted by firms to enter new markets. We shall explore the various modes of entry available to understand their advantages and disadvantages and also describe some examples of firms in different parts of the world which have had some experience with these entry modes.

2. Strategic Options For Market Entry

There are a variety of market entry strategy alternatives available to companies that are internationalizing. At the broadest level there are basically two entry strategy alternatives; (a) exporting and (b) foreign manufacturing. Within these broad strategy alternatives there are several sub-alternatives.

Firms may export manufactured products, services, information and raw materials and may adopt a variety of methods to achieve their objectives. Similarly foreign manufacturing may be accomplished through a variety of methods. Table 1 depict the methods available within the broad alternative of exporting.

Table 1: Exporting	
Product Export	Technical Know-how or Service Export
Indirect Direct	Technical training/start up assistance agreements Technical know-how licensing Patent licensing Plant installation/training and management contract

2.1. Exporting

Exporting is one of the most preferred methods as an initial mode of entry into a new market as the level of risk involved is the least. Many geographical markets are not large enough to justify setting up f a manufacturing facility abroad; in such situations it would be advantageous for firms

to manufacture at one location - perhaps the home country - from where it would be possible to cater to the target country or market. This would enable the firm to reap benefits of economies of scale and achieve higher capacity utilization. Firms may have several strategic objectives which may be satisfied through exporting. The more important reasons for exporting *(Alkhafaji, p.276; Douglas and Craig, p.155; Felker, Chaudhuri, Gyorgy, et.al; Kirpalani, p.312)* are: (a) it enables firms to achieve higher capacity utilization at one location and thereby benefit from economies of scale, (b) it allows firms to explore new markets, products and new technologies, (c) it may enable firms to overcome growth constraints in their domestic markets, (d) it enables firms learn about competing in new environments without commitment of larger resources and therefore at low degrees of risk and (e) to improve profitability.

2.1.1. Indirect Exporting

Firms can export indirectly or directly *(Douglas and Craig, p. 155; Paliwoda, p.58; Alkhafaji, pp.276-277; Bhattacharyya, pp.71-76)*. Indirect exporting involves the use of intermediaries like export agents or export trading or management companies who have expertise in market research, handling documentation, organizing product shipment, dealing with distribution channels, financing agencies, customs and insurance companies.

Often manufacturers whose products are being exported may not even have knowledge about their products being exported. *Alkhafaji (pp.276-277)* and *Paliwoda (pp.59-62)* list several ways by which indirect export can take place:

a) A domestic firm imports foreign imports foreign goods for resale in foreign markets;

b) A domestic firm imports foreign products for sale in the domestic market;

c) An international firm uses an imported product in its foreign manufacturing facilities;

d) An export agent or export house or a trading company buys directly from a domestic company on behalf of a foreign principal or the agent sells products overseas on behalf of a domestic manufacturer;

e) A firm sells its products to the sales offices of foreign companies located in its country of origin;

f) A firm may export its goods through membership of cooperative agreements. *Douglas and Craig (p.157)* give the examples of California Dried Fruit Export Association or the American Cotton Exporters which shoulder the responsibilities of identification of potential export markets, product shipment, advertising and promotion, etc.

g) Piggybacking *(Douglas and Craig, p.157; Paliwoda, p.61)* is another form of indirect exporting in which one firm sell its products or services through the distribution set up of another company with compatible products in a foreign market.

Firms which do not have adequate resources can resort to exporting through a consortium. Small exporters may form export clubs or industry-wide trade associations *(Paliwoda, pp.85-86; Douglas and Craig, p.157)*. In this form of exporting each member of the consortium retains its identity and independence whilst enjoying the strength of the group. The benefit from such joint marketing is that the individual firm is able to access export markets through the efforts of the group which otherwise would not have been possible because of resource requirement required beyond the capacity of small individual firms. *Paliwoda (p.85)* provides details regarding the

creation of exporting consortiums. Some key elements of the method are:

* A target export market is identified in geographical terms.
* A few firms with complementary products/services enter into an agreement to export jointly, which might involve the export of a complete package that includes the offerings of the members of the consortium along with financial arrangements.
* The consortium is registered and managed as a company with a board of directors and has its own employees.

Commodities such as forest and rubber products, rice, woodchips, dried fruit or oranges are exported through consortiums (*Douglas and Craig, p.157; Jeannet and Hennessey, p.275)*.

Other variations of indirect exporting methods are (*Jeannet and Hennessey, p.274)*:
Brokers are typically used by firms which are not consistent exporters. They charge a modest fee or commission to the company that engages them and do not take possession of the goods. Usually brokers specialize in exporting to a particular country or in specific product groups. They take the responsibility of transportation of the goods to foreign buyers.

Other intermediaries are the "manufacturer's export agent (MEA)" and "combination export manager (CEM)". The difference between brokers, MEAs and CEMs is one of the scope of the function performed by them. Manufacturers prefer to use broker when they do not have a long term interest in indirect export whereas an MEA usually obtains the right to export in a limited number of areas and usually has long term involvement with the exporter. A CEM virtually

works as a manufacturer's export department. MEAs and CEMs are also compensated on a commission basis. CEMs, however, charge substantially higher commissions than brokers and MEAs.

Each of the alternatives described in the foregoing have some advantages as well as some disadvantages. In general the advantages of indirect exporting are:

i) it allows the firm to focus on its competence in manufacturing.

ii) it involves limited commitment of resources and low exposure to risk

iii) it provides a learning experience.

On the other hand there are also some associated disadvantages *(Bhattacharyya, p.71; Douglas and Craig, p.156)*.

a) The external agency may sell the products through inappropriate distribution channels, with poor servicing and inadequate promotion and at higher or lower prices in comparison with competitors. This can have a deleterious long term impact on the firm's image abroad.

b) The effort put in by the agent may not be adequate thus resulting in potential opportunity loss.

c) The manufacturer is unable to develop much knowledge about the characteristics of the export market and therefore has little information for developing a long term approach to international expansion.

d) The manufacturer may be receiving lower profit margins.

2.1.2. Direct Exporting

A firm is said to be involved in direct exporting when it has some form of direct contact with customers in the foreign market where it sells its products or services *(Jeannet and Hennessey, p.276, Alkhafaji, p.277, Bhattacharyya, p.74)*. When a firm decides to go for direct exporting it may choose between basically four options; (a) agent middleman; (b) merchant middleman; (c) company owned sales office (foreign sales subsidiary); and (d) independent distributor. The intermediary or the sales subsidiary is located in the foreign market in direct exporting.

An agent does not become party to a deal. Brokers are agents commonly used in the export of standardized products like agricultural and mining products. Manufacturers' representatives are agents who sell within a predetermined territory or a region of a country. They also provide some additional services such as after-sales service. Like brokers manufacturers' representatives also do not take title to the goods. Just as in the case of indirect exporting brokers and manufacturers' representatives basically substitute the manufacturer's sales force. They are compensated on a commission basis.

Merchant middlemen (also known as distributor, dealer or import jobber) operate in foreign markets. They buy products for resale to final users and hence undertake all the risks. This explains their higher margins compared to the commission charged by brokers or manufacturers' representatives. The distributor is usually assigned a territory, which may be a group of

countries, a country or a geographical region. Distributors carry non-competing products, maintain an inventory and effect sales through their own sales representatives. Usually manufacturers and distributors or dealers have long term relationships. In certain industries such as the truck industry, major manufacturers have dedicated independent dealers.

Firms desirous of long term involvement in international business may set up their own foreign sales organizations, which perform the role of the distributor or dealer - stocking products, executing sales, collecting payment, assuring credit risk, doing market research and analysis, advertising and promotion and providing after-sales service.

The evolutionary or incremental commitment theory of firm level internationalization posits that the middleman/agent/distributor is an intermediate step on a firm's path to becoming a multinational or global company *(Ansoff and McDonnell, pp.221-222)*. However, there are firms which may intend to remain in the exporting mode with regard to their international business. Small and medium-sized German companies which operate in specialized niche segments in global markets as exporters are examples of such firms *(Douglas and Craig, p.158)*.

Many multinational companies (MNCs) which own manufacturing plants in several countries remain exporters in some markets due to economic reasons. Many MNCs do not find it economical to locally manufacture products for the local market. Hence they export to these smaller markets from plants set up in some strategic locations.

Another recent method under direct exporting is direct mailing *(Bhattacharyya, p.75)*. This has been used not only for consumer goods such as garments or other low-value consumer products

but also computers. Dell Computer Corporation of USA entered the European market in 1987 through direct mailing though the common practice was to sell through distributors and retailers. Dell priced its computers lower than the competing products and launched an educative, TV programme to remove doubts from the customers' minds regarding issues like quality, service and price. In a short span of 5 years in Europe Dell achieved a sales of US $ 240 million.

As in the case of indirect exporting there are some advantages and disadvantages associated with direct exporting. On the positive side direct exporting enables the exporter to have better contact with the market and is hence likely to enable it to achieve a more effective sales effort. Also it enables the firm to have greater control over the distribution channel. The disadvantages are that it entails a long term commitment on the part of the exporter because of the need to invest in creating a sales organization.

2.1.3. Export of Technical Know-How and Services

Trade in technical know-how and related services has become quite important in recent times *(Paliwoda, 1989, p.63)*. In India since the enunciation of the New Economic Policy in mid 1991 there has been a dramatic increase in all kinds of collaborative activity between Indian and foreign firms. Most of these collaboration agreements have transfer of technology as an important component *(Chaudhuri, 1997)*. Several alternatives are available for export of technical know-how and services; technical training/start up assistance programmes, patent licensing, know-how licensing, franchising management/marketing service agreements and joint ventures, etc. Several of these methods are common to the other major market entry mode - foreign manufacturing which we take up next.

2.2. Foreign Manufacturing Licensing

Firms often prefer to continue to export to other countries till the pressures from the government of the importing country makes it very difficult for them to continue their business without making direct investment in the form of a manufacturing plant or it is not economical to continue with exports only beyond a particular break even volume. Generally firms tend to reduce the risk to their investments by limiting exposure to the vagaries of the international market. Within the broad strategic entry option of foreign manufacturing are several sub-alternatives which are discuss below.

2.2.1. Licensing

Under a licence, a company, which possesses a patented technology, trademark or brand name confers a right to utilize it to another company for a fee or royalty. This is a method of entry into a foreign market which permits a company to establish presence outside its domestic market without having to commit much resources to international operations.

Hence licensing is well suited to smaller firms which do not have the capital, or managerial experience required for direct investment in a foreign manufacturing plant *(Alkhafaji, p. 255)*. Under a licensing agreement, the licensor may have to part with designs and drawings of products and components, manufacturing process details and flow sheets, drawings of tooling, details of plant and machinery and its layout, etc. -- information and knowledge necessary to establish a manufacturing plant the licensee's location. The licensing agreement may also include training of licensee's representatives in its own plant as well as on-site. In licensing agreements,

however, the interaction between the licensor and the licensee is minimal. Hence sharing of operational experience, intensive training of licensee's personnel or sharing of technical developments after the signing of the agreement has been signed do not generally form part of licensing agreements. The scope of a licence depends inter alia on the technical capability and experience of the licensee. In cases where the technology recipient is at a high level of technological capability only transfer of drawings may suffice; on the other hand if the licensee possesses a low level of technological capability, the agreement may have several of the features mentioned previously.

The process of technology acquisition, adaptation and assimilation is quite complex, time consuming and costly as brought out by several researchers *(Baranson, 1967; Chaudhuri, 1980, 1986, 1990; Raina, 1989; Sikdar, 1996)*. The tacit element is quite significant in successful technology transfers. This may be in the form of unpatented knowledge in organizational skills, production management and occasionally marketing *(Contractor, 1981, p.74)*. Due to this character of international technology transfer licensing as method of entry has some disadvantages in the case of complex technologies or when the technical level of the licensee is not adequate. In such situations a collaboration agreement is more suitable. In India pure technical collaboration agreements have been quite common. Such agreements were very much in vogue in India during the late 60s, the 70s and until the mid 80s due to the government's restriction on equity holding by foreign collaborators.

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Licensing conditions vary from company to company and industry to industry. There is no fixed duration for licenses. They can be either exclusive or unrestricted. Continental Can, the U.S. packaging manufacturer commenced its internationalization process in the 1930s by relying largely on licensing. At one time it had 88 foreign licensees, though in later years it acquired equity in a number of licensees. Anheuser-Busch, a well known name in the brewery industry has licence agreements with brewers in Canada, the United Kingdom, France, Germany and Japan *(Jeannet and Hennessey, pp.279-280)*.

Many factors influence a firm's decision to license its technology or brand name. The market potential of the export market may be too small to warrant local manufacture. It could be beneficial to a licencee if a licence is available for a new product that can be produced in its existing plant as it would help in achieving higher capacity utilization thus obviating the need for additional investment. For the licensor with limited resources licensing is a way of entering a market without making investments in plant and machinery, or creating a distribution channel. In some countries foreign firms may not be permitted to hold equity in a company or free import of products is also not allowed; in such cases licensing may be the only way out if the licensor wants to expand internationally.

Licensing, however, results in limited returns to the licensor as typically the fees are a percentage of sales. Another drawback of licensing is that the licensee may not devote sufficient resources and attention to market development. *Douglas and Craig (p.160)* provide illustrations of the risks associated with licensing. Perriev, which was licensed by PepsiCo. to bottle and distribute its

brands in France was unable to penetrate the hyper - and supermarkets as its competitors Badoit and Evian were stronger. The Rank-Xerox collaborative venture failed to develop the European market. Both Pepsi Co and Xerox had to terminate their licensing agreements.

A negative impact on the licensor's image may be another disadvantage of licensing if a licensee is unable to manufacture products to the licensor's quality standards *(Jeannet and Hennessey, p. 281)*. Often there is also the risk of the licensor becoming a competitor. Hence the licensor has to guard against this possibility as otherwise its subsequent entry into the country as a manufacturer on its own may be thwarted by its erstwhile licensee. Another difficulty is that because the royalty is usually tied to the sales the licensee may pay royalty amounts smaller than what is due by showing lower sales.

Licensing fees vary with the industry. It may vary from 1 to 20 per cent of sales. For industrial products it typically varies between 3 and 5 per cent.

Despite the negatives there seems to have been a substantial growth in international licensing. Licensing is common in several industries. Of late firms have been observed to use this method of entry in industries like software, designer wear (e.g. Pierre Cardin), children's entertainment and toys (cartoon characters of Disney), children's clothing (e.g. sports teams like the Chicago Bull), and cosmetics (perfumes). The Walt Disney Company earns millions of dollars from licensing its characters *(Douglas and Craig, p.161)*.

Licensing may be a way for an innovating company to prevent diffusion of a competitor's technology and from its becoming the industry standard thereby assuming a strong market position for itself. Philips licensed its cassette recording technology which later became the industry standard *(Jeannet and Hennessey, p.280)*.

2.2.2. Franchising

This method of market entry is closely related to licensing. Under a franchising agreement the franchisor - usually in service industries such as fast-food, retailing, car hire, hotels, employment agencies - transfers the right to use its name, logo, products and method of operations, trademark or copyright. Franchise agreements are more comprehensive than licensing agreements. Such agreements may also incorporate a management contract *(Paliwoda, p.66; Douglas and Craig, p.161; Jeannet and Hennessey, p.282)*. According to *Alkhafaji (p.275)*. Franchising is the fastest growing segment of international licensing *(Alkhafaji, p.275)*.

In the early eighties there were over two hundred American firms operating thousands of franchisee outlets abroad *(Kirpalani, p.312; Jeannet and Hennessey, p.282)*. Three markets accounted for two thirds of all franchises in the UK - home improvements and home maintenance, food and drink and business services *(Paliwoda, p.63)*. Though larger franchisers dominated in terms of total outlets abroad large size did not seem to be a prerequisite for globalization. A few examples of major franchisers are; McDonald's, Kentucky Fried Chicken, Burger King with operations in various parts of the world, Coca-Cola; Pepsi Cola; Domino's Pizza; Hilton Hotels, Bodyshop with its Radio Shack Stores; and Tandy Corporation. Immediate as well as long term market potential seem to be motivating factors for franchisers.

Kirpalani (p.312) notes that in international franchising the most commonly used entry mode is 100 per cent franchisee ownership; however, new markets are tested with company-owned outlets before the launch of major franchising efforts.

Douglas and Craig (p.162) aver that franchising is advantageous where close contact and operational efficiency on a day today basis is critical. Through a franchise agreement the franchiser is able to access local entrepreneurial talent with skills in handling local personnel and dealing with local customers and regulatory bodies. The franchisee, being an owner in the enterprise is likely to be highly motivated. The downside is that the franchiser has to be alert to whether its product and service quality standards are being adhered to by the franchisees. This may be even more difficult in a franchise than in the case of licensing due to the fact the former usually deals with intangibles (service) rather than physical products. *Paliwoda (p.64)* provides an example of the difficulties that may be faced by franchisors. McDonald's relationship with a franchisee in Paris came under strain as the former found the restaurants not being maintained to the prescribed standards. Ultimately after a long protracted court battle McDonald's won the law suit in Chicago in 1982. In the UK all the McDonald's operations in the late 80s were wholly owned. Kentucky Fried Chicken and Burger King also bought over several of their franchises - perhaps because of problems in maintenance of standards and the need for standardization.

2.2.3. Contract Manufacturing

In "contract manufacturing" a manufacturer, unwilling or unable to commit resources to building

a manufacturing facility, contracts out production to a foreign manufacturer but retain control of marketing *(Jeannet and Hennessey, p.283; Douglas and Craig, p.159)*. The advantage to the marketer is that it enables it to have great flexibility. In case of problems related to quality, reliability of delivery it can shift to another manufacturer or stop production and exit from the market. Contract manufacturing is common in situations where the technology is widely available but effective marketing is critical to success. Though not an absolute must, contract manufacturing agreements are usually long in duration specifying terms regarding to volume, prices and delivery *(Jeannet and Hennessey, p.283)*. Companies using contract manufacturing as a mode of entry into a foreign country must, however, be very careful in negotiating agreements. The dangers inherent in this method of entry are very well illustrated by the case of Schwinn, a US bicycle manufacturer. Facing market share reduction in the U.S., its home market, Schwinn closed its U.S. factory and joined hands with Giant, a Taiwanese bicycle manufacturer. Schwinn provided Giant with technology and engineering expertise but did not have any equity in the latter. After acquiring knowledge about the new markets Giant launched its own brand in the United States and Europe undercutting its collaborator, Schwinn *(Douglas and Craig, p.160)*.

2.2.4. Turnkey Projects

In the petrochemical, chemical, petroleum refining and power generation industries "turnkey projects" are quite common *(Alkhafaji, p.257)*. In such agreements a contractor takes total responsibility for the project conceptualization, basic and detailed engineering design, plant and equipment installation, building and road construction, plant commissioning and training of

client's personnel. On commissioning of the plant the turnkey contractor is required to run it at a predetermined level for a specified duration before handing it over to the client. In some cases the contractor may also obtain an equity holding in the project. Turnkey projects may be implemented either on a fixed price or cost plus basis. In the former the contractor bears the risk of not completing within the budgeted time and cost and in the latter the risk is associated with client. When turnkey projects are very large they may be implemented through a joint venture of two or more firms *(Beamish and Lane, 1983)*.

2.2.5. Management Contracts

These agreements are common in the field of services, e.g. hotel industry, private hospital management *(Paliwoda, p.66)*. Management contacts involve the transfer of management systems and know-how from one company to another. According to *Gabriel (1967, p.3)* a management contract is an inter-organizational arrangement by which a foreign firm performs essential managerial functions for a local firm in which it has no ownership interest. This sort of arrangement is an alternative for making available corporate know-how to countries or industries or projects within countries where there are very difficult obstacles to direct investments by foreign companies. This mode of entry into a new market is appropriate -- where there is a scarcity of managerial expertise and is observed in industries which are characterized by need for quality, service and management attention, e.g. hospital management. Tata Electric and Locomotive Works, a major firm in the Indian commercial vehicle industry won contracts for managing transport systems in developing countries having conditions similar to that in India *(Chaudhuri, 1988, pp.135-138)*. *Gabriel's* study of four management contracts confirms the

effectiveness of the management contract as an investment of international transfer of corporate know-how.

2.2.6. Joint Ventures

The term "joint venture" has indeed become very common in the management lexicon over the last decade and a half. Joint ventures often imply the creation of a separate firm, whose equity is shared by two or more partners, each expecting dividends as compensation proportional to their shareholding *(Contractor, 1988. p.7)*. *Kogut (1987, p.319)* defines a joint venture as an organizational arrangement between two or more firms which pool a portion of their resources and which has legal sanction. *Datta (p.154)* gives a slightly more operational definition:

* There is an acknowledged intent on the part of partners to share in the management of the resulting venture.
* They are partnerships between legally incorporated entities (such as companies or chartered organizations), and not between individuals, and
* Equity positions are held by each of the partners.

The three definitions are quite similar but one aspect which is implied by them is that the partners in joint venture also share the risk associated with an enterprise. This is brought out by *Harrigan (1984)*.

2.2.6.1. Reasons for Forming Joint Ventures

In the Indian context joint ventures have been used by foreign firms for decades but a spurt was

observed after the enunciation of the New Economic Policy in mid 1991 which dramatically liberalized the entry of foreign companies into India. Several MNCs, intending to capitalize on the high growth potential of the market with an oft quoted figure of 200 million middle class consumers, but lacking experience of working in India entered into JVs in collaboration with Indian firms. Some examples are; Wipro with General Electric of the USA and TVSE with Invertomatic Victoria Holding of Holland in the electrical industry; Wipro with Sun Hydro of the USA and IFB Industries with Asko of Finland in the engineering industry; Tata with IBM, Tata Consultancy Services with Erst and Young, an accountancy and financial consultancy, Microsoft Corporation and Singapore Airlines and Tata Elxsi (India) Ltd. with 15 partners including hardware companies such as Silicon Graphics and NEC of Japan in computer and software industries; Arvind Mills with Laceffenmushle of Germany and Arvind with Cluett Peabody (Arvind Clothing Ltd.) in the textile industry; Ranbaxy with Eli Lilly of the USA, Cadila Healthcare with US based Centeon in the pharmaceutical industry.

According to the United Nations Economic Commission for Europe, joint venture registrations increased dramatically throughout Eastern Europe in late 19889 *(Alkhafaji, p.279)*. Given the popularity of joint ventures it is natural that there would be several benefits accruing to partners. We shall now look at the possible advantages of the joint venture as a mode of entering a foreign market.

An internationalizing company can share the risk of entering into an unknown market through a joint venture. The JV partner may have significant skills which the internationalizing company

may be able to tap. For example, Black and Decker entered into a tie-up with Bajaj Electricals Ltd., of India to distribute its power tools. Bajaj with a 50,000 strong retail network all over the country and its financial resources was ideally suited to mass market Black and Decker's products *(Raman and Mohan, 1993, p.9)*. It may turn out that the local partner is willing to contract for a portion of the new plant's output in return for a portion of the equity. The local partner's contacts with government officials may be handy in negotiating many a blind alley in the new market.

Often MNCs enter into JVs to comply with host government's regulations that stipulate mandatory involvement of local companies. This is time of entry into state controlled economies. *Jeannet and Hennessey (p. 289)* provide the example of China. Within two years of China's adopting its law on joint ventures in 1979 more than 400 joint ventures were signed by Chinese firms with foreign counterparts. Even though in most cases the foreign partner had to settle for a minority position the bait was the burgeoning market. Even when no specific law exists against opening a wholly owned company MNCs often opt for Jvs. This is to protect themselves from possible negative protectionist measures. Locally owned companies would not be affected by the host government's policies. Most developing countries tend to encourage foreign companies to set up Jvs with local companies as they offer the possibility of foreign technology and capital along with local management *(Berlew, pp.49-54)*.

Joint ventures tend to be used four times more frequently in less developed countries than in economically advanced countries because of the influence of government policy in the former

(Beamish, 1985, pp.13-19). The example of Maruti Udyog Ltd., a joint venture between the Government of India and Suzuki Motor Company of Japan illustrates how joint ventures may benefit through tax incentives, grants, excise duty relief, etc. *(Venkataramani, p.62)*. Another reason for internationalizing firms to form JVs with local companies is that negotiation with regulatory agencies for licenses or certification may be easier. In the following paragraphs we discuss a few examples.

A JV may be an effective mode of entry into a market which is culturally very different from the home market. Japan, China and the erstwhile Soviet Union are examples of countries which are considered "culturally distant" by western advanced countries. Nabisco set up a JV with Yamazaki bakery to enter the Japanese market. The former contributed capital, technology, brandnames and Yamazaki, access to its bakeries and distribution network. Wella, a German hair products company entered into a JV with a Japanese company to penetrate the Japanese market. Wella obtained access to beauty saloons and then developed its hold in pharmacies and other outlets. Later Wella bought out its partner. GM has set up a $ 100 million JV with Gold Cap of China. With a 30 per cent stake the former's role is essentially to provide financial support while the Chinese vehicle manufacturer takes care of the production plant that assembles vehicles from partially knocked down kits imported from the US *(Douglas and Craig, p.164)*.

2.2.6.2. **Problems Faced by Joint Ventures**

A JV, though an effective mode of entry into a new international market is also associated with several drawbacks which partners should be aware of. Consider the following example:

Procter & Gamble of the US formed a JV with Godrej & Boyce of India in 1992. The JV was considered to be a "marriage made in heaven" because among other things both the partners had expertise in complementary functional areas. Godrej had a large distribution network of two million outlets that was to be used by P&G to launch its soap brands Camay and Dove and Ariel its detergent brand. Godrej had large unused capacity with excellent quality standards and considerable experience in vegetable oil technology. Vegetable oil had to be used as using beef tallow is banned in India. P&G therefore had to learn this new technology. On the other hand P&G had enormous marketing prowess which according to Godrej would be useful in the merging competitive scene in India. However, inspite of the tremendous promise in the JV the partnership collapsed in 1996. Why did this happen? P&G's agreement with Godrej was that it would source soap from Godrej at cost-plus terms. Godrej charged exorbitant prices from P&G obviously to make the best of the situation. On the other hand P&G abandoned its initial strategy of supporting the entire brand portfolio that included Godrej's brands also. P&G's approach was to enter the high priced segment with global brands, and create a premium image for only its own products. Once this had been achieved it planned to introduce its lower priced range. As a consequence of P&G's pursuing this strategy Godrej's major brands languished. Also the utilization level of Godrej's plant was lower than what had been expected. Therefore, the benefits to Godrej did not come upto expectation. P&G was able to gain access to a vast distribution network which would remain loyal to its brands. Also it learned over a period of time that soap could be sourced more competitively from other sources in the country. Godrej realized the changed bargaining position as it was clear that its services had become redundant to P&G. This resulted in the JV breaking up *(Rakshit, pp.52-54; Karmali)*.

What do we learn from the above short case study?

1. Even in JVs where partners bring in complementary resources and capabilities there may be the seeds of conflict because of the differences in the strategic objectives of the partners.
2. The success of a JV can be jeopardized if the benefits to the partners is uneven on account of initial assumptions going wrong.
3. If the acquisition of new capabilities by JV partners is uneven the relative bargaining power of the partners undergoes change and unless the agreement is renegotiated keeping in mind the changed situation the continuation and success of the JV may be at stake.

That difficulties in managing JVs abound is amply clear from the foregoing discussion. A study done by the Boston Consulting Group brought out that more than 90 joint ventures in Japan collapsed between 1972 and mid 1976 *(Killing, p.120)* cites a. Many of these JVs involved well known US firms such as Avis, Sterling Drug, General Mills and TRW. In the same article the author refers to a Harvard Business School study which found that 30 per cent of the sample JVs formed before 1967 between US companies and companies originating in other industrialized countries proved unstable because of strategic and organizational changes made by a venture's parents.

In a study of 49 strategic alliances it was found that ownership was critical to alliances *(Bleeke, p.134)*. If one partner has a majority stake, it attempts to dominate. One of the findings was that alliances are usually acquired by a major partner.

Several studies point to the potential instability in JVs. Seventy per cent of the sample of JVs in studies by McKinsey and Coopers & Lybrand and 50 per cent in Harrigan's research sample and one third of Franko's eventually broke up *(Gomes-Cassers p.97)*.

Cultural differences leading to communication difficulties and misunderstandings between partners may also be the cause of JV divorce. Communication difficulties may also arise between companies which may not be culturally very distant. Dunlop's (UK) JV with Italy's Pirelli failed due to the difficulty in building an Anglo-Italian corporate culture *(Perlmutter and Heanan, pp.136-152)*

2.2.7. Strategic Alliances

Though the term "strategic alliance" (SA) is very commonly used in the business press and academic writings most writers do not provide definitions of SAs. *Jeannet and Hennessay (1989, p.291)* have attempted to do this. They differentiate alliances from traditional joint ventures. In the former two entire firms pool their resources directly in a collaboration which goes beyond the limits of a joint venture. In SAs formation of a new entity is not a requirement although it may be formed through some equity acquisition of one or reciprocally by both partners. This is different from the arrangement in a traditional JV in which two partners contribute a fixed amount of resources. According to *Jeannet and Hennessey* in a SA partners bring a particular skill or resources. Usually such skills or resources are complementary. The objective is to profit from the partner's experience.

Grosse and Kajawa (p.641) provide a slightly different definition. To them a SA is a cooperative agreement between two or more firms. SAs cover the whole gamut from JVs with mutual part-ownership of a venture to cross licensing, joint marketing, joint research, etc. In the following paragraphs a few examples of SAs are discussed.

2.2.7.1. R&D Based Alliances *(Shiva Ramu, 1997, pp.154-155)*

In the 1970s Nippon Sheet Glass developed the fibre-optic cable, which, however, lacked mechanical strength. It then teamed up with Sumitomo Electric Industries to develop a coating technology for increasing the cable's strength. Here we see two Japanese firms forming an alliance to develop technology having potential for worldwide application. Hitachi of Japan has entered into a SA with Texas Instruments of the U.S. for the development of 256 Mb memory chips.

Hewlett Packard (HP) of the U.S. has a SA with Canon of Japan for laser printers. Canon's responsibility is for developing the engines for throwing the ink on the page while HP's responsibility is for developing software, microcontrollers, customer research and marketing.

2.2.7.2. Alliances Based on Reciprocal Sharing of Marketing, Technological and Production Resources *(Jeannet and Hennessey, pp.291-292)*

To achieve economies of scale in its US operations AT&T wanted to enter the European computer market. However, lacking marketing contacts it tied up with Olivetti, which wanted to broaden its existing range to include larger computers. As part of the alliance Olivetti became

a key supplier of personal computers for sale through AT&T's distribution network in the US market and AT&T supplied its computers to Olivetti for sale in Europe through the latter's distribution system. In effect both companies agreed to share each other's marketing, technology and production resource.

2.2.7.3. Alliances Based on Sharing of Production Technology for Market Access *(Jeannet and Hennessey, pp.292-293)*

General Motors established an SA with Toyota to obtain manufacturing know-how for producing small cars in return for providing market access to the US to the latter.

A new venture called New United Motor Manufacturing Inc. (NUMMI) was formed to jointly operate an assembly plant to produce 2,00,000 small cars for both GM and Toyota. Another alliance formed by GM was with Fanuc of Japan. GM received the technology to manufacture robots and Fanuc obtained access to one of the world's largest robot markets.

2.2.8 Wholly Owned Subsidiaries

An internationalizing firm may enter a foreign market by acquiring an existing operation or through establishing a green field operation. In both cases the ownership and control lies with only one firm in the case of a wholly owned subsidiary. The wholly owned subsidiary enables the firm to overcome the difficulties associated with JVs and SAs. Complete control over production and marketing helps eliminate potential conflict of interest and resulting management problems associated with entry modes that have inbuilt interpartner dependency.

Acquisition of an existing operation in the target country has certain advantages such as; (a) rapid entry, (b) access to distribution channels, (c) access to existing management experience, (d) established brand name and (e) reduction of competition. Coca-Cola's return to India in the early 90s through the acquisition of Parle's soft drink business gave it an instant re-entry into India. Almost all the possible benefits mentioned above accrued to Coca-Cola through this mode of entry. Electrolux's acquisition of Kelvinator in India to rapidly enter the white goods industry is another illustration of the use of acquisition of an existing operation as a strategy to enter a foreign market.

Several illustrations of this mode of entry are available from other parts of the world. In 1990 Aquasuctum, the upscale British clothing firm was acquired by Renocon, the largest Japanese clothing manufacturer, thus enabling it establish a beachhead to expand form in Europe and the United States. Volkswagen of Germany bought over Skoda, the Czech auto manufacturer, while Suzuki of Japan bought Autokonzern of Hungary. Kraft Jacobs Suchard has acquired a number of companies in central and eastern Europe *(Douglas and Craig, p.167)*.

Firms pursuing acquisition as a mode of entry must be aware of several associated problems. In return for a rapid entry into the market the internationalizing firm may have to live with heavy debt burden, a weak product line or poor management. The political risk of expropriation is also present in some countries. Other difficulties may also come up. For example, GE acquired Tungsram's light bulb manufacturing plant in Hungary in order to expand into Europe. However, its strategy floundered when it realized that the machinery was outdated and the company had

been starved of cash for years by the Communist government. Also rising inflation negated the 30 per cent wage advantage Tungsram had initially. GE in an effort to cut costs reduced the work force by half which alienated it from the workers *(Douglas and Craig, p.167)*.

Some firms prefer to establish green field operations in order to avoid the problems associated with acquisitions. Establishing green field operations through a wholly owned subsidiary is fraught with several difficulties and risks; however, there are firms which prefer to use this mode of entry. The reason for this is the possibility of being able to have full control over all strategic decisions and also utilize the most appropriate technology, choose the most advantageous location from the perspective of labour cost, land cost, taxes and transportation cost. Another advantage is that the firm can dovetail the acquisition into its global strategy. There are, however, difficulties that may befall companies pursuing this entry mode. To establish green field operations a firm must be prepared to commit itself totally as it would have no local partner to share the responsibilities of learning about the new market and environment and simultaneously invest and manage the expanding operations.

Conclusion

In this chapter we have reviewed the literature on modes of entry into international markets. There are a variety of entry strategy options that are available to internationalizing firms. Exporting is one of the most preferred methods as an initial mode of entry into international markets as the level of risk involved is the least.

Firms can export indirectly or directly. Indirect exporting involves the use of intermediaries like export agents or export trading companies. Indirect exporting minimizes the commitment of resources thereby reducing the exposure to risk while allowing the firm to concentrate on its core competitors. However, the returns from indirect exporting is also less. The firm is also not able to have proper control over the distribution channels.

Direct exporting involves direct contact with foreign customers and hence this mode overcomes the difficulties of the previous method to some extent; though this alternative entails a long term commitment to developing the foreign market.

Foreign manufacturing generally involves even greater commitment of resources than direct exporting, though licensing which is one mode of entry into manufacturing abroad is more or less an arms-length arrangement. Franchising, contract manufacturing, turnkey projects, management contracts, joint ventures and strategic alliances are other methods of entry into international markets which are utilized by firms. These methods may combine both exports as well as foreign manufacturing. An important conclusion from our discussion is the foregoing sections is that each entry mode has some benefits and some associated disadvantages. The choice of the entry mode would depend on the unique characteristics of a particular situation -- namely the nature of competitive environment, the firm's overall strategy with specific reference to its desire for internationalization, the home government's economic and industrial policies, the target host government's economic, industrial and regulatory policies, the firm's technical, marketing and managerial capabilities, etc.

The firm would need to tailor a mode of entry for a particular country after giving consideration to these factors. It is very likely that a firm would have to use a portfolio of entry modes rather than one single mode. Also this portfolio may have to be changed in a dynamic response to changes in the external environment as well as the internal organizational characteristics.

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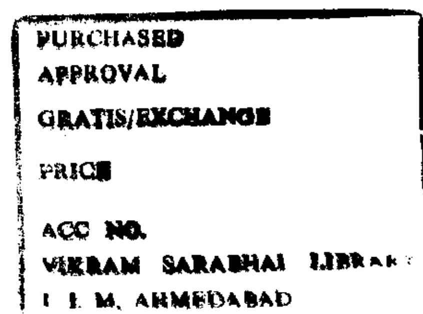
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