ENTRY METHODS

Introduction

In today’s global economy, what is the best way for a company to go global, go beyond its shores and enter untested territories on foreign shores? What is the safest way? What is the most profitable way? What is the most practical way? These are some of the questions every company has to answer when it makes globalization as its goal. These are also the issues that every company has to tackle when it puts its strategy to enter a new market.

In this article, we have short listed a few entry methods that are most often used. Along with these strategies are the brief descriptions, the advantages and the disadvantages associated with them. Entry methods or strategies can be broadly classified into two categories:

1) Strategic alliances
2) Standalone entries

In many cases, no company would like to share businesses or profits that it visualizes or expects in any markets. Often, companies are forced to form strategic alliances while entering new markets, or for that matter to continue servicing its current markets. This is the result of just one cause – inadequacy, inadequacy related to different resources required to successfully service the markets and derive profits from it. Some of the important inadequacies that force a company to consider or even welcome an alliance are:
- Capital / capability to take risk
- Knowledge/experience about technology
- Knowledge/experience about the market
- Knowledge/experience about the environment

The nature of the *strategic alliance* usually depends on what complimentary resources the foreign company is looking for in its local partner. Strategic alliances can be broken down into the following types:

1) Joint Ventures
2) Contract Manufacturing
3) Licensing
4) Franchising
5) Exporting

*Standalone entries* are done by companies which perceive themselves to have adequate capability in taking capital risk and are ready to gain the knowledge associated with the new markets over time. Companies that enter new markets on their own have to realize and accept the risk in not depending on others to gain experience about the new markets.

**Joint Venture**

The term ‘Joint Venture’ applies to those strategic alliances where there is equity participation from both the foreign entrant and the local collaborator. The equity participation can be of different ratios, ranging from a minority stake, equal stake to a
controlling stake or a more predominant majority stake. From the perspective of the foreign entrant, a joint venture has the following advantages:

- Decrease the capital risk involved.
- Leverage the local company’s facilities, in manufacturing, distribution and retailing.
- Leverage the local company’s managerial capability in the local environment.
- Leverage the local company’s contacts with the government to get green signals.

Many companies avoid having joint venture due to the complexity involved in coordinating policies, decisions and execution with a different company. There are instances when companies which have the ability to take the risk involved in entering a new market still enter into joint venture. This is often a result of the policies laid out by governments in many emerging markets. For example, China has a policy wherein foreign companies have to enter joint collaboration with state owned companies to even set up shop there. As in India, the government has policies which prevent foreign companies from having full ownership in certain industries. In such cases, foreign companies end up having to enter into joint venture to take advantage of the low cost of manufacturing and the large size of the markets. Still, the disadvantages or hurdles stay which a foreign company has to deal with to make its venture successful. Some of disadvantages of joint venture are:

- Difference in culture.
- Difference in managerial styles.
- Differences in the motivation behind the participation.
- Communication problems.
- Selection of the right partner.

Other than the above stated hurdles, there are also risks associated with entering in joint venture. One of the risks is the complication at the time of exit, i.e. when a foreign entrant decides to leave the market and hence, the joint venture. A very important aspect of an entry strategy is to have an exit strategy also. The nature of this entry method often results in a very complicated exit strategy and this is not even under the complete control of the foreign company. The second major risk is associated with the safety of a company’s intellectual property (IP). It is definitely more difficult to control the access to one’s technology when one is not the only entity in charge. Furthermore, the theft of IP by the local partner is also an issue to deal with, especially in countries rife with piracy, like China. This probably explains why the majority of companies which enter markets where wholly owned subsidiaries are allowed, prefer that route over joint venture.

**Contract Manufacturing**

Contract manufacturing has a limited role as an entry strategy and is more often used as a compliment to other entry strategies. It is used in conjunction with strategies like wholly owned subsidiaries or franchising. Contract Manufacturing is also often used when a company enters a new market and has an activity that is required but is not a core nor is proprietary in nature, like the manufacturing of clothes, or simple goods like clothing irons and other consumer goods. In most of the industries where contract manufacturing is resorted to, the core activities of the company lie more in marketing and research and
development rather than in manufacturing. Below are the lists of advantages and disadvantages in resorting to contract manufacturing as an entry method.

Advantages:

- Less capital required.
- Low managerial risk.
- Focus on core activities.
- Less complicated exit problems.
- Less complicated division of responsibility.

Disadvantages:

- Chance for a lack of control on certain product parameters.
- Differences in quality standards.
- Scalability of problems.
- Selection of vendors.

A company that seeks to employ contract manufacturing as an entry method needs to carefully select its contract manufactures/vendors. A wrong decision regarding the selection of a vendor can result in a bull whip effect along its supply chain in its new market. Such an outcome could result in a very negative initial experience for the company’s customers as well as for the company itself.

**Licensing**

 Licensing is a common method of international market entry for companies with a distinctive and legally protected asset, which is a key differentiating element in their marketing offer. It involves a contractual arrangement whereby a company licenses the
rights to certain technological know-how, design, patents, trademarks and intellectual property to a foreign company in return for royalties or other kinds of payment. For example, Disney's mode of entry in Japan had been licensing. Because little investment on the part of the licensor is required, licensing has the potential to provide a very large ROI. However, because the licensee produces and markets the product, potential returns from manufacturing and marketing activities may be lost.

Here are several conditions where licensing is favorable over other entry methods:

- Import and investment barriers.
- Legal protection possible in target environment.
- Low sales potential in target country.
- Large cultural distance.
- Licensee lacks ability to become a competitor.

Licensing offers businesses many advantages, such as rapid entry into foreign markets and virtually no capital requirements to establish manufacturing operations abroad. Returns are usually realized more quickly than for manufacturing ventures. The other major advantage of licensing is that, despite the low level of local involvement required of the international licensor, the business is essentially local and is in the shape of the local business that holds the license. As a result, import barriers such as regulation or tariffs do not apply.

On the other hand, the disadvantages of licensing are that control over use of assets may be lost over manufacturing and marketing. The licensee usually has to obtain approval from the international vendor for product design and specification. This is because the licensee is not a representative of the international vendor and, compared to a
distributor or franchisee, is much more of an independent business that licenses only one specific and closely defined aspect of the marketing offer. Perhaps, the most important disadvantage of licensing is to run the risk of creating future local competitors. This is particularly true in technology businesses, in which a design or process is licensed to a local business, thus revealing “secrets,” in the shape of intellectual property that would otherwise not be available to that local business. In the worst case scenario, the local licensee can end up breaking away from the international licensor and quite deliberately stealing or imitating the technology. Even in a best case scenario, the local licensee will certainly benefit from accelerated learning related to the technology or product category. Participation in international markets via licensing is therefore best suited to firms with a continuous stream of technological innovation because those corporations will be able to move on to new products or services that retain a competitive advantage over “imitator” ex-licensees.

Licensing to a foreign company requires a carefully crafted licensing agreement. A great care must be taken to protect trademarks and intellectual property. One way to help ensure that intellectual property is protected is to secure proper patent and trademark registration. In the interim before a patent is filed, a potential licensee will be asked to sign a confidentiality and non-disclosure agreement barring the licensee from manufacturing the product itself, or having it manufactured through third parties. Also, such agreements should not be in violation of laws in the host country because rules on licensing vary from country to country.
Franchising

Franchising is one of the entry modes that has been widely used as a rapid method of international expansion, most notably by fast food chains, consumer service businesses such as hotel or car rental, and business services. A franchise is an ongoing business relationship where one party ('the franchisor') grants to another ('the franchisee') the right to distribute goods or services using the franchisor’s brand and system in exchange for a fee. Franchising enables rapid market expansion using the intellectual property of the franchisor, and the capital and enthusiasm of a network of owner operators. More sophisticated franchise arrangements specify a precise business format under which the franchisee is expected to carry on business and ensuring a common customer experience throughout the network such as McDonald’s.

Some of the common, but not essential, features of franchised businesses are as follows:

- Group purchasing arrangements.
- An exclusive territory for each franchisee.
- Group advertising programs.
- Initial and ongoing training and support from the franchisor.
- Assistance from the franchisor with equipment specification, site selection and premises fit-out and signage.

Franchising is suitable for replication of a business model or format, such as a fast-food retail format and menu. Since the business format and the operating models and guidelines are fixed, franchising is limited in its ability to adapt, a key consideration in employing this entry mode when entering new country-markets. There are two arguments
to counter this. First, the major franchisers are increasingly demonstrating an ability to adapt their offering to suit local tastes. McDonald’s, for example, is far from being a global seller of American-style burgers, but it offers considerably different menus in different countries and even different regions of countries. In such cases, the format and perhaps the brand is internationally consistent, but certain customer-facing elements such as service personnel or individual menu choices can be tailored to local tastes. Secondly, it must be recognized that there are product-markets in which customer tastes are quite similar across countries. It is also important to note that in such businesses, the local service personnel are a vital differentiating factor, and these will obviously still be local in orientation even if they operate within an internationally consistent business format.

The main drawback of franchising is the difficulty of adapting the franchised asset or brand to local market tastes. A key indicator that franchising carries this constraint is the fact that marketing budgets at local levels are usually restricted to short-term promotions rather than market development. This is consistent with the concept that franchising is a rapid replication strategy. For example, Weight Watchers is a highly successful dieting business that franchises its programs to operators of local clubs and groups of people motivated to lose weight and maintain their new lighter shape. Its expansion into Mexico, which was the result of an opportunistic network initiative by a member of the U.S. executives’ network, encountered some cultural differences. In some parts of the country, the attitude still prevailed that being overweight was not bad because it indicated sufficient affluence to eat well. In addition, Mexican consumers were far less nutritionally aware than their northern counterparts, who encountered extensive
nutritional information on all food products by law. Clearly, market development required heavy local investment in market education to establish the dieting club concept.

**Exporting**

Exporting is one of the methods that organizations can use to enter foreign markets. In this entry method, products produced in one country are marketed in another country through marketing and distribution channels. Thus, it requires a significant investment in marketing strategies. In reality, exporting is the most traditional and well-established form of operating in foreign markets. It can be further categorized into direct or indirect export.

**Direct Export:** the organization uses an agent, distributor, or overseas subsidiary, or acts via a Government agency. Usually, companies export through local agents or distributors mainly because they have local knowledge that is important in conducting the business; they speak the language, understand the local business, and know who the customers are and how to reach them.

**Indirect Export:** products are exported through trading companies (common for commodities like cotton and cocoa), export management companies, piggybacking and counter-trade. The main advantage of indirect exporting is that the manufacturer/exporter does not need too much expertise and can count on trading companies and/or export management companies’ knowledge. In the counter-trade method there are two separate contracts involved, one for the delivery and payment for the goods supplied and the other for the purchase and payment for the goods imported. The seller, in fact, accepts products and services from the importing country in partial or total payment for his exports. This
method is suited for situations where competition is low and currency exchange is difficult.

Another option for exporters is to sell products direct to foreign end-users. This option does not incur intermediary costs and exporters have higher control over price and profits. However, it is more practical for markets where potential buyers are limited in number or easily identified and reached. Mail order sales and web-based B2C and B2B sales are the most common forms of selling direct to end-users.

Additionally, there is a distinction from passive and aggressive exporters. The last relies heavily in marketing strategies to build awareness and sell its products to foreign markets. In contrast, passive exporters wait for foreign orders, basically not making additional efforts to generate sales/export.

As an entry method, exporting has several advantages. Comparing to other methods, exporting is fairly simple and with low costs/investments and risks. Consequently, it is usually the first entry method used by organizations in order to obtain knowledge of the foreign market. According to the exporting results, companies can further decide on entering the market using another method such as acquisitions, joint ventures, licensing, etc. Other advantages of exporting are increased utilization of the domestic plant, thus using idle capacity and reducing unit costs through economies of scale. Exporting also helps in diversifying markets, which reduces the company’s exposure to domestic demand instability.

On the other hand, the disadvantages of exporting include high transport costs, trade barriers, tariffs, and problems with local agents. In addition, exporters have lower control of distribution and local agents, face the risk of exchange rate fluctuations, and
are subject to custom duties and taxes in the importing counties. Although exporting costs are relatively low compared with the other entry methods, to enter and develop these markets exporters usually incur costs to gain exposure, set up sales and distribution networks, and attract customers. Furthermore, products might need to be modified or redesigned, including packaging, in order to meet local requirements or customer preferences. Similarly, linguistic, demographic and environmental differences demand special attention to ensure exporting success.

**Wholly Owned Subsidiaries**

Many organizations prefer to establish their presence in foreign markets with 100% ownership through wholly owned subsidiaries. Under this method, organizations obtain greater control over operations and higher profits since there is no ownership split agreement. However, such entry method requires large investments and faces higher risks, especially in the political, legal and economical arenas. There are two approaches for the wholly owned subsidiaries entry method; one is through acquisition and the other through greenfield investments.

Greenfield investment means using funds to build an entirely new facility. Even though such approach entails full control and no risk of cultural conflicts, its costs are extremely high, and returns on investment are obtained in the long-run due to the extent of time required to build the facility, start operations, and attain economies of scale and the experience-curve.

In contrast, acquisition allows organizations to get to the foreign market faster. Organizations taking the acquisition approach use its funds to buy existing facilities and
operations. This is done by acquiring the equity of the firm that previously owned the facility.

 Acquisition as an entry method is preferable in the following situations:

- When speed of entry is important for the business’ success.
- When barriers to entry (i.e. high economies of scale of local competitors) can be overcome by acquisition of a firm in the industry targeted.
- When the entering firm lacks competencies important in the new business area.

Since the organization buys an existing firm, it can take advantage of well-established brands and existing economies of scale to increase its competitiveness in the new market. However, in order to be successful, the organization must properly identify potential companies in the targeted market and conduct a thorough evaluation of the to-be acquired company. The evaluation process should prevent the organization of overestimating the economic benefits of the acquisition, as well as underestimating its costs. After the acquisition, the success depends on how well the integration of both organizations is done. Synergy is essential in this case. Besides high investments and high risks, most acquisitions difficulties arise from the complexity of integrating differing corporate cultures, which can generate many unforeseen problems.
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