Entering Developed and Emerging Markets

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Learning Objectives

After reading this chapter, you will be able to:

LO13-1 Explain the three basic decisions that firms contemplating foreign expansion must make: which markets to enter, when to enter those markets, and on what scale.

LO13-2 Compare and contrast the different modes that firms use to enter foreign markets.

LO13-3 Identify the factors that influence a firm's choice of entry mode.

LO13-4 Recognize the pros and cons of acquisitions versus greenfield ventures as an entry strategy.

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IKEA Entering India, Finally!

opening case

The Swedish home furnishings giant IKEA has finally entered India in 2018 after more than five years of preparation (including the last two years building the stores). The question still lingers though, can IKEA adapt to the aesthetic wants and needs of Indian customers and can the company motivate the Indian customers to buy into the do-it-yourself bug that is a symbol of the IKEA brand? After all, many customers around the world think that IKEA's success was built on the "L-shaped" metal IKEA tool used to put together virtually all of IKEA's furniture after you get the pieces out of the flat box. And no one knows what to call the L-shaped tool—although there is an official IKEA emoji for it on smartphones and a keyboard app for iOS and Android phones for IKEA emoticons (the meatball plate with a Swedish flag at the top looks interesting)! But is this a style, emoji, emoticons, and lifestyle that will work in India? How is it working so far?

India became the 51st country that the largest furniture company in the world, IKEA, entered since its founding in 1943. Since its founding, IKEA has become a $43 billion company in sales annually (€35 billion), which has been the envy of the furniture industry and the benchmarking model for companies across several industries around the world. The flat packaging, high quality for the price you pay (i.e., great value), and global supply chains make IKEA a superbly efficient company with a very effective business model. Amazingly, the business model has been in place ever since Ingvar Kamprad founded IKEA, with very minimal changes except for being implemented on a much larger scale—growing rapidly almost every year.

The IKEA business model and the company's assortment of products are now on the move to take over India like they have been doing with other countries. After all, IKEA's market entry into China in 1998 went reasonably well. IKEA has three stores in Shanghai, two stores in Beijing, two stores in Chengdu, and one store each in Tianjin, Guangzhou, Shenzhen, Nanjing, Dalian, and Shenyang, along with eleven more stores across smaller cities in China. For India, IKEA initially plans to open 25 stores but has marked some 49 Indian cities that have potential to get an IKEA store in the future. The 25-store plans call for an investment of about $2 billion over 15 to 20 years. As we said in the opening, IKEA began its India market entry planning in 2013 and started building in 2016. The first construction took place in Hyderabad and is a 400,000 square-foot store at a cost of $110 million.

To ease Indian customers into the IKEA model before the store opened in 2018, the company unwrapped its first experiential center IKEA Hej (Hello) Home close to the IT hub of Hyderabad. The Hej Home small-scale store provides some insight into IKEA products and solutions, which future Indian customers could buy before the store opened in Hyderabad. This also eased the market entry into India and helped point out glaring problems that IKEA management could tackle before opening the actual large-scale IKEA store. The Hej Home, designed and built over a six-month period, highlights what IKEA stands for and what to

continued

expect. Ikea Hej Home reflects IKEA's understanding of life at home in India and its unique home furnishing solutions, including food and room settings, for Indian homes.

The preparation to get to the IKEA Hej Home concept and ultimately to the first large-scale store opening in Hyderabad was a long research-oriented endeavor. The Swedish home furnishings giant with a reputation for being very Swedish in almost everything they do sent one of its top design executives, Marie Lundström, to India with a mission to understand the Indian mindset and aesthetic. IKEA had decided that it needed to learn everything it possibly could about the Indian customers in a variety of Indian homes, places, and settings. The entry into China in 1998 went well but was also undertaken before the social media world we now live in. India could not go wrong for IKEA; the brand depended on it.

Marie Lundström didn't leave a single stone unturned. She visited nearly 200 Indian homes all across the large landscape of India. She spent countless hours interacting with Indian family members. IKEA also did the customary customer surveys with a large cross-section of the potential customers. In all, under the leadership of Marie Lundström, IKEA found some important characteristics of the Indian customers that could be effectively used by IKEA to make sure that their market entry into the country in 2018 was as successful as it could possibly be. Some of the findings indicated that Indians love color. Indians' family lives center around the couch. They watch TV while eating, which is not much different than Americans and many other nationalities, but nevertheless a finding that was helpful to understand India, the country's customers, and their characteristics. Unfortunately, customers in India are not also big fans of the IKEA trademark of do-it-yourself.

Taking all of this into account, IKEA could now plan accordingly. The company meticulously planned its large-scale store design and product range for one of the largest economies in the world with one of the largest potential customer populations. It is a remarkable journey that took IKEA through five years from initiation of the idea of entering India, to three years of detailed planning and research, and a couple of years of actually building the first store in Hyderabad. It is a fascinating story, journey, and a deviation from normal practice for IKEA—the company that prides itself on being Swedish in its processes, product names, and food served in its restaurants! To date, IKEA has about 400 employees in India and the company has plans to increase that number to 15,000 employees by 2025, with half being women. ●

Sources: Rathna Bhushan, "Ikea Betting on New Markets; Will Open Stores in India Next Year," *The Economic Times*, April 27, 2017; Ashish Gupta, "Is India Ready for IKEA?" *Fortune India*, March 24, 2017; Natasha Lomas, "IKEA Does Emoji," *Tech Crunch*, February 11, 2015; V. Rishi Kumar, "IKEA Opens First Hej Home in India at Hyderabad," *Business Line*, November 22, 2017; and Saurabh Singh, "IKEA's India Plan: To Hire 15,000 Co-Workers with Equal Representation from Women," *EnTrackr*, December 7, 2017.

Introduction

This chapter is concerned with two closely related topics: (1) the decision of which foreign markets to enter, when to enter them, and on what scale; and (2) the choice of entry mode. We covered strategic alliances in Chapter 12 when we discussed the strategy of international business, which also has implications for entering foreign markets. Specifically, a company can engage in a strategic alliance to enter a foreign market, and this becomes the company's internationalization strategy. However, most companies are not strategic and instead choose a market entry mode that requires lower levels of commitment and involvement. This includes choices between entering foreign markets by exporting, licensing, or franchising. Strategic alliances, like joint ventures, which we also cover as a market entry form in this chapter (in addition to the material we covered on strategic alliances in Chapter 12), require greater involvement and commitment.

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At the basic level, any firm thinking about foreign expansion must first struggle with the issue of which foreign market or markets to enter and the timing and scale of entry. The choice of which markets to enter should be driven by an assessment of the potential for relative long-run growth and profit. For example, in the opening case, how to go about entering a foreign market is a major issue with which IKEA wrestles even today. Keep in mind that IKEA is the largest furniture manufacturer in the world, usually does most of its operations in a very Swedish way, and seldom customizes to the foreign market it enters. However, finally, the IKEA business model and the company's assortment of products are now on the move to take over India like they have been doing in other countries. IKEA's market entry into China in 1998 went reasonably well, and the Chinese entry was done the Swedish way, but IKEA decided that the Indian market entry needed to be done the Indian way to reach the success the company is used to achieving.

globalEDGE — Interactive Rankings

Entering foreign markets is the focus of Chapter 13. The selection of country markets to choose from is getting larger for many product categories as more countries see their populations' purchasing power growing. With almost 200 countries in the world, the data are overwhelming, and even the starting point for analysis is not always an easy decision. The Interactive Rankings on globalEDGE™ can serve as a great pictorial view of the world on some 50 important variables in categories covering the economy, energy, government, health, infrastructure, labor, people, and trade and investment (globaledge.msu.edu/tools-and-data/interactive-rankings). Active data maps such as the Interactive Rankings maps are a good starting point for analysis to evaluate data for a specific country as well as the countries around it in a region. This allows for a focus on entry into one market now and a strategy for expansion later on to nearby countries with similar characteristics. Which are the top three countries for Internet users?

The journey into India has been unique, as the opening case attests. To facilitate the Indian customers' mindsets before IKEA opened the store in 2018, the company unwrapped its first experiential center IKEA Hej (Hello) Home close to the IT hub of Hyderabad. This Hej Home small-scale store provided insight into IKEA products and solutions, which future Indian customers could buy before the store opened in Hyderabad. But to get IKEA to the Hej Home concept and ultimately to the first large-scale store opening in Hyderabad, the road was a long research-oriented endeavor spanning five years. For IKEA, the market entry included a commitment to build their own stores, hire their own Indian people, and still place a great deal of emphasis on Swedish furniture and processes but with an Indian feel and flavor.

IKEA's choice was to set up a wholly owned subsidiary in India but there are lots of choices for market entry into a new country. The various modes for serving foreign markets are exporting, licensing, or franchising to host-country firms, establishing joint ventures with a host-country firm, setting up a new wholly owned subsidiary in a host country to serve its market, and acquiring an established enterprise in the host nation to serve that market. Each of these options has advantages and disadvantages. The magnitude of the advantages and disadvantages associated with each entry mode is determined by a number of factors, including transportation costs, trade barriers, political risks, economic risks, business risks, costs, and firm strategy.

The optimal entry mode varies by situation, depending on these factors. Thus, whereas some firms may best serve a given market by exporting, other firms may better serve the market by setting up a new wholly owned subsidiary or by acquiring an established enterprise. Starbucks, for example, has had a preference for entering into joint ventures with local partners and then licensing its format to the joint venture. Cutco, on the other hand, usually adopts different models for domestic and international sales. IKEA builds their own stores and manages the operations as subsidiaries.

Basic Entry Decisions

A firm contemplating foreign expansion must make three basic decisions: which markets to enter, when to enter those markets, and on what scale.[1]

LO 13-1
Explain the three basic decisions that firms contemplating foreign expansion must make: which markets to enter, when to enter those markets, and on what scale.

WHICH FOREIGN MARKETS?

There are now almost 200 nations in the world (technically, there are 195 countries and 61 territories in the world as of 2018; with an additional 6 disputed territories), and they do not all hold the same profit potential for a firm contemplating foreign expansion. Ultimately, the choice must be based on an assessment of a nation's long-run revenue potential. This potential is a function of several factors, many of which we have studied in earlier chapters. Chapters 2 and 3 looked in detail at the economic and political factors that influence the potential attractiveness of a foreign market. The attractiveness of a country as a potential market for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country.

Chapters 2 and 3 also noted that the long-run economic benefits of doing business in a country are a function of factors such as the size of the market (in terms of demographics), the present wealth (purchasing power) of consumers in that market, and the likely future wealth of consumers, which depends on economic growth rates. While some markets are very large when measured by number of consumers (e.g., China, India, Brazil, Russia, and Indonesia), one must also look at living standards and economic growth. On this basis, China and India, while relatively poor, are growing so rapidly that they are attractive targets for inward investment. Alternatively, weak growth in Indonesia implies that this populous nation is a far less attractive target for inward investment. As we saw in Chapters 2 and 3, likely future economic growth rates appear to be a function of a free market system and a country's capacity for growth (which may be greater in less developed nations). Also, the costs and risks associated with doing business in a foreign country are typically lower in economically advanced and politically stable democratic nations, and they are greater in less developed and politically unstable nations.

The discussion in Chapters 2 and 3 suggests that, other things being equal, the benefit–cost–risk trade-off is likely to be most favorable in politically stable developed and developing nations that have free market systems and where there is not a dramatic upsurge in either inflation rates or private-sector debt. The trade-off is likely to be least favorable in politically unstable developing nations that operate with a mixed or command economy or in developing nations where speculative financial bubbles have led to excess borrowing.

Another important factor is the value an international business can create in a foreign market. This depends on the suitability of its product offering to that market and the nature of indigenous competition.[2] If the international business can offer a product that has not been widely available in that market and that satisfies an unmet need, the value of that product to consumers is likely to be much greater than if the international business simply offers the same type of product that indigenous competitors and other foreign entrants are already offering. Greater value translates into an ability to charge higher prices and/or to build sales volume more rapidly. By considering such factors, a firm can rank countries in terms of their attractiveness and long-run profit potential. Preference is then given to entering markets that rank highly. For example, Tesco, the large British grocery chain, has been aggressively expanding its foreign operations, primarily by focusing on emerging markets that lack strong indigenous competitors (see the accompanying Management Focus).

timing of entry
Entry is early when a firm enters a foreign market before other foreign firms and late when a firm enters after other international businesses have established themselves.

first-mover advantages
Advantages accruing to the first to enter a market.

first-mover disadvantages
Disadvantages associated with entering a foreign market before other international businesses.

pioneering costs
Costs an early entrant bears that later entrants avoid, such as the time and effort in learning the rules, failure due to ignorance, and the liability of being a foreigner.

TIMING OF ENTRY

Once attractive markets have been identified, it is important to consider the **timing of entry**. Entry is early when an international business enters a foreign market before other foreign firms and late when it enters after other international businesses have already established themselves. The advantages frequently associated with entering a market early are commonly known as **first-mover advantages**.[3] One first-mover advantage is the ability to preempt rivals and capture demand by establishing a strong brand name. This desire has driven the rapid expansion by Tesco into developing nations (see the Management Focus). A second advantage is the ability to build sales volume in the country and ride down the experience curve ahead of rivals, giving the early entrant a cost advantage over later entrants. This cost advantage may enable the early entrant to cut prices below those of later entrants, thereby driving them out of the market. A third advantage is the ability of early entrants to create switching costs that tie customers into their products or services. Such switching costs make it difficult for later entrants to win business.

There can also be disadvantages associated with entering a foreign market before other international businesses. These are often referred to as **first-mover disadvantages**.[4] These disadvantages may give rise to **pioneering costs**, costs that an early entrant has to bear that a later entrant can avoid. Pioneering costs arise when the business system in a foreign country is so different

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Tesco's International Growth Strategy

Tesco, founded in 1919 by Jack Cohen, is a British multinational grocery and merchandise retailer. It is the largest grocery retailer in the United Kingdom, with a 28 percent share of the local market, and the second-largest retailer in the world after Walmart measured by revenue. By 2019, Tesco had sales of more than £55 billion ($77 billion), more than 476,000 employees, and 6,553 stores.

In its home market of the United Kingdom (with a headquarters in Chestnut, Hertfordshire, England), the company's strengths are reputed to come from strong competencies in marketing and store site selection, logistics and inventory management, and its own label product offerings. By the early 1990s, these competencies had already given the company a leading position in the United Kingdom. The company was generating strong free cash flows, and senior managers had to decide how to use that cash. One strategy they settled on was overseas expansion.

As they looked at international markets, they soon concluded the best opportunities were not in established markets, such as those in North America and Western Europe, where strong local competitors already existed, but in the emerging markets of eastern Europe and Asia, where there were few capable competitors but strong underlying growth trends. Tesco's first international foray was into Hungary in 1994, when it acquired an initial 51 percent stake in Global, a 43-store, state-owned grocery chain. By 2019, Tesco was the market leader in Hungary, with more than 200 stores and additional openings planned. In 1995, Tesco acquired 31 stores in Poland from Stavia; a year later, it added 13 stores purchased from Kmart in the Czech Republic and Slovakia; and the following year, it entered the Republic of Ireland. Tesco now has more than 450 stores in Poland, some 80 stores in the Czech Republic, more than 120 stores in Slovakia, and more than 100 stores in Ireland.

Tesco's Asian expansion began in 1998 in Thailand when it purchased 75 percent of Lotus, a local food retailer with 13 stores. Building on that base, Tesco had more than 380 stores in Thailand by 2015. In 1999, the company entered South Korea when it partnered with Samsung to develop a chain of hypermarkets. This was followed by entry into Taiwan in 2000, Malaysia in 2002, Japan in 2003, and China in 2004. The move into China came after three years of careful research and discussions with potential partners. Like many other Western companies, Tesco was attracted to the Chinese market by its large size and rapid growth. In the end, Tesco settled on a 50–50 joint venture with Hymall, a hypermarket chain that is controlled by Ting Hsin, a Taiwanese group, which had been operating in China for six years. In 2014, Tesco combined its 131 stores in China in a joint venture with the state-run China Resources Enterprise (CRE) and its nearly 3,000 stores. Tesco owns 20 percent of the joint venture.

As a result of these moves, by 2019 Tesco generated sales of $25 billion outside of the United Kingdom (its UK annual revenues were about $52 billion). The addition of international stores has helped make Tesco the second-largest company in the global grocery market

Tesco is the largest grocery retailer in the United Kingdom and the second-largest retailer worldwide after Walmart.
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behind only Walmart (Tesco is also behind Carrefour of France if profits are used). Of the three, however, Tesco may be the most successful internationally. By 2019, all its foreign ventures were making money.

In explaining the company's success, Tesco's managers have detailed a number of important factors. First, the company devotes considerable attention to transferring its core capabilities in retailing to its new ventures. At the same time, it does not send in an army of expatriate managers to run local operations, preferring to hire local managers and support them with a few operational experts from the United Kingdom. Second, the company believes that its partnering strategy in Asia has been a great asset. Tesco has teamed up with good companies that have a deep understanding of the markets in which they are participating but that lack Tesco's financial strength and retailing capabilities. Consequently, both Tesco and its partners have brought useful assets to the venture, increasing the probability of success. As the venture becomes established, Tesco has typically increased its ownership stake in its partner. For example, by 2019 Tesco owned 100 percent of Homeplus, its South Korean hypermarket chain, but when the venture was established, Tesco owned 51 percent. Third, the company has focused on markets with good growth potential but that lack strong indigenous competitors, which provides Tesco with ripe ground for expansion.

Sources: Ivana Kottasová, "Women in Supermarkets Want Same Pay as Warehouse Workers," *CNN Money*, February 7, 2018; P. N. Child, "Taking Tesco Global," *The McKenzie Quarterly* 3 (2002); H. Keers, "Global Tesco Sets Out Its Stall in China," *Daily Telegraph*, July 15, 2004, p. 31; K. Burgess, "Tesco Spends Pounds 140m on Chinese Partnership," *Financial Times*, July 15, 2004, p. 22; J. McTaggart, "Industry Awaits Tesco Invasion," *Progressive Grocer*, March 1, 2006, pp. 8–10; Tesco's annual reports, www.tesco.com; P. Sonne, "Five Years and $1.6 Billion Later, Tesco Decides to Quit US," *The Wall Street Journal*, December 6, 2012; and "Tesco Set to Push Ahead in the United States," *The Wall Street Journal*, October 6, 2010, p. 19.

from that in a firm's home market that the enterprise has to devote considerable effort, time, and expense to learning the rules of the game. Pioneering costs include the costs of business failure if the firm, due to its ignorance of the foreign environment, makes major mistakes. A certain liability is associated with being a foreigner, and this liability is greater for foreign firms that enter a national market early.[5] Research seems to confirm that the probability of survival increases if an international business enters a national market after several other foreign firms have already done so.[6] The late entrant may benefit by observing and learning from the mistakes made by early entrants.

Pioneering costs also include the costs of promoting and establishing a product offering, including the costs of educating customers. These can be significant when the product being promoted is unfamiliar to local consumers. In contrast, later entrants may be able to ride on an early entrant's investments in learning and customer education by watching how the early entrant proceeded in the market, by avoiding costly mistakes made by the early entrant, and by exploiting the market potential created by the early entrant's investments in customer education. For example, KFC introduced the Chinese to American-style fast food, but a later entrant, McDonald's, has capitalized on the market in China by correcting mistakes that KFC made and implementing a better approach.

An early entrant may be put at a severe disadvantage, relative to a later entrant, if regulations change in a way that diminishes the value of an early entrant's investments. This is a serious risk in many developing nations where the rules that govern business practices are still evolving. Early entrants can find themselves at a disadvantage if a subsequent change in regulations invalidates prior assumptions about the best business model for operating in that country.

Is First-Mover Advantage Always a Good Thing?

Timing of entry into a foreign market is one of the most critical aspects of going international. Popularized by Marvin Lieberman and David Montgomery in 1988, first-mover advantage was an idea that resonated with every company. But 10 years later, in 1998, Lieberman and Montgomery actually backed off their own idea that taking advantage of being the first mover was always a good strategy. At this time, it was too late: Venture capitalists, companies, people, and many scholars had already latched onto the positive things about being first in a new foreign market and stressed this approach over any other timing of entry. Now we are some 20 years into the twenty-first century, and the realization is that first-mover advantages also come with pioneering costs. If you had a choice of being the first-mover into a new emerging foreign market (e.g., Turkey) and being the fifth company entering that market with your product, what would you choose and why?

Sources: M. B. Lieberman and D. B. Montgomery, "First-Mover Advantages," *Strategic Management Journal* 9 (1988), pp. 41–58; and M. B. Lieberman and D. B. Montgomery, "First-Mover (Dis)Advantages: Retrospective and Link with the Resource-Based View," *Strategic Management Journal* 19 (1998), pp. 1111–1125.

SCALE OF ENTRY AND STRATEGIC COMMITMENTS Another issue that an international business needs to consider when contemplating market entry is the scale of entry. Entering a market on a large scale involves the commitment of significant resources and implies rapid entry. Consider the entry of the Dutch insurance company ING into the U.S. insurance market in 1999. ING had to spend several billion dollars to acquire its U.S. operations. Not all firms have the resources necessary to enter on a large scale, and even some large firms prefer to enter foreign markets on a small scale and then build slowly as they become more familiar with the market.

The consequences of entering on a significant scale—entering rapidly—are associated with the value of the resulting strategic commitments.[7] A strategic commitment has a long-term impact and is difficult to reverse. Deciding to enter a foreign market on a significant scale is a major strategic commitment. Strategic commitments, such as rapid large-scale market entry, can have an important influence on the nature of competition in a market. For example, by entering the U.S. financial services market on a significant scale, ING signaled its commitment to the market. This will have several effects. On the positive side, it will make it easier for the company to attract customers and distributors (such as insurance agents). The scale of entry gives both customers and distributors reasons for believing that ING will remain in the market for the long run. The scale of entry may also give other foreign institutions considering entry into the United States pause; now they will have to compete not only against indigenous institutions in the United States but also against an aggressive and successful European institution. On the negative side, by committing itself heavily to one country, the United States, ING may have fewer resources available to support expansion in other desirable markets, such as Japan. The commitment to the United States limits the company's strategic flexibility.

As suggested by the ING example, significant strategic commitments are neither unambiguously good nor bad. Rather, they tend to change the competitive playing field and unleash a number of changes, some of which may be desirable and some of which will not be. It is important for a firm to think through the implications of large-scale entry into a market and act accordingly. Of particular relevance is trying to identify how actual and potential competitors

might react to large-scale entry into a market. Also, the large-scale entrant is more likely than the small-scale entrant to be able to capture first-mover advantages associated with demand preemption, scale economies, and switching costs.

The value of the commitments that flow from rapid large-scale entry into a foreign market must be balanced against the resulting risks and lack of flexibility associated with significant commitments. But strategic inflexibility can also have value. A famous example from military history illustrates the value of inflexibility. When Hernán Cortés landed in Mexico, he ordered his men to burn all but one of his ships. Cortés reasoned that by eliminating their only method of retreat, his men had no choice but to fight hard to win against the Aztecs—and ultimately they did.[8]

Balanced against the value and risks of the commitments associated with large-scale entry are the benefits of a small-scale entry. Small-scale entry allows a firm to learn about a foreign market while limiting the firm's exposure to that market. Small-scale entry is a way to gather information about a foreign market before deciding whether to enter on a significant scale and how best to enter. By giving the firm time to collect information, small-scale entry reduces the risks associated with a subsequent large-scale entry. But the lack of commitment associated with small-scale entry may make it more difficult for the small-scale entrant to build market share and to capture first-mover or early-mover advantages. The risk-averse firm that enters a foreign market on a small scale may limit its potential losses, but it may also miss the chance to capture first-mover advantages.

MARKET ENTRY SUMMARY There are no "right" decisions here, just decisions that are associated with different levels of risk and reward. Entering a large developing nation such as China or India before most other international businesses in the firm's industry and entering on a large scale will be associated with high levels of risk. In such cases, the liability of being foreign is increased by the absence of prior foreign entrants whose experience can be a useful guide. At the same time, the potential long-term rewards associated with such a strategy are great. The early large-scale entrant into a major developing nation may be able to capture significant first-mover advantages that will bolster its long-run position in that market.[9] In contrast, entering developed nations such as Australia or Canada after other international businesses in the firm's industry and entering on a small scale to first learn more about those markets will be associated with much lower levels of risk. However, the potential long-term rewards are also likely to be lower because the firm is essentially forgoing the opportunity to capture first-mover advantages and because the lack of commitment signaled by small-scale entry may limit its future growth potential.

This section has been written largely from the perspective of a business based in a developed country considering entry into foreign markets. Christopher Bartlett and Sumantra Ghoshal have pointed out the ability that businesses based in emerging countries have to enter foreign markets and become global players.[10] Although such firms tend to be late entrants into foreign markets and although their resources may be limited, Bartlett and Ghoshal argue that such late movers can still succeed against well-established global competitors by pursuing appropriate strategies. In particular, companies based in emerging countries should use the entry of foreign multinationals as an opportunity to learn from these competitors by benchmarking their operations and performance against them. Furthermore, a local company may be able to find ways to differentiate itself from a foreign multinational, for example, by focusing on market niches that the multinational ignores or is unable to serve effectively if it has a standardized global product offering. Having improved its performance through learning and differentiated its product offering, the firm from an emerging country may then be able to pursue its own international expansion strategy. Even though the firm may be a late entrant into many countries, by benchmarking and then differentiating itself from early movers in global markets, the firm from the emerging country may still be able to build a strong international business presence. A good example of how this can work is given in the accompanying Management Focus, which looks at how Jollibee, a Philippines-based fast-food chain, has started to build a global presence in a market dominated by U.S. multinationals such as McDonald's and KFC.

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The Jollibee Phenomenon

Jollibee Foods Corporation, abbreviated JFC and more popularly known as Jollobee, is one of the Philippines' phenomenal business success stories. Jollibee, which stands for "Jolly Bee," began operations in 1975 as a two-branch ice cream parlor. It later expanded its menu to include hot sandwiches and other meals. Encouraged by early success, Jollibee Foods Corporation was incorporated in 1978, with a network that had grown to seven outlets. In 1981, when Jollibee had 11 stores, McDonald's began to open stores in Manila. Many observers thought Jollibee would have difficulty competing against McDonald's. However, Jollibee saw this as an opportunity to learn from a very successful global competitor. Jollibee benchmarked its performance against that of McDonald's and started to adopt operational systems similar to those used at McDonald's to control its quality, cost, and service at the store level. This helped Jollibee improve its performance.

As it came to better understand McDonald's business model, Jollibee began to look for a weakness in McDonald's global strategy. Jollibee executives concluded that McDonald's fare was too standardized for many locals and that the local firm could gain share by tailoring its menu to local tastes. Jollibee's hamburgers were set apart by a secret mix of spices blended into the ground beef to make the burgers sweeter than those produced by McDonald's, appealing more to Philippine tastes. It also offered local fare, including various rice dishes, pineapple burgers, and banana *langka* and peach mango pies for desserts. By pursuing this strategy, Jollibee maintained a leadership position over the global giant. By 2019, Jollibee had over 801 stores in the Philippines for its Jollibee brand and some 2,040 total stores across all of its brands (e.g., Jollibee, Chowking, Greenwich, Red Ribbon, Mang INasal, and Burger King), a market share of more than 60 percent, and revenues in excess of $600 million. McDonald's, in contrast, had about 400 stores.

The international expansion started in the mid-1980s. Jollibee's initial ventures were into neighboring Asian countries such as Indonesia, where it pursued the strategy of localizing the menu to better match local tastes, thereby differentiating itself from McDonald's. In 1987, Jollibee entered the Middle East, where a large contingent of expatriate Filipino workers provided a ready-made market for the company. The strategy of focusing on expatriates worked so well that in the late 1990s, Jollibee decided to enter another foreign market where there was a large Filipino population—the United States.

Between 1999 and 2019, Jollibee opened 32 stores in the United States, 20 of which are in California. Even though many believe the U.S. fast-food market is saturated, the stores have performed well. While the initial clientele was strongly biased toward the expatriate Filipino community, where Jollibee's brand awareness is high, non-Filipinos increasingly are coming to the restaurant. In the San Francisco store, which has been open the longest, more than half the customers are now non-Filipino. Today, Jollibee has some 500 international stores and a potentially bright future as a niche player in a market that has historically been dominated by U.S. multinationals.

Sources: Tina G. Santos, "Up to 10,000 Jollibee Workers to Be Regularized," *Inquirer.net*, April 6, 2018; "Jollibee Battles Burger Giants in US Market," *Philippine Daily Inquirer*, July 13, 2000; M. Ballon, "Jollibee Struggling to Expand in U.S.," *Los Angeles Times*, September 16, 2002, p. C1; J. Hookway, "Burgers and Beer," *Far Eastern Economic Review*, December 2003, pp. 72–74; S. E. Lockyer, "Coming to America," *Nation's Restaurant News*, February 14, 2005, pp. 33–35; Erik de la Cruz, "Jollibee to Open 120 New Stores This Year, Plans India," *Inquirer Money*, July 5, 2006, business.inquirer.net; and www.jollibee.com.ph.

LO 13-2
Compare and contrast the different modes that firms use to enter foreign markets.

Entry Modes

Once a firm decides to enter a foreign market, the question arises as to the best mode of entry. Firms can use six different modes to enter foreign markets: exporting, turnkey projects, licensing, franchising, establishing joint ventures with a host-country firm, or setting up a new wholly owned subsidiary in the host country. Each entry mode has advantages and disadvantages. Managers need to consider these carefully when deciding which to use.[11]

EXPORTING

Many manufacturing firms begin their global expansion as exporters and only later switch to another mode for serving a foreign market. We take a close look at the mechanics of exporting in Chapter 14. Here we focus on the advantages and disadvantages of exporting as an entry mode.

exporting
Sale of products produced in one country to residents of another country.

Advantages

Exporting has two distinct advantages. First, it avoids the often substantial costs of establishing manufacturing operations in the host country. Second, exporting may help a firm achieve experience curve and location economies (see Chapter 12). By manufacturing the product in a centralized location and exporting it to other national markets, the firm may realize substantial scale economies from its global sales volume. This is how many Japanese automakers made inroads into the U.S. market over the last two decades (although more and more they are also setting up factories in the United States due to the favorable tax incentives and also restrictions placed on them for SUVs).

Disadvantages

Exporting has a number of drawbacks. First, exporting from the firm's home base may not be appropriate if lower-cost locations for manufacturing the product can be found abroad (i.e., if the firm can realize location economies by moving production elsewhere). Thus, particularly for firms pursuing global or transnational strategies, it may be preferable to manufacture where the mix of factor conditions is most favorable from a value creation perspective and to export to the rest of the world from that location. This is not so much an argument against exporting as an argument against exporting from the firm's home country. Many U.S. electronics firms have moved some of their manufacturing to the Far East because of the availability of low-cost, highly skilled labor. They then export from that location to the rest of the world, including the United States.

A second drawback to exporting is that high transportation costs can make exporting uneconomical, particularly for bulk products. One way of getting around this is to manufacture bulk products regionally. This strategy enables the firm to realize some economies from large-scale production and at the same time to limit its transportation costs. For example, many multinational chemical firms manufacture their products regionally, serving several countries from one facility.

Another drawback is that tariff barriers can make exporting uneconomical. Similarly, the threat of tariff barriers by the host-country government can make it very risky. A fourth drawback to exporting arises when a firm delegates its marketing, sales, and service in each country where it does business to another company. This is a common approach for manufacturing firms that are just beginning to expand internationally. The other company may be a local agent, or it may be another multinational with extensive international distribution operations. Local agents often carry the products of competing firms and so have divided loyalties. In such cases, the local agent may not do as good a job as the firm would if it managed its marketing itself. Similar problems can occur when another multinational takes on distribution.

The way around such problems is to set up wholly owned subsidiaries in foreign nations to handle local marketing, sales, and service. By doing this, the firm can exercise tight control over marketing and sales in the country while reaping the cost advantages of manufacturing the product in a single location or a few choice locations.

TURNKEY PROJECTS

Firms that specialize in the design, construction, and start-up of turnkey plants are common in some industries. In a **turnkey project**, the contractor agrees to handle every detail of the project for a foreign client, including the training of operating personnel. At completion of the contract, the foreign client is handed the "key" to a plant that is ready for full operation—hence, the term *turnkey*. This is a means of exporting process technology to other countries. Turnkey projects are most common in the chemical, pharmaceutical, petroleum-refining, and metal-refining industries, all of which use complex, expensive production technologies.

turnkey project
A project in which a firm agrees to set up an operating plant for a foreign client and hand over the "key" when the plant is fully operational.

Advantages

The know-how required to assemble and run a technologically complex process, such as refining petroleum or steel, is a valuable asset. Turnkey projects are a way of earning great economic returns from that asset. The strategy is particularly useful where foreign direct investment (FDI) is limited by host-government regulations. For example, the governments of many oil-rich countries have set out to build their own petroleum-refining industries, so they restrict FDI in their oil-refining sectors. But because many of these countries lack petroleum-refining technology, they gain it by entering into turnkey projects with foreign firms that have the technology. Such deals are often attractive to the selling firm because without them, they would have no way to earn a return on their valuable know-how in that country. A turnkey strategy can also be less risky than conventional FDI. In a country with unstable political and economic environments, a longer-term investment might expose the firm to unacceptable political and/or economic risks (e.g., the risk of nationalization or of economic collapse).

Disadvantages

Three main drawbacks are associated with a turnkey strategy. First, the firm that enters into a turnkey deal will have no long-term interest in the foreign country. This can be a disadvantage if that country subsequently proves to be a major market for the output of the process that has been exported. One way around this is to take a minority equity interest in the operation. Second, the firm that enters into a turnkey project with a foreign enterprise may inadvertently create a competitor. For example, many of the Western firms that sold oil-refining technology to firms in Saudi Arabia, Kuwait, and other Gulf states now find themselves competing with these firms in the world oil market. Third, if the firm's process technology is a source of competitive advantage, then selling this technology through a turnkey project is also selling competitive advantage to potential and/or actual competitors.

licensing agreement
Arrangement in which a licensor grants the rights to intangible property to a licensee for a specified period and receives a royalty fee in return.

LICENSING

A **licensing agreement** is an arrangement whereby a licensor grants the rights to intangible property to another entity (the licensee) for a specified period, and in return, the licensor receives a royalty fee from the licensee.[12] Intangible property includes patents, inventions, formulas, processes, designs, copyrights, and trademarks. For example, to enter the Japanese market, Xerox, inventor of the photocopier, established a joint venture with Fuji Photo that is known as Fuji Xerox. Xerox then licensed its xerographic know-how to Fuji Xerox. In return, Fuji Xerox paid Xerox a royalty fee equal to 5 percent of the net sales revenue that Fuji Xerox earned from the sales of photocopiers based on Xerox's patented know-how. In the Fuji Xerox case, the license was originally granted for 10 years, and it has been renegotiated and extended several times since. The licensing agreement between Xerox and Fuji Xerox also limited Fuji Xerox's direct sales to the Asian Pacific region (although Fuji Xerox does supply Xerox with photocopiers that are sold in North America under the Xerox label).[13]

Advantages

In the typical international licensing deal, the licensee puts up most of the capital necessary to get the overseas operation going. Thus, a primary advantage of licensing is that the firm does not have to bear the development costs and risks associated with opening a foreign market. Licensing is very attractive for firms lacking the capital to develop operations overseas. In addition, licensing can be attractive when a firm is unwilling to commit substantial financial resources to an unfamiliar or politically volatile foreign market. Licensing is also often used when a firm wishes to participate in a foreign market but is prohibited from doing so by barriers to investment. This was one of the original reasons for the formation of the Fuji Xerox joint venture. Xerox wanted to participate in the Japanese market but was prohibited from setting up a wholly owned subsidiary by the Japanese government. So Xerox set up the joint venture with Fuji and then licensed its know-how to the joint venture.

Finally, licensing is frequently used when a firm possesses some intangible property that might have business applications, but it does not want to develop those applications itself. For example, Bell Laboratories at AT&T originally invented the transistor circuit in the 1950s, but AT&T decided it did not want to produce transistors, so it licensed the technology to a number of other companies, such as TI (Texas Instruments). Similarly, Coca-Cola has licensed its famous trademark to clothing manufacturers, which have incorporated the design into clothing. Harley-Davidson licenses its brand to Wolverine World Wide to make footwear that embodies the spirit of the open road, which Harley-Davidson emphasizes in its advertisements and product positioning.

Exporting or Licensing?

In Chapter 13, we discuss a series of advantages and disadvantages of exporting and licensing (as well as turnkey projects, franchising, joint ventures, and wholly owned subsidiaries as other entry mode choices). Exporting refers to the sale of products produced in one country to residents of another country. Licensing refers to an arrangement in which a licensor grants the rights to intangible property to the licensee for a specified period and receives a royalty fee in return. Both of these modes of entry into a foreign market have unique advantages and disadvantages. Oftentimes, selecting exporting or licensing depends on myriad factors—one being the global mindset of the business owner. Assume you have a choice to enter three emerging markets—Bolivia, Chile, and Peru, neighboring countries in South America. You have a great product, with lots of technological innovation and a lightweight packaging. Would you opt for exporting or licensing, and why?

Disadvantages

Licensing has three serious drawbacks. First, it does not give a firm the tight control over manufacturing, marketing, and strategy that is required for realizing experience curve and location economies. Licensing typically involves each licensee setting up its own production operations. This severely limits the firm's ability to realize experience curve and location economies by producing its product in a centralized location. When these economies are important, licensing may not be the best way to expand overseas.

Second, competing in a global market may require a firm to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another. By its very nature, licensing limits a firm's ability to do this.

A licensee is unlikely to allow a multinational firm to use its profits (beyond those due in the form of royalty payments) to support a different licensee operating in another country.

A third problem with licensing is one that we encountered in Chapter 8 when we reviewed the economic theory of foreign direct investment (FDI). This is the risk associated with licensing technological know-how to foreign companies. Technological know-how constitutes the basis of many multinational firms' competitive advantage. Most firms wish to maintain control over how their know-how is used, and a firm can quickly lose control over its technology by licensing it. Many firms have made the mistake of thinking they could maintain control over their know-how within the framework of a licensing agreement. RCA Corporation, for example, once licensed its color TV technology to Japanese firms including Matsushita and Sony. The Japanese firms quickly assimilated the technology, improved on it, and used it to enter the U.S. market, taking substantial market share away from RCA and ultimately RCA became defunct in 1986.

There are ways of reducing this risk. One way is by entering into a cross-licensing agreement with a foreign firm. Under a cross-licensing agreement, a firm might license some valuable intangible property to a foreign partner, but in addition to a royalty payment, the firm might also request that the foreign partner license some of its valuable know-how to the firm. Such agreements are believed to reduce the risks associated with licensing technological know-how, since the licensee realizes that if it violates the licensing contract (by using the knowledge obtained to compete directly with the licensor), the licensor can do the same to it. Cross-licensing agreements enable firms to hold each other hostage, which reduces the probability that they will behave opportunistically toward each other.[14] Such cross-licensing agreements are increasingly common in high-technology industries.

Another way of reducing the risk associated with licensing is to follow the Fuji Xerox model and link an agreement to license know-how with the formation of a joint venture in which the licensor and licensee take important equity stakes. Such an approach aligns the interests of licensor and licensee, because both have a stake in ensuring that the venture is successful. Thus, the risk that Fuji Photo might appropriate Xerox's technological know-how and then compete directly against Xerox in the global photocopier market was reduced by the establishment of a joint venture in which both Xerox and Fuji Photo had an important stake.

FRANCHISING

Franchising is similar to licensing, although franchising tends to involve longer-term commitments than licensing. **Franchising** is basically a specialized form of licensing in which the franchiser not only sells intangible property (normally a trademark) to the franchisee but also insists that the franchisee agree to abide by strict rules as to how it does business. The franchiser will also often assist the franchisee to run the business on an ongoing basis. As with licensing, the franchiser typically receives a royalty payment, which amounts to some percentage of the franchisee's revenues. Whereas licensing is pursued primarily by manufacturing firms, franchising is employed primarily by service firms.[15]

franchising
A specialized form of licensing in which the franchiser sells intangible property to the franchisee and insists on rules to conduct the business.

So, You Think You Want to Own a Franchise?

Franchising is a specialized form of licensing in which the franchiser 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. Some of the advantages of franchising include branding, advertising, reputation, and headquarters/company support for development of the infrastructure needed to operate the franchise business. Some of the disadvantages of franchising include restrictions on territory and pricing, not being completely independent, franchise fee and ongoing royalty payments, and dependence on other franchise owners for nurturing the brand. Well-known worldwide franchise systems include Subway, 7-Eleven, Pizza Hut, and McDonald's. Assume you are interested in being an international entrepreneur. Would franchising be your choice of starting a business?

Source: T. Hult, D. Closs, and D. Frayer, *Global Supply Chain Management: Leveraging Processes, Measurements, and Tools for Strategic Corporate Advantage* (New York: McGraw-Hill Education, 2014).

Advantages

McDonald's is a good example of a firm that has grown and taken advantage of a franchising strategy (Subway is another). McDonald's strict rules as to how franchisees should operate a restaurant extend to control over the menu, cooking methods, staffing policies, and design and location. McDonald's also organizes the supply chain for its franchisees and provides management training and financial assistance.[16] Overall, the advantages of franchising as an entry mode are very similar to those of licensing. The firm is relieved of many of the costs and risks of opening a foreign market on its own. Instead, the franchisee typically assumes those costs and risks. This creates a good incentive for the franchisee to build a profitable operation as quickly as possible.

Thus, using a franchising strategy, a service firm can build a global presence quickly and at a relatively low cost and risk, as McDonald's has. Two Men and a Truck—a Lansing, Michigan–headquartered moving company—effectively used the franchising concept to scale up from a local company to a U.S. nationwide company almost immediately in 1989 after its inception in 1985. Now, the company has 410 locations worldwide.

Disadvantages The disadvantages of franchising are less pronounced than with licensing. Since franchising is often used by service companies, there is no reason to consider the need for coordination of manufacturing to achieve experience curve and location economies. But franchising may inhibit the firm's ability to take profits out of one country to support competitive attacks in another. A more significant disadvantage of franchising is quality control. The foundation of franchising arrangements is that the firm's brand name conveys a message to consumers about the quality of the firm's product. Thus, a business traveler checking in at a Four Seasons hotel in Hong Kong can reasonably expect the same quality of room, food, and service that she would receive in New York. The Four Seasons name is supposed to guarantee consistent product quality. This presents a problem in that foreign franchisees may not be as concerned about quality as they are supposed to be, and the result of poor quality can extend beyond lost sales in a particular foreign market to a decline in the firm's worldwide reputation. For example, if the business traveler has a bad experience at the Four Seasons in Hong Kong, she may never go to another Four Seasons hotel and may urge her colleagues to do likewise. The geographic distance of the firm from its foreign franchisees can make poor quality difficult to detect. In addition, the sheer numbers of franchisees—in the case of McDonald's, tens of thousands—can make quality control difficult. Due to these factors, quality problems may persist.

One way around this disadvantage is to set up a subsidiary in each country in which the firm expands. The subsidiary might be wholly owned by the company or a joint venture with a foreign company. The subsidiary assumes the rights and obligations to establish franchises throughout the particular country or region. McDonald's, for example, establishes a master franchisee in many countries. Typically, this master franchisee is a joint venture between McDonald's and a local firm. The proximity and the smaller number of franchises to oversee reduce the quality control challenge. In addition, because the subsidiary (or master franchisee) is at least partly owned by the firm, the firm can place its own managers in the subsidiary to help ensure that it is doing a good job of monitoring the franchises. This organizational arrangement has proven very satisfactory for McDonald's, KFC, and others.

joint venture
A cooperative undertaking between two or more firms.

JOINT VENTURES

A **joint venture** entails establishing a firm that is jointly owned by two or more otherwise independent firms. Fuji Xerox, for example, was set up as a joint venture between Xerox and Fuji Photo. Establishing a joint venture with a foreign firm has long been a popular mode for entering a new market. The most typical joint venture is a 50–50 venture, in which there are two parties, each holding a 50 percent ownership stake and contributing a team of managers to share operating control. This was the case with the Fuji–Xerox joint venture until 2001; it is now a 25–75 venture with Xerox holding 25 percent. The GM SAIC venture in China was a 50–50 venture until 2010, when it became a 51–49 venture, with SAIC holding the 51 percent stake. Some firms, however, have sought joint ventures in which they have a majority share and thus tighter control.[17]

Advantages Joint ventures have a number of advantages. First, a firm benefits from a local partner's knowledge of the host country's competitive conditions, culture, language, political systems, and business. Thus, for many U.S. firms, joint ventures have involved the U.S. company providing technological know-how and products and the local partner providing the marketing expertise and the local knowledge necessary for competing in that country. Second, when the development costs and/or risks of opening a foreign market are high, a firm might gain by sharing these costs and or risks with a local partner. Third, in many countries, political considerations make joint ventures the only feasible entry mode. Research suggests joint ventures with local partners face a low risk of being subject to nationalization or other forms of adverse government interference.[18] This appears to be because local equity partners, who may have some influence on host-government policy, have a vested interest in speaking out against nationalization or government interference.

Disadvantages Despite these advantages, there are major disadvantages with joint ventures. First, as with licensing, a firm that enters into a joint venture risks giving control of its technology to its partner. Thus, a proposed joint venture in 2002 between Boeing and Mitsubishi Heavy Industries to build a new wide-body jet (the 787) raised fears that Boeing might unwittingly give away its commercial airline technology to the Japanese. However, joint-venture agreements can be constructed to minimize this risk. One option is to hold majority ownership in the venture. This allows the dominant partner to exercise greater control over its technology. But it can be difficult to find a foreign partner who is willing to settle for minority ownership. Another option is to "wall off" from a partner technology that is central to the core competence of the firm, while sharing other technology.

A second disadvantage is that a joint venture does not give a firm the tight control over subsidiaries that it might need to realize experience curve or location economies. Nor does it give a firm the tight control over a foreign subsidiary that it might need for engaging in coordinated global attacks against its rivals. Consider the entry of Texas Instruments (TI) into the Japanese semiconductor market. When TI established semiconductor facilities in Japan, it did so for the dual purpose of checking Japanese manufacturers' market share and limiting their cash available for invading TI's global market. In other words, TI was engaging in global strategic coordination. To implement this strategy, TI's subsidiary in Japan had to be prepared to take instructions from corporate headquarters regarding competitive strategy. The strategy also required the Japanese subsidiary to run at a loss if necessary. Few, if any, potential joint-venture partners would have been willing to accept such conditions, since it would have necessitated a willingness to accept a negative return on investment. Indeed, many joint ventures establish a degree of autonomy that would make such direct control over strategic decisions all but impossible to establish.[19] Thus, to implement this strategy, TI set up a wholly owned subsidiary in Japan.

A third disadvantage with joint ventures is that the shared ownership arrangement can lead to conflicts and battles for control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be. This was apparently not a problem with the Fuji Xerox joint venture. According to Yotaro Kobayashi, the former chair of Fuji Xerox, a primary reason is that both Xerox and Fuji Photo adopted an arm's-length relationship with Fuji Xerox, giving the venture's management considerable freedom to determine its own strategy.[20] However, much research indicates that conflicts of interest over strategy and goals often arise in joint ventures. These conflicts tend to be greater when the venture is between firms of different nationalities, and they often end in the dissolution of the venture.[21] Such conflicts tend to be triggered by shifts in the relative bargaining power of venture partners. For example, in the case of ventures between a foreign firm and a local firm, as a foreign partner's knowledge about local market conditions increases, it depends less on the expertise of a local partner. This increases the bargaining power of the foreign partner and ultimately leads to conflicts over control of the venture's strategy and goals.[22] Some firms have sought to limit such problems by entering into joint ventures in which one partner has a controlling interest.

wholly owned subsidiary
A subsidiary in which the firm owns 100 percent of the stock.

WHOLLY OWNED SUBSIDIARIES

In a **wholly owned subsidiary**, the firm owns 100 percent of the stock. Establishing a wholly owned subsidiary in a foreign market can be done two ways. The firm either can set up a new operation in that country, often referred to as a greenfield venture, or it can acquire an established firm in that host nation and use that firm to promote its products.[23] For example, ING's strategy for entering the U.S. insurance market was to acquire established U.S. enterprises, rather than try to build an operation from the ground floor. IKEA, as the largest furniture manufacturer in the world, always seems to build on their large-scale stores to drive their brand, concept, and "Swedish way" of doing business. (IKEA India is one exception to this Swedish influence! In India, the Swedish way was nicely combined with the Indian mindset to open IKEA India in 2018. See the opening case.)

Advantages

There are several clear advantages of wholly owned subsidiaries. First, when a firm's competitive advantage is based on technological competence, a wholly owned subsidiary will often be the preferred entry mode because it reduces the risk of losing control over that competence. (See Chapter 8 for more details.) Many high-tech firms prefer this entry mode for overseas expansion (e.g., firms in the semiconductor, electronics, and pharmaceutical industries). Second, a wholly owned subsidiary gives a firm tight control over operations in different countries. This is necessary for engaging in global strategic coordination (i.e., using profits from one country to support competitive attacks in another).

Third, a wholly owned subsidiary may be required if a firm is trying to realize location and experience curve economies (as firms pursuing global and transnational strategies try to do). As we saw in Chapter 11, when cost pressures are intense, it may pay a firm to configure its value chain in such a way that the value added at each stage is maximized. Thus, a national subsidiary may specialize in manufacturing only part of the product line or certain components of the end product, exchanging parts and products with other subsidiaries in the firm's global system. Establishing such a global production system requires a high degree of control over the operations of each affiliate. The various operations must be prepared to accept centrally determined decisions as to how they will produce, how much they will produce, and how their output will be priced for transfer to the next operation. Because licensees or joint-venture partners are unlikely to accept such a subservient role, establishing wholly owned subsidiaries may be necessary. Finally, establishing a wholly owned subsidiary gives the firm a 100 percent share in the profits generated in a foreign market.

Disadvantages

Establishing a wholly owned subsidiary is generally the most costly method of serving a foreign market from a capital investment standpoint. Firms doing this must bear the full capital costs and risks of setting up overseas operations. The risks associated with learning to do business in a new culture are less if the firm acquires an established host-country enterprise. However, acquisitions raise additional problems, including those associated with trying to marry divergent corporate cultures. These problems may more than offset any benefits derived by acquiring an established operation. Because the choice between greenfield ventures and acquisitions is such an important one, we discuss it in more detail later in the chapter.

test PREP

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LO 13-3

Identify the factors that influence a firm's choice of entry mode.

Selecting an Entry Mode

As the preceding discussion demonstrated, all the entry modes have advantages and disadvantages, as summarized in Table 13.1. Thus, trade-offs are inevitable when selecting an entry mode. For example, when considering entry into an unfamiliar country with a track record for discriminating against foreign-owned enterprises when awarding government contracts, a firm might favor a joint venture with a local enterprise. Its rationale might be that the local partner will help it establish operations in an unfamiliar environment and will help the company win government contracts. However, if the firm's core competence is based on proprietary technology, entering a joint venture might risk losing control of that technology to the joint-venture partner, in which case the strategy may seem unattractive. Despite the existence of such trade-offs, it is possible to make some generalizations about the optimal choice of entry mode.[24]

CORE COMPETENCIES AND ENTRY MODE

We saw in Chapter 12 that firms often expand internationally to earn greater returns from their core competencies, transferring the skills and products derived from their core competencies to foreign markets where indigenous competitors lack those skills. The optimal entry mode for these firms depends to some degree on the nature of their core competencies. A distinction can be drawn between firms whose core competency is in technological know-how and those whose core competency is in management know-how.

Technological Know-How

As was observed in Chapter 8, if a firm's competitive advantage (its core competence) is based on control over proprietary technological know-how, licensing and joint-venture arrangements should be avoided if possible to minimize the risk of losing control over that technology. Thus, if a high-tech firm sets up operations in a foreign country to profit from a core competency in technological know-how, it will probably do so through a wholly owned subsidiary. This rule should not be viewed as hard and fast, however. Sometimes a licensing or joint-venture arrangement can be structured to reduce the risk of licensees or joint-venture partners expropriating technological know-how. Another exception exists when a firm perceives its technological advantage to be only transitory, when it expects rapid imitation of its core technology by competitors. In such cases, the firm might want to license its technology as rapidly as possible to foreign firms to gain global acceptance for its technology before the imitation occurs.[25] Such a strategy has some advantages. By licensing its technology to competitors, the firm may deter them from developing their own, possibly superior, technology. Further, by licensing its technology, the firm may establish its technology as the dominant design in the industry. This may ensure a steady stream of royalty payments. However, the attractions of licensing are frequently outweighed by the risks of losing control over technology, and if this is a risk, licensing should be avoided.

13.1 TABLE

Advantages and Disadvantages of Entry Modes

Entry Mode	Advantages	Disadvantages
Exporting	Ability to realize location and experience curve economies Increased speed and flexibility of engaging target markets	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	Creation of efficient competitors Lack of long-term market presence
Licensing	Low development costs and risks Moderate involvement and commitment	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 Possible circumvention of import barriers, and strong sales potential	Lack of control over quality Inability to engage in global strategic coordination
Joint ventures	Access to local partner's knowledge Shared development costs and risks Politically acceptable Typically no ownership restrictions	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 Need for more human and nonhuman resources, and interaction and integration with local employees

Management Know-How

The competitive advantage of many service firms is based on management know-how (e.g., McDonald's, Starbucks). For such firms, the risk of losing control over the management skills to franchisees or joint-venture partners is not that great. These firms' valuable asset is their brand name, and brand names are generally well protected by international laws pertaining to trademarks. Given this, many of the issues arising in the case of technological know-how are of less concern here. As a result, many service firms favor a combination of franchising and master subsidiaries to control the franchises within particular countries or regions. The master subsidiaries may be wholly owned or joint ventures, but most service firms have found that joint ventures with local partners work best for the master controlling subsidiaries. A joint venture is often politically more acceptable and brings a degree of local knowledge to the subsidiary.

PRESSURES FOR COST REDUCTIONS AND ENTRY MODE The greater the pressures for cost reductions, the more likely a firm will want to pursue some combination of exporting and wholly owned subsidiaries. By manufacturing in those locations where factor conditions are optimal and then exporting to the rest of the world, a firm may be able to realize substantial location and experience curve economies. The firm might then want to export the finished product to marketing subsidiaries based in various countries. These subsidiaries will typically be wholly owned and have the responsibility for overseeing distribution in their particular countries. Setting up wholly owned marketing subsidiaries can be preferable to joint-venture arrangements and to using foreign marketing agents because it gives the firm tight control that might be required for coordinating a globally dispersed value chain. (The accompanying Management Focus on General Motors illustrates GM's joint venture to access the Chinese market.) It also gives the firm the ability to use the profits generated in one market to improve its competitive position in another market. In other words, firms pursuing global standardization or transnational strategies tend to prefer establishing wholly owned subsidiaries.

management FOCUS

General Motors on the Upswing

The late 2000s were not kind to General Motors Corporation (GM), but the company is on a much-needed upswing. The Chinese market, in particular, is becoming one of the most important foreign markets for GM. General Motors, of course, is a U.S.-based multinational corporation headquartered in Detroit, Michigan. GM was founded in 1908 in Flint, Michigan, and Mary Barra is the company's CEO. In 2019, GM had revenues of $149 billion and more than 180,000 employees, produced almost 10 million vehicles, and consisted of four core divisions (Buick, Chevrolet, Cadillac, and GMC).

Hurt by a deep recession in the United States and plunging vehicle sales, GM capped off the 2000s decade, where it had progressively lost market share to foreign rivals such as Toyota, by entering Chapter 11 bankruptcy. Between 1980, when it dominated the U.S. market, and 2009, when it entered bankruptcy protection, GM saw its U.S. market share slip from 44 to just 19 percent. The troubled company emerged from bankruptcy a few months later a smaller enterprise with fewer brands, and yet going forward, some believe that the new GM could be a much more profitable enterprise. One major reason for this optimism is the success of its joint ventures in China.

GM entered China in 1997 with a $1.6 billion investment to establish a joint venture with the state-owned Shanghai Automotive Industry Corporation (SAIC) to build Buick sedans. At the time, the Chinese market was tiny (fewer than 400,000 cars were sold in 1996), but GM was attracted by the enormous potential in a country of more than 1.4 billion people that was experiencing rapid economic growth. While the company initially recognized that it had much to learn about the Chinese market and would probably lose money for a few years in the early years, GM executives believed it was crucial to establish operations and to team up with SAIC (one of the early leaders in China's emerging automobile industry) before its global rivals did. The decision to enter a joint venture was not a hard one. Not only did GM lack knowledge and connections in China, but Chinese government regulations made it all but impossible for a foreign automaker to go it alone in the country.

While GM was not alone in investing in China—many of the world's major automobile companies entered into some kind of Chinese joint venture during this time period—it was among the largest investors. Only Volkswagen, whose management shared GM's view, made a similar-sized investment. Other companies adopted a more cautious approach, investing smaller amounts and setting more limited goals.

By 2007, GM had expanded the range of its partnership with SAIC to include vehicles sold under the names of Chevrolet, Cadillac, and Wuling. The two companies had also established the Pan-Asian Technical Automotive Center to design cars and components not just for China but also for other Asian markets. At this point, it was already clear that both the Chinese market and the joint venture were exceeding GM's initial expectations. Not only was the venture profitable, but it was also selling more than 900,000 cars and light trucks in 2007, an 18 percent increase over 2006, placing it second only to Volkswagen in the market among foreign nameplates. Equally impressive, some 8 million cars and light trucks were sold in China in 2007, making China the second-largest car market in the world, ahead of Japan and behind the United States. In 2015, GM sold about 3.16 million vehicles in China, up from some 2.4 million vehicles sold in 2010.

Much of the venture's success could be attributed to its strategy of designing vehicles explicitly for the Chinese market. For example, together with SAIC, GM produced a tiny minivan, the Wuling Sunshine. The van costs $3,700, has a 0.8-liter engine, hits a top speed of 60 mph, and weighs less than 1,000 kilograms—a far cry from the heavy SUVs GM is known for in the United States. For China, the vehicle was perfect, making it the best seller in the light truck sector.

It is the future, however, that has people excited. From a market of about 9 million passenger and commercial vehicles sold in China in 2008 to 25 million in 2019, the Chinese vehicle market is booming compared with those in the United States and Europe. China has now become GM's largest market in vehicles sold. GM also plans to expand its Chinese dealer network to more than 5,000, and it plans to have 17 assembly plants in China, more than the 12 it has in the United States. Driving this expansion are forecasts from GM that demand in China will reach 35 million vehicles a year by 2022, a huge increase from the 25 million vehicles sold in 2019. Underlying these forecasts are the still relatively low vehicle penetration rates in China. China has about 85 vehicles per 1,000 people compared to around 800 vehicles for every 1,000 people in the United States.

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LO 13-4

Recognize the pros and cons of acquisitions versus greenfield ventures as an entry strategy.

Greenfield Venture or Acquisition?

A firm can establish a wholly owned subsidiary in a country by building a subsidiary from the ground up, the so-called greenfield strategy, or by acquiring an enterprise in the target market.[26] The volume of cross-border acquisitions has been growing at a rapid rate for two decades. Over most of the past decades, between 40 and 80 percent of all foreign direct investment (FDI) inflows have been in the form of mergers and acquisitions.[27]

PROS AND CONS OF ACQUISITIONS Acquisitions have three major points in their favor. First, they are quick to execute. By acquiring an established enterprise, a firm can rapidly build its presence in the target foreign market. When the German automobile company Daimler-Benz decided it needed a bigger presence in the U.S. automobile market, it did not increase that presence by building new factories to serve the United States, a process that would have taken years. Instead, it acquired the third-largest U.S. automobile company, Chrysler, and merged the two operations to form DaimlerChrysler (Daimler spun off Chrysler into a private equity firm in 2007). When the Spanish telecommunications service provider Telefónica wanted to build a service presence in Latin America, it did so through a series of acquisitions, purchasing telecommunications companies in Brazil and Argentina. In these cases, the firms made acquisitions because they knew that was the quickest way to establish a sizable presence in the target market.

Second, in many cases, firms make acquisitions to preempt their competitors. The need for preemption is particularly great in markets that are rapidly globalizing, such as telecommunications, where a combination of deregulation within nations and liberalization of regulations governing cross-border foreign direct investment has made it much easier for enterprises to enter foreign markets through acquisitions. Such markets may see concentrated waves of acquisitions as firms race each other to attain global scale. In the telecommunications industry, for example, regulatory changes triggered what can be called a feeding frenzy, with firms entering each other's markets via acquisitions to establish a global presence. These included the $56 billion acquisition of AirTouch Communications in the United States by the British company Vodafone, which was the largest acquisition ever; the $13 billion acquisition of One 2 One in Britain by the German company Deutsche Telekom; and the $6.4 billion acquisition of Excel Communications in the United States by Teleglobe of Canada.[28] A similar wave of cross-border acquisitions occurred in the global automobile industry, with Daimler acquiring Chrysler, Ford acquiring Volvo (and then selling Volvo as well), and Renault acquiring Nissan.

Third, managers may believe acquisitions to be less risky than greenfield ventures. When a firm makes an acquisition, it buys a set of assets that are producing a known revenue and profit stream. In contrast, the revenue and profit stream that a greenfield venture might generate is uncertain because it does not yet exist. When a firm makes an acquisition in a foreign market, it not only acquires a set of tangible assets, such as factories, logistics systems, and customer service systems, but it also acquires valuable intangible assets, including a local brand name and managers' knowledge of the business environment in that nation. Such knowledge can reduce the risk of mistakes caused by ignorance of the national culture.

Despite the arguments for engaging in acquisitions, many acquisitions often produce disappointing results.[29] For example, a study by Mercer Management Consulting looked at 150 acquisitions worth more than $500 million each.[30] The Mercer study concluded that 50 percent of these acquisitions eroded shareholder value, while another 33 percent created only marginal returns. Only 17 percent were judged to be successful. Similarly, a study by KPMG, an accounting and management consulting company, looked at 700 large acquisitions. The study found that while some 30 percent of these actually created value for the acquiring company, 31 percent destroyed value, and the remainder had little impact.[31] A similar study by McKinsey & Company estimated that some 70 percent of mergers and acquisitions failed to achieve expected revenue synergies.[32] In a seminal study of the postacquisition performance of acquired companies, David Ravenscraft and Mike Scherer concluded that on average, the profits and market shares of acquired companies declined following acquisition.[33] They also noted that a smaller but substantial subset of those companies experienced traumatic difficulties, which ultimately led to their being sold by the acquiring company. Ravenscraft and Scherer's evidence suggests that many acquisitions destroy rather than create value. While most research has looked at domestic acquisitions, the findings probably also apply to cross-border acquisitions.[34]

Why Do Acquisitions Fail? Acquisitions fail for several reasons. First, the acquiring firms often overpay for the assets of the acquired firm. The price of the target firm can get bid up if more than one firm is interested in its purchase, as is often the case. In addition, the management of the acquiring firm is often too optimistic about the value that can be created via an acquisition and is thus willing to pay a significant premium over a target firm's market capitalization. This is called the "hubris hypothesis" of why acquisitions fail. The hubris hypothesis postulates that top managers typically overestimate their ability to create value from an acquisition, primarily because rising to the top of a corporation has given them an exaggerated sense of their own capabilities.[35] For example, Daimler acquired Chrysler in 1998 for $40 billion, a premium of 40 percent over the market value of Chrysler before the takeover bid. Daimler paid this much because it thought it could use Chrysler to help it grow market share in the United States. At the time, Daimler's management issued bold announcements about the "synergies" that would be created from combining the operations of the two companies. However, within a year of the acquisition, Daimler's German management was faced with a crisis at Chrysler, which was suddenly losing money due to weak sales in the United States. In retrospect, Daimler's management had been far too optimistic about the potential for future demand in the U.S. auto market and about the opportunities for creating value from "synergies." Daimler acquired Chrysler at the end of a multiyear boom in U.S. auto sales and paid a large premium over Chrysler's market value just before demand slumped (and in 2007, in an admission of failure, Daimler sold its Chrysler unit to a private equity firm, now owned by Fiat Chrysler Automobiles).[36]

Second, many acquisitions fail because there is a clash between the cultures of the acquiring and acquired firms. After an acquisition, many acquired companies experience high management turnover, possibly because their employees do not like the acquiring company's way of doing things.[37] This happened at DaimlerChrysler; many senior managers left Chrysler in the first year after the merger. Apparently, Chrysler executives disliked the dominance in decision making by Daimler's German managers, while the Germans resented that Chrysler's American managers were paid two to three times as much as their German counterparts. These cultural differences created tensions, which ultimately exhibited themselves in high management turnover at Chrysler.[38] The loss of management talent and expertise can materially harm the performance of the acquired unit.[39] This may be particularly problematic in an international business, where management of the acquired unit may have valuable local knowledge that can be difficult to replace.

Third, many acquisitions fail because attempts to realize gains by integrating the operations of the acquired and acquiring entities often run into roadblocks and take much longer than forecast. Differences in management philosophy and company culture can slow the integration of operations. Differences in national culture may exacerbate these problems. Bureaucratic haggling between managers also complicates the process. Again, this reportedly occurred at DaimlerChrysler, where grand plans to integrate the operations of the two companies were bogged down by endless committee meetings and by simple logistical considerations such as the six-hour time difference between Detroit and Germany. By the time an integration plan had been worked out, Chrysler was losing money, and Daimler's German managers suddenly had a crisis on their hands.

Finally, many acquisitions fail due to inadequate preacquisition screening.[40] Many firms decide to acquire other firms without thoroughly analyzing the potential benefits and costs. They often move with undue haste to execute the acquisition, perhaps because they fear another competitor may preempt them. After the acquisition, however, many acquiring firms discover that instead of buying a well-run business, they have purchased a troubled organization. This may be a particular problem in cross-border acquisitions because the acquiring firm may not fully understand the target firm's national culture and business system.

Reducing the Risks of Failure These problems can all be overcome if the firm is careful about its acquisition strategy.[41] Screening of the foreign enterprise to be acquired, including a detailed auditing of operations, financial position, and management culture, can help to make sure the firm (1) does not pay too much for the acquired unit, (2) does not uncover any nasty surprises after the acquisition, and (3) acquires a firm whose organization culture is not antagonistic to that of the acquiring enterprise. It is also important for the acquirer to allay any concerns that management in the acquired enterprise might have. The objective should be to reduce unwanted management attrition after the acquisition. Finally, managers must move rapidly after an acquisition to put an integration plan in place and to act on that plan. Some people in both the acquiring and acquired units will try to slow or stop any integration efforts, particularly when losses of employment or management power are involved, and managers should have a plan for dealing with such impediments before they arise.

PROS AND CONS OF GREENFIELD VENTURES The big advantage of establishing a greenfield venture in a foreign country is that it gives the firm a much greater ability to build the kind of subsidiary company that it wants. For example, it is much easier to build an organization culture from scratch than it is to change the culture of an acquired unit. Similarly, it is much easier to establish a set of operating routines in a new subsidiary than it is to convert the operating routines of an acquired unit. This is a very important advantage for many international businesses, where transferring products, competencies, skills, and know-how from the established operations of the firm to the new subsidiary are principal ways of creating value. For example, when Lincoln Electric, the U.S. manufacturer of arc welding equipment, first ventured overseas in the mid-1980s, it did so by acquisitions, purchasing arc welding equipment companies in Europe. However, Lincoln's competitive advantage in the United States was based on a strong organizational culture and a unique set of incentives that encouraged its employees to do everything possible to increase productivity. Lincoln found through bitter experience that it was almost impossible to transfer its organizational culture and incentives to acquired firms, which had their own distinct organizational cultures and incentives. As a result, the firm switched its entry strategy in the mid-1990s and began to enter foreign countries by establishing greenfield ventures, building operations from the ground up. While this strategy takes more time to execute, Lincoln has found that it yields greater long-run returns than the acquisition strategy.

Set against this significant advantage are the disadvantages of establishing a greenfield venture. Greenfield ventures are slower to establish. They are also risky. As with any new venture, a degree of uncertainty is associated with future revenue and profit prospects. However, if the firm has already been successful in other foreign markets and understands what it takes to do business in other countries, these risks may not be that great. For example, having already gained great knowledge about operating internationally, the risk to McDonald's of entering yet another country is probably not that great. Also, greenfield ventures are less risky than acquisitions in the sense that there is less potential for unpleasant surprises. A final disadvantage is the possibility of being preempted by more aggressive global competitors who enter via acquisitions and build a big market presence that limits the market potential for the greenfield venture.

WHICH CHOICE? The choice between acquisitions and greenfield ventures is not an easy one. Both modes have their advantages and disadvantages. In general, the choice will depend on the circumstances confronting the firm. If the firm is seeking to enter a market where there are already well-established incumbent enterprises and where global competitors are also interested in establishing a presence, it may pay the

How Risky Would Indonesia Be for a New Greenfield Investment?

Business is all about risk, the right risks. Choosing which risks to accept and which to avoid is at the heart of international business. These risks increase and become more interesting with entry into foreign markets. David Conklin discusses the idea of managing risk through planned uncertainty. By "planned uncertainty," he means an awareness of contingencies, with possible what-if scenarios developed in advance. The key idea here is that through an ongoing monitoring of the various risk areas, decision makers can have much of the data they may need to address a number of possible outcomes. Of course, we have to know what uncertainty to plan for, and we don't know what we don't know. Planning for everything is impossible, but what Conklin suggests is that planned uncertainty is a way of thinking. Given that we don't know the future, this way of thinking may be helpful in career development and other parts of our lives. Who ever said business wasn't like surfing? So, as just one country example, how big do you think the risk is by entering Indonesia with a new greenfield investment?

firm to enter via an acquisition. In such circumstances, a greenfield venture may be too slow to establish a sizable presence. However, if the firm is going to make an acquisition, its management should be cognizant of the risks associated with acquisitions that were discussed earlier and consider these when determining which firms to purchase. It may be better to enter by the slower route of a greenfield venture than to make a bad acquisition.

If the firm is considering entering a country where there are no incumbent competitors to be acquired, then a greenfield venture may be the only mode. Even when incumbents exist, if the competitive advantage of the firm is based on the transfer of organizationally embedded competencies, skills, routines, and culture, it may still be preferable to enter via a greenfield venture. Things such as skills and organizational culture, which are based on significant knowledge that is difficult to articulate and codify, are much easier to embed in a new venture than they are in an acquired entity, where the firm may have to overcome the established routines and culture of the acquired firm. Thus, as our earlier examples suggest, firms such as McDonald's and Lincoln Electric prefer to enter foreign markets by establishing greenfield ventures.

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Key Terms

timing of entry, p. 360
first-mover advantages, p. 360
first-mover disadvantages, p. 360
pioneering costs, p. 360
exporting, p. 364
turnkey project, p. 365
licensing agreement, p. 366
franchising, p. 367
joint venture, p. 368
wholly owned subsidiary, p. 369

Summary

This chapter reviewed basic entry decisions and entry modes (exporting, turnkey projects, licensing, franchising, joint ventures, and wholly owned subsidiaries), and how to go about selecting an entry mode. We reviewed entering foreign markets in developed countries (e.g., United Kingdom, Sweden, United States, and similar countries) and emerging markets (e.g., Argentina, Brazil, China, India, Indonesia, Mexico, Poland, South Africa, South Korea, Turkey). We touched on market entry into less developed nations as well. The chapter made the following points:

1. Basic entry decisions include identifying which markets to enter, when to enter those markets, and on what scale.
2. The most attractive foreign markets tend to be found in politically stable developed and developing nations that have free market systems and where there is no dramatic upsurge in either inflation rates or private-sector debt.
3. There are several advantages associated with entering a national market early, before other international businesses have established themselves. These advantages must be balanced against the pioneering costs that early entrants often have to bear, including the greater risk of business failure.
4. Large-scale entry into a national market constitutes a major strategic commitment that is likely to change the nature of competition in that market and limit the entrant's future strategic flexibility. Although making major strategic commitments can yield many benefits, there are also risks associated with such a strategy.
5. There are six modes of entering a foreign market: exporting, creating turnkey projects, licensing, franchising, establishing joint ventures, and setting up a wholly owned subsidiary.
6. Exporting has the advantages of facilitating the realization of experience curve economies and of avoiding the costs of setting up manufacturing operations in another country. Disadvantages include high transport costs, trade barriers, and problems with local marketing agents.
7. Turnkey projects allow firms to export their process know-how to countries where foreign direct investment (FDI) might be prohibited, thereby enabling the firm to earn a greater return from this asset. The disadvantage is that the firm may inadvertently create efficient global competitors in the process.
8. The main advantage of licensing is that the licensee bears the costs and risks of opening a foreign market. Disadvantages include the risk of losing technological know-how to the licensee and a lack of tight control over licensees.
9. The main advantage of franchising is that the franchisee bears the costs and risks of opening a foreign market. Disadvantages center on problems of quality control of distant franchisees.
10. Joint ventures have the advantages of sharing the costs and risks of opening a foreign market and of gaining local knowledge and political influence. Disadvantages include the risk of losing control over technology and a lack of tight control.
11. The advantages of wholly owned subsidiaries include tight control over technological know-how. The main disadvantage is that the firm must bear all the costs and risks of opening a foreign market.
12. The optimal choice of entry mode depends on the firm's strategy. When technological know-how constitutes a firm's core competence, wholly owned subsidiaries are preferred, since they best control technology. When management know-how constitutes a firm's core competence, foreign franchises controlled by joint ventures seem to be optimal. When the firm is pursuing a global standardization or transnational strategy, the need for tight control over operations to realize location and experience curve economies suggests wholly owned subsidiaries are the best entry mode.
13. When establishing a wholly owned subsidiary in a country, a firm must decide whether to do so by a greenfield venture strategy or by acquiring an established enterprise in the target market.
14. Acquisitions are quick to execute, may enable a firm to preempt its global competitors, and involve buying a known revenue and profit stream. Acquisitions may fail when the acquiring firm overpays for the target, when the cultures of the acquiring and acquired firms clash, when there is a high level of management attrition after the acquisition, and when there is a failure to integrate the operations of the acquiring and acquired firm.
15. The advantage of a greenfield venture in a foreign country is that it gives the firm a much greater ability to build the kind of subsidiary company that it wants. For example, it is much easier to build an organization culture from scratch than it is to change the culture of an acquired unit.

Critical Thinking and Discussion Questions

1. Review the Management Focus "Tesco's International Growth Strategy," and then answer the following questions:
   a. Why did Tesco's initial international expansion strategy focus on developing nations?
   b. How does Tesco create value in its international operations?
   c. In Asia, Tesco has a history of entering into joint-venture agreements with local partners. What are the benefits of doing this for Tesco? What are the risks? How are those risks mitigated?
   d. When Tesco decided to enter the United States, this represented a departure from its historic strategy of focusing on developing nations. Why do you think Tesco made this decision? How is the U.S. market different from other markets that Tesco has entered?
2. Licensing proprietary technology to foreign competitors is the best way to give up a firm's competitive advantage. Discuss.
3. Discuss how the need for control over foreign operations varies with firms' strategies and core competencies. What are the implications for the choice of entry mode?
4. A small Canadian firm that has developed valuable new medical products using its unique biotechnology know-how is trying to decide how best to serve the European Union market. Its choices are given below. The cost of investment in manufacturing facilities will be a major one for the Canadian firm, but it is not outside its reach. If these are the firm's only options, which one would you advise it to choose? Why?
   a. Manufacture the products at home, and let foreign sales agents handle marketing.
   b. Manufacture the products at home, and set up a wholly owned subsidiary in Europe to handle marketing.
   c. Enter into an alliance with a large European pharmaceutical firm. The products would be manufactured in Europe by the 50–50 joint venture and marketed by the European firm.

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Use the globalEDGE™ website (globaledge.msu.edu) to complete the following exercises:

1. *Entrepreneur* magazine annually publishes a ranking of the *top global franchises*. Provide a list of the top 25 companies that pursue franchising as their preferred mode of international expansion. Study one of these companies in detail, and describe its business model, its international expansion pattern, desirable qualifications in possible franchisees, and the support and training the company typically provides.
2. The U.S. Commercial Service prepares reports known as the *Country Commercial Guide* for countries of interest to U.S. investors. Utilize the *Country Commercial Guide* for Russia to gather information on this country's energy and mining industry. Considering that your company has plans to enter Russia in the foreseeable future, select the most appropriate entry method. Be sure to support your decision with the information collected.

Cutco Corporation—Sharpening Your Market Entry

closing case

The name Cutco comes from "Cooking UTensils COmpany," a name once owned by Alcoa. Alcoa is a U.S. company now concentrating on work with lightweight metals and advanced manufacturing techniques. Together with W. R. Case & Sons Cutlery Company, Alcoa created the joint venture Alcas Corporation in 1949, which subsequently became Cutco Corporation in 2009.

Cutco Corporation includes the wholly owned subsidiaries Vector Marketing Corporation, which it acquired in 1985, and Cutco Cutlery Corporation. Vector Marketing is the U.S.-based sales arm of Cutco Corporation, which is headquartered in Olean, New York. More than 700 manufacturing and administrative employees work at the Olean location.

Cutco is now the largest manufacturer of high-quality kitchen cutlery in the United States and Canada. The product line includes kitchen knives and utensils, shears, flatware, cookware, and sporting knives. Look around your house and your friends' houses, and you are likely to see one of their well-known blocks of knives in the kitchen! The price for one of the blocks with a dozen or so knives ranges from about $100 to upwards of a couple of thousand dollars. Some 16 million people have bought Cutco knives.

Originally, Cutco was created as a product for Wear-Ever Aluminum (a company focused on cookware), which at the time was a division of Alcoa. Cutco evolved from there, eventually adding its signature Wedge-Lock handle and Double-D recessed edge on some of its knives. Two things that have never changed are Cutco's commitment to fine craftsmanship and the Forever Guarantee. The guarantee means what it implies—that Cutco stands behind its knives' performance and sharpness forever. They also have a forever guarantee of replacing their knives for any misuse or abuse at half the cost.

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Cutco, as it operates today, was formed in 1982 following a management buyout that took the company private. As with any employee or manager buyout, it was a leap of faith for the team that bought the company. But based on the company's story, it was also the moment that secured Cutco's future for generations to come. In this process, in 1985, Vector Marketing Corporation became the exclusive marketer of Cutco products directly to consumers via sales representatives located throughout the United States and Canada. Cutco International Inc. is responsible for international marketing.

Annual sales for Cutco now stand at about $200 million worldwide, but mainly in the United States and Canada. The product line includes more than 100 choices under the Cutco name alone. The extended line includes kitchen utensils, gadgets and flatware, sporting and pocket knives, and garden tools. For the Cutco line, the products are marketed via what is called "direct selling" (marketing of products directly to the consumer away from a fixed retail location). Internationally, outside North America, Cutco has independent office arrangements in Australia, Costa Rica, Germany, South Korea, and the United Kingdom. Puerto Rico also has independently run sales locations.

In the United States and Canada, Vector Marketing Corporation typically employs college students in the 18-to-24 age range part-time during the school year and full-time during the summers to be part of their direct sales force. The sales pitch to students is good pay, flexible schedules, personal growth, no experience needed, great training, and engagement with quality products. In fact, 85 percent of the sales force at Cutco is college-aged individuals.

This sales force is a drastic change from the early days of the company. Early on, Cutco had hundreds of small independent sellers of the company's knives and other products. Vector Marketing became one of these sellers in 1981 and stayed in this role until 1984. In 1985, Cutco bought out Vector Marketing, and Vector became the sole channel for sales across the United States. As a core member of the Direct Selling Association, Vector Marketing Corporation drives Cutco sales using college-aged students whom they pay $12 to $20 per hour in a direct-to-customer business model. But internationally, Cutco products are still sold via a myriad of independent sellers in Australia, Costa Rica, Germany, South Korea, and the United Kingdom.

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CASE DISCUSSION QUESTIONS

1. The Cutco brand is affiliated with Cutco Corporation, Vector Marketing Corporation, and Cutco Cutlery Corporation. It seems overly cumbersome for customers to understand that Vector Marketing Corporation is selling Cutco knives! Meanwhile, Cutco is now the largest manufacturer of high-quality kitchen cutlery in the United States and Canada. How would you structure Cutco's branding if you entered a new international market?
2. Two things that have never changed at Cutco are their commitment to fine craftsmanship and the Forever Guarantee. The guarantee means what it implies—that Cutco stands behind its knives' performance and sharpness forever. They also have a forever guarantee of replacing their knives for any misuse or abuse at half the cost. Is this a viable international strategy when considering entry into the vastly diverse markets that exist globally?
3. Vector Marketing Corporation is the exclusive marketer of Cutco products directly to consumers via sales representatives located throughout the United States and Canada. Cutco International Inc. is responsible for international marketing. Can the direct sales model work as a market entry strategy internationally? Where can it work and where does it potentially not work?
4. Cutco's product line includes more than 100 choices under the Cutco name alone. The extended line includes kitchen utensils, gadgets and flatware, sporting and pocket knives, and garden tools. Is it realistic to think that Cutco can enter global markets with all of its products for each market every time they consider a new market entry?

Endnotes

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