A Theoretical Approach to the Methods Introduction to International Markets

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Abstract

The process of decision making for the optimum mode of entry for a firm to enter into international markets is a complex issue in international business because of the many factors involved. This paper studies the entry modes when multinational firms use to enter into a foreign market as a nature of internationalization. In this paper, entry modes will be examined under three main groups; Export modes, Contractual modes and Investment modes. A firm may choose an entry mode under these three main groups to enter into foreign markets. This paper presents brief definition for each modes, and Explain, the attractiveness of each mode to the firms.

Keywords: Internalization, Market entry modes, Export, Wholly owned subsidiaries, Joint venture, Contractual modes

1. Introduction

In a world where there is intensive competition, Adopting an activity based on the only domestic market is not right strategy for a firm to survive. Therefore, A firm needs to go abroad and look for the opportunities. Otherwise, the firm may face with the loosing of own domestic market to local or multinational rivals at the end. For this kind of reasons, Firms may go abroad by choosing strategic entry modes.

The choice of entry mode is an important part of a firm's foreign investment strategy. Firms are not only concerned about what foreign markets to enter, and what activities to perform in those markets, but how to enter: whether by greenfield investment, by acquisition, or by joint venture. Choosing one or another entry mode can have enormous strategic consequences for the firm (Chang, Rosenzweig, 2001: 747).

Firms contemplating expansion into international markets have several entry options. These generally include exports, licensing/franchising, joint ventures (JVs) and wholly owned subsidiaries (WOS) such as greenfield investments and acquisitions. Each of these modes entails different levels of resource requirements, organizational control, expected future returns and risk exposure (Ahsan and Musteen, 2011: 377)

In this study, Entry modes will be discussed under three main groups. These are; Export type modes, Contract type modes and Investment type modes. This study presents brief definition for each modes, and Explain, the attractiveness of them to the firms.

2. Internationalization

Johanson &Vahlne (1977) defined Internationalization as a process in which the firms gradually increase their international involvement. They claimed that internationalization is the product of a series of incremental decisions (Wu and Zhao, 2007:184).

Tracking the development of the large global corporations today reveals a recurring, sequential pattern of expansion. The first step of Internationalization process is to understand the international marketing environment, particularly the international trade system. Second, the company must consider what proportion of foreign to total sales to seek, whether to do business in a few or many countries and what types of countries to enter.

And the third step is to decide on which particular markets to enter and this calls for evaluating the probable rate of return on investment against the level of risk (market differences). Then, the company has to decide how to enter each attractive market (Akkaya, 2002: 7). The Stage of deciding how to enter into target market (Entry mode) is a frontier issue which is one of the most critical decisions in international marketing. It has a large and lasting impact on the success of a firm's international operations (Sarkar and Cavusgil, 1996: 826).

Many companies start as indirect or direct export exporters and then move to licensing, joint-ventures and finally direct investment; this company evolution has been called the internationalization proces (Akkaya, 2002: 7).

3. The Entry Modes

(Root, 1994) Described the international market entry mode as “an institutional arrangement that makes possible the entry of a company’s products, technology, human skills, management, or other resources into a foreign country”. This process can combine different risks that must be evaluated in advance when making the decision (Polesello, Amal, Hoeltgebaum, 2013:182)

According to the business history reports, for every successful market entry, about four entries fail. Inexperienced start-ups suffer from some of these disappointments, but so do many sophisticated corporations. (Barber, Peinado and Madhok, 2010: 736) Therefore, the choice of entry mode plays an important role for a firm in determining its success or failure and effects all the future decision and operations of the firm in the new marketplace (Reger, Duhaime, and Stimpert 1992, p. 190).

Expanding into a new foreign market, it is important for foreign firms to learn and accumulate knowledge about the host market to overcome the liability of foreignness. Foreign firms are usually unfamiliar with the host market conditions, and customized products require a considerable amount of local market knowledge. To successfully introduce products or services in a new market, firms need to develop local market knowledge so that they can meet the requirements and preferences of local customers (Murray, Ju, and Gao, 2012: 53).

A firm cannot afford poor decisions in assigning their limited resources to diminishing markets while avoiding the attractive ones, or using the wrong entry mode for the selected market. The decision on which market to enter and how to enter the selected market is of critical importance for the company’s profit making and sustainable growth (Chen, and Messner, 2011: 2). Firms contemplating expansion into international markets have several entry options. These generally include exports, licensing/franchising, joint ventures (JVs) and wholly owned subsidiaries (WOS) such as greenfield investments and acquisitions. Each of these modes entails different levels of resource requirements, organizational control, expected future returns and risk exposure (Ahsan and Musteen, 2011: 377)

The firms normally start by exporting which is followed by licensing the manufacture of the product or the sale. Next comes franchise operation where the local businessman franchisee can use the brand name of the firm get managerial support. On being successful, the firm can start a joint venture manufacturing unit and finally, the firm can have their own organization to manufacture and market products in that and in other countries as well (Mathur, 2008: 512).

3.1. Exporting

In a simple way, Exporting is the process of sending or carrying of the goods abroad, especially for trade and sales (Baker, 2013: 611). With Export entry modes, a firm's products are manufactured in the domestic market or a third country, and then transferred to the host market (Driscoll and Paliwoda, 1997: 61) via two broad options: indirect, and direct exporting (Kotabe and Helsen, 2010: 299).

Export is the most common mode for initial entry into international markets (Hollensen, 1997: 310). And It is a conservative way to test the international waters (Thompson, Strickland and Gamle, 2010: 215). For many small businesses, exporting is very often the sole alternative for selling their goods in foreign markets (Kotabe and Helsen, 2010: 299). Sometimes an unsolicited order is received from a buyer in a foreign country, or a domestic customer expands internationally and places an order for its international operations. This prompts the firm to consider international markets and to investigate their growth potential (Hollensen,1997: 310).

A firm can limit its involvement in foreign markets by contracting with foreign wholesalers experienced in importing to handle entire distribution and marketing function in their countries or regions of the world.

If it is more advantageous to maintain control over these functions, however, a firm can establish its own distribution and sales organizations in some or all of the target foreign markets (Thompson, Strickland and Gamle, 2010: 215).

3.1.1. Indirect Exporting

The market-entry technique that offers the lowest level of risk and the least market control is indirect export, in which products are carried abroad by others (Lambin, 2007: 2) The firm is not engaging in international marketing and no special activity is carried on within the firm; the sale is handled like domestic sales. includes dealing through export management companies of foreign agents, merchants or distributors. Several types of intermediaries located in the domestic market are ready to assist a manufacturer in contacting international markets or buyers. The major advantage for managers using a domestic intermediary lies in that individual`s knowledge of foreign market conditions. Particularly, for companies with little or no experience in exporting, the use of a domestic intermediary provides the exporter with readily available expertise (Akkaya, 2002: 22). There are five main entry modes of indirect exporting: (Hollensen,1997: 314);

1. Export buying agent;
2. Broker;
3. Export management company/Export house;
4. Trading company;
5. Piggyback

3.1.2. Direct Exporting

In direct exporting, the firm becomes directly involved in marketing its products in foreign markets (Lambin, 2007: 3). Although initial outlays and the associated risks are greater, the profits are likely to be greater, too. Direct exporting signals a commitment of the company and its management to fully engage in international trade (U.S. Small Business Administration, 2008: 61). Direct exporting includes setting up an export department within the firm or having the firm`s sales force sell directly to foreign customers or marketing intermediaries. Under direct exporting, an exporter must deal with a large number of foreign contacts, possibly one or more for each country the company plans to enter. Although a direct exporting operation requires a larger degree of expertise, this method of market entry does provide the company with a greater degree of control over its distribution channels than would indirect exporting (Akkaya, 2002: 23).

3.2. Contractual Entry Modes

3.2.1. Licensing

Licensing is a contractual transaction where the firm **the licensor** offers some proprietary assets to foreign company **the licensee** in exchange for royalty fees (Kotabe and Helsen, 2010: 301). Licensing offers more control than exporting in that it grants a foreign entity the right to produce and sell the firm’s product in return for a royalty fee on every unit that the foreign entity sells (Sooreea, Sharma and Luong, 2012: 40) Licensing is considered a low involvement and low-control entry mode since it does not necessarily entail equity participation, and because "control over operations and strategy is granted to the licensee in exchange for a lump-sum payment, a per-unit royalty fee, and a commitment to abide by any terms set out in the licensing contract" (Aulakh, Cavusgil and Sarkar, 1998: 410).

In terms of licensing rights, a licensor may grant exclusive or non-exclusive rights to a particular licensee. An exclusive license gives the licensee the right to use the intellectual property to the exclusion of others, including the licensor. This right of exclusive use could be restricted to a particular geographical area and/or field of use. In non-exclusive licensing, a licensor keeps the right to issue additional licenses in the same geographical area, as well having the option to operate in the territory itself (Aulakh, Jiang and Pan, 2010: 589).

The licensor may give the licensee the right to use one or more of the following things: (Hollensen,1997: 332);

- A patent covering a product or process;
- Manufacturing know-how not subject to a patent;
- Technical advice and assistance, occasionally including the supply of components,
- Materials or plant essential to the manufacturing process;
- Marketing advice and assistance;
- The use of a trade mark/trade name.

3.2.2. Franchising

A franchise agreement is a contractual arrangement between two independent firms, whereby the franchisee pays the franchisor for the right to sell the franchisor's product and/or the right to use the franchisor's trademark at a given place and for a certain period of time (Lafontaine, 1993: 258) Under the franchising mode, the franchiser typically leases its brand name, and provides marketing support, technical advice and training, to the franchisee (Erramilli, Agarwal, and Dev, 2002: 224).

Franchisors typically offer managerial assistance for example, site selection, training programs, standard operating procedures, design of physical layout, and advertising to the franchisee, and the franchisee agrees to run the business according to the franchisor's stipulations. The franchisor typically exercises substantial control over the franchisee (Norton, 1988: 199)

To snap up opportunities in foreign markets, the method of choice is often master franchising. With this system, the franchisor gives a master franchise to a local entrepreneur, who will, in turn, sell local franchises within his territory. The territory could be a certain region within a country or a group of countries (e.g., Greater China). Usually, the master franchise holder agrees to establish a certain number of outlets over a given time horizon (Kotabe and Helsen, 2010: 304).

3.2.3. Contract Manufacturing

In contract manufacturing, the firm’s product is produced in the foreign market by local producer under contract with the firm (Lambin, 2007: 4) The manufacturer’s responsibility is restricted to production. Afterward, products are turned over to the international company which usually assumes the marketing responsibilities for sales, promotion and distribution (Akkaya, 2002: 29).

The use of contract manufacturing is important and growing in a range of industries, including electronics, pharmaceuticals, automotive, and food and beverage production. For example, In the electronics industry, contract manufacturing grew at a compounded average growth rate of roughly 25% from 1989 to 1998. Contract manufacturing's share of total electronics production grew from 9% in 1994 to 17% in 1998 (Plambeck, Taylor, 2005: 133).

Contract manufacturing offers substantial flexibility. Depending on the duration of the contract, if the firm is dissatisfied with product quality or reliability of delivery it can shift to another manufacturer. In addition, if management decides to exit the market it does not have to sustain possible losses from divesting production facilities. On the other hand, it is necessary to control product quality to meet company standards (Hollensen,1997: 330).

Cost savings is the prime motivation behind contract manufacturing. Significant cost savings can be achieved for labor-intensive production processes by sourcing the product in a low-wage country (Kotabe and Helsen, 2010: 305). Typically, contract manufacturing is chosen for countries with a low-volume market potential combined with high tariff protection. In such situations, local production appears advantageous to avoid the high tariffs, but the local market does not support the volume necessary to justify the building of a single plant (Akkaya, 2002: 30).

3.2.4. Management Contracting

Management contracting is where one firm (contractor) supplies management know-how to another company that provides the capital and takes care of the operating value chain functions in the foreign country (Hollensen,1997: 341). Management contracts are concentrated in particular industries, with hotels and transportation being especially important; other industries in which contracts are significant include agriculture, public utilities and mining and mineral. Research by Brooke (1985b) has indicated that the major uses of management contracts include the following (Young, 1987: 38);

- Support for other contractual arrangements here the management contract is entered into as part of a deal which involves licensing, franchising, turnkey or other arrangements.
- The supplier type; in this case, the motive for a management contract is to support an existing market following moves towards protectionism. Licensing, direct investment or management contracts may then be employed, with, for many companies, the contract as a last resort.

- The purchaser type; the contracted company wishes to guarantee its sources of raw materials or components and the management contract with a mining or petroleum extraction company maybe a means of ensuring this.
- The part-owner approach; in this instance a management contract is linked to a minority equity stake (the latter perhaps following indigenization measures in a host country). The minority contract can be a means of ensuring that controls systems, marketing knowledge and other expertise are used by the affiliate.
- The consultancy type; the contracted company is in the business of providing management services in its own right. Such arrangements may go under the term ‘technical assistance agreements’.
- The business extension type; this refers to the use of management contracts to enter otherwise closed markets.
- The consortium approach; in large scale projects, one partner company maybe under contract for the management, which is likely to include funding, control, staffing, purchasing, marketing and general consultancy services

Hilton management services (HMS) can be a good example for Management contracting. It is one of the largest Hotel management companies in the industry with over 635 managed properties globally of which over 315 in the Americas with total America’s team members exceeding 69,000. HMS managed properties globally include that Hilton Hotels & Resorts, Embassy Suites, Double Tree by Hilton, Waldorf Astoria Hotels & Resorts, Conrad Hotels & Resorts, Hilton Garden Inn, Homewood Suites by Hilton, Home2 Suites and Hampton (http://www.hiltonmanagementservices.com/en/home.html).

3.3. Direct Investments

3.3.1. Joint Venture

With continued globalization of the world's economy, Joint ventures (JVs) have become an important element of many firms' international strategy (Geringer, Hebert, 1989: 235). Joint ventures are business agreements where by two or more owners create a separate entity. The joint venture can be a partnership or a closely held corporation, or can issue corporate securities in its own right (Harrigan, 1988: 142). An alternative to wholly-owned subsidiaries, JVs are commonly used by firms as a mean of competing within multidomestic or global competitive arena (Geringer, Hebert, 1989: 235).

In many industries, however, joint ventures not only share risks, but also decrease the total investment. Because the parties bring different capabilities, the venture no longer requires the full development costs. Due to its benefits of sharing risk and of reducing overall investment costs, joint ventures serve as an attractive mechanism to invest in an option to expand in risky markets (Kogut, 1991: 19).

Entering into a new foreign industry through an international Joint ventures (IJV) diminishes the investment risk due to the elimination of certain entry barriers such as: (a) lack of access to distribution and supply channels; (b) government policies that protect certain industries from foreign capital; (c) elevated need for capital; and (d) lack of knowledge on conditions and characteristics of industry in the new context. An IJV covers this need through access to the knowledge, experience, and learning curve of the local partner (Martinez, Lopez 2009: 53).

Partner Commitment and compatibility is a critical issue in IJV relationships (Madhok, 1995: 123). Therefore, the choice of a particular partner is an important variable influencing IJV performance, since it influences the mix of skills and resources which will be available to the venture and thus the IJV's ability to achieve its strategic objectives (Geringer, 1991: 42).

The chosen partner should bring the desired complementary strength to the partnership. Ideally the strengths contributed by the partners will be unique, for only these strengths can be sustained and defended over the long term. The goal is to develop synergies between the contributions of the partners, resulting in a win–win situation for both. Moreover, the partners must be compatible and willing to trust one (Hollensen,1997: 343).

Joint ventures also have several disadvantages beside of all advantages. Due to potential for conflicting objectives, disagreements over how to best operate the venture, culture clashes and so on. Joint ventures are generally the least durable of the entry options, usually lasting only until the partners decide to go their own ways (Thompson, Strickland and Gamle, 2010: 244). Approximately, the average lifespan for alliances is only about seven years, and nearly 80 per cent of joint ventures ultimately end in a sale by one of the partners (Hollensen,1997: 344).

3.3.2. Acquisition

Acquisition is typically presented as the alternative to greenfield. The acquisition entry in a foreign market is defined as the purchase of the stocks of an established firm in the host country by another firm headquartered outside the country, alone or with one or more partners, in an amount sufficient to confer control. In general, acquisition has been one of the chief driving forces behind FDI growth. Recent trends in deregulation in international capital markets have given acquisition new importance as a mode for FDI (Cheng, 2006: 203).

Buying an ongoing operation allows the acquirer to move directly to the task of building a strong position in the target market rather than getting bogged down in going to internal start up route and trying to develop the knowledge, resources, scale of operation, and market reputation necessary to become an effective competitor within a few years (Thompson, Strickland and Gamle, 2010: 243). Especially, Acquisitions may present special advantages when speedy entry is desired. Because, Building a subsidiary from scratch takes more time than buying an ongoing operation, Another specific advantage is acquisitions make it possible for the foreign investor can usually successfully combine with a foreign acquisition is marketing knowledge. A domestic example is Philip Morris' entry into the beer industry through its purchase of Miller Brewing. Philip Morris' firm specific advantage was its marketing skills, and these skills could be profitably combined with an existing beer brand (Hennart, Park, 1993: 1058).

On the other hand, Acquisition strategies are not always feasible. Good prospects may already have been nabbed by the company’s competitors. In many emerging markets, acceptable acquisition candidates often are simply not available. Overhauling the facilities of possible candidates is sometimes much more costly than building an operation from scratch (Kotabe and Helsen, 2010: 305).

3.3.3. Greenfield Entry Mode

The difficulties encountered with acquisitions may lead firms to prefer to establish operations from the ground up, especially where production logistics is a key industry success factor, and where no appropriate acquisition targets are available or they are too costly (Hollensen,1997: 344).

A greenfield entry into a foreign market involves the establishment of a new affiliate in a host country by another firm headquartered outside the country, alone or with one or more partners. Basically, greenfield is an attractive mode of FDI for a firm in the foreign market because it can choose the site that meets its needs best, start afresh, and acclimate itself to the new business culture at its own pace (Cheng, 2006: 203).

According to Yoshida's interviews of the managers of 15 R&D intensive Japanese subsidiaries in the U.S. The managers he interviewed pointed out that they preferred greenfield entry because "they could transfer or devise their own management systems with freshly hired U.S. employees" and that greenfield entry "offered less risk, in terms of organizational control than acquisitions" (Hennart, Park, 1993: 1056).

4. Summary

The decision on which market to enter and how to enter into the selected market is the most critical stage for the company’s profit making and sustainable growth. A firm cannot afford poor decisions in assigning their limited resources to diminishing markets while avoiding the attractive ones, or using the wrong entry mode for the selected market. Choosing the right entry modes for based on firm' skills and economic power is the most critical stage for a firm (Chen, and Messner, 2011: 2).

According to the business history reports, for every successful market entry, about four entries fail (Barber, Peinado and Madhok, 2010: 736). For instance, Ford paid a handsome price to acquire Jaguar but was not able to make the Jaguar brand a major factor in the luxury- car segment in competition against Mercedes, BMW, and Lexus. In 2008, Ford sold Jaguar to India's Tata Motors. In the same deal, Ford also sold its Land Rover division to Tata because of disappointingly low sales volumes (Thompson, Strickland and Gamle, 2010: 173).

Of course, Each model has various advantages and disadvantages and there is no ideal mode for all the Firms. In my opinion, The key of success of the firm to identify a right mode based on firms' skill and vision to enter into right international markets for the company’s profit making and sustainable growth.

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