UNIT 6 INTERNATIONAL MARKETING ENTRY DECISIONS

Structure

6.0 OBJECTIVES

After studying this unit, you should be able to :

- define international market entry
- explain various modes of international market entry
- identify appropriate mode(s) of entry in different situations.

6.1 INTRODUCTION

Companies intending to undertake international business must determine the type of presence they desire to maintain in every market where they would like to operate. One major choice concerns the technique of market entry. A company may want to produce in its home country and export to the overseas market or alternatively it may prefer to produce overseas and sell it there. A second major choice involves the extent of direct ownership desired; should the company strive for full ownership of it local operations or should it associate a local firm with its operations? These initial decisions on market entry have short term, medium term and long term implications, leaving little room for change once a commitment has been made. Therefore, it is important that these decisions are taken with utmost care. In this unit we shall discuss the major entry strategy alternatives by exploring each one in detail and citing relevant company experiences.

6.2 ENTRY MODES

One of the critical decisions in international marketing is the mode of entering the foreign market. At one extreme, a company may decide to produce the product domestically and export it to the foreign market. In this case the company need not make any investment overseas. On the other extreme, the company may establish manufacturing facilities in the foreign country to sell the product there. This strategy requires direct foreign investment by the company. In between these two extremes, there are several options each of which demand different levels of foreign investment. No matter how mighty your company may be, it is not a practical strategy to enter all markets with a single entry method. With all its power, even a largest company may have to formulate different entry strategies to different countries. You may opt for one entry strategy in one market and another strategy in another market, because one entry strategy may not suit all the countries.

As stated already, international marketing activities of business firms can take varied modes ranging from indirect/export on the one hand to direct investment in manufacturing facilities abroad on the other. Each of these strategies require different levels of investment, ranging from no additional investment to high investment in production facilities, where the investment is low, the international business firm faces less risk, less control over the foreign market and may not be able to reap all the profits. On the other hand, when the investments are high in the form of manufacturing facilities abroad, international firm can have full control over the market and reap all the profits, but faces higher risk. Look at Figure 6.1 carefully and note various modes of market entry, and the associated risks and advantages. Let us now examine each of the market entry modes in detail.

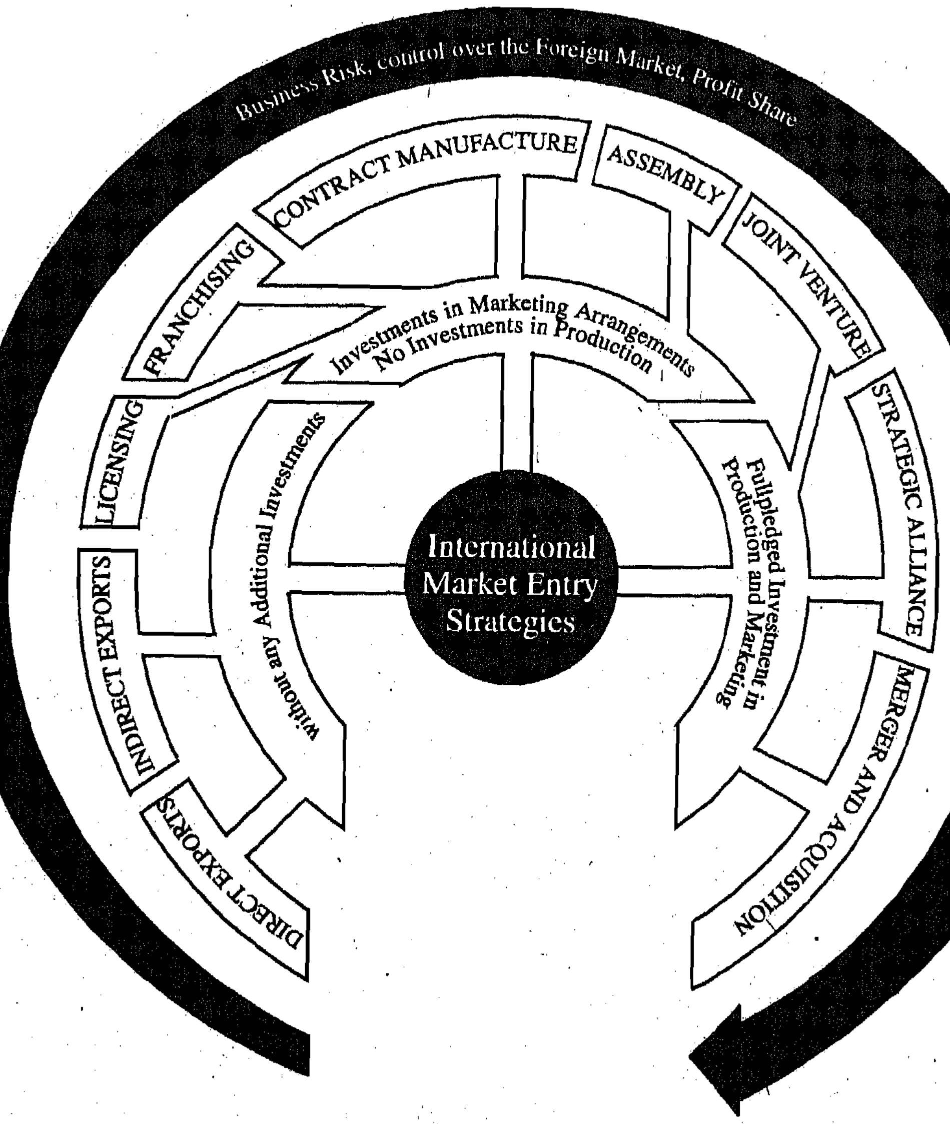

Figure 6.1 Foreign Market Entry Modes

6.2.1 Exporting

Exporting to a foreign market is a quite common entry strategy many firms follow for atleast some of their markets. Under this strategy, the company exports the product from its home base, without any marketing or production or organization overseas. Normally, company exports the same product which is being marketed in the home market.

Exporting may be appropriate under the following circumstances:

- The volume of foreign market is not large enough to justify production in the foreign market.
- Cost of production is higher in the foreign market.
- Foreign market is characterized by production bottlenecks like infrastructural problems, problems of materials supply, labour unrest, etc.
- There are political or other risks of investments in the foreign country.
- There is no guarantee of the market available for longer period.
- Foreign investment is not encouraged by the concerned foreign government.
- There is excess production capacity in the domestic market or expansion of existing facility is less expensive and easier than setting up production facilities abroad.
- Very attractive incentives are available in the country for establishing facilities for export production.

Exporting allows a firm to centrally manufacture its products for several markets and obtain economies of scale. Furthermore, when exports represent incremental volume out of an existing production operation located elsewhere, the marginal profitability of such exports tends to be high. The main advantage of an exporting strategy is that it is easy to implement. Risks are least because the company simply exports its excess production when it receives orders from abroad. A firm has the following two basic options in carrying out its export operations: (i) indirect exporting, and (ii) direct exporting.

1) **Indirect Exporting**

When a firm delegates the task of selling goods abroad to an outside agency, it is called indirect exporting. Markets can be contacted through a domestically located middleman (located in the exporter country of operation). Several types of middlemen located in the domestic market assist a manufacturer in contacting foreign buyers. The major advantage of using a middleman lies in the middleman's knowledge of foreign market conditions and avoidance of problems connected with export procedures and documentation or leaving the manufacturer to concentrate on production. For small companies with little or no experience in exporting, the use of a domestic middleman readily provides expertise. The most common types of middlemen are merchant exporter, export house, trading house, and buying house of overseas firms located in the manufacturer's country.

Exporting through a merchant exporter or an export house can confer the following advantages:

a) The manufacturer can overcome the problems of direct exporting such as investment of resources in collecting marketing intelligence for setting up of export department, etc. and can receive instant foreign market knowledge.

b) Since the operational cost of export house/merchant exporter will be spread over several parties, going through export house/merchant exporter will result in saving in unit cost.

c) In case the export house works on commission basis, there is incentive for the export house to expand sales.

d) In view of the fact that the export house will be effecting consolidated shipments, there is a possibility of reduction in unit freight.

e) The reputation of export house will enable the manufacturer to get better representation for his products abroad. In case the export house is selling complementary products, sales might increase.

Main disadvantages of involving an export house or a merchant exporter are as follows:

a) The export house/merchant exporter, in order to earn more through commission, may take on too many unrelated lines resulting in the producer getting neither the expertise nor the attention he is looking for.

b) Under this arrangement, there is a possibility of the manufacturer continually depending on the export house and not developing export expertise himself.

c) There is also possibility of both the manufacturer and the export house lacking personal involvement in the export business since either party may drop the other at any moment.

d) In view of the fact that the export house will be pushing the product abroad on its own name and reputation, the foreign customers may not be able to relate the product with the manufacturer at all. This danger is more if the export house uses its letter-head and brand name.

Another form of indirect export is the **consortium approach** i.e., a limited number of manufacturers of the same product joining together and exporting on a cooperative basis. In this arrangement, export management function is performed for several firms at the same time. There is closer cooperation and control as compared to merchant exporter or export house.

Export orders will be procured on a joint basis and distributed amongst the constituent units. The individual units will be permitted to use their own letter-head and brand name. This arrangement confers more bargaining power on the consortium since the parties coming together can bargain over a position of strength. As in the case of exporting through export house, there is a possibility of saving in unit freight on account of consolidated shipment. Under-cutting is reduced to a great extent and all the economics of scale associated with joint operation can be reaped.

The great disadvantage of consortium approach is that for this approach to succeed, there should be perfect understanding among the members and each should put in his best. As is well known, cooperation can succeed only to the extent the individual members want it to succeed. Misunderstanding may arise over many issues and one unscrupulous member is enough to spoil the business of the entire consortium.

2) **Direct Exporting**

When a manufacturing firm itself performs the task of selling goods abroad rather than entrusting it to any outside agency it is called direct exporting. Usually a home based export/international marketing department in the firm is given responsibility for selling abroad. The exporting firm may also establish its own sales subsidiary as an alternative mode. When a manufacturer engages in direct export, he takes more risks but gets more returns. More than anything else, direct export means more involvement for the manufacturer, more control and more expertise within the firm.

Of the about 300,000 manufacturing companies in the United States, about 10 per cent are actively exporting. Almost 85 per cent of the US exports, however, is accounted for by the top 250 US companies, which means that a substantial part of export operations is undertaken by merchant exporters. In Japan also, major share of exports are effected by their "sogashosas" which are specialized merchandising firms. While direct exporting operation requires a greater degree of expertise and involvement and involves greater risks. It also provides the company with greater control over its operations than will be the case under indirect exporting.

6.2.2 Licensing

A manufacturer should consider licensing when: (1) capital is scarce, (2) import restrictions discourage direct entry, and (3) the country is sensitive to foreign ownership. When the company finds it difficult to export and at the same time not ready to invest money in the foreign country, licensing could be suitable strategy. *Under licensing, a company assigns the right to undertake production locally using its patent (which protects a product, technology/ or process) or a trademark (which protects a product name) to a local company for a fee or royalty.* Under this strategy, the company (licensor) gives license to a foreign company (licensee) to manufacture the company's product for sale in that foreign country and sometimes in other specified markets also. Licensing enables a company to gain market presence overseas without equity investment. The local company or licensee gains the right to commercially exploit the patent or trademark either on an exclusive (the exclusive right to a certain geographic region) or unrestricted basis.

Licenses are signed for a variety of time periods, depending on the period to pay off the initial investment. Typically, the licensee will make all necessary capital investments (such as in machinery and inventory), and market the products in the assigned sales territories, which may consist of one or several countries. Licensing agreements are subject to negotiation and tend to vary considerably from company to company and from industry to industry. In general, a license contract should include these six basic elements: (1) product and territorial coverage, (2) length of contract, quality control, (3) grant back and cross-licensing, (4) royalty rate and structure, (5) choice of currency, and (6) choice of law.

Reasons for licensing: Companies have used licensing for a number of reasons, Licensing strategy is very flexible as it allows a quick and easy way to enter the foreign market if there are some direct import restrictions in the foreign market. Licensing is a better alternative than exporting when the transportation costs are higher in relation to product value. For one, a company may not have the knowledge or the time to engage more actively in international marketing. The market potential of the target country may also be too small to invest in manufacturing facilities in that country. A licensee has the advantage of adding the licensed products volume to an ongoing operation, thereby reducing the need for large scale additional investment. For a company with limited resources, it can be advantageous to have a foreign partner for marketing its products by signing a licensing agreement. Licensing not only saves capital since no additional investment is necessary, but it also saves scarce managerial resources. In some cases when the firm's product enjoys huge demand, it may not be able to satisfy the demand unless licenses are granted to other companies with the required manufacturing capacity. In some countries where the political or economic situation appears uncertain, a licensing agreement will avoid the potential risk associated with investments in fixed facilities under such uncertain conditions, licensing is a suitable entry strategy since both commercial and political risks are absorbed by the licensee.

Disadvantages of licensing: A major disadvantage of licensing is the substantial dependence on the local licensee to generate revenues and pay royalties. Once a license is granted, royalties (usually paid as percentage on sales volume only) will only be paid if the licensee is capable of performing an effective marketing job. Since the local companies marketing skills may be less developed, revenues from licensing may suffer accordingly. Traditionally, Johnson & Johnson, the large US based health care company, had been licensing its newly discovered drugs in markets where it had little penetration. In 1985, the company licensed Hismanal, a non-sedating antihistamine, to Mochida, a Japanese pharmaceutical company. The drug, now selling in some 116 countries and the company's fastest growing drug, earns only thin royalties from the Japanese market. As a result, the company has moved into developing its own sales force in Japan by hiring about 300 sales representatives through its majority-owned affiliate. Several drugs are now in the process of being licensed and none are planned to be licensed to third companies.

Pepsico experienced the limitations on relying on a licensing partner in France. Pepsi was licensed through Perrier, the French mineral water company. However, the retail structure in France changed and supermarkets emerged as important channels. Other French brands, such as Badoit and Evain, did better in those channels. The resulting decline for Perrier also had a negative impact for Pepsi losing almost half of its market share. This led to the breakup of the relationship and Pepsico has decided to develop the French market on its own, in future.

Another disadvantage of the licensing arrangement relates to the incapability of the local firm to produce products of quality standard for which the parent company is known. The parent company's image may suffer if a local licensee markets a product of substandard quality. Ensuring uniform high quality might require additional resources from the licensor, which may reduce the profitability of the licensing activity.

When license is granted, the foreign firm (licensee) gains technological and product knowledge. This is in a way nurturing a prospective competitor. Another problem often develops when the licensee performs poorly. Termination of the license may be a very complicated task when the licensee is performing very unsatisfactorily. If the license is not terminated, it may even prevent the company (licensor) to directly enter the market. If the licensee does not adhere to the quality standards, it can damage the product image.

6.2.3 Franchising

Franchising is a special form of licensing in which a parent company (the franchiser) grants another independent company (the franchisee) the right to do business in a prescribed manner. In this arrangement, the franchisor makes a total marketing programme (including the brand name, logo, and the method of operation) available to the franchisee. Usually, the franchise agreement is more comprehensive than a regular licensing agreement in as much as the total operation of the franchisee is prescribed. Numerous companies that have successfully exploited franchising as a distribution strategy in their home market are adopting the same strategy to exploit opportunities abroad also. Burger King, McDonalds and other US fast food chains with operations in Latin America, India and European countries are good examples of such firms. Another common form of franchising is where the franchisor supplies an important ingredient (part, material, etc) for the finished product. For example, Coca Cola and pepsi foods have franchise arrangement with their bottling units all over the world. They supply the concentrated syrup to the bottlers. Similarly, in India you can notice NIIT training centres all over India, which look similar and provide the same training programmes with same fee structure. All these training centres are the franchisees of NIIT. Some of the major forms of franchising are: manufacturer-retailer systems (such as automobile dealership), manufacturer-wholesaler systems (such as soft drink company with its bottlers), and service firm-retailer systems (such as fast food outlets).

Franchising had all the advantages and disadvantages of licensing strategy. One added advantage over licensing is the better control over the product and the franchisee.

Check Your Progress A

1. What is the main difference between direct and indirect exporting?

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2. Differentiate between licensing and franchising strategies.

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3. State any three reasons for adopting licensing strategy.

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4. State whether the following statements are true or false.
   a) Exporting is appropriate when the cost of production is higher in the foreign market.
   b) Normally, there are no additional investments in manufacturing facilities in case of exporting strategy.
   c) In consortium approach of exporting, one manufacturer exports to several buyers abroad.
   d) Under licensing strategy, international business firm manufactured directly in the foreign market.
   e) In franchising, international business firm proposes the total marketing programme.

6.2.4 Contract Manufacturing

Under contract manufacturing, a company arranges to have its products manufactured by an independent local company on a contractual basis. A company doing international marketing enters into contract with a local firm in the foreign country to manufacture the product, while retaining the responsibility of marketing. The local manufacturer produces and supplies the product to the international company, while international company assumes responsibilities for sales, promotion, and distribution. In a way, the international company hires the production capacity of the local firm without establishing its own plant and thus circumvents barriers on import of its products. This strategy is practicable only when there is a foreign producer with the necessary manufacturing capacity and ability to maintain quality. The local producer undertakes manufacturing based on orders from the international firm and the international firm gives virtually no commitment beyond the placement of orders.

Typically, contract manufacturing is adopted with regard to countries with low 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 plant. These conditions tend to exist in the small sized countries of Central America, Africa, and Asia. Usually, contract manufacturing is employed where the production technology involves is widely available and where the marketing effort is of crucial importance in the success of the product.

Contract manufacturing has the following advantages:

- The company does not have to commit resources for setting up production facilities abroad.
- It frees the company from the risks of investing in foreign countries.
- If idle production capacity is readily available in the foreign country, it enables the marketer to get started immediately.
- In many cases, the cost of the product obtained by contract manufacturing is lower than if it were manufactured by the international firm. If excess capacities are available with existing units, it may even be possible to get the product supplied on the marginal cost basis.
- Contract manufacturing is a less risky way to start with. If the business does not pick up sufficiently, dropping it is easy; but if the company had established its own production facilities, the exit would be difficult.

The disadvantages of contract manufacturing are:

- The parent company has to forego the manufacturing profit to the local firm.
- It is always not easy to locate a local party with the necessary capabilities to manufacture the product upto the requirements of the parent firm.
- The local party gains experience in marketing, and in course of time may pose a threat to the parent company.

- On many occasions, local firms face difficulties in maintaining the quality of the product upto the standards required by the parent firm.

6.2.5 Assembly

By moving to an assembly operation, the international firm locates a portion of the manufacturing process in the foreign country. Typically, assembly is the last stage of manufacturing and depends on the ready supply of components or manufactured parts to be shipped from another country. Assembly usually involves heavy use of labour rather than extensive investment in capital outlays or equipment. Under assembly strategy, most of the components or ingredients are produced domestically and the finished product is assembled in the foreign country. In several cases, parts or components are produced in various countries in order to gain each country's comparative advantage, and labour intensive assembling is carried in another country where labour is abundant and labour costs are lower. It allows the company to be price competitive against cheap imports. For example, US apparel makers ship the pre-cut fabric to a low wage country for sewing before bringing them back to the USA for finishing and packaging. Thus, they achieve price competitiveness in the US markets.

Motor vehicle manufacturers have made extensive use of assembly operations in many countries. General Motors has maintained major integrated production units only in the United States. In Germany, the United Kingdom, Brazil, Australia and in many other countries, disassembled vehicles arrive and the final product is assembled on the spot. This method of shipping cars as CKDs (completely knocked down) and assembling them in local markets is extensively used by Ford Motor Company, American Motors' Jeep subsidiary, and most European and Japanese car manufacturers.

Having assembly facilities in foreign markets is very ideal particularly under two conditions: (1) when there are economies of scale in the manufacture of parts and components, and (2) when assembly operations are labour intensive and labour is cheap in the foreign country. It may be noted that a number of US manufacturers ship the parts and components to the developing countries, get the product assembled there and bring it back home. The US tariff law also encourages this. Thus, even products meant to be marketed domestically are assembled abroad.

Often, the companies want to take advantage of lower wage costs by shifting the labour-intensive operation to the foreign market. This results in lower price of the final products. In many cases, however, it is the local government that forces the setting-up of assembly operations by sometimes banning the imported parts. Often in countries with chronic foreign exchange problems, supply interruptions can occur. In some countries, such as Brazil where some 70 per cent of the parts are produced locally, car manufacturers find no option but to engage in assembly operations to produce for the local markets.

Assembling the product meant for the foreign market in that foreign country itself has certain other advantages, besides the cost advantage. The import duty is normally low on parts and components than on the finished product. Assembly operations would satisfy the 'local content' demand, at least to some extent. Because of the employment generation, the foreign government's attitude will be more in favour than import of the finished product.

Another advantage is that the investment to be made in the foreign country is very small in comparison with the expenditure required for establishing complete manufacturing facilities. The political risks of foreign investment is, thus, not much.

6.2.6 Joint Venture

In the context of international business, an international joint venture is an enterprise formed by the international business company sharing ownership and control with a local company in the foreign country. International joint venture is another alternative strategy you may consider to enter in overseas market.

In countries where fully foreign owned firms are not allowed or favoured, joint venture is the alternative if the international marketer is interested in establishing an enterprise in the foreign market. Many foreign companies entered the communist, socialist and other developing countries by joint venturing. The essential feature of a joint venture is that the ownership and management are shared between a foreign firm and a local firm. In some cases there are more than two parties involved. For example, Pepsi's Indian joint venture involved Voltas and Punjab Agro Industries Corporation. Under a joint venture arrangement, the local company invites an outside partner to join as share owner in the new unit. The terms of participation may vary with companies accepting either a minority or majority stake. A joint ownership venture may be brought about by a foreign investor buying an interest in a local company or a local firm acquiring an interest in an existing foreign firm or by both the foreign and local entrepreneurs jointly forming a new enterprise.

It is also a common practice to split the local interest between a partner and various public participation (including public sector firms or industrial development organizations). Such a strategy may enable the international firm to retain much control despite a minority holding as the power of the remaining shares is spread out. Further, equity holding by the public would help the enterprise get some public support. Partnership with government organization may help to obtain favourable treatment from the government.

Experience has shown that JVs are successful if the partners share the same goals with one of them accepting primary responsibility for operational matters.

Corning glass works (a US based company in a number of technology intensive businesses) has used joint ventures extensively to open up markets (two-thirds of them with foreign firms) which together account for more than half of Corning's operating profits. Corning's optical fiber business has six joint ventures abroad. Many of its customers are local telephone companies who favour local suppliers. By joining with local partners, Corning gets access to markets and customers that would otherwise, perhaps, be closed to the company. In the TV glass business, Corning used joint ventures with Asahi Glass of Japan and Samsung of Korea to acquire new technology. This became important as Corning's traditional US customers gave up TV manufacturing and the industry became dominated by Japanese and Korean companies.

Once a joint venture partner secures part of the operation, the international firm can no longer function independently, which sometimes leads to inefficiencies and disputes over responsibility. If an international firm has strictly defined operating procedures such as for budgeting, planning and marketing, it may become difficult to get a local company to agree to accept maximization of dividend payout instead of reinvestment, or when the capital of the Joint Venture has to be increased and one party is unable to raise the required funds, problems may arise in the relationship.

Joint ventures are, nowadays, quite popular because they offer the following important advantages to the foreign firm:

- Potentially greater returns from equity participation as opposed to royalties;
- Greater control over production and marketing;
- Better market feedback;
- More experience in international marketing,
- By bringing in a local partner, the company shares the risks involved in a new venture,
- Furthermore, the JV partner may possess skills and contacts that are of value to the international firm. Sometimes, the partner may be an important customer who is willing to underwrite a portion of the new unit's output in return for equity participation. In other cases, the partner may represent important local business interests with excellent contacts with the Government.
- A firm with advanced product technology may also gain market access through the JV route by teaming up with companies that have wide distribution network locally.

The disadvantages of joint ventures are:

- A joint venture may go through several points of crisis, caused by the realization on the part of either (sometimes both) of the partners that its expectations are not being fulfilled and, perhaps, even being negated. Chances of such flash points are more with the flattening out of the gains curve on any of the parameters that govern either partner's decision to be involved in the joint venture. For, at this point, the gains of one of the partners become disproportionate to those of the other, leading the former to re-examine the rationality of retaining the relationship. Such flash points, however, need not necessarily result in the termination of the joint venture. In fact they may be managed so that there will be more equitable gains from the joint venture.
- Joint ventures involve greater risk.
- They also involve greater investment of a capital and management resources.
- On the other hand, there is a possibility of conflict of interest in joint venture, with the national partner.

A joint venture can succeed only if both the partners have something definite to offer to the advantage of the other, and reap definite advantages, and have mutual trust and respect.

Check Your Progress B

1. What is the difference between franchising and contract manufacturing?

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2. Differentiate between licensing and contract manufacture.

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3. Differentiate between assembly and franchising.

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4. Names of some products sold in India by international firms are given below. Probe to find out the entry strategy adopted by the firm.

   a) Matiz Car

   b) Pepsi Drink

   c) Whirlpool Washing Machines

   d) LG Refrigerators

   e) Sony Colour TV

6.2.7 Strategic Alliance

A more recent phenomenon is the development of a range of strategic alliances. Alliances are different from traditional joint ventures in which two partners contribute a fixed amount of resources and the venture develops on its own. *In an alliance, two firms pool their resources directly in a collaboration that goes beyond the limits of a joint venture.* Although a new entity may be formed, it is not a requirement. Sometimes, the alliance is supported by some equity acquisition of one or both the partners. In an alliance, partners bring a particular skill or resource, usually one that is complementary to each other. By joining forces, both are expected to profit from each other's experience. Typically, alliances involve either distribution access or technology transfers or production technology, with each partner contributing a different aspect to the venture.

This strategy seeks to enhance the long term competitive advantage of the firm by forming alliance with its competitors (existing or potential in critical areas), instead of competing with each other. The goals are to leverage critical capabilities, increase the flow of innovation and increase flexibility in responding to market and technological changes. Strategic alliance is also sometimes used as a market entry strategy. For example, a firm may enter a foreign market by forming an alliance with a firm in that foreign market for marketing or distributing the farmer's product.

Strategic alliance, more than an entry strategy, is a competitive strategy. Strategic alliances which enable companies to increase resource productivity and profitability by avoiding unnecessary fragmentation of resources and duplication of investment and effort. Alliances are growing in popularity and are very conspicuous in such industries as pharmaceuticals, computer, nuclear, telematics, etc., which are characterized by high fixed costs in R & D and manufacturing, high technology and fast changing technology.

Technology-based alliances: Exchanging technology for market access was the basis of the AT&T alliance with Olivetti of Italy, entered into in 1984. AT&T needed to enter the European computer market to obtain economies of scale for its US operations. But it did not have any marketing contacts of its own. On the other hand, Olivetti was eager to add larger computers through its extensive distribution system in Europe. In return, Olivetti became the key supplier to AT&T for personal computers and was able to use AT&T as its distribution arm in the US market. Both companies were attempting to benefit from each other's market access and each other's production and technology resources. However, after a quick start that involved mostly the sale of Olivetti-produced PCs through AT&T sales offices in the United States, the alliance lapsed when the cooperation became too much of one-sided. In 1989, AT&T was able to take a 20 per cent stake in Intel, the Italian state-owned telecommunications equipment company. With this alliance, AT&T hoped to gain better access not only to the Italian market but to other markets in West Europe as well.

Production-based alliances: In the automobile industry in particular a large number of production based alliances have been formed over the past years. These alliances or linkages fall into groups. *First*, they are in the search for efficiency through component linkages which may include engines or other key components of a car. *Second*, companies have begun to share entire car models, either by producing them jointly or by developing them together. In the United Kingdom, the British Rover Group and Honda of Japan produce some cars jointly. Regional cooperation also exists between Volkswagen and Ford in Latin America.

Distribution-based alliances: Alliances with a special emphasis on distribution are becoming increasingly common. General Mills, a US based company marketing breakfast cereals, had long been number two in the United States with 27 per cent market share compared to Kellogg's 40 to 45 per cent share. With no effective position outside the United States, the company entered into a global alliance with Nestle of Switzerland.

6.2.8 Merger and Acquisition

Mergers and Acquisitions (M&A) have been a very important market entry strategy as well as expansion strategy. A number of Indian companies have used this entry strategy. In the case of a merger, the international business firm absorbs one or more enterprises abroad by purchasing assets and taking over liabilities of those enterprises on payment of an agreed amount. Similarly, the international business firm may also take over the management of an existing company abroad by taking the controlling stake in the equity of that company at a predetermined price. This is called acquisition.

Merger and acquisition as an entry strategy provides instant access to markets and distribution network. As one of the most difficult areas in international marketing is distribution, this is often a very important consideration for M&A. The General Electric (GE), USA, took over Hungary's light bulb maker Tungsram. Instead of starting a 'greenfield' operation in Hungary by building a new factory and hiring the people needed, why did the multinational giant take over Tungsram, a typical Hungarian enterprise bogged down with so many problems calling for a painful restructuring? The answer is that Tungsram gave GE entry to the East European light bulb market, from which it had been virtually excluded by Philips and Osram. Tungsram's share of the market in the 1980s was a respectable 9 to 10 per cent.

Another important objective of M&A is to obtain access to new technology or a patent right. M&A also has the advantage of reducing the competition. M&A may also give rise to some problems which arise mostly because of the deficiencies of the evaluation of the case for acquisition. Sometimes the cost of acquisition may be unrealistically high. Further, when an enterprise is taken over, all its problems are also acquired with it. The success of the enterprise will naturally depend on the success in solving the problems.

It has also been observed that the takeover spree lands several companies in trouble. For example, in the early 1990s a number of Japanese companies began to sell some of the foreign businesses which they had acquired a few years ago. The main reason for this was the financial crunch.

6.3 ENTRY STRATEGY ANALYSIS

You have studied various foreign market entry strategies. You know, each entry strategy had certain advantages and also had certain limitations. Now you have to take a very careful decision in choosing the appropriate entry strategy for your business enterprise. For this a firm must analyse thoroughly and properly all the entry modes so that a proper strategy can be developed. Collection of data is the corner stone of any entry strategy analysis. Sales projections have to be supplemented with relevant cost data and financial requirement projections. Data need to be assembled for all entry strategies for comparison and selecting the most appropriate strategy.

Financial data need to be collected not only on the proposed venture but also on its anticipated impact on the overall operations of the international firm. The combination of two sets of financial data results in incremental financial data incorporating the net overall benefit of the proposed move to the total company structure. In this section we provide a general methodology for the analysis of entry decisions. It is assumed than any firm approaching a new market is looking for profitability and growth. Consequently the entry strategy must be subordinated to these goals. Each strategy has to be analyzed for the following five factors: (1) expected sales, (2) costs, (3) extent of investments in assets, (4) profitability, and (5) risk factors. Let us discuss each of them briefly.

1) **Expected sales**: An accurate estimate of sales volume is crucial to the entry strategy decision. Sales depend on the company's market share and the total potential size of the market. The foreign company can influence the market share through a strong marketing mix which, in turn, is also dependent on marketing expenditures. The various types of entry strategies also allow a foreign firm to unfold its marketing strategy to varying degrees. Typically, direct or indirect exporting results in lower market presence. This weaker presence may cause a loss of control over export operations. Also, to some extent, there may be dependence on some independent firms to carry out the company's marketing functions.

Of course, market potential is not subject to the influence of the international firm seeking entry. The size of a local market combined with the expected market share often determines the outcome of an entry strategy analysis. Local assembly or production with correspondingly high levels of assets and fixed costs need large volumes to offset these costs, whereas exporting operations can usually be rendered profitable at much lower sales volumes.

Particularly in markets with considerable growth potential, it becomes essential to forecast sales over a longer period of time. A low expected volume right now may indicate little success for a new entry strategy. Since it is often impossible to shift quickly into another entry mode once a firm is established, special attention has to be focused on the need to ensure that the chosen entry strategy offers a long term opportunity to maximize profits.

2) **Costs**: The international firm will have to determine the expected costs of its operation in a foreign country, with respect to both manufacturing and general administration. Unit variable costs may vary depending on local production, assembly, or exporting as the chosen strategy. To establish such costs, you have to take into consideration local material costs, local wage levels and tariffs on imports. Again unit variable costs may be expected to vary according to the entry strategy alternatives considered.

   Fixed costs represent another important element in the analysis. Administrative costs tend to be much lower for a sales subsidiary compared to a local manufacturing unit. Through a contribution margin analysis, break even for several levels of entry strategies can be considered. Government regulations or laws may also affect local costs and vary from country to country. Estimating and forecasting costs in the international environment requires a keen sense of awareness of environmental factors of political, economic and legal nature.

3) **Assets**: The level of assets deployed greatly influences the profitability of each of the entry strategy. The assets may consist of any investments made in conjunction with the entry into (or exit from for that matter) the new market. Such investments may comprise working capital in the form of cash, accounts receivable, inventory, it may include fixed assets, etc., depending on the particular entry strategy chosen. Exporting or sales subsidiaries require an investment in working capital only with little additional funds for fixed facilities. Local assembly or production demands substantial investments.

4) **Profitability**: Conceptually, a company should maximize the future stream of earnings discounted at the cost of capital. Some companies may prefer return on investment (ROI) as a more appropriate measurement of profitability. In either case, profitability is dependent on the level of assets, costs and sales. Several exogenous risk factors influence profitability and, therefore, must be included in the analysis.

5) **Risk factors**: Each country hosting a foreign subsidiary may take action of a political, economic or regulatory nature that can completely devastate any carefully drawn up business plan. Political turmoil in many parts of the world have greatly affected business and investment conditions. Departure of the Shah of Iran during the 70s, ethnic problems in Sri Lanka, and Soviet Union's disintegration have harmed the political environment in these countries to such an extent that business could not be conducted in these areas as in the past.

   Changes in economic systems also add to uncertainties and are reflected in currency changes and/or diverging economic trends. Manufacturing costs are particularly sensitive to such changes. Many times, a company has shifted production from one country to another on the basis of the latest cost data just to find out few years later that costs have changed due to fluctuations of macro-economic variables beyond the company's control. Local labour costs have fluctuated considerably over the years and are very sensitive to local inflation and foreign currency changes.

6.4 FACTORS AFFECTING ENTRY DECISIONS

The selection of a company's best method of entry into overseas markets depends on several factors, some of which are peculiar to the firm and the industry. A few of these main variables related to the firm are:

- **Company goals** regarding the volume of international business desired, expected geographic coverage, and the time span of foreign involvement.
- The **size** of the company in terms of sales and assets.
- The company's **product line** and the nature of its products (industrial or consumer, high or low unit price, technological content).
- **Competition** abroad.

The firm must evaluate these factors for itself case by case.

Beyond the factors peculiar to the firm and the industry, there are other decision criteria that relate more generally to the method of entry into foreign markets. This second group includes factors relatively independent of the firm and the industry. They are briefly discussed below:

1) **Number of markets covered**: Different entry methods offer different coverage of international markets. For example, wholly owned foreign operations are not permitted in some countries; the licensing approach may be impossible in some other markets because the firm may not be able to find qualified licensees; or a trading company might cover some markets very well, but may not have representation in many other markets. To get the kind of international market coverage it wants, the firm will probably have to combine different kinds of market-entry methods. In some markets, it may have wholly owned operations; a marketing subsidiary in another and local distributors in some other market.

2) **Penetration with markets covered**: Related to the number of markets covered in the quality of the coverage a combination export manager, for example, might claim to give the producer access to a number of countries. The producer must probe further to find out if this "access" is to the whole national market or it is limited to the capital or a few large cities. Having a small catalogue sales office in the capital city is very different from having a sales force to cover the entire national market.

3) **Market feedback available**: If it is important for the firm to know what is going on in its foreign markets, it must choose an entry method that will provide this feedback. Although, in general, the more direct methods of entry offer better market information, feedback opportunities will depend on how the firm prepares and manages a particular form of market entry.

Check Your Progress C

1. Differentiate between merger and acquisition.

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2. When you analyze the market entry strategy, what factors would you keep in mind?

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3. What is strategic alliance?

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4. Differentiate between strategic alliance and joint venture.

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5. State whether the following statements are true or false.

   a) In an alliance, two firms pool together their resources and always form a joint venture.

   b) Strategic alliance, more than entry strategy, is a competitive strategy.

   c) In the automobile industry you may find more production based alliances.

   d) In the case of merger, international business firm takes over the management of an existing firm abroad.

   e) Direct or indirect exporting results in lower market presence.

6.5 LET US SUM UP

You have now some idea of how the firm can reach the market which it has selected to sell to. The range of alternative means is large enough that almost any firm in any product area can find an appropriate way to reach some foreign markets. The nature of entry and commitment ranges from indirect exporting to mergers and acquisitions in foreign markets. Specific foreign entry strategy options available to international business firms include: (1) exporting (direct and indirect exporting), (2) licensing, (3) franchising, (4) contract manufacturing, (5) assembly, (6) joint ventures, (7) alliance, and (8) merger and acquisitions. Each of these strategies has certain advantages and disadvantages. Each of these strategies require different levels of investment ranging from no additional investment to full investment in manufacturing facilities abroad, and the risks also increase with increase in the investment levels. Similarly, control over the market may be higher if the company involves itself directly in manufacturing by investments in production facilities. Various entry strategies must be analyzed in terms of sales, costs, assets, profitability and risk factors. A manager, while taking an entry decision, would be affected by various considerations like: number of markets covered, level of penetration within markets, degree of feedback available, control factor, possibility of sales volume over a period time, etc.

6.6 KEY WORDS

Acquisition: An international business enterprise takes over the management of an existing company abroad by taking the controlling stake in the equity of that company at a predetermined price.

Assembly: An international business firm produces most of the components or ingredients in one (or more) countries and carries out the labour intensive assembling in the foreign country where labour is abundant and cheap.

Contract Manufacture: An international marketing company enters into contract with a local enterprise abroad to manufacture its product and undertakes the marketing responsibility on its own.

Direct Export: Sale of goods abroad without involving middlemen.

Export: Domestically produced goods sold in other country without any marketing or production or organization overseas.

Franchising: It is a special form of licensing in which an international business company (franchiser) grants another independent company (franchisee) right to do its (franchiser's) business in a prescribed manner. Franchiser makes a total marketing programme available to the franchisee.

Indirect Export: A firm sells its products abroad through middlemen.

Joint Venture: An international joint venture is an enterprise formed abroad by the international business company sharing ownership and control with a local company in that foreign country.

Licensing: An international business firm (licensor) allows a foreign company (licensee) to manufacture its product for sale in the licensee's country and sometimes in other specified markets

Merger: An international business firm absorbs one or more enterprises abroad by purchasing the assets and taking over liabilities of those enterprises on payment of an agreed amount.

Strategic Alliance: Two or more competing firms pool their resources in a collaboration to leverage their critical capabilities for common gain. Although a new entity may be formed, it is not an essential requirement.

6.7 ANSWERS TO CHECK YOUR PROGRESS

A.4	a) True	b) True	c) False	d) False	e) True
C.5	a) False	b) True	c) True	d) False	e) True

6.8 TERMINAL QUESTIONS

1. State the various modes of entry to foreign markets. Briefly explain each of them.
2. Differentiate between joint venture and strategic alliance. Explain their relative advantages and disadvantages as strategies for foreign market entry.
3. Differentiate between licensing and franchising and explain their relative advantages and disadvantages as international market entry strategies.
4. International business firm wants to produce the product in the foreign country and market it there. But the firm is not interested in investing in establishing manufacturing facilities in the foreign country. Identify the entry modes suitable in this regard and explain them.
5. Which is the mode of entry where the international business firm can start international marketing without any investments abroad? Explain it alongwith its merits and limitations.
6. A company wants to enter into international markets. The company decided to involve another company in the foreign country. State the modes of entery where the scope for the involvement of a foreign company is possible. Explain those modes and critically evaluate and state in which situations each of them is suitable.

SOME USEFUL BOOKS

Francis Cherunilam. *International Marketing*, Himalaya Publishing House, Delhi.

Philip R. Cateora. *International Marketing*, McGraw Hill, Chicago.

San Onkuisit and John J. Shaw. *International Marketing — Analysis and Strategy*, Prentice Hall of India, New Delhi.

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