

# Entry Modes



Our development strategy adapts to different markets addressing local needs and requirements. We currently use three business strategies: joint ventures, licenses, and company-owned stores.

—*Starbucks Corporation*

# 13

## Market Entry in International Social Media

With the increasing business being done on the Internet, it might seem that anyone can easily become an Internet entrepreneur. In reality, it might be a little more complicated.<sup>a</sup>

It's true that there is a worldwide presence on the web. In the United States alone, some \$1.5 billion worth of advertising will be done on social networking sites by 2012, and internationally it is becoming increasingly common for companies to use social media as a key tool for conducting market research.<sup>b</sup> Social media sites such as Facebook, Myspace, LinkedIn, and hi5 have extensive foreign operations. For example, Facebook is the top social network in most of the nations it serves, such as the Philippines, Indonesia, Malaysia, Singapore, and Hong Kong, and its percentage penetration of web users ranges from 63 percent to 85 percent in each of those nations.<sup>c</sup>

As a result of the international expansion of social networking sites, the French luxury company Cartier began featuring separate pages for its "Love by Cartier" product line on Myspace's sites for the United Kingdom, China, France, Italy, Spain, and Japan. Two things are interesting here. First, because Myspace is best known as a youth site, the advertising of luxury brands seems out-of-place—you wouldn't think the audience would be there. Love by Cartier, after all, also has a campaign on the elite, invite-only social network A Small World, which has a jet-set user base that seems a much more appropriate target for a pricey jewelry brand. But Myspace representatives say their image as a teen hangout is a bit misleading, citing comScore statistics that estimate a quarter of its traffic comes from households with annual incomes greater than \$100,000. Second, Cartier chose to enter Myspace's country-specific sites rather than stay with a single approach. Thus, for example, an Italian will see the site in Italian (written in Italian, not machine translated to Italian).

Yet, even with the international success of sites such as Facebook, in order to achieve deep penetration abroad, perhaps you also need to utilize localized or country-specific sites. This might give you a leg up when it comes to understanding the local environment, especially for younger citizens. In fact, although Facebook serves about 44 percent of the world's Internet users and is the leader in most of the nations it serves, it is not the top social network in a number of key developed and emerging markets, such as India, Brazil, South Korea, Russia, and Japan. Indeed, of the largest networking sites in the world, about half of them

### Learning Objectives

After reading this chapter, you should be able to:

- LO13-1** Understand the pros and cons of entering markets as a "market pioneer" versus being a "fast follower."
- LO13-2** Explain the international market-entry methods.
- LO13-3** Discuss why firms export and the options available for indirect and direct exporting.
- LO13-4** Explain the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.



are sites whose followers are primarily outside the United States. For example, Orkut has 100 million users, Badoo more than 86 million users, hi5 has an estimated 80 million users, and Odnoklassniki about 45 million users. Among these localized, country- or regional-specific sites are the following:

### IN ASIA

In India, Orkut is popular, with nearly 50 percent penetration of the web-user market.<sup>d</sup> [Bigadda.com](#) and hi5 are also popular in India (and hi5 also has strong penetration in Mongolia, Thailand, Romania, Jamaica, Central Africa, Portugal, and Latin America). In China, three social networks are popular: [Renren.com](#), [Kaixin001.com](#), and [51.com](#). Facebook's site in China is blocked from that country's 420 million Internet users, although there are rumors that the company is exploring ways to gain approved entry to that market.<sup>e</sup> In South Korea, [CyWorld.com](#) is a major site, especially for young adults, and it reaches more than half of all web users in that country. CyWorld has a major music component, and many Korean socialites and celebrities post their tours and news of their work on it. Wretch.cc is a popular site in Taiwan, with nearly two-thirds' penetration of the web-user market, and Mixi.jp is popular in Japan. ZING Me is the leading social network site in Vietnam.

### IN EUROPE

[Hyves](#) is the most popular social networking property in the Netherlands, penetrating about two-thirds of the market. The German site StudiVZ also records strong traffic, with 17 million visitors, and Grono.net is popular in Poland. Vkontakte dominates the Russian market with a penetration into about three-quarters of the market (more than seven times greater than Facebook's penetration rate in Russia), while Odnoklassniki has about 45 million users in Russia and former Soviet republics.<sup>f</sup>

### IN LATIN AMERICA

Several sites are well-established, including Orkut, hi5, and Wamba. Orkut has more than 70 percent penetration of Brazil's social networking market. Another site that is important in Latin America is Sonico, based in Argentina. In addition, Peru is a hi5 stronghold, and Badoo is particularly strong in Venezuela.

Of course, the "just-around-the-corner" commercial battleground is mobile networking: 88 percent of Latin Americans own a mobile phone, versus the more than 60 percent worldwide average.<sup>g</sup> The largest single collection of cell phone users is in China. While American youth have the highest rate of mobile Internet usage, Chinese youth have a 50 percent higher rate of mobile

data usage than is the case for the United States and more than double the rate for Europe.<sup>h</sup>

Given the importance of appealing to local tastes, are the obstacles to exporting created by a two-tiered social networking structure—where many citizens access major worldwide sites such as Facebook and Myspace, but also access a local or regional network—significant enough that only the largest companies should attempt to do this?

<sup>h</sup>Sources for this introductory vignette include: Nyay Bhushan, Berwin Song, and Mark Russell, “Rising in the East: A Guide to the Key Asian Social Networking Services,” *Billboard*, May 24, 2008, p. 20, [http://books.google.com/books?id=VxQEAAAAMBAJ&pg=PA20&lpg=PA20&dq=Rising+in+the+East:+A+Guide+to+the+Key+Asian+Social+Networking+Services&source=bl&ots=\\_ipfto5\\_l8&sig=LJWb4YVqYvDSLygCBzbZ30yLxU&hl=en&ei=x\\_wATrytD4f6swPj25S2DQ&sa=X&oi=book\\_result&ct=result&resnum=1&ved=0CBkQ6AEwAA#v=onepage&q=Rising%20in%20the%20East%3A%20A%20Guide%20to%20the%20Key%20Asian%20Social%20Networking%20Services&f=false](http://books.google.com/books?id=VxQEAAAAMBAJ&pg=PA20&lpg=PA20&dq=Rising+in+the+East:+A+Guide+to+the+Key+Asian+Social+Networking+Services&source=bl&ots=_ipfto5_l8&sig=LJWb4YVqYvDSLygCBzbZ30yLxU&hl=en&ei=x_wATrytD4f6swPj25S2DQ&sa=X&oi=book_result&ct=result&resnum=1&ved=0CBkQ6AEwAA#v=onepage&q=Rising%20in%20the%20East%3A%20A%20Guide%20to%20the%20Key%20Asian%20Social%20Networking%20Services&f=false) (accessed June 21, 2011); “List of Social Networking Sites,” *Wikipedia*, [http://en.wikipedia.org/wiki/List\\_of\\_social\\_networking\\_websites](http://en.wikipedia.org/wiki/List_of_social_networking_websites) (accessed June 21, 2011); “German Social Networking Community Reaches 14.8 Million,” [www.comscore.com/Press\\_Events/Press\\_Releases/2007/09/Social\\_Networking\\_Sites\\_in\\_Germany](http://www.comscore.com/Press_Events/Press_Releases/2007/09/Social_Networking_Sites_in_Germany) (accessed June 21, 2011); and Eric Eldon, “The Latin American Social Networking Wars,” June 3, 2008, <http://venturebeat.com/2008/06/03/>

[the-latin-american-social-networking-wars-market-leader-hi5-has-been-growing-but-so-has-facebook-and-sonico/](http://the-latin-american-social-networking-wars-market-leader-hi5-has-been-growing-but-so-has-facebook-and-sonico/) (accessed June 21, 2011).

<sup>b</sup>Michael Stanat, “Social Media, the Future of Market Research?,” [www.greenbook.org/marketing-research.cfm/social-media-the-future-of-market-research](http://www.greenbook.org/marketing-research.cfm/social-media-the-future-of-market-research) (accessed June 21, 2011).

<sup>c</sup>comScore, “Social Networking Habits Vary Considerably Across Asia-Pacific Markets,” [www.comscore.com/Press\\_Events/Press\\_Releases/2010/4/Social\\_Networking\\_Across\\_Asia-Pacific\\_Markets](http://www.comscore.com/Press_Events/Press_Releases/2010/4/Social_Networking_Across_Asia-Pacific_Markets) (accessed June 21, 2011).

<sup>d</sup>Ibid.

<sup>e</sup>J.P. Mangalindan, “China: Facebook’s Undiscovered Country,” *CNNMoney*, January 17, 2011, <http://tech.fortune.cnn.com/2011/01/17/how-facebook-can-conquer-china/> (accessed June 21, 2011).

<sup>f</sup>Jay Yarow and Kamelia Angelova, “Chart of the Day: The Countries Facebook Doesn’t Dominate,” September 23, 2010, [www.businessinsider.com/chart-of-the-day-facebook-not-popular-in-countries-2010-9](http://www.businessinsider.com/chart-of-the-day-facebook-not-popular-in-countries-2010-9) (accessed June 21, 2011).

<sup>g</sup>Jose Feroso, “U.N. World Report Picks Up Massive Growth in Mobile Phone Ownership,” [www.wired.com/gadgetlab/2009/03/report-60-of-wo/](http://www.wired.com/gadgetlab/2009/03/report-60-of-wo/) (accessed June 21, 2011); and Euromonitor, International, “Latin America Enjoys Mobile Telephone Boom,” May 28, 2010, <http://blog.euromonitor.com/2010/05/regional-focus-latin-america-enjoys-mobile-telephone-boom.html> (accessed June 21, 2011).

<sup>h</sup>“U.S. Youth Have Higher Smartphone Penetration Than Adults,” [www.marketingcharts.com/uncategorized/us-youth-have-higher-smartphone-penetration-than-adults-15665/nielsen-smartphone-penetration-jan-2011jpg/](http://www.marketingcharts.com/uncategorized/us-youth-have-higher-smartphone-penetration-than-adults-15665/nielsen-smartphone-penetration-jan-2011jpg/) (accessed June 21, 2011).

As you learned in Chapter 1, we can use a variety of names to identify large firms that operate on a multicountry scale: *global*, *multidomestic*, and *international* firm or company; *multinational enterprise (MNE)* or *multinational company (MNC)*; *international company (IC)*; *transnational company*; and even *multicultural multinational company*. Long before companies become any of these, however, they are usually smaller companies with only domestic experience. In this chapter we examine the very start—that is, the entry into international operations. We first examine issues associated with the decision whether to enter a market as a pioneer or as a fast follower. Then we discuss the different methods available for market entry, beginning with nonequity modes of market entry, followed by equity-based modes.

## Entering Markets: Should You Be a Market Pioneer or a Fast Follower?

In the opening vignette, we gained some insight into which social networking sites are market leaders today. But we can’t be sure that the same will be true by the time you are reading this book. Across industry after industry, market leaders rise, then plummet, sometimes disappearing completely. Compaq was once the undisputed leader in laptops and is not even a minor player now. Motorola dominated the first generation of cell phones, then its market share dropped precipitously as Nokia overtook it when second-generation cell phones appeared—subsequently, Nokia’s market dominance has been threatened by companies such as Apple as a new generation of “smartphones” replaces second-generation technology. Not all pioneers capitalize on their potential advantages, yet some evidence does suggest that pioneers gain and maintain a competitive edge in new markets. For instance, researchers have found that surviving pioneers hold a significantly larger average market share when their industries reach maturity than do firms that were either fast followers or late entrants in the product category.

On the other hand, as Compaq illustrates, pioneers can certainly fail. One recent study that took failed pioneers into account and averaged their performances with those of the more successful survivors found that, overall, pioneers did not perform as well over the long haul as

**LO13-1 Understand** the pros and cons of entering markets as a “market pioneer” versus being a “fast follower.”

followers. Of course, what measures are used can be important here: volume and market share are not the only dimensions by which success can be measured. The truth is that there really is little evidence one way or the other concerning the effect of the *timing* of a firm's entry into a new market on its ultimate profitability in that market or the value it generates for shareholders.

In many cases, a firm entering into international markets becomes a follower by default, because a quicker competitor simply beats it by entering into the market first. But even when a company has the capability of being the first-mover, there are possible advantages to letting others go first and shoulder the initial risks while the follower observes the pioneers' shortcomings and mistakes.

A pioneering firm stands the best chance for long-term success in market-share leadership and profitability when (1) the pioneering firm is insulated from the entry of competitors (high-entry barriers), at least for a while, by strong patent protection, proprietary technology (such as a unique production process), or substantial investment requirements; or (2) the firm has sufficient size, resources, and competencies to take full advantage of its pioneering position and preserve it in the face of later competitive entries. Indeed, some recent evidence suggests that organizational competencies such as R&D and marketing skills not only affect a firm's success as a pioneer but also influence the company's decision about whether to be a pioneer in the first place. Firms that lack the competencies necessary to sustain a first-mover advantage may be more likely to wait for another company to take the lead and then enter the market later.

On the other hand, a follower will most likely succeed when there are few legal, technological, cultural, or financial barriers to inhibit entry (low-entry barriers) and when it has sufficient resources or competencies to overwhelm the pioneer's early advantage. The most successful fast followers tend to have the resources to enter the new market on a larger scale than the pioneer. Thus, they can quickly reduce their unit costs and offer lower prices than incumbent competitors.<sup>1</sup>

Thus, the evidence is not clear on whether the firm should be first—or nearly first—into a foreign market. Even after that decision, we have other decisions to make regarding which entry mode the firm should use in entering the market first (or not).

**L013-2 Explain**  
the international  
market-entry methods.

## What Methods Are Available for Entering Foreign Markets?

Once a company has decided to enter into a foreign market, it must decide which of the many different options for market entry would represent the optimal choice for the company's particular circumstances. We first examine nonequity modes of market entry, followed by equity-based modes.

### NONEQUITY MODES OF ENTRY

If a company wishes to enter foreign markets through nonequity-based methods, a number of alternatives are available. In this section, we discuss exporting, turnkey projects, licensing, franchising, management contracts, and contract manufacturing as alternatives for non-equity modes of foreign market entry.

**Exporting** Most firms begin their involvement in overseas business by exporting—that is, by selling some of their regular production overseas. This method requires little investment and is relatively free of risks. It is an excellent means of getting a feel for international business without committing a great amount of human or financial resources.

**Benefits of Exporting** Many firms, both large and small, engage in exporting for reasons such as the following:

- To serve markets where the firm has no or limited production facilities. Many large multinationals, like DuPont or Procter & Gamble, supply some of their foreign markets by exporting because no firm, no matter how large, can afford to manufacture a complete product line in every country where its goods are sold. Markets without local factories are

**L013-3 Discuss**  
why firms export and  
the options available  
for indirect and direct  
exporting.

supplied through exports from the home country or from a foreign affiliate. In markets of sufficient size to justify the production of some but not all of the product mix, the affiliate will supplement local production with imports. A car plant in a developing nation may produce the least expensive cars and import luxury models. Also, the more vertically integrated plants may export semifinished products that are inputs for the less integrated subsidiaries.

- To satisfy a host government's requirement that the local subsidiary have exports. Governments of developing nations often require that the local affiliate export at least a portion of its output, and some require that it earn sufficient foreign exchange to cover the cost of its imports.
- To remain price competitive in the home market. Many firms import labor-intensive components produced in their foreign affiliates, or export components for assembly in countries where labor is less expensive and import the finished product.
- To test foreign markets and foreign competition inexpensively. This is a common strategy for firms that want to test a product's acceptance before investing in local production facilities. Exports may also enable firms to test market strategies and make adjustments with reduced risk in a smaller market. If the strategy or product fails, the firm can withdraw without having a costly and sometimes damaging failure to the entire firm. There is, however, a downside to this strategy: whatever the firm does in the foreign market may be seen by a competitor. This is especially true for large, global firms such as Unilever and Procter & Gamble. Former P&G CEO Edwin Artzt changed the company's strategy for introducing new products. Rather than postpone a global launch until the firm accumulated marketing experience in a country, P&G began to introduce products on a worldwide basis early in their development to avoid giving competitors time to react in other markets.
- To meet actual or prospective customer requests for the firm to export. This type of accidental exporting is fairly common. A foreign buyer often will search for something it cannot find locally by consulting the Internet or Thomas Net, a website listing North American producers for thousands of products.
- To offset cyclical sales in the domestic market.
- To achieve additional sales, which will allow the firm to use excess production capacity to lower per-unit fixed costs.
- To extend a product's life cycle by exporting to currently unserved markets where the product will be at the introduction stage of the life cycle.
- To respond strategically to foreign competitors that are in the firm's home market by entering their home market.
- To achieve the success the firm's management has seen others achieve by exporting.
- To improve the efficiency of manufacturing equipment, which usually works better at or near full capacity.

If management does decide to export, it can choose between *indirect* and *direct* exporting.

**Indirect Exporting** **Indirect exporting** is simpler than direct exporting because it requires neither special expertise nor large cash outlays by the company producing the product. Instead, the work of exporting the product is done by other home country-based companies, which can (a) sell for the manufacturer, (b) buy for their overseas customers, (c) buy and sell for their own accounts, or (d) purchase on behalf of foreign middlemen or users. Although each type of exporter usually operates in the manner explained next, any given company may actually perform one or more of these functions.

### **indirect exporting**

The exporting of goods and services through various types of home country-based exporters

#### **A. Exporters That Sell for the Manufacturer**

1. *Manufacturers' export agents* act as the international representatives for various non-competing domestic manufacturers. They usually direct promotion, consummate sales, invoice, ship, and handle the financing. They commonly are paid a commission for carrying out these functions in the name of the manufacturer.

2. *Export management companies (EMCs)* act as the export department for several non-competing manufacturers. They also transact business in the name of the manufacturer and handle the routine details of shipping and promotion. When the EMC works on a commission basis, the manufacturer invoices the customer directly and carries any financing required by the foreign buyer. However, most EMCs work on a buy-and-sell arrangement under which they pay the manufacturer, resell the product abroad, and invoice the customer directly. Depending on the arrangement, the EMC may act in the name of the firm it represents or in its own name.
3. *International trading companies* are similar to EMCs in that they also act as agents for some companies and as merchant wholesalers for others. This, however, is only part of their activities. They frequently export as well as import, own their own transportation facilities, and provide financing.

#### **B. Exporters That Buy for Their Overseas Customers**

1. *Export commission agents* represent overseas purchasers, such as import firms and large industrial users. They are paid a commission by the purchaser for acting as resident buyers in the exporting nation.

#### **C. Exporters That Buy and Sell for Their Own Accounts**

1. *Export merchants* purchase products directly from the manufacturer and then sell, invoice, and ship them in their own names so that foreign customers have no direct dealings with the manufacturer, as they do in the case of an export agent. If export merchants have an exclusive right to sell the manufacturer's products in an overseas territory, they are generally called *export distributors*. Some EMCs may actually be export distributors for a number of their clients.
2. Sometimes called *piggyback exporters*, **cooperative exporters** are established international manufacturers that sell the products of other companies in foreign markets along with their own. Carriers (exporters) may purchase and resell in their own name, or they may work on a commission basis. Carriers, like EMCs, serve as the export departments for the firms they represent.
3. *Webb-Pomerene Associations* are organizations of competing firms that have joined together for the sole purpose of export trade. At this time, there are fewer than 25 such associations. The Motion Picture Association (MPA), which is the legacy of a Webb-Pomerene Association, is the primary organization combating movie piracy around the world.

#### **D. Exporters That Purchase for Foreign Users and Middlemen**

1. *Large foreign users*, such as mining, petroleum, and international construction companies, buy for their own use overseas. The purchasing departments of all the worldwide companies are continually buying for their foreign affiliates, and both foreign governments and foreign firms maintain purchasing offices in industrialized countries.
2. *Export resident buyers* perform essentially the same functions as export commission agents. However, they are generally more closely associated with a foreign firm. They may be appointed as the official buying representatives and paid a retainer, or they may even be employees. This is in contrast to the export commission agent, who usually represents a number of overseas buyers and works on a transaction-by-transaction basis.

**Drawbacks of Indirect Exporting** Indirect exporters pay a price for having another company handle their exports: (1) they pay a commission to the first three kinds of exporters, (2) foreign business can be lost if exporters decide to change their sources of supply, and (3) firms gain little experience from these transactions. This is why many companies that begin in this manner generally change to direct exporting.

**Direct Exporting** To engage in **direct exporting**, the export business is handled by someone within the firm. The simplest arrangement is to give someone, often the sales manager, the

#### **cooperative exporters**

Established international manufacturers that export other manufacturers' goods as well as their own

#### **direct exporting**

The exporting of goods and services by the firm that produces them

responsibility for developing the export business. Domestic employees may handle the billing, credit, and shipping initially, and if the business expands, a separate export department may be set up. A firm that has been exporting to wholesale importers in an area and serving them with visits from either home office personnel or foreign-based sales representatives frequently finds that sales have grown to a point that will support a complete marketing organization.

Management may then decide to set up a **sales company** in the area. The sales company imports in its own name from the parent and invoices in local currency. It may employ the same channels of distribution, although the new organization may permit the use of a more profitable arrangement. This type of organization can grow quite large, often invoicing many millions of dollars annually. Before building a plant in Mexico, for many years Eastman Kodak imported and resold cameras and photographic supplies while doing a large business in local film developing. Many firms that began with local repair facilities later expanded to produce simple components. Gradually, they produced more of the product locally until, after a period of time, they were manufacturing all the components in the country.

The Internet has made direct exporting much easier. For the beginning exporter, the possibility of creating awareness that your product will be available abroad is dramatically increased. And although it is likely that a substantial international presence on the Internet will require a significant investment, the cost of trial is now very low.

**Distribution Options for Direct Exporters** If the firm chooses to do its own exporting but not directly handle distribution in the market it is exporting to, then it has four basic types of overseas middlemen from which to choose: (1) manufacturers' agents, (2) distributors, (3) retailers, and (4) trading companies. These may be serviced by sales personnel who either travel to the market or are based in it. If the sales volume is sufficient, a foreign sales company may be established to take the place of the wholesale importer. The manufacturing affiliates of most worldwide companies also import from home country plants or from other subsidiaries those products that they themselves do not produce.

1. **Manufacturers' agents** are residents of the country or region in which they are conducting business for the firm. They represent various noncompeting foreign suppliers, and they take orders in those firms' names. Manufacturers' agents usually work on a commission basis, pay their own expenses, and do not assume any financial responsibility. They often stock the products of some of their suppliers, thus combining the functions of agent and wholesale distributor.
2. **Distributors**, or *wholesale importers*, are independent merchants that buy for their own account. They import and stock for resale. Distributors are usually specialists in a particular field, such as farm equipment or pharmaceuticals. They may be given exclusive representation and, in return, agree not to handle competing brands. Distributors may buy through manufacturers' agents when the exporter employs them, or they may send their orders directly to the exporting firm. Instead of hiring manufacturers' agents, exporters may employ their own salespeople to cover the territory and assist the distributors. For years, worldwide companies such as Caterpillar and Goodyear have utilized field representatives in export territories.
3. *Retailers*, especially of consumer products, are frequently direct importers. Contact on behalf of the exporter is maintained either by a manufacturers' agent or by the exporter's sales representative based in the territory or traveling from the home office.
4. **Trading companies** are relatively unknown in the United States but are extremely important importers in other parts of the world. In a number of African nations, trading companies not only are the principal importers of goods ranging from consumer products to capital equipment, but also export such raw materials as ore, palm oil, and coffee. In addition, they operate department stores, grocery stores, and agencies for automobiles and farm machinery. Another form of trading company is owned by the state. State trading companies handle exports and imports in North Korea and Cuba, and in noncommunist nations where an industry is a government monopoly, such as petroleum in Mexico, exporters or their agents must deal with these government-owned entities.

**sales company**

A business established for the purpose of marketing goods and services, not producing them

**manufacturers' agents**

Independent sales representatives of various noncompeting suppliers

**distributors**

Independent importers that buy for their own account for resale

**trading companies**

Firms that develop international trade and serve as intermediaries between foreign buyers and domestic sellers and vice versa`

### turnkey project

An export of technology, management expertise, and, in some cases, capital equipment where a contractor agrees to design and erect a plant, supply the process technology, provide the necessary suppliers of raw materials and other production inputs, train the operating personnel, and after a trial run, turns the facility over to the purchaser

### licensing

A contractual arrangement in which one firm grants access to its patents, trade secrets, or technology to another for a fee

**Turnkey Projects** Turnkey project is an export of technology, management expertise, and, in some cases, capital equipment. The contractor agrees to design and erect a plant, supply the process technology, provide the necessary suppliers of raw materials and other production inputs, and then train the operating personnel. After a trial run, the facility is turned over to the purchaser.

The exporter of a turnkey project may be a contractor that specializes in designing and erecting plants in a particular industry, such as petroleum refining or steel production. It may also be a company in the industry that wishes to earn money from its expertise by delivering a plant ready to run rather than merely selling its technology. Another kind of supplier of a turnkey project is the producer of a factory.

**Licensing** Frequently, worldwide companies are called on to furnish technical assistance to firms that have sufficient capital and management strength. By means of a **licensing** agreement, one firm (the licensor) will grant to another firm (the licensee) the right to use any kind of expertise, such as manufacturing processes (patented or unpatented), marketing procedures, and trademarks for one or more of the licensor's products.

The licensee generally pays a fixed sum when signing the licensing agreement and then pays a royalty of 2 to 5 percent of sales over the life of the contract (five to seven years with an option for renewal is one common way to structure such agreements). The exact amount of the royalty will depend on the amount of assistance given and the relative bargaining power of the two parties. In 2009, the total paid to American firms in foreign royalties and license fees amounted to \$90 billion.<sup>2</sup>

In the past, licensing was not a primary source of income for international firms due to patent infringement, which can be considered a form of piracy. Licensing has changed in recent years, however, especially in the United States, because (1) the courts began upholding patent infringement claims more than they used to, (2) patent holders became more vigilant in suing violators, and (3) the federal government pressed foreign governments to enforce their patent laws.

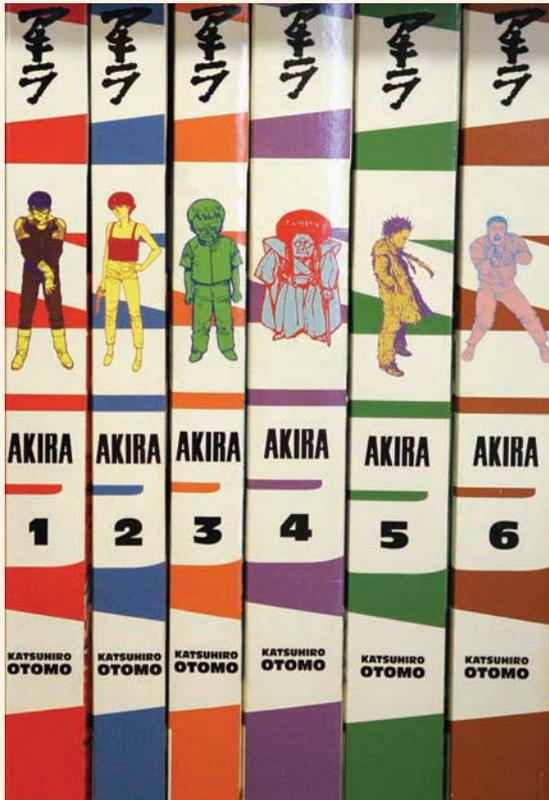
As a result, more companies at home and abroad began to obtain licenses instead of making illegal copies. Texas Instruments (TI), for example, sued nine Japanese electronics



A woman sits beside her stall with Pierre Cardin shirts on a Hanoi street in June 2004. The shirts are made under French designer Pierre Cardin's firm license by a local garment factory. Each shirt sells for around 10 US dollars.



Piracy as a Means of Foreign Market Entry



Although we discuss elsewhere in this chapter the threats to companies from piracy of intellectual property such as brand names or patented technology, piracy can also contribute to the global spread of a product—sort of market entry by accident.<sup>a</sup>

Japanese *anime* has estimated global sales of \$80 billion, 10 times what it was a decade ago. Former Japanese Prime Minister Junichiro Koizumi once called it the “savior of Japanese culture.” Disney has purchased the American rights to a number of anime films. The Cartoon Network shows several anime series as part of its Adult Swim programming. TOKOPOP will publish 400 volumes of translated Japanese comics for U.S. consumption.

Two decades ago, there was no U.S. market for Japanese anime. The change occurred not through a concerted push from Japanese media companies but in response to American fans who pulled anime in.

Although Japanese anime was exported to the West in the early 1960s, some saw it as inappropriate for American children, and by the late 1960s it was available only in Japanese overseas communities. The advent of the videotape recorder allowed dubbing and sharing, and soon anime fans were contacting both Japanese citizens and American soldiers stationed in Japan for tapes. Fan clubs emerged as essentially lending libraries and dubbing

centers. In the late 1980s and 1990s, amateurs began dubbing these tapes into English: this “fansubbing” spread. In the early 1990s, large-scale anime conventions brought artists and distributors from Japan, who were astonished to see this thriving content they had never marketed. They returned to Japan ready to service this market commercially. The fan clubs continued their operations, but stopped fansubbing and distributing titles as they became commercially available.

This “piracy” is now supported by the commercial industry, which in fact sponsors events where fan-made *manga*,<sup>b</sup> a highly derivative version of the commercial product, is sold. The media companies use these events to publicize their own releases, spot new talent, and monitor shifts in audience tastes.

The idea that some piracy actually helps to diffuse new products is not limited to Japanese anime. It has also been tested for software.

Careful analysis actually found that software piracy is not necessarily harmful to a software firm seeking to launch a new product, because it establishes initial adopters (pirates) and speeds up software diffusion: these initial adopters then influence others to buy the product. Generally speaking, however, as the product diffuses in the market, the level of protection against piracy should be increased.

In a third industry, an international sample across 25 countries suggested that piracy of theatrical movies was actually slightly beneficial to the movie industry!

Questions:

1. How can piracy help a company to successfully, and profitably, enter foreign markets?
2. Consider the case of a small or medium-sized company that was producing software or applications for use on cell phones. If you were asked by this company to assist them in developing a strategy for using piracy as a means of entering foreign markets, what advice would you give them regarding how to successfully develop and implement such a strategy?

<sup>a</sup>Sources for this box include: Henry Jenkins, “When Piracy Becomes Promotion,” *MIT Technology Review*, August 10, 2004, [www.technologyreview.com/biomedicine/13722/](http://www.technologyreview.com/biomedicine/13722/) (June 21, 2011); Ernan Haruvy, Vijay Mahajan, and Ashutosh Prasad, “The Effect of Piracy on the Market Penetration of Subscription Software,” *Journal of Business* 77, no. S2 (April 2004), pp. S81–S107; Ashutosh Prasad and Vijay Mahajan, “How Many Pirates Should a Software Firm Tolerate? An Analysis of Piracy Protection on the Diffusion of Software,” *International Journal of Research in Marketing* 20, no. 4 (2003), pp. 337–53, [www.sciencedirect.com/science/article/pii/S0167811603000491](http://www.sciencedirect.com/science/article/pii/S0167811603000491) (June 21, 2011); TorrentFreak, “Internet Piracy Boosts Anime Sales, Study Concludes,” <http://torrentfreak.com/internet-piracy-boosts-anime-sales-study-concludes-110203/> (June 21, 2011); and Sung Woo Ji, “Piracy Impact on the Theatrical Movie Industry,” [www.allacademic.com/meta/p172966\\_index.html](http://www.allacademic.com/meta/p172966_index.html) (accessed July 4, 2008).

<sup>b</sup>Anime in Japan refers to an animated film, and *manga* is a printed cartoon.

manufacturers for using its patented processes without paying licensing fees. The defendants have paid TI more than \$1 billion since 1986. Although the company does not publish its royalty receipts in its income statements, here's an idea of the magnitude of the earnings from royalties associated with TI's 6,000 patents: TI announced 10-year agreements with both Hyundai Electronics and Samsung Electronics projected to yield royalty payments of more than \$1 billion.

Technology is not the only thing that is licensed to support a firm's market entry. In the fashion industry, a number of designers license the use of their names. Pierre Cardin, one of the largest such licensors, reported more than 400 licenses in more than 170 countries for thousands of different products, ranging from a broad range of clothing to such items as skis, frying pans, sardines, floor tiles, and silk cigarettes. These licenses have earned the company approximately \$75 million annually. As Cardin himself commented, "If someone asked me to do toilet paper, I'd do it. Why not?"<sup>3</sup>

Are you giving Coca-Cola free advertising on your T-shirt? The company's manager for merchandise licensing expects the company to make millions from an agreement with the founder of Gloria Vanderbilt. He says the firm agreed to the arrangement because "clothes enhance our image. The money is not important."

Another industry, magazine publishing, is licensing overseas editions. For example, you can buy *Cosmopolitan* in more than 100 countries, and it is printed in 32 different languages.<sup>4</sup> *Playboy* is available in 23 different international editions, including in the Islamic nation of Indonesia.<sup>5</sup>

Despite the opportunity to obtain a sizable income from licensing, many firms, especially those that produce high-tech products, still will not grant licenses. They fear that a licensee will become a competitor upon expiration of the agreement or that the licensee will aggressively seek to market the products outside its home territory. At one time, licensors routinely inserted a clause in the licensing agreement that prohibited exports, but most governments will not accept such a prohibition.

### franchising

A form of licensing in which one firm contracts with another to operate a certain type of business under an established name according to specific rules

**Franchising** Firms have also gone overseas with a different kind of licensing—**franchising**. Franchising permits the franchisee to sell products or services under a highly publicized brand name and a well-proven set of procedures with a carefully developed and controlled marketing strategy. Of some 500 U.S. franchisors with approximately 50,000 outlets worldwide, fast-food operations (such as McDonald's, KFC, Subway, and Pizza Hut) are the most numerous. Other types of franchisors are hotels (Intercontinental), business services (Muzak, The UPS Store), fitness (Curves, Jazzercise), building maintenance (Service-Master, Nationwide Exterminating), and real estate (ReMax).

### management contract

An arrangement by which one firm provides management in all or specific areas to another firm

**Management Contract** The **management contract** is an arrangement under which a company provides managerial know-how in some or all functional areas to another party for a fee that typically ranges from 2 to 5 percent of sales. International companies make such contracts with (1) firms in which they have no ownership (e.g., Hilton Hotel provides management for nonowned overseas hotels that use the Hilton name, and Delta provides management assistance to foreign airlines), (2) joint venture partners, and (3) wholly owned subsidiaries. The last arrangement is made solely for the purpose of allowing the parent to siphon off some of the subsidiary's profits. This becomes extremely important when, as in many foreign exchange-poor nations, the parent firm is limited in the amount of profits it can repatriate. Moreover, because the fee is an expense, the subsidiary receives a tax benefit in the foreign subsidiary's country. This practice may also allow the parent firm to better manage its corporate-wide tax burden by reducing profits within higher-tax nations and moving them instead to countries with lower tax rates.

### contract manufacturing

An arrangement in which one firm contracts with another to produce products to its specifications but assumes responsibility for marketing

**Contract Manufacturing** International firms employ **contract manufacturing** in two ways. One way is as a means of entering a foreign market without investing in plant facilities. The firm contracts with a local manufacturer to produce products for it according to its specifications. The firm's sales organization markets the products under its own brand.

The second way is to subcontract assembly work or the production of parts to independent companies overseas. Although the international firm has no equity in the subcontractor, this practice does resemble foreign direct investment. When the international firm is the largest or only customer of the subcontractors, it has in effect created in another country a new company that generates employment and foreign exchange for the host nation. Frequently, the international firm will lend capital to the foreign contractor in the same way that a global or multinational firm will lend funds to its subsidiary. Because of these similarities, this practice is sometimes called *foreign direct investment without investment*.

## EQUITY-BASED MODES OF ENTRY

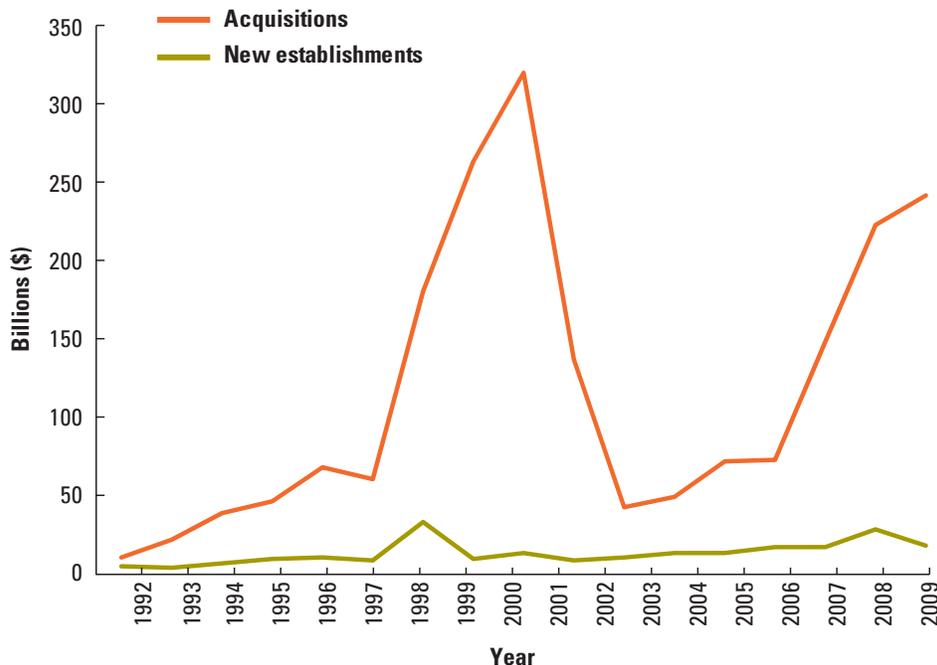
When management does decide to make a foreign direct investment, it usually has several alternatives available, though not all of them may be feasible in a particular country:

1. Wholly owned subsidiary
2. Joint venture
3. Strategic alliances

**Wholly Owned Subsidiary** A company that wishes to own a foreign subsidiary outright may (1) start from the ground up by building a new plant (greenfield investment) or (2) acquire a going concern. In the latter instance, a company might even purchase its distributor, thus obtaining a distribution network familiar with its products, although in such a case it will typically be necessary to build production facilities.

Historically, firms making a foreign direct investment have generally preferred wholly owned subsidiaries, but they have not had a marked preference for either of the two means of obtaining them. However, this has not been the case for foreign investors in the United States, who have demonstrated a general preference for acquiring going concerns for the instant access to the market they provide. Moreover, they also have one less competitor after the purchase. In 2008, 93 percent of the \$261 billion that was invested in the United States was used to acquire existing companies, versus spent to create new businesses.

Sometimes it is not possible to have a wholly owned subsidiary in a foreign market. The host government may not permit it, the firm may lack either capital or expertise to



**FIGURE 13.1**

Investments into the United States for Acquisitions versus New Establishments, 1992–2009

## joint venture

A cooperative effort among two or more organizations that share a common interest in a business enterprise or undertaking

### L013-4 Explain

the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.

undertake the investment alone, or there may be tax and other advantages that favor another form of investment, such as a joint venture.

**Joint Venture** A **joint venture** may be (1) a corporate entity formed by an international company and local owners, (2) a corporate entity formed by two international companies for the purpose of doing business in a third market, (3) a corporate entity formed by a government agency (usually in the country of investment) and an international firm, or (4) a cooperative undertaking between two or more firms of a limited-duration project. Large construction jobs such as a dam or an airport are frequently handled by this last form.

## Benefits of Joint Ventures

**Reduced Risk and Competition or Increased Scale Economies** Sometimes, forming a joint venture can allow the partners to avoid making expensive and time-consuming investments of their own, while simultaneously helping to avoid dangerous competition with another company. Some firms, as a matter of policy, enter joint ventures to reduce investment risk. Their strategy is to enter into a joint venture with either native partners or another worldwide company. Still others have joined together to achieve economies of scale. Incidentally, any division of ownership in a joint venture is possible unless there are specific legal requirements.

**Government Regulations for Local Participation** When the government of a host country requires that companies have some local participation, foreign firms must engage in joint ventures with local owners to do business in that country. In some situations, however, a foreign firm will seek local partners even when there is no local requirement to do so.

**Strong Nationalism** Strong nationalistic sentiment may cause the foreign firm to try to lose its identity by joining with local investors. Care must be taken with this strategy, however. Although a large number of people in many developing countries dislike multinationals for “exploiting” them, they still believe, often with good reason, that the products of the foreign companies are superior to those of purely national firms. One solution to this ambivalence has been to form a joint venture in which the local partners are highly visible, give it an indigenous name, and then advertise that a foreign firm (actually the partner) is supplying the technology. Even wholly owned subsidiaries have followed this marketing strategy.

**Expertise, Tax, and Other Benefits** Other factors that influence companies to enter joint ventures are the ability to acquire expertise that is lacking, the special tax benefits some governments extend to companies with local partners, and the need for additional capital and experienced personnel.

**A Disadvantage of Joint Ventures: Loss of Control** Although a joint venture arrangement offers the advantage of a smaller commitment of financial and managerial resources and thus less risk, there are some disadvantages for the foreign firm. One, obviously, is that profits must be shared. Furthermore, if the law allows the foreign investor to have no more than 49 percent participation, it may not have equity-based control. If the stock markets in these countries are small or nonexistent, it is generally impossible to distribute the shares widely enough to permit the foreign firm with its 49 percent ownership position to be the largest stockholder.

Lack of full control over the joint venture is the reason many companies resist making such arrangements. They feel that they must have tight control of their foreign subsidiaries to obtain an efficient allocation of investments and production and to maintain a coordinated marketing plan worldwide. For example, local partners might wish to export to markets that the global company serves from its own plants, or they might want to make the complete product locally when the global company’s strategy is to produce only certain components there and import the rest from other subsidiaries.

In the recent past, numerous governments of developing nations have passed laws requiring local majority ownership for the purpose of giving equity-based control of firms within their borders to their own citizens. Despite these laws, a substantial level of control may still be feasible, even with a minority ownership.

**Control of Joint Ventures through Management Contracts** Management contracts, which were discussed earlier in this chapter under nonequity-based modes of entry, can enable the global partner to control many aspects of a joint venture even when holding only a minority position. If it supplies key personnel, such as the production and technical managers, the global company can be assured of the product quality with which its name may be associated. It may also be able to earn additional income by selling the joint venture inputs manufactured in the home plant. This is possible because the larger global company is more vertically integrated. A local paint factory, for example, might have to import certain semi-processed pigments and driers that the foreign partner produces in its home country for domestic operations. If these can be purchased elsewhere at a lower price, the local majority could insist on other sources of supply. This rarely happens, because the production and technical managers can argue that only inputs from their employer will produce a satisfactory product, especially if the production machinery being used has been purchased based on specifications from the foreign partner. The production and technical managers are the experts, and they generally have the final word.

**Other Options for Exercising Control in Joint Ventures** Even as a minority shareholder, a partner company may be able to exercise some control over the joint ventures operations through such mechanisms as supermajority voting requirements (e.g., requiring a two-thirds or more vote in a venture with a 51 percent to 49 percent ownership split in order to approve strategic decisions), maintaining the right to appoint or approve key managerial positions, splitting control of the venture so that each partner may have primary influence over certain key activities (e.g., sourcing of raw materials or components, finance, production, technology), control over or participation in the design and implementation of performance appraisal and reward systems for top management and other personnel of the joint venture, and so forth.

**Strategic Alliance** Faced with expanding global competition; the growing cost of research, product development, and marketing; and the need to move faster in carrying out their global strategies, many firms are forming **strategic alliances** with customers, suppliers, and competitors. In fact, in a 12-country study, consultants Ernst & Young found that 65 percent of non-U.S. and 75 percent of U.S. companies are engaged in some form of strategic alliance.<sup>6</sup> The aim of these companies is to achieve faster market entry and startup; gain access to new products, technologies, and markets; and share costs, resources, and risks. Alliances include various types of partnerships and may or may not include equity. Companies wanting to share technology may cross-license their technology, with each licensing its technology to the other. If their aim is to pool research and design resources, they may form an R&D partnership. For example, Nokia and Microsoft formed an alliance in 2011 to collaborate in the development of software for technologically advanced cell phones.

**strategic alliance**

A partnership between or among competitors, customers, or suppliers that may take one or more of various forms, both equity and nonequity

**Alliances May Be Joint Ventures** Other companies carry the cooperation further by forming joint ventures in manufacturing and marketing.

*Nissan of Japan was a struggling automaker in the 1990s, with \$20 billion in debt and declining market share. Renault of France decided to form an alliance with Nissan rather than merge the companies. Renault sent Carlos Ghosn to become CEO and president of Nissan. Ghosn's team developed and implemented an aggressive turnaround plan, one that has provided benefits for both partners. They have leveraged their size and competencies to enter new markets more rapidly and with lower costs, because they do not need to build new plants. For example, Renault has used Nissan's assembly plants in Mexico, and Nissan uses Renault's Brazilian plant and distribution network. The alliance has increased sales, profitability, and market capitalization for both of the partners. In 2006, these two partners began discussing the possibility of an alliance with another ailing automaker, General Motors of the United States. However, these discussions ended without an alliance.*



## Joint Venture Challenges: Danone and Wahaha in China

Group Danone SA of France is a major player in the international food and beverage industry, with 90,000 employees spread across five continents. In contrast, the Chinese company Wahaha Group Co. Ltd. was established by Zong Qinhou in the late 1980s as a venture involving three people selling beverages to schoolchildren, later growing into the largest Chinese bottled-water company.

In 1996, Danone and Wahaha agreed to establish a joint venture (JV) in China, eventually expanding to 39 different JVs between them. Danone was the majority owner in the JVs, with a 51 percent share of the equity, and Zong was the chairman of the JVs' boards. Danone had limited involvement in the day-to-day operation of the JVs, delegating this task to Zong and his Chinese management team. In 2006, these ventures generated revenues of \$2 billion and a strong position in the Chinese beverage market. From the outside, this partnership seemed to be a great success.

All was apparently not perfect between the partners, however. By 2005, Danone learned that Zong apparently had been setting up "mirror" businesses that produced and sold products that were nearly identical to those offered by the partners' JVs. These mirror companies, which would be a violation of the JV agreements, even used the Wahaha name to benefit from the JVs' advertisements and sales networks.

Danone negotiated quietly with Zong to resolve the newly discovered problem. In December 2006, an agreement was apparently achieved to combine the mirror companies with the JVs

and to pay \$566 million to Zong. Zong subsequently backed out of the deal, which he claimed to have only signed under "forced" conditions and for an amount far below the mirror companies' value.

After the agreement collapsed in 2007, the disputes between the partners first became public. Danone sought arbitration with Zong in Sweden. Danone also filed lawsuits in the United States and elsewhere for trademark infringement and violation of non-compete clauses. Danone accused Zong of masterminding the fraud with assistance from relatives and offshore entities.

Zong's response was to organize rallies and news conferences that denounced Danone's managers as "rascals" who had committed "evil deeds"; Zong even accused Danone of having engaged in poor treatment of the Chinese. Reflecting an escalation of tensions between the companies, Wahaha executives apparently prevented Danone officials from entering the JVs' buildings.

Zong also filed a request for arbitration in China, in Wahaha's headquarters' city of Hangzhou, arguing that the Wahaha trademark was owned by Wahaha and not the Danone-Wahaha JV. Zong acknowledged that he had signed an agreement with Danone to transfer use of Wahaha's trademark to the JV and to prevent Wahaha from expanding independently into the Chinese beverage market. However, Zong said he never submitted the agreement to the Chinese trademark office for approval, so the agreement never took effect. The Hangzhou Arbitration Commission upheld Zong's assertion that no agreement had been approved by the government and therefore Zong was not prevented from also using the Wahaha trademark or from entering the Chinese beverage market.

### pooling alliance

An alliance driven by similarity and integration among partners

### trading alliance

An alliance driven by the logic of partners contributing dissimilar resources

**Pooling versus Trading Alliances** A useful distinction can be made between pooling and trading alliances. **Pooling alliances** are driven by similarity and integration, while **trading alliances** are driven by the logic of contributing dissimilar resources. These two types are typically different in their goals (common versus compatible goals), optimal structures (many versus few partners), and managerial challenges (low versus high coordination needs).<sup>7</sup>

**Alliances versus Mergers and Acquisitions** Generally mergers and acquisitions are not considered alliances. However, both may be ways for firms to get their hands on new technology, by either acquiring or working with smaller, innovative firms. For example, the merger between Canadian brewer Molson and U.S. brewer Coors was analyzed by many as a union of two "struggling" mid-sized beer companies. The merged company was part of a joint venture with the U.S. operations of SABMiller plc, the maker of Miller beer. Sandoz, a Swiss pharmaceutical manufacturer, acquired Gerber for \$3.7 billion in order to double the size of its food products division. Two years later, because of the increased global competition and the mounting cost of technology, Sandoz and Ciba Geigy, another Swiss drug company, merged to form Novartis, which became the second-largest pharmaceutical firm in the world. Novartis later sold Gerber to Nestlé.

**Future of Alliances** Many alliances fail or are taken over by one of the partners. The existence of two or more partners—which are often competitors as well as partners and

Several of Zong's companies also sued JV directors nominated by Danone, arguing that they violated non-compete clauses by serving not just on the Danone-Wahaha boards but also on boards of other companies in China that were competing with Wahaha.

Ultimately, the disagreement included at least a dozen lawsuits or arbitration cases filed in a variety of nations, including China, France, Sweden, the United States, Italy, British Virgin Islands, and Samoa. The situation became a major international dispute, including unsuccessful mediation efforts by the leaders of both France and China. Danone's public image and future competitiveness in China were put at risk. Strong feelings of nationalism caused many Chinese consumers and other observers to side with the local Chinese company, Wahaha. Zong was even viewed by some as a national hero for battling heroically against a giant, foreign bully, Danone. Heated debates appeared among Chinese bloggers to promote a boycott of Danone products. At the same time, the Chinese government was concerned about how the Danone-Wahaha dispute might affect the image of China as a desirable destination for international business investment as well as maintaining popular support within China.

In late 2009, Danone agreed to sell its 51 percent share of the JVs to Wahaha for cash and announced that all legal proceedings between the partners were concluded. Danone's CEO and chairman, Frank Riboud, commented, "The collaboration between Danone and Wahaha helped to build a strong and respected leader in the Chinese beverage industry. We are confident that Wahaha will continue to be highly successful under its future management guidance." Wahaha's chairman, Zong, said, "China is an open country. Chinese people are broad-minded people. Chinese companies are willing to cooperate and grow with the world's leading peers on the basis of equality and reciprocal benefit."



#### Questions:

1. Why do you think the problems arose between Danone and Zong?
2. What might Danone have done to either avoid or reduce the problems that occurred over the life of the JVs?

Sources: Samuel Shen and Jacqueline Wong, "Danone Ends Wahaha Dispute, to Sell China JV Stake," [www.reuters.com/article/2009/09/30/us-danone-wahaha-idUSTRE58T12120090930](http://www.reuters.com/article/2009/09/30/us-danone-wahaha-idUSTRE58T12120090930) (June 21, 2011); "Danone v. Wahaha—Which of Us Is the Most China Rookie?," China Law Blog, [www.chinalawblog.com/2007/04/danone\\_v\\_wahaha\\_which\\_of\\_us\\_is.html](http://www.chinalawblog.com/2007/04/danone_v_wahaha_which_of_us_is.html) (June 21, 2011); "Danone Settles Dispute with Wahaha," *China Daily*, September 30, 2009, [www.chinadaily.com.cn/china/2009-09/30/content\\_8758022.htm](http://www.chinadaily.com.cn/china/2009-09/30/content_8758022.htm) (June 21, 2011); David Barboza, "Danone Exits China Venture after Years of Legal Dispute," *The New York Times*, September 30, 2009, [www.nytimes.com/2009/10/01/business/global/01danone.html](http://www.nytimes.com/2009/10/01/business/global/01danone.html) (June 21, 2011); and Jingzhou Tao and Edward Hillier, "A Tale of Two Companies," *China Business Review*, May–June 2008, pp. 44–47.

typically have differences in strategies, operating practices, and organizational cultures—often causes alliances to be difficult to manage, particularly in rapidly changing international competitive environments.<sup>8</sup> Alliances can also allow a partner to acquire the firm's technological or other competencies, thereby raising important competitive concerns. The management consulting firm McKinsey & Co. surveyed 150 companies whose alliances with Japanese partners had been terminated. It found that three-quarters of the alliances had been taken over by Japanese partners.

Despite the challenges involved with forming and managing alliances successfully, there is no question that some alliances have accomplished what they set out to accomplish. For example, CFM International, the alliance between General Electric and France's Snecma (Société Nationale d'Étude et de Construction de Moteurs d'Aviation), has been producing jet engines for nearly four decades. It seems that alliances in their various forms will continue to be used as important strategic and tactical weapons, particularly given the financial, technological, political, and other challenges facing companies involved in increasingly competitive international marketplaces.

We began the chapter with a discussion of whether being first in the market meant profitability and discovered that the answer is, "It depends." Whether one is first, an early follower, or a late entrant, there are still chances for success, particularly if a company chooses an appropriate mode of entry and then manages the entry process in an effective manner.



### Mark Haupt: A Central California–based International Career



Mark Haupt graduated from Cal Poly with a business degree, concentrating in international business. He loved the area where he went to university and wanted to continue living there, so he put together a career that is both international and allows him to work near home. Here's his story:

*I think my interest in international business started when I was little. My father had a job with IBM and he was constantly traveling domestically and internationally. I'm also a big soccer fan and soccer is such a global sport that you start learning more and more about different countries, cities, cultures, etc. . . . and that has always been fascinating to me. I grew up with a lot of different ethnicities and cultures around and it's the differences—and sometimes similarities—that make things interesting to me.*

*After graduation, I wanted to remain in the Central Coast region of California, near the ocean, but also have international business opportunities. Despite the rural nature of this area, I was able to find a position with a local sporting goods company. I am in charge of our specialty/sporting goods division and my title is "Specialty Sales Manager." I manage a network of sales representatives, domestic and international, as well as select independent accounts and key accounts.*

*In less than two years with the company, I have worked with customers in more than 30 different nations, including Australia, New Zealand, Canada, Mexico, Colombia, Brazil, Chile, Venezuela, Ireland, England, Germany, Italy, France, the Benelux Region (Belgium, Netherlands, Luxembourg), Scandinavia (Iceland, Sweden, Norway, Finland, Denmark), Romania, Latvia, Belarus, China, Japan, Singapore, Australia, New Zealand, South Africa, Egypt, and Russia. My business association with most of these customers is a distribution arrangement. Companies in these countries distribute my company's products as well as those of other firms.*

*To prepare for travel, I always like to research the country I am visiting. I start by finding out a little about that country's sport of choice. For me, that's always an easy conversation starter and something that almost everyone has an opinion on. Then I like to find out about popular venues, sights, etc. Finally, I find out what to do or not to do. I research online and talk to people who have already visited the country. I pack light because I never seem to need much besides a few business outfits and some casual clothes. English has been the accepted business language for all my travels, but I like to learn at least a few words of the native language. For me, that shows that I am interested in the country and people*

*seem to appreciate that. I don't have any routines for when I return from travel. I always seem to take way too long to unpack to the point where I run out of clothes. I am working on that.*

*To help myself adjust to being away, I always make sure I'm exhausted before I get on the plane. I sleep amazingly well on planes, probably because I have been flying ever since I was little. Usually, I wake up completely refreshed when I arrive.*

*To make my U.S. location convenient for my international counterparts, I have kept some odd hours. I rely on e-mail, but that usually creates a one-day delay and sometimes doesn't deliver the message effectively. If I use phone or video chat, I try to make the hours work for my customers, which isn't always easy. I have fielded calls as early as 5 A.M. and as late as midnight. That's all part of the job.*

*My biggest challenge to date has been working on a special order from one of my customers in Asia. Our factory is located in Taiwan, and I have encountered endless complications with molds, materials, packaging, etc. It's easy enough to say you can make a special product and give pricing. It is much more complicated once this actually comes to fruition. For big special orders, it's important that you get everything right. Errors that you might not think about can ruin a project and, potentially, a business relationship.*

*My greatest international-related enjoyment was going to New Zealand. I loved it over there. The scenery, people, and activities are all amazing. My greatest international business-related enjoyment was starting a relationship with what I first considered to be a mid-sized customer internationally and watching that customer blossom into one of our biggest customers. In sales, you don't always see your efforts pay off. Sometimes you work extra hours and put your heart and soul into something and get nothing out of it. It's extremely satisfying when you put in the extra effort, work extra hours, and it all pays off.*

*My greatest learning point from my international experience is that I have learned to assume nothing. I have become so incredibly detailed in everything I do because I can never assume that a customer or client understands something exactly the way I do, especially when English isn't their native language. It is much easier to go over something twice in the beginning rather than look back and try to correct a misunderstanding.*

*My advice for others who are interested in going abroad or working with others who are abroad is the following: if you have the chance, learn any language you can. This is an invaluable asset. Spend some time learning about the countries you are visiting or doing business with, and be extremely inquisitive. Do not act as if you already know everything. It's good to be knowledgeable and worldly, but people love talking about their country and culture and*

(continued)

*love it when you ask questions and are curious about their lifestyles. Be curious, but not ignorant. Make sure you don't ask anything that might bring up a sore subject.*

## Resources for Your Global Career

Making the “no go” decision is just as critical as making the “go” decision when considering if your organization should go international. The following articles and tools will assist you in objectively assessing the variables involved in this decision. The wrong decision will be costly to your organization in terms of money, staff time, and your organization’s reputation. Take the time to do the analysis so the decision you make is the right decision. Here are some websites that can help you to make good decisions:

- KPMG’s “Value and International Performance Research” on foreign market entry: [www.kpmg.com/hk/en/virtual\\_library/Consumer\\_markets/Foreign\\_market\\_entry.pdf](http://www.kpmg.com/hk/en/virtual_library/Consumer_markets/Foreign_market_entry.pdf)
- Should you go international? This article from the Washington *Business Journal* provides insight: <http://washington.bizjournals.com/washington/stories/2005/06/06/smallb3.html>
- Six major concerns about going into foreign markets: [www.inc.com/magazine/20070401/features-how-to-get-started.html](http://www.inc.com/magazine/20070401/features-how-to-get-started.html)
- Strategies for identifying international markets: [www.canadabusiness.ca/eng/88/194/](http://www.canadabusiness.ca/eng/88/194/)
- Your portal for market-entry assistance: <http://faculty.philau.edu/russowl/market.html>
- How to select which foreign market to enter: [http://marketingteacher.com/Lessons/lesson\\_international\\_marketing\\_entry\\_evaluation\\_process.htm](http://marketingteacher.com/Lessons/lesson_international_marketing_entry_evaluation_process.htm)
- Using FDI as a mode of entry: [www.canadabusiness.ca/eng/105/175/](http://www.canadabusiness.ca/eng/105/175/) and <http://jobfunctions.bnet.com/abstract.aspx?&docid=76544&promo=110000>
- Modes of foreign market entry: <http://jobfunctions.bnet.com/abstract.aspx?&docid=72028&promo=100511>
- Research on corporate culture as a factor in foreign market-entry decisions: <http://smib.vuw.ac.nz:8081/WWW/ANZMAC2001/anzmac/AUTHORS/pdfs/Evans1.pdf>
- Exporting information from AUSTRADE, the Australian government’s Office of Export Management and Assistance: [www.austrade.gov.au/Getting-ready-for-export/default.aspx](http://www.austrade.gov.au/Getting-ready-for-export/default.aspx)
- Case study: Campbell Soup Company’s entry strategy into Russia: [www.edamba.eu/userfiles/Permiakova.pdf](http://www.edamba.eu/userfiles/Permiakova.pdf)
- Costs of developing foreign markets: [www.smallbusiness-notes.com/aboutsb/rs241.html](http://www.smallbusiness-notes.com/aboutsb/rs241.html) and [archive.sba.gov/adv/research/rs241tot.pdf](http://archive.sba.gov/adv/research/rs241tot.pdf)

## Summary

### **L013-1 Understand the pros and cons of entering markets as a “market pioneer” versus being a “fast follower.”**

A firm can succeed from any position, as the examples illustrate. In general, however, a follower is more likely to succeed if it has lots of resources. Smaller, less-well-financed followers are less likely to be successful. Pioneers appear to have the best chance for long-term success in market share profitability when they are insulated from entry by competitors due to strong patent protection, proprietary technology, or substantial investment requirements, or if the pioneering firm has sufficient size, resources, and competencies to take full advantage of and preserve its pioneering position in the face of later competitive entry.

### **L013-2 Explain the international market-entry methods.**

Methods of entering foreign markets can be assessed as nonequity- or equity-based situations. Nonequity-based modes of entry include indirect or direct exporting, turnkey projects, licensing, franchising, management contracts, and contract manufacturing. Equity-based modes of market entry include wholly owned subsidiaries, joint ventures, and strategic alliances.

### **L013-3 Discuss why firms export and the options available for indirect and direct exporting.**

Firms can achieve many benefits from exporting, including serving markets where they have no or limited production facilities, responding to host government requirements for exports by local subsidiaries, remain price competitive in the home market,

inexpensively test foreign markets and competitors, meet foreign customer requests, offset cyclical sales in the domestic market, achieve additional sales and utilize excess production capacity, extend a product’s life cycle, respond strategically to foreign competitors that are in the firm’s home market by entering their home market, achieve success observed by other exporters, and improve the efficiency of manufacturing equipment. Indirect exporting can occur through exporters that sell for the manufacturer, exporters that buy for their overseas customers, exporters that buy and sell for their own accounts, and exporters that purchase for foreign users and middlemen. Direct exporting can occur through manufacturers’ agents, distributors, retailers, and trading companies.

### **L013-4 Explain the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.**

Joint ventures can allow the partner companies to benefit from reduced risk and competition or increased scale economies; ability to meet government regulations for local participation; respond to strong nationalism, and achieve expertise, tax, and other benefits. A major potential disadvantage of joint ventures is loss of control, but even as a minority shareholder a partner company may be able to exercise some control over the joint venture through management contracts, supermajority voting requirements, appointment of key managers, split control structures, and the design and implementation of performance appraisal and reward systems for the venture’s personnel.

## Key Words

**indirect exporting** (p. 325)

**cooperative exporters** (p. 326)

**direct exporting** (p. 326)

**sales company** (p. 327)

**manufacturers' agents** (p. 327)

**distributors** (p. 327)

**trading companies** (p. 327)

**turnkey project** (p. 328)

**licensing** (p. 328)

**franchising** (p. 330)

**management contract** (p. 330)

**contract manufacturing** (p. 330)

**joint venture** (p. 332)

**strategic alliances** (p. 333)

**pooling alliance** (p. 334)

**trading alliance** (p. 334)

## Questions

1. If a company wanted to be a pioneer for entering a market, what conditions might increase the likelihood of success? If the company wanted to instead be a fast follower, what would be different in terms of the conditions that would increase the likelihood of the company's successful entry?
2. What are the methods by which a firm can enter foreign markets?
3. Why might a company want to engage in exporting?
4. What is indirect exporting, and how does it differ from direct exporting? What are the main types of indirect exporting, and what are the primary strengths and weaknesses of each type?
5. What are the distribution options that a direct exporter can use, and what are the primary strengths and weaknesses of each type?
6. What entry mode do fashion designers such as Pierre Cardin, and some high-tech firms like Texas Instruments, share in common? Why might this be an attractive option for entering foreign markets?
7. Under what circumstances might piracy be beneficial to an exporter?
8. Why would a global firm or multinational require that a wholly owned foreign subsidiary sign a management contract when it already owns the subsidiary?
9. Under what conditions might a company prefer a joint venture to a wholly owned subsidiary when making a foreign investment?
10. How can a company control a joint venture if it only has a minority share of the equity?
11. What is the difference, if any, between a joint venture and a strategic alliance?

## Research Task



Use the globalEDGE site (<http://globalEDGE.msu.edu/>) to complete the following exercises:

1. *Entrepreneur* magazine annually publishes a ranking of America's top 200 *franchisers* seeking international franchisees. Provide a list of the top 10 companies that pursue franchising as a mode of international expansion. Study one of these companies in detail, and provide a description of its business model, its international expansion pattern, the qualifications it looks for in its franchisees, and the type of support and training it provides.
2. You are working for a computer manufacturer that is planning to set up an assembly unit in Uruguay to serve the region. Because this would involve

importing parts from other countries and then exporting the finished products throughout Latin America, top management has requested information on the trading practices of Uruguay. In particular, these managers want to know (a) the average time to clear both imports and direct exports through Customs; (b) the percentage of losses from direct export due to theft, as well as, breakage; and (c) the percentage of firms identifying Customs and trade regulations as a major constraint. Using *Enterprise Surveys*, a site provided by the World Bank, that measures business perceptions of the investment climate, prepare a brief executive report summarizing your findings. How does Uruguay compare to other countries in Latin America on these measures?

## Minicase: Method of Entry—The Foley Company

The Foley Company, a manufacturer of soybean harvesters, has for years sold a substantial number of machines in Brazil. However, a Brazilian firm has begun to manufacture them, and Foley's local distributor has told Jesse Osborne, Foley's president, that if Foley expects to maintain its share of the market, it will also have to manufacture locally. Osborne is in a quandary. The market is too good to lose, but Foley has had no experience with foreign manufacturing operations. Because Brazilian sales and repairs have been handled by the distributor, no one in Foley has had any firsthand experience in that country.

Osborne has made some rough calculations that indicate the firm can make money by manufacturing in Brazil, but the firm's lack of marketing expertise in the country troubles him. He calls in Joanne Poe, the export manager, and asks

her to prepare a list of all the options open to Foley, with their advantages and disadvantages. Osborne also asks Poe to indicate her recommendation.

### Questions:

1. Assume you are Joanne Poe. Prepare a list of all the options available to Foley, and give the advantages and disadvantages of each.
2. Which of the options would you recommend? Why?
3. Assuming that the president's calculations are correct and that a factory to produce locally the number of machines that Foley now exports to Brazil will offer a satisfactory return on investment, what special information about Brazil will you want to gather?