

## 16.13: Risk Tradeoffs in Global Business

### Learning Outcomes

- Differentiate among the risk tradeoffs for exporting, licensing, alliances, wholly owned affiliates, and global ventures.

Improved transportation, low-cost communication technologies, and a growing mass of educated people in countries around the world are contributing to business globalization. This section will focus on some different ways businesses can enter these new global markets. We will look at the benefits and examine the risks of these enterprises.

### Franchising, Licensing, and Export/Import Businesses

#### Export/Import Business



This McDonald's restaurant in Bydgoszcz, Poland, is one of nearly 30,000 McDonald's locations worldwide owned and operated by franchisees.

Exporting is the shipping of goods from the domestic country to a foreign country. Importing, the flip side, is bringing in goods from another country. Both types of businesses create local jobs and so are generally favored by governments. Both types of businesses are scrutinized by custom authorities and reported in various categories as part of a country's gross domestic product. The main advantage of an export business is a wider market for the products, as importers can frequently sell goods below the price charged for domestic items. You also retain control over how the product is designed and produced. But as with any international business, there are risks involved with interruptions in the supply chain and fluctuating foreign currencies. There are also increased transportation and tariff costs.

#### Licensing

Licensing is a strategic alliance made by a **licensor** that allows a **licensee** to provide products or services under the licensor's brand name. Let's say that a food snack manufacturer is prevented by a foreign government from competing against local sellers of food snacks. The company can license its formula to a local producer, thus avoiding the regulations. The licensee makes the product and returns a percentage of the overall revenues to the outside company, usually in the form of royalties. There are subtle but key differences between franchising and licensing. An important one is that the owner of the license retains complete control over the product. For example, Microsoft licenses its software to users; it does not "sell" the product outright. The software is licensed to customers subject to strict terms and conditions. Licensing has many of the same advantages and disadvantages of franchising. Advantages include avoiding barriers to entering a foreign market, such as tariff and production costs. The major risk is that the licensor trusts their brand to an outside partner, and that partner may eventually become a competitor.

#### Franchising

Franchising lets businesses enter into foreign markets at a low cost while at the same time offering local entrepreneurs the chance to operate an established business. When McDonald's or Subway wants to expand into a new foreign market, it often arranges for a company or individual to pay for the use of its trademarked or protected resources, such as the plans for buildings, product ingredients, recipes, and management systems. The buyer, or **franchisee**, agrees to follow product and operating procedures to

safeguard the franchiser's brand name and reputation. The **franchiser** receives a percentage of the revenue from the local operator. The benefits include relative low risk and easy market penetration for the franchiser. Franchising requires very little capital investment or effort on the corporation's side. A locally run franchise can avoid many of the cultural pitfalls facing a foreign-run investment. Risks, or downsides, include a loss of quality control and a lower rate of return than a wholly owned and operated business. The franchiser must also make sure the local manager can implement the required training and quality control measures to safeguard the corporate brand.

### Strategic Alliances

Some types of businesses are **strategic alliances** in which international partners cooperate for mutual gains. Companies agree to combine key resources, costs, risks, technology, and personnel. Each organization sees an opportunity to get something they couldn't get on its own. Examples include joint ventures, affiliates, and subsidiaries. There are two types of strategic alliances: joint ventures and wholly owned affiliates.

### Joint Venture

In an **international joint venture**, two or more companies (usually one foreign and one local) agree to work together on a new project. Each company contributes to the partnership in time, equity, or effort for the development of the project. Sometimes one company buys into an already established firm. Each partner benefits from the arrangement. One partner may hope to widen their market with the help of local experts; the other partner may want access to technology and training in advanced skills. The advantage is that each partner carries part of the burden of costs to start and run the joint company. The disadvantages may include leadership/management power struggles and the fact that profits must be shared. In 2014, Sony of Japan set up joint ventures in China to produce its popular PlayStation. One company produced the software; the other company produced the hardware.

### Wholly Owned Foreign Affiliates

A business may decide that instead of partnering with a company in a foreign country to expand its market, it is more efficient to acquire an existing firm. The acquiring company takes full ownership of the acquired company. The advantage is that the company saves on transportation, distribution, and storage costs while gaining local business knowledge through the affiliate's (or subsidiary's) employees. For example, Kraft Foods bought Cadbury, an English confectionary (candy) company. Home Depot bought Home Mart, a popular home-improvement retailer in Mexico. Finally, in 2010 Wal-Mart Stores Inc. spent \$2.4 billion to acquire Massmart, a South African retail store much like Wal-Mart with stores throughout Africa.

### Greenfield Venture

A different type of foreign investment is called a **greenfield venture**, where a company builds a subsidiary from scratch in a foreign country instead of acquiring an established firm. This is the riskiest type of direct investment but also, if successful, can be extremely profitable because the profits do not have to be shared. The parent company can dictate from the beginning how the company should be managed and developed. But the company must be committed to a long-term association with the market and country it is entering. Large, multinational companies are most likely to use a greenfield strategy to enter a market because of the high start-up costs and the long-term commitment, as well as their experience in negotiating trade barriers. In July 2017, Foxconn, a large electronics manufacturer in Taiwan, announced plans to invest more than \$10 billion in a greenfield venture in Wisconsin. The obvious risk with this business structure is that a great difference in the laws between the parent and subsidiary countries can lead to misunderstandings and false assumptions. This is especially true in the handling of intellectual property such as patents, trademarks, and copyrights.

Watch the following video to see some other recent greenfield ventures taking place in the United States.

A link to an interactive elements can be found at the bottom of this page.

You can [view the transcript for "Chinese Greenfield investors seek larger market in the US" here \(opens in new window\)](#).

#### ? Practice Question

<https://assessments.lumenlearning.co...essments/12336>

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