

5.38: International-Expansion Entry Modes

Learning Objectives

1. Describe the five common international-expansion entry modes.
2. Know the advantages and disadvantages of each entry mode.
3. Understand the dynamics among the choice of different entry modes.

The Five Common International-Expansion Entry Modes

In this section, we will explore the traditional international-expansion entry modes. Beyond importing, international expansion is achieved through exporting, licensing arrangements, partnering and **strategic alliances**, acquisitions, and establishing new, wholly owned subsidiaries, also known as **greenfield ventures**. These modes of entering international markets and their characteristics are shown in Table 8.1. Shaker A. Zahra, R. Duane Ireland, and Michael A. Hitt, "International Expansion by New Venture Firms: International Diversity, Mode of Market Entry, Technological Learning, and Performance," *Academy of Management Journal* 43, no. 5 (October 2000): 925–50. Each mode of market entry has advantages and disadvantages. Firms need to evaluate their options to choose the entry mode that best suits their strategy and goals.

Table 8.1 International-Expansion Entry Modes

| Type of Entry | Advantages | Disadvantages |
|---------------------------------------------------------------|-----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|
| Exporting | Fast entry, low risk | Low control, low local knowledge, potential negative environmental impact of transportation |
| Licensing and Franchising | Fast entry, low cost, low risk | Less control, licensee may become a competitor, legal and regulatory environment (IP and contract law) must be sound |
| Partnering and Strategic Alliance | Shared costs reduce investment needed, reduced risk, seen as local entity | Higher cost than exporting, licensing, or franchising; integration problems between two corporate cultures |
| Acquisition | Fast entry; known, established operations | High cost, integration issues with home office |
| Greenfield Venture (Launch of a new, wholly owned subsidiary) | Gain local market knowledge; can be seen as insider who employs locals; maximum control | High cost, high risk due to unknowns, slow entry due to setup time |

Exporting

Exporting is a typically the easiest way to enter an international market, and therefore most firms begin their international expansion using this model of entry. Exporting is the sale of products and services in foreign countries that are sourced from the home country. The advantage of this mode of entry is that firms avoid the expense of establishing operations in the new country. Firms must, however, have a way to distribute and market their products in the new country, which they typically do through contractual agreements with a local company or distributor. When exporting, the firm must give thought to labeling, packaging, and pricing the offering appropriately for the market. In terms of marketing and promotion, the firm will need to let potential buyers know of its offerings, be it through advertising, trade shows, or a local sales force.

Amusing Anecdotes

One common factor in exporting is the need to translate something about a product or service into the language of the target country. This requirement may be driven by local regulations or by the company's wish to market the product or service in a locally friendly fashion. While this may seem to be a simple task, it's often a source of embarrassment for the company and humor for competitors. David Ricks's book on international business blunders relates the following anecdote for US companies doing business in the neighboring French-speaking Canadian province of Quebec. A company boasted of *lait frais usage*, which

translates to “used fresh milk,” when it meant to brag of *lait frais employé*, or “fresh milk used.” The “terrific” pens sold by another company were instead promoted as *terrifiantes*, or terrifying. In another example, a company intending to say that its appliance could use “any kind of electrical current,” actually stated that the appliance “wore out any kind of liquid.” And imagine how one company felt when its product to “reduce heartburn” was advertised as one that reduced “the warmth of heart”! David A. Ricks, *Blunders in International Business* (Hoboken, NJ: Wiley-Blackwell, 1999), 101.

Among the disadvantages of exporting are the costs of transporting goods to the country, which can be high and can have a negative impact on the environment. In addition, some countries impose tariffs on incoming goods, which will impact the firm’s profits. In addition, firms that market and distribute products through a contractual agreement have less control over those operations and, naturally, must pay their distribution partner a fee for those services.

Ethics in Action

Companies are starting to consider the environmental impact of where they locate their manufacturing facilities. For example, Olam International, a cashew producer, originally shipped nuts grown in Africa to Asia for processing. Now, however, Olam has opened processing plants in Tanzania, Mozambique, and Nigeria. These locations are close to where the nuts are grown. The result? Olam has lowered its processing and shipping costs by 25 percent while greatly reducing carbon emissions. Michael E. Porter and Mark R. Kramer, “The Big Idea: Creating Shared Value,” *Harvard Business Review*, January–February 2011, accessed January 23, 2011, <http://hbr.org/2011/01/the-big-idea-creating-shared-value/ar/pr>.

Likewise, when Walmart enters a new market, it seeks to source produce for its food sections from local farms that are near its warehouses. Walmart has learned that the savings it gets from lower transportation costs and the benefit of being able to restock in smaller quantities more than offset the lower prices it was getting from industrial farms located farther away. This practice is also a win-win for locals, who have the opportunity to sell to Walmart, which can increase their profits and let them grow and hire more people and pay better wages. This, in turn, helps all the businesses in the local community. Michael E. Porter and Mark R. Kramer, “The Big Idea: Creating Shared Value,” *Harvard Business Review*, January–February 2011, accessed January 23, 2011, <http://hbr.org/2011/01/the-big-idea-creating-shared-value/ar/pr>.

Firms export mostly to countries that are close to their facilities because of the lower transportation costs and the often greater similarity between geographic neighbors. For example, Mexico accounts for 40 percent of the goods exported from Texas. Andrew J. Cassey, “Analyzing the Export Flow from Texas to Mexico,” *StaffPAPERS: Federal Reserve Bank of Dallas*, No. 11, October 2010, accessed February 14, 2011, www.dallasfed.org/research/staff/2010/staff1003.pdf. The Internet has also made exporting easier. Even small firms can access critical information about foreign markets, examine a target market, research the competition, and create lists of potential customers. Even applying for export and import licenses is becoming easier as more governments use the Internet to facilitate these processes.

Because the cost of exporting is lower than that of the other entry modes, entrepreneurs and small businesses are most likely to use exporting as a way to get their products into markets around the globe. Even with exporting, firms still face the challenges of currency exchange rates. While larger firms have specialists that manage the exchange rates, small businesses rarely have this expertise. One factor that has helped reduce the number of currencies that firms must deal with was the formation of the European Union (EU) and the move to a single currency, the euro, for the first time. As of 2011, seventeen of the twenty-seven EU members use the euro, giving businesses access to 331 million people with that single currency. “The Euro,” European Commission, accessed February 11, 2011, http://ec.europa.eu/euro/index_en.html.

Licensing and Franchising

Licensing and franchising are two specialized modes of entry that are discussed in more detail in Chapter 9. The intellectual property aspects of licensing new technology or patents is discussed in Chapter 13.

Partnerships and Strategic Alliances

Another way to enter a new market is through a strategic alliance with a local partner. A strategic alliance involves a contractual agreement between two or more enterprises stipulating that the involved parties will cooperate in a certain way for a certain time to achieve a common purpose. To determine if the alliance approach is suitable for the firm, the firm must decide what value the partner could bring to the venture in terms of both tangible and intangible aspects. The advantages of partnering with a local firm are that the local firm likely understands the local culture, market, and ways of doing business better than an outside firm. Partners are especially valuable if they have a recognized, reputable brand name in the country or have existing relationships with customers that the firm might want to access. For example, Cisco formed a strategic alliance with Fujitsu to develop routers for Japan. In the

alliance, Cisco decided to co-brand with the Fujitsu name so that it could leverage Fujitsu's reputation in Japan for IT equipment and solutions while still retaining the Cisco name to benefit from Cisco's global reputation for switches and routers. Steve Steinhilber, *Strategic Alliances* (Cambridge, MA: Harvard Business School Press, 2008), 113. Similarly, Xerox launched signed strategic alliances to grow sales in emerging markets such as Central and Eastern Europe, India, and Brazil. "ASAP Releases Winners of 2010 Alliance Excellence Awards," Association for Strategic Alliance Professionals, September 2, 2010, accessed February 12, 2011, newslife.us/technology/mobile/ASAP-Releases-Winners-of-2010-Alliance-Excellence-Awards.

Strategic alliances are also advantageous for small entrepreneurial firms that may be too small to make the needed investments to enter the new market themselves. In addition, some countries require foreign-owned companies to partner with a local firm if they want to enter the market. For example, in Saudi Arabia, non-Saudi companies looking to do business in the country are required by law to have a Saudi partner. This requirement is common in many Middle Eastern countries. Even without this type of regulation, a local partner often helps foreign firms bridge the differences that otherwise make doing business locally impossible. Walmart, for example, failed several times over nearly a decade to effectively grow its business in Mexico, until it found a strong domestic partner with similar business values.

The disadvantages of partnering, on the other hand, are lack of direct control and the possibility that the partner's goals differ from the firm's goals. David Ricks, who has written a book on blunders in international business, describes the case of a US company eager to enter the Indian market: "It quickly negotiated terms and completed arrangements with its local partners. Certain required documents, however, such as the industrial license, foreign collaboration agreements, capital issues permit, import licenses for machinery and equipment, etc., were slow in being issued. Trying to expedite governmental approval of these items, the US firm agreed to accept a lower royalty fee than originally stipulated. Despite all of this extra effort, the project was not greatly expedited, and the lower royalty fee reduced the firm's profit by approximately half a million dollars over the life of the agreement." David A. Ricks, *Blunders in International Business* (Hoboken, NJ: Wiley-Blackwell, 1999), 101. Failing to consider the values or reliability of a potential partner can be costly, if not disastrous.

To avoid these missteps, Cisco created one globally integrated team to oversee its alliances in emerging markets. Having a dedicated team allows Cisco to invest in training the managers how to manage the complex relationships involved in alliances. The team follows a consistent model, using and sharing best practices for the benefit of all its alliances. Steve Steinhilber, *Strategic Alliances* (Cambridge, MA: Harvard Business School Press, 2008), 125.

Joint ventures are discussed in depth in Chapter 9.

Did You Know?

Partnerships in emerging markets can be used for social good as well. For example, pharmaceutical company Novartis crafted multiple partnerships with suppliers and manufacturers to develop, test, and produce antimalaria medicine on a nonprofit basis. The partners included several Chinese suppliers and manufacturing partners as well as a farm in Kenya that grows the medication's key raw ingredient. To date, the partnership, called the Novartis Malaria Initiative, has saved an estimated 750,000 lives through the delivery of 300 million doses of the medication. "ASAP Releases Winners of 2010 Alliance Excellence Awards," Association for Strategic Alliance Professionals, September 2, 2010, accessed September 20, 2010, newslife.us/technology/mobile/ASAP-Releases-Winners-of-2010-Alliance-Excellence-Awards.

Acquisitions

An **acquisition** is a transaction in which a firm gains control of another firm by purchasing its stock, exchanging the stock for its own, or, in the case of a private firm, paying the owners a purchase price. In our increasingly flat world, cross-border acquisitions have risen dramatically. In recent years, cross-border acquisitions have made up over 60 percent of all acquisitions completed worldwide. Acquisitions are appealing because they give the company quick, established access to a new market. However, they are expensive, which in the past had put them out of reach as a strategy for companies in the undeveloped world to pursue. What has changed over the years is the strength of different currencies. The higher interest rates in developing nations has strengthened their currencies relative to the dollar or euro. If the acquiring firm is in a country with a strong currency, the acquisition is comparatively cheaper to make. As Wharton professor Lawrence G. Hrebiniak explains, "Mergers fail because people pay too much of a premium. If your currency is strong, you can get a bargain." "Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home," *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473>.

When deciding whether to pursue an acquisition strategy, firms examine the laws in the target country. China has many restrictions on foreign ownership, for example, but even a developed-world country like the United States has laws addressing acquisitions. For example, you must be an American citizen to own a TV station in the United States. Likewise, a foreign firm is not allowed to own more than 25 percent of a US airline. “Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home,” *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473>.

Acquisition is a good entry strategy to choose when scale is needed, which is particularly the case in certain industries (e.g., wireless telecommunications). Acquisition is also a good strategy when an industry is consolidating. Nonetheless, acquisitions are risky. Many studies have shown that between 40 percent and 60 percent of all acquisitions fail to increase the market value of the acquired company by more than the amount invested. “Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home,” *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473>. Additional risks of acquisitions are discussed in Chapter 9.

New, Wholly Owned Subsidiary

The process of establishing of a new, wholly owned subsidiary (also called a greenfield venture) is often complex and potentially costly, but it affords the firm maximum control and has the most potential to provide above-average returns. The costs and risks are high given the costs of establishing a new business operation in a new country. The firm may have to acquire the knowledge and expertise of the existing market by hiring either host-country nationals—possibly from competitive firms—or costly consultants. An advantage is that the firm retains control of all its operations. Wholly owned subsidiaries are discussed further in Chapter 9.

Entrepreneurship and Strategy

The Chinese have a “Why not me?” attitude. As Edward Tse, author of *The China Strategy: Harnessing the Power of the World’s Fastest-Growing Economy*, explains, this means that “in all corners of China, there will be people asking, ‘If Li Ka-shing [the chairman of Cheung Kong Holdings] can be so wealthy, if Bill Gates or Warren Buffett can be so successful, why not me?’ This cuts across China’s demographic profiles: from people in big cities to people in smaller cities or rural areas, from older to younger people. There is a huge dynamism among them.” Art Kleiner, “Getting China Right,” *Strategy and Business*, March 22, 2010, accessed January 23, 2011, www.strategy-business.com/article/00026?pg=al. Tse sees entrepreneurial China as “entrepreneurial people at the grassroots level who are very independent-minded. They’re very quick on their feet. They’re prone to fearless experimentation: imitating other companies here and there, trying new ideas, and then, if they fail, rapidly adapting and moving on.” As a result, he sees China becoming not only a very large consumer market but also a strong innovator. Therefore, he advises US firms to enter China sooner rather than later so that they can take advantage of the opportunities there. Tse says, “Companies are coming to realize that they need to integrate more and more of their value chains into China and India. They need to be close to these markets, because of their size. They need the ability to understand the needs of their customers in emerging markets, and turn them into product and service offerings quickly.” Art Kleiner, “Getting China Right,” *Strategy and Business*, March 22, 2010, accessed January 23, 2011, www.strategy-business.com/article/00026?pg=al.

KEY TAKEAWAYS

- The five most common modes of international-market entry are exporting, licensing, partnering, acquisition, and greenfield venturing.
- Each of these entry vehicles has its own particular set of advantages and disadvantages. By choosing to export, a company can avoid the substantial costs of establishing its own operations in the new country, but it must find a way to market and distribute its goods in that country. By choosing to license or franchise its offerings, a firm lowers its financial risks but also gives up control over the manufacturing and marketing of its products in the new country. Partnerships and strategic alliances reduce the amount of investment that a company needs to make because the costs are shared with the partner. Partnerships are also helpful to make the new entrant appear to be more local because it enters the market with a local partner. But the overall costs of partnerships and alliances are higher than exporting, licensing, or franchising, and there is a potential for integration problems between the corporate cultures of the partners. Acquisitions enable fast entry and less risk from the standpoint that the operations are established and known, but they can be expensive and may result in integration issues of the acquired firm to the home office. Greenfield ventures give the firm the best opportunity to retain full control of operations, gain local market knowledge, and be seen as an insider that employs locals. The disadvantages of greenfield ventures are the slow time to enter the market because the firm must set up operations and the high costs of establishing operations from scratch.

- Which entry mode a firm chooses also depends on the firm's size, financial strength, and the economic and regulatory conditions of the target country. A small firm will likely begin with an export strategy. Large firms or firms with deep pockets might begin with an acquisition to gain quick access or to achieve economies of scale. If the target country has sound rule of law and strong adherence to business contracts, licensing, franchising, or partnerships may be middle-of-the-road approaches that are neither riskier nor more expensive than the other options.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What are five common international entry modes?
2. What are the advantages of exporting?
3. What is the difference between a strategic alliance and an acquisition?
4. What would influence a firm's choice of the five entry modes?
5. What is the possible relationship among the different entry modes?

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