

Global Marketing

Contemporary theory, practice and cases

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Chapter 16

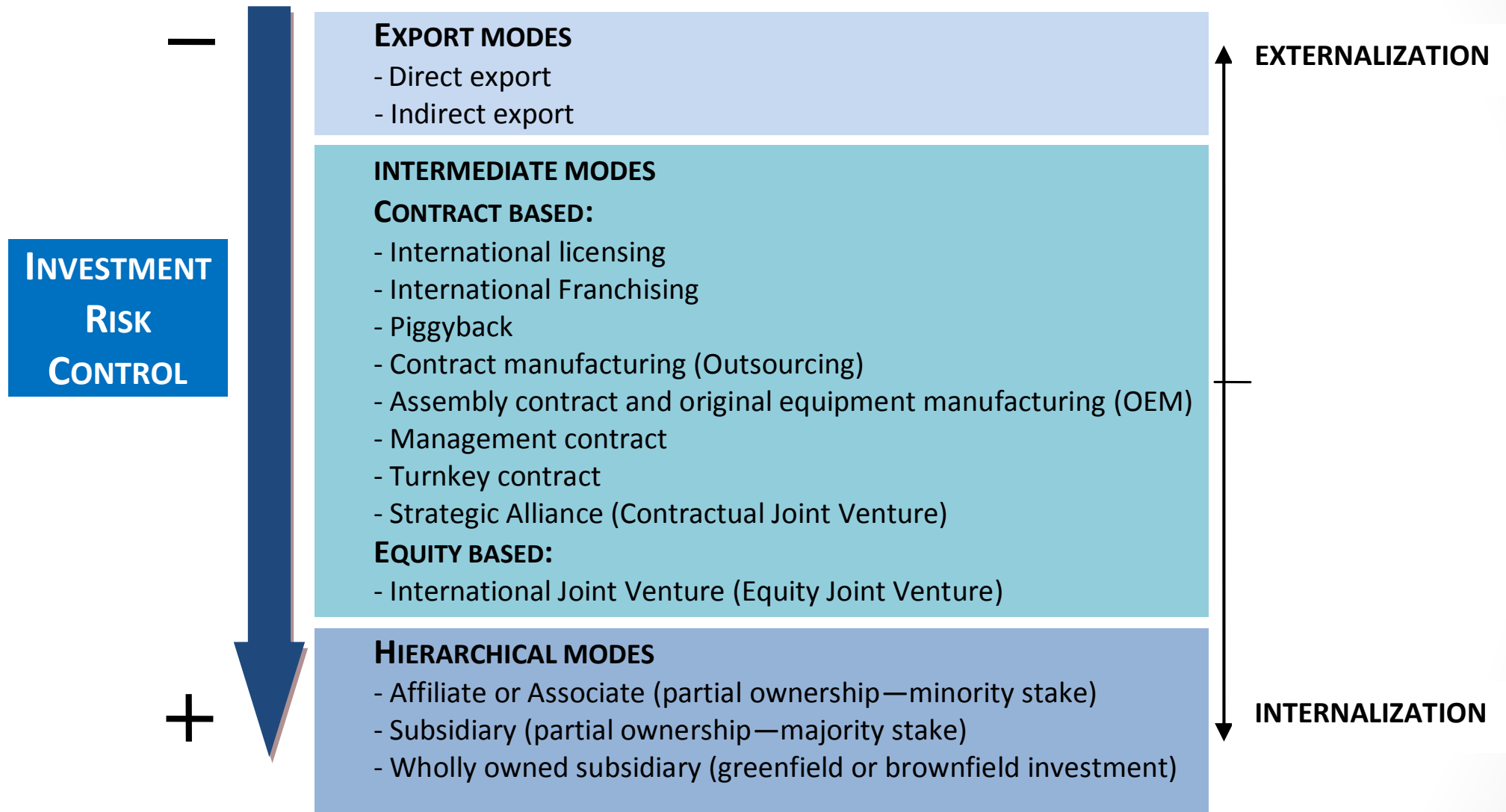
Entering global markets

Learning objectives

After reading this chapter you should be able to:

- Distinguish between the various options a firm has for establishing presence in foreign markets.
- Compare the risks and the advantages of the export modes, intermediate modes, and hierarchical modes of entry.
- Understand the difference between direct and indirect exports.
- Apply distributor selection process, channel management, and control to export management.
- Explain the characteristics of international licensing, international franchising, and other important contract-based intermediate modes.
- Understand the difference between strategic alliances and joint ventures.
- Explain why joint ventures are prone to failure.
- Compare different hierarchical modes of entry: wholly owned subsidiaries, subsidiaries, and affiliates
- Distinguish between *greenfield* and *brownfield* investments
- Understand the factors that influence foreign market entry decision.
- Understand the dynamics of entry mode decisions.

Methods of entry to international markets



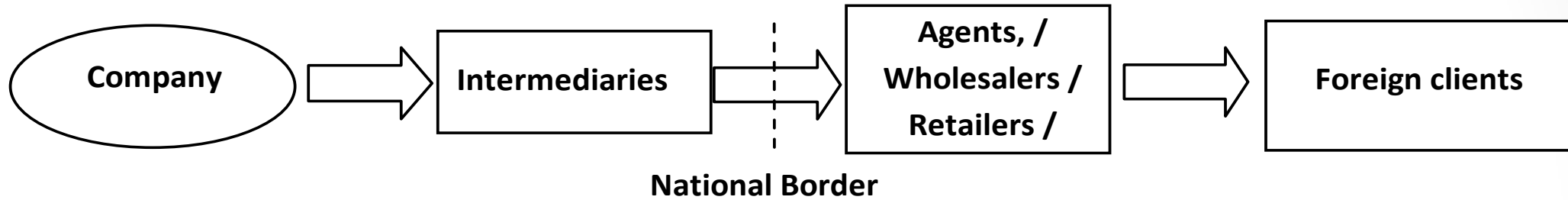
Export modes

- Export is the **most common and low-risk method of entering overseas markets**, and it is also the one requiring the least financial, marketing and human resources, and time investments.
- For the above reasons, export is the **preferred mode of entry for most small and entrepreneurial businesses**. It is an especially well-suited method for **initial market tests** owing to the relative ease of pulling out of a market (high flexibility) if said market turns out to be unprofitable.
- Exportation has been favored by the diffusion of **internet**.
- Export is limited to actual physical products that are produced outside the target country market. By nature, **this mode of entry is unsuitable for service companies**.

Indirect and direct export

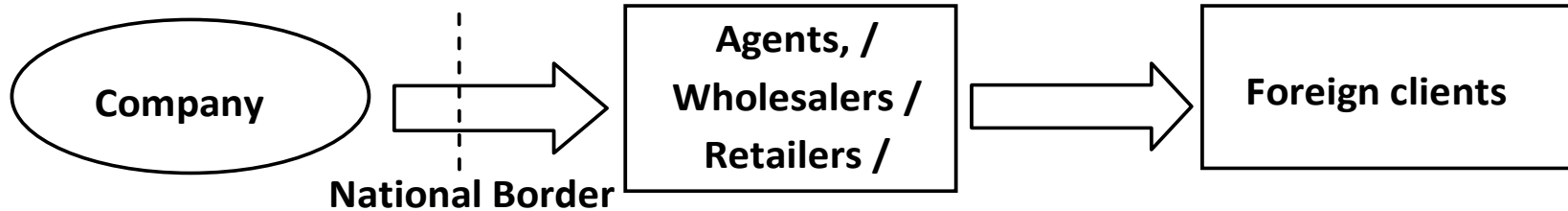
1)

INDIRECT EXPORTING



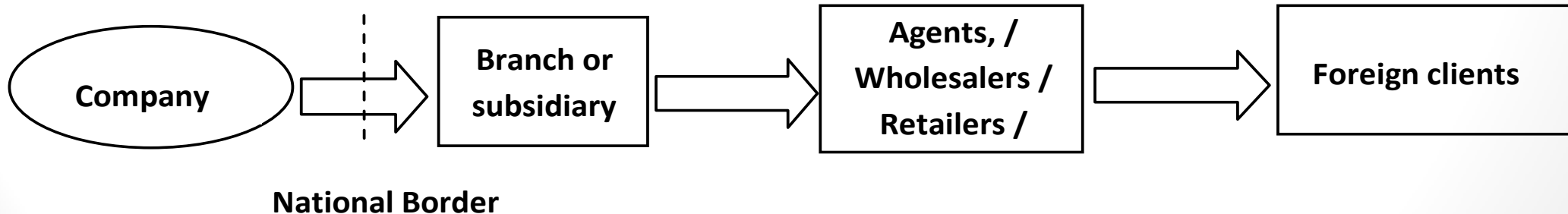
2)

DIRECT EXPORTING (WITH INDEPENDENT DISTRIBUTOR)

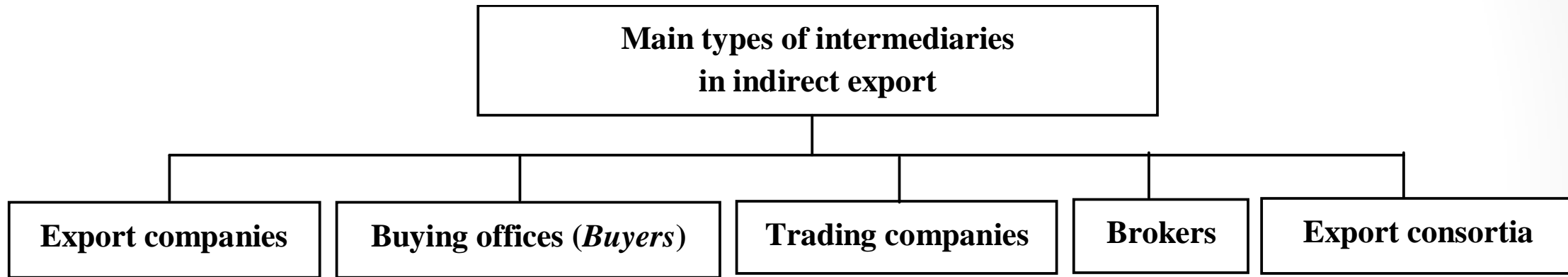


3)

DIRECT EXPORTING (WITH WHOLLY OWNED SUBSIDIARY)



Main types of intermediaries in indirect export



In indirect export, products are **exported abroad by intermediaries** who specialize in this activity **from the home base**.

Export companies

- Export companies are **commercial companies that undertake export activities of non-competing firms**, often belonging to the same industry, or at least the same sector.
- This mode of entry is **often used by companies that** have a commercial office but **lack an export office**.
- All concluded **contracts are negotiated on behalf of the producing company**, and all estimated prices and orders must be confirmed by it.
- This is indeed **indirect control, managed by the export company**, which does not allow on its own to start up a gradual internationalization process.

Buying offices

- Buying offices are typically **independent commercial operators representing some abroad-based companies** that wish to maintain continuous contact with the sellers operating in the importing countries.
- They operate as a single physical person or as a representative office, are **located in the importing country**, and **buy the imported product on behalf of a third company**.
- They may **support the export activity, suggest adaptation strategies, and offer controlling services and logistical platforms** for the products, such as show-room or e-selling.
- The “**big buyers**”, refers to specialized and big-sized sales operators who establish contracts with abroad-based sellers in order to insert their products in a catalogue sold under their own brand.

Trading companies

- Trading companies are **large-sized commercial intermediaries**, able to **undertake both export and import activities**.
- They may indeed be present in **both the domestic and the foreign market**.
- They buy and sell either on their own behalf or on behalf of a third party. In the latter case, they may **support the exporting companies with finance, logistics, and managerial and marketing services** necessary for the development of the exporting companies' presence abroad.
- This support may be **offered from the outset beginning** with market research, feasibility study, negotiating assistance or, at more advanced stages (e.g., preparation and management of the export process) including contracting and documentation, transportation, logistics management, and storage.

Brokers

- A Broker **connects the exporting company with potential clients abroad**, eventually providing consulting support.
- Brokers **usually operate in the national context**, but are not directly involved in the buying and selling process.
- The broker is an intermediary who **does not maintain a continuous relationship with the firm**, but is used rather occasionally by the firm to sell the product in the short term.

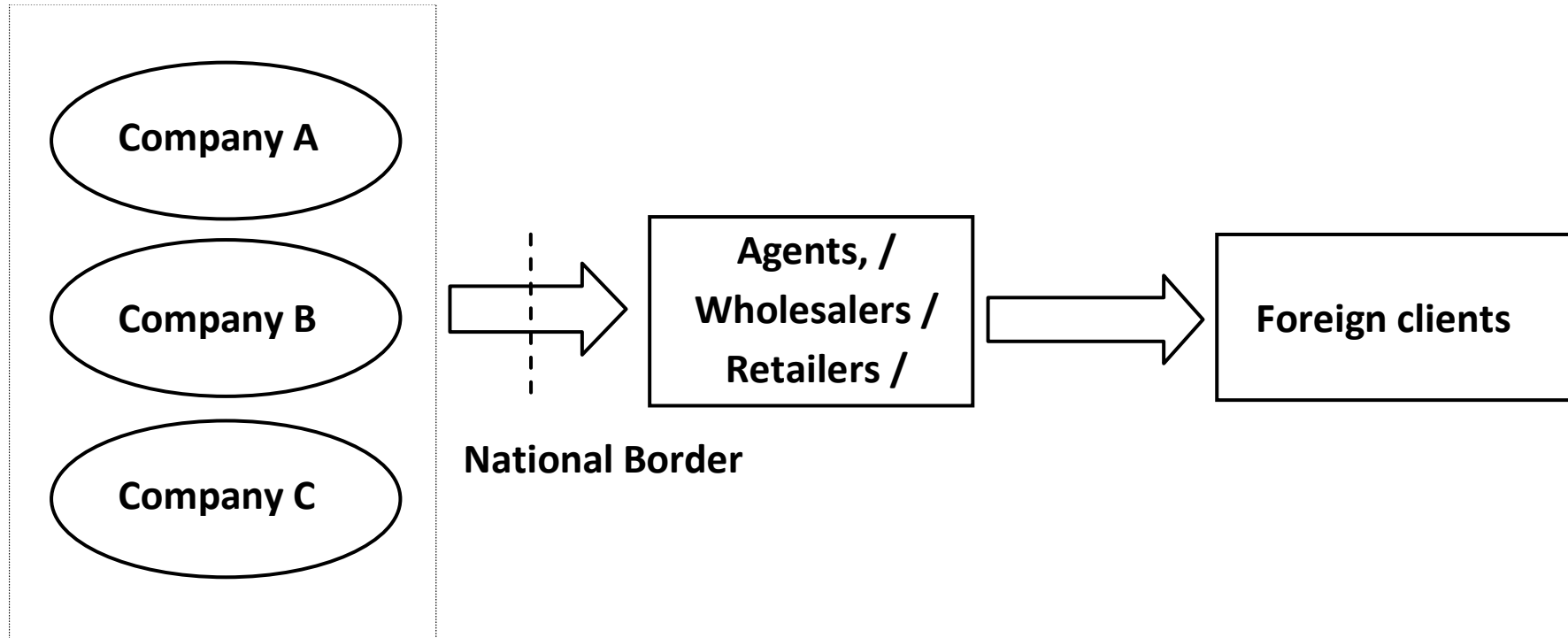
Export consortia

- Export consortia are **voluntary aggregations** constituted to organize common activities, e.g., foreign export and global communication.
- **Mono-sectorial or pluri-sectorial**
 - A mono-sectorial consortium organizes firms within the same sector but with competing products
 - A pluri-sectorial consortium includes firms from different sectors and often undertakes activities that individual members are unable to perform on their own.
- **Promotion-focused or selling-focused**
 - A promotion-focused consortium offers only supporting services for international activities
 - A selling consortium undertakes not only the promotion but also the commercialization of its members' products, either under the consortium's brand or under the manufacturer's individual brand.

Direct export

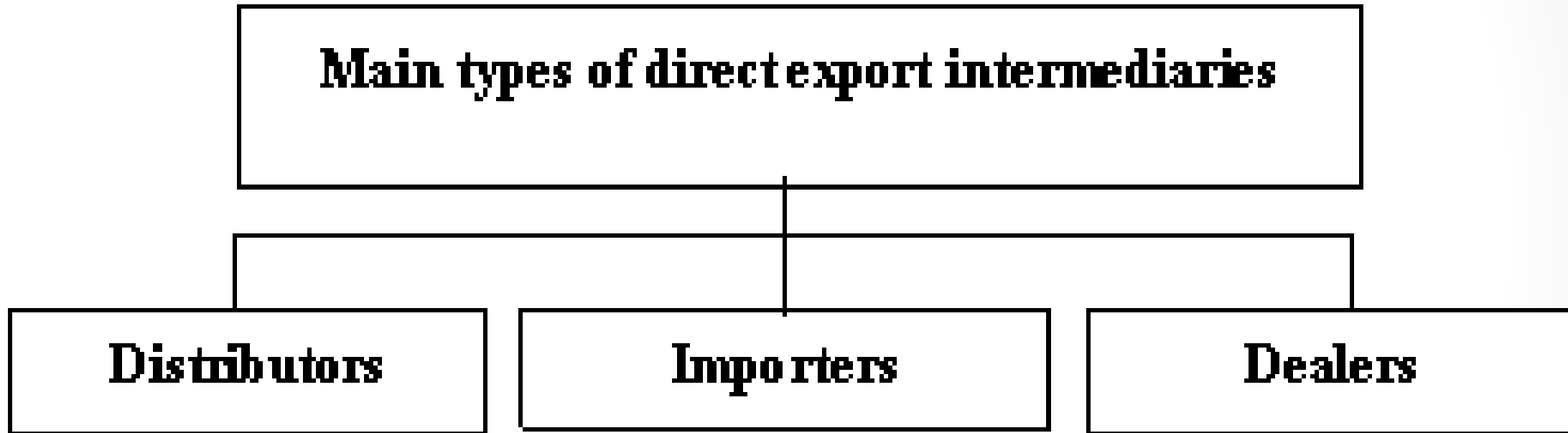
- In direct export the **products can be exported directly through agents and/or wholesalers or retailers in the target country.**
- The commercial organization of **the company is able to directly manage the selling process in a foreign market.** The company is responsible for segmenting a potential market, implementing a communication strategy, and contacting potential customers, final users, retailers, wholesalers (for example distributors, importers or dealers), or independent agents.
- A company can also **export products to its branch or subsidiary**, that is in charge of managing the distribution channel in the foreign country. In this case, the company has previously done an investment in the foreign market.
- Direct exporting may be accomplished through the following routes:
 - **Negotiating with foreign clients**
 - **Implementing own distribution network**
 - **Relying on intermediaries such as distributors, importers, and dealers**

Example of cooperative exporting



In the case of **direct export**, companies can set up **collaborative agreements** to jointly manage the export process

Main types of intermediaries in direct export



Advantages and disadvantages of export-based modes

Advantages

Low risk

Easy market entry or exit

Low operational costs

Low investment

Local market knowledge acquisition

Disadvantages

Lack of market control

Inappropriate feedback from distributor

Tariffs and quotas

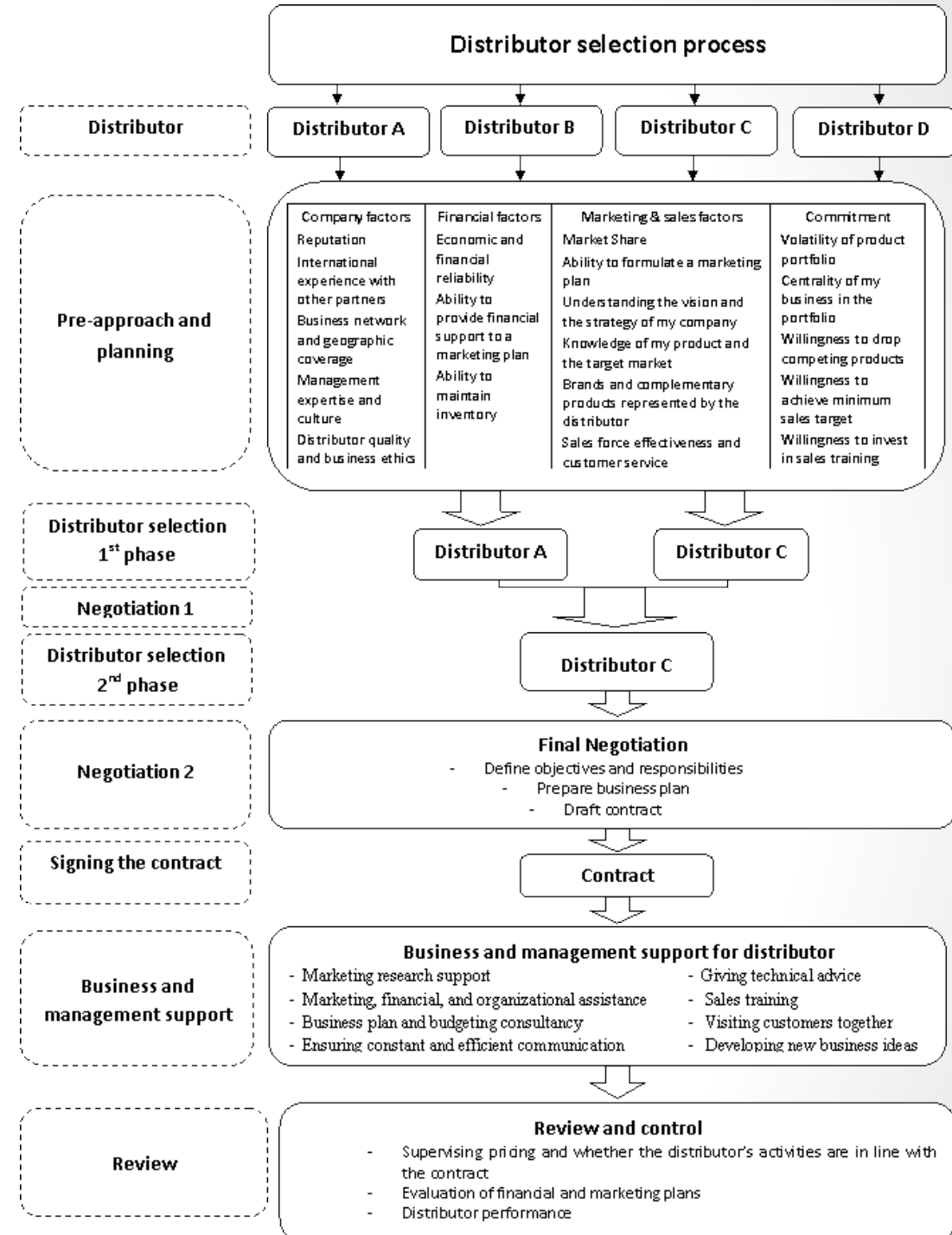
Transportation costs

Multiple export intermediaries

Possible distributor selection and relationship issues

Example of distributor selection process

The selection and effective management of distributors is extremely **critical**, especially **in countries with a distinctive different business culture**, where manufacturers are required to **tailor channel governance strategies** to fit their distributors' orientations.



Company and financial factors

Company factors

- Reputation
- International experience with other partners
- Business network and geographic coverage
- Management expertise and culture
- Distributor quality and business ethics

Financial factors

- Economic and financial reliability
- Ability to provide financial support to a marketing plan
- Ability to maintain inventory

Marketing & sales factors

- Market Share
- Ability to formulate a marketing plan
- Understanding the vision and the strategy of my company
- Knowledge of my product and the target market
- Brands and complementary products represented by the distributor
- Sales force effectiveness and customer service

Commitment

- Volatility of product portfolio
- Centrality of my business in the portfolio
- Willingness to drop competing products
- Willingness to achieve minimum sales target
- Willingness to invest in sales training

In the distributor selection process...

It is important:

- to evaluate carefully the **costs** that the exporting company will incur
- to define a **detailed distribution agreement**, covering the following points:
 - Business and geographical areas
 - Target segments
 - International Clients
 - Products and the use of trademarks
 - Distribution channels
 - Advertising and promotion
 - Pricing and terms of payment
 - Minimum volumes, orders, and supply conditions
 - Length and termination of agreement

Channel management

- Role of **relationship management** in distribution
- **Performance management**, which identifies those activities that are finalized to improve operating performance through the definition of roles, responsibilities, and measurable performance goals.
- **Coverage management**, which focuses on channel structure efficiency and its coordination with the target market.
- **Capability-building programs**, which include all activities that facilitate the channel members' operations (promotional material written in the local language, training, etc.)
- **Motivational programs**: Partners' motivation can be increased not only through monetary benefits (for example, higher commissions) but also by maintaining transparent relationships and providing frequent updates on products, market, and company developments, and inviting partners to visit the company headquarters regularly to share common values that can motivate them to achieve channel goals in foreign markets.

Intermediary entry modes

- **Contract-based:** contract-based modes are *non-equity agreements*, such that there is no investment in risky capital. These include the following different alternatives:
 - International Licensing
 - International Franchising
 - Piggyback
 - Contract Manufacturing or Outsourcing
 - Assembly Contract and OEM – Original Equipment Manufacturing
 - Contract Management
 - Turnkey Contract
 - Strategic Alliances
- **Equity-based:** In equity-based agreements, **an organized entity is set up, with its social capital shared between partners**. These agreements are a form of Foreign Direct Investment (FDI), and they include minority joint ventures, 50/50 joint ventures, and majority joint ventures.

International licencing

- International licensing is the process of transferring the rights of a firm's products to a foreign company for the purpose of producing or selling. For a set royalty fee, the licensor allows the licensee to use its technology, trademarks, patents, characters, and other intellectual property in order to gain presence in the markets covered by the licensee.
- In some cases, the **company's core-products are licensed**, and the **technology** directly necessary for producing the product is provided, often at lower costs and, if necessary, the product is adapted to local demands.
- However, companies do adopt strategies that allow reducing potential drawbacks associated with sharing their **intellectual property**.
- In other cases, if the **innovative technology** is required for manufacturing only part of the product, this part is directly assembled in the final product as produced by the licensee, without requiring the licensor to transfer the related knowledge.
- The international expansion of **famous brands** has been often based on the use of licensing contracts. Also **well-known people or movie characters**, who are employed for launching new products or collections in different industries, can benefit of licencing.

International Licensing: advantages and disadvantages for licensor

Advantages

Royalties

Bypassing regulations and tariffs

Limited investment in the foreign market

Fast market access

Risk is mainly taken by the licensee

Licensor can gain local market knowledge from the licensee

Licensor can use the licensee's distribution network

Licensee can suggest marketing adaptations for the local market

Licensor can profit from a mature technology

Disadvantages

Licensee acquires technological and marketing skills from the licensor and can become a future competitor

Intellectual property concerns

Licensee is an independent entrepreneur: risk of limited control over market and revenues for the licensor

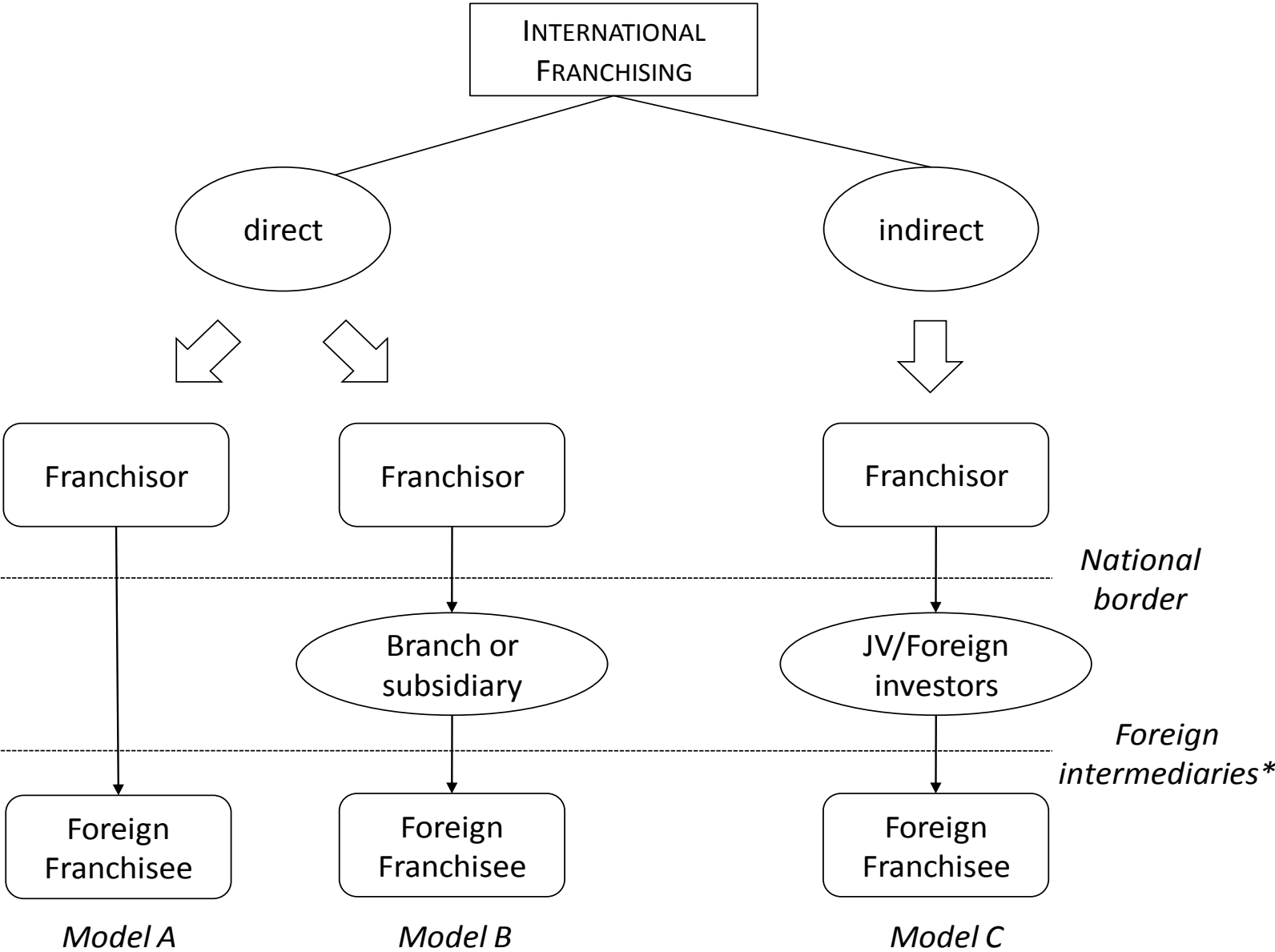
Brand image not homogeneous across countries

International franchising

- Under international franchising, the company (franchisor) enters a foreign market by giving to a foreign independent company (*franchisee*) the right to operate its business.
- In comparison with licensing, international franchising gives the franchisor greater control over the franchisee licensing the **franchisor company's trademarks, products and/or services, and production and/or operation processes**.
- Control is exerted through the franchise fee, which can be expropriated if contracts are not adhered to, and by elaborating contracts that govern the relationship between the franchisor and the franchisees. On the flip side, the franchisor is also required to provide more materials, training, and other forms of support to the franchisee.
- A well-functioning franchise provides a **win-win arrangement for both parties**: the franchisor gets to expand into new markets with little or no risk and investment, while the franchisee gets a proven brand, marketing exposure, an established client base, and management expertise to help it succeed.
- International franchising can **support the production systems of global companies**. For example, Coca-Cola is the world's largest beverage company, producing and distributing via local franchisees in more than 200 countries.
- Franchising is **growing in emerging countries**.



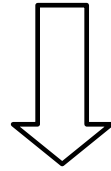
Direct and indirect international franchising



* Master franchisor, Area Developer, or Area Representative Manager

Master franchising

Franchisor / Foreign branch or subsidiary / JV or Foreign Investor



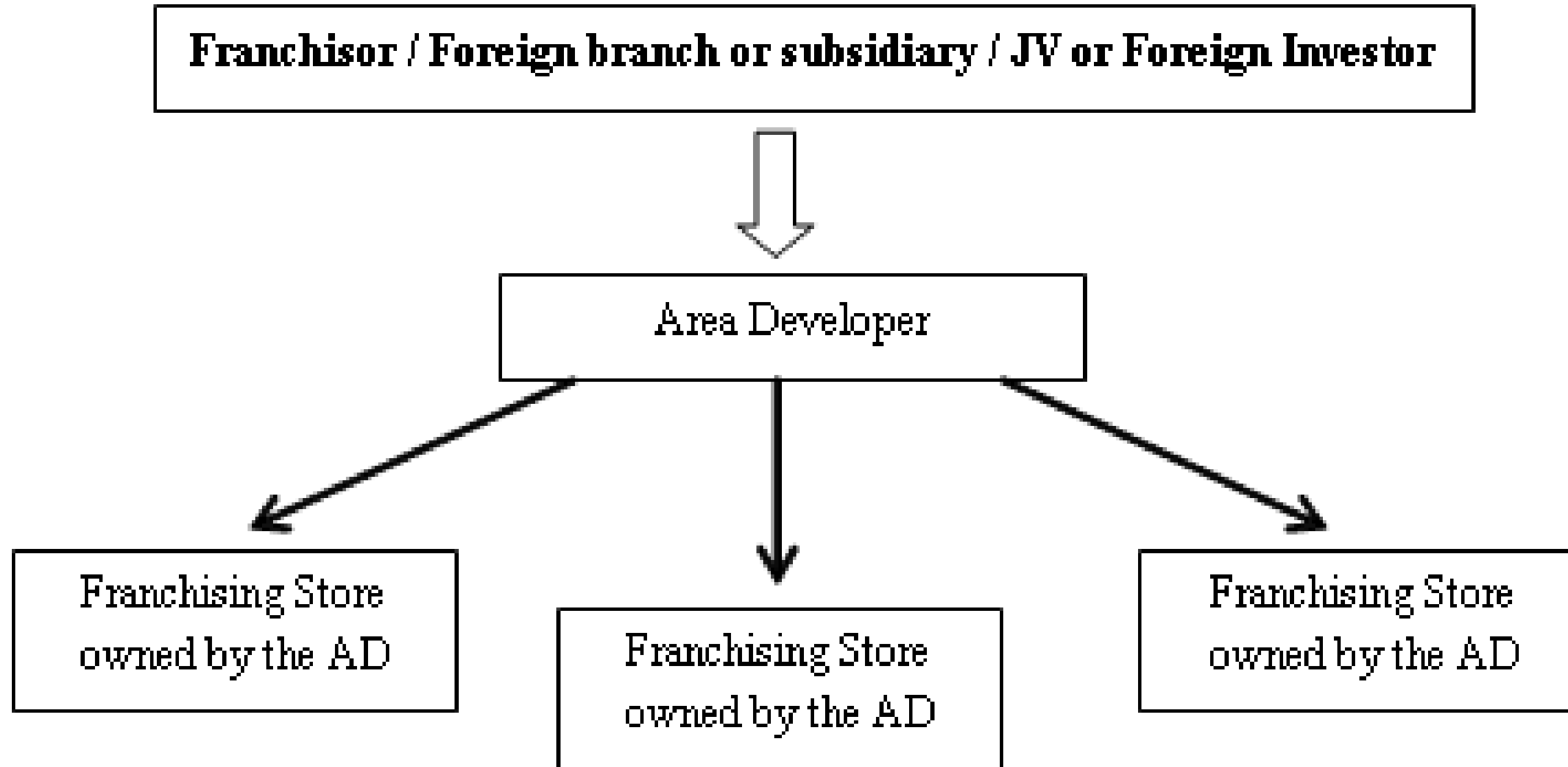
Master Franchisor

Foreign
Franchisee

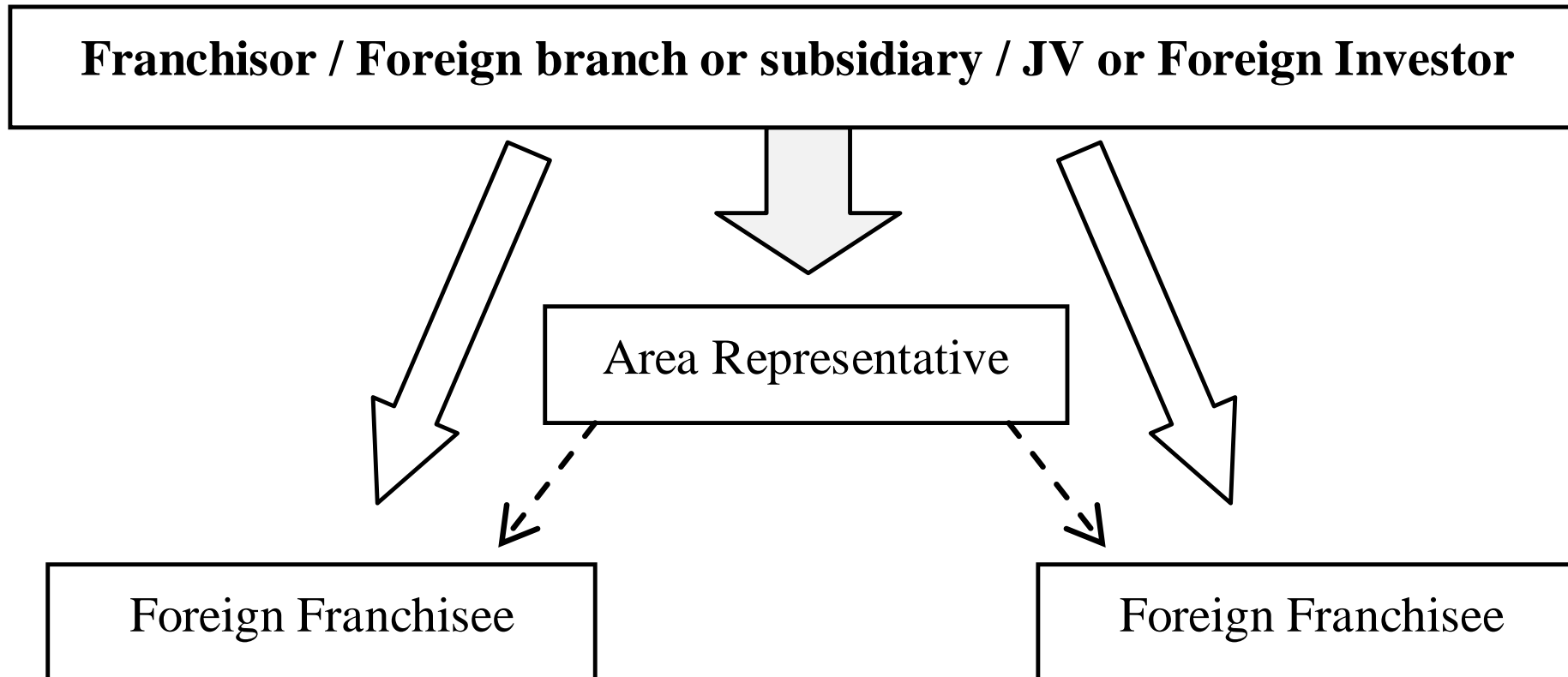
Foreign
Franchisee

Foreign
Franchisee

Area Developer Agreement



Area Representative Manager



International Franchising: advantages and disadvantages for franchisor

Advantages

Royalties

Relatively quick development of a store chain

Risk is mainly borne by the franchisee

Investment is mainly made by the franchisee

Greater control than the export modes

Rapid increase in brand awareness within the country and in different foreign countries

Franchisor can gain local market knowledge from the franchisee

Franchisee can suggest marketing adaptations for the local market

Economies of scale in production

Disadvantages

In some countries, the legal system is not stable

Identification of a good franchisee is often not easy and time consuming

Reliability of the relationships with franchisees/potential franchisees

High investments to identify the best adaptation of the franchising format in each foreign country

Limited control over market and revenues

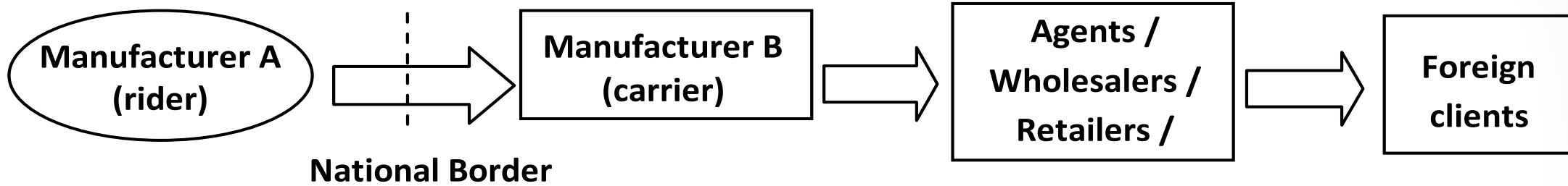
Piggyback

“Piggyback” refers to being carried by someone. This kind of agreement stipulates that **the company (rider) gets international by inserting its own products in the product portfolio, and, consequently, in the distribution system of another company (carrier), that sells complementary products in the foreign market.**

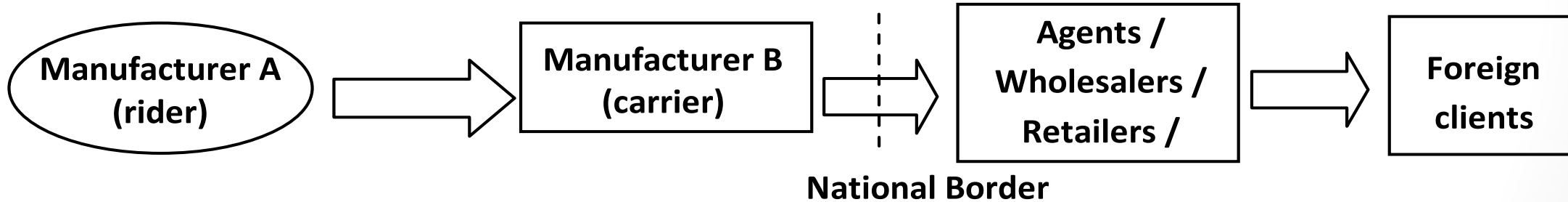
- The carrier may be localized in the export market (**direct piggyback**) or in the domestic market (**indirect piggyback**)
- In some cases, **indirect piggyback may be realized between companies from the same country.** In this case, though, the rider does not develop any form of international culture because this is a simple business-to-business sale to a company from its own country.
- Piggyback is an interesting choice for **small and medium-sized companies** operating within high-quality product niches.
- Piggyback allows for **maintaining distinction and control over the distribution channel** in which the product is inserted.

Direct and Indirect Piggyback

1) *DIRECT PIGGYBACK*



2) *INDIRECT PIGGYBACK*



Contract manufacturing (outsourcing)

- The arrangement of using cheaper overseas labor for the production of finished goods or parts by following an established production process is called contract manufacturing or outsourcing.
- Companies using this mode of entry benefit not only from lowering their production costs but also by **gaining entry to a new market with small amounts of capital** and no ownership hassles.
- The company outsourcing production (contractor) maintains **control over the marketing and distribution channels**, but faces relevant **risks of losing the control over the manufacturing process and the working conditions in the facilities**
- A key element of such a contract is indeed the **choice of the supplier**, which must offer not only quality, on-time supply, and financial solidity but work as well with exclusive supplying.

Assembly Contract and OEM (Original Equipment Manufacturing)

- In the Assembly Contract format, the company sends abroad product components for transformation or assembly. The finished products are sent back for selling.
- In the Original Equipment Manufacturer (OEM) format, the company buys the “original product” from a foreign partner to then finish and resell it as its own, hence appearing as the official producer in the market.



Textile factory in China

@ author

Management contract

- Management contract is most widely used in the **hotel and airline industries**.
- Under a management contract, **a company in one country can utilize the expertise, technology, or specialized services of a company from another country to run its business for a set time and fee or percentage of sales**.
- While the **management company is responsible for day-to-day operations**, it cannot decide on ownership, financial, strategic, or policy issues pertaining to the business.
- It is suitable **for companies that are interested in earning extra revenues abroad** without getting entangled in long-term financial or legal obligations in the foreign market.
- Practically, the foreign company manages the productive / commercial activity set up and financed by the local investor previously. Hence, the main advantage to the foreign company is that its **capabilities and brand are put into practice without it having to incur massive investment** in the form of start-up capital, as well as without having to deal with administrative matters such as permits and authorization.
- However, the foreign company has **no guarantee of existing in the long-term** because since the owners may, at the end of the contract, choose to retain the management of the business.
- On expiry, **a management contract may be renewed**, but the foreign company managing the business may indeed avail its **option to buy back** the business entity.

Turnkey contract

- Turnkey operations typically involve the design, construction, and equipment of a large facility, and, often, the initial personnel training, by a foreign company (exporter), which then turns over the key to the ready-to-run facility to the purchaser (importer).
- Turnkey operations projects are usually **contracted out by governments for enormous developments** such as dams, oil refineries, airports, energy plants, etc. Nevertheless, opportunities exist for the participation of smaller entrepreneurial firms as subcontractors.
- Turnkey projects can be:
 - **self-engineered** - the importer sets the performance requirements, while the exporter defines the equipment and plant design: the risk of performance failure rests with the exporter
 - **construction to specification** - the importer sets all the specifications, and the exporter constructs accordingly: the importer bears the risk.
- Such projects require **long-term commitments** in terms of personnel, financial reserves, supplies, and other resources.
- A company should carefully examine whether it is ready to absorb the long-term currency exchange fluctuations; extended drain on its resources; and other high political, economic, and financial risks that are likely to crop up in such complex undertakings.

Strategic Alliances (Contractual Joint ventures)

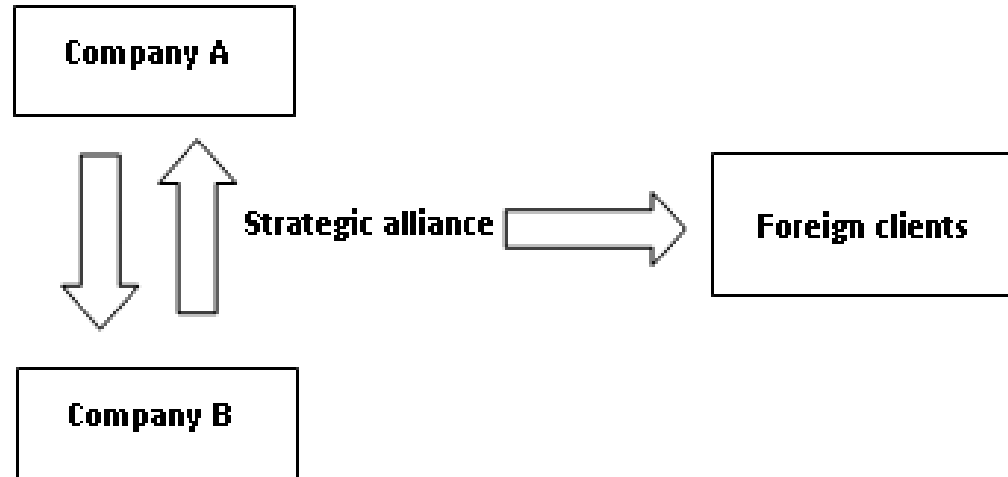
- A Strategic Alliance is a formal, **contractual relationship between two or more firms that share resources to pursue a common goal**. These are **non-equity agreements (contractual)** in which partners to the alliance share some strategic assets such as technology, trademarks, or other assets to create synergies or gain access to resources that one or both firms do not possess.
- They can reach the same goals of an Equity Joint Venture but **differently from Equity Joint Ventures, a Strategic Alliance or Contractual Joint Venture does not create a new company**.
- **What makes an alliance “strategic”?** It is critical to a core business goal or objective and to the achievement of a competitive advantage
- Strategic alliances have the **potential**: to lower transaction costs, hedge against strategic uncertainties, acquire needed resources, overcome international entry barriers, protect a firm’s home market from international competition, broaden a firm’s product line, enter new product markets, and enhance efficiency.
- Firms utilizing strategic alliances could **enhance their firm-specific resources** (physical assets, intangible property, patents and trademarks, human resources, and complementary resources), **technical capabilities** (R&D, manufacturing, marketing, sales, and market knowledge), **and managerial competencies** (management skills and abilities and value-added activities).
- Strategic alliances can face many **difficulties related to managing a business jointly**.
- Similarly to Equity Joint Venture, they can be **horizontal or vertical as well as upstream or/and downstream**.

International Joint ventures

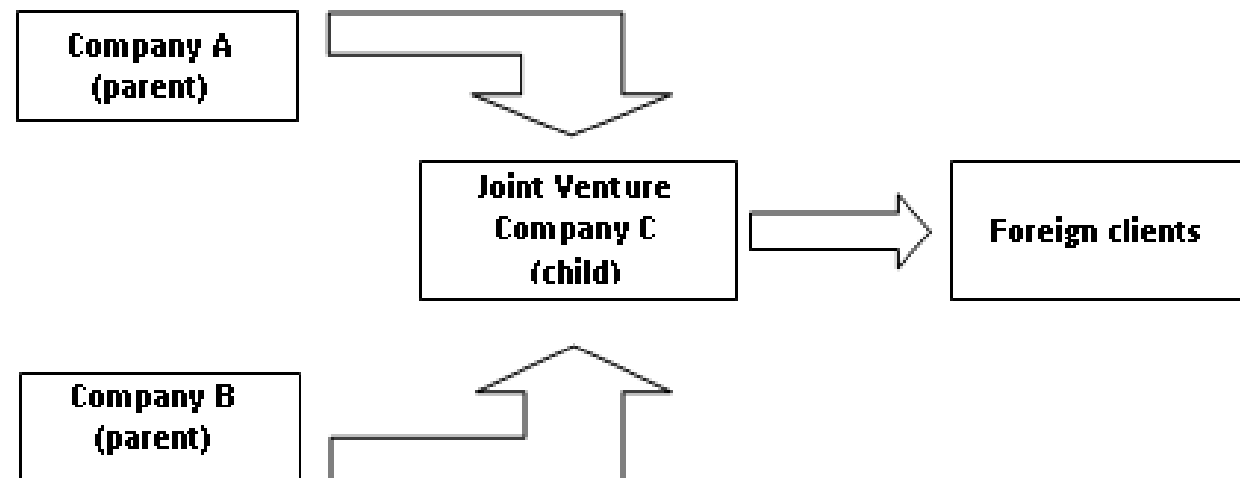
- **Equity-based IJVs are a form of Foreign Direct Investment (FDI) when two or more companies agree to share ownership of a third commercial entity and collaborate in the production of its goods or services to pursue a common goal.** Differently from Strategic Alliances (Contractual JVs), where the operations in foreign market are based on a contract, in International Equity JVs **two or more parent companies create a third new company** in the foreign market of entry
- The result for the company that enters a foreign market can be
 - a **minority joint venture** (less than 50 percent of the shares),
 - a **50/50 joint venture**,
 - or a **majority joint venture** (more than 50 percent of the shares).
- IJVs are attractive to businesses because of their **shared risk, shared knowledge and expertise**, and the potential for **synergy and competitive advantage in the global marketplace** .
- IJVs can take **many different forms**:
 - Two or more companies from the same country form an alliance to enter another country
 - An overseas company joins a local company to enter the local company's domestic market
 - Firms from two or more countries band together in a JV formed in a third country
 - A foreign private business and a government agree to join forces to pursue mutual interests
 - A foreign private firm enters into a JV with a government-owned firm to enter into a third national market
- A JV can involve companies of the same sector (**horizontal JV**) or different sectors (**vertical JV**)

Strategic alliance (Contractual JV) and Equity IJV

1) Strategic alliance (Contractual JV)

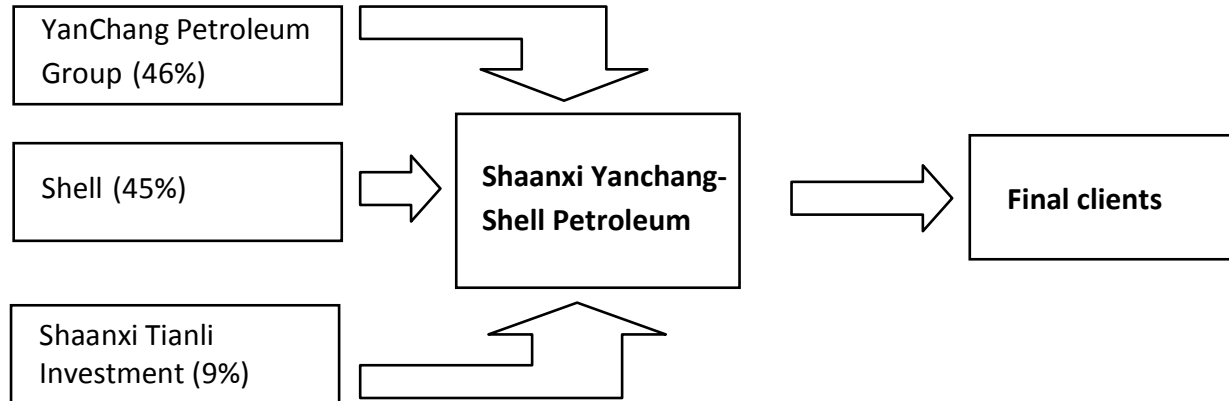


2) International joint venture (Equity IJV)

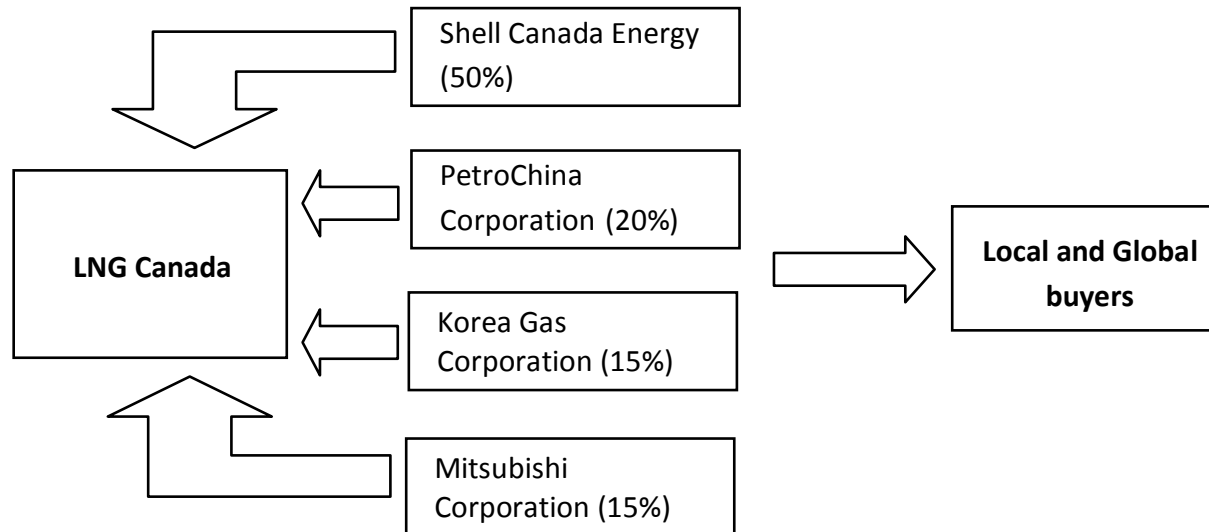


Downstream and Upstream IJV

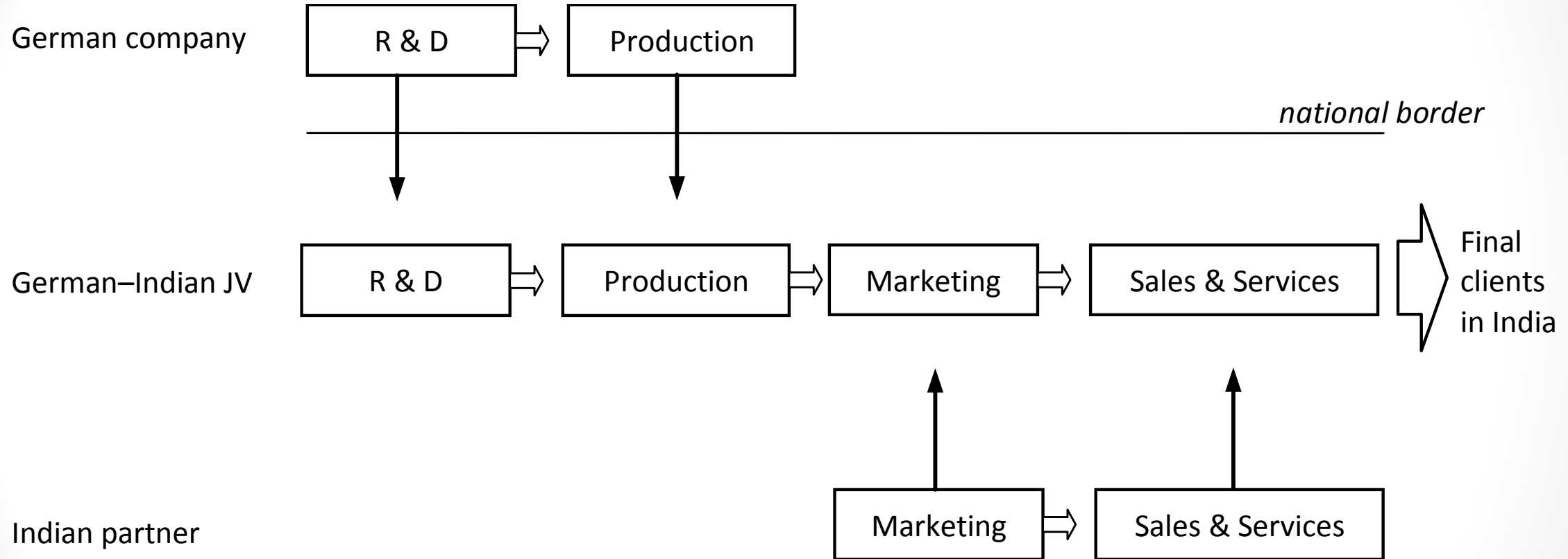
1) *Downstream joint venture*



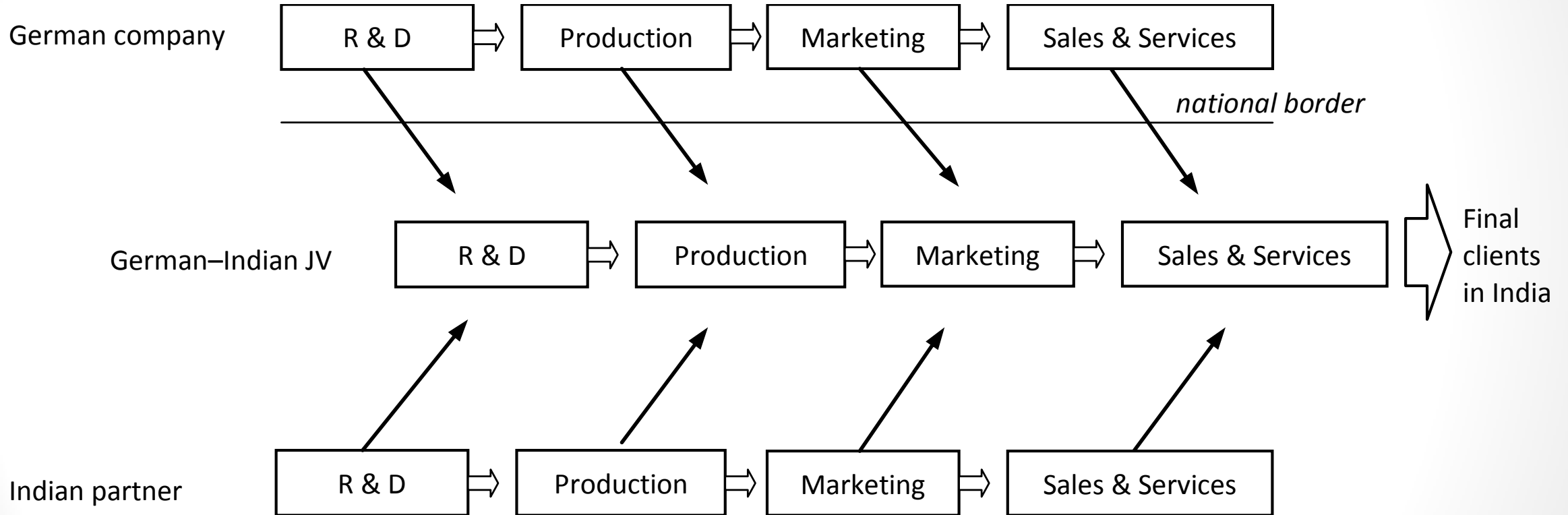
2) *Upstream joint venture*



X-form equity joint venture



Y-form equity joint venture



Main phases in the formation and evaluation of IJV

- Aim formulation
- Costs/benefits analysis
- Evaluation and partner choice
- Business plan development
- JV agreement and contract
- Performance evaluation

Failure of International Joint Ventures

- Bad ideas
- Insufficient planning
- Inadequate capitalization
- Lack of leadership
- Lack of commitment
- Cultural and ideological differences

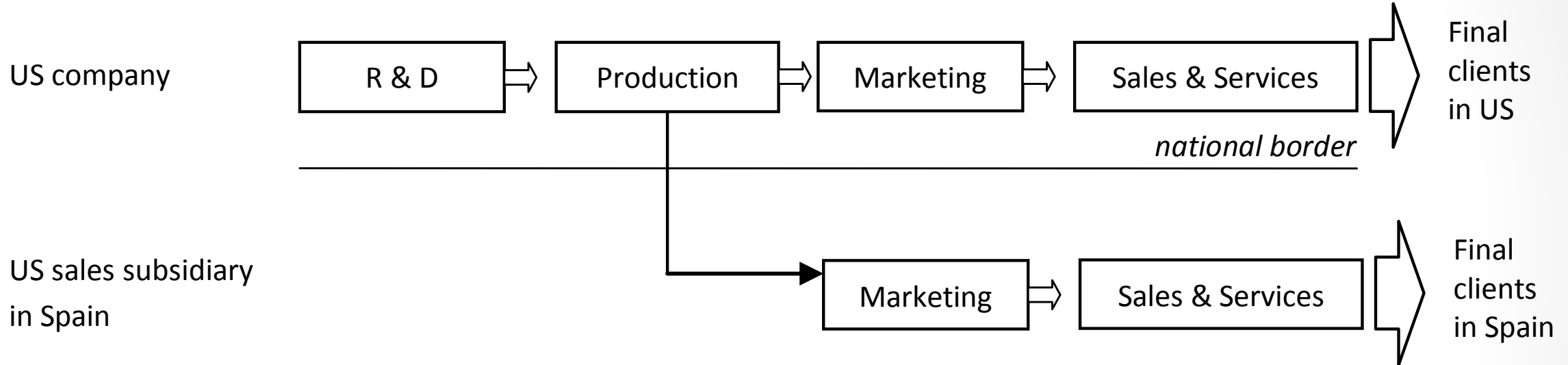
Hierarchical entry modes

- They are **equity-based**.
- They are a form of **Foreign Direct Investment (FDI)** in which a company assumes direct ownership of facilities in a foreign market.
- Hierarchical entry modes **are the riskiest**, but they are the most suitable choice for companies endeavoring **to grow** in the market while maintaining a **high degree of control over operations**.

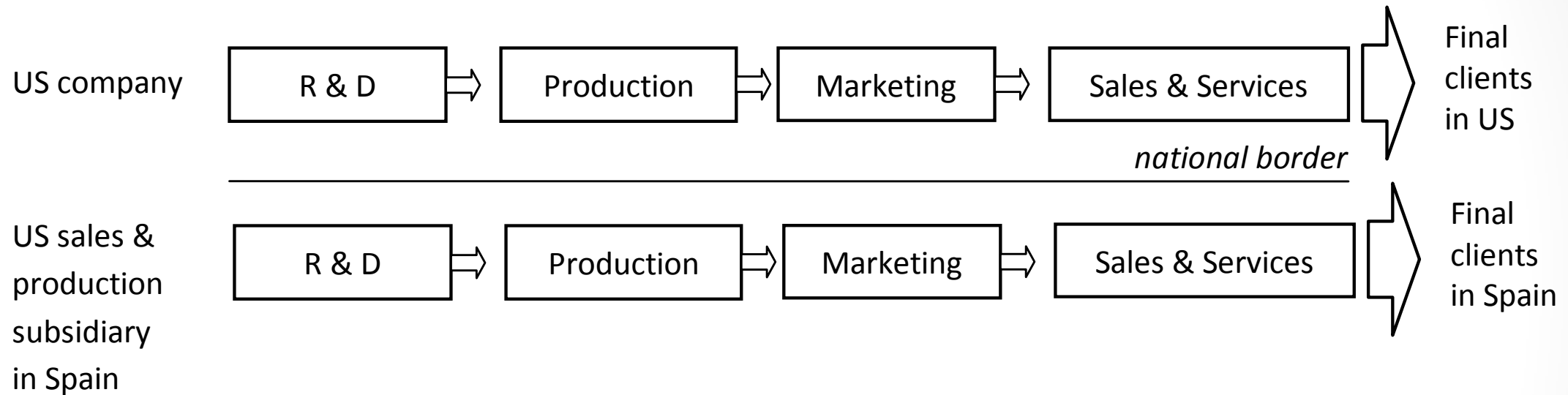
Types of Foreign Direct Investments

- **Representative office:** it is an office usually established to support marketing and service activities for the company's exports. This office only "represents" the parent company but it cannot buy and sell goods or services.
- **Branch:** it can carry out a much broader range of activities such as selling goods and signing contracts. A branch should not be confused with a sales subsidiary. In fact, the branch is not a separate legal entity of the parent corporation.
- **Sales subsidiary - sales and production subsidiary:** it is a society with its own juridical personality, separate from the parent company, and it may operate as an importer as well as manage the distribution and sales activity for the parent company in the foreign country. A subsidiary can be constituted as any type of separate legal entity based on the laws of the foreign country of entry, with its own income, liabilities, and local taxation.

Example of a sales subsidiary of a US company in the Spanish market



Example of a sales and production subsidiary of a US company in the Spanish market



Types of subsidiaries

According to the degree of ownership of the parent company in another company abroad, these entities are classified as follows:

- **Wholly owned subsidiary:** If the parent company owns 100 percent of the subsidiary;
- **Subsidiary:** If the share of the parent company is higher than 50 percent (majority stake);
- **Associate or Affiliate:** These two terms are generally used synonymously when the share of the parent company is lower than 50 percent (minority stake).

Wholly owned subsidiaries

- **New establishment (Greenfield investment)**

- Advantage of building a new ad hoc entity reflecting both the market and internal organizational needs and goals.
- New jobs are created and new technology is introduced.
- However, it takes more time and leads to greater competition in the market.
- Used to establish not only a new manufacturing company but also for Directly Operated / Owned Stores (DOS).

- **Merger or acquisition (Brownfield investment)**

- It consists of buying an existing foreign company.
- It requires a shorter period, but the process of finding the best company to acquire can be time-intensive.
- Additional time (and costs) required for integrating the new entity within its organization, which means integrating its technology, production processes, informatics systems, and organizational culture as well.
- Less aggressive from the competitive standpoint, but there is no job creation.

Factors that influence mode of entry decision process

- **Internal factors**
 - Financial resources
 - Human resources
 - Type of product and/or service
 - Time horizons
 - Risk tolerance
 - Company value chain
- **External factors**
 - Market
 - Consumer factors
 - Competitive environment
 - Production conditions
 - Environmental conditions

Factors that influence mode of entry decision process

- **Market entry is not static**, and entry modes may have to be restructured as environmental conditions change.
- **The choice of the entry mode is not always sequential**, as hypothesized in the Uppsala model.
- In many cases, the company may choose **more than one entry mode given the complexity of the market and the multiplicity of targets**.
- It is even possible to talk about **hybrid entry modes**, including JVs associated with distribution contracts, own-property stores, or franchising managed by subsidiaries.
- **Born global firms** follow different internationalization patterns.

Discussion questions

1. What in your opinion are the most difficult challenges facing SMEs deciding to enter foreign markets?
2. In your opinion, are there any differences facing SMEs and larger firms when dealing with an entry mode decision?
3. Joint ventures in emerging countries have higher failure rates than in more developed countries. Why do you think this is so?