**Chapter Four**

1. **Foreign market entry strategies**

***Introduction***

This Chapter deals with relevant variables to be considered in market analysis of an international business environment and discusses alternative overseas market entry strategies.

* 1. ***Market Analysis***

Marketing opportunities exist in all countries regardless of the level of economic development. In assessing market opportunities, there is no single ideal criterion. A marketer must therefore employ a set of criteria that are relevant to the market opportunity under consideration. Economic variables that should be considered include GDP, population, GDP /capita, Income, and personal consumption.

* + - 1. Gross Domestic product (GDP): is a measure of the value of all the goods and services produced by a nation. As such, GDP in effect measures the size of the economy.

Although a higher GDP is generally regarded as an indicator of a better market, GDP alone does not accurately reflect market potential. India’s GDP of $1.7 Trillion is much higher than Austria’s $134 billion, yet the larger number doesn’t necessarily mean that India is a better market.

By dividing a country’s GDP by its population, the result achieved is the GDP /capita, which measures market intensity. This figure can help a company establish country priorities since it is a measure of the richness of a market-degree of concentrated purchasing power. A country with a higher GDP/capita generally has a more advanced economy than otherwise. In the case of Austria and India, Austria has a $17,000 GDP/capita which is much more attractive in terms of wealth than India, whose GDP /capita is only $1,300.

* + - 1. Size of a country’s population: On this score, china is the foremost market because its population exceeds 1 billion.

According to the private, nonprofit population reference bureau, by the year 2025, 83 % of the world’s population will live in Africa, Asia, and Latin America.

Population size is a good indicator of market opportunity for low–unit-value products or necessities. Much like GDP, a larger population generally indicates a more attractive market. Still population by itself, like GDP, can be misleading when high-priced products or luxuries are involved.

Switzerland’s 7.1 million population does not seem impressive at first when compared to the 128 million population of Bangladesh, But GDP/capita reveals a totally different picture Switzerland’s GDP/capita of $23,000 is about 20 times greater than Bangladesh’s $1,100. Therefore, a larger population doesn’t necessarily indicate a better market opportunity.

It is inadequate to assess markets by relying only on each country’s total population without considering its land area. From this standpoint, the level of population density should be examined. Whereas total population indicates the overall size of the market, population density determines the ease in reaching that market. As the population in a certain area becomes dense or more concentrated, the efficiency of distribution & promotion increases as well. In addition to Indonesia’s large total population, 2/3 of more than 204 million Indonesians live in java, an island that constitutes only 7% of the country’s land area. Java’s population density is 740 persons per square kilometer-a big difference from the country’s average density of 83 persons.

In contrast, Canada has a vast land area and a relatively small population, suggesting that the country could not be an attractive market. A closer examination, however, reveals that Canada’s population density is actually a positive attribute since its three largest cities –Toronto, Montreal, and Vancouver contains 29% of the population, which controls 33% of the country’s buying power.

* + - 1. Personal income: income can reflect the degree of attractiveness of a market because consumption generally rises as income increases. Income however should not be strictly considered in absolute terms. Consumers in LDCs may have low income but may still have ample buying power. Because costs of living in these countries may be relatively low due to low food and heating costs. As a result, consumers in these countries can still have adequate disposable or discretionary income.

How the income is spent will provide another clue to market potential. If a large portion of a person’s income must go toward purchases of essentials, market opportunity for luxuries may be limited. The Japanese spent 25% of their disposable income for food while their American counterparts, are much more fortunate; spend only 15% of their income and leaving them more discretionary income for nonessentials. Income should never be considered by itself as a determinant of market attractiveness. China for example is the 2nd largest economy in the world. Yet its per capita income is somewhat greater than $5357, a figure which is not satisfactory.

Per capita income assumes everyone gets an equal share of the nation’s wealth. To overcome this weakness, a marketer should examine the distribution of income.

When income is evenly distributed across the populous segments, a firm’s product is likely to be suitable for all individuals. In contrast, the product may be unsuitable for certain segments if income varies significantly from one group of consumers to another. According to the US Bureau of census, the top 12% of the US population accounts for 38% of the national wealth, and the poorest 26% accounts for only 10% of the income. In Brazil, the top 20% of the population has accumulated 61.5% of the nation’s income. Exporters should pay attention to the income elasticity’s of imports and exports of target countries, because these coefficients indicate how imports & exports are influenced by consumer’s income changes in each country.

* + - 1. **Cultural analysis:** The information in this analysis must be more than a collection of facts.

Whosoever is responsible for the preparation of this material, should attempt to interpret the meaning of cultural information. That is, how does the information help in understanding the effect on the market? For example, the fact that almost all the populations of Italy and Mexico are Catholic is an interesting statistic but not nearly as useful as understanding the effect of Catholicism on values, beliefs, and other aspects of market behavior. Even though both countries are predominantly Catholic, the influence of their individual and unique interpretation and practice of Catholicism can result in important differences in market behavior.

Many companies have a country notebook for each country in which they do business. A **country notebook** is a guide for developing a marketing plan. The country notebook contains information a marketer should be aware of when making decisions involving a specific country market. As new information is collected, the country notebook is continually updated by the country or product manager. Whenever a marketing decision is made involving a country, the country notebook is the first database consulted. New product introductions, changes in advertising programs, and other marketing program decisions begin with the country notebook. It also serves as a quick introduction for new personnel assuming responsibility for a country market.

Market opportunity assessment and country selection for an entry depends upon proactive vs reactive approaches of the firm. In a proactive market selection, the firm proactively makes visits and does marketing research to assess the potential of a market.

In a reactive market selection, the firm is not actively collecting information or analyzing any market to assess its potential. Firms following this approach, often wait for unsolicited order, or an initiative taken by importers from a potential market. Often these firms wait for other firms (their competitors) to enter the market first. Such firms believe that the first movers will have to pave the way and handle initial problems, and then they can enter. This approach however, is not always a wise choice as it is very difficult to snatch market share from existing firms. Instead of following such approach, a firm has to do its own assessment according to its objective, product and positioning.

While making entry decisions, a firm has to carry out competition analysis and has to see whether it is the first foreign firm in the particular product group or not. To be the first in the market entails first mover advantages: if the product is accepted by the market, it can gain major share. This was the case for Pepsi cola which entered Russia and India as the first mover. Coca cola entered these markets after few years and had to struggle harder to gain respectable market share. Moreover, the first mover gains valuable experience/knowledge of the market. Enables to lessen uncertainties and gain cost advantage.

Disadvantages of first mover: convincing and educating the market that the new product is useful. Thus, the first mover takes the initial costs and if the market reacts positively, other firms reap the benefits.

* 1. ***Foreign market entry strategies***

Normally companies have three main objectives when entering a foreign market:

1. ***market seeking***

A market seeking strategy means that the company is looking for a considerable market for its products/offers. A saturated market at home, a firm’s belief that it has a strong brand which can penetrate into new markets may be reasons.

1. ***resource seeking***

Resource seeking firms strive to enter into countries to get access to raw materials or crucial inputs that can provide cost reduction and lower operation costs. For example, oil companies in Middle East and textiles and garment companies in Pakistan and India. For resource seeking firms, we will have to look at suppliers of those resources and their existing relationship and network, and whether it will be possible for the firm to penetrate into these networks or not.

1. ***efficiency seeking***

Firms want to enter countries/markets where they can achieve efficiency in different ways. e.g. R & D and other infrastructural effects. Efficiencies can also be achieved due to the fact that a certain industry has gathered at a place creating a beneficial infrastructure.

There are many foreign market entry strategies

1. ***Exporting***

Exporting is a strategy in which a company is without any production organization overseas (in foreign markets it targets) exports a product from its home base. The firm exports a product from its home base or using company owned outlets abroad. Often the exported product may be fundamentally the same as the one marketed in the home market and sometimes adaptation may involve.

Many companies employ this entry strategy when they first become involved with international business.

An exporter has two options for export: 1) it may have domestic base international division or its own outlets in the targeted countries or markets.

2) It can export through independent exporting firms (working as exporters as an additional function). Exporting is seen as an alternative when:

* Sales potential in target country is limited;
* Required product adaptation is little
* Distribution channels are close to the exporting plant
* Production costs in the target country are high
* The importing policies are liberal
* Political risks in the target country are high

**Advantages of this foreign market entry strategy**

Easy in implementing the strategy- risks are minimized because the company may simply export its excess production capacity when it receives orders from abroad. This is the most likely approach to enter to an overseas market for small firms.

In addition exporting involves limited investment cost, speed of entry, maximum scale via using existing facilities.

**Disadvantages of this strategy**

An exporting strategy is that it is not always an optimal strategy. A desire to keep international activities simple, together with a lack of product modification, make a company’s marketing strategy inflexible and unresponsive.

The exporting strategy functions poorly when the company’s home-country currency is strong. In 1970s, the Swiss Franc was so strong that Swiss companies found it exceedingly difficult to export and sell products in the US Market.

1. ***Joint Venture***

A joint venture is simply a partnership at corporate level, and it may be either domestic or inter-national. An international joint venture is one in which the partners are from more than one country. It is an enterprise formed for a specific business purpose by two or more investors sharing ownership and control.

According to one study, firms tend to use joint ventures when they enter markets that are characterized by high legal restrictions or high levels of investment risks.

Mergers often are favorable when:

* There is convergence of partners’ strategic goal and divergence of their competitive goals
* The partners’ market power, size and resources are small compared to industry leaders
* The partners are able to learn from one another

1. A joint venture substantially reduces the amount of resources (money & personnel) that each partner must contribute.

2. Frequently, joint venture strategy is the only way, especially when wholly owned activities are prohibited in a host country. Generally planned economies, in particular usually limit foreign firm’s entry to some sort of cooperative arrangements. Some countries make it clear that only those investors with long-term commitments will be allowed to engage in overseas market with local partners.

3. Sometimes, social rather than legal circumstances require a joint venture to be formed. Joint ventures often have social implications. The familial and tightly knit relationship between suppliers and middlemen is prevalent in many countries. In Japan, this relationship is known as Keiretsu, which means that family like business groups are linked by cross-ownership of equity. Such customs and business relationships make it difficult for a new supplier to gain entry. Even in the event that the new supplier is able to secure some orders, the orders may be terminated as soon as a member of the family is able to supply the product in question.

4. A joint venture can also simultaneously work to satisfy social, economic, and political circumstances, since these concerns are highly related. In any kind of international business undertaking, political risks always exist and a joint venture can reduce such risks while it increases market opportunities. In this sense, a joint venture can make the difference between securely entering a foreign market or not entering at all. Most American firms seek Saudi partners to establish joint ventures so that they can deal effectively with Saudi Arabia’s political demands. Mexico has stringent “mexicanization” rules requiring majority local ownership.

**Limitations of Joint Ventures**

1. If the partners to the joint venture have not established clear-cut decision making policy and must consult with each other on all decisions, then the decision-making process may delay a necessary action when speed is essential.
2. Wherever two individuals or organizations work together, there are bound to be conflicts because of cultural problems, divergent goals, disagreements over production and marketing strategies, and weak contributions by one or the other partner. Although the goals may be compatible at the outset, goals and objectives may diverge over time, even when joint ventures are successful.
3. The matter related to control: By definition, a joint venture must deal with double management. If a partner has less than 50% ownership, that partner must in effect let the majority partner make decisions. If the board-of-directors has a 50-50 split, it is difficult for the board to make a decision quickly or at all.
4. It is interesting to note that, while cultural differences indeed affect international joint venture performance, culture distance stems more from differences in organizational culture than from differences in national cultures.
5. ***Manufacturing***

The manufacturing process can be employed as a strategy involving all or some manufacturing in a foreign country. One kind of manufacturing involves manufacturing operations in a host country, not so much to sell but for the purpose of exporting to the home country or other countries.

The goal of manufacturing strategy may be to set up a production base inside a target market country as a means of invading it.

There are several variations on this method, ranging from complete manufacturing (foreign direct investment) to contract manufacturing.

Foreign direct investment is the direct ownership of facilities in a host country. It involves the transfer of resources including capital, technology, personnel, etc. direct foreign investment may be made through the acquisition of an existing entity or the establishment of a new enterprise.

Direct ownership provides a high degree of control in the operation and the ability to better know the consumers and competitive environment. However, it requires a high level of resources and a high degree of commitment.

Foreign direct investment, unlike other forms of capital inflows, usually brings additional resources that are very desirable to developing economies. These resources include technology, management expertise, and access to export markets.

**Factors to be considered in manufacturing abroad**

* *Incentive:* Incentive preferences of MNC’s and absence of restrictions on intercompany payments to be the most important determinant (no control on dividend remittances, import duty concessions, guarantees against expropriations and tax holidays).
* *Product image:* From the marketing stand point product image deserves attention. Winston cigarettes made in Venezuela with the same tobaccos and formulas as the Winston cigarettes in the US are cheaper than the US made Winston. However, the Venezuela’s prefer the more expensive US made Winston. Country of origin image determines a product’s demand.
* *Competition:* to a great extent, competition determines potential profit. The resources of various countries should be compared to determine each country’s comparative advantage. The comparison should include production consideration including production facilities, raw materials, equipment, real estate, water, power, and transport, import taxes, as well as other trade barriers. Human resource as an integral part of the production factor must be available at reasonable cost.
* *Changes in labor costs:* Manufacturers should pay attention to absolute as well as relative changes in labor costs. A particular country is more attractive as plants location if the wages there increases more slowly than those in other countries. The increase in labor costs in a country leads operating firms to switch their production facilities to other low labor cost nations. Many Japanese firms have been attracted by the $1 hourly wage rate in Mexico. The same is true in Ethiopia to foreign direct investors.
* *Type of product:* A manufacturer must weigh the economies of exporting a standardized product against the flexibility of having a local manufacturing plant that is capable of tailoring the product for local preferences.
* *Taxation:* countries commonly offer tax advantages among other incentives to lure foreign investment. In addition, exchange problem, shipping delays will be made minimal or non-existent.
* *Investment climate:* the investment climate is determined by geographic and climatic conditions, market size and growth potential as well as the political atmosphere.

***Note:*** less experienced service firms tend to enter foreign markets that are similar to their home country and they choose less similar markets after gaining more experience.

1. ***Assembly Operations***

An assembly operation is a variation on a manufacturing strategy. According the US customs service, “assembly means the fitting or joining together of fabricated components.” The methods used to join or fit together solid components may be welding, soldering, riveting, gluing, laminating, and sewing. In this strategy, parts or components are produced in various countries in order to gain each country’s comparative advantage.

Capital intensive parts may be produced in advanced nations and labor intensive assemblies may be produced in an LDC, where labor is abundant and labor costs are low. This strategy is common among manufacturers of consumer electronics.

When a product becomes mature and faces intense price competition, it may be necessary to shift all of the labor-intensive operation to LDCs.

An assembly operation allows a company to be price competitive against cheap imports and this is a defensive strategy.

Assembly operations also allow a company’s product to enter many markets with tariffs and quotas consideration.

In assembling, if the product’s local contents are less than half of the components used, the product may be viewed as imported and subject to tariffs and quota restrictions.

1. ***Management Contracts***

In some cases, government’s pressures and restrictions force a foreign company either to sell its domestic operations or to relinquish control. In such a case, the company must formulate a way to generate revenue given up. One way to generate revenue is to sign a management contract with the government or the new owner in order to manage the business for the new owner.

The new owner may lack technical and managerial expertise and may need the former owner to manage the investment until local employees are trained to manage the facility.

Management contracts do not have to be used only after the company is forced to sell its ownership interest. Such contracts may be used as a sound strategy for entering a market with a minimum investment and minimum political risks.

1. ***Turnkey Operations***

A turnkey operation is an agreement by the seller to supply a buyer with a facility fully equipped and ready to be operated by the buyer’s personnel, who will be trained by the seller.

The term is sometimes used in fast-food franchising when a franchisor agrees to select a store site, build the store, equip it, train the franchisee and employees, and some-times arrange for the financing.

It is a full end-to-end solution that encompasses a full set of services needed to immediately start running of operation. It encompasses designing, building and implementing the complete process that enables the buyer to start managing his operations immediately and independently. In international marketing, the term is usually associated with giant projects that are sold to governments or government-run companies.

Large-scale plants requiring technology and large-scale construction process unavailable in local markets commonly use this strategy. Owing to the magnitude of giant turnkey projects, the winner of the contracts can expect to reap huge rewards.

Thus, it is important that the turnkey construction packaged offered to a buyer is an attractive one. Such a package involves more than just offering the latest technology, since there are many other factors important to LDCs in deciding on a particular turnkey project. For example, financing is crucial.

Local personnel must be trained to run the operation, and after-sales services should be contracted for and made available for the future maintenance of the plant.

1. ***Acquisition***

When a manufacturer wants to enter a foreign market rapidly and yet retain maximum control, direct investment through acquisition should be considered.

The reason for wanting to acquire a foreign company includes product/geographical diversification, acquisition of expertise (technology, marketing and management) and rapid entry.

Acquisition is viewed in a light different from other kinds of foreign direct investment.

A government generally welcomes foreign investment that starts up a new enterprise called-Greenfield enterprise. Greenfield enterprise increases employment and enlarges to tax base. An acquisition fails to do this, since it displaces domestic ownership.

Therefore, acquisition is very likely to be perceived as exploitation or a blow to national pride. In this basis, it stands a good chance of being turned down.

A special case of acquisition is the brown field entry mode. This mode happens when an investor’s transferred resources dominate those provided by an acquired firm. In addition, this hybrid mode of entry requires the investor to extensively restructure the acquired company so as to assure fit between the two organizations. The extensive restructuring may yield a new operation that resembles a green field investment.

As such, integration costs can be high. However, brown field is a worth-while strategy to consider when neither pure acquisition nor green field is feasible.

1. ***Strategic Alliance***

A strategic alliance in business is a relationship between two or more businesses that enables each to achieve certain strategic objectives neither would be able to achieve on their own.

There is no one way to form strategic alliance. Strategic alliance may be the result of mergers, acquisitions, joint ventures and licensing agreements. Joint ventures are naturally strategic alliances, but not all strategic alliances are joint ventures.

Unlike joint ventures, which require two or more parties to create a separate entity, a strategic alliance does not necessarily require a new legal entity. As such it may not require partners to make arrangements to share equity. Instead of being an equity-based investment, a strategic alliance may be more of a contractual arrangement whereby two or more partners agree to cooperate with each other and utilize each partner’s resources and expertise to achieve rapid global market penetration.

Airlines are a good example of the international nature of strategic alliances. Almost all major airlines have joined one of the three strategic groups: Star, SkyTeam, and Oneworld. The passengers of member airlines earn frequent-flier points on their home carrier when flying

with the alliance members. These members also provide reciprocal access to their airport lounges.

1. ***Licensing***

When a company finds exporting ineffective but is hesitant to have direct investment abroad, licensing can be a reasonable compromise. Licensing is an agreement that permits a foreign company to use intellectual properties (patents, trademarks, and copyrights, technical know-how and skills, architectural & engineering designs, or any combination of these in a foreign market.

Essentially, a licensor allows a foreign company to manufacture a product for sale in the licensee’s country and sometimes in other specified markets.

An owner of a valuable brand name can benefit greatly from brand licensing. In addition to receiving royalties from sales of merchandise bearing its name or image, the trademark owner receives an intangible benefit of free advertising which rein-forces the brand’s image. Licensing is supposed to work good in situations where:

* Import and investment barriers in the host government are intense
* Cultural distance between the investor and the market is significant
* Sales potential in target country is low i.e. not rewarding for direct investment
* The licensee lacks to become a competitor of the licensor

**Advantages of Licensing**

* It allows a company to spread out its research &development and investment costs, while enabling it to receive incremental income with only negligible expenses.
* Obtain extra income for technical know-how and services
* Is highly attractive for companies that are new in international business
* Pave the way for future investments in the market
* Granting a license protects the company’s patent and/or trademark against cancellation for nonuse. This protection is especially critical for a firm that, after investing in production and marketing facilities in a foreign country, decides to leave the market either temporarily or permanently.
* A manufacturer should consider licensing when its capital is scarce
* When import restrictions discourage direct entry, and when a country is sensitive to foreign ownership.
* The method is flexible because it allows a quick and easy way to enter the market.
* Licensing also works well when transportation cost is high, especially relative to product value.
* The brand name is extended to new product categories in which the trademark owner has no expertise.

**Disadvantage of Licensing**

* Licensing may be the least profitable of all entry strategies.
* By granting a license to a foreign firm, the licensor may be nurturing a competitor in the future-someone who is gaining technological and product knowledge. Texas instruments had to sue several Japanese manufacturers to force them to continue paying royalties on its patents on memory chips.
* Once licensing is in place, the agreements can also prevent the licensor from entering that market directly. Japanese laws give a licensee virtual control over the licensed product and such laws present a monumental obstacle for an investor wishing to regain the rights to manufacture and sell the investor’s own product.
* Poor performance of the licensee-Inconsistent product quality across countries caused by licensee’s lax quality control can injure the reputation of a product on a worldwide basis. Even when exact product formulations are followed, licensing can still damage the reputation of the firm psychologically.

Licensing terms must be carefully negotiated and explicitly treated. In general a license contract should include those basic elements: product and territory coverage, length of contract, quality control, grant back and cross-licensing, choice of currency, choice of law, royalty rate.