

An international entry mode is an institutional agreement

[Business](#)



Introduction

An international entry mode is an institutional agreement necessary for the entry of a company's products, technology and human capital into a foreign country or market. The reluctance of firms to change entry modes once they are in place, and the difficulty involved in doing so, make the mode of entry decision a key strategic issue for firms operating in today's rapidly internationalizing market place.

The choice of mode will depend on internal characteristics (eg firm size, international experience) and external characteristics (eg the sociocultural distance between the host country and the home country) as well as the trade-off between desired mode characteristics (risk adverse, control and flexibility). The diagram below conveys 3 broad categories of modes of entry, and their fundamental trade offs.

Further to the issues discussed above, no matter which of three of the export modes the manufacturer uses in a market, it is important to think about what level of 'mindshare' the manufacturer occupies in the mind of the export partner, as there has been a strong proven correlation between mindshare levels and how willing the export intermediary is to place on company brand in front of another, or how likely the intermediary is to defect. Good mind share will depend on scoring well across the three drivers of commitment and trust, collaboration and mutuality of interest & common purpose.

Export Modes Baring in mind the factors discussed above we will now review the different types of entry modes, beginning with export modes, as they are typically the modes used in initial entry to international markets, as they

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require a lower financial investment than other modes and can be viewed as a 'toe in the water'; for in experienced and smaller firms or where there may be risks (eg political, economic environmental) preventing FDI. The three major types of exporting are indirect, direct and cooperative.

Indirect export modes are modes in which the exporting manufacturer uses independent organizations located in a producer's country, they include the use of an export buying agent, a broker, an export house, a trading company, or a piggyback. Indirect export modes may be appropriate for firms with limited- rather than long term- international expansion objectives. For example, if international sales are primarily used as a means of disposing of surplus production. The lack of contact with firms abroad will provide limited information to develop a plan for international expansion.

In the use of such modes, there is limited control over the marketing mix (other than product). A direct export mode may be more appropriate in gaining a little more control, in which the manufacturer sells directly to an importer, agent or distributor in the foreign target market. The local party will bring the advantage of existing distribution networks, and will provide good local market knowledge. However, a company must be careful in entering into contracts as they can be difficult and costly to terminate, and can go wrong when there is a conflict in interests (e. . it may sell rivals goods or competing product lines). Similarly, there is a serious disincentive for the agent/distributor in that if it performs well and develops the market, it risks being replaced by a subsidiary of the principal. Intermediate modes As a firm gradually evolves towards more foreign based operations, Intermediate modes will become more suitable modes of entry. This will likely include <https://assignbuster.com/an-international-entry-mode-is-an-institutional-agreement/>

firms possessing some sort of competitive advantage that are unable to exploit this advantage because of resource constraints.

Intermediate modes take the form of contract manufacturing, licencing, franchising, a joint venture or a strategic alliance. Contract manufacturing- where manufacturing is contracted to an external foreign partner provides a low risk and potentially low cost mode of entry. Benetton and Ikea are a good example of companies who successfully rely on a contractual network of small overseas manufacturers. Benetton has over 80% of its production outsourced to 450 contractors (located in low cost production countries such as India and China).

As a result of the money saved on labour, Benetton can sell products 20% cheaper, helping it to maintain a low cost position in comparison to competitors. Of course, this method may not be appropriate for every company as there is a loss of knowledge and intellectual property rights, and the transaction costs involved must also be considered. Licensing differs from contract manufacturing in that more value chain functions have been transferred to the licensee. In outsourcing production and downstream activities a licensor firm can concentrate on its core competences and therefore will remain technologically superior in its product development- for example Apple licenses its brand to manufacturers of accessory products, and the BBC licenses rights to broadcast TV shows around the world. However a lack of control over licensor operations and therefore quality may lead a company to use franchising (a sub variant of licensing) in which the franchisor gives a right to the franchisee against a payment, EG a right to

use a total business concept/system, including the use of trademarks/brands, against some agreed royalty.

Franchising not only provides a greater degree of control than licensing, but it can also be seen as low cost and low risk as the franchisees are the ones investing in the necessary equipment and know-how. This entry mode has been seen to generate great successes for companies such as McDonalds who now franchises 25000 restaurants globally. However, it should be noted that there is still a lack of full control over franchisee's operations, which can result in problems with cooperation, communications, quality control etc, and a risk of damage to the company's international reputation if some franchisees underperform ("free-riding").

Another intermediary mode that will allow greater control is a joint venture, in which 2 'parent' companies create a new 'child' company. This high degree of control and local knowledge is a clear advantage of such an entry mode. The shared knowledge and resources gained through a JV as compared with wholly owned subsidiaries will bring many advantages such as economies of scale. However of course there is a loss of confidentiality and flexibility, and the use of double management will raise questions about how the company is split- 50/50?

If 50/50, it is difficult for the board to make decisions, if at all! Hierarchical modes of entry allow the highest degree of control for a firm, while at the same time, the highest degree of risk as the firm completely owns and controls the foreign entry mode. To have a wholly owned subsidiary a firm can either acquire an existing company (acquisition) or build on its own operations from scratch (greenfield/brownfield investment). An acquisition <https://assignbuster.com/an-international-entry-mode-is-an-institutional-agreement/>

will provide rapid entry, access to distribution channel, an existing customer base.

This may be the only feasible way of establishing a base in the host country in saturated markets, or where there are substantial entry barrier and therefore little room for a new entrant. Of course, as with intermediary modes, there is the issue of contracts, negotiation and the different management styles between companies. If difficulties (eg no appropriate acquisition) are encountered with acquisitions, it may lead firms to prefer to establish greenfield (new facility) and brownfield (existing facilities) operations.

Out of the two- greenfield is seen as an advantageous option because the new plant will involve the latest technology and equipment, avoiding the problem of trying to change the traditional practices of an established concern. Although this is a big investment for a company involving slow entry into the foreign market, the returns are long term and the firm has control over the entire operation.

Conclusion

It cannot be stated categorically which alternative is the best. There are many internal and external conditions which affect this choice and it should be emphasized that a manufacturer wanting to engage in global marketing may use more than one of these methods at the same time (Petersen and Welch, 2002). Such 'mode packages' may take the form of a concerted use of several operation modes in an integrated, complementary way. Zara is a good example of this- in markets where the hierarchical model is used, there

is high growth potential and relative low sociocultural distance between the home country of Spain and target market.

The intermediate modes (usually joint venture and franchising) are mainly used in countries where the sociocultural distance is relatively high. For example in 1999, Zara entered into a 50-50 JV with the German firm OTTO Versand, which had experience in the distribution sector and market knowledge in one of Europe's largest markets, Germany. Whereas franchising is used by Zara in high risk countries which are socio-culturally distant or have small markets which allow sales forecast such as Andorra, Puerto Rico or the Philippines.