Global review of market entry strategies economics essay

When a firm is going to explore a foreign market, the choice of the best mode of entry is decided by the firm's expansion strategy. The main aim of every business organization is to establish itself in the global market. Thus, the process calls for developing an effective international marketing strategy in order to identify the international opportunities, explore resources and capabilities, and utilize core competencies in order to better implement the overall international strategies. The decision of how to enter a foreign market can have a significant impact on the results. Companies can expand into foreign markets via the following four mechanisms: exporting, licensing, joint venture and direct investment (Meyer, Estrin, Bhaumik, and Peng, 2008).

All of them have their advantages for the firm to explore as well as disadvantages which must be considered by the firm's top management. " What entry mode that a multinational company chooses has implications for how much resources the company must commit to its foreign operations, the risk that the company must bear, and the degree of control that the company can exercise over the operations on the new market." (Zekiri and Angelova, 2011, pp 576)

1. 1. 1 Global Review of Market Entry Strategies

Taylor, Zou and Island (1998) conducted a study on a transaction cost perspective on foreign market entry strategies of USA and Japanese firms and concluded that several transactions costs affected the decision making of market entry mode for the US firms but did not affect the market entry mode for Japanese firms.

Meyer, Estrin, Bhaumik, and Peng (2008) conducted a study on Institutions, Resources, and Entry Strategies in Emerging Economies to investigate the impact of market-supporting institutions on business strategies by analyzing the entry strategies of foreign investors entering emerging economies. The authors made three contributions, to enrich an institution-based view of business strategy (Oliver, 1997; Peng, 2003; Peng, Wang, and Jiang, 2008) by providing a more fine-grained conceptual analysis of the relationship between institutional frameworks and entry strategies. Secondly, they argued that institutions moderate resource-based considerations

when crafting entry strategies and finally, by amassing a primary survey database from four diverse but relatively underexplored countries and combining such data with archival data, they extended the geographic reach of empirical research on emerging countries.

Stiegert, Ardalan, and Marsh (1997) conducted a study on foreign market entry strategies in the European Union where the study utilized intra-firm, socio-cultural, geographical-proximity, and political-stability variables to explain bimodal foreign direct investment (FDI) patterns by agri-food and beverage multinational companies into and within the European Union. A logit framework incorporated a unique-count database of firm-level investment patterns from 1987-1998 and the results showed the 1992 structural changes under the Maastricht Treaty increased the probability of wholly owned FDI modes such as greenfields and buyouts, and also found that past modal strategies of firms, language barriers, and exchange-rate volatility all correctly explained modal investment patterns. The authors asserted that these results provide important contributions toward understanding modal investment strategies including the role of macroeconomic changes within a custom union.

Czinkota & Ronkainen (2003) carried out a study on the motivation factors for market entry and asserted that several factors results in firms taking measures in a given direction as in the case of internationalization. These are a variety of motivations both pushing and pulling companies to internationalize which are differentiated into proactive and reactive motivations.

1. 1. 2 Market entry strategies for Multinationals in Kenya

Multinational corporations (MNCs) operate in a global environment unfamiliar in political, economic, social, cultural, technological and legal aspects. Increased competition among multinational corporations and the entry of other players in the Kenyan market necessitate the design of competitive strategies that guarantee performance. Creating strategies for coping with competition is the heart of strategic management which is critical for the long term survival of any organization. MNCs in Kenya have adopted a number of strategies including: better quality, excellent customer service, innovation, differentiation, diversification, cost cutting measures, strategic alliances, joint venture, mergers/acquisitions and not forgetting lower prices, to weather competitive challenges.

Kinuthia (2010) suggests that Foreign Direct Investment (FDI) has risen in Kenya from the 1990s due to the liberalization of the economy. It is mainly concentrated in the manufacturing sector and is mainly Greenfield in nature. Most of FDI in Kenya is export oriented and market seeking. The most important FDI determinants are market size in Kenya as well as within the region, political and economic stability in both Kenya and its neighbours and bilateral trade agreements between Kenya and other countries. The most important FDI barriers in Kenya are political and economic instability in Kenya, crime and insecurity, institutional factors such as corruption, delayed licenses and work permits among other factors.

According to the Financial Post (2010), well-established and hitherto dominant multinational companies in Kenya are suddenly finding themselves sailing in turbulent waters. The latest multinational to leave the scene with a bloodied nose is the 200-year-old Colgate Palmolive, a global business concern which begun in New York as a small soap and candle business. The list also includes, Johnson & Johnson, Agip, Unilever, Procter & Gamble, and recently, ExxonMobil, just to mention a few. The Financial Post (2010) suggests that majority of the multinationals who have so far relocated, shut down or downsized their operations consider Kenya as one of the least competitive investment destinations worldwide. Apart from the notoriously high cost of power in Kenya, difficulties in obtaining licenses and visas, inefficiencies at the Port of Mombasa and deteriorating infrastructure are among other non-tariff barriers to investment in this market. Financial Post (2010) notes that it is in the petroleum sector where the multinationals are finding it difficult to cope. A few years back, Agip shut down its pipes and sold out to BP Shell. BP sold it stake to Kenya Shell, a move that changed shareholding of BP Shell, which has been operating as a joint venture company. Recently, ExxonMobil sold its Kenya franchise to Tamoil, who will now take over the company’s over 64 service stations countrywide.

Ndegwa and Otieno (2008) conducted a study on market entry strategies for a transition country, Kenya, a case study that focused on mode of entry strategies that would be used by a Finnish firm, YIT Group to enter a developing country, Kenya. The focus was on motives to enter developing countries, the strategies used to enter developing countries, the factors influencing the decision of entry strategy, and finally problems facing companies entering developing markets experience. The study concluded that the most significant motive to enter developing countries is potential growth of the market, the most suitable entry mode strategy is joint venture, the most significant factor influencing the entry mode decision is the legal framework, and the largest problem experienced by companies investing in the country is bureaucracy.

1. 1. 3 Performance and non financial performance

Performance Measures are quantitative or qualitative ways to characterize and define performance. They provide a tool for organizations to manage progress towards achieving predetermined goals, defining key indicators of organizational performance and Customer satisfaction. Performance Measurement is the process of assessing the progress made (actual) towards achieving the predetermined performance goals (baseline). Traditional, financially based performance measurement approaches have a number of serious drawbacks (Kaplan & Norton, 1992). These include the element of outcome focus. Established financial indicators such as turnover and profit before tax are outcome indicators. Profitability measures the extent to which a business generates a profit from the factors of production: labour, management and capital. Profitability analysis focuses on the relationship between revenues and expenses and on the level of profits relative to the size of investment in the business (Gilbert and Wheelock, 2007).

Four useful measures of firm profitability are the rate of return on firm assets (ROA), the rate of return on firm equity (ROE), operating profit margin and net firm income. The ROA measures the return to all firm assets and is often used as an overall index of profitability, and the higher the value, the more profitable the firm business. The ROE measures the rate of return on the owner's equity employed in the firm business. It is useful to consider the ROE in relation to ROA to determine if the firm is making a profitable return on their borrowed money. The operating profit margin measures the returns to capital per dollar of gross firm revenue. Recall, the two ways a firm has of increasing profits is by increasing the profit per unit produced or by increasing the volume of production while maintaining the per unit profit. The operating profit margin focuses on the per unit produced component of earning profit and the asset turnover ratio (discussed below) focuses on the volume of production component of earning a profit (Crane, 2011).

Net firm income comes directly off of the income statement and is calculated by matching firm revenues with the expenses incurred to create those revenues, plus the gain or loss on the sale of firm capital assets. Net firm income represents the return to the owner for unpaid operator and family labour, management and owner's equity. Like working capital, net firm income is an absolute dollar amount and not a ratio, thus comparisons to other firms is difficult because of firm size differences (Gilbert and Wheelock, 2007).

1. 1. 4 Manufacturing Sector in Kenya

Kenya has the biggest formal manufacturing sector in East Africa (UNIDO, 2008). This sector has grown over time both in terms of its contribution to the country's GDP and employment. It is evident from these trends that the sector makes an important contribution to Kenya's economy (KAM, 2009). The average size of this sector for tropical Africa is 8 percent. Despite the importance and size of this sector in Kenya, it is still very small when compared to that of the industrialized nations (KIRDI, 2009). Awino (2007) and K'Obonyo (1999) argues that Kenya's manufacturing sector is going through a major transition period largely due to the structural reform process, which the Kenya government has been implementing since the mid-eighties with a view to improving the economic and social environment of the country.

The manufacturing industry in Kenya can be classified under three main sectors, namely, the agro-based industrial sector, engineering and construction industrial sector and the chemical and mineral industrial sector (GOK Vision 2030). However, the three major classifications can still be categorized into two: (i) agro-based and non-agro-based (K'Obonyo, 1999). The agro-based industrial sector in Kenya consists of seven sub-sectors and provides the bulk (68 per cent) of value added from the manufacturing industry, (KAM, 2009). K'Obonyo (1999) argues that the agro-based industrial sector has developed on the basis of traditional domestic resource activities. The major challenges faced by this sector are related to the quantity, quality and price of raw materials mostly produced by small scale farmers. The seven sub-sectors that form the agro-based industrial sector are food processing, animal feeds, beverages and tobacco, miscellaneous food products, tannaries and leather products, woods and wood products and pulp and paper (Awino, 2007).

1. 2 Problem Statement

Mode of entry into an international market is the channel which organization that want to operate in international markets employ to gain entry to a new international market. The choice for a particular entry mode is a critical determinant in the successful running of a foreign operation. Therefore, decisions of how to enter a foreign market can have a significant impact on the results. However, it may seem that the use of particular strategies by international firms may yield higher growth and performance than others. There are several strategies that manufacturing firms can select from when they want to gain entry to a new international market such as exporting; licensing and franchising; strategic alliances; and wholly owned foreign subsidiaries. This study wants to investigate and indicate the particular modes of entry that manufacturing MNCs in Kenya use and of what value they are.

Studies on the relationship between the choice of international market entry strategy and firm performance are abundant. These include Taylor and Zou (1999); Zekir and Angelova(2011) ; Chung and Enderwick (2001); Zand (2011); Sadaghiani, dehghan, and Zand (2011); and Mushuku(2006). There lacks conclusiveness on these studies about the choice of market entry strategy and firm performance. There exist glaring knowledge gaps as far as scarcity of local studies, context, conclusiveness and difference in opinions is concerned. This implies that there are scarce studies in developing economies such as Kenya. Studies on the choice of international market entry strategy and firm performance seem to concentrate on the developed and emerging countries which leave a knowledge gap for developing economies such as Kenya. There is a paucity/scarcity of studies on the marketing strategies techniques used by firms in Kenya and the researcher is not aware of any study that has been done on the influence of international market entry strategies on the performance of manufacturing multinationals in Kenya. This study therefore wishes to bridge this knowledge gap by assessing the influence of market entry strategies in manufacturing firm’s performance in Kenya.

1. 3 Study Objectives

The study attempts to achieve the following study objectives

To identify the international market entry strategies by manufacturing multinationals in Kenya

To establish the motive behind the choice of market entry strategies by manufacturing multinationals in Kenya

To examine the influence of market entry strategies on the performance of manufacturing multinationals in Kenya

1. 4 Significance of the study

The study may be of use to management of manufacturing concerns in Kenya. This is because it will highlight the impact of choice of entry strategy to growth of a firm. Managers may therefore use these results to select the optimal strategies that would optimize growth of multinationals.

The study will aid managers of prospective firms, and also those other people that want to go into other markets. The study will also provide ample information to those firms already in the market with strategies that are not working for them.

The study results may be used by the implementation panel for vision 2030. Perhaps, they can craft a policy based on the study results that would increase the impact of entry strategies on growth of multinationals operating in Kenya. This would consequently lead to higher productivity and achievement of vision 2030 goal of annual economic growth of 10%.

The study may also be a valuable addition to literature review and scholars of international business management, business strategy and growth.

1. 4 Scope of the study

There are several strategies that manufacturing firms can select from when they want to gain entry to a new international market such as exporting; licensing and franchising; strategic alliances; and wholly owned foreign subsidiaries. The study will restrict itself to market entry strategies and their influence on performance of multination manufacturing organizations.

The scope of this study is the manufacturing sector. The manufacturing industry in Kenya can be classified under three main sectors, namely, the agro-based industrial sector, engineering and construction industrial sector and the chemical and mineral industrial sector (GOK Vision 2030). However, the three major classifications can still be categorized into two: (i) agro-based and non-agro-based (K’Obonyo, 1999).

Kenya's main industries are food and beverages processing, manufacture of petroleum products, textiles and fibers, garments, tobacco, processed fruits, cement, paper, pyrethrum products, engineering, wood products, pharmaceuticals, basic chemicals, sugar, rubber, and plastics products.

CHAPTER TWO: LITERATURE REVIEW

2. 0 Introduction

This chapter reviewed the various theoretical concepts that have been explored in the study. Specifically, the study reviewed the concept of multinationals, market entry strategies and organizational performance. The empirical review addressed the various studies that have been done on the area.

2. 1 Theoretical Review

This section elaborates on various concepts that are being used in the study. For instance definitions of multinationals, market entry strategies and performance were given.

2. 1. 1 Multinationals

A multinational corporation (MNC) or multinational enterprise (MNE) is a corporation enterprise that manages production or delivers services in more than one country. It can also be referred to as an international corporation. They play an important role in globalization (Pitelis, and Sugden, 2000).

Various attempts have been made in literature to capture the true richness of MNCs with definitions and concepts. Perlmutter (1969) for instance, used a taxonomy which was based on management styles – namely geo-, poly- and ethnocentric – to measure a firm's degree of multinationality. Porter (1986) distinguished between multidomestic and global firms based on the configuration and coordination of the firm's value chain. The framework developed by Prahalad and Doz (1987) offers a rather context oriented classification based on the nature of business, differentiating between global, multi-focal and local firms. Probably Bartlett's and Ghoshal's (1989) four-fold typology of multinational, international, global and transnational companies has been the most influential and extensive one. The typology constructed, inter alia, included, environmental, corporate, subsidiary, control and human resource characteristics.

Kinuthia (2010) suggests that Foreign firms in Kenya since the 1970s have invested in a wide range of sectors. Most notably they played a major role in floriculture and horticulture, with close to 90 percent of flowers being controlled by foreign affiliates. In the Manufacturing sector FDI has concentrated on the consumer goods sector, such as food and beverage industries. This has changed in the recent years with the growth of the garment sector because of African Growth and Opportunities Act (AGOA). Of the 34 companies involved in AGOA 28 are foreign most of them concentrated in the Export Processing Zones (EPZs). FDI is also distributed to other sectors including services, telecommunication among others. 55 percent of the foreign firms are concentrated in Nairobi while Mombasa accounts for about 23 percent, thus Nairobi and Mombasa account for over 78 percent of FDI in Kenya. The main form of FDI establishment has been through the form of green fields establishments and Kenya has in total more than 200 multinational corporations. The main traditional sources of foreign investments are Britain, US and Germany, South Africa, Netherlands, Switzerland and of late China and India (UNCTAD, 2005).

2. 1. 2 Market Entry Strategies

International market entry modes can be classified according to level of control, resource commitment, and risk involvement (Hill, Hwang and Kim, 1990). For example, in a study of the international operations of service firms in the United States, Erramilli and Rao (1993) classify market entry modes into two categories based on their level of control-full-control (i. e. wholly owned operation) and shared-control mode (i. e. contractual transfer or joint venture).

The classification system adopted by Kim and Hwang (1992) is three fold: licensing, joint ventures and wholly owned subsidiaries. Kim and Hwang believe that these methods provide three distinctive levels of control and require different levels of resource commitment. Kwon and Konopa (1993) indicate that each foreign market entry mode is associated with advantages and disadvantages in terms of risk, cost, control, and return. Their study was designed to examine the impacts of a series of determinants on the choice of foreign production and exporting adopted by 228 U. S. manufacturing firms. Agarwal and Ramaswami (1992) suggest that the most commonly used entry modes are exporting, licensing, joint venture and sole venture. These methods involve varying levels of resource commitment.

When multinational enterprises (MNE) plan to expand overseas, they face several entry modes. Root (1994) defines an international market entry mode as an “ institutional arrangement that makes possible the entry of a companys products, technology, human skills, management, or other resources into a foreign country.” Entry modes can be classified into three categories: Export entry mode, contractual entry mode and investment entry mode (Root, 1994).

Expansion into foreign markets can be achieved via the following mechanisms: Exporting, Licensing,€ Franchising,€ Joint Venture, Direct Investment (Kim and Hwang, 1992; Agarwal and Ramaswami, 1992; Root, 1994; Erramilli and Rao, 1993).

These are explained below;

2. 1. 1. Exporting

Exporting is the marketing and direct sale of domestically-produced goods in another country. Exporting is a traditional and well-established method of reaching foreign markets. There is no need for the company to invest in a foreign country because exporting does not require that the goods be produced in the target country. Most of the costs associated with exporting take the form of marketing expenses. Therefore, exporting is appropriate when there is a low trade barrier, home location has an advantage on costs and when customization is not crucial (Kim and Hwang, 1992).

2. 1. 2. Licensing

A license arrangement is a business arrangement where a licensor using its monopoly position and right such as a Patent, a Trade Mark, a design or a copyright that has exclusive right which prevents others from exploiting the idea, design, name or logo commercially. The licensee pays a fee in exchange for the rights to use the intangible property and possibly for technical assistance (Erramilli and Rao, 1993).

2. 1. 3. Franchising

Franchising is a similar entry mode to licensing. By the payment of a royalty fee, the franchisee will obtain the major business know-how via an agreement with the franchiser. The know-how also includes such intangible properties as patents, trademarks and so on. The difference from the licensing mode of entry is that the franchisee must obey certain rules given by franchiser. Franchising is most commonly used in service industries, such as McDonald’s, etc. (Hill, Hwang and Kim, 1990).

2. 1. 4. Joint Venture

Joint ventures represent an agreement between two parties to work together on a certain project, Operate in a particular market, etc. Some of the main common objectives in a joint venture:€ Market entry;€ Risk and reward sharing;€ Technology sharing and joint product development, etc. (Kwon and Konopa, 1993)

2. 1. 5. Foreign Direct Investment

Foreign direct investment (FDI) is the direct ownership of facilities in the target country. It involves capital, technology, and personnel. FDI can 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 operations and the ability to better know the consumers and competitive environment, and the market in general. However, it requires a high level of resources and a high degree of commitment (Root, 1994).

2. 1. 6. Foreign Acquisition

Acquisitions can be defined as a corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and niche compared to expanding on its own. (Investopedia. com, 2011)

2. 1. 7. " Green Field" Entry

Green field can be defined as a form of foreign direct investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees (Investopedia. com, 2011). The main advantages of setting up a new company:€ normally feasible, avoids risk of overpayment, € avoids problem of integration, Still retains full control. The main disadvantages of setting up a new company:€ Slower startup, requires knowledge of foreign management, € high risk and high commitment

We can conclude that acquisition is appropriate when the market is developed for corporate control, the acquirer has high absorptive capacity, and when there is high synergy, whereas Green field entry is appropriate when there is lack of proper acquisition target, in-house local expertise, and embedded competitive advantage (Agarwal and Ramaswami, 1992).

2. 1. 3 Organization Performance

Organizational performance comprises the actual output or results of an organization as measured against its intended outputs (or goals and objectives). According to Richard et al. (2009) organizational performance encompasses three specific areas of firm outcomes: (a) financial performance (profits, return on assets, return on investment, etc.); (b) product market performance (sales, market share, etc.); and (c) shareholder return (total shareholder return, economic value added, etc.). Most organizations view their performance in terms of effectiveness in achieving their mission, purpose or goals. Most NGOs, for example, would tend to link the larger notion of organizational performance to the results of their particular programs to improve the lives of a target group (e. g. the poor). At the same time, a majority of organizations also see their performance in terms of their efficiency in deploying resources. This relates to the optimal use of resources to obtain the results desired. Finally, in order for an organization to remain viable over time, it must be both " financially viable" and relevant to its stakeholders and their changing needs.

A fundamental debate in strategic management and international marketing research is questioning about the performance, especially when the companies involve in international performance (Florin and Agboei, 2004). An accurate understanding of the crucial link between international strategy and performance is especially important in the face of world markets that are increasingly global. Consequently, international marketing research has moved from being descriptive – studying the differences between exporters and non-exporters – to providing performance explanations (shoham and kropp, 1998). In today’s complex business world, performance is an indispensable guide for any company analyzing its level of success, in both the domestic and international arenas. Assessing export performance is quite a complex task, as export performance can be conceptualized and operationalized in many ways. Broadly speaking, the literature considers three aspects of export performance: financial, strategic, and that of performance satisfaction (Lages and Montgomery, 2004).

Although considerable progress has since been made, research remains underdeveloped. Defining and understanding performance is problematic, especially in terms of identifying uniform, reliable, and valid performance measures (Katsikeas, Leonidou and Morgan, 2000). Export performance is the dependent variable in the simplified model and is defined as the outcome of a firm’s activities in export markets. There are two principal ways of measuring export performance: economic (financial measures such as sales, profits, and market share) and noneconomic (nonfinancial measures relating to product, market, experience elements, etc.). Most background and intervening variables were associated with economic measures of performance, particularly export sales intensity (export-to-total sales ratio), export sales growth, and export profitability (Katsikeas, Leonidou and Morgan, 2000). Also, Export performance, a widely studied construct, refers to the outcomes of a firm’s export activities, although conceptual and operational definitions vary in the literature (Calantone, 2005)

2. 2 Empirical Literature

2. 2. 1 International Market Entry Strategies by Multinationals

International market entry modes can be classified according to level of control, resource commitment, and risk involvement (Anderson and Gatignon, 1986; Erramilli and Rao, 1993; Hill, Hwang and Kim, 1990). For example, in a study of the international operations of service firms in the United States, Erramilli and Rao (1993) classify market entry modes into two categories based on their level of control-full-control (i. e. wholly owned operation) and shared-control mode (i. e. contractual transfer or joint venture).

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Agarwal and Ramaswami (1992) suggest that the most commonly used entry modes are exporting, licensing, joint venture and sole venture. These methods involve varying levels of resource commitment. Based on the location of products produced, Terpstra and Sarathy (2000) divide market entry methods into three major categories-indirect exporting, direct exporting and foreign manufacturing.

Many forms of market entry strategy are available to firms to enter international markets. One classification first distinguishes between equity and non-equity modes. Equity modes involve firms taking some degree of ownership of the market organizations involved, including wholly owned subsidiaries and joint ventures. Non equity modes do not involve ownership and include exporting or some form contractual agreements such as licensing or franchising (Wilkinson and Nguyen, 2003).

Caves (1982) identified four basic ways to expand internationally, from the lowest to the highest risk: exporting; licensing and franchising; strategic alliances; and wholly owned foreign subsidiaries.

Cateora and Graham (2002) stated there are six basic strategies for entering a new market: export/import, licensing and franchising, joint venturing, consortia, partially-owned subsidiaries, and wholly-owned subsidiaries.