Drivers and modes of entry for multinational enterprises economics essay

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According to Needle (2010), “ A Multinational firm is one that operates and is managed from bases in a number of countries. Most Multinationals are large firms with diverse interest coordinated by a centrally planned strategy.” The world economy is seem to be more integrated, while many products being sold multinational and firms operating in more than one country. For the retailers who seek to expand into new markets, multinational plans will remain as an important stream of strategy (Hynes 2010). There reasons driving the Multinational Enterprises to expand in numbers and its operations are discussed along with the ways in which a firm can become multinational.

DRIVERS OF MULTINATIONAL ENTERPRISES:

Theoretically, the most comprehensive approach arguing the necessity of three factors for ‘ going multinational’ was given by Dunning (1993). The three factors he identified under ‘ eclectic paradigm’ are

Ownership Factors: Dunning argues that in order to be successful in an overseas market, the multinational firm must hold some advantages like technology, brand image, high amount of finance, superior distribution channel and better organization and management than local firms.

Location Factors: There may be a number of reasons that operate in the host country like no or less import tariff, cheap labour, low business rates, availability of specific resource, etc., which acts as reason for a firm to operate overseas.

Internationalization Factors: It relates to the extent of ownership, control and risk a firm can hold while going multinational. According to the entry mode ranging from exports to wholly owned subsidiary, the MNE chooses

internalization where the market does not function properly or does not exist so as to drive the transaction expenses of the external route very high.

In general, the reasons for going multinational can be internal and external factors of the firm.

POTENTIAL FOR MNE

EXTERNAL

INTERNAL

Technological know-how Market Factors

Product Innovation Economic Factors

Financial Capital Competitive Factors

Brand Image Environment Factors

According Eicher, Mutti and Turnovsky (2009), the internal or firm specific advantages are

Technological Know-How: A need for new market is mandatory for the firm with special expertise in the field of technological know-how. This can include a new process to produce a product, upgraded production methods with minor changes in the process, etc.

Product Innovation: Heavy investment in R&D which would have resulted in product innovation can be one of the reasons to enter into new markets. To

take out the investment in R&D to develop the new product, firms try to go international and spread their fixed cost.

Access to Financial Capital: A firm with heavy financial capital, which cannot be floated in domestically becomes imperative for the firm to go multinational to tap the potential from international markets.

Brand Image: The brand image and the niche strategy of the company can be used to exploit the competitive advantage, by narrowing the market segment within the clearly defined market sector. For example, the fashion sector aerated drinks, Cigarette Company use their brand recognition and enter into foreign markets.

According to John et al. (1997) and Rugman and Collinson (2006), the external factors that drive the Multinational Enterprises can be sub-divided into

Market factors

Economic factors

Competitive factors

Environment factors

Market Factors:

Emergence of group of customers with homogenous market needs, emergence of new trading blocs like Asian Tigers, China and Russia, creation of global brands, global standardization and simplification of products,

internationalized supply chain, protecting the firm against cyclical problems of national economies, smallness of home-market, growing world market for goods and services and higher price on the international market are some of the market factors that drive multinational enterprises.

Economic Factors:

Worldwide economies of scale in manufacturing and distribution, worldwide sourcing, significant difference in country cost, raising production development cost (R&D), risk and uncertainties of the domestic business cycle are the economic drivers of Multinational Enterprises. To diminish the negative effects of home country and tap the advantages of other countries, firm go multinational.

Competitive Factors:

Competitive interdependence among countries, increased foreign competition, global moves of competitors, opportunity to pre-empt a competitor's global move tend to drive the competitive factors to set up Multinational Enterprises. Using the ' follow competitor's strategy', many MNE set up their operations following the competitors move.

Environmental Factors:

Falling transportation cost, increasing pace of innovations, technological change, improving communications, Government policies and removal of international trade barriers such as trade and non-trade barriers are the environmental factors pushing the MNE's to grow in numbers.

MODES OF ENTRY:

The decision criteria for mode of entry are market size and growth, risk, Government regulations, competitive environment, local infrastructure, company objectives, internal resources, flexibility, assets and capabilities and need for control (Katsioloudes and Hadjidakis 2007).

Hynes (2010) developed a model of three approaches for firm's going multinational. The three approaches are

Stage Approach: According to the stage approach, a firm goes multinational in a gradual manner starting from markets close to the domestic market and the primary mode of entry is through exports.

Network Approach: In network approach, it is assumed that the successful multinational business is dependent on developing business networks relationships consisting formal and informal relationships and alliance with local or other firms at any stage of value chain. Network approach can accommodate the scarce financial and non-financial resources.

The Born Global Approach: The born global approach assumes to business to have a global orientation from the onset of its business.

The methods or modes of foreign market entry (Needle 2010; Moosa 2002; Holt and Wigginton 2002) are

Exporting: The simplest form of foreign market entry is through exporting where the cost and risk are low. Exporting is done foreign distributors, agents and marketing subsidiary. But in exporting, the firms may face

problems in the form of tariffs and high transportation cost which may increase the price of the product. In exporting, the production of goods or services is located in the home country. Exporting is the first stage in multinational growth. However exporting from the firm's home base may not be a good idea if lower-cost manufacturing locations can be spotted abroad. Initially, an enterprise with less international exposure may prefer to export with arrangements of low-risk brokerage..

All other modes of entry have foreign production sources.

Licensing: It may involve the supply of technological know-how, usage of trademark or patent for a fee. This mode of entry creates a chance to generate revenue from other markets, which are otherwise not accessible. It requires only little investment and is relatively low risk. Licensing is an effective option for companies that lack in managerial capabilities that they would need to operate effectively in multinationals. The biggest disadvantage of licensing is the lack of control.

Franchising: Under franchising, the firms enter foreign markets with a contractual agreement. Companies with good brand names like McDonalds, KFC, etc., move into international market by allowing the foreigners to sell their product. The firms provide technical and marketing assistance for an initial fee and corresponding royalties. International Franchisee management challenges the world because they are becoming the fastest growing economic sector in nearly all developing and developed nations. Again, it involves little investment and risk. Small businesses are particularly suited for franchisee business and it involves risk of quality control.

Off-shore Outsourcing: Under off-shore outsourcing market entry, in order to achieve cost-effectiveness in the production of goods and services, many firms tend to contract some part of activities to firms in foreign countries. Cost-effectiveness can be achieved because of lower cost of labour and cheap availability of raw materials. But, moving operations out of home, creates employment opportunities in host country leaving unemployment at home. Lower quality products, lower standards, transfer of technological know-how to host country are some of the risks involved with off-shore outsourcing.

Joint Venture: A joint venture can happen strategically either with a host country firm or Government Institution, as well as with another company that is foreign to the host country. Alliances can be formed with flexibility where one firm provides technical expertise, raising finance while other firm provides strategic assets, local knowledge of bureaucracy and local laws and regulations. It is form of FDI with joint ventures occurring with suppliers, R&D projects with difference in ownership and control. Shared ownership arrangement can lead to conflicts and battles for control between the firms.

Wholly-Owned Subsidiary: This mode of entry occurs through Mergers and Acquisition of a firm or establishing Greenfield site operations in host country. Generally a weaker firm of host country is acquainted. Under Greenfield site operations investment occurs when the firm establishes new production, distribution or other facilities in the host country. This form of FDI involves more risk than other modes because it is a costly method of entering a foreign market from the viewpoint of capital investment. Firms

doing this must bear the full capital cost and risks of setting up overseas operations.

M&A GREENFILED OPERATIONS

LICENSING & FRANCHISING

EXPORTING

JOINT VENTURE

AMOUNT OF OWNERSHIP, RISK, CONTROL AND PROFIT SHARING

CONCLUSION:

When a company decides on its multinational entry, choice and compromise will have to be made between the desired and necessary levels of control, capital investment and expected profitability (Katsioloudes and Hadjidakis 2007). A clear understanding of the factors that motivates the firm to go multinational and choosing the best mode of entry after considering the criteria will make the firm succeed in its multinational operations.