The importance of entry mode selection

ASSIGN BUSTER

A mode of entry is a channel an organisation adopts to enter into a new international market. This paper discusses and considers many alternatives and also reckons that the alterative are many and diverse. There is no one specific mode of entry an organisation can adopt to enter into a new international market. The most important point is that all the modes of entry are useful depending on many other factors ant it is like which pigeon-hole it fits into. The theory of international investment is the basis of the interest in market entry mode choice. The choice of market entry mode has a strong impact on international operations and can be regarded as a leading edge in international marketing (Wind & Perlmutter, 1977). An organization or a firm seeking to enter any foreign market must carefully consider which entry mode to use and make important strategies accordingly. The most common modes of foreign market entry are licensing, joint venture, exporting and sole venture. All of these modes require backup supplies and therefore the firm’s initial choice of a particular entry mode are difficult to amend or change without considerable loss of time and money (Root, 1987). Therefore, entry mode selection is very important if not a critical strategic decision. Dunning (1977, 1980, 1988) carried a research that stated that the choice of an entry mode for a target market is influenced by three types of determinant factors: location advantages of a market, ownership advantages of a firm and internalization advantages of integrating transactions within the firm. Many studies have directly or indirectly attempted to use the Dunning framework in explaining choice between licensing and sole venture (Caves, 1982; Davidson and McFetridge, 1985), joint venture and sole venture (Kogut & Singh, 1988), extent of foreign direct investment (Cho,

1985; Dunning 1980; Kimure, 1989; Sabi 1988; Terpstra & Yu, 1988; Yu & Ito, 1988), and ratio of acquisition to total subsidiaries (Wilson, 1980).

For an organisation it is very crucial to decide one specific entry mode which can have a significant impact on the outcome. The four mechanisms of the entry modes are briefly discussed as follows:

Exporting: Exporting is selling and marketing of the products which are produced in the domestic market into the foreign market. Marketing expenses or costs are important in exporting since the goods are manufactured domestically and does not require to be manufactured in the international market. This also waives off investment in the production facilities in foreign country. As far as exporting is concerned, coordination of four players are very important which includes of an exporter, an importer, transport provider and the government.

Licensing: Licensing is when an organisation charges a fee and/or royalty for the use of its technology, brand, expertise, trademark, patents and production techniques. Licensing allows a firm to use the property of the licensor in the target country. A good return on investment can potentially be experienced because of the little investment on the part of the licensor. However, potential returns on manufacturing and marketing activities may be lost as the licensee produces and markets the products.

Joint Venture: The main objective for a firm to setup a joint venture with the other firm is to gain entry in a new foreign market for effective outcome. For example, any business willing to enter Indian market needs to source local Indian partners. Joint venture is when a new company is set up with parties

owning a proportion of the new business. The other objectives include sharing of management skills and technology, risk/reward sharing, joint product development and conforming to government regulations. The most common forms of joint ventures are access to distribution channels, manufacturing and R&D.

Foreign Direct Investment (FDI): Foreign direct investment means owning an overseas manufacturing plant by investing in plant, machinery and labour in target overseas market. Direct foreign investment can be made by acquiring a current business or establishing a new business. The main advantage of FDI is that a firm can enjoy all the benefits by serving the local customers by locally manufacturing goods or services. It gives an organization an opportunity to learn the needs, tastes & preferences of the customers and learn about the local market creating a cushion to carry business in the local market. However, there can always be a risk associated with the local market. Therefore, owning a business in overseas involves high level of resources and high degree of commitment.

The Case of EuroDisney

The mode of entry is a crucial factor to be considered for a project to be successful. This can be done by acquiring different entry modes for different circumstances. Walt Disney Co. had chosen licensing as a mode of entry in Japan but decided to directly invest to build a Disney theme park in European market by owning 49% directly and 51% publicly. This shows that different entry modes are practiced by Walt Disney Co. for different markets. Apart from choosing an appropriate entry mode, Disney also faced challenge

to choose a location in Europe. Many factors are to be considered in selection of a location. Over the past years Disney has enjoyed its success in California, Florida and Tokyo theme parks. But this does not guarantee future success in a new market like Europe where the culture is different. Adjustments must always be made when entering a new market to overcome the national differences. (Accessed at http://www. quickmba. com/strategy/global/marketentry/ on 12-04-2010).

Examination of the effects of inter-relationships comes from the fact that they may explain firm behaviours that cannot be derived by the independent effects of the factors. For example, firms who have lower advantage of direct foreign investment may consider not to enter the foreign market or to adopt a low risk entry mode such as exporting. These type of firms are commonly observed to enter the foreign market having high market potential by the entry modes like joint ventures or licensing (Talaga, Chandran & Phatak, 1985). A better explanation of these firms behaviour can be given considering the joint effects of ownership advantages and location advantages of the market. Companies which are large in size with descent multinational experience have a better chance of choosing ownership in a potential foreign market as a mode of entry. Countries that have lower market potential are less likely to attract foreign investments, however well established and large firms may be interested in such markets for their recognition, growth and future profit. For example, countries like Brazil and India which is not attractive as other developed countries can provide a potential platform to the countries willing to invest. It is not clear what entry modes should be chose by firms to enter foreign markets with high potential

and high risk involved. Some firms may therefore adopt entry modes such as exporting or joint ventures to enter foreign market to avoid investments risks and providing them market access. In countries where the market potential is high and also the investment risk firms may show a higher preference for joint venture or exporting entry modes. Firms that have the expertise of developing differentiated products and are popular and successful in its domestic market are more likely to choose a sole venture mode to enter foreign markets characterized by high contractual risks.

To conclude, I would like to state that there is no specific mode of entry to be decided when entering a new target market. There are many modes of entries that can be considered according to different circumstances. We can observe that not all the authorities on international marketing agree as to which mode of entry is suitable for which market. Globalisation has been tremendously growing where not only multinational companies are developing its strategies to grow internationally but also countries are beginning to realize its economic development strategies in order to gain international benefits. The results and implications which have been drawn from this study state the importance to learn about all useful market entry modes and its implementation considering all circumstantial factors.

PART – B

A Franchise is the agreement or license between two legally independent firms where a franchisee gets the right to market a product or service using the trademark of the franchisor in a given location for a specific period of time. In franchising the franchisee buys the right to use the operating methods of the franchisor and is obliged to pay the franchisor fees for these

rights. In a franchise agreement a franchisor provides a franchisee his own trademark or trade name and also provides support like financing, advertising and marketing and training which helps a franchisee to expand its business. Franchising is a well established business phenomenon, from the data available in 1986, an estimated retail markets in US saw 35% of their business through franchised chains by selling 13. 5% of gross domestic product (Kostecka, 1988). There are two main types of franchises product distribution and business format. In Product distribution franchises franchisee simply sells a franchisors products or services maintaining supplier-dealer relationship. The franchisor licenses its trademark and logo to the franchisee but does not provide complete system for running their business. The most common type of industries using product distribution franchisees are automobile dealers, soft drink distributors and petrol stations. For example, companies like Coca Cola, Exxon and Ford Motors fall in the category of product distribution franchise. Although, product distribution franchising is practised largely in retail industries, most franchises available today are business format franchising which has its own potential. Business format franchises offers a little more than product distribution franchises. It means that in business format franchising a franchisee not only gets the support of using a franchisors trade mark, product and service, sometimes financing, but also gets the right to complete method to conduct its business such as advertising and marketing plans and operational support. It is the most common type of franchise in today’s world. Some popular business format franchises include restaurants, education and training, retail, health and beauty, real estate, etc. (Beshel, 2000).

Franchisors growth depends on growing the size of their franchise systems. The two ways to expand is through establishing company owned outlets or through establishing franchised outlets. Franchisors prefer to expand their business by opening franchised outlets in geographically distant locations to gain internationalization benefits (Norton, 1988 & Martin, 1988). Research shows that franchisors focus on a particular geographic location to put up a franchise for the firms growth, saturating a geographic location and then expands its franchise to a new location (Martin, 1988). Geographical expansion of the franchises is the interest of a franchisor by establishing franchised outlets and expanding its business internationally. Over a period of time US has expanded its international franchise system by selling most of its franchises to foreign nationals. The evidence collected by the researchers shows that between 73% (Hacket 1976) and 94% (Commerce Department 1987) of all the international outlets of American franchise systems are rooted through the sales of its franchises to the international franchisees. In the earlier part of the paper, various modes of entry into the foreign markets have been discussed. Similarly, research indicates that many firms have developed explicit strategies to enter the foreign market in order to establish and expand its franchises. For example, foreign expansion is a result of inquiries of potential franchises (Walker, 1989), whereas according to Hackett (1976) has stated that international expansion is clearly the result or a response to saturation of the domestic market or to take maximum advantage of a potential international market. Above authors have realised that over the time franchisors develop recognition for the things operating procedures, outlet design and location selection which makes foreign expansion smoother. In expansion of the franchise system internationally, a

franchisor can face issues related to the distance, cultural differences, and monitoring of the franchise. Hence to avoid opportunistic behaviour by the franchisee, a franchisor can introduce a bond that is forfeited and avoids any opportunistic behaviour against the financial incentive. A franchisee pays a franchisor by an upfront fee and through ongoing royalties and advertising fees as a percentage of sales revenue. A high franchise fee which is relative to the size of ongoing royalty and advertising appears to be an effective bond. A franchise fee is basically a significant amount which is related to the amount invested by the owner to establish the outlet.

The main advantage of franchising is that through franchising capital is earned which is invested by individual franchise owners. The opportunity margin for new or a unique business is very less nowadays. Through franchising multiple outlets can be opened simultaneously gaining competitive advantage over its market competitors. Franchising gives charge to the business owners ensuring that qualified managers are operating the franchisees instead of employees. Franchisees get motivation to perform and draw positive results because they are the owners of the business and have invested capital to run it. As a result of this the franchises may run better and more profitably than company owned outlets. A franchisee is more motivated than an employee because of the risk of the capital invested in running a franchise. Because of this the results delivered by a franchisee is higher than the result delivered by an employee. Franchisors can negotiate with the suppliers on the products they provide to the franchisees resulting in sharing higher operating margins and gaining advantage over their competitors in the market. The brand positions into

consumers mind by opening various franchises in different locations. In U. S the rate of customer loyalty towards recognised brands are high. As accessed at http://www. fransource. com/WhatIsFranchising/Benefits. aspx on 13/04/2010.

Technology means utilizing the necessary materials and processes by transforming inputs into outputs. People are affected by the outcome of the technology as in the goods and services it produces and by the working environment it generates. Technology is a vital factor in the development of economy and social behaviour of a country. Therefore government of different nations encourage technology. Franchising is one of the methods of transferring technology from one country to another. In franchising, a franchisee is provided by a franchisors name, trademark, products, technique, business methods, etc. in return for a fee and a percentage of gross monthly sales. International franchising gives firms a chance to expand at a much faster rate from a limited capital base. It gives birth to the combination of the technical experience of the franchisor and local knowledge of the franchisee. With this combination great results can be achieved by both the parties. As discussed above, a franchisor provides all kinds of valuable support to the potential franchisee. The benefits enjoyed by the franchisor are the local knowledge of the franchisee which lessens the burden of a franchisor to learn the regional difference in depth. A franchisor owns the business in different outlets without even carrying business activities in that region compared to personally owned business. Large profits can be achieved with low capital head sharing the risks with the franchisee. Franchisors are able to sell their franchises and expand

internationally without even investing in the franchise i. e., using the capital of the franchisees and can earn profits reducing the risks and expenses in conventional chain operations.