The Five Common International-Expansion Entry Modes

In this section, we will explore the traditional international-expansion entry modes. Beyond importing, international expansion is achieved through exporting, licensing arrangements, partnering and strategic alliances, acquisitions, and establishing new, wholly owned subsidiaries, also known as greenfield ventures. These modes of entering international markets and their characteristics are shown in Table 8.1 "International-Expansion Entry Modes".Shaker A. Zahra, R. Duane Ireland, and Michael A. Hitt, "International Expansion by New Venture Firms: International Diversity, Mode of Market Entry, Technological Learning, and Performance," *Academy of Management Journal* 43, no. 5 (October 2000): 925–50. Each mode of market entry has advantages and disadvantages. Firms need to evaluate their options to choose the entry mode that best suits their strategy and goals.

Table 8.1 International-Expansion Entry Modes

Type of Entry	Advantages	Disadvantages
Exporting	Fast entry, low risk	Low control, low local knowledge, potential negative environmental impact of transportation
Licensing and Franchising	Fast entry, low cost, low risk	Less control, licensee may become a competitor, legal and regulatory environment (IP and contract law) must be sound
Partnering and Strategic Alliance	Shared costs reduce investment needed, reduced risk, seen as local entity	Higher cost than exporting, licensing, or franchising; integration problems between two corporate cultures
Acquisition	Fast entry; known, established operations	High cost, integration issues with home office
Greenfield Venture (Launch of a new, wholly owned subsidiary)	Gain local market knowledge; can be seen as insider who employs locals; maximum control	High cost, high risk due to unknowns, slow entry due to setup time

Exporting

Exporting is a typically the easiest way to enter an international market, and therefore most firms begin their international expansion using this model of entry. Exporting is the sale of products and services in foreign countries that are sourced from the home country. The advantage of this mode of entry is that firms avoid the expense of establishing operations in the new country. Firms must, however, have a way to distribute and market their products in the new country, which they typically do through contractual agreements with a local company or distributor. When exporting, the firm must give thought to labeling, packaging, and pricing the offering appropriately for the market. In terms of marketing and promotion, the firm will need to let potential buyers know of its offerings, be it through advertising, trade shows, or a local sales force.

Among the disadvantages of exporting are the costs of transporting goods to the country, which can be high and can have a negative impact on the environment. In addition, some countries impose tariffs on incoming goods, which will impact the firm's profits. In addition, firms that market and distribute products through a contractual agreement have less control over those operations and, naturally, must pay their distribution partner a fee for those services. Because the cost of exporting is lower than that of the other entry modes, entrepreneurs and small businesses are most likely to use exporting as a way to get their products into markets around the globe. Even with exporting, firms still face the challenges of currency exchange rates. While larger firms have specialists that manage the exchange rates, small businesses rarely have this expertise. One factor that has helped reduce the number of currencies that firms must deal with was the formation of the European Union (EU) and the move to a single currency, the euro, for the first time. As of 2011, seventeen of the twenty-seven EU members use the euro, giving businesses access to 331 million people with that single currency."The Euro," European Commission, accessed February 11, 2011, http://ec.europa.eu/euro/index_en.html.

Licensing and Franchising

Licensing and franchising are two specialized modes of entry that are discussed in more detail in Chapter 9 "Exporting, Importing, and Global Sourcing". The intellectual property aspects of licensing new technology or patents is discussed in Chapter 13 "Harnessing the Engine of Global Innovation".

Partnerships and Strategic Alliances

Another way to enter a new market is through a strategic alliance with a local partner. A strategic alliance involves a contractual agreement between two or more enterprises stipulating that the involved parties will cooperate in a certain way for a certain time to achieve a common purpose. To determine if the alliance approach is suitable for the firm, the firm must decide what value the partner could bring to the venture in terms of both tangible and intangible aspects. The advantages of partnering with a local firm are that the local firm likely understands the local culture, market, and ways of doing business better than an outside firm. Partners are especially valuable if they have a recognized, reputable brand name in the country or have existing relationships with customers that the firm might want to access. For example, Cisco formed a strategic alliance with Fujitsu to develop routers for Japan. In the alliance, Cisco decided to co-brand with the Fujitsu name so that it could leverage Fujitsu's reputation in Japan for IT equipment and solutions while still retaining the Cisco name to benefit from Cisco's global reputation for switches and routers.Steve Steinhilber, *Strategic Alliances* (Cambridge, MA: Harvard Business School Press, 2008), 113. Similarly, Xerox launched signed strategic alliances to grow sales in emerging markets such as Central and Eastern Europe, India, and Brazil. "ASAP Releases Winners of 2010 Alliance Excellence Awards," Association for Strategic Alliance Professionals, September 2, 2010, accessed February 12, 2011, http://newslife.us/technology/mobile/ASAP-Releases-Winners-of-2010-Alliance-Excellence-Awards.

Strategic alliances are also advantageous for small entrepreneurial firms that may be too small to make the needed investments to enter the new market themselves. In addition, some countries require foreign-owned companies to partner with a local firm if they want to enter the market. For example, in Saudi Arabia, non-Saudi companies looking to do business in the country are required by law to have a Saudi partner. This requirement is common in many Middle Eastern countries. Even without this type of regulation, a local partner often helps foreign firms bridge the differences that otherwise make doing business locally impossible. Walmart, for example, failed several times over nearly a decade to effectively grow its business in Mexico, until it found a strong domestic partner with similar business values.

The disadvantages of partnering, on the other hand, are lack of direct control and the possibility that the partner's goals differ from the firm's goals. David Ricks, who has written a book on blunders in international business, describes the case of a US company eager to enter the Indian market: "It quickly negotiated terms and completed arrangements with its local partners. Certain required documents, however, such as the industrial license, foreign collaboration agreements, capital issues permit, import licenses for machinery and equipment, etc., were slow in being issued. Trying to expedite governmental approval of these items, the US firm agreed to accept a lower royalty fee than originally stipulated. Despite all of this extra effort, the project was not greatly expedited, and the lower royalty fee reduced the firm's profit by approximately half a million dollars over the life of the agreement."David A. Ricks, *Blunders in International Business* (Hoboken, NJ: Wiley-Blackwell, 1999), 101. Failing to consider the values or reliability of a potential partner can be costly, if not disastrous.

To avoid these missteps, Cisco created one globally integrated team to oversee its alliances in emerging markets. Having a dedicated team allows Cisco to invest in training the managers how to manage the complex relationships involved in alliances. The team follows a consistent model, using and sharing best practices for the benefit of all its alliances.Steve Steinhilber, *Strategic Alliances* (Cambridge, MA: Harvard Business School Press, 2008), 125.

Acquisitions

An acquisition is a transaction in which a firm gains control of another firm by purchasing its stock, exchanging the stock for its own, or, in the case of a private firm, paying the owners a purchase price. In our increasingly flat world, cross-border acquisitions have risen dramatically. In recent years, cross-border acquisitions have made up over 60 percent of all acquisitions completed worldwide. Acquisitions are appealing because they give the company quick, established access to a new market. However, they are expensive, which in the past had put them out of reach as a strategy for companies in the undeveloped world to pursue. What has changed over the years is the strength of different currencies. The higher interest rates in developing nations has strengthened their currencies relative to the dollar or euro. If the acquiring firm is in a country with a strong currency, the acquisition is comparatively cheaper to make. As Wharton professor Lawrence G. Hrebiniak explains, "Mergers fail because people pay too much of a premium. If your currency is strong, you can get a bargain.""Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home," *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473.

When deciding whether to pursue an acquisition strategy, firms examine the laws in the target country. China has many restrictions on foreign ownership, for example, but even a developed-world country like the United States has laws addressing acquisitions. For example, you must be an American citizen to own a TV station in the United States. Likewise, a foreign firm is not allowed to own more than 25 percent of a US airline.“Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home,” *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473.

Acquisition is a good entry strategy to choose when scale is needed, which is particularly the case in certain industries (e.g., wireless telecommunications). Acquisition is also a good strategy when an industry is consolidating. Nonetheless, acquisitions are risky. Many studies have shown that between 40 percent and 60 percent of all acquisitions fail to increase the market value of the acquired company by more than the amount invested.“Playing on a Global Stage: Asian Firms See a New Strategy in Acquisitions Abroad and at Home,” *Knowledge@Wharton*, April 28, 2010, accessed January 15, 2011, http://knowledge.wharton.upenn.edu/article.cfm?articleid=2473. Additional risks of acquisitions are discussed in Chapter 9 "Exporting, Importing, and Global Sourcing".

New, Wholly Owned Subsidiary

The proess of establishing of a new, wholly owned subsidiary (also called a greenfield venture) is often complex and potentially costly, but it affords the firm maximum control and has the most potential to provide above-average returns. The costs and risks are high given the costs of establishing a new business operation in a new country. The firm may have to acquire the knowledge and expertise of the existing market by hiring either host-country nationals—possibly from competitive firms—or costly consultants. An advantage is that the firm retains control of all its operations. Wholly owned subsidiaries are discussed further in Chapter 9 "Exporting, Importing, and Global Sourcing".

Some question

What are five common international entry modes?

What are the advantages of exporting?

What is the difference between a strategic alliance and an acquisition?

What would influence a firm’s choice of the five entry modes?

What is the possible relationship among the different entry modes?