International marketing

Market Entry Strategies Part 1

Learning objectives

- Understanding the main foreign market entry strategies.
- Differentiate between equity and non-equity modes of foreign market entry.
- Understanding the differences between exporting, contractual and investment modes.
- Identifying the advantages and disadvantages of each foreign market entry strategy.

Foreign market entry decision

- The foreign market entry decision is determined to a large extent by:
  - The firm's objectives and attitudes to international marketing.
  - The confidence in the capability of managers to operate in foreign countries.
  - The financial sources of the companies.
  - The power and nature of competition within the market.
  - The nature of the product itself, particularly any area of competitive advantage such as trade mark.
  - The need for control.
  - The time of the move to in relation to the market and competitive situation .

Foreign market entry strategies

- A company has four different modes of foreign market entry from which to select:

1. Exporting.
2. Contractual agreements (licensing, franchising).
3. Strategic international alliance and joint ventures.
4. Direct foreign investments (wholly owned subsidiaries, mergers and acquisitions).

- Based on equity, foreign market entry modes can be classified to:
- Non-equity modes of market entry:
  - Exporting (direct or indirect).
  - Contractual agreements (licensing, franchising).
- Equity modes of market entry:
  - Direct investment.
  - Strategic international alliance and joint venture.
- The amount of equity required by the company to use different modes affects the risk, return, and control that it will have in each mode.

- For example, indirect exporting involves less equity investment and thus has a low risk, low rate of return, and little control, whereas direct foreign investment requires the most equity of the four modes and creates the greatest risk while offering the most control and the potential highest return.

Exporting

- Exporting is the simplest way to enter a foreign market. It accounts for 10 % of global economic activity. Exporting requires the least investment by multinational corporations.
- Exporting is a non-equity mode of market entry, it is one of the oldest market entry approach which involves selling some regular production overseas.
- Exporting is also defined as selling "domestically" produced products abroad through local independent agents or directly to customers.

- Exporting can be either direct or indirect .
- With direct exporting, the company sells to a customer in another country. This method is the most common approach employed by companies taking their first international step because the risks of financial loss can be minimized.
- While implementing direct exporting, exporters take on the duties of intermediaries and make direct contact with customers in the foreign market.

- **Indirect exporting** usually means that the company sells to a buyer (importer or distributor) in the home country ,which in turn exports the product.
- **Indirect exporting** happens when the firm decides to sell its products in the foreign market through independent intermediaries
- Customers include large retailers, wholesalers, trading companies, and others that buy to supply customers abroad.

Strategic Advantages of Exporting

- Companies export in order to:

1. Increase sales revenues.
2. Achieve economies of scale in production.
3. Expand markets.
4. Minimize risk.
5. High flexibility.
6. All of these objectives are ultimately motivated by the potential for greater profitability.

Pitfalls of Exporting

- A catalog of pitfalls and specific problems of exporting include:
- Insufficient commitment by top management to overcome initial and ongoing difficulties.
- Misestimating the complexity and costs of ocean shipping and taxes clearance to export transactions.
- Poor selection of overseas agents or distributors.
- Neglecting export markets when the domestic market booms.
- Failure to treat international distributors on an equal basis with their domestic counterparts.
- Unwillingness to modify products to meet other countries' regulations or cultural preferences.

Contractual agreements

- Contractual agreements are long-term, non-equity associations between a company and another in a foreign market.
- Contractual agreements generally involve the transfer of technology, processes, trademarks, and/or human skills. In short, they serve as a means of transfer of knowledge rather than equity.
- Contractual agreements includes licensing and franchising.

Licensing

- **Licensing** is an agreement that permits a foreign company to use industrial property (i.e., patents, trademarks, and copyrights), technical know-how and skills e.g. (feasibility studies, technical advice, architectural and engineering designs), or any combination of these in a foreign market.

- A means of establishing a foothold in foreign markets without large capital outlays is licensing.
- Patent rights, trademark rights, and the rights to use technological processes are granted in foreign licensing.
- Licensing is a favorite strategy for small and medium-sized companies.
- Licensee avoids the high entry costs.

- Essentially, a licensor allows a foreign company to manufacture a product for sale in the licensee’s country and sometimes in other specified markets.
- For a fee or royalty, the licensee buys the right to use the company’s manufacturing process, trademark, patent, trade secret or other item of value.
- The company (licensor) thus gains entry into the market at little risk; the licensee gains production expertise or a well-known product or brand name without having to start from scratch.

- Licensing takes several forms. Licenses may be granted for production processes, for the use of a trade name, or for the distribution of imported products.
- Common examples of industries that use licensing arrangements in foreign markets are television programming and pharmaceuticals.
- The duration of licensing agreements depends to a large degree on technology and market uncertainties—more uncertainty favors shorter contracts

Advantages of licensing

- The method is very flexible because it allows a quick and easy way to enter the market.
- Low financial risks.
- Relatively low development costs.
- It allows host country to gain technology and create jobs.
- It allows host country and licensee to keep most profit.

Advantages of licensing cont’2

- It allows a company to spread out its research and development and investment costs, while enabling it to receive income with only negligible expenses.
- Licensing permit expansion without great capital or personnel commitment if licensees have the essential capabilities.

Advantages of licensing cont’3

- The advantages of licensing are most apparent when capital is scarce, import restrictions forbid other means of entry, a country is sensitive to foreign ownership, or patents and trademarks must be protected against cancellation for nonuse.
- An owner of a valuable brand name can benefit greatly from brand licensing. In addition to receiving royalties from sales of merchandise bearing its name or image, the trademark owner receives an intangible benefit of free advertising which reinforces the brand’s image.

Disadvantages of licensing

- The risks of choosing the wrong partners.
- Quality and other production problems.
- Payment problems.
- Loss of marketing control.
- Low profits.
- License usually is not good for much more than a decade.

Franchising

- A franchise is a business arrangement under which one party (the franchisor) allows another (the franchisee) to operate an enterprise using its trademark, logo, product line, and methods of operation in return for a fee.
- Franchising is a rapidly growing form of licensing in which the franchiser provides a standard package of products, systems, and management services, and the franchisee provides market knowledge, capital, and personal involvement in management.

- The combination of skills permits flexibility in dealing with local market conditions and yet provides the parent firm with a reasonable degree of control.
- The franchiser can follow through on marketing of the products to the point of final sale.

- The key factors that influence success of franchising approaches are:
  - Monitoring costs (based on physical and cultural distances).
  - The principal's international experience.
  - The brand equity in the new market.

Franchising business model

- The franchising business model consists of two operating partners:
  - The franchisor, or parent company
  - The franchisee that operates one or multiple store locations.
- Franchises is widely employed in soft drinks, retailing, fast foods. Examples, McDonalds, KFC, Pizza Hut, Dominos pizza.
- In England, for example, annual franchised sales of fast foods are estimated at nearly $2 billion, which accounts for 30 percent of all foods eaten outside the home

Advantages of franchising

- Franchising is a faster, cheaper form of expansion.
- Franchising is an attractive form for companies wishing to expand quickly with low capital investment
- The franchisor can also capitalize on the local franchisees' knowledge of the local marketplace.
- The combination of skills permits flexibility in dealing with local market conditions and yet provides the parent firm with a reasonable degree of control.

Advantages of franchising cont’2

- The franchiser can follow through on marketing of the products to the point of final sale.
- Low financial risk.
- Relatively low development costs.
- The franchising system combines the knowledge of the franchiser with the local knowledge and entrepreneurial spirit of the franchisee.
- Foreign laws and regulations are friendly toward franchising because it tends to foster local ownership, operations, and employment.

Disadvantages of franchising

- Lack of direct control over quality.
- Successful international franchising requires considerable start-up and ongoing presence overseas (this requires high costs).
- Growth may be slower depending on franchisee's intentions.
- Sharing of profit “pie”.
- Possible loss of know-how to potential competitor.