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Foreign Market Entry

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Introduction. Foreign market entries are important stepping stones for [→] MNEs expanding their global reach and establishing an international network of interdependent business units. Within this network, each [→] subsidiary has a specific role, for instance to provide access to local resources or markets. The design of an entry strategy thus has to match the needs and resources of the MNE with the opportunities and constraints in the local environment. Entry strategies are thus adapted to the local resource endowment, market demand and institutional environment, though the degree of such adaptation varies across firms, industries and locations.

Setting up a new business operation requires several strategic decisions, including the entry mode, location, timing, marketing, human resources and logistics. Most scholarly research has focused on entry modes: export, contractual co-operation, or [→] FDI. The FDI mode is further distinguished by the investors' share of equity ownership, and whether to invest in a [→] Greenfield project or acquire an existing firm. These decisions are interdependent though economic analysts often prefer to analyze them *ceteris paribus* to generate more parsimonious theoretical models. Key parameters influencing the entry strategy vary with the objectives of the project; they are here illustrated primarily with a focus on market-seeking FDI.

Foreign entries are undertaken for a reason, or motive, which is normally specified before the entry strategy is designed. The motives of FDI relate to the development and exploitation of resources of the MNE across its operations. Hence, any specific entry decision cannot be viewed in isolation, but has to be considered in relation to the overall strategic posture of the MNE. The MNE's global strategy thus sets the framework for specific foreign entries. This essay considers the following aspects of foreign entry: entry mode, location, timing, marketing, human resource management and logistics.

Entry Modes

Foreign entry modes are classified in multiple ways. Firstly, non-equity modes are distinguished from equity modes: the former include exports with and without trade intermediaries, as well as contractual forms of business such as licensing, franchising, outsourcing, and turn-key projects. Equity modes are distinguished by the ownership stake taken by the foreign investor: portfolio investment, [→] joint venture (JV), and wholly owned subsidiary (Young et al., 1989; Welch et al., 2007).

Portfolio investment involves the acquisition of a small equity stake as a financial investor, yet without influencing the strategy of the firm. JVs are created by two or more partner firms each contributing resources and sharing the control of the operation. They are differentiated by ownership levels taken by the foreign investor; the higher the equity stake and the more dispersed the residual ownership the more the investor has control over the operation. Wholly owned subsidiaries provide the investor with full control.

Theoretical models of the choice of foreign equity focus on the internalization of transactions and control over operations (Buckley and Casson, 1998; Brouthers and Hennart, 2007). [→] Transaction costs economics and [→] internalization theory suggest that a JV would be chosen if three conditions are met: (a) the new business unit depends on resource contributions from two or more firms, (b) the transfer of these resources or the expected benefits for the investors are subject to high transaction costs, and (c) it is not feasible for the entire parent firms to be integrated into one firm, for instance because they are big relative to the envisaged project, or one of them is a state-owned enterprise.

High transaction costs are in particular likely to arise for investors who transfer intangible assets. This is a particular pertinent issue for MNEs because their ability to achieve competitive advantages in foreign markets is often based on the deployment of intangible assets. However, they face asymmetric information regarding the content, value and usage of these assets, which are classic sources of market failures. Thus, the more markets are characterized by information asymmetries, the more likely MNEs

prefer to internalize an operation and thus to establish a wholly-owned subsidiary. Moreover, scholars like Kogut and Zander (1993) argue that knowledge to be transferred is often tacit and thus requires 'learning by doing' and thus an intra-organizational mode of transfer. This provides an alternative explanation why knowledge intensive firms would abstain from licensing or JVs as a mode of foreign entry. Thus, the more MNEs compete on the basis of technology, brand names or other intangible assets, the more likely they would entry with wholly owned subsidiaries.

A different source of transaction costs is interdependence of business activities and thus high asset specificity. This leads in particular to vertical JVs in industries that require large investments in assets specific to a business relationship, as in the mining and processing of certain natural resources.

Yet, transaction costs also depend on the institutional environment governing the market, notably the feasibility and cost of enforcing contracts. Where these institutions are weak, investors would abstain from relying on contracts; at the same time local partners may be helpful to interact with other local businesses in such contexts. Thus, JVs may provide an avenue to operate in unfamiliar contexts, especially where market supporting institutions are weak.

A different distinction of investment modes concerns the make-or-buy decision, namely the establishment of a Greenfield operation *viz* an acquisition of (a stake in) an existing company. This decision is primarily driven by the investor's need for local resources: An acquisition provides local organizationally embedded resources, such as human capital and networks with local authorities. A Greenfield operation in contrast allows investors to create a new operation from scratch according to their own designs, and thus to replicate organizational procedures and practices. The Greenfield option thus is preferred in particular by investors whose competitive advantages are grounded in the firm's organizational structure and culture. Acquisitions are preferred by those who need complementary local resources.

Location. Location concerns both the choice of country to invest in, and the selection of a specific site. For resource or efficiency seeking projects aiming to create an [→] export platform, the primary concern are costs of production. Hence, the key decision parameters for such location decisions are the costs and quality of the local [→] factor endowment. Entrants would consider the specific inputs that they require for their operations, including natural assets, like cost of the local workforce and natural resources, and 'created assets' like intermediate goods, human capital and [→] infrastructure.

Created assets are often of primary concern in industrialised countries, but they are also of increasing importance in emerging economies. Created assets are often provided by other businesses, which is one cause of the [→] agglomeration of FDI: Foreign entrants invest where a strong community of local and foreign-owned businesses already exists.

Market seeking investors are primarily concerned with the access to distribution channels and potential customers. They would identify the relevant market and then seek a central location for sales, marketing and distribution operations. In some industries, also the actual production needs to be located close to the customer or the point of consumption, notably in service industries such as hotels and financial services, and for manufactured goods that face high transportations costs. Thus, location decisions market-seeking investors are a function of the expected [→] market size and of transportation costs of bringing produce to the customer. For consumer goods, market demand may be predicted based on demographic data such as per capita incomes and population size. For business-to-business operators, size and growth of the local customer industry is crucial. A special case are 'follow-the-customer' entrants, who set up operations such as to best supply a specific customer, as commonly observed for instance the automotive industry.

In addition to the primary considerations of factor costs and markets, location decisions are often moderated by the institutional environment. For instance investors are concerned about regulation of the industry, political risk and law enforcement, especially with regard to [→] intellectual property rights. Moreover, they may moreover prefer

locations in cultural proximity because cultural differences between existing and new operations may reduce the efficiency of communication and coordination.

Location decisions may be made in two stages, first the country and then the site, but businesses may also compare alternative sites in different countries. The relevant parameters for both between-country and within-country location choice tend to be similar. MNEs may shortlist alternative sites, and then negotiate with the pertinent national and local authorities in parallel. At this stage, investment incentives such as provision of specific local infrastructure or [→] subsidies and financial incentives may tip the balance for a particular site, especially if [→] competition for FDI is strong.

Timing of Entry. Market-seeking foreign investors normally aim to be number one or two in their industry or market segment, especially if the industry tends top oligopolistic market structures [→ FDI under oligopoly]. Such market leadership may best be achieved by taking an early lead, or by taking over a local market leader (Lieberman and Montgomery, 1988). Thus, market-oriented investors often pursue first-mover advantages; while others enter the host country shortly after the first mover, aiming to challenge first mover before its position is too strong.

Early entrants may attain a lead in building reputation and consumer loyalty, and in establishing relationships with major suppliers and customers. First movers may thus be able to lock their partners and customers into a relationship, and thus raise barriers to entry for later entrants. Moreover, first movers may build goodwill with local authorities, slide down the learning curve, and acquire unique local resources, such distribution channels, local brands and raw material sources.

Followers, on the other hand, may benefit from a less uncertain business environment, from observing the experiences of the first mover, and from customers and local authorities already familiar with the product and the practices of the industry. In particular, ‘fast seconds’ may benefit from these advantages, while challenging the first mover before the market structure has stabilized. Empirical evidence suggests that first

movers can maintain their leadership position if they continuously commit resources and focus on learning about the local environment. Yet, evidence also points to many first-movers who did not succeed in creating sustained market leadership.

Related to timing is the question how fast to accelerate commitment to a market. In some industries, heavy up front investment is required to establish a strong position in view of (potential) competitors, as for branded consumer goods, or because of the capital intensity of the industry, as for oil exploration. In other industries, a ‘platform strategy’ may be appropriate as investors establish a small foothold from where to observe the local industry and to flexibly react to business opportunities if and when they emerge.

Marketing. The marketing literature on foreign entry has focused on standardization versus local adaptation (Meyer and Tran, 2006). A standardization strategy would use the same product, brand, and processes in all countries. Advantages of such a strategy include economies of scale in product development, production and marketing. It is most likely to be appropriate in industries that are technology intensive and face little variation in consumer preferences. In contrast, a local adaptation strategy would emphasize localization of products to accommodate local needs and preferences. It may in particular include the creation or acquisition of local brands for the mass market. Such localization is important for instance in the food and beverage industry.

Standardization and localization are not exclusive as MNEs may combine a high degree of standardization for their internal processes, such as product development and production, with adaptation of products and customer interfaces, notable marketing practices. Others pursue a multi-tier strategy and offer both an international product positioned in the premium segment and a local brand aimed at the mass market. Such a strategy allows synergies for instance in the use of distribution channels.

Human Resources. A foreign entry depends on qualified and motivated people to implement the strategy. Human resources management is particular important to manage knowledge sharing within the organization, both to transmit key organizational practices

to the new operation, but also to inform decision makers at headquarters about the local business. Thus, along with the establishment of a new subsidiary, expatriate managers have to be selected and prepared for their assignment, and local staff needs to be recruited and trained. Expatriates play a pivotal role in this process, as do training programs for local staff that may include learning by doing in other operations of the MNE. Other human resource management challenges include leadership of a workforce in a culturally different context, and adaptation of systems for recruitment, performance assessment and remuneration of local staff.

Logistics. An important aspect of a foreign entry strategy that is little analyzed in the literature but of great importance for management practice is logistics. Lower labor costs are only valuable for a business, if the products can be transported to the customer in good time at acceptable costs. Modern transportation infrastructure and IT systems are designed to allow MNEs to optimize the integration of their internal operations as well as supplier relations. Specialist intermediaries offer services that may include not only warehousing, [→] shipping and door to door delivery, but processing of customer orders and identification of appropriate suppliers. A foreign entry often triggers changes in these systems, especially if it involves the relocation of production.

Interdependencies. An entry strategy consists of many elements; entry strategy is, therefore, a multidimensional construct. Any decision has to take account of other dimensions. Take, for example, the choice of entry mode. If timing and speed of entry are crucial for an investor – as they are for those pursuing a first-mover advantages – an acquisition or a JV may offer quick market access. On the other hand, acquisitions pose greater challenges in terms of marketing, logistics and human resource management, as the acquired firm's existing structures and practices. Thus, foreign market entry decisions have to reflect the complex interdependence of multiple dimensions.

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