Foreign Entry Strategies (Mike Peng & Klaus Meyer, International Business)

PROF. DR. NORIFUMI KAWAI, MPIA (Pittsburgh)
Special Topics in Internationalization
Università degli Studi di Bergamo
Dipartimento di Scienze Aziendali
Bergamo, ITALY

UNIVERSITÀ DEGLI STUDI DI BERGAMO

Overview

Introduction

Learning Objectives

After completing this lecture you should be able to:

- Explain **why** MNEs establish subsidiaries abroad [***why enter***] ;
- Identify relevant **location-specific advantages** that attract foreign investors [***where to enter***];
- Compare & contrast **first- & late-mover advantages** [***when to enter***] & alternative **modes of entry** [***how to enter***];
- Explain the **interdependence** of operations & entry strategies; &
- Understand how **institutional constraints** affect foreign entry strategies.

Overview

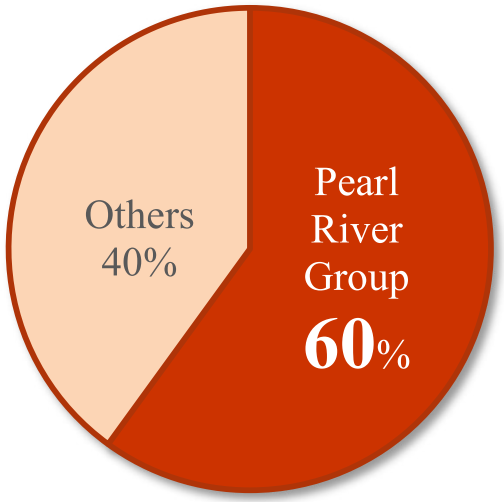
1. Introduction
2. **Opening Case: Pearl River Piano**
3. What Objectives do MNEs Desire to Achieve?
4. Where, When & How to Enter
5. How to Organize Your Operations
6. Institutions & Foreign Entry Strategies
7. Debates & Extensions
8. Implications for Practice

Opening Case: Pearl River Piano

Emerging Chinese Dragons

PEARL RIVER PIANO
Year of Foundation: 1956
Location: Guangzhou, China
Capacity: 100,000 piano/year
Employees: 4,000

DOMESTIC SALES



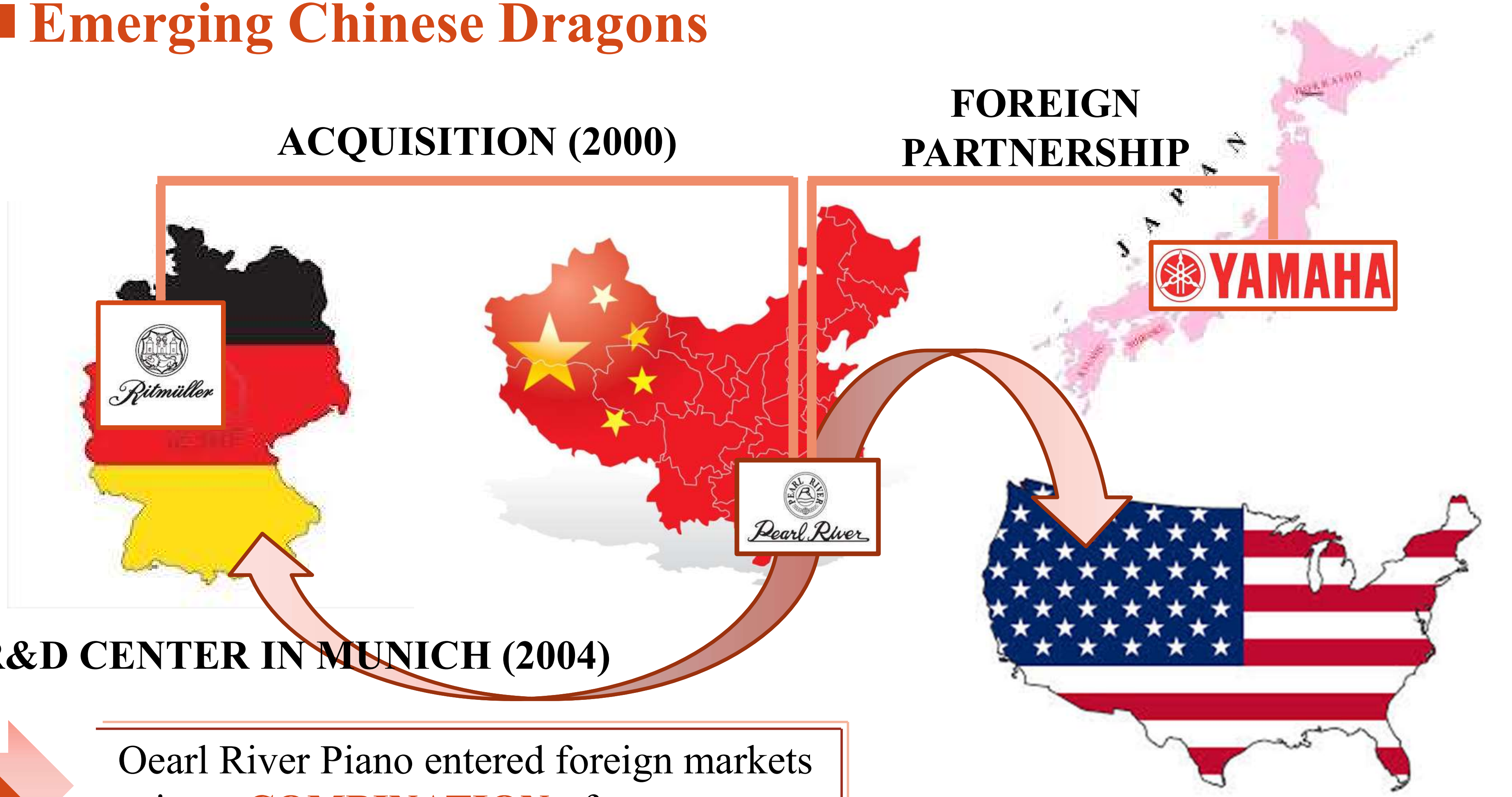
EXPORT SALES

20% in the US market
15% in the EU market
Over **100** countries

Source: Peng & Meyer (2011: 360-361); Fan (2008)

Opening Case: Pearl River Piano

■ Emerging Chinese Dragons



Oearl River Piano entered foreign markets using a **COMBINATION** of exports, greenfield investments & acquisitions.

EXPORT (1980s) – WOS (1999)

Opening Case: Pearl River Piano

Emerging Chinese Dragons

- **HOW** does Pearl River enter foreign markets?
- **WHAT** strategic objectives did they desire to achieve?
- **WHY** did they start their ambitious international growth in Hong Kong & later USA before entering Europe?
- **WHY** did Pearl River Piano establish a greenfield operation in the United States, but acquired a business in Germany?
- **WHAT** are the advantages of building your own brand?

Opening Case: Pearl River Piano

■ The Building Blocks of An Entry Strategy

KEY POINTS

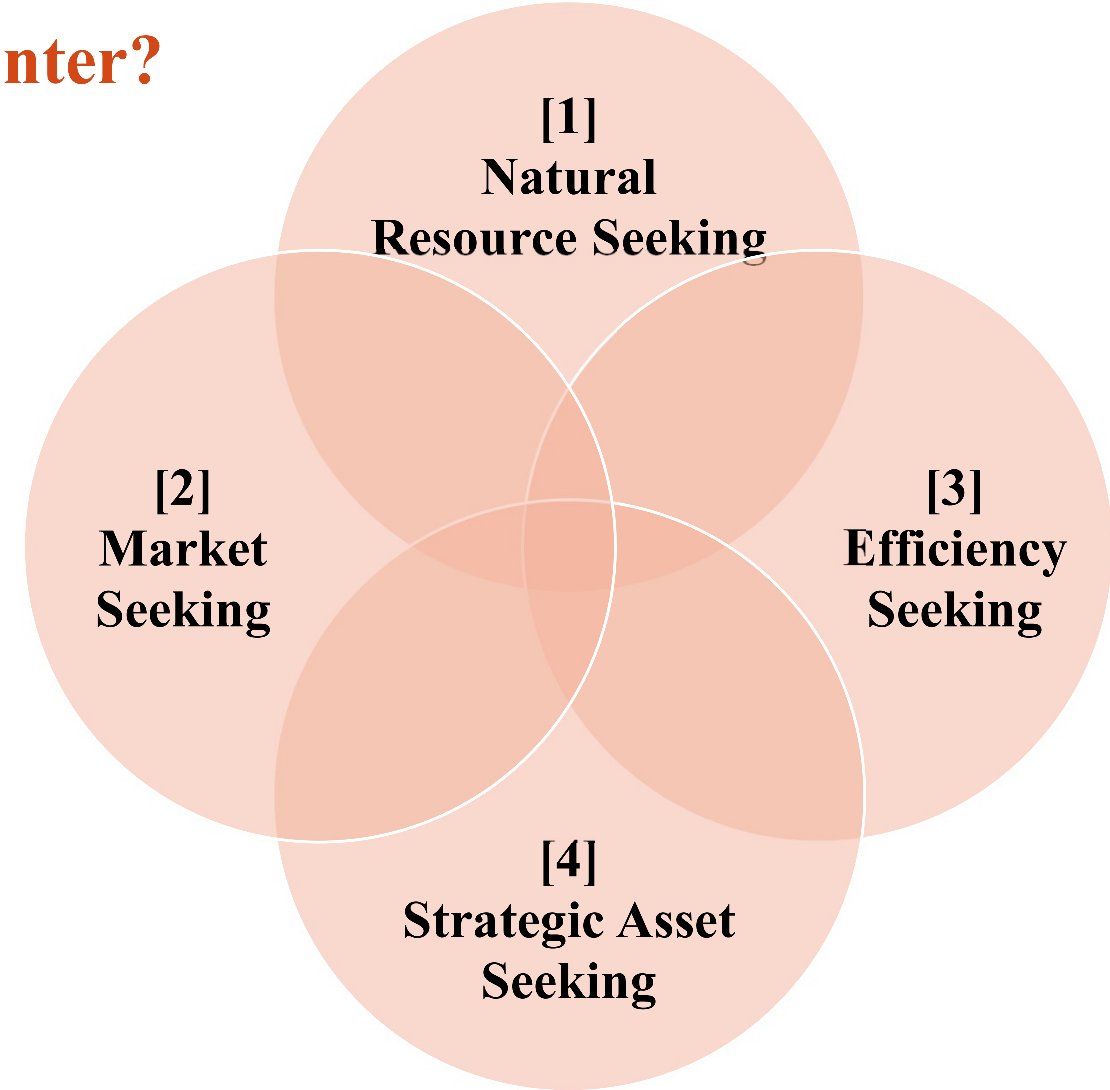
(1) Timing
(2) Location
(3) Ownership
(4) Greenfield or acquistion
(5) Marketing
(6) Logistics
(7) HRM

> When designing an entry strategy, MNEs have to consider them together, ensuring a good **FIT** between the different elements of the **strategy** – like the pieces of a jigsaw puzzle.

Overview

What Objectives do MNEs Desire to Achieve?

■ Why to Enter?



What Objectives do MNEs Desire to Achieve?

Why to Enter?

[1]
Natural
Resource Seeking

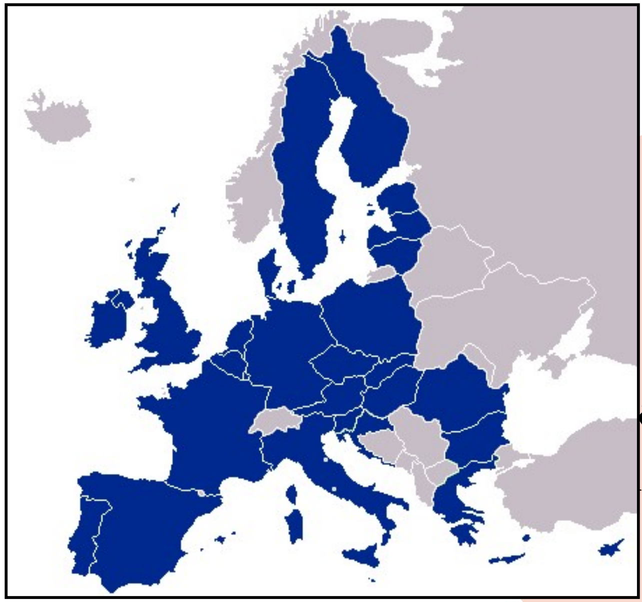
Natural Resource-Seeking FDI

- … capture **rich natural resources** that are either not available or available at an unaffordable cost in their home markets.
- The majority or all of the specific resources acquired by MNEs are likely to be **exported back to their home markets**.




What Objectives do MNEs Desire to Achieve?

Why to Enter?



- **Market-Seeking FDI**
  - The FDI aimed at **selling products or services** in foreign markets.

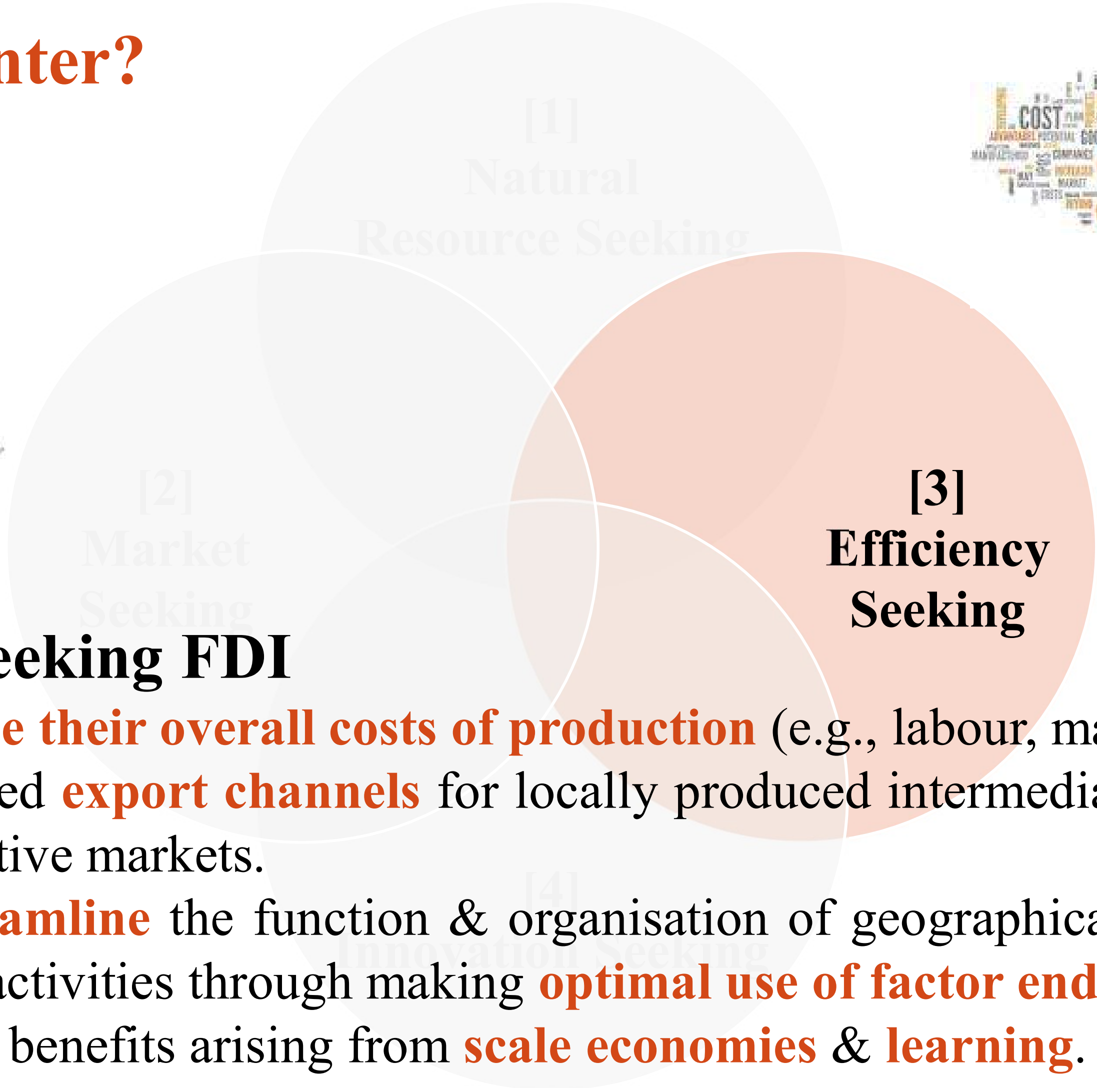
- **Defensive Market-Oriented FDI**
  - To circumvent **discriminatory trade barriers** (e.g., anti-dumping rules & countervailing duties imposed by host countries)
  - **Examples:** The initiation of EU's **anti-dumping** cases against imported consumer electronics & automobile products from Japan.
  - The '**follow-my-leader**' or '**band wagon**' form of market entry.

- **Offensive Market-Oriented FDI**
  - To respond to **emerging demands** or **changes in consumer tastes**.
  - **Examples:** The Single European Market (**SEM**), North American Free Trade Agreement (**NAFTA**).

What Objectives do MNEs Desire to Achieve?

■ Why to Enter?

TATA CONSULTANCY SERVICES



❖ Efficiency-Seeking FDI

- Aim to **reduce their overall costs of production** (e.g., labour, materials, machinery)
- Well-developed **export channels** for locally produced intermediate & final products to other lucrative markets.
- … helps **streamline** the function & organisation of geographically dispersed MNE value-added activities through making **optimal use of factor endowments**.
- Firms exploit benefits arising from **scale economies** & **learning**.

What Objectives do MNEs Desire to Achieve?

■ Why to Enter?

❖ Strategic Asset-Seeking FDI

> Aims to **acquire proprietary resources** that foreign rivals possess to rationalize the efficiency of geographically dispersed MNE activities.

> ‘**2**’ basic forms:

(1) Strategic alliances: A firm may build partnerships with its rival firms to **SHARE** complementary assets to enhance its international competitiveness essential to survival in a more complex global market.

(2) Cross-border M&A: A firm directly purchases its rival firms to **DIVERSIFY** the range of product lines of value-added MNE activities.

> … **BLOCKS** competitors from buying a firm’s proprietary resources.

[4]
Strategic Asset Seeking

What Objectives do MNEs Desire to Achieve?

■ Why to Enter?

Tata and Geely acquire capabilities

When Indian and Chinese MNEs invest overseas their first aim is often to build their own capabilities. Even when they have been highly successful at home, they still face a gap in capabilities, such as technological and managerial competencies, marketing to premium customers, engaging with financial advisors and private equity, managing R&D processes and leading creative people.

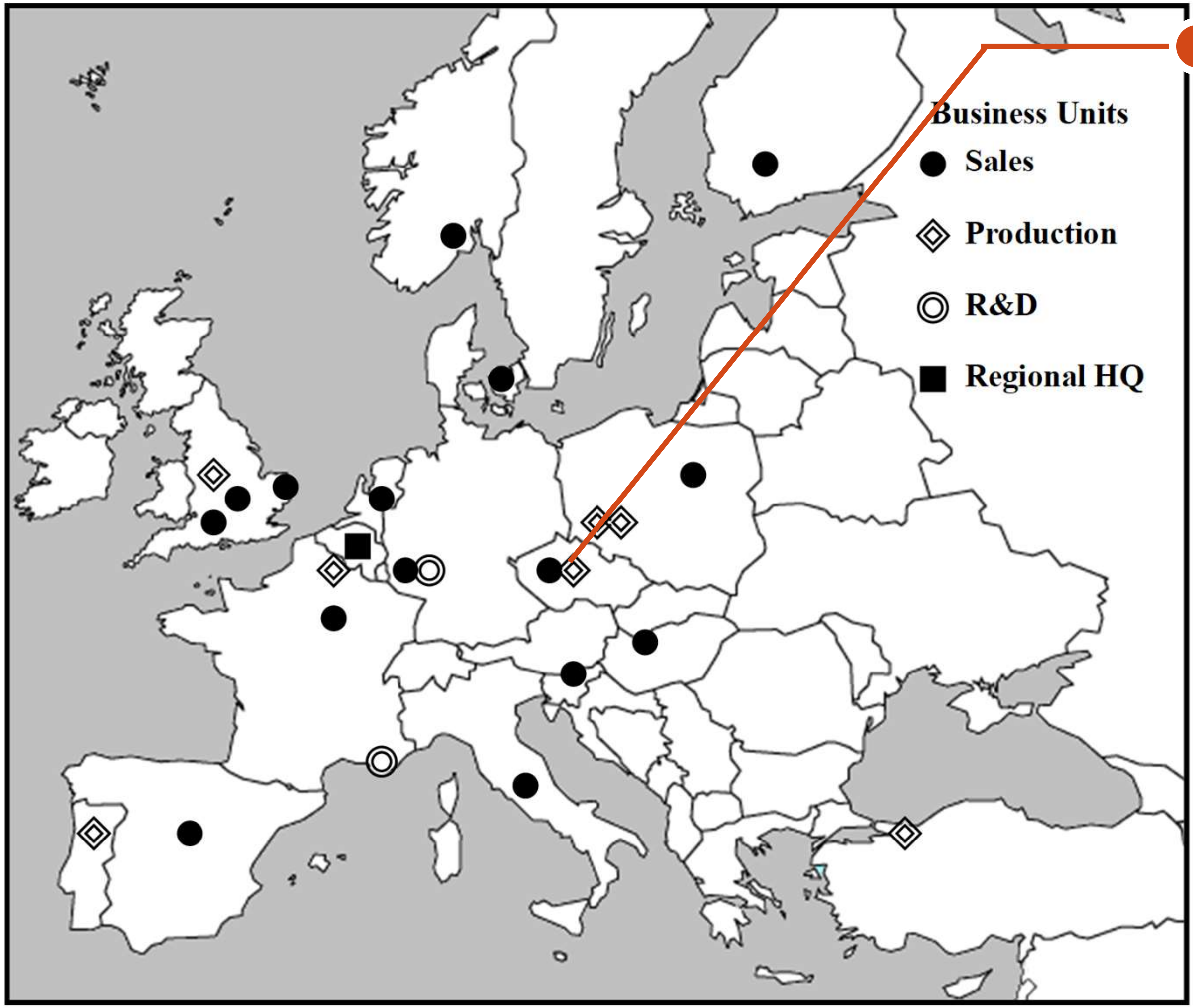
Consider two examples in the car industry. India's *Tata* acquired *Corus Steel*, *Tetley Tea* and *Jaguar Land Rover (JLR)* in the UK. Contrary to typical Western acquisitions, these foreign entries were not (primarily) aiming to sell Indian products in Europe, or reduce costs of existing operations, or access natural resources. In fact, the acquired firms have only been loosely integrated with other member firms of the *Tata Group*. So why did *Tata* make these big and risky investments? In addition to financial motives (risk diversification), *Tata*'s ambition has been to compete in global markets, and therefore it needed to build a range of managerial competencies. After the acquisition, the acquired firm was given high operational autonomy and additional financial resources for investment. On this basis, *Tata*-owned *JLR* has successfully rebuilt its UK manufacturing operations and its emerging economy market share. At the same time, parent organization *Tata Motors* continued to struggle in its Indian home market.

Similarly, *Geely*, a private Chinese car manufacturer, acquired Swedish premium car maker *Volvo* and the manufacturer of London taxis, *Manganese Bronze*. Like *Tata*, *Geely* was not geared towards European markets (their growth was close to zero at the time). Rather, *Geely* aimed to use the acquired brands and technologies to strengthen its position in the largest and fastest growth market for passenger cars, China. After the acquisition, *Volvo* built a new car assembly plant in China and invested in building its premium brand in China. In 2014 alone, *Volvo* added 30 new dealerships in China to increase its network to 157, and sales surged by 33%. Thus China overtook the USA as *Volvo*'s most important market.

In both cases, the new owners thus helped build bridges to potential customers in emerging economies by investing in new plants, distribution channels and brand marketing. Yet their main objective was even

What Objectives do MNEs Desire to Achieve?

■ Case of Toyota



TOYOTA PEUGEOT CITROËN AUTOMOBILE
Automobilka s budoucností

Toyota Peugeot Citroën Automobile (TPCA)

Location Decision Strategy

(1) Strategic location in the **centrality** of Europe
(2) Short **distance to key markets**
(3) A **history** of car production
(4) Road **infrastructure**
(5) Remarkable **engineering tradition**
(6) Government policies supporting investments (e.g., **incentives**)

Entry Mode Strategy

> Sharing **a mix of ownership advantages** both firms possess

❖ **PSA:** Purchasing & logistics

❖ **Toyota:** Production management methods & processes

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When to Enter?

■ First-Mover Advantages & Late-Mover Advantages

First-mover advantages ⟷ **Late-mover advantages**

First-mover advantages:

(1) Proprietary, **technological leadership**
(2) Quick **acquisition** of scarece resources
(3) Establishment of **entry barriers** for late entrants
(4) Avoidance of **clash** with dominant firms at home **(↓)**
(5) Relationships & connections with **key stakeholders** (e.g., customers & governments)

Late-mover advantages:

(1) Opportunity to **free ride** on first-mover investments
(2) Resolution of technological & market **uncertainty (↓)**
(3) First mover's difficulty to **adapt to market changes** (Late movers' willingness to take advantage of first movers' inflexibility)

"*Entry timing per se is not the sole determinant of success & failure of foreign entries. It is through interaction with other strategic factors that **entry timing affect performance***".

How to Enter?

Modes of Entry

- … are the format of foreign market entries.
- The first step is to determine whether to pursue **equity or non-equity modes of entry** (e.g., exports & contractual agreements).

The Choice of FDI Entry Modes

Access to local resources

Degree of control	Internal (organic)	External (acquisitive)
High	**Wholly owned Greenfield**	**Full Acquisition**
Low	**Newly created Joint Venture**	**Partial Acquisition**

KEY POINTS

- Equity modes are preferred when it comes to transferring **INTANGIBLE** assets (technology & brand names).
- The greater **ASYMMETRIC** information the more willingness to hand transactions internally.
- **TWO** decision criteria
  - **Access** to complementary local assets
  - Degree of **control**

How to Enter?

■ Joint Venture ZF Kamaz in Russia

Joint venture ZF Kama *in Russia*

by Irina Mihailova

ZF Friedrichshafen (ZF), a German automotive supplier, and *Kamaz Corporation*, a Russia truck manufacturer, set up a joint venture '*ZF Kama*' to produce transmissions in Russia.

ZF is one of the world's leading suppliers of driveline and chassis technology, with an annual turnover of €12.8 billion, over 72 600 employees and 122 production sites worldwide. For *ZF*, the JV in Russia was an important step towards building a strong market position in the Russian market, where *ZF* previously did not have production facilities. The cooperation with *Kamaz* was expected to help this objective by creating an association with a leading local truck manufacturer and its extensive dealer network in Russia. In addition, the technological and managerial capabilities of *Kamaz* were significant criteria for the choice of partner. The Russian JV generated an increase in demand for parts produced in *ZF* plants in Western Europe and thus contributed to the growth and viability of these established business units.

> **Kamaz:** Extensive distribution & service networks in Russia & neighboring countries.
> **The primary requirements for the JV selection?** (1) The possession of product technology, (2) A record of sincere cooperation initiative, & (3) A willingness to share risks.
> **Kamaz:** Responsible for day-to-day operations & key business relationships.
> **ZF:** The provision of product technology & expertise.

How to Enter?

■ Equity Modes of Entry: Advantages & Disadvantages

- **Greenfield (wholly owned)**
- Full Acquisition
- Joint Ventures (newly established)
- Partial Acquisition

ADVANTAGES

> Design operations to **FIT** the parent
> Full equity & operational **CONTROL**
> Better **PROTECTION** of know-how & ability to coordinate globally

DISADVANTAGES

> Add new capacity to an industry, which will make a competitive industry more **CROWDED** & increases the intensity of competition
> **SLOW** entry speed (relative to M&As)

RISKS

> **NO** co-owner related risks
> **NO** integration failure risk
> **HIGH** investment risk due to large capital commitent

How to Enter?

■ Equity Modes of Entry: Advantages & Disadvantages

Greenfield (wholly owned)

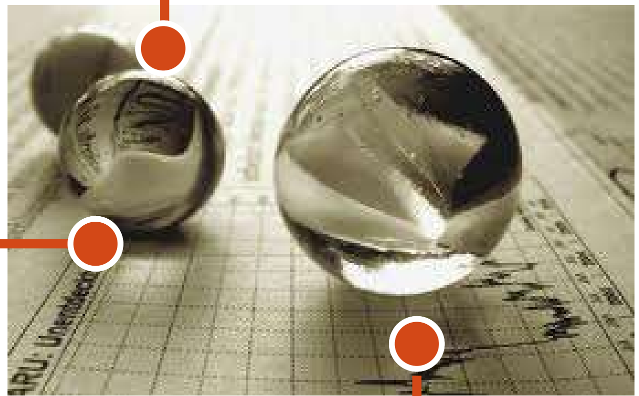
▶ **Full Acquisition**

Joint Ventures (newly established)

Partial Acquisition

ADVANTAGES

> Complete equity & operational **CONTROL**
> Better **PROTECTION** of know-how & <u>ability to coordinate globally</u>
> Do **NOT** add new capacity
> **FAST** entry speed



DISADVANTAGES

> Political **SENSITIVITY**
> **NATIONALISTIC** sentiments
> **HIGH** up-front capital
> Post-acquisition **INTEGRATION** challenge

RISKS

> High investment **RISK** due to large up-front capital commitment
> **DIFFICULTIES** in integration process

How to Enter?

■ Equity Modes of Entry: Advantages & Disadvantages

Greenfield (wholly owned)

Full Acquisition

Joint Ventures (newly established)

Partial Acquisition

ADVANTAGES

> **SHARING** costs, risks, & profits
> **ACCESS** to partners' knowledge & assets
> Politically acceptable (**LEGITIMACY**)
> Secure vertical & horizontal **LINKS**

DISADVANTAGES

> **DIVERGENT** goals & interests of partners
> **LIMITED** equity & operational control
> **DIFFICULTIES** in coordinating globally
> **DISTRUST**
> Culture **CLASHES**

RISKS

> Limited investment risk due to **LOWER** capital commitment
> High risk of coordination **FAILURE**

How to Enter?

Equity Modes of Entry: Advantages & Disadvantages

- Greenfield (wholly owned)
- Full Acquisition
- Joint Ventures (newly established)
- **Partial Acquisition**

ADVANTAGES

> **ACCESS** to operations that the previous owner heisitate to give up
> Previous owners continued **COMMITMENT**

DISADVANTAGES

> **NEED** to restructure & integrate, yet with limited control
  – e.g., **France Telecom's acquisition of Polish Telecom** in 2000: Tough negotiations with trade union that resisted layoff & outsourcing.

RISKS

> **LIMITED** investment risk due to lower capital commitment
> High risk of **INTEGRATION** problems
> High risk of **CONFLICTS** with co-owners

Overview

How to Organize Your Operations?

The Interdependence of Operations & Entry Strategies

1	**Marketing**	> **Global standardization** *versus* **local adaptation** of products & brands > **Standardization:** Economies of scale in the exploitation of capabilities of the global firm (*e.g.*, R&D, marketing, production etc.). > **Adaptation** strategies to meet local needs; The case of the **Polish brewing industry** (<u>**Local brands owned by Heineken & Carlsberg**</u>).
2	**Human Resource Management**	> Human resources are crucial to foreign entry because each subsidiary needs **qualified & motivated people** to facilitate **knowledge sharing** within an organization. > <u>Sending</u> **expatriate managers** while <u>recruiting, training & motivating</u> **local staff**.
3	**Logistics**	> **Effective supply chain management practices** are crucial capabilities for MNCs aiming to **exploit synergies between operations globally**. > **Modern transportation** & **communication systems** enable MNCs to **optimize the integration** of their internal operations & supplier relations.

Overview

Institutions & Foreign Entry Strategies

■ Institutional Constraints on Foreign Entry (1/4)

❖ **Type of Constraints: Coercive institutional pressures**

- The Indian government imposes ownership requirements in the retail sector to be **51%** (*e.g.*, Wal-Mart-Bharti Retail).
- **Legal restrictions:** The building code (*e.g.*, Wal-Mart in Germany).
- **Only shared ownership** : (1) **Chinese automobile assembly industry**, (2) **US airline regulation:** Up to **25%**, & (3) **EU airline regulation:** Up to **49%**.

■ Institutional Constraints on Foreign Entry (2/4)

❖ **Type of Constraints: Lack of market-supporting institutions**

- Unique rules & extensive use of networks exist in China & Vietnam.
- Under **underdeveloped institutional environments**, Western investors need to join in the knowledge exchange within "**informal local networks**" dictated by expatriates & local firms.

Institutions & Foreign Entry Strategies

Institutional Constraints on Foreign Entry (3/4)

- **Type of Constraints: Transaction costs from weak institutions**
  - Weak formal institutions = search costs (↑) + enforcement costs (↑)
  - **RELATIONSHIP**-based governance > arm's-length transactions.
  - **Acquisitions** are **costly** due to **underdeveloped financial market institutions** (*e.g.*, scarce reliable accounting & auditing information & no intermediaries - financial advisors & consultants).

Institutional Constraints on Foreign Entry (4/4)

- **Type of Constraints: Higher tariffs or other trade barriers**
  - Institutions inhibiting trade may in some circumstances actually increase foreign entry with local production facilities.
  - **Local production** allows entrants to **overcome tariffs & non-tariffs** that inhibit serving a market through an export strategy.
  - **Local content requirements (*e.g.*, Japanese MNCs in Europe).**

Overview

Debates & Extensions

■ Scale of Entry: Commitment & Experience

TYPES	BENEFITS (+)	COSTS (–)
1 **Large Scale Entry**	> **HEAVY** up-front investments avoid competitors' retaliation > **DETERS** potential entrants > **ASSURE** local customers & suppliers (*Cherry pick* strategy)	> **LIMITED** strategic flexibility elsewhere > Huge **LOSSES** if large-scale entries "bets" turn out wrong
2 **Small Scale Entry**	> **REDUCES** the costs & risks of entry > **LEARNING** by doing > **FLEXIBLE RESPONSE** to business opportunities if & when they emerge	> **A LACK OF STRONG COMMITMENT**, which may lead to difficulties in building market share & capturing first-mover advantages

Debates & Extensions

■ Acquisition Dynamics

TYPES	PURPOSE	RISKS
1 Conventional Acquisition	> Ta… …as lo… …ces &	> Overpaying > Post acquisition integration
2 Brownfield Acquisition	> Obta… …rolled by ar… …ade it to fit… .	> Very **HIGH** capital investment > Complex post-acquisition upgrading & integration
3 Multiple Acquisition	> Buil… …re in a previ… …nted mark… …arket)	> Very **HIGH** capital investment > Integration of multiple local units with the global operation
4 Staged Acquisition	> Take… …ellers are u… – … (CZ)	> **CONFLICTS** with co-owners > Integration problems

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Overview

Conclusive Remarks

■ Managerial Relevance

> **UNDERSTAND** the rule of the game (formal & informal) & **FIT** your strategies to the constraints & opportunities of these institutions.

- **Compliance** with regulation & **legitimacy** with local groups.

> **BRING TOGETHER** the MNEs global capabilities & complementary local resources:

- ***Fast-mover advantages***: Technological leadership.
- ***Joint ventures***: Learning from the partner.
- ***M&As***: Embedded resources in the acquired firms.

> **MATCH** the different elements of an **entry strategy** with the **firm's strategic objectives**.

- If global integration of marketing, logistics & HRM is important, the existing structures & practices of an acquired firm may pose major obstacles. (WOS more appropriate).

The End of Today's Lecture

ご清聴有難う御座いました。

Thank you so much!

Merci beaucoup !

Vielen Dank für Ihre Aufmerksamkeit!

Grazie mille !

【Contact Address】

ADDRESS: 208 in Via dei Caniana 2, 24127 Bergamo, ITALY

E-mail: norifumi.kawai@unibg.it