MODULE-II
MODES OF ENTRY INTO INTERNATIONAL BUSINESS

MEANING OF INTERNATIONAL BUSINESS

In simple words, International business refers to the trade of goods, services, technology, capital, and/or knowledge across national borders and at a global scale.

It involves cross-border transactions of goods and services between two or more countries. Transactions of economic resources include capital, skills, and people for the purpose of the international production of physical goods and services such as finance, banking, insurance, and construction.

MODES OF ENTRY

1. Exporting
2. Licensing
3. Partnering
4. Acquisition
5. Franchising
6. Turnkey/Greenfield

→ **Exporting: -** Exporting is **directly selling goods from one country into others**. Exporting can be direct (there is no intermediary; goods are sold from the company headquarters directly) or indirect (goods are sold to an intermediary who then is responsible for the sale of these goods in the foreign market). Indirect exporting carries lower risk to the company in general, but direct exporting is recommended for companies that expect international marketing to become a significant part of their operational strategy.

This can be the fastest way to enter an international market, and it protects the company's intellectual property, but the logistics and shipping may add additional cost to the product and complications to the process. In this case, very little capital investment is required, as there will be no production in the new region, but significant investment in marketing is a must in order for exporting to be successful. Exporting can be a good test run to explore foreign markets, and moving business transactions online can help streamline the process, but it will require preparation by the sales and marketing teams to ensure success.

Advantages of Direct Exporting

- You can select your foreign representatives in the overseas market.
- You can utilize the direct exporting strategy to test your products in international markets before making a bigger investment in the overseas market.
- This strategy helps you to protect your patents, goodwill, trademarks and other intangible assets.
- It helps in the distribution of surplus.
- It is less risky.
- Under direct export, the exporter has control over the selection of market.
- It helps in fast market access

Disadvantages of Direct Exporting

- High start-up cost in case of direct exports.
- In Indirect export, the exporter has no control over the distribution of products.
- Exporting through export intermediaries increase the cost of the product.

→ **Licensing**: - Licensing is a method in which a firm gives permission to a person to use its legally protected product or technology and to do business in a particular manner, for an agreed period of time and within an agreed territory. It is a very easy method to enter foreign market as less control and communication is involved.

To be successful, licensing depends mainly on an exchange of proprietary and confidential information, which can put the company's strategic advantages at risk, but agreements can be adapted to protect both parties. The licensee provides some of the capital absorbs some of the risk and should provide an independent income stream, as it pays the fees associated with the license itself. The downside is a loss of control over both operations and intellectual property.

Example: Starbucks (licensor) and Nestle (licensee) for exclusive rights to sell Starbuck's product.

Advantages

- ✓ Less investment is involved
- ✓ Low cost of labor

Disadvantages

- ✓ This method is time-consuming

- ✓ Decline in product quality may harm the reputation of licensor

→ **Franchising**: -Franchising is offering a potentially independent business owner the rights to operate a franchise using the company's strategies, business format and technology. Franchising is similar to licensing, although a franchise usually offers **the entire package of a company's standard operations**, while a licensee may have its own business methods.

Franchising allows the home company to share the risk with the semi-independent business owner and can better protect trade secrets, but the success of the franchise will heavily depend on the decisions made by the franchise team. The franchisee comes to the table with capital to invest, but the home company gives up a portion of control over the international franchise.

It is a system in which semi-independent business owners (franchisees) pay fees and royalty to a parent company (franchiser) in return for the right to be identified by its trademark, to sell its product or services, and often to use its business format or system.

Example: Burger king, McDonald etc.

Advantages of Licensing and Franchising

- Low cost of entry into an international market
- Licensing or Franchising partner has knowledge about the local market
- Offers you a passive source of income
- Reduces political risk as in most cases, the licensing or franchising partner is a local business entity
- Allows expansion in multiple regions with minimal investment

Disadvantages of Licensing and Franchising

- In some cases, you might not be able to exercise complete control on its licensing and franchising partners in the overseas market
- Licensees and franchisees can leverage the acquired knowledge and pose as future competition for your business
- Your business risks tarnishing its brand image and reputation in the overseas and other markets due to the incompetence of their licensing and franchising partners

→ **Joint Ventures: -** A joint venture is one of the preferred modes of entry into international business for businesses who do not mind sharing their brand, knowledge, and expertise.

Companies wishing to expand into overseas markets can form joint ventures with local businesses in the overseas location, wherein both joint venture partners share the rewards and risks associated with the business.

Both business entities share the investment, costs, profits and losses at the predetermined proportion.

This mode of entry into international business is suitable in countries wherein the governments do not allow one hundred per cent foreign ownership in certain industries.

In case of a Joint Venture, both the brands have a similar level of brand strength for that particular product. And therefore, they wish to explore that product in that international market together.

It is a strategy used by companies to enter a foreign market by joining hands and sharing ownership and management with another company. It is used when two or more companies want to achieve some common objectives and expand international operations.

Example: Uber (a taxi company) and Volvo (heavy vehicle co.)

The common objectives are –

- Foreign market entry
- Risk/reward sharing
- Technology sharing
- Joint product development
- It is useful to meet shortage of financial resources, physical or managerial resources

Advantages of Joint Venture

- Both partners can leverage their respective expertise to grow and expand within a chosen market
- The political risks involved in joint-venture is lower due to the presence of the local partner, having knowledge of the local market and its business environment
- Enables transfer of technology, intellectual properties and assets, knowledge of the overseas market etc. between the partnering firms

Disadvantages of Joint Venture

- Joint ventures can face the possibility of cultural clashes within the organisation due to the difference in organisation culture in both partnering firms
- In the event of a dispute, dissolution of a joint venture is subject to lengthy and complicated legal process.

→ **Acquisition**: - Acquisition involves purchasing an existing company in the new region and integrating it as a subsidiary within the parent company. The acquisition of a competitor, supplier or related business already located internationally can be an ideal way to introduce the company's products to the new market. Acquisition of a local business is one of the fastest ways to enter an international market.

It can be difficult to integrate business cultures, and transitioning an acquisition's production to align with the company's strategy can take time. The advantages lie in the acquisition's knowledge of regional cultures, markets and strategies as well as its already-established management and corporate structure. An acquisition can also provide new opportunities for development of new products and expansion of the company's portfolio, especially if the strategy is to lean into goods tailored to each market.

Acquisition implies the acquisition of controlling interest in a company by another company. It does not lead to dissolution of company whose shares are acquired. It may be a friendly or hostile acquisition or a bail-out takeover.

Example: LIC Acquire IDBI Bank.

Advantages of Strategic Acquisitions

- Your business does not need to start from scratch as you can use the existing infrastructure, manufacturing facilities, distribution channels and an existing market share and a consumer base
- Your business can benefit from the expertise, knowledge and experience of the existing management and key personnel by retaining them
- It is one of the fastest modes of entry into an international business on a large scale

Disadvantages of Strategic Acquisitions

- Just like Joint Ventures, in Acquisitions as well, there is a possibility of cultural clashes within the organisation due to the difference in organisation culture
- Apart from that there mostly are problems with seamless integration of systems and process. Technological process differences is one of the most common issues in strategic acquisitions.

<u>International Business APPROACHES:</u>

- Ethnocentric
- Geocentric
- Polycentric

- Regiocentric

1. **Ethnocentric approach: -** Countries with branches in foreign countries have to decide how to select management level employees. Ethnocentric staffing means to hire management that is of same nationality of parent company.

   When a company follows the strategy of choosing only from the citizens of the parent country to work in host nations, it is called an ethnocentric approach. Normally, higher-level foreign positions are filled with expatriate employees from the parent country. The general rationale behind the ethnocentric approach is that the staff from the parent country would represent the interests of the headquarters effectively and link well with the parent country. The recruitment process in this method involves four stages: self-selection, creating a candidate pool, technical skills assessment, and making a mutual decision. Self-selection involves the decision by the employee about his future course of action in the international arena. In the next stage, the employee database is prepared according to the manpower requirement of the company for international operations. Then the database is analysed for choosing the best and most suitable persons for global assignments and this process is called technical skills assessment. Finally, the best candidate is identified for foreign assignment and sent abroad with his consent.

Advantages

- Ethnocentric approach helps in attaining better coordination in between parent country and host country.
- It enables in achieving effective control by company's head branch over all its subsidiaries operating in distinct countries worldwide.
- Facilitates efficient transfer of technical know-how among various branches.
- The parent company can easily close watch over the activities of all subsidiaries.
- Avoids the need of having a well-developed local labor market at international level.
- It promotes effective communication in between the parent and host company.
- Enables easy transfer of parent country culture to the subsidiaries company. It assists in infusing beliefs and practices into foreign country.

Disadvantages

- It becomes difficult to train or guide employees at far distant place away from the parent country.

- Staff from parent country may face difficulty in adjusting themselves in host country because of differences in culture.
- There may be cultural clashes among executives from parent country and employees of host country.
- Government in host countries may impose strict restrictions on subsidiaries that will adversely impact business of parent company.
- Opportunity of hiring best talented human resource from host country is missed.
- Expatriates of parent country are more expensive in comparison to employees in host country.
- Rate of failure is very high.

2. **Geocentric approach: -** When a company adopts the strategy of recruiting the most suitable persons for the positions available in it, irrespective of their nationalities, it is called a geocentric approach. Companies that are truly global in nature adopt this approach since it utilizes a globally integrated business strategy. Since the HR operations are constrained by several factors like political and ethnical factors and government laws, it is difficult to adopt this approach. However, large international companies generally adopt the geocentric strategy with considerable success.

   For international recruitment, especially on foreign soil, organizations generally use manpower agencies or consultants with international connections and repute to source candidates, in addition to the conventional sources. For an effective utilization of the internal source of recruitment, global companies need to develop an internal database of employees and an effective tracking system to identify the most suitable persons for global postings. The geocentric approach uses Ihe best available managers for a business without regard for their country of origin.

Advantages of Geocentric Approach

- MNC's can develop a pool of senior executives with international experiences and contacts across the borders.
- The expertise of each manager can be used for the accomplishment of MNC's objective as a whole.
- Reduction in resentment, i.e. the sense of unfair treatment reduces.
- Shared learning, the employees, will learn from each other's experiences.

Disadvantages of Geocentric Approach

- The cost of training, compensation, and relocation of an employee is too high.
- Highly centralized control of staffing is required.

- Proper scrutiny is required by the HR to select the most suitable person for the job, which could be time-consuming.
- This approach is very costly since the recruitment agencies or the consultants are to be hired for the global search for eligible candidates.

3. **Polycentric approach: -** When a company adopts the strategy of limiting recruitment to the nationals of the host country (local people), it is called a polycentric approach. The purpose of adopting this approach is to reduce the cost of foreign operations gradually. Even those organizations which initially adopt the ethnocentric approach may eventually switch over lo the polycentric approach. The primary purpose of handing over the management to the local people is to ensure that the company understands the local market conditions, political scenario, cultural and legal requirements better. The companies that adopt this method normally have a localized HR department, which manages the human resources of the company in that country. Many international companies operating their branches in advanced countries like Britain and Japan predominantly adopt this approach for recruiting executives lo manage the branches." The polycentric approach uses natives of the host country to manage operations in their country and natives of the parent country to manage in the home office.

Advantages of Polycentric Approach

- The difficulty in the adjustment of expatriates from the parent country gets eliminated.
- The hiring of locals or the nationals of the host country is comparatively less expensive.
- The morale of the local staff increases.
- Better productivity due to better knowledge about the host market.
- The career opportunities for the nationals of the host country increases.
- Better government support.
- Chances of success are high.

Disadvantages of Polycentric Approach

- Lack of coordination between the host and the parent company, due to the absence of a link that gets created when expatriates from the parent country hold the managerial positions at the subsidiary.

- The lack of effective communication between the staff members of both the host and the parent company, due to the language barrier.
- Difficult to exercise control over the subsidiary.
- Lack of knowledge about the market conditions of the host country.
- The conflict may arise between the managers of both the host and the parent company due to the different thinking processes.

4. **Regiocentric Approach: -** The Geocentric Approach is one of the methods of international recruitment where the Multi National Companies recruit the most suitable employee for the job irrespective of their Nationality. The regiocentric approach uses managers from various countries within the geographic regions of business. Although the managers operate relatively independently in the region, they are not normally moved to the company headquarters.

   The regiocentric approach is adaptable to the company and product strategies. When regional expertise is needed, natives of the region are hired. If product knowledge is crucial, then parent-country nationals, who have ready access to corporate sources of information, can be brought in. One shortcoming of the regiocentric approach is that managers from the region may not understand the view of the managers at headquarters. Also, corporate headquarters may not employ enough managers with international experience.

   The regiocentric approach places managers from various countries within geographic regions of a business. In this example, the U.S. parent company uses natives of the United States at company headquarters. Natives of European countries are used to manage the Italian subsidiary.

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