Entry modes

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References for this lecture

- BBGV
  - Chapter 7, paragraphs 7.6, 7.7, 7.8

Entry modes

- The way a firm **enters foreign markets** depends on:
  - **Firm-specific** features
  - **Home-country** features
  - **Host-country** features

Entry modes

- **Equity-modes** ➔ control through ownership of shares
  - Acquisition
  - Joint venture
  - Greenfield

- **Non-equity modes**
  - Exporting
  - Licensing
  - Franchising

Licensing

- **Contract** between **firms** in **different countries** for the **use** of a **technology** or a **trademark**

- Used very often for **horizontal** multinational activity ➔ a trademark or production technology (usually a patent) is **licensed** to a foreign firm to **serve** a **foreign market**

Licensing

- Licensing is an **alternative** to **exporting**
  - **Exporting** may be **too costly** in presence of **high trade costs** (either transportation or other costs)

- **Risks** arising from licensing
  - **No direct control** of the foreign firm (only indirect control)
  - **Dissemination risk ➔ misuse** of the trademark or the technology by the foreign firm
  - Particularly relevant if the **institutional quality** of the host country is **poor**

Franchising

- Very **similar** to **licensing**
- The multinational grants to firms in the host country to **use** the **business model** developed by the firm in the home country

- **Business model**:
  - Logo, trademark, way of working, products, etc

- The **headquarter** also provide **assistance** to the local firm in the host country in establishing the business model in the host country

Franchising

- Differently from **licensing**, the **degree of control** of the headquarter on the foreign firm is **higher**
- The **headquarter** dictates the **requirements** that the foreign firm needs to have **to use** the **logo** and **trademark**
- **Feedbacks** from the foreign firm about the **suitability** of the **business model** for the host country are very important to **adapt** the business model

Acquisition

- The multinational firm gains **control** over an **existing firm** located in the **host country** by entering its **equity**

- The multinational usually **buys shares** of the foreign firm
  - **Full** acquisition ➔ full control
  - **Partial** acquisition ➔ full or partial control

- Acquisition is suitable both for **vertical** and **horizontal** multinational activity

Acquisition

- Acquisition does **not increase** the production **capacity** in the **host country** ➔ just **change** in the **ownership** of existing production capacity

- **Rapid** way of entering a foreign market
  - The production **plant already exists**
  - **Intangible assets** (human capital, know-how, knowledge of local markets and institutions) are **acquired** together with tangible assets

Acquisition

- **Risks** arising from **acquisition**
  - Difficult to **integrate** the **acquired firm** into the multinational ➔ established **routines** of the acquired subsidiary may be in **conflict** with headquarter's routines
  - It may be difficult to **transfer** and **exploit** the **firm-specific advantage**

Greenfield

- The multinational activity creates a **brand new firm** in the **host** country (e.g. a production plant)
- **Full ownership** and **control** of the new foreign firm
- The new firm **increases** the **production capacity** in the **host** country

Greenfield

- **Advantages** of **greenfield** wrt acquisition
  - Full direct **control** over the subsidiary
  - **Low risk** of **knowledge externality**

- **Risks** of **greenfield** investments
  - **Liability of foreignness** ➔ difficult to adapt to local culture, institutions, conditions
  - Difficult to acquire **intangible assets**
  - Difficult to hire **qualified workers**

Joint venture

- Multinational **firms** located in **different countries** establish a **new firm**
  - Located in **one of the countries** of the two multinational firms OR
  - Located in a **third country** (both need to overcome the liability of foreigness)

- **50/50** joint venture
  - **Ownership** is **equally shared** between the two firms
  - **Decisions** need to be taken with **unanimity**

Joint venture

- With a joint venture, firms from different countries **pool** their **firm-specific advantage** ➔ may be **mutually beneficial**
- A partnership with a firm located in the host country **reduces** the **liability of foreignness**
- If the **firm-specific advantage** can be easily ‘**copy-pasted**’, the joint venture may be particularly **risky**
- Often joint venture deals are **not stable** in time ➔ useful to **enter a new market**

Optimal choice between entry modes

- **Factors** to be taken into account when chosing the entry mode
  - Degree of **control**
  - Resource **commitment**
  - **Dissemination** risk

Entry modes

	Degree of control	Resource commitment	Dissemination risk
Licensing	Low	Low	High
Franchising	Medium-low	Medium-low	High
Acquisition	High	High	Medium-low
Greenfield	High	High	Low
Joint venture	Medium	Medium-high	Medium-high

Transaction costs theory

- **Coase** (1937) and **Williamson** (1975)

- There are two alternative ways of **organizing** a '**transaction**' (of any kind)
  - Through the **market**
  - Through the establishment of a **hierarchy** (i.e. an organization)

- **Market**
  - The two individuals sign a **contract** and set a **price**
- **Hierarchy**
  - The **resources** of the two individuals are **pooled** into a single **organizational unit** (e.g. the firm)

Transaction costs theory

- The **firm** (as an organization) emerges **when** it represents the **most efficient** way of organizing **transactions**

- A **multinational** firm will arise if the **internalization** of **foreign activities** within the same organization (i.e. the MNE) is **more** efficient than relying on **foreign markets**

Transaction costs theory

- **Markets** work if
  - A **price** can be set (and this is not always the case)
  - The **contract** can be **coordinated** (information) and **enforced** (institutions)