CHAPTER 13
SELECTING AND MANAGING ENTRY MODES

LEARNING OBJECTIVES:
1. Explain why and how companies use exporting, importing, and countertrade.
2. Explain the various means of financing export and import activities.
3. Describe the different contractual entry modes that are available to companies.
4. Explain the various types of investment entry modes.
5. Discuss the important strategic factors in selecting an entry mode.

CHAPTER OUTLINE:
Introduction
Exporting, Importing, and Countertrade
Why Companies Export
Developing an Export Strategy: A Four-Step Model
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   Step 2: Match Needs to Abilities
   Step 3: Initiate Meetings
   Step 4: Commit Resources
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   Export Management Companies
   Export Trading Companies
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Strategic Factors in Selecting an Entry Mode
  Cultural Environment
  Political and Legal Environments
  Market Size
  Production and Shipping Costs
  International Experience

A Final Word

A comprehensive set of specially designed PowerPoint slides (designated ‘PPT’ below) is available for use with Chapter 13. These slides and the lecture outline below form a completely integrated package that simplifies the teaching of this chapter’s material.

**Lecture Outline**

1. **INTRODUCTION**
   An entry mode is the institutional arrangement by which a firm gets its products, technologies, human skills, or other resources into a market. Companies seek entry to new marketplaces for manufacturing and/or selling products. Entry mode selection depends on market experience, level of control desired, and market size.

2. **EXPORTING, IMPORTING, AND COUNTERTRADE**
   The most common method of buying and selling goods internationally is exporting and importing. Companies use countertrade when exporting and importing products when using currencies is not an option.

   A. Why Companies Export
      1. Expand total sales when the domestic market is saturated.
      2. Diversify sales to levels cash flow, making it easier to coordinate payments to creditors with receipts from customers.
      3. Owners and managers with little or no knowledge of how to conduct business in other cultures, use exporting as a low-cost, low-risk way of gaining valuable international experience.
B. Developing an Export Strategy: A Four-Step Model (PPT #3)

A logical approach to exporting is to research and analyze international opportunities and develop a coherent export strategy. A firm with such a strategy pursues export markets rather than waiting for orders to arrive.

1. Step 1: Identify a Potential Market
   a. To identify clearly whether demand exists in a target market, market research should be performed and results interpreted.
   b. Novice exporters should focus on one or a few markets that are culturally understood.
   c. A new exporter should seek advice on regulations, exporting in general and to a target market in particular.

2. Step 2: Match Needs to Abilities
   a. Assess a company’s ability to satisfy market needs.

3. Step 3: Initiate Meetings
   a. Early meetings with potential distributors, buyers, and others. Initial contact should focus on building trust and cooperation.
   b. Later meetings can estimate potential success of an agreement.
   c. In the most advanced stage, negotiations take place and details of agreements are finalized.

4. Step 4: Commit Resources
   a. After all the meetings and negotiations, it is time to put the company’s human, financial, and physical resources to work.
   b. The objectives of the export program must be clearly stated and should extend out at least 3 to 5 years.
   c. As companies expand activities, they discover the need for an export department or division.

C. Degree of Export Involvement (PPT #4)

Some companies use intermediaries to get their products in a market abroad. Other companies perform all of their export activities themselves, with an infrastructure that bridges the gap between the two markets.

1. Direct Exporting
   Company sells directly to buyers in a target market. Need not sell directly to end-users; can rely on local representatives or distributors.
   a. Sales representatives represent their own company’s products, not those of other companies. Promote products by attending trade fairs and making personal visits to local retailers and wholesalers. Do not take title to the merchandise.
   b. Distributors take ownership of merchandise when it enters their country. Accept the risks associated with local sales and sell to retailers and wholesalers or end users through their own channels of distribution. Using a distributor reduces the exporter’s risk but lessens the exporter’s control over prices.

2. Indirect Exporting
   Company sells its products to intermediaries who resell them to buyers in a target market. The choice of intermediary depends on the ratio of international sales to total sales, available resources, and the growth rate of the target market.
   a. Agents
i. Individuals or organizations that represent one or more indirect exporters in a target market. Compensated with commissions on sales.

ii. Represent several indirect exporters and might focus their promotional efforts on the products of the company paying the highest commission.

b. Export Management Companies

i. EMC exports on behalf of indirect exporters, operating contractually, either as an agent or as a distributor.

ii. Provides services on a retainer basis: gather market information, formulate promotional strategies, perform promotional duties, research customer credit, arrange shipping, and coordinate export documents.

iii. Advantage: deep understanding of the cultural, political, legal, and economic conditions of target market. Disadvantage: breadth and depth of an EMC’s service hinders exporter’s international skills development.

iv. After the EMC contract expires, a company can go at it alone in exporting its products.

c. Export Trading Company

i. ETC provides services in addition to those directly related to clients’ exporting activities: import, export, and countertrade services, distribution channels, storage facilities, trade/investment projects, and manufacturing.

ii. Concept met limited success in the U.S.; remain small and are dwarfed by Asian counterparts.

iii. Governments, financial institutions, and companies have closer working relationships in Asia. The U.S. regulatory environment is wary of such arrangements, and the lines between companies and industries are clearly drawn.

D. Avoiding Export and Import Blunders (PPT #5)

1. Companies new to exporting often make errors; many fail to conduct adequate market research and obtain adequate export advice.

2. Companies can hire a freight forwarder—a specialist in such export-related activities as customs clearing, tariff schedules, and shipping and insurance fees. Can pack shipments for export and take responsibility for getting a shipment from the port of export to the port of import.

E. Countertrade (PPT #6)

Selling goods or services that are paid for, in whole or part, with other goods or services. Developing and emerging markets often rely on countertrade to import goods due to lack of hard currency. Formerly communist countries in Eastern and Central Europe use countertrade as well as nations in Africa, Asia, and the Middle East. Requires an extensive network of international contacts, but smaller companies can take advantage of its benefits.

1. Types of Countertrade

   a. Barter: Exchange of goods or services directly for other goods or services without the use of money.
b. **Counterpurchase**: Sale of goods or services to a country by a company that promises to make a future purchase of a country’s product.

c. **Offset**: Agreement that a company will offset a hard-currency sale to a nation by making a hard-currency purchase of an unspecified product from that nation in the future.

d. **Switch trading**: One company sells to another its obligation to make a purchase in a given country.

e. **Buyback**: Export of industrial equipment in return for products produced by that equipment.

2. Countertrade can provide access to markets otherwise off-limits because of a lack of hard currency. But typically involves commodity and agricultural products such as oil, wheat, or corn—products whose prices on world markets fluctuate.

3. Problems arise when the price of a product falls between the barter time and the selling time; fluctuating prices generate the same type of risk as in currency markets. Managers might hedge this risk on commodity futures markets as they hedge against currency fluctuations in currency markets.

F. **Export/Import Financing (PPT #7-12)**

International trade poses risks for both exporters and importers. Exporters risk not receiving payment after delivery, whereas importers fear that delivery might not occur once payment is made. Export/import financing methods:

1. **Advance Payment**
   a. Importer pays for merchandise before it is shipped. Used when two parties are unfamiliar with each other, the transaction is small, or the buyer has a poor credit rating.
   b. Prior payment eliminates the risk of nonpayment, but creates the complementary risk of non-shipment—importers might pay for goods but not receive them.

2. **Documentary Collection**
   a. Bank acts as an intermediary without accepting financial risk. Used in ongoing business relationships between two parties.
   b. A draft (bill of exchange) is a document ordering an importer to pay an exporter a specified sum of money at a specified time. A bill of lading is a contract between an exporter and a shipper that specifies merchandise destination and shipping costs.
   c. After receiving the appropriate documents from the exporter, the exporter’s bank sends the documents to the importer’s bank.
   d. Documentary collection reduces the risk of non-shipment because the packing list details the contents of the shipment, and the bill of lading is proof that the merchandise was shipped. The risk of nonpayment is increased because the importer does not pay until he receives the necessary documents.

3. **Letter of Credit**
   a. Importer’s bank issues a document stating that the bank will pay the exporter when the exporter fulfills the terms of the document.
   b. Used when an importer’s credit rating is questionable, when the exporter needs it to obtain financing, and when a market’s regulations require it.
c. Banks issue letters of credit after an importer has deposited a sum equal to the value of the imported merchandise. The bank pays the exporter, but the deposit protects the bank if the importer fails to pay for the merchandise.

d. Several types of letters of credit:
   - An irrevocable letter of credit allows the bank issuing the letter to modify its terms only after obtaining the approval of both exporter and importer.
   - A revocable letter of credit can be modified by the issuing bank without obtaining approval from either the exporter or the importer.
   - A confirmed letter of credit is guaranteed by both the exporter’s bank in the country of export and the importer’s bank in the country of import.

e. Letter of credit reduces the risk of non-shipment because of proof of shipment before payment.

f. Although risk of nonpayment is increased, this is more secure because the importer’s bank accepts nonpayment risk when it pays the exporter’s bank.

4. Open Account
   a. Exporter ships merchandise and later bills the importer.
   b. Used for sales between two subsidiaries within an international company and when the parties are familiar with each other.
   c. Reduces risk of non-shipment for importer but increases the risk of nonpayment for exporter.

3. CONTRACTUAL ENTRY MODES
   Some products simply cannot be traded in open markets because they are intangible. Companies can use a variety of contracts to market highly specialized assets and skills in international markets.

A. Licensing (PPT #13)
   1. Contractual entry mode in which a company owning intangible property (the licensor) grants another firm (the licensee) the right to use that property for a specified period of time.
   2. Licensor receives royalty payments based on a percentage of revenue generated by the property. Commonly licensed intangible property includes patents, copyrights, special formulas and designs, trademarks, and brand names.
   3. Licensing often involves granting companies the right to use process technologies inherent to production.
   4. Cross licensing occurs when companies employ licensing agreements to swap intangible property (e.g., Fujitsu and Texas Instruments use cross-licensing to use each other’s technology, saving R&D costs).
   5. Advantages
      a. Finance international expansion.
      b. Less risky method of international expansion.
      c. Can reduce likelihood of product appearing on black market.
      d. Licensees can upgrade existing production technologies.
   6. Disadvantages
      a. Can restrict a licensor’s future activities.
b. Might reduce the global consistency of the quality and marketing of a product.
c. Might amount to “lending” strategically important property to future competitors.

B. Franchising (PPT #14)
1. Contractual entry mode in which one company (the franchiser) supplies another (the franchisee) with intangible property and assistance over an extended period of time. Franchisers typically receive compensation as flat fees, royalty payments, or both.
2. The brand name or trademark of a company is normally the single most important item desired by the franchisee.
3. Franchising differs from licensing in three ways:
   a. Gives greater control over sale of a product in a target market.
   b. Although licensing is fairly common in manufacturing industries, franchising is primarily used in the service sector.
   c. Although licensing normally involves a one-time transfer of property, franchising requires ongoing assistance from the franchiser.
4. Companies based in the United States dominate the world of international franchising. Franchising is growing in the EU with the single currency and a unified set of franchise laws. In Eastern Europe, expansion suffers from a lack of capital, high interest rates and taxes, bureaucracy, restrictive laws, and corruption.
5. Advantages
   a. Low-cost, low-risk mode of entry into new markets.
   b. Allows for rapid geographic expansion.
   c. Uses cultural knowledge and know-how of local managers.
6. Disadvantages
   a. Cumbersome to manage many franchisees in several nations.
   b. Franchisees can experience a loss of organizational flexibility in franchising agreements.

C. Management Contracts (PPT #15)
1. One company supplies another with managerial expertise for a specific period of time. The supplier of expertise is compensated with either a lump-sum payment or a fee based on sales.
2. Two types of knowledge are transferred through management contracts: (1) specialized knowledge of technical managers, and (2) business-management skills.
3. Advantages
   a. Exploit an international opportunity but risk few physical assets.
   b. Nation can award contract to operate and upgrade public utilities when a nation is short of investment financing.
   c. Help nations develop skills of local workers and managers.
4. Disadvantages
   a. Places the lives of managers in danger in developing or emerging nations undergoing political or social turmoil.
   b. Suppliers of expertise may nurture a formidable new competitor in the local market.
D. Turnkey Projects (PPT #16)
1. Designing, constructing, and testing a production facility for a client. Are often large-scale and often involve government agencies.
2. Transfer special process technologies or production-facility designs to a client (e.g., power plants, telecommunications, petrochemical facilities).
3. Advantages
   a. Firm specializes in core competency to exploit opportunities.
   b. Governments can obtain designs for infrastructure from the world’s leading companies.
4. Disadvantages
   a. Company may be awarded a project for political reasons rather than for technological know-how.
   b. Can create future competitors.

4. INVESTMENT ENTRY MODES
Investment entry modes entail the direct investment in plant and equipment in a country coupled with ongoing involvement in the local operation.

A. Wholly Owned Subsidiaries (PPT #17)
1. Facility entirely owned and controlled by a single parent company. Can establish by purchasing an existing company or by forming a new company from the ground up.
2. Whether an international subsidiary is purchased or newly created depends on its operations; for high-tech products, a company may build new facilities because state-of-the-art operations are hard to locate.
3. Major drawback of “greenfield” is the time it takes to construct new facilities, hire and train employees, and launch production.
4. Advantages
   a. Managers have complete control over day-to-day operations in the target market and over access to valuable technologies, processes, and other intangible properties within the subsidiary.
   b. Firm can coordinate activities of its national subsidiaries.
5. Disadvantages
   a. Expensive, so difficult for small and medium-sized firms.
   b. Requires substantial resources so risk exposure is high.

B. Joint Ventures (PPT #18)
Separate company is created and jointly owned by two or more independent entities to achieve an objective.
1. Joint Venture Configurations
   a. Forward Integration Joint Venture
      Parties invest together in downstream business activities.
   b. Backward Integration Joint Venture
      Parties invest together in upstream business activities.
   c. Buyback Joint Venture
      Input provided by, and output absorbed by each partner.
   d. Multistage Joint Venture
      One partner integrates downstream, and the other, upstream.
2. Advantages
   a. Can reduce risk.
   b. Penetrate international markets that are otherwise off-limits.
c. Access another company’s international distribution network.
d. Defensiveness: Local government or government-controlled company gives authorities a direct stake in venture’s success.

2. Disadvantages
a. Can result in conflict between partners.
b. Loss of control over a joint venture’s operations can also result when the local government is a partner in the joint venture.

C. Strategic Alliances (PPT #19)
1. Two or more entities cooperate (but do not form a separate company) to achieve the strategic goals of each.
2. Like joint ventures, can be formed for short or long periods, depending on the goals of the participants.
3. Can be established between a company and its suppliers, its buyers, and even competitors; sometimes each partner purchases the other’s stock.
4. Advantages of Strategic Alliances
a. Share the cost of an international investment project.
b. Tap into competitors’ specific strengths.
c. Similar reasons as for entering into joint ventures.
5. Disadvantages of Strategic Alliances
a. Can create a future local or even global competitor.
b. Conflict can arise and eventually undermine cooperation.

D. Selecting Partners for Cooperation
1. Each partner must be firmly committed to the stated goals of the cooperative arrangement. Detailing duties and contributions of each party through prior negotiations helps ensure continued cooperation.
2. Although the importance of locating a trustworthy partner seems obvious, cooperation should be approached with caution.
3. Each party’s managers must be comfortable working with people of other cultures and traveling to (perhaps even living in) other cultures.
4. A suitable partner must have something valuable to offer. Managers must evaluate the benefits of a potential international cooperative arrangement as they would any other investment opportunity.

5. STRATEGIC FACTORS IN SELECTING AN ENTRY MODE (PPT #20-21)
Because entering a new market requires an investment of time and money, and because of the strategic implications of the entry mode, selection must be done carefully.

A. Cultural Environment
1. Culture can differ greatly, and managers can feel less confident in their ability to manage operations in the host country.
2. Company may avoid investment entry modes in favor of exporting or a contractual mode; cultural similarity encourages manager confidence and thus the likelihood of investment.
3. Importance of cultural differences diminishes when managers are knowledgeable about the culture of the target market.

B. Political and Legal Environment
1. Political instability in a target market increases the risk exposure of assets. Significant political differences and instability cause companies to avoid large investments in favor of entry modes that shelter assets.

2. Target market’s legal system influences the choice of entry mode: certain import regulations such as high tariffs or low quota limits can encourage investment.

3. Company producing locally avoids tariffs that increase product cost; it does not have to worry about making it into the market below quota.

4. Governments may enact laws that ban certain types of investment.

C. Market Size
1. Size of a potential market also influences the choice of entry mode. Rising incomes encourages investment entry modes because a firm can prepare for expanding market demand and increase its understanding of the target market.

2. High domestic demand in China is attracting investment in joint ventures, strategic alliances, and wholly owned subsidiaries. If investors believe that a market will remain small, they might prefer exporting or contractual entry.

D. Production and Shipping Costs
1. By helping to control total costs, low-cost production and shipping can give a company an advantage.

2. Setting up production in a market is desirable when the total cost of production is lower than at home. Low-cost local production might encourage contractual entry through licensing or franchising.

3. Companies producing products with high shipping costs prefer local production; exporting is feasible when products have low shipping costs.

E. International Experience
1. As companies gain international experience, they select entry modes that require deeper involvement. This also means that they must accept greater risk in return for greater control over operations and strategy.

2. They initially explore the advantages of licensing, franchising, management contracts, and turnkey projects.

3. Once they become comfortable in a market, joint ventures, strategic alliances, and wholly owned subsidiaries become viable options.

4. Advances in technology and transportation allow small companies to undertake entry modes requiring a more commitment to the local market.

6. A FINAL WORD
This chapter explains important factors in selecting entry modes and key aspects in their management. It details the circumstances in which each entry mode is most appropriate and the advantages and disadvantages that each provides. The choice of which entry mode(s) to use in entering international markets should match a company’s international strategy. Some companies want entry modes that give them tight control over activities abroad because they are pursuing a global strategy. Another company might not require an entry mode with central control because it is pursuing a multinational strategy. The entry mode must also be chosen to align well with an organization’s structure.