
GLOBAL MARKET ENTRY STRATEGIES



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Orange, France Telecom's mobile phone unit, was supposed to offer the marketing savvy and technological expertise.¹ TelecomAsia, at the time a Thai fixed-line phone operator, would leverage its local market knowledge and connections. Together, the two partners expected to conquer Thailand's booming mobile phone market. Alas, the honeymoon was short-lived. The joint venture partners split after merely two years. The relationship was troubled by different competing strategic visions. Orange managers wanted to expand the business with a low-price strategy to build up a broad customer base. TelecomAsia managers, however, preferred to push more multimedia options to attract higher-margin subscribers. TelecomAsia agreed to buy Orange's 39 percent stake. Orange left Thailand and TelecomAsia relaunched its mobile service under a new brand, True. True's president commented: "I learned a lot, I hope they learned too, about how important it is for a local partner to take the lead in the marketing area."

¹"Thailand's Rocky Road," *Far Eastern Economic Review*, September 23, 2004, pp. 39–40.

Making the “right” entry decisions heavily impacts the company’s performance in global markets. Granted, other strategic marketing mix decisions also play a big role. A major difference here is that many of these other decisions can easily be corrected, sometimes even overnight (e.g., pricing decisions), while entry decisions are far more difficult to redress.

We can hardly overstate the need for a solid market entry strategy. Entry decisions heavily influence the firm’s other marketing mix decisions. Several interlocking decisions need to be made. The firm must decide on: (1) the target product/market, (2) the corporate objectives for these target markets, (3) the mode of entry, (4) the time of entry, (5) a marketing mix plan, and (6) a control system to monitor the performance in the entered market.² This chapter covers the major decisions that constitute market entry strategies. It starts with the target market selection decision. We then consider the different criteria that will impact the entry mode choice. Following that, we will concentrate on the various entry strategy options that MNCs might look at. Each of these will be described in some detail and evaluated. We will then focus on cross-border strategic alliances. The final two questions that we consider deal with timing-of-entry and divestment decisions.

TARGET MARKET SELECTION



A crucial step in developing a global expansion strategy is the selection of potential target markets. Companies adopt many different approaches to pick target markets. A flowchart for one of the more elaborate approaches is given in **Exhibit 9-1**.

To identify market opportunities for a given product (or service) the international marketer usually starts off with a large pool of candidate countries (say, all central European countries). To narrow down this pool of countries, the company will typically do a preliminary screening. The goal of this exercise is twofold: you want to minimize the mistakes of (1) ignoring countries that offer viable opportunities for your product, and (2) wasting time on countries that offer no or little potential. Those countries that make the grade are scrutinized further to determine the final set of target countries. The following describes a four-step procedure that a firm can employ for the initial screening process.

Step 1. Indicator selection and data collection. First, the company needs to identify a set of socioeconomic and political indicators it believes are critical. The indicators that a company selects are to a large degree driven by the strategic objectives spelled out in the company’s global mission. Colgate-Palmolive views per capita purchasing power as a major driver behind market opportunities.³ Starbucks looks at economic indicators, the size of the population, and whether the company can locate good joint-venture partners.⁴ When choosing markets for a particular product, indicators will also depend on the nature of the product. P&G chose Malaysia and Singapore as the first markets in Asia (ex-Japan) for the rollout of Febreze, a fabric odor remover.⁵ Not only were both markets known for “home-proud” consumers but people there also tend to furnish their homes heavily with fabrics. A company might also decide to enter a particular country that is considered as a *trendsetter* in the industry. Kodak, for example, re-entered the digital camera market in Japan precisely for that reason. As the president of Kodak Japan put it, “what happens in Japan eventually happens in the rest of world.”⁶

Information on socioeconomic and political country indicators can easily be gathered from publicly available data sources (see Chapter 6). Typically,

²Franklin R. Root, *Entry Strategies for International Markets*, New York: Lexington Books, 1994, p. 23.

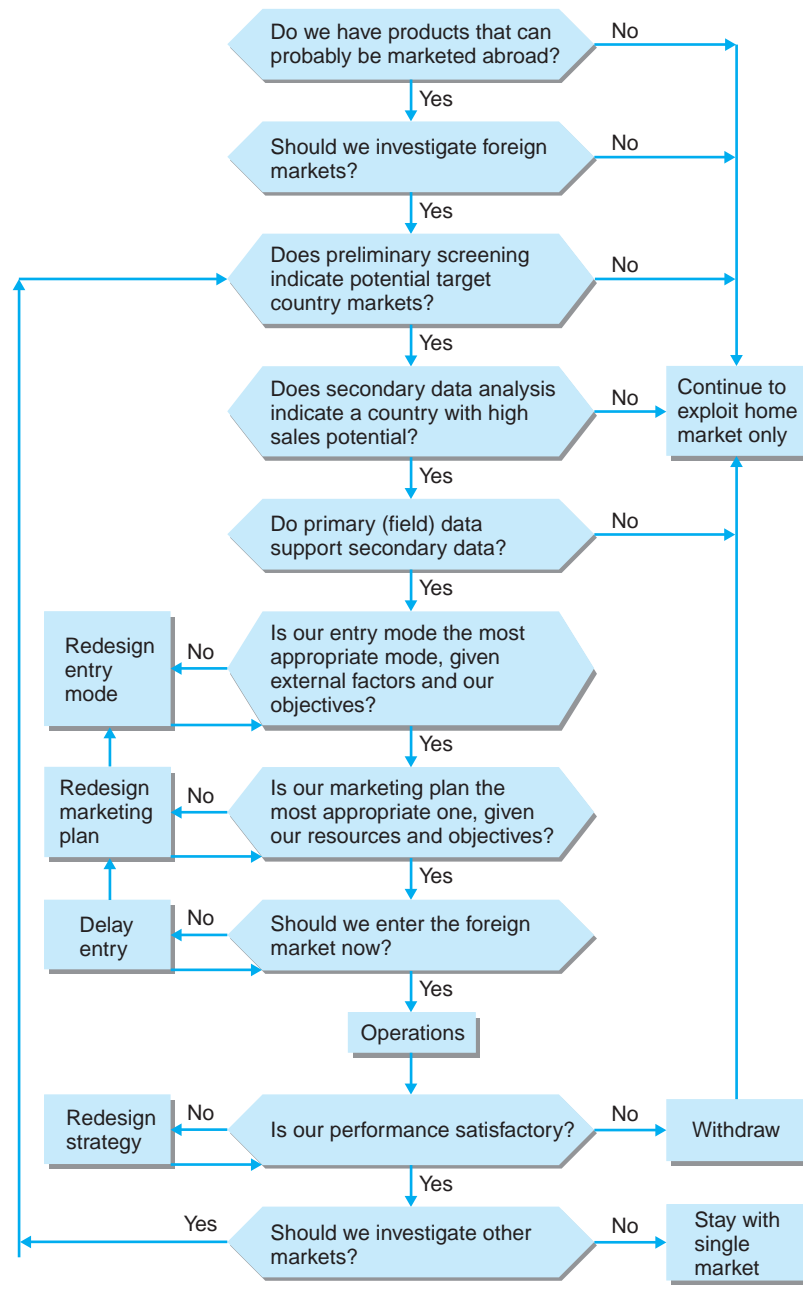
³“Tangney is bullish on L. America,” *Advertising Age International*, May 17, 1993, p. I-23.

⁴“Coffee Talk,” *Asia Inc*, March 2005, pp. 16-17.

⁵“Grey Showers Febreze over Southeast Asia,” *Ad Age Global* (May 2002), p. 18.

⁶“Kodak Sets for Gamble on Re-entry to Japan,” *Financial Times* (December 15, 2004), p. 21.

EXHIBIT 9-1
A LOGICAL FLOWCHART OF THE ENTRY DECISION PROCESS



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countries that do well on one indicator (say, market size) rate poorly on other indicators (say, market growth). For instance, India’s beer market is growing rapidly at 14 percent a year but its per capita consumption of one liter per year is still a small fraction of the world average of 22 liters.⁷ Somehow, the company needs to combine its information to establish an overall measure of market attractiveness for these candidate markets.

Step 2. *Determine the importance of country indicators.* The second step is to determine the importance weights of each of the different country indicators identified in the previous step. One common method is the “constant-sum”

⁷“SABMiller in Battle to Take Lid off India’s Beer Market,” *Financial Times*, December 30, 2008, p. 12.

EXHIBIT 9-2
METHOD FOR PRESCREENING MARKET OPPORTUNITIES: EXAMPLE

| Country | Per capita Income | | Political Risk | | Score | |
|---------|-------------------|-------------|----------------|-------------|-------|--|
| | Population | Competition | Population | Competition | | |
| A | 50 | 25 | 30 | 40 | 3400* | |
| B | 20 | 50 | 40 | 10 | 3600 | |
| C | 60 | 30 | 10 | 70 | 3650 | |
| D | 20 | 20 | 70 | 80 | 3850 | |
| Weight | 25 | 40 | 25 | 10 | | *(25 × 50) + (40 × 25) + (25 × 30) + (10 × 40) = 3400 |

allocation technique. This method simply allocates 100 points across the set of indicators according to their importance in achieving the company's goals (e.g., market share), so, the more critical the indicator, the higher the number of points it is assigned. The total number of points should add up to 100.

- Step 3.** *Rate the countries in the pool on each indicator.* Next, each country in the pool is assigned a score on each of the indicators. For instance, you could use a 10-point scale (0 meaning very unfavorable; 100 meaning very favorable). The better the country does on a particular indicator, the higher the score.
- Step 4.** *Compute overall score for each country.* The final step is to derive an overall score for each prospect country. To that end, the weighted scores that the country obtained on each indicator in the previous step are simply summed. The weights are the importance weights that were assigned to the indicators in the second step. Countries with the highest overall scores are the ones that are most attractive. An example of this four-step procedure is given in **Exhibit 9-2**.

Sometimes, the company may desire to weed out countries that do not meet a cut-off for criteria that are of paramount importance to the company. For instance, Wrigley, the U.S. chewing gum maker, was not interested in Latin America until recently because many of the local governments imposed ownership restrictions.⁸ In that case, the four-step procedure should be done only for the countries that stay in the pool.

Other far more sophisticated methods exist to screen target markets. Kumar and colleagues, for example, developed a screening methodology that incorporates multiple objectives a firm could have (instead of just one), resource constraints, and its market expansion strategy.⁹ One procedure, which is a bit more sophisticated than the method described here, is described in the appendix.

Over time, companies sometimes must fine-tune their market selection strategy. Grolsch, the Dutch premium beer brewer, used to export to emerging markets like China and Brazil. In the wake of flagging profits, Grolsch¹⁰ decided to focus on mature beer markets where buying power is high and the premium segment is growing. Markets that meet those criteria include the United States, the United Kingdom, Canada, Australia, and continental Europe.¹¹ **Exhibit 9-3** shows the market opportunity matrix for the Asia-Pacific division of Henkel, a German conglomerate. The shaded area highlights the countries that look most promising from Henkel's perspective.

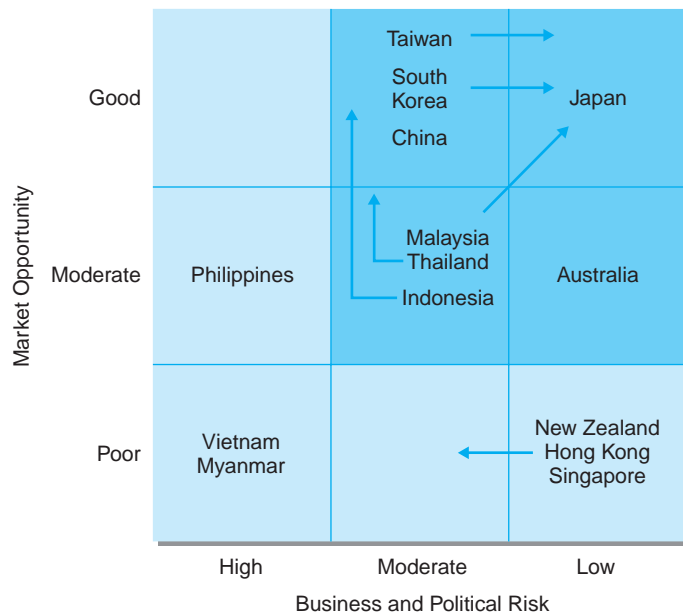
⁸“Guanxi spoken here,” *Forbes*, November 8, 1993, pp. 208–10.

⁹V. Kumar, A. Stam and E. A. Joachimsthaler, “An interactive multicriteria approach to identifying potential foreign markets,” *Journal of International Marketing*, vol. 2, no. 1, 1994, pp. 29–52; see also Lloyd C. Russow and Sam C. Okoroafo, “On the way towards developing a global screening model,” *International Marketing Review*, vol. 13, no. 1, 1996, pp. 46–64.

¹⁰In November 2007, SABMiller, one of the world's largest brewers, offered €816 million to buy Grolsch. The takeover was completed in March 2008.

¹¹“Grolsch targets mature markets,” *Financial Times* (February 10, 1999), p. 20.

EXHIBIT 9-3
OPPORTUNITY MATRIX FOR HENKEL IN ASIA PACIFIC



Source: Reprinted from Hellmut Schütte, “Henkel’s Strategy for Asia Pacific,” *Long Range Planning*, 28 (1), p. 98. Copyright 1995, with kind permission from Elsevier Science Ltd., The Boulevard, Langford Lane, Kidlington OX51GB, UK.

◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ **CHOOSING THE MODE OF ENTRY**

Decision Criteria for Mode of Entry

Several decision criteria will influence the choice of entry mode. Roughly speaking, two classes of decision criteria can be distinguished: internal (firm-specific) criteria and external (environment-specific) criteria. Let us first consider the major external criteria.

Market Size and Growth. In many instances, the key determinant of entry choice decisions is the size of the market. Large markets justify major resource commitments in the form of joint ventures or wholly owned subsidiaries. Market potential can relate to the current size of the market. However, future market potential as measured via the growth rate is often even more critical, especially when the target markets include emerging markets.

Risk. Another major concern when choosing entry modes is the risk factor. The role of risk in global marketing is discussed in Chapter 5. Risk relates to the instability in the political and economic environment that may impact the company’s business prospects. Generally speaking, the greater the risk factor, the less eager companies are to make major resource commitments to the country (or region) concerned. Obviously, the level of country risk changes over time. In Bolivia, for example, the election of Evo Morales, a left-leaning indigenous former coca farmer, created enormous uncertainty for foreign investors in that country.¹² Many companies opt to start their presence with a liaison office in markets that are high-risk but, at the same time, look very appealing because of their size or growth potential. For instance, MetLife, the insurance company, opened

¹²<http://lapaz.usembassy.gov/commercial/2005InvestClimateStat.pdf>.

a liaison office in Shanghai and Beijing while it was waiting for permission from the Chinese government to start operations. A liaison office functions as a low-cost listening post to gather market intelligence and establish contacts with potential distributors and/or clients.

Government Regulations (Openness). Government regulations are also a major consideration in entry mode choices. In scores of countries, government regulations heavily constrain the set of available options. A good example is the regulation of the airline industry in the United States: airlines are classified as “strategic assets” and as a result foreign airlines cannot acquire majority ownership of U.S. carriers.¹³ Trade barriers of all different kinds restrict the entry choice decision. In the car industry, local content requirements in countries such as France and Italy played a major role behind the decision of Japanese carmakers like Toyota and Nissan to build up a local manufacturing presence in Europe.

Competitive Environment. The nature of the competitive situation in the local market is another driver. The dominance of Kellogg Co. as a global player in the ready-to-eat cereal market was a key motivation for the creation in the early 1990s of Cereal Partners Worldwide, a joint venture between Nestlé and General Mills. The partnership gained some market share (compared to the combined share of Nestlé and General Mills prior to the linkup) in some of the markets, though mostly at the expense of lesser players like Quaker Oats and Ralston Purina. By the same token, the acquisition by SABMiller, one of the world’s largest beer brewers, of Colombia-based Bavaria in a \$7.8 billion deal brought the company near-monopoly control in four South American countries: Peru, Colombia, Ecuador, and Panama.¹⁴

Cultural Distance. Some scholars argue that the cultural distance between countries also has an impact on entry mode choice decisions. Opinions about the nature of the relationship differ. Some argue that through higher percentages of equity ownership, MNCs are able to bridge differences in cultural values and institutions. Others note that by relying on joint ventures instead of wholly owned subsidiaries MNCs are able to lower their risk exposure in culturally distant markets. A comprehensive analysis of a wide range of studies in the literature found no clear-cut evidence in favor of either argument.¹⁵

Local Infrastructure. The physical infrastructure of a market refers to the country’s distribution system, transportation network and communication system. In general, the poorer the local infrastructure, the more reluctant the company is to commit major resources (monetary or human).

The combination of all these factors determines the overall market attractiveness of the countries being considered. Markets can be classified in five types of countries based on their respective market attractiveness:¹⁶

- *Platform* countries that can be used to gather intelligence and establish a network. Examples include Singapore and Hong Kong.
- *Emerging* countries in which the major goal is to build up an initial presence, for instance, via a liaison office. Vietnam and the Philippines are examples.

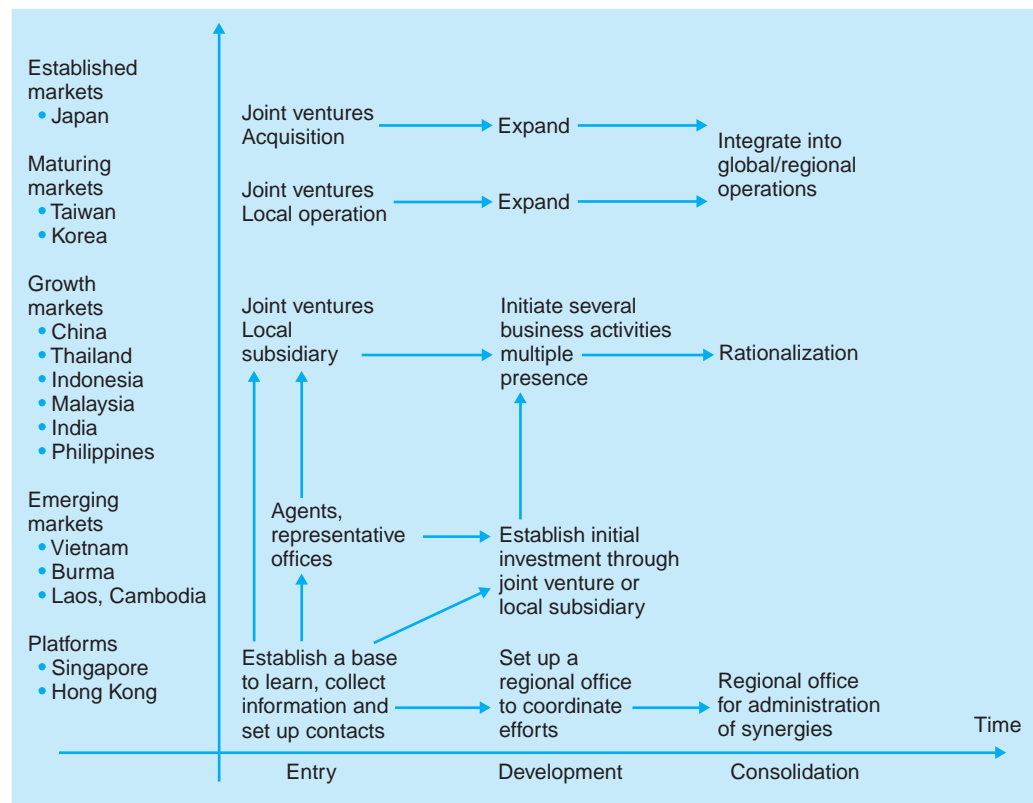
¹³http://www.businessweek.com/debateroom/archives/2008/04/lift_us_airline.html.

¹⁴“SABMiller to Raise its Glass to Loyalty,” *Financial Times*, July 25, 2005, p. 16.

¹⁵Laszlo Tihanyi, David A. Griffith, and Craig J. Russell, “The Effect of Cultural Distance on Entry Mode Choice, International Diversification, and MNE Performance: A Meta-Analysis,” *Journal of International Business Studies* 36 (2005): 270–83.

¹⁶Philippe Lasserre, “Corporate strategies for the Asia Pacific region,” *Long Range Planning*, vol. 28, no. 1, 1995, pp. 13–30.

EXHIBIT 9-4 ENTRY MODES AND MARKET DEVELOPMENT



Source: Reprinted from Philippe Lasserre, "Corporate Strategies for the Asia Pacific Region," *Long Range Planning* 28 (1), p. 21. Copyright 1995, with kind permission from Elsevier Science Ltd., The Boulevard, Langford Lane, Kidlington OX5 1GB UK.

- *Growth* countries offer early mover advantages that often push companies to build a significant presence to capitalize on future market opportunities as in China and India.
- *Maturing* and *established* countries like South Korea, Taiwan and Japan. These countries have far fewer growth prospects than the other types of markets. Often local competitors are well entrenched. On the other hand, these markets have a sizable middle class and solid infrastructure. The prime task here is to look for ways to further develop the market via strategic alliances, major investments or acquisitions of local or smaller foreign players. A case in point is General Electric, the U.S. conglomerate. In the hope of achieving big profits in Europe, GE has invested more than \$10 billion from 1989 through 1996, half of it for building new plants and half for almost 50 acquisitions despite the fact that Europe is a fairly mature market.¹⁷

Different types of countries require different expansion paths although deviations cannot be ruled out (see **Exhibit 9-4**).

We now give an overview of the key internal criteria.

Company Objectives. Corporate objectives are a key influence in choosing entry modes. Firms that have limited aspirations will typically prefer entry options that entail a minimum amount of commitment (e.g., licensing). Proactive companies with ambitious strategic objectives, on the other hand, will usually pick entry modes that give

¹⁷"If Europe's dead, why is GE investing billions there?" *Fortune*, September 9, 1996.

them the flexibility and control they need to achieve their goals. InBev, a Belgo-Brazilian beverage company, needed a strong foothold in the U.S. market to become the leading beer brewer worldwide. In June 2008, InBev made an offer for Anheuser-Busch, which accepted the offer a month later after InBev raised the offer price.¹⁸ By merging the two firms, InBev's CEO Carlos Brito hopes to create a "stronger, more competitive global company with an unrivaled worldwide brand portfolio and distribution network."¹⁹

Need for Control. Most MNCs would like to possess a certain amount of control over their foreign operations. Control may be desirable for any element of the marketing mix plan: positioning, pricing, advertising, the way the product is distributed, and so forth. Caterpillar, for instance, prefers to stay in complete control of its overseas operations to protect its proprietary know-how. For that reason, Caterpillar avoids joint ventures.²⁰ To a large degree, the level of control is strongly correlated with the amount of resource commitment: the smaller the commitment, the lower the control. Most firms face a trade-off between the degree of control over their foreign operations and the level of resource commitment they are willing to make.

Internal Resources, Assets and Capabilities. Companies with tight resources (human and/or financial) or limited assets are constrained to low-commitment entry modes such as exporting and licensing that are not too demanding on their resources. Even large companies should carefully consider how to allocate their resources between their different markets, including the home-market. In some cases, major resource commitments to a given target market might be premature given the amount of risk. On the other hand, if a firm is overly reluctant to commit resources, it could miss the boat by sacrificing major market opportunities. Internal competencies also influence the choice-of-entry strategy. When the firm lacks certain skills that are critical for the success of its global expansion strategy, it can try to fill the gap by forming a strategic alliance.

Flexibility. An entry mode that looks very appealing today is not necessarily attractive 5 or 10 years down the road. The host country environment changes constantly. New market segments emerge. Local customers become more demanding or more price conscious. Their preferences may change over time. Local competitors become more sophisticated. To cope with these environmental changes, global players need a certain amount of flexibility. The flexibility offered by the different entry mode alternatives varies a great deal. Given their very nature, contractual arrangements like joint ventures or licensing tend to provide very little flexibility. When major exit barriers exist, wholly owned subsidiaries are hard to divest and, therefore offer very little flexibility compared to other entry alternatives.

Although some of the factors listed above favor high-control entry modes, other criteria suggest a low-control mode. The different entry modes can be classified according to the degree of control they offer to the entrant from low-control (e.g., indirect exporting, licensing) to high-control modes (e.g., wholly owned subsidiary). To some extent, the appropriate entry-mode decision boils down to the issue of how much control is desirable. Ideally, the entrant would like to have as much control as possible. However, entry modes that offer a large degree of control also impose substantial resource commitments and huge amounts of risk. Therefore, the entrant faces a tradeoff between the benefits of increased control and the costs of resource commitment and risk.

**Mode-of-Entry
Choice—Two
Opposing
Paradigms: A
Transaction-Costs
versus Resource-
Based View**

¹⁸After the merger the company was renamed Anheuser-Busch Inbev.

¹⁹"InBev Bags Anheuser-Busch," *Forbes*, <http://www.forbes.com/>, accessed August 22, 2008.

²⁰"Engine Makers Take Different Routes," *Financial Times* (July 14, 1998), p. 11.

Transaction-Cost Economics (TCE). One useful framework to resolve this conundrum is the so-called **transaction-cost economics (TCE)** perspective. A given task can be looked at as a “make-or-buy” decision: either the firm sources the task out to third party agents or partners (low-control modes such as exporting) or it does the job internally (high control modes such as foreign direct investment). TCE argues that the desirable governance structure (high- versus low-control mode) depends on the comparative transaction costs, that is, the cost of running the operation.

In the context of entry mode choice, the TCE perspective treats each entry as a “transaction.”²¹ The TCE approach begins with the premise that markets are competitive. Therefore, market pressure minimizes the need for control. Under this utopian scenario, low-control modes such as exporting are preferable because the competitive pressures force the outside partner to comply with its contractual duties. When the market mechanism fails, high-control entry modes become more desirable. From the TCE angle, market failure typically happens when **transaction-specific assets** become valuable. These are assets that are valuable for only a very narrow range of applications. Examples include brand equity, proprietary technology, and know-how. When these types of assets become very important, the firm might be better off to adopt a high-control entry mode in order to safeguard these assets against opportunistic behaviors of its managers and uncertainty.²²

Resource-Based View (RBV). The **resource-based view (RBV)** is based on the premise that possessing resources is not sufficient to create a competitive advantage: a firm also needs to be organized to take full advantage of its resources. RBV suggests that an entry should be considered in the context of the overall strategic posture of the firm.²³ According to this paradigm, firms with imperfectly imitable resource-based competitive advantages prefer to expand through wholly owned subsidiaries for two reasons. First, through wholly owned entry modes, the firm is better able to protect the value of its resource-based advantages against value erosion (e.g., patent theft). Second, by having a wholly owned subsidiary, the firm can capture and transfer knowledge between the parent and the foreign unit more efficiently.²⁴ There are three differences between the TCE and RBV perspectives.²⁵ First, the two theories differ in how they predict different entry modes. Whereas TCE predicts high-control entry modes because of opportunistic behavior of the firm’s partner (e.g., licensee), the RBV attributes market failures to other mechanisms: when the multinational has superior capabilities in deploying its know-how and the prospective partner (e.g., licensee) faces challenges in efficiently acquiring and integrating that knowledge the MNC will prefer high-control entities.²⁶ Second, while TCE focuses on entries as a one-time event, RBV looks at a sequence of entries as a dynamic process where the MNC is able to learn from and build on its previous entry experience. The third difference relates to the firm-specific advantages: whereas TCE focuses on their exploitation the RBV stresses both their exploitation and development. The RBV states that market entries are not only “pushed” by the resources held by the MNC, but that the target entry could also help the MNC in developing new advantages.

²¹Erin Anderson and Hubert Gatignon, “Modes of Foreign Entry: A Transaction Cost Analysis and Propositions,” *Journal of International Business Studies*, 11 (Fall 1986), pp. 1–25.

²²For a good overview of entry mode choice studies that incorporate the TCA paradigm, see Hongxin Zhao, Yadong Luo, and Taewon Suh, “Transaction Cost Determinants and Ownership-Based Entry Mode Choice: A Meta-Analytical Review,” *Journal of International Business Studies* 35 (2004): 524–44.

²³C. Hill, P. Hwang, and W.C. Kim, “An Eclectic Theory of the Choice of International Entry,” *Strategic Management Journal*, 9 (1990), pp. 93–104.

²⁴Keith D. Brouthers, Lance Eliot Brouthers, and Steve Werner, “Resource-based Advantages in an International Context,” *Journal of Management*, 34 (April 2008), pp. 189–217.

²⁵Mike W. Peng, “The Resource-based View and International Business,” *Journal of Management*, 27, (6) 2001, pp. 803–29.

²⁶A. Madhok, “Cost, Value and Foreign Market Entry Mode: The Transaction and the Firm,” *Strategic Management Journal*, 18, (1) 1997, pp. 39–61.

An empirical study of entry decisions made by the 180 largest MNCs over a fifteen-year period found that MNCs are most likely to enter with wholly owned subsidiaries when one of the following conditions holds:²⁷

- The entry involves an R&D-intensive line of business
- The entry involves an advertising-intensive line of business (high brand-equity)
- The MNC has accumulated a substantial amount of experience with foreign entries

On the other hand, MNCs are most likely to prefer a partnership when one of these holds:

- The entry is in a highly risky country
- The entry is in a socioculturally distant country
- There are legal restrictions on foreign ownership of assets.

EXPORTING



Most companies start their international expansion by exporting. For many small businesses, exporting is very often the sole alternative for selling their goods in foreign markets. A fair number of Fortune 500 companies, such as Boeing and Caterpillar also generate a major part of their global revenues via export sales.

Chapter 17 discusses in detail export and import management matters. In this chapter we will give you a snapshot overview of exporting as an entry mode. Companies that plan to engage in exporting have a choice between three broad options: indirect, cooperative, and direct exporting. **Indirect exporting** means that the firm uses a middleman based in its home market to handle the exporting. With **cooperative exporting**, the firm enters into an agreement with another company (local or foreign) where the partner will use its distribution network to sell the exporter's goods. **Direct exporting** means that the company sets up its own export organization and relies on a middleman based in a foreign market (e.g., a foreign distributor).

Indirect Exporting. Indirect exporting happens when the firm decides to sell its products in the foreign market through independent intermediaries. An **export merchant** is a trading company that will buy the firm's goods outright and then resell them in the foreign markets. The exporter merchant usually specializes in a particular line of products and/or in a certain geographical region. An **export agent** is a trading company that acts for local manufacturers, usually representing a number of non-competing manufacturers. They seek and negotiate foreign purchases. In return for obtaining an export order, the export agent receives a commission. Unlike the export merchant, the agent does not become the owner of the goods and therefore does not assume the risk of not being able to sell profitably overseas. The use of an **export management company (EMC)** is very popular among small businesses. An EMC is an independent firm that acts as the exclusive export sales department for non-competing manufacturers. EMCs come in all shapes and sizes. Some act as an agent, soliciting orders in foreign markets in the name of the manufacturer. Other EMCs act as a distributor on a "buy-sell" basis: the EMC buys from the firm at a set price and resells to the foreign customers at prices set by the EMC. Indirect exporting offers several advantages to the exporting company compared to other entry modes. The firm gets instant foreign market expertise. The indirect exporters are professionals. They can handle all the details involved in processing exporting orders. They also can appraise market opportunities for the manufacturer. Other strengths are their know-how in selecting agents and/or distributors and management of the distribution network. Often very little risk is involved.

²⁷Hubert Gatignol and Erin Anderson, "The multinational corporation's degree of control over foreign subsidiaries: an empirical test of a transaction cost explanation," *Journal of Law, Economics, and Organization*, vol. 4, no. 2, Fall 1988, pp. 305–36.

Generally speaking, no major resource commitments are required. When the middlemen's profits are based on how successfully they export, they are motivated to do a good job.

Indirect exporting has some downsides. The company has little or no control over the way its product is marketed in the foreign country. Lack of adequate sales support, wrong pricing decisions, or poor distribution channels will inevitably lead to poor sales. Ill-fated marketing mix decisions made by the intermediary could also damage the company's corporate or brand image. The middleman may have very limited experience with handling the company's product line. Also, as they are often relatively small, they may have limited resources to handle tasks such as warehousing or providing credit financing to foreign customers. Often intermediaries will focus their efforts on those products that maximize their profits. As a result, they might not support new product lines or products with low short-term profit potential.

Given the low commitment required, indirect exporting is often seen as a good beach-head strategy for "testing" the international waters: Once the demand for the product takes off, the manufacturer can switch to another, more proactive, entry mode. The decision to develop an export business via an independent middleman centers around three basic questions:²⁸

1. Does the firm have the time and know-how to enter export markets?
2. Does the firm have money and/or specialized personnel needed to develop an export business?
3. Is the foreign business growing at a satisfactory rate?

If the answer to any of these questions is negative then manufacturers should seriously consider relying on specialized export firms.

Cooperative Exporting. Companies that are unwilling to commit the resources to set up their own distribution organization but still want to have some control over their foreign operations should consider cooperative exporting. One of the most popular forms of cooperative exporting is **piggyback exporting**. With piggybacking, the company uses the overseas distribution network of another company (local or foreign) for selling its goods in the foreign market. Wrigley, the U.S. chewing gum company,²⁹ entered India by piggybacking on Parrys, a local confectionery firm. Through this tie-up, Wrigley could plug into Parrys' distribution network, thereby providing Wrigley immediate access to 250,000 retail outlets. The two major attractions that Parrys' network offered to Wrigley was the overlap in product category and the size of the distribution network.

The quality of the distribution network can also play a role. Gillette tied up with Bangalore based TTK, an Indian manufacturer of pressure cookers and kitchenware for the distribution of Braun products, despite the fact that Gillette has its own distribution network in India. Gillette needed department store-type outlets for its Braun product range, precisely the type of distribution channels that TTK uses for the distribution of its merchandise.³⁰

Direct Exporting. Under direct exporting, the firm sets up its own exporting department and sells its products via a middleman located in the foreign market. Once the international sales potential becomes substantial, direct exporting often looks far more appealing than indirect exporting. To some degree, the choice between indirect and direct exporting is a "make-or-buy" decision: should the company perform the export task, or is it better off sourcing the task out to outsiders? Compared to the indirect approach, direct exporting has a number of pluses. The exporter has far more

²⁸<http://www.powerhomebiz.com/vol7/export.htm>.

²⁹In 2008 Mars acquired Wrigley via a stock offer of around \$23 billion.

³⁰"India—Distribution Overview," IMI960321, U.S. Department of Commerce, International Trade Administration.

control over its international operations. Hence, the sales potential (and profit) is often times much more significant than under indirect exporting. It also allows the company to build up its own network in the foreign market and get better market feedback.

There is a price to be paid, though. Given that the responsibility for the exporting tasks is now in the hands of the company, the demands on resources—human and financial—are much more intense than with indirect exporting. Besides the marketing mix tasks, these tasks involve choosing target markets, identifying and selecting representatives in the foreign market, and scores of logistical functions (e.g., documentation, insurance, shipping, packaging).

LICENSING



Companies can also penetrate foreign markets via a licensing strategy. **Licensing** is a contractual transaction where the firm—the **licensor**—offers some proprietary assets to a foreign company—the **licensee**—in exchange for royalty fees. Examples of assets that can be part of a licensing agreement include trademarks, technology know-how, production processes, and patents. Royalty rates range from one-eighth of 1 percent to 15 percent of sales revenue.³¹ For instance, Oriental Land Company owns and operates Tokyo Disneyland under license from Disney. In return for being able to use the Disney name, Oriental Land Company pays royalties to Disney. In high-tech industries, companies often enter **cross-licensing** agreements. Under such agreement, parties mutually share patents without exchange of licensing fees when the patents involved are nearly equal in value. One big practitioner of cross-licensing is Microsoft. In August 2008, for instance, Microsoft and Nikon inked a patent cross-licensing agreement that covers digital cameras and other consumer products. The agreement enables both parties to innovate with each other's technologies.³² Kodak and Nokia entered into a similar cross-patent agreement in October 2008 through which each company would get access to the other's intellectual property portfolio.³³

For many companies, licensing has proven to be a very profitable means for penetrating foreign markets. In most cases, licensing is not very demanding on the company's resources. Therefore, it is especially appealing to small companies that lack the resources and the wherewithal to invest in foreign facilities. Compared to exporting, another low-commitment entry mode, licensing allows the licensor to navigate around import barriers or get access to markets that are completely closed to imports. For instance, several foreign tobacco companies in China used licensing agreements to avoid the high import tax levied on imported cigarettes.³⁴ Local governments may also favor licensing over other entry modes.

Benefits

Companies that use licensing as part of their global expansion strategy lower their exposure to political or economic instabilities in their foreign markets. The only volatilities that the licensor faces are the ups and downs in the royalty income stream. Other risks are absorbed by the licensee.

In high-tech industries, technology licensing has two more appeals. In highly competitive environments, rapid penetration of global markets allows the licensor to define the leading technology standard and to rapidly amortize R & D expenditures.³⁵ Research in Motion (RIM), the Canadian maker of the BlackBerry device, has entered numerous software-licensing agreements with competitors such as Nokia and

³¹“Licensing may be quickest route to foreign markets,” *Wall Street Journal*, September 14, 1990, Sec. B, p. 2.

³²<http://www.microsoft.com/Presspass/press/2008/aug08/08-27MSNikonPatentPR.msp>.

³³http://www.kodak.com/eknec/PageQuerier.jhtml?pq-path=2709&pq-locale=en_US&gpcid=0900688a809cc514.

³⁴“Smoke signals point to China market opening,” *South China Sunday Post*, October 6, 1996, p. 5.

³⁵M. Kotabe, A. Sahay, and P.S. Aulakh, “Emerging role of technology licensing in the development of a global product strategy: conceptual framework and research propositions,” *Journal of Marketing*, vol. 60, no. 1, January 1996, pp. 73–88.

Palm to establish its software architecture as the platform of choice for wireless communication tools.

Caveats Licensing comes with some caveats, though. Revenues coming from a licensing agreement could be dwarfed by the potential income that other entry modes such as exporting could have generated. Another possible disadvantage is that the licensee may not be fully committed to the licensor's product or technology. Lack of enthusiasm on the part of the licensee will greatly limit the sales potential of the licensed product. When the licensing agreement involves a trademark, there is the further risk that misguided moves made by the licensee tarnish the trademark covered by the agreement. Other risks include the risk of not getting paid, failure to produce in a timely manner or the desired volume, and loss of control of the marketing of the product.³⁶

The biggest danger is the risk of opportunism. A licensing arrangement could nurture a future competitor: Today's comrade-in-arms often becomes tomorrow's rival. The licensee can leverage the skills it acquires during the licensing period once the agreement expires. **Global Perspective 9-1** chronicles the mishaps that Borden went through when its relationship with Meiji Milk, its licensee in Japan, turned sour.

Companies can make several moves to protect themselves against the risks of licensing arrangements.³⁷ If possible, the company should seek patent or trademark protection abroad. A thorough profitability analysis of a licensing proposal is an absolute must. Such an analysis must identify all the costs that the venture ensues, including the opportunity costs that stem from revenues that need to be sacrificed. Careful selection of prospective licensees is extremely important. Once a partner has been chosen, the negotiation process starts, which, if successful, will lead to a licensing

GLOBAL PERSPECTIVE 9-1



THE BORDEN-MEIJI MILK SAGA: THE MELTDOWN OF LADY BORDEN

When Borden, the U.S. multinational food company, entered Japan in 1971, it decided to tie up through a licensing arrangement with Meiji Milk. Borden's licensing agreement with Meiji Milk, Japan's leading dairy company, was the envy of many companies. Borden could benefit from Meiji Milk's vast distribution network. Meiji Milk, in turn, was able to acquire the expertise to manufacture various kinds of dairy products. The partnership also developed the premium ice cream market in Japan with its Lady Borden brand.

But the venture was not a fairy tale. Other brands entered the market and Lady Borden's market share started to flounder. As a result Borden wanted to dissolve its partnership with Meiji Milk, marketing Lady Borden on its own. Borden

wanted to have more control over the marketing of its products in Japan so that it could respond more rapidly to the competitive challenges. Meiji Milk retaliated by rolling out two ice cream brands of its own, one of which, Lady Breuges, was in direct competition with Lady Borden. When Borden cut its ties with Meiji Milk, it also lost access to Meiji Milk's distribution channels. The company hoped that brand clout would pull Japanese customers to the Lady Borden brand. The pull of the Borden brand name did not make up for the loss of Meiji Milk's distribution muscle.

In June 1994, Borden, in a desperate move, licensed its trademarks and formulations for the Lady Borden brand to the confectionery maker Lotte Co. When Borden broke up with Meiji Milk in 1991, its share of Japan's premium ice cream market was around 50 percent. Three years later, when a Japanese newspaper compiled a score chart of the ice cream market, Meiji had 12 percent while Borden's share was so negligible that it didn't make the list.

Sources: "Borden's breakup with Meiji Milk shows how a Japanese partnership can curdle," *The Wall Street Journal*, February 21, 1991, pp. B1, B4; and, "Borden's hopes melt in Japanese market," *Advertising Age*, July 18, 1994, p. 38.

³⁶Sandra Mottner and James P. Johnson, "Motivations and Risks in International Licensing: A Review and Implications for Licensing to Transitional and Emerging Economies," *Journal of World Business*, 35 (2) (2000), pp. 171-87.

³⁷Franklin R. Root, *Entry Strategies for International Markets*, Chapter 5.

contract. The contract will cover parameters such as the technology package, use conditions (including territorial rights and performance requirements), compensation, and provisions for the settlement of disputes.

FRANCHISING

Scores of service industry companies use franchising as a means for capturing opportunities in the global marketplace. For instance, of the 35,000-plus Yum! Brands restaurants,³⁸ more than two-thirds (24,297) are franchised.³⁹ The internationalization efforts of ten well-known franchise companies are summarized in **Exhibit 9-5**. Franchising is to some degree a “cousin” of licensing: It is an arrangement whereby the **franchisor** gives the **franchisee** the right to use the franchisor’s trade names, trademarks,

EXHIBIT 9-5

INTERNATIONALIZATION EFFORTS OF TEN WELL-KNOWN FRANCHISE COMPANIES

| <i>Company</i> | <i>Industry</i> | <i>Year Established</i> | <i>Year of First Franchise</i> | <i>Year First International Franchise</i> | <i>No. of Operating Units</i> | <i>No. of Countries</i> |
|---------------------------|--------------------------|-------------------------|--------------------------------|---|---|-------------------------|
| General Nutrition Centers | Vitamins retailing | 1935 | 1988 | 1991 | USA: 2954 CAN: 18 RoW: 227 ¹ | 27 |
| Mrs. Fields | Cookies | 1977 | 1990 | 1992 | USA: 849 CAN: 11 RoW: 60 | 12 |
| Uniglobe Travel | Travel Agencies | 1980 | 1981 | 1991 | USA: 856 CAN: 192 RoW: 87 | 15 |
| Subway | Sandwiches | 1965 | 1974 | 1984 | USA: 11452 CAN: 1259 RoW: 693 | 70+ |
| Computertots | Computer education | 1983 | 1989 | 1994 | USA: 132 CAN: 0 RoW: 92 | 12 |
| Midas | Automotive Services | 1956 | 1956 | 1968 | USA: 1898 CAN: 246 RoW: 561 | NA |
| Mailboxes Etc. | Business Support | 1980 | 1981 | 1988 | USA: 2971 CAN: 209 RoW: 377 | 70+ |
| Sir Speedy | Print & Copying Services | 1968 | 1968 | 1984 | USA: 1372 CAN: 9 RoW: 49 | 23 |
| Ponderosa | Steakhouse | 1965 | 1966 | 1985 | USA: 506 CAN: 8 RoW: 40 | NA |
| World Gym Fitness | Fitness | 1977 | 1985 | 1985 | USA: 276 CAN: 3 RoW: 9 | NA |

Source: www.franchiseintl.com.

¹RoW = Rest of the World.

³⁸Yum Brands! restaurant brands in the global arena are primarily Pizza Hut and KFC. The three remaining brands—Taco Bell, Long John Silver’s, and A&W—are primarily U.S.-based and have a very marginal presence globally. In 2008 Yum! announced plans to also turn Taco Bell into a global brand.

³⁹http://www.yum.com/investors/media/units_ww.pdf.

business models, and/or know-how in a given territory for a specific time period, normally 10 years.⁴⁰ In exchange, the franchisor gets royalty payments and other fees. The package could include the marketing plan, operating manuals, standards, training, and quality monitoring.

To snap up opportunities in foreign markets, the method of choice is often **master franchising**. With this system, the franchisor gives a master franchise to a local entrepreneur, who will, in turn, sell local franchises within his territory. The territory could be a certain region within a country or a group of countries (e.g., Greater China). Usually, the master franchise holder agrees to establish a certain number of outlets over a given time horizon.

Benefits The benefits of franchising are clear. First and foremost, companies can capitalize on a winning business formula by expanding overseas with a minimum of investment. Just as with licensing, political risks for the rights-owner are very limited. Further, since the franchisees' profits are directly tied to their efforts, franchisees are usually highly motivated. Finally, the franchisor can also capitalize on the local franchisees' knowledge of the local marketplace. They usually have a much better understanding of local customs and laws than the foreign firm.

Caveats Franchising carries some risks, though. Just like in the case of licensing, the franchisor's income stream is only a fraction of what it would be if the company held an equity stake in the foreign ventures. Firms with little or no name recognition typically face a major challenge finding interested partners in the foreign market. Finding suitable franchisees or a master franchisee can be a stumbling block in many markets. In many countries, the concept of franchising as a business model is barely understood.⁴¹ A major concern is the lack of control over the franchisees' operations. Dissatisfied with the performance of its franchisees in Mexico and Brazil, Blockbuster Video changed tracks in 1995. The entertainment company decided to set up joint ventures and equity relations in Mexico and Brazil to replace the franchising arrangements held there, thereby getting more control and oversight.⁴² Given the largely intangible nature of many franchising systems, cultural hurdles can also create problems. In fact, a recent study showed that cultural and physical proximity are the two most popular criteria used by companies for picking international markets in franchising.⁴³ **Exhibit 9-6** offers an overview of the key specifications of an international franchise agreement with Papa John's, the third largest pizza company in the world.

EXHIBIT 9-6

INTERNATIONAL FRANCHISING WITH PAPA JOHN'S (PJ)

Franchise Support

- *Training.* PJ provides training and development solutions and assistance with the development of trainers and training solutions.
- *Restaurant openings.* PJ offers assistance with determining the ideal site, review of market trade areas and site criteria, the build-out of the restaurant, and ordering of equipment.
- *Operations.* The company assists the franchisee with creating strategies and tactics to improve the operations, market penetration, and human resources development.
- *Food and supply chain.* PJ develops partnerships with suppliers in each country to ensure that international franchisees receive the highest-quality ingredients and supplies at the best possible prices.

(continued)

⁴⁰ Albert Kong, "How to Evaluate a Franchise," *Economic Bulletin*, (October 1998), pp. 18–20.

⁴¹ Colin McCosker, "Trends and Opportunities in Franchising," *Economic Bulletin*, (October 1998), pp. 14–17.

⁴² "Blockbuster's fast-forward," *Advertising Age International*, September 18, 1995, p. 1-32.

⁴³ John F. Preble and Richard C. Hoffman, "Franchising systems around the globe: A status report," *Journal of Small Business Management*, April 1995, pp. 80–88.

- *Marketing.* PJ offers assistance in menu creation, long-term strategic planning, grand openings, and other marketing programs.
- *Information services.* The firm's information services department offers knowledge and tools to international franchisees to manage their operations.
- *Quality management.* PJ has three teams that support Research & Development, Quality Assurance, and Quality Control worldwide.

Length of Contract

- The initial term is ten years, with an option to renew for an additional 10-year term if certain criteria are met.

Franchise Fee

- US\$25,000

Ongoing Fees

- Royalty fee of 5 percent of net sales is due monthly.

Source: http://company.papajohns.com/franchise_opps/franchise_int.shtm.

CONTRACT MANUFACTURING (OUTSOURCING)



With **contract manufacturing** (also known as **outsourcing**), the company arranges with a local firm to manufacture or assemble parts of the product or even the entire product. The marketing of the products is still the responsibility of the international firm.

Countless companies have become very successful by specializing in contract manufacturing. Flextronics, headquartered in Singapore, is one of the leading contract manufacturers with FY08 revenues of more than \$33.6 billion.⁴⁴ The company helps its customers to design, build, ship, and service electronics products through its network of facilities in over thirty countries.⁴⁵ Its client list includes mostly electronics firms such as Sony Ericsson, Microsoft, Hewlett-Packard, and Nortel.⁴⁶ However, in 2006 the Danish toymaker Lego also decided to outsource most of its production to Flextronics as part of restructuring its supply chain.⁴⁷

Cost savings is the prime motivation behind contract manufacturing. Significant cost savings can be achieved for labor-intensive production processes by sourcing the product in a low-wage country. Typically, the countries of choice are places that have a substantial comparative labor cost advantage. Labor cost savings are not the only factor. Savings can also be achieved via taxation benefits, lower energy costs, raw materials costs, or overhead.

Some of the benefits listed for the previous entry modes also apply here. Subcontracting leads to a small amount of exposure to political and economic risks for the international firm. It also allows the company to focus on its core competencies (e.g., design, marketing prowess) and leave the manufacturing side to others. Other benefits include flexibility, access to external expertise, and less demand on the firm's resources (capital, staff).

Contract manufacturing does have drawbacks, however. Clearly, the "nurture-a-future-competitor" concern raised for licensing and franchising also applies here. Consider what happened to Schwinn, the U.S. bicycle company.⁴⁸ Schwinn used to source about

Benefits

Caveats

⁴⁴ www.flextronics.com.

⁴⁵ Contract manufacturing in the electronics industry is often referred to as Electronics Manufacturing Services (EMS).

⁴⁶ <http://www.ventureoutsource.com/contract-manufacturing/industry-pulse/2008/dissecting-the-new-flextronics>, accessed on September 1, 2008.

⁴⁷ "Billionaire's Lego Farms Out to Flextronics," *Forbes*, <http://www.forbes.com>, accessed January 29, 2009.

⁴⁸ "Giant Grows, Peddling Its Own Brand," *Asian Wall Street Journal* (January 2, 2003), p. A5.

80 percent of its bikes from Giant Manufacturing, a Taiwanese company. When Schwinn switched suppliers, Giant, which had until then been a pure contract manufacturer, decided to create high-end bicycles under its own brand name. Giant is now the largest bike maker in the world, selling its bikes in around fifty countries. It has become the second-biggest brand of high-end bicycles in the United States. Schwinn, meanwhile, filed for bankruptcy and was sold to Pacific Cycle at a bankruptcy auction in 2001.⁴⁹ Because of such risk, many companies prefer to make high-value items or products that involve proprietary design features in-house. Contract manufacturers themselves often make products under their own brand, which usually leads to a conflict of interest with their customers. Acer, a Taiwanese computer maker, wrestled with such issues.⁵⁰ In 2000, business from products made for other global computer firms generated \$1.8 billion revenue compared with about \$1.2 billion revenue from its own-brand products. The key concern for many of Acer's clients was that by giving Acer business, they were subsidizing Acer's own-brand products, which were often similar but much less expensive. Acer's solution for this predicament was to split up the company. Giant, the Taiwanese bicycle maker mentioned earlier, addressed its customers' concerns by reassuring their clients that the firm would never launch cheap knockoffs of their products.

Contract manufacturing also offers less flexibility to respond to sudden market demand changes. Sony Ericsson Mobile Communications, which heavily relies on contracting for the manufacturing of its cellular phones, lost potential sales when its first color-screen model quickly sold out in Europe. Nokia, on the other hand, makes most of its products in-house. When it faced a last-minute glitch for the rollout of its first color-screen model, it plugged the gap by increasing the output of an existing model by 50 percent, using its plants in Finland, Germany, and China.⁵¹

A fixation with low-labor costs can often have painful consequences. Low-labor cost countries typically have very low labor productivity. Some of these countries, such as India and South Korea, also have a long tradition of bad labor relations. Too much reliance on low-cost labor could also create a backlash in the company's home-market among its employees and customers. Monitoring of quality and production levels is a must, especially during the start-up phase when "teething problems" are not uncommon.

When screening foreign subcontractors, the ideal candidate should meet the following criteria:⁵²

- Be flexible and geared toward just-in-time delivery.
- Be able to meet quality standards and implement total quality management (TQM).
- Have solid financial footing.
- Be able to integrate with the company's business.
- Have contingency plans to handle sudden changes in demand.

◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ EXPANDING THROUGH JOINT VENTURES

For many MNCs who want to expand their global operations, joint ventures prove to be the most viable way to enter foreign markets, especially emerging markets. With a joint venture, the foreign company agrees to share equity and other resources with other partners to establish a new entity in the host country. The partners typically are local companies, but they can also be local government authorities, other foreign companies, or a mixture of local and foreign players. Depending on the equity stake, three forms of

⁴⁹Pacific Cycle was in turn acquired by Dorel Industries in 2004.

⁵⁰"Reinventing Acer," *Far Eastern Economic Review* (May 24, 2001), pp. 38–43.

⁵¹"Nokia Defies Odds and Thrives," *Asian Wall Street Journal* (January 6, 2003), pp. A1, A9.

⁵²E. P. Hibbert, "Global make-or-buy decisions," *Industrial Marketing Management*, vol. 22, 1993, pp. 67–77.

partnerships can be distinguished: majority (more than 50 percent ownership), fifty-fifty and minority (50 percent or less ownership) ventures. Huge infrastructure or high-tech projects that demand a large amount of expertise and money often involve multiple foreign and local partners. Another distinction is between cooperative and equity joint ventures. A **cooperative joint venture** is an agreement for the partners to collaborate but does not involve any equity investments. For instance, one partner might contribute manufacturing technology whereas the other partner provides access to distribution channels. Cooperative joint ventures are quite common for partnerships between well-heeled multinational companies and local players in emerging markets. A good example of the collaborative approach is Cisco's sales strategy in Asia. Instead of investing in its own sales force, Cisco builds up partnerships with hardware vendors (e.g., IBM), consulting firms (e.g., KPMG), or systems integrators (e.g., Singapore-based Datacraft). These partners in essence act as front people for Cisco. They are the ones that sell and install Cisco's routers and switches.⁵³ An **equity joint venture** goes one step further. It is an arrangement in which the partners agree to raise capital in proportion to the equity stakes agreed upon.

A major advantage of joint ventures compared to lesser forms of resource commitment such as licensing is the return potential. With licensing, for instance, the company solely gets royalty payments instead of a share of the profits. Joint ventures also entail much more control over the operations than most of the previous entry modes discussed so far. MNCs that like to maximize their degree of control prefer full ownership. However, in many instances, local governments discourage or even forbid wholly owned ventures in certain industries. Under such circumstances, partnerships (joint ventures) are a second-best or temporary solution.

Apart from the benefits listed above, the **synergy** argument is another compelling reason for setting up a joint venture. Partnerships not only mean a sharing of capital and risk. Other possible contributions brought in by the local partner include: land, raw materials, expertise on the local environment (culture, legal, political), access to a distribution network, personal contacts with suppliers, relations with government officials. Combined with the foreign partner's skills and resources, these inputs offer the key to a successful market entry. The Sony Ericsson partnership offers an excellent example. The tie-up combined Ericsson's technology prowess and strong links to wireless operators with Sony's marketing skills and expertise in consumer electronics. Each partner stood to gain from helping the other grow in regions where it was weak: Japan for Ericsson and Europe for Sony.⁵⁴

For many MNCs, lack of full control is the biggest shortcoming of joint ventures. There are a number of ways for the MNC to gain more leverage. The most obvious way is via a majority equity stake. However, government restrictions often rule this option out. Even when for some reason majority ownership is not a viable alternative, MNCs have other means at their disposal to exercise control over the joint venture. MNCs could deploy expatriates in key line positions, thereby controlling financial, marketing and other critical operations of the venture. MNCs could also offer various types of outside support services to back up their weaker joint ventures in areas such as marketing, personnel training, quality control, and customer service.⁵⁵

As with licensing agreements, the foreign firm runs the risk that the partner could become a future competitor. Scores of China's most successful domestic companies started off as partners of multinationals. A case in point is Eastcom, a state-owned Chinese manufacturer and distributor of telecom equipment. After a 10-year-old

Benefits

Caveats

⁵³"Cisco's Asian Gambit," *Fortune* (January 10, 2000), pp. 52–54.

⁵⁴"Sony Ericsson: 'In Big Bloody Trouble,'" *Business Week (Asian Edition)*, (November 4, 2002), pp. 54–55.

⁵⁵Johannes Meier, Javier Perez and Jonathan R. Woetzel (1995), "Solving the puzzle—MNCs in China," *The McKinsey Quarterly*, No. 2, pp. 20–33.

EXHIBIT 9-7
CONFLICTING OBJECTIVE IN CHINESE JOINT VENTURES

| | <i>Foreign Partner</i> | <i>Chinese Partner</i> |
|--------------|--|---|
| Planning | Retain business flexibility | Maintain congruency between the venture and the state economic plan |
| Contracts | Unambiguous, detailed, and enforceable | Ambiguous, brief, and adaptable |
| Negotiations | Sequential, issue by issue | Holistic and heuristic |
| Staffing | Maximize productivity; fewest people per given output level | Employ maximum number of local people |
| Technology | Match technical sophistication to the organization and its environment | Gain access to the most advanced technology as quickly as possible |
| Profits | Maximize in long term; repatriate over time | Reinvest for future modernization; maintain foreign exchange reserves |
| Inputs | Minimize unpredictability and poor quality of supplies | Promote domestic sourcing |
| Process | Stress high quality | Stress high quantity |
| Outputs | Access and develop domestic market | Export to generate foreign currency |
| Control | Reduce political and economic controls on decision making | Accept technology and capital but preclude foreign authority infringement on sovereignty and ideology |

Source: Reprinted from M. G. Martinsons and C.-S. Tsong, "Successful Joint Ventures in the Heart of the Dragon," *Long Range Planning*, 28 (5), p. 5. Copyright 1995, with kind permission from Elsevier Science Ltd., The Boulevard, Langford Lane, Kidlington OX5 1GB UK.

collaboration with Motorola, the company launched its own digital cell phone, undercutting Motorola's StarTAC model by \$120.⁵⁶

Lack of trust and mutual conflicts turn numerous international joint ventures into a marriage from hell. Conflicts could arise over matters such as strategies, resource allocation, transfer pricing, ownerships of critical assets like technologies and brand names. In many cases, the seeds for trouble exist from the very beginning of the joint venture. **Exhibit 9-7** contrasts the mutually conflicting objectives that the foreign partner and the local Chinese partner may hold when setting up a joint venture in China. Cultural strains between partners often spur mistrust and mutual conflict, making a bad situation even worse. Autolatina, a joint venture set up by Ford Motor Co. and Volkswagen AG in Latin America, was dissolved after 7 years in spite of the fact that it remained profitable to the very end. Cultural differences between the German and American managers were a major factor. One participating executive noted that "there were good intentions behind Autolatina's formation but they never really overcame the VW-Ford culture shock."⁵⁷

When trouble undermines the joint venture, the partners can try to resolve the conflict via mechanisms built in the agreement. If a mutually acceptable resolution is not achievable, the joint venture is scaled back or dissolved. For instance, a joint venture between Unilever and AKI in South Korea broke up after seven years following disagreements over brand strategies for new products, resource allocation, advertising support, and brand ownership.⁵⁸ **Global Perspective 9-2** chronicles a partnership between Danone, the French beverage maker, and the Chinese Wahaha Group that involved a very bitter dispute.

Drivers Behind Successful International Joint Ventures

There are no magic ingredients to foster the stability of joint ventures. Still, some important lessons can be drawn from academic research of international joint ventures.

Pick the Right Partner. Most joint venture marriages prosper by choosing a suitable partner. That means that the MNC should invest the time in identifying

⁵⁶"The Local Cell-Phone Boys Get Tough," *Business Week (Asian Edition)*, (September 20, 1999), p. 24.

⁵⁷"Why Ford, VW's Latin marriage succumbed to 7-year itch," *Advertising Age International*, March 20, 1995, p. I-22.

⁵⁸"How Unilever's South Korean partnership fell apart," *Advertising Age*, August 31, 1992, pp. 3, 39.



GLOBAL PERSPECTIVE 9-2

THE WAHAHA/DANONE JOINT VENTURE BRAWL

The Wahaha Joint Venture Company is a China based joint venture that was established between the Hangzhou Wahaha Group and Danone, the French food and beverage conglomerate. Since forming their joint venture in 1996, the partners have set up 39 companies in which Danone owns 51 percent each. The partnership was hailed as a “showcase” joint venture by *Forbes* magazine. Wahaha’s bottled water, iced tea, and juices make up around 15 percent of the Chinese beverage market. The Wahaha brand is now a household name in China. Unfortunately, the honeymoon period has become a dim memory for both partners.

When Danone entered the joint venture, it left most of the day-to-day running in the hands of Wahaha’s longtime chairman, Zong Qinghou, one of China’s wealthiest businessmen. Zong was known for a brash management style. At the same time, Zong’s entrepreneurial instinct was a key factor behind the success of the Wahaha brand.

In 2005, Danone noticed something odd with the financial figures coming from the joint venture. After a lengthy investigation, Danone suspected that Zong was setting up copycat operations outside the joint venture that were mimicking the joint venture and siphoning off revenues. Danone demanded a 51 percent stake in these non-joint venture companies. After months of negotiations, the two joint venture partners failed to settle their differences. In April 2007, Danone issued a statement saying that Zong was in breach of the joint venture agreement. The firm alleged that Zong was illegally selling similar products under the Wahaha brand name outside of the joint venture. Also, dealers who sold these products were apparently asked to set up new bank accounts for their payments.

The dispute partly centers on the issue of who owns the rights to use the Wahaha brand name. In the initial 1996 joint venture

agreement, the Wahaha Group agreed to transfer the trademark to the partnership. However, when the dispute started, the Wahaha Group claimed that the government authorities of Hangzhou, the group’s hometown, had rejected this transfer agreement. In essence, Wahaha was claiming that the brand name was never really controlled by the joint venture.

Soon the dispute between the two partners became a full-blown brawl leading to ugly legal battles. The two partners filed a string of lawsuits and complaints against each other under Chinese and foreign jurisdictions (some of the external companies were registered overseas). Danone filed for arbitration in Stockholm in May 2007. One month later, Danone also launched a lawsuit against a Wahaha subsidiary in Los Angeles claiming \$100 million in damages. Wahaha lodged suits in Shenyang and Jilin against Danone executives. Zong also fought back in the public domain. He posted a letter on the internet claiming that Danone officials had been fully aware of the outside companies and wanted to acquire them cheaply. A Hangzhou Arbitration Committee also ruled in favor of the Wahaha Group on a technicality. Local distributors and employees strongly came out in support of Zong, even calling for a boycott of Danone products. In December 2007, following a China visit by French President Sarkozy, Danone and Wahaha agreed to suspend all lawsuits and begin talks. So far, negotiations at allowing one side to buy out the other have failed. The dispute also took on a personal dimension when Danone helped the US tax authorities with a tax evasion investigation of Mr. Zong. The firm also tried to undermine Zong’s claim that he was protecting the Wahaha brand heritage from foreign interference by pointing out the fact that Zong holds a U.S. green card. Each side claimed it remains committed to a successful Wahaha business and the products continue to be popular. Yet, both sides play down the likelihood of a friendly settlement. Mr. Zong is seeking a “divorce.” One hurdle though is that the two sides differ in valuing the ventures.

Several drivers led to the breakdown of this lucrative partnership. Conflicts about marketing strategies and goals played a major role. Zong resented the fact that Danone was just collecting the money and restricted him from investing to expand the business. He also claimed that Danone reneged on their joint venture agreement by entering joint ventures with other related businesses (e.g., Huiyuan juice). Danone’s lack of supervision of the joint venture also contributed a great deal. Although Danone owned 51 percent, it became little involved in Mr. Zong’s operations, an arrangement that seemed to work for years.

Sources: “For Danone, China Risk Escalates in Nasty Brawl,” *International Herald Tribune*, June 13, 2007, pp. 1, 12; “Danone Blow in China Brand Dispute,” *Financial Times*, Dec. 11, 2007, p. 21; “Danone Dealt Setback in Battle with Wahaha,” <http://www.iht.com/articles/2008/07/14/business/danone.php>, accessed September, 4, 2008; “Chinese Partners Mature, Rocking JV Status Quo,” <http://www.reuters.com/article/reutersEdge/idUSPEK22401820070618>, accessed September, 4, 2008; “Danone, Wahaha Agree to End Confrontation, Resume Talks,” <http://www.chinadaily.com.cn/bizchina/wahaha.html>, accessed on September 4, 2008; “Danone, Wahaha Look Likely to Part Ways,” *The Wall Street Journal*, July 28, 2008, p. 4; and “Exit from Chinese Ventures not Always so Smooth for Danone,” *Financial Times*, September 4, 2008, p. 14.

proper candidates. A careful screening of the joint venture partner is an absolute necessity. One issue is that it is not easy to sketch a profile of the “ideal” partner. The presence of complementary skills and resources that lead to synergies is one characteristic of successful joint ventures. Prospective partners should also have compatible goals. **Exhibit 9-8** lists the attributes that Starbucks requires.

EXHIBIT 9-8**STARBUCKS COFFEE'S CRITERIA IN SELECTING PARTNERS**

- Shared values and corporate culture
- Strategic fit
- Seasoned operator of small-box, multi-unit retail
- Sufficient financial and human resources
- Involved and committed top management
- Real estate knowledge and access
- Local business leader
- Strong track record developing new ventures
- Experience managing licensed & premium brands and concepts
- Leverageable infrastructure
- Food & beverage experience

Source: <http://www.starbucks.com/aboutus/international.asp>, accessed January 30, 2009.

Some evidence indicates that partners should be similar in terms of size and resources. Partners with whom the MNC has built up an existing relationship (e.g., distributors, customers, suppliers) also facilitate a strong relationship.⁵⁹ The more balanced the contributions by the partners, the more trust and the more harmonious the relationship.⁶⁰ One issue that latecomers in a market often face is that the “best” partners have already been snapped up. Note, however, that the same issue arises with acquisition strategies. One study on joint venture performance in China offers five guidelines for partner selection.⁶¹ First, integrate partner selection with your strategic goals. Second, obtain as much information as possible about the candidate (e.g., company brochures, business license). Third, visit the site. Fourth, check whether or not the potential partner shares your investment objective. And, finally, do not put too much emphasis on the role of *guanxi* (relationships).

Establish Clear Objectives for the Joint Venture from the Very Beginning.⁶² It is important to clearly spell out the objectives of the joint venture from day one. Partners should know what their respective contributions and responsibilities are before signing the contract.⁶³ They should also know what to expect from the partnership.

Bridge Cultural Gaps. Many joint venture disputes stem from cultural differences between the local and foreign partners. Much agony and frustration can be avoided when the foreign investor makes an attempt to bridge cultural differences. For instance, when setting up joint ventures in China, having an ethnic Chinese or an “old China hand” as a middleman often helps a great deal. The problem is that knowledgeable people who share the perspectives of both cultures are often very hard to find.⁶⁴

Top Managerial Commitment and Respect. Short of a strong commitment from the parent companies' top management, most international joint ventures are doomed to become a failure. The companies should be willing to assign their best managerial talent to the joint venture. Venture managers should also have complete access to and support from their respective parent companies.⁶⁵

⁵⁹Karen J. Hladik, “R&D and International Joint Ventures,” in *Cooperative Forms of Transnational Corporation Activity*, edited by P. J. Buckley, London: Routledge, 1994.

⁶⁰Akmal S. Hyder and Pervez N. Ghauri, “Managing International Joint Venture Relationships,” *Industrial Marketing Management*, 29 (2000), pp. 205–18.

⁶¹Yadong Luo, “Joint Venture Success in China: How Should We Select a Good Partner,” *Journal of World Business*, 32 (2) (1998), pp. 145–66.

⁶²Dominique Turpin (1993), “Strategic alliances with Japanese firms: Myths and realities,” *Long Range Planning*, vol. 26, no. 4, pp. 11–16.

⁶³Maris G. Martinsons and Choo-sin Tseng, (1995) “Successful joint ventures in the heart of the dragon,” *Long Range Planning*, vol. 28, no. 5, pp. 45–58.

⁶⁴M.G. Martinsons and C.-S. Tseng (1995), “Successful joint ventures in the heart of the dragon,” p. 56.

⁶⁵D. Turpin, “Strategic alliances with Japanese firms: myths and realities,” p. 15.



GLOBAL PERSPECTIVE 9-3

STARBUCKS IN CHINA: A COMBINATION OF GOOD PARTNERS & FLEXIBILITY

Since the first Starbucks outlet in (mainland) China opened in Beijing in 1999, Starbucks has become one of the most popular brands among Chinese white-collar workers in the 25–40 year-old segment. Like many Western retailers, Starbucks sees China as a key growth opportunity due to its fast-growing economy and the sheer size of its population.

To lower the risks of overseas expansion, Starbucks uses different types of ownership structures. It either designates a local developer to use the Starbucks brand or sets up a joint venture. Starbucks entered the China market with different partners in three regions.

For northern China, Starbucks authorized Beijing Meida Coffee to establish its brand. This firm is 90 percent owned by a Hong Kong-based company. A leading Chinese dairy held the remaining shares. For Shanghai and eastern China's Jiangsu and Zhejiang provinces, Starbucks set up a joint venture with the Taiwan-based Uni-President Group. Initially, Starbucks only held a 5 percent stake. However, in 2003 Starbucks raised its stake to 50 percent after paying \$21.3 million to its partner. A similar arrangement existed for southern China region (plus Hong Kong and Macau), which Starbucks entered through a joint venture with Maxim's, a Hong Kong-based catering conglomerate. Also here, Starbucks raised its stake from an initial 5 percent to 51 percent in 2005.

Sources: www.starbucks.com, accessed February 2, 2009; "Starbucks Soars in China," http://www.atimes.com/atimes/China_Business/HF15Cb06.html; "Starbucks Sees no Slowdown in China," <http://uk.reuters.com/article/consumerproducts-SP/idUKPEK1296020090113?sp=true>; "Starbucks to Boost China Investment After Closing U.S. Stores," <http://www.bloomberg.com/apps/news?pid=20601082&sid=aOowxTtMI8jY&refer=canada#>; "China Central to Starbucks Growth," news.bbc.co.uk, accessed on February 2, 2009; and "China's Next Export: Starbucks Coffee," http://www.chinadaily.com.cn/china/2009-01/14/content_7397643.htm.

Describing its growth model in China, Howard Schultz, the Starbucks CEO, said: "The Starbucks growth model has been successful with many different types of ownership structures. From time to time we revise those ownership structures because of strategic opportunities. China is no different from many other markets around the world. In 1999, we didn't have the infrastructure that we have today in China. Now we are more prepared and more capable of doing things. That might mean, over time some changes in equity."⁶⁶

Even when the firm announced plans in 2008 to close 600 U.S. outlets its expansion drive in China continued. By 2009 Starbucks had more than 350 stores in 26 cities in China. Wang Jinlong, the company's Greater China president, declared: "We still have a long way to go. We'll continue to expand. The number of stores will not be in the hundreds, but in the thousands."⁶⁷ The retailer plans to expand in big cities such as Beijing and Shanghai, as well as smaller ones like Wuhan. Apart from adding stores, Starbucks also launched a new blend of coffee sourced in China's southwestern province of Yunnan. The launch of this new coffee blend, labeled "South of the Clouds," took three years. "Our intention is to work with the officials and the farmers in Yunnan province to bring Chinese coffee not (only) to China, but Chinese coffee to the world. Ultimately I'd love to see our coffees from China feature on the shelves of every one of our stores in 49 countries around the world," stated Marin Coles, president of Starbucks Coffee International.⁶⁸

⁶⁶"Starbucks Soars in China," http://www.atimes.com/atimes/China_Business/HF15Cb06.html.

⁶⁷"Starbucks to Boost China Investment After Closing U.S. Stores," <http://www.bloomberg.com/apps/news?pid=20601082&sid=aOowxTtMI8jY&refer=canada#>.

⁶⁸"China's Next Export: Starbucks Coffee," http://www.chinadaily.com.cn/china/2009-01/14/content_7397643.htm.

Incremental Approach Works Best. Rather than being overambitious, an incremental approach towards setting up the international joint venture appears to be much more effective. The partnership starts on a small scale. Gradually, the scope of the joint venture is broadened by adding other responsibilities and activities to the joint venture's charter. The foreign partner often starts off with a minority stake and gradually increases its stake in the joint venture. A case in point is Starbucks' expansion strategy in China as described in **Global Perspective 9-3**.

A study by a team of McKinsey consultants also advises the parents to create a launch team during the launch phase—beginning with the signing of a memorandum of understanding and continuing through the first 100 days of operation.⁶⁹ The launch team should address the four key joint venture challenges:

⁶⁹James Bamford, David Ernst, and David G. Fubini, "Launching a World-Class Joint Venture," *Harvard Business Review* 82, February (2004): 90–101.

1. Build and maintain *strategic alignment* across the separate corporate entities, each of which has its own goals, market pressures, and shareholders.
2. Create a *governance* system that promotes shared decision-making and oversight between the parent companies.
3. Manage the *economic interdependencies* between the corporate parents and the joint venture (e.g., compensation of each parent for its contributions).
4. Build the *organization* for the joint venture (e.g., staffing positions, assigning responsibilities).

◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ ◆ WHOLLY OWNED SUBSIDIARIES

In September 2008, Coca-Cola offered \$2.4 billion in cash to buy China Huiyuan Juice Group. At the time, this was the largest takeover offer ever made by a foreign company to buy a Chinese company. Muthar Kent, Coke's CEO, stated that the acquisition would "provide a unique opportunity to strengthen our business in China, especially since the juice segment is so dynamic and fast growing."⁷⁰ In March 2009, the Chinese government rejected the takeover bid due to fears that the acquisition could harm Coca-Cola's smaller competitors and raise consumer prices.⁷¹ If the bid had been approved by the Chinese government,⁷² it would have more than doubled Coca-Cola's market share in China's fruit juice market to around 20 percent.⁷³ Multinational companies often prefer to enter new markets with 100 percent ownership. Ownership strategies in foreign markets can essentially take two routes: **acquisitions** where the MNC buys up existing companies, or **greenfield operations** that are started from scratch. As with the other entry modes, full ownership entry entails certain benefits to the MNC but also carries risks.

Benefits Wholly owned subsidiaries give MNCs full control of their operations. It is often the ideal solution for companies that do not want to be saddled with all the risks and anxieties associated with other entry modes such as joint venturing. Full ownership means that all the profits go to the company. Fully owned enterprises allow the foreign investor to manage and control its own processes and tasks in terms of marketing, production, logistics and sourcing decisions. Setting up fully owned subsidiaries also sends a strong commitment signal to the local market. In some markets—China, for example—wholly owned subsidiaries can be erected much faster than joint ventures with local companies that may consume years of negotiations before their final take-off.⁷⁴ The latter point is especially important when there are substantial advantages of being an early entrant in the target market.

Caveats Despite the advantages of 100 percent ownership, many MNCs are quite reluctant to choose this particular mode of entry. The risks of full ownership cannot be easily discounted. Complete ownership means that the parent company will have to carry the full burden of possible losses. Developing a foreign presence without the support of a third party is also very demanding on the firm's resources. Obviously, apart of the market-related risks, substantial political risks (e.g., expropriation, nationalization) and economic risks (e.g., currency devaluation) must be factored in.

Companies that enter via a wholly owned enterprise are sometimes also perceived as a threat to the cultural and/or economic sovereignty of the host country. When InBev, the Brazilian/Belgian brewer, made a \$46.3 billion unsolicited takeover bid for

⁷⁰"Coke Eyes Record China Deal," *Financial Times*, (September 4, 2008), p. 13.

⁷¹"Beijing Thwarts Coke's Takeover Bid," online.wsj.com, accessed on July 20, 2009.

⁷²Even though Huiyuan Juice is a private company, the deal still had to be approved by the Chinese government.

⁷³"Coke to Squeeze More From China," *Financial Times*, (September 4, 2008), p. 14.

⁷⁴Wilfried Vanhonacker, "Entering China: An Unconventional Approach," *Harvard Business Review*, March–April 1997.

Anheuser-Busch, the leading American beer brewer, several U.S. politicians and journalists were dismayed. Barack Obama, the 2008 Democratic presidential candidate and ultimate victor, stated at a press conference in St. Louis, headquarters of Anheuser-Busch, “I do think it would be a shame if Bud is foreign-owned. I think we should be able to find an American company that is interested in purchasing Anheuser-Busch.”⁷⁵ Likewise, during the 2008 Italian elections campaign, when Alitalia, Italy’s beleaguered airline, was approached by Air France-KLM, Berlusconi promised to keep the airline out of foreign hands.⁷⁶ In January 2009, however, Alitalia decided to sell a 25 percent stake of the company to Air France-KLM.⁷⁷ One way to address hostility to foreign acquisitions in the host country is via “localizing” the firm’s presence in the foreign market by hiring local managers, sourcing locally, developing local brands, sponsoring local sports or cultural events and so forth.⁷⁸

Companies such as Sara Lee have built up strong global competitive positions via cleverly planned and finely executed acquisition strategies. MNCs choose acquisition entry to expand globally for a number of reasons. First and foremost, when contrasted with greenfield operations, acquisitions provide a rapid means to get access to the local market. For relative latecomers in an industry, acquisitions are also a viable option to obtain well-established brand names, instant access to distribution outlets, or technology. Cadbury Schweppes \$4.2 billion purchase in 2003 of Adams, Pfizer’s candy business, illustrates the advantages of the acquisition entry mode. By acquiring the business, Cadbury was able to pick up several leading candy and chewing gum brands including Trident, Chiclets, Certs and Halls lozenges. The Adams purchase also bolstered Cadbury’s position in the fast growing candy markets in the United States and Latin America. In recent years, some of the South Korean *chaebols* have used acquisition entries in foreign markets to gain a foothold in high-tech industries. Highly visible examples include Samsung’s acquisition of the American computer maker AST and LG Electronics’ take-over of Zenith. LG would have had to invest more than \$1 billion to build up a strong global TV brand from scratch.⁷⁹ Cash-rich Chinese companies are also trying to gain a foothold in overseas markets by buying up foreign firms. These efforts have not always been successful. Huawei, the Chinese telecom equipment maker, had to drop its bid to buy a major stake in 3Com when U.S. lawmakers raised alarms concerned about Huawei’s alleged ties with the People’s Liberation Army.⁸⁰ **Global Perspective 9-4** discusses the acquisition of IBM’s PC division by Lenovo, the Chinese computer behemoth.

Expansion via acquisitions or mergers carries substantial risks, however. Differences in the corporate culture of the two companies between managers are often extremely hard to bridge. A well-publicized example of a company that has been plagued with corporate culture disease is Alcatel-Lucent, the telecommunications equipment group that resulted from the 2006 merger of Alcatel and Lucent. Since its creation, the group has been hampered by cultural differences between the American and French arms. As one analyst observed: “. . . Alcatel-Lucent was a merger that sounded good in a PowerPoint presentation. But there have been a lot of serious integration challenges, including cultural issues, that were underestimated and still linger.”⁸¹

⁷⁵<http://www.flex-news-food.com/pages/17605/Anheuser-Busch/InBev/obama-says-shame-anheuser-busch-sold-inbev.html>; ultimately the deal went through and Inbev was renamed Anheuser Busch-InBev.

⁷⁶“Berlusconi: Alitalia’s White Knight?” http://www.forbes.com/2008/03/20/berlusconi-alitalia-italy-face-cx_vr_0320autofacescan01.html.

⁷⁷“Air France-KLM Buys Stake in Alitalia,” <http://edition.cnn.com/2009/BUSINESS/01/13/alitalia.air.france.klm/index.html>.

⁷⁸W. Vanhonacker, “Entering China: An Unconventional Approach.”

⁷⁹“Guess who’s betting on America’s high-tech losers,” *Fortune*, October 28, 1996.

⁸⁰http://www.businessweek.com/globalbiz/blog/eyeonasia/archives/2008/02/huaweis_3com_de.html.

⁸¹“Culture Clash Hits Home at Alcatel-Lucent,” <http://www.iht.com/bin/printfriendly.php?id=14867263>.

Acquisitions and Mergers



GLOBAL PERSPECTIVE 9-4

THE LENOVO/IBM DEAL—A WINNING COMBINATION?

The \$1.75 billion acquisition of IBM's personal computer business by Lenovo, the Chinese PC maker, marked the dawn of a new era. The cross-border deal gave Lenovo much more than Big Blue's PC business. Lenovo became the first state-controlled Chinese firm to acquire an iconic global brand. "If anyone still harboured any doubts that Chinese corporates were serious players on the global M&A stage those have now totally been dispelled," said Colin Banfield at CSFB.

The talks behind the deal took 18 months. By bringing together China's largest PC maker and IBM's PC division, Lenovo executives hoped they could create a formidable force to challenge the dominance of Hewlett-Packard and Dell, the market leaders. Lenovo estimated that it could save \$200m a year by component cost savings. Lenovo would own IBM's Think trademark and IBM would become Lenovo's "preferred supplier" as part of the deal.

Sources: "IBM Brand Loyalty Holds Key for Lenovo," *Financial Times*, December 9, 2004, p. 16; "Deal Divides Opinion Over Future Trends," *Financial Times*, December 9, 2004, p. 16; "Your Rules and My Processes," *Financial Times*, November 10, 2005, p. 10; "Quick-fire Lessons in Globalisation," *Financial Times*, November 11, 2005, p. 8; http://www.businessweek.com/technology/content/dec2005/tc20051221_376268.htm.

The growth plan spelled out for "new" Lenovo had three key elements: developing the ThinkPad notebook computer franchise, expanding into emerging markets such as India, Brazil, and Russia, and introducing Lenovo-branded PCs for small business owners in the United States and Europe.

Many observers were skeptical about blending the two very diverse corporate cultures. The focus at the "old" Lenovo was on rules. All employees were expected to clock in and clock out. Employees were forbidden to turn up late for meetings. Where Lenovo had rules, IBM had processes: regular meetings, conference calls, and milestones to keep projects on track. To the Chinese, the focus on processes could be as alien as the emphasis on rules for former IBM staff. Another cultural gap stems from conversational style differences: Americans like to talk; Chinese like to listen. Still, the enthusiasm is not lacking. The working language for the new Lenovo is English as hardly anyone from the IBM side speaks Chinese. Lenovo shifted its official headquarters from Beijing to Purchase, N.Y. Steven Ward, formerly head of IBM's PC division, became Lenovo's new CEO. Ward was replaced in December 2005 by William Amelio, who had been charge of the Asia-Pacific division of Dell, Lenovo's main competitor. With the new CEO, Lenovo was hoping to plug a gap in China, its home-market. Lenovo had a 32 percent market share in 2005 but was not strong among corporate buyers.

The assets of the acquisition do not always live up to the expectations of the acquiring company. Outdated plants, tarnished brand names or an unmotivated workforce are only a few of the many possible disappointments that the acquiring company could face. The local government might also attach certain conditions to the acquisition or expectations in terms of job creation. Failure to live up to such expectations could tarnish the image of the MNC in the host country. In 2005, BenQ, the Taiwanese consumer electronics firm, acquired the mobile phone division of Siemens in the hope of creating a leading brand in the category. Unfortunately, the German branch proved to be an albatross for BenQ, which decided to discontinue manufacturing phones in Germany. This move created a lot of bad feelings among German stakeholders (unions, government) with the suspicion that BenQ only bought the Siemens mobile business for its patents.⁸² A careful screening and assessment of takeover candidates can avoid a lot of heartburn on the part of the acquiring company.

As mentioned earlier, open hostility toward foreign companies can also complicate acquisition plans. A joint \$10.5 billion bid by Cadbury and Nestlé to buy Hershey Foods, the U.S. chocolate maker, got derailed in part of strong opposition against a "foreign takeover" from the local community. Another drawback is that acquisition entry can be a very costly global expansion strategy. Good prospects are usually unwilling to sell themselves. If they are, they do not come cheap. For instance, the \$2.4 billion takeover offer that Coca-Cola made in 2008 for China's Huiyuan Juice Group was worth 35 times the Chinese firm's forecast 2009 earnings.⁸³ Other foreign or local

⁸²"Siemens Strikes Back," <http://www.spiegel.de/international/0,1518,440409,00.html>.

⁸³"All the Juice in China," *Financial Times*, September 4, 2008, p. 12.

companies are typically interested too, and the result is often a painful bidding war. The costs and strains of integrating the acquisition with the company can also be a substantial burden.

Acquisition strategies are not always feasible. Good prospects may already have been nabbed by the company's competitors. In many emerging markets, acceptable acquisition candidates often are simply not available. Overhauling the facilities of possible candidates is sometimes much more costly than building an operation from scratch. In the wake of these downsides, companies often prefer to enter foreign markets through greenfield operations that are established from scratch. Greenfield operations offer the company more flexibility than acquisitions in areas such as human resources, suppliers, logistics, plant layout, or manufacturing technology. Greenfield investments also avoid the costs of integrating the acquisition into the parent company.⁸⁴ Another motivation is the package of goodies (e.g., tax holidays) that host governments sometimes offer to whet the appetite of foreign investors. A major disadvantage, though, of greenfield operations is that they require enormous investments of time and capital.

Greenfield Operations

STRATEGIC ALLIANCES



A distinctive feature of the activities of global corporations today is that they are using cooperative relationships such as licensing, joint ventures, R&D partnerships, and informal arrangements—all under the rubric of alliances of various forms—on an increasing scale. More formally, a **strategic alliance** can be described as *a coalition of two or more organizations to achieve strategically significant goals that are mutually beneficial*.⁸⁵ The business press reports like clockwork the birth of strategic alliances in various kinds of industries. Eye-catching are especially those partnerships between firms that have been archenemies for ages. A principal reason for the increase in cooperative relationships is that firms today no longer have the capacity of a General Motors of the 1940s, which developed all its technologies in-house. As a result, firms, especially those operating in technology intensive industries, may not be at the forefront of all the required critical technologies.⁸⁶

Strategic alliances come in all shapes. At one extreme, alliances can be based on a simple licensing agreement between two partners. At the other extreme, they can consist of a thick web of ties. The nature of alliances also varies depending on the skills brought in by the partners. A first category, very common in high-tech industries, is based on technology swaps. Given the skyrocketing costs of new product development, strategic alliances offer a means to companies to pool their resources and learn from one another. Such alliances must be struck from a position of strength. Bargaining chips might be patents that the company holds. A second type of cross-border alliances involves marketing-based assets and resources such as access to distribution channels or trademarks. A case in point is the partnership established by Coca-Cola and Nestlé to market ready-to-drink coffees and teas under the Nescafé and Nestea brand names. This deal allowed the two partners to combine a well-established brand name with access to a vast proven distribution network. In India, Huggies, Kimberly-Clark's diapers, are manufactured and distributed through an alliance with Hindustan Lever, the local unit of Unilever, whose powerful distribution network covers 400,000 retail outlets. A third category of alliances is situated in the operations and logistics area. In their relentless search for scale economies for operations/logistics activities, companies

Types of Strategic Alliances

⁸⁴Jiatao Li (1995), "Foreign entry and survival: effects of strategic choices on performance in international markets," *Strategic Management Journal*, vol. 16, pp. 333–51.

⁸⁵Edwin A. Murray, Jr. and John F. Mahon (1993), "Strategic alliances: Gateway to the new Europe?" *Long Range Planning*, August, pp. 102–11.

⁸⁶Noel Capon and Rashi Glazer (1987), "Marketing and Technology: A Strategic Co-alignment," *Journal of Marketing*, 51(July), 1–14.

EXHIBIT 9-9
GENERIC MOTIVES FOR STRATEGIC ALLIANCES

Source: Reprinted from P. Lorange, J. Roos, and P. S. Brønn, "Building Successful Strategic Alliances," *Long Range Planning*, 25 (6), 1992, p. 10. Copyright 1992, with kind permission from Elsevier Science Ltd., The Boulevard, Langford Lane, Kidlington OX51GB, UK.

| | | Business Market Position | |
|--|------------|--------------------------|-------------|
| | | Leader | Follower |
| Strategic Importance in Parent's Portfolio | Core | Defend | Catch Up |
| | Peripheral | Remain | Restructure |

may decide to join forces by setting up a partnership. Finally, operations-based alliances are driven by a desire to transfer manufacturing know-how. A classic example is the NUMMI joint venture set up by Toyota and General Motors to swap car-manufacturing expertise.

The Logic behind Strategic Alliances

The strategic pay-offs of cross-border alliances are alluring, especially in high-tech industries. Lorange and colleagues⁸⁷ suggest that there are four generic reasons for forming strategic alliances: defense, catch-up, remain, or restructure (see **Exhibit 9-9**). Their scheme centers around two dimensions: the strategic importance of the business unit to the parent company and the competitive position of the business.

- *Defend.* Companies create alliances for their core businesses to defend their leadership position. Basically, the underlying goal is to sustain the firm's leadership position by learning new skills, getting access to new markets, developing new technologies, or finessing other capabilities that help the company to reinforce its competitive advantage(s).⁸⁸
- *Catch-Up.* Firms may also shape strategic alliances to catch up. This happens when companies create an alliance to shore a core business in which they do not have a leadership position. Nestlé and General Mills launched Cereal Partners Worldwide to attack Kellogg's dominance in the global cereal market. Likewise, Pepsi and General Mills, two of the weaker players in the European snack food business, set up a joint venture for their snack food business to compete more effectively in the European market.
- *Remain.* Firms might also enter a strategic alliance to simply remain in a business. This might occur for business divisions where the firm has established a leadership position but which only play a peripheral role in the company's business portfolio. That way, the alliance enables the company to get the maximum efficiency out of its position.
- *Restructure.* Lastly, a firm might also view alliances as a vehicle to restructure a business that is not core and in which it has no leadership position. The ultimate intent here is that one partner uses the alliance to rejuvenate the business, thereby turning the business unit in a "presentable bride," so to speak. Usually, one of the other partners in the alliance ends up acquiring of the business unit.

Cross-Border Alliances that Succeed

The recipe for a successful strategic alliance will probably never be written. Still, a number of studies done by consulting agencies and academic scholars have uncovered several findings on what distinguishes enduring cross-border alliances from the

⁸⁷Peter Lorange, Johan Roos and Peggy S. Brønn (1992), "Building successful strategic alliances," *Long Range Planning*, vol. 25, no. 6, pp. 10–17.

⁸⁸See also David Lei and John W. Slocum, Jr. (1992), "Global strategy, competence-building and strategic alliances," *California Management Review*, Fall, pp. 81–97.

floundering ones. An analysis of cross-border alliances done by McKinsey came up with the following recommendations:⁸⁹

- *Alliances between strong and weak partners seldom work.* Building up ties with partners that are weak is a recipe for disaster. The weak partner becomes a drag on the competitiveness of the partnership. As a senior Hewlett-Packard executive put it: “One should go for the best possible partners—leaders in their field, not followers.”⁹⁰
- *Autonomy and flexibility.* These are two key ingredients for successful partnerships. Autonomy might mean that the alliance has its own management team and its own board of directors. This speeds up the decision-making process. Autonomy also makes it easier to resolve conflicts that arise. To cope with environmental changes over time, flexibility is essential. Market needs change, new technologies emerge, and competitive forces regroup. Being flexible, alliances can more easily adapt to these changes by revising their objectives, the charter of the venture, or other aspects of the alliance.
- *Equal ownership.* In 50-50 ownerships, the partners are equally concerned about the other’s success. Both partners should contribute equally to the alliance.⁹¹ Thereby, all partners will be in a win-win situation where the gains are equally distributed. However, 50-50 joint ventures between partners from developed countries and developing countries are more likely to get bogged down in decision-making deadlocks. One recent study of equity joint ventures in China found that partnerships with minority foreign equity holding run much more smoothly than other equity sharing arrangements. Indeed, 50-50 partnerships ran into all sorts of internal managerial problems including difficulties in joint decision-making and coordination with local managers. Majority foreign equity ventures had fewer internal problems but encountered many external issues such as lack of local sourcing and high dependence on imported materials.⁹² So, in spite of the findings of the McKinsey study, the ownership question—50/50 versus majority stake—remains murky.

We would like to add a few more success factors to these. Stable alliances have the commitment and support of the top of the parents’ organization. Strong alliance managers are key to success.⁹³ Alliances between partners that are related (in terms of products, markets, and/or technologies) or have similar cultures, assets sizes and venturing experiencing levels tend to be much more viable.⁹⁴ Furthermore, successful alliances tend to start on a narrow basis and broaden over time. A partnership between Corning, the U.S. glassmaker, and Samsung, the Korean electronics firm, started with one plant making television tubes in South Korea. Over time, the partnership broadened its scope, covering much of East Asia. Finally, a shared vision on the goals and the mutual benefits is the hallmark of viable alliances.

TIMING OF ENTRY



International market entry decisions also cover the timing-of-entry question: when should the firm enter a foreign market? Numerous firms have been burnt badly by entering markets too early. Ikea’s first foray in Japan in 1974 was a complete fiasco.⁹⁵

⁸⁹Joel Bleeke and David Ernst (1991), “The way to win in cross-border alliances,” *Harvard Business Review*, Nov.–Dec., pp. 127–35.

⁹⁰“When Even a Rival Can Be a Best Friend,” *Financial Times* (October 22, 1997), p. 12.

⁹¹Godfrey Devlin and Mark Bleackley (1988), “Strategic alliances—guidelines for success,” *Long Range Planning*, vol. 21, no. 5, pp. 18–23.

⁹²Yigang Pan and Wilfried R. Vanhonacker, 1994, “Equity sharing arrangements and joint venture operation in the People’s Republic of China,” Working Paper, February, Hong Kong University of Science & Technology.

⁹³Godfrey Devlin and Mark Bleackley (1988), “Strategic alliances—guidelines for success,” *Long Range Planning*, vol. 21, no. 5, pp. 18–23.

⁹⁴Kathryn R. Harrigan (1988), “Strategic alliances and partner asymmetries,” in *Cooperative Strategies in International Business*, F.J. Contractor and P. Lorange, eds., Lexington, MA: Lexington Books.

⁹⁵http://www.businessweek.com/magazine/content/05_46/b3959001.htm.

EXHIBIT 9-10**TIMELINE OF WAL-MART'S INTERNATIONAL EXPANSION**

| <i>Market</i> | <i>Retail Units (as of Dec 31, 2008)</i> | <i>Date of Entry</i> | <i>Date of Exit</i> |
|------------------------|--|----------------------|---------------------|
| Mexico | 1,201 | Nov 1991 | |
| Puerto Rico | 56 | Aug 1992 | |
| Canada | 310 | Nov 1994 | |
| Brazil | 349 | May 1995 | |
| Argentina | 28 | Aug 1995 | |
| China | 225 | Aug 1996 | |
| South Korea | 16 | 1998 | 2006 |
| Germany | 85 | 1998 | 2006 |
| United Kingdom | 358 | Jul 1999 | |
| Japan | 387 | Mar 2002 | |
| Costa Rica | 164 | Sep 2005 | |
| El Salvador | 77 | Sep 2005 | |
| Guatemala | 160 | Sep 2005 | |
| Honduras | 50 | Sep 2005 | |
| Nicaragua | 51 | Sep 2005 | |
| India (cash-and-carry) | | Aug 2007 | |

Source: www.walmartstores.com/factsnews/

The Swedish furniture retailer hastily withdrew from Japan after realizing that Japanese consumers were not yet ready for the concept of self-assembly and preferred high quality over low prices. Ikea re-entered Japan in late 2005, but this time offering assembly services and home delivery.

Exhibit 9-10 shows the timeline of Wal-Mart's international expansion strategy. Note that the gap was almost thirty years between the foundation of Wal-Mart by Sam Walton in 1962 and the retailer's first international operation in Mexico (1991). Since, then Wal-Mart has expanded very aggressively. Initially, Wal-Mart concentrated mostly on markets in the Americas. It is only toward the end of the 1990s that the retailer shifted its attention toward Europe and the Asia-Pacific region. As of 2009, Wal-Mart had about 3,100 stores in 13 countries outside the United States. It also operates a cash-and-carry wholesale operation in India through a joint-venture with Bharti Enterprises, an Indian conglomerate.⁹⁶

Timing decisions also arise for the global launch of new products or services. Microsoft launched the Xbox videogame console first in its home-market (Fall 2001), next in Japan (February 2002), and then in Europe (March/April 2002). However, products are not always pioneered in the company's home market. A case in point is the Volkswagen New Beetle, which was first rolled out in the United States and later in Germany. Likewise, Toyota's luxury car marque Lexus was launched in July 2005 in Japan, more than 15 years after its 1989 debut in the United States. Qoo, a Coca-Cola children's fruit drink, was first rolled out in Japan in 1999. It was then introduced rapidly in other Asian markets (Korea, Singapore, China, Thailand, and Taiwan). In January 2003, Coke launched Qoo in Germany, the first European market.⁹⁷

Research on international entry-timing decisions is scarce. One study examined the timing-of-entry decisions of U.S. Fortune 500 firms in China.⁹⁸ According to the study's findings, firms tend to enter China earlier:

- The higher the level of international experience;
- The larger the firm size;

⁹⁶<http://walmartstores.com/FactsNews/>, accessed February 2, 2009.

⁹⁷"Coca-Cola's Qoo to go to Germany," *Advertising Age* (December 16, 2002), p. 12.

⁹⁸Vibah Gaba, Yigang Pan, and Gerardo R. Ungson, "Timing of Entry in International Markets: An Empirical Study of U.S. Fortune 500 Firms in China," *Journal of International Business Studies*, 33 (First Quarter 2002), pp. 39–55.

- The broader the scope of products and services;
- When competitors had already entered the market;
- The more favorable the risk (political, business) conditions; and
- When non-equity modes of entry (e.g., licensing, exporting, non-equity alliances) are chosen.

In general, companies that entered China relatively late often had an advantage over earlier entrants. A main reason is that latecomers face fewer restrictive business regulations than their predecessors. Companies now have much more flexible ways of setting up their joint ventures. In many industries, companies are now free to set up a wholly owned subsidiary instead of partnering with a Chinese company.⁹⁹ Still, some early entrants such as Yum! (the owner of KFC and Pizza Hut restaurants) and Procter & Gamble have been able to leave their competitors in the dust.

A second study looked at the entry-timing pattern for a sample of nineteen multinational firms.¹⁰⁰ This study develops the concept of **near-market knowledge**. Near-market knowledge is defined as the knowledge (cultural, economic) generated in similar markets in which the MNC already operates. The study's key findings are fourfold, namely:

- Near-market knowledge has an important impact on foreign market entry timing. Near-market knowledge accumulated from successful foreign entries will lead to earlier entry in similar markets.
- Cultural similarity with the home market is not related to foreign market entry timing. Although cultural similarity with the domestic market may matter for initial foreign entry forays, it turns out not to be critical for later entries.
- Several economic attractiveness variables matter a great deal. Specifically, countries with wealthier consumers, larger economies, more developed infrastructure, and more easily accessible consumers are likely to be entered earlier.
- Economic factors are more crucial than cultural factors in entry timing decisions.

EXIT STRATEGIES



So far we have concentrated on international entry strategies. In this section we will concentrate on their flipside: exit (or divestment) strategies. Exits in global marketing are not uncommon. In 2001, Colgate-Palmolive sold its laundry detergent brands in Mexico to Henkel, its German competitor. Gateway radically overhauled its strategy in 2001 when it decided to discontinue its company-owned operations outside North America.¹⁰¹ The personal computer maker closed down its manufacturing operations in Ireland and Malaysia. In 2006 Wal-Mart retreated twice in a row: the American mega-retailer first sold its stores in South Korea (see **Global Perspective 9-5**) and then, barely two months later, it also sold its German stores to Metro.¹⁰² Similarly, Nokia, the world's largest mobile phone maker, decided to stop making phones for the Japanese market in 2008.

Decisions to exit or divest a foreign market are not taken lightly. Companies may have multiple good reasons to pull out of their foreign markets:

Reasons for Exit

- *Sustained losses.* Key markets are often entered with a long-term perspective. Most companies recognize that an immediate payback of their investments is not realistic and are willing to absorb losses for many years. Still, at some point, most companies have a limit to how long a period of losses they are willing to tolerate.

⁹⁹“In China, It May Pay to Be Late,” *Asian Wall Street Journal*, February 9, 2004, pp. A1, A6.

¹⁰⁰Debanjan Mitra and Peter N. Golder, “Whose Culture Matters? Near-Market Knowledge and Its Impact on Foreign Market Entry Timing,” *Journal of Marketing Research*, 39 (August 2002), pp. 350–65.

¹⁰¹http://www.gateway.com/about/news/2001report/01_annual_report.pdf.

¹⁰²“Wal-Mart Gives Up Germany,” July 29, 2006, <http://www.iht.com/articles/2006/07/28/business/walmart.php>.



GLOBAL PERSPECTIVE 9-5

WAL-MART LEAVES SOUTH KOREA

In May 2006, Wal-Mart announced that it had agreed to sell all sixteen of its South Korean stores to its biggest competitor there, Shinsegae. Wal-Mart is not the only outsider that fared poorly in South Korea. The French retailer Carrefour, the second-largest retailer worldwide after Wal-Mart, sold its 32 South Korean stores a month earlier. Wal-Mart arrived in Korea in 1998 by taking a majority stake in four supermarkets and six plots of land. It left Korea after grabbing a 3.8 percent market share and two years of huge losses. Wal-Mart had aimed to become one of Korea's three largest discount retailers.

Wal-Mart and Carrefour faced an uphill climb against local retailers. Both Wal-Mart and Carrefour were slow in broadening the scope of their operations. With a network of only sixteen stores (and just one in Seoul, Korea's capital), Wal-Mart failed to build up market share. Shinsegae, the discount store leader in Korea, adds on average 10 stores each year to its E-Mart chain. That network gives Shinsegae bargaining power with suppliers. Wal-Mart also fell short on the product mix by

misreading the tastes of local consumers. The frozen imported food it sold in bulk had limited appeal to local shoppers who prefer fresh products sold in smaller bundles. Shoppers also resented the subdued lighting and the height of the shelves. Koreans also prefer service over price. Another barrier was South Korea's chaebol system of interrelated companies that benefits local retailers who form part of the system. Such conglomerate connections help local retailers with costs and real estate.

In contrast to Wal-Mart and Carrefour, the British retailer Tesco is a remarkable case of succeeding in localizing. Tesco teamed up with Samsung Group to open its first store in 2000. Tesco holds an 89 percent stake in the partnership and pays royalties to use its partner's name—Samsung Tesco Home Plus. The latter was a clever move, as Koreans trust the Samsung name. Tesco also relied heavily on local managers and hired a Korean chief executive, which both Wal-Mart and Carrefour failed to do. Tesco planned to double its Korean network to 102 outlets by 2009. Martin Roll, an expert on Asian branding, notes that: "Asian consumers are showing a form of modernity and sophistication that would challenge even the most experienced brands. The retailers with local-market knowledge and distribution network will ultimately emerge as the winners."

Sources: "Lost in Cultural Translation," *International Herald Tribune*, May 26, 2006, p. 23; "Wal-Mart Exits Conglomerate-dominated Korea," *The Wall Street Journal*, May 23, 2006, p. 3; and "Wal-Mart Selling Stores and Leaving South Korea," <http://www.nytimes.com>, accessed on September 12, 2008.

- *Difficulty in cracking the market.* A company may also decide to pull the plug when it has difficulty to crack the market in the host country. This was the main reason why Nokia decided to stop making and selling mobile phones for the Japanese market in 2008. The Finnish mobile phone maker never had any luck into cracking open Japan's mobile phone market since entering the country in 2003. As a senior Nokia executive stated: "In the current global economic climate, we have concluded that the continuation of our investment in Japan-specific, localized products is no longer sustainable."¹⁰³ However, Nokia would still continue selling its luxury Vertu brand in Japan.
- *Volatility.* Companies often underestimate the risks of the host country's economic and political environment. Many multinationals have rushed into emerging markets lured by tempting prospects of huge populations with rising incomes. Unfortunately, countries with high growth potential often are very volatile. However, it is easy to ignore or downplay the risks associated with entering such markets, such as those stemming from exchange rate volatility, weak rule of law, political instability, economic risks, and inflation. Numerous multinational companies pulled out of Argentina and Indonesia in the wake of these countries' economic turmoil. As the then CEO of a major multinational wisecracked during an analyst meeting: "I wish we could just close Argentina."¹⁰⁴

¹⁰³<http://news.zdnet.co.uk/hardware/0,1000000091,39564647,00.htm>.

¹⁰⁴"Submerged," *Advertising Age* (March 4, 2002), p. 14.

- *Premature entry.* As we discussed earlier, the entry-timing decision is a crucial matter. Entering a market too early can be an expensive mistake. Entries can be premature for reasons such as an underdeveloped marketing infrastructure (e.g., in terms of distribution, supplies), low buying power, and lack of strong local partners. Often exiting a market is the only sensible solution instead of hanging on.
- *Ethical reasons.* Companies that operate in countries such as Myanmar or Cuba with a questionable human rights record often get a lot of flak in other markets. The bad publicity engendered by human rights campaigners can tarnish the company's image. Rather than running the risk of ruining its reputation, the company may decide to pull out of the country. Heineken, for instance, decided to pull out of Myanmar in 1996 under pressure from a boycott of its products triggered by human rights activists.¹⁰⁵
- *Intense competition.* Intense rivalry is often another strong reason for exiting a country. Markets that look appealing on paper usually attract lots of competitors. The outcome is often overcapacity, triggering price wars, and loss-loss situations for all players competing against one another. Rather than sustaining losses, the sensible thing to do is to exit the market, especially when rival players have competitive advantages that are difficult to overcome.
- *Resource reallocation.* A key element of marketing strategy formulation is resource allocation. A strategic review of foreign operations often leads to a shake-up of the company's country portfolio, spurring the MNC to reallocate its resources across markets. Of all emerging markets, only China has outgrown the United States in annual economic growth rate over the last three decades. This explains why several European companies such as Unilever, Nestlé, and Reckitt-Benckiser have shifted their focus to North America.¹⁰⁶ Poor results from global operations are often a symptom of overexpansion. For instance, following a review of the results of its global operations in 2002, McDonald's stated that it would concentrate on sales growth in existing restaurants. As a result, the fast-food giant announced that it would (1) close operations in three countries, (2) restructure its business in four other countries, and (3) close down 175 restaurants in about ten other countries.¹⁰⁷ More recently, in July 2008 Starbucks decided to close 61 Australian outlets (out of a total of 85)¹⁰⁸ as part of a global overhaul.¹⁰⁹

Obviously, exiting a market is a decision that should be taken carefully. Just as there are barriers to entry, there are exit barriers that may delay or complicate an exit decision. Obstacles that compound divestment decisions include:

Risks of Exit

- *Fixed costs of exit.* Exiting a country often involves substantial fixed costs. In Europe, several countries have very strict labor laws that make exit very costly (e.g., severance payment packages). It is not uncommon for European governments to cry foul and sue a multinational company when the firm decides to shut down its operations. Long-term contracts that involve commitments such as sourcing raw materials or distributing products often involve major termination penalties.
- *Damage to corporate image.* A negative spillover of a divestment decision could also include damage to the firm's corporate image if plant closures lead to job losses. Nokia's decision to close down its manufacturing operations in Germany and shift them to more cost-friendly sites in Eastern Europe led to calls for a boycott of the firm's phones in Germany. Kurt Beck, the head at the time of the Social Democrats

¹⁰⁵“Heineken Quits its Burmese Venture,” <http://query.nytimes.com/gst/fullpage.html?res=9C06E4D81139F932A25754C0A960958260>.

¹⁰⁶“Western Aggression,” *Advertising Age* (March 4, 2002), p. 14.

¹⁰⁷<http://www.mcdonalds.com/corporate/press/financial/2002/11082002/index.html>.

¹⁰⁸“Starbucks to Close 61 Australian Outlets,” <http://business.theage.com.au/business/starbucks-to-close-61-australian-outlets-20080729-3mkm.html>.

¹⁰⁹The company also announced the closure of 600 U.S. stores.

(SPD) told a local newspaper that “As far as I am concerned there will be no Nokia mobile phone in my house.”¹¹⁰

- *Disposition of assets.* Assets that are highly specialized to the particular business or location for which they are being used also create an exit barrier.¹¹¹ The number of prospective buyers may be few and the price they are willing to pay for these assets will most likely be minimal. Hence, the liquidation value of such assets will be low. Sometimes, assets can be sold in markets where the industry is at an earlier stage in the product life cycle.
- *Signal to other markets.* Another concern is that exiting one country or region may send strong negative signals to other countries where the company operates. Exits may lead to job losses in the host country; customers risk losing after-sales service support; distributors stand to lose company support and might witness a significant drop in their business. Therefore, an exit in one country could create negative spillovers in other markets by raising red flags about the company’s commitment to its foreign markets.
- *Long-term opportunities.* Although exit is sometimes the only sensible thing to do, firms should avoid shortsightedness. Volatility is a way of life in many emerging markets. Four years after the ruble devaluation in August 1998, the Russian economy made a spectacular recovery. The country became one of the fastest growing markets worldwide for many multinationals, including Procter & Gamble, L’Oréal, and Ikea.¹¹² Rather than closing shop, it is often better to pay a price in the short term and maintain a presence for the long haul. Exiting a country and re-entering it once the dust settles, comes at a price. Rival companies that stayed in the country will have an edge. Distributors and other prospective partners will be reluctant to enter into agreements. Consumers will be leery about buying the firm’s products or services, especially when long-term relationships are involved.

Guidelines

Growing through international expansion is not the right formula for all companies. The lure of emerging markets such as the BRIC countries¹¹³ has titillated many marketing managers. Unfortunately, reality does not always live up to hype. Still, companies should handle exit decisions carefully. Here are a few guidelines that managers should ponder before making an exit decision:

- *Contemplate and assess all options to salvage the foreign business.* Exiting is painful—both for the company and other stakeholders (local employees, distributors, customers). Before making any moves, it is crucial to analyze why results are below expectations and to consider possible alternatives that might save the business. Original targets in terms of market share, return on investment, or payback period may have been too ambitious. Costs could be squeezed by, for instance, sourcing locally rather than importing materials or using local staff instead of expatriates. Repositioning or retargeting the business can offer a solution. NutraSweet’s foray into China provides a good example. When NutraSweet’s consumer division first entered the China market, it targeted the mass market. Sales were far below expectations. Instead of simply exiting the China market, which was one of the options being contemplated, NutraSweet decided to lower its sales targets, pursue the diabetics niche market, and position its brand as a medical product.
- *Incremental exit.* Short of a full exit, an intermediate option is an incremental exit strategy. Firms could “mothball” their operations and restart them when demand or

¹¹⁰“Germany Threatens Nokia Boycott,” <http://www.france24.com/france24Public/en/archives/news/business/20080122-Nokia-strike-boycott-germany-backlash-finnish-mobile-company.php>.

¹¹¹Michael E. Porter, *Competitive Strategy. Techniques for Analyzing Industries and Competitors*, New York: The Free Press, 1980.

¹¹²“To Russia With Love,” *Business Week (Asian Edition)* (September 16, 2002), pp. 26–27.

¹¹³Brazil, Russia, India, and China.

cost conditions improve.¹¹⁴ McDonald’s restructured its presence in four countries by transferring ownership to licensees. Dial Corp. revamped its operations in Mexico by licensing its brands instead of selling them directly.

- *Migrate customers.* If exiting proves to be the optimal decision, one delicate matter is how to handle customers who depend on the company for after-sales service support and parts. Obviously, it is important that customers not be “orphaned.” One solution is to migrate them to third parties. Gateway, for example, entered into contracts with third-party service providers to offer customer service support to its customers in the affected markets.

¹¹⁴David Besanko, David Dranove, and Mark Shanley, *Economics of Strategy* (New York: John Wiley & Sons, 2000), p. 338.

SUMMARY

Companies have a wide variety of entry strategy choices to implement their global expansion efforts. Each alternative has its pros and cons (see **Exhibit 9-11**). There is no shoe that one-size-fits-all solution. Many firms use a hodgepodge of entry modes. Starbucks, for instance, uses a combination of company-owned stores, licensing, and joint ventures.

Within the same industry, rivals often adopt different approaches to enter new markets. Cummins Engines, a leading U.S.-based diesel engine maker, uses a strategy based on joint ventures with outside groups—mostly customers but also competitors like Komatsu. Caterpillar, on the other hand, prefers to have total control over its new ventures, using acquisitions as a

EXHIBIT 9-11

ADVANTAGES AND DISADVANTAGES OF DIFFERENT MODES OF ENTRY

| <i>Entry Mode</i> | <i>Advantages</i> | <i>Disadvantages</i> |
|------------------------|---|---|
| Indirect exporting | <ul style="list-style-type: none"> • Low commitment (in terms of resources) • Low risk | <ul style="list-style-type: none"> • Lack of control • Lack of contact with foreign market • No learning experience • Potential opportunity cost |
| Direct exporting | <ul style="list-style-type: none"> • More control (compared to indirect exporting) • More sales push | <ul style="list-style-type: none"> • Need to build up export organization • More demanding on resources |
| Licensing | <ul style="list-style-type: none"> • Little or no investment • Rapid way to gain entry • Means to bridge import barriers • Low risk | <ul style="list-style-type: none"> • Lack of control • Potential opportunity cost • Need for quality control • Risk of creating competitor • Limits market development |
| Franchising | <ul style="list-style-type: none"> • Little or no investment • Rapid way to gain entry • Managerial motivation | <ul style="list-style-type: none"> • Need for quality control • Lack of control • Risk of creating competitor |
| Contract manufacturing | <ul style="list-style-type: none"> • Little or no investment • Overcome import barriers • Cost savings | <ul style="list-style-type: none"> • Need for quality control • Risk of bad press (e.g., child labor) • Diversion to gray and/or black markets |
| Joint venture | <ul style="list-style-type: none"> • Risk sharing • Less demanding on resources (compared to wholly-owned) • Potential of synergies (e.g., access to local distribution network) | <ul style="list-style-type: none"> • Risk of conflicts with partner(s) • Lack of control • Risk of creating competitor |
| Acquisition | <ul style="list-style-type: none"> • Full control • Access to local assets (e.g., plants, distribution network, brand assets) • Less competition | <ul style="list-style-type: none"> • Costly • High risk • Need to integrate differing national/corporate cultures • Cultural clashes |
| Greenfield | <ul style="list-style-type: none"> • Full control • Latest technologies • No risk of cultural conflicts | <ul style="list-style-type: none"> • Costly • Time consuming • High political & financial risks |

route to expand overseas.¹¹⁵ In the car industry, Ford likes to expand through acquisitions; General Motors prefers to rely on strategic alliances. Rick Wagoner, GM's chief executive, rationalizes the alliance strategy as follows: "Our alliance approach allows us to realize synergies faster than we could in a full buy-out situation. Alliances help us to grow in markets where we are underrepresented."¹¹⁶ A company's expansion strategies can also vary across regions. Computer software company CA's expansion strategy in the United States was to buy up software companies and then integrate their software products with the rest of the firm. In Asia, the software maker has taken a different route. Instead, the firm expanded by forming joint ventures with local players.¹¹⁷ In China, for instance, CA established six joint ventures, all with industry leaders. A key motivation was that the local government prefers partnerships for the software industry. CA claimed that it is in a much better position to compete with foreign and domestic vendors than if it had followed Microsoft's or Oracle's in-house approaches.¹¹⁸

Companies often adopt a phased entry strategy: they start off with a minimal-risk strategy; once the perceived risk declines they switch to a higher commitment mode, such as a wholly owned venture. Caterpillar, Inc., the U.S.-based manufacturer of earth-moving and construction equipment, entered the former Soviet bloc in 1992 via direct exporting to minimize its financial risk exposure. After sales took off,

Caterpillar upped the ante by establishing joint ventures with Russian and U.S. firms.¹¹⁹

As this chapter discussed, a broad range of variables impact the entry mode choice. The three major dimensions include the resource commitment the firm is willing to make, the amount of risk (political and market) the firm is willing to take, and the degree of control that is desirable.

To compete more effectively in the global arena, more and more companies use cross-border strategic alliances to build up their muscle. Depending on the strategic role and the competitive position of the business unit involved, the goal of the alliance could be to defend, strengthen, sustain, or restructure the strategic business unit (SBU). The benefits that the partners can derive from the synergies of the alliance often downplay the concerns the parent companies might have about the partnership. Still, the formation of the alliance should always be preceded by a meticulous analysis of questions like:¹²⁰

- What are the mutual benefits for each partner?
- What learning can take place between firms?
- How can the parties complement each other to create joint capabilities?
- Are the partners equal in strength or is this the case of the "one-eyed guiding the blind"?

Satisfactory answers to these questions improve the chances of the cross-border alliance becoming a win-win situation for all partners involved.

¹¹⁵"Engine Makers Take Different Routes," *The Financial Times* (July 14, 1998), p. 11.

¹¹⁶"Carmakers Take Two Routes to Global Growth," *The Financial Times* (July 11, 2000), p. 29.

¹¹⁷"Integrating Into Asia," *Far Eastern Economic Review* (March 16, 2000), pp. 55-56.

¹¹⁸"Speak Nicely and Carry a Big Check," *Business China* (January 29, 2001), p. 12.

¹¹⁹Avraham Shama, "Entry Strategies of U.S. Firms to the Newly Independent States, Baltic States, and Eastern European Countries," *California Management Review*, vol. 37, no. 3, Spring 1995, pp. 90-109.

¹²⁰Peter Lorange, Johan Roos and Peggy S. Bronn (1992), "Building successful strategic alliances," pp. 12-13.

KEY TERMS

| | | | |
|-----------------------------|----------------------|-----------------------|----------------------------|
| Acquisition and merger | Equity joint venture | Greenfield operation | Resource-based view (RBV) |
| Contract manufacturing | Export agent | Licensing | Strategic alliance |
| Cooperative exporting | Export management | Master franchising | Synergy |
| Cooperative joint venture | company (EMC) | Near-market knowledge | Transaction-cost economics |
| Cross-licensing | Export merchant | Outsourcing | (TCE) |
| Direct (indirect) exporting | Franchising | Piggyback exporting | |

REVIEW QUESTIONS

1. Why do some MNCs prefer to enter certain markets with a liaison office first?
2. What are the possible drawbacks of 50-50 joint ventures?
3. Draw up a list of the respective pros and cons of licensing.
4. What are the respective advantages and disadvantages of greenfield operations over acquisitions?
5. What mechanisms can firms use to protect themselves against ill-fated partnerships?

DISCUSSION QUESTIONS

1. NTT DoCoMo, which dominates Japan's mobile phone market, follows a somewhat unusual international expansion strategy. Its strategy is to take minority stakes rather than full control in a foreign mobile operator. The reason is that it prefers to acquire stakes up to a level that allows it to participate in management but respect the local company's

autonomy. DoCoMo claims that it can provide valuable technology expertise in mobile multimedia and 3G to its partners. Assess DoCoMo's expansion strategy.

2. Companies tend to begin their internationalization process in countries that are culturally very close. For instance, U.S.-based companies would enter Canada and/or the United Kingdom first, before moving on to other countries. The so-called psychic distance between the United States and Canada (or Britain) is small given that these countries are supposedly very similar. A recent survey, however, found that only 22 percent of Canadian retailers felt that they were operating successfully in the United States. Explain why culturally close countries are not necessarily easy to manage.

3. Assignment. Check some recent issues of the *Wall Street Journal* and/or the *Financial Times*. Look for articles on cross-border strategic alliances. Pick one or two examples and find out more about the alliances you chose via a search on the Internet. Why were the alliances formed? What do the partners contribute to the alliance? What benefits do they anticipate? What concerns/issues were raised?

4. Helmut Maucher, former chairman of Nestlé was quoted saying: "I don't share the euphoria for alliances and joint ventures. First, very often they're an excuse, and an easy way out when people should do their own homework. Secondly, all joint ventures create additional difficulties—you share power and cultures, and decisions take longer." Comment.

5. Exhibit 9-12 shows the timeline of Starbucks' global expansion. Discuss Starbucks' entry decisions. Do you see any patterns in its expansion strategy? Did the company over-expand in recent years especially given the turmoil the company experienced in 2008?

6. Ben Verwaayen, former chief executive of British Telecom (BT), was named as the new CEO of Alcatel-Lucent, the US/French telecommunications equipment group in September 2008. The merger that was completed in December 2006 was supposed to make the transatlantic group a world leader capable to compete with the likes of Nokia and Ericsson. Instead, the group has gone through a rocky marriage: the group reported a €1,102 million loss for the 2nd quarter of 2008 or €0.49 per share. A major reason for the wobbly merger has been the cultural differences between the French and American arms. The new CEO is an anglophile Dutchman who speaks fluent French. During his leadership at BT he built up a reputation as a turnaround artist. Can the new CEO end

EXHIBIT 9-12

TIMELINE INTERNATIONAL EXPANSION OF STARBUCKS COFFEE

| | |
|------|--------------------------------------|
| 1971 | First location in Seattle |
| 1987 | Canada (Vancouver, British Columbia) |
| 1996 | Hawaii |
| | Japan |
| | Singapore |
| 1997 | Philippines |
| 1998 | Malaysia |
| | New Zealand |
| | Taiwan |
| | Thailand |
| 1999 | China (Beijing) |
| | Kuwait |
| | Lebanon |
| | South Korea |
| 2000 | Australia |
| | Bahrain |
| | China (Shanghai) |
| | Dubai |
| | Hong Kong |
| | Qatar |
| | Saudi Arabia |
| 2001 | Austria |
| | Switzerland |
| 2002 | China (Shenzhen and Macau) |
| | Germany |
| | Greece |
| | Indonesia |
| | Mexico |
| | Oman |
| | Puerto Rico |
| | Spain |
| 2003 | Chile |
| | Cyprus |
| | Peru |
| | Turkey |
| 2004 | France |

Source: www.starbucks.com.

the culture clash at Alcatel-Lucent? What actions can incoming executives take to resolve internal strife in a global business? Is improved performance the best cure for cross-border chasms? Or should a new management team address cultural issues head-on?

SHORT CASES



BENQ'S DEAL OF THE CENTURY?

Like other Taiwanese firm, BenQ has tried to escape the anonymity of contract manufacturing by promoting brands. The company's core products include flat-screen TV sets, notebooks, PC monitors, MP3 players, mobile phones, and other consumer electronics gadgets. Spun off from Acer in 2001, it took the name BenQ ("bringing enjoyment and quality to life"). The US\$ 5.5 billion company wants to do more than churn out hardware with someone else's name on it. At present, 37 percent of BenQ's sales carry the BenQ brand name.

On June 7, 2005, BenQ, the Taiwanese consumer-electronics maker, suddenly became the world's fourth largest cellular-phone maker by acquiring the ailing handset division of Siemens AG, the German conglomerate. It looked like the bargain of the century. BenQ was getting the mobile handset business of Siemens for nothing—and the German company was even eating \$430 million in costs surrounding the transaction. One Taipei-based brokerage analyst commented: "It's a deal too good to be true for BenQ. They get the whole business and a decent brand for free." BenQ would acquire the rights to the Siemens trademark for 18 months, and co-branding rights for five years. BenQ would also gain access to Siemens' intellectual property, including its CSM, GPRS and 3G patents. Further, Siemens agreed to buy 50 million euros of BenQ stock.

As a result of the deal, mobile phones would now become one of BenQ's core businesses. Armed with a renowned brand name, new technology, and access to Siemens' customer base in Europe and Latin America, BenQ aspired to become a major player in the mobile phone market. Martin Roll, the author of *Asian Brand Strategy*, commented, "Siemens brand equity will give BenQ a major push in its stride to gain credibility in the European and U.S. markets." Lee Kun-yao, BenQ's chairman, explained the reasoning behind the deal as follows: "In BenQ we come more from the enjoyment side and consumer side of technology . . . Siemens has a very strong heritage in German technologies."

Some skeptics raised major concerns, however. After grabbing the no. 4 slot and 9 percent market share in global handset sales in 2002, the Siemens unit slipped to no. 5 in 2005 with a share of just 5.5 percent. Siemens has provided no guarantees to BenQ about the profitability of the handset business. Market leaders Nokia, Motorola, and Samsung, which currently command 60 percent of the worldwide handset market, have been steadily pulling away from their smaller competitors. It is unclear how BenQ plans to turn the Siemens business unit

around. In 2004, it incurred losses of \$615 million on sales of \$5.8 billion according to Merrill Lynch estimates. Siemens' efforts to squeeze costs were hampered by German trade unions, which had resisted relocations to lower-cost sites.

BenQ could use a lift. Vincent Chen, an analyst with CLSA Taipei, said that "Feedback on BenQ's products hasn't been great, and they've been late getting products to market." Kent Chan, an analyst with Citigroup Hong Kong, observed that: "The risk is that Siemens could wipe out BenQ profits in 2006." BenQ has little brand name recognition in Europe and in the United States. Its handset business was hit hard by a tumble in orders from Motorola, its biggest customers, after BenQ introduced its own brand name. BenQ has tried to make up for some of the Motorola loss with orders from the likes of Nokia and Kyocera, but its handset business is still smarting. BenQ's Q1 '05 profits tumbled by 90 percent to \$9.7 million as its revenues fell 23 percent to \$1 billion, compared with a year earlier.

The Siemens deal might solve some of its problems. BenQ planned to start using the Siemens name, then gradually introduce co-branded phones to build up the BenQ name in Europe and in the United States. The deal would also help BenQ gain access in new markets such as Latin America. Moreover, BenQ would inherit factories in Brazil and Germany and research facilities that have been working on next-generation products. "This kind of intellectual property is crucial to our success," noted BenQ president Sheaffer Lee.

BenQ and Siemens' combined market share dropped from 13.5 percent in the fourth quarter of 2004 to 9.8 percent in the third quarter of 2005. To reverse the fall, BenQ planned to focus on making handsets for 3G networks. It also sought to differentiate itself by using organic LED displays. Such displays are much brighter than standard LED screens, but wear out faster.

Still, BenQ's challenges seem tremendous. Professor Jagdish Sheth, co-author of *The Rule of Three*, said that further consolidation of marginal players would be required for BenQ to succeed. BenQ will also inherit the labor troubles that plagued Siemens, taking over 3,700 workers in high-cost Germany. BenQ must honor labor contracts through 2006. For BenQ, making this the deal of the century will be a huge task.

DISCUSSION QUESTIONS

1. How do you evaluate BenQ's acquisition deal of the Siemens handset unit? Is it indeed "too good to be true"? What are the pros and cons?
2. Where is BenQ vulnerable?
3. What strategic marketing recommendations would you make to BenQ's going forward?

Sources: "BenQ May Be Getting What It Paid For," *Business Week*, June 20, 2005; "BenQ Must Capitalize on 'Fleeting Platform'," *Media*, July 29, 2005; "BenQ's Combined Brand in Handset Drive," *Financial Times*, January 18, 2006, p. 18; www.benq.com



ASE 9-2

CAN MCDONALD'S DE-THRONE THE COLONEL IN CHINA?

McDonald's opened its first restaurant in China in Shenzhen in 1990. McDonald's expansion since then has been rapid: it had 750 outlets by the end of 2005 and planned to have 1,000 restaurants by the time of the Beijing Summer Olympics in 2008, for which McDonald's is a sponsor. Contrary to KFC, which is opening outlets in second and third tier cities, McDonald's prefers to grow within the large cities. Tim Fenton, McDonald's executive in charge of Asian operation, says: "When you start to get out of the bigger cities you start to fragment your transportation infrastructure."

However, although McDonald's may be the undisputed fast food brand in the Western world, it is far behind Yum! Brands in China. Yum! Brands operates Pizza Hut (180 restaurants) and, most importantly, KFC. KFC has over 1,500 outlets in China and a broader geographic coverage than the Golden Arches. Yum! may have had a first-mover advantage: it was the first fast-food restaurant chain to enter China in 1987 (Pizza Hut was introduced in 1990). The fact that most Chinese consumers prefer chicken to beef also helped Yum! to build up a successful business in China. KFC has also a much more localized menu than McDonald's featuring items such as a "Dragon Twister," egg tarts, and congee. David Novak, Yum! Brands chief executive, predicts that KFC's China business is on track to become as big as McDonald's in the USA.

Still, McDonald's is not willing to cede China to the Colonel. One way that McDonald's is trying to narrow the gap is by

adding drive-through restaurants. KFC was the first western fast-food chain to open a drive-through in China in 2002. McDonald's opened its first one in November 2005. The three it had by early 2006 were outperforming average volume of existing restaurants by 50–80 percent. The chain plans to open 12 to 15 drivethroughs every year for the coming three years. The company hopes to benefit from the rapid growth of car ownership.

McDonald's will also introduce menu changes. The company believes that there are three basic customer tiers: value-conscious diners; less price-sensitive diners loyal to the core menu items of Big Macs and fries; upper-level consumers who are willing to buy premium items. In China, McDonald's launched nine products priced at 60 US cents or less. It will also launch a rice burger, first introduced in Taiwan, targeted at higher spending consumers.

Clearly, McDonald's remains a brand to watch in China, in spite of the strides made by Colonel Sanders' KFC army. Fears triggered by bird flu might convince Chinese consumers to enjoy a Big Mac or rice burger instead of the Colonel's fried chicken. Nutritional concerns that have cast a shadow in developed markets are less of an issue in China. As Tim Fenton pointed out: China is obviously the biggest opportunity that we have going right now."

DISCUSSION QUESTIONS

1. Do you agree with the steps McDonald's plans to take to expand its business in China (adding drivethroughs, focus on big cities, localize menu)?
2. What other remedies would you prescribe if you were in Tim Fenton's shoes?

Sources: "Can McDonald's Steal Yum's China Crown?" *Media* (January 13, 2006): 15; and "McDonald's Drive Towards Big City Sales," *Financial Times* (February 22, 2006): 12.

ASE 9-3

FONTERRA ENGULFED IN CHINA'S TAINTED MILK CRISIS

Fonterra is a New Zealand dairy cooperative that is owned by 11,000 farmers. Its core business consists of exporting New Zealand dairy products across the globe. The cooperative accounts for more than a third of international dairy trade. With annual sales revenues of NZ\$13.9 billion (around US\$8.8 billion), Fonterra is the world's sixth largest dairy producer with

Sources: www.fonterra.com, accessed on October 10, 2008; "NZ Dairy raps China over secrecy; one brand is recalled in a first for the U.S. over the milk scandal," *The Wall Street Journal Asia*, Sept. 29, 2008: p. 2; http://www.economist.com/world/asia/displaystory.cfm?story_id=12262271; http://en.wikipedia.org/wiki/Sanlu_Group, accessed on October 10, 2008; "Unknown risks of globalized food," *International Herald Tribune*, October 13, 2008: pp. 1, 6; and <http://www.abc.net.au/news/stories/2008/09/24/2373501.htm>.



brands such as Anchor and Anlene in its portfolio. As part of its mission to become a global business, Fonterra has established manufacturing sites and joint ventures in numerous countries.

In 2005 Fonterra paid \$107 million to establish a 43 percent joint venture equity stake in Sanlu [literally *three deer*], a state-owned dairy food company based in Shijiazhuang, the capital city of Hebei province. Sanlu's milk powder brand had been China's leading brand in the category for many years. The group's 2007 turnover was ¥10 billion (around US\$1.4 billion). Sanlu prided itself in its stringent quality control measures boasting that over 1,000 different tests were carried out before its products leave the factory. Posters at Sanlu's headquarters in Shijiazhuang proclaimed, "Quality and safety are the foundations of social harmony." The Sanlu Fonterra joint venture also gained much publicity in May 2008 when it donated \$1.25 million worth of baby milk formula to infants orphaned or displaced by a devastating earthquake in Sichuan province.

In mid-July 2008 the government of Gansu province in Western China informed China's Ministry of Health about an unusual string of illnesses among infants caused by kidney stones. The infants had all consumed the same brand of Sanlu baby milk formula. Later investigations would point the finger to middlemen who collected milk from the farmers. Several of these middlemen had cheated by diluting their milk with water. To fool instruments used to measure protein content, melamine was added to the milk. Melamine, a white powder used to make plastics, was also the root cause behind the pet food poisoning that occurred a year earlier. The Chinese central government had boasted that it had reacted rapidly to the baby milk poisoning scandal. The chronology of events, however, suggested otherwise.

Sanlu's board told was informed about the melamine contamination at a board meeting on August 2nd though Beijing authorities claimed that Sanlu knew of reports of children becoming sick after drinking Sanlu formula as early as March. The following day Fonterra's China directors met with the local health officials in Shijiazhuang, Sanlu's hometown, and demanded a public recall. Instead, these officials advocated a "quiet" recall without any public disclosure. They cited the need for social stability. Some speculate that government officials were worried that the upcoming Beijing Olympics might be marred by a food scare. Fonterra accepted the compromise. Mr. Ferrier, Fonterra's CEO, said that the other option was to go public outside China to put pressure on the Chinese government. However, the company feared it would "lose control of the whole thing. At least we were effective in recalling the product." Sanlu withdrew over 10,000 tons of tainted milk powder from local stores. Still Fonterra felt that it was misled by local health officials who the company thought would have informed the central government. As the weeks

passed the scandal was still kept under wraps. Finally, on September 5 Fonterra approached New Zealand's prime minister, Helen Clark, to prod the Beijing government to cope with the problem more urgently. Helen Clark alerted the Beijing government on the milk contamination by Fonterra. A few days later, on September 11, Sanlu announced a nationwide recall. Shortly after, the Ministry of Health gave its first press conference on the scandal and declared a national food-safety emergency. Though Sanlu was the focus of the scandal, traces of melamine were also found in many other dairy products produced in China, prompting the European Union and other governments to ban or recall products with Chinese milk ingredients. Eventually, the contamination caused kidney illnesses in 50,000 Chinese infants and led to at least four infant deaths.

The scandal clearly hurt Fonterra's profits and reputation. The company has been criticized by Helen Clark and others for not coming forward earlier. Fonterra executives maintained they had not made any mistakes. A Fonterra spokeswoman pointed out that: "Melamine is not something you would be reasonably expected to find in milk. We have only recently become aware of one dairy company in the world who routinely tests for melamine." Fonterra defended its decision to keep its information under wraps for so long. Andrew Ferrier, the company's chief executive, stated, "If you don't follow the rules of an individual market place then I think you are getting irresponsible." The company claimed that it tried to ensure a recall "as quickly as we could in the environment we were working in." The company was frustrated with the initial lack of public disclosure. Still Mr. Ferrier was concerned by allegations that Sanlu knew there was a problem for eight months: "If something did exist prior to that we're shocked that it did and we obviously feel that if people were aware of it, it should have gone to the [Sanlu] board." Fonterra does not regret investing in China but it acknowledges that the Sanlu brand could have been damaged beyond repair.

DISCUSSION QUESTIONS

1. Fonterra waited 40 days (from August 2 until September 11) before going public with the information that its products in China were contaminated with melamine. Andrew Ferrier, its CEO, defended its response to the crisis and took what it regarded as the best action by working within the Chinese system. Do you agree? Where there any better alternative responses available to the company?
2. To what extent will the China milk contamination crisis hurt Fonterra's business?
3. What lessons are to be drawn from Fonterra's experience in China?

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APPENDIX

Alternative Country Screening Procedure. When the product has already been launched in some regions, the firm might consider using a variant of the country screening procedure described in this chapter. The alternative method leverages the experience the firm gathered in its existing markets. It works as follows: Suppose the MNC currently does business in Europe and is now considering an expansion into Asia.

Step 1. *Collect historical data on European market*

Go back to your files and collect the historical data for the European markets on the indicators that you plan to use to assess the market opportunities for the Asian region. Let us refer to these pieces of information as X_{iec} , that is, the score of European country ec on indicator i .

Step 2. *Evaluate the MNC's post-entry performance in each of its existing European markets*

Assess the MNC's post-entry performance in each European country by assigning a success score (e.g., on a ten-point scale). If performance is measured on just one indicator, say, market-share achieved five years after entry, you could also simply use that indicator as a performance measure. Let us refer to the performance score for country ec as S_{ec} .

Step 3. *Derive weights for each of the country indicators*

The next step is to come up with importance weights for each of the country indicators. For this, you could run a cross-sectional regression using the European data gathered in the previous two steps. Our dependent variable is the

post-entry success score (S_{ec}) while the predictor variables are the country indicators (X_{iec}):

$$S_{ec} = a + w_1 X_{1ec} + w_2 X_{2ec} + \dots + w_i X_{iec} \\ ec = 1, 2, \dots, EC$$

By running a regression of the success scores, S_{ec} , on the predictor variables, X_{iec} ($i = 1, \dots, I$), you can derive estimates for the importance weights of the different indicators.

Step 4. *Rate the Asian countries in the pool on each indicator*

Each of the Asian candidate markets in the pool is given a score on each of the indicators that are considered: X_{iac} .

Step 5. *Predict performance in prospect Asian countries*

Finally, predict the post-entry performance in the prospective Asian markets by using the weights estimated in the previous step and data collected on each of the indicators (the X_{iac} 's) for the Asian countries. For instance, the regression estimates might look like:

$$\text{Performance} = -0.7 + 6.0(\text{Market Size}) \\ + 2.9(\text{Growth}) - 1(\text{Competition})$$

By plugging in the ratings (or actual values) for the Asian markets in this equation, you can then predict the MNC's performance in each of these countries.