THE UNIVERSITY OF NEWCASTLE
AUSTRALIA

Faculty of Business and Law

GSBS6481 International Business Strategy

Week 5: Foreign Market Entry

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Reference & Readings

- Peng, Mike W (2021), *Global Strategy*, 5th ed. USA: Cengage Learning.
  - Chapter 5 & 6
- Ghemawat, P. 2001. Distance still matter. Harvard Business Review, September, 79(8), 137-140, 142-7, 162.
- Tan, H., Yang, M. 2021. The new liability of origin in global decoupling, Management and Organization Review, 17, 624-629.

Key concepts

- Liability of foreignness
- Liability of origin
- Born-global firms
- First-mover v.s. later mover advantages
- Entry mode
- Internalization

Key questions around foreign market entry

- Liability of foreignness and the CAGE distance framework
- Why go abroad?
- Where to enter?
- When to enter?
- How to enter?

Why go abroad

- Liability of foreignness
  - The *inherent* disadvantage foreign firms experience in host countries because of their non-native status
- Asset of foreignness
  - A contrasting view to liability of foreignness argues that under certain circumstances, being foreign can be an asset (that is, a comparative advantage)

Sources of the liability of foreignness

- The CAGE Distance framework suggests that four dimensions of distance are important for firms when considering to expand into a foreign market

  - **<u>C</u>**ultural distance
  - **<u>A</u>**dministrative and political distance
  - **<u>G</u>**eographic distance
  - **<u>E</u>**conomic distance

See Ghemawat, P. 2001. Distance still matter. Harvard Business Review, September, 79(8), 137-40, 142-7, 162. (The supplementary reading of this week)

Cultural distance

- Differences in religious beliefs, race, social norms and language etc between two countries can have a huge impact on trade

  - ➢ E.g. all other things being equal, trade between countries that share a language will be three times greater than between countries without a common language
  - ➢ Other cultural attributes e.g. social norms also have significant implications to IB (e.g. attitudes toward copyright infringement in different nations)

Cf. Ghemawat (2001)

Administrative / Political distance

- Shared monetary or political association
- Political hostility
- Government policies
- Institutional weakness
- Additional question: *Are companies more likely to internationalize to countries politically/culturally close or distant to their home countries?*

Geographic distance

- Geographic distance is a major barrier of international trade
  - e.g.
  - A 10% increase in transport costs reduces trade volumes by 20%.
  - Bilateral trade declines about 1% for every percentage increase in the distance separating a pair of countries

Source: see Ellis (2007)

Economic distance

- Differences in consumer income
- Differences in resources, infrastructure and technologies

Liability of Origin

- The negative perception of firms and products from a certain country

- A term particularly used to describe disadvantages of emerging economy-multinational enterprises (EE-MNEs) associated with their national origins

- New liability of origin due to global decoupling and geopolitical conflicts?

Why (why not) go abroad?

- Industry-based considerations

- Resource-based considerations

- Institution-based considerations

Why Go Abroad - Industry-based considerations

Size of the Firm

Size of the Domestic Market	*Large Firm*	*Small Firm*	
	(Cell 1) Enthusiastic internationalizer	(Cell 2) Follower internationalizer	*Small Domestic Market*
	(Cell 3) Slow internationalizer	(Cell 4) Occasional internationalizer	*Large Domestic Market*

Why go abroad - Industry-based considerations (cont.)

- Rivalry among established competitors
  - E.g. retail supermarket chains
- Entry barriers
  - E.g. Gain economy of scale by selling to foreign markets
- Bargaining power of suppliers
  - E.g. Entry through backward vertical integration with upstream activities
- Bargaining power of buyers
  - E.g. Entry through forward vertical integration with downstream activities
- Substitute products/services

Why go abroad - Possible resource-based considerations

- Capitalize on valuable, rare, difficult to imitate resources - the exploitation benefits, e.g.
  - Reach larger economies of scale
  - Spread investment risks
  - Increase market power over suppliers, distributors and customers
- Enhance the knowledge base, capabilities, and competitiveness through experiential learning - the exploration benefits, e.g.
  - Natural resource seeking
  - Market seeking
  - Efficiency seeking
  - Innovation seeking

Why go abroad - Possible institution-based considerations

- Trade barriers: Tariff/Non Tariff barriers (e.g. local content requirements, entry modes restrictions etc.)
- Regulatory risks
- Cultural distance
- Business norms

Overcoming the liability of foreignness

How do foreign firms crack new markets?

- The institution-based view suggests that firms need to take actions deemed legitimate and appropriate by the various formal and informal institutions governing market entities
- The resource-based view argues that foreign firms need to deploy overwhelming resources and capabilities to offset their liability of foreignness

Where to Enter - Two approaches/ schools of thought

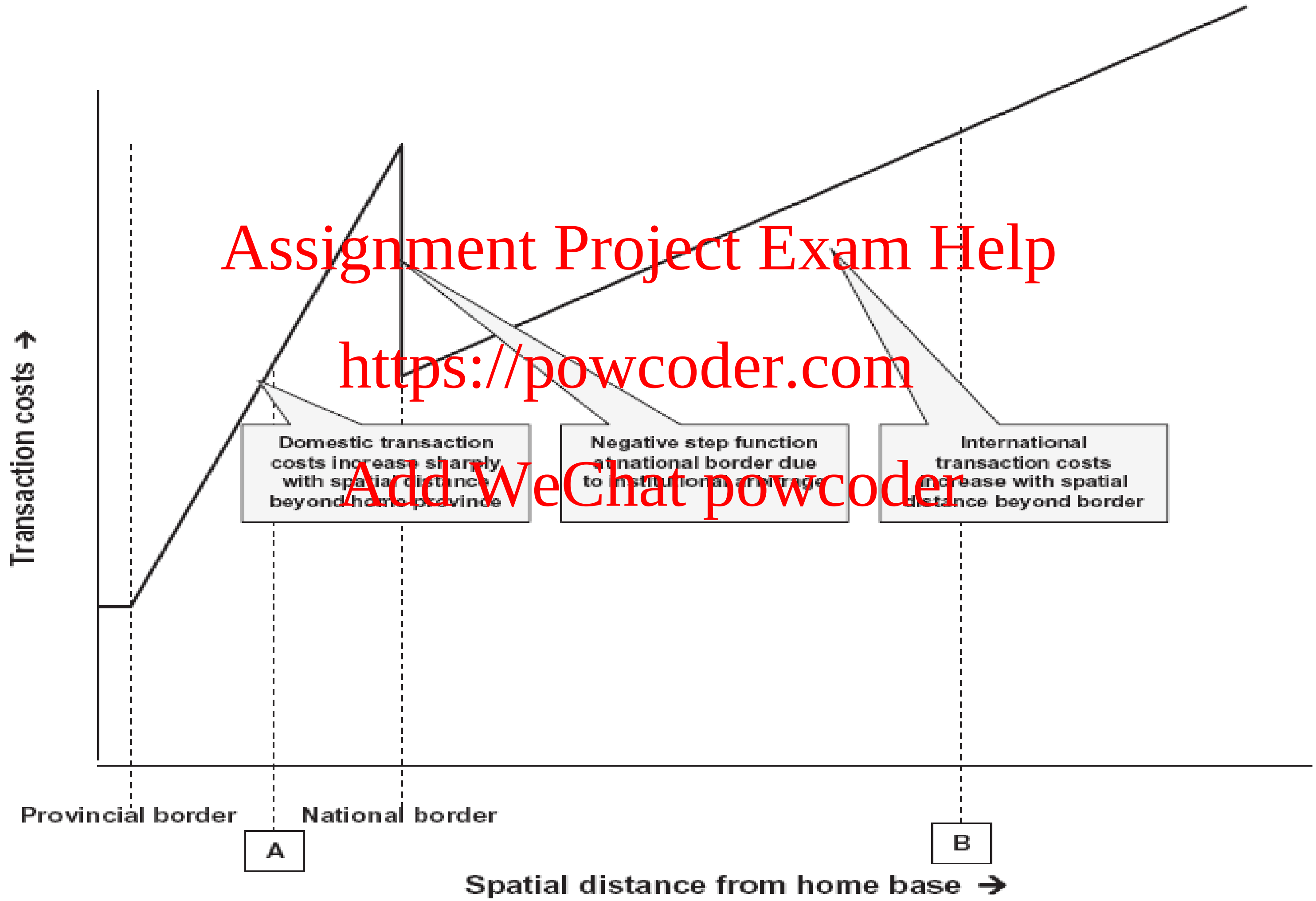
- Stage models in which firms enter culturally similar countries during the first stage of internationalization and, as they gain confidence, enter culturally more distant countries in later stages.

- Born-global firms

When to enter - First-mover advantages vs. late mover advantages

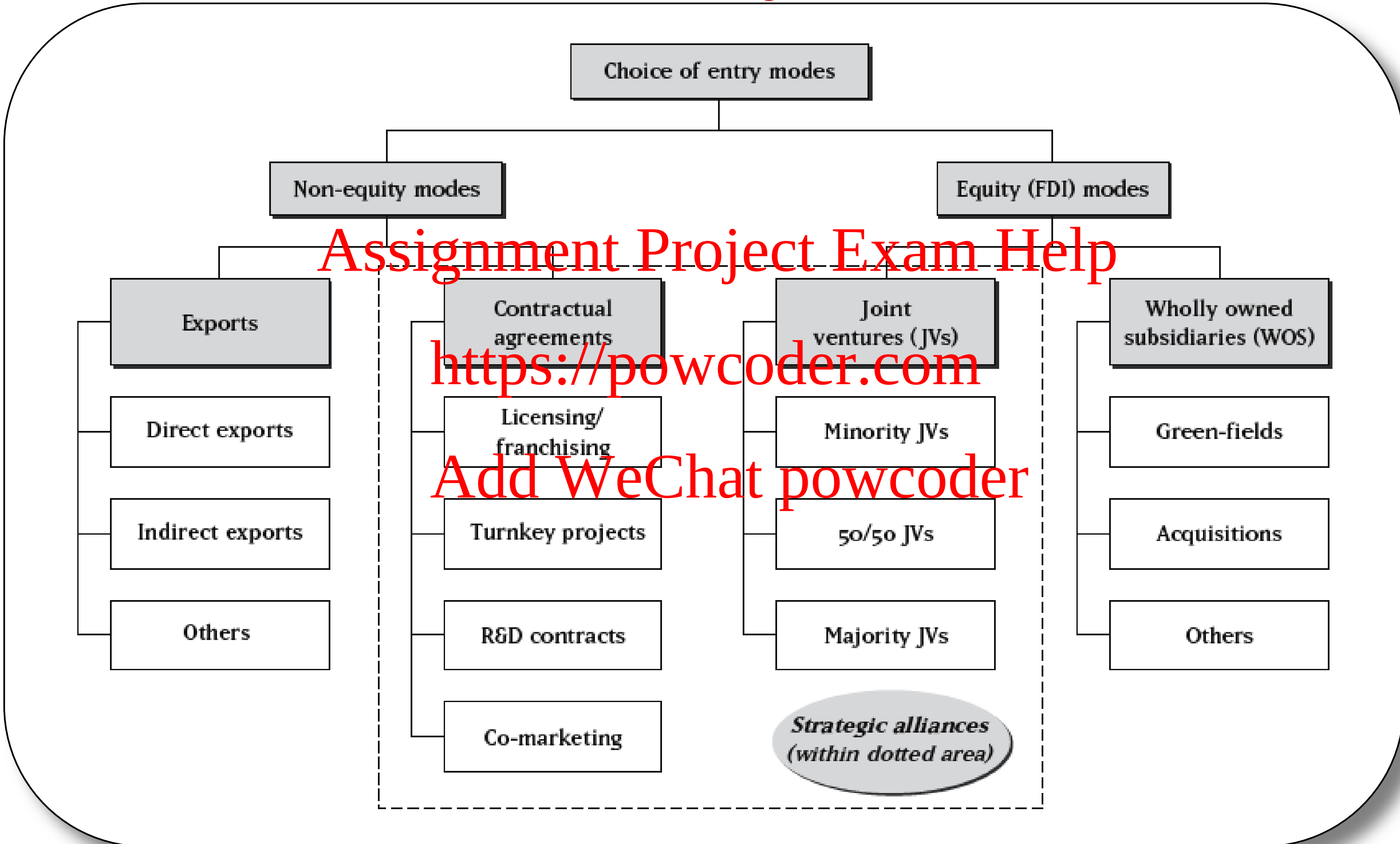
- First-mover advantages
- Late mover advantages
- Also timing of internatialization in terms of the development stage of the company
  - Early vs. late internationalization

Early vs. Late Internationalization: The Chinese case



Source: Boisot & Meyer (2008) "Which Way through the Open Door? Reflections on the Internationalization of Chinese Firms". **Management and Organization Review** 4:3 349–365

How to enter: The choice of entry modes



Source: Adapted from Y. Pan & D. Tse, 2000, The hierarchical model of market entry modes (p. 538), Journal of International Business Studies, *31: 535–554.*

Exporting and Importing

- Often the only available choices for small and new firms wanting to go international
- Provide an avenue for larger firms that want to begin their international expansion with a minimum of investment
- Exporting and importing can provide easy access to overseas markets
- Subject to trade barriers and protectionism

Exporting and Importing

Licensing

- An agreement that allows one party to use an industrial property right in exchange for payment to the other party

- By licensing to a firm already there, the licensee may avoid entry costs

- Licensor usually may be a small firm that lacks financial and managerial resources

- Companies that spend a relatively large share of their revenues on research and development (R&D) are likely to

Exporting and Importing

Licensing

Franchising

- Business arrangement under which one party (the franchisor) allows another (the franchisee) to operate an enterprise using its trademark, logo, product line, and methods of operation in return for a fee
- Widely used in the fast-food and hotel/motel industries
- With minor adjustments for the local market, it can result in a highly profitable international business

Exporting and Importing

Licensing

Franchising

Alliances & JVs

Alliance

- Any type of cooperative relationship among different firms.
- ***Global Strategic Alliance*** (GSA): Voluntary agreements between two or more firms from different countries who pursue exchange, sharing, or co-developing of products, technologies, or services.
- As globalization increases, strategic alliances and networks have proliferated globally.

International joint venture (IJV)

- An agreement under which two or more partners from different countries own or control a business

Advantages

- Improvement of efficiency
- Access to knowledge, Political factors

Why do firms become MNEs by engaging in FDI?

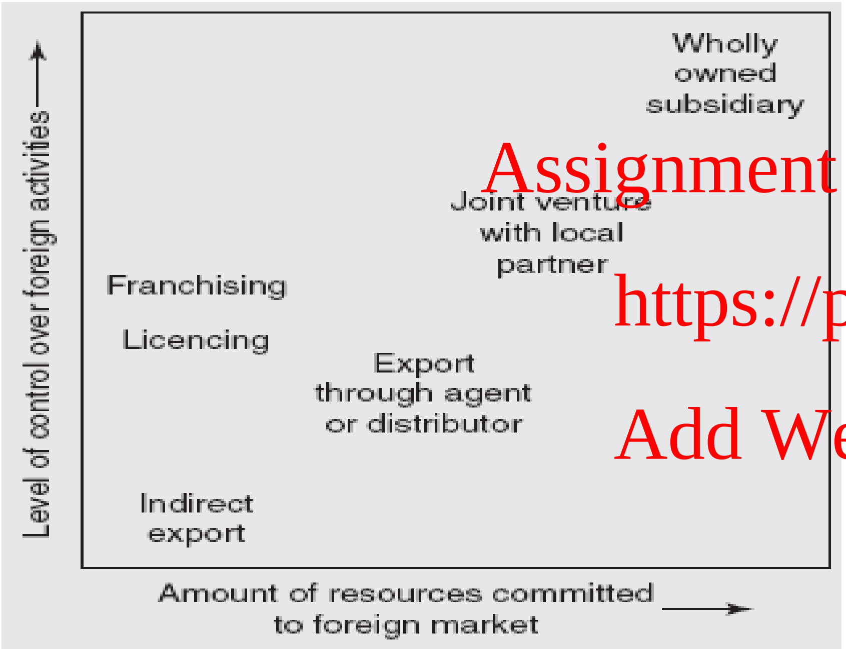
OLI advantages – a firm's quest for ownership (O) advantages, location (L) advantages, and internalization (I) advantages via FDI

- Ownership – an MNE's possession and leveraging of certain valuable, rare, hard-to-imitate, and organizationally embedded (VRIO) assets overseas in the context of FDI

- Location – advantages enjoyed by firms operating in a certain location

- Internalization – the replacement of cross-border markets (such as exporting and importing) with one firm (the MNE) locating and operating in two or more countries

Key strategic consideration: Control versus Commitment



- Large-Scale Entries
  - Benefit from a strategic commitment
  - Drawbacks of large-scale entries – Limited strategic flexibility and potential huge losses
- Small-scale entries
  - Focus on accumulating experience
  - “Learning by doing”
  - Drawbacks of small-scale entries
    - A lack of strong strategic commitment
    - Difficulties in building market share