CHAPTER

5

MODES OF ENTERING INTERNATIONAL BUSINESS

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Chapter Outline

(A) Introduction;
(B) Modes of Entry: Exporting, licensing, franchising, contract manufacturing, management contracts, turnkey projects, foreign direct investment, alliances like mergers and acquisitions, joint ventures;
(C) Comparison of Different Modes of Entry;
(D) Functional Alliances;
(E) Managing Conflict Situations;
(F) Break-up of Alliances.

Learning Objectives

After studying this chapter, you should be able to –

- Understand the reasons for entering international markets;
- Know-how the external environment helps the firms in entering global markets;
- Explain the various methods of entry to foreign markets;
- Analyse the pros and cons of each method;
- Decide the most appropriate method for a specific firm to enter the global market;
- Describe how the strategic alliances provide the appropriate channel for entering international markets;
- Analyse the functional alliances;
- Understand and evaluate the conflicting situations and the method of managing conflict situations;
- Describe the situations when the coalitions break.

Toyota enters foreign markets through a
companies in foreign countries cannot produce

Companies with low cash reserves normall
investment (FDI). Merck entered Israel by issuing
in order to save the expenses of establishing i
FDI. Firms also enter through FDI in order to
synergies between their domestic and internation

I. **EXPORTING**

1. Indirect Exports
2. Direct Exports
3. Intra-corporate Transfers

II. **LICENSING**

However, the software companies prefer licensing and franchising mode as they have to respond quickly to the market needs. *For example*, Microsoft and Compaq.

Thus, different firms select different modes based on the nature of the industry, company's abilities and the conditions in the host country.

Now, we shall shift our discussion to the different modes of entry to the foreign markets. *Fig. 5.1* presents the different modes of entry to international business

I. EXPORTING

Exporting is simplest and widely used mode

Exporting is the simplest and widely used mode of entering foreign markets.

The advantages of exporting include:

- **Need for Limited Finance:** If the company selects a another company in the host country to distribute the company can enter international market with no or less financial resources. Alternatively if the company chooses to distribute on its own, it needs to invest financial resources, but this amount would be quite less compared to that would be necessary under other modes.
- **Less Risk:** Exporting involves less risk as the company understands the culture, customer and the market of the host country gradually. The company can enter the host country on a full-scale, if the product is accepted by the host country's market. A British company selected this mode to export jams to Japan. *Box 5.1 presents this mode of the British company.*

BOX 5.1 : JUMPING ON A JAPANESE JAM DEAL

Managers at Chivers Hartley recently scored a major coup by landing a big order from Jusco, one of Japan's largest retailers. Chivers is a UK firm that makes a variety of fruit preserves — jellies, jams, and marmalades. Because its domestic market has matured, Chivers sees exports as an important growth opportunity. The firm currently obtains 15 per cent of its revenues from exports, with France, Germany, and Holland its largest foreign markets.

Based on this feedback, Chivers began developing a new product line just for the Japanese market. First, product formulas were altered to include more fruit and less sugar. In addition, Chivers also developed blueberry as a flavour, since it is popular among Japanese consumers. The firm also switched to smaller jars because Japanese consumers are accustomed to making more frequent trips to market, use jams more sparingly than British consumers do, and have less storage space. Chivers also created an exclusive new brand name just for Jusco called Cambridgeshire. The jar labels have a sepia picture of King's College, Cambridge, taking advantage of Japanese respect for British universities.

Source: "Japanese Jam Deal Set to Boost Preserve Group," *Financial Times*.

- **Motivation for Exporting:** Motivations for exporting are proactive and reactive. Proactive motivations are opportunities available in the host country. *San Antonio's Pace, Inc., producing Tex-Mex food products exported its products to Mexico as Mexicans relished the taste of its products.*

Reactive motivations are those efforts taken by the company to export the product to a foreign country due to the decline in demand for its product in the home country.

Toto Ltd., of Japan started exporting its products, i.e., Porcelain bathroom fixtures to China when the Japanese economy started slowing down in 1990s. (See Box 5.2).

Forms of Exporting

Forms of exporting include: indirect exporting, direct exporting and intracorporate transfers.

1. Indirect Exporting

Indirect exporting is exporting the products either in their original form or in the modified form to a foreign country through another domestic company. *Various publishers in India including Himalaya Publishing House sell their products, i.e., books to various exporters in India, which in turn export these books to various foreign countries.*

2. Direct Exporting

Direct exporting is selling the products in a foreign country directly through its distribution arrangements or through a host country's company. Baskin Robbins initially exported its icecream to Russia in 1990 and later opened 74 outlets with Russian partners. Finally, in 1995 it established its ice cream plant in Moscow.

3. Intra-corporate Transfers

affiliated

Intra-corporate transfers are selling of products by a company to its affiliated company in host country (another country). Selling of products by Hindustan Lever in India to Unilever in the USA. This transaction is treated as exports in India and imports in the USA. *(See Box 5.2)*.

Factors to be considered: The company, while exporting, should consider the following factors:

- Government policies like export policies, import policies, export financing, foreign exchange etc.
- Marketing factors like image, distribution networks, responsiveness to the customer, customer awareness and customer preferences.
- *Logistical consideration:* These factors include physical distribution costs, warehousing costs, packaging, transporting, inventory carrying costs etc.
- *Distribution Issues:* These include own distribution networks, networks of host country's companies. Japanese companies like Sony, Minolta and Hitachi rely on the distribution networks of their subsidiaries in the host country.

BOX 5.2 : INTER-CORPORATE TRANSFERS OF GENERAL MOTORS

General Motors Latin America, Africa and Middle East region (GM LAAM) is one of GM's four regional business units, made up of its Latin American Operations (LAO) sub-division in South America, its Africa (AO) and Middle East Operations (MO) sub-division. General Motors opted for the strategy of entering South American market is to locate its manufacturing facilities in the South American countries in view of lower labour cost and logistics and material cost. It produces in South American countries and transfer the product to other markets in Africa, Middle East, etc., for sale.

GM employs approximately 33,000 people in its core automotive business and majority owned joint ventures. In South America, GM enjoys a longstanding leadership position in the key automotive markets of GM LAAM vehicle sales in 2006 totalled 1,035,277 units, representing an increase of 17.4 per cent from the previous year and an overall market share of 17.7 per cent. The total vehicle market in South America strengthened in 2006, with total industry sales at 3,271,812 up 4,81,540 units from 2005. GM's South American operations achieved total sales of 7,30,897 representing an increase of 14.6 per cent from 2005 and a market share of 22.3 per cent.

Source: GM Annual Reports

Export Intermediaries: Export intermediaries perform a variety of functions and enable the small companies to export their goods to foreign countries. Their functions include: handling transportation, documentation, taking ownership of foreign-bound goods, assuming total responsibility for exporting and financing. Types of export intermediaries include:

- *Export Management* companies act as export department of the exporting firm (its client). These companies act as commission agents for exports or they take tittle to the goods.
- *Cooperative Society:* The domestic companies desire to export the goods form a co-operative society, which undertakes the exporting operations of its members.
- *International Trading Company:* This company is engaged in directly exporting and importing. It buys the goods from the domestic companies and exports. Therefore, the companies can export their goods by selling them to the international trading company.
- *Manufacturers' Agents:* They work on a commission basis. They solicit domestic orders for foreign manufacturers.

- *Manufacturers' Export Agents:* They sell the domestic manufacturers' products in the foreign markets and act as their foreign sales department.
- *Export and Import Brokers:* The brokers bridge the gap between exporters and importers and bring these two parties together.
- *Freight Forwarders:* Freight forwarders help the domestic manufacturers in exporting their goods by performing various functions like physical transportation of goods, arranging customs documents and arranging transportation services.

Now, we shall discuss the next mode of entering foreign markets, *i.e.*, International Licensing.

II. LICENSING

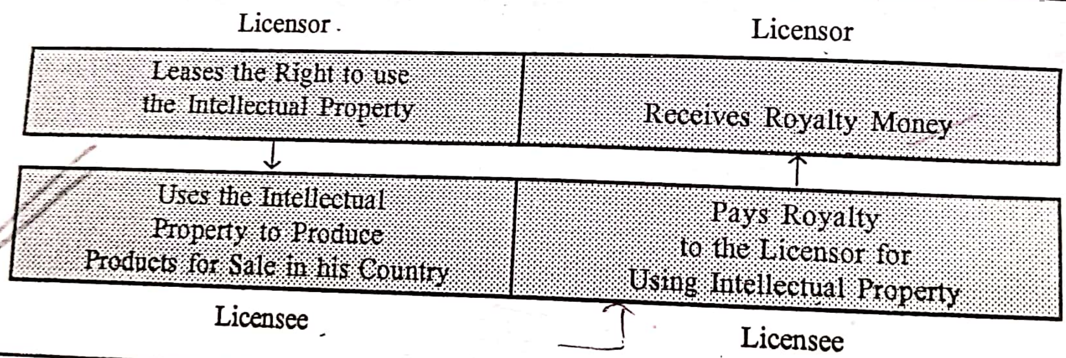
4. International Licensing

Under international licensing, manufacturer leases the right to use intellectual property to a manufacturer in a foreign country for a fee.

In this mode of entry, the domestic manufacturer leases the right to use its intellectual property, *i.e.*, technology, work methods, patents, copy rights, brand names, trade marks, etc., to a manufacturer in a foreign country for a fee. Here the manufacturer in the domestic country is called 'licensor' and the manufacturer in the foreign country is called 'licensee'. *The process of the licensing is as shown in the Fig. 5.2.*

Licensing is a popular method of entering foreign markets. The cost of entering foreign markets through this mode is less costly. The domestic company need not invest any capital as it has already developed intellectual property. As such, the domestic company earns revenue without additional investment. Hence, most of the companies prefer this mode of foreign entry.

FIGURE 5.2 : Licensing Process



The domestic company can choose any international location and enjoy the advantages without incurring any obligations and responsibilities of ownership, managerial, investment, etc. Kirin Brewery — Japan's largest beer producer entered Canada by granting license to Molson and British market by granting license to Charles Wells Brewery.

Basic Issues in International Licensing: Companies should consider various factors in deciding negotiations. Each international licensing is unique and has to be decided separately. However, there are certain common factors, which affect most of the international licenses. They are: specifying the agreement's boundaries, determining the royalty, determining rights, privileges and constraints, defining dispute resolution methods, specifying the duration of the contract. Now, we shall discuss these factors in detail. *(See Box 5.3).*

» **Boundaries of the Agreements:** The companies should clearly define the boundaries of agreements. They determine which rights and privileges are being conveyed in the agreement. *Pepsi-Cola granted license to Heineken of Netherlands with exclusive rights of producing and selling Pepsi-Cola in Netherlands. Under this agreement the boundaries are: (i) Heineken should not export Pepsi-Cola to any other country, (ii) Pepsi supplies concentrated cola syrup and Heineken adds carbonated water to produce beverage, and (iii) Pepsi can grant license to other companies in Netherlands to produce other products of Pepsi like Potato chips.*

- **Determination of Royalty:** The most important factor in deciding the license is the amount of royalty. It is needless to mention that the licensor expects high rate of royalty while the licensee would be unwilling to pay much royalty. However, both the parties negotiate for a fair royalty for both the sides in order to implement the contract more successfully.

BOX 5.3 : RANBAXY TO SELL UK FIRM'S CANCER DRUG

Ranbaxy Laboratories Ltd., Indias largest pharmaceutical company, it has an exclusive licensing agreement with K S Biomedix Ltd., a UK-based bio-pharmaceutical company for marketing TransMID, a novel bio-pharmaceutical product for treatment of brain cancer.

Ranbaxy has exclusive marketing rights for TransMID in India and an option to extend this arrangement to China and other South East Asian markets.

According to the statement, TransMID is set to enter Phase III trials and is in development for the treatment of high-grade glioma, a terminal brain cancer for which there is no known cure.

"A study conducted at leading neuro-oncology centres in the United States showed highly promising clinical response rates and an improvement in survival times in patients with recurrent brain cancer. The US FDA has granted TransMID a 'fast-track' status for the treatment of malignant tumours of the central nervous system", the statement said.

Dr. Brian Tempest, president-pharmaceuticals, Ranbaxy said, "We will continue to provide novel products for Indian customers and are very excited at add TransMID to our portfolio and believe this product will help strengthen our position in the high value Oncology Segment".

Source: Adapted from Deccan Chronicle.

- **Determining Rights, Privileges and Constraints:** Another important factor, in granting licence is determining clearly and specifically the rights, privilege and constraints. *For example,* if the Indian licensee of Aiwa TV uses interior inputs in order to reduce price, boost up sales and profits, the image of the Japanese licensor would be damaged.

  Another constraint is that the licensee may under-report the volume of the sales in order to reduce the royalty payment to the licensor. Therefore, the licensing agreement clearly and specifically indicate the rights, privileges, etc., of both the parties and reduces the freedom of the licensee in order to reduce the hurdles in the implementation of the agreement.

- **Dispute Settlement Mechanism:** The licensee and licensor should clearly mention the mechanism to settle the disputes as disputes are bound to crop up. This is because, settlement of disputes in courts is costly, time-consuming and hinders business interests.

- **Agreement Duration:** The two parties of the agreement specify the duration of the agreement. Licensing cannot be a short-term strategy. Hence, the duration of the licensing should not be of the short-term. It would always be appropriate to have long duration of the licensing. Tokyo Disneyland demanded on a 100-year licensing agreement with The Walt Disney Company.

  Exhibit 5.1 presents the advantages and disadvantages of licensing.

III. FRANCHISING

Now, we shall discuss the next mode of going abroad, *i.e.*, international franchising.

Franchising i[s] form of licen[sing]

5. International Franchising

Franchising is a form of licensing. The franchisor can exercise more control over the franchised compared to that in licensing. International franchising is growing at a fast rate.

Under franchising, an independent organisation called the franchisee operates the business under the name of another company called the franchisor. Under this agreement the franchisee pays a fee to the franchisor. The franchisor provides the following services to the franchisee:

Under franchising, independent organisaiton franchisee operates the business und[er] the name of another company — franchisor.

EXHIBIT 5.1 : ADVANTAGES AND DISADVANTAGES OF LICENSING

Advantages	Disadvantages
• Licensing mode carries relatively low investment on the part of licensor. • Licensing mode carries low financial risk to the licensor. • Licensor can investigate the foreign market without much efforts on his part. • Licensee gets the benefits with less investment on research and development. • Licensee escapes himself from the risk of product failure.	• Licensing agreements reduce the market opportunities for both the licensor and licensee. Pepsi-Cola cannot enter Netherlands and Heineken cannot sell Coca-Cola. • Both the parties have the responsibilities to maintain the product quality and promoting the product. Therefore, one party can affect the other through their improper acts. • Costly and tedious litigation may crop-up and hurt both the parties and the market. • There is scope for misunderstanding between the parties despite the effectiveness of the agreement. The best example is Oleg Cassini and Jovan. • There is a problem of leakage of the trade secrets of the licensor. • The licensee may develop his reputation. • The liensee may sell the product outside the agreed territory and after the expiry of the contract.

- Trade marks
- Operating systems
- Product reputations
- Continuous support systems like advertising, employee training, reservation services, quality assurance programmes, etc. *(See Box 5.4).*

Basic Issues in Franchising

- The franchisor has been successful in his home country. McDonald was successful in the USA due to the popular menu and fast and efficient services.
- The factors for the success of the McDonald are later transferred to other countries.
- The franchisor may have the experience in franchising in the home country before going for international franchising.
- Foreign investors should come forward for introducing the product on franchising basis.

BOX 5.4 : CHICKEN FRANCHISE INDUSTRY SHOWS STRONG INTERNATIONAL GROWTH

Fast food chicken franchising also has gone global, nd the pace is accelerating. KFC has already stablished itself as the leading chicken franchise brand China.

Bojangles opened in Honduras in 2003, China in 2005, d has plans to open 10 units in Mexico. The company's al is to have 15 to 20 per cent of its units in foreign rkets.

And chicken is coming into the US as well, from both th and south. The Canadians are coming in the form 0-year-old Dixie Lee, which plans to continue its ansion into the US And from the south, Guatemala-ed Pollo Campero, with 150 units in seven Latin American countries, is already in the US, and has big plans for China.

Popeyes too, has a strong international presence, with more than 1,800 restaurants in the US and 27 international markets including Puerto Rico, Japan, Germany, Korea, UK, Mexico, Panama, Honduras, Jamaica, Saudi Arabia, Indonesia, Guam, Canada, and Jordan.

Church's, with more than 1,500 locations worldwide in 16 countries, has announced a plan to award development agreements for 150 new US and 950 international restaurants within the next year.

Franchising Agreements: The franchising agreement should contain important items as follows:

- Franchisee has to pay a fixed amount and royalty based on the sales to the franchisor.
- Franchisee should agree to ~~adhere~~ to follow the franchisor's requirements like appearance, financial reporting, operating procedures, customer service etc.[15]

- Franchisor helps the franchisee in establishing the manufacturing facilities, services facilities, provides expertise, advertising, corporate image, etc.
- Franchisor allows the franchisee some degree of flexibility in order to meet the local tastes and preferences. McDonald restaurants in Germany sell beer also and McDonald restaurants in France sell wine also.

Franchising is more popular in the USA. Fast food companies like McDonalds, Dairy Queen, Domino's, Pizza Hut, KFC have franchised restaurants worldwide. NIIT has the franchised computer training centres throughout India.

Hotels like Hilton and Marriott, rental cars like Hertz and Avis also have international franchises.

Like every mode, franchising also has advantages and disadvantages. We now enumerate the advantages and disadvantages of franchising. *(See Exhibit 5.2).*

IV. SPECIAL MODES

Some companies cannot make long-term investments or long-term contracts to enter foreign markets. Therefore, they may use specialised strategies.

These specialised strategies include:

- Contract manufacturing
- Management contract
- Turnkey projects.

EXHIBIT 5.2: ADVANTAGES AND DISADVANTAGES OF FRANCHISING

Advantages	*Disadvantages*
• Franchisor can enter global markets with low investment and low risks. • Franchisor can get the information regarding the markets, culture, customs and environment of the host country. • Franchisor learns more lessons from the experiences of the franchisees, which he could not experience from the home country's market. McDonald benefited from the worldwide learning phenomenon. McDonald is convinced to open a restaurant in inner-city office building in Japan. This location has become a more successful one. Based on this lesson, McDonald opened its restaurants in downtown locations in various countries. • Franchisee can also start a business with low risk as he selects an established and proven product and operating system. • Franchisee gets the benefits of R&D with low cost. • Franchisee escapes from the risk of product failure.	• International franchising may be more complicated than domestic franchising. McDonald taught the Russian farmers the methods of growing potatoes to meet its standards. • It is difficult to control the international franchisee. As one of the French investors did not maintain the stores as per the standards, McDonald did revoke the franchise. • Franchising agents reduce the market opportunities for both the franchisor and the franchisee. • Both the parties have the responsibilities to maintain product quality and product promotion. • There is scope for misunderstanding between the parties. • There is a problem of leakage of trade secrets.

Raj

Great wall China

6. Contract Manufacturing

Some companies outsource their part of or entire production and concentrate on marketing operations. This practice is called the contract manufacturing or outsourcing.

Nike has contracted with a number of factories in South-East Asia to produce its athletic footwear and it concentrates on marketing. Bata also contracted with a number of cobblers in India to produce its footwear and concentrate on marketing. Mega Toys — a Los Angeles based company contracts with Chinese plants to produce toys and Mega Toys concentrates on marketing.

Contract manufacturing is outsourcing entire or part of manufacturing operations.

The advantages and disadvantages of contract manufacturing are presented in *Exhibit 5.3*.

- IT is one of the Government of India's top five priorities.
- The National IT Task Force submitted its 108-point Action Plan to promote IT in the country. The Government of India has approved the plan and is in the process of implementing it.
- A separate Ministry of Information Technology was set up to expedite swift approval and implementation of IT projects and to streamline the regulatory process.
- **Information Technology Act, 2000:** The Information Technology Bill that was passed in the Indian Parliament in May 2000, has now been notified as the IT Act, 2000. The IT Bill brings E-commerce within the purview of law and accords stringent punishments to "cyber criminals". With this, India joins a select band of 12 nations that have cyber laws.

Regulatory Enablers

- 100% foreign ownership permitted in IT enabled services industry unlike other sectors where foreign ownership is restricted.
- Software Technology Parks (STPs) established.
- To provide ready to plug IT infrastructure and telecom facilities
- Single window clearance for all regulatory compliance issues.

Infrastructure Enablers

- Basic, Cellular, Paging and Internet Services privatized.
- Domestic leased circuit tariff reduced by 80% in the last one year.
- International Internet Gateway privatized — likely reduction in tariff.

As India emerges as a global outsourcing hub, the industry is forecast to explode at exponential rates — from 23,000 people and $ 10 million per year in 1998 to over a million people and revenues in excess of $ 20 billion by 2008. Pivotal segments are going to be back-office operations, medical transcriptions, insurance claims processing, customer interaction centers and content development. Current trends suggest that the country is well on course for achieving the above target.

8. Management Contracts

The companies with low level technology and managerial expertise may seek the assistance of a foreign company. Then the foreign company may agree to provide technical assistance and managerial expertise. This agreement between these two companies is called the management contract.

A management contract is an agreement between two companies, whereby one company provides managerial assistance, technical expertise and specialised services to the second company of the agreement for a certain agreed period in return for monetary compensation. Monetary compensation may be in the form of:

- A flat fee or
- Percentage over sales, and
- Performance bonus based on profitability, sales growth, production or quality measures.

Advantages and disadvantages of management contracts are presented in *Exhibit 5.4*.

EXHIBIT 5.4: ADVANTAGES AND DISADVANTAGES OF MANAGEMENT CONTRACTS

Advantages	*Disadvantages*
• Foreign company earns additional income without any additional investment, risks and obligations. • eg. Hilton Hotels provided these services to other hotels without additional investment and earned additional income. • This arrangement and additional income allows the company to enhance its image with the investors and mobilise the funds for expansion. • Management contract helps the companies to enter other business areas in the host country. • The companies can act as dealers for the business of the host country's business in the home country. Italy's ENI (Ente Nazionale Idrocarburi) used its knowledge of European energy industry to help the Algerian national oil firm. Later the Algerian national firm requested the ENI to increase their business in European petroleum market. Under a management contract, ENI constructed	• Sometimes the companies allow the companies in the host country even to use their trade marks and brand name. The host country's companies spoil the brand name, if they do not keep up the quality of product service. • The host country's companies may leak the secrets of technology.

Management contracts are mostly due to governmental interventions. The Government of the Kingdom of Saudi Arabia nationalised Armco and requested the former owners to manage the company. Exxon and other former owners of Armco accepted the offer. Delta, Air France and KLM often provide technical and managerial assistance to the small airlines companies owned by the Governments.

Now, we discuss another mode, *i.e.*, turnkey project.

9) Turnkey Project

Indonesian Government during 1974 invited global tenders for construction of a sugar factory in the country. Indonesian Government received the tenders from the companies of the USA, UK, France, Germany and Japan. One Japanese Company quoted highest price compared to all other companies.

Indonesian Government studied the quotation of this Japanese company. This quotation includes: development of the fields for growing sugarcane, development of seedlings, construction of sugar factory, roads, communication, power, water, etc., connecting the factory, train the local people, development of the distribution channels in Indonesia, production of byproducts and their market, plans for the export of surplus sugar etc. It also made a provision for the transfer of the factory along with the total package to the Indonesian Government and follow-up the activities after it is transferred to the Indonesian Government.

Indonesian Government was very much satisfied with the total package and invited the Japanese company to implement the project. The Japanese company and Indonesian Government entered an agreement for implementation of this project by the Japanese company for a price. This project is called "Turnkey Project".

A turnkey project is a contract under which a firm agrees to fully design, construct and equip a manufacturing/business/service facility and turn the project over to the purchaser when it is ready for operation for a remuneration. The forms of remuneration includes:

A turnkey project is a contract under which a firm agrees to fully design, construct and equip a manufacturing/business/service facility and turn the project over to the purchaser when it is ready for operation for a remuneration.

- a fixed price (firm plans to implement the project below this price)
- payment on cost plus basis (*i.e.*, total cost incurred plus profit).

This form of pricing allows the company to shift the risk of inflation /enhanced costs to the purchaser.

International turnkey projects include nuclear-power plants, airports, oil refinery, national highways, railway lines, etc. Hence, they are large and multiyear projects. International companies involved in such projects include: Bechtel, Brown and Root, Hyundai Group, Kennengen, Friedrich Krupp GmbH, etc.

The companies normally approach the host country's Governments or International Finance Corporation, Export-Import Bank of the USA and the like for financial assistance as the turnkey projects require huge finances.

The recent approach to turnkey projects is Build, Operate and Transfer (BOT). The company builds the manufacturing/services facility, operates it for sometime and then transfers it to the host country's Government. In this approach, the contractor will not be paid the remuneration. Government of Gabon and the Electricity Supply Board International of Ireland and Campagine Generale des Eaux of France agreed to establish electric supply system and water system in Gabon and operate for twenty-five years and then transfer the ownership of these projects to the Government of Gabon.

So far, we have discussed the various indirect methods of entering foreign markets. Now, we shall discuss the direct method, *i.e.*, Foreign Direct Investment.

V. FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

anies which the national ts through n direct nent (FDI), their establish cturing keting s through ip and

Some companies, enter the foreign markets through exporting, licensing, franchising, etc., get the knowledge and awareness of the foreign markets, culture of the country, customers' preferences, political situation of the country, etc., and then establish manufacturing facilities by ownership in the foreign countries. Baskin-Robbins in Russia followed this strategy. In contrast, some other companies enter the foreign market through ownership and control of assets in host countries.

Companies which enter the international markets through foreign direct investment (FDI), invest their money, establish manufacturing and marketing facilities through ownership and control.

Foreign firm needs to control the operations when –

- It has subsidiaries to achieve strategic synergies.
- The technology, manufacturing expertise, intellectual property rights have potentialities and their full utilisation needs planned exploitation.

The US companies transferred their managerial expertise and technological skills to their subsidiaries operating in UK and hence these subsidiaries have become successful competitors to UK companies.

Exhibit 5.5 depicts the advantages and disadvantages of FDI.

ADVANTAGES AND DISADVANTAGES OF FDI

Advantages	*Disadvantages*
lostly, the customers of the host country prefer the oducts produced in their country like — 'Be American, ıy American', 'Be Indian, Buy Indian'. In such cases FDI lps the company to gain market through this mode rather n other modes.	• FDI exposes the company (to a fullest extent) to the host country's political, and economic risks.
chase managers of most of the companies prefer to buy l production in order to ensure certainty of supply, r services, quality dependability and better nunication with the supplier.	• FDI also exposes the company to the exchange-rate fluctuations.
ompany can produce based on the local environment anging preferences of the customers.	• Some countries discourage the entry of foreign companies through FDI in order to protect the domestic industry.
	• Changing Government policies of the host country may create uncertainties to the company.
	• Host country Governments, sometimes, ban the acquisition of local companies by foreign companies, impose restrictions on repatriation of dividends and capital. India has allowed 100% convertibility.

Now, we shift our discussion to the different methods of FDI. The mode of FDI without alliances is Greenfield strategy.

10. The Greenfield Strategy

The term greenfield refers to starting with a virgin green site and then building on it. Thus, greenfield strategy is starting of the operations of a company from scratch in a foreign market. The company conducts the market survey, selects the location, buys or leases land, creates the new facilities, erects the machinery, remits or transfers the human resources and starts the operations and marketing activities. This strategy is followed by Fuji in locating its manufacturing facilities in South Carolina, by Mercedes-Benz in locating automobile assembly plant in Alabama and by Nissan in locating its factory in Sunderland, England.

The term greenfield refers to starting of the operations of a company from scratch in a foreign market.

Disney management faced the problems in building Disneyland in Paris.

These problems include:

- Problems in dealing with French construction contractors.
- Communication difficulties with painters.
- Local contractors demanded \$ 150 million extra at the time of opening and threatened the opening.
- Local employees resisted the firm's attempt to impose its US work values.

The next one is the FDI with strategic alliances.

Exhibit 5.6 presents the advantages and disadvantages of Greenfield strategy.

EXHIBIT 5.6: ADVANTAGES AND DISADVANTAGES OF GREENFIELD STRATEGY

Advantages	*Disadvantages*
• The company selects the best location from all viewpoints. • The company can avail the incentives, rebates and concessions offered by the host governments including local governments. • The company can have latest models of the buildings, machinery and equipment technology. • The company can also have its own policies and styles of human resources management. • The company can have its gestation period to understand and adjust to the new culture of the host country. Thus, it can avoid the cultural shock.	• This strategy results in a longer gestation period as the successful implementation takes time and patience. • Some companies may not get the land in the location of its choice. • The company has to follow the rules and regulations imposed by the host country's Government in case of construction of the factory buildings. • Host country's Government may impose conditions that the company should recruit local people and train them, if necessary, to meet the company's requirements.

VI. FOREIGN DIRECT INVESTMENT WITH STRATEGIC ALLIANCES

Innovations, creations, productivity, growth, expansions and diversifications, in the recent years, are mostly accomplished by the strategic alliances adopted by various companies like mergers, acquisitions and joint-ventures.

Strategic alliance is a co-operative and collaborative approach to achieve the larger goals.

Strategic alliance is a cooperative and collaborative approach to achieve the larger goals. Strategic alliance takes different forms like licensing, franchising, contract manufacturing, joint-ventures, etc. Alliance is a strategy to explore a new market which the companies individually cannot do. *For example*, Xerox of the USA and Fuji of Japan collaborated to explore new markets in Europe and Pacific Rim.

Two companies join hands in order to align their distinctive and different strengths. Dunlop and Pirelli — the two tyre making corporations — joined together in order to synergise the strength of marketing capabilities of Dunlop and R&D capabilities of Pirelli.

♦ ROLE AND LOGIC OF ALLIANCES

- Alliances play vital role in today's market conditions and environment. *Many complicated issues are solved through alliances.* AT&T joined hands with Apple, IBM and Sun Micro-

Systems so that all their products would work with AT&T's new video conferencing system. Alliances would help to develop the technologies. AT&T, IBM, Motorola and Loral joined hands to develop advanced computer chip manufacturing technology.

- The alliances play a vital role *in providing the parties each other's strengths.* The Ford and Mazda alignment, provided technological knowledge to Ford and marketing knowledge to Mazda. Alliances play pivotal role in providing competitive advantage. The alliance between Ford and Volkswagon AG made the joint-venture 'Autolatina' dominate the car market in Brazil and Argentina.
- There are several ways to argue for strategic alliance. Only one company used to develop products historically due to the limited addition to the existing products in the process of development or innovation of the products on the small-scale. Thus, the products were developed within the industry boundaries. The explosion of technology made it possible, necessary and relevant to *develop the new products with the interaction* of two or more industries. This process proves the logic of having alliance.
- A number of industries provided inputs for the development of high density television. *Similarly*, IBM, Apple, Motorola joined their unique technological capabilities to meet the *challenges of technological revolution.*
- The product life cycles of most of the companies is increasingly becoming shorter. The companies invest heavily on the product development and incur loss when the product becomes obsolete. Hence, the companies *collaborate with each other for product development and share the outlay.*
- The fast changing technology and particularly information technology led to the heavy outlay on Research and Development. It would be *beyond the ability of a single company to meet the requirements of the heavy outlay.* The companies can meet the outlay for R&D through alliance.
- It is a gigantic task to the individual companies to hit a multinational company or to get some market share from the global competitors. Hence, the companies collaborate with each other in order to have the advantage of synergy and become very strong *in order to compete with a multinational company.* Fujistu's computer searched alliance to hit IBM.
- Multinational companies, in recent years, are forced to meet the local customer needs. Hence, these companies are forced to *enter the local markets only through joint-ventures with the local companies.* These local companies are familiar with the customer needs, preferences and customer behaviour, availability of the various inputs in the local area, marketing intermediaries and their network in the local area, etc.

Thus, the multinational corporations are expected to balance the product standardisation and local response to the product design and quality. This activity led to the formation of transnational companies, which produce the products with local inputs based on the taste and preference of the local customer.

♦ BUILDING COMPETITIVE COALITIONS

Competitive advantage in any feature of a business firm that enables it to earn a high return on investment despite counter pressure from competitors. Competitive advantage is gained through synergy and market share. Synergy is derived from size and diversification. A large firm gets the advantages of large-scale operations, less cost of doing business per unit, etc. Diversified firms can use portfolio planning to get synergistic advantage by allocating the resources according to the market shares and scope for development.

Further, the firm gets the advantage through market entry risk sharing and learning potential. Each collaborating company will achieve more competency effectively than it had attempted to

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