International Marketing
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Module - 2
Lecture - 6
International Business, Entry Modes, and Theories

Hi, good morning, welcome back. So, we will have the next session and where we have left in the previous session about the export and indirect export.

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So, let me just summarize what are the pros and cons of the export. So, the export, what are the pros? The free from investment related restriction in foreign market because, and the economic and lesser resource requirement. As you know, you do not need really the resource, you do not have any direct operation there, you do not have any direct presence there, you do not have any direct sales people there. So, that is a very big advantage for you.

And then, you also by doing some amount of exporting for few years, you can learn about that market. How is the market? What are the customer choice? What is the customer's view about your product? All those intelligence you can learn. These are the advantages. The disadvantage is that tariff and non-tariff barriers. So, this we will learn. So, what is tariff barrier and what is anti-tariff barrier?

So, say a country like India is under the SAARC country. So, we have a different tariff for selling a goods, customs duty. So, if India sells a product to the Bangladesh market, they will have a different customs duty due to the SAARC agreement whether similar product, if other country apart from the SAARC country sells to Bangladesh, might have to pay more duty. So, we will detail discuss what is tariff and non-tariff barriers, time being, so just tariff you understand.

A cluster of countries forms a tariff and then they enjoy some benefits of duty structure and free movement of the goods, like European Union. In European Union, you can produce goods in any of the country in European Union and freely move that goods in any country within European Union and there is no taxation for that, free movement. Whereas, if from India you want to sell to European Union, you have to pay a customs duty to sell in that country and that customs, that the country will charge a customs duty based on the product code and all those things.

We will come to that later. So, tariff and non-tariff barrier might affect you. So, you may have this, some advantage and maybe sometimes the country joins with another tab block and then you might have an issue. Conflict with supply chain partners, conflict with intermediaries, your distributor; conflict might start, distributor might ask for more discounts, more marketing promotion expenses, all those things might ask and you have no other control, you have to accept that; in that case, your profitability goes down.

So, these are the disadvantages. And complexity in supply chain, because you are selling to a distributor, distributor is finally selling to a consumer or a customer in this country which is in a different location in that country. So, there is a supply chain logistics issues are also there. So, these can be for the food products, there can be a huge supply chain issue there, because you know, the some of the food products, there is a shelf life of the food items, so, that supply chain complexity comes into the picture.

Then also there are several issues, some of the products might be shipped, might be transferred in a refrigerated condition; so, that also the huge supply complexity there in the supply chain. So, these are the issues on that.

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Then comes the second one is the licensing. So, export and indirect export we have discussed, this second one is the licensing. So, what do we do that? So, you have a, you sign a, you find out a company in a foreign market, international market, whom you give the license to either manufacture or sell your product. So, you have a license. So, typically, this is used in the manufacturing production.

So, the licensor is the company, you, who is a domestic company and licensee is the foreign company who will produce the goods in their country, manufacture the goods in their country. So, as a licensor, you grant the licensee to use your brand name, trademark, technology, patent and any other form of intellectual property. So, you allow them to use your brand and say; so, if my brand, say X brand, I allow the foreign company to manufacture the product and sell it in the same X brand in that country; so, is a licensing agreement.

So, see, licensee manufacturers manufacture the product and are utilizing the licensor technology brand name. So, you give the entire technology to them and they will manufacture based on your technology. And the agreement involves a financial consideration, that is a royalty. That means, every product they sell, they are supposed to pay you a certain amount of royalty, say 5% royalty or 10% royalty to be paid to you.

So, the foreign company whom you give the license; say you have manufactured this pen and this pen you have some unique manufacturing the technology here and you want to give this technology to another country, another manufacturer whom you will give the entire technology to manufacture this pen and they will manufacture as per your patent and they will follow the intellectual property guidelines and they will use it as your brand pen, whatever their pen's brand, they will use that brand and market it in their country.

So, that is typically how this happens, how this situation happens. And this agreement is a royalty, so, you do not, you are no way involved in selling the product, you are no way involved in the production process, you are no way involved into the supply chain in that country, you have no way involved into the marketing of the products, you have only given the license to them.

Say we manufacture, suppose I am a company, we manufacture gearbox for a car or we manufacture the steering for the car, and we give this technology to another foreign country and they, and give the technology to them to manufacture the gearbox in their country as per our design. Now, after making the gearbox, they might sell it to 10 different car manufacturers in that country or to 1 manufacturer in the country, it is up to them; you have no, you have nothing to do with the marketing of the product or the distribution of the product; you have nothing to do, no promotion; everything is done by the licensee.

So, licensor means the company who gives, who is, who owns the product and licensee is the company who takes the product to manufacture in that country and to produce and then sell it in that country. And in that, they have to pay you the royalty for that.

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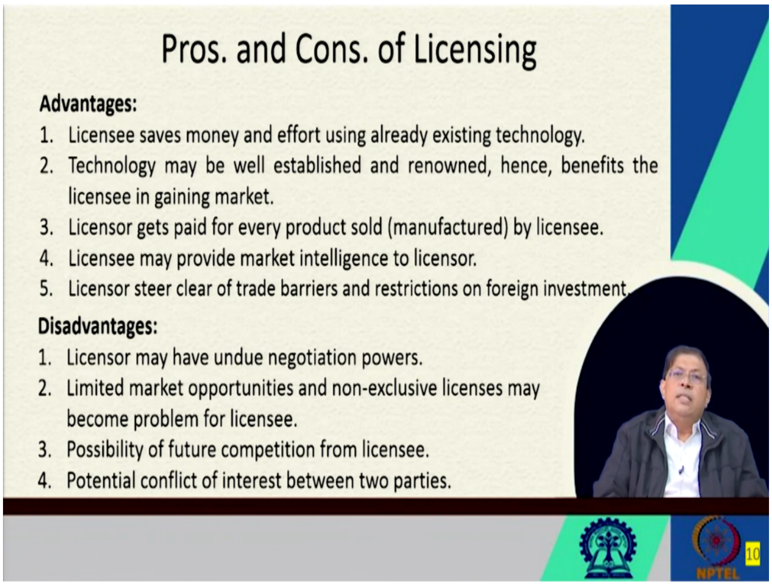

Pros and Cons: So, the pros is, licensee saves money and effort using the existing technology. Technology may be well established and renowned, hence, benefits of the licensee in gaining the market. Licensor gets paid for every product sold and manufactured by the licensee. So, every single product I sell, I will get money sitting in India, because it is, they will have to give me the royalty.

If they sell 100 units, they have to pay me on 100 units whatever the percentage agreed as per the legal agreement, they have to pay me that 5% or 10% whatever is the loyalty fee. Licensee may provide market intelligence to licensor.

So, that is, it is a big, the word is may is very loaded, they might give you the information about the market that the product is good or there is some feedback about the product, product needs some improvement or product is doing extremely good, there should be some new product extension, all the market, or the competitor, some new competitor has come, he has come with a new product to that market, and then that how you handle that and they will continuously give you the marketing intelligence, the market insights of that market to the licensor.

And licensor steer clear trade barriers and restrictions foreign investment. So, you are not making really any foreign investment there. What are the disadvantage? The disadvantage is that license here may have undue negotiation power. In that case, they might ask for a very high loyalty fee. Limited market opportunities, non-exclusive license may be problem for licensee.

If you are giving non-exclusive, that means, apart from that, there can be 4 different manufacturers can manufacture that, then there may be a problem. Lot of times foreign companies give manufacturing licenses under non-exclusive basis, that I will not give to only 1 single company, instead of that, I might give it to the 4 different companies. So, that is the non-exclusive license that might be a problem for the licensee.

Possibility of the future competition from the licensee, that is very important because you know, the licensee, by doing this your job, producing your job, he gains the entire, gets the entire information about the product, technology, everything and he has full grabs grip on the product manufacturing. Then, tomorrow he might start manufacturing the product and sell the product in his brand name and then not pay you the loyalty.

So, this is a huge risk, because the company, the licensee might start producing the product and sell it in a different name in the market and they do not give you any loyalty, then you lose the money. So, that is the big pitfall here. Potential conflict of interest may be there. There can be potential conflict of interest can be there and this, there can be several reasons of conflict. So, that can be between these 2 countries. So, this is the most, about the pros and cons of the licensing agreement.

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Then comes the franchisee. So, in this franchisee, so, franchising is basically a contractual agreement. Understand very clearly the difference between licensing and franchising. Franchising is a contractual agreement between the 2 parties, namely the franchisor and franchisee; just like licensor and licensee is a franchisor and franchisee. Franchisee operates a business under the name of a franchisor.

So, that means, if I am a franchisee of KFC or Domino's, I have to use the KFC's business, I have to use their KFC's brand and logo and I have to operate as per the structure and the design of KFC stalls or the food joints; I have to follow that.

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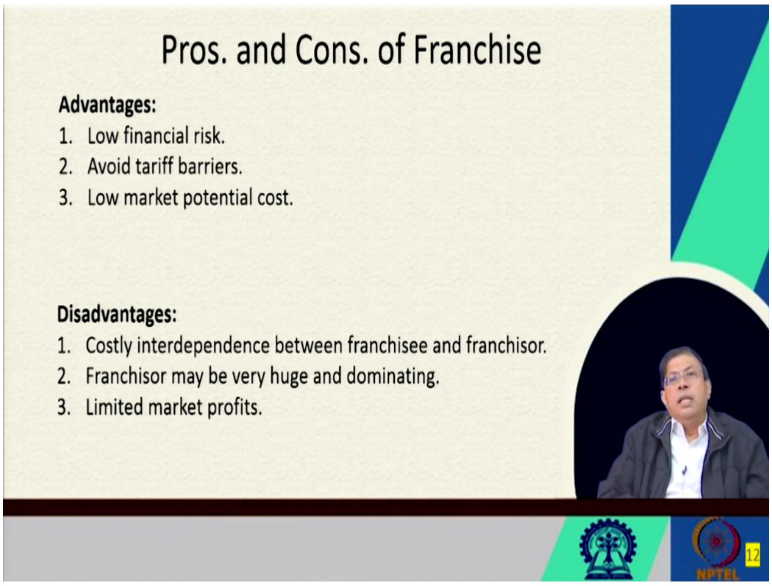

Here, these advantages is that you have a low financial risk because the company who has taken your franchisee in the foreign market has to pay you a very high franchisee fee for that but has to strictly follow your production as well as your, the complete quality as well as your supply chain, everything they have to follow. Suppose the KFC chain in India and suppose the chain in India is somewhere in Midnapore district, say in Kolaghat, there is a KFC chain there, they have to strictly follow the complete guidelines of product sourcing and the branding and also the process of food preparation process, packaging, everything, inventory management as per the KFC's parent company in United States.

So, they have to follow all the parameters, all the guidelines of KFC; same thing for McDonald's or same thing. So, they just cannot sell any other product there. So, in a KFC food joint, I will not able to sell a dosa there, I have to sell the products which is KFC's products. So, in franchisee, this is the biggest control you have in a foreign country. That means, the franchisee has to follow your complete guidelines and they have to go into that market and following your guidelines and they cannot deviate from any of your guidelines.

Tariff barriers: You can avoid the tariff barriers because the company there and they are absolutely; you are not exporting to that country, the country is, there they are locally sourcing the products but there our final product and the brand name everything is used your company's name. Low market potential cost: So, that is there. Disadvantage: Costly independence between franchisee and franchisor.

Franchisor may have a huge and dominating. So, franchisor here in this case, they might be huge company like KFC, McDonald's and they will dictate their terms and their fees are very high, very high fees you have to pay. So, say I do not know exactly the amount of fees charged by these companies, but typically the franchisor charges a fee of 40 percent, 45 percent, 50% of their charges cost, 50% of this resale value they will charge as their cost, as their franchisee fee; and so, this is there.

And in case of franchisee, the profit disadvantage is there. As a franchisee, you have a very limited profit because the major profit is taken by the franchisor. So, as a franchisee, you have a very limited profit, but still it is another good way to enter into the market.

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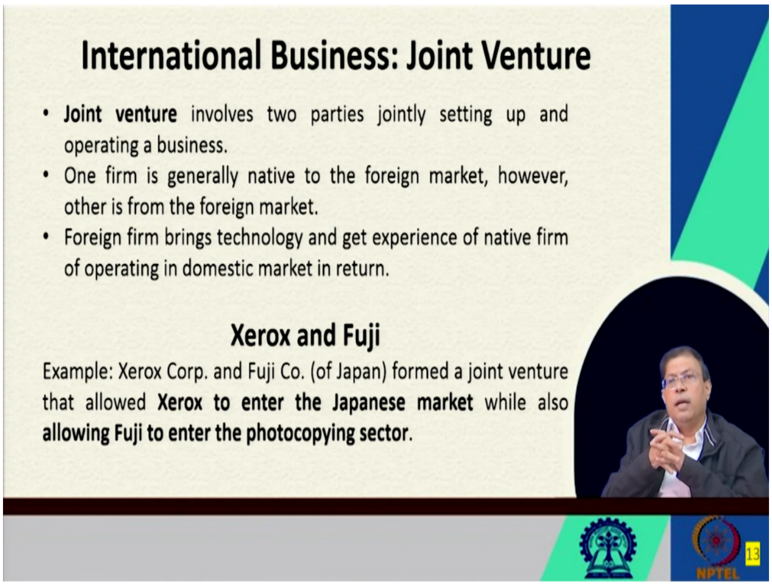

Then comes the third way of entry which is known as the; so, the joint ventures are the international joint ventures and joint ventures involves 2 party jointly setting up and they operating business. So, that means, why we do joint ventures? Why we do? The reason behind is that, as a domestic company, I do not have much knowledge about the foreign market, foreign country.

I do not have and I need and then I do not have, I do not want to invest huge amount in that market. I want to go through a partner there who will invest along with me and we will have jointly make an investment so that you minimize your risk. Suppose the product is not successful or you are not able to enter the market or there is a delay in the project and all those things, the entire cost burden should not come to you, so you select another partner there.

Why I select a partner there? Because the partner in that country has got knowledge and market intelligence about that country. He knows ins and outs about that market. How the; what is the size of the market? All market intelligence data is available with the partner. I am a foreign company; I do not have that much of access to the market intelligence of that country. So, what I do?

I will go with a joint venture in that market, I will go as a joint venture, I will sign a joint venture agreement; that means, and then we will jointly have a company formation and that company will produce, manufacture and sell it in that market. So, one firm is generally native to the foreign market, however the other is from the foreign market. So, typically, one firm will be the native from that country and another is from the foreign market.

Foreign firm brings the technology, get experience of the native firm in operating in domestic market. What is the experience? Experience in the market intelligence, distribution, sales, everything they have the experience of the domestic company. So, that is the biggest advantage. So, I will give you here an example of Xerox and Fuji. So, Xerox Corporation and Fuji Corporation of Japan formed a joint venture and Xerox entered to the Japanese market and also allowing Fuji to enter the photocopying sector.

So, that is the biggest advantage for this type of a joint ventures. In India we do have several joint ventures and you must have heard the joint ventures of several companies like the joint ventures between Mahindra and Ford, you have heard the joint ventures of Hero Honda, you have heard the joint ventures of TVS Suzuki, you have heard about the joint ventures of Bajaj with Kawasaki.

So, there are several joint venture companies; even in financial sectors, say the max life insurance here or maybe ICICI Prudential, all these companies have got a huge joint ventures in our country. So, and then, in initial days, typical joint ventures were the very successful joint ventures where, like Hero Honda joint venture was successfully and this was for more than 26 years, it was very successful joint venture in the country.

As far as I know that, that is the most successful joint venture but currently both the companies have come out of that joint venture and they have started their own operation. Hero is having their own direct own operation and then Honda is having their own operation and they are competing at the marketplace. So, successful joint ventures in India and why joint ventures?

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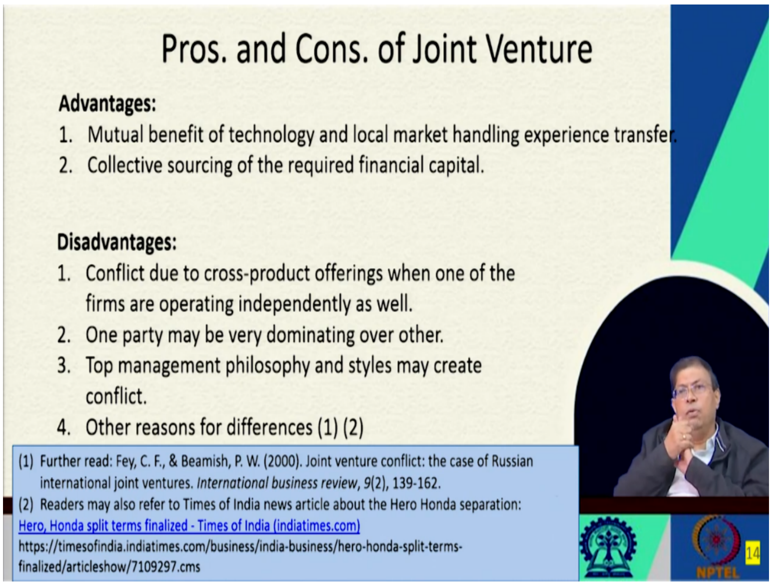

Joint ventures, before I will discuss about the pros and cons of the joint ventures. So, first, what are the advantages of a joint venture? Mutual benefit of technology and local market handling experience. So, I have somebody there, a local company who knows ins and outs about the market. So, I do not have knowledge. So, I am taking the service of that company. And also they are making an investment, so, jointly we are making an investment.

And collective sourcing required in the financial capital which is the most important. The financial capital is shared collectively between the 2 companies. What are the disadvantage? Disadvantages are conflict due to cross product offerings when one of the firms are operating independently as well. One party may be very dominating over the other. Top management philosophy and styles may create conflict. So, these are the various reasons.

So, if we look at the various failures of these joint ventures, why these joint ventures; I will strongly request you to study; I have given there, couple of RT, the reference there. I should tell you to study the Times of India news article on Hero Honda separation; I have given the link there. So, that is a newspaper reading on that. You can read why it has gone out and what are the issues there, Hero Honda separation, and you can have some information on that.

So, the main failure of these are basically the cultural difference. So, what is happening? The cultural and ideological differences stop the list in evaluating the joint ventures partner. Most companies do not perform a proper compatibility and interrogation analysis. So, 2 different cultures; see, imagine Indian managers and the Japanese manager, the 2 people are coming and then managing the company in the foreign marketplace.

So, there is a, neither make their thorough evaluation of corporate culture and management style. So, there is 2 different corporate culture; one different corporate culture of a Japanese company, one different corporate culture of the Indian company. As a result, they fail to find a way behind their difference, which makes the joint ventures mostly unstable. Poor leadership, that is also another very classic example.

Poor or unclear leaders is another top reason for joint ventures failure. Too often, joint ventures partner insists on sharing a project leadership role. When the parties disagree, a standoff occurs. And if the parties do not agree from the very beginning, who will have the day to day operational control of the project and how the fundamental decision will be made, the joint ventures bound to fail.

So, leadership is also another very crucial thing if poor leadership might also reason to the fail. Third one is the insufficient planning. That means, insufficient planning is also one of the most prevalent reasons for failed joint ventures. Too often, a joint venture plan consists of nothing more than a segment of each party's intended contribution to the project and their respective share of profit; this seldom works.

So, that is a problem in joint ventures. So, if the parties wish their joint venture to succeed, they should agree to a comprehensive written plan upfront. And this plan should include provisions for future contributions, logistical issues, governance of the joint ventures, dispute resolution, ownership of jointly developed assets including intellectual property. That is a very crucial thing about the intellectual property.

And then the term of termination of the joint ventures including the provisions of winding up the business. So, one of the professors of one of the management institutes in India has done this study and he says that more than 50 to 55 percent of the joint ventures in this country has failed. I do not have statistical information on that, but I am referring one of the professors. In one of the discussions, he has mentioned that this is the way joint ventures have failed in this country.

I do not have the data, but there are successful joint ventures and there are also various unsuccessful joint ventures in the country. So, be careful on these joint ventures. We do have a very successful joint ventures of Maruti Suzuki, which is a very successful joint ventures. And now the another very successful joint venture was initially the Hero Honda was a very successful joint venture. It is one, it continued for 26 years.

Then the Air Vistara, Vistara Airlines having a joint venture with Singapore Airlines; there, that is a joint venture is still continuing. Mahindra and Ford had a joint venture; unfortunately, that did not continue. Mahindra and Renault had a French car company. Renault had a joint venture; unfortunately, that did not continue. Tata had a joint venture with Fiat motors, Fiat Chrysler. They had a FCA with Fiat Chrysler.

They have an agreement but that did not work. So, there are several examples of, good examples or the successful examples on long term continuation example. TVS Suzuki is one of the one. Another successful is definitely Bajaj with Kawasaki is still continuing and very successful joint venture. So, you can see a good amount of companies who are very successful. You can also see the companies in the joint ventures who are not successful. So, both these situations are there.

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Then the last one is the one acquisition of the existing operations. So, instead of starting a business, you acquire a company in a foreign country. You go and you acquire a company. Suppose a company is very large operation in that country and you go and acquire the company there in that country. So, just like an example, Facebook acquired WhatsApp, Walmart acquired Flipkart; this way you can acquire.

So, Flipkart, what was having? They have an entire supply chain logistics, they have entire digital marketing, e-marketing, everything they had in the marketplace they had. Now, Walmart acquired that and got that entire knowledge and entire expertise with them. So, that is the biggest advantage of acquisition. What is the benefit? Benefit is acquirer will get a running business. So, there is no stop of business.

You can acquire and you can continue. It typically happens in typically like in equipments, where or in the various products where you need a license to go into, enter into that market. There is a period where you have to wait to get that license, so that even if you start an operation, you cannot start marketing the product till you have the regulatory approval from that country to market that product in that country.

Typically, like in my case, like my healthcare medical equipments, we cannot go and sell the medical equipment in a country without the regulatory approvals of the country. That means I have to have a; if I have to start a manufacturing there, I have to wait. Once a product is ready, I have to give it to the regulatory bodies to go through their regulatory approval process.

Once they approve, then only I can go and market that product in that country; but in this type of an acquisition, the easiest part is that the local company whom we are acquiring, the companies we are according, they already have the license for the product. So, you do not have to really bother and everything is continued; you can start doing the business next day onwards after the acquisition. So, it is an ongoing business.

So, that is the biggest advantage in the running business. This saves lot of time in strategic management goes well. Limitation may involve huge capital, because you know, you have to acquire a company, it requires huge capital for you. May be difficult and cost ineffective if major modification is required. So, that is also very cost effective, because the company is already manufacturing a product. So, in that case, it is a, you have to change the design and then you have to change the entire production process. It is a huge cost for them. So, these are the limitations for this.

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And the last one is the establishing a new foreign subsidiary. So, acquiring a business in a foreign country may require huge physical capital investment. Moreover, operations of the existing firm may need modifications due to above two hurdles. A firm may consider setting up a new subsidiary in the foreign market rather than acquiring a running business. So, you start a new subsidiary there.

That means, you establish a new legal entity in that market. Setting subsidiary may involve long gestation period. That is the limitation. That means, subsidiary, when you set it up a subsidiary, it requires various regulatory and legal approvals to start in a new sale subsidiary there; so, it is a long gestation period there. So, that is all about the various modes of entry. To summarize, indirect export, direct export and then we have discussed about the licensing, we have discussed about the franchising, then we have discussed about the what is called your joint ventures.

Then we also discussed about the entry modes of starting a, acquiring a company in that foreign country and also establishing a new sales subsidiary. So, these are the 5 or 6 ways you can enter into a foreign market. The minimum, the lowest one is an indirect export, export, licensing, franchising; and then, after franchising, you can start a joint venture there, acquisition of, acquiring another company there or establishing a new foreign subsidiary. That is all in this section. Then we will discuss the international theories in the next session. Thank you. Thanks a lot.