International Marketing
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Module - 2
Lecture - 9
International Business, Entry Modes, and Theories

Hi, good afternoon, welcome back. So, here we are starting our lecture 9, where we have left at the transaction costs.

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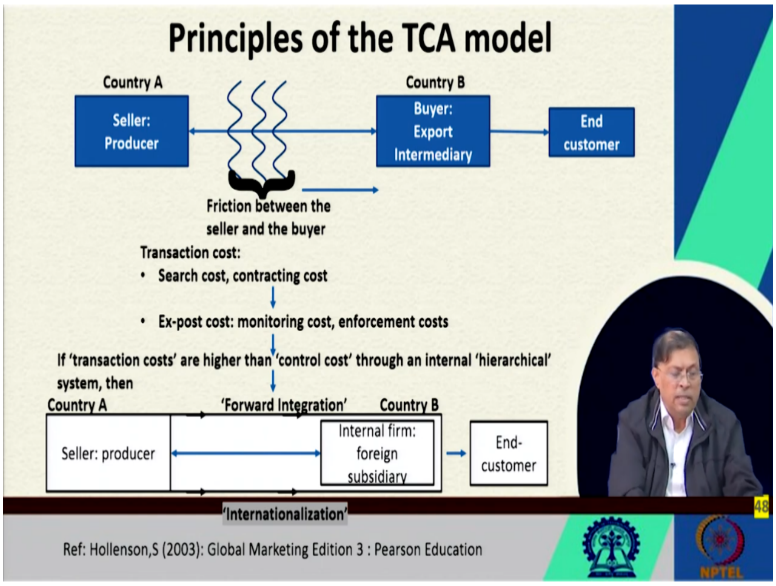

So, I have explained you that there are 2 types of transaction cost, in the previous discussion, that search cost and contracting cost and then also post search there is a monitoring and enforcement cost. Very simple; first one is that you find out a dealer. To find a dealer, you need to have visit so many times to the international market, you have to meet so many dealers, you have to meet so many different countries, because where you are expanding through dealers.

So, there is a search cost is enormous search cost. Then also there is a contracting cost, there is a cost for legal people to sign agreement and various countries different legal systems are there; you have to sign a legal agreement. So, there is a cost there. So, that is known as the pre cost or pre ante cost. And the ex-post cost or pre is typically monitoring. Now we have searched, you have got the distributors, dealers in that foreign market, you have already in 5 different markets, you have got some 5 or 10 dealers, you have already signed a contract with them.

Now that comes here once you sign. Then the dealer starts doing the business of your product which you produce from your country A, the seller country. Here, you have to send your person to monitor the business and then monitor all the enforcement and everything. If the dealer is not doing something correct, you have to ensure that you correct that, so that there are no unethical practices there and everything is perfect, the customers are happy.

So, I can tell you from my experience in the industry where we have worked, we have worked for the very high cost, life-saving medical equipments in various international markets, where the post cost of monitoring was very high, because you know the hospitals in various countries, they buy the equipments from us and they want to ensure that when the equipment is down, we have to provide immediately service.

Now, imagine a situation, suppose we have sold critically an anesthesia machine or an ICU ventilator; you must have heard the anesthesia machine is used in the operation theatre to anaesthetize the patient. So, an ICU ventilator is a mechanical ventilator which is given to a patient in a ICU when the patient is not able to breathe of his own. Now, these equipments are typically very crucial.

If the machine is down due to some reason, the equipment is down, the patient will be extremely difficult for the hospital to have, because these are very high cost capital intensive equipments. So, you cannot have severe large amount of inventory available with you. See, if the machine, the equipment is down, you have to ensure that it has to be serviced immediately. So, that is typically the adoption or the enforcement cost for you.

You have to ensure that you are there, you ensure that your customer, when there is a breakdown, your dealer immediately services that machine and then does the preventive maintenance or rectifies the unit, so that the patient, there is no danger for the patient and there is no problem for the hospital. So, monitoring and enforcement cost, the frequency of travel of the business executives or the international managers are so frequent, the cost of monitoring and enforcement is very there.

Here, then, now the company measures what is my total transaction cost. If my total transaction search cost and the post cost if is higher, then I should start, instead of operating through a dealer, I should remove the dealer and I should put my foreign subsidiary. So, the theory is the chart; I must acknowledge, an excellent way this diagram has been prepared and my thanks to the researchers who has prepared this slide.

It is so easily you can understand from here that there was a friction between the dealer and the seller and the buyer because they are in the 2 different countries. One objective is that they want to make the maximum amount of profit, another also wants a maximum amount the profit, and there is always a conflict, one wants the more terms, more discounts, more credit terms and the seller is, there is always a friction between that.

So, you initially entered in a mode of a dealer or a distributor mode. And then you are constantly monitoring your total cost, your initial cost and also monitoring your present cost of monitoring the dealers in 5 different countries or 10 different countries and also the enforcement costs. Now, if you look at this total cost, compare it with an establishing a foreign subsidiary, how much cost it will be there; if this cost is higher, this transaction cost is higher, then you go for directly placing, instead of a distributor, you put your foreign subsidiary.

So, when you start your foreign subsidiary, this theory, the transaction cost theory will explain you that if your total cost of monitoring its search cost of distributors and monitoring cost of distributor is more compared to building, compared to starting a foreign subsidiary there, you must start a foreign subsidiary. But if you look your; suppose, I just give you a hypothetical number; say your cost of searching a dealer and monitoring a dealer is coming say around 10,000 dollar per month, in a year 120,000 dollar in a year it is coming a cost to you.

So, you are doing this 120,000 dollar. Instead of that, if you see that I can make, I can build an international firm there my own subsidiary and I can reduce that friction there, I can have my own subsidiary, my own people there and that cost will be lower compared 120,000 dollar, then I will start my foreign subsidiary. So, this theory tells when you should really move from your distribution network to your own foreign subsidiary.

So, transaction cost analysis is very crucial to move from a distributor network to a foreign subsidiary. So, here what has happened basically, a change from a producer between the producer and the customer, the intermediary has moved out because the transaction cost for monitoring and search cost was so high, you have replaced it with your own subsidiary there, but the producer and the end users remain same.

So, the intermediaries have change based on the transaction cost. So, that is the way you should always monitor. And this is very helpful, transaction cost is very helpful when you move from distribution network to a direct subsidiary network. So, that is the brilliance and excellence about this transaction cost analysis, and you have to always ensure, you have to always do this.

And the various companies, they operate throughout the world, when they took, when they will take out the dealer and have their own direct presence, if that cost is lower than the transaction costs, they will go for a direct placement.

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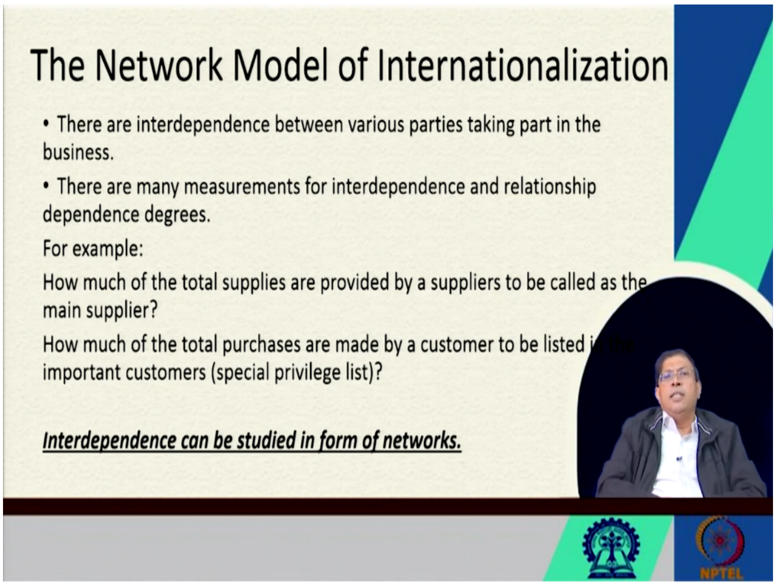

Then comes the network model of internationalization. This is another theory, another model in entry in the marketplace. So, what are the entry till now we have discussed? We have discussed about the entry of Uppsala theory, we have discussed about the transaction cost analysis, when to move out of the distributors and then start your own self sales subsidiary; and then, this next one is a network model of internationalization.

So, there are interdependence between the various parties taking part into the business. There are many measurements of interdependence and relationship. For example, how much total supplies are provided by suppliers to be called as the main supplier? How much of the total purchases are made by a customer to be listed important customer? So, these are very crucial things.

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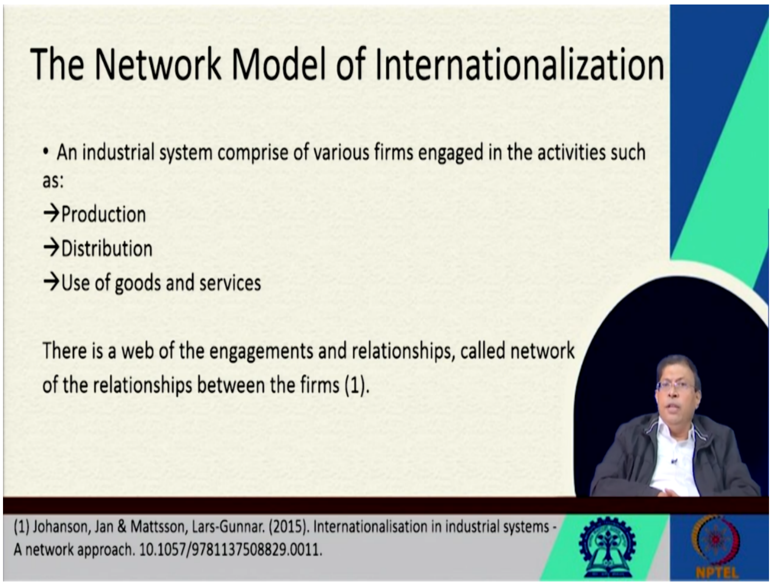

Now here, the network model of internationalization: The industrial system comprises of various firms engaged in activities such as production, distribution, use of goods and services. There is a web of engagements of relationship called network of relationship between the firms. I have given the reference here. You can use that for that.

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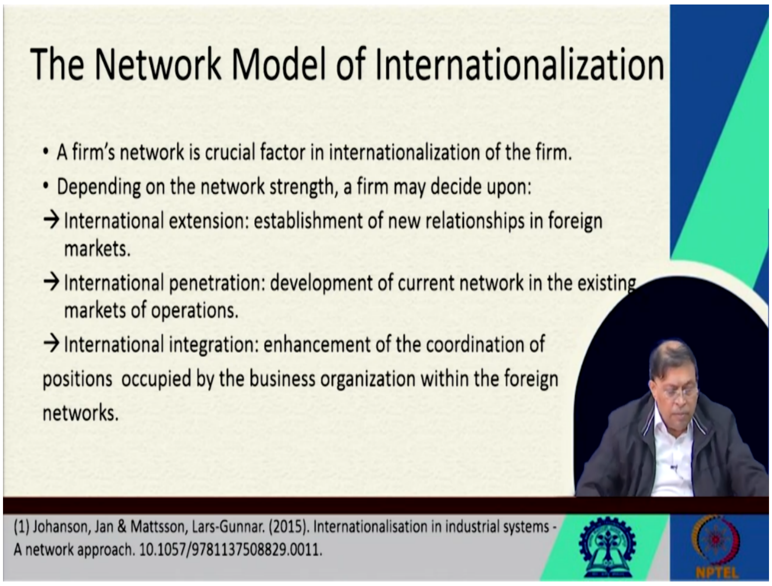

So, the network model, the firm's network is crucial factor in internationalization of the firm. Depending on the network strength, a firm may decide international expansion, establishment of new relationship in the foreign market; international penetration, development of the current network in the existing markets in operation; I will show you in next slide with the diagrams which will be easy for you to understand.

And then, time being bear with me, with this slide, but I will give you the examples here in the next slide which will be easy for you to understand. And then, the international integration, enhancement of the coordination of positions occupied by the business organization within the foreign network. So, these are the inter-network models.

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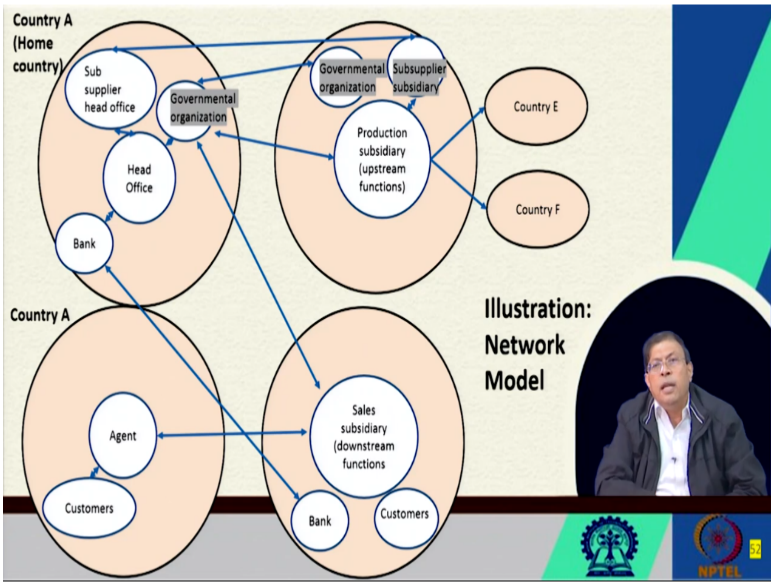

This is the illustration. Now, this will be easy for you because previous slide was lot of text material, this will be much more visualization for you to understand. So, Country A is typically a home country. See, the home country here, you have your home countries; your head office is in this home country; various government organizations and your suppliers are there in the home country and your production is in a different country.

You do not manufacture the product in that home country, you manufacture the product in another country. And then, you sell from that country to country E and country F. And then you have another country where you have your own sales subsidiaries and you have another some set of countries where you have agents and customers. So, see that the one country, the country here, in this country, the home country, you do not have any manufacturing here; you are not even selling into that country.

It is possible, might be selling in that country, you may not have any sales in that country. But you manufacture in one country; in that country, you have a; in a different country, you manufacture. In another set of countries, you have your own sales subsidiaries and your customers there in that country. In some other countries, you have the only agents there and you do not have a sales subsidiary.

So, this is a network of various different nomenclatures and network here. What happens, look here, the country in that, the country where we produce, we are not selling into that country. Why we are producing? Maybe the labour is very labour-intensive and labour is like inexpensive there, so we go and we sell into that, we manufacture in that country, because maybe that product is a labour-intensive product.

So, we produce in that country. And labour is inexpensive or cheap, so we manufacture in that country. And we do have the suppliers and subsidiaries there who gives the supply in the manufacturing plant. And the supplier can be in the home country for some of the components, some of the highly crucial components, can come from the home country to the manufacturing country.

Some there can be local manufacturers in that home country can also supply there. So, there you are manufacturing, but you are not selling into that country. You are now having sales subsidiary in third set of countries where you have sales subsidiaries, because that market is a large market and you operate there and you sell. And there is another set of countries where you have only agents and distributors and you will sell directly to the, through the agents and distributors, sell to the customers.

So, look in this scenario that you are not, you belong to a country, your home country where you have no manufacturing there. You may have some suppliers in that country for your product which they supply to that second country where the product is manufactured. And the third set of countries where you sell your products is your downstream function. You sell your products there in the third set of countries.

And the fourth set of countries, you may not operate through your own subsidiary, you may operate through an agent. And in Country E and F also you sell directly to Country E and F. So, this is known as a network model. So, typically, lot of large global companies, they follow this networking. And it is extremely beneficial for them because they will produce; like if you know about the apple, they produce in couple of countries their iPhones and they sell globally and they have their own subsidiaries in various countries.

In larger markets, they have their own subsidiaries; in smaller markets, they might send through agent. I do not know exactly their details in the various countries, but I am sure they must be having some, either sales subsidiaries or agents. So, they manufacture in 1 or 2 countries, but they sell it in a different, through the subsidiaries in certain countries or through agent in this country. So, this is typically known as the network theory.

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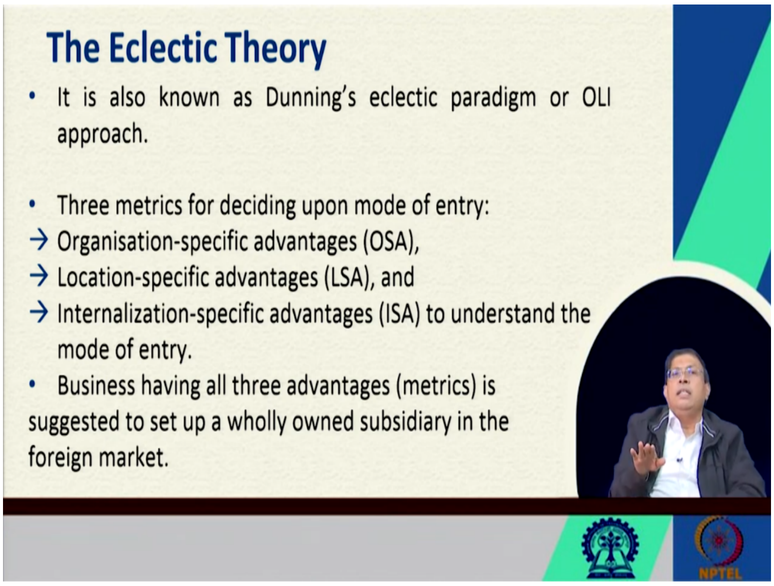

Then comes eclectic theory. This is also known as the Dunning's eclectic or OLI approach. So, 3 matrices are deciding upon this mode of entry. So, all we are discussing in this class are the mode of entry. So, one was Uppsala. Uppsala says that you only go to the nearest geographies and the nearest what is called cultures, and then expand slowly from distribution, from ad hoc export to dealer and then distributor and then sales subsidiary and then manufacturing; Uppsala says that.

Then we learnt about the transaction cost theory. In the transaction cost theory, what we learnt? We learnt that we ensure that what is my search and my cost of monitoring and continuously do that. If my search plus monitoring cost is more than establishing a subsidiary, I should go for establishing a subsidiary instead and removing the dealers. If that cost is higher, I should still continue with that distribution model.

So, that transaction cost theory says that. Network model: I have explained to you where you have one country where you manufacture and then you have these other country where you have your headquarters and then a set of countries you operate through sales subsidiaries, in set of countries your distributor. This may not be the manufacturing is in your own country, you may manufacture in some other countries.

That is typically the network model. So, all these countries are typically, these are all networked together. The last one is the Dunning's eclectic paradigm, which is known as the organization specific advantage. So, there are 3 metrics deciding upon the mode of entry. So, these all discussing about the which mode I should take to enter the foreign market. So, the organization specific, what are my specific advantage of entering the market?

Location specific: Whether that particular location has got some specific advantage to enter. Internationalization specific advantage or ISA to understand the mode of entry. Business having all the 3 advantages suggested to set up a wholly owned subsidiary in a foreign market. So, let it be.

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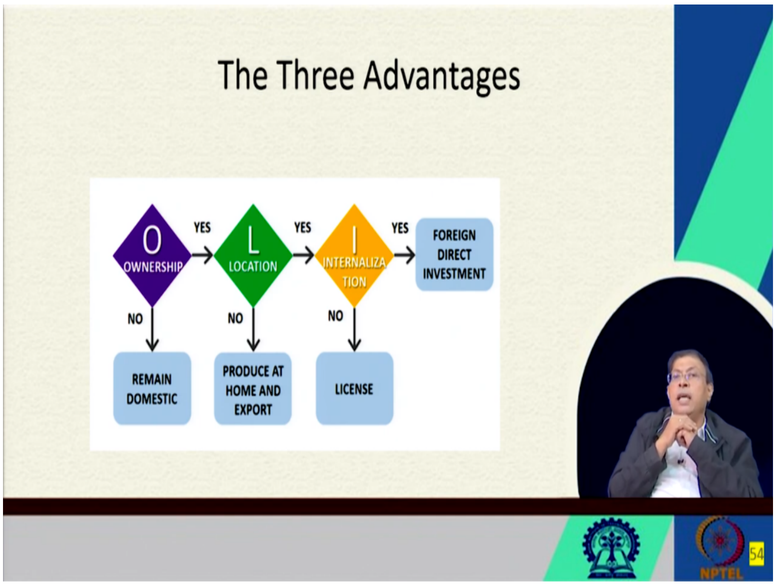

In this diagram, the 3 investment: The first is the ownership. The second, if the ownership, if you have sufficient the cash, the capital available, if you do not have that sufficient capital available to invest, you still remain domestic, you do not operate to that international market. Then, if you have sufficient capital and then you have the location advantage to produce at home and export; if that advantage is not there, then you become international.

If you have still having an advantage in manufacturing at home, no advantage, then you go ahead and manufacture here. The third one is the internationalization that you do not start immediately the direct operation, you give a license there and then someone else will manufacture your product based on that international license. If all these 3 are the advantages, like if ownership has an advantage, location has an advantage and also international advantage, all the 3 advantages are there in that country, then you make a foreign direct investment.

So, OLI approach is typically ownership, location and internalization approach. If all the advantages are there in that foreign country, then only you should go. You have sufficient capital there available for you to expand, have a foreign direct investment; you do have the location advantage there and also you have the internationalization, the market is already internationalized market; there is a several competitors, several international companies are operating into that market; so, in that market, you make a foreign direct investment to be competitive.

So, OLI approach, all the 3 advantages are there, then it makes you to go for the foreign direct investment. So, this is another way to another theory. This theory said that you look at all the 3 approaches that ownership, location and the internationalization, all the 3 approaches; if all the 3 approaches are yes, positive for that country, then you make a foreign direct investment. If one of that is not there, remain domestic.

If location, there is no advantage of producing in a foreign land, produce in the home country and export to the foreign country; do not make subsidiary and do not make foreign direct investment there. The third one is an international; whether the market is really internationalized, whether there are several players at that market, international players at that marketplace, they are coming and operating, then you go there.

If the market is not really internationalized and not very few can, not much companies are operating there, do not go and expand to that market, you give someone else to produce and license. But if all answers are yes, you go and make a foreign direct investment. So, that is the reason if you see, this also helps, another theory which helps you to make a conscious decision about the foreign investments.

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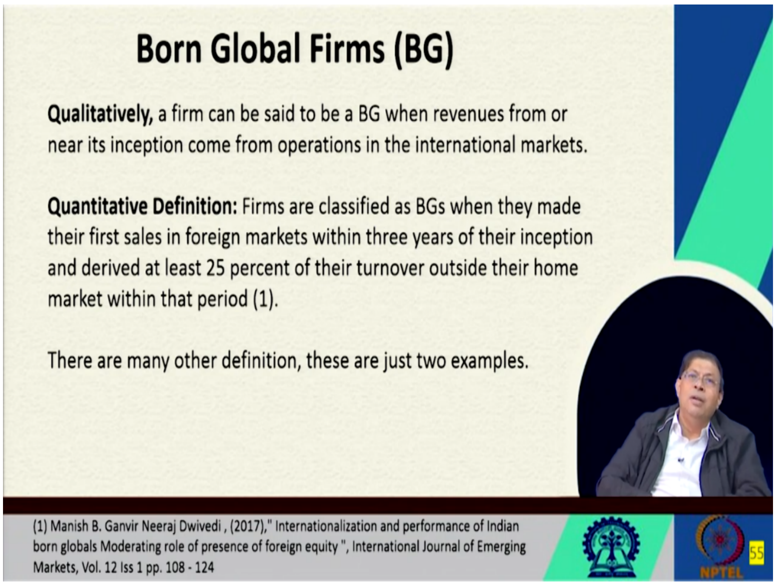

And the last one is the born global. So, the born global firms, they decide that a firm can be said born global when revenues from or near its inception come from the operation in the international market. So, day 1, they are not looking into the domestic market; day 1, they are looking at the global market. So, what is the quantitative definition? Firms are classified as born global when they made their first sales in foreign market within 3 years of their inception and derived at least 25% of the turnover outside their home market within a period.

So, that is the definition. I have given the reference there, at the International, the paper of Mr. Manish Ganvir and the Neeraj Dwivedi's paper and which it clearly says, this researcher has done that analysis; and if you can get an access, you can please go through that. My personal thanks to these researchers for doing an excellent research paper and I am referring that research here which will be helpful for my students to understand from this research. So, there are many examples.

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So, what can support a firm to be born global? So, high technology and knowledge intensive industry: So, technology is very important; so, born global company. So, technology is very intensive and it is very much required and the knowledge intensive. Technology advanced companies with high competitive advantage: Some of the companies like Google, Microsoft, Apple, these companies are typically born global companies.

The potential customers are based in foreign market like Microsoft, Windows OS or Windows operating system or Windows Office, MS Office. Throughout the world, this has got a market, throughout the world irrespective that, everybody needs the operating system or everybody needs a Microsoft Office for Word or Excel or PowerPoint or all those things. So, that is the potential customers throughout the foreign markets. Small domestic markets to support economies of scale or feasible for the operation.

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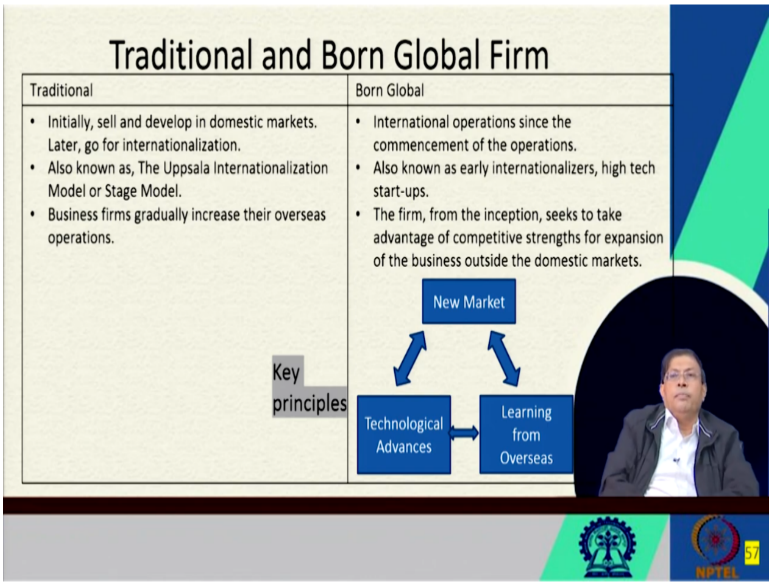

So, traditional and global firms: So, the initially the traditional firms; there is a difference between a traditional firm and a global firm. So, what is a traditional firm? Traditional firms are initially sell, develop in domestic markets, later go for internationalization. As I told you, these are typically traditional companies. So, traditional companies, what they will do? They will first develop in the local market, build the domestic business, then go and explore either Uppsala theory or transaction cost theory or OLS, step by step they will go and expand also known as the Uppsala internationalization model or stage model; they will go stage by stage.

So, remember that ladder I have shown, that beautiful example of the graph which I have referred, where you see the researcher has shown that you can go from the direct from agent and slowly increase up to a final subsidiary. And this is typically the traditional companies. And business firms gradually increase their overseas operation. But in contrary, the global companies, the born global companies, the international operations since the commencement of them.

So, from day 1 they are born global. So, maybe in 1 year or 2 years time they are global, also known as early internationalization high tech startup. So, you have heard about lot of high tech startups, so, they always look whole globe as their market. The firm, from the inception seeks to take the advantage and competitive strains for expansion of the business outside the domestic market.

So, from the inception; so, remember the traditional firms, they first developed the domestic market, but these born global companies, from the inception, they take the competitive advantage and expansion business outside the domestic market. So, they do not consider domestic market as their first entry or first developing the market. So, there is a big difference between the traditional companies and the born global companies.

So, born global companies, if you typically look at this block diagram, new market, learning from the overseas market, technological advances and then you develop another new market, how this whole cycle works. So, there is the difference between a born global and the traditional companies. So, that is all from the entry, various entry levels. So, to summarize in today's all these sessions or whatever we discussed in this today's session, which is, we discussed about the various stages of entry and certain theories.

Now, these theories even for a practicing managers who are; some of you may be a practicing managers; you must go through these theories which will be immensely helpful for you. I can tell you from my experience in these international market, these theories are extremely important for you, when to use transactional costs theory or whether to use Uppsala or whether to use network model theory or whether to use OLI or whether to be a born global company.

So, these are extremely crucial for you to understand the fundamentals of the various entry modes. And each of these theories are very important for you for taking a decision, conscious decision of entering a market. So, I would suggest that I have referred those, all the researchers name and the journals and the books from where I have taken this or some of these informations.

So, please study that books. I acknowledge the authors, the researchers who had produced such beautiful and excellent information for the practicing managers and the students. I am thankful to all of these people. These informations are concised in such a way that you can use depending on your company, depending on your products and depending on various other parameters what we have discussed.

So, today we have completed how are the various modes theories, modes of entry in the international market, each with their positives and negatives and which one to take depending on your size of your operation, your company, your target country, your focus; several things are required, but to heads up a very basics on the 4 theories from the marketing perspective view. So, you are a marketing manager, so, you have to understand very basics of this one so that you can take a decision which mode should be better for you. Thank you very much. Thanks a lot.