International Business
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Lecture – 03
Modes of Entry – I

Welcome everyone to the course International Business. In the last session, we started with the introduction, where we spoke about the definition of international business, the importance of international business, and the scope and nature of it, what challenges international business the organizations are facing today. And then we went into the Modes of Entry, how organizations, the business firms are entering into the different countries right!.

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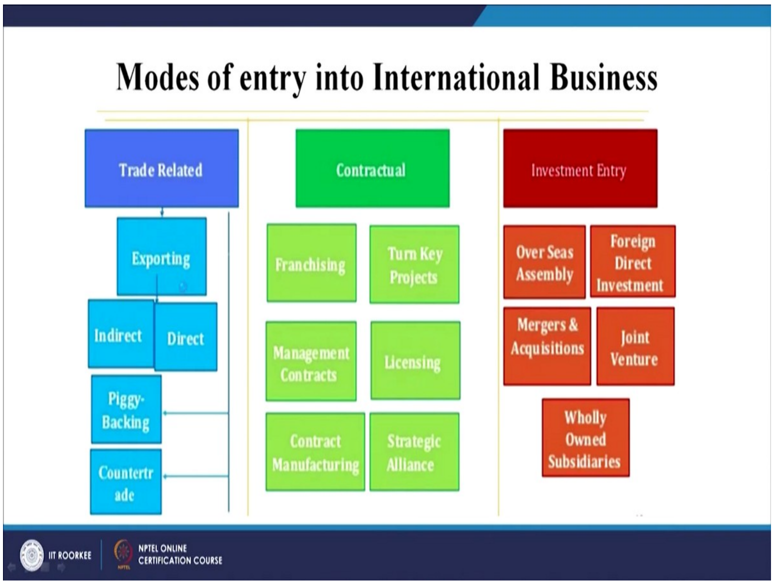

So, today we will start again with that mode of entry. So, let me just show you the model. So, this is a picture where we have shown the different modes of entry into the international business. So, in the last lecture, we discussed on the (you know) this part; this is the trade related part where we spoke about the indirect way of exporting, and the direct way of exporting.

And then we talked about what is piggybacking right! where which is like (you know) strategic partnership or partnering with some other firm. And then we talked about counter trade. So, counter trade again we talk about like (you know) barter, offset, buy back and all these things right! So, this is something we had covered.

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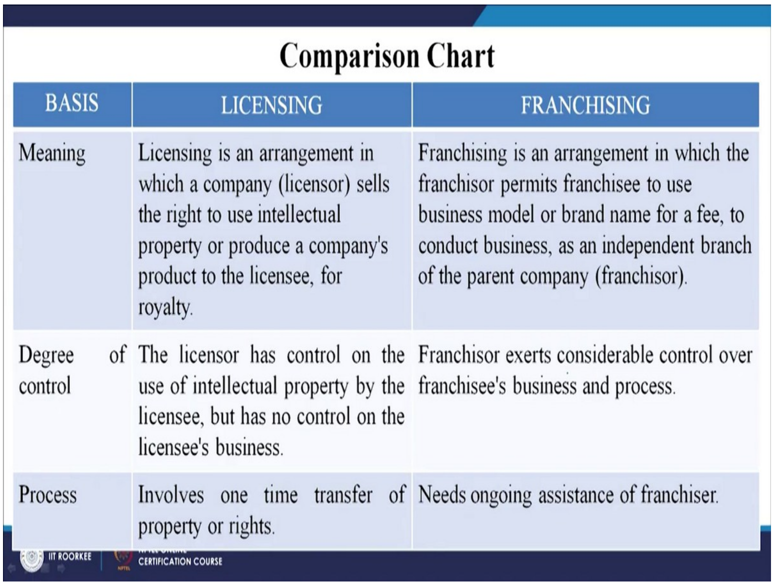

Comparison Chart

BASIS	LICENSING	FRANCHISING
Meaning	Licensing is an arrangement in which a company (licensor) sells the right to use intellectual property or produce a company's product to the licensee, for royalty.	Franchising is an arrangement in which the franchisor permits franchisee to use business model or brand name for a fee, to conduct business, as an independent branch of the parent company (franchisor).
Degree of control	The licensor has control on the use of intellectual property by the licensee, but has no control on the licensee's business.	Franchisor exerts considerable control over franchisee's business and process.
Process	Involves one time transfer of property or rights.	Needs ongoing assistance of franchiser.

But again let me just do for your benefit for the students benefit I have brought a chart where I want to explain how licensing and franchising are different from each other ok. Let us go through it. So, what is it saying? Licensing is an arrangement in which a company sells the right! to use intellectual property or produce a company’s product to the licensee, for a royalty, for a fee basically right!

What is happening here? If you understand, the licensor is giving permission and also support to set up the business, and produce and sell the products, and in return gives it a fee to the licensor right! On the other hand, what happens in the franchising, it is an agreement or an arrangement in which the franchisor permits the franchisee to use the business model or brand name for a fee.

But the point is the franchisor gives all the support to the (you know) franchisee which was unlike the licensing. In the licensing the licensor was not giving any support; the all the infrastructure was being built by the licensee right! But in the franchisee case, the franchisor supports everything and tries to handle in a much efficient manner, so that the brand name of the firm is not affected.

What it says? The degree of control here, the licensor has control on the use of the intellectual property by the licensee, but has no control on the licensee's business, because the licensee is setting up the infrastructure, the plant, whatever facilities, and he is (you know) running it.

On the other hand, the franchisor in this case exerts considerable control over the franchisee's business and processes as I said because most of the time the franchisor supports with even the infrastructure, the (you know) the trademark and all the kinds of supports that the franchisee needs if the franchisor supports it ok.

What processes are involved? It involves a onetime transfer of property or right's in case of licensing. On the other hand, in case of franchising, it needs an ongoing assistance from the franchisor ok. So, these were some basic differences of the licensing and franchising. So, otherwise franchising is nothing but a form of licensing only right! So, this is the first thing which we discussed in the last class. So, another type of entry, contractual mode of entry for international firms is known as management contracts.

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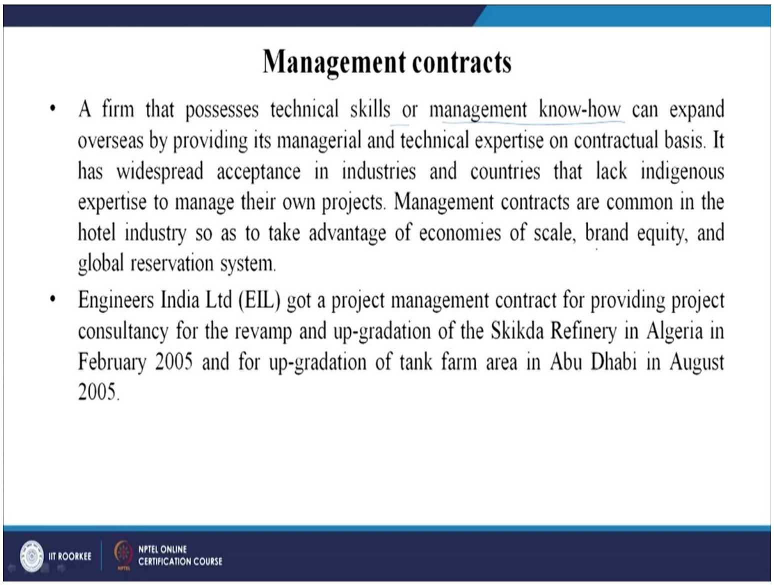

So, what is management contract? Let us understand. A firm that possesses technical skill, a firm that possesses technical skill right! or management know-how right! can expand overseas by providing managerial and technical expertise on a contractual basis, that means, for a time period right! It has widespread acceptance in industries and countries that lack the skill the expertise to manage their own projects.

Suppose, for example, some African nation does not have the skill and expertise. So, another a company from some developed country or some good firm can take advantage of that and support the country, because it needs some guidance and this company has a ability to provide it right!.

Management contracts are common in the hotel industry. So, I brought an example for you also. So, as to take advantage of economies of scale, brand equity and the reservation system for example, in hotels Another example which I have given of management contracts is Engineers India Limited (EIL), it got a project management contract you can look at this for providing project consultancy for the revamp and upgradation of the Skikda Refinery in Algeria.

So, it is a Skikda is a refinery in Algeria in 2005. So, this contract was given to EIL. And EIL was taking care of it because EIL had the expertise. And for upgradation of another tank farm area in Abu Dhabi in August 2005. So, this is what is a management contract.

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So, this is a example I have brought; you can read it in your free time how India's Taj Hotel have employed management contracts for international expansion right! So, you can read it. So, just to show you few things in here the Indian Hotels Management, the IHCL entered into a 10-year management contract with Dubai-based property developer and to develop and manage the Taj Exotica Resort and Spa right! at a luxury resort at the Palm Island in Dubai.

Similarly, Indian hotels entered into a 30-year management contract to operate and manage Piere a luxurious hotel in New York, so which was earlier managed by Four Seasons and their firm right! So, management contracts facilitated rapid international expansion of Taj Hotels without any equity commitment. So, what you have is the expertise, and you are using your expertise to run some firm who needs your expertise right! So, that is how also firms try to (you know) enter into different countries and it is a mode of entry right!

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Another interesting form of entry into different countries is contract manufacturing. Now, what is contract manufacturing? Let us look at it. In order to take advantage of lower costs of production, a firm may subcontract manufacturing in a foreign country, I think you must have heard a lot about these cases in the (you know) with the attached to the word outsourcing right! Nike outsources most of its production right!

So, similarly this case of Nike also has been brought here. Nike, for example, the leading international brand, shoe brand does not own a single production facility and gets its manufacturing done through contract manufacturing throughout the world right!

So, what it is doing? They involve international subcontracting arrangements, may involve supply of inputs such as raw materials, semi-finished goods, components and technical know-how to a local manufacturer in a foreign country, and this local manufacturer does all the production part right!

So, another example you largely see contract manufacturing is where the Indian pharmaceutical industries are connected with that. The Indian pharma industry is largely dependent on the foreign firms pharmaceutical from large firms, and they act as the contract manufacturers. Example Ranbaxy and Lupin industries are contract manufacturers for multinational companies like Eli Lilly and Cynamid right! So, this is an example.

So, we have they need us, they need a low cost operation, and India is a very good place because here there are (you know) labour is cheap and technology is good, there is a large community of English speaking people. So, they can help you in there right!

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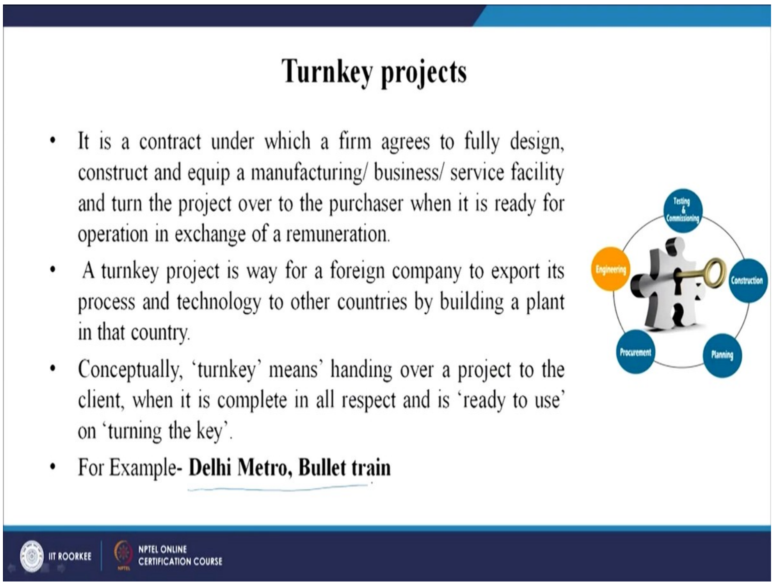

The next is the turnkey projects. Now, what is a turnkey project? Let us start with a definition. It is a contract under which a firm agrees to fully design, construct and equip a manufacturing, business, service facility and give the project back to the purchaser when it is ready for operation in exchange for a remuneration.That means somebody wants me to do a particular commissioning of a plant, and I have the knowledge expertise, resources, everything. So, I do it for them, and then hand over the commission the plant and hand it over to them, and in exchange for a fee right!

A turnkey project is way for a foreign company to export its process and technology to other countries by building a plant in that country. Now, you can see here, what it is doing, there is a planning, procurement, engineering, construction, testing and commissioning right! So, these five things are part of a turnkey project right!

So, conceptually why it is called turnkey? Let us understand. It means handling over a project to the client when it is complete in all respects and is ready to use on just turning the key. So, it is like turning the key or (you know) opening the (you know) lock, it is something like that that is why it is called a turnkey. So, everything is complete I will just hand it over to you, and you need to pay me for that. Examples are in India are the Delhi Metro and the bullet trains right!

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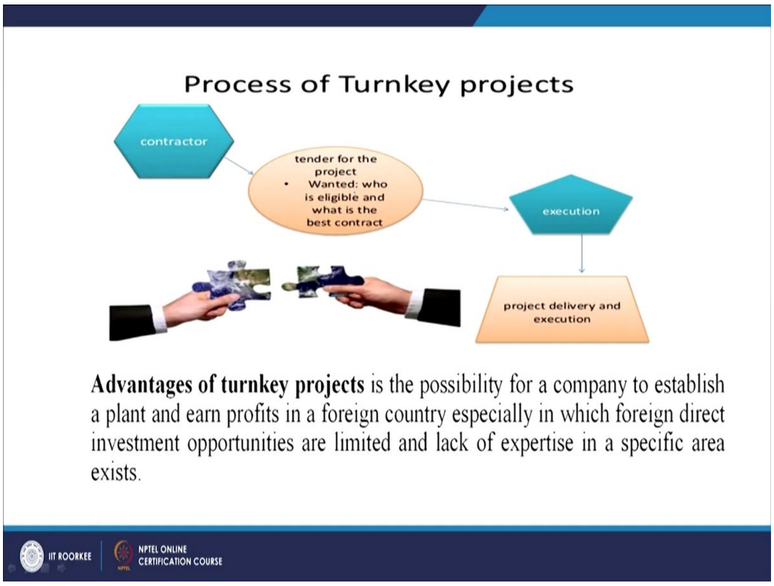

What is the process of turnkey projects and what are the advantages? So, how it is happening you see? Tender for the project wanted, who is eligible and what is the best contract right! So, the contractor is applying. And then after that the selection is done and the execution happens, and the finally, the project is delivered and executed.

So, what are the advantages of this turnkey project? It is a possibility for a company to establish a plant and earn profits in a foreign country especially in which foreign direct investment opportunities are limited. So, you want to and lack of expertise in a specific area exists. For example, L&T (Larsen & Toubro) acts as a turnkey, (you know) operator for many companies in many countries, especially the countries like the African Nations right!

So, if you have to set up a textile plant, a plastic plant (you know), so L&T helps companies to develop where there are raw materials, but they do not have the know-how to set up a plant. So, L and T like companies they do this right! in favour in exchange for some remuneration.

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Next is strategic alliance. As the name suggests strategic alliance right! that means, there is an alliance between two or more firms for some strategic reason right! So, what it is saying? It is a cooperative agreement between two or more companies to work together and share resources to achieve a common business objective. So, they share the resources.

So, if you see resources are always limited right! So, no firm can have all the resources. The resources could be natural resources, raw material, could be knowledge of the local market, anything right! skill, knowledge, so all these things one cannot have. So, when a strategic alliance happens the firms tie hand, they join together and they utilize each other's resources for their success.

Example ICICI Bank and Vodafone; ICICI Bank is a financial company, Vodafone is a telecom right! India entered into a strategic alliance to launch a unique mobile money transfer and payment service called m-pesa right!. So, this is where ICICI bank also would gain and Vodafone also would gain ok.

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What is the advantage? Let us see. So, the advantages of strategic alliance are like, there is a technology exchange between the firms, global competition you do better in (you know) in the competition, the industry is converging as you saw one is a telecom, the other is a financial company right! bank or something, and then you reduce the risk through economies of scale. These are the advantages.

But it must be having some disadvantages also. So, let us see what are they. Clashing cultures, legal entanglements, damage to reputation. So, what is happening? There is a large chance that the companies that have a strategic alliance, they have too very different cultures right!

And because of the differences in culture and habits, the company the employees do not go well with each other, and there is a clash in the style of the management too. So, this leads to failure of the strategic alliance right! There also then once that happens there are legal complications that happens right! And finally, it may lead to a damage in the reputation of the firms which has been (you know) built over a long, long period of time and good work right!

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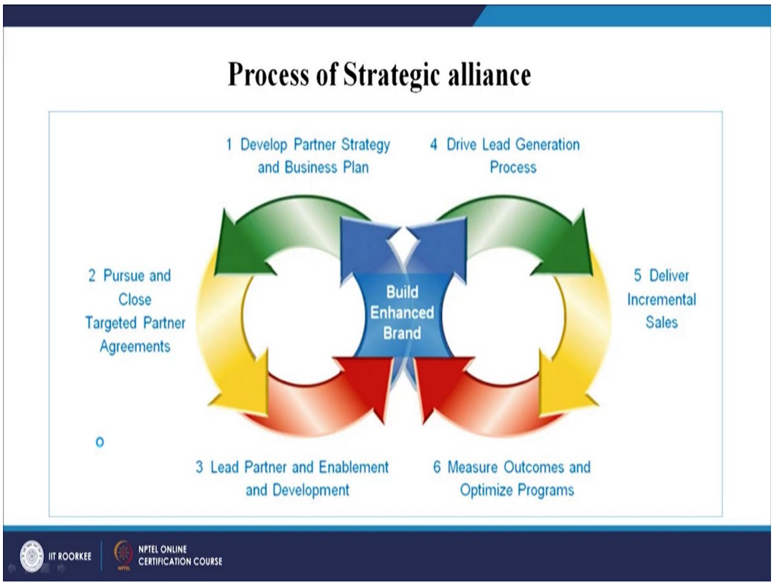

How does it happen? So, there are some steps you can see. So, the first step is develop business partner strategy and business plan right! The second is pursue close targeted partner agreements. So, in the first you have a business plan, and in second you have a agreement. Third, the lead partner and enablement and development. So, now, joining hands and both are trying to work together. In the fourth, lead generation processes. So, they are generating leads now. Five, deliver incremental sales right! and six, they measure the outcomes and the optimization.

So, what you do is you take your time. Slowly look at this diagram, and look at the movement of the arrows, and try to take an example of some company, and try to look at the strategic alliance in between these two firms right! So, you will understand it in a much better way.

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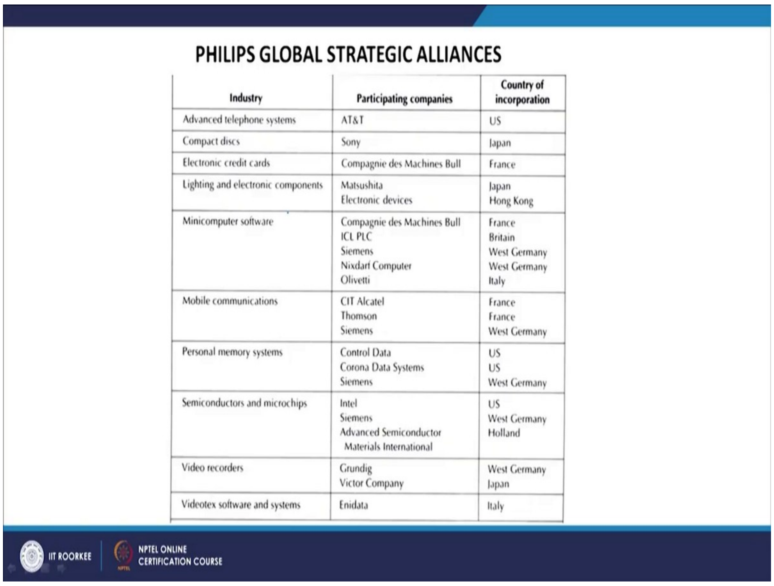

This is an example I have brought for you which talks about Philips global strategic alliances. So, in there are several products and several industries Philips runs its products, and how it has partnered with the different companies, and the incorporation where they have been incorporated it is also mentioned.

So, advanced ATS they have participating companies are AT&T, for example, a few only I can say, compact disc they have tied up with Sony. For example, mini computer software a number of companies are have been tied up right! For semiconductors they have tied up with Intel, Siemens, etc. For (you know) video recorders they have tied up with Grundig, Victor Company.

So, and you can see the different various countries where they are incorporated Italy, Japan, Holland, Germany, France, Britain, Hong Kong, so many countries right! So, strategic alliance helps the companies to grow and use each other’s resources more wisely.

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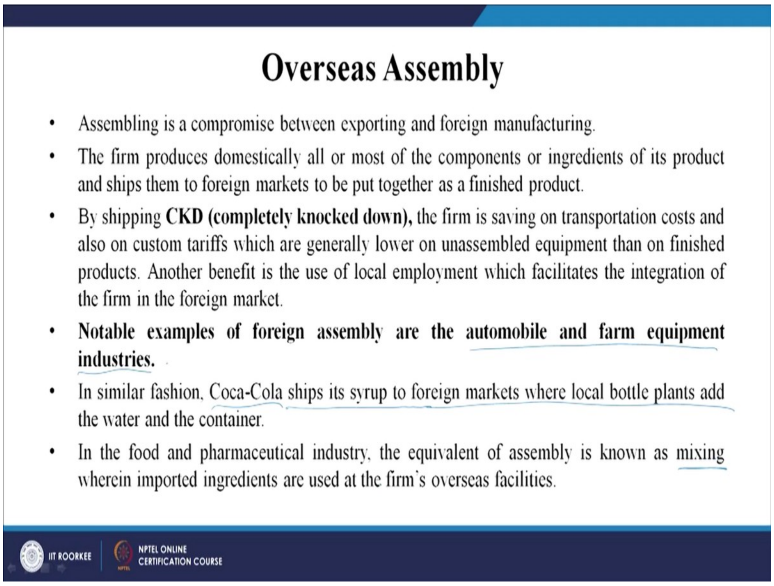

The next thing that we are talking about is overseas assembly. Now, what is this overseas assembly? Let us understand what is assembling. Today with the increase in networking and of (you know) technology, it has become very simple or it has become much easier to send your products to (you know) send details about your products to different places.

So, finally, what has happened, companies are finding it easier and its more cost effective to send a product in different modules or parts which is called (you know) modular design also sometimes it is called, so and instead of sending it in a complete package. So, because that takes more space and logistical difficulties arise.

So, what it is saying assembling is a compromise between exporting and foreign manufacturing. The firm produces domestically all or most of the components are ingredients and shifts them to the foreign markets to be put together as a finished product as I just said modular design.

By shipping the completely knocked down, the firm is saving on transportation cost and also on custom tariffs which are generally lower on unassembled parts than on the finished products ok. Another benefit is the use of local employment which facilitates the integration of the firm in the foreign market. So, these are the advantages when you do an assembly overseas ok.

Some examples are in the automobile and farm equipment industries right! In similar fashion, this is an example of Coca-Cola; you will it is very interesting to know Coca-Cola ships its syrup to foreign markets where local bottle plants add the water in the container. You must be knowing Coca-Cola never shares its (you know) the formula right! So, it is still it is saved in Atlanta in a bank.

So, what happens they send the syrup to the foreign markets, and the local bottle plants add the water and container right! In the food and pharmaceutical industry, the equivalence of assembling is known as mixing which you just saw, where an imported ingredients are used at the firms overseas facilities.

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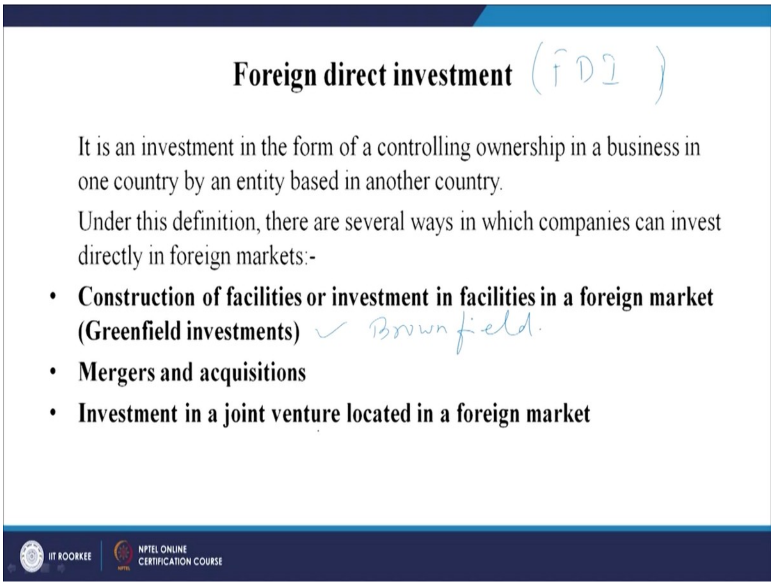

Now, this is another form of now entry, the foreign direct investment or we say FDI right! FDI, where we see that there is a lot of pressure for the governments also to attract FDI in every country. So, a country's growth is assumed or measured as one of the indices to measure is FDI right! So, what it is saying, what is FDI basically? It is an investment in the form of a controlling ownership in a business in one country by an entity based in another country.

So, that means what? Under this definition what is happening there are several ways in which companies can invest directly in foreign markets right! For example, construction of facilities or investment in facilities in a foreign market which is called a Greenfield investment, that means, there is a company from abroad can come here and start an entirely new plant or business, or it can it also the opposite of Greenfield is Brownfield investments.

So, what is a Brownfield investment in which an existing infrastructure is there(existing) and the company just tries to buy it or tries to (you know) in put in its capital, and try to make it much better and improved ok. Another form of which comes through FDI is the merger and acquisition, and the last one is investment in a joint venture located in a foreign market.

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So, let us see some of them. So, FDI, although FDI will be covered more deeply in one more in the know in the forthcoming chapters. So, just I am giving you a touch. Foreign direct investment today every country every (you know) government is pressurized is there is a pressure for the governments to bring in more foreign direct investment, that means, let us invite more foreigners to come to our place and start their operations, so that our people get employment and revenue is generated out here.

Example is Vodafone, a British firm, acquired the Czech Telecom Oscar Mobil right!; eBay acquired Luxembourg's Skype Technologies, a prepacked software company which is both are very famous, you must be aware of them right!.

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So, some of the pros and cons. So, what are the advantages of FDI? Now, look at it. Diversifies the investor's portfolios. They investor, the investing company it; it can diversify its portfolio; it can get into new areas. Promotes stable long term lending right! provides financing to the developing countries.

So, as a result they find new markets also ok. Provides technology to the developing countries. So, it is also not only a kind of a (you know) benevolent behaviour, but also it is economically sound to them. So, in a new country where there is a lot of under development, so through FDI you can send in your technology, you can pass in your technology for the development of the nation and as a return you can earn your revenue also.

But what are the cons? It is not suitable for strategically important industries, because there must be there can be some very difficult things which cannot be passed on, so that is one difficulty. Investors may have less moral attachment because of the kind of pollution and kind of things that it generates right! Unethical access to local markets.

So, sometimes firms may use that as a strategy to enter into the new markets and try to exploit it. So, this diagrams if you can see it the pictures are very clearly (you know) making you understand what are the advantages and disadvantages right!

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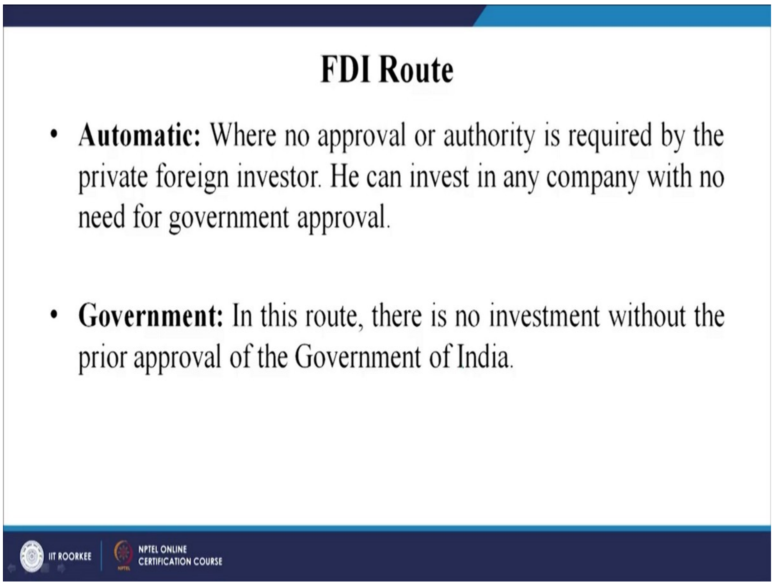

So, the FDI route is done in two ways. One is the automatic route where no approval or authority is required by the private foreign investor. He can invest in any company with no need for government approval that is one way.

The other is a government route in this route there is no investment without the prior approval of the government of India. Why it differs? Obviously, this differs because of the kind of the industry right! and its impact, its local impact that it can make on the host country right! So, on basis of this, the FDI route is divided two ways.

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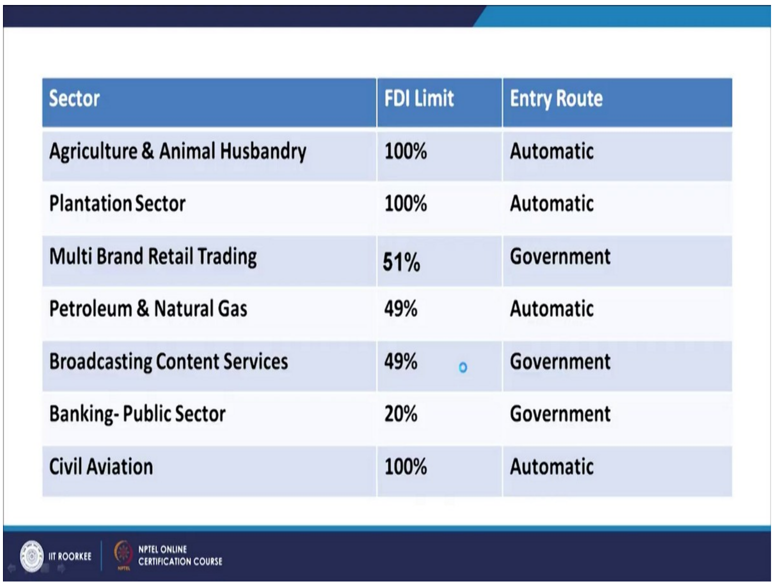

Sector	FDI Limit	Entry Route
Agriculture & Animal Husbandry	100%	Automatic
Plantation Sector	100%	Automatic
Multi Brand Retail Trading	51%	Government
Petroleum & Natural Gas	49%	Automatic
Broadcasting Content Services	49%	Government
Banking- Public Sector	20%	Government
Civil Aviation	100%	Automatic

I have brought some examples for you in India. Agriculture and animal husbandry, there is a 100 percent FDI limit, that means, anybody can put in hundred percent stake, can buy 100 percent stake, and the entry route is automatic; plantation, 100 percent automatic. Multi brand retailing, retail trading this is (you know) the entry route is through government. Why because, obviously, it can impact lot of retailer's small retailer's it is 51 percent limit.

Petroleum and natural gas, 49 percent, it is again automatic. Broadcasting and content services, FDI limit is 49 percent and under government. Banking-Public Sector, 20 percent right! and under government. Civil aviation, it has been made 100 percent and it is automatic. So, these are some of the examples.

You can find many more examples and maybe when you start reading you may make a note of it and make a table or an excel, where you can note down which are the sectors and what is the amount of limit, and what is the route right! It is better if you can do that as a homework.

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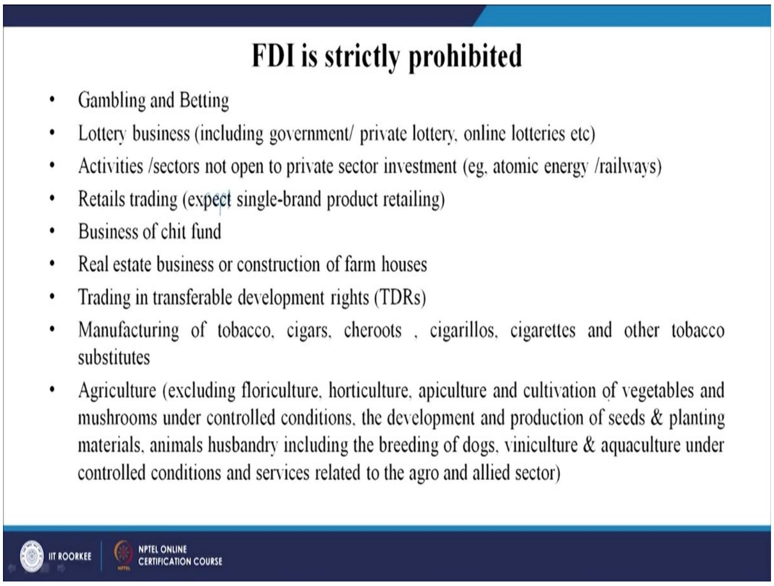

Where is FDI prohibited? FDI is strictly prohibited in some areas some of them being first is the gambling and betting sector. So, here FDA is not encouraged right! Lottery business, including government, private lottery, online lotteries, nowhere FDI is invited. Activities or sectors not open to the private sector investment like atomic energy, railways, still yet in railways also there is no FDI right! Retail branding except single brand, and it is not expect, it is except, except ok, except single brand product retailing right!

Business of chit fund, real estate business, construction of farmhouses, trading and transferable development right's, manufacturing of tobacco, cigar, all these kinds of sin products what you say. So, agriculture, excluding floriculture, horticulture, apiculture, cultivation of vegetables etc., they fall into this prohibited category right!

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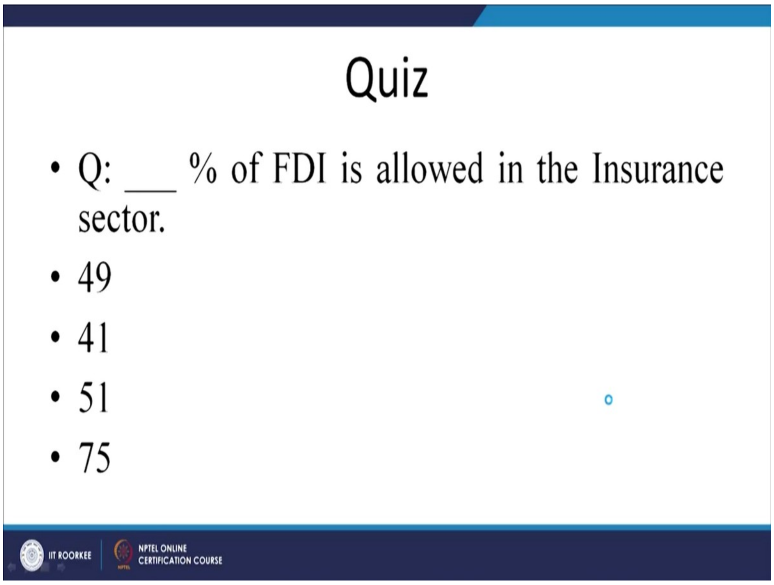

So, this is a quiz I have brought. You may look at this question and you can think of an answer. Dash (fill in the blank) percent of FDI is allowed in the insurance sector right! So, what is the possible answer, can you think of it? Ok. So, the correct answer is 'a', 49 percent FDI is applicable in the insurance sector via the automatic route in India.

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Now, this is a homework for you. So, kindly find the FDI in the following sectors. If maybe I have already mentioned about retail and mine, but still you can do it for the others. For example, print media newspaper, FM radio, airport, airlines, airlines also I have mentioned I think SEZ - Special Economic Zones, retail, mining, education and the NBFCs - Non Banking Financial Corporations. So, what is the kind of FDI involvement/ allowed/ permission that is available to them, just find out and make a note of it right!

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So, this is the Greenfield investment I was talking about. Building new production facilities in a foreign country. It refers to investment in a manufacturing, office, or physical company-related structure or group of structures in area where no previous facilities was existing right! Example McDonald Starbucks both started everything from scratch in India that was a Greenfield investment, it is a FDI part.

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Brownfield used for purchasing or leasing existing production facilities which it was not mentioned in the diagram. So, I had written over there if you remember. To launch a new production activity, example Tata motors acquisition of Jaguar, Tata motors did not need to build a new factory in the UK, but started running the business from the existing factory of Jaguar right! So, this is an example.

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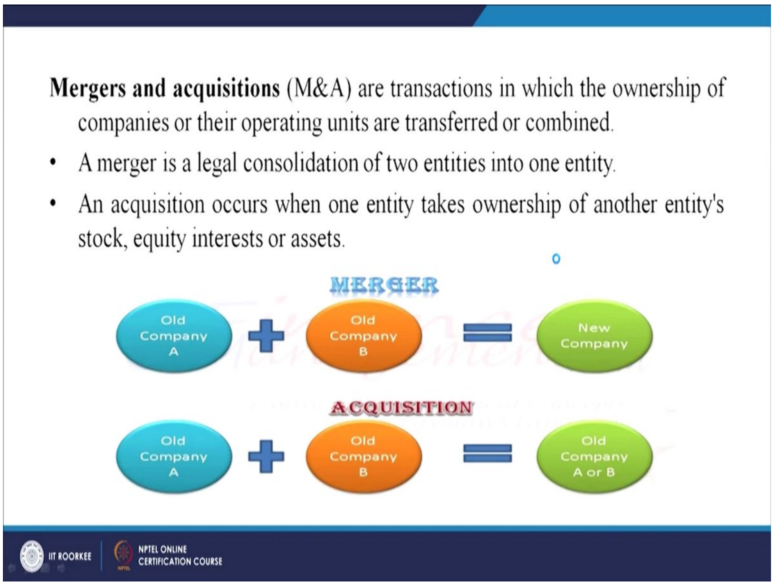

And two more are there. Merger acquisitions are transactions, although we will go deep just for a brief (you know) introduction in which the ownership of companies or their operating units are transferred or combined. A merger is a legal consolidation of two entities into one. So, a very classic example of you see old company A plus old company B is equal to new company right! two merges then it could be a new company or it could be either A or B right!.

So, an acquisition occurs when one entity takes ownership of another's entity stock. One very famous merger and acquisition case I can cite is Compaq and HP right! Hewlett Packard and Compaq merged had a merger right! very famous merger. Sometimes when there is a reverse merger case also which I will explain when a small firm takes over a larger firm or joins hand over a with a larger firm. So, it is called a reverse merger case right!

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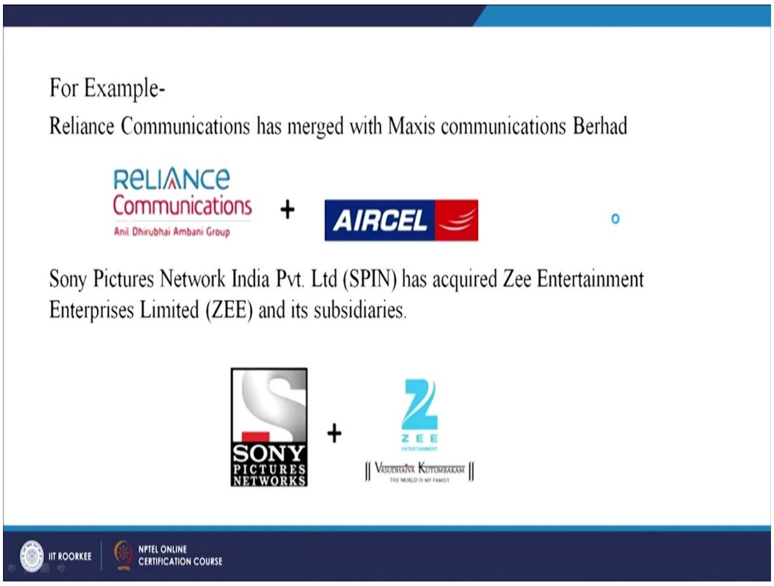

So, these are some of the examples another example in India is Reliance communication has merged with Maxis right! Maxis Communications Berhad. Sony Pictures - SPIN has acquired Zee Entertainment and its subsidiaries. So, I will close here because of lack of time. So, we will wind up here. And in the next session we will start from here only, maybe we will start with the again the last part from the FDI we will start and we will continue from there.

So, I hope you are clear with the modes of entry, what they are, and how they are important. I gave/I tried to give you examples. And through these examples also, so you can connect and relate, so that you do not forget them. And I gave you some tasks, you can do it in your free time, and that will help you to (you know) have a better understanding.

So, thank you so much.