International Business
Prof. J. K. Nayak
Department of Management Studies
Indian Institute of Technology, Roorkee

Lecture – 04
Modes of Entry II

Welcome friends to the course International Business. I hope you must be enjoying this course and learning at the maximum. So, in the initial lectures – the first three lectures, we discussed about the introduction, and we are still carrying on with it. And we started also with the mode of entry, actually what we are now carrying on is the mode of entry which started from the 2nd lecture, and the 3rd lecture was also on the same. And today – the 4th lecture also we will continue with the Mode of Entry.

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So, what we had done in the mode of entry into the international business because as I had said earlier also, international business has its own complications right! The complications arise because of the political climate, the cultural climate, the social climate, the different habits and all, and the government regulations.

So, it is not that easy; it is very complicated. So, how should you enter, how should a firm enter? Why it should enter that is very we have understood, because there is a (you know) market expansion, there is a need to expand your business, the markets are getting saturated in the home markets. So, all these are fine.

But how do you enter, how should you enter right! So, in this we talked about two different aspects, one is the trade related aspect which we have covered and the contractual also we covered right!

In trade related, we covered like exporting direct and indirect, then we cover piggybacking and counter trade which we covered. Then in the contractual we covered what is franchising, licensing, turnkey projects, then management contracts, contract manufacturing, strategic alliance. And then we had started with the investment entry on which we just started with the FDI. And in the last lecture we had just stopped at the FDI ok!.

So, today we will start from there right! And we will go into the other forms which come into the investment mode category right! So, FDI, we all understood why FDI is so important because every government today is trying to attract foreigners or foreign companies to come into it to raise its employment level, and try to earn better foreign revenue and all, so that is one thing we discussed. The next thing is which is very popular as a mode of entry is joint venture.

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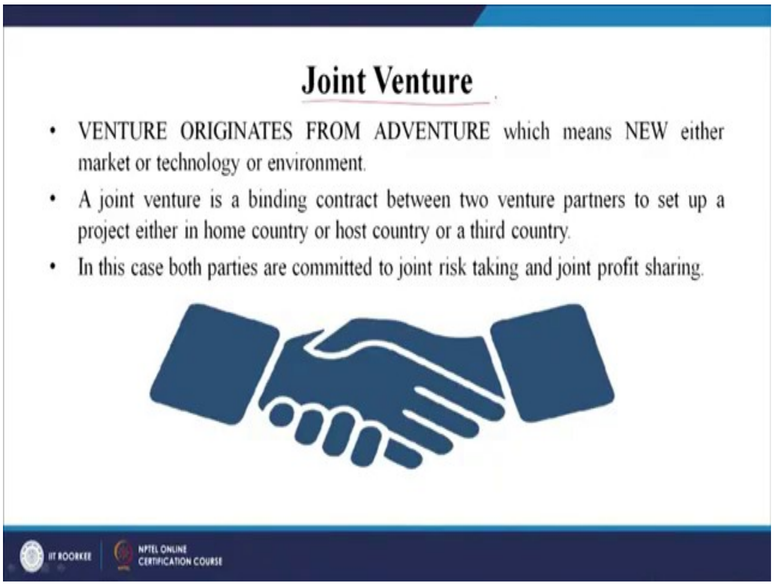

Now, what is joint venture basically? Venture originates from adventure. So, the name comes from adventure which means new, either market or technology or environment. So, there is a new market, new technology or new environment. So, you are looking at a new thing which you are not much aware of.

A joint venture is a binding contract between two venture partners to set up a project either in the home country or host country or some third country right! In this case, both parties are committed to joint risk taking and joint profit sharing. The biggest advantage of joint venture is that both the partners they jointly take the risk and the profit. So, now the element of risk is shared right!

So, this is this happens true mostly in cases where there are huge investments required, for example, petrochemical, oil refinery. So, there a firm cannot takes the risk because you might try to drill, and then you might not touch oil, so in such a condition it is safer to go for a joint venture right!

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So, example I have brought is here you can see. Volvo and Uber have announced that they would form a joint venture to produce self-driving cars right! So, which is also (you know) self-driving driverless cars we talk about, which Google is also doing at the moment. Mahindra and Mahindra has recently entered into a joint venture with Renault to manufacture cars.

So, this are some examples, and as I said all these you can see are generally being done when it is a capital intensive industry, especially, especially I am saying right!

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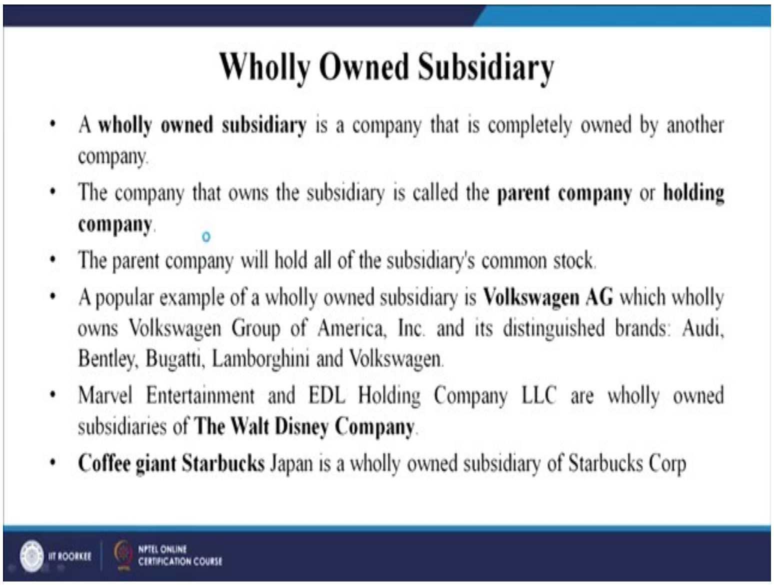

Thus next one is a wholly owned subsidiary. Now, what is a wholly owned subsidiary? It is a company that is completely owned by another company as the name suggests itself. The company that owns the subsidiary is called the parent company or holding company right! The parent company will hold all of the subsidiary's common stock right! Example, let us look! at a popular example.

A popular example of wholly owned subsidiary is Volkswagen AG which wholly owns the Volkswagen group of America, and its distinguished brands Audi, Bentley, Bugatti, Lamborghini and Volkswagen. So, this is the firm entirely holds the complete subsidiary all the subsidiaries are completely owned by them.

Marvel entertainment which you must be looking at Avengers and all kind of movies today coming right, and EDL holding company LLC are wholly owned subsidiary of the Walt Disney company.

So, many times we are not aware of this wholly owned subsidiary, the parent company sometimes, we are not aware even of that, but we think of the subsidiaries as a individual brand, but then they are controlled by somebody else right! Coffee giant Starbucks Japan is a wholly owned subsidiary of the Starbucks Corporation ok!. So, these are some of the (you know) examples where you can learn that a parent company is holding the entire stake of the subsidiary ok!.

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Understanding a holding company, a company that owns the assets, but does not have any operations, activities or other activity active business itself right! Johnson and Johnson is the holding company; the subsidiaries are JANSSEN PHARMACEUTICA, Depuy synthes, LIFESCAN, ACTELION, Neutrogena, and ETHICON, so these are subsidiaries.

Sometimes we are not aware of it. Many a times we are not aware, even we ask to the students also, we do not know; we think they are different, different companies, but actually there were wholly owned subsidiaries basically right!

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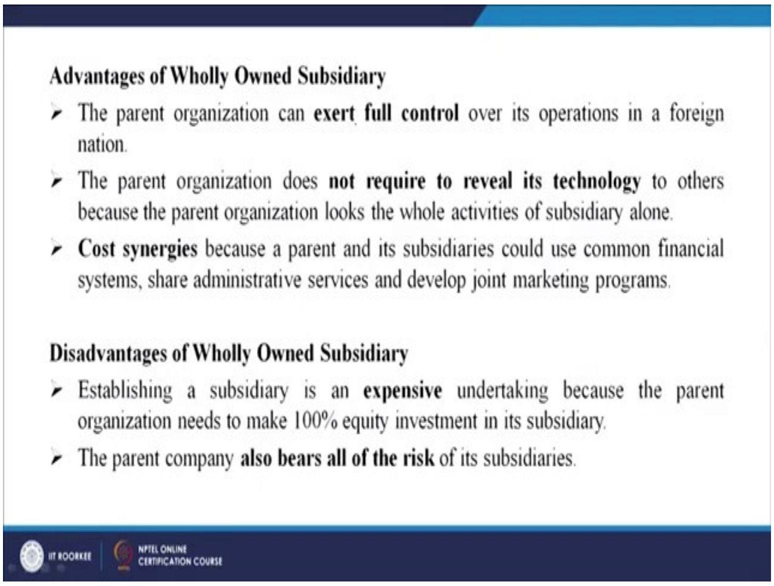

What are the advantages? The parent organization can exert full control over its operations in a foreign nation right! So, all the policies are made and they are controlled right! The parent organization does not require to reveal its technology to others because the parent organization looks the whole activities of the subsidiary alone right!

There is a cost synergy, because a parent and its subsidiaries could use common financial systems, share the administrative services and develop joint marketing programs, so that is an advantage that you have.

But as I always say that if there is an advantage, there is also a disadvantage. Now, what are the disadvantages? Establishing a subsidiary is an expensive undertaking, because the parent organization needs to make 100 percent equity investment in its subsidiary. So, you own it, so to own that you must have you have to put a lot of capital.

So, this capital now is a risk right which you have already taken. So, if you have taken the risk, the fruits are also sometimes are also yours right! So, the parent company also bears all the risk of its subsidiary. So, some of the subsidiaries if they do not do well, it is the risk comes to the holding company the parent company.

Similarly, say risky proposition, if the subsidiaries do well say then the profit also comes to the holding company, again the parent company. So, these are the advantages and the disadvantages of the wholly owned subsidiary.

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Now, this is a case these are some examples I have brought. Now, there are a logos of various companies with the names also, and identify the entry mode strategies of these companies in India. So, what I have done is I have brought some cases for example, how Starbucks entered into India, how has Walmart entered into India, how has Nike entered into India, Nestle, Coca-Cola, KFC, Dominos, Microsoft, McDonalds, Siemens and you can find more in this picture right!

So, what you can do is you can take all of these individually and try to read through and find out what is the entry mode, how they have entered into in India these companies? Today these companies are doing pretty well in India.

So, how did they enter, how did, what was the method, was it a wholly owned subsidiary, was it a strategic alliance, what do what it is a, was it an FDI route, was it like a (you know) joint venture, was it a merger, what was it exactly? Was it a piggybacking, what was it? What was the method they (you know) adopted to enter into the Indian market ok!?

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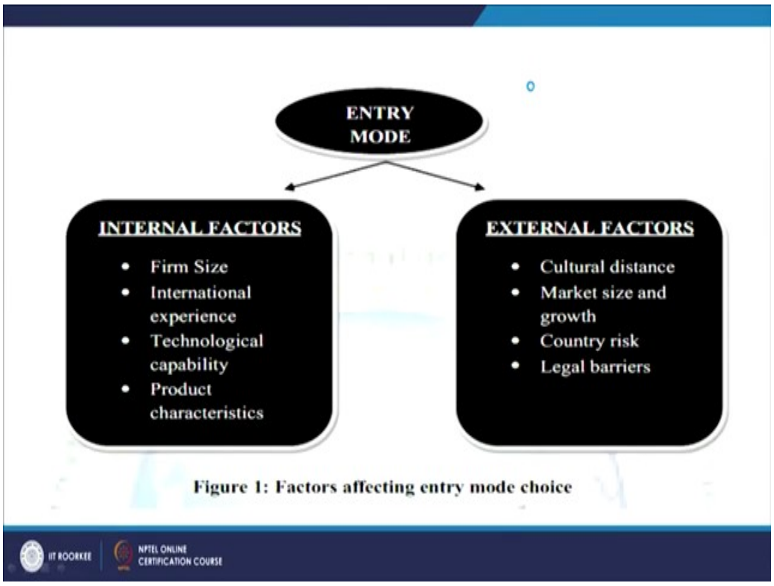

Now, what factors affect the entry mode? So, you have learned the entry (you know) the methods. But what are the factors that affect them? So, there are two basic factors, internal right and external factors. So, in internal factors what comes is the firm size right! the international experience, technological capability and the product characteristics.

So, a firm when it enters into the new market, it the factors that affect is what is the size of the firm? It is generally it is more easier if the firm size is large, it is generally easier, and because they have largest international experience there is a correlation between them right!

Technological capability are also good with big firm's right! And similarly the product characteristics. So, when you are entering what is the kind of the what is the product you are selling, and how it is acceptable in the whether it is acceptable in the foreign markets or not, so that thing also counts.

What are the external factors? Some of them are only given here not all, but you can take it. What are they? The cultural distance, now that is a very interesting, what is cultural distance? How culturally two nations are different from each other, you might be geographically very close, but culturally very different right!

Similarly, two different countries at two different distance points could be separated through a distance – high distance, but culturally they might be very similar right! So, cultural distance is a very important factor because it has been seen that many companies after merger or there is a joint venture or a strategic alliance, they break down or there is a rift in between them just because of this cultural factors right! So, how you communicate, what is your culture, so maybe one culture does not appreciate the other's culture, so these are the problems.

The market size and the growth. So, what is the size of the market you are tapping right, you are trying to tap right, and what is the growth potential. So, if you want to enter into a new market and that market you think it is untapped, but for a particular product category, this is already a very saturated, already saturated in that market, then you do not find much potential right! So, this research has to be done beforehand properly.

Country risk is very, very important. Today when you see when there are so much a political tensions and things are changing so fast, it becomes very important for all of us to understand the risk that a country holds. Now, there are countries for example, although I do not want to name, but few of them I can say which are always on the radar or they are hot topics of discussion, for example Pakistan, Iran.

So, the basically the oil exporting countries, and then in the European also you can find some of the nations which are always into some (you know) some discussion. So, but how much risk this country holds, African countries do hold much, so that under development and the developing ones are always at the in a point of discussion.

So, country risk is very important. If I set up a business, I enter into that country, but then the law is so rigid or something, then I am not able to do something, I am not able to expand my business. And if I do, I may be taken in a wrong way. So, the point is and sometimes people are put behind bars because of for example India had a very I can comment because I am an Indian I can talk about Indian policy.

So, India at one time when there was FERA (Foreign exchange regulation act). At that time there was (you know) one case where an Indian company a very important executive of the Indian company right was arrested because of FERA violations, but today the same would not have hold true because of the change in policy right, so that is one case.

And then legal barriers legal barriers of course, are very, very important because in some country what you define bribe may be different in another country. So, it is just a gift. So, how it is how those things are defined? So, corruption, how do you define bribery, corruption and all. So, these are very important right!

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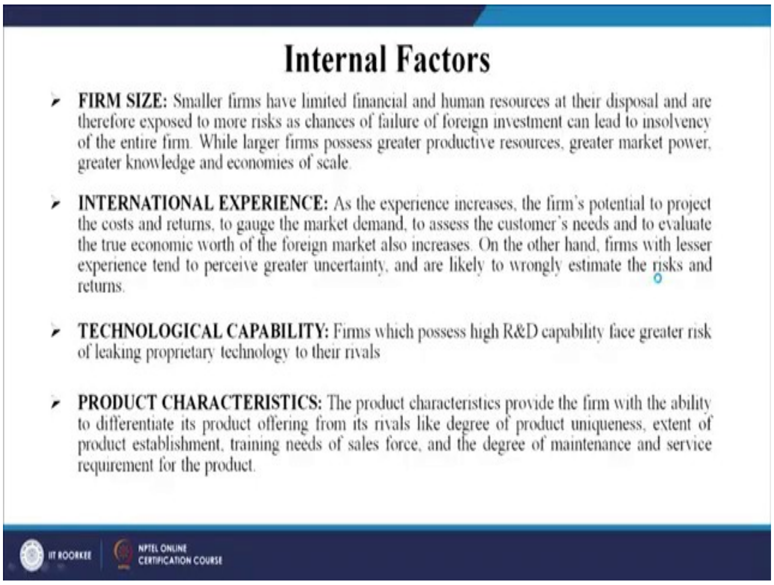

So, let us see some of the internal factors. Smaller firms have limited financial human resources at the disposal. While larger firms possess greater productive resources, greater market power, greater knowledge and economies of scale. International experience – the firms potential to project the cost and returns, to gauge the market demand, to assess the customer need and to evaluate the true economic worth of the foreign market also helps right!

On the other hand, firms with lesser experience tend to perceive greater uncertainty, and are likely to wrongly estimate the risks and returns. So, many a times the experience counts right! If you have a good experience and you can estimate the potential in another market, it helps you and gives to the returns.

Firms which poses high R & D capability face greater risk of leaking proprietary technology to the rivals. So, technological capability also is an internal factor which also impacts right!

Finally, what was the product characteristics we are talking about, product characteristic provide the firm with the ability to differentiate its product offering from its rivals like degree of product uniqueness, extent of product establishment, training, needs of sales force, and the degree of maintenance.

When it comes to product characteristics, I will talk about one case which I have written myself about it was a very popular case of Welspun. Welspun fell into a very difficult situation very recently (on the) .It was a case of product placement where there a towels which they said to be made up of very fine cotton, they say the (you know) Egyptian cotton, it was a case that they which was actually not true.

And because of this reason, the company Welspun fell into a very difficult situation. There was a case against it; they were sued in the US court. And there was a lot of difficulties which was per had to face right! So, this is because they did not understand how to handle the international business condition in a proper manner right!

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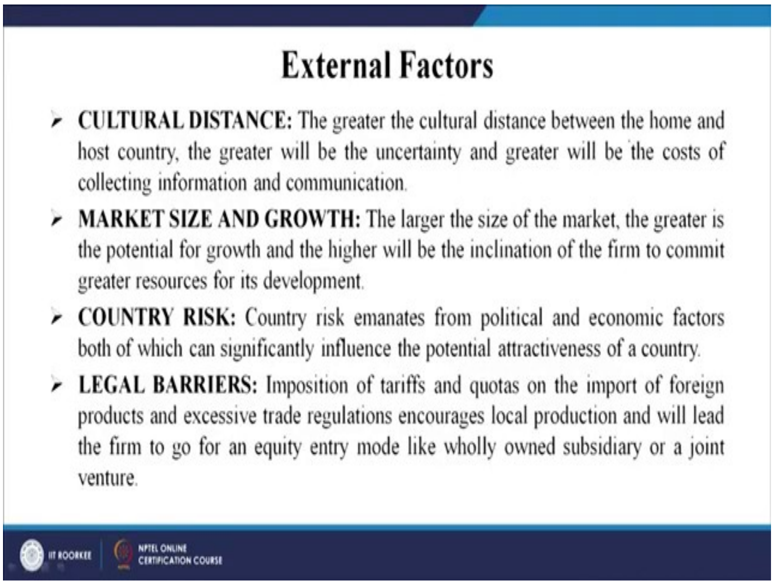

External, as I said greater the cultural distance between the home and the host country, greater will be uncertainty and greater will be the cost of collecting information and communication. Sometimes, it is very interesting to note that what is right in one country (is may not be) may be considered wrong in another country because of the cultural problems right!

Larger the size of the market the greater is the potential for growth. If it is a large market, why is India so popular today, why is everybody eyeing towards India? Because India has a large population base and the economy is growing right! So, every company is thinking that it if it can set a (you know) foothold in India, they would obviously do well because of its sheer size right!

Country risk emanates from political and economic factors both of which significantly influence the political attractiveness of a country. Why would anybody go to a country where there is a lot of instability and there is a fear of the company not (being do not) doing well right! For example, in the past Iraq and Iran were very popular for such cases. Legal barriers also I said imposition of tariffs and quotas on the import of foreign products and excessive trade regulation encourages local production and will lead the firm to go for an equity entry mode like wholly owned subsidiary or joint venture. So, for example, you see India for example, I would like to criticize here, it is good or bad, we have to take it in a different taste.

But Indian government has been trying to protect the local producers which is fine, because absolutely fine because our country is not so, it is not a developed country, and we are in the stage of growing; it is absolutely fine we need to support our domestic producers also.

But sometimes (this) what is the limitation, what is the right limit that we need to understand. And this sometimes makes it difficult for the foreign firms especially when in India because of (you know) issues like patent not being (you know) described properly, cyber security laws not being described properly, there is a problem of (you know) legal problems that arise when firms come to India.

Many a times it has been seen that the (firm) drug manufacturers, they find that their products are being copied and they can do nothing because the laws does not support them right ok!.

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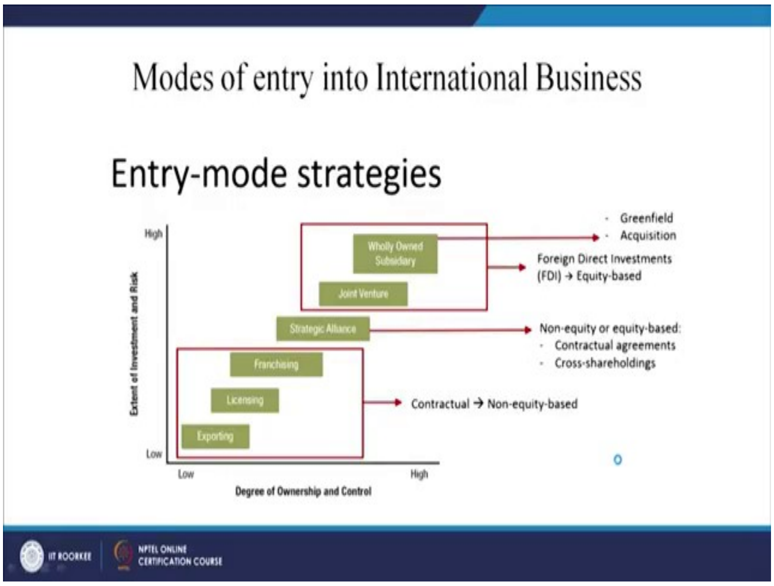

So, this is a mode of entry. So, there are two things which is very important you can see. On the 'x' axis, we have taken the degree of ownership and control; and in the 'y', we have taken the extent of investment and risk right! So, on basis of these two factors, we have tried to divide the various modes of entry in terms of the ownership and risk right! – investment risk.

So, basically if you see exporting comes at the low, right! that means, investment risk is low and ownership is also low. And maximum wholly owned subsidiary the investment is high risky (and) but the ownership is also very high, that means, 100 percent ok!, you are seeing 100 percent right the parent company holds all that is risk. So, these are the different conditions.

Strategic, joint venture also falls in a similar condition where the degree of ownership is suitably high, investment risks are also high. So, they are basically as I said capital intensive industries – oil exploration, drilling, etc., shipbuilding and all right! And if you look at the other cases for example, licensing, franchising, they relatively come under the low or degree of ownership, and low investment risk right!

So, these are some of the, and there are other things also which are explained – the Greenfield acquisition, and FDI equity based, and all these things explained. What do you can do is just go through this diagram and try to understand, and try to place the other modes of entry that (you have been just now just now) we have discussed, try to place them in the according to the 'x' and 'y'-axis right according to their coordinates ok!.

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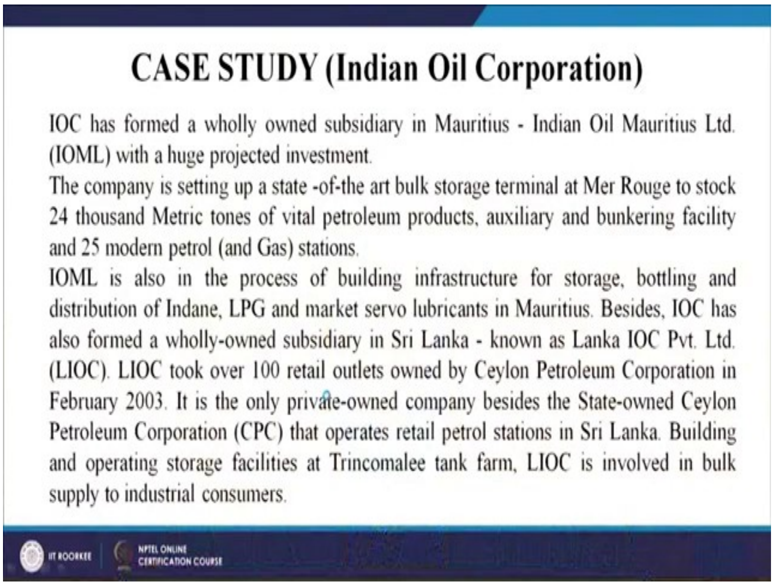

Now, this is a case study which I have brought for discussion. Today as in this class, we will be discussing this case study. This is a real case study. So, first I will discuss the case; and after we discuss the case I have two three questions which I have set up, and then there are possible answers right! What we will do is first you go with me through the case.

So, this is a case of Indian Oil Corporation – IOC has formed a wholly owned subsidiary in Mauritius right, Indian Oil Mauritius Limited with a huge projected investment. The company is setting up a state-of-the art bulk storage terminal at Mer Rouge to stock 24 thousand Metric tones of vital petroleum products, auxiliary and bunkering facility and 25 modern petrol and gas stations ok!.

It is in the process of building infrastructure for storage, bottling and distribution of Indane, LPG and market servo lubricants in Mauritius. Besides, IOC also has found a wholly owned subsidiary in Sri Lanka right! One is in Mauritius; the other is in Sri Lanka known as Lanka IOC Private Limited.

Now, this LIOC Lanka Indian Oil Corporation took over 100 retail outlets owned by Ceylon Petroleum Corporation which is their local in February 2003. It is the only private owned company besides the state owned Ceylon Petroleum Corporation that operates retail petrol stations in Sri Lanka. Building and operating storage facilities at Trincomalee tank farm, LIOC is involved in bulk supply to industrial customers. So, this is the basic case study right! It is this small case let in fact; it is not a case studies case let right!

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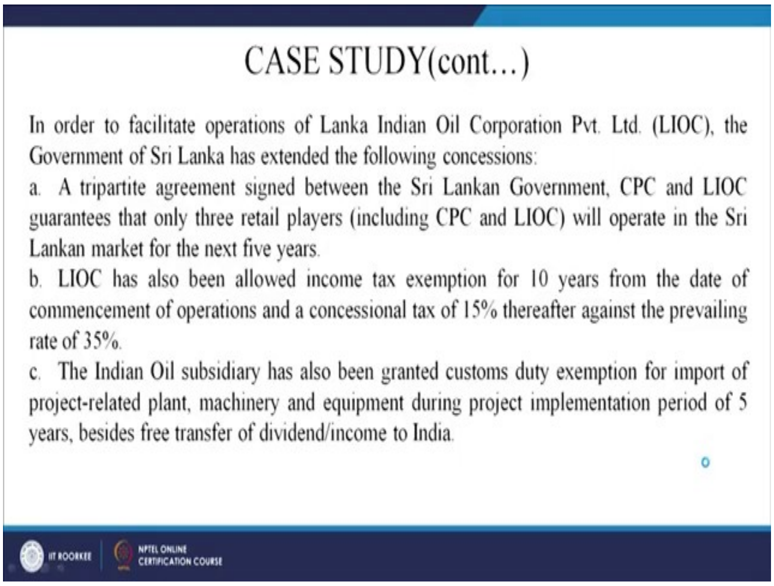

So, let us continue. In order to facilitate operations, Lanka Indian Oil Corporation, the Government of Sri Lanka has extended the following concessions. Now, this is how you attract the foreign players.

A tripartite agreement signed between the Sri Lankan Government, CPC and LIOC guarantees that only three retail players including these two will operate in the Sri Lankan market for the next 5 years. So, 2003 to 2008. LIC has also been allowed income tax exemption for 10 years from the date of commencement of operations, and a concessional tax of 15 percent thereafter against the prevailing rate of 35, so 35 plus another 15.

Indian oil subsidiary has also been granted customs duty exemption for import of project-related, plant, machinery and equipment during project implementation period for a 5 years, besides free transfer of dividend income to India. Now, the government has (done) taken some action, some kind of strategy build up, some policies strategies to attract (you know) people or different countries firms to come to their local country, host country and set up their business right!

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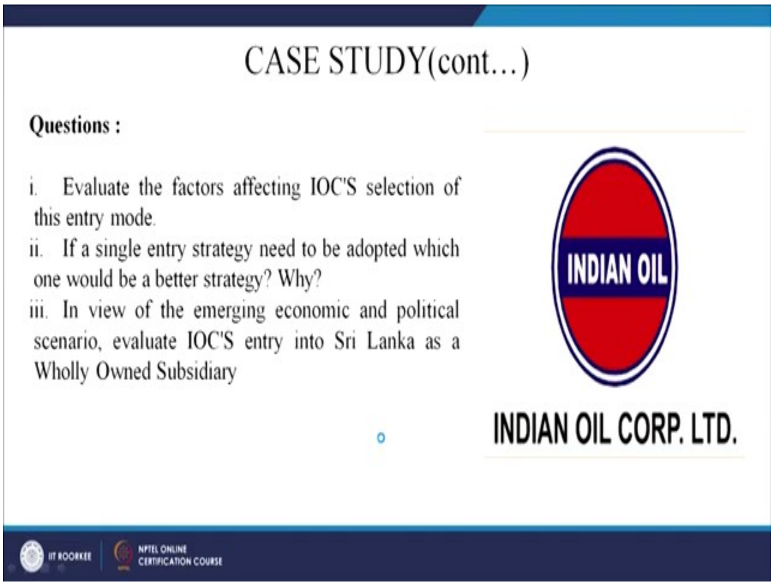

Now, (this question), there are three questions. First, evaluate the factors affecting IOC selection of the entry mode. Now, the government has attracted, but the company has its own choice right! Which mode of selection should they use? Second question, if a single entry strategy need to be adopted, which one would be a better strategy? And why? Right!, third, in view of the emerging economic and political scenario, evaluate IOCs entry into Sri Lanka as a Wholly Owned Subsidiary.

So, what I am doing is, I am leaving you with these questions now for a second right! What you do is, you close this or take a pause, and you try to first answer them, and then I will go through my answers right! So, (what) this is a real case study as I said, so what has happened let us see. So, for one question, we have the real answer. And for others there are hypothetical which I felt; and then you might also have your own opinion it through differ from mine also. So, no issues right, but you need to justify why.

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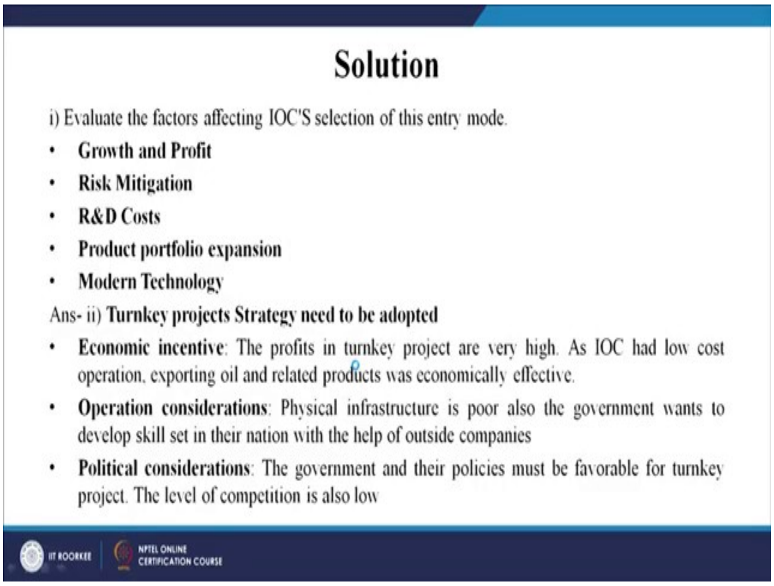

So, let us evaluate the factors affecting IOC selection of this entry mode. What are the factors? First is growth and profit, mitigation of risk, cost of R & D, product portfolio expansion, and modern technology right! So, what was the first question? Evaluate the factors affecting IOC selection of the entry mode. So, we said so these are the factors which we are looking into to decide what IOC should do, how you should enter into the Sri Lankan market right!

So, the answer for the second question is, if a single entry strategy need to be adopted which one would be a better strategy? And why? So, what they did was they adopted the turnkey projects strategy (need to be adopted). Why? Economic incentive, first there are three points, there are some points let us see. The profits in the turnkey project are very high. As IOC had low cost operation exporting oil and related products was economically effective.

Second – operation considerations, physical infrastructure is poor also the government wants to develop skill set in their nation with the help of outside companies right! Third – political consideration, the government and their policies must be favourable for turnkey project. The level of competition is also low. So, what happened here is the government use that the IOC use a turnkey project method to enter into this market right!

Now, the third question which is asked to you is in view of the emerging economic and you might (you know) for the second, you might have another answer, but I gave you the answer which is which has happened right! In view of the emerging economic and political scenario today, let us talk about today, evaluate the entry into Sri Lanka as a wholly owned subsidiary.

What would have happened if the company would have used the wholly owned subsidiary method? So, (you know) recently Sri Lanka has you gone through some turmoil and the there is a lot of political instability which happened right!

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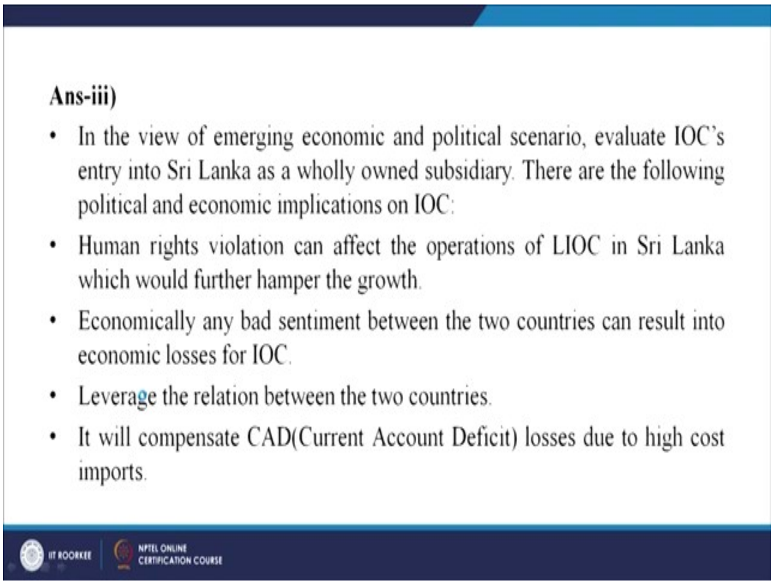

So, in view of the emerging economic and political scenario, evaluate IOCs entry into Sri Lanka as a wholly owned subsidiary. So, the following conditions will have to take into account. Human rights violation can affect the operations of LIOC in Sri Lanka which would further hamper the growth, (first) right! There would be there is a violation of human rights, so that would affect maybe the company right!

Economically any bad sentiment between the two countries which between let us say India and Sri Lanka can result in economic losses right for IOC. Leverage the relationship between the two countries. Finally, it will compensate the current account deficit losses due to high cost inputs right!

So, the third question which (asked) was asked was in view of the emerging economic and political and economic scenario evaluate its entry. So, we have done a small analysis on that right! So, this is something we did. And we now have analyzed the case-let in our in my own way I have done it. So, you might differ, you can have your own argument and also put in your opinion right!

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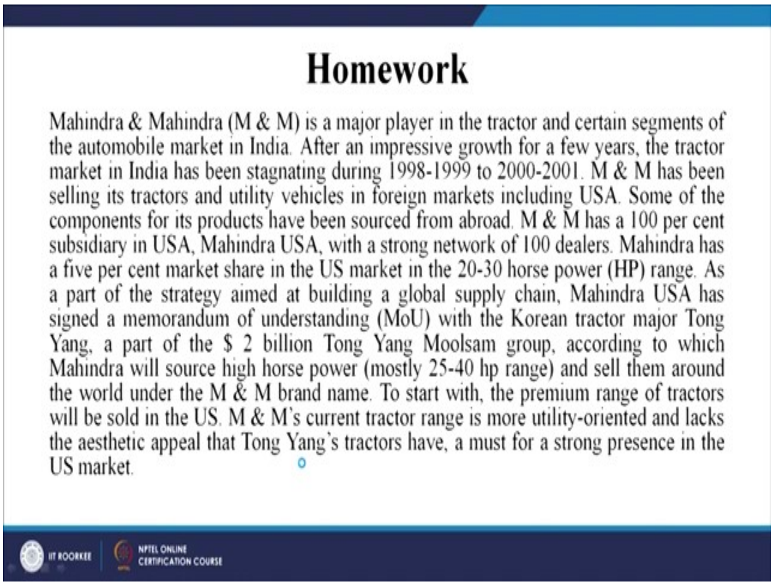

Now, this is one more which I have brought for your as a homework. You can take it and discuss with your friends and your maybe your family, or teachers, and come out with some solution. This is a case-let in which we are saying Mahindra and Mahindra as a major player in the tractor and certain segments of the automobile market in India. After an impressive growth for a few years, the tractor market in India has been stagnating right! M & M has been selling its tractors and utility vehicles in foreign markets including USA.

Some of the components for its products have been sourced from abroad. M & M has a hundred percent subsidiary in US, Mahindra USA with a strong network of 100 dealers. Mahindra has a 5 percent market share in the US market in that 20 to 30 horsepower range. As a part of the strategy aimed at building a global supply chain, Mahindra USA has signed a MoU with the Korean tractor major Tong Yang a part of the 2 billion Moolsam group right!

According to which Mahindra will source high horsepower mostly in the 25 to 40 horsepower range and sell them around the world under the M & M brand name. To start with the premium range of tractors will be sold in the US, and M & M's current tractor range is more utility-oriented, at the current at the moment what they are selling is more utility-oriented and lacks the aesthetic appeal the Tong Yang's tractors have, a must for a strong presence in the US market.

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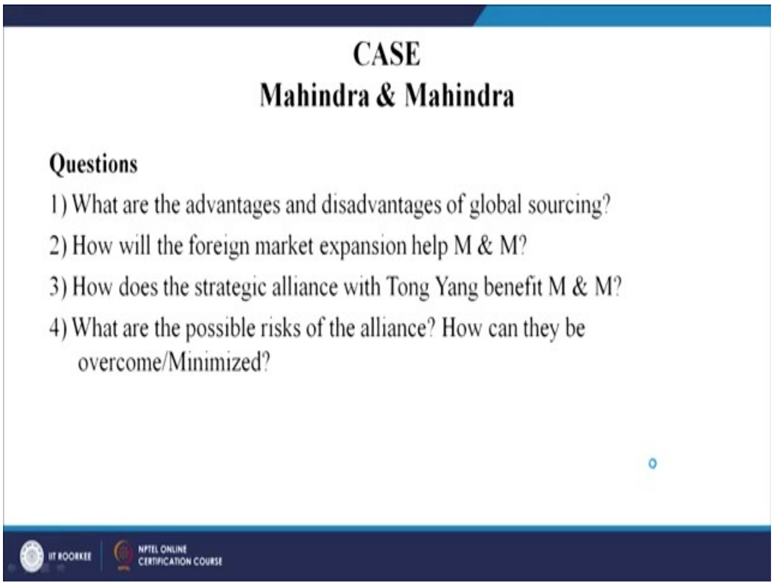

So, now the questions are, what are the advantages and disadvantages of global sourcing? How will the foreign market expansion help M & M? How does the strategic alliances with Tong Yang benefit M & M? What are the possible risks of the alliance how can they be overcome or minimized?

So, I am not giving any answer for it right! This is where I am ending. So, what you can do is you can go through the case right, you can even discuss the earlier cases (so) IOC case, and now discuss this case let, and find out a solution what you would have done had you been in this case right!

So, this will if you do this, this will give you a very clear picture of what international business comprises of, what are the different modes of entry, how should you enter into different markets, and what how should you evaluate the economic and political scenario of the various regions, and what is the best alternative that is possible in your hand right at that moment. So, this is all we have for the day right!

Thank you very much. I hope you have got some idea a little more idea about what you had initially about entry's (into you know) the modes of entry into foreign countries. And if I come if you compare today might be you are little you have added a little bit of more knowledge to yourself. So, I wish you all the luck.

Thank you so much.