entry mode selection

characteristics

author:	Hill, Charles W.L., Hwang, Peter and Kim, W. Chan
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description:

Firms that want to internationalise must decide on a fitting mode of entry into a foreign market in order to make the best use of their resources. Once an entry mode has been chosen, multinational organisations limit their tactical flexibility by developing skills and knowledge to support the chosen arrangement.

The entry mode selection model was developed by academics Charles Hill, Peter Hwang and Chan Kim. They collaborated at the University of Michigan on international management. Desk research on market entry modes gave them the insight that much of the literature up to the 1990s focused on listing considerations without the identification of underlying constructs.

Entry decisions were treated in isolation. Convinced that a unified framework existed, Charles Hill and his two colleagues categorised factors that influence a firm's decision for a particular market entry mode into three underlying constructs:

1. STRATEGIC VARIABLES

influence the choice of entry mode through the control requirements that they entail. Control is the ability and willingness of a firm to influence decisions, systems, and methods in a foreign market. Different strategies require different degrees of control over the operating of foreign affiliates, and thus lead to different entry modes.

2. ENVIRONMENTAL VARIABLES

influence the entry mode decision primarily through their influence on the appropriate level of resource commitment. Resource commitments are dedicated assets that cannot be employed for other uses without incurring costs. Resources may be intangible, such as managerial skills, or tangible, such as machines and money.

3. TRANSACTION VARIABLES

influence the entry mode decision through their influence on dissemination risks and on the appropriate level of control. Risk comes from the chance that a firm's applied knowledge (tangible and/or intangible) can be unintentionally transferred to a local firm creating a new competitor.

"*What entry mode that a multinational company chooses has implications for how much resources the company must commit to its foreign operations, the risk that the company must bear, and the degree of control that the company can exercise over the operations on the new market.* "

Depending on the composition of these three variables, four different ways of entering markets (or entry modes) emerged as most appropriate:

1. EXPORTING

The moving of goods from the home country to a foreign country and selling them locally.

2. LICENSING

Where a licensor grants the rights to intangible property to another entity for a specified period of time; in return the licensor receives a royalty fee from the licensee.

3. JOINT VENTURE

The establishment of a firm that is jointly owned by two or more independent firms.

4. WHOLLY OWNED SUBSIDIARY

The firm owns 100 percent of the stock either by setting up a new operation in a country or by acquiring an established firm.

The choice for a particular entry mode is a critical determinant in the successful running of a foreign operation. If a multinational firm has other foreign operations, an individual entry mode decision needs to be made in light of existing operations.

assets:

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pros:

- The framework aids executives in identifying those factors and issues that need to be considered when reviewing entry modes, thus proving a structure of trade-offs on which to build a fruitful discussion.
- Firms can organise their new markets activities in various ways. The market-entry model provides an overview of the main entry mode options plus the trade-offs that needs to be made when selecting one. Organisational core competences determine entry mode preference. Firms who build their existence on technological know-how prefer wholly owned subsidiaries because they fear leakage of critical knowledge to partnering firms and thus create new competitors. Organisations who see their core competences build on management know-how favour more inclusive arrangements such as licensing.

- The model is based on the economic theory of Transaction Costs (TC) which assumes that organisations change their structure and design to minimize transaction cost in search of profit maximisation. Hill, Hwang and Kim integrated into the Transaction Cost Analysis environmental and strategic factors.

cons:

- The stated list of entry modes is not exhaustive: turnkey projects were left out as an entry mode -- in a turnkey project, the contractor agrees to handle every detail of the project for a foreign client, including the training of operating personnel. At completion of the contract, the foreign client is handed the key to a plant that is ready for full operation.
- The entry mode model views organisations as contractual entities. The model excludes networks. A great number of internationalisation efforts happen through interpersonal and inter-company relations.
- Transaction costs are ambiguous and difficult to measure. TC assumes that the main objective is profit maximization. Firms might make different decisions for competitive or strategic reasons.

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