ANALYSIS OF ENTRY MODE STRATEGIES INTO EMERGING MARKETS

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INTRODUCTION

As there is growing evidence, that the companies are pursuing the international strategy, the research on entry modes to global environment has extensively caught the interest of academic and business world. Over the time, many theories have been developed to identify the factors, determinants and conceptual frameworks, filling the gap in the process of decision making about the entry strategy choice. But those theories mainly focus on transnational and multinational companies from developed countries, and their experience from developed market economies. The context of developing countries has been presented only in few studies.

Basically the company has always the choice of any market entry mode. The choice is mainly influenced by environmental variables, resource capabilities and the experience of the firm in internationalizing (LIN, 2000). Complex environment of organizations willing to do the business abroad, uncertain situation in emerging economy and its higher level of risk strongly influence the entry mode choice of the multinational company investing in the emerging market. Those markets have fast speed of growth and are becoming the important playground for global competitors and therefore despite of all drawbacks, the world’s business is moving there the attention.

The company has to consider the strength of control, but still needs to be flexible. There are two extreme strategies the firm can take. On the one side is using the independent distributor and on the other side is wholly owned subsidiary. But does the entry mode strategies to developed markets significantly differ from the strategies to developing markets?

1 RESEARCH METHODOLOGY

Secondary sources of literature related to international business, entry mode strategies and theories of internalization are taken into account. Together with reports from international organizations dealing with investments to emerging countries and with the special role of emerging countries as home countries, create the base to analyse the issue of market entry mode to emerging markets. The works of leading authors were studied and compared, to understand the unique position of emerging markets and their rapidly rising importance in the world economy. This leads to constitution of the research questions, which this paper is trying to answer:

- Should the companies use different strategies when approaching emerging markets than when entering developed markets?
- What factors are affecting the optimal entry mode strategy decision?

2 EMERGING COUNTRIES

The term Emerging Market Economies (EME) was first time acclaimed by Antoine W. Van Agtamel of IFC World Bank in 1981. The emerging market economies were defined as economies with low-to-middle per capita income. What is more, 80 % of the population lives there and is responsible for 20 % of world economy.

Emerging countries have undergone political and economic reforms, which have lead from closed economy to open market economy. Those reforms are usually followed by the change of regulations and law. Those changes are strengthening the market and are consequently ensued by further changes, which support the market liberalization. Reforms spur the number of opportunities for investment. What is more, emerging markets involve 4 billion customers mainly from middle- and low-income markets.

Due to saturation of the markets in developed countries, the multinationals started to turn their attention to emerging markets, such as Brazil, Russia, India, and China, known under the notion BRIC. Recently the abbreviation is being extended because of another fast growing country, e.g. BRICS, adding South Africa. Some of the predictions, e.g. “Dreaming with BRICs: The path to 2050” report from Goldman Sachs study” (WILSON, ET AL., 2003), say that till 2050 the group of BRIC countries will become stronger than G8 (in dollar terms). University of Iowa, Iowa Center for International
Finance and Development created the term “Big Five”, which consists of countries: Brazil, Russia, India, China and Indonesia and now contributes to global trade with 16.1% comparing to 7.8% in 1992. (LI, 2008) The countries, which have grown very fast in past two decades and become the role model for other countries, represent four “Asian Tigers” (Singapore, Taiwan, South Korea and Hong Kong).

Globalization can bring China and India lower poverty and with right strategy of the resources, those countries can achieve considerable growth. In the Figure 1 is depicted the trend of foreign direct investment to BRIC countries, South Africa and Indonesia. It is immediately evident, that the leading position has been taken by China ad followed by the rest of BRIC countries (Brazil, Russia and India). Moderate growth is demonstrated by Indonesia, however this country has potential to expand noticeably in the near future. South Africa is almost copying the trend of Indonesia with marginal decline in 2010.

**Fig. 1: Inflows of foreign direct investment in BRIC, South Africa and Indonesia**

![Inflows of foreign direct investment](source.png)

In the Figure 1 is also remarkable the overall slowdown in 2008 and 2009. According to The World Bank (THE WORLD BANK, 2012), the biggest deceleration appeared in advanced countries, demonstrated in the Figure 2. The economic forecast of all countries predicts moderate growth in the future. Due to of uncertain external environment, the economy of emerging countries will continue to slow down in 2012. Nevertheless, the process of economic liberalization in China and India and recovery from political changes in Middle East and North Africa will support the fast development of those countries and the slowdown will be not that significant.

**Fig. 2: GDP per capita growth**

![GDP per capita growth](source.png)

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According to the prediction of United Nations Conference on Trade and Development, known as UNCTAD (UNCTAD, 2012), the foreign direct investment (FDI) inflows will slowdown because of financial crises in 2008/9 and ongoing debt crisis. This has concurrently brought also the long-term shift of the economic importance from emerged markets to emerging ones. But still the growing importance of developing countries hasn’t affect the position developed countries (North America and Europe). In compliance with the survey of UNCTAD, related to top prospective host economies for foreign investments in the period of 2012-2014 (UNCTAD, 2012), the position of developed countries stays at the top levels.

3 ENTRY MODE

There are four main questions the company has to answer, when pursuing the foreign market entry decision: Enter or not? How to enter? When to enter? and Where to enter?

The decision about the entry mode highly influences the organization processes. Anderson and Gatignon (Anderson, et al., 1986) stated that the optimal selection of entry market strategy is the “frontier issue” and has to be considered properly.

Furthermore it affects the way, how the company reacts to different market conditions and transfers the knowledge into the new environment. (Gillespie, et al., 2007). “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.” (Hill, et al., 1990 p. 119) The decision about the entry mode has therefore an important role and causes the great success or failure of the international operation.

3.1 ENTRY MODE THEORIES

Before presenting the strategies referring to the foreign market entry, it is essential to introduce the underlying theories, which are mainly responsible for building the right strategy. Additionally, the theories explain the reasons, why companies do benefit, when entering the foreign market and what motivates them to do so.

Given the importance to international operation, it is understandable, that the literature concerning to this wide topic is extant. Two main groups of approaches have been devised. The first one refers to learning and decision-making perspective of the organization and the second is based on economic and strategic approach to business behaviour. (WELCH, ET AL., 2007 P. 20)

Approach concerning learning and decision making perspective of the organization relates to: internalization process perspective, the network approach and inward-outward connection. In this case, knowledge is “fuzzy”, especially for companies, which don’t have international experience, so the learning process is disrupted. Lack of knowledge creates the uncertainty in the decision making about the cross border expansion. (WELCH, ET AL., 2007 P. 20) Learning by doing and establishing of routines are required, and from those reasons the learning process is long and complex.

The second and contrasting group of theories, based on economic and strategic approach to business behaviour assumes that the decision makers are at least partly rational. Nevertheless it cannot be stated that the bounded rationality doesn’t exist. In this case, the belonging theories involve: market imperfections, transaction cost and internalization theory, rivalistic and strategic behaviour and eclectic theory (WELCH, ET AL., 2007 P. 33). As supporting views are considered resource-based and institution-based view.

According to Coase (COASE, 1937), market exchange accompanied with imperfect information produces higher transaction costs, than the trade inside the company. The connection of transaction cost with internalization process has been pervasive in literature more than three decades and studied by scholars, who put forward the relation with strategies of multinational companies (Williamson, 1979; Teece, 1986; Anderson, et al., 1986). Internalization theory and transaction cost theory have been dominant paradigms also in regarding to market entry mode. Transaction cost theory is trying address and determine the entry mode to international market by putting together firm’s boundaries, the capabilities of firm in the terms of competitive advantage, efficiency of transaction cost and contract law, as important variables for considering the market entry decision.

Dunning (DUNNING, 1980) presented the eclectic theory in his work. Later, he explained the importance of three factors, when pursuing foreign direct investment: ownership advantage, location advantage and internalization advantage (DUNNING, 1988). Those three elements, also known as OLI-Model or OLI-Framework, are based on transaction cost theory. They are interdependent to each
other and indeed creating simple construct. They variables are responsible for influencing the market entry choice.

1. To ownership advantages belong trademark, production technique, entrepreneurial skills and returns to scale. (TOWNEY, 2000) The greater are the competitive advantages of the investing company, the higher rate of the success is promised.

2. Location advantages represent existence of raw materials, low wages and special taxes or tariffs. (TOWNEY, 2000) This advantage deems that the stronger the location factors are, the more favourable the foreign direct investment abroad would be.

3. The last part of OLI-tripod refers to international advantage, which means advantages by own production rather than producing through a partnership arrangement such as licensing or a joint venture. (TOWNEY, 2000) With this last sub-paradigm, the organization is able to manage the decision about different entry modes, causing exploitation or exploration the advantages of the foreign country. (DUNNING, 2000)

Dunning (DUNNING, 2000) updated few times the theory to make the model more dynamic. But there are scholars, who doubt about the generalization of this theory and applicability to every multinational company, and rather call it framework or concept.

Barney’s view of resource based theory assumes that the strategy and performance are affected by firm’s specific assets (BARNEY, 1991). Those specific resources represent the competitive advantage of the firm, which is essential when entering the new market and achieving the superior position. The resources should be rare and hard to imitate (BARNEY, 1991). The good example is provided by Intel in India, which operates in IT sector, which is hard to copy. Every new plant costs three billion dollars and the Indian companies as TCS, Infosys, Wipro, etc. have hard time to follow Intel.

The studies concerning to international theory have mostly involved the issues of the environment, as a factor, which is connected with culture and political risk. Peng (PENG, 2006) stated that all those research works are related to institutional based theory. Institutions are formal or informal “rules of game” (NORTH, 1990). The companies have to follow them and the most important is to be aware of rules of the certain country, which the company is wishing to enter. The significant phenomenon comes, when going across the border of developed countries, whose markets and institutions are stable, comparing to emerging economies. The situation in developing countries is different to developed countries. That is why it cannot be taken into account the same balance between formal and informal institutions. In emerging countries with low-income market social institutions dominate. (LONDON, ET AL., 2004) The companies cannot take for granted the same level of legal and political situation. Recently has been put into attention the institutional-based view of international business as a “third leg” of international strategy tripod. (PENG, ET AL., 2008) The institution-based component is not substituting the other two, but complementing them and creating the important perspective when deciding to internationalize. The remaining "two legs" or concepts are industry-based view and resource-based view.

However, Andersen (ANDERSEN, 1997) in his work reviews the previous conceptual frameworks, views and theories of other authors and tries to outline the benefits and drawbacks of them, as a reflection to current status of international theories referring to entry mode. He also presents a statement by noting that, it is not possible to describe the international entry mode just on the base of one theory and that the future research in this area is necessary.

### 3.2 ENTRY MODE STRATEGIES

According to Root (ROOT, 1994), there are 15 different market entry modes. Generally, it can be stated, that there is no central classification, and all existing concepts are sharing similarities and they involve the same entry modes under different groupings (DRISCOLL, ET AL., 1997). The unifying categories presented by Root (ROOT, 1994) involve 3 groups, which are common for all division systems devised by other authors.

1. Export – indirect, direct agent or distributor, direct branch or subsidiary and others. Export includes the goods that is sold in the foreign market, but produced in the domestic market. (DRISCOLL, ET AL., 1997) Indirect exporting is managed through intermediate, like trading companies or export agencies.

2. Contractual – licensing, contract manufacture, management contracts, construction or turnkey contract, co-production agreement, technical agreement, service contracts, franchising and others. Contractual agreements are efficient, when the host country’s company has lack of resources, but still can transfer the competitive advantage to another partner. The competitive
advantage often includes knowledge, skills or "know how". (Driscoll, et al., 1997; Johansson, 2000)

3. Investment – sole venture: new establishment or acquisition, joint venture: new establishment or acquisition and others. Root (ROOT, 1994) presented, that creating the investment is motivated by four factors: tacit knowledge in the organization, exchange of personnel and managerial responsibility, externalities and specific kind of investment to assets.

Johnson and Tellis (JOHNSON, ET AL., 2008) categorised the Root's classification entry modes into five main classes: export, license and franchise, alliance, joint venture and wholly owned subsidiary. The classification based on different type of grouping categories has been described by Anderson and Gatignon (ANDERSON, ET AL., 1986). Their model includes 17 entry modes, divided into three groups based on the entrant’s level of control modes: high-control modes (dominant equity interests), medium-control modes (balanced interest) and low control modes (diffused interest).

The specific choice of the entry mode depends on number of factors. Even though the classification of entry modes and with the detailed definition exist in literature in wide range, the complexity of the environment and the internal prospective of the organization make this issue not that clear and obvious. Driscoll and Paliwoda (DRISCOLL, ET AL., 1997) have classified the factors into three main groups:

1. The first one represents the desire of the company, as degree of control, dissemination risk, resource commitment and flexibility.
2. The second relates to company’s reality, as location, country risk, socio-cultural distance, government regulation and policies, also known as institutional distance and firm’s specific factors. This group of factors is very important when deciding to conduct the entry to emerging country. That means that the bigger the cultural distance, the more difficult the internationalization process would be and vice versa.
3. The third group includes, organization aims as long-term profitability and growth.

4  **OPTIMAL ENTRY MODE**

Entering the emerging markets, the companies have to deal with (Sakarya, et al., 2007): risk of turbulent change, poorly developed communication and distribution systems, lack of managerial resources and cultural differences.

Each market entry strategy has its significant pros and cons and it is not easy to choose the right one. Anderson and Gatignon (ANDERSON, ET AL., 1986) showed their dissatisfaction with the academic research about market entry. Their objection stemmed from the finding that many times, the optimal entry mode had been presented by single case study, where the strategy worked. But one case cannot be generalized. They presented their own model based on transaction cost framework, in which the efficiency is dependent on four factors, consisting of (ANDERSON, ET AL., 1986):

1. Transaction-specific assets (specialised investments);
2. External uncertainty (bounded information about the environment);
3. Internal uncertainty (the difficulty to ascertain the output of internal agents);
4. Free-riding potential (the chance of internal agents gain the benefit without any additional costs).

According to those four factors, the company decides not directly about the optimal entry mode, but about the optimal entrant’s level of control. The authors determined, by providing tested propositions, three levels of control the company should take, when entering the foreign market. The levels of control of this framework were already discussed above in third chapter, which deals with entry mode strategies. The levels of control are following:

1. High-control modes (dominant equity interests);
2. Medium-control modes (balanced interest);
3. Low control modes (diffused interest).

Anderson and Gatignon admit that also this model doesn’t solve the whole issue, and that other factors should be considered. Especially their concept does not involve emerging countries. To use this model in the case of entering emerging markets, the case would become more complex. The four constructs would have to be associated with the nature of emerging markets and with the industry-, market- and country-specifics. Therefore it would be fruitful to expand the model towards to emerging markets.

Johansson (JOHANSSON, 2000) presented in his work optimal entry mode matrix, which consist of three different postures (incremental, protected, control). The Table 1 represents the optimal mode matrix and consists of two dimensions. The first one involves postures, which are dependent on the degree, how stable the firm’s market entry is or how strong the company is, to invest abroad. Second
dimension of the matrix consists of four different product/market situation (emerging, high-growth, mature and services).

Tab. 1: Optimal entry mode matrix

<table>
<thead>
<tr>
<th>Company strategic posture</th>
<th>Product/Market Situation</th>
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<tbody>
<tr>
<td></td>
<td>Emerging</td>
</tr>
<tr>
<td>Incremental</td>
<td>Indirect exports</td>
</tr>
<tr>
<td>Protected</td>
<td>Joint venture</td>
</tr>
<tr>
<td>Control</td>
<td>Wholly owned subsidiary</td>
</tr>
<tr>
<td></td>
<td>Acquisition/Alliance</td>
</tr>
<tr>
<td></td>
<td>Wholly owned subsidiary</td>
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<table>
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<tr>
<th></th>
<th>High-growth</th>
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<tbody>
<tr>
<td>Incremental</td>
<td>Indirect exports</td>
</tr>
<tr>
<td>Protected</td>
<td>Indirect exports</td>
</tr>
<tr>
<td>Control</td>
<td>Acquisition/Alliance</td>
</tr>
<tr>
<td></td>
<td>Wholly owned subsidiary</td>
</tr>
<tr>
<td></td>
<td>Franchising/Alliance/Exporting</td>
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</tbody>
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<table>
<thead>
<tr>
<th></th>
<th>Mature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incremental</td>
<td>Direct exports</td>
</tr>
<tr>
<td>Protected</td>
<td>Alliance/Licensing</td>
</tr>
<tr>
<td>Control</td>
<td>Wholly owned subsidiary</td>
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<table>
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<tr>
<th></th>
<th>Services</th>
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<tbody>
<tr>
<td>Incremental</td>
<td>Licensing alliance</td>
</tr>
<tr>
<td>Protected</td>
<td>Licensing</td>
</tr>
<tr>
<td>Control</td>
<td>Franchising/Alliance/Exporting</td>
</tr>
</tbody>
</table>

Source: Johansson, 2000 p. 171

It is evident, that the emerging markets require risky consideration about the market entry. High-growth market represents advanced markets and fast growing newly industrialized markets in the field of high-technology. As this field consists of unique resources, that represent the competitive advantage, the first entrant can gain easily the superior position. But also the first mover can be easily imitated (LÉVESQUE, ET AL., 2004).

The following model differs from the previous one, because it is tailored for entering only emerging markets. The concept is based on three modes of entries (LÉVESQUE, ET AL., 2004):
1. Strategy to wait with the entry;
2. Strategy to enter with a “low mimicry entry mechanism”;
3. Strategy to enter a “high mimicry entry mechanism”.

The optimal level of entry is affected by timing of the entry (when to entry) and the level in which the companies imitate the entry strategies of other companies (how to entry). The term “optimal stopping approach” is used to determine the right decision to cease the activity (postponing the market entry) or to continue with the activity (enter the market). The research is conducted by comparing the entry modes of developed to emerging countries. The result showed that there are considerable differences in timing between entering developed and emerging market and that the higher level of mimicry is better for entering the emerging market. The model is consistent with the learning scholars and neo-institutional model, according to which the companies learns from the others. On the other hand, it is not compatible with the resource-based view, which says, that resources are valuable, unique and not easy to imitate.

In the research work of London and Hart (LONDON, ET AL., 2004) was exemplified, that the companies from the developed markets should focus their investments on the “base of the economic pyramid”. This notion means that developed countries entering emerging countries should use different type of strategies, away from the “imperialist mindset”. The customer base of emerging market consists of four billion people, who are mostly low-income. Using the strategies valid for developing countries is not targeted to this group, but only to the higher elite class. The companies have to focus more on specific attributes of emerging countries as:
1. Dominant social contracts and social institutions, that means acting in informal economy;
2. Lack of relevant experience of the partners;
3. Importance of societal issues (eradicating poverty and environmental protection).

The authors used the case studies of real companies and identified the gaps and limitation in international entry strategy to emerging markets. They suggested the successful strategies as “scalability, flexibility, decentralization, knowledge sharing, local sourcing, fragmented distribution, non-traditional partners and societal performance”. (London, et al., 2004 p. 18)

Another study is based on the interdisciplinary research of companies from Taiwan investing to China (FILATOTCHEV, ET AL., 2007). The research presents the influence on decision about the entry to emerging market by following three factors: corporate governance then preferences of shareholders (from inside and outside of the company as well) associated with information asymmetry and the last one is network-based business culture. A specific feature of this study is authors’ categorizing Taiwan as “new industrialized country” (as Asian Tiger) and not the developed one. They also argue that most previous studies have focused on the features of the host country (emerging economy in this case) and not home country (investor). The analysis of longitudinal data between 1991 till 2003 showed the effect of mentioned three factors on entry mode decision. The significant were ownership structure of the host company, shared ownership of foreign financial institutions and as additional factor has been determined the location choice.
The analysis of secondary data of US apparel retailers in Turkey (Sakarya, et al., 2007) reveals four additional criteria to previous macroeconomic and political factors, affecting the entry mode choice:
1. Long-term market potential;
2. Cultural distance;
3. Competitive strength of the local industry;

The study is primarily focused on international market selection, based on internal factors. The authors explained the limitation of the previous international market selection strategies based mostly on macroeconomic and political factors. What is more, the authors of this paper highlight the importance of focusing on entry strategies to emerging markets to uncover their future potential and dynamism.

CONCLUSION

Companies, willing to expand to foreign markets, have to go through many decision stages to choose the right entry strategy mode. The environment of emerging markets as host countries affects this process, and makes it more complex, than when entering stable markets of developed economies. The companies operate in uncertain environment, where the forces, which cannot be controlled, are taken place. The company needs to react to those changes with the right timing and with the suitable strategy. Due to fast pace of the globalization processes and quick growth of emerging markets all over the world, the market selection and the strategy mode choice have to be done precisely without delaying.

Some countries are experiencing the economical reforms because of liberalization; the others are witnessing the political changes. With the right use of the resources, they are able to spur the speed of their growth and attract the investors from the developed countries. As the situation in the world economy constantly changes, in the same manner, the strategies are still rapidly evolving. The old ones are becoming useless or need to be revised and updated; some new theories need to be supplemented by more empirical evidence and case studies.

The attention of the scholars studying international business has originated many theories, and motivated other scholars to improve the existing concepts and many studies have been conducted to prove their accuracy. However, the issue about the right entry strategy choice to emerging markets has been quiet omitted. The difference of market entry strategy between developed and emerging countries should be taken to account, because the both academic and empirical research is confirming that most strategies have been targeted on the top of the economic pyramid and didn’t concentrate on the unfamiliar environment of untapped emerging market.

Many factors have to be analysed by company before applying the optimal entry mode. Not only the external factors, as the macroeconomic political situation, market potential, cultural and institutional distance and local industry, but also internal factors, as intended level of control, nature of resources the company owns, the level of resource commitment, host company’s internal agents and product situation have to be identified.

On the whole, the analysis has to be done on the industry-, institution- and firm-level, to choose the optimal strategy for entering the foreign emerging market. Even though the company has basically always the option to choose any market entry mode, the consideration of the factors and the unsteady environment of emerging markets is necessary to absorb the uncertainty.

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ANALYSIS OF ENTRY MODE STRATEGIES INTO EMERGING MARKETS

Abstract
With the competitive pressures in saturated domestic market, the turning to emerging markets started to be one of the success factors for future growth. Countries like Brazil, Russia, India and China (known as BRIC) are locations with rising potential, which has occurred during past two decades. The considerable differences between developed and emerging markets affect the choice of entry strategy and timing. When pursuing the international operation, the most important decision is relating to market entry choice. There are different strategic entry modes, the organization can choose, however, not all of them are suitable in the given situation. The better understanding of the selected market, proper evaluation of the factors and aptly chosen market entry strategy play an important role, when leading the company in the right way to compete with other firms. The effective market entry strategy to developing markets has not been covered enough in the literature of Multinational Enterprises and Global Strategies. The main objective presented here, is to point out the phenomenon of market entry to emerging market, as the rising topic of international business today and outline the review of different constructs influencing the optimal market entry choice strategy. The paper is proposing the underlying theories of internationalization processes to clarify the concepts. The methodology consists of using the secondary data of other scholars. Presented frameworks are aiming to fill the gap between the optimal foreign entry modes to emerging and developed countries. Secondly this paper reviews the main factors of international market entry mode from theoretical point of view. The various constructs and factors are interdependent and cannot be isolated to gain the competitive advantage in internationalization process.

Key words
emerging countries, entry market choice, internalization strategy, and foreign investment

JEL Classification
F20, F23, O19