Lecture 7
Entry, Expansion and Exit Strategies
Partners, the marriage and then break-up”

A Brief Review

• The opening of China has taken a gradual process.
• Entered China as joint ventures (EJVs and CJVs)
• After the mid 1990s, wholly-owned subsidiaries became more common.
• Recently, mergers and acquisitions (M&As) have become a popular approach
• Other modes: licensing, contract management, build-operate-transfer (BOT)
• Gradually, almost all industries are open to foreign companies.
Restrictions of Foreign Investment in China by Sector

- The Chinese Government classifies all investment into three categories by sector:
  - Encouraged
  - Permitted
  - Restricted Prohibited
- Examples:
  - In the oil and natural gas exploration and development industry, foreign investment is required to take the form of equity joint ventures and cooperative joint ventures.
  - In the accounting and auditing sectors, the Chief Partner of a firm must be a Chinese national.
  - In higher education and pre-school, foreign investment is only permitted in the form of cooperative joint ventures led by a Chinese partner.
Entry strategy considerations

- *Where, when, how and how much*

![Market Entry Strategies Diagram]

Entry Approval Procedure

- Project Proposal
- Feasibility Study Report
- Contract & Articles of Association
- Approval Certificate
- Registration for Business License
Location Selection *(Where)*

That is the location within a country that depends upon a number of factors and policies.

- Cost/Tax Factors (transportation, wage, availability of land and its costs, construction cost, materials cost, financing costs, tax rates, investment incentives, profit repatriation costs)
- Resource factors: supplies, raw materials, labor, transportation and logistics
- Demand Factors (market size and growth, customer base)
- Competition (local and foreign firms): multi-market competition
- Other success factors: traffic and market catchment for retailers

First Tier or 2-3tiers

- Foreign firms have decided to focus on the developed markets in the first-tier cities.
- Global brands have adopted intensive advertising to project an quality image.
- Local firms, however, have avoided head-on competition
- Now quality gap is getting closer
Tax Incentives

- Income tax rates vary across industries and locations
  - Tax rate: originally 33% now 25%
  - Preferential rate of 24%: open coastal cities & inland provincial capitals
  - Preferential rate of 15%: for energy, communications and infrastructure; SEZs, Economic & Tech. Development Zones, etc.
  - Others

Timing (When)

- Early Mover (Pioneer)’s advantages: market power, more preemptive opportunities, and strategic advantages
- Early Mover’s disadvantages:
  - Host governments’ lack of experience
  - Underdeveloped investment laws and regulations
  - Protectionism
  - Shortages of skilled workers
  - Underdeveloped support services
  - Lack of financing
  - Uncertain foreign exchange, consulting cost burdens, poor infrastructure systems, and unstable market structures.
Pros and Cons

Legal Framework

- 3 basic laws on Foreign Direct Investment
  - Law on Equity Joint Venture
  - Law on Contractual Joint Venture
  - Law on Wholly Foreign-owned Enterprises
- Implementation regulations
  - Specific requirements may vary by industry
  - Firms in some industries have to wait in line to get a license: insurance, banking, etc..
- On 3 September 2016, the Standing Committee of the National People’s Congress (NPC) promulgated a decision on amending the four major laws regulating foreign direct investment in China
Market Entry Strategies (Non-equity)

- Exporting:
  - *Indirect*: working through independent international marketing intermediaries.
    - Im/export countries in China or home country
    - Agents, brokers, and distributors
    - In the beginning, it is a good low-cost low risk strategy
  - *Direct*: company handles its own exports.
    - Building your own export and sales team
    - Overtime, as your sales grow, it may be necessary as the cost of an indirect approach could be higher and yet one do not have control over indirect exporters.

Exporting

**Advantages**
- avoids the often substantial cost of establishing manufacturing
- May help firm achieve experience curve & location economies
- Firm may manufacture in centralized location & export to other national markets to realize scale economies from global sales volume

**Disadvantages**
- Not appropriate if lower cost manufacturing locations
- High transport costs can make exporting uneconomical especially bulk products
- Tariff barriers can make exporting uneconomical
- If firm delegates marketing, sales & service to another company they may have divided loyalties because they carry competing products or are a large MNE
- Can set up wholly owned subsidiaries to handle local marketing & sales -> can exercise tight control while reaping cost advantage of manufacturing in a single location
Market Entry Strategies (Equity)

- Wholly owned subsidiaries (Equity)
- Joint Venturing: (Equity)
  - Again, more control and risky than exporting
  - Joining with foreign companies to produce or market products or services.
  - Partner-selection
- Other Approaches:
  - Licensing
  - Contract manufacturing
  - Management contracting
- Strategic Alliances
- Turnkey Project

Turnkey Project

**Advantages**
- Means of exporting process technology (chemical, pharmaceutical, petroleum, mining)
- Know-how to assemble & run technologically complex process is valuable asset – earn economic benefit from asset
- Strategy useful where governments restrict FDI - less risky than conventional FDI

**Disadvantages**
- Firm has no long term interest in the country – can take minority equity interest in company
- Firm may inadvertently create a competitor (middle east oil refineries)
- If firm’s process technology is a source of competitive advantage, then selling technology is also selling competitive advantage to potential competitors
Entry Mode - Licensing

**Advantages**
- Receive royalties
- Licensee puts up most of the capital to get the operations going
- Allows firm to participate where there are barriers to investment

**Disadvantages**
- Does not give firm tight control over manufacturing, marketing & strategy to realize experience curve & location economies
- Does not allow firm to coordinate strategic moves across countries by using profits earned in one country for competitive attacks in another
- Firms can lose control over the competitive advantage of their technological know-how.

Entry Mode - Franchising

**Advantages**
- Involves longer term commitment than licensing.
- Franchiser sells intangible property (trademark) & insists franchisee agrees to abide by strict business rules
- Royalty payments that are some percentage of franchisee’s revenues
- Firm relieved of many costs & risks of opening new market.

**Disadvantages**
- No manufacturing so no location economies & experience curve
- May inhibit the ability to take profits out of one country to support competitive attacks in another
- Risk of worldwide reputation if no quality control
Entry Mode – Joint Ventures

**Advantages**
- Typically 50/50 with contributed team of managers to share operating control
- Firm benefits from local partner’s knowledge of competitive conditions, culture, language, political system & business system
- Sharing market development costs & risks with local partner
- In some countries, political considerations make JVs the only feasible entry mode

**Disadvantages**
- Risk of giving away your technology to a partner
- Does not give firm control over subsidiaries that it might need to realize experience curve or location economies
- Global strategic coordination – firm use JV for checking competitor market share and limiting cash available for invading other markets
- Shared ownership can lead to conflicts & battles for control if goals/objectives change or they take different views on strategy

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Entry Mode – Wholly Owned Subsidiary

**Advantages**
- When there is technological competence wholly-owned subsidiary reduces risk over losing control
- Give firm tight control over operations in country -> engage in strategic coordination with profits
- Can realize location & experience curve economies – centrally determined decisions

**Disadvantages**
- Most costly method of market entry
- Risk associated with learning to do business in a new culture
**Greenfield**

- A form of foreign direct investment where a parent company builds its operations in a foreign country from the ground up.
  - better ability to build organization you want
  - Easier to establish own culture & operating routine
  - Do not have revenue & profit history
  - Slower to establish – need to understand how to do business in that country

**Merger & Acquisition**

- Mergers & Acquisitions
  - At least 10% ownership to be influential in managerial decisions
  - 50%-80% of FDI is acquisition
  - Quick to execute – rapidly build presence
  - Acquisitions can preempt competition
  - Buying known revenue & profit stream: NPC of future cash flows!!!
  - Asset valuation, negotiation, government permission (汇源果汁 by Coca Cola failed). premium price
  - Payment methods: cash or stock swaps
  - Need to marry divergent corporate cultures
How much to invest

• Large scale entry
  – Requires commitment of significant resources & implies rapid entry
  – Decision that has long term impact & is difficult to reverse (entering market on large scale)
  – Change the competitive playing field & unleash number of changes – e.g. how competitors might react
  – Can limit strategic flexibility

• Small scale entry
  – Allows firm to learn about a foreign market while limiting the firm’s exposure -> limits risks
  – May be more difficulty to build market share & capture early mover advantages
<table>
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<tr>
<th>Entry Strategies</th>
<th>Key Concerns &amp; Objectives</th>
<th>Mode &amp; Scale</th>
<th>Operations Management</th>
<th>Marketing Strategies</th>
<th>Human Resources</th>
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<tr>
<td>1. Preparation</td>
<td>market research, assessment of demand, political risk, and financial feasibility</td>
<td>middlemen service, offshore office, representative office with a small staff</td>
<td>market research, feasibility study, and transaction cost analysis</td>
<td>advertising and promotion to create consumer need awareness and to stimulate demand</td>
<td>middlemen, expatriates training, relocation, support and performance</td>
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<td>2. Entry</td>
<td>establish beachhead operation, transfer of capital and management, ensure smooth transition</td>
<td>single local market, representative office, and the first joint venture</td>
<td>transfer of capital, equipment, technology, and personnel, business plan implementation and evaluation</td>
<td>focus on brand recognition and consumer preference, establish distribution channels,</td>
<td>expatriates &amp; bicultural/bilinguals, transfer of technical and managerial know-how</td>
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<td>3. Expansion</td>
<td>sales growth, market share, new product development, and distribution</td>
<td>expand to other regional markets, establish national headquarters, increase local partnerships</td>
<td>localize supplies and production, management initiatives and motivation, and meet competition,</td>
<td>encourage brand preference, expand distribution network, and manage channel relations</td>
<td>combination of local and expatriate management, team building, and increased training needs for locals</td>
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<td>4. Experienteed</td>
<td>customer loyalty, competition, coordination and rationalization</td>
<td>expand to marginal markets, wholly owned subsidiary, and even mergers/ acquisitions</td>
<td>coordination among branches, achieve cost effectiveness, and improve post-sale service</td>
<td>sales force development, focus on consumer promotion and post-sale service</td>
<td>localization of human resources, motivation and creativity, and long-term HR development</td>
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Table. Stages of Global Market Expansion and Business Strategy Implications
Figure 1 Annual FDI inflows to China, 1982-2012 (USD million)


China’s FDI Outflows

MOFCOM figure: US$145.7 billion

Source: Statistical Bulletin on China’s Outward Foreign Direct Investment
Case Study

CARREFOUR CHINA: MAINTAINING ITS PAST GLORY OR DROWNING IN THE SEA OF COMPETITION?

• Carrefour became the largest retailer in Europe and the second largest worldwide
• Enter at 1995
• Expansion in China
• Strategies in China
  – Supply Chain Management
  – Pricing
  – Location
  – Localization
  – One-stop shopping concept
• Competition and issues
Use Eastern China as a Base and Extend into the Western China

- A gradual approach -- testing the market first before expansion
- With the policy change, MNCs are also changing their strategies
- In the past few years, they had been developing their businesses mainly in the Eastern region. That is a preparation stage.
- Since 2002, they have adopted clearly a strategy of using Eastern China as a base and extend into the Western China.
- Wal-mart has now also entered Northeastern region and XiAn.
- Others have also entered XinJiang, Sichuan, YunNan

Multiple Operational Methods

- Before 2002, they mainly used shopping plaza method.
- After 2002, they have started using discount shops, club membership shops, community shops, etc.
- For example, Wal-mart, at the end of 2002, had 19 shopping plazas, 4 Sam membership stores, 2 community stores, etc.
- Park & Shop, Watson's, Fortress, Giordano, Moiselle, Jean West, etc., have also entered China market.
Expand in multiple methods
– WuShang has shopping centers, convenient stores, home appliances city.
– ZhongShang Group has shopping centres, warehouse plaza, chain stores.
– Shenzhen Causeway Bay operates in the format of “Mall +Department + Convenient Store”.
– Diversification

• Localization
  – Local sourcing
    • McDonalds, Carrefour
  – Localization of human resources
    • Training and rotation
  – Localization of operational methods
    • Coca-Cola
    • WalMart
    • Superstore method is a preferred method
    • For example, all 36 Carrefour stores are superstores.
    • Membership club store method has entered some embarrassment.
## A Comparison of Strategies

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<th>Partner</th>
<th>Structure</th>
<th>Profit Source</th>
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<td>Carrefour</td>
<td>Alliance with listed companies</td>
<td>Spring up everywhere</td>
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<td>Wal-mart</td>
<td>Joint venture with non retail companies. Intend to take over</td>
<td>Three region strategy</td>
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<tr>
<td>Metro</td>
<td>Joint venture with non retail companies</td>
<td>Focus on Eastern China</td>
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<td>Auchan</td>
<td>Cross share holding and combined to expand</td>
<td>Three point strategy (Beijing, Shanghai and ChenDu)</td>
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<td>Pricesmart</td>
<td>“exclusive right”</td>
<td>Occupy second and third tier markets</td>
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## Why leave

“Already, difficulty finding work has helped push up wages in some parts of the country by up to 40 per cent annually. Other costs, such as complying with environmental and labour regulations, as well as rising commodity prices, have also made low-end manufacturing less attractive.”
Exit Strategies

- Profit repatriation (expatriation), transfer pricing (price low to headquarters or subsidiaries elsewhere)
- Government restrictions on entering and leaving the market
- Capital/currency controls
- Trade sale
- Capitalization: Initial public offering (IPO) — domestic and/or international