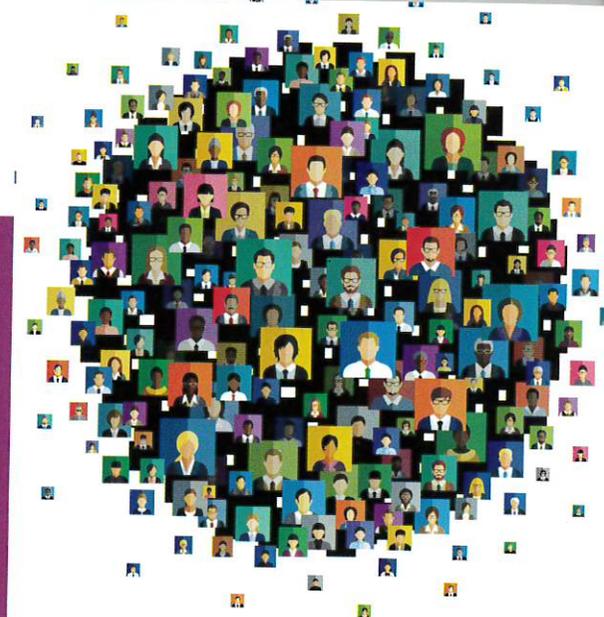


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CHAPTER TWELVE

FOREIGN ENTRY STRATEGIES



LEARNING OBJECTIVES

After studying this chapter, you should be able to

- 1 Explain why MNEs establish subsidiaries abroad (*why* to enter)
- 2 Identify relevant location-specific advantages that attract foreign investors (*where* to enter)
- 3 Compare and contrast first- and late-mover advantages (*when* to enter)
- 4 Compare and contrast alternative modes of entry (*how* to enter)
- 5 Explain the interdependence of operations and entry strategies
- 6 Apply the institution-based view to explain constraints on foreign entry strategies
- 7 Participate in leading debates on foreign entry strategies
- 8 Draw implications for action



OPENING CASE

Pearl River Piano enters foreign markets

A grand piano from a famous maker is the aspiration and passion of pianists around the world. Professionals swear by their favourite brands, like *Bösendorfer* (from Vienna, Austria) or *Steinway* (from New York, USA). Some choose a handmade piano from a traditional family business like *Grotrian-Steinweg* (from Braunschweig, Germany). The manufacture of a piano is a traditional craft that requires highly specialist skills, true to the Latin origins of the word (*manu* = hand). Most people with a passion for music make do with a more mundane brand, such as *Yamaha* (from Yokohama, Japan). *Yamaha* brought together Japanese traditional passion for manufacturing excellence and a more recent passion for classical music to become the largest piano maker in the world in the 1990s. In 2008, *Yamaha* acquired the leading European manufacturer *Bösendorfer* for a stronger positioning in the premium segment.

With such a strong field of incumbents and strong loyalty to traditional brands, it may come as a surprise that a new kid on the block has been rolling up the market: in 2002, *Pearl River* (of Guangzhou, China) overtook *Yamaha* to become the largest piano

producer in the world, making about 100 000 pianos every year. How did it achieve that? Given the relatively low prestige associated with Chinese-made goods, few would associate an aspirational product like a piano with 'made in China'. *Pearl River Piano* was founded in 1956 in Guangzhou, next to the Pearl river. *Pearl River's* centre of gravity has remained in China, where pianos have become more affordable with rising income. The one-child policy induced families to invest heavily in their only child's education. As a result, the Chinese now buy half of the pianos produced in the world.

Pearl River succeeded in becoming the top selling brand in China. This may sound like an attractive market position. Yet rising demand has attracted numerous new entrants, many of which compete at the low end in China. These over 140 competitors have pushed *Pearl River's* domestic market share from 70% at its peak a decade ago down to about 25% – although it is still the market leader.

Facing price competition at home, *Pearl River* sought new opportunities overseas. In North America, it started exporting in the late 1980s by relying on US-based importers. Making its first ever FDI, it set up a US-based sales subsidiary, *Pearl River Piano Group America* in California in 1999. Acknowledging



What challenges does a piano maker face when expanding overseas?

the importance of the US market and the limited international experiences of its management team, *Pearl River* hired an American with long experience in the piano industry, to head the subsidiary. Within two years, the greenfield subsidiary succeeded in getting *Pearl River* pianos into about one-third of the specialized US retail dealers. Within ten years, the *Pearl River* brand became the leader at the low end of the upright piano market in North America.

Efforts to penetrate the high-end market, however, were still frustrated. The *Pearl River* brand suffered from all the usual trappings associated with Chinese brands. 'We are very cognisant that our pricing provides a strong incentive to buy', Rich noted in a media interview, 'but \$6000 is still a lot of money'. In an audacious move to overcome buyers' reservation about purchasing a high-end Chinese product, *Pearl River* made a second strategic FDI in 2000 by acquiring the brand *Ritmüller*. Founded in 1795, *Ritmüller* had manufactured pianos in Göttingen, Germany, for over 100 years, although the factory had closed during the recession of the late 1920s.

By reviving the 'inactive brand', *Pearl River* aimed to position itself in the European piano-making tradition and to move up-market. A new office in Munich focused on design, research and development. A newly-designed product line signalled commitment to a classic heritage and standard of excellence. Moreover, *Pearl River* commissioned international master piano designer Lothar Thomma to integrate

German craftsmanship with the latest manufacturing technology.

In 2016, *Pearl River* stepped up its efforts to become a global player by taking over the largest German piano maker, *Schimmel*. This brand and its production sites in Germany and Poland enabled *Pearl River* to reach customers at home and abroad who considered 'made in China' not good enough for their piano. While the *Ritmüller* brand was successfully positioned in a higher market segment in China, it did not suffice for *Pearl River* to break into the premium segment.

By acquiring 90% of *Schimmel*, *Pearl River* could not only access a recognized premium brand 'made in Germany' but also state-of-the-art production facilities. *Schimmel* continued to operate high autonomously under local management and with close involvement of the descendants of the founder.

Sources: (1) W. Ding, 2009, The return of the king, *Beijing Review*, May 21; (2) Pearl River Piano Group, 2009, www.pearlriverpiano.com; (3) D. Behrendt, 2009, Tradition gibt den Ton an, *Hannoversche Allgemeine Zeitung*, March 4; (4) Stadtarchiv Göttingen, no date, *Stationen der Stadtgeschichte*, www.stadtarchiv.goettingen.de; (5) K.E. Meyer, 2015, Creating value by awaking a sleeping brand, *Forbes blog*, November 9; (6) *China Daily*, 2016, Pearl River Piano now calling the tunes at Schimmel, May 19; (7) Klaus Meyer, personal interviews.

How do companies such as *Pearl River Piano* enter foreign markets? Why did they start their ambitious international growth in the Hong Kong and later the USA, before entering Europe? Why did *Pearl River Piano* establish a greenfield operation in the USA, but acquire a business in Germany? What are the advantages of building your own brand, and when is a combination with an acquired brand appropriate? These are some of the key questions in this chapter.

Recall from Chapter 6 that MNEs engage in foreign FDI by operating subsidiaries abroad. Chapter 6 has already introduced key theoretical ideas as to why FDI and MNEs exist. This chapter approaches FDI from the perspective of a specific firm considering the establishment of a **foreign subsidiary**. Preparing such an investment, MNEs need to design an **entry strategy** that specifies their objectives and how they intend to achieve these objectives.

We here consider foreign entries by mature firms with sufficient resources to establish their own subsidiaries. This complements Chapter 11, which focuses on smaller firms and non-equity modes. We start with a review of the objectives that motivate firms to establish subsidiaries abroad. Foreign entry requires several strategic decisions, including location, timing, entry mode, marketing, human resources and logistics. Most textbooks focus on the entry mode decision: exports, contracts, joint ventures or wholly owned subsidiaries? However, this choice of entry mode actually

foreign subsidiary

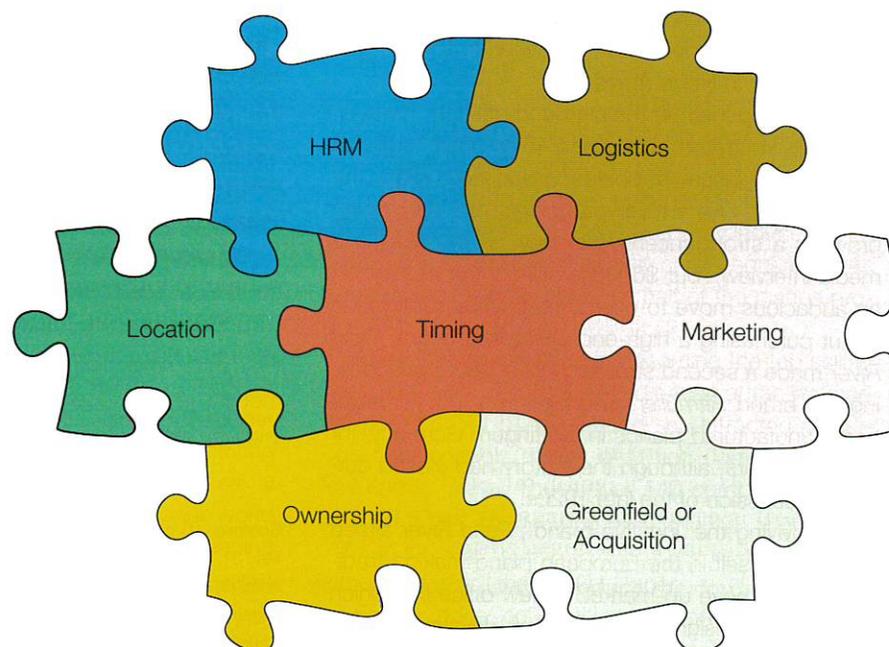
An operation abroad set up by foreign direct investment.

entry strategy

A plan that specifies the objectives of an entry and how to achieve them.

depends on many other aspects of the entry strategy. Our framework integrates these aspects. When designing an entry strategy, MNEs generally have to consider them together, ensuring a good fit between the different elements of the strategy – like the pieces of a jigsaw puzzle (Figure 12.1).

Figure 12.1 The building blocks of an entry strategy



STRATEGIC OBJECTIVES OF ESTABLISHING FOREIGN SUBSIDIARIES

If you want to advise a company on how to set up an operation overseas (a popular topic for BA and MSc dissertations), then the first question you should ask the company is ‘What *exactly* do you want to achieve?’ MNEs establish foreign subsidiaries for a variety of reasons, and each operation contributes to the global MNE in a different way. Hence every entry decision has to be considered in relation to the overall strategy of the MNE and make best use of both the local context and the global resources of the MNE. There are four common objectives for establishing subsidiaries abroad and thus to engage in FDI:¹

- Investors interested in **natural resource-seeking** aim to access particular resources, such as minerals, oil or renewable resources including timber or agricultural produce that they need in their production processes. Their main questions thus are, where do we find these resources, and how can we best secure access to them?
- **Market-seeking** investors aim to sell their products or services to new customers. They would identify the relevant market and then seek a central location for sales, marketing and distribution operations. In some industries, the actual production also needs to be located close to the customer or the point of consumption, notably in service industries such as hotels and financial services, and for manufactured goods that face high transportations costs. Hence market-seeking investors ask, where are our potential future customers, and what do we have to do to reach them better than our competitors do?

LEARNING OBJECTIVE

- 1 Explain why MNEs establish subsidiaries abroad (*why* to enter)

natural resource-seeking FDI

Investors' quest to pursue natural resources in certain locations.

market-seeking FDI

Investors' quest to go after countries that offer strong demand for their products and services.

- **Efficiency-enhancing** investors aim to reduce their overall costs of production. They often single out the locations that enable the most efficient operation of the overall value chain, considering the availability and costs of inputs – especially the labour force, economies of scale and good transportation linkages. Their main question is, how can we lower the costs of our operations to deliver products and services to our customers? For example, Indian IT company *Tata Consultancy Services* set up operations in Hungary because Hungary offered the best combination of labour costs and proximity to European clients.
- **Capability-enhancing** investors, also known as strategic asset seekers, aim to access new ideas and technologies that help them to upgrade their own technological and managerial capabilities. Such entries aim to access the knowledge base of the host country and thus to generate knowledge that may help the entire MNE to advance its organizational learning and growth.² Capability builders such as *Tata Motors* and *Geely* (In Focus 12.1) thus ask, where are the latest technologies and ideas that we can connect to our existing technologies and innovation activities? Note that the primary concern of this type of investor is not to build a new subsidiary but to change the parent organization.

efficiency-enhancing FDI
Investors' quest to single out the most efficient locations for each value chain activity.

capability-enhancing FDI
Investors' quest for new ideas and technologies that to upgrade their own technological and managerial capabilities.



IN FOCUS 12.1

Tata and Geely acquire capabilities

When Indian and Chinese MNEs invest overseas their first aim is often to build their own capabilities. Even when they have been highly successful at home, they still face a gap in capabilities, such as technological and managerial competencies, marketing to premium customers, engaging with financial advisors and private equity, managing R&D processes and leading creative people.

Consider two examples in the car industry. India's *Tata* acquired *Corus Steel*, *Tetley Tea* and *Jaguar Land Rover (JLR)* in the UK. Contrary to typical Western acquisitions, these foreign entries were not (primarily) aiming to sell Indian products in Europe, or reduce costs of existing operations, or access natural resources. In fact, the acquired firms have only been loosely integrated with other member firms of the *Tata Group*. So why did *Tata* make these big and risky investments? In addition to financial motives (risk diversification), *Tata's* ambition has been to compete in global markets, and therefore it needed to build a range of managerial competencies. After the acquisition, the acquired firm was given high operational

autonomy and additional financial resources for investment. On this basis, *Tata*-owned *JLR* has successfully rebuilt its UK manufacturing operations and its emerging economy market share. At the same time, parent organization *Tata Motors* continued to struggle in its Indian home market.

Similarly, *Geely*, a private Chinese car manufacturer, acquired Swedish premium car maker *Volvo* and the manufacturer of London taxis, *Manganese Bronze*. Like *Tata*, *Geely* was not geared towards European markets (their growth was close to zero at the time). Rather, *Geely* aimed to use the acquired brands and technologies to strengthen its position in the largest and fastest growth market for passenger cars, China. After the acquisition, *Volvo* built a new car assembly plant in China and invested in building its premium brand in China. In 2014 alone, *Volvo* added 30 new dealerships in China to increase its network to 157, and sales surged by 33%. Thus China overtook the USA as *Volvo's* most important market.

In both cases, the new owners thus helped build bridges to potential customers in emerging economies by investing in new plants, distribution channels and brand marketing. Yet their main objective was even

more ambitious: to enhance the parent's capability base with an eye on global market leadership. This strategy requires the transfer and integration of knowledge and capabilities from the acquired firm to the new parent.

This intention is, however, challenging to implement. For example, how can a technological laggard identify the sources of a leader's superior performance? How can knowledge that is embedded in organizational processes, or even the education system, be communicated to recipients in another country? How can capabilities be replicated in a parent organization (the acquirer) with very different organizational structures

and culture, say authoritarian leadership in China versus flat hierarchies in Northern Europe? Early indications suggest that both *Tata* and *Geely* found this reverse knowledge transfer quite challenging.

Sources: (1) V. Bajaj, 2012, Tata Motors finds success in Jaguar Land Rover, *New York Times*, August 30; (2) N. Shirouzu, 2013, Geely, Volvo differ over future China look, *Reuters*, September 10; (3) R. Gribben 2015, Jaguar Land Rover: £1.3bn Tata gamble pays off as big cat purrs at last, *The Telegraph*, February 15; (4) A. Sharman, 2015, Volvo drives Geely to record sales, *Financial Times*, February 27; (5) Meyer, K.E., 2015, What is strategic asset seeking FDI? *MBR*, 23(1): 57–66.

These four strategic goals, while analytically distinct, are not mutually exclusive. Thus investors may pursue several objectives when establishing a particular subsidiary. However, it is important to have a fairly clear idea of 'what' you want to achieve, before you consider 'how' to achieve it – in designing foreign entry strategies (as well as your own career, for example). A natural resource-seeker needs to specify the resources sought, and a market-seeker needs to identify the target customers, and so on. Having established the objectives of a foreign entry, we can discuss how a firm can achieve them.

WHERE TO ENTER?

Like real estate, the motto for international business is 'Location, location, location'. In fact, such a spatial perspective (that is, geography beyond one's home country) is a defining feature of international business.³ Location decisions involve (at least) two levels: first the country (say, UK), and second the site (say, Abingdon Business Park, near Oxford). The considerations for these between-country and within-country location decisions tend to be similar. Favourable locations in certain countries may give firms operating there access to **location-specific advantages**, that is, advantages that can be exploited by those present at a location. We may regard the continuous expansion of international business as a continuous search for locational advantages. As we discussed in Chapter 6, locational advantages relate in particular to markets, resource endowments, agglomeration and institutions. Prospective foreign investors access these advantages of possible host countries and – critically – match them with their own needs. Thus the importance of different advantages varies for firms with different objectives (Table 12.1).

The quality and costs of local resources are a prime concern of natural resource-seeking and efficiency-enhancing investors. Their key decision parameters are the specific local resources that they require for their operations. For example, oil majors like *Shell* and *BP* seek accessible oil deposits, software developers like *SAP* seek trained software engineers, and manufacturers seek reliable workers and suppliers of intermediate goods. Some of these resources are available only at a limited number of locations, which takes certain industries to far off locations, such as oil exploration in the Middle East, Russia and Venezuela.

The costs and productivity of the local labour force are prime considerations for efficiency-enhancing investors. Numerous MNEs have entered China with efficiency-enhancing motives. China manufactures two-thirds of the world's photocopiers, shoes,

Table 12.1 Matching strategic goals with locations

Strategic goals	Location-specific advantages	Illustrative locations mentioned in the text
Market-seeking	Strong market demand and customers willing to pay	Marketing and sales of consumer goods anywhere in the world
Natural resource-seeking	Quality and costs of natural resources	Oil exploration in the Middle East, Russia and Venezuela
Efficiency-enhancing	Economies of scale, abundance of low-cost labour force and suppliers, transport and communication infrastructure	Manufacturing in Guangdong, China; logistics in Rotterdam, Vienna and Miami
Capability-enhancing	Innovative individuals, firms and universities, industry agglomeration	Chinese acquisitions of technologies and brands in Germany; wind energy in Jutland; IT in Silicon Valley and Bangalore

toys and microwave ovens; half of its DVD players, digital cameras and textiles; and one-third of its desktop computers.⁴ However, mainland China does not present the absolutely lowest labour costs in the world. Its attractiveness lies in its ability to enhance foreign entrants' efficiency by lowering total costs. Total costs arise from the combination of costs of labour and the productivity of costs – plus costs of other inputs and the costs of bringing goods to market. Since the key efficiency concern is total costs, it is also not surprising that some nominally 'high-cost' countries (such as the USA) continue to attract significant FDI. For instance, *Grupo Mexico*, the world's third-largest copper producer, has moved some of its energy-thirsty refining operations from 'high-cost' Mexico to 'low-cost' Texas, where electricity costs 4 cents per kilowatt hour as opposed to 8.5 cents in Mexico.⁵

The geography and logistics infrastructure is another consideration high on the list of efficiency-enhancing investors. They prefer locations that combine low labour costs with good local infrastructure and access to major ports, such as electronics assembly in Guangdong Province in southern China, or textile factories in Bing Duong and Dong Nai in southern Vietnam.⁶ The location of logistics and coordination activities is even more focused on geography. Rotterdam, for instance, is an ideal stopping point for sea transport entering or leaving continental Europe (see Chapter 5, Opening Case). Vienna is an attractive site for MNEs' regional headquarters for Central and Eastern Europe, as are Singapore and Hong Kong for East Asia. Miami, which advertises itself as the 'Gateway of the Americas', is an ideal location both for North American firms looking south and Latin American companies coming north.

The size and growth potential of a market are the prime attractors for market-seeking investors. They aim to identify patterns of (future) demand for their particular products and services. For consumer goods, they may predict their market demand using demographic data such as per capita incomes and population size. For example, the Japanese appetite and willingness to pay for seafood have motivated seafood exporters around the world – ranging from nearby China and Korea to distant Norway and Peru – to ship their catch to Japan and fetch top dollars (or yen). *Pearl River Pianos* initially focused on the USA because of its sheer market size, and lots of

LEARNING OBJECTIVE

- Identify relevant location-specific advantages that attract foreign investors (*where* to enter)

location-specific advantages

Advantages that can be exploited by those present at a location.

Americans have large private homes to accommodate a piano. However, businesses supplying other businesses focus on the size and growth of their specific local customer industry. For example, *SSI Schaefer* (See Integrative Case) focuses on industrial centres where it can install its automated logistics systems in factories and warehouses. Access to markets may require a local sales operation or even local production if transportation is costly (for instance due to tariffs), or if the local institutional environment inhibits effective marketing and distribution of imported products.

Existing local capabilities are the main attraction for capability-enhancing investors. Similarly, where do you find the world's most famous piano brands? Where do you find the world's best traditional piano-building skills? These two questions have guided *Pearl River Piano* in their foray into Germany, where they were looking to enhance their design and development capabilities by acquiring a brand and competencies in traditional piano-making. Other Chinese investors followed similar motives when they acquired traditional medium-sized German firms because of their technologies and brand reputation in global niche markets. For example in 2005, *SG Group* (see Integrative Case), a manufacturer of industrial sewing machines, acquired a German company with a global network of operations in the industry, *Dürkopp Adler*. *SG* was at the time losing market share in China to foreign investors. The acquisition in Germany provided it with new technologies and a brand name for the premium segment that enabled *SG* to regain market share in China, in addition to gaining access to new markets abroad.⁷

The existing structure of industry is important to all types of investors, as they may join industry clusters (or 'agglomerations'), though for different reasons.⁸ Capability-enhancers like to join innovation clusters, such as information technology in Silicon Valley and Bangalore, or wind energy technology in the Jutland peninsula of Denmark. In addition to communities of experts developing new ideas, they may also meet venture capitalists with expertise in their industry. Efficiency-enhancing investors, such as garments and electronics firms in Vietnam and China, are more concerned about the availability specialized suppliers and a workforce with industry-specific skills. Market-seeking investors in business-to-business sectors may join industrial clusters where they find their main customers, while accountants and consultants locate in hubs where companies maintain their corporate headquarters.

WHEN TO ENTER?

Entry timing considerations centre on whether there are compelling reasons to be early or late entrants in certain markets.⁹ Market-seekers especially often pursue **first-mover advantages**, defined as the advantages that first movers obtain and that later movers do not enjoy. Speaking of the power of first-mover advantages, *Xerox*, *FedEx* and *Google* have now become verbs: you will often hear people say 'Google it'. In some parts of Africa, *Colgate* is the generic term for toothpaste, thanks to *Colgate-Palmolive's* first introduction of the product concept to the continent. *Unilever*, a late mover, is disappointed to find out that some African customers call its toothpaste 'the red *Colgate*'! However, first movers may also encounter significant disadvantages, which in turn become **late-mover advantages**. Table 12.2 shows a number of first- and late-mover advantages.

- First movers may gain advantage through proprietary technology. They also ride down the learning curve in pursuit of scale and scope economies in new countries. In Vietnam, early movers *Toyota* and *Ford* have been learning how to adapt their production and marketing technologies to the local conditions, and were thus prepared to face later entrants, such as *Nissan*.

Table 12.2 First-mover advantages and late-mover advantages

First-mover advantages	Late-mover advantages (or first-mover disadvantages)
<ul style="list-style-type: none"> ● Proprietary, technological leadership ● Pre-emption of scarce resources ● Establishment of entry barriers for late entrants ● Relationships and connections with key stakeholders such as customers and governments 	<ul style="list-style-type: none"> ● Opportunity to free-ride on first-mover investments ● Resolution of technological and market uncertainty ● First mover's difficulty to adapt to market changes

- First movers may be able to lock in the most capable local partners. A number of Japanese MNEs have 'cherry picked' leading local suppliers and distributors as new members of the expanded *keiretsu* networks in Southeast Asia and thereby inhibited access to them by late entrants from the West.¹⁰
- First movers may create significant entry barriers for late entrants, such as customer switching costs. In particular, buyers of expensive equipment or infrastructure are likely to stick with the same providers for components, training and maintenance services for a long time. That is why aircraft manufacturers *Airbus* and *Boeing* compete intensely for airline orders: once the airlines build the service infrastructure around one type of aircraft, they will continue using this airline and need servicing for their existing fleet. In consequence, manufacturers of heavy equipment, such as *Rolls-Royce* (aircraft engines) or *Schindler* (lifts for skyscrapers) earn more in revenues (and usually a higher margin) on service contracts than on equipment sales.
- First movers may build precious relationships with key stakeholders, such as customers and governments. For example, Danish fashion retailer *Bestseller* entered China in 1995, anticipating the rise of the middle class and thus increasing demand for premium brands. When the economy indeed boomed and young people built affinity to luxury brands, *Bestseller* had built both the infrastructure and prestigious brands like *Vero Moda* and *Jack & Jones* to serve them.¹¹

On the other hand, the potential advantages of first movers may be counterbalanced by various disadvantages (see Table 12.2). There are numerous examples of first-mover firms that have lost, such as *EMI* in CT scanners, *de Havilland* in jet airliners and *Netscape* in internet browsers. They were taken over by more resourceful second movers, respectively *GE*, *Boeing* and *Microsoft (Explorer)*. Specifically, late-mover advantages are manifested in three ways.

- Second movers may be able to free ride on first movers' huge pioneering investments to educate customers on the merits of the new technology. A late mover can free-ride on such customer education by only focusing on why its particular product is the best. For example, *HTC* from Taiwan was first to introduce many features of Android-based smartphones; yet *Samsung* from Korea soon took global market leadership of the segment.
- First movers face greater technological and market uncertainties. After some of these uncertainties are removed, second movers may join the game with massive firepower. Some MNEs such as *IBM* and *Matsushita* are known to have such a tendency.
- As incumbents, first movers may be locked into a given set of fixed assets or reluctant to cannibalize existing product lines in favour of new ones. Second movers may be able to take advantage of first movers' inflexibility by leapfrogging first movers.

LEARNING OBJECTIVE

- 3 Compare and contrast first- and late-mover advantages (when to enter)

first-mover advantages

Advantages that first movers obtain and that later movers do not enjoy.

late-mover advantages

Advantages that late movers obtain and that first movers do not enjoy.

Overall, there is some evidence pointing to first-mover advantages, but there is also evidence supporting a second-mover strategy.¹² Although first movers may have an opportunity to win, their pioneering status is not a birthright for success. Empirical research suggests that first movers can maintain their leadership position *if* they continuously commit resources and *if* they actively learn about the local environment. Many first movers, however, did not succeed in creating sustained market leadership.¹³ For example, among all three first movers that entered the Chinese automobile industry in the early 1980s, VW captured significant advantages, *Chrysler* had very moderate success and *Peugeot* failed and had to exit. Among later entrants in the late 1990s, while many are struggling, *GM*, *Honda* and *Hyundai* have gained significant market shares. Thus, entry timing should not be viewed in isolation, and it is not the sole determinant of success and failure of foreign entries. It is through interaction with other strategic variables that entry timing has an impact on performance.¹⁴

HOW TO ENTER?

Modes of entry are the format of foreign market entries. The first step is to determine whether to pursue equity or non-equity modes of entry. This crucial decision differentiates MNEs (involving equity modes) from non-MNEs (relying on non-equity modes). **Non-equity modes** (like exports and contractual agreements) tend to reflect relatively smaller commitments to overseas markets; we have already discussed these in Chapter 11. Also, recall from Chapter 6 that full ownership provides firms with internalization advantages, essentially reducing risks and costs by bringing market transactions in-house. For smaller firms, such as *Grotrian-Steinweg Pianos* (Opening Case), non-equity modes are often the cornerstone of their international strategy. For larger firms, such as *Pearl River Piano*, non-equity modes often complement equity modes.

Equity modes (like JVs and wholly owned subsidiaries) normally require larger, harder-to-reverse commitments. Equity modes establish an organization overseas that the firm owns, at least partially. The distinction between equity and non-equity modes is what defines an MNE: an MNE enters foreign markets via equity modes through FDI. A firm that merely exports/imports with no FDI is usually not regarded as an MNE.

Equity modes are particularly preferred when it comes to transferring intangible assets. Many businesses aim to achieve competitive advantages in each of their foreign markets by deploying intangible assets. However, they face asymmetric information regarding the content, value and usage of these assets, which are classic sources of market failures. Thus the more markets are characterized by information asymmetries, the more likely MNEs are to prefer to handle this transaction internally and thus to choose an equity mode.¹⁵ Moreover, the transfer of tacit knowledge requires ‘learning by doing’ and direct face-to-face interaction between people. That is difficult to achieve unless they work in the same company.¹⁶ Thus firms competing especially on the basis of technology, brand names or other intangible assets, are likely to use equity modes rather than contractual collaboration.

Once a firm has decided to use an equity mode, it still has a choice of different entry modes that vary in terms of commitment, risk, return and control.¹⁷ The decision depends essentially on two questions: how do we access complementary local resources? And, how much control will we attain? Figure 12.2 thus depicts the entry modes for foreign investors in a simple 2 × 2 matrix.

Most investors prefer full control over their operations and thus establish a **wholly owned subsidiary (WOS)** in which they are the only owner. The advantage of a WOS is that it provides full control and thus the ability to integrate the operation tightly with the parent firm and to determine what the subsidiary should do. A WOS can be established in two ways: (1) as a greenfield project or (2) as a full acquisition.

LEARNING OBJECTIVE

- 4 Compare and contrast alternative modes of entry (*how to enter*)

modes of entry

The format of foreign market entry.

non-equity mode

A mode of entry that does not involve owning equity in a local firm.

equity mode

A mode of entry (JV that involves taking full or partial) equity ownership in a local firm.

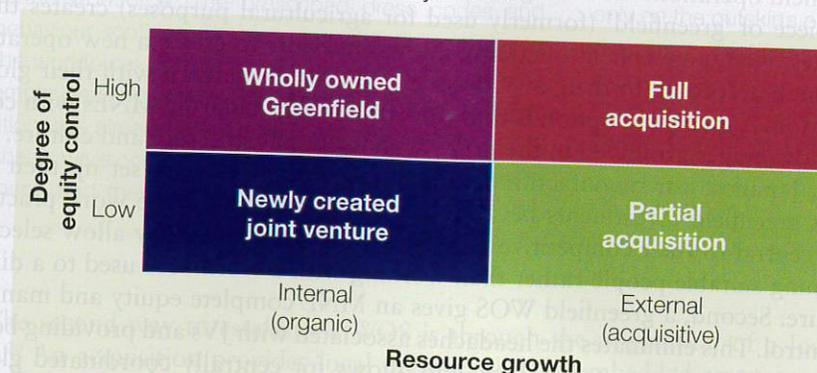
LEARNING OBJECTIVE

- 5 Compare and contrast the advantages and disadvantages of different entry modes.

wholly owned subsidiaries (WOS)

A subsidiary located in a foreign country that is entirely owned by the parent multinational.

Figure 12.2 The choice of FDI entry modes



The resource dimension

Foreign entrants usually need some local resources to complement their own resources, and thus they face a make-or-buy decision: should they develop and deploy their own resources, or should they buy local resources? Moreover, should they buy specific resources one by one, or should they buy an entire local business that has all the relevant resources? Firms seeking to establish a WOS thus have to choose between a greenfield entry and an acquisition entry (Table 12.3).¹⁸

Table 12.3 Equity modes of entry: advantages and disadvantages

Entry modes	Advantages	Disadvantages	Risks
Greenfield (wholly owned)	<ul style="list-style-type: none"> Design operations to fit the parent Complete equity and operational control Better protection of know-how Option to scale operation to needs 	<ul style="list-style-type: none"> Add new capacity to industry Slow entry speed (relative to acquisitions) 	<ul style="list-style-type: none"> No co-owner related risks No integration failure risk High investment risk due to large capital commitment and long pay-back periods
Acquisition (full)	<ul style="list-style-type: none"> Complete equity and operational control Better protection of know-how Do not add new capacity Fast entry speed 	<ul style="list-style-type: none"> Political sensitivity High up-front capital needs Post-acquisition integration challenges 	<ul style="list-style-type: none"> High investment risk due to large up-front capital commitment Integration process related risks No co-owner related risks
Joint venture (newly established)	<ul style="list-style-type: none"> Sharing costs, risks and profits Access to partners' knowledge and assets Politically acceptable 	<ul style="list-style-type: none"> Divergent goals and interests of partners Limited equity and operational control Difficult to coordinate globally 	<ul style="list-style-type: none"> Limited investment risk due to lower capital commitment High risk of coordination failure
Partial acquisition	<ul style="list-style-type: none"> Access to operations that the previous owner is reluctant to give up Previous owners' continued commitment 	<ul style="list-style-type: none"> Need to restructure and integrate, yet with limited control 	<ul style="list-style-type: none"> Limited investment risk due to lower capital commitment High risk of integration problems High risk of conflicts with co-owners

greenfield operation

Building factories and offices from scratch.

Greenfield operations – building new factories and offices from scratch on a proverbial piece of ‘greenfield’ (formerly used for agricultural purposes) creates three advantages. First, a greenfield operation allows investors to create a new operation from scratch according to their own designs and thus to match it with their global organization. A greenfield option is thus preferred in particular by MNEs with competitive advantages grounded in the firm’s organizational structure and culture. For example, Japanese car manufacturers *Nissan*, *Toyota* and *Honda* set up their UK plants as greenfield investments because this allows transfer of the work practices that are central to their competitive advantage.¹⁹ In particular, they allow selecting and training suitable people rather than working with a workforce used to a different culture. Second, a greenfield WOS gives an MNE complete equity and management control. This eliminates the headaches associated with JVs and providing better protection of proprietary technology, and allows for centrally coordinated global actions. Third, greenfield investments may be designed to be small, initially, and to grow with the market development (especially for sales units), thus limiting the up-front capital commitment.

In terms of drawbacks, a greenfield WOS tends to add new capacity to an industry, which will make a competitive industry more crowded and thus increases the intensity of competition (Chapter 13). Finally, greenfield operations, relative to acquisitions, suffer from a slow entry speed because they normally take two or more years to plan and build the new plants and new distribution channels. In terms of risk, greenfield investments reduce the risk of failure due to conflict between the JV partners or with employees in an acquired firm. However, it usually takes quite some time to build a greenfield plant, which means pay-back periods are likely to be long and investment risks are high (In Focus 12.2).



IN FOCUS 12.2

Walmart tries to enter European markets

Walmart is the largest retailer in the USA. It succeeded with a low price business model, enabled by a combination of scale in its stores, low labour costs, efficient supply chains and an extensive sourcing network in Asia. In the 1990s, *Walmart* decided to seek new challenges and bring its low-cost shopping experience to Europe. A major challenge was, however, that European consumers prefer smaller-scale shops and more frequent but shorter-distance shopping trips.

In the UK, *Walmart* acquired local chain *ASDA* for a steep €6.7 billion in 1999 and introduced elements of their own business model. They gradually added new supersized outlets to *ASDA* and thus accelerated its growth. *ASDA* became a major provider for cost-conscious consumers and soon rose to second place among retailers in the UK, a position it maintained until 2014 when *Tesco* and *Sainsbury's* took the #1 and #2

spots. After almost two decades, *Walmart* changed its priorities and announced in 2018 the intention to sell *ASDA* to *Sainsbury's*.

In Germany, *Walmart* tried a greenfield approach with 90 stores. Yet, after a few years they gave up; they simply weren't able to make the operation profitable. The causes of the failure have been much debated – probably several challenges came together. First, the logistics network behind *Walmart's* system needs scale, and hence building supermarkets fast was imperative to be able to realize scale advantages. Yet, getting planning permissions for super-sized malls and the associated parking lots proved to be very challenging in a country where local councils (and hence locally elected politicians) have the final say on planning permissions.

Also, *Walmart* did not make friends with the labour unions. The jobs they offered were low paid (by German standards) and not making use of the skills available

in the workforce. The prescribed dress codes and behaviour routines (like morning chants to motivate the workforce) did not go down well among potential employees and customers. Last but not least, competition was already intense: with *Aldi* and *Lidl*, two local chains were competing intensively in the low-cost segment, and they had secured attractive locations not

only on the outskirts of cities near the motorway but in downtown locations where Europeans still do a lot of their shopping.

Sources: (1) M. Landler & M. Barbaro, 2006, Walmart finds that its formula doesn't fit every culture, *New York Times*, August 2; (2) D. Macaray, 2017, Why did Walmart leave Germany, *Huffington Post*, August 29; (3) authors' own interviews.

The second way to establish a WOS is through the **acquisition** of a local business.²⁰ An acquisition provides local organizationally embedded resources, such as human capital and networks with local authorities. Acquisitions are probably the most important mode in terms of the amount of capital involved, representing approximately 70% of worldwide FDI flows. In addition to sharing many benefits of greenfield WOS, acquisitions enjoy two other advantages, namely: (1) adding no new capacity to the industry and (2) faster entry speed. Foreign entry by full acquisition is particularly feasible when another foreign investor is withdrawing from the market. For example, *Behr*, a German manufacturer of automotive air conditioning and engine cooling systems, acquired its South African operation from a US firm, *Federal Mogul*, who wanted to divest from this sub-segment of the automotive supplier industry. This acquisition allowed *Behr* to strengthen its position as supplier to its key customers *VW*, *Mercedes* and *BMW*, who had recently upgraded their South African manufacturing plants.²¹ Full ownership was desirable for *Behr* because it had to integrate the new operations with its existing operations, and it was feasible because a facility of high technological standard was for sale at that time. As another example, consider *Thai Union Frozen Foods*, who aggressively entered EU markets by acquiring a French company owning brands like *John West* and *Petite Navire* (See Closing Case).

In terms of drawbacks, acquisitions are most likely to attract political resistance from both individuals working in the plant and from nationalistic sentiments – especially if high-profile companies are involved. In addition, acquisitions have to confront a different and potentially devastating disadvantage – the restructuring and integration of the acquired business (see Chapter 14). The restructuring challenges are particularly acute when acquiring firms that were previously run very inefficiently, such as state-owned enterprises in transition economies. Restructuring challenges are considerably easier when acquiring a business formerly owned by another foreign investor, such as the *Behr* example above. In terms of risks, acquisitions present high investment risks because of the high capital commitment required up front and the chance of the integration process going wrong.

The control dimension

A **joint venture (JV)** is a ‘corporate child’ that is a new entity jointly owned by two or more parent companies.²² It has three principal forms: minority JV (the focal firm holds less than 50% equity), 50/50 JV, and majority JV (more than 50% equity). A JV with a local partner is an attractive entry strategy with three advantages (see Chapter 14 for other uses of JVs). First, an MNE shares costs, risks and profits with a local partner, thus limiting the financial risk of the investment. Second, the MNE gains access to knowledge about the host country, and the local firm, in turn, benefits from the MNE’s technology, capital and management. Third, JVs may be politically more acceptable.²³

acquisition

The transfer of the control of operations and management from one firm (target) to another (acquirer), the former becoming a unit of the latter.

joint venture (JV)

A new corporate entity created and jointly owned by two or more parent companies.

In terms of disadvantages, first, JVs often involve partners from different backgrounds and goals; conflicts are natural. For example, *McDonald's* established JVs with two different partners to sell its burgers in India. One JV prospered, while the other faced slow growth and repeated legal conflicts (see Integrative Case *McDonald's* in India). Second, effective equity and operational control may be difficult to achieve because everything has to be negotiated (and in some cases, fought over). Finally, the nature of the JV does not give an MNE the tight control over a foreign subsidiary that it may need for global coordination (such as simultaneously launching new products around the world). In terms of risks, JVs reduce the investment risks because less capital is committed. However, JVs are highly exposed to internal risks such as conflicts between the parent firms, and they constrain the investors' ability to change its strategy. Hence the risk of not reacting sufficiently flexibly to changing internal or external circumstances is high.

JVs are thus appropriate in special situations, namely when three conditions are met: (1) the new business unit depends on resource contributions from two or more firms, (2) high transaction costs inhibit the markets for these resources or for the expected outputs and (3) it is not feasible for the entire parent firm to be integrated into one firm, for instance because they are big relative to the envisaged project, or one of them is a state-owned enterprise.²⁴ In other words, JVs are common where two firms are trying to achieve something that neither could do on its own and where the outcomes are highly uncertain. These conditions often apply to entries into emerging economies: MNEs that lack local knowledge and relationships with influential local players in their target markets may obtain such knowledge and relationships by collaborating with a local firm (In Focus 12.3).

JVs thus provide an avenue to operate in unfamiliar contexts, especially in countries with weak market supporting institutions, such as China or Russia. JVs are also used, for example, when two multinationals want to jointly conduct an operation, such as R&D, or servicing a foreign market. For example, Japanese brewer *Suntory* first served the Thai market through a JV with a local partner, but that was not successful. After terminating that JV, *Suntory* formed a new JV with *PepsiCo* of the USA that would distribute both *PepsiCo's* soft drinks and *Suntory's* beers.²⁵



IN FOCUS 12.3

Joint venture ZF Kama in Russia

by Irina Mihailova

ZF Friedrichshafen (ZF), a German automotive supplier, and Kamaz Corporation, a Russia truck manufacturer, set up a joint venture 'ZF Kama' to produce transmissions in Russia.

ZF is one of the world's leading suppliers of drive-line and chassis technology, with an annual turnover of €12.8 billion, over 72 600 employees and 122 production sites worldwide. For ZF, the JV in Russia was an important step towards building a

strong market position in the Russian market, where ZF previously did not have production facilities. The cooperation with Kamaz was expected to help this objective by creating an association with a leading local truck manufacturer and its extensive dealer network in Russia. In addition, the technological and managerial capabilities of Kamaz were significant criteria for the choice of partner. The Russian JV generated an increase in demand for parts produced in ZF plants in Western Europe and thus contributed to the growth and viability of these established business units.

Kamaz Corporation is one of the largest automobile corporations in Russia with, at the time, 59 000 employees. It operates an integrated production complex that incorporates the whole technological cycle of truck production, from the development, production of components and assembly of vehicles, to the marketing of vehicles and after-sales services. *Kamaz* produces a wide range of trucks, trailers, buses, tractors, engines, power units and a variety of machine tools, and operates the largest automotive distribution and service network in Russia and neighbouring countries. For *Kamaz*, the primary objective for establishing the JV was to access the advanced technologies of ZF and to ensure the supply of high-quality car components. Hence the primary criterion for the choice of JV partner was the possession of product technology. Moreover, a track record of sincere cooperation initiatives and a willingness to share risks were also important arguments for partnering with ZF.

ZF Kama was founded in 2005 to manufacture commercial vehicle transmissions, the first production facility established by *Kamaz* with a foreign partner. The JV is located within the industrial site of *Kamaz* in the city of Naberezhnye Chelny, in Tatarstan. ZF holds 51% of the equity of the JV, while *Kamaz* holds the remaining 49%. Both partners actively participate in the management of the JV, and they both have representatives in the management team. *Kamaz*, is responsible for day-to-day

operations of the JV and manages key business relationships with customers, suppliers and government authorities. ZF contributes primarily through product technology and expertise.

In 2014, ZF Kama invested €90 million to build a new production plant in Naberezhnye Chelny to manufacture transmission gearboxes and their parts. The main customer of the JV is *Kamaz*, but the JV also supplies truck transmissions to ZF plants in Friedrichshafen (Germany), Bouthéon (France) and Eger (Hungary).

After the JV with ZF, *Kamaz* has built a range of JVs with other Western partners in the automotive industry, including suppliers *Cummins* and *Federal Mogul* (both from the USA) and *Knorr Bremse* (Germany), agricultural machines with *Case New Holland* (part of the Italian *Fiat Group*), and construction cranes with *Palfinger* (Austria). The jewel in its portfolio of partnerships is a truck distribution and assembly JV, *Mercedes-Benz Trucks Vostok* with *Daimler* (Germany), which also acquired 11% of the equity of *Kamaz*.

Source: Originally prepared by Irina Mihailova (Aalto University) based on interviews with the companies, and updated by Klaus Meyer. Additional sources: (1) RT, 2009, Daimler announces joint ventures with Kamaz, December 21; (2) ZF Kama, 2012, YouTube Video (www.youtube.com/watch?v=cj8QM8zPzw); (3) www.zf.com; (4) www.daimler.com; (5) www.palfinger.com; (6) www.kamaz.ru.



partial acquisition

Acquisition of an equity stake in another firm.

Shared control can also be established by an acquisition of an equity stake but not full ownership. Such **partial acquisitions** occur in particular (1) if a seller is unwilling to sell the business in full, or (2) if the previous owners are still needed to run the operation. For example, privatization agencies often sell only a small equity stake and keep the remainder.²⁶ *France Telecom* acquired a 35% equity stake in *Polish Telecom* in 2000, with local investors and the Polish Treasury holding the remainder. The company needed major improvements in efficiency, as standards in telephone and internet communications were lagging behind. For example, *Polish Telecom* employed far more people per customer than other European telecom service providers. This restructuring led to tough negotiations with trade unions that resisted layoff and outsourcing of jobs until generous redundancy payments had been agreed.²⁷

Partial acquisitions are also common for MNEs buying out entrepreneurial firms: if the entrepreneurs retain an ownership stake, they are probably more motivated to continue to pull their weight for the company. For example, when French luxury goods manufacturer *LVMH* acquired Italian fashion brand *Loro Piana*, the founder retained 20% of the equity and remained involved in the management. The advantage of partial acquisitions is to provide access to a firm that otherwise would be 'not for sale', while limiting the capital commitment. The main disadvantage of partial acquisition is that acquirers may have to implement organizational change without full equity control and thus without the power to enforce changes in structures or processes. In terms of risks, partial acquisitions face fewer investment risks because the initial capital investment is limited, and it is often easier to sell on again than a stake in a custom-designed JV. However, the risks arising from the integration process and potential conflict with co-owners are likely to be higher than in JVs.

JVs and partial acquisitions are special cases of a **strategic alliance**, that is, collaboration between independent firms in a given economic space and time for the attainment of a set of agreed goals. It can take various organizational forms, including using equity modes, non-equity contractual agreements, or both. However, the term strategic alliance is often used very broadly. Understanding the relationship between two firms normally requires a more detailed specification of contributions, control and risk-sharing arrangements. Therefore, we prefer to use more specific terms to describe the nature of a relationship between two firms.

HOW TO ORGANIZE YOUR OPERATIONS

In the classroom we can systematically analyze each aspect of entry strategy in isolation. Yet in the real world they are all interdependent, and decisions over multiple aspects have to be made together. Even operational strategies are important for the design of an entry strategy. Thus at the time of entry it is already necessary to consider how the operation will be run in the future, notably (1) marketing, (2) human resources and (3) logistics – issues that we will discuss in detail in Chapters 15 to 17.

First, a key issue in marketing is global standardization versus local adaptation of products, processes and brands. Advantages of standardization across the operations of the MNE include economies of scale in the exploitation of capabilities of the global firm, including product development, production and marketing. In contrast, local adaptation strategies aim to accommodate local needs and preferences. They normally require the creation or acquisition of local resources such as mass-market brands. This is common for instance in food and beverage industries. The Polish brewing industry is dominated by three global players: *Heineken*, *SABMiller* and *Carlsberg*. Yet most Polish pub revellers probably don't know this. The leading brands in Poland are *Tyskie*, *Zywiec* and *Okocim*, all of which are local brands

strategic alliance

Collaboration between independent firms using equity modes, non-equity contractual agreements, or both.

LEARNING OBJECTIVE

- 5 Explain the interdependence of operations and entry strategies

owned by one of the big three.²⁸ These brewing MNEs pursue multi-tier strategies that combine international premium brands with local brands aimed at the mass market – all acquired by taking over local breweries. The importance of local brands, however, implies that first-mover advantages and the acquisition of local brands were important, which put constraints on other aspects of entry strategy.

Second, human resources are critical to foreign entry because each subsidiary needs qualified and motivated people, especially to facilitate knowledge sharing within an organization. This involves both the transfer of organizational practices to the new operation and the tapping of headquarters into local knowledge. Foreign investors thus have to send expatriate managers, who lead in recruiting, training and motivating local staff. Expatriates play a pivotal role in coordinating between headquarters and subsidiaries, as do locally recruited people who can liaise with other units of the MNE. Firms with a pool of internationally experienced managers are better able to establish a new operation without a local JV partner.

Third, logistics is an important aspect of a foreign entry strategy because lower labour costs are only valuable for a business if the products can be transported to the customer in good time at acceptable cost. Likewise, serving a local market is only feasible if you can get your products to the customer in good condition at acceptable cost. Effective supply chain management practices are thus crucial capabilities for companies aiming to exploit synergies between operations around the globe. For example, modern transportation and communication systems enable MNEs to optimize the integration of their internal operations as well as supplier relations. A foreign entry often triggers changes in these systems. In particular, the choice of location for production sites is interdependent with the choice of logistics systems.

INSTITUTIONS AND FOREIGN ENTRY STRATEGIES

Foreign entry strategies are often constrained by the institutional environment in the host economy. Institutions may (1) prohibit certain types of operations or transactions, (2) create a need for local knowledge, (3) change the relative (transaction) costs of alternative strategies, or (4) motivate tariff-jumping FDI. Table 12.4 illustrates the possible impact of such constraints on entry mode and location decisions.

LEARNING OBJECTIVE

- 6 Apply the institution-based view to explain constraints on foreign entry strategies

Table 12.4 Institutional constraints on foreign entry

Types of constraints	Impact of entry mode (examples)	Impact on location (examples)
Certain operations or transactions are not permitted	● Establish JVs where WOSs are not permitted	● Locate where planning permissions are easier to obtain
Need for local knowledge	● Establish JVs to access local knowledge	● Locate in agglomerations of foreign investors that help attaining local knowledge
Higher transaction costs due to costly contract enforcement	● Avoid complex arm's-length contracts with unfamiliar partners	● Locate in areas where local uncertainty is lower
Higher transaction costs due to lack of financial intermediaries	● Avoid full or partial acquisitions of local firms	—
Higher tariffs or other trade barriers	—	● Locate production in the target market

First, some governments discourage or ban WOSs, thereby leaving JVs with local firms as the only entry choice. For example, the Indian government dictates the maximum ceiling of foreign firms' equity position in the retail sector to be 51%, forcing foreign entrants to set up alliances such as JVs with local firms. The Indian retail market is an attractive target for multinational retailers, as it is still highly fragmented. Yet foreign investors have to accept the ownership constraint. Thus in 2009, *Walmart* formed a 50/50 JV with *Bharti Retail* with the goal of setting up wholesale cash-and-carry stores throughout India. *Carrefour* negotiated a similar deal with the *Future Group* of Indian magnate Kishore Biyani, combined with a wholly owned wholesale operation, as foreign ownership in wholesale trade is not restricted.²⁹ Legal restrictions such as the building code also affect where hypermarkets are opened. For example, the inability to obtain planning permissions for new stores has been a major reason for the withdrawal of *Walmart* from Germany (In Focus 12.2).³⁰

Recently, there has been a general trend towards less restrictive policies, as many governments that historically only approved JVs now allow WOSs. As a result, there has been a noticeable decline in JVs and a corresponding rise in acquisitions in emerging economies.³¹ However, despite the general movement towards more liberal policies, many governments still impose considerable requirements, especially when foreign firms acquire domestic assets. For example, only shared ownership is permitted in industries considered strategic, such as automobile assembly in China and the oil industry in Russia. US regulations only permit up to 25% of the equity of any US airline to be held by foreign carriers, and EU regulations limit non-EU ownership to 49% of EU-based airlines.

Second, the institutional environment in many emerging economies is characterized by idiosyncratic rules and extensive use of networks. Such institutions, often characterized as 'weak institutions' by Western investors, create a need for local knowledge, local network relationships and other tacit resources held by local firms. For example, even after the legal restrictions have been removed, many foreign entrants use JVs to enter countries like China and Vietnam because they lack the necessary local knowledge and contacts. Hence foreign entrants are likely to see a greater need to cooperate with local partners, for instance by establishing a JV. An alternative route to access local knowledge is to locate near other foreign investors and to participate in the knowledge exchange within informal 'expatriate networks'.³²

Third, 'weak institutions' also increase transaction costs, such as search costs arising from information asymmetries and contract enforcement costs associated with inefficient legal systems. This implies that businesses are to a large extent based on relationships rather than arm's-length transactions. Licensing or franchising contracts with a stranger could thus be costly because they are difficult to enforce. Moreover, acquisitions are costly where financial market institutions are underdeveloped, for instance due to the lack of reliable accounting and auditing information and non-existence of intermediaries such as financial advisors and consultants.³³ Foreign investors may thus avoid complex arm's-length relationships or locate in advanced regions where legal uncertainties have been reduced.

Fourth, institutions inhibiting international trade may in some circumstances actually increase foreign entry with local production facilities. For example, local production allows entrants to overcome tariff and non-tariff barriers that inhibit serving a market through an export strategy. For example, *Ford* is operating a production facility in Vietnam at well below its efficient scale; yet it is important to gain access to the Vietnamese market. Another institution that may attract foreign investors is local content requirements that may induce manufacturers to ask their suppliers to set up a local operation.

DEBATES AND EXTENSIONS

This chapter has already covered some crucial debates, such as first- versus late-mover advantages. Here we discuss two recent debates: (1) the scale of entry and (2) the dynamics of acquisitions.

Scale of entry: commitment and experience

Small firms facing resource constraints typically enter with a small operation that they gradually expand, as suggested by the internationalization process model (Chapter 11). However, resource-rich companies face a strategic choice regarding the **scale of entry** between entering with a large up-front investment or with a small foothold operation. In some highly competitive industries, heavy up-front investment is required to prevent retaliation from incumbents or to realize first-mover advantages, as for branded consumer goods. A number of European financial services firms, such as *HSBC* and *ING Group*, have spent several billion dollars to enter the USA by making a series of acquisitions. The benefits of these large-scale entries demonstrate strategic commitment to certain markets. This both helps assure local customers and suppliers ('We are here for the long haul!') and deters potential entrants. Moreover, in some capital-intensive industries, for instance oil exploration, only large-scale operations are economically viable. The drawbacks of such hard-to-reverse strategic commitment are (1) limited strategic flexibility elsewhere and (2) huge losses if these large-scale 'bets' turn out wrong.

On the other hand, small-scale entry reduces the costs and risks of entry. They focus on organizational learning by getting firms' feet 'wet' – learning by doing – while limiting the downside risk.³⁴ Such **platform investment** provides investors with a small foothold from which to observe the local industry and to flexibly react to business opportunities if and when they emerge.³⁵ For example, to enter the market of Islamic finance in which no interest can be charged (per teachings of the Koran), *Citibank* set up a subsidiary *Citibank Islamic Bank*, *HSBC* established *Amanah* and *UBS* launched *Noriba*. They were designed to experiment with different interpretations of the Koran on how to make money while not committing religious sins. This capability cannot be acquired outside the Islamic world; it needs to be developed locally. Such development of new capabilities internally takes time. The main drawback of small-scale entries is a lack of strong commitment, which may lead to difficulties in building market share and capturing first-mover advantages.

Acquisition dynamics

Recall from Chapter 11 that internationalizing firms can use a range of different strategies to build resources specific to contexts they want to enter. The acquisition of a local firm can greatly accelerate this process. However, a single acquisition is often insufficient to create the operation that the foreign investor needs to achieve its objectives. Hence acquisitions are often followed by extensive restructuring and additional investments or divestments.³⁶ This leads to complex strategies involving acquisitions (Table 12.5).

In some cases, the subsequent investment completely overlays the acquired organization; we then talk of a **brownfield acquisition**.³⁷ In these cases, the foreign investor may be interested only in a particular asset, such as an operating licence, a distribution outlet or a brand name. Yet often this asset is not 'for

LEARNING OBJECTIVE

- 7 Participate in leading debates on foreign entry strategies

scale of entry

The amount of resources committed to foreign market entry.

platform investment

An investment that provides a small foothold in a market or location.

brownfield acquisition

Acquisition where subsequent investment overlays the acquired organization.

sale' on its own and can only be accessed by taking over the entire company. For example, cosmetics company *Beiersdorf* of Germany acquired *Pollonia-Lechia* in Poland, which owned the rights to the *Nivea* brand in Poland, yet had few other assets of interest. *Beiersdorf* added a new, parallel organizational structure to market the *Nivea* brand by Western standards, but operated largely independently of the old structures. This set-up allowed the restructuring to run smoothly. Once the new operation was up and running, the old structure was closed down.³⁸

Table 12.5 Types of acquisitions

Types	Purpose (example)	Risks
Conventional acquisition	<ul style="list-style-type: none"> Take over a company that has complementary resources and capabilities 	<ul style="list-style-type: none"> Not overpaying Post-acquisition integration
Brownfield acquisition	<ul style="list-style-type: none"> Obtain specific asset controlled by another firm but upgrade it to fit the global operation 	<ul style="list-style-type: none"> Very high capital investment Complex post-acquisition upgrading and integration
Multiple acquisitions	<ul style="list-style-type: none"> Build a strong market share in a previously highly fragmented market 	<ul style="list-style-type: none"> Very high capital investment Integration of multiple local units, as well as integrating them with the global operation
Staged acquisition	<ul style="list-style-type: none"> Take over a firm whose sellers are unwilling to let go, or where their continued commitment is important 	<ul style="list-style-type: none"> Integration process with initially limited control Uncertainty over long-term ownership structure

In other cases, foreign investors may want to build an operation that incorporates several local businesses, especially when the local industry is highly fragmented. Thus investors may pursue a strategy of **multiple acquisitions**, that is, a strategy based on acquiring and integrating several businesses. A single acquisition may be insufficient to build the kind of operation that the foreign investor aspires to, notably economies of scale and a leading market share. The acquisition of smaller firms in a new market may make sense only in the context of a broader strategy that involves further acquisitions. For example, *Carlsberg* in Poland acquired four different breweries – yet they still ended up in third place behind two competitors that were even more aggressive: *Heineken* and *SABMiller*.³⁹

We have noted before that some acquisitions only involve the acquisition of an equity stake – partial acquisitions. However, this is rarely a stable arrangement. Often the foreign investor soon increases its equity stake, sometimes based on a pre-agreed schedule. In such **staged acquisitions** the ownership transfer takes place over stages: what looks like a shared ownership arrangement to outsiders is actually a way to implement an acquisition. For example, in the case of *Skoda Auto*, VW initially acquired a minority equity stake but attained management control over the company in 1993. Thus VW led the restructuring of the company while it was still formally a JV with the Czech state. Only later did VW acquire full ownership and then fully integrate *Skoda* into its global operations. The advantages of staged

multiple acquisition
A strategy based on acquiring and integrating multiple businesses.

staged acquisition
Acquisition where ownership transfer takes place over stages.

acquisitions are, first, reduced political sensitivity; second, less up-front capital needs; and third, continued commitment of the previous owners. The disadvantages and risks are similar to partial acquisitions (Table 12.3).

IMPLICATIONS FOR PRACTICE

Foreign market entries represent a foundation for overseas actions. Without these crucial first steps, firms will remain domestic players. The challenges associated with internationalization are complex and the stakes high. Returning to our fundamental question, we asked: what determines the success and failure in foreign market entries? The answer boils down to the two core perspectives: institution- and resource-based views. Consequently, three implications for action emerge (Table 12.6). First, from an institution-based view, managers need to understand the rules of the game, both formal and informal, governing competition in each of their foreign markets. Entry strategies need to 'fit' these institutions, notably by complying with local regulation and informal norms, as well as by building legitimacy with local interest groups.

Table 12.6 Implications for action

- Understand the rules of the game in the host country – both formal and informal – and fit your strategies to the constraints and opportunities of these institutions.
- Bring together the MNEs' global capabilities and complementary local resources.
- Match the different elements of an entry strategy with the firm's strategic goals.

Second, from a resource-based view, managers need to bring together the capabilities of their MNE with complementary local resources. Few investors would be able to compete in foreign markets solely based on their existing resources: their liability of outsidership works against them. Different entry strategies allow building or acquiring local capabilities in different ways: a gradual entry with a platform investment would emphasize learning along the lines of the internationalization process models (Chapter 11), a JV would facilitate learning from the partner, while an acquisition would provide embedded capabilities of the acquired firm. With competition from both local firms and other foreign investors, managing your resources and capabilities is key to succeeding in foreign countries.

Finally, managers need to match the different elements of an entry strategy with their strategic goals. Decisions on one element influence other aspects. If timing and speed of entry are crucial for an investor – for example when pursuing first-mover advantages – then an acquisition or a JV may offer quick market access. On the other hand, if global integration of marketing, logistics and human resource management are important, then the existing structures and practices of an acquired firm may pose major obstacles, and a greenfield entry may be more appropriate. Thus foreign entry decisions have to reflect the complex interdependence of multiple dimensions. Decision-makers may develop alternative scenarios and compare their respective merits, for example, an acquisition of a specific firm in the Czech Republic versus a greenfield investment in a specific industrial zone in Poland.

Overall, appropriate foreign market entries, while important, are only a beginning. To succeed overseas, post-entry strategies are equally or more important. These would entail managing competitive dynamics (Chapter 13), developing global strategies (Chapter 14) and creating dynamic and efficient operations (Chapter 15 to 17).

LEARNING OBJECTIVE

- 8 Draw implications for action

CHAPTER SUMMARY

- 1 Explain why MNEs establish subsidiaries abroad (*why* to enter)
 - Firms' strategic goals can be grouped into four categories: (1) natural resources, (2) market, (3) efficiency and (4) innovation.
- 2 Identify relevant location-specific advantages that attract foreign investors (*where* to enter)
 - Foreign entrants seek locational advantages that match their strategic objectives.
- 3 Compare and contrast first- and late-mover advantages (*when* to enter)
 - First-movers can attain advantages, such as early brand building, yet there are countervailing benefits for fast followers.
- 4 Compare and contrast alternative modes of entry (*how* to enter)
 - Entry modes vary by the degree of control that entrants attain over the local operation.
 - Entry modes provide access to local resources in different ways.
- 5 Explain the interdependence of operations and entry strategies
 - Entry strategies need to take (1) marketing, (2) human resources and (3) logistics operations into account.
- 6 Apply the institution-based view to explain constraints on foreign entry strategies
 - Formal and informal institutions may restrict the options for foreign entry, create needs for local knowledge and increase transaction costs of certain forms of transaction.
- 7 Participate in leading debates on foreign entry strategies
 - These leading debates are (1) the scale of a foreign entry and (2) the acquisition dynamics.
- 8 Draw implications for action
 - From an institution-based view, managers need to fit their strategies to the constraints and opportunities of local institutions.
 - From a resource-based view, managers need to bring together the MNEs' global capabilities and complementary local resources.
 - Managers must match the different elements of an entry strategy with the firm's strategic goals.

KEY TERMS

Acquisition	Greenfield operation	Non-equity mode
Brownfield acquisition	Joint venture (JV)	Partial acquisition
Capability-enhancing FDI	Late-mover advantage	Platform investment
Efficiency-enhancing FDI	Location-specific advantage	Scale of entry
Entry strategy	Market-seeking FDI	Staged acquisition
Equity mode	Modes of entry	Strategic alliance
First-mover advantages	Multiple acquisition	Wholly owned subsidiary (WOS)
Foreign subsidiary	Natural resource-seeking FDI	

CRITICAL DISCUSSION QUESTIONS

- 1 Since joining the EU, countries like Poland and Hungary have seen an increase in FDI. Yet some foreign investors move their operations from these countries to locations further East, complaining about rising labour costs. Use institution-based and resource-based views to explain these changes.
- 2 From institution- and resource-based views, identify the obstacles confronting MNEs from emerging economies interested in expanding overseas. How can such firms overcome them?
- 3 In what situations should companies consider sharing control over an operation with a local firm that is directly or indirectly owned by the host country's government?
- 4 In what situations should branded consumer goods' manufacturers consider foregoing potential first-mover advantages and delay their entry until after a competitor has entered?

RECOMMENDED READINGS

- K.D. Brothters, 2013, A retrospective on: Institutional, cultural and transaction cost influences on entry mode choice and performance, *JIBS*, 44: 14–22** – an assessment of the state-of-the-art on entry-mode research.
- J.-F. Hennart, 2009, Down with MNE-centric theories! Market entry and expansion as the bundling of MNE and local assets, *JIBS*, 40: 1432–1454** – a conceptual paper that integrates the perspective of a foreign investor with that of local partner firms.

- K.E. Meyer & Y.T.T. Tran, 2006, Market penetration and acquisition strategies for emerging economies, *LRP*, 39: 177–197** – a study that illustrates many of the issues discussed in this chapter, using the case of *Carlsberg*.
- A. Verbeke, 2009, *International Business Strategy*, Cambridge: Cambridge University Press** – a textbook that develops concepts of business strategy out of the economics-based theory of the MNE.



CLOSING CASE

Thai Union acquires market access

A family business founded in Thailand in 1977 by a Chinese immigrant, *Thai Union Frozen Products Plc*, has become one of the world's largest seafood processors, with subsidiaries in Canada, China, France, India, Indonesia, Japan, Norway, the USA and Vietnam. By 2017, *Thai Union* sold seafood and related products for €3.6 billion, of which 37% were in the USA and 32% were in Europe; only 10% of sales were generated in its home market of Thailand.

Thai Union's international growth started with exports to Japan and the USA in 1988. In Japan, a JV with a local trading partner soon followed. In the USA, *Thai Union* went step-by-step to build up its market presence. Exports were followed by sales offices. In 1997, *Thai Union* purchased 50% of *Chicken of the Sea*, which was increased to full ownership in 2006; and in 2003, it acquired *Empress International*. In Europe, *Thai Union* made a big splash in 2010 by acquiring *MW Brands*, a French manufacturer and distributor of canned seafood, for €670 million. At the time, this was the second-largest outward FDI in Thai history. In 2014 to 2016, *Thai Union* added further European brands to its portfolio by acquiring *King Oscar* in Norway, *MerAlliance* in France and *Rügen Fisch* in Germany.

Thai Union's initial strategy focused on exploiting its lower cost base arising from (1) lower-cost skilled

labour in Thailand and seafood caught off the Thai coast, and (2) product diversification that enables full exploitation of the raw seafood. The best parts of fish or shrimp became top-end food products, while the residual was used for, for example, pet food.

The purchase of European brands was primarily motivated by market-seeking motives, but also added fishing and processing capacity. The acquisition of *MW Brands* increased the share of Europe in *Thai Union's* total sales from 11% to over one-third, thus reducing its dependence on the US market. *MW Brands* became market leader for tuna and other seafood products in France, the UK, Ireland, the Netherlands and Italy, with brands like *John West*, *Petite Navire*, *Conserverie Parmentier* and *Mareblu*. These brands represented a strategic asset that could also be exploited in further European markets. In addition, the acquisition also supported efficiency-seeking motives by adding four processing plants in France, Portugal, the Seychelles and Ghana to its existing facilities in Thailand, Indonesia, Vietnam and the USA, and by increasing its fishing fleet from four to nine vessels.

The ambitions of CEO Thiraphong Chansiri (the son of the founder) went even further. In 2015, he pursued a €1.3 billion bid for *Bumble Bee Foods* in the USA in an attempt to move into higher margin premium products in North America. Yet this acquisition failed over objections of the US authorities regarding the industry concentration in the seafood industry. However, he



acquired crab purveyor *Orion Seafood* in New Hampshire, USA, in 2015 and the majority of *Les Pêcheries de Chez Nous*, a lobster processing company based in New Brunswick, Canada, in 2016.

Competing in European and North American markets, however, created challenges that *Thai Union* had not encountered in Asia: pressures from NGOs. Informal norms in Western markets expect suppliers to secure high standards of environmental sustainability and treatment of workers, independent of where in the world the production is taking place – here, the catching and processing of fish. For example, Greenpeace accused *Thai Union* of abusing workers, especially those from Myanmar. *Thai Union* thus invested in upgrading its fleet and in other social responsibility initiatives to retain the momentum of its brands in Europe and North America.

By 2017, *Thai Union* had turned its focus to the fast-growing China market. Chinese consumers traditionally preferred fresh seafood, and for Chinese consumers ‘fresh’ means that the fish is alive when picked by the diner or by the cook. However, *Thai Union* saw opportunities in the markets for imported frozen seafood provided it came with the pedigree of a Western brand (there had been a few scandals involving domestic producers). *King Oscar* was chosen from the brand portfolio because it could best be translated and communicated to Chinese consumers. *Thai Union* saw a special opportunity in the Chinese demand for premium fresh seafood like lobsters and thus aimed to grow the exports of crab and lobsters from the USA and Canada to China.

Yet the Chinese market for fresh foods was challenging because distribution channels were highly fragmented. While urban middle-class consumers moved

online for much of their shopping, many were still reluctant to buy fresh foods online due to quality control concerns. *Thai Union* thus aimed to develop multiple channels. *King Oscar* branded fresh lobsters were sold via the *Tmall* platform for more than twice the price of most competing offerings. A high profile partnership was launched with *Hema* supermarket, a start-up company supported by *Alibaba*. *Hema* offered new forms of online-offline integration by providing a high-end shopping experience with opportunities to enjoy freshly prepared foods onsite, along with fresh food delivery within 30 minutes to customers living within a 3 km radius.

CASE DISCUSSION QUESTIONS

- 1 From a resource perspective, what are the key resources and capabilities that have enabled *Thai Union* to successfully enter markets in Europe and North America?
- 2 From an institutional perspective, what factors in the institutional environment at home and abroad have enabled or hindered *Thai Union's* global expansion?
- 3 How would you design *Thai Union's* strategy for the China market? Who would be appropriate partners, and what organization form would you choose?

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NOTES

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