EURODEV EUROPEAN BUSINESS DEVELOPMENT GROUP

WHITEPAPER

THE MARKET ENTRY STRATEGIES TO EUROPE FOR AMERICAN MANUFACTURERS

ABSTRACT

This whitepaper is created together with the University of Twente and EuroDev. It discusses American manufacturers' market entry strategies doing business in Europe. Furthermore it contains subjects such as international market entry modes, how entry modes relate to the internationalization process of SMEs, elements of SMEs choice of market entry strategy, factors influencing entry mode and market selection, classification of entry modes, and initial versus current operational strategies.

WHAT ARE INTERNATIONAL MARKET ENTRY MODES

'International market entry mode is as an institutional arrangement that makes possible the entry of a company's products, technologies, human skills, management, or other resources into a foreign country' (Root, 1994 p. 24). International market entry modes refer to the methods of business organization employed by companies to enter international markets for the purpose of undertaking value creating activities. Since these refer to both initial entry into a new foreign market and also successful development in that market, a more accurate term is international market entry and development (Young, Hamill, Wheeler & Davies, 1989).

Entry mode research is both important, timely and requires depth and subtlety, within a context in which many SMEs have increased prospects for growth (Autio, Sapienza & Almeida, 2000) but decreased prospects for survival (Sapienza, Autio, George & Zahra, 2006).

HOW ENTRY MODES RELATE TO THE INTERNATIONALIZATION PROCESS OF SMES

The establishment of an entry mode is an important element of the process of internationalization that has been discussed in previous paragraphs. The internationalization process indicates the formal organizational arrangements of business practices that; (1) cross borders; (2) transfer aspects of the business into the host country; and (3) indicate the form of return in terms of revenue and investment. Therefore the entry mode has legal, accounting, organizational and strategic implications (Jones, 2009).

Jones and Coviello (2005) propose a simple, descriptive model of internationalization as process linked events consisting of organizational learning, leading to entry mode and country choice in a dynamic process of resource commitment and change. The entry mode is positioned as a formal event linking post and antecedent processes.

The model describes internationalization as a dynamic process (such as networking, knowledge development and the establishment of organizational routines) leading to the establishment of an entry mode in a specific country. This in turn may lead to an altered internationalization state of the firm, leading to more, or less resource commitment. Further change in an organization may trigger the establishment of a new entry mode (or the same) in a new country (or the same). So, internationalization of an organization is described as a dynamic and entrepreneurial process of behavior wherein each entry mode established in each country represents a radical or incremental innovation. According to Schumpeter (1934) each adjustment of mode and country potentially creates new value for the firm.

ELEMENTS OF SMES' CHOICE OF MARKET ENTRY STRATEGY

Root (1994) points out to SMEs that planning entry strategies may appear to be something that only MNCs can afford to do. SMEs identify such planning with elaborate research techniques that are applied by specialists to a massive body of quantitative data. However this is a misconception. More important is the idea of planning entry strategies. Once this idea is accepted, it will find ways to plan international market entry, even if the company resources are limited. To state that a company cannot afford to plan an entry strategy is to say that it cannot afford to think systematically about its future in world markets.

An entry strategy for international markets is a comprehensive plan. It sets forth the objectives, goals, resources, and policies that will guide a company's international business operations over a future period long enough to achieve sustainable growth in world markets (Root, 1994). For most companies the entry strategy time horizon is from three to five years, which is the typical time period for achieving enduring market performance. Many organizations see entry strategy as a single plan. However, it is actually a composite of several product/market plans. Managers need to plan the entry strategy for each product in each foreign market.

The market entry strategies include a set of decisions, as presented in Figure 4: (1) the choice of a target market, (2) the objectives and goals in the target market, (3) the choice of an entry mode to penetrate the target market country, (4) the marketing plan to penetrate the target market, and (5) the control system to monitor performance in the target market. The elements in Figure 4 are presented as a logical sequence of activities and decisions. However, the design of a market entry strategy is actually interactive, with many feedback loops. For example, the evaluation of alternative entry modes may force a company to revise its target markets objectives or goals, and may even initiate the search for a new target market.

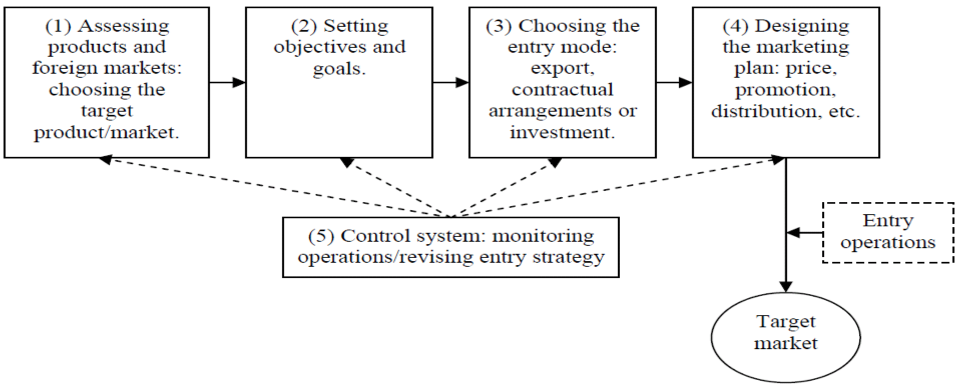

Figure 4. Elements of entry strategy (Root, 1994).

FACTORS INFLUENCING ENTRY MODE AND MARKET SELECTION

According to Root (1994), internal factors such as products resources and commitment are important to determine foreign entry mode. If the products are highly differentiated, then an export entry mode is favored, but if the products are technology intensive then contractual entry, such as licensing is preferred. Having varied resources gives a firm more entry options ranging from low to high commitment modes. External factors, such as home country and foreign market characteristics, environmental and production factors also affect the entry mode chosen for targeted countries.

Below two models are explained that describe the factors that are responsible for market selection and entry mode choice.

MARKET ENTRY AND MARKET SELECTION (MEMS)

Both internal and external forces influence the choice of foreign market selection and entry mode. Koch (2001) argues that these internal and external forces can be mixed, and thereby these forces can also be interrelated. Koch (2001) introduces a holistic model for market entry and market selection (MEMS).

FORCES	FACTORS FOR MARKET SELECTION	FACTORS FOR ENTRY MODE SELECTION
INTERNAL	Stage of internationalization	Company size / resources
	Company strategic orientation	Market locus of control
	Company strategic objectives	Experiencing in using MEMS
	Overseas market selection experience	Management risk attitudes
	Company international competitiveness	Market share targets
	Calculation methods applied	Calculation methods applied
		Profit targets
EXTERNAL	Country market potential	Characteristics of overseas country
	Competitive significance of the market	Business environment
	Anticipated overseas market risks	Industry feasibility / viability of MEMS
		Popularity of individual MEMS in the overseas market
		Market growth rate
		Image support requirements
		Global management efficiency requirements
MIXED	Own / Accessible resources	Competitiveness. Capabilities and skills required / available for each MEMS
	Networking	Sufficiency and reliability of information inputs
	Similarity / Proximity of overseas market	
	Market portfolio congruity	
	Expansion sequence optimization	

Table 9. Factors for market and entry mode selection based on MEMS model of Koch (2001).

The model indicates that internal factors, such as the strategic orientation and objectives, strongly influence the stages of internationalization and these are linked to external factors like market competitiveness and possible risk. External factors, like the host countries business environment and the feasibility of certain industries are affected by the companies experience and measures to handle risks. In deciding which market to enter, both external and internal factors rely on sufficient and reliable information.

The table concludes that interrelated forces affect market and entry mode selection, and demonstrated the complexity and dynamics of internationalization (Koch, 2001). This is in line with Johanson and Vahlne (2003), who suggest that the internationalization process is a mixture of strategic thinking, strategic action, emergent developments, chance and necessity.

FACTORS INFLUENCING INTERNATIONAL MARKET AND ENTRY MODE CHOICE

Perks (2009) developed a framework for international decision making. This framework includes six propositions which influence the entry mode choice of entrepreneurs in medium sized firms. The six influential factors are explained below.

PERSONAL FACTORS

Managers may have different biases for focusing their efforts on either domestic or international markets based on their educational background or prior experiences of living in other countries. Some organizations have a desire for concentrating their activities on domestic markets for fear of losing out to locally based competitors (McDougall & Oviatt, 1996). However, SMEs can improve their performance through international expansion. Some managers may have stronger international capabilities due to their prior international experience or ability to leverage their tacit knowledge about international opportunities (Peng & York, 2001).

PRODUCT/SERVICE AND RELATIONSHIP FACTORS

The decision about market entry mode may vary depending upon the nature of the product or service (Cloninger, 2004). The level of complexity of a product or service may determine the nature of supplier-buyer relations. With a complex product or service, users may want a direct relationship with the original source of the technology (the producer, or an intermediary service provider). Similarly, if the product requires education, customization of the needs to their needs or is subject to rapid technological change, then the buyer may demand direct links with the knowledge or technical source rather than a commercial intermediary (Rangan, Menezes & Maier, 1992). The buyer, or customer, is a critical influence on a firm's international strategy (Whitelock, 2002). If domestic firms build strong ties with internationally active companies, they may become client followers and start their internationalization process (Sharma & Blomstermo, 2003). Buyers may be important for strategic reasons, or because the relationship contributes to a significant level of revenues or profits. Consequently, the level of international involvement by the seller will rise as the significance of the relationship increases. In the internationalization process of the firm domestic and international customer networks also act as an influence on the internationalization process, particularly mode of entry (Coviello & Munro, 1995).

RESOURCES

A firm needs to support market growth and sustain competitive advantage through heterogeneous resources which are valuable, rare, inimitable and non substitutable (Barney et al., 2001). Arguably SMEs encounter more financial and managerial resource constraints than larger firms, when making the decision to enter international markets (Chetty & Campbell-Hunt, 2003).

ENVIRONMENTAL FACTORS

It is recognized that the environmental context shapes entrepreneurial strategies in particular internationalization (Rao, Erramilli & Ganesh, 1990). Customer preferences and the demands they make on suppliers affect internationalization decisions (Bell, 1995). For example, a domestic or international customer may require a supplier to sell directly to its subsidiaries in international markets. On the other hand the international customer may prefer to deal with locally based intermediaries. So, the industry environment can impact the entry mode decision.

CULTURE BARRIERS

When organizations consider engaging in foreign markets, managers have to cope with psychic distances and barriers in terms of culture and language which may disturb the flow of internationalization of a firm (Moen, Endresen & Gavlen, 2003). Marcella, Davies and Williams (2002) argue that the language element can cause a degree of ambivalence when making decisions about the entry mode. Organizations are more likely to select a market entry mode that will overcome language and cultural barriers, such as local agents if they lack confidence or are uncertain about a particular country. On the other hand if a company perceive cultural similarity between the home country and the potential market (Sharma & Blomstermo, 2003; Erramilli & Rao, 1993) they may be more likely to deal directly with customers.

CLASSIFICATION OF ENTRY MODES

Over the years, authors have offered different typologies of market entry modes. For example, Anderson and Catignon (1986) listed 17 mode structures ranging from small shareholder organizations to wholly owned subsidiaries (WOS), whereas Erramilli and Rao (1990) identified 11 mode types ranging from licensing and franchising to WOS and Greenfield ventures. Brouthers and Hennart (2007) classify these entry modes into two categories, contracts and equity, by which a distinction is being made on the basis of the methods whereby payments are made to input providers. These modes represent a variety of involvement from exporting through to wholly owned subsidiaries. This categorization adopts a variety of control, commitment and risk, but also differences in the nature of resources and rights transferred (Jones, 2009).

This is in line with Pan and Tse (2000) who collapsed the range of models into two categories: equity and non equity, which are often used for analytical purposes in current literature. However, this group classification of foreign entry modes has been adapted from Root (1994). Remarkably, Root (1994) classifies the entry modes into three main areas, namely export entry modes, contractual entry modes and investment entry modes. Appendix V provides an explanation of each entry mode and is based on Root’s classification. The explanations of the variety of entry modes are based on multiple theoretical sources (Root, 1994; Cavusgil, 2002; Ball et al., 2007; Hisrich, 2010).

Neelankavil and Rai (2009) ranked various entry modes by ease or difficulty. From Table 10 below it appears that an export entry is the easiest to implement, however the exporter does not have control of the operations and is not able to develop the full potential of the local market offers. On the other hand, a wholly owned subsidiary offers full control and the foreign company is able to exploit the market's full potential, this mode of entry is risky and takes time to implement. Two other modes of entry, joint ventures and licensing/franchising, do not offer control of the operations but are easy to implement. Table 10 presents a comparison of the ease and difficulties involved in the various entry strategies.

FACTORS	EXPORTING	LICENSING/ FRANCHISING	JOINT VENTURES	WHOLLY OWNED SUBSIDIARIES
Ease of entry	High	Medium	Medium/High	High
Speed to market	High	Medium	Medium/High	Low
Regulatory constrains	Medium	Low	Medium	High
Market penetration	Low	Medium	Medium/High	High
Access to customer feedback	Low	Low	Medium	High
Control of operations	Low	Low	Medium	High
Management commitment	Low	Low	Medium	High
Cost, tariffs, fees	Medium	Medium	Low	Low
Capital needs	Low	None	Medium	High
Profit potential	Medium	Low	Medium	High
Financial risks	Low	Low	Medium	High
Technology risks	Medium	High	Medium	Low
Economies of scale	High	Low	Medium	Medium
Nationalization risk	Low	Low	Medium	High

Table 10. Comparison of various entry modes (Neelankavil & Rai, 2009).

U.S. BASED SMES MARKET ENTRY INTO EUROPE

Prater and Ghosh (2005) researched U.S. based SMEs that were expanding into Europe. This paragraph is essential since this demonstrates exactly what the business model for SMEs in an international context is created for in order to create value by solving customer problems. The findings of Prater and Ghosh that are described are European entry and current operating strategies of SMEs, growth strategies and operational challenges and the use of collaboration.

EUROPEAN ENTRY AND CURRENT OPERATING STRATEGIES OF SMES

Once a firm has made the strategic decision to locate facilities overseas, it must then determine its entry strategy (Root, 1994). In comparing initial entry strategies and current operations strategies (Table 11), there is little difference. There is a growing use of more capital intensive strategies, such as establishing overseas subsidiaries and manufacturing facilities (Prater & Ghosh, 2005). In terms of initial strategies that SMEs use to expand into Europe, the key issue is cost. Entry strategies with the least investment are most preferred by SMEs. Operational strategies for SMEs focus on low cost options such as using local management or exporting. This can have negative long term as well as short term effects (Bernstein, 2001). However, MNCs have the financial capital to use joint ventures or buyouts as options in their international expansion. This supports Bantel and Osborn (1995), who found that smaller firms were more likely to have no identifiable strategy. They also found that SMEs tend to concentrate on means rather than the end in their operations. This may be due to competition and uncertainty that a firm has to deal with. So, when uncertainty is high, SMEs tend to rely on 'gut instinct' rather than a formal planning process.

INITIAL VERSUS CURRENT SMES OPERATIONS STRATEGIES	
Initial entry strategies	*Current operating strategy*
Using locally hired management	Using locally hired management
Alliances with foreign distributors	Overseas subsidiaries
Exporting	Overseas sales office
Overseas sales office	Alliances with foreign distributors
Overseas subsidiaries	Exporting
Licensing programs	Overseas manufacturing facility
Joint Ventures	Licensing programs
Overseas manufacturing facility	Foreign acquisition
Foreign acquisition	Alliances with foreign suppliers
Technology alliances with foreign companies	Joint Ventures
Alliances with foreign suppliers	Technology alliances with foreign companies

Table 11. Initial entry strategies versus Current operations strategies based on Prater and Ghosh (2005).

GROWTH STRATEGIES AND OPERATIONAL CHALLENGES

Once a firm established a presence in Europe, its next goal can be to establish a growth strategy in the short to medium term. Table 12 identifies the growth strategies of U.S. SMEs in the European market based on importance (Prater & Ghosh, 2005). Introducing new products and expanding into new markets are fairly well established growth strategies for firms. However, it is interesting to mention that upgrading operations technology is not used as a frequent growth strategy by SMEs.

There are also several operational challenges that SMEs must deal with. Operational challenges can be quite different than those encountered by the firm in its home market. Table 12 also lists the key operational challenges regarding U.S. firms physically operating in Europe.

U.S. BASED SMES IN EUROPE	
Growth strategy	*Operational challenges*
Introduce new products/services	Obtaining good financial data
Expand into new international markets	Improving quality
Expand into new European markets	Improving automation/technology
Upgrade financial systems and information	Managing inventory
Upgrade operations technology	Dealing with environmental issues
Acquire another company	Having reliable suppliers
Merge with another company	Improving turnaround time

Table 12. SMEs growth and operational challenges (Prater & Ghosh, 2005).

SMES AND COLLABORATION

Prater and Ghosh (2005) found that no US based SME doing business in Europe had any contractual agreement that was over 12 months long concerning a strategic alliance. This supports the idea that SMEs generally do not tend to make use of strategic alliances for collaborative operations. Research has found that while formal cooperation such as strategic alliances and joint ventures are common for large firms (Wyatt, 1992; Bowersox, 1990), smaller firms in general prefer flexible and informal relationships (Malecki & Tootle, 1996). However, this may be not applicable in other regions. SMEs in China found the use of joint ventures and strategic alliances very useful (Worldsources, 2000). This is pointing out the fact that the operational differences between SMEs in different international areas may be just as great as those differences between SMEs and MNCs (Prater & Ghosh, 2005). Additionally, legitimacy can be seen as a motivation to collaborate, whereby the local partner provides reputation benefits for a newcomer in the market (Inkpen, 2001).

CONCLUSION MARKET ENTRY STRATEGIES

An international market entry mode makes possible the entry of a company's products, technologies, human skills, management, or other resources into a foreign country. It is remarkable that SMEs foreign market entry has increased prospects for growth, but decreased prospects for survival.

It should be clear that internationalization theory as discussed in former paragraphs is closely related to entry strategies namely, internationalization is a dynamic process (such as networking, knowledge development and establishing organizational routines) which leads to an entry mode in a specific country. Developing a market entry strategy is a comprehensive plan. The plan should set forth the objectives, goals, resources, and policies that will guide a company's international business operations over a future period long enough to achieve sustainable growth in foreign markets.

Several models are identified that describe factors that influence the entry mode choice and selection of the markets such as the MEMS model by Koch, and the six influential factors by Perks. These models offer helpful knowledge in assisting SMEs doing international business.

A variety of market entry modes are described that can be in export entry modes, contractual entry modes, and investment entry modes. From the overview of the types of entry modes and the classification by Reelankavil and Raj, it should be clear that for example a traditional export entry mode is easiest to implement and that a wholly owned subsidiary is most risky to implement for an SME.

Although there is little literature available on small firms expanding internationally compared to larger firms, smaller firms often internationalize since they follow their clients because they are expected to do so concerning financial issues. In contrast, larger firms tend to plan and strategize their entry into foreign markets. In addition, strategic alliances and joint ventures are common for large firms. Noteworthy, smaller firms in general prefer flexible and informal relationships concerning foreign market entry.

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