Explain what factors a business has to take into account if it wants to internationalise.
Question A2

When a company decides to go international it has to consider the strategy for internationalisation. The strategy depends on internal factors such as availability of resources (financial, human resources), the degree of control a company wants to have, the knowledge it wants to gain as well as the speed of entry. Nevertheless, external factors play a vital role also on the perceived risk in a foreign country affects the decision as well as factors such as trade barriers, tariffs or competition and the market potential. A business has to carefully evaluate its internal and external factors in order to make a well thought out entry strategy decision. A company can usually use the following entry modes:

1) Export (indirect or direct)
2) Franchising / Licensing
3) Joint Ventures (equity and non equity)
4) FDI (Foreign Direct Investment) >Greenfield Investment, Merger and Acquisition

In the following each main strategy is explained with its advantages and disadvantages and to analyse which strategy is best suitable for a developing country with low tariff barriers.

1) Export

* Export is an easy way to sell products to a foreign market, because it involves less risk compared to other forms of entry, it is fast and a country can be penetrated quickly. Exports means selling products
goods domestically and selling it to foreign markets. Usually, exporting has the following advantages and disadvantages:

**Advantages**
- Speed to market.
- Minimum risk / less resource commitment required.
- Lack of capacity of foreign companies.
- When low tariffs available.
- Gaining market knowledge.

**Disadvantages**
- No high control of foreign operations.
- Not suitable when products need high adoption.
- Company is seen as outsider → limited sales potential.
- Gaining knowledge, but slowly compared to other forms.
- Not suitable when high entry barriers → high tariffs.

Another way of market entry is Licensing / Franchising.

2) Licensing / Franchising

It means selling a production process, trademark, brand-name, marketing-concept or software for a royalty fee for a specific time to a foreign company. This has the following advantages and disadvantages:

**Advantages**
- Circumvent trade barriers
- Low risk
- High Return on Investment (ROI)
- Speed to market
- Less resource commitment
Disadvantages
- Licensee can become a competitor
- Licensee does not stick to agreements e.g. production capacity, quality
- Can damage brand image
- No control of operations abroad
- No gaining of own market knowledge

Another form of entry is through Joint Ventures.

3) Joint Venture

By this is meant that to companies coming together for a specific project and objective to share resources, knowledge, production capacity, as well as research and development. This mode has the following benefits and drawbacks

Benefits
- Shared risk
- Gaining of market knowledge
- Access to foreign suppliers, customers, contacts
- Seen as foreign company
- Speed to market

Drawbacks
- Shared profits
- Power conflicts
- Partner can become competitor
- Language / cultural barriers
- Medium-to-high resource commitment.
Another form of entry is through foreign direct investment.

Foreign Direct Investment (FDI)

* FDI can either be in form of buy a foreign company or buy building a company/facility from scratch. FDI has usually the following advantages and disadvantages:

- Advantages
  - High control of operation abroad
  - No profit sharing
  - Gain in-depth market knowledge
  - Knowledge of customer wants and needs
  - Quick reaction to changing environment

- Disadvantages
  - High risk of operation
  - High resource commitment (financial/human)
  - Can be seen as outsider (greenfield)
  - Difficult to integrate bought company into culture

As a result, every entry mode has its own benefits and drawbacks and companies have to make a trade-off when deciding for the right entry mode. In the following each entry mode will be illustrated with an example.

Example 1: Export

A company who is producing computers exporting its products to foreign countries, for example, Lenovo is producing in China and exports to countries such as Germany, UK, Japan or America. Easy and low risk internationalisation strategy.
Example 2: Licensing / Franchising

McDonald's, for example, is a franchise company who sells its concept for a fee to a franchisee. Good for speed to market and enter foreign countries with relatively low risk and commitment.

Example 3: Joint Venture

Volkswagen and a Chinese automobile company formed Shanghai Automotive to produce cars for the Chinese and Asian market. They share productive capacity as well as knowledge and profits.

Example 4: Greenfield Investment

When the risk in a foreign country is low and the sales potential high companies, for example, H&M setting up their own retail stores in foreign countries to fully take control of operations and profits.

Selecting the best entry mode

A developing market usually involves a higher risk compared to advanced countries, for example, political risks, economic conditions, infrastructural barriers and a potential for conflicts. Companies usually want to take part of it, because developing countries offer potential opportunities for increasing profits and market share and enable companies to gain economies of scale.

In this case, export is the best one for entering a developing country.
Export in developing countries with low tariffs minimise the risk for a company to be too committed, for example, with financial and human resources and at the same time increase the speed of entry to the market and enabling economics of scale. Exports are usually used for two reasons: (1) gaining economies of scale; (2) gaining (experimental) knowledge of a foreign country. However, an export operation can be difficult as documentation are essential in international trade.

Export Procedures

Within an export operation a company usually needs the following documents:

- **Commercial Invoice**: Invoice from the seller for the buyer containing data such as: Buyer, Seller, Origin, Description, Port load/unload, description of goods, net weight, gross weight, volume, terms, insurance, bank information, value of goods to determine custom value.

- **Bill of Lading**: When shipped by a vessel the carrier provides shipper with a negotiable or non-negotiable Bill of Lading. It is a contract between carrier and seller/consignee of the goods.

- **Certificate of Origin**: To claim preferential trade agreement this certificate needs to provided.

- **Packing List**: A list of all goods within a shipment.
**Letter of Credit:** When payment is made through a letter of credit, this has to be provided as well.

**Certificate of Insurance:** Certificate stating that goods or parts are insured against agreed risk of loss and damage.

Depending on the products, other forms and documents may be needed, for example, "declaration of dangerous goods." Therefore, to minimise the risk of wrong or not having all documents provided, companies can make use of export management companies or through freight forwarders.

Furthermore, low tariffs in a developing country do not make the goods expensive, which means customers with limited money can afford to buy these products and increasing the company’s revenues.

### Example Low Tariff vs. High Tariff

<table>
<thead>
<tr>
<th></th>
<th>Low Tariff</th>
<th>High Tariff</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Value of product:</strong></td>
<td>£1000</td>
<td>£1000</td>
</tr>
<tr>
<td><strong>Insurance:</strong></td>
<td>£200</td>
<td>£200</td>
</tr>
<tr>
<td><strong>Shipping:</strong></td>
<td>£100</td>
<td>£100</td>
</tr>
<tr>
<td><strong>Duty:</strong></td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td><strong>Duty Paid:</strong></td>
<td>£1100</td>
<td>£260</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td>£1430</td>
<td>£1560</td>
</tr>
</tbody>
</table>

This example illustrates how a tariff can increase the price of a good when exported to a country with high tariffs. Especially, it's attractive to export to developing countries with low export tariff barriers.
Indicators of Export / Trade

Governments of countries usually measure the imports and exports in its country and certain indicators such as

- Intra-Industry-Trade
- Flow of investments (FDI)
- GDP (Gross Domestic Product)

are good indicators to evaluate, monitor and measure trade between countries. Therefore, governments can take control and take actions based on it, for example, lower trade barriers to stimulate demand or investments. However, developing countries even increase its tariffs, for example, Brazil in order to stimulate domestic investments into the country or by trying to protect its domestic companies.

Excellent work!