Entry Strategies in Emerging Countries

Relatore: Prof. Paolo Boccardelli
Correlatore: Prof. Stefano Manzocchi

Filippo Mattia Pollavini
Matr. 619391

Academic Year 2009/2010
To my family
“Do what you can, with what you have, where you are.”

Theodore Roosevelt
# Table of Contents

READERS GUIDE ......................................................... 7

INTRODUCTION ......................................................... 8

1 - INTERNATIONALIZATION PROCESS AND EMERGING COUNTRIES ........................................ 10

1.1 FIRMS STRATEGIES OF INTERNATIONALIZATION: THE THEORETICAL BASE .................. 10
1.2 NEW INTERNATIONAL TRENDS ......................................................................................... 18
1.3 THE GLOBAL VALUE CHAIN AND THE EMERGING ECONOMIES .................................. 20

2 - WHY EMERGING COUNTRIES? ..................................................................................... 23

2.1 EMERGING COUNTRIES ............................................................................................... 24
2.2 EMERGING MARKETS AND PROFITABILITY ............................................................... 27
2.3 EMERGING ECONOMIES AND DIFFICULTIES ASSOCIATED ....................................... 30

RESEARCH
ENTRY BARRIERS
INVESTMENT RISK
MARKET FAILURES AND CORPORATE COUNTER-STRATEGIES

2.4 INTERNATIONAL STRATEGIES AND EMERGING MARKETS ................................... 35

GLOBAL COUNTER STRATEGIES
SEEKING LOW-COST FACTORS: A MODEL FOR FRAGMENTATION OF PRODUCTION OPPORTUNITIES AND THE PYRAMID
LEVERAGE AND PRODUCT INNOVATION

2.5 SOCIAL EMBEDDEDNESS AND NON TRADITIONAL PARTNERS .................................. 44

BUSINESS GROUPS

3 – COUNTRY ANALYSIS AND STRATEGIC PLANNING ................................................. 49

3.1 EMERGING COUNTRY ANALYSIS ............................................................................... 49

COUNTRY PORTFOLIO ANALYSIS (CPA)
5-CONTEXTS FRAMEWORK
POLITICAL RISK ASSESSMENT

3.2 STRATEGIES IN EMERGING ECONOMIES: THE THEORETICAL PERSPECTIVES

INSTUTIONAL THEORY

TRANSACTION COSTS THEORY

AGENCY THEORY

RESOURCE-BASED VIEW

3.3 STRATEGY INTEGRATED FRAMEWORK FOR EMERGING ECONOMIES

3.4 PARTNER SELECTION

4 – ENTRY MODE CHOICE

4.1 ENTRY MODE STRATEGY SET

4.2 DETERMINANTS AND VARIABLES AFFECTING ENTRY MODE CHOICES

INVESTING FIRM SPECIFIC DETERMINANTS

TIMING OF ENTRY

4.3 ENTRY MODE CHOICES

INSTITUTIONS, RESOURCES AND ENTRY STRATEGIES

BARGAINING POWER AND ENTRY MODES

ORGANIZATIONAL CAPABILITY

OLI ADVANTAGES AND ENTRY MODES

4.4 MARKET PENETRATION STRATEGIES

CASE STUDY – PERFETTI VAN MELLE INDIA LTD.

CONCLUSIONS

REFERENCES

ATTACHMENTS
TABLES AND FIGURES

Table 1 – Integration and responsiveness in MNCs types p. 17
Table 2 – Private sector development strategy/cross border linkage policies p. 19
Figure 3 – Emerging Economies GDP vs. Advanced Economies GDP p. 27
Table 4 – Types of market failure and choice of mitigating corporate strategies p. 34
Table 5 – Competitor Analysis Framework for Emerging Markets p. 36
Figure 6 – Fragmentation and multinational production p. 39
Table 7 – Limitations of the transnational model: interview p. 41
Figure 8 – How specific attributes of company’s products compare in EM and HM p. 43
Table 9 – How groups can add value p. 46
Figure 10 – CPA of an American fast food group p.51
Table 11 – Labor Market (example of a 5-contexts framework) p. 52
Table 12 – A general framework for political risk assessment p. 54
Figure 13 – Competitive advantage, Managerial ties and Market Orientation p. 61
Figure 14 – The institution based view: a third leg of a strategy tripod p. 67
Table 15 – Partner selection determinants in Emerging Market Contexts p. 69
Table 16 – Twelve entry strategies and their variants p. 78
Figure 17 - Twelve entry strategies and their variants p. 79
Table 18 – Costs of alternative strategies compared with the profit norm p. 80
Table 19 – General entry mode choice determinants p. 83
Table 20 – Investing firm specific determinants p. 85
Table 21 – Resources, Institutions and entry modes p. 90
Figure 22 – A transaction cost framework and the efficiency of entry modes p. 91
Table 23 – Market Penetration strategies p. 95
Table 24 - Indian Macro Economic datas p. 98
Table 25 - Indian Key development indicator p. 98
Figure 26 – Global composite indexes p. 99
Figure 27 - Political Indicators p. 101
Figure 28 - Key business risk to foreign investors p. 105

Attachment 1 – Questionnaire to identify institutional voids p. 71
Attachment 2 – India Governance Indicators
Readers Guide

- Internationalization
  - Pros:
    - Low costs
    - Market growth
    - Leverage
    - ...
  - Emerging countries
  - Contros:
    - Barriers
    - Market failures
    - Partners
    - ...
  - Specific-EC analysis
    - Strategy elaboration
      - Determinants
      - Entry mode choice
        - Partner selection
        - FDI
The literature of International Business has still many unanswered questions about reasons and determinants of success and failure of firms on the global stage as well as the effectiveness of drivers concerning global and international strategies. Scholars and managers have traditionally referred to two frameworks, the *industry-based view* by Porter (1980) and the *resource-based view* by Barney (1991). These extremely influential perspectives deal with the two fundamental dimensions of firm strategies, on one hand the *industry* intended as environment and on the other hand, a firm’s *specific resources* intended as internal matter. Porter’s framework explores the environment that determines strategies in an industry, whereas Barney’s view focuses its analysis on a firm’s resources in terms of competitive differences and advantages. More recently, these two theories have been criticized because of their weakness not considering the institutional context which determines the competition between firms in the industrial field industries (Hoskisson et al. 2000; Peng 2002; Meyer and Peng 2005; Wright et al. 2005; Meyer et al. 2008). Basically, the reason of such failure in assuming institutions as mere “background” is explained by Porter and Barney’s reference country of research. These scholars chose the United States, an environment that assumes stable and market based institutional frameworks (Peng 2007). None of these kind of assumptions can be considered within the Emerging Economies (EEs). The increasing prominent position of such countries calls for a review of the determining elements in elaborating international strategies for firms. Therefore the major challenges for conventional theories are emphasized according to the extent to which developed economies differentiates their institutional contexts from the social, political and economic environments of EEs (Wright 2005). Multinational Companies (MNCs), as a consequence, should develop organizational structures that fit into environment, strategy, and processes in a progressive integration with the countries that they target for investments. John A. Mathews (2002) correctly points out that global reach, global capabilities and global synergies can be achieved only through global strategies: these can be
seen as a preeminent source of advantages, since for instance (referring to Porter’s view) “a viable framework must incorporate analysis of global competitors, particularly in terms of cultural profiles that will dramatically influence strategic choices” (Nielsen, 2005, p.418).

So how can MNCs develop successful global strategies and dominant positions by entry in EEs? How should firms choose the entry modes in emerging countries (ECs)? And finally, how and why can EEs be considered crucial steps in building such advantages?

Our answers to these questions are the crucial introductory elements of this essay.
Chapter 1
Internationalization process and Emerging Countries

- Firms strategies of internationalization: the theoretical bases
  (research following L. Melin, 1992)

The path toward the definition of an EC-based strategy necessarily starts with an analysis of the main internationalization theoretical frameworks. As Welch and Luostarinen wrote (1986) internationalization can be defined as a sequential process of increasing involvement in international operations. Furthermore, John A. Mathews (2002) poses internationalization needs as integration mechanisms: as a process of firms that gradually become integrated in the international stage. From this point of view the concept of integration covers both push and pull cases “seeing the global economy as pre-existing and offering resources to the firms that seek strategic involvement at this level”. In this case the emphasis is on the process of exploiting opportunities in the global economy which particularly help in defining emerging countries as strategic targets of MNCs international strategies. We are going to go deeper into these kind of opportunities in the next chapters but, for the moment, we can argue that the language of resources, the global leverage of capabilities, and the research of economies of scale and scope exploiting the global environment (namely, the opportunities coming from ECs specificities), provide a strong framework concerning the international activity of many MNCs.

So, we can say that the Resource-based view of internationalization turns out to be a powerful approach in understanding the dynamics of inter-firm competition (Mathews 2002), as well as the Institutional frameworks, that actually constitute a step forward in international investment activities. When these two aspects are combined we are given a fair view of how emerging countries specific characteristics can be exploited.
The essence of the international dynamism of companies inspires an interesting picture of how industrial economy has developed its presence worldwide. There are two views which explain how a such global phenomenon has happened. The standard economic field, maintains an atomistic view of the different firms around the globe, highly individual operations and independent value chains. Instead the Network economy sees the global economy as an extremely interconnected network at firm level. A picture of the global industrial economy is populated by thousands of firms, cross-linked with each other with chains of linkage, constituted of several forms of aggregation called value-adding partnerships (VAP) (Mathews 2002). These are the units that compose “the new zoology of the networked global economy”.

As many scholars have actually recognized, the field of international business has in itself a natural lack of common theoretical base concerning internationalization. This is explained by the many and more frequent areas that compose this vast subject (e.g. Finance, Human resources management, FDI, Coordination and Control in MNCs, Host government relations, Cross Cultural aspects etc). But, if we consider internationalization as a strategic step for firms in obtaining global competitiveness as well as domestic advantages, we can reduce the several theoretical frameworks to only a few, clear views.

Welch and Luostarinen (1988) explain internationalization as a Longitudinal process that is developed through the time-dimension. It incorporates four different approaches: In type A (Time series of events), the longitudinal process is a composition of detached events or states that have characterized the firm during its history; In type B (Relatively short episodes), the time period varies from a few weeks to a few years, and the process is analyzed by studying single episodes or transitions; In type C (Lengthy epoch), varying from 2 to 20 years, the process is a lengthy revolutionary epoch implemented by an influential CEO or during a long evolutionary changing period of the firm strategy; In type D (Biographic History) the whole development of firm since its foundation till the present time is considered.
The longitudinal process has been criticized starting from a substantial dichotomy that characterizes internationalization: process vs. content. Process intended as a mere changing path in fact (as Welch and Luostarinen actually did), does not focus on contents. This is misleading and thus it should be avoided (Melin, 1992).

Furthermore, there is the product cycle model developed by Vernon in 1966. This pillar of internationalization perspectives of firms relates in content, product, and process, which are seen as a path towards the achievement of economies of scale in production. Vernon tried to call for more realism versus the dominating comparative-cost-advantage theories, emphasizing the role of product innovation, the effects of scale economies and the role of uncertainty in influencing trade patterns across national borders (Vernon 1966). The product cycle model is made up of the introductionary stage, with a domestic-based market; the growth stage, where export activities and FDI are made in expanding demand countries; the maturity stage, where major markets become saturated and products standardized, and where a delocalization of production toward low factor cost countries is implemented. Finally in the decline stage, production and sometimes also sales are entirely relocated to countries where the first stage of the cycle has not been implemented. McKiernan (1992) observed though that the descriptive value of this stage-model is weak regarding products with short life cycles and it can be applied mostly to companies that are internationalizing and not to those that are already MNCs. The main contribution made by Vernon can be resumed in the conclusion that an increasing product maturity allows more possibilities to the firm if it leaves production operations detached from corporate decision making centres as well as product development ones.

In our opinion one of his most influential conclusions is that re-localization of production activities should be based on country level analysis: mainly exploiting factor cost advantages, technological know-how and other several national specific features, nowadays one of the main carriers for entry strategies in ECs.

Another important view of firm internationalization is the Internationalization process model (1977). The so-called Uppsala framework considers
internationalization as a gradual and increasing commitment to foreign markets and operations through a process of logical steps of international behaviour (Johanson and Vahlne, 1977). The internationalization is started by neighbour markets and only successively gains greater physical distance. This is because in nearer countries there is a less perceived market uncertainty: we observe however that this view does not consider the homogenization of even geographically distant markets, namely thanks to the Westernization of customs and habits that nowadays involve the larger part of countries in the world. This implies that the criteria for market targeting, also thanks to a substantial decrease of international trading costs, may not be a unique guarantee for the best performances. A Scandinavian firm entering into a nearby Eastern Europe country for instance, may face the same or even more cultural concerns than if he enters a more distant country. Except for Muslim countries, EEs prefer the developed ones which are complying more and more to western customs and to a market economy: geographical proximity may be a misleading factor, cultural distance is another matter (see chapter 3).

Dunning (1980; 1988) develops the so-called Eclectic paradigm. This approach is interesting because it enhances the involvement of firms in de-localization of operations through the three kind of advantages that can be reached. Ownership-specific advantages, Internationalization advantages, and Localization advantages: these steps base their burden on transaction and factor cost savings through the rational decision in making investments (see chapter 3 for a deeper review of the model). However, Buckley (1991) argues that the process of internationalization is not explained by Dunning, but only the existence and the reasons to develop a MNC. Neither do Johanson and Vahlne even try to explain why firms internationalize. Melin (1992) in fact states that the Internationalization process proceeds along the presented stages regardless of whether strategic decisions in this direction are made or not. In other words, the determinism that characterizes the internationalization process path does not contemplate the implementation of other strategic options like leapfrogging of intermediate stages may be common (Hedlund and Kvenneland, 1984).
Another understanding of how internationalization affects firm strategies is explained in “Strategy and Structure” by A.D. Chandler. From this point of view, International Business, seen as a cause of diversification in firm activities leads to new and emerging problems of organizational structure: in other words, Structure follows Strategy. Stopford and Wells (1972) found that MNCs following similar strategies even in quite different industries have developed similar organizational structures. This can be crucial within an international strategy assessment, mainly for the managers knowledge of how their firms should adapt in this kind of process. In this case, since there can be similar outcomes in firms’ international structural accommodations, an a-prior theoretical framework may be developed in order to facilitate companies in their global spread. Stopford and Wells argued that regarding the larger US firms, an initial phase of international structure characterized by several semi-autonomous subsidiaries was followed by the implementation of an international business division, able to enhance fair control and coordination. This strengthened the need for a global perspective, and had its consequences in the adoption of two new global structure organizational standards: the worldwide product division and the geographic area division for all products. The first was the dominant choice of high product diversity firms, the second emerged in firms with greater geographic diversity.

On the same lines, Franko (1976) focusing on European MNCs, demonstrated that most of them maintained the parent-subsidiary form (direct ties head office-autonomous subsidiary), without choosing an international division as an intermediate form before ending up in the worldwide product structure. His conclusion was that structure does not follow strategy in continental Europe, unless the competitive environment forces this kind of choice. Melin (1992) notes that while Stopford and Wells determined a major finding in describing the changing of organizational structures due to internationalization, they have perhaps failed to explain “the process dimension of how they changed it”. They simply emphasize formal aspects of structure as de-facto steady states in the process of internationalization. The difficulty in the exploration of the
internationalization essence as an evolutionary process from an organizational point of view is indeed clear.

A solid framework was established by the Stepford and Wells in the so called grid structure too, apparently shifting from the formal view on structure to a more dynamic view of fluid aspects of structure. From hierarchical ties to contractual management, from agency and control problems to cooperation and shared values, within a matrix structure that involves the firms internal entities in organic mechanisms. This emphasis on the internal relationships of a firm called for studies on decision making centralization and bureaucratic control mechanisms. Martinez and Jarillo (1989) noted that MNCs are characterized by both a formal and informal mode of control, a consequence of increased dispersion as well as the need for integration, mainly due to geographical fragmentation of the firm.

According to Doz and Prahalad this whole field of multinational management literature is too ”architectural” to be consistent with a complete analysis of the internationalization process. So, in 1984 they identified two imperatives for MNCs managers. The economic imperative (a) and the political imperative (b):

(a) global competition push for a transcendence of the national market boundaries: the lack of control and dynamic co-ordination over global operations could be crucial.

(b) The political imperative enhances a sort of local responsiveness, especially regarding consumer demands and distribution channels which match a greater autonomy of the subsidiaries and the implementation of adjusting relations with host government demand.

In the end, actually, no specific structure can solve internationalized organizational structure dilemmas, but it can merely help in defining more and more efficient arrangements. A strategic control in multinational companies can be the most efficient tool in dealing with these kinds of processes, sub-processes of change and collection of management tools (Doz and Prahalad, 1984). The first
Filippo Mattia Pollavini

has three dimensions: cognitive perspective, strategic priorities and power allocation. The second one is of three kinds as well: data management tools, manager management tools and conflict resolution tools (global integration vs. local responsiveness). This framework calls for a Multifocal strategy: “no a-priori assumptions of dominance of one model over the other” (Doz and Prahalad, 1986). Their main conclusion is that positive performance is the result of tension between defenders of national responsiveness and those of global integration: a fair concept of big MNCs who invest in EEs, as well as in operating facilities and product markets. This tension between global and local dimension is tested by Harzing (2000), but for a more advanced comprehension of how the strategies are involved in these different patterns, we should analyze the main typologies of MNCs that are distinguished by all the major studies (Bartlett and Ghoshal 1989; Welge 1996; Roth and Morrison 1990 etc.). Firstly, because they reduce the complexity of multinational organizations into manageable numbers of related characteristics, secondly because organizational typologies can be used in a predictive way especially when considered features are grouped together in different typologies, we might be able to predict the remaining elements, thanks to the presence of one or more of these characteristics in other samples (Harzing, 2000).

There are therefore three general types of Multinationals: Multidomestic, that combines low integration and high responsiveness1; Global, combining high integration and low responsiveness; Transnational, that enhances a high integration as well as a high responsiveness. While nearly all studies agree on the first three models, International firm is simply equated by several authors to the Transnational, but we will try to differentiate it from the others as some scholars

---

1 "Integration of activities is the response of the international firm to pressures to reduce overall costs and maximize return through exploiting market imperfections inherent in the multi-location aspects of its operations; Responsiveness is required with regard to market and regulatory forces in its many locations: the firm attenuates the rigors of standardization and/or co-ordination as necessary, and thus becomes more locally responsive". (James H. Taggart, 1997)
actually did (Goshal and Welge), even if it is commonly recognized that it is not simple to empirically verify it.

The table below shows the types of MNCs with reference to the degree of integration and responsiveness.

### Table 1 – Integration and Responsiveness in MNCs types.

<table>
<thead>
<tr>
<th>Integration</th>
<th>Responsiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>International firm</td>
</tr>
<tr>
<td></td>
<td>Multidomestic</td>
</tr>
<tr>
<td>High</td>
<td>Global</td>
</tr>
<tr>
<td></td>
<td>Transnational</td>
</tr>
</tbody>
</table>

We can also approach this kind of argumentation thanks to other contributions. In particular, we have evidence of empirically tested typologies, based on the Bartlett and Ghoshal model, by Leong and Tan (1992). Senior executives of some MNCs were asked to classify their companies, secondly to evaluate and schematically analyze their configuration by assets and capabilities, roles of overseas operations and diffusion and development of knowledge. This kind of assessment confirmed the ineffectiveness of the “International Firm” typology, mainly because the comparison and parallel evaluation of the different cited typologies, emphasized differences especially between Multi-domestic, Global and Transnational (that revealed the same outstanding features of the International one). This classification, even based on simple and limited number of characteristics, is generally accepted by scholars.

To conclude this review of the general patterns of study around firm internationalization and models of MNCs analysis, we can pose some questions:
Are these frameworks only useful for scholars in order to develop theoretical bases about the behaviour of companies on the international stage or are these also solid bases for MNCs agents, managers in particular, in order to gain advantages on global stages?

Consequently, to which extent managers can benefit from more and more accurate researches and model structures within the framework of international firms?

- New International trends

The last part of this first introductive chapter will focus on the new trends of international networking and strategy development, related to emerging, transition and developing countries. Here we will analyze host country behaviour on inward FDI from MNCs.

First and foremost, everyone agrees that governments have, over the last few decades, pursued relevant private sector strategies. As Peter Wad (2006) argues, four types of strategy have been realized: State led strategy, which enforces networking and linkages between foreign investors and domestic companies; Strategic targeting strategy which builds competitive sector advantages through cluster development in strategic industries; Open door strategies, where the advanced factor of production and supporting sectors are under government planning; and finally the passive, laissez-faire strategy which substantially promotes the market as a wealth and development natural engine.

These kind of considerations are the pro-domo in focussing on EMs. The reason is that when the private sector is promoted, a fundamental contribution for domestic development is carried out (Schulpen and Gibbon, 2001), and the ECs focus of interest is development, economic growth, spread of wealth etc.: a dependent variable of growth in the private sector is in a new market economy. This general trend which has been pursued by economies has pushed for the international dynamism of MNCs that, looking for global costs and scale advantages, have built up new lucrative business global dimensions. On the other hand, as Porter (2004) argues, transition and developing economies main challenge, consists in
overcoming their own labour costs and raw material-abundance attractiveness, through production of technology and marketing activities improvement, moving up the value chain. Nowadays, both the aspects, MNCs dynamism on one side, and EEs challenge for domestic development on the other, can actually be considered the most relevant aspects in dealing with this argument.

Regarding this cross-border developmental linkage formation, Peter Wad and Soren Jeppesen (2006) elaborated a matrix that summarizes how the private sector is strategically developed by hosting countries with reference to: local firms, TNCs and internal upgrading (see table 2).

Table 2 - Type of Private sector development strategy and cross border linkage policies

<table>
<thead>
<tr>
<th></th>
<th>Support for local firms</th>
<th>Support for TNCs</th>
<th>Support for cross-border linkage formation and upgrading</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State-led strategy</strong></td>
<td>General &amp; Specific</td>
<td>Specific</td>
<td>-</td>
</tr>
<tr>
<td><strong>Strategic targeting strategy</strong></td>
<td>General &amp; Specific</td>
<td>Specific</td>
<td>Specific</td>
</tr>
<tr>
<td><strong>Open door strategy</strong></td>
<td>General</td>
<td>General</td>
<td>-</td>
</tr>
<tr>
<td><strong>Passive</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: Peter Wad and Soren Jeppesen (2006)*

The evidence is that what matters more in developing countries, is not the national context and the government in itself but the power relationship between states and foreign firms, whereas the capability of less developed countries to intervene directly in private sector development is often weak and insufficient. This is one of the reasons why in chapters 2 and 3 we will mainly focus on institution based perspectives for MNCs entry strategies in emerging markets.

Moreover, linkages to foreign investors can represent the main way for ECs in upgrading several determinants that can positively involve the economy within
the global networks. As we have already pointed out, EEs are within global value chains thanks to the delocalization of production based on MNCs cost reduction strategies and the role of national government, seen as the crucial nexus, becomes the key for the domestic development. By facilitating training and technology transfer, by introducing new types of value-added activity, and better exploiting human resource endowments, EEs may reach higher levels of value in the global chains. This can represent, for the MNCs, a new opportunity in elaborating regional and local production planning in order to improve time-to-market performances “while taking advantage of their parent company’s governance, business processes, and management expertise, to offer products at dramatically lower prices that match the lower purchasing power of most buyers in emerging markets” (Coleman, 2007, p. 106), and finally being able to reach new horizontal targets even through vertical based strategies.

• The global value chain and the emerging economies

When trying to explain the organization of the international economy in 1994 Gereffi proposed the Global Commodity chain perspective. This framework explains the trans-national network as constituted by several, geographically dispersed companies, each one operating in a different integrated function (e.g. design, marketing, manufacturing, R&D, etc). The international corporate governance is therefore “the non-market coordination of activities and is defined as the ability of some firms to impose and enforce the parameters under which other firms in the chain operate” (Humphrey and Schmitz, 2004). Gereffi studies two groups of leading companies that are at the head of this governance system: producers in capital intensive industries, with a strong focus on reaching economies of scale and reducing transaction costs; and buyers in wearing and garment industries, where transaction and labour costs are the main way to reach competitive positions.
The Gereffi’s perspective was then expanded by several other scholars towards a wider view of what the chain comprehends. Considering value, instead of commodity, non-firm actors such standard organizations, governments or international organizations. are involved. Within these chains, the productive patterns may move out toward EEs, Gereffi (1994) pointed out how cost efficiency imperative characterizes such strategies. Even more, the mechanism sees the dominant buyers demanding power and lower prices of inputs supplied, thus reinforcing pressure on the down-chain, powerless suppliers. This aspect may have its consequence in the necessity for the individual firms to reduce costs by, for example decreasing wages of its employees. Coleman G., Managing Director of Manufacturing Industries for Deloitte argued that “delivering commercially viable products at dramatically lower prices requires an efficient global value chain encompassing governance, business process and management know-how […] and 15% of Deloitte member firms that have successfully mastered the growing complexity of their value chains, are up to 50% more profitable”(2007, p. 107). The theory behind this is that to expand sales in EMs, companies have to be able to match global value chains and the responsiveness that local autonomy can provide, an argumentation that London and Hart had already claimed, against the “current wisdom of world-scale production, global supply chains, and mere local adaptation of centrally developed solutions” (2004, p.18).

We can see, therefore, the two general opportunities coming from the EEs: product market and low cost factors cannot be considered to be unrelated. The relation of these two aspects can provide increasing of sales thanks to product customization, throughout the domestic development of such economies. These processes can remain ineffective for long time. Barriers to this may come from the lack of ability by local industries to meet requirements of the MNCs which causes a persistent asymmetric relationship between the emerging economic environment and the leading firms (Hoskisson et. al, 2000).
Examining what can be the role of such linkages, Meyer (2003) identifies four spill-over effects of Backward linkages:\(^2\): 1) Transferring of knowledge through joint product development and direct training to suppliers; 2) Process and product standards chosen by customers; 3) International competition for supply linkages vs. local suppliers; 4) Local suppliers provide their own staff. In this way linkages may produce a local entrepreneurial capacity from which new enterprises can spring (Hansen 2006).

Wad (2006) reports a survey of Danish firm executives which shows how the policies for cross-border linkages and practices on the ground are, different “country-wise, two thirds of the Danish firms with Malaysian linkages and around half of the Danish firms with South African linkages did not experience any significant facilitation of their linkages with local firms. Furthermore, very few Danish firms in Malaysia found any relevant impediments, […] while in India and Vietnam, governments created obstacles”. Impediments often came in relation to the ineffectiveness of judiciary contract enforcement and slow bureaucratic mechanisms. When dealing with subsidies, the home country matters much more than the host one does, evidence from Vietnam shows that among the responding firms, 45% considered aids as attractive, in South Africa less than 20%, compared to 5% in India and 0% in Malaysia. Only in Ghana 90% of the respondents answered that Danish aid made an attractive difference. One of the most encouraging results is that if there is a perceived governmental facilitation of cross border linkages, Danish firms make more upgrading activities, in terms of “linkage intensity”.

---

\(^2\) Backward linkages (suppliers, vendors and sub-contractors); Forward linkages (distributors, service providers, sales agents and costumers); Horizontal linkages (joint venture partners, licensing and franchising) (Hansen, 2006)
Chapter 2
Why Emerging Countries?

Once we have described how scholars explain the process of firm internationalization in the world, we can pass on to the next logical step concerning this essay: why entry specifically in EEs. Reasons that push for an internationalization process that involves countries with a high rate of growth, low cost factors and unseen domestic market opportunities emerge just from their specific nature: “being emerging”.

“A MNC spreads its operations around the world either to access resources in other countries, whether it be petroleum in Nigeria or software professionals in India, so as to add to its competitive edge, or to use its competitive advantages to sell its products on the local host country market” (Bhamuik and Gelb, 2005, p.8).

In very general terms, we can individuate two different opportunities for MNCs investments in EEs: the first is related to relative low-cost factors and fragmentation of production for high intensive products and processes (e.g. Delocalization; Economies of Scale Vertical Integration; Horizontal Integration); while the second is related to the domestic product market opportunity itself: high rates of growth, and new demands from the population that consume more thanks to growing per capita incomes, (e.g. Market Seeking; Horizontal Expansion etc.).

We are in this case “proponents of the view that host country differences are the major determinant of the variation in foreign affiliate performance” (Makino et al., 2004, p. 1030). Namely, looking for the benefits and outcomes deriving for instance, from the exploitation of location-specific advantage (LCA) in terms of factor costs. Firm specific advantages (FCA) constitutes a view related with the focus of the firm’s parent resources which may actually provide good insights concerning EEs entry strategies, but it is just not enough to explain the specific profitability of the entry into these countries.
• Emerging Countries

The term emerging market economy can mean different things, and there are several and not commonly accepted definitions. An Emerging economy can be defined as a country that satisfies two criteria: a rapid pace of economic development, government policies favouring economic liberalization and the adoption of a free market system (Arnold and Quelch, 1998). Most analysts argue that an EM can be defined according to its size, growth rate and length of time it has opened to global markets. Khanna and Palepu (2007, p.42) claim: “the most important criterion is how well an economy helps buyers and sellers come together”. Moreover, a political scientist, Ian Bremmer (2008), defines the EMs: countries where politics (e.g. institutions, public organizations) are as important as the market itself. That is the reason for the importance of the institutional view in a strategy elaboration step (we will go on this in the 2nd and 3rd chapter).

Arnold and Quelch (1998) identify the pillars by which any definition of an emerging market should be based on1:

1. Average GDP per capita and relative balance of agrarian and industrial/commercial activity
2. GDP growth rate
3.Extent and stability of the free market system, namely, the openness and reliance of the market.

Another aspect in defining such economies, is to be able to differentiate the adjective “emerging” from the “developing, transition, LDCs etc.” economies, expressions to which authors commonly refer to in articles and papers. A developing economy by IMF classification system has low levels in: (1) per capita income level, (2) degree of export diversification (3) integration into the global financial system. We are instead talking about a transition economy, where four different levels of the country’s environment are being reformed:
(1) Liberalization of the market; 2) Macroeconomic stabilization; 3) Restructuring financial sector and privatization; 4) Legal and institutional policies (IMF\textsuperscript{3}, 2000). Indeed an Emerging Economy (EE) is the one that actually can be retained between the developing and the developed status, once it has elaborated and put into force the reforms expected for transition economies. It is really difficult to describe this phenomenon in very specific terms, since we are mostly speaking about potential and perspective, but to be as precise as possible, we want to make a list of the emerging economies, as the global economic and financial world has drawn it up.

We have decided to consider Morgan Stanley Capital International\textsuperscript{4} (trading as MSCI Barra), and Dow Jones Total Stock Market Index\textsuperscript{5} - Emerging Market Segment. As of May 2010, MSCI Barra has identified 21 Emerging Economies in the world:

* Brazil
* Chile
* China
* Colombia
* Czech Republic
* Egypt
* Hungary

* India
* Indonesia
* Malaysia
* Mexico
* Marocco
* Peru
* Philippines

* Poland
* Russia
* South Africa
* South Korea
* Taiwan
* Thailand
* Turkey

Dow Jones instead, lists 35 countries as Emerging Economies, , adding to MSCI the Barra list**:

* Argentina
* Bahrain
* Bulgaria

* Latvia
* Lithuania
* Mauritius

* Qatar
* Romania
* Slovakia

\textsuperscript{3} IMF, “Transition Economies: An IMF Perspective on Progress and Prospects” (November 2000)
\textsuperscript{4} the list tracked by The Economist is the same except Singapore, Saudi Arabia and Hong Kong included.
\textsuperscript{5} Cme Group Index Services, “Dow Jones Total Stock Market Index”, (May 2010)

** South Korea is excluded
We will consider the Dow Jones list of countries as our geo-reference point in order to be able to include a wider range of world regions and countries (e.g. Eastern Europe, South America etc.). in our research

Over the last decade, the international community has created new terms to describe the largest developing countries, such as BRIC, that stands for Brazil, Russia, India, and China, along with BRICET (BRIC + Eastern Europe and Turkey), BRICS (BRIC + South Africa), BRICM (BRIC + Mexico), BRICK (BRIC + South Korea) and CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa)\(^6\). These countries do not share a common agenda, whereas they globally represent similar positions vis-a-vis the developed economies. The power that is associated with their global role *de facto* has been increasing their burden in the economic and political international stages. In 2007, the World Investment Report: “Emerging markets have witnessed a phenomenal level of in-bound, direct investment, much of it through international joint ventures”, in other words, the importance of these countries may be quantitatively indicated by the volume of corporate investments. In recent years Merchant (2005) argues that the inclusion of EMs in MNCs strategic growth plans, has become an economic imperative.

We have tried to underline who these countries are and why they are relevant on the global stages. Now we are going to analyze the potential profitability of these countries in relation with MNCs global strategies.

---

\(^6\) from: [http://www.reuters.com/article/idUSLDE63Q26Q20100427](http://www.reuters.com/article/idUSLDE63Q26Q20100427)
Emerging Markets and Profitability

The 2007 and 2008 financial crisis had a minor impact on the global economy equilibrium thanks to the good performance of these double-digit ECs. Investors were urged to consider investing an essential part of their portfolios in EMs because investments in that arena out-performed those in developed markets during the crisis.

In table 3 we can see that higher rates of economic growth during recent years, made it possible for emerging markets to account for a larger and larger share of the world GDP. Forecasts say that in less than three years Emerging Markets will account for the 50% of the Global GDP (IMF, 2010).

Figure 3 - Emerging Economies GDP vs. Advanced Economies GDP

According to the estimates of the United Nations Population Division (2008) more than 3 billion people, and a million companies are in EEs. MNCs are definitively being involved in this new wave coming from the consequent opportunities. Coleman (2007) reports that when Deloitte asked manufacturing
executives about their prospects in emerging markets compared with those coming from developed economies, 58% were expecting a substantial growth coming from the firsts, while just the 23% were optimistic for the second.

Market potential as a general approximate indicator of such markets can be assessed through a simple formula that measures the relative scale of the demand opportunity (without reliable data on current expenditure levels or industry sales) and not taking in account all the specific environmental, social and demographic features of the country:

$$Q = (P+NP) \times (\text{DevGDP}-\text{AdjGDP})$$

Where:
- $Q$ = total market potential
- $P$ = national population
- $NP$ = population growth in a given period
- $\text{DevGDP}$ = average per capita GDP in developed markets
- $\text{AdjGDP}$ = GDP in emerging market adjusted to PPP level

The first element of the formula is adjusted by the population growth rate in order to account for the future growth population potential. The second element instead, gives the relative size of the country’s economic development stage, by comparing its per capita GDP with the developed-market average. Just to give an example, we have calculated the total market potentials for two ECs, Brazil and Turkey, and a developed one with low demographic potential, Italy. The results show us how favourable the potential in EEs is, and how much more these markets can be profitable vis-a-vis than the developed one:

- $Q$ (Brazil) = $4$ billion
- $Q$ (Turkey) = $1.5$ billion

---

7 from Arnold and Quelch (1998)
8 “This is important in assessing emerging markets, mainly for the threshold effect, the phenomenon in which disproportionately large increases in demand result from small increases in wealth as consumers pass thresholds of disposable income that trigger their ability to purchase additional goods, such as consumer durables, for the first time.” (Arnold and Quelch, 1998)
Demirbag, Tatoglu and Glaister (2008) claim that market potential in the host country is an important determinant for entry mode choice, and Khanna and Palepu (2005) reported that the 61% of Business Executives polled by Mckinsey Global Survey, said that market size and growth drove their firm’s decisions to enter in new markets, while 17% said that political and economical stability is the main driver. How and why foreign investors should choose to entry, and the entry mode in relation with the market potential, is going to be analyzed more specifically in the 3rd chapter. For now it is enough to understand that both market growth and the rate of growth of the country influence the mode of entry; Luo (2001, p. 452) argues: “industrial sales growth conditions in a host market affect expected net returns and the growth of firms during international expansion”, indeed this becomes matter of entry mode and strategic orientation decisions.

Profitability of EMs is, as we have seen in the above paragraphs, mostly related to medium and long term, with population demographics and economic growth, given skills and productivity levels. Whereas ECs exhibit favourable demographic profiles, developed economies show opposite trends: declining population and labour force (e.g. Japan’s fertility rate is almost half that of Indonesia). Da Silva (2009) reports that in the Q1 2008, period of significant financial turmoil, China Mobile signed up 21 million new subscribers in three months: about 1/3 of the United Kingdom population!

Skills are increasing sharply too, China and India produced 1.2 million graduates in science and engineering disciplines in 2002/04, more that Japan, US and EU put together. It is clear that EEs are going to be the home of low-skilled manufacturing for much longer.
Emerging Economies and the difficulties associated with them

Research
The main difficulty for research, is the need to challenge conventional theories and methods that are specifically related with developed economies features. Most of the theories for developed economies cannot be appropriated for EEs, and empirically, data collection, measuring firm performance and timing issues can be really problematic. When reviewing these issues, Hoskisson (2000, p.257), argues: “obtaining a representative sample of enterprises through conventional sampling techniques can pose problems, for instance, there may not be list of privatized firms available in Russia, which makes random or structured sampling procedures difficult”. Researches from resource based perspective, have demonstrated that valued, rare and inimitable resources are difficult to measure (Godfrey and Hill, 1995). Moreover, institutional frameworks, difficulties arising from the inconsistency in building up a set of measures of the institutional factors (Oliver 1997).have to be considered. What is more measuring financial performances too can be really hard, because financial reports cannot always be based on conventional developed market standards since they are combined with high rates of inflation and devaluation of local currencies (Hoskisson 2000). Finally the timing issues, caused by the political instability of EEs and the changes in the institutional environment, that “may produce misleading results concerning the impact of particular strategies” (Hoskisson, 2000, p. 259).

Entry barriers
From a “on ground” perspective, EMs hide several difficulties. As London and Hart (2000, p.18) wrote: “Scalability, flexibility, decentralization, knowledge sharing, local sourcing, fragmented distribution, non-traditional partners, societal performance and local entrepreneurship” appear as the elements that should be taken into account. Aspects that can match with the different patterns of evolution that characterize these heterogeneous countries. There are several classes of entry
barriers that imply disadvantages for entrants. From the classification of Porter (1980):

- Scale effects (here the entrant may need substantial volume in order to attain low costs)
- Product differentiation (this creates preferences and loyalties among buyers and sellers)
- Switching costs (customers who want to switch from one supplier to the other)
- Access to distribution channels (available channels might be dominated by competitors)
- Costs independent of scales (such as access to raw materials, or innovations etc)
- Government policies and regulations (interventions might be required)

As Pehrsson (2002, p. 145) noted though, “since managers often have incomplete information on such barriers in ECs, they are required to make value judgements on the base of their experiences”. This means that different assessments of the existence and importance of the barriers will result.

Some researchers (Zhang et al. 2007; Luo, 2002; etc.) reported that uncertainties in EMs can be classified at three levels: culture specific (e.g. cultural distance); country specific (e.g. policy environments); and market specific (e.g. property rights, suppliers). We will see how these different elements can shape entry mode choices in the 3rd chapter.

**Partners**

Other kind of difficulties associated with EEs occurring in contextual unstable and evolving regulatory systems, raise the probability of opportunisms and violations by local partners. Since Western firms may not be able to enforce agreements without incurring extra and uncompetitive costs, there can be other ways to avoid this eventuality. Chelariu (2005) mentions the case of Eastern Europe, which can,
generally speaking, be applied to many of the EEs indexed by the MSCI Barra. Other than the uncertain enforcement of contracts and the effectiveness of legal pleas in the specific environment, a benign uncertainty can be compounded by cognitive and cultural differences as well. These difficulties may be caused by a lack of skills by local affiliates or distributors as well by a lack of understanding the local market by the exporter (Chelariu, 2005).

Scholars suggest influencing MNC local affiliate, through recommendations, using business procedures and practices. The importance of the distinction between legal coercive pleas and non-coercive recommendations is the object of the studies of the knowledge transfer theorists. It underlines the distinction between “the implementation and internalization of the transnational transfer of organizational practices […] a recipient that commits to the practice, is satisfied with it, and embraces it through psychological ownership engaged in internalization” (Chelariu 2005, p. 527). A way to avoid difficulties coming from headquarter uncertainties, promoting transfer of knowledge, may be crucial not only for the development of local entrepreneurial skills, but for MNCs as well. It may render the choice of local responsiveness a regional and not a global based decision, to being more local respondent with a gradual transferring of ownership and activities.

**Investment risk**

Risk can be defined as the probability that an outcome will be unfavourable (Thunell, 1977). It can be illustrated with a simple formula from Raftery, (1994):

\[
Risk = Probability\ of\ event \times Magnitude\ of\ loss/gain
\]

We can find out two dimensions of the Investment Risk in a host emerging country. Both come from the risk associated with operating in the new environment. The first dimension, defined by Gatignon and Anderson (1998), Investment Risk is the extent to which a country’s political, legal, cultural and economic environments threaten the stability of a business operation. The second by Helios and Henisz (2000, p.307): “because the state possesses a legal
monopoly on coercion and is present in the background of every economic transaction, it poses a threat to the revenue streams of all private firms”. Indeed, as Brouthers and Brouthers (1998) argue, firms facing high investment risk will tend to use shared-control entry modes to try and minimize the impact of changes that can have an adverse impact on investments.

MNCs are deeply involved in these kind of risks, firstly because they are operating in a new environment, and all the political, legal and economic variables can constitute hurdles if they are not well known and managed. Secondly, because EEs political dynamism may be adverse to foreign capitals for certain reasons, with relevant phenomena of public or private expropriation (we will go further into this argument in chapter two).

Moreover, in joint ventures, there can be cases of private expropriation hazard. In general terms the local partner can behave opportunistically, so as to divert the revenue stream away from the MNC. More specifically, there are two types of private expropriation: technological leakage and free riding. Technological leakage is carried out by “the variance in transaction-specific ability to contract for technology, it gives rise to the private expropriation hazard, as this hazard increases, the costs of writing, monitoring and enforcing contracts increase” (Helios and Henisz, 2000, p.308). Free riding on brand name and reputation risk then, as Gatignon and Anderson (1998) argued, is high for MNCs with strong brand equity. To prevent such local operations from diluting or confusing the international positioning of the brand, MNCs should assume higher equity positions in joint ventures. This means that although environmental complexity makes foreign firms often consider seeking partnerships and affiliates in EEs so as to reduce risk and lower costs of getting pioneering-risky positions in the hosting systems, hazards from partners are always present. Since uncertainty raises financial risk perception in investments, the transferring of technical know-how might be lowered, especially when the investment is irreversible (Isobe, 2000).

Indeed, the hypothesis for public expropriation hazard suggested by Helios and Denisz is: “the greater is the level in a country, the lower the ownership position assumed by a foreign investing firm”. Whereas for private expropriation: “the
greater the level of private expropriation hazards in a foreign investing firm’s assets, the higher the ownership position it assumes”.

**Market failures and corporate counter-strategies**

EMs can boast various forms of market failures, given their fragile market system. Under market-model conditions, there is free exchange of goods and/or services through demand and supply mechanisms (Khanna, Palepu and Sinha, 2005), it means that no extra market facts or actors can interfere with such mechanisms. In EMs though, such market-models conditions hardly work effectively, “in fact, market failure is more the norm than the exception in such settings. It is in this regard that research has explored the use of a corporate diversification strategy to mitigate these inherent shortcomings of the market” (Li et al., 2006, p.441). In the table below we can see what are the firm’s strategies to counteract failures of product, labour or capital markets. The strategies are divided by the authors in Horizontal Diversification and Vertical Integration: the first ones deal with a progressive and focussed enlargement of company activities or assets, in a way that the “strengths” in a certain field can be transferred and adapted to gain advantages within another selected area. On the other hand, vertical strategies are internalization strategies that seek to incorporate elements or activities in order to reduce uncertainty and transaction costs coming from outsourcing.

Tab 4 Types of market failure and choice of mitigating corporate strategies

<table>
<thead>
<tr>
<th>Product Market Failure</th>
<th>Horizontal Diversification Strategies</th>
<th>Vertical Integration Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Leverages brand equity across multiple products/services</td>
<td>- Overcome transaction cost inefficiencies and heps organize stable supply chains and distribution system</td>
</tr>
<tr>
<td></td>
<td>- Address distribution bottlenecks to gain scope economies</td>
<td>- Enhances quality assurance for input product and materials</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Establishes after sales service</td>
</tr>
</tbody>
</table>
To sum up, corporate strategies are responses which can be used by companies in addressing these failures, “vertical strategies could be effective for dealing with product and skilled labour market failure, and the horizontal strategies for the capital and managerial labour market failure” (Li et. all. 2006, p.445).

- International strategies and emerging markets

EEs have a unique potential in the world. In order to make win-win strategies, companies have to build up high levels of innovation capabilities, adjust assumptions about customer demands, elaborate product design and innovation (Coleman, 2007). Survive and win in the global competitive stage does not only mean internal innovation and business development but challenging the external competitive dimension, through competitive advantages as well. This last aspect may be considered a long term matter, and long term requires strategic planning. Hamel and Prahalad (1994) has found two elements of success:
1) articulation of long term goals
2) formation of a strategic architecture, a network of internal competencies and coalition partners

In her paper Christine Nielsen “The global chess game..or is it Go?” focuses her analysis on strategic planning for emerging countries through the lens of a game board player. Unlike Chess (namely, kill the enemies), Go⁹ is about capturing space from the competitor which, in an international strategy formulation is “the winner who pre-empts competition in critical global markets” (Hamel and Prahalad, 1994, p. 25). “The conceptualization of capturing space as a market-entry strategy is not just about geographic territories, but also about controlling key suppliers, technologies, key components and distribution channels in order to eliminate the liberties of competitors: “strangulation through encirclement” (Nielsen, 2005, p.401), the Go player strategy.

To build up strategies we need to include the cultural paradigms to better elaborate our path through the environment. Competitor analysis frameworks, are not able enough to comprehend the antecedent factors characterizing EMs. As a step in this direction Nielsen elaborated a Competitor Analysis framework for Emerging Markets.

---

⁹ The game is played by two players who alternately place black and white stones on the vacant intersections of a grid of 19×19 lines. Once placed on the board, stones cannot be moved elsewhere, unless they are surrounded and captured by the opponent's stones. The object of the game is to control (surround) a larger portion of the board than the opponent. Placing stones close together helps them support each other and avoid capture. On the other hand, placing stones far apart creates influence across more of the board. Part of the strategic difficulty of the game stems from finding a balance between such conflicting interests. Players strive to serve both defensive and offensive purposes and choose between tactical urgency and strategic plans.
The paradigms of competition based on the different cultural segments are represented on the one hand by the Global Chess game, and on the other by the game of Go. “Chess reflects the competitive perspective of companies whose leadership is drawn from individualistic cultures (USA, EU etc), while Go reflects the competitive stance of those embedded in collectivist cultures” (Nielsen, 2005, p.419). These aspects are represented in the different goals that the players choose for market entries: immediate gain for chess players, shareholders care only about the short-term: for Go players long-term profits where cross-shareholding exists and the ownership is distributed within a network (e.g. Keiretsu).

In terms of business geography, Chess players are more likely to protect core products and markets, while Go players are likely to defend against incursions into their controlled territories, referring both to geographic space and to critical resources in the supply chain. Finally in terms of strategies: the chess player opts for head-to-head actions and frontal attacks, whereas the Go player will employ its multi-firm network to control key suppliers and resources (Nielsen, 2005).
Global counter-strategies

Whereas “western companies can lower costs by setting up manufacturing facilities and service centres in EMs, where skilled labour and trained managers are relatively inexpensive; [...] several emerging-country transnational corporations have entered North America and Europe with low-cost strategies” (Khanna and Palepu, 2005, p.64). From this point of facts, being active and delocalizing in ECs becomes a compulsory counter-Strategy for western companies. As Khanna and Palepu (2005) argue, western MNCs cannot avoid engaging across their value chains with developing countries, since they cannot remain competitive for long time. This can be explained by the progressive upgrading of the product quality and market knowledge of the EC’s companies, combined with the indisputable advantage coming from a huge domestic market potential that can provide Economies of scale and competitive advantages thanks to home markets. London and Hart(2000, p.18) claimed: “the capability to include more voices in strategy and product development could generate societal benefits and become increasingly valuable for companies looking for new sources of competitive advantage [even] in saturated developed markets”, in sum, benefits coming from cultural heterogeneity.

Moreover, as we have seen, there are many difficulties associated with less developed markets, CEOs cannot do business in the same way there, they have to succeed in leveraging EMs within the global stage, innovating, being local respondent. The challenge is interesting but decidedly tough.

Seeking low-cost factors: a model for the fragmentation of production

One of the reasons that pull a MNC toward EEs is the factor of low-cost: delocalization of production and fragmentation. As transport costs fell for intermediate goods, firms started to fragment their production, becoming either vertical (if upstream activities are labour intensive), or horizontal (if downstream activities are labour intensive) (Venables 1999).

Venables builds up a model in which two economies, Home and Foreign, are endowed with two factors (K; L), and there are two industries X (produce in both
the economies) and YZ (it has an upstream and a downstream activity producing intermediate good Y and final output Z). It is then demonstrated that fragmentation of production may lead to the development of either vertical or horizontal MNCs. Demirbag (2008) argues, that comparative cost advantages in a host country influence the foreign investor’s entry mode choice, vertical or horizontal fragmentation in EEs becomes a crucial step in building successful global strategies. If upstream production is relatively labour intensive, then vertical MNCs develop and trade flows increase. Fragmentation of production starts when $t(Y)^{10}$ is low enough to make Y production convenient in a Foreign country. But if downstream production is labour intensive then firms become horizontal MNCs, just by moving some of their final assembly to the country in which it is sold. This reduces the value of trade, as trade in final products is replaced by trade in intermediates. Whether MNC activity is a substitute or a complement with trade therefore depends on the relative factor intensities of upstream and downstream production (Venables, 1999).

---

10 Trade costs of moving the Y production to Foreign country
Through global chains, patterns of industrial production (and organization) are extending to the Southern emerging world, “an international division of labour is organized by dominant firms in chains sending signal of cost efficiency through the chain” (Hansen and Kuada, 2006, p.42).

**Opportunities and the Pyramid**

When we think about developed markets compared to those of the EMs, we can easily discover which is the most profitable option for the near future. In the last decade MNCs have turned to EEs as key location for growth. EMs (4 billion
people) have been conceptualized as a Pyramid where the base is composed of customers with an annual purchasing power of less than 1500$ (PPP), (London and Hart, 2002). Following these low PPP numbers though, there is a fast growing economic system and an enormous quantity of entrepreneurs and consumers who, served by low-quality vendors or exploited by predatory suppliers and intermediaries, gives the chance to generate both profits and consumer surplus (Prahalad and Hammond, 2002).

As Delios and Henisz (2000) argued, when there are no enforceable legal mechanisms, the MNCs that usually build-up competitive advantages through patenting, branding, and contracting, have to try to overcome these weaknesses through new entry strategies and partnerships (forming alliances, joining networks, using interpersonal ties etc.). MNCs can overcome liabilities of foreignness through internalization, leverage or sharing existing products and resources within the firm’s boundaries: in order to capture EMs opportunities the MNC strategy can either exploit economic global efficiency (economies of scale) or encourage the adaptation to local needs and conditions (local responsiveness).

In this strategic mix, the suggestion made by International Management Scholars is to develop different strategies for different market segments among the different countries. “To enter into the base-of-the-pyramid, beyond the adaptive skills of national responsiveness, MNC should import business models based on past global practices and capabilities, extracting knowledge, protecting and controlling resource flows”. (London and Hart, 2000, p. 6).

To this purpose, London and Hart have developed a research on the limitations of MNC transnational model in targeting low income markets and the base-of-the-pyramid. Among four MNCs, venture managers provided interesting insights about major difficulties and drivers of insuccess.
Table 7 Limitations of the transnational model: analysis of interview with MNC managers\textsuperscript{11}

<table>
<thead>
<tr>
<th>MNC #1</th>
<th>Transferring existing metrics and relying on existing relationship did not work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relying on existing product development knowledge restricted design innovation</td>
<td><em>Global Efficiency:</em> Leveraging existing knowledge was not effective</td>
</tr>
<tr>
<td><em>National Responsiveness:</em> Adapting resources to local environment did not work</td>
<td><em>Implications:</em> Inability to understand local context</td>
</tr>
<tr>
<td>MNC #2</td>
<td>Local subsidiary did not understand low income market context</td>
</tr>
<tr>
<td>Moving forward showed surfacing biases at the subsidiary levels</td>
<td><em>National Responsiveness:</em> Adapting resources to local environment did not work</td>
</tr>
<tr>
<td><em>Worldwide learning:</em> existing knowledge did not need to enter the market</td>
<td><em>Implications:</em> important to find partners with context-specific knowledge</td>
</tr>
<tr>
<td>MNC #3</td>
<td>Benefits from piloting in country with no local subsidiary to create learning environment</td>
</tr>
<tr>
<td>Important to be aware of potential biases and over reliance on traditional metrics</td>
<td><em>National Responsiveness:</em> subsidiaries could not successfully adapt existing resources</td>
</tr>
<tr>
<td><em>Worldwide learning:</em> sharing existing knowledge could prevent success due to existing biases</td>
<td><em>Implications:</em> critical to find ways to overcome gaps and biases in existing knowledge base</td>
</tr>
<tr>
<td>MNC #4</td>
<td>Difficult to leverage existing products, consumers or channels in these markets</td>
</tr>
<tr>
<td>Needed new mindset about transferrable capabilities and resource allocation process</td>
<td><em>Global efficiency:</em> relying on traditional metrics was not an effective strategy</td>
</tr>
<tr>
<td><em>Worldwide learning:</em> firm needed to unlearn as opposed to leveraging internal knowledge</td>
<td><em>Implications:</em> required new perspective on appropriate metrics and valuable capabilities</td>
</tr>
</tbody>
</table>

\textsuperscript{11} from London and Hart (2000, p.9)
The results of the research conducted by London and Hart elaborate the two following propositions:

1- When entering base-of-the-pyramid markets, identifying and leveraging existing strengths in the business environment can enhance effectiveness;

2- When entering base-of-the-pyramid markets, strategies that include understanding social context, building up from the bottom, and sharing resources across organizational boundaries enhance effectiveness;

And the following suggestions to successfully capture this large segment characterizing EMs:

- Collaborating with non-traditional partners (including non profit and/or non corporate partners);
- Co-inventing consumer solutions (multiple distributors; functionality of the products);
- Building local capacity (local institutions; local training; see missing infra-structures or services as potential opportunities).

**Leverage and product innovation**

Coleman (2007) points out that innovation can be a fuel for achieving substantial market share and profitable growth: in Table 4 we can see how companies are less likely to adapt product features and types to emerging markets compared with home markets.
Table 8. How specific attributes of company’s products compared in EM and home markets

<table>
<thead>
<tr>
<th></th>
<th>Very Similar</th>
<th>Somewhat Different</th>
<th>Very Different</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product Features</td>
<td>53%</td>
<td>35%</td>
<td>12%</td>
</tr>
<tr>
<td>Product Types</td>
<td>40%</td>
<td>41%</td>
<td>13%</td>
</tr>
<tr>
<td>After-Sale Service</td>
<td>34%</td>
<td>47%</td>
<td>19%</td>
</tr>
<tr>
<td>Discounts &amp; Rebates</td>
<td>28%</td>
<td>48%</td>
<td>26%</td>
</tr>
<tr>
<td>Pricing</td>
<td>24%</td>
<td>49%</td>
<td>27%</td>
</tr>
</tbody>
</table>

Source: Deloitte Touche Tohmatsu, (2007)

We can see in the figure above, how the product features are less likely to change, namely one of the main attributes that is supposed to make a relevant impact on sales and market share. Another obligatory choice is to change the price in that the product is for low income countries, in fact only less than 1 product out of 5 has a very similar pricing. As London (2000) argues, MNCs cannot rely on the assumption that all markets in the developing world are evolving in a similar manner: local product innovation can represent a prompt answer. Changing product features is a difficulty associated with the entry choice in the EE, but substantially it is an opportunity for market coverage in the medium and long term (Coleman, 2007).

It is argued that serving the majority of the EMs requires not only a 10-15% cut in costs but above all new products that really have lower production costs compared to developed markets have to be designed. Lower costs should not mean less sophistication, but conversely, that product development, since the R&D until the final assembly, should be EC-based, in order to capture the cost advantages in terms of production factors and social embeddedness. In fact “now major manufacturers have been starting to locate R&D facilities in EEs, because of the tax credits and government incentives, incorporating local needs and expertise in product design” (Coleman, 2007, p.105).

---

12 an example is Procter&Gamble that is spending around the 30% of its 2 billion R&D budget on developing products for low income consumers, spending time in people’s home, looking for the most effective patterns of innovation (Financial times, 2005)
Past studies confirmed that all attempts to reach cultural uniformity for MNCs in a global stage, revealed to be ineffective either with the local diversity and social embeddedness. As Melin (1992) suggests, there is a need for different research methodologies to penetrate non-western markets: internationalization should incorporate an ethnographic and interpretative field work approach. Boundaries between organization theory, strategic management and international management become fluid, and successful MNCs’ policies can only be the result of a constant development able to capture the diversity and dynamism of the EEs over time.

This path through out local diversity and dynamism may be efficiently elaborated by relying on non-traditional partners. These are the main active players in EEs contexts, no-profit organizations and business groups, as well as local and even village level governments are included. Unsuccessful strategies relied primarily on traditional partners such as national governments and large local companies. A successful strategy goes beyond leveraging internal capabilities and adapting standard entry strategies, looking for “an access to external competencies where ever possible” (London, 2000). As Nobel Prize Joseph Stiglitz remarked in Globalization and its discontents (2002): “The failure of global financial institutions in their efforts to facilitate economic development that is more inclusive, demonstrates the dangers of relying on traditional players and their limited views of what is appropriate and effective (Stiglitz, 2002).

Some scholars claim that the definition of institution should include NGOs and organized community groups. It is significant though, that most institutional well-known theorists, such as Child and Tsai (2005) have not taken into account the relevant role played by such organizations.

Perez-Aleman and Sandilands (2008, p. 24) argue: “NGO pressure for sustainable practices has particularly targeted companies leading global supply chains in diverse industries, including mining, forestry, agribusiness, electronics, garment, and footwear, among others. Such actions have led to the creation of new
standards, codes of conduct, and certification programs that represent norms and practices that define expectations or more socially and environmentally sustainable production processes”. Building such relationships with non-profit partners can provide a direct, strong, social acceptance and institutional favour. A consequence about which Perez-Aleman remarks is the paradox that sustainability standards can represent significant barriers to entry, because it could be that “poor” producers in rural areas are not able satisfy such requirements. A profitable solution for local development can be the upgrading of processes and activities in conformity to such standards: “An active assistance approach means that partnerships provide support during the adoption of new sustainability practices while simultaneously improving the ability of Bottom of the Pyramid producers to participate in global supply chains” (Perez-Aleman and Sandilands, 2008, p. 26). Obviously this may have a consequence on the MNCs policy privileges as well, a crucial aspect for entry strategies in EEs, as we will see.

**Business Groups**

“According to the official definition by the Chinese government, a business group consists of legally independent entities that are partly or wholly owned by a parent firm and registered as affiliated firms of that parent firm” (Yiu et al., 2005,p. 193). Within the hosting environment, Business Groups are an active actor that can constitute an obstacle (opportunity too) for the MNCs’ penetration of the social and industrial context. Literature suggests that “government involvement has been particularly pertinent in the formation of business groups in most EEs, such as Pakistan, Latin America, Indonesia, Korea and China” (Yiu et al., 2005, p. 187). The capability of these groups in benefiting members-of-the-group companies are enormous in contexts such as those of the ECs: obtaining licenses, arranging for financing from shallow capital markets, identifying potential technology partners, setting up distribution chains to overcome infrastructure bottlenecks, and organizing skilled labour pools. These skills are believed to be fundamental requisites for successful entry across a broad spectrum of industries in EMs (Li,
Rammasway and Petit, 2006). The following table summarizes which are the main “services” that Business Groups can provide in order to add value:

**Table 9 - How Groups can add value**

<table>
<thead>
<tr>
<th>Institutional dimension</th>
<th>Institutions that groups imitate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Market</td>
<td>Venture capital firm, private equity provider, mutual fund, bank, auditor</td>
</tr>
<tr>
<td>Labour Market</td>
<td>Management institute/business school, certification agency, head-hunting firm, re-locations service</td>
</tr>
<tr>
<td>Product Market</td>
<td>Certification agency, regulatory authority, extrajudicial arbitration service</td>
</tr>
<tr>
<td>Government regulation</td>
<td>Lobbyist</td>
</tr>
<tr>
<td>Contract enforcement</td>
<td>Courts, extrajudicial arbitration service</td>
</tr>
</tbody>
</table>

*Source: Khanna and Palepu (1997)*

Some studies empirically demonstrated that a business groups with multi-divisional structures may reduce transaction costs, providing economies of scale and scope. Therefore, rather than treating such groups as a mere and uniform set of firms with given characteristics, we can see business groups as collections of resources (Yiu et al., 2005). The ability of business groups may provide efficient types of resources able to penetrate the emerging competitive environment and contribute to members success. A strategic imperative for groups is to manage their corporate identity though, diversified groups which must enforce standards of reliability and quality (Khanna, 1997). In the MNCs’ selection process of potential partners entering an EE, business groups may have priority since they have probably already achieved substantial results in overcoming legal and institutional barriers. Li et. all (2006) argue that this kind of group is related to “a set of vertical relationships ranging from vertical integration to armless arrangements” to face hurdles in input procurements, distribution and all the other possible forms of market inadequacy. Porter (1990) claims that the primary base
for any competitive advantage is the efficiency and the competitiveness of the industry as a whole. Basically, business groups in the particular context of EEs are the main effective tool to build up advantages on competitors. Yiu et al. (2005) define two different kind of resources that a business group could acquire. The first type are the ‘endowed resources’ (coming from business groups formed from formerly state-owned enterprises and government bureaux, already endowed with a pool of government resources), the second type, ‘acquired/developed resources’ are the result of the deployment of capabilities in the market, once the business groups are formed.

Khanna (1997) notes that, based on statistical analysis, from the comparison of groups and independent companies in India and similarly in South Korean, a lot of the groups add little or no value to their operations. “Western companies need access to advanced technology, cheap financing and sophisticated managerial know-how. In the absence of institutions providing these and other functions in EMs diversification may be the best way to match up against competition” (Khanna 1997, p.60). Finally, findings about Japanese firms investing in EEs, demonstrated that even the negative effect of the public expropriation hazard is smaller on the ownership level of an affiliate, if the firm has keiretsu membership or a sogo shohha partners (Delios and Henisz, 2000).
Chapter 3
Country Analysis and Strategic Planning

In this chapter we will develop an analysis step by step, through the analytical frameworks in the table below, in order to effectively represent an EC and all its “environmental“ features, being able, finally, to build-up an effective international EC-based entry strategy.

| Emerging Country Analysis | • Country Portfolio analysis (Ghemawat, 2001)  
|                          | • 5-contexts framework (Khanna & Palepu, 2005)  
|                          | • Political Risk assessment (Raftery, 1994)  
| Elaboration of strategies for Emerging Countries | • Theoretical Perspectives  
|                                               | • Integrated framework (Peng et al., 2007)  
|                                               | • Partner selection (Hitt et al., 2000)  
| Entry Mode choice |  

- Emerging Country Analysis
Country Portfolio Analysis (CPA)

It has been empirically demonstrated that a lot of wrong corporate choices of the country have been the cause of failure and loss of strategic resources. Khanna and Palepu (2005), reviewing the main reasons of such wrong choices (e.g. follow key consumers or rivals, senior managers’ experience, family ties), explain that in order to choose an EC market, the first step is to use the country portfolio analysis (CPA).

The CPA is the base by which the choice of an emerging country should start. Executives usually build up a picture of the country by using the main national indexes (GDP; per capita income; population composition and growth rates; exchange rates; past, present and projected PPP indexes. To complete this first approach to the country, “MNCs may consider: Global Competitiveness index; World Bank governance Indicators; International Transparency corruption ratings; weight in emerging market fund investments; and perhaps, forecasts of its next political transition” (Khanna and Palepu 2005, p.65). Several difficulties can emerge from these composite indexes, in fact such quantitative reference points do not account for institutional voids and they can be used as a unique base for strategies only when target countries have comparable institutional contexts.

Below is a model of CPA, a widely used tool by companies. As shown in the figure taken from Ghemawat (2001), the potential market for an American fast food group is given by the function of two variables. On the $X$-axis, the per capita income of host markets, on the $Y$-axis, the per capita consumption of the product. Localization on the graph and circle sizes, represent respectively how attractive the potential market is, and how much of the product every individual consumes.

---

13 Ghemawat (2001) proposes the CAGE distance framework to better evaluate foreign markets, not underestimating costs and risk of international operation. These barriers coming from culture, administration, geography and economic distances are included in a reviewed CPA model. However the path on Emerging Economies analysis accounts for those and further types of risks and concerns through the Five-contexts framework developed by Khanna and Palepu (2005).
In the table below the principle considered global indexes for ECs.

<table>
<thead>
<tr>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth Competitiveness index ranking</td>
</tr>
<tr>
<td>Business Competitiveness index ranking</td>
</tr>
<tr>
<td>Governance Indicators</td>
</tr>
<tr>
<td>Corruption Perceptions index ranking</td>
</tr>
<tr>
<td>Composite country risk points</td>
</tr>
<tr>
<td>Weight in EMs index (%)</td>
</tr>
</tbody>
</table>

5-Contexts Framework

5-Contexts Framework helps Executives in creating a map of the context of each country in such a way that the political and social system, the degree of openness to FDI, product, labour, and capital markets are shown to the extent by which they work or do not work. “A framework that places a superstructure of key markets on a base of socio-political choices” (Khanna and Palepu, 2007, p. 66).

The 5 Contexts are:

1) Political and Social System
2) Openness
3) Product Markets
4) Labour Markets
5) Capital Markets

The methodology of the Khanna and Palepu’s framework requires managers to be able to find the institutional voids of each targeted country by first asking a series of questions. Secondly, the ability of the managers in taking advantage of this framework can be found in the accuracy through which information is collected and questions are answered. Finally those answers are summarized, as in the example below. Table 9 is taken from Khanna and Palepu (2005) dealing with Labour Markets (4th Context) in: US; Brazil; Russia; India and China.

Table 11 – Labour Market (example of a 5-Context Framework)

<table>
<thead>
<tr>
<th>US/EU</th>
<th>BRAZIL</th>
<th>RUSSIA</th>
<th>CHINA</th>
</tr>
</thead>
<tbody>
<tr>
<td>The level of unionization varies among countries.</td>
<td>Trade Unions are strong and pragmatic, which means that companies can sign agreements with them.</td>
<td>Trade unions are present, but their influence is declining except in certain sectors such as mining and railways.</td>
<td>Workers can join the government controlled all-China federation of Trade Unions. Historically there are no industrial actions, but there have been recent strikes at Hong Kong and Taiwan owned manufacturing facilities.</td>
</tr>
<tr>
<td>Industrial actions take place in EU, especially in the manufacturing and public sectors but not in the U.S.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Khanna and Palepu (2005)

The main business decision after the application of this framework is the choice of one of the four following strategic options (Khanna and Palepu, 2010, p.41):

14 The key questions for identifying institutional voids edited by Khanna and Palepu are attached at the end of the chapter (Attachment 1).
a) Replicate or Adapt? replicate business model to countries while keeping core value propositions constant (e.g. global brand, credibility, know-how, talent, finance). Companies must maintain their successful business models, must not lose their advantages on the global scale, adapt their productive and distribution system to the new environment (e.g. Dell in China and McDonald in Russia).

b) Compete alone or collaborate? Compete alone and acquire capabilities to navigate institutional voids through local partnerships or JVs.

c) Take market contexts as given. But the MNCs that are powerful enough can fill institutional voids, pushing other service companies or actors to open branches in the new countries (e.g., audit firms in Brazil).

d) Stay out of countries where the adaptation of strategies may be uneconomical or impractical. When MNCs heavily depend, for instance, on a variety of institutions, logistic systems such as highways etc, typical of developed economies, the value proposition in terms of business efficiency may block the company for entry in the new EC (e.g. Home Depot in Chile).

Political Risk Assessment

Political Risk is not a statistical, computable element. It is better called political uncertainty, since it is not possible to calculate due to its unsystematic nature (Lindeberg and Morndan, 2000), we consider it as the probability that an event occurs times the magnitude of the possible loss. Political risk refers to the fact that politics decisions and enforcements, can heavily affect the business climate in such a way that investors lose money or do not make as much money as they expected when the investment was made (Kobrin, 1982). In general, when authors refer to such a risk, they are speaking about the extent to which a government may interfere for their own interest. According to Kobrin (1982), political contingencies include micro risks (changes in industry specific conditions) and non-macro risks (uncertainty to which all firms in a country are exposed) as several authors have categorised. Two other aspects that have been pointed out by
scholars are the internal and external dimension of the political event, and the governmental and societal base. The chart below summarizes the main types of political risk considered for each category.

Table 12 – A general framework for political risk assessment

<table>
<thead>
<tr>
<th>EXTERNAL</th>
<th>INTERNAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOCIETAL</td>
<td></td>
</tr>
<tr>
<td>MICRO</td>
<td></td>
</tr>
<tr>
<td>GOVERNMENTAL</td>
<td></td>
</tr>
<tr>
<td>SOCIETAL</td>
<td></td>
</tr>
<tr>
<td>MACRO</td>
<td></td>
</tr>
<tr>
<td>GOVERNMENTAL</td>
<td></td>
</tr>
</tbody>
</table>

Source: Simon (1982)
To manage political risk, Raftery (1994) suggests that four steps are necessary:

I. Risk Identification - What risk do we have?
Identify the sources of information (e.g. statistics, employees and management interviews) and categorize the effect of risks, to better understand which are the aspects to focus on.

II. Risk Analysis – Build an effective risk analysis
For investment decision making and strategic planning, the primary step, according to Kobrin (1982) is the use of political risk analysis (= Risk Assessment). Authors and companies do not refer to a common approach to analyse political risk. It is usually set down as guessing probability for the occurrence of a political event in a certain country, we will use the Mortanges and Allers (1996) framework, which is composed of 3 complementary methods:

- Qualitative un-structured methods
  - Judgement and intuition of managers and further focussed investigations of a team of executives;
Specialized external sources such as advisory councils, banks, academics, journalists etc.

- Qualitative structured methods
  - Delphi method
  - Standardised checklists including different factors and systematic review by managers
  - Scenario analysis, an approach based commonly on the formulation of three different scenarios which represent a pessimistic, an optimistic and a reference-standard outcome.

- Quantitative methods, such as the prediction of the probability of a certain event happening through the use of a number of measurable factors (e.g. low balance on current account > restraints on transfer of currency)

III. Risk Response – How do we make our investment safe?

Once the probability of risk is estimated, the company has to decide how to respond. Raftery (1994) has identified four main responses: retention, reduction, transfer and avoidance. Ting (1988) on the other hand, divides the risk management techniques into two methods, defensive and integrative. Defensive methods are based on the reduction of the exposure of the company regardless of its natural activities, while integrative is, for instance, introduction of new technologies in the country or social responsibility goals. The four responses:

- **Retention**: can be achieved through captive insurance company taking on the risk or establishing reserve funds to cover eventual losses.
- **Reduction**: has three ways, take actions to reduce damage’ probability or actions taken to reduce impact of a political occurrence. Another form of...

---

15 The experts answer questionnaires in two or more rounds. After each round, a facilitator provides an anonymous summary of the experts’ forecasts from the previous round as well as to why they gave these answers. Thus, experts are encouraged to revise their earlier answers in the light of the replies of other members of their panel. During this process the range of the answers will decrease and the group will converge towards the "correct" answer. Finally, the process is stopped and the mean or median scores of the final rounds determine the results.
reduction can be a diversification strategy, balancing multiple investments in multiple countries.

- **Transfer**: stipulate insurances\(^{16}\); hedge the risk through a financial institution\(^{17}\); partnerships as joint ventures or franchising\(^{18}\), shifting part of the risk to external organizations.

- **Avoidance**: is the most practised strategy, and it simply means that firms only make safe and secure country choices for its investments. If it is post-entry instead, the choice could be divestment.

**IV. Follow Up – Is the situation changing?**

Political risk for its intrinsic dynamism has to be object of a follow-up process. Once the political risk is identified, analyzed and a risk response is decided, monitoring the environment becomes a procedure based on the perceptions of employees and managers. When projects are not fully insured, the follow-up strategy may concern higher premiums of insurance or other kinds of adjustments such as exit from the country.

**Public Expropriation Hazard**

Delios and Henisz (2000) see political risk in terms of Public Expropriation Hazard, as a threat that comes from the government and may take the form of regulatory or tax policy shifts, or, at its extreme, outright expropriation of private sector assets. The authors continue to say that the degree of exposure to these kind of threats is bigger for foreign MNCs because: firstly, the national government may privilege and favour domestic firms (the State itself can be the equity owner) owing to strategic national interests on the asset or national pride and perceptions regarding national sovereignty. Secondly, MNCs, possessing superior foreign

\(^{16}\) Due to the difficulties in quantifying the risk, there is a strong reluctance to cover it. Banks can bear the risk through public insurance contracts and transform loans into public guaranteed credits.

\(^{17}\) Letters of credit are based on the guarantee that a bank guarantees for the payment of an importer. So in this way the possibility that the buyer does not meet his engagement, is eliminated.

\(^{18}\) Another way is risk pooling, a mutual guarantee to cover the losses of each other. Difficulties are associated with this method for the parties to accept the assumption that the risk is the same for all.
market knowledge (e.g. foreign factors market), there is the implicit possibility that lower percentages of domestic contents are used. This becomes substantially a cost for the host Country, in terms of: lack of employment, lower tax revenues, lower political contributions Periods of political or economic uncertainty can therefore render joint ventures really the most favourable choice, and, in this case “one strategic option, may be the increase of the equity percentage held by host country partners: MNCs can alleviate the knowledge disparity and the organizational rigidity described above, increasing the share of local content and safeguarding against public expropriation hazards” (Delios and Henisz, 2005, p. 307). In sum: the greater the expropriation hazard associated with the political risk probability, the lower should be the equity position assumed by the MNC.

• Strategy in EEs: theoretical perspectives

“Many competitive advantages in EEs are based on network relationship and close business-government ties, with firms becoming effective monopolies in their home markets. As the institutional context changes, there are necessary changes on both “asset structures and orientations” of the firms (Hoskisson et al. 2000, p. 256). Because of institutional voids, managers must often rely more on their ties with the business community and/or government officials to conduct business (Li et al. 2008). Hoskisson et al. (2000) argued on the other hand, that the importance of an institutional field of research will slow down as the development of the ECs increase, “which means that as EEs move towards a market economy, firms should adopt more market-based strategies, such as market orientation, to improve performance” (Li and Zhou, 2010, p. 856). This last suggestion enhances the necessity of the inclusion of other theoretical frameworks for the near future, and integration with the institutional one.

Institutional Theory
Institutions are defined as collective and regulatory complexes consisting of
political and social agencies (Child and Tsai, 2005). Treating ECs and indeed, the early stages of a market economy, authors find that IT is a pre- eminent vis-a-vis transaction cost, resource based view theories, in explaining impacts on enterprise strategies (Hoskisson et.al. 2000; Khanna and Palepu, 1997, 2005; Wright, 2005; Estrin, 2010; Child, 2005; Peng, 2008). Even with the necessity of other theoretical patterns, the dominant theory guiding strategy elaboration in EEs is indeed, the Institutional perspective. The institutional effect on the performances of firms, however, varies across countries because institutions are developed and sustained in their paths by the dependent and highly localized processes in the country (Makino et al., 2004, p.1032). We have to argue however that government and societal influences have a more crucial role in EEs than in developed ones. As Porter (1990) calls National Competitive Advantage, the mix of different capabilities that a country has in order to create and upgrade innovation and technology. It goes without saying the a government has a strong influence through its institutions and policies on the relative production and business development costs.

Institutions provide the environment of laws, rules and regulations that structure the interaction between actors and organizations: a firms main role “is to reduce transaction and information costs through reducing uncertainty and establishing a stable structure that facilitates interactions (Hoskisson et. al. 2000). It is argued that the growth of firms may be limited by institutional constraints. As Oliver (2001) noted, the main response for a firm in an emerging host country should be an active behaviour, changing the institutional environment and developing strategies, instead of simply adapting to it passively. This can be achieved through a relational framework, an “institutional sanctioned arrangement that connects actors through participation in a common discourse” (Child and Tsai, 2005, p. 97), that crosses system levels in order to involve people who occupy key positions and roles in decision making processes.

In an under-institutionalized environment like EEs, managerial ties may primarily matter in order to gain institutional advantage. Several empirical researches (e.g. Peng and Luo, 2000) demonstrate that personal ties with government officials
possessed by a firm’s top managers are positively associated with steady performance, thus giving an institutional advantage. Even more so, a resource based perspective evaluates managerial ties as a valuable and intangible resource. So what are the underlying processes by which performance is affected? To answer this question Li and Zhou (2010) have developed a model (see tab. 16), which explains how managerial ties and market orientation affect competitive advantage and firm performance. Institutional advantage is a crucial institutional support if the legal system is not reliable and subject to personal ties. The argument is generally based on the fact that both managerial ties and market orientation can enhance firm performance, but in two different ways. The first, through an institutional advantage, while market orientation through differentiation and cost advantages.

Table 13 – Competitive advantage, Managerial ties and Market Orientation

![Diagram of competitive advantage, managerial ties and market orientation]

<table>
<thead>
<tr>
<th>Managerial ties</th>
<th>Institutional advantages</th>
<th>Differentiation advantage</th>
<th>Cost advantage</th>
<th>Firm performance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Solid line: hypothesized effects
Dashed line: controlled effects

Controls:
1 – Firm size
2 – Firm Age
3 – Firm ownership
4 - Industry
5 – Market Growth

Source: Li and Zhou (2010)

Child and Tsai (2005) focus on the social arrangements and the relational frameworks that companies can enhance in order to be connected with the institutional and organization host regime. However, from a networking point of view, the development of institutions, “greater transparency of accounting
standards, advances in the legal environment, and more consistent government regulation, would be expected to lead to lower needs for a relationship based market” (Yiu et al., 2005, p. 203). For now, an efficient way to match EEs institutional priorities might be the building up of a relational framework that accommodates those strategies preferred by firms. This may become a channel for political lobbying and particular corporate policies and practices, shaping in this way, institutional regulations by offering technical (scarce and relevant) expertise.

Institutional regulations are then the main way for the government to enforce environmental standards to foreign MNCs. First movers may establish a dominant position together with important cost savings on related technologies and procedures (Child and Tsai, 2005). Such industrial standards must, in fact, be generally followed by the up-coming competitors. In EEs, where environmental protection is emergent, governments have been known to utilize environmental codes of reputable corporations (Child and Tsai, 1997). A case, for instance, to legitimate operations and be legitimated as a business actor in the territory of an EC as well, can be the ability to embed environmental standards and gradually become leader and local example. This mechanism will spread mimicry and normative conformity, because once a firm conforms to environmental standards, there is the need to bring the costs of its competitors into line (Salop and Scheffman, 1993).

However, in the existing literature, as we have noticed that the above should not be based only on Institutional Theory (IT): scholars have developed theoretical patterns based on several integrated frameworks (e.g. Peng 2008; Wright 2005). Basically because a fair analysis of EEs strategies can be examined only through a multiple view, based on the interaction between IT and other relevant perspectives.

Here follows are the main frameworks we can integrate with the Institutional theory:
- Transaction cost theory (TCT);
- Resource-based view (RBV) (including Knowledge and Learning perspectives);
- Agency theory (AT);

**Transaction costs theory**

“TC’ objective is to assess the optimal governance structure for a particular economic activity and the choice is determined by three factors: frequency of the transaction, asset specificity and level of opportunism of the transacting parties” (Hansen and Kuada, 2006, p.46). TC are likely to be higher in EEs than in developed markets, suggesting a preference for more hierarchical governance structures. The TC theory in fact, has led to many studies about the adoption of vertical integrated, strategic alliances or multi-divisional structures (Hoskisson 1993), in order to face higher TCs markets.

With respect to hierarchical governance and costs of transactions, TCs theories may provide more efficient organization forms, but, within EEs even other concerns can emerge. In fact, because TCs have been primarily applied to developed market economies characterised by strong legal regimes and binding social norms, less is known about governance structures for transaction in EEs: opportunistic behaviour, typical of these market contexts may be reduced, in under-developed markets, through enforcement mechanisms (contract law, trust, reputation etc) (Hoskisson, Eden, Lau, Wright, 2000, p.254). Scholars find that two transactions costs are critical for EEs: *measurement* and *enforcement* costs. Measurement costs, when the price system does not provide signals for efficient resource allocation, and enforcement when official discretion is a way more than the rule of law, the mechanism to ensure property rights.

Finally, TC theory is extended by several authors adding the institutional dimension. This combined approach is very important in EEs since the institutional environment is the one that may affect equity based entry modes, shaping TC and business risks (Demirbag et al. 2008). Meyer (2001) claims that
the relation is crucial for EMs since the inefficiency of the institutional dimension directly affects business, increasing cost of transactions and risk levels.

**Resource-based view**

RBV helped to specify the nature of resources required to overcome the liability of foreignness, and it built a bridge to investigate the resources that provide the foundation for product and international diversification (Barney et al., 2001, p. 629). Barney (1991) suggested that the resources of firms differ in terms of value; rareness; inimitability; and substitutability, since competitive advantages of firms come from a unique bundle of resources which are difficult for competitors to duplicate.

Oliver (1997) tries to elaborate a view that integrates RBV and institutional factors in order to develop an institutional capital, optimizing the use of resources. Resources are generally defined to include all assets, capabilities, organizational processes, information, knowledge and other attributes controllable by firms and necessary for the implementation of strategies (Hansen and Kuada, 2006, p. 49).

Although some capabilities are standard across all economies (e.g. first mover advantages), others are especially prominent in EEs (Hoskisson et al. 2000, p. 256). Firms that are able to exploit the benefits of being the first mover in EEs in terms of reputation, market share, sales and volume. They can moreover, through domination of distribution and communication channels, obtain strong dominant positions. But, as institutions change and the ECs dynamism is deployed, firms without government relationship could lose their advantages (while local competitors have developed their capabilities). “In essence, a firm must understand the relationship between its company assets and the changing nature of the institutional infrastructure as well as the characteristics of the industry” (Hoskisson et al. 2000, p. 256).

With respect to EMs, RBV has been important in underlining a few aspects: local firms interest in acquiring resources from foreign alliances; the importance of
network ties as an intangible resource; changing benefits of unrelated diversification as economic institutions develop (Barney et al. 2001). Indeed “one of the most popular fields for RBV focuses on foreign entrants, and on the resources and capabilities underpinning successful alliances and acquisitions in EEs” (Hoskisson et. al. 2000, p.5). Authors have found that addressing group resource-sharing, two concepts are faced: heterogeneity and cross-subsidization of tangible and intangible resources. This way firms enjoy benefits from sharing resources with other member firms (namely business groups): for debt guarantee, equity investment, internal trade, as well as, technical capabilities, intangible assets and financial assets (Hitt et al. 2000).

Finally, a particular form is the Knowledge-based perspective, in a sense that, from tangible assets to finance, scholars have noticed that the focus of firms move towards processes of knowledge creation. Knowledge has been identified as the core resource on which dynamic capabilities are based (Hansen and Kuada, 2006).

**Agency theory**

AT suggests that managers are expected to comply with the interests of external owners of private enterprises. The main reason is constituted by “the asymmetric information that exists between managers and external (especially diffused) investors” (Hoskisson et. al. 2000, p.255). In fact, AT theorists suggest that poor performance can be substantially avoided, in case of information asymmetries, through networking and hierarchical governance structure mechanisms. The first approach is based on the transfer of detailed information between the exchange partners (Uzzi, 1996) that may significantly reduce information concerns. The second is conversely based on a formal communication and management control system. Indeed MNCs’ headquarters could discipline poor performance of the affiliated (Gatignon and Anderson, 1988) and the same function can be provided by business groups for their members. This implies that poor performance by unaffiliated EEs firms will persist more than poor performance by affiliated EE firms.
In terms of internal governance, the Russian case shows how block holders may improve firm performance by improving monitoring, enabling foreign owners to introduce new capital and western experience (Earle and Estrin, 1996). Moreover, evidence from Central and Eastern Europe show that incentives for managers are not always an efficient tool in enhancing performance, but, on the other hand they can constitute a more effective manager replacement policy option. Several scholars (Wright, Filatotchev or Estrin) have demonstrated that with severe product market conditions or the need of retrenchment strategies, the main outcomes might be the improvement of the governance system and the reduction of agency costs. However, even if there is relatively little AT based research, an integrated approach with IT perspective can be useful. We will discuss it further in the following paragraphs.

- **Strategy integrated framework** for EEs

None of the above explained perspectives, can work efficiently by themselves, especially when we are building strategies for specific countries such as EEs. Several authors have noted that the industry and resource-based approach on context-aspects, namely task environment\(^\text{19}\), is incomplete. Peng (2006; et al., 2008) argues that the institution based view constitutes one leg sustaining a “strategy tripod”, in an integrated theoretical framework composed of Porter’s industry and Barney’s resource-based view. Peng, Wang and Jiang (2007) argue that the treatment of institutions as a mere background is insufficient and can rarely represent a source of advantage opportunities. Here we deal with the institutions as independent variables (Peng, 2006), the strategic options are outcomes of the interaction between these and the dynamism of the company. In the figure below the strategy tripod:

\(^{19}\)economic variables such as market demand and technological change
Institutions, have a direct impact on the performance of a firm as it has on the strategic choices when creating competitive advantages. For example, there are several documented researches concerning MNCs subsidiaries (Makino et al., 2004), explains that country-effects in EEs (proxies for institutional differences) are crucial, while corporate-effects are more critical when explaining subsidiary performance in developed economies (Peng et al. 2008). “Institutions govern societal transactions in the areas of politics (e.g. corruption, transparency), law (e.g. economic liberalization, regulatory regime), and society (e.g. ethical norms, attitudes toward entrepreneurship)” (Peng et al. 2008, p. 922).

In order to add understanding to strategy in EEs, Peng et al. (2008 considered the institution based view on several aspects: entry barriers, interpersonal ties to overcome institutional ineffectiveness and governance corporate aspects in EEs. Entry barrier research was usually focused on market based variables (economy of scale or product differentiation), while concerns coming from anti-dumping for instance, represented an even more crucial institutional aspect. In 21st century, non-tariff barriers became increasingly important when the WTO enhanced the openness of the markets by removing tariff barriers, This implied a potential government assistance in defending domestic companies. So that, anti-dumping penalties represented a crucial determinant for MNCs foreign market entries (Peng et al., 2008)
From an on-ground point of view, if interpersonal relationships are the main drivers for market performance when institutions are ineffective, MNCs should leverage on them and aim at building effective relations. MNCs dynamism and flexibility of strategies is definitively required in such contexts, since interpersonal relationships (as we have seen previously) among managers are translated as informal substitutes for formal institutional structures.

Furthermore, governing the corporation is historically an area of study based on AT. In developed economies, the key conflicts are principal-agents between shareholders and managers: while in EEs, recent researches have demonstrated that principal-principal (controlling shareholders vs. minority shareholders) is the more problematic method. The standard measure to enhance corporate governance, that is to increase the number of outside managers, is not relevant here. To the contrary, it becomes the connection and embeddedness of directors in networks the main requirement for a successful governance. Peng et al. (2007) suggests that increasing the shareholding of block holders (owing more than 5% of the equity), can be disastrous in EEs, because such controlling shareholders usually have already too much concentrated ownership and control rights, which allow some of the them a potential expropriate power vis-a-vis minority shareholders.

Wright et al. (2005) concludes that two strategic options exist for MNCs in EEs, considering resources, institutional changes and governance concerns:

- Exploit the skills developed in the home market, especially in the first post-entry stages.
- Incumbent and start-up firms should develop exploratory strategies and a continuous learning approach in order to match changes in the EC’ institutional environment and eventually reconsider modes of operation, and finally presence in the country.
Partner selection

We can argue that partner selection is a crucial matter of strategy in EEs. This means that for both MNCs and ECs subsidiaries, collaboration becomes decisive. Child et al. (1998, p. 297) argued that “when one of the partners comes from an EC and the other from a highly developed economy, their configuration of objectives will most certainly differ from that in the case of partners from two developed countries”. Moreover, from a resource-based point of view, Dunning (2000) argues that partner selection importance comes from the need to complement firm core competencies with those of other firms, concluding appropriate collaborative arrangements.

In the table below the determinants in selecting partners from both developed countries MNCs and EMs affiliates (Hitt et al. 2000).

Table 15 – Partner selection determinants in Emerging Market Contexts

<table>
<thead>
<tr>
<th>Partner selection determinants</th>
<th>Foreign MNC</th>
<th>EM Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>++</td>
<td>++</td>
</tr>
<tr>
<td>Technological capabilities</td>
<td>/</td>
<td>++</td>
</tr>
<tr>
<td>Managerial capabilities</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Sharing expertise</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Market Knowledge</td>
<td>++</td>
<td>/</td>
</tr>
<tr>
<td>Complementary capabilities</td>
<td>++</td>
<td>++</td>
</tr>
<tr>
<td>Unique competencies</td>
<td>++</td>
<td>+</td>
</tr>
</tbody>
</table>

The table is based on a survey completed by executives from 202 firms, analyzed through a hierarchical linear model (Hitt et al., 2000)
++ high correlation; + correlation; / neutral
High potential for economic growth in EEs is associated with volatility and high risk. A poorly developed financial market (weak institution for capitals, and high volatility) determines the difficulties in finding capital for investments. A strategic alliance could provide help for both the EC’ affiliate and the MNC in this, a financially healthy partner can represent a need for competition and/or survival (Hitt et al., 2000).

Another important determinant for partner selection might be technology ownership and knowledge. It might be that EM firms do not have the chance to develop high sophistication technologies, and so they seek MNCs partners in order to have access to such learning processes. On the other hand developed market firms, own technological capabilities, and they might be less interested in this aspect and so select their partners. It has been noticed though, that “from a policy-making perspective, entry mode is a consequence of the stylized result that the extent of technology transfer by a MNC to a developing or emerging country affiliate, depends significantly on the extent to which the parent can exert control over the affiliate, which, in turn, is determined by the mode of entry of the MNC into that country” (Bhaumik and Gelb, 2005, p. 21).

There is also the need of management capabilities and expertise of international markets and competition: undoubtedly EM firms look for it more than a MNC from a developed one. Foreign MNCs though, might desire a managerial capability based on a EC specific features, in particular to compensate its own deficiencies on market knowledge and to counteract lack of effective enforcement mechanisms. As regards to intangible resources, executives from EM firms may more strongly emphasize intangible assets in selecting international strategic alliance partners. On the other hand, developed MNC markets better evaluate partners with positive intangible resources and attractive reputations, since transnational strategies and local responsiveness patterns may strongly require it (Hitt et al., 2000)
ATTACHMENT 1 - Questionnaire to identify institutional voids (Khanna and Palepu, 2005)

**Political and social system**

1. To whom are the country’s politicians accountable? Are there strong political groups that oppose the ruling party? Do elections take place regularly?
2. Are the roles of the legislative, executive and judiciary clearly defined? What is the distribution of power between the central, state and city governments?
3. Does the government go beyond regulating business to interfering in it or running companies?
4. Do the laws articulate and protect private property rights?
5. What is the quality of the country’s bureaucrats? What are bureaucrats incentives and career trajectories?
6. Is the judiciary independent? Do the courts adjudicate disputes and enforce contracts in a timely and impartial manner? How effective are the quasi-judicial regulatory institutions that set and enforce rules for business activities?
7. Do religious, linguistic, regional and ethnic groups coexist peacefully or are there tensions between them?
8. How vibrant and independent is the media? Are newspapers and magazines neutral or do they represent sectarian interests?
9. Are NGOs, civil rights groups and environmental groups active in the country?
10. Do people tolerate corruption in business and government?
11. What role do family ties play in business?
12. Can strangers be trusted to honor a contract in the country?
Openness

1- Are the country’s government, media and people receptive to foreign investments? Do citizens trust companies and individuals from some parts of the world more than others?

2- What restrictions does the government place on foreign investments? Are those restrictions in place to facilitate the growth of domestic companies to protect state monopolies, or because people are suspicious of multinationals?

3- Can a company make greenfield investments and acquire local companies, or can it only break into the market by entering into joint ventures? Will that company be free to choose partners based purely on economic considerations?

4- Does the country allow the presence of foreign intermediaries such as market research and advertising firms, retailers, media companies, banks, insurance companies, venture capital firms auditing firms, management consulting firms, and educational institutions?

5- How long does it take to start a new venture in the country? How cumbersome are the government’s procedures for permitting the launch of a wholly foreign-owned business?

6- Are there restrictions on portfolio investments by overseas companies or on dividend repatriation by multinationals?

7- Does the market drive exchange rates, or does the government control them? If it’s the latter, does the governments try to maintain a stable exchange rate, or does it try to favor domestic products over imports by propping up the local currency?

8- What would be the impact of tariffs on a company’s capital goods and raw materials imports? How would import duties affect that company’s ability to manufacture its products locally versus exporting them from home?

9- Can a company set up its business anywhere in the country? If the government restricts the company location choices, are its motives political or is it inspired by a logical regional development strategy?
10- Has the country signed free-trade agreements with other nations? If so, do those agreements favor investments by companies from some parts of the world over others?

11- Does the government allow foreign executives to enter and leave the country freely? How difficult is it to get work permits for managers and engineers?

12- Does the country allow citizens to travel abroad freely? Can ideas flow into the country unrestricted? Are people permitted to debate and accept those ideas?

Product Market

1- Can companies obtain reliable data on costumer tastes and purchase behaviours? Are there cultural barriers to market research? Do world class market research firms operate in the country?

2- Can consumers easily obtain unbiased information on the quality of the goods and services they want to buy? Are there independent consumer organizations and publications that provide such information?

3- Can companies access raw materials and components of good quality? Is there a deep network of suppliers? Are there firms that assess suppliers quality and reliability? Can companies enforce contract with suppliers?

4- How strong are the logistics and transportation infrastructures? Have global logistics companies set up local operations?

5- Do large retail chains exist in the country? If so, do they cover the entire country or only the major cities? Do they reach all consumers or only wealthy ones?

6- Are there other types of distribution channels, that deliver products to customers?

7- Is it difficult for multinationals to collect receivables from local retailers?

8- Do consumers use credit cards, or does cash dominate transactions? Can consumers get credit to make purchases? Are data on costumers creditworthiness available?
9- What recourse do consumers have against false claims by companies or defective products and services?

10- How do companies deliver after-sales service to consumers? Is it possible to set up a nationwide service network? Are third party service providers reliable?

11- Are consumers willing to try new products and services? Do they trust goods from local companies? How about from foreign companies?

12- What kind of product related environmental and safety regulations are in place? How do the authorities enforce those regulations?

Labor markets

1- How strong is the country’s education infrastructure, especially for technical and management training? Does it have a good elementary and secondary education system as well?

2- Do people study and do business in English or in another international language, or do they mainly speak a local language?

3- Are data available to help sort out the quality of the country’s educational institutions?

4- Can employees move easily from one company to another? Does the local culture support that movement? Do recruitment agencies facilitate executive mobility?

5- What are the major post-recruitment training needs of the people that multinationals hire locally?

6- Is pay for performance a standard practice? How much weight do executives give seniority as opposed to merit in making promotion decisions?

7- Would a company be able to enforce employment contracts with senior executives? Could it protect itself against executives leaving the firm and then compete against it? Could it stop employees from stealing trade secrets and intellectual property?
8- Does the local culture accept foreign managers do the laws allow a firm to transfer locally hired people to another country? Do managers want to stay or leave the nation?

9- How are the rights of workers protected? How strong are the country’s trade unions? Do they defend workers interest or only advance a political agenda?

10- Can companies use stock options and stock based compensation schemes to motivate employees?

11- Do the laws and regulations limit a firm’s ability to restructure, downsize or shutdown?

12- If a company were to adopt its local rivals or suppliers business practices, such as the sale of child labor, would that tarnish its image overseas?

**Capital markets**

1- How effective are the country’s banks, insurance companies and mutual funds at collecting savings and channelling them into investments?

2- Are financial institutions managed well? Is their decision making transparent? Do noneconomic considerations such as family ties, influence their investment decisions?

3- Can companies raise large amounts of equity capital in the stock market? Is there a market for corporate debt?

4- Does venture capital indstry exist? If so does it allow individuals with good ideas to raise funds?

5- How reliable are sources of information on company performance? Do the accounting standards and disclosure regulations permit investors and creditors to monitor company management?

6- Do independent financial analysts, rating agencies and the media offer unbiased information on companies?

7- How effective are corporate governance norms and standards protecting shareholder interests?
8- Are corporate bonds independent and empowered and do they have independent directors?
9- Are regulators effective at monitoring the banking industry and stock markets?
10- How well do the courts deal with fraud?
11- Do the laws permit companies to engage in hostile takeovers? Can shareholders organize themselves to remove entrenched managers through proxy fights?
12- Is there an orderly bankruptcy process that balances the interest of owners, creditors, and other stakeholders?
Chapter 4

Entry mode choice

The entry mode choice is, in this research, the most crucial aspect and at the same time the final objective of our ECs’ strategic method. Given the analysis in the second chapter of the country’s potential profitability in terms of market; the research of all the institutional voids of the country through the 5-contexts framework; the political risk assessment; the elaboration of an integrated framework throughout the main theoretical perspectives (IT, RBV, TCT, AT); and finally the analysis of the determinants that involve the firm in its selection of a partner. We are now able to choose the mode through which the MNC may enter in the targeted Emerging Host Country.

Since the 1970s the internationalization approach identified licensing, franchising, and subcontracting other than exporting and FDI as entry modes. The 1980’s highlighted the choice between greenfield and acquisitions and JV. Finally in the 90’s the role of FDI in EEs brought back the determinants of the various modes of entry (Zhang Y. et al., 2007). We have chosen to give a comprehensive introduction to the argument through a Strategy Set. It encompasses all the major entry market strategies, distinguishes production, distribution and takes into account the strategic interaction between the foreign entrant and its leading host country (Buckley and Casson 1998).

- Entry mode Strategy set

The objective of the Strategy is to determine all the possible entry modes and measure the profitability associated with each of them.

In the table below twelve entry strategies are listed, six of them have several variants (on the right of the table), while the dimensions of the strategy laid out are based on the following issues: (1) where production is located; (2) whether production is owned by the entrant; (3) whether distribution is owned by the
entrant; (4) whether ownership is outright or shared though a JV; and (5) whether ownership is obtained through greenfield investment or acquisition (Buckely and Casson, 1998).

Table 16 – Twelve entry strategies and their variants

<table>
<thead>
<tr>
<th>Entry mode</th>
<th>Description</th>
<th>Variants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Normal FDI</td>
<td>Entrant owns foreign production and distribution facilities</td>
<td>1.1 both facilities are greenfield</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.2 both facilities are acquired</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.3 production is greenfield and distribution is acquired</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.4 distribution is greenfield and production is acquired</td>
</tr>
<tr>
<td>2 FDI in production</td>
<td>Entrant owns foreign production, but uses independent distribution facilities</td>
<td>2.1 production is greenfield</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2.2 production is acquired</td>
</tr>
<tr>
<td>3 Subcontracting</td>
<td>Entrant owns foreign distribution, but uses independent production facilities</td>
<td>3.1 distribution is greenfield</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.2 distribution is acquired</td>
</tr>
<tr>
<td>4 FDI in distribution</td>
<td>Entrant exports to own distribution facility</td>
<td>4.1 distribution is greenfield</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4.2 distribution is acquired</td>
</tr>
<tr>
<td>5 Exporting/Franchising</td>
<td>Entrant exports to independent distribution facility</td>
<td></td>
</tr>
<tr>
<td>6 Licensing</td>
<td>Entrant transfers technology to independent integrated firm</td>
<td></td>
</tr>
<tr>
<td>7 Integrated JV</td>
<td>Entrant jointly owns an integrated set of production and distribution facilities</td>
<td></td>
</tr>
<tr>
<td>8 JV in production</td>
<td>Entrant jointly owns foreign production, but uses an independent distribution facility.</td>
<td></td>
</tr>
<tr>
<td>9 JV in distribution</td>
<td>Entrant jointly owns foreign distribution, but subcontracts production to an independent facility.</td>
<td></td>
</tr>
<tr>
<td>10 JV in exporting</td>
<td>Entrant exports to a jointly owned</td>
<td></td>
</tr>
</tbody>
</table>
The figure below, distinguishes linkages involving the flow of information from R (R&D) to P (Production) and M (Marketing) to D (Distribution), and linkages involving the flow of physical product from P to D, and from D to final demand. Location is distinguished by the columns and ownership by the rows. Ownership by the entrant is also identified by shading: facilities owned by the local rival are shown as clear. Finally the entry modes associated with each particular linkage are indicated by the numbers 1-12 (see table above).

**Figure 17 – Twelve entry strategies and their variants**

![Diagram of twelve entry strategies and their variants](source: Buckley and Casson (1998))
Profit equations

Applying the assumptions of the figure above, we are able to identify the cost equations of each strategy. Given that every strategy faces some additional costs compared with reference strategy 1 pursued in ideal conditions. The correspondent profit equations for each possible strategy are in the table below:

Table 18 – Costs of alternative strategies compared with the profit norm

<table>
<thead>
<tr>
<th></th>
<th>Variables:</th>
</tr>
</thead>
<tbody>
<tr>
<td>( C_{1,1} = )</td>
<td>( r q_1 + r q_2 + ra + s + rm )</td>
</tr>
<tr>
<td>( C_{1,2} = )</td>
<td>( r q_1 + r q_2 + ra + rm )</td>
</tr>
<tr>
<td>( C_{1,3} = )</td>
<td>( rq_2 + ra + rm )</td>
</tr>
<tr>
<td>( C_{1,4} = )</td>
<td>( rq_3 + ra + rm )</td>
</tr>
<tr>
<td>( C_{2,1} = )</td>
<td>( t_3 + s )</td>
</tr>
<tr>
<td>( C_{2,2} = )</td>
<td>( rq_1 + t_3 + ra + s + rm )</td>
</tr>
<tr>
<td>( C_{3,1} = )</td>
<td>( t_1 + -t_3 + ra + s + rm )</td>
</tr>
<tr>
<td>( C_{3,2} = )</td>
<td>( t_1 + r q_2 + t_3 + ra + s + rm )</td>
</tr>
<tr>
<td>( C_{4,1} = )</td>
<td>( z + ra + s + rm )</td>
</tr>
<tr>
<td>( C_{4,2} = )</td>
<td>( z + r q_2 + r q_3 )</td>
</tr>
</tbody>
</table>

\( a \) a case in which the firm is already acquainted with the local market, and there is no indigenous rival: (sales \( p_1 \) \( \cdot \) local rival price; \( p_2 \) \( \cdot \) entrant price; \( t_1 \) \( \cdot \) internal costs of technology transfer; \( t_2 \) \( \cdot \) cost of licensing; \( t_3 \) \( \cdot \) additional transaction costs; \( q_1 \) \( \cdot \) cost to build trust in technology transfer; \( q_2 \) \( \cdot \) build trust in transferring marketing expertise; \( q_3 \) \( \cdot \) build trust in transferring an intermediate product (when P or D is acquired)

\( s \) \( \cdot \) lost sales revenue (\( p_1 \) \( - \) \( p_2 \))

\( j_1 \) \( \cdot \) technology transfer; \( j_2 \) \( \cdot \) marketing expertise; \( j_3 \) \( \cdot \) intermediate output flow.

Once for all costs: \( m \) \( \cdot \) learning costs; \( a \) \( \cdot \) adaptation costs; \( q_i \) and \( j_i \) \( \cdot \) trust-building costs
Finally, the strategy choice depends on the relative magnitude represented by the several variables. The easiest way to understand what is the best win strategy for a given MNC is to eliminate any strategy that is dominated by the others through a gradual comparison of the various costs and advantages that might be achieved.

- Determinants and variables affecting entry mode choices

To be consistent with the biggest part of the researchers on entry mode choices, almost exclusively based on the three reference entry forms, we are going to investigate how JV, Greenfield and Acquisition are determined by several crucial factors.

In general terms: “a JV is the most convenient way to acquire the resources of a local partner as well as minimizing environmental risk; Greenfield provides the greatest control over the local facilities but sometimes may not be related with policy privileges from governments; and finally, acquisitions offer the fastest means of building a presence in foreign market, but problems may be caused by overpayment and the challenge of cultural and national differences” (Zhang et al. 2007, p.756).

Usually, a MNC entering an EE may have a technological advantage vis-a-vis local competitors, as well as concerns about local market knowledge and business
environment. Normally, we will see that entering in a new country by partnership can alleviate many concerns, it definitely reduces the MNC’s transaction costs of doing business (Bhaumik and Gelb, 2005). Therefore if a MNC enters the new EC for resource seeking, and the environmental difficulties associated with the country (institutional voids) are not conducive for an efficient business, a local partner (JV or acquisition) might be the best choice. There are however several costs that are normally associated with JV, acquisitions and greenfields. Bhaumik and Gelb (2005) review the general concerns associated with the main entry modes:

- A JV for instance, can create agency concerns between the partners, since long-term objectives of the actors may be different or not complementary for most of the time. On one hand, the MNC generally implements a learning approach about local environment and business conditions. On the other hand, the EC partner is supposed to seek access to the proprietary technology of the MNC. The conflicts may, after few years, even be solved by the dissolution of the JV. Empirical studies have though demonstrated that only when the home country has a relative technological advantage, a firm might exploit it abroad by establishing greenfield operations (Anand and Delios, 2002).

- Acquisitions, present many problems as costs associated with the restructuring of the acquired organization (the more it is culturally distant, the higher the costs), can be inefficient. Besides, a greenfield may be the best option only when the MNC has a prior operating experience in similar countries: firms entering the market with small cultural differences perceive low levels of country risk and therefore, they may use entry modes that maximize firms specific advantages (Brouthers and Brouthers, 2000).

- Another element that can be important for entry choices is the relative size of the EC-based operations: a greenfield entry might be the best choice when the EC affiliate constitutes a significant portion of the MNC assets and turnover, mainly because, in case of partnership, the
opportunistic behaviour of a partner could affect the global performance of the company and spread risk within the whole corporate structure.

When in presence of a very competitive local market, a risk averse behaviour suggests finding a partner, because the MNC’ superior technological knowledge might not be sufficient to gain absolute advantage on local competitors. But then, for instance, it might be more likely to opt for a greenfield entry if the rules governing the specific industry and the domestic government are working well.

Below, the entry mode function of the main aspects that determinates the choice between JV/Acquisition/Greenfield, based on Bhaumik and Gelb (2005):

\[
\text{Entry mode} = f: (\text{Growth of local industry}, \text{Technology-intensiveness of product}, \text{Competition in the local market}, \text{Resource needs of the MNC}, \text{Local institutions, governance, and business regulations}, \text{Prior operating experience in developing-country environments}, \text{Cultural distance between MNC’s home country and host country}, \text{Extent of liberalization of FDI regulations and industry-specific regulations}, \text{Perceptions about quality of host country’s managerial labour}, \text{Sector of operation of the MNC})
\]

<table>
<thead>
<tr>
<th>Table 19 – General entry mode choice determinants$^{22}$</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cultural distance</strong></td>
</tr>
<tr>
<td><strong>Competition</strong></td>
</tr>
<tr>
<td><strong>Resource need</strong></td>
</tr>
<tr>
<td><strong>Knowledge of the country</strong></td>
</tr>
<tr>
<td><strong>Relative size of the investment</strong></td>
</tr>
<tr>
<td><strong>Quality of local management</strong></td>
</tr>
</tbody>
</table>

$^{22}$ The table is based on the results of a multinomial logit regression model based on responses from a sample of 114 observations in South Africa.
Technology intensiveness of the product & x & \\
Growth of local industry & x & \\
Extent of liberalization of FDI regulations and industry-specific regulations & x & \\
Future Expected Profitability of the industry & x & \\

Specific determinants of the Investing firm

One of the investing firm specific factors for EC entry, is the MNC’ input dependency. Demirbag et al. (2008) argues that this aspect can be explained by both the Resource Dependence Theory and the RBV: the first considers the firm facing a complex set of resource dependencies, thus, in general terms, MNCs would choose a greenfield mode of entry to avoid agency concerns and costs coming from partner-relationships. RBV instead (resources are inimitable and imperfectly substitutable), considers a greenfield investment as preferable because it protects such resources, allowing a more efficient knowledge transmission between parent and subsidiary.

Diversified companies could prefer acquisitions instead of greenfields, in this way getting all the advantages coming from such mode of entry, and exploiting their sophisticated management practices, minimizing transaction costs (Brouthers and Brouthers, 2000). Even if empirical studies have produced ambiguous results when dealing with this aspect, in most of them is confirmed the tendency toward acquisition mode strategies concerning diversified companies.

Another specific determinant for firms is the past experience and knowledge of the country. An initial mode of entry experience in the host country may affect investment decision (path dependency). If the path dependency is based on a previous commercial association of the MNC, it is likely that the chosen mode of entry will be an acquisition. The basic argument is that lower transaction costs are expected with previous commercial association in the country. Larimo (2003) also
suggests that past experience in a country could facilitate more autonomy and so greenfield investments.

*Cultural distance* is a widely used determinant to elaborate entry strategies for MNCs (Harzing, 2002), as we have already seen. However, Demirbag et al. (2005), integrate it with TCT: as cultural distance (or dissimilarity) increases, investment in non-redeployable capabilities liable assets in the EC becomes riskier. So, we might hypothesize higher efficiency levels of a greenfield investment, since strong differences in the host country contexts could create concerns in the management practices, between MNCs and partners. Indeed, an higher cultural distance facilitates partnerships (JV or acquisitions), in order to avoid lack of environment/market knowledge (Brouthers and Brouthers, 2000).

Finally, it can be argued that there is a relationship between the *size of the parent firm* and the entry modes. The greater is the size of the parent organization, the greater the likelihood of a greenfield entry (Demirbag et al. 2005). Scholars have also sustained the opposite argument: since larger firms have managerial resources and capabilities to facilitate integration and transaction costs, they may tend to prefer acquisitions.

**Table 20 – Investing firm specific determinants**

<table>
<thead>
<tr>
<th>The higher is…</th>
<th>Acquisition</th>
<th>Greenfield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Input dependency</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Extent of diversification</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Previous commercial association</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Cultural distance</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Parent size</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

23 The table is based on the Demirbag et al. (2005) research on 145 foreign affiliates formed by MNCs from 15 different countries. The method is the binomial logit analysis
Timing of Entry

EEs can present several reasons for delaying entry decisions by MNCs. In many cases, it is empirically demonstrated that the trade off between a pioneering presence in the country and the “wait and see” choice, can favour cautious behaviour. Anyway as Brourthers and Brourthers (2000) argued, in fast growing markets opportunity costs for absent companies are high.

The “wait and see” position is obviously in contrast with the largest MNCs entry choices. They usually make aggressive penetration strategies and investments but with relative low risk (e.g. Coca-Cola; Nestle), given the dimension of the capital involved (Arnold and Quelch, 1998).

Theoretically being First-mover provides economic advantages from critical sales volumes, domination of distribution, communication channels, reputational effects etc. However this could be the wrong approach for some of the EEs, since institutional voids and a difficult environment could block the enabling conditions for a quick and effective commercialization. However early entrants can gain advantage in terms of favourable government relations, marketing productivity, pent-up demand, marketing resources and consequent learning (Arnold and Quelch, 1998).

Several scholars argue that in order to be successful in a local market place, MNCs must enter faster than rivals. There are three reasons on which such advantages could be based:

- preference built by costumers that favours pioneering positions;
- switching costs that create barriers to late movers;
- product that becomes the industry standard, or market-dominant for its design.

Even if empirical evidence recognizes a superior performance to first movers, pioneers may have many problems. Late entrants in fact, may acquire or imitate technology with lower costs, or use superior technology after a learning process and capture shifts in consumer tastes more quickly (Isobe et al., 1998).
Another view of the MNCs entry timing is reported by Zhang et al. (2007) and it can be represented by three phases: 1) experimental phase; 2) strategic investment phase; 3) dominant phase. This gradual entering refers to MNCs entries in China, and it is based on different levels of involvement of both resources and financial commitments. It has been adopted by firms that invest in lines of business where they already have a competitive advantage. Over time, deeper market knowledge and stronger government relations, can enhance the entry of additional lines through strategic investments.

However, an early establishing of relations with government may have direct consequences on infrastructure projects led by governments. This kind of plan can be object of lobbying when the MNC can guarantee advantages for the local market and country development. Moreover, other than the possibility of catching up on the best local partners, long time government relationships may be built and they may provide good outcomes in the medium and long period. On the other hand, for smaller players, being first mover may mean to competitively leapfrog, therefore becoming an effective global counter-strategy. Arnold and Quelch (1998) found this true when there are: (a) less established brand preferences; (b) more fragmented industry structures; (c) high growth rates of the young firms seeking global competition and global customers.

Several authors argued that entry order effects might be significantly moderated by factors coming from entrant capabilities. Entrant incumbents always have advantages on newcomers, thanks to their superior knowledge and strategic assets ownership. Luo (1998), showed that early entrants in China attained higher performance in profitability, growth of sales and local competitive position.

Finally, Isobe et al. (1998) find three factors that influence a MNC timing strategy and related resource commitments:

- Strategic importance of the investment in the particular local market with respect to the global firm position
Entry Strategies are moderated by specific characteristics of the particular context in which each firm operates (Hoskisson et al., 2000). Therefore we will go on a review of the main effects that market supporting institutions have in certain cases, integrating them with the one determined by RBV and TCT.

Institutions, resources and entry strategies

Formal rules establish the permissible range of entry choices but informal rules (e.g. the extent to which bribery is accepted) may also affect entry decisions (Meyer et al. 2009). Weak institutional arrangements may magnify information asymmetries, so firms face higher partner related risks (Meyer, 2001). The more the institutional context is improved in a country, the lower are the costs associated in doing business (Estrin, 2002) and, from a ownership point of view, the more the need of a partner may decline. Institutions discriminate primarily between JV and acquisition/greenfield, while resource needs primarily discrimination between greenfield and JV/acquisition. Moreover, a lack of transparency in financial information on firms and a shortage of financial intermediaries can raise the complexity and costs of M&A (Meyer et al., 2009).

There are three main kind of resources as Meyer and Estrin (2001) argued: firm specific assets; excess managerial resources; and financial resources. These resources are the common engine for international transferring or leverage.

Now we will illustrate the main findings made combining Institutional and resource-based view:
- **H1** - *The stronger the market supporting institutions in an emerging economy, the less likely foreign entrants will enter by JV (as opposed to greenfield or acquisition).* (Meyer et al. 2009)

Even though Bhaumik and Gelb (2005, p. 20) confirm Meyer’s finding, he argues the opposite: “in South Africa, a low perceived quality of the institutions, is associated with a lower probability for acquisition and with a higher probability for JV relationships. In Egypt, on the other hand, a high value of institutions is associated with a lower probability for JV and a higher (though not statistically significant) probability for acquisition. The results suggest that, *ceteris paribus*, a low quality of institutions increases restructuring cost in South Africa and agency costs in Egypt”.

In EEs, investing firms usually require specific context resources to achieve competitive advantages. They come in two forms: 1) network and relationship-based strategies (since law and property rights enforcements are weak). 2) Local sources of strategic capabilities that enable the firms to build and maintain networks and relationships.

- **H2a** - *The stronger the need to rely on local resources to enhance competitiveness, the less likely foreign entrants are to enter in EEs by greenfield (as opposed to acquisition or JV); and H2b - this effect is stronger when requiring intangible assets compared to tangible assets.* (Meyer et al. 2009)

Finally, to understand how the two dimensions of institutions and resources interact, Meyer et al. (2009) built the following table:\(^{24}\):

\(^{24}\) Meyer et al. used a Multinomial logit regression model over a collection of datas coming from 613 responses received among 4 countries (Egypt, India, South Africa, and Vietnam)
Table 21 – Resources, Institutions and entry modes

<table>
<thead>
<tr>
<th>Local resources acquired</th>
<th>Extent of market failure</th>
<th>Institutional framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>None</td>
<td>weak</td>
</tr>
<tr>
<td>Tangible</td>
<td>Tangible</td>
<td>strong</td>
</tr>
<tr>
<td>Intangible</td>
<td>Intangible</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sensitivity to market failure</th>
<th>Greenfield</th>
<th>Greenfield</th>
</tr>
</thead>
<tbody>
<tr>
<td>H2a</td>
<td>JV</td>
<td>Greenfield</td>
</tr>
<tr>
<td>H2b</td>
<td>JV</td>
<td>Acquisition</td>
</tr>
</tbody>
</table>

Source: Meyer et al. (2009)

More specifically, by the integration of the institution and resource perspective:

- **H3 (a)** – Under conditions of strong institutions, the greater is the need of foreign entrants for intangible resources, the more likely they are to use acquisition or joint venture rather than greenfield; and (b) – under conditions of strong institutions, the need for local tangible resources will not influence the choice of entry mode. (Meyer et al. 2009)

**Transaction costs and entry modes**

TCT means that the MNC is seeking for a governance structure that minimizes transaction costs in a venture (Anderson and Gatignon, 1986). Costs are incurred for instance for the searching of suitable targets, analyzing economic viability, and negotiating with management (Meyer and Estrin, 2001). Demirbag et al. (2008) points out that one of the main arguments that TCT may provide about entry modes “lies in the transfer or use of the firm specific advantages in cross-border operations”. If TCs are low, the firm will prefer costs of adaptation, performance monitoring, and safeguarding against opportunistic behaviour, governed by the market (Luo, 2001), but there can be several cases in EMs, in which TC analysis might be less applicable. It appears in fact, that in situations

---

25 except when asset specificity is high, when acquisition or JV may be appropriate
26 except when market failure is bilateral and takeover is infeasible (e.g., due to scale issues)
like those faced by firms entering Central and Eastern Europe, concerns over costs of finding, negotiating and monitoring partners, may be nullified by either the lack of potential partners and the lack of a sound legal system of enforcement (Brouthers et al., 1998, p. 501). Sometimes phenomena such as bounded rationality and opportunism can increase TCs and so:

➢ **MNCs may opt for a high control mode if:** 1) the uncertainty of demand for a MNCS product is high; 2) foreign market attractiveness high; 3) cultural distance between a MNC home country and host country is high; 4) specificity of assets of the MNC is high; 5) the need for local contributions is low. (Luo, 2001)

Anderson and Gatignon (1986) argue that whereas MNCs are large enough to break even on the fixed costs of a high control mode, they have a choice to make, depending on four elements: a) transaction costs specific assets; 2) external uncertainty; 3) internal uncertainty; 4) free-riding potential. In the figure below, associated with each MNC construct there are the Possible modes of entry.

**Figure 22 – A transaction cost framework for analyzing the efficiency of entry modes**

---

Source: Anderson and Gatignon (1986)
Anderson and Gatignon (1986) provide the Entry modes associated with the TC framework above. P1: modes of entry offering greater control are more efficient for high proprietary products of processes; P2: entry modes offering higher degrees of control are more efficient for unstructured, poorly-understood products and processes; P3: entry modes offering higher degrees of control are more efficient for products customized to the user; P4: the more mature the product class, the less control firms should demand of a foreign business entity; P5: the greater the combination of country risk and transaction costs specified

- L) once the location is chosen, if this offers high attractiveness in terms of market opportunities, the investment mode choices are those that are supposed to give greater profitability in the long term;
- I) entry mode selection should be determined by global integration and internationalization needs. Low control modes might be appropriate for MNCs that are not looking for integration with target host country.

**Organizational capability**

“The impact that organizational capability can have on entry modes comes from the MNC’s need to be more and more globally efficient. A stronger need to complement and reinforce knowledge through collaboration for the purpose of developing firm capabilities” (Luo, 2001, p. 447). The conditions of developing new required capabilities in the context of the new hosting country can be hard and costly. Mainly because the entry mode choice is influenced by the costs of replicating knowledge within the firm (Collis, 1991).

High control and internalized entry modes may guarantee a competitive advantage when the firm has strong knowledge to protect and possesses good practices, since incremental costs are marginal and the efficiency of resource utilization may increase with the time. Meyer and Estrin (2001) talk about Brownfield project, an hybrid entry choice. This entry mode is based on the enablement of projects that neither foreign investors nor the local firm would have been able to adopt, typically it incurs high costs in term of integration and organization. Brownfield is seen by the authors as an opportunity especially when traditional entry modes
are not feasible. Indeed, brownfield requires both the acquisition of the firm and a radical restructuring, since many of its assets might not be interesting for the investor. It may be strategic in very particular cases.

**Bargaining power and entry modes**

Bargaining power theory argues that the entry modes chosen by MNCs depend on the relative power that it has to set discussion parameters, “win compromises from the other party and skew the outcome of negotiations towards its desired ownership alternative” (Luo, 2001, p.446). Bargaining power can indeed be advanced as a modification to resource dependency theory or as well as a strategic response to institutional pressures (Child and Tsai, 2005). On the one hand, resource dependency, may be mediated by the relative bargaining power and skills of the organization management (e.g. huge capital amounts and geostrategic choices in oil extraction sector). On the other hand though, a company might be able to bargain valued social benefits (e.g. local labor market or investments in local facilities) with favorable terms in institutional regulations.

In general terms finally, the bargaining power seeking may be itself a tool for strategic choice analysis. Organizations may seek to realize their goals in fact, “through selection between environments and through seeking accommodation and co-operation with external parties within given environments” (Child and Tsai, 2005, p. 100).

Here the major sources of bargaining power:

- **Host government**: ability to control market access and withdrawal of investment incentives. They prefer for MNCs *low degrees of control* in order to help transfer of technology to local firms and profits sharing.

- **MNCs**: it may come from the ability to dominate the market and protect proprietary technology. They may prefer *higher degrees* of control in these cases.
OLI advantage and Entry modes

Dunning (1988) argues that the choice of the entry mode during an international expansion of a firm, is based on three determinants: the Ownership advantages, the Localization advantages of the market, the Internationalization advantages of integrating transactions within the firm. Indeed, these determinants create three different entry mode choices:

- O) riskier modes of entry (full ownership) once competencies are strong enough to expect great return potential;
- L) once the location is chosen, if this offers high attractiveness in terms of market opportunities, the investment modes choice are those that are supposed to give greater profitability in the long term;
- I) entry mode selection should be determined by global integration and internationalization needs. Low control modes might be appropriate for MNCs that are not looking for integration with target host country.

Market penetration strategies

In the previous chapters we have reported the main existing theories about entry choices. These can actually be defined static. Several authors rightly assume that there is no limit to the traditional set of entry modes, we can in fact observe in the table below, how obstacles can be overcome “by customising a mode of entry to the local context, rather than opting for a second-best mode” (Meyer and Tran, 2006, p. 183). Empirical studies suggest that firms initially start with lower ownership positions, taking a series of sequential decisions as the experience in the country allows more secure benefits. The logic of this internationalization process is based on a grading from lower to higher levels or resource commitment (Zhang et al. 2007). Many scholars describe the entry in a foreign market as an integrated process of both exploiting home-based knowledge and exploring host-country specific knowledge (Peng and Wang, 2005: Zhang et al., 2007).

Entrants can go on idiosyncratic forms of acquisition such as staged, multiple, indirect and brownfield, as well as JV.
<table>
<thead>
<tr>
<th>Products</th>
<th>Foothold strategies</th>
<th>Aggressive market leadership strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Examples</strong></td>
<td>- Partial/staged acquisition - JV</td>
<td>- Conventional (full) - Multiple acquisition - Brownfield acquisition</td>
</tr>
<tr>
<td><strong>Resource commitment</strong></td>
<td>Initially low or moderate</td>
<td>High</td>
</tr>
<tr>
<td><strong>Control</strong></td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td><strong>Required knowledge of local context</strong></td>
<td>Low</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Speed of entry</strong></td>
<td>Low</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Sources of risk</strong></td>
<td>Risk being too slow, limited control over brand portfolio</td>
<td>Moderate degrees of all sources of risk</td>
</tr>
<tr>
<td><strong>Sources of flexibility</strong></td>
<td>Low initial sunk costs allow choosing alternative paths of growth later</td>
<td>High control allows changing the organization in a top-down manner</td>
</tr>
<tr>
<td><strong>Sources of rigidity</strong></td>
<td>Lock in contracts and relationships may limit growth options</td>
<td>Existing organizational structures may not fit the entrants business practices</td>
</tr>
</tbody>
</table>

Source: Meyer and Tran (2006)

Brouthers et al. (1998), referring to the Central and East European transitional markets, suggests the use of shared-control modes, but being prepared to utilize full control modes, can: (1) reduce the firm’s exposure to political and legal risks, (2) develop a greater understanding of the existing marketing infrastructures, (3) minimize their investment risks, and (4) increase the ability to participate in local markets by entering closed networks for distribution, gain access to raw material suppliers, and gain some levels of protection from the government.
Case study

Perfetti VanMelle: the Entry in India

We are here going to analyze, the Perfetti VanMelle’s entry in India.
The following case study is based on an interview with Stefano Pelle, COO of Perfetti VanMelle India (October the 27th, 2010).

The framework on which the analysis is based is the actual object of the theoretical research of this thesis.

- India: Emerging Country Analysis

Country Overview

India is considered by far the second largest emerging economy in the world, China being the first. Historically the attractiveness of such country has been enhanced by the economic liberalization and by a well functioning competitive market. Its strongest fundamentals are: a large domestic market, high savings and investment rates, diversified high-performance production, favourable demographics, balanced growth driven by investment, exports, and rapid growth of middle-class consumption.

Currently, India is the 4th largest economic system in the world in terms of purchasing power parity. This explain the extent to which, for MNCs, entering in
such a market is considered to be potentially profitable: the base of the pyramid is huge, being Indian population of 1.139.964.932 (World Bank, 2008). One of the major challenges for the Indian economy is to remove the economic inequalities that are still persistent in India after its independence in 1947. Poverty is still one of the major issues although these levels have dropped significantly in recent years. Over 26-27% of the working Indian population in fact is living below the poverty line.

In the table below some of the main Indian macroeconomic indicators (India Economic Survey Report, 2010). Further more, in table 25, Indian key development indicators in terms of Poverty, Mortality and Literacy., while table 26 the Global composite indexes

### Table 24 – Indian Macro Economic datas

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth rate</td>
<td>9.7</td>
<td>9.2</td>
<td>6.7</td>
<td>7.2</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-1.0</td>
<td>-1.3</td>
<td>-2.4</td>
<td>-3.3</td>
</tr>
<tr>
<td>Inflation CPI</td>
<td>6.7</td>
<td>6.2</td>
<td>9.1</td>
<td>11.4</td>
</tr>
<tr>
<td>Export growth</td>
<td>22.6</td>
<td>29.0</td>
<td>13.6</td>
<td>-20.3</td>
</tr>
<tr>
<td>Import growth</td>
<td>24.5</td>
<td>35.5</td>
<td>20.7</td>
<td>-23.6</td>
</tr>
<tr>
<td>Percapita consumption growth</td>
<td>6.7</td>
<td>8.3</td>
<td>5.4</td>
<td>2.7</td>
</tr>
</tbody>
</table>

*Source: India Economic Survey, 2010*

### Table 25 – Indian Key development indicator

- **Poverty (Below National Poverty Line)**
  - Rural: 28%
  - Urban: 26%
- **Fertility rate**: 2.5 births per woman
- **Life expectancy at birth**: 64 years
- **Infant mortality** (per 1000 live births): 57
- **Maternal Mortality** (per 100,000 live births): 450
- **Children Underweight** (below 5 years): 46%
- **Primary school enrollment, net**: 90%
- **Male Adult literacy** (age 15 and older): 73%
Table 26 - Global composite indexes

<table>
<thead>
<tr>
<th>Index</th>
<th>Rank / Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Competitiveness index ranking</td>
<td>51th</td>
</tr>
<tr>
<td>(out of 139 countries, for 2010)</td>
<td></td>
</tr>
<tr>
<td>Governance Indicators rank 28</td>
<td>44th</td>
</tr>
<tr>
<td>Voice and Accountability</td>
<td>0.47</td>
</tr>
<tr>
<td>Political Stability</td>
<td>-1.87</td>
</tr>
<tr>
<td>Government Effectiveness</td>
<td>-0.01</td>
</tr>
<tr>
<td>Regulatory Quality</td>
<td>-0.27</td>
</tr>
<tr>
<td>Rule of Law</td>
<td>-0.05</td>
</tr>
<tr>
<td>Control of corruption</td>
<td>-0.32</td>
</tr>
<tr>
<td>(Out of 214 countries, 2009)</td>
<td></td>
</tr>
<tr>
<td>Corruption Perceptions index ranking</td>
<td>84th</td>
</tr>
<tr>
<td>(Out of 180 countries, 2009)</td>
<td></td>
</tr>
<tr>
<td>Composite country risk points</td>
<td>70.5</td>
</tr>
<tr>
<td>(for January 2010; the larger the number, the less risky the country)</td>
<td></td>
</tr>
<tr>
<td>Weight in EMs MSCIbarra index (%)</td>
<td>5.12%</td>
</tr>
<tr>
<td>(out of 21 Emerging Markets, for February 2010)</td>
<td></td>
</tr>
</tbody>
</table>

However, we can sum up saying that the Entry in India embeds all the aspects that we have so far considered as the main drivers for entering in emerging economies.

As a consequence Perfetti VanMelle have 4 objectives:

1. The access to large and growing market
2. The access to low factor costs

---

28 an extended and more comprehensive “Governance Indicator analysis” is in the Attachment II at the end of this thesis
3. The access to global intellect (local talents and R&D investments)
4. The access to Asia (to be able to make early investments against reliance on other countries)

India: PVM country choice

Q (Pollavini): Why did PVM choose India? What were the objectives related with such choice: e.g. market potential; low cost factors; local talents; strategic position for Asia? Can it be represented as global counter strategy?

A (Pelle): “Market Potential, local talent were the main reasons for setting up business in India. The fact that there was also cheap labor was an add on, rather than a main reason, considering that the company was more a market seeker than a resource seeker.

India is also one of the few markets in the world which offers high prospects for growth and earning potential in practically all areas of business. Most of the employable population of India are professionals and degree holders in their respective fields with good command over English. Indian work force is also young. 54% of the Indian population is under the age of 25. This is also very important since our core target as a confectionery company are young people.

Indeed, as the growth potential for India was the main engine of PVM country choice, we asked which were the main tools to understand such context. But as we are going to see, country choice was mainly related with opportunity perceptions.”

Q (Pollavini): How did PVM develop India’s country analysis?

A (Pelle): “There was no specific country analysis at the moment of entry (1992/1993), but only the perception of a large opportunity coming up after the decision of the opening and liberalization of the Indian economy in 1991”.

5-Context Framework

In order to deal with the several institutional voids that an emerging country is supposed to present, firm’s executives may ask the 60 questions (see the questionnaire “Spotting Institutional voids” at p.71 of this thesis, from Khanna and Palepu, 2007).

In the table below we present a simplified version of such institutional context mapping.

<table>
<thead>
<tr>
<th>Political and Social System</th>
</tr>
</thead>
</table>
| **Figure 27 – Political Indicators**

Political Structure

The government is highly bureaucratic. Corruption is rampant in State and local governments. Concerning Private Property Rights protection Indian enforcement agencies are working effectively and there is a decline in the levels of piracy. In addition to intensifying raids against copyright violators, the Government has taken a number of measures to strengthen the enforcement of copyright law (e.g. Handbook of Copyright Law; training programs for the police; Copyright

---

Enforcement Advisory Council; setting up of special cells for copyright enforcement).

In 2005 a study done by Transparency international in India claimed that the 50% of the people are used to pay bribe or peddling influence to get a job done in a public office. Taxes and bribes are common between state borders, Transparency International estimates that truckers pay annually US$5 billion in bribes. A 2009 survey of the leading economies of Asia, revealed Indian bureaucracy to be not just least efficient out of Singapore, Hong Kong, Thailand, South Korea, Japan, Malaysia, Taiwan, Vietnam, China, Philippines and Indonesia; further it was also found that working with India's civil servants was a "slow and painful" process.

Civil Society

Three quarters of the population live in the rural areas, however democracy is vibrant, a dynamic press and vigilant NGOs act as checks on politicians and companies. “Upon an internal cultural diversity, within the ambit of civilizational unity, is based the reality of the multi-ethnic society of India. Several cultural markers - language, race, tribe, caste, religion, and region serve as identity axes for ethnic groups and their mobilization. In most of the ethnic groups, more than one of these cultural markers are pertinent for identification. The identity composition of ethno-communities has been further complicated by the imposition of class distinctions, not only between one and another ethno-community, but also within each. India also bears witness to the fact that the precipitation and intensification of ethnic conflicts by cultural diversity is not a unilinear or irreversible process. Ethnic conflicts have been resolved and reduced, but also re-created. The conflict arising out of the demand for the Tamil language and land during the early 1960s was resolved, although potential

30 from Business week, 2007: http://www.businessweek.com/magazine/content/07_12/b4026010.htm
tension between Tamil and the declared (but not imposed) national language, Hindi, still exists.”

2 - Openness

Modes of entry and FDI restrictions

Foreign investors can enter into the business in India either as a foreign company in the form of a liaison office/representative office, a project office and a branch office by registering themselves with Registrar of Companies (ROC), New Delhi within 30 days of setting up a place of business in India or as an Indian company in the form of a Joint Venture and wholly owned subsidiary. For opening of the foreign company specific approval of Reserve Bank of India is also required. Red tape hinders companies in sectors where the governments does allow foreign investments (e.g. arms and ammunition, atomic energy, railway transport, minings). FDI is permitted as under the following forms of investments (e.g. through financial collaborations, through joint ventures and technical collaborations, through capital market via euro issues, through private placements or preferential allotments). Investment in stock markets and real estate will not be permitted. Companies may retain the proceeds abroad or may remit funds into India in anticipation of the use of funds for approved end uses. Any investment from a foreign firm into India requires the prior approval of the Government of India. Foreign Investment Promotion Board (FIPB) is a competent body to consider and recommend FDI, which do not come under the automatic route.

3 - Product Market

Infrastructures

Logistics infrastructure is a critical enabler of India’s agenda for economic development.

---

32 Muni S.D., 2006, Ethnic conflict, federalism, and democracy in India: http://www.unu.edu/unupress/unupbooks/uu12ee/uu12ee0j.htm
33 from Indian Ministry of Commerce & Industry official website: www.dipp.nic.in
development and urbanization. Recognizing its pivotal role, the Indian government will have tripled annual spending on logistics infrastructure over the past seven years, from about $10 billion in 2003 to $30 billion in 2010. Despite this increase, the country’s network of roads, rail, and waterways will be insufficient to accommodate a threefold increase in freight movement over the coming decade. Urban infrastructure is a severe constraint to the expansion of key centers of growth, while weaknesses in basic rural infrastructure—from roads to electrification—have constrained the growth of the rural economy.

Market Research
There are loads of Market Research agencies and consulting firms that gives excellent report, provides a helping hand to the Indian and international companies. Out of the lot, IMRB International is the ground breaker in Indian Market Research. Others following the lead are: Delphi Research services; ORG-MARG; MRUC; NFO; Nielson India.

“Overall importance given by both rural and urban consumers to the foreign products against Indian products reveal that foreign products are far ahead than Indian products in the minds of the consumers in terms of style, appearance, prestige, wider choice and quality. Foreign products in comparison to Indian products have more positive image in the minds of rural consumers than urban consumers. The differences between rural and urban consumers as regards to image of foreign vis-à-vis Indian products were found significant in all the factors studied (e.g. better durability; technically advanced; more prestige; better maintenance services) except ‘good style and appearance’ of foreign brands” (Singh and Goyal, 2008, p.37).

---

34 McKinsey report, 2010, Building India: Transforming the nation’s logistics infrastructure
35 from World Bank official website: India country overview
4 - Labor Market

Workers Market

Labor Market in India is among one of the cheapest in the world. Besides, there are a large number of English knowing technically qualified workforce in the country. Mostly 70-80% of the schools and colleges in urban India in fact, and almost 50% of the schools in rural India teach subjects in English, except for languages.

The trade union movement is active and volatile, although it is becoming less important. Labor force participation is a low 400 million of a 1 billion population. Organized employment though has been stagnant at 30 million for thirty years (22 million in public sector, 8 million in private sector), while unorganized employment is the bulk of the labor force (340 million). Even if skilled labour low wages are attractive, the rise of them is susceptible of eroding this competitive advantage. Given that 269 million people are below the poverty line, even the majority of those employed can barely sustain themselves, given India’s employment elasticity (0.15), the 8 million new jobs needed to freeze unemployment require an impossible annual GDP growth rate of 13.6% and investments of $125 billion.

5 - Capital Markets

Figure 28 - Key business risk to foreign investors

---

37 TeamLease, 2005, India’s labor market, White paper
Debt and Equity

The local banking system is well developed. Multinationals can rely on local banks for local needs. Equity is available to local and foreign entities. Here both the government and public companies can raise short term and long term funds, depending on their requirements. Historically, different kinds of financial intermediaries have existed in the Indian financial system. Banks financed only working capital requirements of corporates. As the capital market was underdeveloped, a number of development finance institutions (DFIs) were set up at the all-India and the State levels to meet the long-term requirement of funds. As the stock market played a limited role in the early stages, the relationship between the stock market and the real economy in India has not been widely examined. Most of the earlier empirical studies focused on banks’ role in financial deepening and development. More recent work suggests that the functional relationship between stock market development and economic growth is weak in the Indian context (Nagaishi, 1999). On the contrary, Shah and Thomas (1997) argue that the stock market in India is more efficient than the banking system and hence an efficient capital market would contribute to long-term growth through efficient allocation and utilisation of resources.\(^{39}\)

Accounting Standards and Financial Distress

Financial reporting which is based on a common-law system functions well. In India it is generally believed that law overrides accounting standards. However, with an increase in number of corporate entities taking the M&A route as a strategy for growth and expansion, the Ministry of corporate affairs and the competent accounting bodies are working on harmonising the legal and other regulatory requirements with the International Financial Reporting Standards.

Bankruptcy processes exist but are inefficient. Promoters find it difficult to sell off or shut down “sick” enterprises. However Indian financial market is considered the fastest growing, and best among all the financial markets of the emerging economies.

“5-contexts framework” has helped us in pointing out which are the main reasons of markets failures and firms low performances. But as well this may represent a tool for entrants to understand and counteract all the possible institutional and country specific voids.

Q (Pollavini): Which were the main Institutional voids that India presented at the entry time? Which tools and techniques did PVM use to deal with them? How did PVM respond from a strategic and organizational point of view?

A (Pelle): “Unexpected delays and cost-overruns due to overlapping governmental jurisdiction, corruption and bureaucratic inefficiency were present at the time of our entry and, though improved substantially during the years, are to some extent still present today.

One of the legislative voids we were confronted to, was the difficulty to protect our trademarks. We dealt with this through strong legal actions, involving the police in the same so as to arrest those who acted in violation of a law in existence but hardly enforced. We also involved media in order to create awareness of the seriousness of the matter and the possible consequences. Another legislative void was the food law within we had to operate, a 1956 act (Prevention of Food
Adulteration) that was outdated and draconian. The same foresaw obsolete norms and allowed some middle level bureaucrats to blackmail companies by threatening to arrest the whole Board of Directors for minor offences (e.g. level of moisture in the product beyond a given limit). We also had to operate within the scheme of a reservation for small scale industry for the hard boiled candies. In order to find a viable solution to this we were obliged to produce our candies only under the toffee umbrella or under alternative allowed segment (e.g. Ayurvedic).

Also lack of proper infrastructure and transparency in doing business (obtaining approvals, permits etc…) were majors sources of delay and hurdles.”

**Political Risk Assessment**

In India, several consultancy agencies implement focussed advices to foreign investors. Foreign MNCs in fact may have little or no control over external events with reference to political risk. However, BusinessFoundations, a prestigious Indian Political Risk consultant, found the following elements to be crucial for business viability in the Indian context:

- slow-down in government decisions due to political instability
- adverse changes or unpredictability on foreign investment, import, ownership, pricing or tax issues
- cultural problems, delays or legal disputes due to local partners and suppliers
- labour unrest and industrial action
- disruption of normal business due to social and political unrest
- corruption and bureaucratic inefficiency
- unexpected delays and cost-overruns due to overlapping governmental jurisdiction
- fluctuation in interest, inflation and currency rates

Q (Pollavini): How did PVM deal with India’s political risk? Which were the tools
that PVM used to analyze it? And what about the responses: insurances, government relationships?

A (Pelle): “Many foreign investors like us find that, frequently, they have little or no control over external events which can adversely affect the commercial viability of their investments and future business plans. A possible example of this in India were the sanctions that some countries including USA were trying to slam on India after the nuclear tests at the end of the ‘90s. This might have affected the business in the country as well as our business. At this times in India government decisions are slow due to the political instability: however this happens also in Western country, e.g. Italy. There is sometimes disruption of normal business due to social and political unrest in some regions, but this happens also in European countries (e.g. recent public protests in France and Greece).

However one did not see a major political risk in India, due to the strong democratic feeling rooted in the country. As a good Corporate Citizen Perfetti decided to abide to the local rules and regulations and follow all procedures to set up a foreign investment in the country. In fact initially we needed to have a financial partner, since a fully owned subsidiary was not allowed at that time. We always had a good relationship with the government and made sure that we had respected local personalities within our business circle in order to help us in setting up and building our network in the business community as well as with the local authorities.”

• Strategy Elaboration

- PVM is a global confectionary company that manufactures and distributes confectionery & chewing gum products in over 130 countries the world with over 9000 employees.
- Many of its brands are famous names enjoying worldwide popularity: Mentos, Frisk, Fruittella, Alpenliebe, Golia, Happydent,
Vivident, Big Babol, Air Heads, Chupa Chups and Smint.
- There are 38 Confectionery companies in India but PVM is the largest selling company in India and, so far, even the largest player in the Asian Market.
- The Indian subsidiary also takes care of the development of South Asian markets and exports to other Asian countries

Perfetti VanMelle and the Indian Market: insights
“Per capita consumption of gum in India is 8 pieces per year, compared with 200 pieces in the US and 100 pieces in Russia. So there is an upside that confectioners like Perfetti can leverage. Suneja is pinning his hopes on India’s growing disposable income as well as changing lifestyle. […] Besides Chlormint, Perfetti is present in three sub-segments of the gum market: Center Fresh and Center Shock in chewing gum, Center Fruit and Big Babol in bubble gum and Happydent in functional gum. Happydent is a more cosmetic brand, Center Fresh is fruity but Chlormint is a coated gum through which we’ll target the young male adult,” explains Suneja. The positioning makes sense considering that half the country’s population is below 30. Brand experts believe the product will be consumed by those who smoke and want fresh breath — just like the hard-boiled Chlormint candy“ (Perfetti Managing Director, Sameer Suneja, 2010).

Strategy
In strategy elaboration, one of the main aspect to be considered by MNCs entering in ECs is the timing of entry. As we have analyzed in Chapter 4, the entry mode choice, related with the host country features, and as well the entry timing, mainly compared with competitors respective choices, may represent the fuel for sound future performances in the country.

40 Byravee Iyer, Perfetti Van Melle: Gum power, Business Standard, 2010
Q (Pollavini): What about the timing of the entry, compared to international competitors, was it first mover or “wait and see”? Which were the outcomes of such choice, so far? Firms that are able to exploit the benefits of being the first mover in EEs in terms of reputation, market share, sales and volume, through domination of distribution and communication channels, can obtain strong dominant positions. Was this the entry strategy for PVM in India? If so, why?

A (Pelle): “We were amongst the 1st movers. We started studying the market in 1992 and looked for an appropriate opportunity to purchase a land soon after the government opened its doors to foreign investment in the country in 1991. Cadbury, possibly the only International player at that time, was already present in the country since long time. We entered almost at the same time with another of our main competitors (Wrigley’s) and to some extent we did enjoy some of the 1st mover’s advantages. At that moment the market had mainly regional and not national brands. We were among the first to invest in Brand Building on a pan India basis. One of the successful actions was to link our gum brand Center Fresh to cricket, the national sport in India, and this yielded very good results. Also, we were among the first to innovate and offer good quality product at the market prices. Hence we gained distribution and popularity and our brands became household names”.

Moreover, as we have several times remarked in the theoretical part of this thesis, institutions and infrastructures efficiency constitute the main element to be considered for entry strategies as well for post entry strategies.

Q (Pollavini): Institutions, in emerging economies have a direct impact on firms performance as on firms strategic choices to create competitive advantages. For example, there are several documented researches concerning MNCs subsidiaries, explaining that country-effects in EEs (proxies for institutional differences) are crucial, while corporate-effects are more critical explaining
subsidiary performance in developed economies. How did PVM deal with a low degree of institutions effectiveness from an entry point of view?

A (Pelle): “As mentioned earlier, we adapted business model to the local reality. One of the example of adaptations to the poor local infrastructures was in the communication. At the time of our entry and throughout the year ‘90s the fixed phone landlines were difficult to obtain initially and often having problems of disrupted activities. We decided then to use mobile lines (at that time not so widely spread in India) to operate from offices so as to ensure the regularity of the business transactions.

In order to tackle the harassment from middle level bureaucrats (e.g. various inspectors, custom officers, etc) we made sure that our people were trained to understand our Group guidelines and code of conduct, and that strong actions were taken as soon as suspect behaviors were detected. In fact at times such issues happen also due to the different perception of values from the local people. We also created a local internal audit department which could serve as whistle blower in case of possible irregularity”.

Q (Pollavini): About transaction costs theory: scholars find that for EEs two transaction costs are critical: measurement and enforcement costs. Measurement costs, when price system does not provide signals for efficient resource allocation, and enforcement when official discretion is rather than the rule of law, the mechanism to ensure property rights. Is this the case of PVM India?

A (Pelle): “Availability of datas is the core matter for measurability. Such availability was not good when operations started, hence we had to develop it in time. We progressively developed our own databases also for external data (e.g. for the distribution and secondary sales). We measured our performances basis our estimated internal and external data. Later on international market research companies came to the market and improved the availability of external data. We progressively created an internal cost control department that ensured that our
costing and results were in line with the budgeted guidelines. Later on, when the size of operations justified the decision, we adopted an international ERP, an integrated system in planning and controlling our business activities in the various departments so as to help take informed decisions”.

Finally corporate social responsibility, in complex social context such as the emerging countries, is crucial. Firstly, considering social embeddedness and secondly considering potential favourable government relationships. In this respect the main actors considered by PVM were NGOs.

Q (Pollavini): *How does PVM India fit with non traditional partners such as NGOs?*

A (Pelle): “We did cooperate with few reputed NGO’s for social responsibility initiatives. We made sure to deal only with serious and renown NGOs for specific projects in Corporate Social Responsibility. Our cooperation with them was quite fruitful. One example of this was our adopting a fisherman’s village in South of India after the Tsunami disaster that affected the south India coastal areas”.

Other than these, among “context-partners”, business groups in such countries constitute a real important element that both may constitute an obstacle as well a driver to get advantage on competitors. It mostly depends if you are in, or you are out of that as COO Pelle is going to point out below.

Q (Pollavini): *Are there effective business groups? Are they an obstacle or an opportunity for PVM India?*
A (Pelle): “There are business groups in India. As an example we are part of Association of Confectionary Manufacturers. There are also other important business group, such the CII (Confederation of Indian Industries), which help lobbying to protect the interests of some industrial entrepreneurs and develop business opportunities. There are also more specific business groups (e.g. Association of sugar producers) who manage at times to influence the government and support the interests of the associated members. However such groups may sometimes create hurdles particularly for foreign investors, when they aim to protect local interests”.

In this respect, even personal ties, as we have seen in the 3rd chapter considering ties as drivers of competitive advantage (Li and Zhou, 2010), could help. However PVM performance was barely not affected by such elements.

Q (Pollavini): *To which extent PVM-India performance is affected by managerial ties in terms of institutional advantage vis-a-vis competitors?*

A (Pelle): In our industry we have not seen much of this, though one of our competitors has been operating in India for many years. However for instance, in the retail regulation the restrictions on foreign investment in retail sector, have so far impeded the flourishing of international retailing chains in the country.

**Entry Mode choice**

Entry mode choice is finally the outcome of all such strategic elaboration. PVM could not entering in the first 90’s with a fully ownership position. And as COO Pelle is going to explain below, this was due to the restrictions made by India with respect to foreign entrants. However this choice has been developed through a progressive penetration strategy (that we have examined in chapter 4). This
penetration bath is basically achieved buying progressively the equity of the local partner, as soon the host regulations permitted it. And, therefore after a good result in term of market knowledge and local culture adaptation of PVM.

Q (Pollavini): *What was the PVM India entry mode choice? And how did firm specific determinants (e.g. Input dependency, Cultural distance, Parent size) and general determinants (e.g. Knowledge of the country, Relative size of the investment, Extent of liberalization of FDI, regulations and industry-specific regulations) influence PVM entry strategy?*

A (Pelle): “We established a subsidiary through foreign direct investment. We bought land and built a factory by remitting resources from the Head Quarter. Initially we were obliged to have a local partner, since the full ownership of the subsidiary was not permitted. Later on, as soon as it had become possible, we bought over the shares of our partner and became 100% owner of the local subsidiary. The Group approach to various markets, as well as India, was to focus on few markets and go in depth in the same. The marketing approach was adaptation rather than standardization, so as to partly adapt the international products to the local needs. We did use some of our international brands though; at the same time we also created local brands, when we thought that these could be more appropriate. We made sure that we could understand the local culture and adapt our business model to this. This happened both for the distribution, where we set up our own network to fully respond to the local distribution channel reality (highly fragmented trade with thousands of mamas and papas corner shops), and for the communication. For the latter we decided to progressively produce our own commercials locally so as to speak the same language of our target groups”.
Conclusion

Objectives and introductory elements
This thesis aims at outlining a structure, a method, able to help MNCs from Developed Countries, for entry mode choices in economies with peculiar characteristics such as the Emerging Countries. We started with the view that sees the Emerging Countries as a new center of mass global business and then as an engine of MNCs global expansion. We have tried to show the weight of these countries in terms of global investment flows which is indeed massive and growing. We then laid out guidelines as to what is an "emerging" country, in order to single out the main complex and potential difficulties of this new global geo-economic category. On one hand, the high growth potential of the internal market attracts companies to look for new markets for their products (eg market seeking, horizontal expansion), on the other hand, there is the arising opportunity from lower cost inputs (e.g. outsourcing and production fragmentation horizontal integration) that triggers the FDI by foreign companies.

The chapter on internationalization in the introductory part of this work is a key step to understanding the need for MNCs in the logic of global expansion. When dealing with emerging economies we noted that not only FSA (firm-specific advantage) is the main source for the construction of competitive advantages, but in particular the LSA (Location specific advantage), which embeds: fragmented production processes, economies of scale, market seeking, horizontal differentiation and thus potential market and increasing availability of resources at lower cost compared to developed countries (such as HR high-skilled Indian and Chinese). The emerging country is, in actual fact, the true resource for the MNCs looking for global competitive advantages.

The entry onto emerging markets is a hybrid between an opportunity and a must for MNCs. It also becomes a fundamental necessity when dealing with competitors and combating MNCs from developing countries themselves: true global leaders are the companies which exploit their comparative advantage in terms of costs, savings and national strategies which are aimed at the creation of
highly competitive industries, thanks to the availability of natural resources and/or advanced techniques (see Brazil for bio-fuels). It is in this respect that international strategy becomes a counter-global strategy, which means competition from emerging countries on the share of world production must be withstood.

Method

The strategies that target the entry onto emerging markets are laid out in a series of consecutive steps that allow us to analyze in detail, the specific structure and nature of the country where the MNC is going to invest and then to choose the effective entry mode according to comparative determinants and theoretical approaches.

1.
The first session, Emerging Country Analysis consists of:

• Country Portfolio analysis
• 5-contexts framework
• Political Risk Assessment

The first step is crucial in order to understand what is the market potential related to the selected sector or product. The author we refer to in this case (Ghemawat, 2001), crosses data of per capita consumption of the product (or industry) with those of income. From this, the CPA model is able to give us a first, clear idea of the profitability of the chosen target.

The second step provides us 5 profiles, useful in understanding what the institutional voids in the country are (Political and social system; Openess, product market, Capital Market, and Labor Market). Due to the weak regulatory and institutional structure that characterizes the country this is an essential part in the country analysis.
The third step, the political risk assessment, is a natural continuation of the second, because the dynamic politics of certain emerging countries and the relative lack of strength in the public institutional apparatus, does not provide adequate safeguards with respect to security of the investments. Therefore the sources of risk and the main counter-acts must necessarily be identified.

2.

After the Country Analysis, we move on to the development of the MNC strategic view of the results obtained previously. The main Theoretical Perspectives: Institutional theory, Resource based view, Agency theory, Transaction costs theory are taken into consideration. The steps are as follows:

- Development of an Integrated Theoretical Framework
- Partner selection (Hitt et al., 2000)

With regard to the structuring of an integrated framework, Peng et al (2007), in consideration of the specific factors that determine the strategic choices of foreign MNCs in developing countries, alongside the traditional Porter’s industry based approach and Barney’s RBV, the institutional apparatus does actually make a permanent imprint on the dynamics of business. The institutional based view integrated with the above-mentioned theoretical perspectives, can help in developing a conscious vision of how MNCs should structure their entry mode strategy. This is, of course, a preparatory phase of the actual choice of the entry mode, namely the subsequent analysis of the determinants and the desirability of a local partner, according to the assessment of the advantages and disadvantages from that choice.

The partner selection is also determined by a series of elements. The issues considered are those outlined by Hitt et al. (2000) (financial assets, technological and managerial capabilities, potential complementariness, intangible assets, expertise sharing, market knowledge and unique competencies). These, as they are held or sought by either of the parties concerned, outline any increase or
decrease in opportunities in terms of costs (opportunity, transaction or agency) of a partner, and eventually, the any weight in terms of equity that it should be allowed.

3.
So we come to the final chapter and the actual Entry Mode Choice phase. In the light of previous consideration, a clear analysis the specific nature of the country with reference to the requirements of the MNC investor is done. The first theoretical reference is Buckley and Casson (1998) which we intend to clarify with a clear outline of the main mode of entry and potential profit associated equations. The strategy set is therefore crucial in understanding what are the modal parameters of entry into a foreign market, in reference to the costs that the authors have outlined in relation to specific dimensions (home or foreign) in which the activities (R & D, Production, Distribution, Marketing) are located. The determinants (General determinants vs. Firm specific determinants) are of a fundamental value here. We chose the General determinants identified by Bhaumik and Gelb (2005) (Cultural distance, Competition, Resource need; Knowledge of the country; Relative size of the investment; Quality of local management; Technology intensiveness of the product; Growth of local industry; Extent of liberalization of FDI, Regulations and industry-specific Regulations; Expected Future Profitability of the industry). These are then compared with the determinants from the characteristics of the MNC (Demirbag et al., 2005) (Input dependency; Extent of diversification; Previous commercial association; Cultural distance; Parent size). The entry modes that are identified in this phase, are compared according to the costs that are created and to the strategic importance that the individual determinants with respect to the entire considered complex of elements. From this comparison an entry mode among those considered by the authors (JV, Acquisition and Greenfield) emerges. The result we get is obviously not definitive as it will have to be submitted for further inspections, based on the Institutional theory.
Before the final entry choice, we included some assessments about the timing of entry. Timing, in fact, turned out to be important in high potential contexts such as emerging countries. The considerations made here (Zhang, 2007; Arnold and Quelch, 1998) are summarized in the choice between so-called pioneering aggressive positions (first mover), placing more than caution (wait and see) or positions that result in gradual stages in the sequence (experimental phase - strategic investment phase - phase dominant).

From the results obtained previously, we can compare the entry mode choices that are defined in that section. The institutional based view as mentioned above must be integrated with other major theories. Meyer et al. (2003) encourages us in this with the use of RBV with a cross-institutional one. Secondly, the Transaction cost theory is considered, thanks to the empirical research by Anderson and Gatignon (1986) and Luo (2001), and it provides us with crucial insights. Finally, a corollary to the previous considerations are on: Bargaining Power, Organizational Capability and OLI Advantage.

At the end of our research and we will have singled out the most efficient entry mode in relation to our business and the chosen host country context.
References


Chelariu C., Bello D., Gilliland D. 2005. Institutional antecedents and performance consequences of influence strategies in export channels to eastern


Errunza V, 1997, Research on emerging markets: past present and future, MGGill University, Montreal.


Lopez-Duarte C., Vidal-Suarez M., 2010, *External Uncertainty and entry mode


Oliver C., 1997, *Sustainable competitive advantage: combining institutional and resource based views*, 18 (9) 697–713-


Singh J., Goyal B., 2008, *Comparative Analysis of Rural and Urban Indian
Ting, W., 1988, Multinational Risk Assessment and Management, Green Press Inc., Westport.
emerging economy, Management decision, 45(4): 749-772.

Reports: