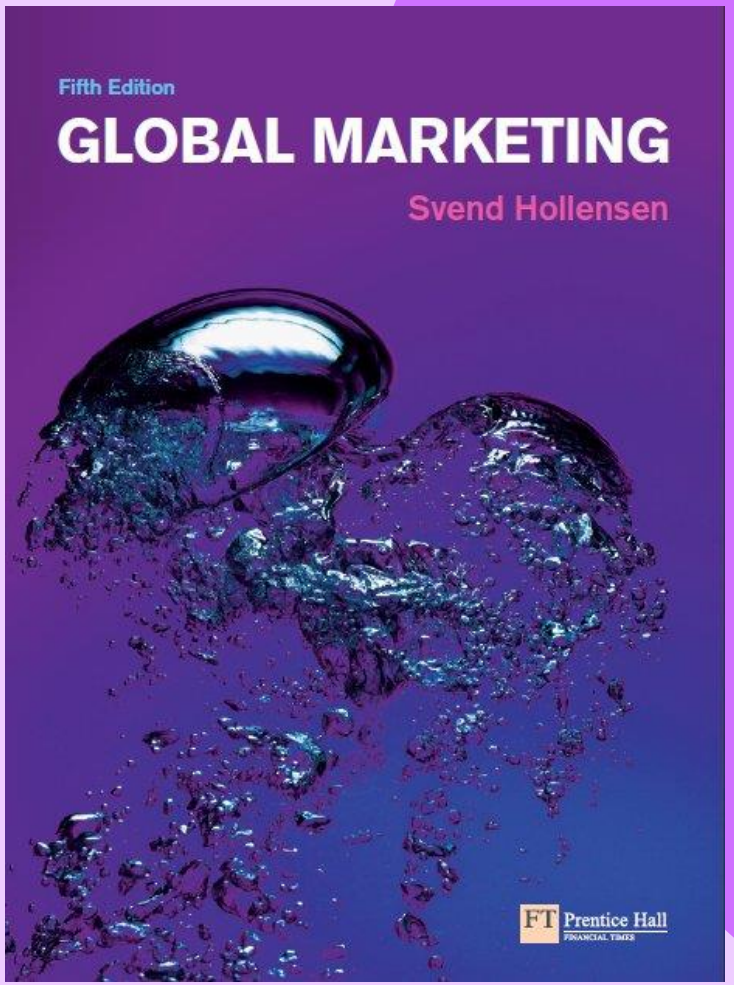

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GLOBAL MARKETING

5th Edition

Chapter 11 Intermediate entry modes

Learning objectives (1)

- Describe and understand the main intermediate entry modes
- contract manufacturing;
  - licensing;
  - franchising; and
  - joint venture/strategic alliances
- Discuss the advantages and disadvantages of the main intermediate entry modes
- Explain the different stages in joint-venture formation

Learning objectives (2)

- Explore the reasons for the ‘divorce’ of the two parents in a joint-venture constellation
- Explore different ways of managing a joint venture/strategic alliance

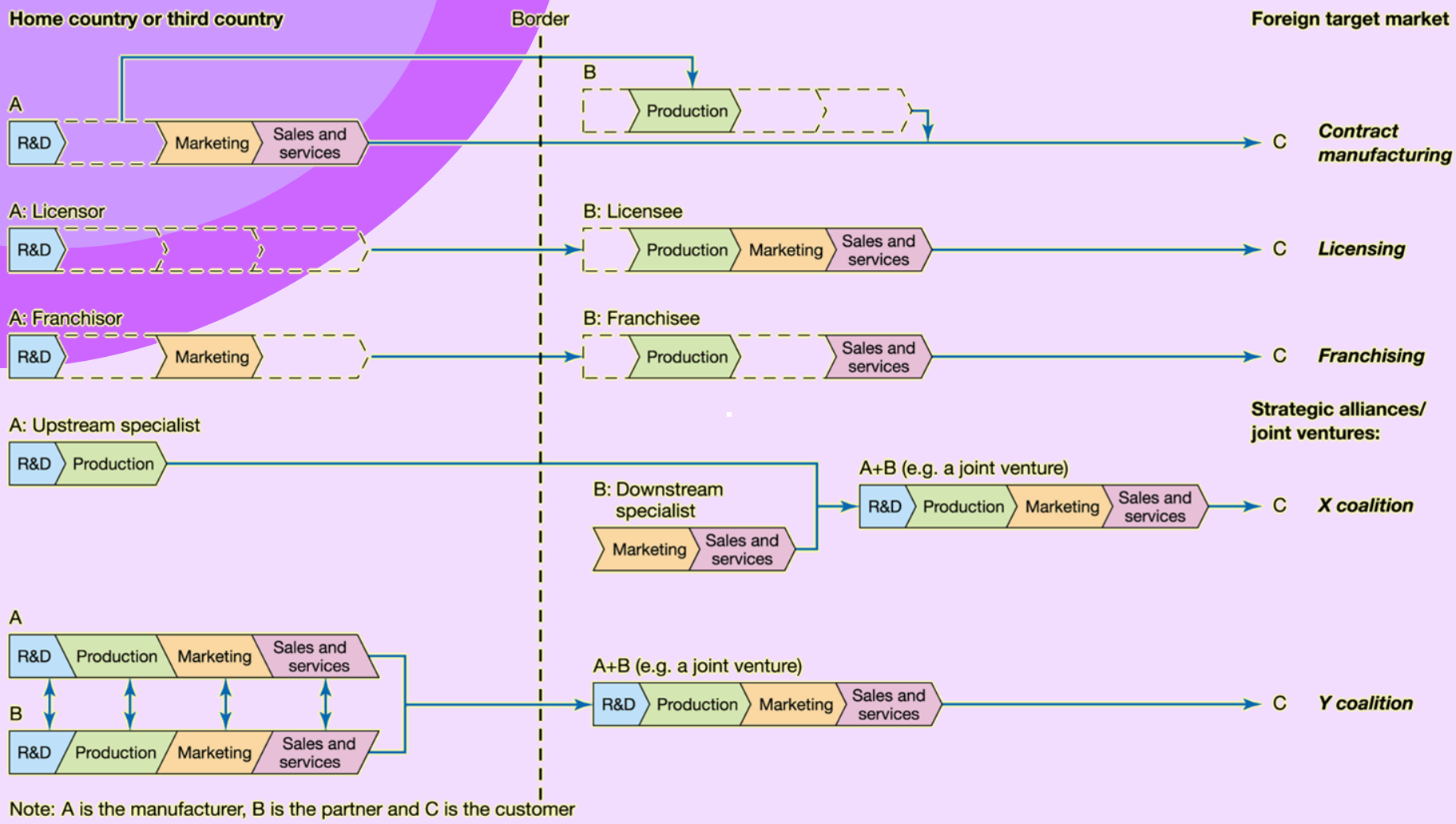


Figure 11.1 Intermediate modes

Factors encouraging foreign market production

- Desirability of being close to foreign customers
- Foreign production costs are low
- Transportation costs may render heavy products non-competitive
- Tariffs can prevent entry of an exporter's products
- Government preference for national suppliers

What is this?

_____ is the term used to refer to manufacturing which is outsourced to an external partner, one that specializes in production and production technology.

Contract manufacturing

What is this?

What term refers to the exchange of rights, such as manufacturing rights, to another in exchange for payment?

Licensing

Rights that may be offered in a licensing agreement

- Patent covering a product or process
- Manufacturing know-how not subject to a patent
- Technical advice and assistance
- Marketing advice and assistance
- Use of a trade mark/trade name

Components of royalty fees

- Lump sum not related to output
- Minimum royalty
- Running royalty

Motives for licensing out (1)

- Licensor firm will remain technologically superior in its product development
- Licensor is too small to have financial, managerial or marketing expertise for overseas investment
- Product is at end of product life cycle in advanced countries but stretching product life cycle is possible in less developed countries

Motives for licensing out (2)

- Opportunity for profit on key components
- Government regulations may restrict foreign direct investment or, if political risks are high, licensing may be only realistic entry mode
- Constraints may be imposed on imports

How the licensee can pay to the licensor:

- A lump sum not related to output. This can include a sum paid at the beginning of an agreement for the initial transfer of special machinery, parts, blueprints, knowledge and so on.
- A minimum royalty – a guarantee that at least some annual income will be received by the licensor.
- A running royalty – normally expressed as a percentage of normal selling price or as a fixed sum of money for units of output.

Table 11.1 Relative costs of licensing overseas (%)

Breakdown of total costs of licensing overseas	
Protection of industrial property	24.4
Establishment of licensing agreement	46.6
Maintenance of licensing agreement	29.0
	100.0
Breakdown of establishment costs	
Search for suitable licensee	22.8
Communication between involved parties	44.7
Adoption and testing of equipment for licensee	9.9
Training personnel for licensee	19.9
Other (additional marketing activity and legal expenses)	2.7
	100.0
Breakdown of maintenance costs	
Audit of licensee	9.7
Ongoing market research in market of licensee	7.2
Back-up services for licensee	65.0
Defence of industrial property rights in licensee's territory	11.0
Other	7.1
	100.0

Sources: Based on Carstairs and Welch (1981) and Young *et al.* (1989), p. 132.

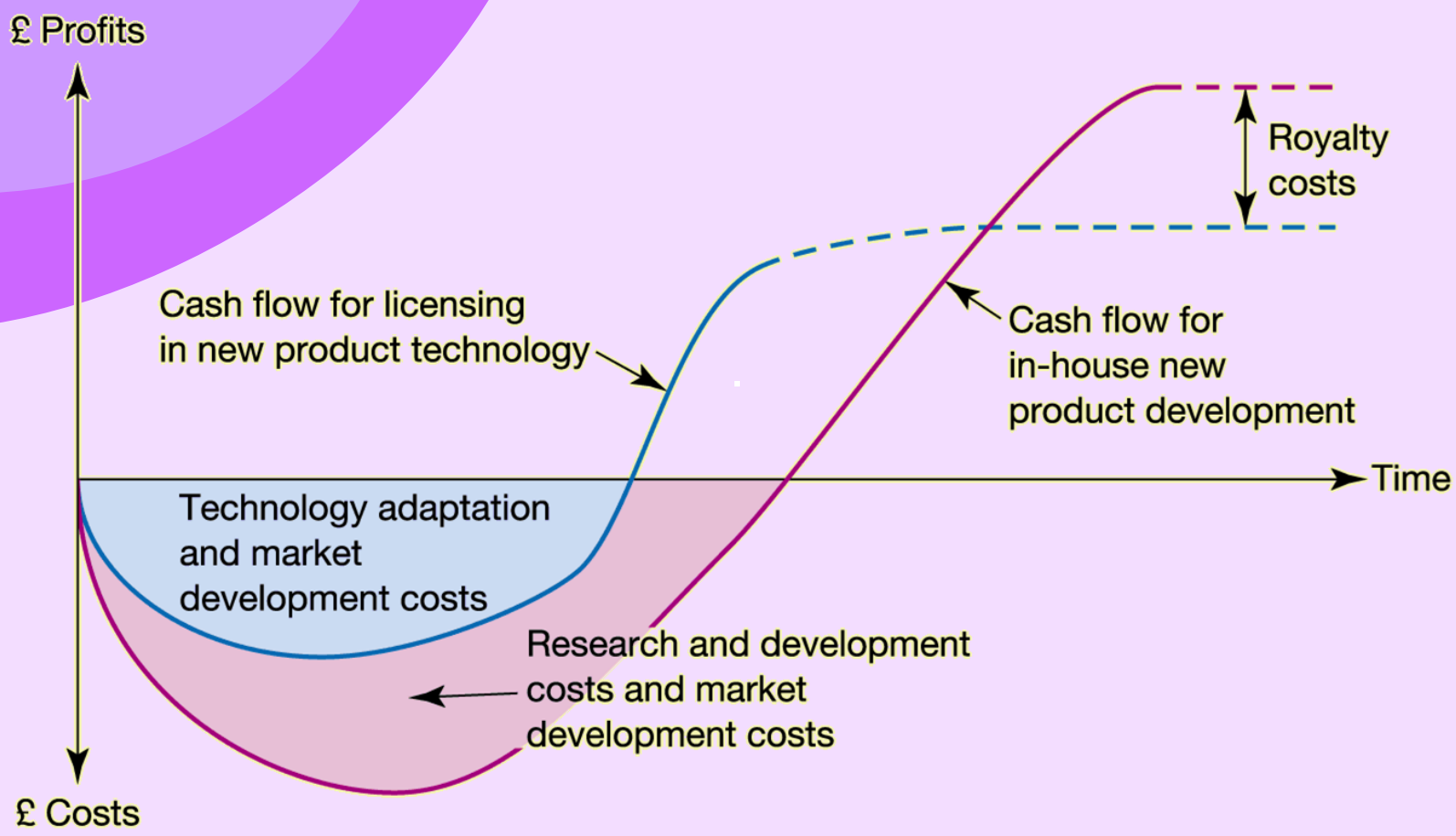


Figure 11.2 Life cycle benefits of licensing

Sources: Lowe and Crawford (1984); Bradley (1995, p. 388)

What is this?

What term refers to the exchange of rights between a franchisor and franchisee, such as the right to use a total business concept including use of trade marks, against some agreed royalty?

Franchising

Types of Franchising

Product and trade name franchising

Business format 'package' franchising

Interdependence between franchisor–franchisee

Franchisor–franchisee

- Fast growth
- Capital infusion
- Income stream
- Community goodwill

Franchisee–franchisor

- Trade mark strength
- Technical advice
- Support services
- Marketing resources
- Advertising

Key success factors in the franchisor–franchisee relationship

Integrity of business system

Capacity for renewal of business system

Table 11.2 How licensing and franchising differ

Licensing	Franchising
The term 'royalties' is normally used.	'Management fees' is regarded as the appropriate term.
Products, or even a single product, are the common element.	Covers the total business, including know-how, intellectual rights, goodwill, trade marks and business contacts. (Franchising is all-encompassing, whereas licensing concerns just one part of the business.)
Licences are usually taken by well-established businesses.	Tends to be a start-up situation, certainly as regards the franchisee.
Terms of 16–20 years are common, particularly where they relate to technical know-how, copyright and trademarks. The terms are similar for patents.	The franchise agreement is normally for 5 years, sometimes extending to 11 years. Franchises are frequently renewable.
Licensees tend to be self-selecting. They are often established businesses and can demonstrate that they are in a strong position to operate the licence in question. A licensee can often pass its licence on to an associate or sometimes unconnected company with little or no reference back to the original licensor.	The franchisee is very definitely selected by the franchisor, and its eventual replacement is controlled by the franchisor.
Usually concerns specific existing products with very little benefit from ongoing research being passed on by the licensor to its licensee.	The franchisor is expected to pass on to its franchisees the benefits of its ongoing research programme as part of the agreement.
There is no goodwill attached to the licence as it is totally retained by the licensor.	Although the franchisor does retain the main goodwill, the franchisee picks up an element of localised goodwill.
Licensees enjoy a substantial measure of free negotiation. As bargaining tools they can use their trade muscle and their established position in the marketplace.	There is a standard fee structure and any variation within an individual franchise system would cause confusion and mayhem.

Sources: Based on Perkins (1987), pp. 22, 157 and Young *et al.* (1989), p. 148.

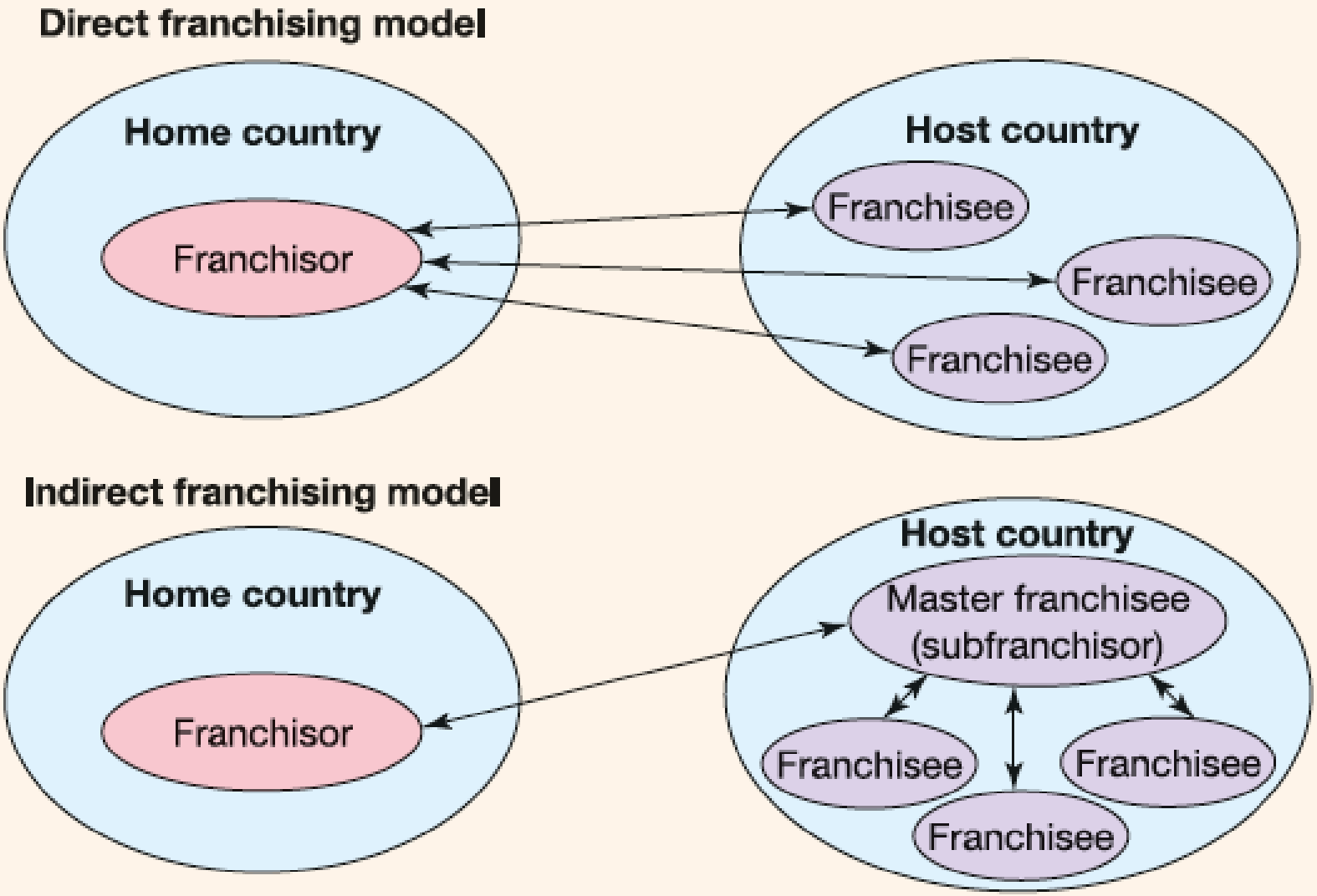


Figure 11.3 Direct and indirect franchising models

Sources: Lowe and Crawford (1984); Bradley (1995, p. 388)

EXHIBIT 11.1 Build-A-Bear Workshop's use of the indirect franchising model

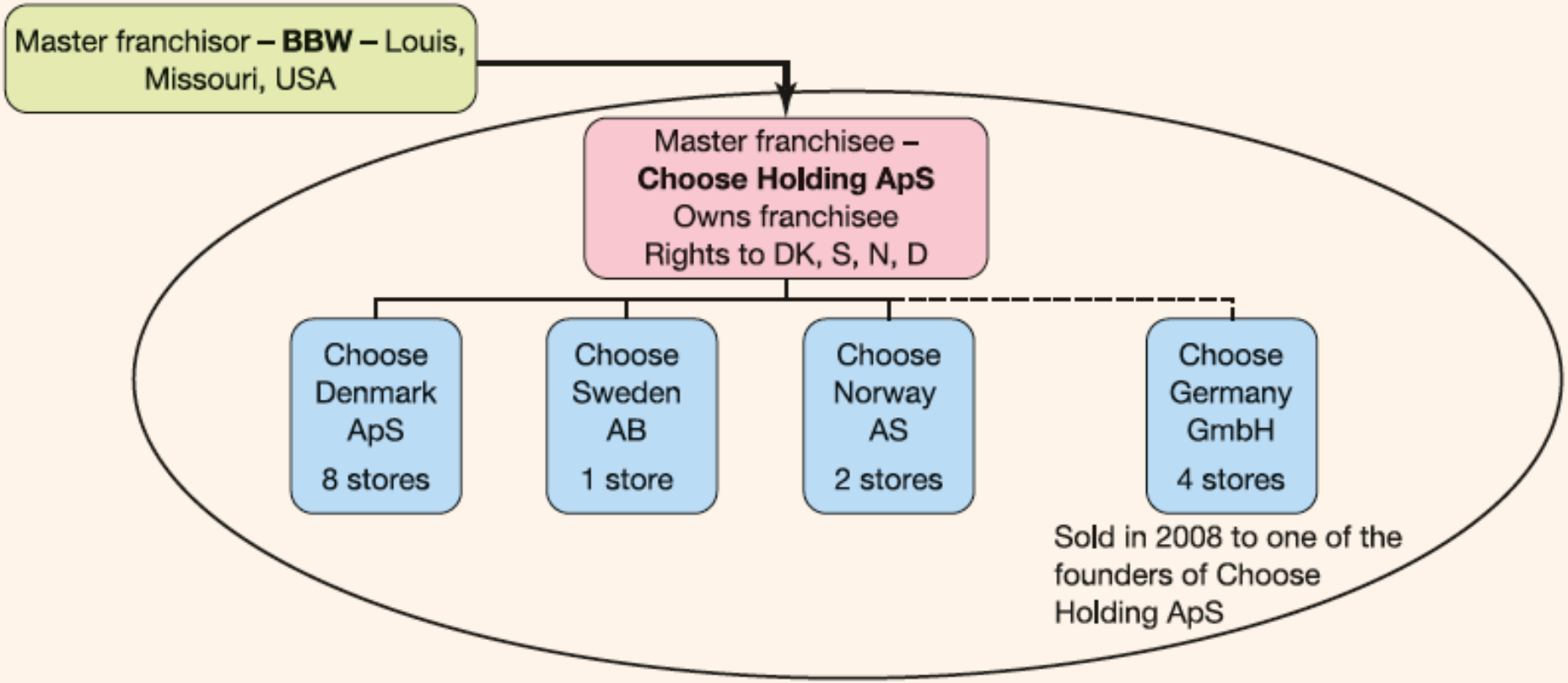


Figure 11.4 The BBW indirect franchising model for Scandinavia and Germany

What is this?

What term refers to an equity partnership between two or more partners?

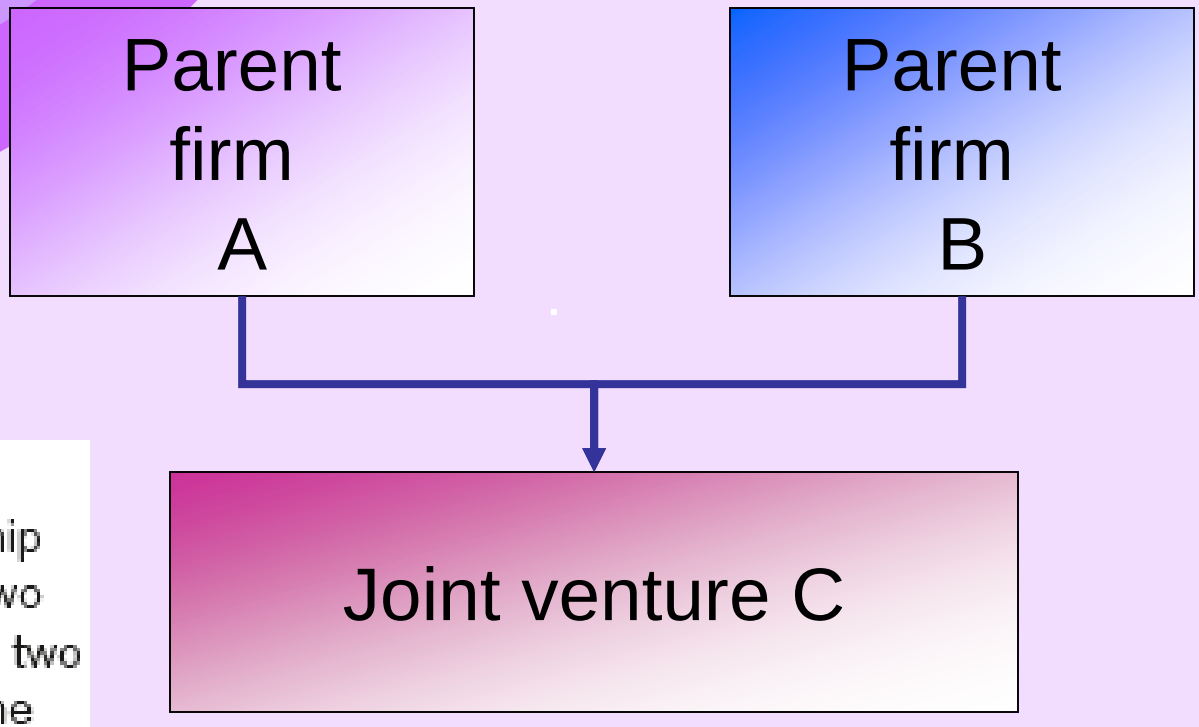
Joint venture

Reasons for using joint ventures

- Complementary technology or management skills can lead to new opportunities
- Firms with partners in host countries can increase speed of market entry
- Less developed countries may restrict foreign ownership
- Costs of global operations in R&D and production can be shared

A **joint venture** (JV) or a strategic alliance is a partnership between two or more parties. In international joint ventures these parties will be based in different countries, and this obviously complicates the management of such an arrangement.

Equity alliance:



Joint venture
An equity partnership typically between two partners. It involves two 'parents' creating the 'child' (the joint venture acting in the market).

Figure 11.5 Joint ventures and strategic alliances

Non-equity alliance:

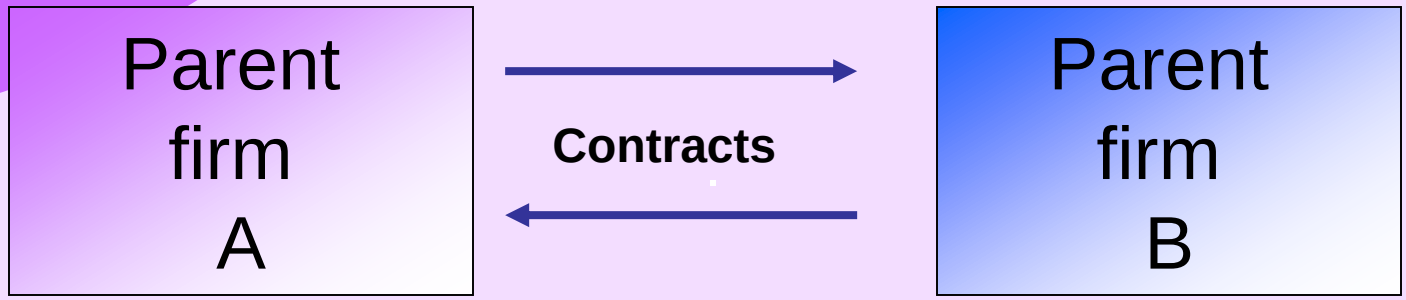


Figure 11.5 Joint ventures and strategic alliances (Continued)

Principle objectives for forming a joint venture

Entering new markets

Reducing manufacturing costs

Developing and diffusing technology

Table 11.3 Stages in joint-venture formation

1. Joint venture objectives
2. Cost/benefit analysis
3. Partner selection
4. Business plan development
5. Joint-venture agreement
6. Contract writing
7. Performance evaluation

Source: Source: Adapted from Young *et al*., 1989, p. 233.

Factors to consider during the cost–benefit analysis

- Financial commitment
- Synergy
- Management commitment
- Risk reduction
- Control
- Long-run market penetration

Criteria in 3. Partner selection:

Table 11.4 Analysis of prospective partners: examples of criteria that may be used to judge a prospective partner's effectiveness by assessing existing business ventures and commercial attitudes

1. **Finance**
   - Financial history and overall financial standing (all the usual ratios).
   - Possible reasons for successful business areas.
   - Possible reasons for unsuccessful business areas.
2. **Organization**
   - Structure of organization.
   - Quality and turnover of senior managers.
   - Workforce conditions/labour relations.
   - Information and reporting systems; evidence of planning.
   - Effective owner's working relationship with business.
3. **Market**
   - Reputation in marketplace and with competitors.
   - Evidence of research/interest in service and quality.
   - Sales methods; quality of sales force.
   - Evidence of handling weakening market conditions.
   - Results of new business started.
4. **Production**
   - Condition of existing premises/works.
   - Production efficiencies/layouts.
   - Capital investments and improvements.
   - Quality control procedures.
   - Evidence of research (internal/external); introduction of new technology.
   - Relationship with main suppliers.
5. **Institutional**
   - Government and business contacts (influence).
   - Successful negotiations with banks, licensing authorities, etc.
   - Main contacts with non-national organizations and companies.
   - Geographical influence.
6. **Possible negotiating attitudes**
   - Flexible or hard line.
   - Reasonably open or closed and secretive.
   - Short-term or long-term orientation.
   - Wheeler-dealer or objective negotiator.
   - Positive, quick decision-making or tentative.
   - Negotiating experience and strength of team support.

Sources: Walmsley (1982); Paliwoda (1993).

Types of value chain partnerships

- Upstream-based collaboration
- Downstream-based collaboration
- Upstream/downstream-based collaboration

What is this?

Which type of value chain partnership involves each partner contributing complementary product lines or services, with each partner taking care of all value chain activities within their own product line?

Y coalitions

What is this?

Which type of value chain partnership involves each partner in the value chain dividing the value chain activities between them?

X coalitions

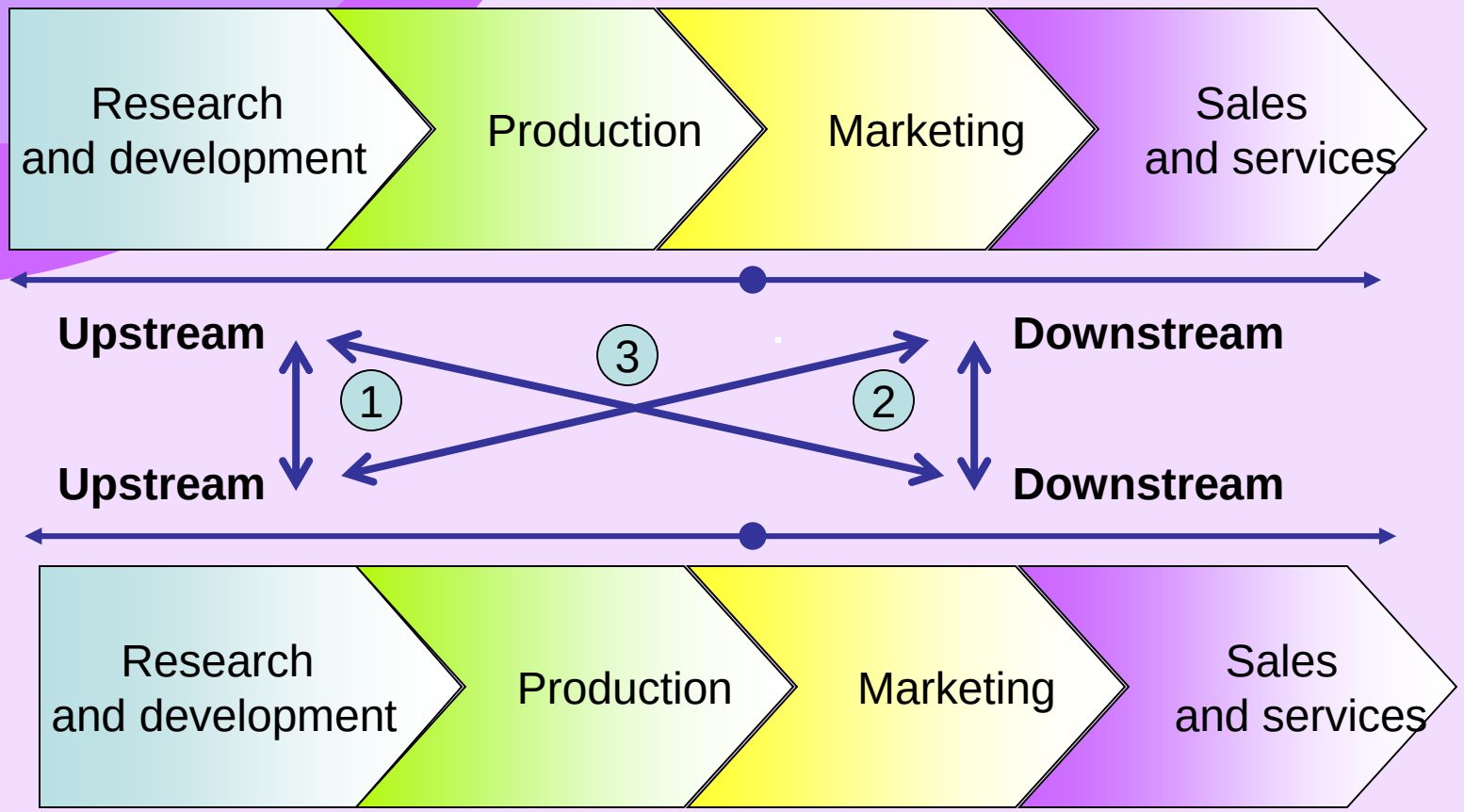


Figure 11.6 Collaboration possibilities for partners A and B in the value chain

Source: adapted from Lorange and Roos (1995, p. 16)

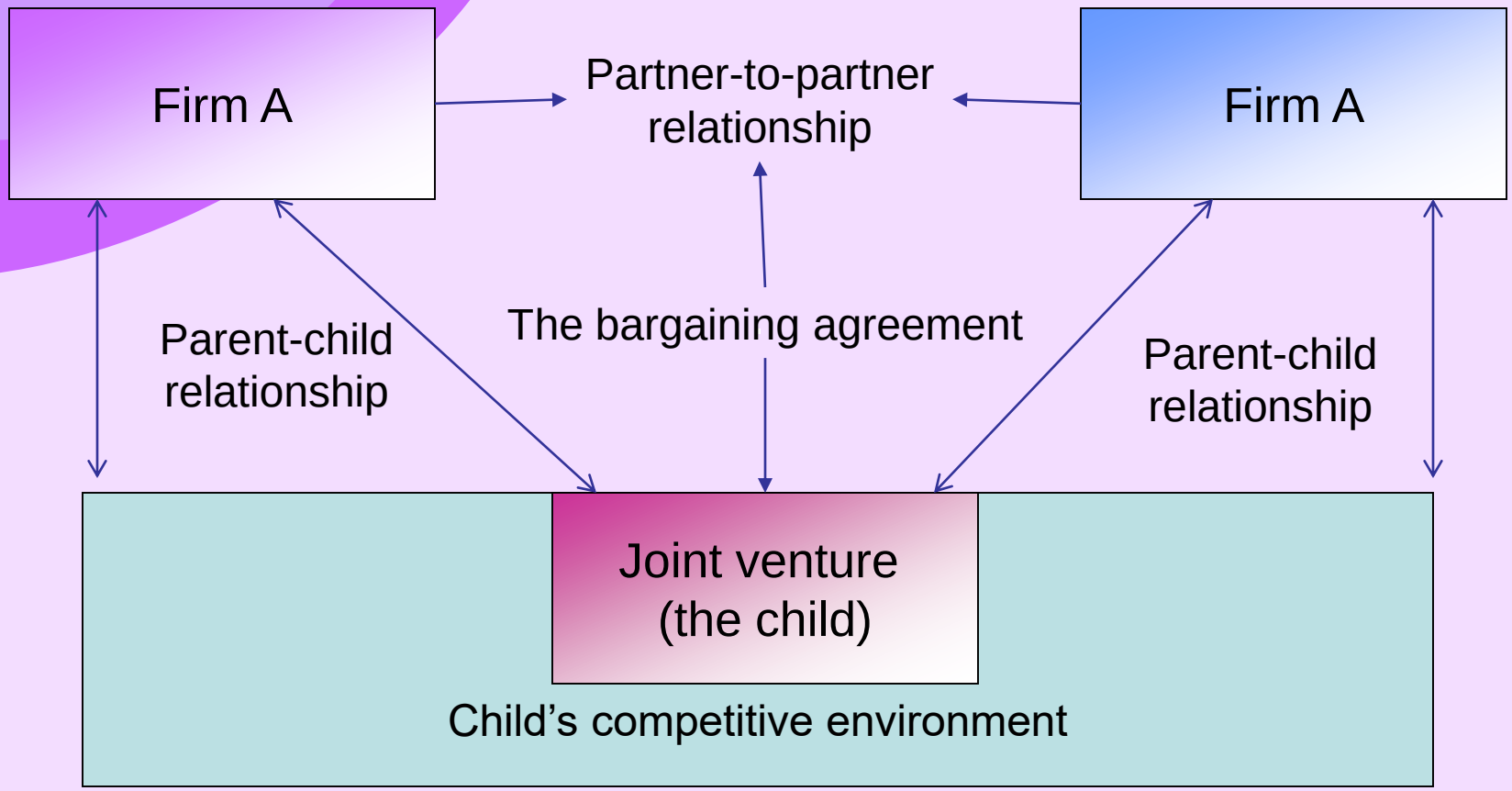


Figure 11.7 Partner-to-partner relationships creating a joint venture

Source: Harrigan (1985, p. 50)

Source: Source: Harrigan, 1985, p. 50.

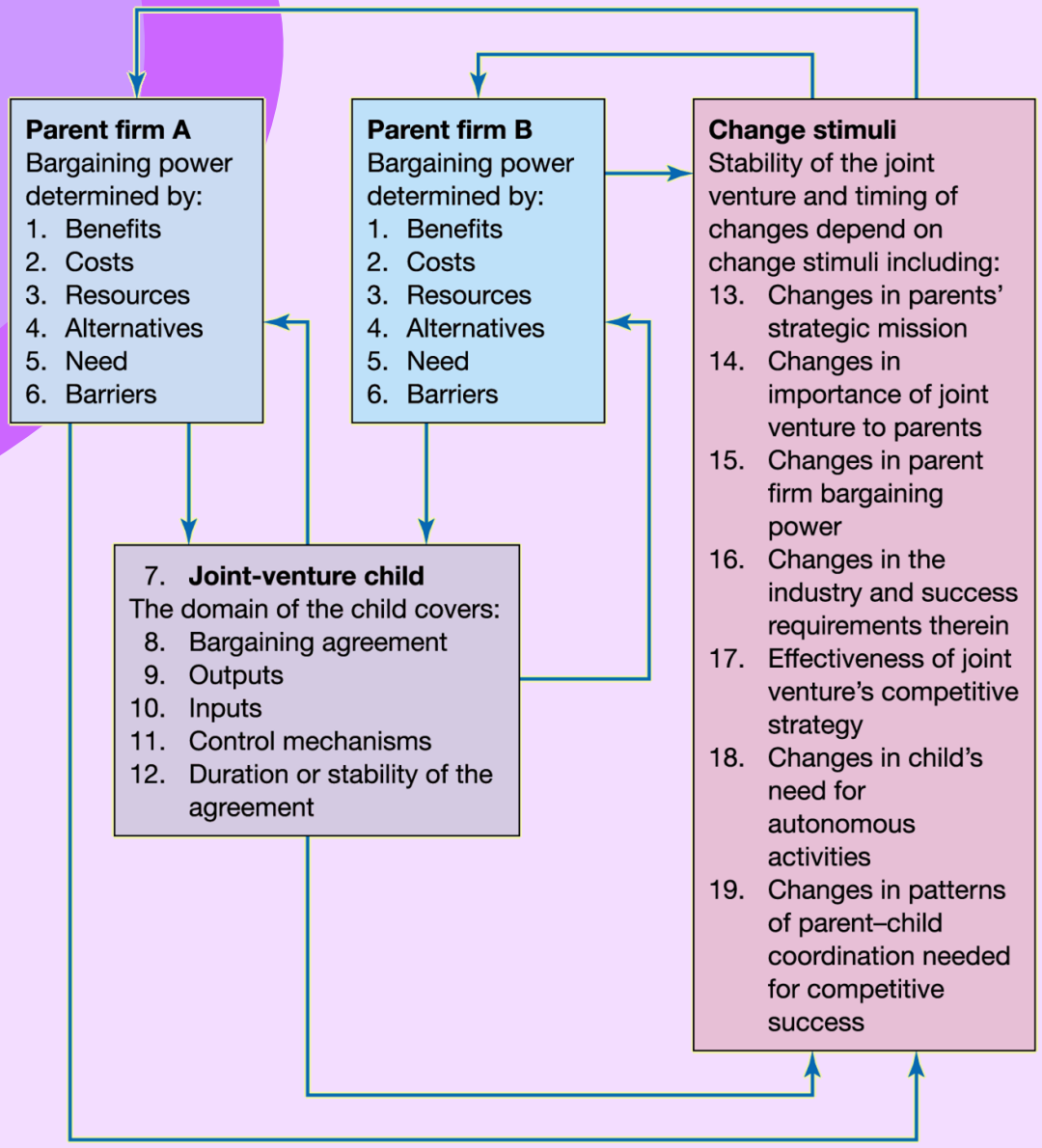


Figure 11.8 Model of joint-venture activity

Source: Harrigan (1985, p. 52)

Sources of potential conflict

- Diverging goals
- Double management
- Repatriation of profits
- Mixing different cultures
- Shared equity
- Developing trust in joint ventures
- Providing an exit strategy

EXHIBIT 11.2 McDonald's + Coca-Cola + Disney = a powerful alliance

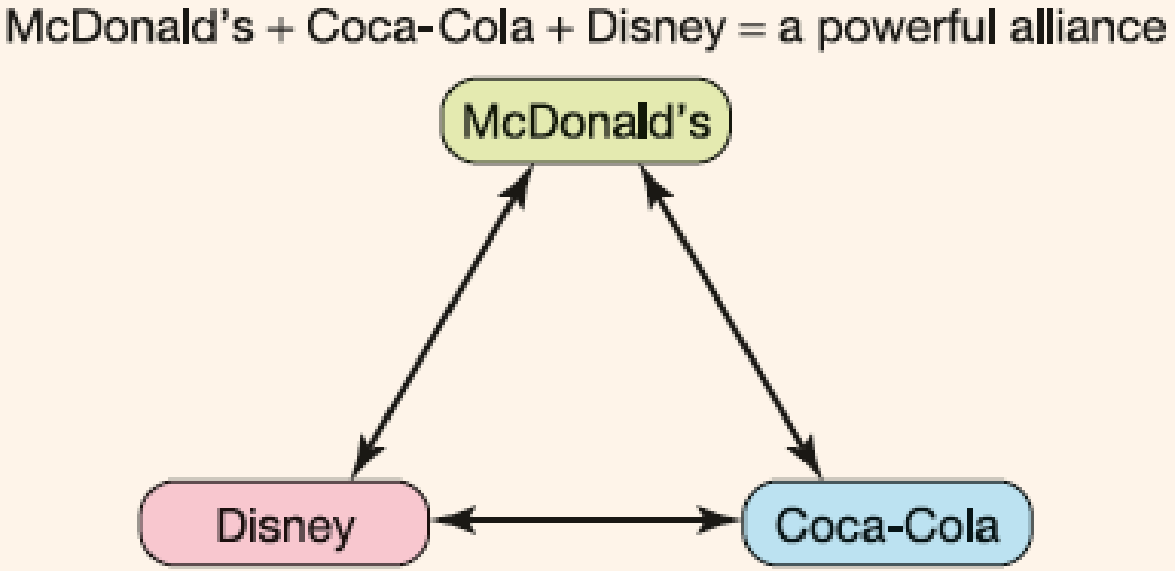


Figure 11.9 McDonald's + Coca-Cola + Disney = a powerful alliance

CASE STUDY 11.1

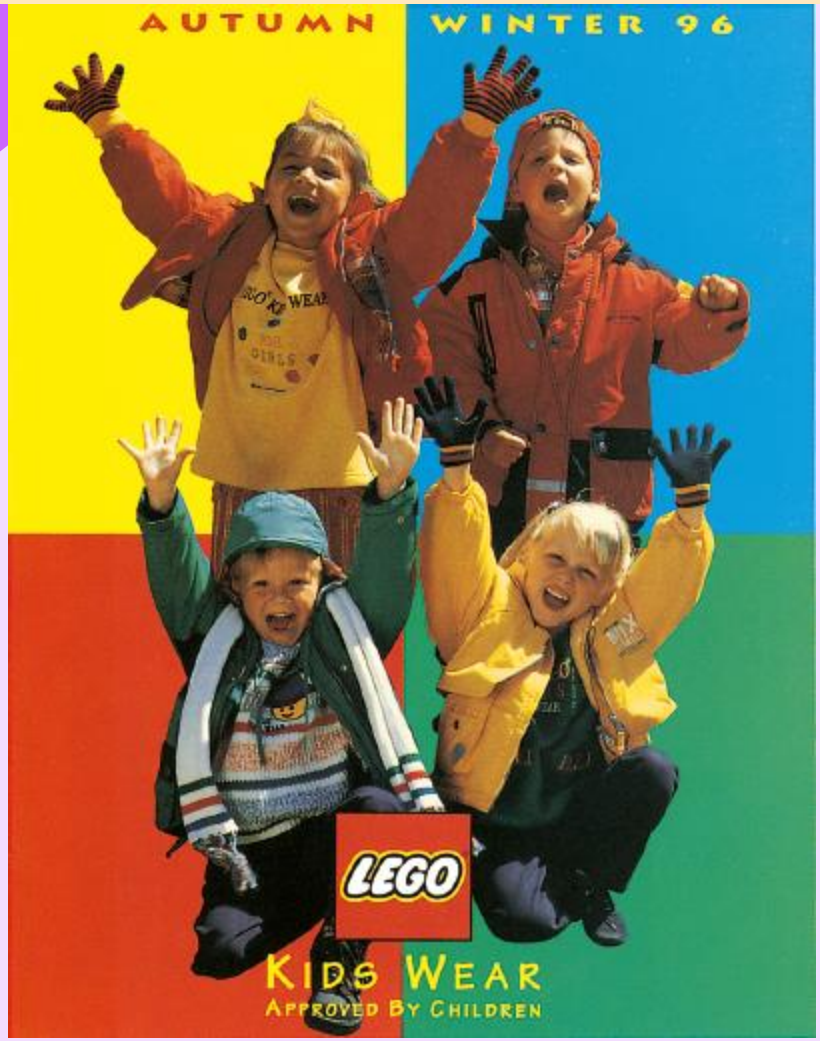
Hello Kitty: can the cartoon cat survive the buzz across the world?

QUESTIONS

1. Do you think that Hello Kitty will continue to rule the world? What are the pros and cons?
2. What are the reasons that Hello Kitty is licensed to so many different product manufacturers?
3. Suggest the future licensing strategy for Hello Kitty.

CASE STUDY 11.2

Ka-Boo-Ki: licensing in the LEGO brand



QUESTIONS

You have just been employed by LEGO Licensing A/S in connection with the development of the licensing data. You are given the following assignments.

1. What are the most important factors determining future market demand for LEGO children's clothes from Ka-Boo-Ki?
2. Which other products could be considered for licensing out the LEGO brand?
3. List some criteria for choosing suitable licensees and future products for the LEGO brand (licensing out).
4. What values/benefits can LEGO transfer to the licensee (e.g. Ka-Boo-Ki) apart from the use of the LEGO brand?
5. What values/benefits can the licensee transfer to the licensor?

VIDEO CASE STUDY 11.3 Marriott

download from www.pearsoned.co.uk/hollensen

Questions

1. What could be the main motives for Marriott in using franchising, compared to other entry modes and operation forms?
2. Identify several major categories of segmentation used by Marriott. For each relate specific examples of hotel services tailored to various target markets; www.marriott.com offers a brief description of 13 brands of various Marriott hotels catering to different types of customers.

Questions for discussion (1)

- Why are joint ventures preferred by host countries as an entry strategy for foreign firms?
- Why are strategic alliances used in new product development?
- Under what circumstances should franchising be considered? How do these circumstances vary from those leading to licensing?

Questions for discussion (2)

- Do you believe that licensing in represents a feasible long-term product development strategy for a company? Discuss in relation to in-house product development.
- Why would a firm consider forming partnerships with competitors?
- Apart from the management fees involved, what benefits might a firm derive from entering into management contracts overseas?