A STUDY ON THE IMPACT OF THE ENTRY MODE AND THE FINANCIAL PERFORMANCE OF FOREIGN SUBSIDIARIES

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ABSTRACT

The mode of entry is a fundamental decision a firm makes when it enters a new market because the choice of entry automatically constrains the firm's strategy. The mode of entry also affects how a firm faces the challenges of entering a new country and deploying new skills to market its product successfully. A firm entering a foreign market faces an array of choices to serve the market which includes: Export, License and franchise, Alliance, Joint venture and wholly owned subsidiary. A firm can choose any of these entry modes or some combination of them to enter a host country. The key attribute that distinguishes the different modes of entry is the degree to which they give a firm control over its key marketing resources. Control and commitment are linked in mode of entry. High control in entry strategies entails high commitment. Higher costs imply that higher levels of investments are needed for the firm to break even and make a profit. From their entry specific experience, firms can learn the specific knowledge of how to manage subsidiaries of one kind of entry mode. Compared with general entry experience, entry specific experience represents deeper knowledge within a given entry mode.

1. INTRODUCTION

Over the past half century, firms have moved towards internationalization by increasing their level of assets, employees, and revenue abroad. Yet there is always a question regarding the degree to which this internationalization movement is contributing to overall performance of the firm. In the global economy; Multinational enterprises play a key role as their domestic and foreign activities generate one third of world value added and exports. Internationalization strategies may have an uneven impact on the performance of the firm, depending on the purpose of the investment and its destination. Different measures can be employed in the assessment of performance (i.e., profit growth, increase in market share, and satisfaction) with the objective of analysing the degree of the firm's success in achieving its strategic goals of internationalization. The performance of foreign subsidiary is considered as a control tool, as it is used to evaluate the outputs of a foreign affiliate in a certain period of time. The extent to which a host country can secure these benefits is likely to depend upon the mode of entry of the firms. In order to maintain or achieve the level of and prosperity, an industrialized firm should respond to a range of challenges according to the requirements of the environment.

Firms' entry specific experience comes from adopting one kind of specific entry mode repeatedly. In expanding into foreign markets, firms can choose among a variety of entry modes. The study focuses on three major types of entry modes: contractual agreements, equity joint ventures and wholly owned subsidiaries. Contractual agreements include licensing, technology transfer, cooperation agreement, R&D contracts, franchises and so forth. For example, foreign firms make partnerships with local firms in contractual agreements and equity joint ventures. Consequently, they must learn to cooperate with local partners and integrate both national and corporate cultures. Wholly owned subsidiaries offer a higher degree of control. But they also entail great resource commitment, including actual investments and high overhead. When using wholly own subsidiaries, foreign firms can fully employ their proprietary assets. Meanwhile, they have to learn the host country culture by themselves and lack potential benefits from operating with local partners. From their entry specific experience, firms can learn the specific knowledge of how to manage subsidiaries of one kind of entry mode.

Compared with general entry experience, entry specific experience represents deeper knowledge within a given entry mode.

2. REVIEW OF THE LITERATURE

The article titled "The relative economic performance of foreign subsidiaries in UK manufacturing" by ChengqiWang, Pamela Siler &Xiaming Liu compares the economic performance of UK and foreign-owned firms in UK manufacturing industry. The observation showed that foreign subsidiaries labour productivity is higher than in UK firms and that higher levels of human capital are employed by foreign subsidiaries and enjoy greater economies of scale.

The article titled "Configurations of Strategy and Structure in Subsidiaries of Multinational Corporations" by Julian M. Birkinshaw and Allen J. Morrisonthe study found that there were higher strategic autonomy in world mandates compared to local producers, foreign subsidiaries value-chain was more internationally configured and had specialized contributors than local producers .

The article titled "Survival and Profitability: The Roles of Experience and Intangible Assets in Foreign Subsidiary Performance" by Andrew Delios and Paul W. Beamishcompares research on the financial performance of multinational firms with research on survival of foreign subsidiary. They examined the influences of firm's intangible assets of Japanese subsidiaries. The results show that Host country experience has a direct effect on survival but a contingent relationship with profitability.

The article titled "Corporate Performance Implications of Multinationality: The Role of Firm Specific Moderators" by Madan Annavarjula, Sam Beldona &FaridSadrieh brings about the importance of firm-specific moderators in understanding the relationship between multinationality and performance. Results of the study show that there is significant and positive moderation between multinationality and performance

The article titled "Performance Evaluation of Foreign Subsidiaries: A Review of the Literature and a Contingency Framework" by Stefan Schmidand Katharina Kretschmerreviews the literature on performance evaluation and an integrative contingency framework. This serves as a tool to identify the factors influencing performance evaluation at corporate and at subsidiary level. Based on these findings, further research is suggested outside the classical tradition of contingency approaches.

The article titled "Control and Performance of International Joint Ventures" by J. Michael Geringerand Louis Hebert reviews prior studies addressing the conceptualization and operations control with International Joint Venture's, also the International Joint Ventures control performance relationship.

The article titled "Subsidiary performance in multinational corporations: the importance of technology embeddedness"by Ulf Andersson, Mats Forsgren and Torben Pedersenexplains that subsidiaries have access to different types of resources and therefore perform differently in their market-place and also within a multinational corporation . Results indicate that a positive, direct, impact on subsidiary market performance has been created by technology embeddedness, and brings about indirect impact on the subsidiaries organizational performance.

The article titled "A Literature Review and Integrative Performance Measurement Framework for Multinational Companies" by SengunYeniyurtprovides useful frameworks for performance measurement and strategic alignment. Based upon previous research, this paper presents an integrated framework for performance measurement for multinational companies and also provides directions for future studies.

The article titled "Effects of International Diversity and Product Diversity on the Performance of Multinational Firms" by Stephen Tallman and Jiatao Liexamined the relationships among global diversity, product diversity, and organisational performance. It indicates a consistent relationship between product diversification and the performance of Multi National Enterprise but considering international diversity there were minimal performance differences.

The article titled "An Integral Framework for Performance Measurement" by Paul Rouse and Martin Putterill brings about a performance framework in order to extend capacity for performance appraisal. This open system ensures active flows among various levels of organization. Three basic dimensions of performance that form a performance triplet are observed, which constitute a sequence of performance measurement principles.

The previous studies analysed the various dimensions of performance of Multinational Companies and its subsidiaries. It was found that the research relating to the performance of Multinational firms' subsidiaries was not carried out. Thus the present study aims to fill the research gap.

3. DIFFERENT MODES OF ENTRY BY MNC's

Exporting

Exporting is the process of selling of goods and services produced in one country to other countries.

Types of Exporting

- **Direct Exports**

Direct exports represent the most basic mode of exporting made by a (holding) company, capitalizing on economies of scale in production concentrated in the home country and affording better control over distribution. Direct export works the best if the volumes are small. Large volumes of export may trigger protectionism. The main characteristic of direct exports entry model is that there are no intermediaries.

- **Indirect exports**

Indirect export is the process of exporting through domestically based export intermediaries. The exporter has no control over its products in the foreign market.

Types

- Export Trading Companies (ETCs)
- Export Management Companies (EMCs)
- Export Merchants
- Confirming Houses
- Nonconforming Purchasing Agents

Licensing

An international licensing agreement allows foreign firms, either exclusively or non-exclusively to manufacture a proprietor's product for a fixed term in a specific market. In this foreign market entry mode, a licensor in the home country makes limited rights or resources available to the licensee in the host country.The rights or resources may include patents, trademarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without requiring the licensor to open a new operation overseas.The licensor earnings usually take forms of one time payments, technical fees and royalty payments usually calculated as a percentage of sales. Licensing is a relatively flexible work agreement that can be customized to fit the needs and interests of both, licensor and licensee.

Franchising

The franchising system can be defined as: "A system in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system." Compared to licensing, franchising agreements tends to be longer and the franchisor offers a broader package of rights and resources which usually includes: equipment, managerial systems, operation manual, initial trainings, site approval and all the support necessary for the franchisee to run its business in the same way it is done by the franchisor. In addition to that, while a licensing agreement involves things such as intellectual property, trade secrets and others while in franchising it is limited to trademarks and operating know-how of the business.

Strategic alliance

strategic alliance is a type of cooperative agreements between different firms, such as shared research, formal joint ventures, or minority equity participation. The modern form of strategic alliances is becoming increasingly popular and has three distinguishing characteristics:

- They are frequently between firms in industrialized nations.
- The focus is often on creating new products and/or technologies rather than distributing existing ones.
- They are often only created for short term durations.

Joint Venture

There are five common objectives in a joint venture: market entry, risk/reward sharing, technology sharing and joint product development, and conforming to government regulations. Other benefits include political connections and distribution channel access that may depend on relationships.Such alliances often are favourable when:

- The partners' size, market power, and resources are small compared to the Industry leaders
- Partners are able to learn from one another while limiting access to their own proprietary skills

Wholly Owned Subsidiaries (WOS)

A wholly owned subsidiary includes two types of strategies: Greenfield investment and Acquisitions. Greenfield investment and acquisition include both advantages and disadvantages. To decide which entry modes to use is depending on situations.Greenfield investment is the establishment of a new wholly owned subsidiary. It is often complex and potentially costly, but it is able to provide full control to the firm and has the most potential to provide above average return. "Wholly owned subsidiaries and expatriate staff are preferred in service industries where close contact with end customers and high levels of professional skills, specialized know how, and customization are required."Greenfield investment is more likely preferred where physical capital intensive plants are planned.This strategy is attractive if there are no competitors to buy or the transfer competitive advantages that consists of embedded competencies, skills, routines, and culture.Greenfield investment is high risk due to the costs of establishing a new business in a new country. This entry strategy takes much time due to the need of establishing new operations, distribution networks, and the necessity to learn and implement appropriate marketing strategies to compete with rivals in a new market.

4. CONCLUSION

Entering or expanding in a foreign market can be achieved through a wide variety of options. The best mode of entry should be selected only after carefully analysing each alternative and comparing it to the others.In general, exporting requires the least amount of resources and allows for the lowest level of control. Wholly owned subsidiaries, on the other hand, require the most resources but allow for the most control. As for technology, exporting is the least risky while licensing is generally the most risky.Clearly, not every mode of entry works for every situation. A company considering entry into a foreign market should look at the experiences of other companies in similar markets to gain insight into the best alternative. The company should also enlist the help of a professional, such as an international marketer, to insure the best possible strategy. The most control is usually the main objective. However, complete control can be expensive.

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