European marketing strategies: market related decision factors for the choice of entry mode

The purpose of this paper is to examine how external market factors influence the choice of international market entry (direct investment, partnership or acquisition). It is based upon initial interviews with companies in 4 industry sectors and 4 countries. The research confirmed the importance of external market factors in addition to the more prevalent research approach which focuses more upon internal company factors such as the resource-based view and company attributes and culture. The study therefore contributes to the body of knowledge on international market entry. It shows that a company, with the same set of internal resources and culture, can act in very different ways depending on local market conditions.

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Introduction

Companies have often chosen to expand their overseas activities by following different strategies and starting from different corporate situations in order to seek new growth opportunities, to overcome problems in their domestic markets, to exploit externalities, or to leverage their domestic competitive advantage. In 1800, only a small number of business enterprises owned and managed assets in more than one country, although many were engaged in international trade. Two hundred years later there are at least 60,000 multinational companies worldwide, controlling more than 800,000 affiliates. More recently, a growing number of small and medium-sized enterprises have also sought to expand their operations in several countries in response to global forces.

How companies choose to become directly involved in overseas markets, as distinct from 'looser' international expansion, can be classified into three types:

- **Organic growth** - starting from zero in the new market, recruiting a sales force, establishing commercial relationships to produce or distribute goods or services. This is often referred to as "Greenfield investment".
- **Strategic partnerships** - establishing contracts with existing players such as producers, distributors, importers, licensees. This can involve various degrees of control from mere distribution agreements with importers or local wholesalers to more capital-intensive partnerships through joint-ventures.
- **Acquisitions** - of companies already in business in the country.

This article focuses upon this question of the **method** of market entry (rather than the issue of market selection or market attractiveness). Much of the relevant literature appears to emphasise the internal company factors that determine the method of market expansion such as integration, resources or control rather than external market criteria such as market maturity and the competitive environment.

The central research question is why does a company choose different market entry strategies when from the resource based viewpoint the internal factors are the same? What variables influence its decision? More strongly, we postulate that the external market drivers can be of greater importance, and that specifically market maturity and the degree of local competition are key. Hence our possibly facetious title "market-driven market entry strategies".

The research is case study based using an action research methodology involving longitudinal research spread over two years working closely with the top-management of a major German food company expanding their operations initially into Italy and the United Kingdom. Over this period 41 in-depth interviews were conducted in 3 countries with 20 companies, all food producers, distributors or end-customers (restaurants, hotel chains, canteens).

Literature review

The selected market entry method depends upon both internal company factors and external environmental factors.

From an internal perspective the resource-based view of the firm considers FDI as a way of leveraging existing resources that then generates additional revenues by transferring capabilities and know-how into a new market, see for example Barney (1991). Although other notable authors such as Dunning (1958) and Penrose (1956) predated him, perhaps the seminal work came from Hymer (1976) from his original thesis completed in 1960. This made reference to internalization, control and integration as key determinants of market entry. Prahalad and Hamel (1990) made the case that internal factors such as resources, capabilities and competencies are critical in acquiring and sustaining competitive advantage and Agarwal and Ramaswami (1992) have emphasized the role of ownership and internalization. This is of primary importance when expanding internationally and could explain the success of Japanese corporations in global markets in the 1990's, Prahalad and Hamel (1989).

The question of the most suitable market entry strategy was also addressed by Halliburton et al (1993) through their competitive strategy framework for the Single European Market. One of the three major dimensions is strategic integration defined by cooperation agreements and/or mergers and acquisitions. Smaller and medium-sized companies are more inclined to enter into strategic agreements because of lower capital involvement. If successful the company can then increase penetration with acquisitions.

It has been suggested that firms initially going abroad prefer to enter foreign markets by acquisition in order to reduce uncertainty, while large established multinationals might be more willing to undertake a Greenfield investment. More recently Chen and Hu (2002) have reviewed such entry criteria, Tan et al (2001) have considered risk and management skills and Sanchez-Peinado and Pla-Barber (2006) have examined uncertainty from a multidimensional viewpoint. Other authors have compared manufacturing to service businesses from an internal perspective, such as Ekeledo and Sivakumar (2004) and Brouthers and Brouthers (2003).

From an external viewpoint acquisition has been suggested when a firm has to enter in an oligopolistic market, or when the market is static or declining, whereas a Greenfield strategy may be more attractive when a market is growing really fast, Knickerbocker (1973). On the other hand when the environment is different from the domestic culture of the enterprise an agreement or a joint venture can be the best entry strategies. Japanese firms used this option many times, trying to reduce the cultural gap with the host countries, Hennart (1991). Numerous authors have examined the impact of environmental factors upon the market entry decision. This has included the general environment, e.g. Bartlett and Ghoshal (1991), industry structure, e.g. Robinson and McDougall (2001), competitive behaviour, e.g. Bengtsson (1998) and business proximity, e.g. Palich et al (2000).

In summary, much of the literature appears to have approached market entry strategy from an internal perspective or from a more general environmental viewpoint rather than a more explicitly market-based perspective.

The research issue

This paper seeks to explore the determinants of market entry strategy from an external, market perspective.

- What are the market-based criteria which determine the choice of market entry?
- Can we establish an actionable framework to analyze local market specificities?

More specifically it postulates that the following market-based factors may be expected to influence entry mode:

- Market growth: evolution of total market sales, existence of numerous new players.
- Market maturity: measured by the state of consolidation of the market e.g. total number of players, also closely linked to market growth.
- Competitive intensity: number of established players in the market.
- Fragmentation of the value chain: existence of integrated players, number of players in the various stages of the value chain.
- Degree of market consolidation: have mergers and acquisitions started to occur, resulting in the emergence of a few players controlling a significant part of the market?

We explore which of these factors seem to be the primary market entry drivers and how might they be incorporated within an analysis framework?

Approach to the study

The study involves an in-depth analysis of a company that targets several countries and implements its international strategy tailored to the local market environment. The aim of this research was to work closely with a company, addressing a managerial issue as well as deriving generalisable findings to contribute to the body of knowledge - for the present study:

- To address the company's issue: what is the best way to enter the Italian and British markets?
- To contribute to management knowledge in the field of market expansion and internationalization.

The study therefore provides an example of Action Research where a framework is developed out of a real empirical situation and then actually applied in practice.

The study involved working over a two year period and it included in-depth interviews with 41 managers within the company, and with different players along the value chain: food producers, distributors and end-customers. These interviews were selected to provide coverage regionally across Germany, Italy and the U.K., across management positions and across activities on the value chain.

Case description

The company is a German corporation operating in 5 main businesses: food, beer and non alcoholic beverages, sparkling water, wines and spirits, and shipping, with other interests in hotels and financial services. The company was established in the early 1900's and sales totalled over 6 billion euros in 2006.

The research project took place within the food division, more specifically in the foodservice segment (sales to restaurants, school canteens, company restaurants). Most of the company revenues in this segment are generated from local operations where the company enjoys a leading position in a slow-growing market. As a result the company came to the conclusion that future growth could only come from international expansion where economies of scale could then contribute to increase the marginal profits.

As the company already had brands in the U.K. and Italy in the retail food business, it was decided that those two countries would also be the next targets for the expansion of the foodservice operations. The key research issue then was how to select the optimal strategy to enter the Italian and the U.K. market.

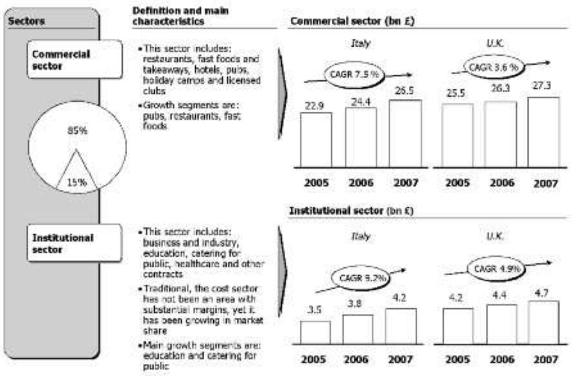
Analysis

The initial market entry questions were:

- What was the nature of the market environment: market size, drivers, segments, level of competition, value chain?
- Was there potential for a new entrant?
- What were the key success factors?

With a size of £31 Bn. the U.K. foodservice market is the largest in Europe and the second in growth of the top four countries (U.K., France, Germany and Italy), with a forecast compound annual growth rate (CAGR) of 3-4 % in the next four years. At £28 Bn, the Italian market is slightly smaller, but shows a stronger growth with a CAGR of 8%. In both markets the main drivers are changing food habits, in particular changes in family structure and the increase in food spending outside the home, as well as a rising interest in higher quality and specialty foods (such as health food). Customer segmentation of both markets is broadly similar and is illustrated in **Figure 1.**

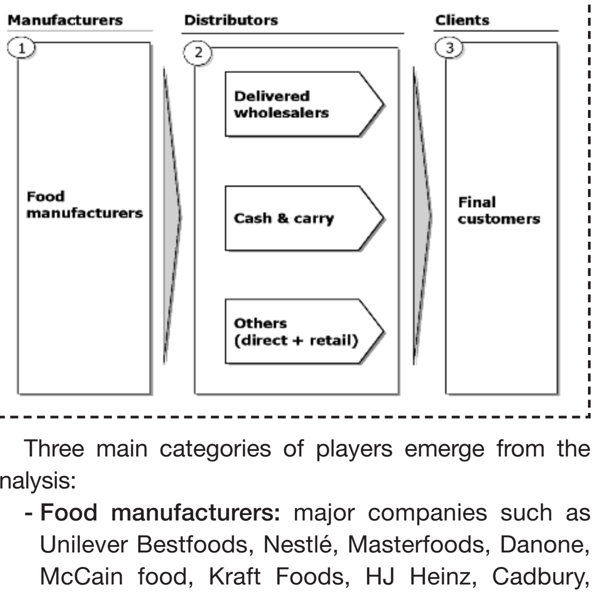
Figure 1. Foodservice markets - Customer segmentation



In addition the product category mix is similar in both countries, with the smallest category chilled food growing more than twice as fast as the other three main categories, ambient, fresh and frozen food (e.g. 6.5% to 2.7%, 3.5% and 1.6% respective CAGRs from 2000 to 2005 in the U.K.).

The two markets are broadly similar in terms of customer and product segments, overall market trends and growth drivers - the major difference lies in the growth rate, (3-4% in the U.K., 8% in Italy). The foodservice business is more established in the U.K. whereas it is emerging in Italy. In this respect the U.K. market is more mature. The foodservice value chain is structured according to **Figure 2.**

Figure 2. The foodservice value chain



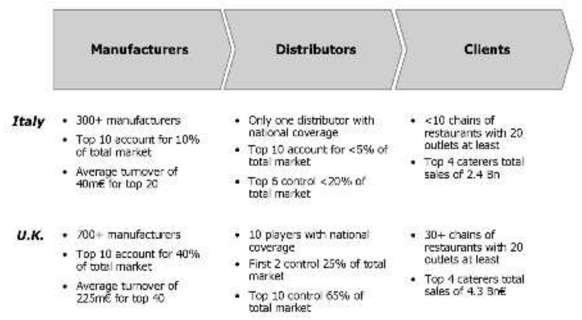
Three main categories of players emerge from the analysis:

- **Food manufacturers:** major companies such as Unilever Bestfoods, Nestlé, Masterfoods, Danone, McCain food, Kraft Foods, HJ Heinz, Cadbury, Barilla. In addition there are smaller ones, mostly regional food producers specialized on a limited number of products.

- **Distributors,** divided into three categories:
  > *Delivered wholesalers* are the dominant distribution channel offering more one-stop shopping and a wider portfolio of products and services. In the U.K. consolidation is already well advanced in contrast to Italy;
  > *Cash and carry* companies are used extensively by small restaurant businesses and are facing strong competition from the retail operators such as Tesco in the UK which now can offer similar low prices (thanks to its buying power with suppliers);
  > *Direct sales* from the manufacturers and/or purchases from retail outlets and supermarkets.
- **End-customers** represent the third segment of the value chain and are of two types:
  > *Commercial operators* such as hotels, restaurants and fast food chains the largest of whom prefer to buy from major wholesalers offering one-stop shopping;
  > *Institutional operators* who target specific communities such as school canteens, hospitals, firm restaurants, public administration. Here consumers (students, patients, workers) are not the decision makers in buying food. Most of the sector is directly supplied by a few dominant global caterers such as Compass, Sodexho, Aramark. Not surprisingly the latter buy predominantly from medium and large wholesalers.

Although the value chain is structurally the same for both the Italian and U.K. markets, its degree of fragmentation differs considerably in the two countries.

Figure 3. Value chain characteristics



This is especially true for food manufacturers and distributors, as illustrated in **Figure 3.**

Application of the research framework

There were three postulated market entry strategy options:

- **Organic growth**
- **Strategic partnership(s)**
- **Acquisition(s)**

In order to assess these options, selection criteria were formulated in alignment with the parent company's strategic guidelines:

- **Time to market:** the company targeted substantial sales within a two-year horizon with an ambitious market share objective of 3%;
- **Strategic fit:** product range and customer segments of the local entity should match with the existing business in Germany, with the focus on ambient and frozen products with balanced sales in commercial and institutional sectors;
- **Control over strategy and margins:** the company wanted to retain control over the local strategy and ensure that the local profitability matched the corporate standards with positive margins after 3 years.

Figure 4 illustrates the three strategies and their assessment against the above criteria.

Figure 4. Market entry strategies

Strategic options	Time-to-market	Strategic fit	Control
1 Acquisition	• Potentially immediate after acquisition • Potential access to trained salesforce and logistic network • Access to key accounts	• Depends on acquired company	• Full control on sales network and pricing strategy • Ownership of end customer
2 Strategic Partnership	• Potentially immediate if partner has key accounts • Possibility of substantial volumes if managed carefully	• Depends on partner	• No access to end customer • Depends on partner's effort • Potentially reduced margins
3 Organic Growth	• Limited time-to-market • Strong effort: recruitment, business development... • Starts from zero on local experience curve	• In line with parent company	• Full control

Within the U.K., because of the maturity of the market, the high level of competition, the required speed and the ability to reach a strong position, acquisition of a producer was considered the best solution as opposed to organic growth.

This would allow control of the customer base, access to key accounts and potentially to an existing sales force as well as local knowledge of the market and access to preferred distribution channels. Among the 700 small-medium producers in the U.K., 60 were identified as possible targets using as the main screening criteria product range and customer segment matching, access to existing sales force and logistic network, access to key accounts, geographical coverage and potential cross-selling with the retail business. Given the pivotal role of large wholesalers, all pre-identified 60 targets already had strong relationships with at least one of the top wholesalers. A strategic partnership with a distributor was seen as a potential complementary strategy in the U.K. This could enable fast access to the market provided the partner was a major wholesaler controlling a significant part of the market. However a distribution partner could constrain the margins and control strategy as well as the access to customers, which limited the interest of such an option. This was therefore mostly envisaged as a complementary strategy.

By contrast in Italy the retained option was a strategy based upon organic growth coupled with select partnerships rather than acquisition. The market entry model for Italy was then chosen to reflect the local market specificities especially the power of customers who are the key players. Distributors and manufacturers are still relatively too small to have any significant market power, the value chain is less efficient and has not yet stabilized, and consolidation is only emerging

The fact that the market is growing faster, is at an earlier stage, and that there are no large distributors with national coverage led to the conclusion that it was better to enter the market by building a small sales force and to grow organically. The largest foodservice users (canteens, restaurant and hotel chains) are relatively concentrated which would enable direct sales. In addition smaller clients could be targeted through several partnerships with medium-sized wholesalers. At a later date an acquisition could be considered if relevant targets emerge through the likely future consolidation of producers.

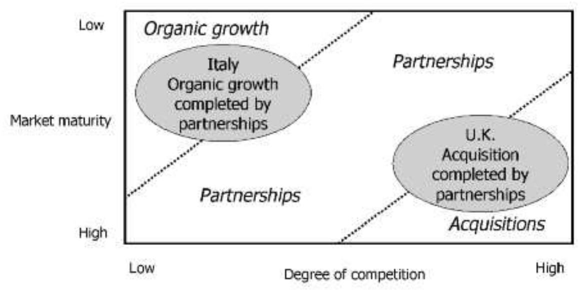
In conclusion, these differences in local market specificities, (value chain balance of power; market player dynamics (consolidation vs. fragmentation); market growth; competitive intensity), led to the choice of two completely different entry strategies despite the fact that the company internal factors were constant. The findings thus supported our strong hypothesis in the initial research brief: these variables are key determinants in the choice of market entry mode.

We also developed a proposed matrix framework:

- **Degree of relative competition for new entrant:** the proxy we used here is based on the existence of multiple significant and powerful players as well as the value chain's balance of power (market controlled by major wholesalers vs. power spread across value chain segments). Interestingly these players need not necessarily be competitors but may be producers, distributors or large customers. The Italian market, with numerous small and fragmented players is therefore less competitive.
- **Market maturity:** this reflects the quantitative measure of the overall market growth as well as the state of consolidation of the players. A high maturity is exemplified by limited growth and high degree of consolidation as in the U.K. case.

This matrix framework is presented in **Figure 5.**

Figure 5. Framework for market entry strategy selection



Contribution to theorie

The study therefore provides an example of Action Research where a framework is developed out of a real empirical situation and then actually applied in practice. Although this paper is based upon a single company initially entering two overseas European markets it contributes to an understanding of the main market drivers affecting the choice of entry strategies and it proposes a framework for market entry strategies. The longitudinal approach over a period of 2 years coupled with a substantial series of interviews across countries, functions and value chain players supports the findings as a base for further conceptualization.

As outlined in the literature review much of the attention has been concentrated upon internal factors which can be classified into two categories:

- **Firm-specific capabilities and attitudes:** such as managerial skills, risk tolerance, uncertainty, control, company culture
- **Firm-specific resources:** such as proprietary technology, company reputation, organizational resources

In this example we focused upon external factors, notably upon market specificities and the competitive environment. Our findings therefore contribute to a theoretical understanding of the underlying market drivers of entry strategies; they emphasize their importance in the decision as to whether to proceed locally through acquisition, organic growth or through strategic alliance.

Limitations

We recognize two limitations to the current research:

- It is based on one single company in one industry. Our results and data could be enriched in the future by adding new companies operating in different industries.
- Our conclusions are limited to two countries, Italy and the U.K. We have already started to investigate the drivers of market entry strategies in Spain and Poland, which should develop further the findings presented here.

Conclusion and further research

Our research demonstrates that the same company, with the same set of internal resources, can act in very different ways depending on local market conditions. In a mature and consolidating market (the U.K. example), the market entry must be fast and should aim at catching up with established first movers. To do so, an acquisition was the most appropriate option. On the other hand in a growing and more fragmented market (Italy), entry through organic growth using a small sales force was chosen as the best strategy especially when the industry value chain is not yet efficient and players still have unstable positions.

The study outlines a framework for the choice of international market entry strategies based upon local market specificities. It shows the case of an industry where the driving forces behind the international strategy are closely linked to market characteristics such as the level of competition, the maturity of the market, and the structure of the value chain. This is intended to complement the established literature which emphasizes internal factors such as control, resources, organizational culture, or managerial skills. It has sought to make the case that in addition market entry strategies should also be "market-driven".

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