MICHIGAN
ROSS SCHOOL OF BUSINESS

WDI PUBLISHING

conceptual note 1-428-587
April 8, 2009

Robert E. Kennedy

Note on Entry Mode

By all accounts, cross border economic activity grew rapidly in the early 2000s. The largest American corporations generated more than half of their revenues outside the United States. This was true, for example, of Intel, which saw 74% of its sales outside the United States, as well as Texas Instruments, with 87%, and IBM, with two-thirds of its sales and workers located outside the United States.[1]

Why Go Abroad?

Firms expand globally for different reasons, including to expand sales, to access production resources, and to gain experience. A number of triggers might push a firm to move outside its home country, including a saturated home market, the recognition of an untapped opportunity in a foreign market, the opportunity to obtain access to (or control over) raw materials or labor, or the opportunity to leverage a core competency such as a strong brand. For example, Starbucks expanded into India because of its population of 1.15 billion people and rapidly growing economy.[2] The company perceived Russia as an attractive market because it was one of the largest and fastest-developing economies in Europe and had demonstrated an affinity for Western brands.[3]

A firm might also decide to internationalize because technological changes lowered the transaction costs of doing business abroad, or because the political environment of a country or region changed and now allowed foreign investment. For example, firms such as Unilever and Procter & Gamble established production facilities and distribution networks in Central and Eastern Europe following the collapse of communism in order to build their brands and capture first-mover advantage. The trend toward privatization and deregulation enabled firms like Spain's Telefónica to enter Latin American markets.

It is important to remember the fact that internationalizing is expensive. Firms with cross-border operations are subject to an additional layer of taxes, tariffs, regulations, and administrative costs. Risk factors include macroeconomic shocks, political instability and changes in the regulatory environment. To succeed, an internationalizing firm must have some advantage to offset these extra costs. There are generally two ways to offset such costs:

Published by WDI Publishing, a division of the William Davidson Institute (WDI) at the University of Michigan.