

Chapter 14

Basic Types of Foreign Operation Modes

The choice of foreign operation mode is one of the most important components of an internationalisation strategy, since the operation mode determines the type and intensity of control over foreign market activity, necessary resource transfers and the associated risks. This Chapter provides an overview of different operation modes and highlights their various characteristics.

Introduction

A company planning to conduct business activities in a foreign market must choose an appropriate operation mode. Most tasks can be performed in various ways, including via vertically integrated organisational units in the foreign country (wholly-owned subsidiaries), via external organisational units (e.g. distributors in the foreign market), or jointly (cooperative arrangements).

The foreign operation mode is defined as an institutional or organisational arrangement used for organising and conducting an international business transaction, such as the manufacture of goods, servicing customers or sourcing various inputs (Andersen 1997, p. 29; Welch/Benito/Petersen 2007, p. 18). The choice of foreign operation mode is strategically important. It is a core component of the internationalisation strategy and exerts a strong and lasting influence on many of the company's other activities and options. It is seen as a crucial success factor, because it is not easily reversible in the short- and mid-term.

Many textbooks discuss the issue of foreign operation modes under the heading of *market entry modes*. For two reasons, the term "foreign operation mode" is used throughout this book instead:

- First, the issue is still relevant even when the entry context no longer applies (Welch/Benito/Petersen 2007, p. 10). In recent decades, the focus has shifted from "going international" to "being international" (Bäurle 1996, p. 123). Thus, for an MNC, the initial market entry mode is often less important than the operation mode chosen at any given point in time.
- Second, the term "market entry" suggests that the international activities are sales-related. Even though this Chapter mainly focuses on this di-

Definition

Market Entry Modes vs. Foreign Operation Modes

mension, foreign operation modes are broader, and also apply to procurement, production, R&D, services, etc.

The Basic Types of Foreign Operation Mode

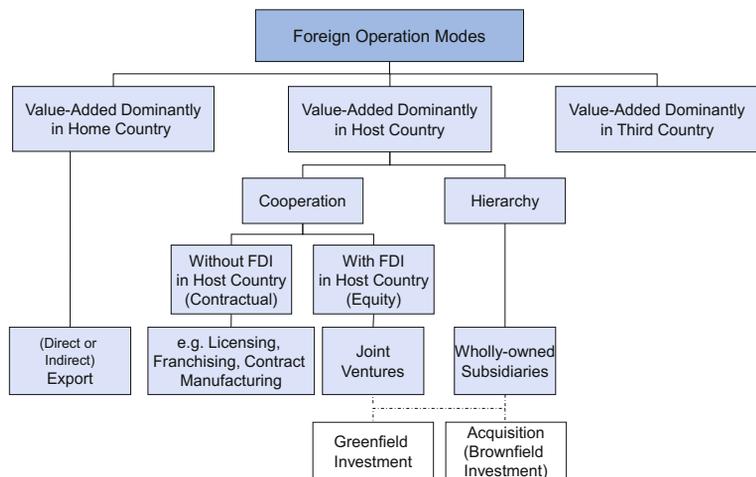
Different schemas for classifying foreign operation modes can be found in the literature. A distinction is frequently made between

- export modes (indirect export, direct export via agents, etc.)
- contractual modes (e.g. licensing, franchising, contract manufacturing)
- investment equity entry modes (e.g. joint ventures, wholly-owned subsidiaries).

An increasing level of *vertical integration* can generally be seen here. Export modes – at least when intermediaries in the host country are used – are market modes (see Chapter 15). Contractual and equity alliances are cooperative modes (see Chapters 16 and 17). Wholly-owned subsidiaries constitute the highest level of vertical integration (i.e. “hierarchy”) (see Chapter 18). It should be noted, however, that export modes can differ significantly. If, e.g., an MNC exports to a foreign customer through a direct customer relationship, this affords the MNC a very high level of control over this transaction.

Figure 14.1

Classification of Selected Foreign Operation Modes



Source: Adapted and expanded from Zentes 1993, p. 67.

More concretely, the choice of foreign operation mode involves several different dimensions (see Figure 14.1): *Where* to locate production, whether to *cooperate* and whether the MNC should *invest* abroad. During the *establishment process*, joint ventures and wholly-owned subsidiaries can be established through a greenfield investment, i.e., by building a new facility in the host country, or through acquisition of existing facilities.

Location of Value-Added

There are three main options when deciding on *location*: producing in the home country and then exporting to the target market; having the value added mainly in the target market (through internal production or via a partnership); or producing in a third country (with internal production or via a partnership) and then exporting to the target market. Different determinants for this decision have been investigated in the literature. In the early economic approaches, international trade (and, thus, the location of value-added) was explained through *comparative cost advantages* or, building on these, via *relative factor endowments* in a country.

Later, dynamic approaches were developed. In the *international product lifecycle theory* of international trade, Vernon (1966) argued that *new product innovations* are usually developed and produced in a company's home country, even if factory costs are high. In the early stage, cost is of secondary importance due to the innovating company's monopoly. Also, demand is difficult to predict. Foreign demand emerges during the later stages of a *maturing product*, but new competitors also bring cost pressures. Production is partly shifted to foreign countries, closer to the new sales markets. Finally, in the third stage (*standardised product*), industrialised countries may still be the most important markets, but they have become too expensive for production. Thus, production is shifted to emerging countries. From there, the MNC (or competitors) exports the product to the relevant markets.

Generally, location theories of internationalisation assume that the decision for value-added in a specific country is determined by location characteristics. The relevant characteristics include *market factors* (e.g. market size, market potential) and *cost-related factors* (e.g. differences in labour costs, input goods, taxes). Another relevant location factor is the *country risk*. In cases of high risk, exporting or contractual arrangements reduce the risk exposure of the MNC compared with a wholly-owned subsidiary where the commitment of the MNC's own resources is substantial.

The *configuration decision* will be discussed in more detail for the different value chain activities, i.e. production (see Chapter 19) and R&D (see Chapter 20).

Cooperation vs. Hierarchy

The decision whether to establish foreign value-added via cooperation (e.g. a joint-venture or via contract manufacturing) or in a hierarchical operation mode (e.g. a wholly-owned subsidiary) depends on many influence factors. A comprehensive study by Morschett, Schramm-Klein and Swoboda (2008; 2010) has shown that a number of factors have a strong influence on this decision. The likelihood that an MNC uses a wholly-owned subsidiary instead of a cooperative arrangement increases with:

- *the number of employees*: because larger MNCs can more easily afford to establish a subsidiary on their own and have the necessary management capacity to coordinate their subsidiaries
- *experience* in the host country: because increased knowledge about the country decreases the uncertainty in the market and makes a partner less necessary
- *advertising intensity*: since a partner in a foreign country may “free-ride” on an MNC’s high reputation. This can best be avoided by exploiting the good reputation of the MNC through a wholly-owned subsidiary (advertising intensity is usually seen to indicate high specificity)
- *export intensity*: because a higher percentage of foreign sales indicate that the MNC has substantial knowledge of foreign markets, and thus is less dependent on a partner.

Conversely, MNCs seem to prefer cooperation over a wholly-owned subsidiary, if

- *country risk* is high
- *legal restrictions* in the host country are tight
- the *market size* of the foreign market is large (which might be explained by the high investments necessary in large markets)
- the *resource intensity* of the foreign activity is high, since host-country companies often have a first-mover advantage over local resources which can only be tapped through a partnership
- the subsidiary is active in a business field that is not closely related to the business of the parent company, requiring *external (partner) knowledge* for this subsidiary.

Additional arguments for cooperative and hierarchical operation modes are discussed in Chapters 16 and 17.

Characteristics of Foreign Operation Modes

To make a rational decision about a foreign operation mode, several partly interconnected characteristics have to be considered. Table 14.1 lists and evaluates these for selected operation modes.

Characteristics of Selected Foreign Operation Modes

Table 14.1

	Export	Contractual Cooperation	Equity Cooperation	Wholly-owned Subsidiary
Control	low/medium/high	low	medium	high
Resource Commitment	low	low	medium	high
Flexibility	high	medium	medium-low	low
Knowledge Dissemination Risk	low	high	medium	low

Source: Adapted from Driscoll/Paliwoda 1997, p. 60.

The ability to exert tight control over foreign operations is seen as the main advantage of the stronger internalised operation modes. Control refers to the authority over strategic and operational decisions during foreign operations. Compared with cooperative operation modes, “maintaining decision-making control allows the MNC to determine its own destiny” (Driscoll/Paliwoda 1997, p. 64), and control is “the single most important determinant of both risk and return” (Anderson/Gatignon 1986, p. 3). As Table 14.1 illustrates, different operation modes imply different levels of control. While wholly-owned subsidiaries allow for tight coordination (*full control modes*), most cooperative modes lead to limited or joint control (*shared control modes*). In the case of contractual agreements (like licensing), the control over foreign markets is largely shifted to the licensee in exchange for payment.

Often, the trade-off between control (*benefits of integration*) and the necessary *resource commitment* (*cost of integration*) is highlighted as the main decision for an MNC. Resource commitment refers to the assets that an MNC needs to dedicate to the foreign market operations. Obviously, a high resource commitment by an MNC enhances its risk exposure. In the case of export and contractual cooperation, this is comparatively low. In the case of wholly-owned subsidiaries, the resources have to be invested by the company alone. Equity cooperation falls between these two extremes. Sharing equity investment with a cooperation partner allows for a reduction in personal risk.

Flexibility is closely linked to resource commitment. It refers to a company's ability to switch the chosen operation mode rapidly and at comparatively low cost or even to withdraw from a foreign market when external condi-

Control

*Resource
Commitment*

Flexibility

Dissemination Risk

tions change (Anderson/Gatignon 1986). High resource commitment acts as market exit barrier and thus reduces the strategic flexibility of the MNC.

A fourth characteristic of foreign operation modes is the so-called “*dissemination risk*”, i.e., the risk that knowledge is absorbed by another company which then uses this knowledge against the MNC’s interests (Agarwal/Ramaswami 1992). Since technological and marketing expertise are crucial competitive advantages, it is important to secure the company against uncontrolled knowledge outflows, since this may reduce the income a company can generate from its knowledge. Protection against knowledge dissemination is therefore a major criterion for the choice of operation mode (Driscoll/Paliwoda 1997, p. 66). In particular, cooperative operation modes, where a partner company (e.g. a licensee) is actively provided with the company’s knowledge, are characterised by a high risk of knowledge dissemination. The lowest risk exists in the case of wholly-owned subsidiaries (or through direct exports to a foreign customer).

Cost and Profit Potential

Different foreign operation modes lead to different *costs of serving* the selected markets (Grünig/Morschett 2012, p. 143). Producing in the host country may reduce production costs due to lower labour costs and reduced costs of distribution logistics. It may help to overcome substantial custom tariffs. But decentralised production also leads to reduced economies of scale and therefore higher unit costs. With partner strategies, the profit has to be shared with partners but it may be higher due to better market knowledge. With licensing, a company gets its income from royalties, not directly from sales. All of these aspects have to be considered when evaluating different market entry modes.

Choice of Foreign Operation Mode

The literature provides a number of theories to explain the choice of international market entry mode. These theories are covered in more detail in Chapter 6:

- The dominant theory to explain the choice of foreign operation mode in recent decades has been the *transaction cost approach* (Williamson 1985) and the closely related *internalisation theory* (Buckley/Casson 1976). These approaches argue that companies choose operation modes that minimise the cost of cross-border transactions.
- Internalisation logic alone is not sufficient to explain location choice, i.e., it does not fully explain why a company might locate its production in the host country instead of merely exporting from the home base. Dunning’s *eclectic paradigm* offers a general framework to determine which

operation mode is the most appropriate. It is also known as *OLI paradigm* because it argues that three conditions must prevail simultaneously to stimulate FDI by a company (Dunning/Lundan 2008, pp. 96-108): ownership-specific advantages (O), location-specific advantages (L) and internalisation advantages (I).

- With a dynamic perspective, the *internationalisation process model* (IP model) proposes that companies follow a specific sequence of foreign operation modes in a foreign country, based on increasing experiential knowledge: no international activities, export activities via agents, export activities via the company's own sales subsidiaries or establishment of production subsidiaries in the foreign country (Johanson/Vahlne 1977).

Corporate Strategy as Determinant

One influence factor on the choice of foreign operation mode that is largely neglected by the approaches described above is *corporate strategy*. For example, the MNC's concrete motive for entering the host country (see Chapter 4) is likely to have an effect on the chosen operation mode.

The corporate strategy approach focuses on the competition and required characteristics of the operation mode that stem from the corporate strategy and the specific role of the foreign subsidiary in its host country. Following the general idea that *structure and strategy* should be aligned, this approach investigates strategy variables and their influence on the operation mode choice. More particularly, "the strategy approach regards the issue of ownership structure primarily as a question of the level of control that is needed in order to coordinate global strategic action" (Benito 1996, p. 164). There are many influential strategy variables here (Kim/Hwang 1992; Malhotra/Agarwal/Ulgado 2004, p. 19):

- *Synergy effects* emerge if companies can use certain resources and processes like R&D, production or marketing to achieve economies of scale and scope across different host countries. Usually, tight control and the corresponding operation modes are considered favourable for achieving synergy effects.
- *Global strategic motives* refer to whether the MNC follows a global or multinational orientation (see Chapter 2). A multinational orientation allows for low-control operation modes and, e.g., partnerships in the host countries, while a global strategy implies wholly-owned and tightly controlled subsidiaries.
- *Market concentration* is a relevant external factor since it leads to a worldwide oligopoly. Following Knickerbocker's theory of *oligopolistic reactions*

Structure and Strategy

(Knickerbocker 1973), it is argued that the interdependency of different countries in this case is high, and a tight coordination of the foreign subsidiaries is necessary to react flexibly to a competitor's actions. From this perspective, direct investment in a foreign country can also be seen as an "exchange of threats" between competitors.

Foreign Operation Mode Combinations and Foreign Operation Mode Changes

In recent years, there has been substantial and relevant criticism concerning previous foreign operation mode research. Welch, Benito and Petersen (2007) point out that most research assumes that an MNC applies one specific foreign operation mode in a specific host country while "observation of business practice reveals a 'messier' reality" (Benito/Welch/Petersen 2009, p. 1455). They put forward three main arguments in their bid for a more realistic conceptualisation of foreign operation modes (Welch/Benito/Petersen 2007; Benito/Peterson/Welch 2009).

- *Mode combinations* (or "mode packages") in a specific country whereby companies use different modes for different value chain activities are not the exception but the rule. Companies may, for example, use a wholly-owned subsidiary for production activity and a joint-venture for distribution activity. Even within the same type of activity (e.g. sales), companies may use their own sales force for one group of customers (e.g. large industrial companies) while selling via independent distributors to another group of customers (e.g. smaller commercial customers). Or they may combine operation modes, e.g. by creating a joint venture to which they grant a production licence. This is logical when considering the different influence factors. From a transaction cost perspective, some of the activities carried out in the host country may be characterised by high asset specificity while others have low asset specificity. This, together with the increased unbundling of different value chain activities leads to a separate optimisation for both the location and operation of these activities, even within the same country.

As a consequence, it is not sufficient to recommend one specific foreign operation mode. A specific foreign operation mode for each value chain activity and the links between them must be considered to create a specific combination.

- Switches are not confined to foreign operation modes; in fact, *within-mode changes* are very common as well. For example, within exporting, one distributor could be exchanged with another, or within licensing, the number or extent of technologies and brands that are licenced to a for-

eign partner can be increased or reduced. In equity-based modes, the share in a joint venture may be increased or reduced, etc.

- *Mode switches* are also very common, and not necessarily in the systematic sequence of a few stages that the IP model would imply. In terms of explanatory models for the mode choice, there is no reason to assume that there is always an increase towards “more commitment”; changes in the context or the strategy can also justify switches to “lower” foreign operation modes. However, switching costs must also be considered.

It must be remembered that these aspects act together, increasing complexity. Thus, instead of investigating one foreign operation mode for each country in a static manner, the dynamic changes from one combination of foreign operation modes in one country to another combination provides a more realistic conceptualisation of the managerial problem. These dynamic changes may include within-switches, between-switches, and reductions or increases in the number of different operation modes, which clearly points to a very complex managerial decision process.

Conclusion and Outlook

The choice of a foreign operation mode is one of the most important internationalisation strategy decisions. This Chapter has presented the basic types. For each of the three basic options – market, cooperation and hierarchy – the following Chapters will provide a more detailed discussion.

It must be stressed, however, that a choice of foreign operation mode has to be made for each value chain activity. Thus, an MNC might – for a specific foreign country – decide to outsource its R&D, internalise its sales and marketing activities, offer its after-sales service in a joint venture with a local partner and have major production steps carried out by a contract manufacturer. In addition, the interdependence between these activities has to be considered, since inter-functional coordination is also affected by the chosen operation modes.

Considering the theoretical explanations and the complex influences on the choice of operation mode, most recent texts argue that the different perspectives should be seen as complementary.

Further Reading

ANDERSEN, O. (1997): Internationalization and Market Entry Mode: A Review of Theories and Conceptual Framework, in: *Management International Review*, Vol. 27, No. 2, pp. 27-42.

WELCH, L.; BENITO, G.; PETERSEN, B. (2007): *Foreign Operation Methods: Theory – Analysis – Strategy*, Glos, Edward Elgar Publishing.

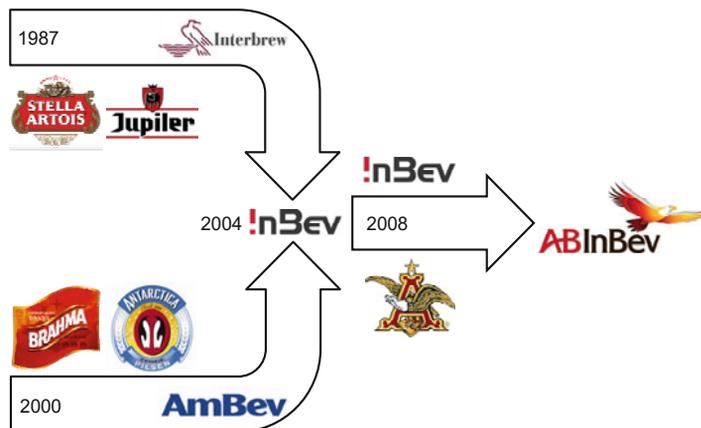
Case Study: AB InBev*

Profile, History and Status Quo

AB InBev is a leading global brewer and one of the world's top five consumer product companies. Based in Leuven, Belgium, the company sells in more than 100 countries and has geographically diversified operations in 25 countries on four continents. With a portfolio of over 200 beer brands and a beer volume of 400 million hectolitres, *AB InBev* realised a turnover of 43.2 billion USD in 2013. With the vision of being the “best beer company in a better world”, the brewer focuses on a consumer-centric, sales driven growth approach, aiming to occupy the No. 1 or 2 position in leading markets.

Figure 14.2

The Creation of AB InBev



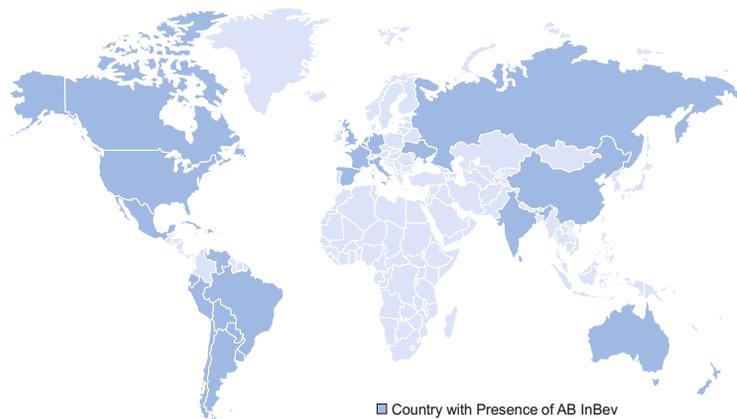
Source: AB InBev 2014.

* Sources used for this case study include the corporate websites (mainly <http://www.ab-inbev.com>) and various annual and interim reports, investor-relations presentations and explicitly cited sources.

The *AB InBev* group looks back on more than 600 years of experience in beer brewing. Today's structure is the result of four huge mergers or acquisitions, characterised by a strong international orientation. The first merger took place in 1987, between the two largest breweries in Belgium: *Artois*, located in Leuven, and *Piedboeuf*, located in Jupille, signalling the formation of *Interbrew*. *Interbrew* operated as a family-owned business, before joining the stock market at the end of 2000. The second merger took place in 1999, when the Brazilian breweries *Brahma* and *Antarctica* created *AmBev*. The two breweries were founded in the 1880s belonging to the first breweries in the country. *AmBev* is seen as the nucleus of the group, controlled by the Swiss-Brazilian dual citizen Jorge Paulo Lemann and his investment fund *GP Investimentos* (Barmettler 2014, p. 7). A decisive event in the formation of *AB InBev* was the merger between *Interbrew* and *AmBev* to create *InBev* in 2004. Then, in November 2008, *InBev* took over *Anheuser-Busch*, a brewery multinational from the United States to become today's MNC, *AB InBev*, a strong global player (see Figure 14.3).

AB InBev's Global Presence

Figure 14.3



Source: AB InBev 2014.

AB InBev's Business Development

As the history of *AB InBev* has already shown, the company has a strong focus on global markets. Different foreign operation modes play a role in the company's market development; a number of foreign operation modes de-

*Brand Strategy
and Outlook on
Focus Markets*

scribed in this Chapter can be identified. *AB InBev's* business development and market selection is closely linked to their brand strategy. They distribute more than 200 brands of which 17 individually have estimated retail sales values of more than 1 billion USD. Six of them ranked among the global top 10 most valuable beer brands (AB InBev 2014). To achieve this, the brands are structured into three categories:

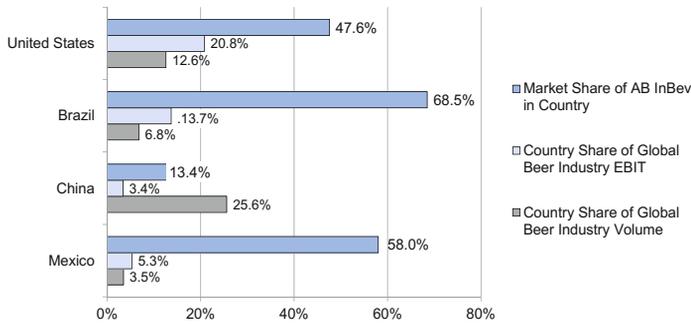
- global brands: *Budweiser, Corona Extra, Stella Artois*
- international brands: *Beck's, Leffe, Hoegaarden*
- local champions: e.g. *Bud Light, Skol, Antarctica, Jupiler, Sibirskaia Korona, Modelo Especial, Harbin.*

For its operations, *AB InBev* focuses on a balanced mix of both developed and fast-growing regions, with zone operations covering North America, Mexico, Latin America North, Latin America South, Europe and the Asia-Pacific region. In North America, the focus is on strong innovations and the extension of the brand portfolio, whereas in Mexico the goal is the creation of strong brands. In the Latin America North key region including Brazil, *AB InBev* has bet on its key commercial strategies of innovation, premiumisation, expansion in the Northern and North-Eastern regions and packaging, like redesigning or the use of returnable bottles. Latin America South is characterised by a growing market share, a focus on trade programmes and the strengthening of key brands' digital profiles. To gain a stable market share in Europe, *AB InBev* defines its key goals as driving the premiumisation of products and increasing the profitability of the brands sold in a shrinking market. The Asia-Pacific region provides a strong consumer market, and a solid execution of a growth strategy with brand focus is possible.

AB InBev has defined four focus markets (USA, Brazil, China, Mexico); these markets provide nearly half of the beer industry's worldwide volume and are expected to generate the industry's strongest growth opportunities in the near future (see Figure 14.4). To strengthen its global presence, *AB InBev* used different operation modes with different levels of commitment to enter new markets, reflecting the importance of a market to *AB InBev's* strategy. A selection of these is described below.

Characteristics of AB InBev's Focus Markets

Figure 14.4



Source: AB InBev 2014.

Mergers

As already shown with the foundation process of *AB InBev*, mergers have been used to form new, larger entities and gain access to specific foreign markets. The most important merger in the company's history was that with American brewer *Anheuser-Busch* in 2008 to create a new global leader in the beer industry. 40% of the merged company's revenues are now generated in the US market and the former *Anheuser-Busch* headquarters is the new North America headquarters to profit from the existing knowledge in this important market. Thanks to the merger, the newly shaped company is geographically diversified, with leading positions in the world's top beer markets of China, USA, Russia, Brazil and Germany and balanced exposure to developed and developing markets with huge potential for future growth.

Wholly-Owned Subsidiaries and Acquisitions

AB InBev has a market presence in about 140 countries and has employees in about 25 countries. In total, 452 companies belong to *AB InBev's* widespread network. For example, brewing subsidiaries have been established in Belgium, China, France, Germany, Mexico, The Netherlands, United Kingdom and the United States.

The company buys many existing assets in foreign countries to establish wholly-owned subsidiaries with the aim of growing and gaining market share. In 2000, *AB InBev* bought the second and the third largest brewers in

Acquisition of Beck's, One of the Company's International Brands

Acquisition of Corona, One of the Company's Global Brands

Operation Modes without FDI in Host Country

the United Kingdom, *Whitbread Brewing* and *Bass Brewers*, with a combined turnover of 2.9 million GDP and a combined UK market share of 32%. The two brewers are focus brewers committed to UK beer heritage and offering a rich portfolio of typical UK ales and lagers, from which UK consumers can benefit. Therefore, the two breweries remain independent, however they both can benefit from international network synergies with *AB InBev*. Furthermore, *AB InBev* was able to take advantage of the rapid consolidation of the UK beer market and regain full control over its *Stella Artois* brand in UK, which has been brewed under licence by *Whitbread* since 1976.

Further noteworthy acquisitions include the acquisition of the Canadian brewer *Labatt* in 1995, which allowed *AB InBev* to double its size overnight and move from 17th place to 2nd position in the world's brewing industry five years later, as well as the acquisition of the breweries *Beck's* and *Diebel's* in Germany in 2001. These two acquisitions created a solid platform in the German beer market and further progressed *AB InBev's* strategy of being a leading operator in the world's major beer markets.

A huge acquisition occurred in 2013, when the Mexican brewer *Grupo Modelo* with its flagship brand *Corona* was acquired for 20 billion USD and integrated into the portfolio. The combination of the two companies was logical, given their long-standing partnership of more than 20 years and *AB InBev's* 50% stake in *Grupo Modelo*. This integration created a new global leader in the world's beer industry with an annual beer volume of 460 million hectolitres, as well as enhancing revenues and saving costs due to scale effects.

At the beginning of 2014, *AB InBev* announced their re-acquisition of the largest brewer in South Korea, *Oriental Brewery*, to strengthen their position in the Asia-Pacific region. *Oriental Brewery* was sold in 2009 to reach deleveraging targets after the merger with *Anheuser-Busch*. The repurchase from the investment group *KKR* had already been arranged as part of the 2009 deal.

Export

For those markets in which the company has no operations, export is the preferred option for generating sales. To centralise part of their export functions, a European shared service centre was established in the Czech Republic in 2006 to bundle orders and provide export services for Belgium, Bulgaria, Croatia, the Czech Republic, Germany, Hungary, Ireland, the Netherlands, Romania, Russia, the UK and Ukraine.

Furthermore, *AB InBev* has contracts with independent distributors to import, distribute and market brands in specific regions. As an example, a distribution agreement was signed in 2004 with *Carlton & United Breweries* to import and market the brands *Leffe* and *Hoegaarden* in Australia, to take

advantage of the success of Belgian beer in the Australian market, which falls outside the traditional Australian mainstream beer territory. A further distribution agreement for these two brands was signed with the brewery *Lion Nathan* in 2005 to serve the New Zealand market, in order to benefit from the strong growth in Belgian beer consumption in the country.

Before the merger between *Anheuser-Busch* and *InBev* took place, *InBev* had used *Anheuser-Busch* since 2007 as their exclusive US importer. *Anheuser-Busch* was also responsible for the distribution, promotion and sale of *InBev's* premium European brands. An additional example of an *AB InBev* export brand is *Corona*, exclusively brewed in Mexico and exported in more than 180 countries.

In the beer industry, export can have the advantage of positive country-of-origin image. This sometimes becomes apparent when production location is changed. For example, *Beck's* beer has long been exported to the US market from Germany. When the company changed its production location to St. Louis (where it is now brewed alongside with *Budweiser*), many US customers complained, arguing that it would no longer taste "German". This discussion can be found on Internet forums and social networks.

Loss of Country-of-Origin Image

Licensing

Shipping beer to foreign countries is relatively expensive for such a low value product, and the transport takes time. Thus, brewing in the target country can help reduce costs and improve delivery and service levels. To achieve this without using its own resources, *AB InBev* makes use of licensing agreements in several countries. The relevance of this operation mode becomes apparent in *AB InBev's* claim on its website: "With operations and licence agreements around the globe, *AB InBev* is a truly global brewer" (*AB InBev* 2014).

In Australia, an exclusive long-term agreement was concluded in 2004 with the brewer *Lion Nathan* to brew, distribute and market the international brand *Beck's* (which *Lion Nathan* had already been distributing and marketing since 2001). For *Lion Nathan*, which also acts as an importer for other *AB InBev* Brands, *Beck's* is a key brand in the growing premium segment. In 2004 *Beck's* had a market share of 9% in the country; this agreement was an opportunity to secure the future and further growth of the brand in the Australian market.

Lion Nathan as Exclusive Partner in Australia and New Zealand

Another brewing licence for the *Stella Artois* brand was held by the *Foster's Group*. This licence was originally granted in 1997 and later renewed in 2002 for ten years. The renewal was based on the brand's outstanding Australian growth results under the stewardship of *Foster's* since the first licence was awarded and an ongoing growth of approximately 15% per year in the premium beer premium segment. However, in 2012 *Foster's* lost the licence to *Lion Nathan*. It is noteworthy that *Foster's* had at that point been acquired by *SABMiller*, the No. 2 brewing company in the world, and a fierce competitor of *AB InBev*, while *Lion Nathan* was acquired in 2009 by *Kirin*, the Japanese brewing group. *Lion Nathan* is now *AB InBev's* partner for all company brands in Australia and in New Zealand, distributing and marketing all of them and producing many of them under licence agreements. This illustrates how MNCs may have the choice between several competent licence partners in a country. It also shows, from *Lion Nathan's* perspective, how a successful licence partnership may be the basis for further contracts in the future.

In the Thai market, *AB InBev* has operated with brewing licences since 1975. In 2003, the licence for the *Kloster* brand was transferred from *Thai Amarit* to *Boon Rawd*, Thailand's oldest brewing company and owner of the country's most internationally recognised brands, *Singha* and *Leo*. This agreement between the two companies reflects the importance of Thailand in the company's Asian strategy. *Boon Rawd's* vast knowledge of the local beer market has provided a solid base for increasing the brand's market share.

Another interesting example of licensing as a substitute for internal production operations can be observed in Central Europe. *AB InBev* sold its operations in this region in 2009 to an investment fund. The newly formed company took over *AB InBev's* operations in Central Europe (e.g. Czech Republic, Hungary, Romania, Bulgaria, Bosnia-Herzegovina, Croatia). In 2012, this company was acquired by the Canadian brewer *Molson Coors*. *Molson Coors Central Europe* now acts as a distributor for *Hoegaarden* and *Lefte* in Central Europe and brews *Beck's* and *Stella Artois* for these countries under a licence agreement.

Joint Ventures and Buying Stakes in Foreign Companies

AB InBev also employs the operation mode of joint ventures in some countries. Reasons include governmental regulations, risk reduction, the partner's assets or the need to gain market knowledge. In 2001, a strategic partnership with *Union Breweries*, the second largest brewer in Slovenia, was signed. *AB InBev* took over a minority participation of 20% in *Union Breweries* with the aim of strengthening its presence in the growing Central European markets. Furthermore, *AB InBev* promotes the *Union* brand outside the Slovenian

Operation Modes with FDI in Host Country

borders and strengthens the brand in the South-East European region by using its existing distribution capabilities.

In 2002, a joint venture with the Chinese *Zhujiang Brewery* was signed, taking over 24% of the shares in *Zhujiang* and actively participating in the management of the brewery. While entering this strategic partnership, *Zhujiang's* beers were available in more than 30 provinces or autonomous regions in China and the brewer was the largest in terms of hectolitres sold in China. The brewery had a market share of 50% in Guangdong province and above 80% in Guangzhou province.

In 2007, another strategic and long-term joint venture was entered into with the *RKJ Group*, a leading beverage group in India, to invest in this promising beer market. While this partnership will not have a material impact on *AB InBev's* global business in the short- to medium-term, the company expects, that its 49% stock will provide access to a strong distribution network and that it is possible to build a meaningful presence over time.

Foreign Operation Modes as Complex Cross-Country Activities

These examples have clearly shown that the practice for MNCs often goes far beyond the simple single-country perspective. For example, export and wholly-owned subsidiaries with internal production operations are not mutually exclusive. In fact, *AB InBev* exports are frequently done from countries other than the MNC's home country of Belgium, and it may also occur from countries other than the country-of-origin of the specific beer brand. Once a production location in a foreign country is established, it may serve neighbouring countries as well. For example, *Beck's* beer is brewed locally in the USA and the plan is to export from this production site to neighbouring countries, e.g. Canada.

This becomes even more evident when analysing the acquisitions that *AB InBev* has undertaken. Acquiring *Grupo Modelo* not only gave *AB InBev* a much stronger position in the focus market Mexico (in which *AB InBev* had already been present before the acquisition) it gave them ownership of *Corona*, a global brand that is the leading import beer in 38 countries worldwide, and of production facilities in different countries.

Thus, if an MNC acquires another MNC or merges with it, this usually influences operations in many different countries. Instead of just looking at the home country and one host country, the overall portfolio of production locations (owned or in partnerships) and the overall portfolio of sales markets has to be considered.

Summary and Outlook

In summary, the example of *AB InBev* illustrates the wide range of possible options a company has for operating in foreign countries. With its chosen strategy, *AB InBev* is able to adapt its needs to match the conditions of particular countries. Thanks to its market diversification strategy, *AB InBev* is able to profit from both mature and developing markets. In future, the world's largest brewing company expects further growth and the creation of long-term value, especially in its key markets of the USA, Mexico, Brazil and China.

Questions

1. Explain the basic types of foreign operation modes that a brewer can choose when pursuing the international expansion of its business operations.
2. *AB InBev* enters foreign markets with different operation modes. Try to explain the choice of a specific operation mode based on market conditions and the importance of the market in *AB InBev's* strategy. Provide an explanation and examples for each operation mode addressed in the previous question.
3. Within its business development and brand strategy, *AB InBev* structures its brands in three categories. Explain the chosen structure and speculate why the selected brands are in these categories.

Hints

1. See, e.g., <http://www.ab-inbev.com> for an overview of *AB InBev's* company structure and strategy.

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