The Best Way to Internationalise Business: Acquisitions versus Organic Development

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Abstract: Most companies generally decide to internationalise their business by considering internal companies’ factors and host countries attractiveness aspects. No single strategy fits all circumstances to enter international markets. The best way of entry into host countries between acquisitions and “do it yourself” is not unconstrained. The appropriate selection depends on contexts, benefits gained, companies’ capabilities and the experience of management. Acquisitions and organic development have their own positives and shortcomings. To examine choices of global expansion modes of entry, Transaction Cost Theory, Real Options Framework, and Resource Based View Framework are utilised as tools to analyse each context to determine the best mode of entry. Key factors in choosing acquire company in host countries or go it alone are level of urgency, level of uncertainty, types of capabilities, and modularity of capabilities. If there is a high urgency and uncertainty, acquisitions will be the best way. Then, if soft capability is a mandatory, organic development is the most accurate mode by considering the consistency of culture. Next, if there is high level of modular capabilities, “go it alone” seems more effective than acquisitions.

1. Introduction

The motives of firms to decide to internationalise their business activities would help to explain about how and why companies should engage in activities of international business. There is an underlying question arise i.e. why certain companies are expanded the business operations abroad while others are staying locally? For sure, it depends on what the company wants to achieve in the period of time. When the firm decides to extend its business overseas, generally there are two elements needed to consider i.e. organisational aspects arising from within the company such as decision-maker characteristics, firm-specific factors, and environmental factors appeared from outside of the company such as the host country attractiveness.

Deciding to go abroad is not the end of story. The company, then, needs to understand the various modes of entry into host countries. Each mode has different context and characteristics. Undeniably, no best single way that fits all contexts to enter the international markets. This is the rationale that the management need to clearly understand options of entry mode such as export, licensing, franchising, international joint venture, and wholly owned venture Greenfield strategy, and mergers and acquisitions (M&A). Different with other modes of entry, wholly owned ventures contain a higher level of risk. Multinational enterprises have two choices i.e. acquire an existing established local company or green-field investment in wholly new facilities. In fact, approximately 70% foreign direct investment (FDI) is acquisition. It means that the company might prefer full control of the target company. Then, the next question emerges which one is a better way to go to expand the business activities internationally? It might depend on the circumstances, the benefits gained, the capabilities and experience of management, and other considerations affecting the firm.

This paper will discuss factors considered by the company in internationalising the business activities by going alone or by acquiring the current company through analysing theoretical frameworks and examples. Then, based on the analysis, this study will draw a conclusion.

2. Research Methodology

Choosing the appropriate research methodology to be used will be critical to the accomplishment of this study. Bryman and Bell stated that even if the data and information are available, the research will not meet its purpose if the methodology is not appropriately used [5]. Various research choices are depicted in Onion Models as shown in Figure 1 [12]. This research is categorised as an applied research which has an intention to develop and explore the knowledge of international business including
understanding various modes of entry regarding expansion of business overseas.

Figure 1: Research Onions [12]

The philosophical underpinnings of this research will refer to positivism that emphasises on analytical perspectives of theoretical frameworks regarding internationalisation and modes of entry. It also considers concepts, theories, ideas, insights, and research findings in practical outcomes in particular contexts. It will be definitely supported by examples happened in international business. Furthermore, the approach utilised for theory development in this research is the Abductive approach. It starts with a ‘surprising fact’ being observed which is the conclusion rather than a premise [12]

This research uses a qualitative method which is often utilised for the technique of data collection that uses or generates non-numerical data. By using this method and theories, the researcher has the intention to explore and analyse a set of issues regarding the factors influencing companies in choosing the appropriate modes of entry regarding expand their business internationally. Also, the researcher will try to investigate and get stories about the issues. By taking into account the grounded theory especially international business frameworks, the researcher tries to analyse circumstances and factors in each theories as a research strategy.

3. Internationalisation: Organic Growth vs Merger & Acquisitions

Figure 2: The Option of Foreign Direct Investment (cited from Peng and Meyer, 2011)

There are five drivers for companies to do FDI including resource seeking, market seeking, gaining a foothold in economic unions, protection of domestic or foreign markets, acquiring technological and managerial know-how. Then, based on Figure 2, the degree of equity control plays a crucial role in deciding the use of M&A than wholly owned Greenfield or joint venture. This essay will focus more on the wholly owned Greenfield and full acquisition strategy.

2.1 Organic Development

As, the default approach for pursuing the strategy, the wholly owned Greenfield strategy might be categorised as an internationalisation strategy that entails creating an entirely new subsidiary from scratch in a host country to enable foreign production and/or sales. The parent company generally implements their structure, procedure and strategy to the abroad subsidiary by transferring its supply chain, technology, corporate and organisational culture [16]. Generally, organic development could be used to deepen the existing markets penetration, and for product development.

Then, one question arise, why the company need to choose this strategy to internationalise its business? The availability of internal resources and capabilities could include the rationale for enterprises to adopt wholly owned Greenfield [9]. In other words, the company goes to expand their business abroad by itself because they have enough capabilities and resources to do it by itself. For example, Amazon relied on its own subsidiary Lab126 and expertise in software, book retailing, and the internet, to enter e-book market through offering its Kindle product organically. Going it alone become preferable relative to acquisitions or alliance with existing e-books producers because it has capabilities and resources.

There are several advantages of taking going internationalisation alone [10]. First positive is technology appropriation has relatively no issue. At the same tone, this strategy could enhance company’s learning experience and knowledge, especially in the foreign market [9]. The company, then, can control operations abroad. Due to going it alone, generally the conflict between a parent
company and subsidiary are at the low level. In addition to a low level of conflict, the company often has no problem in integrating different procedures, cultures, technologies, and structures. Then, generally it has less change in financial structure. Finally, the company’s managers of abroad subsidiaries generally contain a strong attachment to the parent company.

On the other hand, this approach has several weaknesses because it is far from easy to utilise current capabilities as the platform for significant leaps regarding internationalisation. Firstly, the company needs to add the extra capacity to the existing company. Then, there is a high possibility emerges that existing employees and managers have a potential problem in familiarity in accessing local market conditions. Also, local stake-holders might see the company as a foreign company. Then, compared to M&A, this strategy is relatively slower than M&A in the speed of entry. At the same tone, the company cannot rely on current connections with government officials, suppliers and customers [10].

2.2 Mergers and Acquisitions (M&A)

Bower’s (2001) statement “Know what you’re buying” represents the rationale of the frequent attention of headlines about interest, success or failure of mergers and acquisitions [4]. They generally involve public competition for the support of shareholder with a large amount of money [9]. The example of mergers and acquisitions failure is the Royal Bank of Scotland case in 2007 took over of the Dutch ABN AMRO, which was terminated with commercial disaster as well as the bank’s nationalisation of the government of the United Kingdom.

Fundamentally, the uses of mergers and acquisitions terms are often blurred. Practically, the concepts are often interchangeable; thus the common word called M&A or just acquisitions. Based on Sudarsanam (2003), there are several phases of M&A i.e. corporate strategy step, organising for acquisition step, structuring the deal phase, post-acquisition integration phase, and post-acquisition audit phase [13].

The M&A is the standard approach in achieving growth strategies [9], and the number of deals and their value in M&A activity are changing year by year. Based on Thomson One (2016) as described on Figure 3, there are about 32,599 completed deals with value $3.38 trillion and 45,256 announced deals with approximate value $4.6 trillion from March 2015 up to March 2016 [14]. Among all M&As, in 2016, 44.9% occurs in the America which increased from 44.6% in 2015. Then, Europe contains 26.4% of total M&As in 2016 which also rose from 20.9% in 2015. However, Asia-Pacific (except Central Asia) shows a decrease from 31.8% in 2015 to 23.8% in 2016. There is a contrast between the number of M&A in the UK and the USA compares to other economies like Germany and Japan. This might be because of difference in attitude and culture of in funding. The data proved that M&As mode of entry is still a favorite mode for companies concerning international expansion of business.

Figure 3: M&As Trends from March 2015 until March 2016 [14]
However, there is a high rate of failure, around 50-80%, of M&As. The possible initial rationale behind this fact is there is a difficulty in illustrating a true image of the target company. Another reason might be underestimation of the managerial and cultural problems in combining two companies. Also, key employees may leave the organisation as well as suppliers and customers due to an integration of both companies. Moreover, the value of target firm sometimes is too high while the acquirer is overstretched. Finally, acquirers did not realise that management skills and implementation are the most crucial components, and they are over focused on the deal.

There are several strengths of cross-border M&A. Firstly, the acquirer is able to have a high degree of control of operations abroad [2]. Then, M&A could provide high experiential skill and knowledge in foreign markets. Also, it offers low risks of technology appropriation and much faster than organic development. It is a good strategy when companies do not have sufficient internal resources. The acquirer company could rely on current connections with government, suppliers, and customers. Besides, access familiarity to the local market situations could benefit the existing employees as well as managers. Then, for sure, the firm does not need to add extra capacity to the market.

Nevertheless, there are several weaknesses of cross-border M&A. Firstly, the acquisitions can go wrong due to inadequate valuation of a target company, lack of fit with acquirers’ strategy due to exaggerated expectations, underestimated about organisational fit problems [9]. On top of that, even it was a good idea, but sometimes it went wrong because of poor due diligence conducted, target company over-valued, post-merger acquisition integration poorly considered or implemented, anticipated synergy not achieve due to culture clash, company becomes too diversified, company becomes too large, managers become overly focused on acquisitions. Also, there is a problem in integrating foreign subsidiaries into the parent’s system. Then, managers of acquired foreign subsidiaries may have a weak attachment to the parent firm [9].

4. Transaction Cost Theory

To examine options of global expansion modes of entry, commonly managements used the transaction cost framework. The primary content of this framework is the company should select the mode of entry that minimises cost of transaction [1]. This framework has been implemented in explaining multinational company’s options of modes of entry. The transaction includes the costs to find and negotiate with the target firm in the host country, and the costs to monitor target company performance. Therefore, the primary concern of this framework related to modes of entry and uncertainty is behaviour uncertainty. That is the rationale why this paper takes this framework into account.

Commonly, this theory will influence the appropriate modes of entry, especially going international by acquiring a company or going alone. Multinational companies might utilise market structures, like collaborative ventures, in case the transaction cost are relatively low. However, if the transaction costs are high, the companies need to internalise its operation. By way of example, at the end of 2015, Infineon Technologies AG, semiconductor Germany-based company, tended to acquire Fairchild Semiconductor International, Inc., US-based company [3]. The motive is to increase market power, to exploit imperfection of market, and to transfer technology. The Infineon Company realised that transaction cost by acquiring Fairchild is much cheaper, faster, and more beneficial than doing it alone. However, due to market attractiveness and low transaction cost, many competitors want to win the bidding of Fairchild.

Furthermore, this framework states that the costs of transaction will increase in the same tone with the increase of uncertainty and opportunism [1]. When the transaction costs rise, the multinational companies will generally attempt to minimise them through internalising its activities, instead of relying wholly on the market. However, the company will choose market arrangement such as M&A, when associated uncertainty, opportunism and specialised investments including knowledge are relatively low.

In addition to behaviour uncertainty, this framework covers environmental factors of a host country and its impact in deciding modes of entry [1]. It, then, links the concept of the cultural and institutional uncertainty. According to Geert Hofstede (2016), culture means national beliefs, values and customs. Then, regulations, politics and laws in the host country is represented by host institutions [7]. Hence, uncertainty that arises from an institutional and cultural context in the host country is undoubtedly affecting the choice of modes of entry. A company could go with M&A with the target company in host country to understand how the ways in doing business with countries having a different culture. If in the host country there are strong institutions supporting market exchange, the company could rely on target company in the host country. However, it does not work if there are weak bodies in the market.
Nevertheless, beside its interesting insights, the Transaction Cost Theory is not without limitations. Its treatment of the uncertainty is generally limited because it only concerns on the impact of cultural and institutional context that could exacerbate behavioural uncertainty. In the context of modes of entry, this framework, also, is far from strong because it failed to take into account learning and the opportunity costs. It, then, usually thinks that uncertainty is related to negative factors without seeing the upside of each uncertainty. Therefore, it often shaped a way of thinking in the company about a failure of obtaining the possible advantages in dealing with uncertainty.

5. Real Options Framework

To answer some limitations of the transaction cost theory, real options framework emphasises the importance of the companies’ maintaining and learning flexibility of the strategy during the process of choosing the appropriate mode of entry under uncertainty. This framework offers flexibility to decide about the investment since the company could defer creating the commitment in particular action, so it has an opportunity to collect more information [1]. There are two crucial criteria to be categorised as a real option. Firstly, the decision about investment has to be categorised as uncertainty. Then, the investment could not be reversed with the absence of incurring costs. Having uncertainty and irreversibility denotes to defer the decision to convince about the current uncertainty.

Due to involving a smaller investment, this framework contains a great level of diversibility. Concerning foreign market entry strategy, generally, this framework is as join ventures, primarily, and acquisitions because the option to extend business might be relatively easier than organic development. Also, this framework offers the company flexibility to have option to defer as well as option to abandon.

The real option framework categorises uncertainty into two divisions i.e. exogenous and endogenous uncertainty [1]. This framework describes that endogenous uncertainty, in particular, will have company-specific learning when the company chooses the suitable mode of entry. The contemporary managers who have experience have to consider the learning from the local context linked with the ability of their company. Therefore, no wonder, the emerging company from developing country internationalise precisely due to benefits gained from learning.

By way of example, internationalisation of a Chinese firm, the Haier Group, is taken into account. This company initially launched its international expansion in developing country. Initially, the company expanded the business abroad via joint ventures with a local firm. Once the company got international experience, it expanded its business to developed countries, including USA market. In fact, within around three years, the firm chose wholly-owned investments as the strategy to expand its international business. This is the evidence that the company from emerging country could go global precisely to developed country due to gaining a benefit from learning. Also, fortunately, the company has a flexibility of learning strategy of the executives in deciding the international mode of entry. They set a different mode of entry to each host country by considering the capability, resources and urgency. The motives of the company utilised a broad expansion of business is to sell products abroad as well as to gain new skills and knowledge from international markets.

Although the real options approach illustrates valuable insights considering the appropriate mode of entry option under different uncertainty, it still has several shortcomings. Firstly, there is little evidence of empirical studies, so the validity of the statement in this theory is relatively limited. Then, this framework did not analyse more about the effect of exogenous uncertainty related to the mode of entry. Moreover, this theory seldom concerns the joint effect of exogenous and endogenous uncertainty in deciding the appropriate mode of entry.

6. Resource Based View Framework

Due to more and more companies venture internationally, the Resource Based View (RBV) framework has played a major role behind the successful of the internationalisation of the company rapidly (Peng, 2001). It provides the substantive work via a proposed organising theory concerning on five research areas i.e. multinational management, strategic alliance, market entries including modes of entry, international entrepreneurship, and emerging market strategies. That is the rationale why this paper takes this framework into account.

The significant contribution of the RBV is it could identify international experience and knowledge as difficult-to-imitate, unique, and valuable resources [11]. By understanding this concept, the company could decide it is better to go international alone in its business or to acquire a target company in a host country. Through this understanding, it will distinguish the winners and losers in the international competition.

Regarding internationalisation of the business, the RBV states that modes of entry could be viewed as a choice to retain access to innovation in the target
company country, hence, producing information spillovers may lead the company to the future organisational growth [11]. Thus, this framework claims that market entries are pushed by company-specific advantages owned by the company, and pulled by the capabilities and resources of the target firm overseas helping the investment of the company to gain new benefits. The rationale is companies exist due to their capabilities to exploit and transfer skills and knowledge more effectively in the internal contextual compare to via external markets.

Related to modes of entry, the RBV study aims to link modes of entry – particularly, acquisitions-with post-entry performance [11]. A Cultural distance may support acquisition performance by providing access to the acquirer’s and target’s diverse set of routines and cultures. However, if the company has enough expertise with the new abroad market, capabilities, resources and knowledge, the company could do it or organic development considering its advantages stated in number 2 in this paper.

The RBV states that level of analysis about whether it is better to rely on an external market measure (e.g. exports) or to internationalise operations (e.g. FDI), has to be considered with an overall strategic posture of the company. There are three dimensions differing the RBV from the Transaction Cost Framework. First, the RBV predicts modes of entry based on attributes such failure to a different underlying assumption i.e. heterogeneity of company resources. Then, the RBV highlights an extensive and dynamic process where multiple entries occur each building on capabilities and learning from the past entry experience. Lastly, the RBV concerns both companies’ development and exploitation.

For example, as the largest steel company in the integrated private sector in India in 2006, Tata Steel desperately needed to expand their business abroad to increase global competitiveness. Tata realised that it needed access to the latest technology and strategic European markets. The company also realised that it needed a plant in Britain to gain benefits from reduced production costs due to large volume, broader product range, and combined the operations of R&D. Mode of entry was chosen is to acquire Corus, not wholly greenfield investment, by considering urgency and its capability. Tata targeted Corus because it will boost the world rank of Tata as large steel producer in the world from 56th rank to 5th rank. In addition to the rank catapult, they know that beside in Britain, Tata had plants in Belgium, France, Germany, and the Netherlands. It will make Tata much more competitive. The wealth-accretion value of the deal would be expected to accrue over the long-term period. Tata expected efficiencies and synergies would bring annual benefits of $450 million a year by the year 2010. Many people doubted about the high price of Tata declining several weeks after the deal announcement. However, Tata management has international experience and historical performance. They absolutely have thought about long-term value creation and benefits. Then, cultural differences of both companies had been taken into account.

The RBV links a strong analytical framework bridging company-specific advantage with International Strategic Human Resource Management (ISHRM). The International Strategic Human Resources Management framework, as a subfield of Human Resource framework, consists of three levels i.e. the parent firm, the subsidiary, and the employee, examined by some RBV studies [11]. Initially, primary attention is focused on high-level managers for the parent firm level. Based on RBV principles, the unique, valuable, and difficult-to-imitate resources may be represented by top managers within a firm. In other words, the more an MNC internationalises, the more its high-level managers gain significant international experience. Regarding HR development, a company that interested in acquiring tacit knowledge will be interested more in executives’ international experience. In addition to top managers, the subsidiary level has three finding insights. Firstly, if the MNC is concerning in tapping in the capabilities of these geographically dispersed units, it is crucial to assist and train subsidiaries with entrepreneurial managers. Secondly, the MNC need to offer an appropriate incentive to subsidiary managers to facilitate subsidiary capability development and knowledge and skills sharing. Lastly, a fit between HR practices and the local culture is needed to seek by the MNC. Finally, at the employee’s level, recognisably, that company valuing people as their source of competitive advantage generally achieve higher performance. There may not be issues about human resource management in organic development mode of entry. However, if the company decides to expand the business through M&A, the company needs to consider issues stated above relating to ISHRM.

Even though this framework shows benefits and contributions to international business, this framework doesn’t emerge without weaknesses. First, it is hard to interpret the RBV logic in deciding the five areas of research even though there is a definite impact on them. Also, there are unequal benefits of the RBV to these five areas. Then, too many portions of the knowledge of the strategy of entry timing is according to US data and experience. Besides, the RBV still needs to put more attention on
implementation and processes, especially understanding of M&A processes.

7. Summary of Key Factors in Choosing to Acquire a Company or to Go it Alone

Generally, M&A could go wrong due to exaggerated hopes of strategic fit, excessive initial valuations, and underestimated of organisational fit problems. With these high failure rates, the company also needs to take into consideration the default option of going international alone (organic development). In other words, based on all frameworks and examples analysed, one thing for sure is the most appropriate method will be different depending on circumstances. Figure 4 could help companies to analyse among these options by understanding each factor and its circumstances.

![Figure 4: Acquisitions or Do it Yourself Matrix](image)

**6.1 Urgency**

Expanding business internationally through acquiring a company abroad or going alone absolutely depends on the urgency factors. M&A might be a relatively short-cut approach taken by companies to internationalise their business. For this type of factors, going international alone might be the slowest mode of entry compared to M&A and strategic alliances. If the company does the organic development mode of entry, the firm needs to realise that everything must be made from scratch, and it will take time to do so.

**6.2 Uncertainty**

When there is a high level of uncertainty related to the technologies or markets involved, the better option of strategy is the alliance. If the technologies or markets turn out become a success, there is a possibility to turn the alliance to a full acquisition, but a buy option needs to be included in the initial alliance contract [9]. Also, if it turns out a failure, thus, the loss will be shared with the partner in the alliance. M&A, then, have an advantage when things do not turn out well because the acquired company could often be resold in a lower value than the original buy. However, if the organic development is fail, they will be written off wholly with no value because the company unit involved, previously, has never been on the market [9].

**6.3 Type of Capabilities**

M&A will work best if the desired capabilities such as competencies or resources are ‘hard’ e.g. physical investments in manufacturing facilities [9]. In bidding processes, factories as hard resources are easier to value than soft resources like brands or people. Also, hard resources are relatively easier to control post-acquisition than skills, knowledge and people. M&A composes the risk of significant cultural issues. Sometimes the image of acquiring companies could tarnish the acquired company brand image. Acquisition of competencies and soft resources should be concerned more with greater caution. Undeniably, the organic development or “do it yourself” approach is the most effective regarding the sensitivity of soft capabilities such as people and skills [9]. Obviously, organic development is more culturally consistent than M&A.

**6.4 Modularity of Capabilities**

If the capabilities are distributed in clear distinct divisions of the target company, M&A might face a problematic issue if the acquiring company tends to buy the whole company, not only the division that they are interested in. Moreover, the organic growth approach might also be effective under modularity conditions since the new business could be developed under a distinct new venture module rather than involving the whole firm [9].

By considering key factors above, the company needs to analyse modes of entry beforehand. Organic development is preferred when specific technical and organisational skills define the firm’s ability to compete. On the other hand, regarding M&A, there are several things needed to understand to be successful in this mode of entry. Firstly, the company needs to realise that intangible assets often become the most valuable assets of the company. Secondly, the company needs to identify clearly about each part of the new organisation provides more contribution. Then, there is a need that managers, especially key managers, should be integrated at least within a year. Furthermore, it needs to be realised that planning is everything. After finishing to set a planning, the company should implement quickly, communicate honestly, act appropriately and ethically. Also, the
new company should result value more than costs and enhance competitive advantage.

8. Conclusion

Certainly, there are no one modes of entry to expand business internationally that fit in all circumstances. In other words, the best option between acquisitions or organic development is not unconstrained. Choosing to acquire a company abroad or going international alone in order to sustain the business and growth absolutely depends on several key factors. If there is a high urgency, acquiring a company will be much faster than going alone. Then, when the level of uncertainty is relatively high, there is a possibility failure in both modes of entry, however, if needed to choose, acquisitions seems more appropriate under this circumstance. Moreover, if a soft capability is important, it is better to go alone than an acquisition by considering the consistency of culture. Also, when the modular capabilities are high, going alone seems more effective than acquisition.

Again, it is crucial for the company to consider whole factors before choosing the mode of entry systematically. It needs a careful analysis beforehand. In a simple conclusion, the final rationale to consider going international alone is where an acquisition would be far from easy or there is no target company which fit the acquirer.

References


