A MODEL OF OPTIMAL INTERNATIONAL MARKET EXPANSION THE CASE OF US HOTEL CHAINS EXPANSION INTO CHINA

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ABSTRACT:
Departing from the explanatory and descriptive approaches common in many of the academic studies of international expansion, this paper uses a managerial approach to develop and illustrate a process that can assist managers in the formulation of their international expansion strategies and plans. A comprehensive model of international expansion is outlined and applied to determine the optimal country to be targeted for entry by a US hotel firm and the optimal entry mode to be used. The model consists of three sections. Section One (macro assessment) identifies the major external macro-environmental variables that determine the risks and opportunities of international expansion: market size, market growth and purchasing power; political, economic, legal and regulatory risks; and cultural and geographic distances. Through macro assessment, countries with the optimal risk/opportunity profiles are identified and ranked. Section Two (micro assessment) is applied to the optimal countries identified in Section One to estimate the potential profitability and financial value created (as measured by net present value) of expanding a firm's operations into these countries. Micro-environmental variables capturing the countries' local market conditions and the firm's specific characteristics are utilized to estimate potential profitability and net present value. Section Three focuses on the country, industry, and firm-specific factors that determine the optimal market entry strategy into a given foreign market. International market entry strategies considered include equity investment (ownership), franchising, and management contracts.

Though only 12th in the ranking of the top desirable expansion destinations from a macro opportunity/risk perspective, China moves to the top after the micro (country/industry/firm) assessment. For a US-based hotel company, it is determined that entry into the China segment through management contract would provide the optimal value for this firm.

By helping managers to quickly identify the optimal country to expand to from a possible universe of over 200 potential targets, the model illustrated here can significantly reduce the time and cost to develop and implement a firm's international expansion strategy and reduce potential risk.

KEY TERMS:
International expansion, entry mode, management contracts, franchising, value creation.

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1 INTRODUCTION

Increasingly, US-based franchise firms see expansion into foreign markets as a key strategy in their quest for growth, profits and shareholder value creation. From 1971 to 1985, US-based franchise firms increased their overseas units at a 17 percent annual rate (Justis and Judd, 2003). More US firms venture overseas than ever before. US-based members of the International Franchise Association reported that 52 percent of them had units overseas in 2006 versus only 34 percent in 1989 (Schlentrich and Aliouche, 2006).

The main pull of international expansion for US based franchise firms is the large potential pool of customers available overseas. Although the US is a large market with a population of over 300 million people, it accounts for less than five percent of the world population. Therefore expansion into foreign markets can vastly increase the number of potential customers for US franchise firms. However, this increased market opportunity does not come without risk. Foreign markets are in general much riskier than US markets for a US-based franchise firm, with a larger possibility of loss and failure (Han and Diekmann, 2001). It is imperative, therefore, that franchise firms take into account both potential opportunities and risks in their international expansion plans.

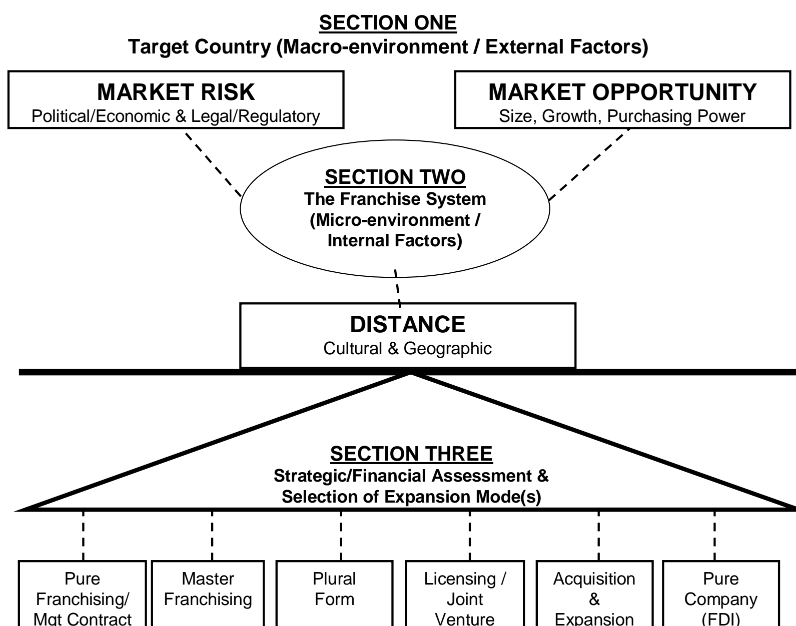
A three-section international franchise expansion model that explicitly takes into account opportunities and risks, along with other factors, was developed in Schlentrich and Aliouche (2009). This model could serve as a guide for franchise firms in their quest for expansion opportunities in foreign markets. This paper summarizes the main sections of the model, and then provides an illustration of how a US-based hotel firm could use it to identify the optimal international market to target for entry or further expansion.

In this paper, we first present a summary of a model of international expansion assessment and its three major sections. Then we apply this model to illustrate how a US-based hotel firm may use it to identify its top international expansion target market and the optimal mode to enter this market. Finally, we offer concluding remarks.

2 THE INTERNATIONAL EXPANSION ASSESSMENT MODEL

After an exhaustive review of the academic and business literature on internationalization and franchising, complemented with a survey and discussions with a large number of franchise executives with extensive international experience, Schlentrich and Aliouche (2009) and Aliouche and Schlentrich (2009) developed a comprehensive three-section model of international expansion assessment (Figure 1).

Figure 1. International Expansion Assessment Model



Based on a strategic approach to international expansion, this model explicitly takes into account the major elements needed to develop an optimal international expansion initiative. These are:

1. Macro-environmental assessment (Section One)2. Micro-environmental assessment (Section Two)

3. Optimal market entry mode (Section Three)

These sections are summarized below.

2.1 Macro-environmental assessment (Section One)

There are over 200 potential countries or markets that may be targets for expansion for a US-based firm planning to expand overseas. Even the most resource-rich franchise firms do not have the financial and human resources needed to enter a large number of international markets simultaneously. Franchise firms need to strategically select priority countries/markets on which to focus their expansion efforts and resources. For profit and shareholder maximizing firms, priority countries should have optimal opportunity/risk profiles. Selecting countries with high potential market opportunities and low market risks at the outset enhances the potential for high revenues, profits and shareholder value, while reducing the risks of failure and loss.

The macro-environmental assessment (Section One) helps identify and rank all potential target countries according to their opportunity/risk profiles. A given country's market opportunity (or potential) is measured as a weighted average of it market size, purchasing power, and real GDP growth. Risk is measured as a weighted average of political, economic, legal and regulatory risks; and distance (cultural and geographic) (Schlentrich and Aliouche, 2009). Figure 2 below displays the Top 25 ranked countries for US-based franchise firms.

Once a ranking based on macro-environmental assessment is obtained, a micro-environmental assessment is performed on these 25 countries[1] in order to assess the country-

1 More or less countries may be included in the analysis depending on a firm's resources and ambitions.

specific, industry-specific and firm-specific factors relevant to successful international market expansion (Section Two).

Figure 2: Macro Assessment - Top 25 Countries

Country	Market Potential	Market Risks	Distance	Score	OVERALL RANK
United States	2	3	1	2.3	
United Kingdom	5	5	3	4.8	1
Canada	12	9	2	9.8	2
Japan	8	15	27	12.7	3
France	9	19	9	13.0	4
Germany	10	17	13	13.1	5
Saudi Arabia	4	20	55	15.5	6
Australia	16	12	33	16.1	7
Spain	20	21	18	20.2	8
Netherlands	36	14	11	24.7	9
Korea, South	6	26	135	26.9	10
Mexico	17	41	24	27.3	11
China	3	49	63	27.4	12
Hong Kong S.A.R	33	13	68	28.5	13
Taiwan	15	35	71	28.6	14
Italy	29	33	16	29.3	15
Sweden	51	7	23	30.6	16
Belgium	46	18	12	31.4	17
United Arab Emira	19	42	57	32.0	18
Chile	28	32	54	32.2	19
Kuwait	34	28	42	32.4	20
Malaysia	14	30	152	34.2	21
Russia	1	63	94	35.1	22
Switzerland	62	8	10	35.2	23
Turkey	24	50	37	35.7	24
Poland	21	46	76	36.5	25

2.2 Micro-environmental assessment (Section Two)

As for most other operational and strategic initiatives, a firm's expansion into a foreign market should ultimately enhance its long term shareholder value. Shareholder value is

enhanced by engaging in projects and initiatives that create value as measured by a positive net present value[2]. NPV is a function of four variables[3]:

$$NPV = f(OCF_t, k_A, I_0, n)$$

where OCF_t = Operating Cash Flows (operating revenues less operating expenses) generated by the project at time t, k_A = weighted average cost of capital (with capital being a mix of debt and equity), I_0 = total investment, and n is the length in years of the venture.

An international expansion initiative may require an initial cost I_0, may need to be financed through debt and/or equity at a cost k_A, and may generate cash flows OCF_t over the life (n years) of the venture. The value created by the international expansion venture is then a function of:

-the magnitude of the future cash flows generated in the new market – everything else being equal, the larger the future cash flows, the more value will be created (this is captured by the OCF term);

-the timing of the future cash flows generated by the new venture: everything else being equal, the sooner the cash flows are received, the more value will be created (due to the time value of money);

-the riskiness of the future cash flows generated by the new venture: everything else being equal, the more certain future cash flows are, the more value is created (this is captured by the cost of capital k_A); and

-the magnitude of the initial investment necessary to deploy the new venture: everything else being equal, the less the initial cost, the more value is created. This is captured by I_0.

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[2]In situations where costs and benefits occur at approximately the same time, the well known rule of setting "Marginal Benefit = Marginal Cost" can be used to make resource allocation decisions. However, in many situations (for example, projects involving capital expenditures), costs occur immediately while benefits materialize over a number of future time periods. In these situations, Net Present Value is the appropriate criterion for decision making.

[3]The Weighted Average Cost of Capital approach to NPV can be represented as follows
$NPV = \Sigma_{t=1}^{n} OCF_t / (1 + k_A)^t - I_0$

All country-, industry-, and firm-specific factors that can impact the magnitude, timeliness, and riskiness of the future cash flows generated in the new markets are therefore important in decisions to enter into and/or expand in a new market. In addition to the macro factors discussed in Section One (market size, market growth, purchasing power; political, economic, legal, and regulatory risks; and cultural and geographic distances), micro country factors may include extent and quality of the local infrastructure; availability, educational level and cost of labor; availability and cost of real estate; availability and cost of capital; quality of supply chain; etc. Industry factors may include size, number and reputation of competitors; presence or absence of local competitors; industry structure; etc. Firm-specific factors may include firm size; human, financial and organizational resources; international experience; core competency; perceived competitive advantages; brand name recognition; management's growth strategies; risk tolerance; products and/or services produced; level of saturation of domestic market; etc. (Schlentrich and Aliouche, 2009).

A given firm, within a given industry, can assess its value generation potential from the 25 top countries identified in Section One. Focusing on the top 1 – 5 value generators from Section Two would generate the most value for this firm and should therefore be its priority expansion markets.

2.3 Market entry mode (Section Three)

When firms have identified a country to target for entry and/or expansion, they must determine what organizational structure and management strategy best help them maintain their competitive advantage and maximize their value creation. The interplay between the characteristics of the host country, the industry, and the firm itself (as discussed above) will determine the entry mode that is optimal for a particular firm planning to enter a particular country. There are a large number of possible market entry modes, including direct ownership, franchising (in its various forms – multi-unit franchising, master franchising, area development, etc.), management contracts, and a variety of combinations of these basic modes. Here, we focus on the three basic market entry modes most common in the hotel

industry (the subject of this study): equity (ownership), franchising and management contracts.

In equity projects, the owner of the property operates it itself. Franchising and management contracts, on the other hand, do not require ownership of the property in order to generate revenue. Franchising consists of a continuing commercial relationship between a firm with a proven business system (the franchise company) and a third party (the franchisee), whereby the franchise company (the franchisor) grants rights to the franchisee for a given period of time to operate their business system using a common brand and common format for promoting, managing, and administering this business. In a management contract, the management company agrees to manage the hotel on behalf of the owner in exchange for management fees. The owner provides the property (land, building, and equipment) and (in most cases) working capital, while the management company provides the professional expertise to build, market and operate the hotel. A major distinction between management contracts and franchising is that the management company operates the hotel itself, whereas the franchise company relies on an independent franchisee to run the property.

The macro and micro factors discussed above determine to a large extent the mode of entry that is optimal for a particular firm into a particular country.

2.3.1 Country characteristics and entry mode

The perceived level of political and economic risks has long been recognized as having an important impact on the choice of entry mode (Anderson and Gatignon, 1986; Gatignon and Anderson, 1988; Erramilli, 1990; Erramilli and Rao, 1993; Contractor and Kundu, 1998). Generally, when political and economic risks are perceived to be large, non-equity forms of market entry would be seen as less risky and would be favored by new foreign entrants. Likewise, perceived legal and regulatory risks have important effects on firms' entry mode choice. For example, a country's slack enforcement of intellectual property laws discourages firms from using franchising as an entry mode into this country (Chekitan, 2002; Zhu et al. 2009). Large cultural distance between host country and home country imply a higher risk of failure and would incent a firm to select a non-equity mode of entry, such as franchising or

management contracts (Contractor and Kundu 1998; Tes and Pan, 1997; Pine et al., 2000; Zhu et al., 2009).

Inadequate availability of managerial skills discourages the entry of foreign firms through franchising, while a lack of qualified and reliable local investment partners discourages the use of management contracts as a way to enter the country (Chekitan, 2002). More generally, franchising is a more appropriate mode of entry into developed countries (such as the US and European countries) than into developing countries (such as most Asian, Latin American and African countries) due to the differences in the levels of development of the respective legal, financial, social, and educational capabilities (Cherikan, 2002; Contractor and Kundu, 1998a, b; Chen and Dimou, 2005).

2.3.2 Industry characteristics and entry mode

Industry characteristics also play an important role in the choice of market entry. Industries that are capital intensive (such as the hotel industry) try to reduce their financial exposure by favoring non-equity forms of market entry. In the hotel industry, franchising is a more appropriate mode of entry for budget and midscale hotels (that involve only basic services) than for luxury hotels that require a high level of quality and service (Chen and Dimou, 2005; Chekitan, 2002; Chen and Dimou, 2005). Everything else being the same, a firm providing a non-separable service (a service whose production and consumption happen at the same place and at the same time, such as restaurants and hotels) would prefer an equity mode of entry (Ekeledo and Sivakumar, 2004).

2.3.3 Firm characteristics and entry mode

Firm size matters in the choice of market entry, though its impact depends on other firm-specific and country-specific factors. Everything else being the same, larger firms would prefer franchising, while smaller firms would likely rely more on equity and management contracts to expand (Gallini and Lutz, 1992, Chen and Dimou, 2005). A firm with a competitive advantage obtained through the possession of proprietary resources and

capabilities would most likely select management contracts over franchising as an entry mode (Chekitan, 2002). For example, a hotel firm with superior customer service and quality skills (such as firms in the luxury hotel industry) would favor management contracts (Chen and Dimou, 2005). International experience of the expanding firm significantly impacts its choice of market entry. Firms with international experience tend to prefer entering new markets through full ownership or management contracts (Anderson and Gatignon, 1986; Agarwal and Ramaswani, 1992; Herrmann and Datta, 2002). Some studies confirm that multinational corporations (MNCs) with more experience in a particular host country tend to expand by means of the full control mode (Agarwal and Ramaswani, 1992). Culture also plays a role in the choice of market entry mode. Tes and Pan (1997) conclude that two culture dimensions (power distance and uncertainty avoidance) greatly affect the choice of market entry modes. They state that firms with a more distant culture prefer an equity-based entry mode while firms from countries with a lower uncertainty avoidance culture are more likely to choose the low cost entry mode to avoid risks. Everything else being the same, firms originating from Anglo-Saxon countries are more likely to use franchising as a foreign entry mode than firms from Latin-European countries (Chen and Dimou, 2005).

The micro-environments of the 25 countries identified in Section One are assessed along with an analysis of the hotel industry in each of these 25 countries. Matched with the specific attributes of the particular firm, the potential revenues, profits, and cash flows that can potentially be generated over the life of the initiative can be estimated for each country. Net present values are estimated and countries are ranked according to highest potential net present value. The top ranked country would then be the priority target for entry and/or expansion. Based on the country's profile and this country's hotel industry's characteristics, the optimal mode of entry is determined.

In the rest of this paper, we apply the model outlined above to the case of a particular US-based hotel company's quest for international expansion opportunities. This international expansion assessment model can assist this firm to identify its optimal expansion target from a universe of over 200 potential target countries. For this particular US-based hotel firm, it is determined that China is the optimal country to expand to. For the sake of brevity, only

the country ultimately determined to be the optimal target (China) is discussed in the rest of the paper.

3. APPLICATION OF MODEL TO US HOTEL CHAIN ENTRY INTO CHINA

3.1 Country profile: China

China, the largest country in the world with 1.3 billion people, has become an economic powerhouse since the onset of its Open-door Policy in 1979. It is now the second largest economy in the world with an $8.3 trillion GDP (at purchasing power parity) (CIA World Factbook, June 2009) and continues to grow at the fastest rate among major economic nations. A further boost to China's economy came when China joined the World Trade Organization in 2001. This facilitated China's exports to the rest of the world. It also opened China for more foreign investment. With tremendous economic growth came far-reaching improvements in China's basic infrastructure (telecommunications, airports, railroads, highways, education, etc.). The 2008 Beijing Olympics provided further stimulus for modernizing China's (and especially Beijing's) infrastructure as Beijing was required to "improve its infrastructure, build modern communication facilities and modern sporting venues, modernize its tourist accommodations, and invest money in alternative energy" (ChinaOrbit.com).

One sector that has greatly benefited from these developments is the tourism industry. According to a report by the World Travel and Tourism Council, China now has the third largest travel and tourism demand in the world, and is projected to move to number two (behind the United States) by 2019. Between 2009 and 2019, the amount of travel and tourism in China will go from $526.6 billion to $1,880.5 billion, growing at the second fastest rate in the world (behind tiny Sao Tome and Principe) (World Trade & Tourism Council, 2009). Another report estimates that by 2020, China will be the world's top tourist destination, with 130 million arrivals annually (WTO, 1999). As China's economy grows, the number of wealthy Chinese and the size of its middle class also grow, giving a big boost

to internal tourism. From 1994 to 2006, the per capita total domestic tourism expenditures increased by 129 percent (China Statistical Yearbook, 2009).

While the economy grew rapidly, China's political, legal, and regulatory systems did not, as dramatically shown by the Tiananmen Square events in 1989. To be sure, notable improvements to the business environment faced by foreign firms have taken place, especially since China's entry into the World Trade Organization in 2001. However, China remains a relatively risky country for foreign firms to do business in with high political, legal, and regulatory risks, in addition to large cultural and geographic distance. This fact will be detailed further below.

3.2 Profile of China's hotel industry

The changes in China since 1979 have had a profound impact on its hotel industry. The number of hotels in China went from 1,987 in 1990 to 10,481 in 2000. Over the same period, the number of rooms went from less than 293,827 to 948,185 (Yearbook of China Tourism Statistics, 2002).

China's hotel industry is characterized by a variety of ownership structures, with state ownership representing 57 percent of the country's hotels in 2002. Non-government collective enterprises owned 10 percent; investors from Hong Kong, Macau, and Taiwan owned 4.6 percent; and Chinese partnerships, private owners, and strategic alliances controlled about 25 percent. Foreign investors controlled only about 3 percent of the market. China tourism hotels were predominantly 2-star (half of all tourism hotels) and 3-star (one third) hotels in 2002. Five-star and four-star hotels made up only 2 percent and 7.2 percent, respectively, while one-star hotels represented 9 percent of the total tourism hotels (Yu and Huiman, 2005).

Compared with foreign multinational hotel firms, China's domestic hotel companies are relatively small and immature, and the performance of many of them lags behind that of internationally managed operations. Domestic hotel firms, especially state-owned ones, have difficulties effectively running their properties. Management of their properties is often

deficient due to bureaucratic controls, lack of fiscal discipline, low operating efficiency, and lack of innovation ((Pine, 2002; Yu and Huimin, 2005). For example, a hotel industry survey of 248 hotels in China found that the 4- and 5-star hotels operated by foreign hotel firms significantly outperformed similar hotels operated by Chinese independently managed hotels. RevPAR (revenue per available room) for 4-star hotels operated by domestic independent operators was on average 23 percent lower than that of 4-star hotels managed by foreign firms. Also, the EBITDA (earnings before interest, taxes, depreciation, and amortization – a measure of operating profits) of domestic 4-star hotels operated by domestic hotels companies was on average 13.5 percent of revenue, while it was 23.3 percent for similar hotels managed by international firms (Yu and Huimin, 2005). Foreign firms were much better at generating revenue and controlling operating costs, making it very challenging for domestic firms to compete with them.

International hotel companies have aggressively expanded their operations into China, and now most of the major international chains have established their presence there, including InterContinental Hotels, Marriott International, Accor, Starwood Hotels and Resorts, Best Western International, Hilton International and Hyatt Corporation. International hotel firms typically manage 5- and 4-star hotels. Recently, encouraged by the government, some Chinese domestic hotel firms have emerged to compete with the global firms, including the Jinjiang International Hotel Management Corporation, Jianguo Hotels International, and Rujia Hemei Hotel Management Group. Because of the fast growth in the hotel industry in general, competition for competent management talent is fierce, especially in some critical areas such as strategic development, asset management, yield management, and brand management.

The top priority of the tourism industry for many years was to build hotels that met international standards. China's prodigious economic growth, the government's restructuring of the hotel industry, and its encouragement of foreign investment and entry of foreign-based hotel companies drove a boom in hotel construction to the point where hotel supply exceeded demand of high end luxury hotels (Pine, 2002). The supply/demand imbalance was further exacerbated by the frenzied construction related to the 2008 Beijing

Olympic Games. Oversupply of high end hotels continues to be a major risk for hotel firms in China.

A particular cultural trait that plays an outsize role in China's business environment is "*guanxi*," a practice based on personal relationships and networks. This practice makes it almost impossible for a foreign hotel firm to be successful without the assistance of a well connected Chinese partner (Pine, 2002), for example to obtain building permits and operating licenses.

3.3 Firm-specific characteristics

In order to illustrate how the international expansion assessment model presented earlier can be used as a guide by a US-based hotel company, we develop the profile of a hypothetical hotel firm (the USH Company) that is representative of the major US hotel firms. The model can be adapted to fit any firm.

The USH Company is a large US-based hotel firm owning multiple brands catering to every segment of the hotel industry. It owns, develops, operates, and franchises a variety of hotel properties in a number of countries, though most of its properties are located in the United States. It has deep managerial talent, and is recognized as a leader in the US hotel industry. Its flagship brand name is well established and well respected. It has a number of other competitive advantages, including a proprietary reservation system; alliances with many global businesses; a strong culture of customer service, quality, and innovation; and a long experience managing under a variety of business arrangements (franchising, management contracts, ownership, etc.) Though it has large financial resources, it also has a large debt load that it is attempting to reduce. The USH Company has extensive international experience. Its flagship brand name is well known in China where it has operated luxury hotels under management contracts for many years. However, its mid-market and economy brands are not known in China.

Overall, the USH Company management's objective is to maximize shareholder value by strengthening the company's position as one of the leading global hotel firms, efficiently

taking advantage of business opportunities, and delivering superior service and value to its customers.

3.4 Macro Assessment - Conclusions

Figure 3: China - Summary of Macro Assessment (2007)

Macro Indicators

GDP (US$), 2007:	3,250.83 billion
Inflation rate:	4.75 percent
Currency:	Chinese Yuan (1 US$ = 6.8985 CNY)
National Language:	Mandarin

	Country	
	Value	**Rank**
Market Opportunity	**34**	**3**
Total population, 2007:	1,322 million	1
Per capital GDP (US$, PPP), 2007	$5,300	82
5-year (2007-2012) annual growth of Real GDP	9.85 %	4
Market Risk	**54**	**49**
Economic/Political Risk	60.48	44
Legal/Regulatory Risk	83	64
Distance	**77.75**	**63**
Cultural	5.12	70
Geographic	85.5	79

Expansion Strategy	**Country Rank**
Balanced (50/50)	12
Aggressive (70/30)	9
Risky (100/0)	3

Though China has opened up to the rest of the world, it remains a risky and distant place for US-based firms. Figure 3 above presents a profile of China based on a macro-environmental assessment (Section One) presented earlier.

From a market potential perspective, China is very attractive for foreign firms, having the largest potential number of customers (# 1 in total population), and having a very high expected economic growth rate (# 4 in expected Real GDP growth). However, China has a low per capita income, ranking at # 82. Overall, it ranks #3 in Market Opportunity, behind

the US and Russia (see Figure 2). China is still a high risk place to do business for a US-based firm (ranking # 49) and a distant place (ranking # 63). Balancing risks and opportunity (i.e., assigning 50 percent weight to opportunity and 50 percent to risks and distance) in assessing China's attractiveness as an expansion market, China would rank # 12 among over 200 countries of the world. When risks and distance are disregarded and only Market Opportunity is taken into account, China moves up to #3 (see Figure 3).

3.5 Micro Assessment - Conclusions:

From the micro assessment (Section Two), it became evident the high end (luxury) hotel market in China is saturated and presented high risks with limited potential for growth. On the other hand, it was also apparent that the mid-market segment (2 – and 3-star hotels) presented the best opportunities for future expansion as a result of the expected future growth in internal tourism, the development of second-tier and third-tier cities away from the Eastern coast, and the shift by many businesses to less costly hotels as businesses try to rein in costs in the face of a slowdown in business. Even though the USH Company has no experience operating mid-market hotels in China, it can leverage its well known and well regarded luxury brand, its networks of local partners, and its experience in China to launch and expand its mid-market brand in China.

Having decided that the best opportunity for value creation in China is through the expansion of its mid-market operations, the USH Company estimates the potential value to be created over the life of the venture. Detailed financial and economic data are collected (construction costs, interest rates, pricing, wage rates, inflation rate, food costs, real estate costs, etc.) and the net present value resulting from this potential venture is estimated.

The USH Company performs a similar analysis for each of the 25 top countries identified in Stage One (macro assessment). The countries are then ranked according to estimated net present value. Relative to the other top countries, China presents the following characteristics:

-lower labor costs;
-relatively lower construction costs;

-average RevPAR that is close to other countries';
-higher anticipated occupancy rates; and
-higher financing costs (due to higher perceived risks).

These characteristics lead to a higher NPV in China than in any of the other 25 countries. Over a 20 year period, it is estimated that operating a mid-market hotel in China would generate more value than in any of the other top countries. China, then, is identified as the priority country to expand into. The remaining question relates to what mode of entry would be optimal.

3.6 Entry Mode - Conclusions

The optimal entry mode selected would be the one that maximizes the potential value generated in China while minimizing the risks to this value creation opportunity. The potential entry modes considered are ownership, management contracts, and franchising.

By the time the country, industry, and firm analyses are completed, in most cases, the optimal market entry mode becomes generally evident. Relevant factors influencing the entry mode choice by the USH Company into the mid-market hotel segment in China include:

-High potential value creation opportunity;
-Relatively high political and legal risks;
-Scarce high quality managerial talent;
-Large cultural and geographic distance;
-Large capital required for ownership (though lower for mid-market than for luxury hotels);
-USH Company's extensive experience operating management contracts in China.

Based on the above factors and a detailed financial analysis, it is concluded that initially, management contracting would be the optimal way to expand into the China mid-market

segment at this time. As China further strengthens its legal and financial system, and more managerial talent becomes available, the USH Company may consider further expansion in China through franchising.

4. CONCLUDING REMARKS

Using a managerial approach, this study has attempted to develop and illustrate a process that can assist managers in the formulation of their international expansion strategies and plans. The comprehensive model of international expansion outlined here explicitly takes into account a large number of variables that are critical in international expansion decisions, and provides managers with a time-efficient and cost-effective way of identifying their optimal expansion targets when faced with a large number of potential target markets. This model explicitly incorporates several elements of risk that, in many cases, many managers have tended to discount, with often disastrous results. The proper consideration for risk, and mitigation of risk by the use of the optimal entry mode, for example, are important for the long term success of international expansion initiatives. It is also important to note that the international arena is very dynamic and that the optimal target countries, market segments, and modes of entry will change over time. Due to the many changes taking place in China, it is likely that franchising will grow in importance as a preferred mode of entry for hotel firms.

China offers enormous opportunities for the international firm with the appropriate resources, experience, and ability to overcome high risks and challenges. However, in most cases, China should not be the first, or one of the first, international markets a US-based firm tries to enter. The level of risk, the time required, and the resources needed to succeed in China are too high for a small firm or a new international player.

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