

Revisiting the eclectic theory of the choice of international entry mode

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Essay questions for " An Eclectic Theory of Choice of International Entry Mode " What are the major variables that affect the decision of entry mode? Should they be weighted equally? Why yes or why no? Given that different variables may pull the MNC in the different directions, what approach is suggested by the authors? What theories have been taken as the basis for conceptualization? Considering the nine propositions, do they all make sense to you? In case you find any fault with them, state it with your arguments. Review the methodology adopted by this paper and make your comment on its appropriateness. Discuss briefly what contributions this thesis has made to the theory of international entry mode choice. What do you think of the limitation of this thesis? Revisiting the Eclectic Theory of the Choice of International Entry Mode During the internationalization process of a company, the decision of entry mode to a particular market is determined by a set of different considerations.

The paper " An Eclectic Theory of Choice of International Entry mode" is a theoretical approach to answer the questions of which factors are relevant and which are not. It reflects on how contemporary studies (particularly, Transaction Cost Theory) had a limited view of the problem by not including a globalstrategy factor in the analysis, therefore the authors try to advance the discussion by enriching the construct of additional variables that were disregarded by economical orthodoxy at the moment. This short paper is aimed to introduce in part the aforementioned document and present more recent findings in the topic.

In that fashion I have divided the paper into 4 main parts besides this short introduction. The first section is a brief literature review of the theoretical

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background behind the understanding of entry mode in the internationalization process given that the paper was published more than two decades ago. The second section aims at synthesizing the main propositions of the paper and what I consider its limitations and contributions. The third section displays empirical evidence that aimed to negate or confirm the different propositions of the authors and finally, the fourth and last section is a set of concluding remarks.

Literary review

There is no short list about existing research regarding the internationalization process of MNEs? When focusing on the entry mode (or ownership strategies), one can begin to see that there are three different streams of thought: one stream of research has often framed such a choice as determined by the need for control to minimize transaction costs arising from asset specificity and potential partner opportunism (Anderson & Gatignon, 1986; Williamson, 1985). According to transaction costs theory, for investments characterized by high asset specificity, integrated ownership structures, such as whole owned subsidiaries (WOSs), should be used to enhance MNEs' strategic and operational control over the assets (Anderson & Gatignon, 1986) and to protect MNEs from the risk of knowledge dissemination to their partners (Davidson & McFetridge, 1985; Hill, Hwang, & Kim, 1990). Thus, transaction costs theory advocates the use of ex ante control mechanisms to minimize transaction costs arising from asset specificity and potential partner opportunism (Williamson, 1985). Another stream of research has suggested that the institutional environment shapes

such a choice and proposed that MNEs may exchange ownership for legitimacy in the host country (Chan & Makino, 2007; Yiu & Makino, 2002).

When foreign ownership is not prevalent or well accepted in the host country industry, MNEs can partner with local firms or keep the ownership level lower (Chan & Makino, 2007). By doing so, MNEs can show the local communities that their activities are not ethnocentric or harmful to local firms, and they also obtain the local identity and legitimacy to acquire the resources that they need in the local environment (Xu & Shenkar, 2002). On the other hand, when FDI is well accepted in the local market, MNEs can pursue integrated ownership structures and high equity shares.

Choice of an ownership structure thus does not necessarily reflect MNEs' deliberate efforts to economize on transaction costs for an efficient governance mechanism but may rather be a response to pressures from the institutional environment (Yiu & Makino, 2002). The third stream is as in the case of Hill et al. which posits that in addition to control and legitimacy, MNE ownership strategy is also fundamentally concerned with the choice between flexibility and commitment (Buckley & Casson, 1998; Chi & McGuire, 1996; Kouvelis, Axaroglou, & Sinha, 2001). More recent papers have taken again the same question.

Li & Li in 2010 resuscitated the topic and made a contribution by not only providing a theoretical background proposing similar hypothesis as in the case of Hill, Hwang and Kim in 1990 but also by analyzing the ownership structure and equity shares of over 5, 000 new foreign investments in manufacturing industries in China during 2000 to 2006. Explaining the contents of the paper is outside of the objectives of this short essay, but the <https://assignbuster.com/revisiting-the-eclectic-theory-of-the-choice-of-international-entry-mode/>

Li & Li's took Hill et al style of theoretical constructions one step further and provided stronger empirical evidence (outside the realm of small sample surveys) that supports the logic behind such framework. Empirical tests of MNEs' initial entry modes are rather limited, even though existing theoretical research has elaborated on the options features of JVs compared with other investment modes (Buckley & Casson, 1998; Chi, 2000; Lee, 2004; Pennings & Sleuwaegen, 2004). Cuypers and Martin (2010) observed that foreign investors are inclined to take a smaller equity share in a JV when they face strong exogenous uncertainty (e. g. , exchange rate uncertainty) rather than endogenous uncertainty (e. . , cultural uncertainty). Brouthers et al. (2008) showed that, in choosing international entry modes, MNEs tend to adopt JVs (over WOSs) under high demand uncertainty. Synthesis What are the major variables that affect the decision of entry mode? Given that different authors have considered variables like country risk, country familiarity, country development stage, technology, and transaction costs, Hill et al. begin their work with a vision to unify the framework and analyze how different factors affect the decision.

The first attempt to create a unified framework was carried out by Anderson and Gatignon in 1986 through the use of transaction cost theory. I believe that the authors see the shortcoming of this initial unified proposal in the Ceteris Paribus assumption of Economics that is used only as a theoretical tool to analyze relations among events or variables. Any theory that treats related events in isolation will be insufficient and that's why the authors propose the strategic relationship as another vital element of the decision.

Their proposal includes the following factors. Should they be weighted equally? Why yes or why no? Different factors in the decision often suggest different entry modes, it is according to the particular weights each company puts in this factors that the final choice of entry is done. In other words, when deciding entry mode different factors have different weights and according to each company's strategic considerations, such weights will have different magnitudes.

Given that different variables may pull the MNC in the different directions, what approach is suggested by the authors? The authors suggest that instead of focusing in a single variable, the company will have a set of strategic constraints that will limit their decision options. They focus their attention on how much control the company wants, according to the resource commitment they will provide and taking into consideration the dissemination risks of their knowhow. This can be formulated as the following. These factors come from previous research and theoretical constructs. One important analysis that needs to be done is how these factors correlate to each other.

One factor that I'm not sure if it's included in any of these variables is regulation. For example, many automobile giants in the world wanted to enter the Chinese market as WOSs but because of regulation they are forced to enter as JVs. This makes me believe that there is an unspoken assumption that the markets the authors were conceiving in their constructs were open markets with little participation of the government (maybe they include it with country risk?). What theories have been taken as the basis for conceptualization? This theoretical construct is a criticism to the Transaction

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Cost analysis to the entry mode decision, but in the words of Hwan, the theoretical heritage of the Eclectic Theory can be traced in part to the seminal work of Perlmutter [1969], which acknowledged the increasing existence of geocentric approaches to multinational management. The geocentric approach outlined by Perlmutter provided a succinct explanation for the existence of and benefits attached to managing subsidiary units not as a portfolio of independent units but as an interdependent network.

Another foundation, upon which their argument rests, is the rich body of literature on global strategy (e. g. , Hout, Porter and Rudden [1982]; Hamel and Prahalad [1985]; Kogut [1985a, 1985b]; Kim and Mauborgne [1988]; Yip, [1989]), which has either explicitly or implicitly built upon Perlmutter's geocentric conception. I believe that the biggest theoretical difference from this global-strategy construct and classical economics theory within the entry mode decision is that the overriding objective is overall corporate success, not the maximization of each individual subsidiary unit's efficiency.

The second is that in achieving this objective, interdependencies across subsidiary units must be actively managed, meaning that sometimes it would mean that in order to maintain global strategy, some SBUs might even be required to operate at a loss (which is a rationale outside the boundaries of traditional economics). Considering the nine propositions, do they all make sense to you? In case you find any fault with them, state it with your arguments. The first thing I noticed is why are they called propositions instead of Hypothesis? Any theory is based in hypothesis because its aim is to provide chances for something to be proved or not.

The second thing I notices is that the propositions are not “ symmetrical”. By this I mean that when you make such kind of propositions, in order to fully understand the relationship of the explanatory variables with the dependent variable, the author must not only look at one side of the coin but at both. For example, Proposition 1: Other things being equal, firms that pursue a multi-domestic strategy will favor lowcontrol entry modes. That is one side of the coin, the other side would be: Other things being equal, firms that do not pursue multi-domestic strategy will not favor low-control entry modes.

The value of such construct is that it gives a more robust base for empirical testing. Each proposition is set to analyze the validity of each factor within the whole unified framework, so its validity remains to be tested empirically. Review the methodology adopted by this paper and make your comment on its appropriateness. This paper is a theoretical construct based upon the works of others with the addition of new factors, it does not apply specific methodological tools for testing its validity. In terms of epistemological value, the theory is constructed in the same fashion as Falsificationism (Popper?) would propose because the validity of the theory that was accepted previously was put into question by the authors and therefore they provided a new set of hypothesis that should accommodate more accurately to reality than Transaction Costs theory. To discuss the appropriateness of such construct without empirical evidence would be to begin an epistemological debate about the validity of theories and their validity into describing “ Truth”. If it were me who wrote the paper I would have not done a theoretical construct without any experimental study about its validity. I believe that? why some of the authors (specifically Hwan) wrote another

paper a couple of years later were with the use of surveys they tried to analyze the validity of such constructs. Methodologically speaking, I believe that is a much more fruitful contribution to science than providing list of propositions that may or may not be of use. Discuss briefly what contributions this thesis has made to the theory of international entry mode choice. The biggest contribution of this paper was the search of different factors that could explain the decision of mode of entry for the internationalization process of a company.

Previous studies at the moment had already identified a diversity of variables that influence the entry mode decision, and the authors grouped them into one of two categories: environmental or transaction specific factors. Furthermore, according to the theoretical constructs of the time, the studies of the factors had an underlying assumption that each entry decision is made in isolation and is driven essentially by efficiency considerations at the level of the individual entrant or subsidiary unit.

This paper made a case directed towards establishing the importance of a third group of factors: global strategic, namely the strategic relationship it envisages between its operations across borders, in reaching its entry mode decision. For a business manager who is in such internationalization process, this theoretical construct can provide him a roadmap to which variables he/she should pay attention to in order to make the decision of entry.

In my opinion, managers tend to first see how other companies enter the market in their initial stages and see if that would be a viable choice and such "contextual" approach is not included in the factors. What do you think of the limitation of this thesis? The biggest limitation of any theoretical
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construct is that it remains just a theory and not be applicable. That's why I took it upon me to see if someone had tried to prove or deny the Eclectic Theory. The results of that search are shown in section three of this paper.

Empirical evidence 2 years after the publication of Hill et al. Eclectic Theory, one of the co-writers, Peter Hwang along with W. Chan Kim published the paper: "Global Strategy and Multinationals? Entry Mode Choice". The main objective of the paper was to provide empirical tests to the propositions made by the Eclectic Theory. They used a survey from ninety-six multinational managers and had a fundamental result that an express incorporation of global strategic variables into an analysis of the entry mode decision is warranted.

The survey was a mail questionnaire composed of four parts: modes of entry, global strategic factors, environmental factors, and transaction-specific factors. It was distributed to 629 U. S. based MNE, mostly from the manufacturing sector and targeted senior-level management. 137 questionnaires were returned (22% response rate), of which 41 were disregarded because of incomplete answers. Another 18 were disregarded because respondents provided a positive response to the control question of whether government regulations imposed restrictions on the mode options available.

The respondents operations were geographically wide with 25 located in Asia Pacific, 17 in South America, 25 in Europe, 16 in North America, 4 in Africa and 9 in the Middle East. One big methodological problem to measure the validity of the propositions is that such variables are not easy to measure.

This translates that the nine key variables recognized to influence the focal
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decision of foreign entry mode are linked to the empirical world only through indicators.

Moreover, they appear to be wide-ranging, multifaced constructs. As such, psychometric measurement based on multiple items rather than a single-item proxy seemed a more fitting approach [Peter 1979; Fomnell 1982; Churchill 1979], and was used in the analyses. I personally believe that psychometric variables do not fully reflect the necessary information, but that is just because I am biased towards more robust statistical data and believe that what people think they know is not actually what they know.

Continuing with the questionnaire, the respondents were asked to evaluate the foreign venture under discussion across each of these items on a 7-point Likert-type scale. After data collection, an iterative procedure was employed to refine the set of indicators for each construct. The item-to-total correlation, i. e. , the correlation between the score of each indicator and the total score of those indicators used to capture each construct, was then examined. Following the steps suggested by Nunnally [1978], those indicators with a low correlation with the total score.