

Entry mode strategies and internationalization



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This chapter makes obvious earlier findings that are relevant for this study. It examines most of the major areas related to entry mode strategies begin with an introduction of the motives of internationalization. The theoretical frameworks initiated with descriptions of the theoretical approaches to entry modes. The study is covering the motives behind a firm's decision to internationalize its business activities together with an understanding on why and how firms should engage in international business activities. Finally, the theoretical framework will end with the choices of foreign direct entry modes and the factors for that choice of entry modes. This chapter is drafted in connection to the research questions.

2. 2. The Theoretical Approaches to Entry Modes

Most past studies (Liu, 2004; Ekeledo & Sivakumar, 2004; Johansson, et. al., 2006; Kalfadellis & Gray, 2002; Ekeledo & Sivakumar, 2004; Buckley and Casson, 1976; Casson, et. al., 2009) on the international entry mode of MNEs have adopted one of three theoretical approaches: the internalization theory, the eclectic theory and the resource-based theory.

2. 2. 1 Internalisation theory

Internalisation theory provides a clarification of the enlargement of the multinational enterprise (MNE) and gives insights into the reasons for foreign direct investment (FDI) (Kalfadellis & Gray, 2002). Internalization theory was conceptualized by Buckley and Casson (1976). Buckley and Casson (1976) assets this theory has been a leading theme in international business literature relating to the growth of the MNEs and FDI. In other words, internalization is all-purpose encompassing theory which can clarify FDI.

In brief, Buckley and Casson (1976) make obvious clarification that the MNEs organize bundles of activities internally such that it is capable to extend and utilize firm-specific advantages (FSAs) in familiarity. Given the occurrence of market failure, internalization proceeds as a governance mechanism to extend and utilize FSAs. The theory is first and foremost concerned with categorizing the circumstances in which the cross boarder markets for transitional products are likely to be internalized within hierarchies (Dunning & Lundan, 2008). Besides, drawing the upon the earlier insights of Casson, et. al. (2009) internalization theory is best known as a theory of the boundaries of the firm. From their explanation, the boundaries of a firm will be set at the margin where the benefits of bringing a further activity into the firm are just counterbalance by the costs involved. About the cost involved, Ekeledo & Sivakumar (2004) contends that the internalization theory relies heavily on transaction costs analysis. Hence, Ekeledo & Sivakumar (2004) distinguishes between research, which view the internalization theory and the transaction cost theory are the same theory; both are costs associated with negotiating, and enforcing a contract. These transaction costs contain every single costs associated with various aspects of the value-added chain from the production to the consumption of goods and services. In this academic paper, the internalization approach stresses the values of firm-specific advantages (FSAs) and has been used to illustrate how U. S. MNEs enter and operate in China's market.

2. 2. 2 Eclectic paradigm

The second approach is proposed by Dunning (1980, 1993, 2000). Eclectic paradigm which builds on the framework of Dunning (1980), has been

combined numerous strands of international business supposition on cross-border business activities. Eclectic paradigm put forward that cross-border business activities of multinational companies are composed of 'three advantages': they are ownership specific advantages, Location specific advantages and Internalization advantages (OLI) (Dunning, 1980, 1993, 2000; Zhu, 2008; Liu, 2004). The eclectic paradigm is straightforward, yet reflective. It claim that the extent, geography and industrial composition of foreign production undertaken by MNEs are related to the three sets of mutually supporting variables-which, themselves, contain the mechanisms of those three sub-paradigms (Dunning, 2000). Liu (2004) cited in Dunning (1993) identifies ownership advantages take place as firm-specific factors, such as firm size, internationalize experience and skills of the management or unique know-how. Björk, et. al. (2008) further illustrate the ownership advantage refers to aggressive, or monopolistic, which helps a foreign firm to overcome the disadvantages of competing with local firms. In general, a comprehensive review of these competitive advantages; as the more they engage in, increase their foreign production (Dunning, 2000). The second is the Location specific advantages (L) of alternative countries or regions, for undertaking the value adding activities of MNEs (Dunning, 1980, 1993, 2000). Hill (2009) cited in Dunning sub-paradigm means this advantage arise from make the most of resource endowments or assets that are tied to a scrupulous foreign location and that a firm comes across to combine with its own unique assets (technological, marketing, or management competence). These advantages can be familiarity to the market or even varies regulations favoring an entry, like tax level and political policies. Within the literature from Hill (2009), greater attention has been paid to the two examples of <https://assignbuster.com/entry-mode-strategies-and-internationalization/>

Dunning's argument- natural resources & human resources. " Natural resources, such as oil and other minerals, which are by their character specific to certain locations" (Hill, 2009, p: 253). Meanwhile, human resources, such a low-cost and highly skilled labor, the cost and skill of labor vary from country to country (Hill, 2009, p: 253). A firm who meet the Dunning's argument, thus it must undertake Foreign Direct Investment (FDI). More notably, however, the basis of the model is open to criticism; these factors have an increasing impact on the non-production related costs (i. e., the transaction costs). Dunning (1980, 1993, 2000) also popularized the Internalization theory from previous section approach and distinguish this with his eclectic paradigm of internalization advantage. He refers it to " contractual risks" be in charge of the foreign business more constructive than other entry modes. Further, Dunning describe it toward MNEs' capability to competently internalize their ownership specific advantages to ease the transaction cost during the international production. Importantly, internalization advantages focus on industry-specific variables (Björk, et. al., 2008). Within the theory, the firm can retain the assets and skills also keep away from uncertain transaction cost caused by market imperfection.

2. 2. 3 Resourced-based theory

Resource-based theory stems from research by Edith Penrose (1959) and it has found considerable support by Prahalad and Hemel (1990), Rumelt (1991), Peteraf (1993), Ekeledo & Sivakumar (2004), Halawi et al (2005). The resource-based theory observes the firm but not the industry, as the source of competitive advantage, mainly in the resources and capabilities of the firm (Ekeledo & Sivakumar, 2004; Johansson et al., 2006). One such stream

of research, leading from the Grant (1991) studies the resourced-based view of competition draws upon the resources and capabilities that exist in an organization, or that an organization might want to develop, in sort to achieve a sustainable competitive advantage. A capability is the capacity for a group of resources to act upon the task or activity. While resources are the source of a firm's capabilities, which capabilities refer to the main source a firm's competitive advantage (Björk et al., 2008). Accordingly, competitive advantage defined as the ability to ear returns on investment consistently above the average for the industry (Halawi et al. 2005). They point toward a firm is believed to have a competitive advantage when it implements a significance creating strategy not at the same time being implemented by potential competitors. Whilst the framework of Mahoney and Pandian (1992) further cited upon by Halawi et al. (2005), competitive advantage is a function of industry analysis, organizational governance and firm effects in the form of resource advantages and strategies. In some cases an organization's resource based competitive advantage may allow them to generate new markets and add value for the consumer. Regarding to the entry modes, Ekeledo & Sivakumar (2004) contented the resource-based approach assumes sole ownership to be the default entry mode. The resource-based theory expects the companies will favor sole ownership as entry mode strategy when going international, especially preferred by U. S. firms found from the researchers Anderson & Gatignon (1986).

2. 3 Firm Motives for Internationalization

To start with, this theoretical part will present the framework of theories concerning reasons and motivators for companies seeking foreign markets.

In the literature, extensive research has been done on studying the internationalization motivation. Firstly, the issue we concerned is thus to why the companies expand internationally. Amongst the research, Kotabe (2000) finds that a company initiates its business activities in domestic market, gradually expands to other markets. Another word, the growing of business trade has affected the form of economic integration moving from domestic to internationalization. Ng (2007) contends that, the main reasons for companies internationalize are to stand firm with international competition or business development, impacting continuous business operation. Whilst the framework of Leavy (1984), built upon by Ng, of a company's international activities is important to its market survival and expansion. Similarly, Rundh (2007) sees the major implication of this. Such research, he feels, the success of a company in international business has to distinguish the changes in the international environment and build up the strategies in exceptional competence. However, the international activities decision must be considered carefully to avoid any uncertainties (Leavy, 1984).

Consideration has been given to methods of assessing of international risks.

Based upon motives for internationalisation of the firm, Czinkota (2004) identifies the motivations are mixed and multiple. In his article, he provides an overview of the typical proactive and reactive motivations to go international, which showed in table 1. 1.

From him, “ proactive motivations represent stimuli to attempt strategic change. Reactive motivations influence firms that are responsive to environmental changes and adjust to them by changing their activities over time.”(Czinkota, 2004, P: 4)

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The framework used in this research for the purposes of analysis, further supported by the researchers Johansson, Schorling & Strandberg (2006). According to them, the proactive firms internationalize because they want to and reactive firms go international because they have to.

2.3.1 Proactive internationalize

Johansson, et. al. (2006) explains that the great influence of proactive motivation for a company to internationalise is the earning profits. In general, it is accepted that the leading and the most important motive of internationalisation in the capitalism economy is the profit maximization by either increasing the revenue or decreasing the cost of production (Wattanasupachoke, 2002). Additionally, according to Wattanasupachoke (2002), stated the firms not only compete with the rivals in home countries but also the international competitors in the face of a globally increasing competition. For any product sales or services, there are more potential consumers and sales in the world than in any single country. Yet, the companies operating in international market can make the most of firm-specific advantages by replicating competences abroad in order to achieve continuous business growth (Ng, 2007). This is seen to provide the best visual representation. In another word, the business performance is expected to increase upon internationalization. Management may perceive international sales as a potential source of higher profit margins or of more added-on profits.

The second major motivator according to Johansson, et. al. (2006) results from distinctiveness of the companies' unique product or a technological advantage. According to the author, he pointed the uniqueness be able to

provide a competitive advantage and result in major business success abroad. The companies' products offering might face only slight competition in global markets or its technology know-how may be one of a kind in a specialized field (Czinkota, 2004). Nevertheless, the exploiting of the firm-specific advantages by replicating competences abroad helps to expanding the continuous business growth. For example, interviewed data from HeartMath Scandinavia AB according to Oluduro & Okonkwo (2009) provides a unique service which puts them ahead of their potential competitors. At least in the moment the company affirmed that competition has not been much of a predicament or influence on any of their internationalization decisions.

Czinkota (2004) asserts government incentives have traditionally played a major motivating position. Most countries at this writing seek foreign investments because of jobs it will create, the competitiveness it will enhance, and the impact it will have on their trade balance. For example, Daniels, Radebaugh & Sullivan (2009) pointed out Japan as an example who took out full-page advertisements in the Wall street Journal and Financial Times in mid - 2007 to entice foreign companies to consider Japan as a location for their investment. These incentives consist of lower taxes, training of employees, loan guarantees, low-interest loans, exemption of import duties, and subsidized energy and transportation (Daniels, Radebaugh & Sullivan, 2009). Support for these incentives also comes from Czinkota (2004), further stress the reduced corporate tax remain the host countries as competitive of inward FDI. Yet, with series of attractive incentive packages can change the situation at the right time (OECD, 2002).

The last proactive Johansson, et. al. (2006) state is economic of scale. The authors explain that the internationalisation generates economics of scale and scope as a firm moves into international market by using labour and production abroad instead of more expensive domestic resources. This view is supported by the findings of

Lögdkvist, et. al. (2008), suggested that this is so called economic motive, is arise when firms take advantage of lower labour costs, natural resources and capital, additionally of regulatory conduction such as taxation recession. All the way through capabilities abroad enlargement, the company can increase the cash inflows further creates economies of scale (Lögdkvist, et. al., 2008). Whilst the framework of Shenkar & Luo, (2004, built upon by Lögdkvist, et. al (2008), the ‘ first mover advantage’ also a key of economic motive for a firm to globalize in order to be the first mover to the target market.

2. 3. 1 Reactive motivations

Firms act reactively as well as proactively. There are a variety of reactions, such a prime form of motivation is overproduction (Czinkota, 2004). ‘ Overproduction causes the great depression’ (Czinkota, 2004).

“ Overproduction defined as inventories continued to grow, and as consumers did not spend, business began to cut back on production and workers were laid off. Since laid off workers could not spend money, over production produced a ripple effect throughout the economy” (answers. com, 2010)

In economics, overproduction can be short-term surpluses in various sectors, where there is not enough demand to meet an existing supply. Indeed, firms

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may try to use foreign markets as an inventory outlet through depression in the domestic business cycle (Czinkota, 2004). However, Johansson, Schorling & Strandberg (2006) builds on this distinction, indicates that this internationalization action will reduce once the domestic demand meets the supply. He feels that customers abroad are less interest with this impermanent international business.

Another reactive motivation will be reaction to saturated domestic markets. More specifically, Kim (2004) considers two factors in the domestic market, domestic market saturation and company's competitive position in the domestic market. As he suggested, as the domestic market becomes more saturated, the level of firm's globalization motivation increases. In other word, firms internationalize when their domestic market can no longer offer growth opportunities (Kim, 2004). The work of Kim (2004) is seen by Czinkota (2004) to be in a similar vein to that a firm may not find it profitable when the domestic market is saturated. Whilst Czinkota (2004) offers a comprehensive review of the ' products marketed domestically by the firm may be at the declining stage of the product life cycle' (p. 6). Indeed, nor should he suggested the firms must internationalize, opt to prolong the product life cycle by expanding the market. Increasingly, an alternative way for the firm to grow is to enter a new foreign market.

Kim (2004) extends the reactive motivation with the description of economic of scale, to analyze the relative attractiveness of a firm's competitive position in the domestic market and its global strategic intent. Kim (2004) divides variables into two intents, profit-oriented and growth-oriented. Within the literature, a firm may take domestic competitive position as

consideration before it internationalizes. Data collection spanned, “ the less competitive the firm, the more growth-oriented its global strategic intent,” (Kim, 2004, p. 5). He stress, the less competitive domestic player perceives that its weakness in the domestic market stems from its lack of economies of scale. Thus, the framework used in this research for the purposes of analysis, the firm forced to growth-oriented through internationalization. These two relationships are showed in Figure 1. 1.

2. 4 Where, When, How

In previous theoretical framework review, there must be a strong initiating force to push the firm towards internationalization. Within a number of motivators, attempts have been looking forward the dynamics of the internationalization process. However, when arguing the process of Internationalization, consideration has been given to methods of three different features, Where, When, and How individually. Studies of the location selection Where to expand predominate, Lögdkvist, et. al (2008) contend that, concerns are focus on country-specific factors. Country-specific factors can be observed at various levels. Firstly at the national level, Liu (2004) stresses the host country’s investment environment is significant for multinational firms to settle on their entry decision. Within the literature, greater awareness has been paid to the magnetism of a foreign market in terms of its market size (Cuyvers, et. al., 2008; Liu, 2004) and investment risk (Liu, 2004).

It has been identified that, a country with larger market size, , normally has the better prospects for market growth and higher per capita GDP (Gross Domestic Product) growth taken into account for those investors regard as

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location advantage (Cuyvers, et. al., 2008). Literature in the market size influences the locational decisions of investors has emphasised in two main perspectives. First, is the expected sale volume (Cuyvers, et. al., 2008).

“ Foreign direct investment becomes economical option when the volume of production exceeds a level at which the average cost of serving the market by means of exports is greater than the average cost of production within the market.” (Cuyvers, et. al., 2008, p: 5)

Second, market size can be economic and strategic motivator.

“ A larger market size leads to the realization of scale economies in the production process; capturing demand and scale effects.” (Cuyvers, et. al., 2008, p: 5)

Indeed, in subsequent research, Liu (2004) refers the location selection factors come out with the combined impact of market potential and investment risk. From him, the ideal development is a grouping of high market potential and low investment risk. “ When investment risk is high, firms still willing to penetrate the host country market because high risk is generally associated with high rates of return” (Liu, 2004, p: 22). The establishment in countries with high market potential means better cash flows and future opportunities, indeed, foreign investors has to make known themselves with the business environment to minimize investment risk.

Timing is the second critical factor when come to a decision When to initiate the internationalisation process. According to Lögdkvist, et. al (2008), split the timing option into two groups: early mover and late entrant. In view of

that, both of them have individual advantages and disadvantages. Within the literature, early movers benefit from greater market power, resources, sustainable leadership in technology, buyer switching costs, which all of them are so called 'first mover advantage' (Lögdkvist, et. al., 2008). Within each category there are a number of specific mechanisms. Take an example in technological leadership, an important distinction between the two mechanisms is that made by Liberman & Montgomery (1987): "(1) advantages derived from the "learning" or "experience" curve, where costs fall with Cumulative output," and (2) "success in patent or R&D races, where advances in product or process technology are a function of R&D expenditures" (p: 2). Liberman & Montgomery (1987) contend that, early entrant gain a sustainable cost advantage if learning can be held in reserve proprietary. Similarly, first movers are able to gain advantage if technology know-how can be patented when technological advantage is fundamentally a role of R&D expenditures. Indeed, in subsequent research from Shenkar & Luo (2004), first movers have to express their self in most of the uncertainty from rules and regulations as well as free-rider problems; these first movers' disadvantages are most often the late mover advantages.

Going to the last stage, MNEs that wish to invest abroad are required to choose How to enter the new market by cautiously evaluating various types of entry modes. The importance of the foreign market entry mode decision has been well documented. The entry mode chosen has a major impact on the level of control the MNC has over the venture (Root, 1994). The author stated, entry mode is an institutional arrangement that creates the possibility for a firm's products, technology, human skills, management, or

other resources to enter into a foreign country. The selection of an appropriate entry mode strategy is crucial and affects overall success (HK firm in China). Over the past two decades, market entry researchers have identified several different types of foreign entry modes including low control non-equity modes, covering exporting, licensing/contractual agreement, franchising, strategic alliance, and high control equity modes, such as joint venture and wholly owned subsidiary. Each of these entry modes is aligned with a different level of control, resource commitment, and dissemination of risk. When it comes to FDI-related entry modes involve ownership of property, assets, projects, and businesses invested in a host country. Entry modes with low levels of control over operations and marketing, but are also associated with lower levels of risk. In contrast, other entry modes such as joint ventures and full ownership of facilities involve more control. However, these entry modes give the company more control of foreign operation and economic activities but they also involve more risk, long-term commitment and resource and capital investment (Johansson et al, 2006).

When a firm has decided which foreign market to target, the next question will be how to enter the targeted market hence the company's approach to foreign entry mode selection. According to findings from researchers Root(1994) & Koch (2001), there are numerous factors of various strengths in attendance, affecting the entry mode decision a complex process with frequent trade-offs between suitable entry modes. All factors proposed to influence the market entry mode selection process have been split into two broad categories: external and internal

Internal Factors

- Firm Specific Characteristics

It comes to a decision in the form of market entry strategy, the firms first considers its own-specific characteristics that relate to capabilities and resources that determine the stream of competitive advantage in the marketplace. Strong determinants of the capabilities include superior managerial skills and knowledge provided by employees of the firm, proprietary technology, tacit know-how and business experience (Johansson, 2006). It also described as what a firm can do with its assets, that is, how well and advantageously the firm can perform activities in its business field. On this point, (HK firm in China) cited in Porter (1980) also emphasized firm capabilities and constraints as profoundly influencing the choice of marketing strategy and ability to execute the chosen strategy. In the same study, the firm-own characteristics has been concerned with issues of strategy implementation, choice of organizational structure, systems of control, capability and resources, and management style has been viewed as first and foremost, influences the outcome of entry selection(HK in China).

- Company size/ resources

A number of frameworks have been proposed in the literature signify that the prospect of international activity increases with firm size, for the most part as international expansion call for a great deal of resource commitment by the expanding firm (entry-bank, external and internal, Koch). Hollensen (1998) contends that a company's size is an indicator of its resources, the more resources a company gains the further the international participation will increase. These resources are valuable for the company in addition to

give a competitive advantage when entering a foreign market. A comprehensive review of the influences of company size/ resources, in each of these tiers, companies with limited resources should only choose an entry mode that only demands a small amount of resources commitment (Root, 1994). Koch (2001) further asserts that smaller companies more often than not have fewer market servicing options, as their limited own resources may simply not allow, or depress from varies of the market entry modes. In contrast, larger firms might better than smaller ones due to the large resources and network will conceivably be more likely to establish integrated modes (entry - bank). It is agreeable that the influence of company size on its autonomy of alternative in market entry mode selection and their relevant preferences depends on industry-specific resources demands for individual market entry modes (Koch, 2001).

- International experience

Research on large firms showed that the process of going abroad is fast and continuing. There is a characteristic line drawn between objective and experiential knowledge (entry-bank). Objective knowledge is a sort of community's goods readily accessible to any firms, whereas experiential knowledge is refers to firm' specific factors and achieve d by being active on the market. Exclusively, the internationalization process of the firm is driven by a firm's experiential knowledge. In other words, this is so call a firm's international experience. According to Hollensen (1994), this is attained through operating in a specific foreign country or abroad in the international environment. From him, international experience is important in the detection of opportunities and risks. This significantly makes the cost and

uncertainty lower as well as creates a higher level of likelihood for committing resources to foreign markets. For instance, an experienced firm that has already built up the local market knowledge is likely to avoid hazards by internalizing market transactions. As a consequent, the longer history of a firm active in international market, the more it gains the experience and in turn, the more the firm can expect higher expected profitability (entry-banks).

- Management risk attitudes

Commonly, foreign markets are seen as more risky than domestic markets. The degree to which the firm will accept different international business risks generally depends on the company's financial condition, its strategic alternatives, the competitiveness of its competitive atmosphere and its experience (Koch, 2001). Whilst the framework of Agarwal & Ramaswami (1992), built upon by (entry bank), pointed out the smaller with less experienced companies tend to use low involvement entry modes in high potential markets. Whereas, the large firms with international experience capability tend to use more integrated entry modes in high contractual risk markets. However, it is likely for any large or small firms behavior a proper management risk attitude, which always bear in mind to select a country that only show higher degree for long-term prospects to enhance the firm's capabilities (Koch, 2001).

- Product Factors

Research tends to focus on specific internal factors, while the product characteristic that is concerns of manufactured goods eventually affects the entry mode decision (Johansson, 2006). Literature tends to use the product <https://assignbuster.com/entry-mode-strategies-and-internationalization/>

characteristics defined as the multipart nature of tangible and intangible elements that differentiate it from the other entities in the international marketplace. To the extent that a product's physical characteristics offer several basis of differentiation that decide a firm's success in the international market, however, the condition is depend on how well the product or service is and on how well a firm is able to differentiate the product from the offerings of competitors (HK firm in China). In addition to product factors, Root (1994) stress the common view that highly differentiated products with distinct advantages against competitive products give sellers a momentous degree of pricing discretion. Within the literature, these distinctive products are able to absorb high unit transportation costs and still remain high competitive in a foreign target country. Consequently, product characteristics are associated with increased internationalization and effects of entry performance.

- External Factors

External factors take account of all the external variables that impact the selection of entry mode contained by a country or a region; for case in points like market, environment and production factors (Root, 1994). These factors can seldom be affected by management decisions but may perhaps encourage or discourage certain entry modes (Root, 1994).

- Home country factors

Market, environmental, and product factors in the home country also influence a company's choice of entry mode (Root, 1994). Support for this literature comes from (the influence of external and internal; external and internal), also further suggest that the competitive structure of the home <https://assignbuster.com/entry-mode-strategies-and-internationalization/>

market affects that entry mode. Higher production costs in the home country compare to the foreign target country encourage entry modes involving local production, such as licensing, contract manufacture and investment.

Addition to the home country government's attitude offers upon tax incentives to encourage exporting or foreign investment further increase the motivation of local firms gradual internationalize.

- Target country market factors

Target country's market factors are common criterion used in market selection due to the eventual purpose of a firm to gain foreign market shares and exploit competitive advantages (HK firm in China). According