Entry Mode Strategies for SMEs in the New Global Environment: Multi-Theoretical Framework and Research Propositions

Naresh K. Malhotra - Georgia Institute of Technology, Atlanta, Georgia, USA

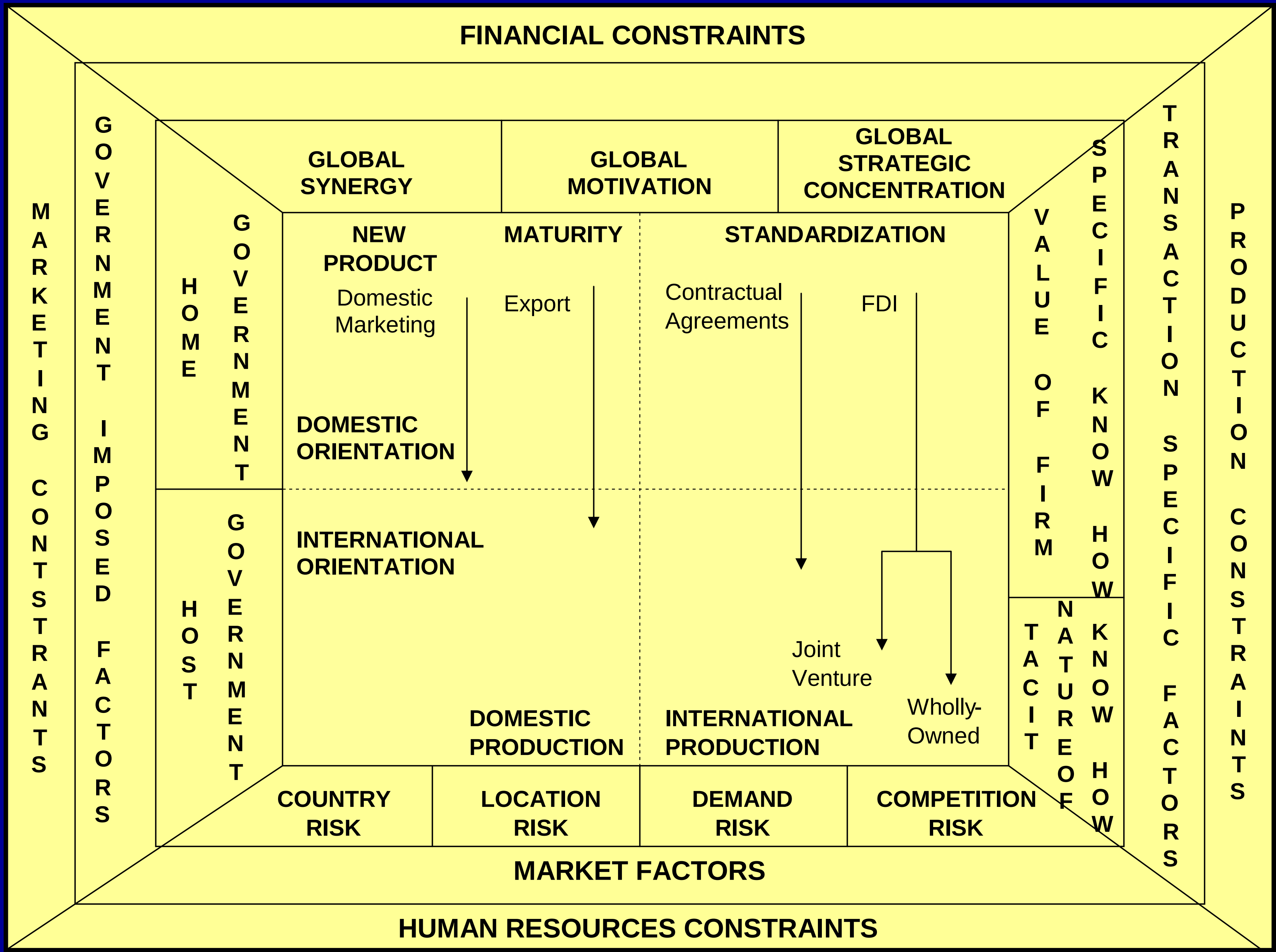
SME-Entrepreneurship Global Conference

October 2006
Malaysia, India

A Brief Review of Existing Relevant Theories

- **IPLC Theory** (Vernon 1966; Wells 1968; Onkvist and Shaw 1983)
- **Theory of Market Imperfections** (Hymer 1976; Kindelberger 1969)
- **Resource Advantage Theory** (Barney 1991; Hunt and Morgan 1995; Andersen 1997; Hunt 1999)
- **Transaction Cost Theory** (Coase 1937; Williamson 1985; Anderson and Coughlan 1987)
- **Strategic Behavior Theory** (Knickerbocker 1973; Graham 1974, 1978; Casson 1987)
- **Eclectic Theory** (Dunning 1981, 1988, 1995, 1998)
- **Internationalization Theory** (Johanson and Vahlne 1977; 1990)

FIGURE 1: A CONCEPTUAL FRAMEWORK OF THE GLOBALIZATION PROCESS



A Summary of Theoretical Support for Research Propositions

Model Component:

PROPOSED MODEL PHASES IPLC Modifications

Proposition:

P1.1: The innovating firm in each phase of the integrated model may originate from developed countries, developing countries, or trading blocs.

Theoretical Support:

IPLC Theory

References:

Vernon (1966), Wells (1968), Onkvisit & Shaw (1983), Jain (1990), Ting (1982), Malecki (1997), Ohmae (1985)

Model Component:

New Product Phase

Proposition:

P2.1: In the new product phase, innovator firms engage primarily in domestic marketing; international marketing is minimal or nonexistent.

Theoretical Support:

Theory of Market Imperfections

References:

Hymer (1976), Kindleberger (1969)

Model Component:

Maturity and Standardization Phase

Proposition:

P2.2: In the maturity phase, exporting is the primary form of foreign market-entry.

P2.3: In the maturity/standardization phase, producers of other countries (developed or developing) or trading blocks start to compete with the innovative firm first in their own market, then in other world markets, and finally in the innovators own market.

P2.4: Contractual agreements as a market-entry strategy occur primarily in the early stages of the standardization phase.

P2.5: In the maturity/standardization phase, the innovator firm experiences increased protectionism in the foreign markets designed to aid domestic firms.

P2.6: FDI as a market-entry strategy occurs primarily in the late stages of the standardization phase, first in the form of joint venture and later through wholly owned operations.

Theoretical Support:

Resource Advantage Theory, Eclectic Theory, and Transaction Cost Theory

References:

Barney (1991), Hunt and Morgan (1995), Dunning (1981, 1995, 1998), Williamson (1985)

Exception to the IPLC Theory:

P2.7: Firms competing on high time specificity and low knowledge specificity (e.g., in information-intensive industries) will introduce new products simultaneously in the global market rather than following the IPLC stages.

Theoretical Support:

Resource Advantage Theory

References:

Barney (1991), Sampler (1998)

Model Component:

IPLC Phases and OLI Advantages

Proposition:

P3.1: To be successful in exporting in the maturity phase, the innovator MNC must possess ownership (O) advantages and internalization (I) advantages over its competitors.

P3.2: To be successful in contractual agreements in the early standardization phase, the innovator MNC must possess at least ownership (O) advantages over its competitors.

P3.3: To be successful in FDI in the late standardization phase, the innovator MNC must possess ownership (O) advantages, internalization (I) advantages, and location (L) advantages over its competitors.

Theoretical Support:

Eclectic Theory

References:

Dunning (1988, 1995, 1998)

Model Component:

External Factors and Globalization Market Risk Factors:
Country Risk, Location Risk, Demand Risk, and Competition Risk

Proposition:

P4.1: The higher the degree of market risk the greater the probability that exporting as a market entry strategy, rather than contractual agreements or FDI, will occur at the standardization phase.

P4.1a: The higher the degree of country risk the greater the probability that exporting as a market-entry strategy, rather than contractual agreements or FDI, will occur at the standardization phase.

P4.1b: The higher the degree of location risk the greater the probability that exporting as a market-entry strategy, rather than contractual agreements, will occur at the standardization phase.

P4.1c: The higher the degree of demand risk the greater the probability that exporting as a market-entry strategy, rather than contractual agreements or FDI, will occur at the standardization phase.

P4.1d: The higher the degree of competition risk the greater the probability that exporting as a market-entry strategy, rather than contractual agreements or FDI, will occur at the standardization phase.

Theoretical Support:

Strategic Behavior Theory

References:

Hill, Hwang, and Kim (1990), Kobrin (1983), Kim and Hwang (1992), Agarwal (1994), Harrigan (1985)

Model Component:

Global Strategic Factors:
Global Synergy, Global Motivations Global Concentration

Proposition:

P4.2: The greater the significance of global strategic variables to the firm, the more likely that wholly-owned FDI as a market-entry strategy will occur at the maturity phase or early stages of the standardization phase.

P4.2a: The greater the significance of global synergies to the firm, the more likely that wholly-owned FDI as a market entry-strategy will occur at the maturity phase or early stages of the standardization phase.

P4.2b: The greater the significance of global strategic motivations to the firm, the more likely that wholly-owned FDI as a market-entry strategy will occur at the maturity phase or early stages of the standardization phase.

P4.2c: The greater the significance of global concentration to the firm, the more likely that wholly-owned FDI as a market-entry strategy will occur at the maturity phase or early stages of the standardization phase.

Theoretical Support:

Strategic Behavior Theory

References:

Hill, Hwang, and Kim (1990), Hout, Porter, Rudden (1982), Hamel and Prahalad (1985), Kim and Hwang (1992); Kim & Mauborgne (1988)

Model Component:

Transaction-Specific Factors:
Value of Firm, Specific Know-how, Tacit Nature of Know-how

Proposition:

P4.3: The higher the value of transaction-specific factors, the greater the probability that wholly-owned FDI as a market-entry strategy will occur during the new product or maturity phase.

P4.3a: The higher the value of firm-specific know-how, the greater the probability that wholly-owned FDI as a market-entry strategy will occur during the new product or maturity phase.

P4.3b: The more tacit the firm-specific know-how, the greater the probability that wholly-owned FDI as a market-entry strategy will occur during the new product or maturity phase.

Theoretical Support:

Transaction Cost Theory

References:

Anderson and Gatignon (1986), Caves (1982), Hill, Hwang, and Kim (1990), Dunning (1981), Hennart (1982), Rugman (1981), Kim and Hwang (1992)

Model Component:

Government Imposed Factors: Regulation of Foreign Ownership, Trade, and Foreign Investment

Proposition:

P4.4: As host and home governments increase regulations of foreign firms, entry strategies will vary for different phases of the IPLC.

P4.4a: As host governments increase regulations of foreign ownership, contractual agreements and joint ventures will occur more often during new product/ maturity phases, whereas wholly owned FDI will occur less often.

H4.4b: As host governments increase regulations involving trade, foreign production entry strategies including contractual agreements and FDI will increasingly occur during the new product and maturity phases.

H4.4c: As home governments increase regulations of foreign investment, exporting will occur more often during the standardization phase.

Theoretical Support:

Economic Development Theory, Dependencia Theory, Bargaining and Negotiation Theory

References:

Benoit (1970), Kendal (1974), Shaker (1970), Gladwin and Walter (1983), Negandhi (1987)

Model Component:

INTERNAL FACTORS AND GLOBALIZATION

Constraints & Commitment:
Financial
Marketing
Production
Human Resource

Proposition:

P5.1: Firms, which have constraints on the internal factors of finance, marketing, production, and human resources and/or lack the commitment to internationalize, may never initiate the globalization process or may not be able to progress through all the phases.

Theoretical Support:

Internationalization Theory, Resource Advantage Theory

References:

Johanson and Vahlne (1977, 1990), Barney (1991), Root (1994)

Model Component:

EXPORT STRATEGIES IN MATURITY PHASE: Pre-Engagement Phase

Proposition:

P6.1: In stage 0, the marketing activity is restricted to domestic market only. The firm may, however, be seriously considering export activity.

Theoretical Support:

Internationalization Theory

References:

Johanson and Vahlne (1977, 1990), Leonidou & Katsikeas (1996), Bilkey and Tesar (1977), Cavusgil (1980), Reid (1981), Wortzel and Wortzel (1981), Barret and Wilkinson (1986)

Model Component:

Initial Phase

Proposition:

P6.2: In stages 1 and 2, the firm engages in sporadic export activity. Its export strategy is not significantly different from its domestic marketing strategy with emphasis on price-based competition. Markets with low physical and psychological distance are preferred.

Theoretical Support:

Internationalization Theory

References:

Johanson and Vahlne (1977, 1990), Leonidou & Katsikeas (1996), Bilkey and Tesar (1977), Cavusgil (1980), Reid (1981),
Wortzel and Wortzel (1981), Barret and Wilkinson (1986)

Model Component:

CONTRACTUAL AGREEMENT STRATEGIES in (EARLY) STANDARDIZATION Phase: Licensing and Franchising

Proposition:

P7.1: In countries that are otherwise closed to foreign firms, licensing can provide an entry point.

P7.2: Where entry barriers are very high, in core sectors such as defense and telecommunications, licensing may be the preferred mode of entry.

P7.3: In products with short life cycles due to rapid changes in technology, firms should transfer technology through licensing at the early (new product) stage in order to be successful.

P7.4: In countries with weak appropriability regimes, firms should transfer technology through licensing at the early (new product) stage in order to be successful.

P7.5: Licensing, as it is an extremely flexible vehicle, can be easily combined with other entry modes to form mixed entry modes.

P7.6: While standardization characteristics of franchising have been successful in the domestic market, appropriate customization should be built in for success in the global market.

P7.7: In markets characterized by high country risk, franchising may be the preferred mode of entry as compared to FDI due to no asset-specific commitment requirement.

P7.8: In markets characterized by high moral hazard risk and high adverse selection risk, franchising may be the preferred mode of entry as compared to FDI.

P7.9: As the markets in developed countries become saturated, franchising is expanding into developing countries that are characterized by a high level of economic growth and with a substantial middle class.

Theoretical Support:

Eclectic (Internalization) Theory, Transaction Cost (Agency) Theory, Resource Advantage Theory

References:

Dunning (1988, 1995), Anderson and Gatignon (1986), Kolde (1985), Barney (1991), Kotabe et al (1996), Teece (1987), Fulop and Forward 1997, Martin 1988, Brickley, Dark, and Weisbach 1991, Shane 1996, Contractor and Kundu 1998, Alon and McKee 1999.

Model Component:

Advanced Phase

Proposition:

P6.3: In stages 3, 4 and 5, the firm engages in regular export activity. Its export strategy is significantly different from its domestic marketing strategy with emphasis on price as well as quality. Export expands to markets that are physically and psychologically distant.

P6.3 Continued: In the final stage, the firm develops a multi-country export strategy with emphasis on customization.

Theoretical Support:

Internationalization Theory

References:

Johanson and Vahlne (1977, 1990), Leonidou & Katsikeas (1996), Bilkey and Tesar (1977), Cavusgil (1980), Reid (1981), Wortzel and Wortzel (1981), Barret and Wilkinson (1986)

Model Component:

FOREIGN INVESTMENT STRATEGIES IN (LATE) STANDARDIZATION PHASE: Joint Ventures and Strategic Alliances

Proposition:

P8.1: A joint venture is an appropriate mode of entry in a market characterized by high market potential, high specific market knowledge, and high cultural dissimilarity.

P8.2: Ventures are more likely to succeed when partners possess complimentary missions, resource capabilities, managerial capabilities, and other attributes that create a strategic fit in which the bargaining power of the venture's sponsors is evenly matched.

P8.3: Significant asymmetries among sponsoring firms are expected to be stabilizing to a venturing relationship (survival and duration) because partners each need what the other can supply. However, ventures between partners of similar organizational values, asset sizes, and venturing experience levels perform better.

P8.4: Strategic alliance is the recommended mode of entry for markets characterized by high entry barriers and high technological and competitive uncertainty.

Theoretical Support:

Transaction Cost Theory, Strategic Behavior Theory, Resource Advantage Theory, Modified Eclectic Theory

References:

Hennart (1988), Ghoshal (1987), Harrigan (1986, 1988), Dunning (1995, 1998), Sengupta and Perry (1997), Madhok (1997)

Model Component:

FOREIGN INVESTMENT STRATEGIES IN (LATE) STANDARDIZATION PHASE: Wholly Owned Operations

Proposition:

P9.1: Wholly owned operations are appropriate when control of decisions and policies is important to the multinational firm.

P9.2: Wholly owned operations are appropriate when high dissemination risk and low country risk characterizes the market in the host country.

P9.3: Greenfield operations are preferred to acquisitions when the multinational firm is resource-sufficient.

Theoretical Support:

Transaction Cost theory, Eclectic (Internalization) Theory, Resource Advantage Theory

References:

Hennart (1988), Contractor and Kundu (1998), Contractor (1990), Nitsch, Beamish, & Makino (1996), Dunning (1988, 1995), Barney (1981)

A Summary of Managerial Implications and Case Illustrations

Model Component:

PROPOSED MODEL PHASES

Summary of Managerial Implications:

The importance and role of Non-U.S. and Less Developed multinationals needs to be recognized and understood.

Non-US based overseas operations are a viable source of new product innovation and marketing ideas.

Appropriate segmentation strategy and strategic alliance is the key to penetrating markets inside a trading bloc.