International Business Review 19 (2010) 209–222

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

Foreign market entry mode behavior as a gateway to further entries: The NAFTA experience

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ARTICLE INFO

Article history:
Received 2 November 2007
Received in revised form 2 December 2009
Accepted 2 December 2009

Keywords:
Entry mode choices
Involvement levels of firms
NAFTA
Regional trading blocs

ABSTRACT

Trade liberalization policies have created a vibrant economy in Mexico by successfully increasing the flow of trade and foreign direct investments. This study investigates whether involvement in Mexico is considered attractive as a market in and of itself, or whether it is also attractive because Mexico can also serve as a gateway to other Latin American markets. We call this latter idea “The Gateway Proposition” and present it against the backdrop of NAFTA. The Gateway Proposition suggests that the ability of firms to expand their markets further into Latin American countries in the future could be an additional incentive to invest in Mexico. Accordingly, we analyze entry mode strategy for U.S. and Canadian firms in Mexico as well as their involvement level, equity participation, resource commitment, risk tolerance, and control. The findings of these analyses support The Gateway Proposition, suggesting that a firm’s future involvement level is motivated not only by the Mexican market potential, but also by Mexico’s ability to serve as a gateway to other Latin American markets. Evidence also suggests that large multinational firms with past experience in Mexico are inclined to respond to emerging Latin American market opportunities by becoming more involved in Mexico.
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1. Introduction

Over the past two decades, globalization has profoundly affected the economies of both developed and developing countries. By increasing the flow of trade and foreign direct investments, trade liberalization policies have transformed and modernized the economies of emerging markets. In the case of Mexico, trade liberalization policies that were instituted under NAFTA have led to an increase in foreign direct investment – from $4 billion in 1993 to nearly $20 billion by 2006 – as Canadian and U.S. firms increased their investments in Mexico (Cavusgil, Knight, & Reisenberger, 2008: 235). This economic transformation has made Mexico one of the wealthiest countries in Latin America in terms of per capita income. The success of economic reforms and rising foreign direct investment in Mexico has prompted other Latin American countries to open up their markets to foreign competition (Buckley, Clegg, Forsans, & Reilly, 2003; Galan & Gonzalez-Benito, 2006; Garcia, 2009). These changes in governmental policies could lead to significant market opportunities beyond Mexico for Canadian and U.S. firms. In this paper, we investigate whether entry mode and investment decisions are driven by the perception that Mexico is

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0969-5931/$ – see front matter © 2009 Elsevier Ltd. All rights reserved.
doi:10.1016/j.ibusrev.2009.12.001

an attractive target market in and of itself, or whether such decisions could be also due to Mexico's ability to serve as a gateway to other emerging markets in Latin America.

The extant literature on entry mode decisions by firms has focused on general aspects of entry decisions at the firm level (Erramilli & Rao, 1993; Kim & Hwang, 1992; Kumar & Subramaniam, 1997; Madhok, 1997), as well as on industry and country characteristics (e.g., Anderson & Gatignon, 1986; Galan & Gonzalez-Benito, 2006; Kogut & Singh, 1988; Rugman & Gestrin, 1993; Tse, Pan, & Au, 1997). The patterns and determinants of entry mode have been explained by an eclectic set of factors (e.g., Canabal & White III, 2008). Past research has also emphasized the ownership and control issues implied by various modes of entry (Agarwal & Ramaswami, 1992; Contractor, 1990a; Erramilli, 1991; Hennart, 1991; Hennart & Reddy, 1997), and the effect of factors such as cultural distance, country risk, and economic development on entry mode decisions (e.g., Cho & Radmanabhan, 1995; Gatignon & Anderson, 1988; Kogut & Singh, 1998).

While the past literature has identified several key factors that influence entry mode decisions, the issue of investing in a country because it can serve as a gateway to other emerging economies has not been addressed. In the context of Latin America, past studies have examined entry mode decisions to Mexico and other Latin American countries separately (Galan & Gonzalez-Benito, 2006; Garcia, 2009). The potential for Mexico to serve as a gateway to other Latin American countries, however, has drawn only scant attention (Richardson, 1993). One of the contributions of this study is that the attractiveness of Mexico as a final market is treated separately from its attractiveness to serve as a gateway to other Latin American markets. This distinction is critical, since some Latin American countries have also instituted aggressive economic reforms (Porzecanski & Gallagher, 2007), thus becoming more attractive to U.S. and Canadian firms. Our analysis extends the existing literature by showing a unique entry mode strategy based on the interplay of macro-policy considerations and micro-variables. We explore U.S. or Canadian firms' current involvement level in Mexico and the factors that can contribute to their future intentions to invest in Latin America. Our investigation treats the entry to a foreign market and the mode of that entry under the multilateral macro-agreements.

Garcia (2009) notes that, as a consequence of NAFTA, Mexican trade is highly concentrated within the North American bloc. The firms pursuing internationalization as a strategy and/or adopting it as an entrepreneurial perspective need to leverage their resources and look beyond the region or markets they currently serve (Anderson, 2000; McDougall, 1994; Ruzzier, Hisrich, & Bostjan, 2006). According to internationalization theory, firms could reduce risk by investing in markets that are close in terms of geography or culture and by entering foreign markets through such modes as acquisition (Daniels, Krug, & Trevino, 2007). We argue that trade liberalization agreements such as NAFTA may create a friendly business environment for the first entry, which provides experience and opportunities for further expansion into other countries that are culturally and economically connected to the first. By expanding into the neighboring markets, both U.S. and Canadian firms can access new markets, enhance production, and reduce costs (Garcia, 2009), thus enabling firms to achieve scope and scale to compete in the global environment.

The rest of this article discusses the theoretical background, conceptual model and hypothesis development, and then describes the methodology and data. Finally, the findings and conclusions are discussed.

2. Theoretical background

Past studies on entry mode employed a variety of approaches, including the transaction-cost perspective (Cleeve, 1997; Erramilli & Rao, 1993; Gatignon & Anderson, 1988; Hennart, 1991; Makino & Neupert, 2000; Padmanabhan & Cho, 1996; Taylor, Zou, & Osland, 1998), resource-based theory (Chang, 1995), and eclectic theory (Agarwal & Ramaswamy, 1991; Hill, Hwang, & Kim, 1990; Kim & Hwang, 1992). The transaction-cost explanation emphasizes the preeminent role of control that each type of mode affords an entrant. The resource-based theory posits resource availability and utilization advantages in choices among modes of entry (Chang, 1995). The eclectic discussion considers the effects of a wide variety of factors on entry mode. Some of these factors are firm size (Caves & Mehra, 1986), multinational experience (Erramilli & Rao, 1993; Kogut & Singh, 1988), ability to differentiate products (Anderson & Coughlan, 1987), corporate strategy (Caves & Mehra, 1986; Contractor, 1990b), and learning (Barkema & Vermeulen, 1998; Kogut, 1988).[1] Other studies, stemming from the institutional perspective, suggest that the choice of entry mode is based on "legitimacy" criteria: firms choose entry modes structures as a way to respond to isomorphism in both external and internal environments (Brouthers, 2002; Davis, Desai, & Francis, 2000; Yiu & Makino, 2002).

The past literature also suggests that the level of involvement affects the profitability and the strategic options of the firm and those of its competitors (Agarwal & Ramaswami, 1992; Anderson & Coughlan, 1987; Cavusgil, Yeniyurt, & Townsend, 2004; Emden, Yaprak & Cavusgil, 2005; Klein & Roth, 1990). Accordingly, higher involvement levels (for example, wholly-owned subsidiaries) can reduce manufacturing and distribution costs, enhance market presence, increase service levels, and improve control over marketing strategy (Galan & Gonzalez-Benito, 2006; Jain, 1993). Commitment to a mode, however, involves deployment of resources for long periods, since once a particular mode has been chosen, any subsequent change entails considerable loss of time and money (Root, 1987).

[1] This stream of research, albeit fragmented, is in agreement that a firm makes deliberate efforts to (1) enhance its discretion over critical resources, (2) attain a higher level of competitiveness at a lower risk, and (3) increase efficiency. The differences among researchers stem from the fact that each proposes a different set of antecedents for these three objectives.

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