

# The effect of service intangibility on revenue from foreign markets

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## Abstract

Drawing on the Eclectic Theory, this empirical study reports a test of the influence of intangibility on the receipt of revenues from foreign markets, and the moderating influence of management international experience. To insure sufficient variance in service intangibility while also controlling for extraneous sectoral and national variables, this study obtained extensive cross-sectional data from U.S.-based manufacturing and services firms in the environmental control industry. For this sample, the findings indicate that tangibility is positively related to the receipt of foreign revenues and to the use of higher control entry mode, supporting the view that intangibility is an important variable for understanding internationalization and value creation.

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## 1. Executive summary

As the value of international services increases, the need to understand the effect of service characteristics, notably intangibility, on value creation becomes increasingly important. This study reports a test of the influence of intangibility on the receipt of revenues from foreign markets, and the moderating influence of management international experience. The results extend the Eclectic Theory to include intangibility as a necessary variable associated with ownership and internalization advantages, two of the three advantages central to the creation of value in international production. To insure sufficient variance in service intangibility, while also controlling for extraneous sectoral and national variables, this study obtained extensive cross-sectional data from U.S.-based manufactur-

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ing and services firms in the environmental control industry. For this sample, the findings indicate that tangibility is positively related to the receipt of foreign revenues and to the use of a higher control entry mode, supporting the view that intangibility is an important variable for understanding internationalization value creation, and suggesting that service characteristics, such as intangibility, are influential variables in determining the success, as well as the patterns, of internationalization.

Today, the value of service exceeds the value of manufactured, tangible outputs. Service accounts for more than half of the gross domestic product in all developed countries and in most developing economies (Clark and Rajaratnam, 1999; U.N., 1994b). In the United States, the service sector now employs approximately 82% of the overall work force (Hilsenrath, 2002). As the barriers to trade in services have continued to decrease (Campbell and Verbeke, 1994; Dunning, 1993; U.N., 1994b), the value of international services has also begun to surpass that for manufactured goods (Dunning, 1993; U.N., 1994b). This trend is expected to continue. Freer global trade in services is central to current EU and U.S. trade policies (King, 2003). The delivery of services and products is also increasingly linked. Even when trade is permitted, firms may choose to link, or embody, services with goods to export the services through the merchandise flow, where barriers tend to be lower (Dahringer, 1991). To compete in today's global market, manufacturers often find that they must combine more services with their goods (Ansberry, 2003). Services, such as banking, also rely heavily on physical products, such as automatic teller machines, in that the service is embedded in the product. In fact, there are few pure goods or services (Dunning, 1989; Hirsch, 1993; Shostack, 1977).

Interestingly, the research examining the internationalization of services remains notably sparse (Boddeyn et al., 1986; Clark and Rajaratnam, 1999; Coviello and Martin, 1999; Dunning, 1993; Organization for Economic Co-operation and Development, 1997; Westhead et al., 2001). Research has labored under the traditional assumption that services are best suited for domestic markets. Despite phenomenally successful international growth in services, like fast food, service have been treated blithely (Palmer, 1985). The relative neglect in the literature regarding the role of services in creating value abroad is surprising because the growth in international services speaks of the importance of services from a managerial perspective. In addition, from a theoretical perspective, services have long been acknowledged to differ from purely manufactured goods (Dunning, 1989; Hirsch, 1993; U.N., 1994b). Pure services are typically modeled as exhibiting four key characteristics: (1) intangibility, because services outputs are not objects; they cannot be seen, touched, tasted, lifted, or dropped, (2) perishability, because service outputs cannot be inventoried, (3) inseparability, because service outputs are produced as they are consumed with the customer participating in the production of the service rather than merely receiving the service, and (4) heterogeneity, because service outputs vary widely (Aharoni, 1993). Because of these differences, by 1980, for instance, the field of marketing recognized the need to develop a body of knowledge related to services (Upah et al., 1983). Similarly, the need to examine how strategy differed for services was acknowledged (Dan, 1978). Of particular interest to researchers has been the greater intangibility of services compared with manufactured goods (Aharoni, 1993; Arvidsson, 1997). For example, in a series of articles, Parasuraman et al. (1988) refine tangibility as a component of service quality.

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