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Strategy antecedents of modes of entry into foreign markets

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Abstract

Although a firm's choice of mode of entry to a foreign market is central to the implementation of international strategy, we have only limited understanding of the effects of international strategy on the choice. This study explores the effects of business relatedness and corporate international experience. Data were collected on 173 ventures of Swedish manufacturing firms that were present on the German market, and multivariate techniques were applied to test hypotheses. It was found that product/market relatedness and intangible resource relatedness between the foreign business unit and the industrial firm's core business unit favored a full control entry mode based on sole ownership. This finding was also valid for importance of foreign markets. Further, market importance moderated the two relationships regarding business relatedness. Contributions to the literature are discussed.

Keywords: International strategy; Strategy implementation; Business relatedness; International experience; Market entry mode; Type of control; Core competence; Resource-based view

1. Introduction

An industrial firm's implementation of international strategy involves choosing a foreign market entry mode (e.g., Gannon and Johnson, 1997; Root, 1987), where a mode essentially is an institutional arrangement that facilitates the firm's bringing its products and services to the foreign market (Calof, 1993; Root, 1987). Furthermore, corporate control is a key ingredient in the implementation of international strategy (Young et al., 1989); thus, the major types of entry modes are *full control* modes based on sole ownership, and *shared control* modes based on collaboration (Anderson and Gatignon, 1986).

Although the firm's selection of entry mode and accompanying type of corporate control has significant performance effects (e.g., Rasheed, 2005), we have only limited understanding of associations between international strategy and modes of entry to foreign markets. There is, hence, a need to explore relevant empirical patterns. In particular, we need to explore how industrial firms exploit corporate resources in their efforts to implement international strategy. As business relatedness and corporate international experience have been found to be central resources in this respect (Pehrsson, 2004a,b, 2006), the effects of these strategy components are particularly interesting.

Thus, the resource-based view (e.g., Barney, 2001; Grant, 1991; Kogut and Zander, 1993; Tallman, 1991) which focuses on resource exploitation, acquisition, and development, is suitable for the study of international strategy implementation. Moreover, much recent research from the resource school has shifted from focusing on tangible resources as a source of competitive advantage to include intangible resources such as skills and experiences. In sum, resources are considered to be important sources of heterogeneity and competitive advantage.

A number of researchers have conducted studies relevant to the subject. For example, Gannon and Johnson (1997) specifically studied modes of entry into foreign markets in the hotel industry, and corporate control through organizational culture. As to drivers of market entry modes, Driscoll and Paliwoda (1997) examined the effects of situational variables on choice of mode and found that socio-cultural distance, tacit know-how, and product differentiation influenced mode selection. Further, Madhok (1998) contrasted two theoretical views in addressing explanations of foreign market entry modes: transaction-based arguments (e.g., Rugman, 1986) which

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focus on the minimization of transaction costs, and the resource-based view. From an empirical test, Madhok found stronger support for the resource-based view in explaining choices of mode. Ekeledo and Sivakumar (2004) also applied this view in their study of the effects on choice of mode of a mix of resource factors such as technology, knowledge, business experience, specialized assets, firm size, organizational culture, and reputation.

Other studies that go beyond the resource-based view include Koch (2001), who included 16 external and internal determinants of mode selection, and Shi et al. (2001) who focused specifically on factors influencing the choice between a wholly-owned foreign enterprise and a joint venture. Taylor et al. (2000) considered eight broad factors, including bargaining power. However, previous studies have not explicitly focused on international strategy as determinant of foreign entry mode.

The purpose of this article is to extend our knowledge of international strategy drivers of industrial firms' choices of modes of entering foreign markets. Thus, the study follows the resource-based view on strategy and explores relations between business relatedness (i.e., degree of relatedness between the foreign business unit and the core business unit of the parent firm) and type of corporate control, and between corporate international experience and type of corporate control. In this study, business relatedness and corporate international experience are viewed as resources that to some degree are exploited in the implementation of international strategy. Data were collected from 173 ventures of Swedish manufacturing firms that were present on the German market, and multivariate techniques were applied to detect significant relationships; home country and host country influences were held constant.

The article is organized as follows. The next section presents the central concepts, and puts forward hypotheses as regards associations. Then follow method issues, tests of the hypotheses, discussion of the findings, conclusions and implications.

2. Theory and hypotheses

Fig. 1 presents the hypothesized model of the effects of international strategy on modes of entry into foreign markets. Business relatedness, corporate international experience, and interactions are expected to influence entry modes beyond the controls. This section of the article initially presents the theoretical treatment of entry modes; this is followed by a discussion of business relatedness and corporate international experience. Eight hypotheses are then presented.

2.1. Foreign market entry mode

Firms entering foreign markets choose from different entry modes ranging from licensing and franchising, through exporting directly or through independent channels, to foreign direct investments (joint ventures, acquisitions, mergers, and wholly-owned new ventures) (Rasheed, 2005). Essentially, a choice of entry mode comprises choice of location and type of control. Thus, resources may be located domestically or in the

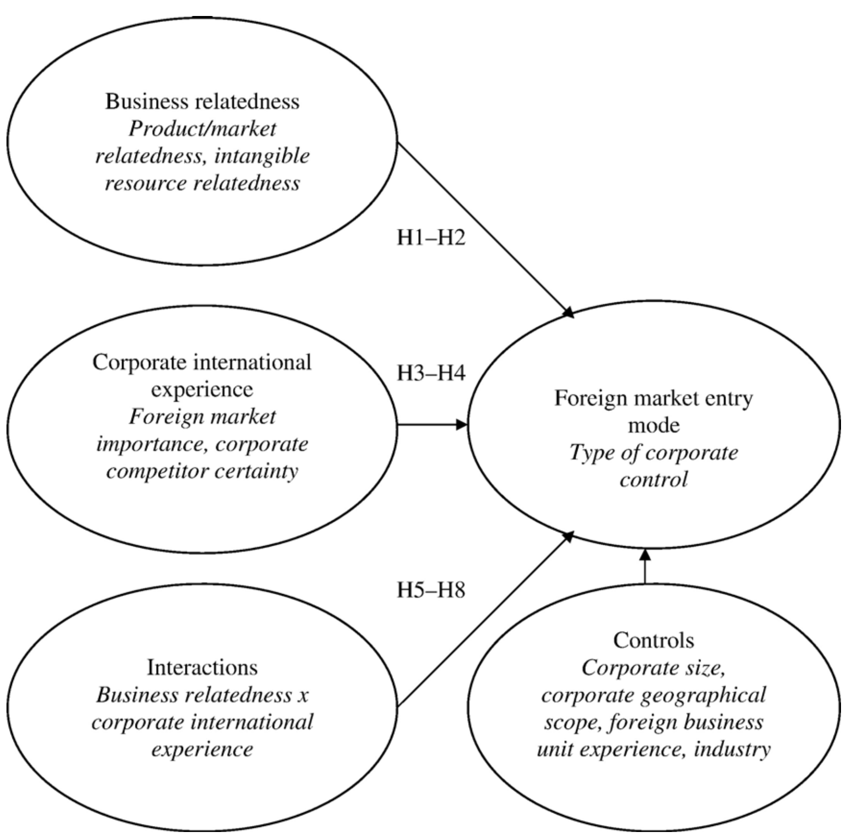

Fig. 1. Hypothesized model of effects of business relatedness and corporate international experience on modes of entry into foreign markets.