Organizing foreign market activities: From entry mode choice to configuration decisions

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ABSTRACT

This article takes a critical look at the extant foreign entry mode research and argues that a richer and more and dynamic view is needed in order to provide a realistic presentation of how firms organize their foreign activities. While researchers have typically assumed a very limited range of foreign operation modes, we propose a systemic rather than a myopic view of foreign operation modes by modeling the entry mode decisions of the firm as a corporate-level process. We substantially broaden the scope of mode choice, thereby moving toward a configuration decision approach. We model and provide numerical examples of how international interdependencies impact mode configuration, and then extend the analysis by incorporating dynamic aspects.

1. Introduction

Firms' foreign entry mode choice is probably one of the most researched topics in international business (Brouthers & Hennart, 2007; Datta, Herrmann, & Rasheed, 2002; Malhotra, Agarwal, & Ulgado, 2003; Melin, 1992; Sarkar & Cavusgil, 1996). Drawing on the theory of foreign direct investment (FDI), the aim of which is to explain the existence and growth of multinational enterprises (e.g. Buckley & Casson, 1976; Hennart, 1982; Rugman, 1986), economists and international business researchers have developed comprehensive models to predict, for example, managers' choice between licensing arrangements and production subsidiaries, between joint ventures and wholly owned subsidiaries, or between exports and local production (see e.g. Dunning, 2001; Hennart, 1988a, 1988b; Hill, Hwang, & Kim, 1990; Hirsch, 1976; Horstmann & Markusen, 1987; Markusen, 1995, 2001). The models have enriched our understanding and predictive ability of foreign operation decisions and identified a large number of factors that potentially have an impact on such choices (Datta et al., 2002).

Yet, despite the considerable attention that researchers have devoted to this topic, it is debatable whether we have attained genuine normative implications as to how top managers in the MNC should make decisions about the foreign business operations of their companies. While we know a lot about the contingencies that are relevant to a given foreign

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operation mode (FOM) decision in a given country at a given point in time, the relevance of this knowledge may be compromised by two generally overlooked "meta-contingencies": (1) the *interdependencies* between foreign operation mode decisions across countries and over time, and (2) the *managerial capacity* of the MNC to make these decisions in a way that takes these interdependencies into account. This has profound implications for the way in which MNCs should ideally make decisions about foreign operation modes.

To draw out these implications explicitly we propose in this paper a systemic rather than a myopic view of foreign operation modes by modeling the foreign operation mode decisions of the firm as a corporate-level process. Our model builds on previous work by Buckley and Casson (1998) and Buckley and Hashai (2004), who have demonstrated how considering multiple countries in the same decision situation and allowing for multiple entry motives can enrich the analysis of foreign operation mode decisions. However, whereas their analyses were static and limited to three countries, we present a more general and dynamic framework that allows for an unlimited number of countries and time periods. The analysis leads to a view of various foreign operation modes as being elements of given foreign operation mode *configurations* of spatially and inter-temporally dispersed business activities.

The structure of the paper is as follows. Section 2 describes the background for the paper and motivates the need for a new conceptualization. Section 3 then presents a descriptive model of foreign operation mode, suggests performance ramifications, and analyses a hypothetical numerical example. Section 4 sketches out an extension of the framework by allowing for changes over time in a given configuration, and uses numerical examples to discuss dynamic configuration. Finally, Section 5 concludes and draws implications for further research.

2. Background

The bulk of research on foreign operation modes have more or less explicitly assumed that companies internationalize on the basis of market seeking rather than sourcing motives (Welch & Luostarinen, 1988, 1993). When market seeking is the main motive for venturing abroad, the individual foreign market may be an acceptable unit of analysis. This is especially so for companies pursuing so-called multi-domestic internationalization strategies, which entails treating foreign markets on a case-by-case basis (Bartlett, Ghoshal, & Beamish, 2008). However, once foreign operations are driven – partly or fully – by sourcing motives, such decisions can no longer be viewed in isolation, i.e. without taking into account their influence and dependence on the company's operations in other countries. A company whose global strategy requires tight coordination of spatially dispersed activities is a case in point for the need to take interdependencies into account when examining how companies organize their operations in various locations. In such cases, the corporation, not the foreign market, is the appropriate unit of analysis.

The temporal dimension has also been neglected in most existing research. Recent empirical work indicates that it is not uncommon that companies change the modes of already established foreign operations (Benito, Pedersen, & Petersen, 2005; Calof, 1993; Clark, Pugh, & Mallory, 1997; Kogut, 1983). Nevertheless, previous analyses of foreign operation modes have, with some notable exceptions (see Buckley & Casson, 1981), taken a static approach focusing only on the initial choices of locations and modes of entry into a market.

When the foreign operations of companies are characterized by strong interdependencies—across national borders and/or between various points in time—a discrete choice approach aimed at *ceteris paribus* predictions of such decisions is prone to give limited predictive and explanatory powers. Companies may not stick to one particular foreign operation mode, but instead employ a variety of them either at a given point in time and space or across such points. Taken together they constitute the operation mode configurations of particular companies. Models that allow for such interdependencies should be a useful starting point in order to improve our understanding of the complexities and dynamics of internationalization.

3. A model of foreign operation mode configuration

Assume that an international firm operates in I foreign countries. Formally, the foreign operation mode configuration of this firm at a given point in time t is defined as the vector $\mathbf{m} = [m_i]$, where $i = 1 \ldots I$ indexes the foreign countries in which the firm does business. Each element in this vector is a categorical variable describing which entry mode the firm utilizes in the given country. An example of a foreign operation mode configuration could be $\mathbf{m} \equiv (m_{DK}, m_{SE}, m_{UK}, m_{US}, m_{PRC}) = (W, S, E, L, J)$. This hypothetical company operates in five countries. The Danish company is a wholly owned manufacturing subsidiary (W), while the Swedish wholly owned sales subsidiary (S) imports and sells products from the Danish plant. There are no owned operations in the UK, but the firm exports to independent distributors there (E). The US is too distant a market to be supplied by Danish production, which is why the product is manufactured and sold by an independent licensee there (L). Finally, to gain access to the Chinese market the company is required to form a joint venture with a local firm (J).

The configuration vector shows that we can discuss the organization of foreign operation modes on two different levels of aggregation. The *country-level* configuration of activities is closest to the operation mode concept used in the extant international business literature. For example, the decision to license in the US market is a country-level decision. The *corporate level*, on the other hand, refers to the entire foreign operation mode configuration of the firm, as captured by the vector $\mathbf{m}$. Designing this vector encompasses all country-level decisions and requires consideration of interdependencies between countries.