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The influence of dissemination risks, strategic control and global management skills on firms' modal decision in host countries

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Abstract

This paper examines how firms' modal choice is influenced by their exposure to dissemination risks, need for strategic control and possession of global management skills. A probabilistic model is specified. The following hypotheses are incorporated in the model: the probability of choosing a more advanced entry, ceteris paribus, is a function of (1) the risk-adjusted expected net benefits of a firm's possession of certain types of intangible, transportable assets; (2) parent company attributes that necessitate control over its strategic resources overseas; and (3) possession of certain global resources that are specific to the firm such that their effective internalization calls for higher entry mode. The models are estimated using polychotomous regression analysis. Results generally confirm that size and possession of some knowledge-based, firm-specific strategic assets, are significantly related to advanced entry modes. They also confirm that firms opt for higher entry mode to gain control of competitive pricing in the foreign markets. © 2001 Elsevier Science Ltd. All rights reserved.

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1. Introduction

A common thread linking most of the traditional models of the internationalization process of firms is the depiction of the progressive involvement of firms while staying

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in the overseas markets. For instance, the "sequential" argument portrays an incremental pattern of internationalization in which firms go through an exporting phase to understand the market before switching first to market-seeking foreign direct investments (FDI) and then to cost-oriented investments (Vernon, 1983). An analogous view held by other researchers sees the firms' overseas activities as one involving a modal change, i.e., firms start with contractual modes such as exporting to licensing to gain valuable knowledge and resources in the markets and then upgraded to FDI modes such as joint ventures and wholly owned subsidiaries (Aharoni, 1966). Further, the Scandinavian "stages" model of market entry, proposed by the Uppsala School, suggested a step-by-step pattern of entry accompanied by an increasing scope of commitment to each market (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1977).

The traditional models, which thrived predominantly on the notion of FDI as an increasing commitment over time, are based on a static modeling of cost and benefits. This notion has now been increasingly challenged. There are many instances in which firms that have delayed entry to a later point in time may have accumulated their resources to the point where the use of lower entry modes is deemed inadequate in terms of risk-adjusted net benefits to justify an investment. While most of the past researches have concentrated on the escalating involvement of firms either through increasing their scale of operation within a particular mode or through a modal change, there is no study that could provide a satisfactory explanation as to why firms often forgo the lower modes and choose more advanced modes of entry modes in the first instance.

In this paper, we add to the literature by proposing a probabilistic framework that models firms' modal choice decision as an intrinsically dynamic process which considers the risks that firms face in the dissemination of their transportable assets, the extent of strategic control they are able to exert over their operations and the possession of applicable global resources. The first part of the paper describes the theoretical underpinning of the entry modes. Next, relevant literature and the hypotheses are discussed. Later, the methodology, analysis, and results are presented. Finally, some important implications of the research are explored.

2. Theoretical background

According to the resource-based theory, a firm may be viewed as a collection of productive resources (Penrose, 1959) that are worth more than their individual market values because of specialized linkages between them within the firm (Wernerfelt, 1984). In those instances where there are under-utilized productive resources, the firm can reap additional benefits by diversifying into new or overseas markets in order to exploit the "public goods" nature of its resources (Chatterjee & Wernerfelt, 1991). A firm's venture in foreign countries requires choosing the most appropriate mode of entry for organizing and conducting international business transactions (Anderson & Gatignon, 1986). This is a critical decision as it can potentially determine the firm's overseas business performance (Terpstra, 1987; Root, 1987). In