

## **New Trends in Foreign Market Entry Mode Choices: The Case of Italian Mid-Sized Companies**

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### **Abstract**

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As Italian SMEs increasingly expand their markets overseas, the internationalization processes evolve towards more complex market entry modes based on equity forms of international expansion and investment such as JVs and WOSs. Research on international high-control entry mode has tended to concentrate on large firms. In order to test the choice between equity and non-equity entry modes to the specific category of the mid-sized companies, the paper provides two main contributions: 1) it proposes an integration of three perspectives, transaction cost, institutional and resource-based theory; 2) it empirically verifies the applicability to the medium sized firms of the proposed framework.

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**Keywords:** internationalization, entry strategies, equity and non-equity modes, mid-sized companies

### **1. Introduction and Objectives**

The explosive growth of globalization over the past decades, mainly due to low-cost technology connecting people and locations, steady dismantling of trade barriers and financial deregulation and emerging new markets for investment, has become one of the prominent issues in business today.

Given the nature of today's marketplace, SMEs are increasingly facing similar international problems as those of larger companies.

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For several decades researchers have focused on the entry mode decision because it is critically important for firms expanding abroad. Substantive progress have been made in understanding of entry mode, as a field of study. In particular, a clear conceptual understanding of how to differentiate entry modes (e.g., Anderson & Gatignon, 1986; Hennart, 2009; Martin & Salomon, 2003), of what determines firm choices amongst various modes (Brouthers, 2002), and some insight into when one mode leads to better performance outcomes (e.g., Brouthers, 2002; Shaver, 1998).

By the late 1990s, the study of the determinants of entry mode choice was well advanced, and codified in many textbooks and articles. Two are the most exciting aspects of international business over the past 20 years (Brouthers, 2013): 1) investments in locations and industries that we had not before as consequence of the opening of economies that have increased the range and depth of foreign investment; 2) the emerging of a new category of firm, the small and mid-sized one, increasingly involved in international activities, irrespective of geographic proximity.

In order to shed light on factors that influence entry mode choice, we attempt to combine insights from three main perspectives: transaction cost theory, new institutional theory and resource based view. The starting point is that a single theory study tends to be incomplete in dealing with alternative explanations – something that is especially critical by dint of the multifaceted context and decision set for entry modes and other IB research (Martin, Swaminathan, & Tihanyi, 2007). Yet bringing multiple theories to bear also entails extra attention to the level (firm and country) at which each theory operates (Martin, 2013).

Research on international high-control entry mode has tended to concentrate on large firms. For this reason we want to test the applicability of one traditional topic of International Business research – the choice between equity and non-equity entry modes - to a specific firms category: the mid-sized one. Control is the focus of the entry mode literature because it is the single most important determinant of both risk and return. High-control modes such as JV and WOS can increase return and risk. Low-control modes (e.g. export, franchising, licenses and other contractual agreements) minimize resource commitment (hence risk) but often at the expense of returns (Andersen and Gatignon, 1986).

For several years in Italy mid-sized firms are recognized as autonomous category, different from the small and the large ones (Tunisini and Dalli, 2007), and are worthy of particular attention for the relevance they have acquired in the Italian industrial system (Mediobanca and Unioncamere, 2012; Confindustria, 2010). Because of their liveliness and good economic performances they are considered the pillar of the Italian manufacturing system, able to revitalize our industry (Alzona, 2007; Iacobucci and Spigarelli, 2007; Varaldo et al, 2009; Coltorti et al., 2013).

Besides, it was demonstrated a greater propensity to internationalization by the mid-sized firms compared to the small and large ones (Mariotti, Mutinelli, 2008). This category of firms is now considered the standard-bearer of Made in Italy in the global markets.

Motivated by these considerations, the present paper extends the earlier work of Resciniti and Matarazzo (2012) by undertaking the first efforts to in-depth analyze the entry mode determinants of some successful medium sized firms in order to understand what enables them to craft better international strategies.

The paper provides two main contributions: 1) it proposes an integration of three perspectives, transaction cost, institutional and resource-based theory; 2) it empirically verifies the applicability to the medium sized firms of the proposed framework.

## **2. Conceptual Framework**

Three theories form the building blocks for this study in order to explain why companies may choose equity or non-modes in the first place: transaction cost analysis (TCA), institutional theory (IT) and resource based view (RBV).

With regard to TCA (Williamson, 1985), scholars have found that when the transaction costs associated with finding, negotiating and monitoring a potential partner firm are high, firms tend to rely on hierarchical modes, such as wholly owned subsidiaries (e.g. Brouthers, 2002; Hennart, 1991; Gatignon and Anderson, 1988).

According to IT, many studies in literature have focused on the relationship between the institutional context and entry mode choices.

More recently, new institutional theory (NIT) has been adopted by some scholars (Yiu and Makino, 2002; North, 1990; Scott, 1995) suggesting that a country's institutional environment is made up of a set of three dimensions: regulatory, cognitive, and normative. Scholars argue that companies tend to be selective and prefer to enter through high control modes (WOS) more attractive, less risky and less legally restricted markets.

The RBV suggests that a firm's competitive advantage is a function of its valuable, rare, and inimitable resources (Barney, 1991). Some studies (Kogut and Zander, 1993; Arora and Fosfuri, 2000) have corroborated the expectation that the more imperfectly imitable the resources and capabilities are (tacit knowledge and embedded capabilities) the more firms favor equity modes (as opposed to non-equity ones, such as licensing and franchising)

Brouthers (2002) was a pioneering combination of insights from TCA and IT to explain performance. At the same time several other scholars were exploring similar issues. For example, Meyer (2001) looks at the level of institutional building in central and eastern European markets, transaction costs and their impact on mode choice. Delios and Beamish (1999) examine the impact of three aspects of the institutional environment, as well as experience and transaction costs and the connection with equity ownership level. Lu (2002) adds insights into the impact of institutional isomorphism to a transaction cost model theorizing how firms conform to environmental pressures, often mimicking the mode choices of others.

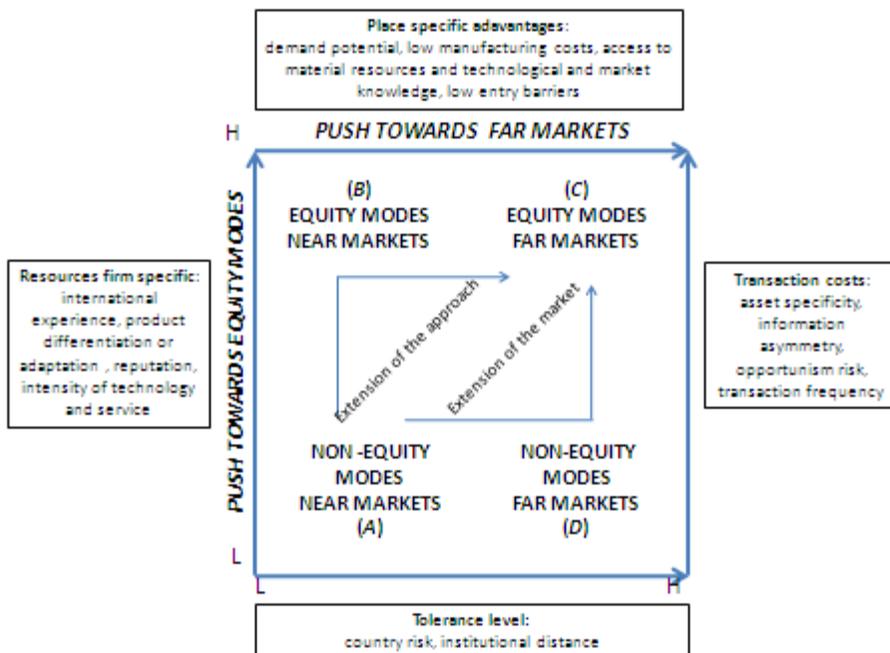
Despite several recent research continue to draw upon these perspectives (e.g., Abdi & Aulakh, 2012; Delmestri & Wezel, 2011; Huang, Rode, & Schroeder, 2011) a few studies looking at the RBV and mode choice in combination with other perspectives.

In this study, we are going to combine the three main literature perspectives mentioned above in an integrated model in order to understand whether mid-sized companies should use equity or non-equity entry modes to have strong performance in the foreign countries and the reason why the ones entry modes are better than the others or vice versa.

In line with this trend we provide the integration of the perspectives illustrated in the previous section in a unique framework in order to understand how each variable considered can affect the others.

The entry modes/markets matrix (fig. 1) correlates the main choices of entry strategies: why, where and how entering foreign markets (Matarazzo, 2012).

**Fig. 1: Entry Modes/Markets Matrix**



Source: our elaborations

It provides a reading key of the phenomenon through a double perspective:

- *static/synchronic*, aimed at enlightening the determinants of companies' entry modes;
- *dynamic/diachronic*, aimed at considering the phenomenon in its evolution.

In the first perspective the matrix can be able to describe the positioning of companies affected by the entry modes.

In the cell A the company adopts an embryonic model based on the choice of non-equity entry modes (exports and strategic arrangements) and markets characterized by proximity not only geographic, but also cultural and by the high level of risk.

The cell C indicates, by contrast, the more complex model of internationalization based either on the choice of equity modes (mainly JV and WOS) or of distant markets.

However especially the diachronic perspective is relevant because it allows to highlight how the various components connect and interact to each other in response to the evolution of the international context, causing a parallel evolution of the companies' entry strategies.

Therefore, in the diachronic perspective the model individuates two different pushes: towards equity (or non-equity) entry modes and towards the markets more (or less) distant geo-culturally, that is different.

These pushes induce company to extend the international approach and the geographical markets and to move from a cell to another of the matrix, each of them characterized, as just said, by a particular entry modes/markets combination. They are much stronger (in the sense that the company is more willing to support the increased commitment rather than in the case of non-equity modes and markets culturally closer) the more the intensity of the mentioned determinants.

The double extension of the approach and of the market converges in the cell C.

### **3. Methodology**

#### Aim of the Research

The aim of the current research is to extend our understanding of the characteristics associated with successful internationalizing companies by examining the extent to which mid-sized companies pattern of internationalization are common across industries.

Methodologically the nature of the questions suggests the use of a multiple case study methodology, because it suited to research questions such as “how” and “why”, although less suitable for such issues as “how often” and “how much” (Eisenhardt and Graebner, 2007). Given the complexity of the phenomenon examined, the use of the multiple case study method allow us to conduct a very deep and detailed analysis. Several scholars (Aspelund et al., 2007; Rialp et al., 2005) outlined that insightful application of the qualitative approach is warranted to advance the research field. They propose that to enhance relevant theory and help further explain firms internationalization, a qualitative approach should be used to assist in understanding the complexities associated with the internationalization processes of an individual firm.

### Sample

Utilizing this approach five Italian mid-sized companies were selected with each producing diverse product categories. The sampling frame is justified on the basis of the need for intensive study of internationalizing mid-sized firms in order to develop a theoretically rich understanding of the phenomenon. Prospective firms were investigated to ascertain whether they contained the characteristics associated with successful internationalizing firms consistent with the established literature:

- High performance and growing trend,
- Rising degree of internationalization and foreign turnover,
- Presence in different markets, developed and emerging ones.

Furthermore, the firms chosen were established in one of the Made in Italy three “F” sectors: Fashion (Kiton, Harmont&Blain and Silvian Heach), Food (Monini), Furniture (Gessi).

### Data Collection

We used three basic tools: documents, interviews and observation. The interviews, qualitative and open, were the primary source of information, and were undertaken with the founders, CEOs, as well as general and senior managers of each firm. Each interview was face-to-face and lasted for more than 1 hour.

In addition to the general characteristics of the selected firms, each interview was structured to explore a number of relevant issues including:

- The firm's internationalization objectives;
- Factors that motivated the choice of specific foreign markets;
- Factors that motivated the choice of specific entry modes.

In order to reduce the risk of bias and to take advantage of different perspectives and increase the wealth of information, a combined use of multiple secondary sources of information was utilized to allow for data triangulation (Fillis, 2004). Documents were mainly delivered by the companies analyzed, including quantitative data.

#### **4. Findings and Discussion**

A significant component of the research activity was directed towards establishing the extent to which firm and context specific factors influenced the entry mode choices of the selected firms inducing them to extend the international approach and/or the market. Andersen and Gatignon (1986) grouped the entry modes in terms of the amount of control (high, medium, low) an entrant gains over the activities of a foreign business entity.

According to them the measurement definitions we used are as follows (with the case examples):

*High extension:* with respect to the international approach, the firm selects high-control entry modes (WOS, JV) (e.g. Monini); with respect to the market, far markets have strong strategic relevance (e.g. Kiton);

*Moderate extension:* with respect to the international approach, the firm selects medium-control modes (licensing, franchising, other distribution agreements) (e.g. H&B); with respect to the market, far markets have medium strategic relevance (e.g. Gessi); *Low extension:* with regard to the international approach, the firm selects low-control modes (export, intensive distribution) (no examples); with regard to the market, far markets have low strategic relevance (no examples). The next section explains in detail the results of the research.

## Extension of the Market

The IT and the TCA suggest that firms tend to be selective and prefer to enter more attractive, less risky markets (i.e., culturally similar countries with stable economic, social and political conditions).

According to the RBV foreign entrants tend to select markets with local resources and capabilities important for enhancing their competitiveness.

For Kiton and H&B a *high market extension* occurs because emerging countries (especially, Asia and Middle East) are strategically relevant and expected to grow further in the coming years. In line with the IT, it is overall the market attractiveness that induces these companies to enter countries characterized by a very high institutional distance with respect to the country of origin.

According to the well-known trade off between risk and return, the expectations of abnormal performance associated to those markets cause an increase of companies' level of tolerance.

In line with RBV, in emerging economies networks and relationships with other firms, with agents in the distribution channels, and with government authorities are all important assets (Meyer et al., 2009).

As better explained in the following section, in fact, Kiton and H&B enter these markets through respectively equity (JVs) and non-equity agreement (master franchising).

Gessi and Silvian Heach, by contrast, have a *moderate market extension*, because the majority of foreign turnover and the highest foreign investments derive from near countries. According to RBV, Gessi chooses some European markets in order to enhance its technological and market competencies as well as the experience, given the high qualitative standard imposed by these countries stimulate the organizational learning and, consequently, the growth.

The special interest of Silvian Heach for the Spanish market depends on the much developed trading network and the high competences of the trading intermediaries.

## Extension of the International Approach

From the perspective of the TCA and RBV in the case of high asset specificity, imperfect imitability of resources and international experience firms tend to adopt equity modes (WOS and JVs) in order to limit opportunism risk of the partner and overcome the difficulties of transferring tacit knowledge and embedded capabilities.

The results are consistent with theoretical predictions (tab. 1). Kiton, Gessi and Monini have a *high extension of the international approach*, based on the choice of WOSs and, for Kiton and Gessi, on JVs. These companies found their success on rare, valuable and hard to imitate resources, on the tacit knowledge accumulated over time and transferred by generations. Besides they have a certain international experience: Kiton entered foreign markets in 1975, Monini at the end of 1980 and Gessi in 1992. Kiton and Gessi use sales WOS in various countries of Europe and USA, Monini in Poland, and in Australia has chosen a manufacturing WOS. According to RBV, the choice of extending the internationalization processes to manufacturing takes into account the great opportunity of exploiting the important local resources (huge arable land, reversal of the seasons in the southern hemisphere of the globe that allows to collect raw olives in April, greater proximity to Eastern countries).

For Silvan Heach and H&B a *moderate extension of the approach* occurs because of low asset specificity, imitability of resources and/or international inexperience.

H&B try to overcome its inexperience through channel partnerships (Master Franchising). Resource-based theory, in this case has a great explanatory power because it shows how intermediaries can support their clients through unique endowments of resources, mainly market knowledge, lowering transaction costs caused by inexperience and thus enhancing their own performance.

Furthermore even the other companies choosing equity modes shy away from WOSs and use JVs in emerging economies where the partner may provide the complementary resources of market and context knowledge they lack due to institutional distance and inexperience in managing high degrees of country risk and violent market dynamism ((Erramilli and D'Souza, 1995; Li and Qian, 2008).

**Tab 1: Growth Paths of the Case-Firms**

	<b>Gessi</b>	<b>H&amp;B</b>	<b>Kiton</b>	<b>Monini</b>	<b>Silvian Heach</b>
<b>Industry</b>	Furniture	Fashion	Fashion	Food	Fashion
<b>Core product</b>	Faucets	Luxury sportswear	Men suits	Oil	Women and kids clothes
<b>Extension of the market</b>	Moderate	High	High	Moderate	Moderate
<b>Relevant variables</b>	Development of technical competences	Market attractiveness	Market attractiveness	Market attractiveness	Exploitation of external resources
<b>Extension of the approach</b>	High	Moderate	High	High	Moderate
<b>Relevant variables</b>	High asset specificity, imperfect imitability of resources, international experience	Exploitation of intermediary resources, liability of smallness international inexperience	Asset specificity, imperfect imitability of resources, international experience	Asset specificity, imperfect imitability of resources, international experience	Low asset specificity, imitability of resources, international inexperience

Source: our elaboration

## 5. Limitations, Further Research and Managerial Implications

This study try to contribute to the advancement of theory on SMEs internationalization, thus stimulating the debate on the successful strategies of the mid-sized companies of “made in Italy”.

It is based on the analysis of a few number of cases and this is the typical limitation for this type of research. A future study focused on a greater number of different successful case studies might better illumine and provide strategists and decision-makers more vital information about entry strategies. Consequently, it would be of interest also to test through a quantitative research this integrated framework in order to understand which factors among asset specificity, valuable resources and institutional distance prevail in the choice of the entry strategy and the relationship with firm performance.

A further limitation is the retrospective trait of the research. Time perspective and lack of memory always make the retrospective research design problematic. In addition, it is difficult to separate consequences related to the specific entry mode choices from the consequences of other events occurring in the company.

Therefore, in order to enhance the obtained results, it would be useful to perform longitudinal research, i.e. observing the internationalization process in different points of time by coming back to the company from time to time and by personally pointing out the differences.

The case study findings reported in this study have implications for entrepreneurs and managers of mid-sized companies. They are reminded that even if the company is a traditional SME with limited international experience, it is able to go international and compete globally. The integrated framework suggests that in a situation of high asset specificity, imperfect imitability of resources and international experience firms should use equity modes (WOSs and JVs) accepting the associated risks. In order to minimize such risk and overcome the liabilities of smallness (limited resources, lack of internationalization knowledge, and sensitivity to external influences), they will facilitate the development of strong capabilities of partnership with other companies operating abroad, overall in emerging economies. In these contexts characterized by uncertainty and high institutional distance JVs are preferred to WOSs in order to exploit the complementary resources of market and context knowledge held by partners. Such relationships, if sustained, should improve a firm's foreign performance.

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