

In what follows, a proposition is formulated for each factor: how is each factor supposed to affect the choice of foreign entry mode? The direction of influence is also indicated both in the text and in Figure 9.1. Because of the complexity of the entry mode decision, the propositions are made under the condition of other factors being equal.

Internal factors

Firm size

Size is an indicator of the firm's resource availability; increasing resource availability provides the basis for increased international involvement over time. Although SMEs may desire a high level of control over international operations and wish to make heavy resource commitments to foreign markets, they are more likely to enter foreign markets using export modes because they do not have the resources necessary to achieve a high degree of control or to make these resource commitments. Export entry modes (market modes), with their lower resource commitment, may therefore be more suitable for SMEs. As the firm grows, it will increasingly use the hierarchical model.

International experience

Another firm-specific factor influencing mode choice is the international experience of managers and thus of the firm. Experience, which refers to the extent to which a firm has been involved in operating internationally, can be gained from operating either in a particular country or in the general international environment. International experience reduces the cost and uncertainty of serving a market, and in turn increases the probability of firms committing resources to foreign markets, which favours direct investment in the form of wholly owned subsidiaries (hierarchical modes).

A high degree of international experience reinforces the use of an already preferred entry mode in subsequent entry decisions (Swoboda *et al.*, 2015). Once a firm has had success with a particular entry mode, it will to use the same entry mode in new markets, but there may also be a tendency to be less risk-averse with greater international experience, which could result in using higher-control modes in subsequent entry decisions.

Dow and Larimo (2009) conclude from their survey that practitioners should be aware that not all forms of experience are equal. International experience from similar countries (with low perceived psychic distance) is positively associated with the choice of a high control entry mode (i.e. entry by wholly owned subsidiary). This indicates that exploiting each geographic region in succession may be advisable, instead of 'jumping' from region to region. This would maximize the benefits of within-cluster experience.

In developing their theory of internationalization, Johanson and Vahlne (1977) assert that uncertainty in international markets is reduced through actual operations in foreign markets (experiential knowledge) rather than through the acquisition of objective knowledge. They suggest that it is direct experience with international markets that increases the likelihood of committing extra resources to foreign markets.

Product/service

The physical characteristics of the product or service, such as its value/weight ratio, perishability and composition, are important in determining where production is located. Products with high value/weight ratios, such as expensive watches, are typically used for direct exporting, especially where there are significant production economies of scale, or if management wishes to retain control over production. Conversely, in the soft drinks and beer industry, companies typically establish licensing agreements, or invest in local bottling or production facilities, because shipment costs, particularly to distant markets, are prohibitive.

The nature of the product affects entry mode selection because products vary so widely in their characteristics and use, and because the selling job may also vary markedly. For instance, the technical nature of a product (high complexity) may require service both before and after sale. In many foreign market areas, marketing intermediaries may not be able to handle such work. Instead firms will use one of the hierarchical modes.

Blomstermo *et al.* (2006) distinguish between *hard* and *soft services*. Hard services are those where production and consumption can be decoupled. For example, software services can be transferred to a CD, or some other tangible medium, which can be mass-produced, making standardization possible. With soft services, where production and consumption occur simultaneously, the customer acts as a co-producer and decoupling is not viable. The soft-service provider must be present abroad from their first day of foreign operations. Blomstermo *et al.* (2006) conclude that there are significant differences between hard- and soft-service suppliers regarding choice of foreign market entry mode. Managers in soft services are much more likely to choose a high control entry mode (hierarchical mode) than those in hard services. It is important for soft-service suppliers to interact with their foreign customers, and thus they should opt for a high degree of control, enabling them to monitor the co-production of the services.

Products distinguished by physical variations, brand name, advertising and after-sales service (e.g. warranties, repair and replacement policies) that promote preference for one product over another may allow a firm to absorb the higher costs of being in a foreign market. Product differentiation advantages give firms a certain amount of impulse in raising prices to exceed costs by more than normal profits (quasi-rent). They also allow firms to limit competition through the development of entry barriers, which are fundamental in the competitive strategy of the firm, as well as serving customer needs better and thereby strengthening the competitive position of the firm compared to other firms. Because these product differentiation advantages represent a 'natural monopoly', firms seek to protect their competitive advantages from dissemination through the use of hierarchical modes of entry. For example, Lu *et al.* (2011) emphasize the importance for a fashion retailer to select a higher control entry mode to ensure a successful transfer of its special assets and brand equity across borders, which are important considerations in a fashion brand's international expansion decision.

External factors

Sociocultural distance between home country and host country

Socioculturally similar countries are those that have similar business and industrial practices, a common or similar language, and comparable educational levels and cultural characteristics. Sociocultural differences between a firm's home country and its host country can create internal uncertainty for the firm, which influences the mode of entry desired by that firm.

The greater the perceived distance between the home and host country in terms of culture, economic systems and business practices, the more likely it is that the firm will shy away from direct investment in favour of joint venture agreements or even low-risk entry modes like agents or an importer. This is because the latter institutional modes enhance firms' flexibility to withdraw from the host market, should they be unable to acclimatize themselves to the unfamiliar setting. To summarize, other things being equal, when the perceived distance between the home and host country is great, firms will favour entry modes that involve relatively low resource commitments and high flexibility. Dow and Larimo (2009) found that the perceived cultural distance (psychic distance) is much more than Hofstede's cultural dimensions. Psychic distance is relevant not only on the country but also at the managerial levels. In particular, language difference seems to be one of the least important factors. Other issues, such as differences in religion, degree of democracy,

industrial development and so on, have a much greater impact on the management's entry mode choice.

Country risk/demand uncertainty

Foreign markets are usually perceived as riskier than the domestic market. The amount of risk the firm faces is a function not only of the market itself but also of its method of involvement there. In addition to its investment, the firm risks inventories and receivables. When planning its method of entry, the firm must do a risk analysis of both the market and its method of entry. Exchange rate risk is another variable. Moreover, risks are not only economic; there are also political risks.

When country risk is high, a firm would do well to limit its exposure to such risk by restricting its resource commitments in that particular national domain. That is, other things being equal, when country risk is high, firms will favour entry modes that involve relatively low resource commitments (export modes).

Unpredictability in the political and economic environment of the host market increases the perceived risk and demand uncertainty experienced by the firm. This, in turn, makes firms less inclined to enter the market with entry modes requiring heavy resource commitments; on the other hand, flexibility is highly desired (Lu *et al.*, 2011).

Market size and growth

Country size and rate of market growth are key parameters in determining the mode of entry. The larger the country and the size of its market, and the higher the growth rate, the more likely management will be to commit resources to its development, and to consider establishing a wholly owned sales subsidiary or to participate in a majority-owned joint venture. Retaining control over operations provides management with direct contact and allows it to plan and direct market development more effectively.

Small markets, on the other hand, especially if they are geographically isolated and cannot be serviced efficiently from a neighbouring country, may not warrant significant attention or resources. Consequently, they may be best supplied via exporting or a licensing agreement. While unlikely to stimulate market development or maximize market penetration, this approach enables the firm to enter the market with minimal resource commitment, and frees resources for potentially more lucrative markets.

Direct and indirect trade barriers

Tariffs or quotas on the import of foreign goods and components favour the establishment of local production or assembly operations (hierarchical modes).

Product or trade regulations and standards, as well as preferences for local suppliers, also have an impact on mode of entry and operation decisions. Preferences for local suppliers, or tendencies to 'buy national', often encourage a company to consider a joint venture or other contractual arrangements with a local company (intermediate modes). The local partner helps in developing local contacts, negotiating sales and establishing distribution channels, as well as in diffusing the foreign image.

Similarly, product and trade regulations and customs formalities encourage modes involving local companies, which can provide information about and contacts in local markets and can ease access. In some instances, where product regulations and standards necessitate significant adaptation and modification, the firm may establish local production, assembly or finishing facilities (hierarchical modes).

The net impact of both direct and indirect trade barriers is thus likely to be a shift towards performing various functions, such as sourcing, production and developing marketing tactics in the local market.

Intensity of competition

When the intensity of competition is high in a host market, firms will do well to avoid internalization, as such markets tend to be less profitable and therefore do not justify heavy resource commitments. Hence, other things being equal, the greater the intensity of competition in the host market, the more the firm will favour entry modes (export modes) that involve low resource commitments.

Small number of relevant intermediaries available

Highly concentrated markets lead to ‘small number bargaining’, which may be executed by the few export intermediaries if they realize that they are in a kind of ‘monopolistic situation’. In such a case, the market field is subject to the opportunistic behaviour of the few export intermediaries, and this will favour the use of hierarchical modes in order to reduce the scope for opportunistic behaviour.