



Foreign market entry mode choice of small and medium-sized enterprises: A systematic review and future research agenda



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ABSTRACT

Despite significant differences between small and medium-sized enterprises (SMEs) and large multinational enterprises (MNEs), the majority of extant foreign market entry mode choice literature has focused on MNEs. The current state of knowledge regarding SME foreign market entry mode choice is equivocal. The present paper reviews the current state of SME foreign market entry mode choice literature and maps future research directions. To this end, we systematically analyze 33 relevant journal articles for their theoretical frameworks and contextual dimensions. Based on this review, we identify gaps in the literature and develop an agenda to guide future scholarship in this important domain of research in taking SME-specific characteristics into consideration.

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1. Introduction

Internationalizing companies have to find a suitable organizational structure in order to manage foreign activities effectively when they enter foreign markets (Anderson & Gatignon, 1986). Firms can choose among several modes of foreign market entry, including exporting, contractual agreements (e.g., licensing), joint venturing, acquiring an existing company, and establishing a wholly-owned greenfield investment from scratch (Pan & Tse, 2000). The choice of a suitable foreign market entry mode is an important strategic decision (Lu, 2002). Foreign market entry mode choice determines the firm's degree of *resource commitment* to the foreign market (Hill, Hwang, & Kim, 1990), the *risks* the firm will bear in the host country (Hill et al., 1990; Hill & Kim, 1988), and the level of *control* a firm can exercise over its foreign activities (Anderson & Gatignon, 1986). Changing an initially chosen entry mode can be costly and time-consuming (Kumar & Subramaniam, 1997), so the wrong entry mode can negatively impact the firm's performance (Lu & Beamish, 2001; Nakos & Brouthers, 2002).

Small and medium-sized enterprises (SMEs), as opposed to large multinational enterprises (MNEs), have *specific characteristics* that are likely to influence their foreign market entry mode choice in terms of the level of commitment to the foreign market, how

they deal with risks in the host country, and the controllability of foreign market activities. Among these characteristics are SMEs' *limited financial and personnel resources* (Brouthers & Nakos, 2004; Nakos & Brouthers, 2002). Resource constraints can limit SMEs' ability to *commit* strongly to a foreign market by choosing high-commitment foreign market entry modes like full acquisitions (Ripollés, Blesa, & Monferrer, 2012). Research has also shown that SMEs have a high level of *sensitivity to external influences* (Cheng & Yu, 2008; Erramilli & D'Souza, 1995), making it particularly important that SMEs find an entry mode that allows them to deal effectively with the *risks* that arise in the host country. SMEs also differ from large MNEs in terms of their *ownership structure and management characteristics* (Cheng, 2008; Pinho, 2007), as many SMEs are family-owned and/or owner-managed. Therefore, their choice of entry mode may differ (from that of large MNEs), as family-owned firms are often less willing to share *control* with a partner (e.g., in an equity joint venture) (Fernández & Nieto, 2006).

Adhering to the specific characteristics of SMEs, scholars posited that SMEs are less prone to choose higher-commitment entry modes (Zacharakis, 1997). However, literature has also shown that some SMEs – in particular those with prior international experience – have the ability to opt for higher-commitment entry modes such as acquisitions (e.g., Brouthers & Nakos, 2004; Maekelburger, Schwens, & Kabst, 2012). To date, knowledge about the critical decision how SMEs enter foreign markets is limited, at least in part because research in this area on SMEs is far more restricted than are studies that investigate large MNEs (e.g., Agarwal & Ramaswami, 1992; Anderson & Gatignon, 1986; Brouthers & Hennart, 2007). This limitation is problematic,

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as knowledge obtained in the context of large MNEs cannot simply be transferred to the SME context (Shuman & Seeger, 1986). As early as 1996, Brouthers et al. contended that entry mode studies concentrated on large MNEs and ignored the activities of smaller firms. An increasing trend toward internationalization among SMEs has caused scholars to repeat the call for more research in the context of SMEs (Burgel & Murray, 2000; Jones, 1999; Zacharakis, 1997).

The current state of knowledge about SME foreign market entry mode choice is equivocal. Two deficits in the research in particular inform the present research: First, the field is unclear regarding theoretical development. While studies that draw on *theoretical frameworks* to explain SME foreign market entry mode choice are overall limited, studies that do draw on theory largely apply the same theories that have been used to explain large MNE entry mode choice. The generalizability of theory is important, but given the characteristics of SMEs (e.g., limited resources, sensitivity to external influences), it is important to reflect on the boundary conditions of existing theory and to examine potential sources of variation (Maekelburger et al., 2012). The second deficit in the research that has particularly informed the present research is the lack of clarity in current knowledge regarding the *contextual dimensions* that have been studied. Studies have focused on various home and host markets and industries, studied different dimensions of psychic distance, and concentrated on firms with various ages. However, existing knowledge concerning the degree to which the studies' designs allowed the researcher to delve deeply into the SME-specific characteristics is unclear.

The aim of the present paper is to review the current state of SME foreign market entry mode choice research and, based on this review, to identify gaps in the literature in order to map productive future research directions. More specifically, we examine the current state of the research in terms of theoretical frameworks used and contextual dimensions studied. Based on our review, we identify gaps in the literature by examining the extent to which the characteristics of SMEs (i.e., lack of resources, sensitivity to external influences, ownership structure and management characteristics) have been considered in SME entry mode research. We focus on these characteristics, as they directly impact an SME's ability to commit to the host country market, to deal with risks abroad, and to maintain control over the foreign activities. All these characteristics represent key aspects of firms' decisions regarding how to enter foreign markets. Based on the gaps we identify, we develop a roadmap for future research to fill these gaps that follows the structure of the SME-specific characteristics. Thus, our roadmap for future research is specifically tailored to the SME context.

We contribute to the literature by reviewing and assessing the current state of research on SME foreign market entry mode and by delineating an outlook for future research. Most existing reviews focus on large MNEs (e.g., Brouthers & Hennart, 2007; Canabal & White, 2008; Morschett, Schramm-Klein, & Swoboda, 2010; Slangen & Hennart, 2007) and give limited consideration to SMEs. However, given the SME-specific characteristics, which are pertinent to decisions firms make about their entry mode, it is important to focus on this type of firm. Hence, we do not "focus on sample setting – for the sake of sample setting" (Shaver, 2013, p. 25); instead, we focus on SMEs in order to enhance existing knowledge beyond what we know about large MNEs and to inform the overall domain of entry mode choice for future theoretical development and contextualization. The laudable review by Coviello and McAuley (1999) was published almost 15 years ago and focuses on general internationalization issues of the smaller firm (including a few topics related to entry mode). We update this effort by conducting an inventory of the state of the art of the literature on SME foreign market entry mode choice and make

specific suggestions for the development of this literature going forward.

We proceed as follows: the next section provides the background literature and is followed by a description of our methodology. Then we review the current state, as reflected by 33 selected articles on SME foreign market entry mode choice and identify gaps in this literature. Based on our review, we develop a roadmap for future research. The paper closes by addressing limitations and some concluding remarks.

2. Background literature

2.1. Commitment, risk, and control in foreign market entry mode choice

Foreign market entry mode choice determines the level of resource commitment, risk, and control a firm undertakes in its foreign market activities (Anderson & Gatignon, 1986; Hill et al., 1990). That is, some entry modes require a large commitment of resources to the host country, while others allow resource commitments to be shared among partners. For example, establishing a wholly-owned foreign greenfield investment from scratch requires a high level of resource commitment, as the internationalizing firm has to shoulder all of the costs of establishing a new firm and serving the foreign market (Hill et al., 1990). However, contractual agreements like licensing limit a firm's resource commitment to monitoring the personnel in their new work environment (Hill et al., 1990). The level of resource commitment required in a joint venture lies somewhere between these two extremes, depending on the type of joint venture (i.e., minority, majority, or equity joint venture) (Hill et al., 1990).

Inseparably connected with the resource commitment, foreign market entry mode choice determines the level of risk to which the firm is exposed in the international setting (Hill et al., 1990; Hill & Kim, 1988). The more resources the firm commits, the greater the risk of losing valuable resources if the foreign market engagement fails. For example, a firm that undertakes a costly greenfield investment in the host country has a greater risk of losing significant resources than does a firm that establishes a licensing agreement with a partner in the same host country. On the other hand, a high-commitment mode (such as the establishment of a wholly-owned subsidiary) can reduce the risk of unintended knowledge diffusion (of, for example, a firm-specific technology). The propensity of such diffusion is much more likely when a partner is involved (e.g., in a franchising agreement or joint venture).

Entry modes also involve varying levels of control over foreign market activities (Agarwal & Ramaswami, 1992; Anderson & Gatignon, 1986; Hill et al., 1990), as control is determined by the firm's level of responsibility for operational and strategic decision-making in the foreign market (Anderson & Gatignon, 1986). For example, when acquiring a host country firm, a firm may delegate certain strategic decisions to the foreign subsidiary, but the acquirer maintains overall control (Hill et al., 1990). In the case of contractual agreements, control can be achieved by means of contract enforcement but only to the extent to which hazards are contractually safeguarded a priori. The danger of ex post opportunistic behavior limits the firm's control in contractual agreements. The level of control in a joint venture lies between that of contractual agreement and acquisition and is contingent on the type of ownership and the number of parties involved, although control must be shared with venture partners in any case (Hill et al., 1990).

Overall, the SME literature operationalizes foreign market entry mode choice by adhering to the commitment, risk, and control dimensions. However, researchers measure foreign market entry

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