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Strategic group influence on entry mode choices in foreign markets

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ABSTRACT

This study examines imitation behavior in the foreign entry mode of the members of a strategic group within the industry. Following the institutionalist perspective, we argue that legitimating actors (trade associations, training institutions and investors, among others) can exert pressure on strategic group members to conform to institutionalized organizational practices and structures. We hypothesize that a company's choice of foreign entry mode is determined by the previous choices of other companies within the strategic reference group. Thus, the probability of entry with a wholly owned subsidiary (versus shared-control entry) increases when the number of wholly-owned subsidiaries established by companies within the strategic reference group of the home-country is higher. We analyze 351 foreign direct investments of 30 Spanish banks in 55 countries between 1986 and 2008. Our results reveal imitation behavior between members of the strategic group and highlight the important role of the strategic group in strategic thinking.

1. Introduction

In recent decades, researchers have made substantial progress in understanding how current choices of foreign entry mode are influenced by past choices of the company and of other companies (see Ang, Benischke, & Doh, 2015; Chan & Makino, 2007; Guillén, 2003; Lu, 2002; Pabmanabhan & Cho, 1999; Shaver, 2013; Vermeulen & Barkema, 2001; Yiu & Makino, 2002). Basically, companies imitate their previous actions or those of their peers to achieve intra-company or external legitimacy (Hennart & Slangen, 2015). This imitation behavior to obtain legitimacy is supported through institutional theory (see DiMaggio & Powell, 1983) in that companies in uncertain situations opt to conform to institutional pressures, imitating prevalent organizational practices and the structures of other successful companies for their legitimation.

By focusing on external legitimacy, previous works have used the density or number of other companies' entries from the same home country or home-country industry as a proxy for mimetic entry. An interesting question that has emerged is whether legitimating actors in the host country (i.e., groups of suppliers, unions and national business associations, as well as the government, which imposes legal restrictions [see Lecraw, 1984; Westney, 1993]) always take other firms from the same home country as their reference (Chan & Makino, 2007). We extend existing research by considering companies of the strategic groups as another level of reference.

Strategic groups are viewed by industrial organization economics as persistent structural features of industries bounded by mobility barriers, which serve to limit entry into the group by preventing imitation (Caves & Porter, 1977; Porter, 1979). Group members recognize their mutual dependence and cooperate, or tacitly collude. These group structures, defined as a set of companies within an industry that pursue similar strategies (Porter, 1979), are also considered relevant by strategic management due to their effect on strategic actions and the companies' performance (Peteraf, 1993). In addition, the institutional approach supports strategic group theory, arguing that member companies within a group benefit from legitimacy by conforming to strategic recipes (Chen & Hambrick, 1995; McNamara, Deephouse, & Luce, 2003). However, the institutional approach does not consider imitation in the foreign entry mode of the strategic group members; for this reason, existing studies have only provided a partial description of imitation patterns of group members. We hypothesize that the specific entry mode of a company into a foreign country is linked to an elevated number of such specific entries that have been established by other companies in the strategic reference group from the same home country. Following the institutionalist perspective, we argue that companies within a strategic group act as a benchmark that assists legitimating actors in making judgments about the legitimacy of a focal firm. Legitimating actors evaluate a firm's behavior by comparing it to that of other firms belonging to the same strategic group. The legitimacy of a focal firm hinges on whether the focal firm conforms to the behavior of its fellow group members. Legitimating actors can exert pressure on such strategic groups to conform to institutionalized organizational practices and structures, and we examine how the company's decision on its subsidiary ownership structure is influenced by the

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decisions of other companies belonging to the strategic reference group.

Imitation behavior and experience have been used conjointly in both the institutional approach (e.g., Lu, 2002) and transaction-cost theory (see Yiu & Makino, 2002) to explain foreign entry mode. Thus, it is also important to examine the influence of the company's experience in the host country within the relationship assumed above. Basically, a company's low experience level in the host country generates uncertainty, which could increase mimetic behavior (Lu, 2002). We extend this reasoning by assuming that experience in the host country moderates imitation in the foreign entry mode of the strategic group members.

The research objective of this paper is to analyze how a company's current choices of foreign entry mode are determined by previous choices made by other companies of the strategic reference group, as well as considering the moderating role of the company's experience in the host country. We study 351 foreign direct investments (FDIs) of 30 Spanish banking firms in 55 countries between 1986 and 2008. Strategic groups are defined through an analysis of the history of the industry (see "Research methodology" section), which is one of the more widely accepted approaches to explaining the configuration of strategic groups (Peteraf, 1993; Porter, 1979). Our study reveals imitative behavior among the members of the strategic group, as described in our hypothesis.

2. Strategic groups in the international competitive space

A strategic group is a dimension of an industry's structure that has been inspired by both strategic management and industrial organization theories, and that is relevant in explaining diverse aspects of competitive strategy, such as available competitive positions within the industry (Cool & Schendel, 1987; Fiegenbaum & Thomas, 1990), the competitive interactions between firms (Cool & Dierickx, 1993; Peteraf, 1993; Smith, Grimm, & Wally, 1997), and the intra-industry performance (Caves & Porter, 1977; Fiegenbaum & Thomas, 1990), among others. Research was originally restricted to competition within national boundaries (Thomas & Venkatraman, 1988). However, the increased internationalization of inter-firm rivalry has led to research being orientated towards international markets. That is, if international expansion has associated difficulties and is not an attractive or feasible option for all the companies in an industry, then it is probable that two different strategic groups appear; one domestically orientated and the other internationally orientated (Mascarenhas, 1989).

The home country can be a relevant characteristic of strategic groups when geographical distance plays an important role in the group's formation, even when competition is becoming increasingly international (Duysters & Hagedoorn, 1995). This idea has led some works to identify strategic groups of companies in their home country (see Lee & Yang, 1990; Namiki, 1988; Morrison & Roth, 1992; Wood & Robertson, 1997). In situations where geographical distance does not play an important role in the group formation, or if the specific nature of the country only plays a restricted role, the strategic group formation would have to be considered from a global perspective (Duysters & Hagedoorn, 1995); for example, in the international off-shore drilling industry (Mascarenhas & Aaker, 1989), the automobile industry (Nohria & García-Pont, 1991) and high-tech industries (Duysters & Hagedoorn, 1995).

Finally, strategic groups have been identified in specific markets or host countries to explain entry strategy (Bogner, Tomas, & McGee, 1996; Dowling & Ruefli, 1992; Jarillo & Martinez, 1990; McGee & Thomas, 1994; Pehrsson, 1990; Ramsler, 1982; Tallman, 1991), as well as the reactions or strategic characteristics of domestic companies in response to the new entrants (De Bondt, Sleuwaegen, & Veugelers, 1988; Kumar, 1990; Vachani, 1990). By focusing on one specific element of entry strategy—foreign entry mode—, Tallman (1991) suggests that foreign direct investment would be principally used by strategic groups of large companies, because this entry mode implies more resources than exports. However, previous literature has paid little attention to imitation behavior in the foreign entry mode used by the members of a strategic group.

Our work is focused on strategic groups of a home country because geographical distance plays an important role in group formation (see "Research methodology" section). Previous studies (e.g., Chen & Hambrick, 1995) have followed institutional theory to suggest that group members are legitimated by conforming to strategic recipes. Accordingly, we extend this research by arguing that legitimating actors in the host country can take other strategic groups' firms from the same home country as their reference. The focus on foreign subsidiaries previously established by companies from the same home country is explained based on the fact that previous evidence has indicated that foreign companies pay more attention to the behavior of other companies of the same home country, than to that of companies from other countries (Chan & Makino, 2007; Shaver, Mitchell, & Yeung, 1997). We analyze the relationship between a company's decision with regards to the ownership structure of the subsidiary in the host country, and previous decisions in the host country of other companies in the same strategic group from the same home country.

3. Imitation behavior in foreign entry mode

The central premise of the institutional theory (see DiMaggio & Powell, 1983) is that organizations adopt structures and practices that are isomorphic to those of other organizations, as a result of their search for legitimacy (Yiu & Makino, 2002). Factors that generate isomorphic pressures are regulative (rules and laws that exist to ensure stability and order in societies), normative (domain of social values, cultures, and norms), and cognitive[1] (cognitive structures established in society that are taken for granted) pillars of the institutional environment (Scott, 1995). Thus, organizations choose a particular form of structure and practice because in doing so they receive regulative and normative approbation or because it is taken for granted that doing so is the proper way to organize. In particular, we focus on the third pillar of the institutional environment, cognitive institutions, because we consider that companies choose an organizational structure—for example, the foreign entry mode (wholly owned subsidiaries versus shared-control entries)—that has been most frequently adopted in the past as a taken-for-granted organizational practice, which will assist in obtaining legitimacy in, and conforming to, the host-country environment.

Several researchers (e.g., Ang et al., 2015; Chan & Makino, 2007; Guillén, 2003; Lu, 2002; Yiu & Makino, 2002) have used institutional theory to explain imitation in the mode of foreign entry. These researchers analyzed the interdependency between previous and current choices of foreign entry mode and distinguished the levels of institutional environment within the country and industry. The idea is that when local actors evaluate the legitimacy of a foreign subsidiary, they refer to the legitimacy of others (external legitimacy) that belong to the same cognitive category, whether they are from the same home country or from the same industry (i.e., organizational field) (Yiu & Makino, 2002).

At a country level, and to capture the magnitude of the legitimacy of foreign entry mode from the legitimating actors' perspective, Lu (2002), Yiu and Makino (2002), and Chan and Makino (2007) consider that multinationals refer to the entry mode in the host country by other multinationals of the same home country. The external pressure to conform leads multinationals to pursue a mimetic behavior by choosing the mode of entry and stakeholder structure that is most widely adopted by competitors from the same home country.

With respect to industry, following the industry norm not only

[1] These factors correspond to the mechanisms of mimetic, normative and coercive isomorphism through which institutional isomorphism is manifested (Ang et al., 2015), initially identified by DiMaggio and Powell (1983).