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# MARKET ENTRY MODE CHOICE: THEORY AND PRACTICE. COMPARING CHINA AND BRAZIL CASES

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Internationalization and foreign market entry mode choice have been the focus and priority of most companies, which have understood that this has become the driving force of the business world ruled by the laws of globalization. If at the beginning of the century internationalization and outsourcing have been a prerogative for big companies, primarily for American or European ones, then nowadays it has become a worldwide process pioneered by SMEs. If before SMEs were considered being in untenable position due to their limited resources,[1] today the number of them operating in international markets has increased.[2] Consequently, the internationalization process has drawn the attention of the academic world. However, the main focus of research has been put on the decision-making process of international market and market entry mode selection.

Foreign market entry strategies combine the processes of choosing a target market (country), entry mode, marketing plan and control system. Market selection process is a decision process which involves narrowing down from a considered set of markets for entry,[3] while market entry mode selection can be defined as a process of narrowing down from a set of market entry methods. The decision on a foreign market entry mode is crucial for the company's success. The international entry mode research has started with the early studies of Stopford and Wells (1972).[4] The early studies examine the type of entry modes used for internationalization, but no particular theoretical explanation was developed. In the 1980s and 1990s the first theoretical frameworks were expounded. However, in the past 15 years the question of internalization and especially the process of foreign market entry mode selection has gained momentum. For the purpose of market entry mode selection the research has identified major paradigms, which take into consideration different factors and aspects to help a firm choose a market entry mode that best suits them. The most common theories adopted are as follows: the transaction-cost analysis theory, the resource-based theory, the institutional theory, and Dunning's eclectic theory. Additionally, Johanson U-model,[5] Perlmutter EPG model[6] and Adam Koch internal and external factors have been considered. Based on the analysed theories an entry mode framework has been developed

1 Jansson, Hans; Sandberg, Susanne. Internationalization of Small and Medium Sized Enterprises in the Baltic Sea Region // *Journal of International Management,* 2008, No.14(1), pp. 65-77.

2 Musso, Fabio; Francioni, Barbara. International Strategy for SMEs: Criteria for Foreign Markets and Entry Modes Selection // *Journal of Small Business and Enterprise Development,* 2014, No.21(2), pp. 301-312.

3 Buerki, Thomas; Nandialath, Anup M.; Mohan, Ramesh; Lizardi, Stephani. International Market Selection Criteria for Emerging Markets, 2014, pp. 7-41.

4 Brouthers, Keith D.; Hennart, Jean-Franзois. Boundaries of the Firm: Insights From International Entry Mode Research // J*ournal of Management,* 2007, No. 33(3), pp. 395-425.

5 Johanson, Jan; Vahlne, Jan-Erik. The Internationalization Process of the Firm – A Model of Knowledge Development and Increasing Foreign Market Commitments // *Journal of International Business Studies,* 1977, No. 8(1), pp. 23-32.

6 Perlmutter, H. V. The Tortuous Evolution of the Multinational Corporation // *Columbia Journal of World Business*, 1969, No. 1, pp. 9-18.

taking into consideration the specificity of the company and industry it operates in.

The main issue discovered was the lack of differentiation between theories used for manufacturing and service companies. The common perception noticed indicates that the theories are universal and applicable to any company with no regard to the type of their business. However, some studies recognize the need for differentiation between manufacturing and service firms, but no framework for analysis is explored.

The purpose of this current paper is to analyse and compare a theoretical-based market entry mode selection model with the market entry mode selection model created and used by a service company with a worldwide presence. This study combines the most common theories and approaches for market entry mode selection in order to develop a theory-based framework, which furthermore is compared to the firm's working theory. The analysis is based on two markets, where the company already operates. This method of analysis identifies the crossing points as well as the controversial aspects of both frameworks. This way the study tests how effective and applicable are traditional theories to such a niche market service company. On the other hand by comparing the company's entry mode selection model with the theory- based model the study identifies the imperfections of company's theory and makes a series of recommendations for its improvement. The study used a number of interviews with the company's officials to better understand the logic and rational behind their market entry mode selection model and why it differs from traditional theories.

## LITERATURE REVIEW AND RESEARCH METHODOLOGY

The key issue of the study was to find appropriate theories for developing an entry mode framework, which would be applicable to a niche market service company. The research has approached the question of the theoretical aspect from two angles – internally and externally.

When looking at a market entry mode selection externally, the most common theories can be divided into three categories. The first group includes classification theories, which identify the type of the analysed company, namely, Perlmutter's EPG model, and institutional theory. The second includes resource-based theoriea, which look at the company's core capabilities and competitive advantages in the market, namely, Dunning's eclectic theory. The third includes market-based theories, which examine the market and discover the most suitable entry mode according to its characteristics, namely, Johanson U-model.

Among the company classification theories the most important one is the Perlmutter's EPG model. In "The Tortuous Evolution of the Multinational Corporation" Howard Perlmutter develops a framework for a multinational company to better understand its strategic profile. According to Perlmutter, companies can be ethnocentric, polycentric and geocentric. Later the model was extended by a fourth dimension – the regiocentric. The ethnocentric attitude implicates the dominant position of the headquarters over the subsidiaries. All the managers and decisions come from the home office, which is superior to all its subsidiaries. The companies with polycentric view come to understanding that the host country is different from the foreign market and they need the locals in order to understand the business atmosphere better. The holding piece in this type of companies is the financial control. Firms with a geocentric orientation do not recognise the view that superiority comes with nationality. They employ the best men regardless of their nationality. The subsidiary contributes to the headquarters in terms of innovation, know-how and new skills. The ultimate goal of companies with such attitude is a worldwide approach in both headquarters and subsidiaries fulfilled with the help of collaborative technique. Depending on the company's orientation it has specific characteristics of its organization design in terms of complexity, authority, evaluation, control, rewards and punishments' incentives. According to Perlmutter, every company starts from the ethnocentric dimension and moves towards the geocentric. This part of the analysis is crucial for the market entry selection, because it helps identify the amount of control that the company is ready to sacrifice.

The second group of theories includes the resource-based view theory and the eclectic theory. The resource-based view theory, unlike all other paradigms, focuses not on market and industry characteristics, but on company's capabilities and resources as the main fraction, which determines the business strategy of the company and represents its competitive advantages.[7] Assets, capabilities, organizational processes, firm attributes, information, and knowledge created and controlled by the company for the purpose of business strategy development and implementation[8] are seen as company's core advantage. This implies that companies with supreme resources get a bigger profit compared to companies with average resources.[9] Furthermore, the theory implies that it's not solely the environment that affects the firm's performance, but there is a reciprocal interdependence. Conner[10] states that the successful performance of the company comes not only from its resource capabilities and the positive influence of the environment, but also from the company's ability to shape this environment. This is why, according to theorists, the focus of analysis should be on the firm and not the industry.

The next theory that is important for the analysis is Dunning's eclectic paradigm.[11] The theory focuses on analysing how ownership-specific, internationalization-specific, location-specific advantages (OLI) shape the behaviour of a certain company in the market. It is said to be a quintessence of the transaction-cost theory combined with environmental and organizational factors influencing the company's performance[12] along with elements of the resource-based view and institutional theory.[13] Dunning uses the OLI framework to identify the ownership advantages of the firm, the location advantages of the target market and the internationalization advantages of the firm, which, according to him, should be the core factors influencing the entry mode decision. When he talks about ownership advantages he refers to such characteristics as the size of the company, its previous international experience, core products and services. The location advantages, on the other hand, include market potential and country risks. Finally, internalization advantages regard to contractual risks the firm might face.[14] Further studies have examined and tested the framework in real-life conditions. For example, Nakos and Brouthers[15] have analysed whether ownership, location and internationalization advantages influence the entry mode choice of SMEs. In the market entry mode selection framework proposed by this study Dunning's eclectic theory plays a role of a transitional phase of the analysis from the resource-oriented to the market-oriented stage, because, as mentioned earlier, the eclectic theory encompasses elements of both stages.

The third group of theories, which refers to market-oriented analysis, consists of the institutional theory, Johanson U-model and Adam Koch study on internal and external factors influencing the successful performance of the company in the market. The study suggests to start this stage of analysis with the Johanson U-model, continue with the institutional theory and finish with

7 Capron, Laurance; Hulland, John. Redeployment of Brands, Sales Forces, and General Marketing Management Expertise Following Horizontal Acquisition: A Resource-Based View // *Journal of Marketing*, 1999, No. 4, pp. 41-54.

8 Ekeledo, Ikechi. Choice of Foreign Market Entry Mode: A Resource-Based Approach. University of Illinois at Chicago, 2000. 452 p.

9 Peteraf, Margaret A. A Cornerstones of Competitive Advantage: A Resource-Based View // *Strategic Management Journal*, 1993, No. 14(3), pp. 179-191.

10 Conner, Kathleen R. A Historical Comparison of Resource-Based Theory and Five Schools of Thought ithin Industrial Organization Economics: Do We Have a New Theory of the Firm? // *Journal of Management*, 1999, No. 17(1), pp. 121-154.

11 Dunning, John H. The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions // *Journal of International Business Studies*, Vol. 19, No. 1, 1988, pp. 1-31.

12 Ekeledo, Ikechi. Choice of Foreign Market Entry Mode: A Resource-Based Approach. University of Illinois at Chicago, 2000. 452 p.

13 Brouthers, Keith D.; Hennart, Jean-Franзois. Boundaries of the Firm: Insights From International Entry Mode Research // *Journal of Management,* 2007, No. 33(3), pp. 395-425.

14 Dunning, John H. The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions // *Journal of International Business Studies*, 1988, Vol. 19, No. 1, pp. 1-31.

15 Brouthers, Keith D.; Nakos, George. SME Entry Mode Choice and Performance: a Transaction-Cost Perspective // *Enterpreneurship Theory and Practice*, 2004, No. 28(3), pp. 229-247.

Adam Koch factors. According to Johanson, the decision-making process consists of two types of aspects: state and change. The "state" refers to foreign market commitment and knowledge, while "change" refers to the decision to commit company's resources and the success of its current performance.[16] Further studies, which were conducted to support and justify the U-model, have identified that the country/market screening methods should be applied by all types of companies, including SMEs.[17] The current study agrees that market screening is a crucial part of the entry mode selection process, especially for niche market companies, which choose to explore culturally and geographically distant countries. The entry mode selection framework, presented by this study, uses the market characteristics suggested by Johanson, which are as follows: present and future demand and supply, competition, channel of distribution, payment conditions and transferability of money.

Moreover, in addition to Johanson's market characteristics, the research examines institutional environment in the host country and compares it with the home country environment. More recent researches in this area have identified five types of risks (uncertainties) in the host country that might influence the company's entry mode decision.[18] The risks are as follows: product, government policy, macroeconomic, materials, and competition. For the purpose of the current study the combination of the U-model and institutional theory are used to examine and make a full profile of the host country. If the host country is considered satisfactory for the company in terms of market potential it allows the analysis to proceed further.

Moreover, before moving on to the next stage of analysis the framework developed by the study offers to evaluate the host market based on Adam Koch's study about factors influencing market and entry mode selection. Koch differentiates the two groups of factors, which influence the outcome of the market selection process to be internal and external factors. The internal factors are classified as company strategic orientation factors. They reflect the company's individual and group experience in the business environment. Internal factors refer to market growth rate, market barriers, image support requirements, popularity of individual MEMs[19] in the overseas market, characteristics of the country business environment, etc. The external factors include experience in using individual MEMs, overseas market selection experience, company international competitiveness, etc. Due to the specifications of the company used for the purpose of the study and the limitations of the industry it operates in, the two groups of factors were combined and enumerated in the following list: similarity/proximity of overseas market cultural distance, country market potential criteria,[20] competitive significance of the market (future potential of the market in terms of product desirability and market growth), international business risks (company size, direct and indirect entry barriers, popularity level of MEM in a certain country). After acquiring a full picture of the host market on this stage the analysis can proceed further.

The next phase of the framework, that this study suggests, is analysing market entry barriers. It is crucial that this part of the analysis is executed after a company profile is prepared, firm's competitive advantages are identified and host market is examined. At this stage all obstacles that can occur when entering a new market should be considered, because all markets and industries are unique in their own way. For that reason the research has not identified any theoretical framework that would fit the purpose of the research. Consequently, each case of business modelling using the framework provided by this study should adjust this stage accordingly. In our case barriers that can

[16] Johanson, Jan; Vahlne, Jan-Eric. The Internationalization Process of the Firm – A Model of Knowledge Development and Increasing Foreign Market Commitments // *Journal of International Business Studies*, 1997, No. 8(1), pp. 23-32.

[17] Papadopoulos, Nicolas. Approaches to International Market Selection for Small- and Medium-Sized Enterprises / P.J. Rosson and S. Reid, eds., Managing Export Entry and Expansion: Concepts and Practice, New York, NY: Praeger, 1987, pp. 128-158.

[18] Brouthers, Keith D.; Hennart, Jean-Franзois. Boundaries of the Firm: Insights from International Entry Mode Research // *Journal of Management*, 2007, No. 33(3), pp. 395-425.

[19] Market Entry Models

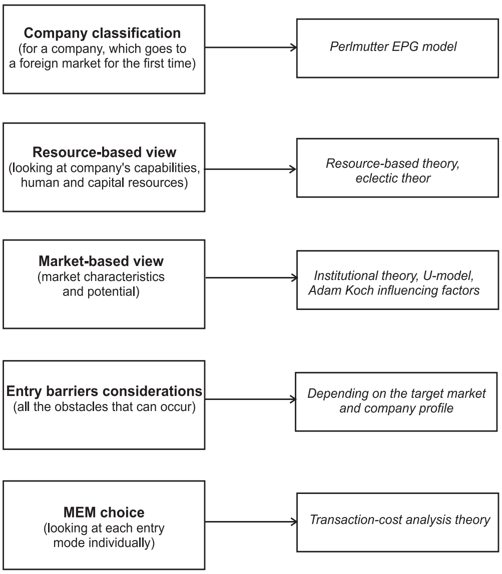
[20] Johanson, Johny K. Global Marketing: Foreign Entry, Local Marketing and Global Management. Chicago: McGraw-Hill Companies, 1997, pp. 33-54

occur in the Chinese and Brazilian markets are analysed and specific attention is paid to those applicable to the niche market of the company.

The final stage of the suggested framework analyses the market entry mode selection process internally. This implies looking at market entry mode selection process from the position of each market entry mode. First, based on previous stages of the framework some of the market entry modes will be already eliminated. Furthermore, with the help of the transaction-cost analysis theory from those left the most suitable one is identified.

The transaction-cost analysis view was introduced by Coase in 1937,[21] when he expressed the idea that the main operating units in production are the market and the firm. According to him, operating in a certain market environment demands transaction, coordination and contracting costs, while operation of a firm is a choice of what is more cost effective. Further studies expand on this idea and use the transaction-cost analysis framework to explain FDI.[22] The transaction-cost analysis theory implies that a firm chooses a mode of operation that minimizes production and transaction costs. Transaction costs refer to expenses that arise from enforcing contracts, administrative costs, etc. According to the theory licensing or management contracts should be seen as initial modes of operation in the market and moving towards a full control. A full control mode of operation, such as sole ownership is seen as the ultimate goal, because it is considered as the only one able to protect the company's competitive advantage. Nevertheless, this theory has met a series of criticism, because although it gives a clear explanation and theoretical background, it doesn't expound company's behaviour in the market. The theory doesn't recognize a collaborative mode of entry as a more profitable for a certain company.[23] This discrepancy may arise from the fact that a market entry mode choice is based on the company's resource capabilities and on the need of the company to influence the target market due to its immaturity.

As a result the market entry mode selection framework presented by the study considers all aspects (internal and external) that can determine the company's success in the chosen market and influence its future performance. The framework developed is as follows (See *Picture 1*).




*Picture 1.* Company-based model

On the second stage of the research the company's market entry mode selection process was examined and compared with the model created and developed by this study based on the theoretical background. Working in close proximity with the business development department and conducting a series of interviews with senior managers contributed to a more in-depth understanding of the company's market entry model. The market entry process of the company can be theoretically divided in two stages, which are market entry mode selection and establishing the business, where entry point is playing the role of a watershed. However, the purpose of this study is to analyse the market entry mode selection process, for that reason only the first stage of the company's framework is presented and examined.

The company divides the entry mode se-

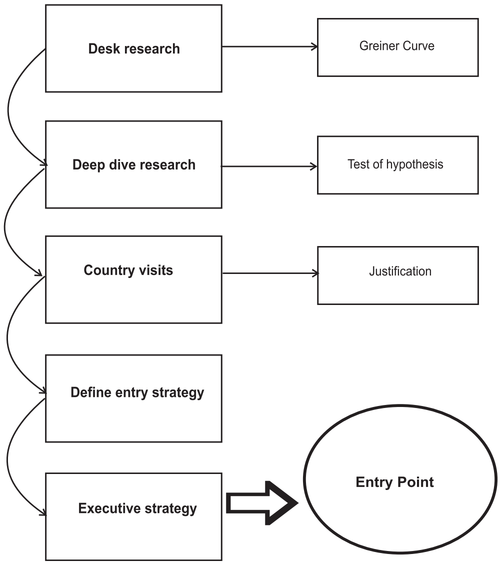
[21] Coase, H. R. The Nature of the Firm // *Economica*, 1937, Vol. 4, No. 16, pp. 386–405.

[22] Anderson, Erin; Gatignon, Hubert. Modes of Foreign Entry: A Transaction Cost Analysis and Propositions // *Journal of International Business Studies*, 1986, No. 17(3), pp. 1–26.

[23] Madhok, Anoop. Cost, Value and Foreign Market Entry Mode: The Transaction and the Firm // *Strategic Management Journal*, 1997, No. 18, pp. 39–61.

lection process in five stages, which are as follows: desk research, deep dive research, country visits, define entry strategy and execute entry strategy. The first stage implies conducting a desk based country research by the company's employees. The focus of this stage is to provide the company's executives with an overview of the country (language, culture, general economy), with a high level review of the industry and the key players in the market. The second stage entitled deep dive research consists of detailed market analysis carried out by an external research consultancy. The purpose of this stage is for the consultancy to fill in the information blanks by conveying a survey, scanning the competitor landscape in the target market, analysing potential entry strategies and potential partners, if a collaborative entry mode is suggested. The third stage involves on-site visits by the company's representatives, whose aim is to validate the results of the previous stages, meet the key players and advisors, and investigate potential partners and acquisition targets. After the country visits are completed the company sets out the market entry strategy with a shortlist of acquisition targets and joint venture partners. At this stage the entry point is set out, and a business plan is created. In addition, market entry barriers are identified and risk is measured taking into consideration the availability of resources and capabilities. The final stage addresses the questions of commercial terms of the entry point, governance process, financial and legal details (See *Picture 2*).

In addition to the presented entry selection process the company uses a modified version of the Greiner Curve. In order to understand the level of the country's technological development and maturity of the market the Greiner growth model[24] is adapted. The Greiner Curve gives a representation of the phases of development and growth of a company. Each phase of the Greiner Curve (creativity, leadership crisis, direction, autonomy crisis, delegation, control crisis, coordination, red tape crisis, collaboration, growth crisis and alliances) is substituted with the corresponding stages of maturity of the researched industry in China and Brazil.




*Picture 2*. Theory-based model

On one hand, this shows whether a consistency of the development of the market is preserved, which gives the opportunity to predict its further evolution. On the other hand, it shows potential possibilities and loops for the company to intervene in as a pioneer. As a result the framework that is used by the company to identify their market entry strategy is as follows.

## FINDINGS AND RESULTS

The business modelling executed on the example of the Brazilian and Chinese markets has identified the similarities and differences of the results which arose from the research. The results of the Brazilian market analysis that both frameworks achieved were identical despite the different methodologies that were applied. The theory-based model discovered that if the market is highly competition intensive the company is more likely to choose a mode of entry with low resource commitments. Therefore, collaborative entry modes, such as joint venture, are more favourable. As result, each of the entry modes offers certain benefits depending on the resource capabilities of the company

24 Greiner, Larry E. Evolution and Revolution as Organizations Grow: A Company's Past Has Clues for Management That Are Critical to Future Success // Family Business Review, 1997, No. 10(4), pp. 397-409.

and its final aim, which can be expanding its business or remaining competitive on a global basis. If applied to the Brazilian market the market potential is high, the competition is low, this implies opportunity to occupy a certain niche in the industry, and therefore a full-control mode is preferable. Such conclusion is justified by the cultural similarity between the Brazilian and Portuguese markets, and the fact that the company has already penetrated the Portuguese market. Accordingly, the analysis revealed that based on the company's resources, managerial capabilities and its aim, which is global competitiveness in short period of time, the best mode of entry would be acquisition.

In the company-based model according to the company's corporate strategy only three entry modes are taken into consideration, namely, joint venture, wholly owned subsidiary and acquisition. Series of interviews conducted with senior managers of the company concerning their reasoning behind choosing a certain strategy have identified that the decision to acquire a company in Brazil and implementing all the corporate strategies and policies has been opportunistic. As the interviews have revealed the decision on how to enter the market was made prior to the analysis and the research was conducted in order to justify such decision. But if the logic of the framework was to follow it would have also identified acquisition as the best entry mode possible based on market profile, company capabilities, priorities and timing.

Based on the Chinese market analysis the two frameworks suggested two different entry modes to be considered. The theoretical framework revealed that from all possible entry modes the most suitable and safe for the company to enter China is through a joint venture with a domestic partner. But because of the threats identified the process of choosing the most reliable and legitimate partner would be more time-consuming and might involve bigger financial expenses for the partner's background check and audit. Furthermore, the analysis would suggest when the company is established and familiarised with the market it should move to a full control business model.

On the other hand, the company-based framework does not suggest the company to establish itself in the market, but rather establish a joint venture with a trusted partner. The reasoning behind such results is the fact that despite the attractiveness of the market in terms of size, future growth and opportunities the market is very immature and bears great losses to the company in case of failure.

If any final results and a conclusion can be drawn they are as follows. Firstly, the analysis identified that the core part of both theoretical and company frameworks is the market examination itself. But unlike the theories suggest the company mainly focuses on market profile and does not take into consideration any other influencing factors, such as company's resources and capabilities. On one hand, this might arise from exclusion of the starting stage when a company profiling is performed to eliminate repetition of stages. Though, this way the company undermines the fact that when entering a new market they deal with a slightly changed profile of their firm as it perhaps expanded its resources or maybe on the contrary reduced them.

Secondly, although both theoretical and company frameworks pay special attention to performing a market profile the theory lacks the insightfulness and sector-specific knowledge that the company has. The theories explore basic economic factors that might be applicable to manufacturing companies or multinationals selling mass-consumption products. In our case a very niche company was chosen, which revealed the imperfections of the theory and the need to adjust the market research specifically to the chosen market and industry.

Thirdly, the series of interviews with senior managers of the company and the comparison of the results of the business modelling revealed that not only theories are not universal and should be adapted to each case individually, they might as well give results that in practice won't serve the best interest of the company. For example, in the case of China the theoretical framework suggests entering through a joint venture, but the company research has identified that such mode of operation will not succeed in the market, because of existing cultural barriers. Consequently, the study concludes that each case should be researched individually and no universal framework can be created.

As a result, although the study tried to create a framework applicable to the same type of companies entering new markets it is worth noticing that such framework is applicable for markets that follow the similar to the native market way of development. A great example is the case of the Chinese market, which does not follow the modified model of the Greiner Curve and customer behaviour is different to the countries where the company already operates in, therefore the framework is inapplicable.

## Market Entry Mode Choice: Theory and Practice. Comparing China and Brazil Cases

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***Abstract:*** *The purpose of this article is to give a brief introduction into a work, which investigated the differences between the actual strategic approach, that a company executes when entering a new market, with the approach offered by various theories. Due to confidentiality agreement signed with the company the author is not authorized to disclose any sensitive or internal information that can reveal the company's identity. The paper combines the most common theories and approaches for market entry mode selection in order to develop a theory-based framework, which furthermore is compared to the firm's working theory. The analysis is performed with the use of two markets, where the company already operates. This method of analysis identifies the crossing points as well as the controversial aspects of both frameworks. This way the study tests how effective and applicable are traditional theories to such a niche market that the company operates in. On the other hand by comparing the company's entry mode selection model with the theory-based model the study identifies the imperfections of the company's theory and makes a series of recommendations for its improvement. Additionally, it reveals the importance of combining and adjusting the theories to the specific company and not vice versa.*

***Key words:*** *Brazil, China, market entry, Johanson U-model, Perlmutter, Greiner's curve.*

## Стратегия выхода на новые рынки: теория и практика. Сравнительный анализ опыта Китая и Бразилии

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***Аннотация:*** *Цель работы – выявить сходства и различия между фактическим процессом выхода на новые рынки и подходом, предлагаемым бизнес-теориями. Из-за подписанного соглашения о неразглашении конфиденциальной информации автор не в праве расскрывать какую-либо информацию о компании, которая послужила основой для бизнес-анализа. Для разработанной теоретической модели в статье представлены самые распространенные теории о выходе на новые рынки. Далее проведен сравнительный анализ данной теоретической модели и рабочей модели компании на примере двух рынков, Бразилии и Китая. Таким образом, проведенное исследование выявило сходства и различия двух методов анализа. В результате были обнаружены несовершенства методологии компании и случаи, в которых теоретическая модель не в состоянии предоставить желаемых результатов.*

***Ключевые слова:*** *Бразилия, Китай, выход на новые рынки, модель интернационализации Уппсала, Перлмуттер, Greiner's curve.*