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AN ECLECTIC THEORY OF THE CHOICE OF INTERNATIONAL ENTRY MODE

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The choice of entry mode into a foreign market has a major impact on the success of a firm's international operations. However, the existing literature on the entry mode decision has either presented a list of considerations without identifying underlying constructs, or treated each entry decision in isolation. Here, a unifying framework is developed. This framework identifies three underlying constructs that influence the entry mode decision. These constructs are linked to considerations that have been previously discussed in the literature. It is argued that a firm's choice of entry mode depends on the strategic relationship the firm envisages between operations in different countries. A particular entry decision cannot be viewed in isolation. It must be considered in relation to the overall strategic posture of the firm. Further, the paper argues that different variables often suggest different entry modes, and that resolving these differences involves accepting trade-offs.

INTRODUCTION

Having decided to enter a foreign market, a multinational corporation (MNC) has to determine the appropriate mode for organizing its foreign business activities. Among the vast array of alternatives a MNC can choose between are a non-equity contractual mode (e.g. licensing), an equity-based cooperative venture, or a wholly owned subsidiary. Each of these modes of entry has different implications for the degree of control that a MNC can exercise over the foreign operation, the resources it must commit to the foreign operation, and the risks that it must bear to expand into the foreign country. Thus,

identifying the appropriate entry mode in a given context is necessarily a difficult and complex task. The choice, however, is a critical determinant of the likely success of the foreign operation (Root, 1987; Davidson, 1982; Killing, 1982).

Unfortunately, much of the existing literature on the choice of entry mode focuses in a piecemeal fashion on many seemingly unrelated factors including country risk, country familiarity, the stage of country development, technology, and transaction costs. There is a clear need for a unified framework within which different factors can be placed and the relationships between them analyzed. Such a framework could go a long way towards clarifying and perhaps resolving the

debate in the literature on the appropriate choice of entry mode (e.g. Anderson and Gatignon, 1986; Contractor, 1984; Davidson and McFetridge, 1985). Moreover, for managers, the advantage of such a framework is that it allows them to combine a set of insightful but often partial analyses to better address the totality of the multidimensional and complex entry mode decision.

A previous attempt to provide such a framework was made by Anderson and Gatignon (1986). While promising, we feel that Anderson and Gatignon's framework is flawed. The shortcoming stems from their attempt to reconcile different entry mode explanations within a transaction cost framework. The position taken in this paper is that while transaction cost explanations are of major importance, transaction cost logic alone does not provide all of the answers. Transaction cost explanations of the choice of entry mode focus on each entry decision *in isolation*, treating each as a self-contained decision. In practice, a MNC's choice of entry mode may depend upon the strategic relationship the MNC envisages between operations in different countries. Thus, a particular entry decision cannot be viewed in isolation. By limiting their framework to transaction cost explanations, Anderson and Gatignon completely overlooked the role that global strategy and global competition plays in determining the appropriate entry mode. As argued herein, we believe that a MNC's global strategy has a *major* impact upon the choice of entry mode. Thus, a more eclectic view of the factors that influence the entry decision appears warranted.¹

The objective of this paper is to review different explanations of the factors that influence the MNC's choice of entry mode and to integrate them within the framework of an *eclectic* theory of the choice of entry mode. One of the central themes of this theory is that different variables often suggest different entry modes, and that resolving these differences involves accepting trade-offs.

¹ A transaction cost theorist might replay that, at a higher level of abstraction, even issues of global strategy can be incorporated within a transaction cost framework. However, we would argue that transaction cost explanations at such high levels of abstract become purely tautological and are of little value to researchers or practitioners.

FOUNDATIONS OF AN ECLECTIC FRAMEWORK

Although it is something of a simplification, much of the international business literature focuses on three distinct modes of entry into a foreign market; licensing (or franchising), entering into a joint venture, and setting up a wholly owned subsidiary. Each of these entry modes is consistent with a different level of control, resource commitment, and 'dissemination' risk. We examine each in turn.²

Entry modes and control

Different entry modes imply a different level of control over the foreign operation (Anderson and Gatignon, 1986; Calvet, 1984; Caves, 1982; Davidson, 1982; Root, 1987). By control we mean authority over operational and strategic decision-making. The level of control is lowest in the case of licensing and highest in the case of a wholly owned subsidiary. In the case of licensing, control over operations and strategy is granted to the licensee in exchange for a lump-sum payment, a per-unit royalty fee, and a commitment to abide by any terms set out in the licensing contract.³ In the case of a wholly owned subsidiary, control over day-to-day operations and certain strategic decisions *may be* delegated to the foreign subsidiary, but ultimate control always resides at the MNC's corporate office. In the case of a joint venture, the level of control is dependent on the ownership split and the number of parties involved. In any event, control must be shared with venture partners. Thus, the level of control will fall somewhere between that consistent with licensing and that consistent with a wholly owned subsidiary.

Entry modes and resource commitment

Each entry mode also requires different resource commitments (Vernon, 1983). By resource commitment we mean dedicated assets that cannot be redeployed to alternative uses without cost

² We are assuming that exporting from the home country is not an option due to tariff barriers, transportation costs, or some variant thereof.

³ Of course, the terms of the contract may impose some limit on the operating and strategic decisions of the licensee, but given the nature of contracting and bounded rationality, these are unlikely to be all-embracing (Williamson, 1985).

(loss of value). These assets may be tangible (e.g. physical plant) or intangible (e.g. management know-how). By its very nature, most foreign production involves some degree of investment in dedicated assets.

In the case of licensing, the licensee bears most of the costs of opening up and serving the foreign market. In other words, the licensee owns all the revenue-generating assets. Thus, the level of resource commitment required from the MNC is low, being limited to personnel involved in training licensees and subsequently monitoring their behavior for violation of any licensing contracts. In the case of a wholly owned subsidiary, the MNC has to bear all of the costs of opening up and serving the foreign market. Thus, the MNC owns all of the revenue-generating assets. The level of resource commitment is correspondingly high. The level of resource commitment consistent with a joint venture will fall somewhere between these two extremes, depending on the ownership split and resource sharing between venture partners.

It is important to note that resource commitments constitute an exit barrier and serve to limit the strategic flexibility of the firm (Harrigan, 1981). When resource commitments are extensive the MNC cannot exit from a foreign market without incurring substantial sunk costs. Of course, from a purely economic perspective sunk costs are an 'irrational' exit barrier (by definition sunk costs cannot be recovered and should not influence future decision-making). However, theories of escalating commitment suggest that sunk costs constitute a very real *perceptual* exit barrier and inhibit the MNC's ability to respond to environmental change (Staw, 1982). The implication is that strategic flexibility is greatest in the case of licensing, and lowest in the case of a wholly owned subsidiary.

Entry mode and dissemination risk

Dissemination risk refers to the risk that firm-specific advantages in know-how will be expropriated by a licensing or joint venture partner (Hill and Kim, 1988). Technological and marketing know-how constitutes the basis of the competitive advantage of many MNCs (Casson, 1982; Caves, 1982; Davidson and McFetridge, 1985; Dunning, 1983). The MNC will not want to see firm-specific know-how disseminated, since that would

reduce the quasi-rents that could be earned from the know-how.

Unfortunately, if a MNC grants a license to a foreign enterprise to use firm-specific know-how to manufacture or market a product, it runs a significant risk of the licensee, or an employee of the licensee, disseminating that know-how, or using it for purposes other than those originally intended (Hill and Kim, 1988). For example, RCA once licensed its color TV technology to a number of Japanese companies. The Japanese companies quickly assimilated RCA's technology and then used it to enter the U.S. market. Now the Japanese have a bigger share of the U.S. market than the RCA brand.⁴

A similar argument can be made with reference to joint ventures, although it seems reasonable to propose that the risks of dissemination are not as great as in the licensing case. The difference is that in a joint venture the MNC's ownership stake may give it greater control over its partner's utilization of firm-specific know-how.

The risk of dissemination of know-how is likely to be lowest of all in the case of a wholly owned subsidiary. One reason for this is that internal organization fosters an 'atmosphere' conducive to a congruence of goals and values between members of the organization. Even in the case of a wholly owned subsidiary, however, there is always the possibility that a key employee with access to firm specific know-how might leave the organization and join another company. Thus, a residual risk of dissemination still remains. In sum, this suggests that the risk of dissemination is highest in the case of licensing, somewhat lower in the case of a joint venture, and lowest of all in the case of a wholly owned subsidiary.

THE DECISION FRAMEWORK

The extent to which control, resource commitments (strategic flexibility), and dissemination risk vary with the type of entry mode is summarized in Table 1. We now turn our attention to the identification of variables that

⁴ In theory the patent system is designed to protect firm-specific know-how from expropriation. However, patents often only provide weak protection, are easy to invent around, and are difficult to enforce in the international arena (Lieberman and Montgomery, 1988; Taylor and Silberston, 1973).

Table 1. The characteristics of different entry modes

Entry mode	Constructs		
	Control	Resource commitment	Dissemination risk
Licensing	Low	Low	High
Joint venturing	Medium	Medium	Medium
Wholly owned subsidiary	High	High	Low

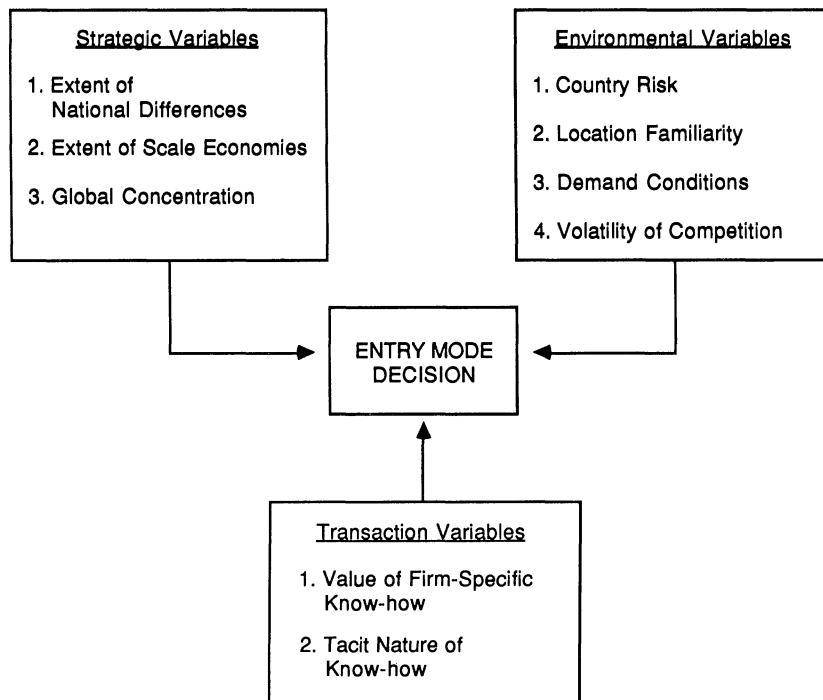


Figure 1. The decision framework.

impact upon the choice of entry mode. The literature suggests three broad groups of variables that influence the entry mode decision: strategic variables, environmental variables, and transaction-specific variables. The theory developed herein suggests that strategic variables influence the choice of entry mode primarily through the control requirements that they entail. Different strategies require different degrees of control over the operating and strategic decisions of foreign affiliates, and thus different entry modes. The environmental variables influence the entry mode decision primarily through their influence on the appropriate level of resource commitments (strategic flexibility). The transaction-specific

variables influence the entry mode decision through their influence on dissemination risks and on the appropriate level of control. This framework is summarized in Figure 1.

Strategic variables

One of the main strategic decisions a MNC has to make is whether to adopt a ‘global’ strategy or a ‘multi-domestic’ strategy (Hout *et al.*, 1982). A multi-domestic strategy is based upon the belief that national markets differ widely with regard to consumer tastes and preferences, competitive conditions, operating conditions, and political, legal, and social structures. Maximizing

value in such circumstances requires that MNCs assign key operating and strategic responsibilities to national subsidiaries. Each subsidiary will have its own marketing function and its own autonomous manufacturing facilities, the attributes of the product will vary between nations according to the tastes and preferences of different consumers, and competitive strategy will vary reflecting differences in competitive conditions. This suggests that, *other things being equal*, only a low degree of control is required for firms pursuing a multi-domestic strategy. Thus, holding other variables constant, it may be proposed that multi-domestic firms favor licensing or joint ventures as the mode of entry, since these represent the low-cost modes of entering a foreign market (i.e. they entail less resource commitments).

Proposition 1: Other things being equal, firms that pursue a multi-domestic strategy will favor low-control entry modes.

However, as has been repeatedly pointed out, in many industries modern communications and transport technologies have created the conditions for a convergence of the tastes and preferences of consumers from different nations (Levitt, 1983). The result is the emergence of enormous global markets for standardized products. Thus, the modern MNC may be able to realize substantial scale economies by centralizing production and marketing a standardized product to the global market place. Referred to as a global strategy, this strategy involves forgoing some of the benefits of a multi-domestic strategy in favor of the cost advantages gained from global scale economies. The conditions necessary for a global strategy to work include the existence of a reasonably homogeneous global market place and the presence of substantial scale economies. These conditions characterize many industries, including aerospace, heavy construction equipment, semiconductors, computers, watches, and heavy electrical equipment.

A global strategy involves configuring the firm's value chain in such a way that value added at each stage is maximized (Hout *et al.*, 1982). Thus, a national subsidiary may specialize in manufacturing only part of the product line, or certain components of the end-product, exchanging parts and products with other subsidiaries in

the MNC's global system. For example, Ford pioneered the concept of the 'world car' with the introduction of its 1981 Escort. The 1981 Escort was assembled in local markets (tailored to local consumers' tastes) from a common set of components. Each component was produced in a very high volume at one location, where it could be done most efficiently, and then shipped around the world to the scattered assembly plants.

Achieving coordination with the context of an interdependent global manufacturing system necessarily requires a high degree of control over the operations of different national affiliates. Different national operations have to be prepared to accept centrally determined decisions as to what they should produce, how much they should produce, and how their output should be priced for transfer between operations. Licensees or venture partners are hardly likely to accept such a subservient role. Thus, holding other variables constant, we would expect firms pursuing a global strategy to favor high-control entry modes (i.e. wholly owned subsidiaries).

Proposition 2: Other things being equal, firms that pursue a global strategy will prefer high-control entry modes.

Independent of whether an industry is suitable for a global strategy of centralized manufacturing and marketing, or multi-domestic strategy of decentralized manufacturing and marketing, an increasing number of industries are characterized by a limited number of players who confront each other in many different national markets around the globe. That is, the global industry is highly concentrated. In such industries, conditions of oligopolistic interdependence spill over national boundaries to influence the competitive strategy of the firms involved.

One feature of global oligopolies is that when MNCs enter a foreign market, especially the home markets of their global rivals, they may have strategic objectives that go beyond the narrow calculus of choosing the most efficient entry mode for that particular market (Edwards, 1971; Watson, 1982; Hout *et al.*, 1982; Hamel and Prahalad, 1985; Kim and Mauborgne, 1988). Consider, for example, the entry of Texas Instruments (TI) into the Japanese semiconductor market. When TI established semiconductor

production facilities in Japan, it did so for the sole purpose of checking Japanese manufacturers' market share and limiting their cash available to invade TI's global markets. Although TI's Japanese operation may have made little economic sense when viewed in isolation (the volume of output was too small to achieve full scale economies), its value lay in its ability to limit the extent of Japanese competition elsewhere. In short TI's inefficient Japanese operation may have been consistent with the maximization of TI's global profits. The loss taken on the Japanese operation was simply part of the cost of deterring Japanese entry elsewhere. In a similar example, when Fuji began cutting deep inroads into Kodak's home market, Kodak launched powerful counterattacks in Fuji's home market, cutting the prices at which its Japanese subsidiary sold film. The result was that Kodak checked Fuji's invasion of its U.S. profit sanctuary by keeping Fuji busy defending its home market.

If a MNC is to achieve the kind of global strategic coordination that TI and Kodak achieved, the competitive strategy of national operations must be controlled by the corporate office. This requires, for example, that national operations take instructions from the corporate center regarding pricing strategy, marketing strategy, and transfer pricing policy. It may also require that certain subsidiaries are run at a loss. Licensees or joint venture partners are unlikely to accept such conditions. Thus, when the need for global strategic coordination is high (the industry is a global oligopoly), a wholly owned subsidiary will be the favored entry mode.

Proposition 3: Other things being equal, when the need for global strategic coordination is high (the global industry is an oligopoly) MNCs will favor high-control entry modes.

Environmental variables

A number of exogenous environmental variables also impact upon a MNC's choice of entry mode. Foremost among these are variables relating to country risk, location familiarity, and the demand and competitive conditions that exist in the host market. Our central proposition is that each of these variables influences the choice of entry mode through its impact upon resource commitments and strategic flexibility.

Country risk

The managers of MNCs have to deal with a variety of host country risks that distinguish their task from that of their domestic counterparts. Root (1987) has identified four types of country risk that have a significant impact on a MNC's entry decision. These are general political risk (e.g. instability of political system), ownership/control risks (e.g. expropriation, intervention), operations risk (e.g. price control, local content requirements), and transfer risk (e.g. currency inconvertibility risk, remittance control).

When these risks are high, the MNC might be well advised to limit its exposure to them by reducing its resource commitments and increasing its ability to exit from the market quickly without taking a substantial loss should the environment worsen. This in itself suggests that, other things being equal, licensing and joint ventures will be favored over wholly owned subsidiaries when country risk is high. Several studies have supported the view that a number of these risks can be substantially reduced by limiting ownership in a foreign venture (Bradley, 1977; Kobrin, 1983; Vernon, 1983). Bradley (1977), for example, found that joint ventures with local partners experienced a relatively low rate of expropriation when compared to wholly owned subsidiaries. He reasoned that joint ventures enjoy favorable expropriation experience since local equity partners, who may have some influence on host government policy, have a vested interest in speaking out against expropriation. Thus:

Proposition 4: Other things being equal, when country risk is high MNCs will favor entry modes that involve relatively low resource commitments.

Location familiarity

The perceived distance between the home and host country in terms of culture, economic systems, and business practices determines location familiarity; the shorter perceived distance, the greater location familiarity. Perceived distance is a function of both the basic level of psychic distance, and the firm's prior experience in that culture. A number of previous studies have argued that the greater the perceived distance between home and host countries, the

more likely it is that a MNC will favor licensing or a joint venture over a wholly owned subsidiary (Anderson and Coughlan, 1987; Davidson, 1980; Green and Cunningham, 1975; Johanson and Vahlne, 1977; Kobrin, 1983; Stopford and Wells, 1972). Not knowing or being comfortable with the culture, economic system, and business practices of the host country, executives may shy away from direct investment in favor of licensing or joint ventures arrangements. Faced with the uncertainty that arises from the unknown, a MNC may be unwilling to commit substantial resources to a foreign operation since such a commitment would substantially reduce the MNC's ability to exit without cost if the host market should prove unattractive. Thus:

Proposition 5: Other things being equal, when perceived distance is great MNCs will favor entry modes that involve relatively low resource commitments.

Demand conditions

When future host country demand for a MNC's product is unknown, a MNC may be unwilling to invest substantial resources in that country. Extensive resource commitments may limit the firm's ability to reduce excess capacity or exit altogether from the host country without incurring substantial sunk costs if demand should fail to reach a significant level. As has been argued elsewhere, uncertainty as to future demand conditions is likely to be greatest in embryonic or declining industries (Harrigan, 1985a, b, c; Vernon, 1966, 1979). Thus, other things being equal, we might expect MNCs to favor low resource commitment modes of entry when a host market is in its embryonic or declining stage (i.e. licensing). When demand conditions become more stable and predictable, as tends to happen in mature markets, so the MNC is better able to identify the optimal capacity necessary to serve a foreign market. However, other things being equal (including comparative costs), this does not imply that the MNC will have a preference for a particular entry mode. Indeed, the MNC is likely to be indifferent between entry modes—which is a way of saying that factors other than demand conditions will determine the MNC's choice of entry mode when the host market is mature. Thus:

Proposition 6: Other things being equal, when demand is uncertain (as in embryonic or declining host markets) MNCs will favor entry modes that involve low resource commitments.

It should be pointed out that transaction cost theory would arrive at a very different prediction here (Williamson, 1985). According to transaction cost theory, uncertainty makes the drafting of contingent claims contracts particularly problematic. This increases the risk of unanticipated opportunism occurring against which the firm has no recourse. Given this, the firm is argued to prefer integration (ownership) over arm's-length contracting (licensing) as a means of attenuating opportunism. While we acknowledge the value of the economic logic that underpins this argument, our position is that the argument ignores the role that resource commitments play in influencing decision-making. Other things being equal, we view managers as unwilling *ex-ante* to commit resources to uncertain situations. Given limited resources, considerations of opportunity cost and sunk costs figure prominently in decision makers' minds; thus Proposition 6.

Competitive conditions

Harrigan (1985a, c) has argued that the nature of competition in a given market setting has a direct impact on whether a firm chooses arm's-length contracting or internal organization to undertake business transactions. Although Harrigan's argument was developed with reference to vertical integration, it has implications for a MNC's choice of entry mode. While licensing can be viewed as an arm's-length contractual relationship, setting up a wholly owned subsidiary involves an extension of the MNC's organizational boundaries and a commensurate reduction in the firm's strategic flexibility.

According to Harrigan, any reduction in strategic flexibility may be unwise when competition is volatile. A volatile market is one where rapidly changing technological, macroeconomic, social, demographic, and regulatory factors produce a situation of intense competition, be that on the basis of price, marketing expenditures, or investments. Such conditions require quick responses from the firm. Insofar as resource commitments limit a MNC's ability to adapt to changing market circumstances without incurring

substantial sunk costs, a MNC can be theorized to favor entry modes involving low resource commitments when competitive pressures in the host market are intense. Thus:

Proposition 7: Other things being equal, the greater the volatility of competition in the host market, the more MNCs will favor entry modes that require low resource commitments.

Transaction-specific variables

The importance of transaction costs for a MNC's choice of entry mode has been extensively discussed in the literature (e.g. Anderson and Gatignon, 1986; Buckley and Casson, 1976; Casson, 1982; Rugman, 1981; Hennart, 1982; Hill and Kim, 1988; Teece, 1977, 1981, 1983). Transaction cost theory (or internalization theory as it is known in the international business literature) stresses the importance of firm-specific advantages in know-how when explaining the competitive advantage that MNCs enjoy relative to host country enterprises (Dunning, 1981; Rugman, 1981). According to this theory, absent of transaction costs MNCs favor licensing. Licensing avoids the costs (resource commitments) associated with opening up a foreign market. However, if a MNC grants a license to a foreign enterprise to use firm-specific know-how to manufacture or market a product, it runs the risk of the licensee, or an employee of the licensee, disseminating that know-how or using it for purposes other than those originally intended. Similar arguments can be made with respect to joint venture partners. The consequence in both situations is a real reduction in the quasi-rent that the MNC can earn from its proprietary know-how.

The risk of dissemination can be insured against if the licensee and licensor (or venture partners) enter into a comprehensive contingent claims contract that specifies the rights and obligations of both parties to any agreement to transfer know-how. However, in a complex and uncertain world populated by economic actors of bounded rationality and opportunistic tendencies the costs of drafting, negotiating, monitoring, and enforcing such contracts are arguably non-trivial (Williamson, 1985). In addition, due to the persistence

of uncertainty and bounded rationality, a truly comprehensive contingent claims contract can never be drafted. Real-world contracts are inevitably incomplete and at best only provide partial insurance against uncertainty and opportunism. There is always the possibility of unanticipated contingencies occurring that give rise to opportunistic actions against which the MNC has no recourse.

The above argument suggests two sources of transaction costs in a licensing (or joint venture) scenario: (1) the costs associated with drafting, negotiating, monitoring, and enforcing a comprehensive contingent claims contract to police the licensing (or venture) agreement; and (2) the *expected loss* anticipated by the MNC due to unanticipated contingencies arising and subsequent opportunism by the licensee (or venture partner). According to transaction cost logic, by establishing a wholly owned subsidiary a MNC can reduce dissemination risk and therefore economize on the transaction costs of licensing (or venturing). If the reduction in transaction costs exceeds the bureaucratic costs of establishing and running an internal market to transfer know-how, establishing a wholly owned subsidiary will make most sense (Hennart, 1982; Hill and Kim, 1988).

This line of reasoning suggests that the factors that determine the propensity of a licensee (or venture partner) to act opportunistically and attempt to expropriate a MNC's proprietary know-how are of critical importance. The greater the propensity of a licensee (or venture partner) to act opportunistically, the greater the transaction costs the MNC must bear as an insurance against expropriation, and the more likely it is that the MNC will favor a wholly owned subsidiary as an entry mode.

Perhaps the key variable here is the level of quasi-rents that can be earned from the MNC's proprietary know-how. The greater the quasi-rent stream generated by an MNC's know-how, the greater the incentive that licensees and venture partners have to act opportunistically and expropriate that know-how. Consequently, the greater the transaction costs the MNC must bear to limit opportunism, and the more likely it is that the transaction cost saving associated with a wholly owned subsidiary will outweigh the costs (resource commitments) of expanding organizational boundaries. Thus:

Proposition 8: Other things being equal, the greater the quasi-rent stream generated by a MNC's proprietary know-how, the greater the probability that the MNC will favor an entry mode that minimizes dissemination risk.

In addition, a number of authors have suggested that the nature of the know-how being transferred is a major determinant of transaction costs (Anderson and Gatignon, 1986; Teece, 1977). Firm-specific know-how is often *tacit* in nature and may be difficult to separate out for sale via licensing. The know-how may be embodied in more than technological blueprints. It may also be embedded in the human capital of the firm and in informal operating procedures or routines (Nelson and Winter, 1982). Consequently, drafting a contract to transfer know-how may be particularly problematic. Successful transfer may involve more than the sale of blueprints. It may also involve the transfer of tacit know-how; which by definition is difficult to articulate.

In these circumstances, the inability to transfer tacit know-how and informal routines via an arm's-length licensing contract suggests that a licensee may not be able to generate the quasi-rents that the firm could if it set up a wholly owned subsidiary in the host market. The licensee may lack the tacit know-how and informal routines that are required to turn a technological blueprint into a successful product. From the MNC's perspective, the transaction costs in these circumstances are equivalent to the loss in royalties that arises from the licensee's inability to maximize the rents that could be earned from the technological blueprints. By setting up a wholly owned subsidiary, the MNC can better transfer tacit know-how and informal routines. Such transfers are easier for intra-organizational transactions due to the MNC's ability to utilize its human capital, draw upon its organizational memory, and use existing organizational routines to structure the transfer problem. Thus, by establishing a wholly owned subsidiary the MNC can economize on the transaction costs of arm's-length contracting and earn greater rents from its technology.

In terms of the concepts discussed at the beginning of this paper, *high control* entry modes give the MNC an enhanced ability to structure the exchange relationship so that tacit know-how and informal routines are transferred intact to

the host market. So long as the additional rents (transaction cost savings) associated with a wholly owned subsidiary exceed the additional costs (resource commitments and bureaucratic costs) of such an operation, the MNC will favor high control over low-control entry modes. Thus:

Proposition 9: Other things being equal, the greater the tacit component of firm-specific know-how, the more a MNC will favor high-control entry modes.

SYNTHESIS

The propositions generated here are all set down as *ceteris paribus* arguments. In reality, *ceteris paribus* conditions do not apply. Therefore, it is important to determine how the interaction between strategic, environmental, and transaction-specific variables influence a MNC's choice of entry mode.

The first point to note is that different variables may pull the MNC in different directions. For example, faced by a volatile host market the MNC may have a preference for entry modes that require low resource commitments such as licensing (Proposition 7). However, because licensing is associated with a high dissemination risk, it may be inappropriate if the MNC's competitive advantage is based on firm-specific know-how that promises to generate substantial quasi-rents (Proposition 8). In theory this conundrum may be resolved by comparing the expected loss that might arise from the lack of strategic flexibility associated with a wholly owned subsidiary against the transaction cost savings that arise from the reduced dissemination risk. If the transaction cost savings exceed the expected loss from the lack of strategic flexibility, a wholly owned subsidiary will be the favored entry mode. If they do not, licensing may be the preferred option. Thus, the optimal decision for the MNC is to choose the entry mode that maximizes the long-term value of the firm when *all* relevant factors have been taken into consideration.

In practice, 'optimization' is extremely difficult given the complexity that characterizes the real world, the uncertainty that exists as to future states of nature, and the bounded rationality of decision-makers. Thus, 'satisfactory' rather than optimal solutions seem to be the best that can

be achieved. Nevertheless, assuming that global markets are reasonably competitive, in the long run competitive forces will select out those MNCs that choose entry modes inconsistent with value maximization. Hence, it is of critical importance that management decision-makers consider the relative weight of the strategic, environmental, and transaction-specific variables identified herein when selecting a mode of entry.

This raises the question of whether any meaningful generalizations can be made about the relative weight of the different variables. In a rough sense it is possible to make two broad generalizations. First, it seems logical to suggest that, for a certain group of MNCs, minimizing dissemination risk is of paramount concern. When a MNC's competitive advantage is based on proprietary know-how, protecting that know-how from expropriation by opportunistic licensees or venture partners should be the firm's first priority. Once the know-how has gone, so has the MNC's competitive advantage. This suggests that, in general, transaction cost variables are of prime importance for MNCs based in knowledge-intensive industries, and that MNCs based in such industries will favor entry by wholly owned subsidiaries. In point of fact, empirical evidence does suggest that in R&D-intensive industries where the role of technical know-how in establishing firm-specific advantages is critical, wholly owned subsidiaries are the favored entry mode (Dunning, 1983; Caves, 1982; Rugman, 1981; Vernon and Davidson, 1979).

A further generalization is that maximizing the overall value of the corporation will usually carry greater weight than choosing the most efficient mode of entry for a given business unit. This suggests two scenarios in which *high-control* entry modes will normally be preferred. First, when the global industry is characterized by relatively homogeneous demand and competitive conditions, and when substantial scale economies can be gained from centralizing parts of the global manufacturing process. In such circumstances a global strategy (which requires high control over national subsidiaries) is consistent with value maximization. The lack of strategic flexibility that results from the required resource commitments is part of the trade-off that has to be accepted when pursuing a global strategy.

Second, high control will often be preferred when the global industry is characterized by

oligopolistic interdependence. For illustration, consider a MNC based in a non-knowledge-intensive industry that is contemplating entry into a host market with which it is unfamiliar, where country risk is high, where future demand is uncertain, and where competitive conditions are unfavorable. All of these factors point towards the desirability of licensing as an entry mode. However, if the global industry is characterized by oligopolistic interdependence between a limited number of global players, and if the host market under consideration is the home base of one of the MNC's global rivals, the MNC is likely to favor a high-control entry mode (a wholly owned subsidiary). The lack of flexibility and sunk costs associated with a wholly owned subsidiary will be offset by the MNC's ability to use the threat to cut prices in the host market as a means of deterring the host country rival from launching competitive attacks in the MNC's home market. Thus, the loss taken on the individual subsidiary may be consistent with maximizing global value.

CONCLUSION

Much of the existing literature on the entry mode decision has presented either a list of considerations without identifying underlying constructs, or focused on each entry decision in isolation, treating each as a self-contained decision. Here we have identified three underlying constructs that influence the entry mode decision: control, resource commitments (strategic flexibility), and dissemination risk. These three constructs were then linked to many of the considerations that have been previously discussed in the literature. In addition, we have argued that a MNC's choice of entry mode depends on the strategic relationship the MNC envisages between operations in different countries. Thus, a particular entry decision cannot be viewed in isolation. Rather it must be considered in relation to the overall strategic posture of the firm.

The framework presented in this paper is intended to enrich rather than replace existing explanations of the choice of entry mode. It synthesizes not only environmental and transaction cost considerations, but also global strategic objectives into an eclectic theory of the variables that influence the entry mode decision. This

allows each entry decision to be considered not in isolation, but with reference to its strategic impact upon a MNC's global network of operations. For managers, such an eclectic theory offers several advantages. For one thing, it can aid executives in identifying those factors and issues that should be considered when reviewing different entry modes. Such a framework better relates the existing insightful but often partial analyses to the totality of real life that managers must contend with when reaching an entry mode decision. Another related and important utility of the framework is that it can help highlight the probable and possible contradictions that exist when diverse variables are considered collectively. As discussed in the synthesis section of this paper, an unfortunate fact of corporate life is that any particular entry decision is rarely an unmixed blessing. Actions taken to achieve a given objective often hinder the attainment of another objective. An eclectic framework can be useful in identifying possible trade-offs between diverse considerations and, therefore, in understanding not only the benefits but also the potential costs associated with pursuing a particular entry mode decision. This makes explicit the strategic dilemmas that management must deal with that might otherwise be resolved through omission.

One important future research task suggested by this paper is the need to systematically explore the situational contingencies that surround the entry mode decision. By this we mean identifying under what set of circumstances each of the particular entry mode considerations, or sets of considerations, should dominate and play a more important role than the others. Such research could assist practitioners in the important and difficult task of prioritizing entry considerations, and could therefore better focus managers' time and resources—which are often limited—on those factors most likely to affect success under a given situation.

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