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THE EXPERIENCE FACTOR IN FOREIGN MARKET ENTRY BEHAVIOR OF SERVICE FIRMS

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Abstract. The paper examines the effect of international experience on service firms' selection of foreign markets and entry modes. The investigation utilizes survey data from 151 United States-based service firms. Results on market selection suggest that, as their experience increases and becomes geographically more diversified, service firms tend to choose markets that are culturally less similar to their home country. On entry mode choice, the paper departs from traditional linear conceptualizations and hypothesizes a U-shaped relationship between experience and propensity for integrated entry modes. Results generally support the hypothesis. The paper explains these findings and describes how service firms resemble and differ from manufacturing firms in their foreign market entry behavior.

The influence of experience on the foreign market entry behavior of firms has been extensively investigated in the literature. However, past research focussed almost exclusively on manufacturing firms. Whether the results of this research are generalizable to the service sector is not entirely clear. Not only are the production and delivery of services distinctive enough to make a direct transfer of goods marketing experiences to the service sector inappropriate (e.g., Gronroos [1983], Lovelock [1983]), service firms face some unique challenges expanding internationally [Carmen and Langeard 1980; Cowell 1983; Palmer 1985].

In this paper, we investigate effects of the experience factor on the service firm's foreign market entry behavior. Specifically, we examine the impact of the *length* and *scope* of the service firm's pre-entry international experience on two major foreign market entry decisions: selection of a foreign market and choice of an entry mode.

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Our study differs from past experience-related investigations in several respects. First, it measures the *quantity* as well as the *diversity* of international experience. Second, it includes the *entire* range of export and non-export entry modes, unlike previous entry mode investigations which typically included only licensing and FDI. Lastly, departing from past investigations, the study focuses exclusively on *service* firms.

In the following sections, we review the relevant literature and develop some predictions concerning the relationship between experience and entry behavior of service firms. Next, we discuss the data collection, sample, and variables. Finally, we describe our analysis and discuss the results.

RELEVANT LITERATURE

Experience and Market Selection

From a normative standpoint, several factors are considered to be important in assessing the potential attractiveness of a foreign market: market size and market growth [Stobaugh 1969; Davidson 1980a], competition [Knickerbocker 1973], servicing costs [Davidson 1982], and the host country's social, political and economic environment [Root 1987; Toyne and Walters 1989]. Papadopoulos and Denis [1988] provide an excellent review of numerous qualitative and quantitative market-selection techniques incorporating these variables. They conclude, however, that there is little evidence firms (small, medium or large) use any such methods on a systematic basis to choose target markets in practice.

In fact, empirical research on actual business practices has consistently highlighted only one major determinant of market selection: *market similarity*, i.e., similarity of the foreign market to the firm's home market or to markets it is currently serving. As Papadopoulos and Denis [1988: 44] conclude:

in an overwhelming number of cases ..[choices of markets].. are still based on such nonsystematic criteria as 'psychic' distance... 'cultural' distance... , and geographic distance.

Several studies show that U.S. exporters have a strong bias for markets such as Canada and U.K. (see Bilkey [1978]; Reid [1981]). Investigations involving U.S. multinational corporations, too, found sharp preferences for English-speaking countries, preferences that were not warranted on economic grounds alone [Davidson 1980b, 1982, 1983]. Parallel findings have been reported in studies on service firms, such as banks [Khoury 1979] and advertising agencies [Weinstein 1977].

Firms prefer entry into similar markets because it facilitates transfer of technology and managerial resources, assures ready demand for their products, and helps reduce uncertainty [Davidson 1983]. This last reason is particularly relevant to the present study. Davidson [1982: 118] argues that when "the firm has little confidence in its ability to estimate or predict costs,

demand, competition or environmental conditions in various markets it can minimize uncertainty in its selection decisions by choosing markets about which it has best information.”

Preference for similar markets, however, appears to be conditioned by the firm's international experience. Reviewing patterns of foreign activity by U.S. multinational corporations, Vernon [1966] noticed a “gradual fanning out from geographically and culturally familiar to the geographically and culturally remote areas of the world.” Likewise, Uppsala School researchers insist that exporting begins with “psychologically close” countries and extends incrementally to “psychologically distant” countries as the firm gains experience [Johanson and Wiedersheim-Paul 1975; Johanson and Vahlne 1977; Wiedersheim-Paul, Olson and Welch 1978].

Explaining the relationship between preference for similar markets and experience, Davidson [1980a] argues that with increasing experience, firms acquire greater confidence in their ability to gauge customer needs, to estimate costs and returns, and to assess the true economic worth of foreign markets. Thus market selection, dominated by concerns of uncertainty in the early phases of international expansion, increasingly becomes a function of economic opportunity as the firm gains experience. The basis for relating uncertainty reductions to experience originates in Johanson and Vahlne's [1977] argument that uncertainty in international markets is reduced only through actual operations in the relevant markets and not through acquisition of “objective” information. Davidson [1983: 453] supports this contention by concluding that “direct experience and not market research activities now provides the principal inputs in market selection decisions.”

In his studies of the foreign direct investment practices of U.S. MNCs, Davidson [1980a, 1980b, 1983] made several important discoveries. First, American MNCs' attraction for countries such as Canada, U.K. and Australia, very high in their early forays into foreign markets, declined perceptibly over time. Second, firms with extensive experience exhibited less preference for near, similar and familiar markets. Markets that were initially perceived as less attractive because of high uncertainty were given increased priority as the firm's experience rose. Finally, the presence of existing manufacturing facilities in a particular market had a positive impact on subsequent entries into the same country. Davidson concluded from these findings that both general and country-specific experience factors played a role in market selection.

In the service sector too, Weinstein [1977] found investments made by U.S. multinational advertising agencies in the late 1950s and the early 1960s were primarily in highly developed, culturally familiar areas of the world. He discovered, however, that “as the agencies grew in size and overseas experience, their investments switched from Canada and Europe to Latin America and the Far East” [Weinstein 1977: 86]. Terpstra and Yu [1988] investigated the FDI behavior of U.S. multinational advertising agencies

after 1970 (by which time, presumably, most of these agencies were highly experienced in foreign markets) and, indeed, found support for their hypothesis that geographic proximity (and hence "similarity") had no significant impact on an agency's decision to invest in a certain country.

The literature is not, however, entirely free of discord. Maclayton, Smith and Hair [1980] found overseas business experience, measured in number of years, to have no relationship with firms' evaluation criteria of foreign markets. Based on evidence drawn from case studies, Sharma and Johanson [1987] likewise concluded that the concept of "psychic" distance did not explain the international expansion of technical consultancy firms.

Experience and Entry Mode Choice

Once a firm decides to enter a certain foreign market it has to choose a mode of entry, i.e. select an institutional arrangement for organizing and conducting international business transactions [Anderson and Gatignon 1986; Root 1987]. As entry modes have a major impact on the firm's overseas business performance, their choice is regarded as a critical international business decision [Wind and Perlmutter 1977; Anderson and Gatignon 1986; Root 1987; Terpstra 1987; Hill et al. 1990].

Firms can often choose from a variety of entry modes. For example, *exporting* firms have two alternative modes: exports through independent intermediaries, and exports via integrated (company-owned) channels [Anderson and Coughlan 1987]. Alternately, firms can produce their products overseas, either through *contractual* modes (e.g., licensing and franchising) or via *foreign direct investment* (joint ventures and wholly owned subsidiaries).

Entry modes differ from each other on several dimensions, one of which is the degree of control they allow the foreign market entrant [Root 1987]. Traditionally, control has been perceived by researchers as flowing from ownership.¹ Thus the greater the firm's level of ownership, the greater the control it enjoys over its international transactions [Anderson and Gatignon 1986]. For this reason, company-owned channels, wholly owned foreign subsidiaries and branches are designated as *full-control* modes in our paper. On the other hand, exports through outside intermediaries, contractual transfers and joint ventures are termed *shared-control* modes.

Much of the literature investigates entry mode choice in terms of the degree of control desired by firms [Stopford and Wells 1972; Anderson and Gatignon 1986; Gatignon and Anderson 1988]. The pertinent question here is: Does experience have positive, negative or no effect on the degree of control a firm takes? The literature is somewhat ambiguous on this question and provides support (in different degrees) for all three options.

Gatignon and Anderson [1988] found that the manufacturing MNC's propensity to employ wholly owned subsidiaries increased with increasing cumulative international experience (measured as number of foreign market entries to

date). Similarly, Davidson [1980a, 1982] noticed that aggregate experience (as measured by the number of market entries or product transfers already executed), and prior manufacturing experience in the recipient country increased the firm's relative preference for wholly owned subsidiaries.

The theoretical explanation for a *positive* relationship between experience and degree of control centers on uncertainty and how firms cope with it. Less experienced firms perceive considerable uncertainty, overstate risks and understate returns [Davidson 1982], and, consequently, shy away from making significant resource commitments and assuming control [Johanson and Vahlne 1977]. With increasing experience, however, firms acquire knowledge of foreign markets, perceive less uncertainty, and become more confident of their ability to correctly estimate risks and returns and manage foreign operations [Johanson and Vahlne 1977; Davidson 1982]. As a result, they become more aggressive in committing resources and assuming control [Anderson and Gatignon 1986].

The literature, however, is not without controversy. There is some evidence to indicate that international experience may have not have *any* effect on degree of control. Kogut and Singh [1988] observed that experience (as measured by the firm's pre-entry presence in the host country, and degree of multinationality) played no significant role in explaining why foreign entrants into the United States used joint ventures in preference to wholly owned acquisitions. Similarly, Sharma and Johanson [1987] could see no evidence of "incremental" internationalization in their case studies of Swedish technical consultancy firms, suggesting experience may not be a determinant of entry mode choice.

Some writers suggest even a *negative* relationship between the firm's international experience and its desire for control. Daniels et al. [1976] observed a tendency among companies investing overseas to start with complete control and share it after the operation became established. Taking a comparative perspective, Shetty [1979] argued that European MNCs were more agreeable to joint ventures than their American counterparts because their longer overseas experience made them more adept at dealing with foreign partners. Davidson and McFetridge [1985] found the probability of using a wholly owned affiliate by U.S. MNCs decreased with increasing number of prior technology transfers. Stopford and Wells [1972] analyzed the first five manufacturing investments outside the U.S. and Canada by American MNCs to determine if these companies preferred joint ventures in the early stages of their international evolution. To their surprise, the authors found almost three-fourths of these initial ventures were *wholly owned*.

Two theoretical explanations may be advanced to explain the observed negative relationship between experience and desire for control. One is the *ethnocentric* argument. It has been suggested that many international neophytes tend to be ethnocentric in their orientation demanding to have their own nationals in key positions in foreign ventures [Weichmann and Pringle

1979; Anderson and Gatignon 1986]. Since these demands can be rarely satisfied in shared-control arrangements, novices may decide to assume full ownership and control. Experienced firms, on the other hand, grow more polycentric in their orientation and, consequently, more confident of their ability to advantageously exploit local expertise [Shetty 1979]. As such, they may be more eager to accept shared ownership and control.

Alternately, *transaction cost analysis* suggests that when internal uncertainty is high (say, due to lack of experience), the firm may find it difficult to accurately assess the performance (output) of agents or partners [Williamson 1985]. The firm may, therefore, find it easier to monitor the effort (input) of its employees, making fully integrated operations more desirable.

In short, the findings reported in the literature on entry mode selection are conflicting and confusing. Below, we attempt to reconcile the divergent viewpoints and make predictions concerning the relationship between experience and entry mode choice.

PREDICTIONS

The review of literature on *market selection* indicates that some dissent exists concerning the true role of experience. On balance, however, the evidence that inexperienced firms choose similar markets and experienced firms enter dissimilar ones appears to be preponderant. Testimony to the contrary is weak at best. It is, therefore, reasonable to expect less experienced American service firms in our study to show a stronger preference for countries culturally, politically and economically proximate to the United States, and more experienced ones to seek out distant markets. In other words, we expect a *positive* relationship between level of a service firm's experience and market distance.

The problem of entry mode choice is, however, more intractable and defies easy generalizations. Although evidence suggesting a positive relationship between experience and degree of control is convincing, the counter-arguments are not easily refutable, especially on theoretical grounds.

In our opinion, the key reason for the controversy appears to be the widely differing time frames adopted by researchers in opposing camps. Proponents of the positive relationship between experience and control, such as Gatignon and Anderson [1988], have generally employed continuous, long-term measures of experience. On the other hand, analysts who noted negative relationships have typically focussed their attention on the early part of firms' international evolution.

It is conceivable that experience influences firms in two distinct and opposing ways in different phases of their multinational evolution. International novices may desire high degrees of control to support ethnocentric beliefs and overcome transactional uncertainty. Operational experience in international markets, however, acts to reduce such ethnocentricity and transactional

uncertainty (as the “negative” proponents have claimed). Not surprisingly, increasing experience in the *early* phase of international evolution leads to greater acceptance of foreign partners and intermediaries, ie., control sharing. In *later* stages of overseas growth, experience acts to instill in firms the confidence to correctly assess risks and returns, and to manage independent foreign operations. Accordingly, increasing experience here will lead to greater integration. Such an argument suggests a U-shaped relationship between experience and desire for control, with the propensity for control declining between “low” to “moderate” levels of experience, and increasing between “moderate” to “high” levels. Figure 1 graphically portrays this relationship.

Mathematically, the relationship between desire for control (y) and level of firm experience (x) can be represented as:

$$y = b_0 - b_1x + b_2x^2$$

Such a nonlinear conceptualization is not only plausible, but can also succinctly explain the divergent findings in the literature. Based on this expectation, we predict a U-shaped relationship between service firms' *propensity to employ full-control modes* and their *length and scope of experience*.

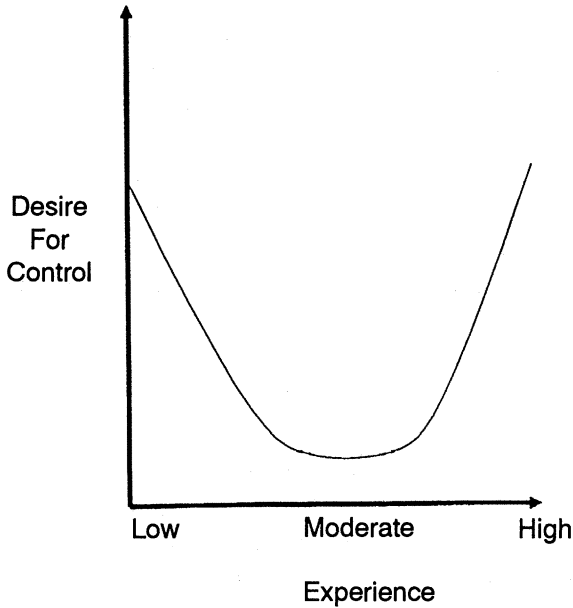
METHODOLOGY

Data Collection

Data for this study were collected through a mail survey of United States service firms engaged in international operations. Despite much effort, we were unsuccessful in procuring a sampling frame for our study (all U.S. service firms involved in international operations) from any source: government agencies, trade groups, and commercial vendors. Therefore, a convenience sample of service firms known to be engaged in international operations was drawn from various business directories [Dun and Bradstreet's *Million Dollar Directory* 1986; *Consultants & Consulting Organizations Directory* 1984; Standard & Poor's *Register of Corporations* 1986]. A total of 463 companies, representing a wide variety of service industries, were included in the mail survey. A questionnaire was developed and extensively pretested initially in personal interviews with six directors of international operations from large and small service firms,² and later with ten others via mail. The final questionnaires, accompanied by personalized cover letters and directions for completion, were mailed to managers most likely to be involved in the foreign market entry decision process in their firms (including executives in charge of international operations, presidents or CEOs). Each respondent provided data on one entry decision which he/she was most familiar with.

Twenty-five questionnaires were returned undelivered, and forty-three companies wrote back regretting their inability to participate for various reasons

FIGURE 1
Effect of Experience on a Firm's Desire for Control



(the most common: they were no longer in international business). From the remaining pool of 395 potential respondents, we received 175 usable responses. The response rate of 44.3% compares favorably with rates reported in other surveys involving international-marketing executives (e.g., Klein [1989]), and service firms (e.g., Zeithaml, Parasuraman and Berry [1985]). Respondents do not significantly differ from nonrespondents in industry distribution, mean firm size (measured in terms of number of employees), or mean annual sales revenue. Thus, nonresponse bias, if any, is negligible.

Sample Characteristics

Salient characteristics of the 175 firms included in the final sample are summarized in Table 1. As can be seen, the sample has a good representation of service firms from various size categories and industries. But firms which market *exportable* services outnumber those providing *nonexportable* ones.³ Nearly 60% of firms have reported entries into other industrialized countries. A similar number reported entries involving foreign production (as opposed to domestic production). Finally, full-control modes (wholly owned subsidiaries, and direct-to-customer/sales subsidiary exports) were employed by about 60% of respondents.

TABLE 1
Characteristics of Firms in Original Sample (N=175)

A. Distribution of Firms: By Size	
No. of Employees	% Firms
a. <500	30.7
b. 500-1000	23.3
c. 1001-4000	25.0
d. Above 4000	21.0
B. Distribution of Firms: By Industry	
Service Industry	% Firms
Advertising	5.7
Banking	8.0
Computer Software & Data Proc.	23.3
Engineering & Architecture	21.0
Management Consulting	18.8
Consumer Services	8.0
Miscellaneous Services (Accounting, R&D, Leasing, Maintenance, etc.)	
C. Distribution of Firms: By Type of Service	
Type of Service	% Firms
1. Exportable Service	59.1
2. Non-Exportable Service	40.9
D. Distribution of Firms: By Country of Entry	
Country of Entry	% Firms
1. English-speaking Industrial	27.8
2. Other Industrial	30.7
3. Non-Industrial	41.5
E. Distribution of Firms: By Entry Mode	
Entry Mode	% Firms
1. Wholly Owned Subsidiary	28.4
2. Joint Venture	18.2
3. Contractual Method	12.5
4. Direct-to-Customer/Subsidiary Exports	30.7
5. Agent/Distributor Exports	10.2

Variables

Measurement of the variables is described in the Appendix. The service firm's pre-entry international experience is represented by two measures. *LENGTH* is the *number of years* the service firm was engaged in international operations prior to the current entry. *SCOPE* measures the *geographic scope* of this experience. The two variables measure different facets of international experience. Whereas *LENGTH* measures the *intensity* of the firm's experience, *SCOPE* measures the *diversity* of this experience.

Market similarity is represented by the variable *DISTANCE*, which is a measure of the *cultural distance* between the United States and the host country. Although it primarily measures cultural distance, the variable probably represents economic and political distance as well since these phenomena are often intertwined. *MODE* is the other dependent variable in our study assuming a value of 1 when the firm employs a *full-control* entry mode (integrated exports, or wholly owned FDI operations) and 0 when it uses a *shared-control* mode (intermediary exports, contractual methods, or joint ventures).

In addition to these variables, our study includes three covariates. *SIZE* (0=Smaller firms, 1=Larger firms) is a dummy variable that measures firm size. Firm size can have a positive impact on both *DISTANCE* and *MODE*. Since international experience and firm size are often correlated, it is necessary to initially partial out the effects of firm size on our dependent variables before conclusions on experience effects are drawn. *FORPROD* (0=Domestic production, 1=Foreign production) is another dummy variable employed to filter out extraneous variation introduced by the pooling of export and non-export entry modes in our study. Finally, *XPORTBLE* (0=Exportable service, 1=Nonexportable service) accounts for any variation that may be introduced due to the type of service a firm provides.³

ANALYSIS AND RESULTS

Preliminary Details

To ensure that an identical set of observations was available for all of the compared models, we initially eliminated twelve observations that had missing values on one or more of the variables in the study. A further deletion of twelve outliers led to significant improvement in estimation and model fit.⁴ This preliminary “purification” of the sample resulted in a “clean” sample of 151 observations.

The correlation matrix for the variables in the study, reported in Table 2, was examined to assess multicollinearity. Two correlations appeared to be noteworthy. The first one involves *FORPROD* and *XPORTBLE*. However, since these variables are not jointly estimated in the same model, the correlation is inconsequential. The second correlation is more serious and involves the two experience variables, *LENGTH* and *SCOPE*. Although some authorities [Belsley et al. 1980] consider a correlation of 0.68 “weak,” we examined several diagnostic statistics, such as the variance inflation factor, condition index, and tolerance factor [Belsley et al. 1980; Neter et al. 1983]. None of these statistics indicated the presence of serious multicollinearity. Still, pilot runs revealed noticeable changes in the coefficient of *LENGTH* when *SCOPE* was added to the model, suggesting the presence of at least moderate levels of multicollinearity. Therefore, following Cohen and Cohen’s [1983] recommendation, a hierarchical regression approach was employed

TABLE 2
Correlation Matrix for Variables in Study
(Product Moment Correlation Coefficients; N=151)

	<i>SIZE</i>	<i>XPORTBLE</i>	<i>SCOPE</i>	<i>LENGTH</i>	<i>DISTANCE</i>	<i>MODE</i>
<i>FORPROD</i>	0.263*	0.697*	0.043	0.114	-0.019	-0.231*
<i>SIZE</i>		0.280*	0.180*	0.373*	0.190*	-0.117
<i>XPORTBLE</i>			0.023	0.069	-0.042	-0.097
<i>SCOPE</i>				0.681*	0.309*	-0.155
<i>LENGTH</i>					0.284*	-0.047
<i>DISTANCE</i>						-0.176*

*Significant at $p < 0.05$

in our analysis. We first estimated the effects of the covariates only. Next, we separately assessed the impact of *LENGTH* and *SCOPE* in the presence of these covariates. Finally, we examined the combined impact of the two experience effects in the company of covariates. Comparisons among models were then made to estimate individual influence of the experience variables.

Market Selection

Multiple regression models were used to assess the impact of *LENGTH* and *SCOPE* on *DISTANCE*. Since neither *FORPROD* nor *XPORTBLE* made any contribution to the explanation of *DISTANCE*, we deleted them and retained *SIZE* as the only covariate.

Table 3 reports parameter estimates, *F*-statistics and adjusted R^2 for the four models estimated to explain *DISTANCE*. Results for Model #1 support the notion that entry into culturally distant markets becomes more common for larger firms. Further analysis (not reported here), however, demonstrated that *SIZE* made no contribution in the presence of *LENGTH*, leading us to conclude that firm size may not have any significant independent impact on selection of markets.

The statistically significant and positive coefficients for *LENGTH* and *SCOPE* in Models #2 and #3 suggest that *individually* these experience variables have the predicted positive influence on *DISTANCE*. However, when the two effects are *jointly* assessed in Model #4, only *SCOPE* emerges significant, perhaps, due to collinearity effects.

The relative contribution of the experience variables individually and collectively to the explanation of market selection was assessed using procedures outlined by Cohen and Cohen [1983] and Neter et al. [1983]. The idea is to compare a *full model*, with the variable(s) of interest included, to a corresponding *reduced model*, with the variable(s) of interest excluded. An "incremental *F*"-statistic is then computed to test whether the reduction in error sum of squares, caused by the variable(s) of interest, is statistically significant. Table 4 presents the results of our analysis. It is clear from the

TABLE 3
Effect of Firm Experience on Selection of Foreign Markets
(Results of Multiple Regression;
Dependent Variable *DISTANCE*; N=151)

Variable	Model #1	Model #2	Model #3	Model #4
<i>INTERCEPT</i>	<i>1.391</i> (9.16) ^c	<i>1.231</i> (8.24) ^c	<i>0.722</i> (3.14) ^c	<i>0.791</i> (3.17) ^c
<i>SIZE</i>	<i>0.514</i> (2.37) ^b	<i>0.265</i> (1.16)	<i>0.376</i> (1.77) ^a	<i>0.319</i> (1.41)
<i>LENGTH</i>	*	<i>0.039</i> (2.92) ^c	*	<i>0.013</i> (0.72)
<i>SCOPE</i>	*	*	<i>0.266</i> (3.61) ^c	<i>0.218</i> (2.19) ^b
Model Statistics:				
-Overall <i>F</i>	5.60 ^b	7.21 ^c	9.55 ^c	6.52 ^c
-df	(1,149)	(2,148)	(2,148)	(3,147)
-Adjusted <i>R</i> ²	0.030	0.077	0.102	0.099

Notes: (1) Numbers in italics are beta coefficients. Associated numbers in parentheses are t-ratios.

(2) Two-tail probabilities are reported for t-tests.

(3) a=significant at $p < 0.10$; b=significant at $p < 0.05$; c=significant at $p < 0.01$.

table that together the experience variables contribute significantly to the selection of foreign markets by service firms. Individually, *LENGTH* appears to make a significant contribution, but not in the presence of *SCOPE*, thereby suggesting that its effects are merely an outcome of its correlation with the latter. *SCOPE*, by contrast, appears to make a tangible contribution regardless of whether *LENGTH* is included or not.

To sum up, the results imply that service firms choose culturally similar foreign markets at low levels of experience, but favor increasingly unfamiliar territories at higher levels of experience. Furthermore, the *geographic scope* of the firm's experience appears to be more influential on market selection decisions than its *length* of experience.

Entry Mode Choice

The influence of *LENGTH* and *SCOPE* on *MODE* was investigated by way of logistic regression. Logistic regression is particularly appropriate when (a) the dependent variable is binary, (b) independent variables are qualitative or quantitative, and (c) underlying assumptions of multivariate normality cannot be met [Cox 1970; Afifi and Clark 1984; Kachigan 1986]. Many recent studies related to entry mode choice have employed logistic regression models [Davidson and McFetridge 1985; Gatignon and Anderson 1988; Kogut and Singh 1988; Terpstra and Yu 1988].

TABLE 4
Contribution of Experience Variables
Towards Explaining Market Selection
(based on data presented in Table 3)

Variable(s)	In Presence of	Models Compared	Incremental <i>F</i>	Contribution of Variable(s)
<i>LENGTH+SCOPE</i>	<i>SIZE</i>	#1 & #4	6.75 ^a (df 2,147)	Significant
<i>LENGTH</i>	<i>SIZE</i>	#1 & #2	8.54 ^a (df 1,148)	Significant
	<i>SIZE+SCOPE</i>	#3 & #4	0.49 (df 1,147)	Not Significant
<i>SCOPE</i>	<i>SIZE</i>	#1 & #3	13.06 ^a (df 1,148)	Significant
	<i>SIZE+LENGTH</i>	#2 & #4	4.75 ^a (df 1,147)	Significant

Notes: (1) Incremental *F* is computed as follows [Neter et al. 1983: 95]

$$\frac{SSE(R) - SSE(F) / [df(R) - df(F)]}{SSE(F)/df(F)}$$

where,

SSE(R) is error sum of squares for the reduced model with smaller number of parameters;

SSE(F) is error sum of squares for the full model, i.e., model with larger number of parameters;

df(R) and *df(F)* are the error degrees of freedom associated with the reduced and full models respectively.

(2) a=significant at *p*<0.01.

Consistent with the pattern of analysis outlined earlier, we first examined the impact of covariates. Neither *SIZE* nor *XPORTBLE* appeared to make detectable contributions to the explanation of *MODE* and were eliminated from further consideration. Retaining *FORPROD*, we added *DISTANCE* as a second covariate in the model. The inclusion of the latter is important because Table 2 suggests a three-way relationship between the experience variables, *DISTANCE* and *MODE*. Unless the effects of *DISTANCE* on *MODE* are partialled out, the possibility of spurious relationships between experience and entry mode choice looms large. The probability of a service firm choosing a full-control entry mode is modeled as follows:

$$P(MODE = 1) = 1 / \{1 + e^{-y}\},$$

where

$$y = f(FORPROD, DISTANCE, LENGTH, SCOPE).$$

Maximum likelihood estimates, along with associated (asymptotically distributed) *t*-statistics, for the parameters are reported in Table 5 for each of the four models estimated to predict entry mode choice. Conforming to our predictions of a U-shaped curve, we expect coefficients for *LENGTH* and *SCOPE* to be *negative*, and those for [*LENGTH*]² and [*SCOPE*]² to be *positive*.

TABLE 5
Effect of Firm Experience on Selection of Entry Mode
(Results of Logistic Regression;
Dependent Variable *MODE*; N=151)

Variable	Model #1	Model #2	Model #3	Model #4
<i>INTERCEPT</i>	1.494 (3.93) ^c	1.851 (4.30) ^c	3.032 (3.53) ^c	2.703 (2.87) ^c
<i>FORPROD</i>	-1.048 (2.89) ^c	-1.109 (2.92) ^c	-1.021 (2.77) ^c	-1.119 (2.92) ^c
<i>DISTANCE</i>	-0.295 (2.25) ^d	-0.309 (2.20) ^b	-0.273 (1.96) ^b	-0.305 (2.13) ^d
<i>LENGTH</i>	*	-0.159 (2.44) ^b	*	-0.090 (0.99)
[<i>LENGTH</i>] ²	*	0.007 (2.64) ^c	*	0.005 (1.52)
<i>SCOPE</i>	*	*	-1.289 (1.94) ^a	-0.768 (0.97)
[<i>SCOPE</i>] ²	*	*	0.205 (1.74) ^a	0.108 (0.82)
Model Statistics:				
<i>X</i> ² (<i>df</i>)	13.50 ^c (2)	21.55 ^c (4)	18.05 ^c (4)	22.74 ^c (6)
-2 Log Likelihood	190.97	182.93	186.43	181.73

Notes: (1) Numbers in italics are beta coefficients. Associated numbers in parentheses are *t*-ratios.

(2) Two-tail probabilities are reported for *t*-tests.

(3) a=significant at $p < 0.10$; b=significant at $p < 0.05$; c=significant at $p < 0.01$.

The explanatory power of the logistic regression model can be examined using the *model chi-square* statistic. Large chi-square values and small *p*-values indicate good fit. Judging by the model chi-square test, all of the models reported in Table 5 are significant. Results for Model #1 imply that the probability of a service firm choosing a full-control entry mode *decreases* when production takes place in the foreign country relative to home country and with increasing host-country cultural distance.

Model #2 estimates the impact of length of experience on the probability of service firms choosing full-control modes in the presence of covariates. All coefficients are statistically significant. More importantly, the negative sign on the coefficient for *LENGTH* and positive sign on its quadratic version strongly support the hypothesized U-shaped relationship. Model #3 results indicate similar, although far weaker, effects for *SCOPE*. Finally, none of the experience parameters is statistically significant when *LENGTH* and *SCOPE* are jointly estimated in Model #4, almost certainly due to multicollinearity.

TABLE 6
Contribution of Experience Variables
Towards Explaining Entry Mode Choice
(based on data presented in Table 5)

Variable(s)	In Presence of	Models Compared	Incremental X^2	Contribution of Variable(s)
<i>LENGTH</i> + [<i>LENGTH</i>] ² + <i>SCOPE</i> + [<i>SCOPE</i>] ²	<i>FORPROD</i> + <i>DISTANCE</i>	#1 & #4	9.24 ^a (df 4)	Significant
<i>LENGTH</i> + [<i>LENGTH</i>] ²	{1} <i>FORPROD</i> + <i>DISTANCE</i>	#1 & #2	8.04 ^b (df 2)	Significant
	{2} <i>FORPROD</i> + <i>DISTANCE</i> + <i>SCOPE</i> +[<i>SCOPE</i>] ²	#3 & #4	4.70 ^a (df 2)	Significant
<i>SCOPE</i> + [<i>SCOPE</i>] ²	{1} <i>FORPROD</i> + <i>DISTANCE</i>	#1 & #3	4.54 (df 2)	Not Significant
	{2} <i>FORPROD</i> + <i>DISTANCE</i> + <i>LENGTH</i> +[<i>LENGTH</i>] ²	#2 & #4	1.30 (df 2)	Not Significant

Notes: (1) Incremental X^2 is computed as follows [Anderson and Schmittlein 1984]:
[-2 Log Likelihood of Reduced Model] - [-2 Log Likelihood of Full Model]
and *df* is the difference in the *df* of the two models.

(2) a = significant at $p < 0.10$; b = significant at $p < 0.05$.

The impact of the individual experience variables can be assessed by examining the “incremental chi-square” statistic, which is the difference in the -2 log likelihoods for relevant full and reduced models. An analysis of model comparisons is presented in Table 6. It is apparent that the experience variables as a group do make a significant contribution to our understanding of how service firms choose entry modes. It is further obvious that *LENGTH* plays an important role in explaining entry mode choice since it reduces log likelihood even after the effects of covariates and *SCOPE* are partialled out. On the other hand, as the table demonstrates, *SCOPE* makes no distinctive contribution to the model. Finally, a comparison of the quadratic and linear formulations (not reported here) demonstrated the superiority of the former.⁵ This provides further support to the underlying theory.

To sum up, the probability of service firms choosing full-control modes appears to be high at low levels of experience, low at moderate levels, and again high at high levels of experience. Also (contrary to results on market selection), *length*, not *scope*, of experience seems to be more important in determining entry mode choice.

DISCUSSION

It is clear from our analysis that experience does play a role in explaining foreign market entry behavior of service firms. However, judging from the small R^2 -values in Table 3 and the large unexplained log likelihoods in

Table 5, it is equally obvious that (at least in our sample) this role is not substantial. Still, the results provide valuable clues to the entry behavior of firms.

The results on market selection support the findings reported by Davidson and others suggesting that uncertainty reduction is a prime driving force in market selection. Firms perceiving high degrees of uncertainty due to inexperience are more likely to enter markets about which they have the best information. With increasing experience, however, they venture into progressively unfamiliar markets.

Additionally, the fact that *SCOPE*, not *LENGTH*, proved to be the determining influence suggests that *diversity* of experience, not *intensity*, is more effective in preparing firms for entry into culturally distant markets. In so doing, these results lend strong support to what Vernon [1966] called the "gradual fanning out from geographically and culturally familiar to the geographically and culturally remote areas of the world." U.S. service firms launching international operations for the first time are likely to establish operations in culturally proximate countries, say other English-speaking countries. As the geographic spread of their experience base becomes wider, however, they explore progressively distant markets.

Still, not all findings reported in the literature are supported by our results. Principally, they seem to contradict Sharma and Johanson's [1987] implication that "psychic distance" does not play a role in the international entry and expansion of service firms.

Turning to results on entry mode choice, the role of covariates merits brief mention. The negative sign on *FORPROD* implies that, relative to exporting service firms, foreign-producing ones are less likely to employ integrated modes per se. This may be because integrated operations associated with foreign production demand greater resource commitments and result in higher risk for firms. Furthermore, the probability of service firms employing full-control modes declines with increasing cultural distance of the host country, in tune with findings reported for manufacturing firms (e.g., Davidson [1982]; Kogut and Singh [1988]; Gatignon and Anderson [1988]).

More importantly, the results presented in Table 5 fulfill our expectations concerning a U-shaped relationship between experience and propensity to integrate. Conforming to reported observations (Stopford and Wells [1972]; Daniels et al. [1976]; Shetty [1979]), firms with little or no experience appear to exhibit a disproportionately high affinity for full-control entry modes. This preference for control supports Williamson's [1985] contention that integrated modes are more efficient under conditions of high uncertainty because they help avoid negotiating with and monitoring difficult-to-evaluate local agents and partners. Further, the results lend credibility to the "ethnocentric" argument that inexperienced firms are better able to impose their own style of management only under an integrated, fully controlled foreign operation.

Results on market selection appear to shed further light on entry mode choice by less experienced firms. Entering culturally similar markets may be a deliberate strategy on the part of inexperienced firms to facilitate the assumption of control. In other words, not only does entry into similar countries help avoid the uncertainty of evaluating unfamiliar markets, it also facilitates the establishment and management of integrated operations. As opportunities in proximate markets fade, however, these firms will venture into economically more attractive but culturally less familiar territories. At this point, their relative lack of experience may become a constricting factor. Lacking the confidence and the organizational wherewithal to independently manage operations in less familiar countries, these firms will increasingly seek out partners and intermediaries. Such control sharing is expedited by diminishing ethnocentrism and transactional uncertainty. Thus a *combination* of factors may underlie the declining incidence of full-control modes between “low” and “moderate” levels of experience. All this speculation suggests that one has to view the relationship between experience and entry mode choice as a dynamic, evolutionary process that is intimately meshed with market selection practices.

Since our study focuses on service firms, it is natural to ask if our findings on entry mode choice are unique to the service sector. Put differently, is the U-shaped curve realizable for manufacturing firms? Theoretically, the relationship between desire for control and experience should follow the curvilinear relationship, irrespective of whether the firm is manufacturing or service. However, the translation of *desire* into *reality* requires *ability* to procure control. Here service firms may have distinct advantages. It is generally recognized that high degrees of control are possible only with high degrees of resource commitment and overhead [Anderson and Gatignon 1986]. This may be true for manufacturing firms. However, for many service firms, overhead is minimal. The cost of establishing a wholly owned subsidiary or branch office is limited to establishing an office. Often, resources committed to one market can be redeployed to another with relative ease. Since costs and risks associated with obtaining control are relatively low, service firms may have greater capability and latitude than manufacturers to establish integrated modes for the purpose of reducing transaction costs or implementing an ethnocentric philosophy. The fact that firm size had no apparent effect on entry mode choice in our study indicates that small and large service firms have uniform ability to establish wholly owned operations. This in turn implies that, although the “typical” manufacturing firm may be *equally desirous* of control, it may be less able to acquire it. As such, the curvilinear relationship between experience and control may be more easily observable in larger manufacturing firms having the requisite ability to establish integrated operations. The fact that this has not been observed in some of the reported studies involving manufacturing multinationals, however, underscores the need to analyze balanced samples having a wide range of experience levels, from very low to very high. To sum up,

the service firms' superior ability to procure control may very well have enabled observed behavior in our study to more closely approximate theory-based predictions. Nevertheless, all this is speculation at this stage warranting empirical validation by future research.

CONCLUSION

The investigation reported here generally indicates that the experience factor plays an important role in the foreign market entry behavior of service firms. Like manufacturing firms, less experienced service firms prefer entering foreign markets that are similar to their home country. However, as their experience increases and becomes more diversified, these firms will increasingly seek out markets that are geographically and culturally distant. The results strongly support models that depict a gradual outward spread of a firm's international operations.

Results on entry mode choice imply that contrary to traditional linear conceptualizations, the relationship between experience and desire for control may be actually U-shaped. Service firms demand high-control modes in the early and late stages of their international evolution. This article offers some speculative arguments to explain this phenomenon and describes why the relationships observed in this study may be more difficult to observe in the manufacturing sector.

The research discussed here should be considered exploratory. Some of the explanations provided are, as a matter of fact, speculative at this point. The real value of the research is that it provides a different perspective on experience and entry mode choice, points out that market selection and entry mode choice are intertwined, and identifies areas in which service firms resemble and differ from manufacturing firms. Future research should concentrate on developing more descriptive research designs, with larger and more representative samples, and test specific hypotheses concerning the effect of experience on selection of foreign markets and entry modes by service firms.

APPENDIX

Measurement of Variables

Experience Measures: LENGTH & SCOPE

LENGTH represents the number of years for which the service firm was engaged in international operations prior to the current entry. To obtain this information, each respondent was asked the following question: "For approximately how many YEARS did your company operate in foreign markets, PRIOR to THIS ENTRY?"

SCOPE is a measure of the geographic spread of the company's international experience. Respondents were given five statements that represented a progressively wider spread of foreign operations, and asked to check one

statement that best described the firm's international operations at the time of entry:

1. No International Operations Prior to this Entry
2. International Operations restricted to North America
3. Operations in One Continent outside North America
4. Operations in more than One Continent outside North America
5. Operations in Every Continent outside North America

Other studies have tried to capture diversity of experience by measuring the "multinationality" of the firm, which is the number of countries the firm is active in [Kogut and Singh 1988]. Being an ordinal measure, our measure is somewhat inferior to theirs. However, it represents diversity better. In terms of diversity, a firm operating in eight South American countries may conceivably be *less* experienced than another operating in just two countries: one in South America and one in Asia. As such, our measure does a better job of representing geographic diversity than a simple number-of-countries scale. The fact that *SCOPE* is subinterval, however, does not necessarily render the use of parametric statistics and multivariate analysis inappropriate or ineffective. Theoretically speaking, imperfect interval scale measures, such as *SCOPE*, are deemed acceptable if the underlying construct is continuous (which it is in this case) [Borgatta and Bohrnstedt 1981]. For this reason, the use of subinterval scales as continuous measures is not uncommon (see, for example, Ryans [1988]; Lecraw [1989]; Douglas and Rhee [1989]; and Tellis and Gaeth [1990]). Finally, treatment of ordinal measures as if they were interval scaled may not lead to serious errors, especially in regression models [Parasuraman and Varadarajan 1988].

Market Similarity: DISTANCE

Based on information provided by 88,000 respondents from 66 countries, Hofstede [1980] developed indices to measure four dimensions of national culture: power distance, uncertainty avoidance, individuality, and masculinity/femininity. Employing these indices, Kogut and Singh [1988] compute cultural distances between the United States and other countries as part of their investigation of cultural influences on entry mode choice of foreign firms entering the United States. Using their computation formula, we measure cultural distance as follows:

$$DISTANCE_j = [(I_{ij} - I_{iu})^2 V_i] / 4$$

where I_{ij} stands for the index for the i th cultural dimension and j th country, V_i is the variance of the index of the i th dimension, u indicates the United States, and $DISTANCE_j$ is cultural distance of the j th country from the United States. For countries in our sample, for which indices are not reported by Hofstede, we use indices of countries that we judged to be culturally

similar. For instance, we substitute Pakistan's indices for other Islamic countries such as Bahrain and Bangladesh.

Countries with small values of *DISTANCE* are culturally similar to the United States; larger values signify increasing dissimilarity. The values of *DISTANCE* ranged from 0.03 (for Australia) to about 4.4 (for Venezuela). Culturally, the six most proximate countries include Australia, the United Kingdom, Canada, Switzerland, New Zealand, and Ireland; and the six most distant countries are Indonesia, Malaysia, Singapore, Philippines, Portugal, and Venezuela.

Entry Mode Choice: MODE

We gave each respondent a list of possible entry modes and asked him/her to indicate which one best described the method his/her company had used to initially enter the foreign market under consideration. The list included branch offices, wholly owned subsidiaries, majority/50-50/minority joint ventures, sales subsidiary exports, direct-to-customer exports, agent/distributor exports, and licensing/franchising. The variable *MODE* assumes a value of 1 if the entry mode is *full-control* (integrated/company-owned export channel, branch office, or wholly owned subsidiary), and 0 if it is *shared-control* (exports via intermediary, contractual mode, or joint venture).

Firm Size: SIZE

Respondents were asked to indicate annual sales revenue at time of entry, using six prespecified categories (less than \$5m; \$5-25m; \$26-50m; \$51-100m; \$101-500m; more than \$500m). *SIZE* is a dummy variable coded 0 for smaller firms, when respondents picked either of the first two categories. It takes on a value of 1 for larger firms belonging to all other categories. The cutoff point was chosen to obtain approximately equal numbers of smaller and larger firms.

Location of Production: FORPROD

If entry mode used is exporting, indicating home country production, *FORPROD* is 0, and if it is contractual transfer or foreign direct investment, suggesting foreign country production, *FORPROD*=1.

Exportability of Service: XPORTBLE

XPORTBLE is a dummy variable, which has values 0 for exportable services, and 1 for nonexportable services. Respondents were asked to indicate whether it is possible or not to produce their service in the U.S. and export it. If "possible" the service is classified as an exportable one; if "not possible" it is categorized as a nonexportable service.

NOTES

1. However, there is now growing recognition of non-equity or contract-based methods of acquiring control [Dunning 1988; Dunning and McQueen 1982].
2. The companies include four multinationals (an advertising agency, a car leasing company, a technical services firm, and an engineering consultancy firm), a very large computer software exporter, and a small data processing firm.
3. *Exportable*, or "foreign-tradeable" [Boddewyn et al. 1986], services are those that are produced outside the host country and transferred to it embodied in a document, disk, or some other tangible form. Examples include software services, engineering design, and architectural services. On the other hand, *nonexportable*, or "location-bound" [Boddewyn et al. 1986], services are those for which production and consumption are simultaneous. As a result, the firm has no choice but to locate production in the host country. Examples include hospitals, hotels, consulting, and advertising.
4. These were principally high-experience firms who, from other data collected on the questionnaire, appeared to have been forced to share ownership and control due to government restrictions. Elimination of these significantly improved the theory-based predictions of the model.
5. The results are not explicitly reported in the manuscript, but the model with covariates + *LENGTH* was compared to the model with covariates + *LENGTH* + [*LENGTH*]². The addition of the quadratic term led to a reduction in -2 log likelihood of 7.86, which is significant at $p < 0.01$.

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