A relational assessment of international market entry in management consulting

Johannes Glückler*

Abstract

This paper criticizes conventional internationalization theory of the firm and argues for a relational perspective in the analysis of international expansion. Using in-depth empirical research from three European metropolitan case studies, the paper demonstrates that social networks (i) are the most frequent cause of international market entry and (ii) they systematically affect the organizational form of entry. A combination of qualitative exploration and logistic regression analysis of fieldwork and survey data suggests that the internationalization of business services cannot be fully understood from firm-specific resources alone, but it also has to take the context of external relationships into systematic consideration. The impact of social networks on entry form changes over time. With increasing international experience firms face fewer constraints on entering a foreign market through brownfield FDI. For economic geography, future analysis should focus more on the context of inter-firm relationships in order to overcome some of the too mechanical arguments about the process of firm internationalization.

Keywords: internationalization theory, entry mode, business network, mixed method, management consulting

JEL classification: D81, F23, L14, Z13

Date submitted: 14 February 2005  Date accepted: 23 September 2005

1. Introduction

In an increasingly globalizing economy, many firms are driven by the need to expand business to international markets to seek market share, critical resources, cost efficiency or strategic assets. Since the 1960s, economic and management theory have developed a range of conceptual approaches to explain the internationalization of multinational companies. Three accounts are particularly important: the theory of the multinational enterprise, the Uppsala stage theory and the Swedish approach to a network theory of internationalization. Today, however, firm internationalization has become a more complex phenomenon than the initially theorized in these mainstream approaches. First, the international expansion of firms has not only grown in traditional manufacturing-based businesses but also in services and particularly in knowledge-intensive services, such as investment banking, legal services, advertising, accounting and management consulting. Second, firm internationalization is no longer a

* Department of Economic and Social Geography, University of Frankfurt, Dantestrasse 9 60325 Frankfurt am Main, Germany. email <glueckler@em.uni-frankfurt.de>
phenomenon of large firms but increasingly involves medium, small and even micro businesses. The example of the born-global companies which are launched from the very beginning as transnational enterprises might serve as one illustration (Chetty, 2004) of a new variety of forms and processes of the internationalization process. Therefore, the notion of a transnational firm today is more complex than the traditional model of the post-war multinational company (Jones, 2003).

This paper focuses on the internationalization of knowledge-intensive firms in the context of management consulting, where international expansion has been an important growth strategy since early on. In Europe, the consulting markets started to experience sustained growth from the beginning of the 1960s (Kipping, 1999, 2000; Ferguson 2002). Today, the top global consultancies, mostly US-based firms, gain more than half and up to 70% of their global revenues outside their home markets (Wet Feet Press, 1996; Zeithaml and Bitner, 1996). The biggest German consultancies, for instance, already obtain more than one-third of their revenues in international markets (Streicher and Lüündonk, 2001). Moreover, a massive expansion of international presence through large office-networks can be observed in this sector (Jones, 2005). The internationalization of management consulting does affect not only large multinational firms but also and in particular medium- and small-sized enterprises, as studies in various European markets have demonstrated extensively over the last years (Keeble et al., 1992; O’Farrell et al., 1996; Bryson, 1997; Walger and Scheller, 1998). This development, thus, offers an adequate empirical case in order to review mainstream internationalization theory and examine how we can account for the process of international market entry of knowledge-intensive firms.

The goal of this paper is 2-fold. First, it reframes the shortcomings of conventional theories reported in many empirical studies within a relational perspective. A theoretical review explores the conceptual limits of existing theories of firm internationalization and recurs on current ideas of relational economic geography to develop an alternative perspective of the internationalization process. Second, the paper seeks an empirical test of this alternative conception of market entry. In particular, qualitative and quantitative fieldwork is used in a mixed-method approach to examine the impact of the context of social relations of a firm on its choice of organizational form of market entry. The paper will thus make two contributions to the existing literature. It will, first, frame the conceptual limits of conventional theories of firm internationalization and, second, go beyond existing network approaches to firm internationalization by examining systematic effects of social networks on the process of market entry.

The argument proceeds as follows. Section 2 criticizes FDI theories and stage theories of internationalization for their implicit atomistic perspective on firm decision and international expansion. The conceptual critique is supported by a number of empirical studies that document the explanatory limits of these approaches, especially for service firms. Instead, the paper argues for a relational perspective on firm internationalization and introduces network theory of internationalization as an alternative approach that takes inter-firm relations as a starting point for the analysis of firm expansion. Section 3 lays out the methodology of the empirical research. Section 4 presents the descriptive results of a logistic regression model on the form of market entry. Section 5 uses evidence from the qualitative fieldwork to develop a causal explanation of the impact of social networks on the organizational form of market entry. Section 6 closes with a conclusion.
2. Theory

The main argument of this paper develops along a critical review of the major theories of firm internationalization. The critique is informed by a relational perspective that embraces many of the arguments put forward in contemporary concepts of embeddedness, social capital and untraded interdependencies. Following Granovetter (1985), the major pitfall in theorising economic action is an explicit or implicit atomism. He qualifies theories as atomistic if they analyse individual action exclusively on the basis of internalized norms (i.e. oversocialized) or on the basis of external assumption by the researcher (i.e. undersocialized), such as formal rationality and profit maximization. Moreover, atomistic conceptions of human action ignore the influence of and interdependence with the social and institutional context. In contrast, a relational perspective acknowledges that individual action is motivated and constituted by the very context of social relations and institutional structures (Storper, 1997; Bathelt and Glückler, 2003). Therefore, the following review critically discusses the underlying atomism in existing internationalization theories and develops the conceptual basis for an empirically more adequate perspective of firm internationalization.

2.1. Atomism in conventional theories of internationalization

Among the many concepts of firm internationalization, two approaches have gained wide reception: the eclectic paradigm as an approach to the theory of the multinational enterprise and the Uppsala school approach to the internationalization of small- and medium-sized firms. The eclectic paradigm is most prominently associated with the work of Dunning (1977, 1988, 2000). His OLI-model is eclectic because it integrates distinct explanatory approaches from different theories into one single framework. The concrete form of international operation that a foreign firm takes in a particular target market is the result of a combination of three advantages. First, a firm must have specific ownership or O-advantages that compensate for the general liability of foreignness as well as competitive position of rival domestic firms in the target market. Second, location or L-advantages of the target market have to be identified and to be evaluated with respect to the firm strategy (Dunning, 1977). Third, it has to be assessed whether the O-advantages can best be realized through internalization (I-advantages) or through external cooperative or market transactions. Given the imperfections of good and factor markets, positive transportation costs, heterogeneity of demand and increasing returns to scale, internalization is an alternative organizational strategy in order to reduce transaction costs (Coase, 1937). The internalization of O-advantages is more efficient than trade, whenever the transaction costs of the market are higher than the costs of hierarchical organization (Rugman, 1980; Bradach and Eccles, 1989).

In the so-called Uppsala School (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977, 1990, 1992), Johanson and Vahlne (1977) conceive of firm internationalization as a process of gradual increase in commitment to a foreign market. Based on empirical observations from the early 1970s, they argue that local experiential knowledge causes incremental advances of market knowledge and thus provokes an establishment chain of international organization. The process of internationalization unfolds as a sequence of stages, where firms stepwise gain experience, build management competence and reduce uncertainty in order to incrementally increase investments.
in a target market (Johanson and Vahlne, 1977; Erramilli, 1991). The individual stages and sequences of stages are conceptualized differently in a number of approaches. However, most approaches to stage theory claim a gradual intensification of operations from indirect export to direct export and licensing arrangements to own international production.

The theory of the multinational enterprise addresses firm-specific advantages that can be used to improve the competitiveness in a foreign market. At the same time it discusses the location-specific advantages of a target market that rest in the immobile resources of a country. In comparison with this normative approach to efficient resource allocation, stage theory focuses on the very process of an international engagement. It puts emphasis on learning and experience and suggests an incremental increase in activities as a consequence of market specific knowledge that can only be acquired through experience. Despite these differences, there are apparent commonalities between the two approaches. Both concepts are biased towards internal resources, strategies and competences. The internationalization process of a firm is not analysed with respect to the specific context in which a firm chooses to internationalize. The following section demonstrates that these theories explain both the selection of a target market and the choice of an organizational form of entry exclusively on the basis of internal conditions within the firm and on the basis of general market characteristics. In the context of management consulting, I will discuss the conceptual limits in the explanation of market selection and market entry. Therefore, these theories miss an important part of the explanation of business service internationalization and are proved empirically insufficient. I call these theories atomistic because they treat the internationalizing firm as analytically independent from its institutional and relational context.

2.1.1. Undersocialized concepts of market selection

The selection of an international target market is undersocialized with respect to two aspects: first, the selection is conceived as a process of rational decision-making by atomistic firms and second, stage theory suggests a gradient of psychic distance as a pattern of international expansion.

Market selection as rational decision-making. The theory of FDI sees international market selection largely as a normative, efficiency led rational decision. Firms identify their specific competitive advantages and then look for those location-specific advantages of a market that provide the best production (or sales) conditions. Hence, markets are systematically screened, compared and assessed with respect to efficiency gains. Finally, a firm always chooses the market that facilitates the best realization of goals, e.g. highest sales potential, lowest labour cost and highest concentration of specific technological knowledge. Also, in stage theory market selection is the result of independent rational decision-making. In order to prevent high levels of uncertainty, firms choose to expand in culturally proximate and often neighboured markets because the lack of specific market knowledge is easier to be compensated in these than in more remote markets. Here, market risk represents the key parameter of market selection. Increasing experience conveys specific knowledge which in turn allows for gradual intensification of market commitment. FDI as well as stage theory are expressions of optimal or rational market selection. Firms compare potential target markets, assess location advantages and choose the best match. Further, both approaches are atomistic
since market selection is explained through conditions within the firm and general market characteristics. External firm-specific conditions are ignored.

Empirical studies do not provide strong support for these concepts (Coviello and Martin, 1999). In a study on British consulting firms O’Farrell and Wood (1998) found that service firms hardly pursued any form of systematic market assessment or formal process of decision-making. Market selection and entry form were mainly constrained by inter-firm relations with clients or strategic partners. Only 6% of the firms had active strategies of comparative market selection (O’Farrell et al., 1996, p. 114). Moreover, Westhead et al. (2001) demonstrated that international exports were mainly a reaction to the demand from abroad or existing domestic clients. Reactive internationalization implies that market selection is not the result of rational decision-making processes but of contextual business relations. A study on German medium-sized manufacturing firms showed that social networks and personal relationships rather than rational market screening procedures were decisive for the actual choice of a target market (Scharrer, 2000, p. 188). These findings suggest that conventional theories underestimate the relevance of concrete social networks.

**Market selection and psychic distance.** Stage theory argues that psychic distance affects the geographical pattern of international expansion. Psychic distance is defined as ‘the sum of factors preventing the flow of information from and to the market’ (Johanson and Vahlne, 1977, p. 24), e.g. differences in language, education, business practice, culture or industrial development (Gertler, 1997). Given the uncertainty of an operation in a market with cultural, legal and business institutions very different from the home base, early international activity will head for more similar, often neighbouring, markets. Hence, stage theory conceives an expansion of international activities from countries with a high level of psychic proximity to those with more psychic distance (Bell, 1995; Buckley and Casson, 1998). Empirical studies on different business service sectors question this argument (Sharma and Johanson, 1987; Bell, 1995; Coviello and Martin, 1999). They show that actual geographical patterns of expansion do not necessarily follow a gradient of psychic distance. Instead, their evidence suggests that those markets promising highest growth or sales potential are often targeted first.

In the case of management consulting, the argument of psychic distance proves ambivalent not only empirically but also theoretically. On the one hand, Sharma and Johanson (1987) argue that the market selection of business service firms is independent from the problem of psychic distance because the necessary investments are lower and less market specific when compared with manufacturing. While manufacturing firms have pronounced sunk costs owing to the installation of machinery and production facilities (Clark and Wrigley, 1995), a consulting firm may start operation with some rented office space. The limited specific investments lower the risk of a local market operation and thus also permit international operation trials in more remote markets with higher psychic distance. On the other hand, the marketing and provision of management services requires fundamental knowledge of local business culture, local and sectoral market conditions, and management methods (Wood, 2002). Therefore, market specific adaptation is far more decisive for consulting firms than for standardized manufacturing products: ‘Selling milk or cars in a foreign country requires, for example, specific labelling or a special advertising campaign. Offering an advanced management service in another country requires perfect knowledge of the client and environment, in order for this service to be unique and its success or failure will be
influenced considerably by the success or failure of the process of cultural adaptation carried out’ (Rubalcaba, 1999, p. 290).

Consequently, it may be expected that psychic distance could indeed play an important role in consulting internationalization. This expectation is fuelled by empirical observations. Great Britain and France have pronounced international consulting activities in countries of former colonies, German consulting firms are particularly present in Austria and Switzerland (Hofmann and Vogler-Ludwig 1991, p. 24), and Spanish consultants have engaged quite intensively in South American markets (Alpha Publications, 1996). These rough incidents are not sufficient to prove the psychic distance hypothesis. However, it seems generally more adequate to analyse the logic of market selection less as a function of internal evaluations of uncertainty and more as a reaction to opportunities from external relations to clients and other stakeholders. Bell (1995) found that business service firms choose their markets only indirectly on the back of their clients. In the course of following a client, many business service firms reacted to the internationalization path of their existing clients or new offers of foreign clients in their respective markets. In turn, Bell could not confirm the gradient of psychic distance as explanatory for market selection (Bell, 1995, p. 67).

2.1.2. Undersocialized concepts of market entry

After the decision to internationalize and the choice of a target market have been taken, the major part of internationalization theory is dedicated to the form of market entry. Also here, the approaches implicitly assume atomistic decision procedures. The theory of FDI interprets the choice of organization form as a make-or-buy problem following transaction cost economics. Firms will tend to internalization whenever internal hierarchical organization incurs less transaction costs than the market (trade). The decision about the appropriate form of entry is, consequently, atomistic. However, empirical processes of market entry do not follow this logic too often. O’Farrell et al. (1996) found in their study that only 20% of firms assessed alternative entry forms before the final establishment. Even though there have been attempts to isolate determinants of organizational choice (Hennart and Park, 1993; Brouthers and Brouthers, 2000), the actual choice of organizational form seems to remain largely contingent upon these factors. Obviously market entry is a highly context-specific procedure (Erramilli, 1991).

Stage theory argues that market entry is initiated through exports and that organizational commitment gradually increases with market experience over time. However, a determinate relation between market experience and the form of entry has not been confirmed by empirical studies on service firms. Neither firms pursue similar strategies of organizational form nor does the development of an operation undergo the same pattern of organizational stages (Buckley et al., 1992). Instead of exports as the first stage of international activity, Young (1987) reported the increasing importance of alternative organizational designs, such as licence agreements and joint ventures. Moreover, the process does not always unfold in a stepwise increase of commitment. Firms may skip certain hypothesized stages as well as step back to less committing forms of engagement at times of downturn (Cannon and Willis, 1981; Turnbull, 1993; McDougall et al., 1994). Given the evident heterogeneity, organizational designs and flexibility of organizational development chosen for market entry, stage theory has been
criticized as deterministic since it postulates a fixed sequence of stages independent from the contextuality of a business venture (Reid, 1983).

Apart from the fact that organizational forms are not always chosen on the basis of rational decision-making, management consulting does not offer all options from the array of organizational designs. While unbound services can be separated from the process of service provision, stored in certain media (e.g. plans, software and reports) and therefore traded, the place of production and the place of provision cannot be separated in the case of consulting: it is a location-bound service (Sampson and Snape, 1985; Boddewyn et al., 1986) that requires physical co-presence of the consultant and the client. As a consequence, management consulting services are hard to trade internationally and exports do not represent a sustainable form of international operation (Vandermerwe and Chadwick, 1989; Buckley et al., 1992; Erramilli and D’Souza, 1995). Only the travel of consulting professionals permits a temporary provision of services across borders.

2.1.3. Focus on large and manufacturing firms

Apart from the implicit atomism, both approaches are mainly confined to the internationalization process of large manufacturing firms (Coviello and Munro, 1997; Grönroos, 1999). Since the internationalization process discussed here refers to, first, service firms and, second, mostly medium- or even small-sized firms, the conventional approaches display major limitations when used for explanation. The international expansion of small- and medium-sized firms often follows a different pattern and cannot be represented by these approaches. For SMEs, the decision to launch an operation abroad is more risky than in the case of large firms. Since the required investment is higher relative to the available firm resources an eventual failure in a new market becomes more expensive (Buckley, 1993). Erramilli and D’Souza (1995) showed that the likeliness for a service firm to invest abroad increases with growing firm size and decreasing capital intensity of the planned operation. Moreover, SMEs often lack financial and management resources. A shortage of financial resources may often lead to the choice of less appropriate organizational entry forms. Decision processes based on a lack of managerial resources are more spontaneous and tend to be short termed (Buckley, 1993). These structural conditions render the launch of an international operation more difficult, especially in the case of the first international establishment. A British study demonstrated that many SMEs failed with their first attempt to expand internationally and only managed to establish foreign operation after repeated trials (Buckley et al., 1988). Overall, the theory of FDI proves not particularly helpful in accounting for small- and medium-sized business service firms (O’Farrell and Wood, 1998). Other research also marks the limitations of stage theory and shows that a general pattern of an establishment chain is inappropriate to understand the internationalization of service firms, especially of knowledge-intensive business services1 (Sharma and Johanson, 1987; Erramilli, 1990; Westhead et al., 2001).

1 In fact, Johanson and Vahlne (1990) have acknowledged this limitation of stage theory themselves and opened their account towards more recent network approaches to internationalization.
2.2. A relational approach to international market entry

A major consequence of the critique of atomism is a shift in perspective towards the actual relations with other firms such as suppliers, clients and strategic partners. This relational perspective has gained increasing attention in economic geography (Yeung, 1994; Storper, 1997; Bathelt and Glückler, 2003) generally, and with respect to internationalization in approaches to global production networks (Henderson et al., 2002) particularly. Recently, scholars of the Uppsala School have also taken up this position and emphasized the use of a network perspective in the theory of firm internationalization. Johanson and Vahlne (1992) describe the process of foreign market entry as a problem of access to networks of new business relations. The network approach to internationalization has been developed mainly in the industrial marketing and international business literatures (Johanson and Mattsson, 1987, 1993; Sharma and Johanson, 1987).

This perspective views the market as a network of exchange relations between producers, suppliers, customers and competitors. These relations may serve very different intentions (Johanson and Mattsson, 1987, p. 37): they may reduce the cost of production or transaction; contribute to the development of new knowledge and competencies; lead to at least partial control over an actor, serve as bridges to unrelated third actors or help to mobilize partners against a third party. In a dynamic perspective, networks undergo constant change through the breaking up of established contacts and the formation of new ones. In contrast to internationalization theory the network approach prioritizes external relations over internal conditions and assets. In line with the concept of resource dependence (Pfeffer and Salancik, 1978), the access to other firms’ resources is considered at least as important to realize market opportunities as internal competencies and competitive advantages. Consequently, a firm’s position in a network takes a specific strategic value. The network approach, then, argues that international market entry is more dependent on a network position than on institutional, economic or cultural conditions of the host market. A business network serves as ‘bridges to foreign markets’ (Sharma and Johanson, 1987, p. 22).

Johanson and Mattson (1987) have formulated an alternative approach to analyse international expansion from the perspective of inter-firm relations. This does not necessarily oppose the network approach to conventional internationalization theory. On the contrary, it promises to be complementary in order to perform a contextual analysis of specific internationalization paths. They emphasize the role of external resources for gaining opportunities to internationalize. However, network relations do not only enable, but can also inhibit internationalization (Coviello and Munro, 1997). Altogether, the process of network formation and the position within network structures are argued to have an important impact on the kind and direction of international firm expansion. The form of market entry is now conceived as a consequence of evolved patterns of business relationships rather than a result of rationally selected optimal solutions (Blankenburg Holm et al., 1996). Similar to the theory of FDI and stage theory, the network model was developed in the context of manufacturing firms. Although it has only been applied to selected case studies, the empirical findings demonstrate the qualitative influence of existing firm relations on the strategic and organizational decisions of firms in international expansion (Coviello and Munro, 1997; Coviello and Martin, 1999; Chetty and Blankenburg Holm, 2000). The model thus increases the explanatory power of existing accounts.
The processes of internationalization are complex and unfold relatively contingent on the theoretical accounts developed so far (Strandskov, 1993). An analysis of the interrelationships between consulting firms and their client and partner organizations as well as the contingent development of their internationalization require an alternative perspective (O’Farrell et al., 1995; O’Farrell and Wood, 1998). A relational perspective that takes into account the concrete sets of relations between firms promises to be a fruitful approach to the analysis of market entry. Knowing, however, that networks do impact internationalization, we do not yet know whether there are any systematic directions of causation. In what way do which kinds of networks affect which forms of internationalization and market entry? This paper tries to make two contributions. First, and in contrast to the conventional theories reviewed above, it argues that social networks external to the firm are key to understanding the process of internationalization in knowledge intensive project-based businesses. Second, it goes beyond existing work related to network approaches of internationalization in that it examines whether there is any necessary relation between the social context of a firm and its choice of a specific entry form. The research question, in other words, is once we know the relational context of a firm, can we expect a particular choice of organizational form more likely than another?

3. Methodology

The empirical research was carried out in three different European consulting markets, in which the major metropolitan regions were selected for qualitative fieldwork. First, London is the international market place for management consulting, which serves as a gateway to the European market for many North-American firms. Second, Madrid represents Spain’s single most dominant concentration of consulting firms. Almost half of all firms and over 56% of employed consultants are located in the autonomous region of Madrid. The third case study was conducted in Frankfurt/Rhine-Main, a polycentric metropolitan region with several core cities. Although the concentration of consulting firms is less pronounced, the metropolitan region still represents the biggest market place for consulting in Germany. In absolute figures, there are approximately 11,000 consulting firms in Greater London (Companies House, 2002), 2600 in Madrid (Instituto de Estadística de la Comunidad de Madrid, 2002) and 4600 in Frankfurt (HSL, 2000).

Since this research focuses on the actual context and process of international market entry, local affiliates and subsidiaries of foreign international firms were the appropriate unit of the analysis. Firms were considered foreign when a natural or legal person outside the host market owned at least 10% of the local operations (OECD, 1999; UNCTAD, 2000; Nachum and Keeble, 2001). Usually the managing directors or presidents of the host market offices are the key individuals who actually launch the foreign operation and develop the new local business. Only there was it possible to obtain rich information on how the establishment of a new operation worked and how business was developed in the new environment. Since the methodology pursues a mixed-method approach the analysis uses two different sets of data from the case studies.

First, the qualitative fieldwork relies on 73 oral semi-structured interviews in the three case regions—Frankfurt ($N = 15$), London ($N = 28$) and Madrid ($N = 30$). All
interviewees were presidents, managing directors or leading senior partners of the host market offices. The interviews took between one and three hours and were based on an interview guide covering the following topics: (i) general company information (year of foundation, international presence and internationalization experience, global headquarter and number of global and local employees); (ii) consulting specialization (firm specialization, service characteristics such as standardization, specificity, project duration, interaction intensity and measurement of project performance); (iii) international market entry (context, organizational form and actual procedure of local market entry in the case region); (iv) quality of business relationships (nature, intensity and frequency of personal interaction, trust, repeat business and private contacts) and (v) market penetration (new business development, marketing, referrals and reputation mechanisms). The interviews were all taped and documented with the aid of software for qualitative data analysis (MaxQDA). The causal analysis in Section 5 is based on this set of qualitative interviews.

Second, in the case of Frankfurt the in-depth interview exploration served to develop questionnaire items and to subsequently conduct a quantitative standardized survey of the entire population of foreign consulting firms in the region (N = 110, response rate 49%). For the quantitative analysis in the next section, the London and Madrid interviews were coded into numerical categories and combined with the Frankfurt survey data. Since the relevant concepts (i.e. choice of entry form and context of market entry) are observations that can be unambiguously codified, it is a reasonable case here to submit qualitative data into quantitative analysis. Other research has adopted similar research designs and methodological operations (e.g. Gersick et al., 2000). Overall, 111 consulting firms were considered for statistical analysis (Table 1).

The firms spread relatively equally across the four major management consulting specializations as defined by the European federation of national consulting associations (FEACO, 1999, p. 5): strategy, information technology, human resources and operations management consulting.

Table 1. Distribution of surveyed firms by consulting service specialization

<table>
<thead>
<tr>
<th>Specialization</th>
<th>Frankfurt</th>
<th>London</th>
<th>Madrid</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td>Information technology</td>
<td>13</td>
<td>6</td>
<td>3</td>
<td>22</td>
</tr>
<tr>
<td>Human resources</td>
<td>18</td>
<td>6</td>
<td>9</td>
<td>33</td>
</tr>
<tr>
<td>Operations</td>
<td>10</td>
<td>10</td>
<td>7</td>
<td>27</td>
</tr>
<tr>
<td>Related services (niches)</td>
<td>6</td>
<td>0</td>
<td>7</td>
<td>13</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>28</td>
<td>30</td>
<td>111</td>
</tr>
</tbody>
</table>

The next section proceeds with the results of the quantitative analysis. It serves to test for a significant pattern of coincidence between the external context of social networks and a particular form of market entry. The qualitative interview material is then discussed to elaborate a causal explanation of these findings and to make use of richer, context-specific observations to infer a relational model of market entry in knowledge-intensive business services.
4. A relational model of market entry

4.1. Variables and model construction

Commonly, internationalization theory draws on internal, firm-specific advantages in order to explain different modes of entry. However, this study suggests that inter-firm relationships have an important impact on entry mode. Two independent variables are tested for their effect on the choice of organizational form: entry context and international experience.

This paper distinguishes two types of entry contexts based on the empirical research. Whenever an entry process drew on business relations from client or other business partner networks, this context was labelled relational entry. In contrast, when firms initiated operations actively without using network contacts, the context was labelled atomistic entry. Given the longer presence of some foreign firms it was not possible to reliably assess the actual context at the time of market entry for the complete sample. There is a limited average duration of employees in consulting firms such that the managing partners often change in an operation after a couple of years. But as far as the information on the historical entry contexts were available from the interview partners, atomistic and relational entry contexts were distinguished. Most firms were pulled into new international markets. Two-thirds of all firms used existing relations to access new local markets. The decision to internationalize was mostly a reaction to an opportunity from within the existing networks of clients, employees or strategic partners. Only one-third of the firms had no contacts to draw on and entered under atomistic conditions.

The organizational experience of past internationalization projects may critically affect future projects of international market entry. Since it is difficult to assess the level of experience and competence to internationalize in an organization directly, the number of countries with foreign operations is used as a quantitative measure. It serves as a measure of the past experience of an organization in entering foreign international markets. The variable ranges between 1 and 130 countries, with a median of 8 countries (mean 18.64; SD 21.36).

Both variables are tested for the impact on the choice of organizational form. The dependent variable, hence, is entry form. The organization of a new international operation may take different forms. It ranges from the establishment of own subsidiaries and affiliates to the acquisition of wholly, majority or minority owned local companies to joint ventures, strategic alliances and loose non-contractual forms of inter-firm cooperation (Daniels, 1995; O’Farrell and Wood, 1999; Samie, 1999). Empirically, the proportion of loose cooperation networks in the overall volume of international revenues can be assumed to be very limited. Since this research focuses on local offices as the unit of analysis, only FDIs could be considered for the analysis. Within the different forms of internalization, two organizational modes of entry are distinguished. An investment is greenfield when an international consultancy sets up de novo subsidiaries or affiliates; it is brownfield when the firm enters the market through acquisition, joint venture or majority-participation in local firms. Of the firms 70% entered through greenfield investments and only a minority through brownfield FDI.

Since the dependent variable is a binary categorical variable, a logistic regression is used for the analysis. Logistic regression is a subset of linear modelling usually employed to test the impact of a set of independent variables on a categorical dependent variable (Rese, 2000). There are two basic applications of logistic regression in social
and management science: to predict group membership for the dependent variable and to measure the instantaneous rate of change in the probability of occurrence of an event with change in a given predictor (Tansey et al., 1996). This procedure has been increasingly used in economic geography (Wrigley, 1985; Sternberg and Arndt, 2001) and especially in the context of internationalization research (Agarwal and Ramaswami, 1992; Li and Guisinger, 1992; Hildebrandt and Weiss, 1997). Independent variables can be categorical, ordinal or interval. The concrete model is as follows:

\[ P(EF = 1) = 1 / (1 + \exp(\beta_0 + \beta_1 EC + \beta_2 IE)). \]

The dependent variable is entry form (EF). The measure distinguishes between greenfield and brownfield forms of FDIs and takes the value one (EF = 1) if the entry is greenfield. Entry context (EC) is the first independent dummy variable and takes the value of one (EC = 1) if the entry context is relational. The second independent variable is international experience (IE) measured as the number of countries with foreign operations at the time of entry in the study region.

4.2. Results

Despite the limited number of observations, the methodological assumptions for a logistic regression model are fulfilled. There are a minimum of 25 observations for both possible values of the dependent variable (Reese, 2000, p. 137) and, since only two dependent variables are used in the model, the size of the sample satisfies the conditions for the model estimations. Table 2 reports the logit coefficients for the dependent variables as well as the test statistics. Because of a slight collinearity\(^2\) between the two independent variables, their explanatory impact is first tested in separate models. All three models are significant or highly significant. Model 1 analyses the effect of entry context on the choice of entry form. Model 2 examines the effect of international experience on entry form. Though Model 2 is less significant than Model 1, the inclusion of international experience in the combined model improves the overall Model 3. Though not fully conclusive, the overall model proves valid with respect to the relevant criteria (Krafft, 1997): the hit ratio is better than in the separate models and slightly better than the proportional chance criterion (71.9%), the model is significant at 0.01 and reaches the highest \(R^2\) among the models. However, it explains only 15.3% of the overall variance in the sample, which, of course, limits its explanatory power. On the one hand, this demonstrates that it is difficult to force the contingency of social interaction into a linear stochastic model; on the other hand, the model evidences a significant association between the actual context of market entry and the organizational mode of entry.

Figure 1 displays the estimated probabilities for a firm to enter greenfield in a foreign market. The graph illustrates that greenfield entry becomes less likely, first, if the firm enters under a context of atomistic entry and, second, with increasing multinational presence of a firm. In its extremes, young firms with little international experience and relational entry context will most likely internationalize through greenfield investment,

\(^2\) The variables entry context and international experience are weakly correlated (Pearson \(r = -0.225; P < 0.05; N = 89\)). This raises the problem of collinearity of independent variables. It leads to less reliable estimations of the logit coefficients in models of logistic regression (Backhaus et al., 2000, p. 41). However, owing to the weak correlation the estimation error can be expected to be limited and acceptable.
whereas large, multinational firms under atomistic entry conditions will most probably enter brownfield through M&A. While the regression model evidences a structural pattern of coincidence, a qualitative analysis of in-depth interviews will be used to explore the nature of causation between the context of market entry and the choice of organizational form of entry.

Table 2. Logistic regression models: logit coefficients for greenfield entry

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.134</td>
<td>1.414$^a$</td>
<td>0.600</td>
</tr>
<tr>
<td></td>
<td>(0.366)</td>
<td>(0.338)</td>
<td>(0.474)</td>
</tr>
<tr>
<td>Entry context (EC)</td>
<td>1.340$^a$</td>
<td></td>
<td>1.175$^b$</td>
</tr>
<tr>
<td></td>
<td>(0.496)</td>
<td></td>
<td>(0.511)</td>
</tr>
<tr>
<td>International experience (IE)</td>
<td>–0.029$^b$</td>
<td></td>
<td>–0.022</td>
</tr>
<tr>
<td></td>
<td>(0.014)</td>
<td></td>
<td>(0.015)</td>
</tr>
<tr>
<td>–2 Log-Likelihood</td>
<td>98.216</td>
<td>100.998</td>
<td>95.681</td>
</tr>
<tr>
<td>Chi-square</td>
<td>7.481$^a$</td>
<td>4.699$^b$</td>
<td>10.015$^a$</td>
</tr>
<tr>
<td>$R^2$ (Nagelkerke)</td>
<td>0.116</td>
<td>0.074</td>
<td>0.153</td>
</tr>
<tr>
<td>Hit ratio (%)</td>
<td>71.9</td>
<td>74.2</td>
<td>77.5</td>
</tr>
<tr>
<td>N</td>
<td>89</td>
<td>89</td>
<td>89</td>
</tr>
</tbody>
</table>

$^aP < 0.01; ^bP < 0.05$

Standard errors in parentheses.

Figure 1. Estimated effects of Model 3 on the probability for a greenfield investment.
5. In search for explanation: trading off two kinds of entry risks

5.1. The bottleneck to successful market entry: new business development

International market entry is not an easy venture. It may become even more challenging if firms do not pursue expansion proactively but are forced to internationalize in order to maintain their business with an existing client. In fact, international market expansion was repeatedly enforced by existing clients as one managing director illustrates: ‘We do not globalize because we think we get more through that. Instead, our clients say ‘we are global, so you have got to be global, too, otherwise we don’t work with you’ (Senior partner of a German consultancy, Frankfurt5). Given the uncertainties affecting consultants in international markets, the launch of a foreign operation is subject to major barriers. Often, the research design in internationalization research a priori excludes the possibility to learn about unsuccessful international ventures. However, the Frankfurt case study revealed two cases which provide drastic examples of the actual key challenge to a successful internationalization, that is, the development of new local business after market entry. In the first case, a top 25 German management consulting firm had tried to enter Spain in a market-seeking mode. The company, founded in 1992, had grown rapidly and won international client corporations. After 3 years they expected to sustain their growth by an international expansion. The CEO reported the experience as follows3.

‘We had started to go to Spain. We sent a consultant and pursued client acquisition for about two years. We invested a whole lot of money but it is not easy to get a foot in the market. It turned out that one better know the local context. We had to learn the lesson that the Spanish market is less open to consulting than the German one. Only the real global players could succeed […] except that one follows a client just as a competitor of ours has done. Their client went to Spain and sought an SAP implementation so that the consultancy simply followed in the market. Today, this client remains the focus apart from the additional local business. […] Ok, the background was that we had a colleague whose wife was Spanish. Since personal relations play an important role in Spain and since that lady belonged to the inner circle in Madrid, we thought to send them to Spain. Our colleague had learnt Spanish and his wife was desperate to repatriate to Spain. So, we thought to make use of this situation and develop business there. I think it was 1995 when we decided to invest in this venture. In fact, we had a number of prominent contacts and presentations with large corporations. Yet, we never won a project and after a while we decided not to continue these efforts. Our colleague, by the way, stayed in Spain’ (CEO of a German operations management consultancy, Frankfurt13).

In the second case, a multinational logistics consulting firm was forced to open an office in the US market in order to get the assignment with a major car manufacturer. However, after 2 years of business, the company exited the market because of a lack of new business development.

---

3 This case illustrates the value of qualitative research. The interviewee first reconstructs the business case through the organizational lens. Only when asked to contextualize the international venture, he begins to reveal the deeper social context of the situation and the actual opportunity driving the market entry attempts. The analysis of socio-structural processes behind business decisions can best be carved out through qualitative or mixed method approaches.
‘We had projects and contacts in the parts and components supplier markets of the automobile industry in Germany and Britain. We reengineered their storehouse and got into contact with people responsible for the logistics planning in the USA. We were hired to do a large distribution survey for that company in the USA. In that context they clearly declared that a future consulting project would only work with an American company and not from Germany. So we were urged to open an office in Ann Arbor which went great during the first two years. Then, the management suddenly changed with somebody who was evidently consulting averse. Our Detroit business was 95% with that client. We had always tried intensively to diversify and win new clients in the US but the rules of the game seemed different from the European logistics market. Size matters, niches are not sustainable. And we certainly were a niche player.’ (Managing director of a German engineering consultancy, Frankfurt12).

While the first case reports the difficulties of developing new local clients without current business in the market, the second carries this problem further and demonstrates that a client-following mode of entry may only provide a short-term basis and maximum dependence on a sole client. Winning new clients in a foreign market is one of the most critical challenges in the internationalization process and the bottleneck for a successful market entry. Personal interviews revealed that prior attempts to launch foreign operations failed in a number of instances, too. These incidents support the argument that the process of internationalization did not at all unravel in a linear way, but rather followed sequences of trial, error and success. These two examples emphasize the fundamental risk of business development failure which inevitably causes market exit.

5.2. Organizational form—two kinds of associated entry risks

Each mode of market entry has inherent benefits and risks. In order to understand the statistical association between entry context and entry form, the specific opportunities and threats implied with greenfield and brownfield forms of foreign investments are to be assessed. This paper argues that the key to understanding the impact of social relationships on organizational design is the comprehension of the organization-specific risks. The following analysis of opportunities and threats associated with greenfield and brownfield investments is drawn from the managers’ rationales and own experiences reported in the interviews.

A greenfield entry enables the internal transfer and control of professional standard, work routines and organizational culture (Table 3). For many consultants this was a key argument in favour of growing organically into a new market. The core asset of a consulting company is represented by the knowledge of its professionals, the reputation of the firm and the quality of the client network. When firms grow through greenfield investments they are able to maintain the quality of their recruitment standards and thus to integrate local professionals into the existing organizational and knowledge architecture. An important consequence of organic growth, it was argued, is that the firm ensures internal cohesion and continuity at an international level to their clients and thus sustains corporate reputation. As another advantage a greenfield entry implies a smaller minimum investment in a local venture as compared with M&A forms of entry. The sunk costs for renting office space and expatriating professionals can be spent step-by-step so that the risk of financial loss can be controlled. The downside to greenfield investment is that internal firm organization and recruitment as well external market relationships have to be fully developed from scratch without local
knowledge. This implies several challenges. First, a greenfield venture has no local business contacts. However, since business contacts are crucial to really winning new clients, the company runs the risk of facing severe barriers to business development which might ruin the whole venture after a while (see above). Second, especially, in developed markets, where competition is high and size becomes a factor of competitiveness, incremental organic growth may just be too slow to build a competitive position. As one interviewee argues;

‘Look at the US market: You launch an office and begin with ten people. You double your headcount every year: 20, 40, 80, 160 and 320. So you will not have got far even after five or six years. You’re still nobody. So, to make a surge in growth you need to buy a local company. In big markets you only grow by M&A.’ (CEO of a German technology consultancy, Frankfurt4).

The advantage of a brownfield entry may exactly compensate for the downside of greenfield entry (Table 3). Mergers and acquisitions are attractive to access a range of client and industry relationships with just one financial transaction. By purchasing a local company, an entrant may get a foot into the business, integrate established professionals, and achieve a considerable market share. One consultant justified his decision for an acquisitive market entry by arguing that in his market human resources (the number of capable and well connected people) was very limited in any country. One would have to buy them out, pay superior salaries, hope that these people assemble a coherent and competitive staff and wait many years for the new firm to grow and generate first profits. New contacts would take time to evolve until they paid off (MD of an American HR consultancy, Madrid2). Moreover, another respondent reported the advantage of brownfield investments by emphasising the opportunity to grow faster and gain profits right form the start, whereas de novo establishments would take a lot of time to reach the point of breakeven. In turn, a brownfield entry bears the risk of purchasing ‘hot air’ (MD of a Swedish HR consultancy, Madrid8). The hot air-argument comprises two components. First, since client relationships are key to competitiveness and market success in the consulting business, these external relationships also largely determine the value and purchase price of a target company.

‘What’s a consulting company worth? The computers or the office equipment? No, the value of a consulting firm is determined, first, by its employees. They are highly mobile, however, and fly away if the integration fails after a merger. The second determinant is the client network. So you can avoid making cold calls and saying “Hello, you

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Greenfield</th>
<th>Brownfield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal transfer of professional standards and knowledge</td>
<td>Purchase of existing business relationships and personnel</td>
<td>Profits from day one</td>
</tr>
<tr>
<td>Full control over organization development and international intra-firm coordination</td>
<td>Speedy entry and fast growth</td>
<td>High potential market share</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Threats</th>
<th>Greenfield</th>
<th>Brownfield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slow growth</td>
<td>Post M&amp;A integration failure</td>
<td>Threat to firm reputation</td>
</tr>
<tr>
<td>Lack of local contacts</td>
<td>Overpriced target company</td>
<td></td>
</tr>
</tbody>
</table>
don’t know us, but could we come for a presentation?”’ (CEO of a German technology consultancy, Frankfurt4).

Second, as the respondent argues, the competitive resources are fundamentally represented by the human capital of the acquired firm and the relational capital of its client portfolio. While human capital is highly mobile and sensitive to changes in a firm’s governance and organizational procedures, the relational capital is often extremely people-bound. Consequently, problems in post-acquisition integration may rapidly lead to the exit of key professionals (‘efectos de rechazo’, MD of an American HR consultancy, Madrid14), their knowledge and their relational capital. In fact, not all market entries were successful at their first attempt. Instead, various firms had tried to establish operations prior to their actual presence. Respondents referred to numerous examples where takeovers of local firms had resulted to be ‘disastrous’ experiences. Some technology and IT-related consulting services had to internationalize through M&A because of the speed of market growth during the 1990s. Geographical expansion and local acquisitions were the only way to keep up with this speed. With the economic downturn since late 2000, this has changed dramatically again and growth—if at all—has to be managed more carefully. One managing partner in London regretted the timely decision for an M&A. In the due diligence procedure speed had been given more weight than accuracy which led to unforeseen problems of post-merger integration. This company changed their expansion strategy towards organic growth by waiting for enough current business to build in a market from outside before entering (MD of an American technology consultancy, London20).

These contrary lines of argument illustrate to some extent the contingencies of entry mode choice. However, the analysis of entry form-specific opportunities and threats informs a strategic decision-problem which focuses on the choice between two kinds of risks: a greenfield investment runs the risk of new business development failure, whereas a brownfield investment avoids this risk exactly by purchasing these relationships. In turn, this is paid by the risk of overpriced target companies and post-merger integration failure. Integration problems can be very harmful and can ruin the whole venture if local professionals decide to leave the company and take their knowledge and client base with them. Empirically, then, which risk will a firm take and what is the impact of entry context on these risks?

5.3. Entry context—safeguard against the risk of business development failure

The regression models reported a significant effect of the context of entry on the choice of entry mode. The particular context of social relationships external to a firm may be relational, i.e. include the pre-existence of business relations in a target market, or may be atomistic, i.e. free of any business contacts. Each entry context is explored here in more detail to find out whether and how they affect the presented risks.

In an atomistic entry context, firms organized their market entry on their own rather than through the support of existing business networks. Although the dominant motive was market-seeking some firms pursued a resource-seeking strategy for international expansion in order to improve their level of competence and innovativeness. Atomistic entry confirms the implicit line of argument of conventional internationalization theory. Firms develop corporate strategies, take optimal decisions and venture into the most profitable markets. Of course, since there seem to be no external relationship
constraints or opportunities, the explanatory power of the internationalization process lies fully within the firm and its resources. Nevertheless, atomistic entry was not very prominent in the sample. Conventional theory tends to champion firm-specific competitive advantage, which is certainly indispensable, over the actual ability to win new clients in a market. However, as demonstrated earlier, one of the key barriers if not the single key constraint to internationalization is new business development. Since local business contacts can only be won in a sustainable way through a local presence, consulting firms had to take a substantial risk in opening an office in a target market and then starting to canvass potential clients. Furthermore, since the development of a new client in the consulting practice takes from a few months up to a year or longer, these firms had to make considerable financial commitments to their venture in advance. In turn, since consulting is a project business, consultancies do usually not build savings for their future business. Hence, the risk of venturing into a new market under atomistic conditions was quite high and demanding. ‘You must have very large savings in order to finance a market entry over one year in advance. I don’t think that many firms can afford this. In fact, we could not’ (CEO of a German technology consultancy, Frankfurt10). Since the generation of a new client base is a lengthy process, atomistic entry context thus fosters brownfield entry. Through the acquisition of local firms, the buying firm aims at taking over the local client network and thus avoids the risk of business development failure at the cost of potential post-merger integration failure.

In contrast, a relational entry context was characterized by existing client relationships, which were key to successful internationalization. The more a consultancy served internationally operating client firms, the more likely it was to benefit from an opportunity to be pulled abroad. It is important to note, however, that the client-following mode does not say much about whether a firm followed deliberately or in response to the command of an existing client demanding international service provision. As soon as the business volume in a host market exceeded a certain threshold, a local presence was ventured. Market selection as well as entry time was therefore dependent on the client organizations’ internationalization path: ‘Where our clients want us, that’s where we will go.’ (Marketing Director of a Swedish technology consultancy, London17). However, relational entry is not synonymous with the client-following mode (Samie, 1999) in that it also embraces other types of business networks (Table 4). A second entry path was through current or former employees (alumni) who had moved to other companies abroad and referred business to their employer. One German-based technology consulting company, for instance, was referred to jobs in Indonesia, Egypt and Brazil by just one former employee. These kinds of dense network contacts even facilitated the entry into markets with pronounced cultural dissimilarities and at long geographical distance. This observation poses, again, an empirical challenge to atomistic arguments about psychic distance and cultural proximity. The third type of business networks worked through the so-called piggybacking (Terpstra and Yu, 1990; O’Farrell et al., 1996). In this case, consulting firms entered a market on the back of strategic partners and collaborators (Table 4). When a service firm had entered a foreign market and required additional capacity or competence to service their new clients, they referred partner firms from their home base into these projects. As such, they served as bridges for consulting firms to new markets. The particular attraction of piggybacking was, first, the access to a whole remote network of clients and business opportunities through just one partner firm abroad and, second, avoiding an early entry risk. The downside, however, was that client access was always mediated through the incumbent
firm and therefore indirect. These diverse sources of referrals within an existing business network are an alternative way to reduce the risk of business development failure. In contrast to the atomistic entry, a company does not need to take a new risk by acquiring an existing local company, i.e. the risk of post-merger integration failure. Instead, the firm enjoys the advantages of a greenfield investment and maintains full control over internal organizational and professional standards. At the same time it benefits from its existing linkages in the market and the potential reputation effects within social networks that create multiplier effects and generate new business (Glückler and Armbrüster, 2003; Glückler, 2005).

5.4. International experience—safeguard against the risk of post-merger integration failure

The argument of relational entry context as safeguarding the risk of business development failure and thus fostering greenfield entry is formulated under static conditions. In a dynamic perspective, the constraint of business networks on entry form seemed to weaken with increasing international experience. The regression model reported a significant effect of international experience on entry form. Firms that entered brownfield were present in double the number of countries than greenfield entrants, on average. Moreover, firms entering under atomistic conditions also had double the amount of foreign operations as compared with firms entering in a relational context. In

Table 4. Types of networks in relational entry context: interview examples

<table>
<thead>
<tr>
<th>Types</th>
<th>Interview quotations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Follow-the-client</td>
<td>‘You can actually build your international capability on the back of existing clients. For example, I was telling you that we do a lot of work in Germany right now. Probably sufficient, certainly sufficient amount of work to establish our own office there. You can fund the investment of establishing ourselves in Germany through an existing client. How you grow then beyond your existing clients...? It is to hire somebody who has the relationships and network to supplement what you have. You buy a person, a team or a firm.’ (MD of a French strategy consultancy, London1)</td>
</tr>
<tr>
<td>Alumni-network</td>
<td>‘Let us take Indonesia as an example. The fellow who worked for us in Indonesia now works for a local manufacturer as director of the sales department. So he controls the contracting for new projects and there is actually quite a number of projects currently initiated. So we take the advantage of this contact and have already managed to win projects and bring our people on those work teams. I would never ever be able to access those projects, no way. It only works across our network’ (CEO of a German technology consultancy, Frankfurt10)</td>
</tr>
<tr>
<td>Piggyback</td>
<td>‘At that time a German colleague went to Spain in order to develop the business in the recently founded Spanish operation. After four years he wanted to do something new. During his time in Spain he had built relations with other strategy consultants who had managed to open a business in Buenos Aires. They had been present for over two years in Argentina and then called: Here is something you could work on in the field of logistics. So he took a flight to Buenos Aires and acquired three projects in only a fortnight. He brought a German and a Spanish colleague from Madrid and they started working from the hotel room. Then they rented a small office and after a year, Argentina gave business to six full-time employed consultants. This is how Buenos Aires began.’ (MD of a German engineering consultancy, Frankfurt12)</td>
</tr>
</tbody>
</table>
consequence, relational entry context and greenfield entry appear to be important drivers in early phases of internationalization but less decisive in later phases. International experience increases the knowledge and competence of how to conduct due diligence processes and how to manage a post-merger integration process in order to avoid the exit of local personnel and their client contacts. The more international a consulting firm grows the better its management competence in M&A integration and the smaller the relative risk of a market entry. This reasoning suggests that increasing international experience reduces the risk of post-merger integration failure and makes brownfield entry more likely. At the same time, international experience reduces the dependence of a firm on its relational links with the business environment through the creation of own competences. In summary, social networks minimize the risk of business development failure and allow for wholly controlled investments in the setting up of own operations. Moreover, increasing international experience compensates for the lack of relational access to a host market. Obviously, multinational firms have enough experience and competencies that are relevant for a successful atomistic entry by acquiring and integrating local companies.

6. Discussion and conclusion

A number of existing empirical studies on the international expansion of business service firms have demonstrated that international market selection and foreign market entry are strongly influenced by existing client relations and business contacts (O’Farrell et al., 1996; O’Farrell and Wood, 1998; Coviello and Martin, 1999; Westhead et al., 2001). This paper has taken up these experiences and developed a conceptual critique of conventional internationalization theories. Moreover, the paper has made the attempt to formalize an argument about the impact of a certain social context in which firms operate on their choice of entry form. As such the paper contributes to both theory and empirics of firm internationalization in business services.

Instead of explaining entry mode by firm attributes or firm-specific assets, this research has challenged the choice of entry from the relational environment of that firm. The empirical analysis reveals two significant findings. First, it evidences the systematic influence of social networks on the choice of an organizational mode of market entry and thus supports the arguments of a network approach to internationalization. Given the decision-problem between the risk of business development failure through greenfield entry and the risk of post-merger integration failure through brownfield entry, the analysis confirmed that a relational entry context reduces the risk of business development failure by providing direct market contacts. Hence, in the relational entry context firms tended towards greenfield investments in order to avoid the risk of M&A integration failure. Second, the regression model confirmed that the impact of relational entry context is strongest for young and less experienced firms in the course of international expansion. Internationalization experience obviously reduces the risk of M&A integration failure because firms develop the competences to manage due diligence procedures and post-merger integration. Hence, when multinational firms know how to integrate a local company at higher levels of control and certainty, they take advantage of local knowledge and client base through brownfield investments.

A relational approach to firm internationalization stresses the importance of the context, in which a firm takes the decision to venture into a new market. For the empirical research, context is defined as the environment of a firm’s relationships.
This perspective also challenges the hyper-analytical distinction between three separate decisions usually discussed in the internationalization theory: often, the existing network of relationships influences, first, the decision to internationalize, second, the selection of a target market and, third, the choice of entry form. If internationalization is a result of the external business relationships of a firm, the three decisions merge into one sole decision. Finally and in a wider context, this research links to other studies that focus on the impact of relational context on economic decisions and processes. Baker and Faulkner (2004), for instance, find relational context important for the probability of capital loss in the course of investments. If investors draw on pre-existing social ties the probability of losing capital in an investment drops significantly.

While the context of social relations has been proved to systematically affect the action framework and organizational decision-taking, one should not conclude that social networks determine strategic action. Provided with the same set and quality of external relations, different actors will still differ in ability and style of making use of those relations. Therefore, internal organizational conditions as well as the strategic context of an organization are still important to understand how social relations are built and used. It is here, where this research has its limits since it has only focused on the quality of external linkages between firms and not on international firm-specific competitive advantages. Future research should aim at simultaneously assessing the impact of relational and attributional variables in order to integrate both streams of theories. Nevertheless, the coherence of qualitative and quantitative findings presented in this paper promises to be a fruitful contribution to the current debate about firm internationalization in business services.

Acknowledgements

The author is grateful to the participants of the annual residential meeting of the IGU Commission on the Dynamics of Economic Spaces in Birmingham, 10–13 August 2004, for comments on earlier drafts of this paper. Moreover, The author would like to thank three anonymous referees as well Neil Wrigley for valuable suggestions to increase the clarity of the argument. This research was financed by the German Research Foundation (DFG).

References


