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Foreign Entry Strategies: Strategic Adaptation to Various Facets of the Institutional Environments

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A comprehensive model of foreign entry strategies by multinational enterprises (MNEs) is developed in this paper, and a theory is proposed on how the entry strategy is likely to be determined in the interface between internal and external pressures for both conformity and legitimacy. In contrast to a selection rationale, an adaptation argument is developed, through which we enhance our understanding of the various facets of the institutional environment and the constraints MNEs encounter in their internationalization strategies.

Keywords: *Foreign Entry Strategies, Adaptation, Multinational Firms, Institutional Environments.*

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Introduction

Despite abundant research on entry strategies in International Business (IB) studies, scholars have paid scant attention to the social context within which entry strategies into foreign markets are embedded (Granovetter, 1985). In fact, few studies have contrasted economic and social explanations for choices on entry mode strategy. It is unclear, for example, how different entry mode strategies reflect internal, inter-firm and external environment pressures. It is accepted, however, that the models of interaction between firms and their institutional environments determine the firms' adjustment to external constraints and may promote the firms' survival, even if the external environments are unknown and cannot be accurately predicted. In the case of multinational enterprises (MNEs), the difficulties are heightened because MNEs are exposed to multiple and distinctly complex foreign business environments (Guisinger, 2001). Guisinger (2000), for example, suggests that the essence of International Business (IB) is the adaptations that firms must undertake when they face unfamiliar, unstable and complex surroundings in foreign countries. But how do MNEs adapt? To adapt, survive and grow, MNEs need to respond effectively to internal institutional pressures as well as to the demands imposed by external environments (DiMaggio and Powell, 1983; Kostova and Roth, 2002; Scott, 2003). Hence, each subsidiary must strategically adapt to the various dimensions of the host country's institutional environments (e.g., regulatory, legal, economic, technological and cultural environments), to the patterns of inter-firm interaction (e.g., industry associations and networks, industry regulations, laws, standards and norms) as well as to MNEs' internal norms. Oliver notes as follows (1997: 697).

Firm's institutional environment includes its internal culture as well as broader influences from the state, society and inter-firm relations that define socially acceptable economic behavior.

An assessment is made of the impact of the internal and external facets of the institutional environments of MNEs on the selection of foreign entry strategies (see also Davis, Desai, and Francis, 2000). Recent research suggesting that firms make choices influenced by their environments will be followed (see also D'Aunno, Sutton, and Price, 1991), including other firms operating in the same industry or in the same host market; firms then formulate a strategic response to their environmental conditions (Oliver, 1991). When analyzing external institutional pressures, two contexts — i.e., home and host countries, and inter-firm interfaces — are distinguished. External institutional pressures

include regulatory structures, governmental agencies, laws, courts, professions, interest groups, public opinion, culture and economy (Scott, 2003). Each new subsidiary's set of rules, procedures, practices, norms, values and structures require legitimacy in light of the host country's institutional environment. Inter-firm interfaces represent practices of rivalry and imitation whereby firms choose to follow strategies implemented by other firms.

Internal institutional pressures applied to the analysis of MNEs' subsidiaries refer to conformity pressures from headquarters and other subsidiaries. For example, the structure and internal processes of a new subsidiary need to adapt, or already be similar, to those of other subsidiaries of the same parent MNE in order for the new subsidiary to be considered a complete member of the corporation. The sense of membership, or identification, is fundamental if the new subsidiary is to receive resource inflows from its subsidiaries and headquarters. Therefore, an adaptation, rather than a selection, argument of MNEs' adjustment to the foreign institutional environments is developed to analyze MNEs' foreign entry strategies. While traditional selection arguments leave few possibilities for a firm's strategic choices, a strategic adaptation rationale is based on how these choices permit an otherwise overly restrictive and limiting environment to be overcome. Firms adapt to be selected, but selection produces a different form of adaptation. Selection as a process does not create perfect firms, and adaptation is an ongoing strategic process aimed at increasing the likelihood of survival and better performance.

Furthermore, although a strategic perspective is taken, strategy is acknowledged to be formulated within the agents' bounded rationality (Simon, 1957), decision-making and the direct influence of surrounding agents (i.e., their actions, beliefs and those used as referent others)(Shah, 1998). Therefore, firms may seldom commit to a definite profit maximizing strategy (DiMaggio and Powell, 1983; Norman, 1988). Efficiency rationale or profit maximizing strategic choices may be disregarded in some cases; instead, MNEs may actually be constrained to choose among a more limited set of alternatives than we often realize. By simultaneously examining firms' entry strategies with both institutional and economic lenses, we can better analyze the effects of both *ex ante* and *ex post* institutional forces upon MNEs' entry strategies.

In contrast to existing studies that present too much of a piecemeal approach to be illustrative of the complexities involved, this study contributes to current research by presenting a more comprehensive and multi-dimensional approach to firms' strategic adaptation to internal and external pressures. A more in-depth analysis of each dimension is offered through recognizing that

varied facets of the institutional environment affect MNEs' decisions differently. Furthermore, in line with recent research (e.g., Xu and Shenkar, 2002), institutional distance (Kostova, 1999; Kostova and Zaheer, 1999) between home and host countries is posited to matter, but possibly more important is the direction of this distance. For example, institutional distance is better conceptualized by considering the pool of prior foreign experience of MNEs, rather than merely the difference between home and host countries. Furthermore, while the extant research assumes the existence of a "model" for firms to imitate, it is proposed that referent models do not always exist; rather, firms are forced to rank order other market players in search of strategies to follow.

Current research on foreign market entry strategies is briefly summarized first. In the second section, an institutional theory as the theoretical foundation for arguments put forth by this paper is reviewed. In the third section, propositions are developed to address MNEs' entry strategies into foreign countries and the evolution of MNEs' responses to their environments is explored in an effort to uncover the rationale behind managers' choices of entry strategies. Moderating effects of MNEs' international experience and technological strategies are also advanced. This paper concludes with a discussion of much-warranted future research.

Foreign Entry Strategies of MNEs

Foreign entry strategies have been extensively studied in international business (IB) research. Some studies have focused on the *antecedents*, or predictors, of entry mode choice, others on the *specific factors* that lead to equity investment as the preferred mode of entry, and yet others on the *consequences* of entry modes (see Werner, 2002). Given the focus of this paper, this section succinctly describes the three main approaches of existing research to explain the *antecedents* of foreign entry strategies. First, earlier studies on internationalization emphasize the effects of international experience accumulation on the selection of investment location and entry mode (Johanson and Wiedershiem-Paul, 1975; Johanson and Vahlne, 1977, 1990; Cavusgil, 1980; Luostarinen and Welch, 1990; Root, 1994). These studies suggest an evolutionary, sequential and largely deterministic model of internationalization that evolves with knowledge acquisition, risk perception, commitment of resources and accumulation of international experience. These studies further prescribe that entry strategies follow a pattern of increasing

involvement in foreign operations, from low involvement entry strategies (e.g., export) to higher commitment strategies (e.g., direct foreign investment through greenfield investments and/or acquisitions).

Second, foreign entry strategies have been studied as the outcome of internalizing market imperfections and the minimizing transaction costs by organizing exchanges within the MNEs (Williamson, 1975, 1981; Rugman, 1981; Hennart, 1982; Dunning, 1988). According to these studies, the best foreign entry strategy minimizes transaction and production costs as well as overcomes market imperfections (Teece, 1986). The higher the market imperfection (e.g., imperfections in the market for knowledge), the more likely the MNEs will internalize those markets and adopt, for example, greenfield entry strategies (Dunning, 1988).

Finally, a third approach to foreign entry strategies is rooted in the social network perspective. The network model of foreign entry strategy suggests that MNEs integrating networks with buyers, suppliers and competitors have privileged access to markets (Johanson and Mattson, 1988; Ellis, 2000). Cooperating with other firms facilitates market entry, reduces risks and costs while attenuating political and cultural constraints (Stinchcombe, 1965; Hannan and Freeman, 1989; Henisz, 2000).

These studies lay out the now well-understood main benefits and drawbacks of each entry strategy (see Root [1994] for an extensive review of entry strategies). The different entry strategies are export, contractual agreements (such as licensing agreements), equity joint ventures, partially and wholly owned foreign acquisitions as well as greenfield startup investments. Non-equity-based entry strategies offer better protection against country risks and transactional hazards than equity-based strategies (Osland and Cavusgil, 1996), but non-equity strategies, such as export and contractual agreements, enable less organizational learning. In fact, low commitment entry strategies may be preferred to overcome unfamiliarity with the host country environment (Barkema, Bell, and Pennings, 1996). For example, establishment of a subsidiary through the acquisition of a local firm permits fast access to foreign firms' knowledge (e.g., market or technological knowledge) and access to an already established market position. Acquisition also provides some degree of immediate embeddedness and allows firms to enter a network of ties to suppliers, clients and agents in the host country. Joint ventures have also been noted as vehicles for learning because cooperation with a local partner provides the focal firm an opportunity to utilize the partner's local market knowledge (Tallman and Fladmoe-Lindquist, 2002) as well as social and business ties. In addition, joint ventures allow technological advancement through the transfer

of technologies among partners. In contrast, contractual agreements (i.e., licensing, R&D contracts, alliances, etc.) often involve explicit descriptions of technologies intended to be learned by one party. Finally, a greenfield entry strategy essentially consists of replicating home country operations in a foreign target. This strategy is based on full control over foreign subsidiaries and is pretty much an ethnocentric orientation whereby directives emanate from corporate headquarters. While this strategy is appropriate when seeking to protect proprietary resources and technologies, it is also the one that imposes higher degrees of "foreignness" in the host market.

Analysis is made of the alternative entry strategy more likely to be selected by MNEs as a function of institutional dimensions. The entry strategy decision is important due to the commitment of resources it entails (Agarwal and Ramaswamy, 1991), and the assumption of risk and readiness for political, social, and cultural challenges the firm will encounter (Henisz, 2000; Hofstede, 1980). The entry strategy is also important because it represents the first interface for a strategic adaptation to conditions in corporations and host countries both.

Institutional Environments of MNEs

Institutional theory typically focuses on the pressures exerted by external institutions on the strategies of firms. External institutions may consist of regulatory structures, agencies, laws, courts, professions, interest groups and public opinion (Oliver, 1991). To build legitimacy, organizations must comply with formal and informal rules, norms, behaviors and ceremonies set forth by external institutions in the locations where they operate (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Oliver, 1991; Kanter, 1997; Kostova and Zaheer, 1999). Hence, institutional theorists emphasizing the value of conformity to the external environment suggest that firms need to be similar, or isomorphic, to their environment and surrounding agents to survive and prosper (Meyer and Rowan, 1977; DiMaggio and Powell, 1983). Isomorphism through mimicry is a strategic choice whereby one firm enhances its legitimacy in a population (Suchman, 1995; Dacin, 1997) by resembling other incumbent firms facing the same set of environmental conditions (Hawley, 1968; Meyer and Rowan, 1977; DiMaggio and Powell, 1983). In fact, recent research primarily highlights legitimacy arguments and mimicking effects, with the latter operationalized as an imitation of incumbent firms or market leaders (Haveman, 1993; DiMaggio and Powell, 1983).

This argument is consistent with a growing body of IB research suggesting the efficacy of adaptation and responsiveness to the local market. Firms seek compliance, or adaptation, to the foreign business environment, not necessarily for efficiency, but rather to conform to the "taken-for-granted assumptions about what constitutes appropriate or acceptable economic behavior" (Oliver, 1997: 699). Similarly, MNEs may follow certain foreign entry strategies not because they are the most efficient or economically rational choices but due to socially obligatory host environment requirements (Oliver, 1997; Zukin and DiMaggio, 1990). Alternatively, MNEs may mimic entry strategies chosen by leading firms, firms in the same industry, firms of similar size, or firms that appear particularly successful (Haveman, 1993). Hence, it is also important to observe foreign entry strategies of competitors to understand the strategies of individual firms.

Institutional pressures are not deterministic. Firms' strategies reflect the ability to respond, change and influence (Oliver, 1991). While institutional theory has traditionally embodied the deterministic effect of institutional rules, ceremonies, myths and beliefs on how organizations become instilled with value and social meaning, Oliver (1991) argues that firms develop through their strategic responses to institutional pressures. This view parallels the argument of intended strategy as proposed by Nelson and Winter (1982), which conceptualizes firms as active agents with the ability to mold their environment. The notion of intended strategy further claims that firms' strategies actually shape the model of adaptation to foreign environments, from which we infer that firms are not imprisoned in an isomorphic determinism (Oliver, 1991, 1997).

Firms adapt to the institutional environment through choosing a foreign entry strategy and a location. For example, Westney (1993: 71) notes that "location is a key variable: Japanese firms tend to locate their plants in areas where the institutionalization of U.S. auto industry pattern is weak or non-existent." According to Westney, these are areas where unionization is low, the labor force is unaccustomed to assembly line work or high unemployment from plant closures de-institutionalized existing patterns (see also Shaver, 1998). Thus, adaptation is reflected in the selection of equity entry strategy and low institutionalized locations in the case of the auto industry.

Foreign entry strategies face dual and potentially conflicting pressures toward compliance to internal norms (corporate normative) and toward adaptation to local environmental requirements (DiMaggio and Powell, 1983). The term "institutional duality" refers to two distinct sets of isomorphic pressures originating from the host country network and the internal MNE

network, and the corresponding need for foreign subsidiaries to hold legitimacy within both networks (Kostova and Roth, 2002). Internal pressures push the new foreign entry and the new subsidiary to resemble prior entries and/or other subsidiaries' structures and internal processes. This similarity will be crucial for resource transfers among subsidiaries. Internal pressures may include hiring expatriates, importing intermediate products instead of acquiring them locally and partnering with host banks rather than home financial service firms. That is, internal pressures rest on taken-for-granted assumptions embedded in the firm's operations, which result from past experience, power relations, inertia, common beliefs and memories. Conversely, external pressures are embodied in formal, informal, and, to a great extent, in locally enacted norms of what is "right" and "wrong." For example, a firm may prefer establishing a subsidiary if the host country's citizens are averse to foreign firms (Root, 1994). Thus, a foreign entry strategy is legitimate insofar as it is perceived by relevant actors in the home or host environment as the "natural way" to enter. To some extent, MNEs reduce potential negative impact of foreignness by seeking local legitimacy (Hymer, 1976; Zaheer, 1995).

In sum, the basic idea of institutional theory is that firms tend to conform to the locally prevailing "ways of doing things," organizing and behaving. These are based on social expectations and influences by which firms should abide to gain legitimacy and improve their capacity to survive and prosper. In contrast, strategic and international management theories seek to discover strategies that are most efficient for the firm, given internal and external constraints and objectives. Mere conformity to internal and external social pressures is in relative contrast to the optimization of firms' strategic choices.

Strategic Adaptation to Various Facets of Institutional Environment

Although many studies have analyzed MNEs' foreign entry strategies, only a few have considered both economic factors and social contexts to explain entry strategy choices (Granovetter, 1985). We illustrate different facets of institutional environments and their impact on entry strategy choices in Figure 1. We do not attempt to provide an entire repertoire of the firms' strategic choices, but rather highlight the dynamics involved when considering each institutional facet in this section. First, we consider more detailed macro-institutional factors of home and host market environments as composed of social/cultural, political, legal/regulatory, economic and technological dimensions while previous research has mainly focused on simple government-

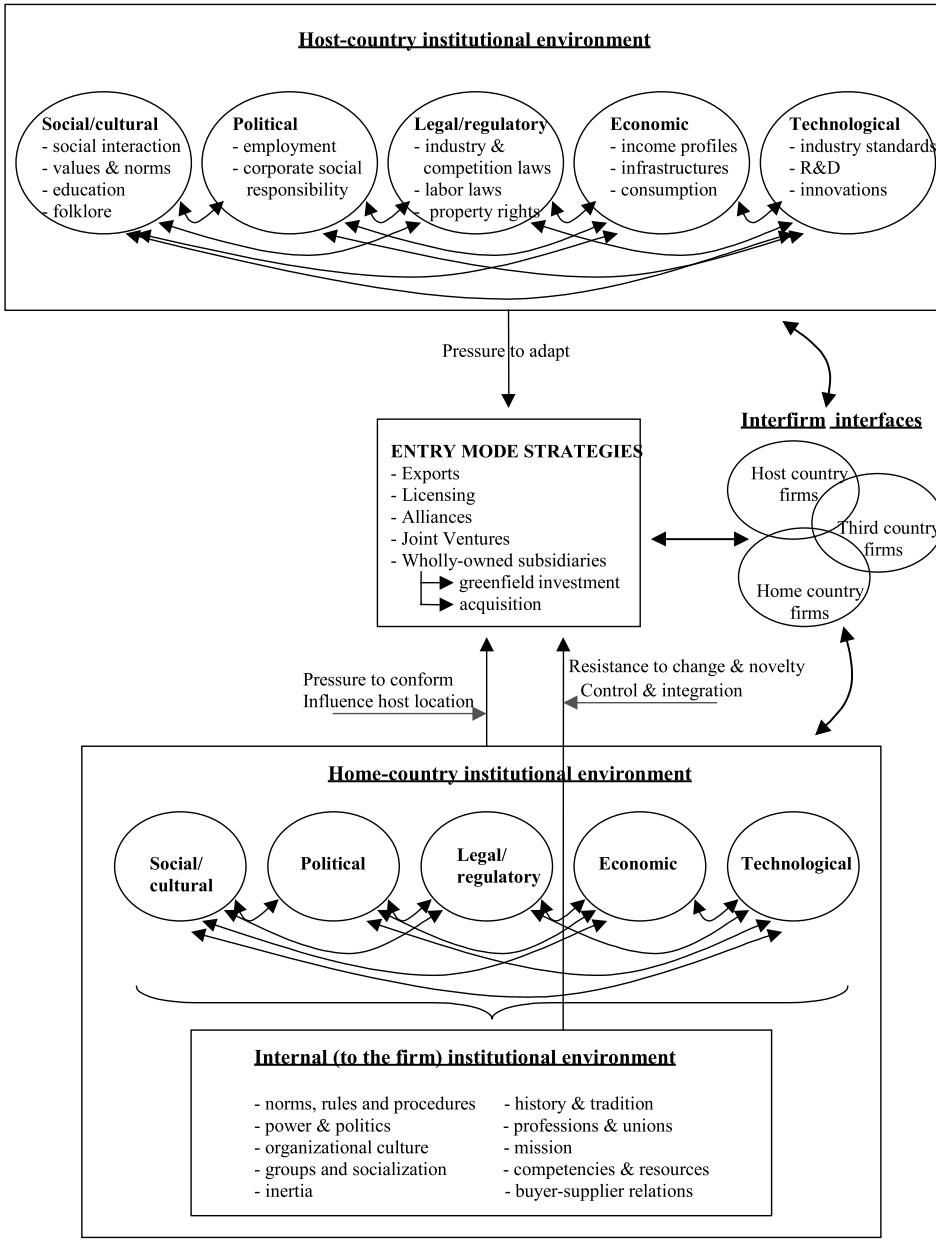

Figure 1. General Model of the Interaction between the MNE and Its Environments

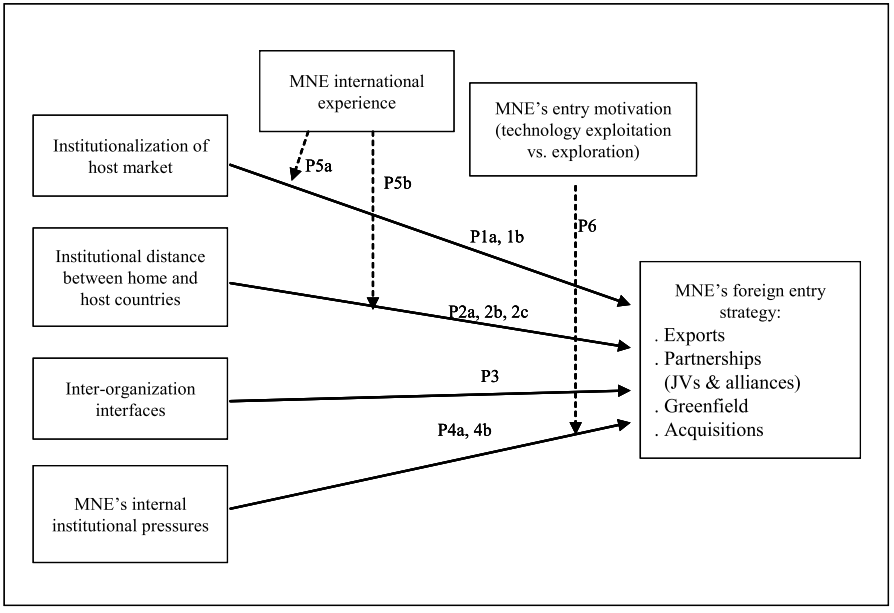

Figure 2. Conceptual Model

induced institutions (Henisz, 2000, 2003). These dimensions interact among themselves and exist in both home and host markets. Second, we see internal organizational pressures as important factors determining entry strategies. Internal factors include norms, values, power and politics, organizational culture, path dependent history and tradition, competencies and resources of the firm (Nelson and Winter, 1982; Barney, 1991). Third, we stress inter-firm relationships with other home-, host-, or third-country firms (represented by the three circles on the right in Figure 1).

Given that MNEs are embedded in a system of inter-related economic and institutional pressures at different levels, it is not likely that any of these pressures will operate in isolation, nor that one will dominate MNEs' strategic choices (Granovetter, 1985; Dacin, 1997). In the following sections, we explore how these different dimensions of an MNE's institutional environment may affect strategic choices regarding the selection of foreign market entry strategies. Major propositions advanced in this paper are illustrated in Figure 2.

Institutional Environment of the Host Country and Foreign Entry Strategies

Characteristics of the institutional environment of the host country affect MNEs' entry strategies. A host country's institutional environment is composed of rules, norms and traditions, some of which are explicitly stated or recorded, while others are not (Meyer and Rowan, 1977). In a well-developed institutional environment, collective sanctions exerted upon norm-violators are severe because the norms are widely accepted, and there are effective institutions that either prevent violations or coercively enforce prevailing norms. Such institutions are necessary for forming successful strategic alliances and joint ventures. Therefore, the MNE are more likely to favor collaborative entry strategies such as strategic alliances and joint ventures when the host country encompasses well-developed institutions that guarantee the enforceability of contracts and reduce transaction hazards and opportunism (Williamson, 1985; Meyer, 2001; Henisz, 2000). Acquiring better knowledge about the local institutional environment can be realized by finding a local partner (e.g., constituting a joint venture with local partners) and/or by transforming local firms into subsidiaries (i.e., by acquiring an incumbent firm). Entering well-institutionalized markets through partnerships allows MNEs to establish bonds with local agents familiar with local norms, thus increasing the subsidiaries' survival prospects. Similarly, an acquisition involves acquiring a firm already embedded in the market and already holding social and business ties to surrounding agents. Conversely, both export and greenfield investment entry strategies involve bringing "foreignness" into the market and are, therefore, more likely to face opposition.

This assertion is interesting for IB research because it entails a significant contrast with the prevailing view of partnerships as inter-organizational models for sharing the hazards associated with unstable and high-risk countries (Henisz, 2000). However, it is consistent with the growth of alliances in Western countries (Dunning, 1995; UNCTAD, 2001) because Western countries are predictably more and better institutionalized than less developed countries. Hence, when other variables are constant, MNEs are more likely to select collaborative entry strategies when the host market is highly institutionalized.

> ***Proposition 1a.*** *MNEs entering highly institutionalized foreign countries are more likely to select joint ventures and acquisitions entry strategies as opposed to export or greenfield entries.*

Decomposing the impact of the host country's institutional environments on entry strategies into normative, cognitive and regulative dimensions (e.g., Xu and Shenkar, 2002), we expect each dimension to exert an idiosyncratic influence on MNEs' entry strategies. The regulative aspects of institutional environments, such as rules and regulations, are clearly articulated and can be observed and followed; thus, gaining legitimacy is relatively straightforward, particularly in the presence of an effective regulatory environment. The normative and cognitive aspects of institutional environments, such as informal norms and standards, however, are considerably less perceptible to outsiders, and hence prove to be a more difficult adaptation. For instance, the importance of understanding cognitive norms and cultural idiosyncrasies is often highlighted in tips for "doing business" in Asian countries. In these countries, the informal norms of gift offerings, hierarchies and an array of complex traditions are difficult for foreigners to grasp. In the case of Italy, particularly southern Italy, "men of honor"[1] tradition and complex social interactions among "families" demonstrate how informal norms construct the social structure of interactions that is challenging for foreign firms to comprehend. Informal norms are unwritten and tacit, and contrast sharply with formal norms imposed by the legal and judicial systems. In other instances, the sheer complexity of governmental apparatus, such as the legal and judicial systems, increases the cognitive difficulties of operating in a foreign country. Notwithstanding, violation of cognitive and/or normative norms may lead to results as fatal as violation of legal rules (Xu and Shenkar, 2002). Hence, MNEs are more likely to rely on local partners to learn and incorporate these invisible rules.

The differentiation we build is between cognitive and normative dimensions on the one hand and the regulative dimensions on the other hand. While the first is implicit, largely tacit and difficult to codify and learn, the second involves explicit norms and regulations that firms must honor. Therefore, it is more necessary for MNEs to rely on local partners or collaborators to understand cognitive and normative dimensions rather than to understand the actions and implications of regulatory institutions.

> ***Proposition 1b.*** *MNEs entering normatively and cognitively institutionalized foreign countries are more likely to select collaborative entry strategies such as joint ventures than when entering regulatively institutionalized foreign countries.*

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[1] The concept here reflects social interactions among people, relationships that bind them together and expectations they have of others' behaviors, namely when it comes to trusting and imbuing value to their word. The contrast is evident when we compare the standard Western legalized manner of regulating relationships and contracts.

Institutional Distance between Home and Host Countries and Foreign Entry Strategies

Another major driver of entry strategy selection is the perceived institutional difference between home and host countries (Kostova, 1999) or between prior entries and prospective host countries (Johanson and Wiedershiem-Paul, 1975). Institutional distance hinders the flow of information between the MNE and the market (Xu and Shenkar, 2002) and may promote the adoption of strategies that are not more efficient but rather more legitimate. For example, if the prospective host country's environment is perceived to be substantially institutionally different from MNEs' home institutional environments or prior entry experience in other foreign countries, MNEs may prefer to commit fewer resources to its operations in the foreign country. Therefore, when entering countries with high institutional distance from the home country or previous experience, MNEs may select non-equity, and low involvement, entry strategies.

The more institutionally distant the host country is, the higher the degree of adaptation needed by MNEs. This is because a larger institutional distance between home and host countries requires the need to evaluate, learn about and adapt more extensively to local institutional agents and norms. For example, in earlier stages of internationalization, the use of export entry strategy may be appropriate because it favors low risk and low commitment of resources while it allows a period of learning about the host's institutional environment. Partial evidence of this effect was uncovered by Li and Guisinger (1991)'s study of failures of foreign-controlled firms in the U.S.; they found higher failure rates in firms from culturally dissimilar countries. To the extent that the "license to operate" (Kanter, 1997) requires cooperation with local partners, MNEs may choose non-equity strategies (e.g., export, licensing) or partnerships (e.g., joint ventures) with local partners.

> ***Proposition 2a.*** *MNEs entering institutionally distant markets are more likely to select export or partnership (joint ventures and partial acquisitions) entry strategies and less likely to choose greenfield startup investments.*

In addition to the institutional distance between home and host countries, one must consider differences in how the distance is structured (Shenkar, 2001; Xu and Shenkar, 2002). We delineate two basic scenarios for the same institutional distance between two countries (a home country and a host

country) with asymmetrical effects: (1) the home country has a more developed institutional environment than the host country, or (2) the home country has a more immature institutional market environment than the host country. The effects are not likely to be equivalent for an MNE from a home country with well-developed institutions entering a host country with poorly developed institutions and vice versa (Xu and Shenkar, 2002).

Partnership and networking resources of various kinds are less important for entering institutionally mature countries, such as those of the European Union or the U.S. because these countries already have well-established institutions that facilitate internationalization (Henisz, 2000). Developed countries possess well-structured, highly specialized and effective institutions, which smooth the process of MNEs' entry. In addition, because these countries have more sophisticated markets and more developed firms (both domestic firms and subsidiaries of foreign MNEs), it is likely that foreign firms entering these countries will base their advantage on some form of intangible resource (e.g., knowledge) or capability (Kogut and Zander, 1992; Dunning, 1998). Thus, it is important for MNEs to internally guard their firm-specific advantage(s) to compete in host countries. As a result, these MNEs are more likely to prefer wholly-owned subsidiaries to protect their advantages (Buckley and Casson, 1976; Dunning, 1998). In contrast, MNEs are more likely to select collaborative entry strategies to uncover the possible hazards of embedded rules and hidden norms when they enter an institutionally primitive market from an institutionally mature market (Johanson and Mattson, 1988; Chen and Chen, 1998).

> ***Proposition 2b.*** MNEs from institutionally mature countries entering institutionally primitive countries are more likely to select joint ventures or acquisitions of local firms as entry strategies.
> ***Proposition 2c.*** MNEs from institutionally primitive countries entering institutionally developed countries are more likely to select greenfield entry strategies.

Inter-firm Interfaces

Organizational ecologists argue that "structural inertia" is an obstacle to flexibility and, as such, limits firms' ability to adapt to external pressures (e.g., Hannan and Freeman, 1984; Scott, 2003). Inertia hinders change and favors replicating past actions, strategies and behavior. This suggests that internal (inertial) pressures affect the entry strategy choices of MNEs and encourage

them not to break away from known, accepted and experienced practices. MNEs are likely to replicate organizational structures and foreign entry strategies with which they are familiar — that is, entry strategies utilized in prior entries (Tallman, 1991).

Given such inertial pressures, how do MNEs select entry strategies that appear to increase their likelihood of success? Imitation of incumbent firms is a form of mimetic isomorphism (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Haveman, 1993) that increases the legitimacy of MNEs' operations in the host country and promotes easier access to resources. A mimicking strategy is particularly effective for MNEs entering an unfamiliar host country for the first time. However, the primary question is which referent(s) firm(s) should be imitated. If there are other MNEs from the same home country already operating in the host country and these MNEs appear to be successful, then it is likely these are good referents to imitate. This is because these MNEs come from a similar (not identical) institutional environment and appear to have successfully adjusted to the host market. Carroll (1993: 246) states as follows:

> At some point the evolutionary process likely becomes calculative in that successful firms are readily recognizable and managers can formulate pretty good guesses as to what equilibrium criterion is being favored and the organizational factors that might produce it.

In the absence of home country models, referent others (Shah, 1998) are other foreign firms from a third country, firms in the same industry or firms of similar size that appear to be particularly successful (Haveman, 1993). It is worth noting that host country firms can hardly be considered as referents for foreign entry strategies because they are not involved in entering their own home country. However, host country firms may be utilized to evaluate appropriate configurations and compositions of network ties needed in the host country as well as other formal characteristics (e.g., organizational structures), all of which are to some extent post-entry decisions. We suggest that in the absence of home country referents, firms from a third country are more likely to be used as referent firms. However, mimicking third-country firms is difficult because they are embedded in a social context of different home countries (Granovetter, 1985), and there may be significant ambiguity (Reed and DeFillipi, 1990) in detecting what these referent firms really do. Nevertheless, third-country firms may still provide valuable insight into appropriate responses to the host institutional environment.

Proposition 3. *MNEs' foreign entry strategies are more likely to resemble those firms competing successfully such that MNEs will mimic other home country MNEs, and MNEs will mimic successful third-country MNEs operating in the host country in the absence of home country referent firms.*

Internal Institutional Environment of MNEs

Foreign entry strategies are also determined by the degree of conformity to internal pressures (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Oliver, 1997; Kostova, 1999; Xu and Shenkar, 2002). Internal pressures include existing organizational structure, corporate mission, vision and goals of MNEs, norms and values, management and dominant coalitions and organizational culture (see Figure 1). For example, MNEs favoring a high degree of control and coordination of subsidiaries are more likely to favor wholly-owned strategies over other foreign entry strategies (Davis, Desai, and Francis, 2000) as the means of parental isomorphism to better override internal disruptions and inefficiencies. Tallman and Yip (2003) argue that absolute adaptation to the host country would reduce the MNEs "to a loose collection of autonomous businesses that enjoy little synergy while incurring the overheads of a large MNE." Specifically, we may expect acquisition of existing firms to be more likely to cause disruption in the overall organization's stability and dominant culture (Prahalad and Bettis, 1986). Conversely, greenfield startup entry strategy permits fuller replication of internal structures and normative values, with less internal disruption.

Relatively small investments in foreign market entries are less likely to have a major internal impact on firms, and hence, may be more easily realized through greenfield investments as opposed to the acquisition of a local firm. On the contrary, collaborative entry strategies are more likely to introduce internal disruptions because participation in equity joint ventures or alliances imposes increased coordination, control and management demands. Partnership entry strategies not only permit a better fit with existing host institutional pressures than, for example, greenfield entries, but they also offer *partial* control over the subsidiary's operations and provide the subsidiary with autonomy for local action. Greenfield subsidiaries allow MNEs to maintain full control over its foreign operations but may be less responsive to host institutional pressures: "as parents exercise increasing control, pressures to maintain internal isomorphism may override pressures for isomorphism in the external environment" (Davis, Desai, and Francis, 2000: 243). Hence, MNEs are more likely to select export or

greenfield entry strategies to minimize internal disruptions. Conversely, MNEs are more likely to utilize acquisition of incumbent firms or entering into international alliances when internal pressures toward conformity are less salient.

> ***Proposition 4a.*** *MNEs are more likely to select joint ventures and acquisition entry strategies when internal isomorphic pressures of organizations are lower, and greenfield entry strategies when internal isomorphic pressures of organizations are higher.*

Internal pressures are greater when foreign entry decisions involve MNEs' core businesses rather than when such decisions involve only peripheral, non-core activities. The core business holds resources and capabilities, namely knowledge-based and experiential capabilities, which have the greatest value. Most of the MNEs' revenues are also likely to come from the core business. In addition, the values, mission and strategic objectives of firms are probably based on the core business. For example, the core business for an automaker may not be the actual manufacturing of many components, but rather the assembly, branding and distribution of automobiles. Automakers can then outsource the design, much of the R&D and manufacturing of, for example, plastic components.

DiMaggio and Powell (1991) and Powell (1991) argue that internal institutional pressures are most likely to generate sub-optimal decisions when investments in current resources represent cognitive sunk costs. Examples of cognitive sunk costs include employees' fears about learning new skills, firms' divergence from pre-set missions/visions, top executives' unwillingness to betray corporate traditions, etc. Cognitive sunk costs are associated with social and psychological costs. Therefore, we expect internal institutional pressures to be lower when foreign entry decisions are not essential to the MNE's core businesses. In non-core activities the degree of experimentation, or exploration (March, 1991), may be higher, without causing substantial attrition of established cognitive and normative practices.

> ***Proposition 4b.*** *MNEs' foreign market entry strategies will be more likely to depart from previously employed entry strategies when the subsidiaries' activities do not represent the core business of MNEs.*

Moderating Effects

In this section, we propose two moderating effects of MNEs' international experience and technological strategies associated with the industry. These two factors seem to carry the most weight on firms' strategic adaptation to a multidimensional institutional environment.

MNEs' International Experience: MNEs learn from their international experience. The evolutionary perspective of internationalization developed by the Uppsala school (e.g., Johanson and Vahlne, 1977; Johanson and Wiedershiem-Paul, 1975) suggests that prior experience accumulated from previous market entries influence future foreign entries. Following this literature and prior work on the impact of the institutional environment on MNEs' strategies (e.g., Xu and Shenkar, 2002), we suggest that prior learning carries over to subsequent entries and that MNEs' entry strategies reflect expectations originating from prior experience. International experience becomes salient when MNEs with operations in multiple markets develop a general structural ability to adapt (Tallman and Fladmoe-Lindquist, 2002) even when they encounter relatively unfamiliar territory. International experience may reduce the risks and uncertainties perceived during international expansion because MNEs learn how to manage new foreign entries. The likelihood of the new entry's survival increases as the subsidiary learns local routines, norms and structures, and absorbs the uncertainties of external environments through experience. In summary, MNEs internalize at least some of the external uncertainties in the subsidiary's routines and processes through experiential learning (Nelson and Winter, 1982).

In the initial stage of market entry, both experience and knowledge of host country institutions are low, supporting the proposition of Johanson and Vahlne (1977) that an export entry strategy is more likely for low levels of experiential knowledge because exporting entails lower risks. This includes lower risks of unintended diffusion of proprietary knowledge, lower risks of selecting an inadequate partner, or lower risks from failing to abide by the host's norms and regulations. The likelihood of failure of the new foreign subsidiary, however, decreases as it becomes progressively more embedded in, aware of and knowledgeable about the surrounding host institutional environment. MNEs with more extensive international experience may more easily leverage their resource-based or knowledge-based capabilities to further their internationalization (Tallman and Fladmoe-Lindquist, 2002). More internationally experienced MNEs will be more likely to replicate their home

activities in the host country through greenfield startups. Thus, the extent to which the MNE is internationally experienced will determine future entry strategy selection (Henisz, 2003). We suggest a moderating effect of MNEs' international experience on selecting an entry strategy.

> ***Proposition 5a.*** *MNEs' international experience moderates the relationship between the level of institutionalization of the host market and the MNEs' entry strategies such that MNEs with more international experience are more likely to select greenfield entry strategies than MNEs with less international experience.*

MNEs with low levels of international experience are likely to prefer low-commitment entry strategies in a host country (Johanson and Vahlne, 1977; Luostarinen and Welch, 1990), but they may also engage in high-commitment strategies, such as acquisition or greenfield startup investments. Interestingly, these three very dissimilar choices entail reducing the risks involved in foreign entry and exploiting the firms' existing capabilities. First, export entries require lower commitment of resources and less assumption of risks in business and country. Second, entries through acquisition involve the acquisition of an incumbent and already legitimized firm. Third, greenfield entries rely on exploitation of MNEs' already existing resources and capabilities as well as what they presumably know how to do best. Acquisitions, despite the well-known potential post-integration hazards (e.g., Harzing, 2002), are likely to reduce some forms of risk, even in the absence of international experience. At low levels of international experience, the acquirer will seek those local firms that seem better embedded in the market. For high levels of international experience, the acquirer is better able to evaluate target firms (Reuer, Shenkar, and Ragozzino, 2004). Similarly, focal MNEs will use their knowledge gained from international experience for greenfield startup foreign investments, thus lowering the risks involved. Conversely, focal MNEs with an intermediate level of international experience are likely to seek partners, both local and foreign, to learn new businesses and new markets. Hence, we assert that one of the facets of MNEs' international experience is that it reduces the importance of host country differences (i.e., institutional distance). In sum, MNEs' international experiences partly offset the institutional distance between home and host countries.

> ***Proposition 5b.*** *MNEs' international experience offsets barriers imposed by institutional distance between home and host countries on MNEs' entry strategies such that, for both low and high levels of international experience,*

MNEs are more likely to select either greenfield or acquisition entry strategies than MNEs with intermediate levels of international experience.

MNEs' Technological Strategy: MNEs' technological strategies also moderate the relationships between internal institutional environment and entry strategies. Here we consider two different technological learning strategies: exploitation and exploration (March, 1991). First, when the objective of an MNE is to obtain and transfer knowledge from the host market, the MNE pursues *exploration* strategies and selects entry modes that facilitate absorbing knowledge from the host country (see Kogut, 1991; Porter, 1990; Dunning, 1998). For instance, acquisition of an incumbent firm provides better chances to explore and acquire technology and knowledge available in the host market. A growing stream of IB research notes that firms internationalize to absorb and develop knowledge from foreign locations (Johanson and Vahlne, 1977, 1990; Bartlett and Ghoshal, 1998; Porter, 1998; Birkinshaw and Hood, 1998; Kogut and Zander, 1993).

Second, we can also imagine an MNE which possesses its own knowledge and technology for exploiting a host market (Hymer, 1976). Especially when the host market institutions are not reliable in protecting their knowledge (e.g., poorly protected patents and proprietary rights) from a potentially opportunistic partner, joint ventures or alliances become less feasible as foreign entry strategies (Teece, 1986). Existing research suggests that MNEs tend to keep the knowledge internal and expand through greenfield entries when local institutions do not protect the owner of the knowledge from opportunistic partners.

MNEs pursuing technological exploitation (March, 1991) strategies are generally knowledge-intensive and base their relative competitive advantage in a set of valuable resources (Barney, 1991; March, 1991) that require integration throughout subsidiaries (Kogut and Zander, 1993; Birkinshaw and Hood, 1998). Inter-subsidiary technology integration increases the complexity of internal relations and the need for coordination by headquarters (Bartlett and Ghoshal, 1998), possibly in a hub-and-spoke model. Thus, pursuing inter-subsidiary technology integration pushes subsidiaries to adopt strategies that lead to parental mimetic isomorphism and to select equity entry strategies for maintaining internalized firm-specific technological advantages.

Proposition 6. *MNEs' technological strategies moderate the relationship between internal institutional environments and entry strategies of MNEs; that is, MNEs pursuing international technology exploitation are more likely*

to select greenfield entry strategies than MNEs pursuing international technology exploration.

Discussion and Conclusion

MNEs select foreign entry strategies that better fit various facets of current external, internal, and inter-firm institutional contexts. In this paper, we develop a series of propositions to capture the impact of these contexts on MNEs' foreign entry strategies. We suggest a more comprehensive model of how MNEs select their foreign entry strategies and highlight the complexity of entry strategies as a multidimensional strategic choice. We advance several factors that affect foreign entry strategies, including host country institutionalization, asymmetric institutional distance between home and host countries, inter-firm interfaces and internal institutional pressures. Moreover, by integrating MNEs' international experience, we support the perspective that entry strategies are not totally discrete events, sustaining one of the most commonly advocated advantages of MNEs' ability to leverage dispersed assets to overcome local firms' superior knowledge of the host market (Hymer, 1976; Kogut and Zander, 1993).

In addition, the strategic choices of MNEs are influenced by institutional pressures operating on a worldwide level (e.g., the push toward quality standards and utilization of consulting and management firms). Conceptualizing MNEs as learning entities capable of strategic adaptation to environments where they operate, it seems reasonable to suggest that more internationally experienced MNEs progressively learn to distinguish institutional pressures to which they need to adapt from those they do not. For instance, internationally experienced MNEs are more able to develop locally optimal foreign entry strategies that buffer them from large external misfits. Future research may examine whether this results in the utilization of a uniform script in every foreign entry or in the use of profoundly distinct scripts that are absolutely tailored to each foreign entry.

In this paper, we use institutional theory but argue that MNEs may escape isomorphic determinism by their strategic behaviors. Isomorphic arguments and less deterministic explanations of strategic management theory jointly contribute to a better understanding of how firms can navigate through the complex interplay of tensions in home and host countries and the inter-firm, be they competitive or collaborative. The strategies are deployed and adjusted to the environmental conditions, but MNEs also act according to their knowledge-based capabilities, such as those accumulated through years of experience in

international business in general and in a specific country in particular.

We further expand traditional research on the impact of the institutional environment on inter-firm interfaces. In fact, firms' actions neither occur in isolation, nor are they driven solely by "undefined" external environment. In our analysis of institutional distance between home and host countries, we suggest that the direction of the distance (from more institutionally developed to less institutionally developed countries, for example) may be more relevant than measures of absolute difference between countries for MNEs' strategies. Finally, contrary to what extant literature seemingly suggests, we argue that selection of the object or strategy to imitate may be far from trivial when entering unfamiliar environments because appropriate referents do not necessarily exist. For example, identification of a referent firm may be a hazardous task for entries into transition and emerging economies, new technological areas, newly opened markets and so forth.

We attempt to construct a more comprehensive model of the impact of various facets of institutional environments on entry strategies. Nevertheless, we do not argue that this is a complete model. Future research may pursue additional factors exerting main or moderate effects on MNEs' selection of foreign entry strategies, as well as disentangle interaction among these factors. For example, it is likely that institutional pressures vary across industries (Henisz, 2003). Strategic industries such as the military, or industries upon which the government imposes legal or ownership boundaries (e.g., transportation, telecommunications, energy, education and Medicare) are more likely to be subject to a higher need to adapt to host institutional requirements. In these cases, foreign entry strategies may require local physical presence and direct investment in host country facilities. Furthermore, direct investment in local facilities may override social pressures such as unfavorable public opinion towards foreign firms, concerns with local development and employment and the nationalist political culture of the host country.

Future Research

Future research may explore how MNEs' structures change over time (i.e., with accumulated international experience) in response to changing institutional pressures. However, the most important step now is to complement conceptual explorations with empirical quantification of the degree of institutionalization of host markets. Extant research lacks concrete measures of institutionalization, in the absence of which it is not surprising that studies of mimicking behavior predominate (Haveman, 1993).

Future research may also examine how organizational decisions are value-laden choices constrained by the power dynamics and social context of decision-making. Top managers commonly make non-rational choices bound by social judgment, historical limitations and the inertial force of habit (Simon, 1957). As Ginsberg (1994) observes, strong internal institutional pressures may dominate in evaluating current resource allocations and hinder any changes in the current pattern of resource deployment. Therefore, MNEs' entry strategies should not violate the core values of MNEs; they should gain support from their top managers. However, there is a notable scarcity of studies on how internal politics and power balance among divisions and top management affect the selection of foreign entry strategies.

Finally, while we use the insights of institutional theory, future contributions may be balanced with other theoretical strands. For example, Kogut and Singh (1988: 412) argue that transaction cost explanation of entry strategy selection "must be qualified by factors stemming from the institutional and cultural context." Transaction cost theory (Williamson, 1985) suggests that whenever the transaction cost of internal organizations is lower than the cost of exchange in the market, MNEs attempt to enter foreign markets through equity strategies. We note, however, that reducing the transaction costs favors economic rationality and efficiency, but may undermine internal conformity and host legitimacy, hence paradoxically increasing the subsidiary's likelihood of failure.

We build our propositions as a generalization of what should be ceteris paribus clauses, because different external institutional pressures are likely to differentially impact MNEs' strategies. Oliver notes that "the more institutional pressures are entrenched in a legal or regulatory apparatus, the less likely it is that organizations will resist these pressures" (Oliver 1991: 167). Hence, while multiple facets of internal and external institutional environments should be considered, some of the facets seem to carry more weight than others. We may also expect organizations to conform easily to external pressures if those pressures are compatible with internal objectives and efficiency criteria.

In conclusion, various facets of institutional environments significantly impact firms' foreign entry strategies. Institutional theory is valuable in evaluating MNEs' local responsiveness and parent-subsidiary relationships as pillars of MNEs' international strategies. Notwithstanding, studies on entry strategies have often overlooked institutional factors and pressures (Davis, Desai and Francis, 2000; Xu and Shenkar, 2002). Using the institutional theory, we argue that entry strategies are not always a result of planned strategies or even attempts to achieve the most efficient outcome. For example, high resource

commitment entry strategies may absorb local uncertainty and enhance legitimacy in the host country while foreign entries through both export and greenfield startup investments may be favored when local institutional pressures are low. Adoption of intermediate, or hybrid, strategies such as joint equity ventures and strategic alliances may depend on the headquarters' strategies and on the level of institutional development of the host countries. MNEs' strategies are influenced, but not absolutely determined, by the external environment in which they operate, and institutional pressures do not necessarily supersede choices among alternative strategies.

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