Modeling SMEs' Choice of Foreign Market Entry: Joint Venture vs. Wholly Owned Venture

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Abstract

Starting with a comprehensive analysis of empirical and theoretical papers on market entry mode choice, as well as by referring to the characteristics of small and medium sized enterprises (SMEs), we develop a new quantitative model that represents SMEs' choice between joint venture (JV) and wholly owned foreign venture (WOFV). With the help of this model, we deduce some useful propositions for decision makers, both in companies concerned and in economic policy.

Keywords: Foreign market entry mode choice; Quantitative model; Small and medium sized enterprises.

1. Literature review

Originated from the study of multinational enterprises market entry mode choice studies, theoretical or empirical, are very popular in marketing literature. Theoretical studies aim to explain how multinationals should choose their entry mode or to identify the determinants of entry mode choice. Empirical studies aim to justify the existing theories through data analysis.

The available theoretical models take two forms in general, i.e. qualitative and quantitative. The former are conceptual and abundant. The latter are mainly game theoretical and rare. However, currently there is no established entry mode theory. Zhao and Decker (2004) have indicated this by a comprehensive analysis on the strengths and weaknesses of existing models. Furthermore, the existing models are designed mainly for multinationals but not for SMEs (Kumar and Subramaniam 1997; Nakos and Brouthers 2002).

The well-known qualitative models are the stage of development (SD) model, the transaction cost analysis (TCA), the ownership, location and internalization (OLI) model and the organization capacity (OC) model (Zhao and Decker 2004). However, these models have some common weaknesses. They largely ignore the decision making process. Moreover, they also largely ignore the role of the decision maker in the process of entry mode choice. A process-oriented model worth

to be mentioned here is the so-called hierarchical (H) model (Kumar and Subramaniam 1997). However, the model itself does not explain how entry mode choice is actually made in reality.

Among the very few quantitative models entry mode choice was usually analyzed in a two or three-firm economy, which enlightens the effects of strategic interactions (Görg 1998; Müller 2001). The optimal entry mode is determined by comparing the expected profits of each alternative in equilibrium. However, their shared shortcoming results from the fact that firms do not really play in such an abstract economy. Furthermore, very few of these papers have investigated the choice between JV and WOFV.

Empirical studies agree with each other neither on what factors are determinative nor on what influences some factors might exert on entry mode choice. Zhao and Decker (2004) present a deeper discussion on the classification of factors investigated, the possible relations identified as well as the conflicts between theory and empirics observed.

In summary, an explanatory framework tailored for SMEs is still indispensable. The new model we aim to develop in this paper explores the factors that influence entry mode choice from different perspectives, in particular the decision maker, the organization as well as the environment. Moreover, we do not ignore the decision making process. In this respect, our approach is both process- and content-oriented.

2. A new market entry mode choice model

SMEs are small; therefore, they operate in a competitive market. Comparatively, they are simple in their organizational structures and organizational goals. Thus, managers have no managerial discretion in their entry mode choice, i.e. they represent the SME completely. Therefore, they adopt an entry mode that maximizes their utilities and the firm's profit as well. However, the mangers face time, information and resource constraints for their decision-making (Kumar and Subramaniam 1997). In essence, they are boundedly rational and they have the difficulty of evaluating all the alternatives at a time. Therefore, they limit their sights to the most promising alternatives in each decision. Against this background, the present paper focuses on the choice between JV and WOFV by assuming that equity entry was selected on the first decision level.

The difference between JV and WOFV is, in essence, the difference in ownership ratios (Anderson and Gatignon 1986). Therefore, the choice between JV and WOFV is actually the choice of optimal ownership ratio. To construct a simple but meaningful model we make the following assumptions:

1. The SME's ownership ratio of operation in the host country is denoted by θ, with $\theta \in (0,1]$, i.e. there is no limitation on ownership ratio θ in the host