UNIVERSITY OF VAASA
FACULTY OF BUSINESS STUDIES
DEPARTMENT OF MARKETING

Antero Kojola (X102860)

Beyond choice of entry mode: How and why SMEs change foreign operation modes during internationalization?

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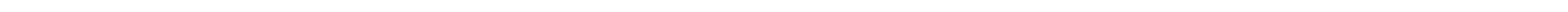

UNIVERSITY OF VAASA
Faculty of Business Studies
Author: Antero Kojola
Topic of the thesis: Beyond choice of entry mode: How and why SMEs change foreign operation mode during internationalization?
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Supervisor: Tahir Ali
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ABSTRACT:

Due to the continuously increasing competition between companies in a global context, the international operations of firms have become increasingly researched subject among scholars. While the research on the choice of operation modes in foreign markets have already gained vast interest, little is researched about mode changes and especially reasons causing the mode change decisions. Therefore, the purpose of this thesis is to improve the understanding of how and why small and medium sized enterprises change their foreign operation modes.

The framework of this thesis is developed by the reviewing literature as well as previous studies on the characteristics of small and medium enterprises, types of foreign operation modes, mode changes and reasons for mode changes. The data for the empirical part was collected through a questionnaire and the final sample consisted of six firms. Accordingly, five dealt with mode increases and one with mode decrease. Empirical findings suggest that managerial attitudes, firm´s performance, firm´s internal environment and external environment all impact the mode change decisions. More specifically, managerial attitudes stimuli dominates both mode directions of mode change decisions, while external environment tends to be the least significant stimuli regarding both direction of mode changes. However, the discussions with the CEOs during the filling of the questionnaire as well as the results from the study highlighted the fact that finding the right partner firm tends to be a significant challenge for international companies, usually resulting as mode increase decision in order to gain more control.

KEYWORDS: Internationalization, small and medium enterprise, foreign business operation modes, mode change

1. INTRODUCTION

The research on foreign operation modes is mainly concentrated on the entry mode to new markets while as the change or development of the operation modes in foreign markets has gained only little attention. For instance, according to Canabal and White (2008), who published a literature review on empirical studies regarding a firm's entry mode choices into a foreign country, they found nearly three times as many articles to include in their review—in comparison to what was found by Putzhammer , Puck & Linder (2020). to their literature review on the changes in operation modes.

In this study the interest is in the development of foreign operation modes of small and medium sized enterprises. A closer look into to the theory of internationalization is presented in this chapter to build the basis for the theory. Further on the research gap, objectives and limitations are presented. In the end of this chapter the explanations of the key concepts and the structure of the thesis are offered.

1.1. Background

Interest in the international operations of corporations has grown over the past decades (Fernández & Nieto 2005; Ruzzier, Hisrich & Antoncic 2006). Internationalization results from the increasing competition between companies in a global context (Felicio, Meidute & Kyvik 2016.) Accordingly, the acceleration of information flows, liberalization of capital markets, increased mobility of people and products and a relative global regulatory harmonization are some of the several factors that have affected the increase of internationalization strategies (Dunning, 2001; Gatignon & Kimberly, 2004).

When studying internationalization, previous academic literature has focused on multinational corporations, whereas small and medium enterprises (SMEs), and especially their internationalization behavior, have only recently attracted broader interest (Miesenbock 1988; Hollenstein 2001). For many SMEs it is no longer possible to operate in the marketplace without taking into account the risks and opportunities presented by foreign competition. Consequently, many of today´s firms actually start their international operations when they are still comparatively small and little by little develop their operations more abroad (Johanson &

Wiedersheim-Paul 1975). Therefore, given that the world economy is becoming increasingly integrated because of the continuous declines in government-imposed barriers, as well as the fact that technological development is accelerating, the internationalization of SMEs can be expected to gain further intensity (Lu & Beamish 2001.)

In order to become more globally oriented and flexible, SMEs have to extend and deepen their use of various forms to operate in international markets. Due to the nature of high uncertainty and risk, the choice of the most appropriate operation mode is strategically highly relevant, especially for the small and medium sized companies whose entire success may depend on it. With limited resources, SMEs must find the most effective ways to execute and develop their business activities and innovation processes, especially when specialized in a specific niche area. Accordingly, the chosen mode is the core component of the firm´s internationalization strategy and has a noticeable impact, not only on the instant revenues and costs of the specific market involvement, but also in the level of resource commitment and the opportunities for developing the firm’s capabilities in general (Swoboda, Olejnik & Morschett 2011).

Despite the fact that the company may choose the right entry mode, nothing guarantees that the particular mode will remain the most efficient or logical choice to operate in that market. Therefore, the original entry mode may as well be replaced by a completely new mode, mode combinations may be build or even the decision to reduce the commitment in the target country may occur. Because internationalization causes a significant challenge for the smaller firms, the decision to increase or decrease the commitment in a foreign market is crucial (Swoboda, et al. 2011).

Regarding theoretical perspective, the research in International Business (IB) characterizes significant part of the internationalization process as constantly adapting a company’s operations, for instance structure, strategy or resources, to the changes in its internal or external setting, and as making continuous adjustments to the foreign commitment over time (Cavusgil, 2002; Johanson & Vahlne, 2009). In line with this theoretical relevance, mode changes, in the broadest sense, have shown to reflect frequent business practice.

1.2. Research gap

Regarding the current research on mode changes, I found empirical studies on reasons for mode changes, mostly covering mode increases, but most importantly, hardly ever both. Regarding studies on mode increases, two categories shall be disclosed; studies addressing mode changes within foreign direct investments (FDI) and studies addressing shifts within non-investment modes such as exporting and licensing. In the context of investment modes, Gomes-Casseres (1990) highlighted two determinants for change, the need for greater adaptation to the market and the dissatisfaction with the previous mode. Steensma, Barden, Dhanaraj, Lyles, and Tihanyi (2008) found that a power imbalance between parents and high levels of conflict increase the likelihood of a joint venture being transformed to a wholly owned subsidiary. Buckley, Pass, and Prescott (1990) presented that the firms respond reactively to the external environment when moving towards foreign direct investment. Lastly, Bjorkman and Eklund (1996) found that changes in top-management precedes and influences FDI decisions.

Regarding studies on distribution-oriented mode changes (non-investment modes), Rosson and Ford (1982) discovered dissatisfaction with the existing agency relationship, manager expectations, and changes in the business environment as factors explaining the mode changes. Accordingly, Buckley et al. (1990) presented that firms switched to more controlled modes when they found exporting through agencies to be unsatisfactory. Nicholas (1983) provided empirical support for accumulation of market knowledge and transaction costs to be significant in the decision to change from agents to sales subsidiaries. Randoy and Dibrell (2002) found that strategic and location specific factors have an important influence on foreign commitments.

In terms of mode reductions, antecedences of international divestments have rarely been analyzed. Moreover, Benito (1997) presented an inverse relation of foreign divestment to economic growth in the host country. On the contrary, Duhaime and Grant (1984) stated that internal factors such as the parent company's financial position influence divestment decisions, whereas factors such as economic conditions do not have an effect. Furthermore, Li (1995) found empirical evidence for diversification, entry strategies and organizational experience to have a significant effect on divestments. However, performance is a significant factor as well because the voluntary decision to reduce commitment may be based on the decline in returns

(Khan & Mehta, 1996). Moreover, Haynes, Thompson, and Wright (2003) stated that divestment is a reasoned response not only to strategic but also to financial factors.

To conclude, the present research indicates that various stimuli are important for mode increases as well as reductions. However, the magnitude of performance and external environment effects is more strongly linked to mode reductions, while internal environment and executives' attitudes are strongly linked to mode increases. Therefore, given that an executive concerned about whether to increase or reduce commitment, would not only consider the former option, the need for the research that systematically explores both directions of modes changes, is relevant. Moreover, data based on empirical research, that explains the reasons for mode changes, is at least interesting to executives as they might profit from the experiences of others to make right decisions. As an example, being aware of someone's experience of a failed cooperation with a foreign partner, that explains the decision to shift from one mode to another, enables to acknowledge the importance of relevant selection criteria that must be met when deciding on who to collaborate with.

1.3. Objective

SMEs can use several different expansion strategies, which may change or be dropped. When making the decision, executives have a wide range of options regarding of increasing or reducing their involvement on a scale of operation modes. These mode changes or adjustments are driven by different types of opportunities and pressures, which are generally hard to predict. Consequently, the ability to react to the need of change becomes increasingly important element of firm´s internationalization strategy (Welch, Benito, Petersen 2007).

Despite the fact that different foreign operation modes are generally well known, little is researched about the actual stimuli's that explain the decision to change foreign operation modes. Given the unquestionable relevance, only few empirical study's so far explicitly analyzes the decision-makers precise view on the reasons for both mode increases and reductions at the same time. Due to the scarcity of studies, the current findings of the stimuli's on mode changes are barely sufficient, which means that more research is needed. Therefore,

the primary objective of this thesis is to improve the understanding on why SMEs change their foreign operation modes. Consequently, the main research question will be as follows:

What are the main reasons explaining the decision to change operation mode?

In order to give answers to the question mentioned above, sub-objectives will be presented below so that it is possible to create a clear pathway for the thesis:

Sub-objective 1: To study foreign operation modes

Sub-objective 2: To increase understanding about the conceptualization and types of foreign operation mode changes

Sub-objective 3: To identify the significant factors that cause foreign operation mode changes

1.4. Delimitations

The theoretical framework regarding the internationalization is limited to focus on SMEs emerging approaches of internationalization. Therefore, common theories such as OLI/eclectic approach, the Uppsala model and the network model are no further discussed. In addition, in order to keep the study simple enough, the incremental and non-incremental steps of mode changes are left outside of further analysis.

The empirical study is concentrated on manufacturing companies that operate in foreign markets and that meet the definition of small- and medium sized company. The sample size of the study may affect to the validity of the research, as it is hard to find executives of those precise firms, that have had operation mode changes during the required timeframe, and that would eventually find time for an interview. Because of the selection criteria, only Finnish-based firms are accepted to the sample so the results cannot be generalized to all manufacturing SMEs that have international operations, but to those that come from small and open economies similar to Finland.

1.5. Definitions

In order to lay out the main theories, there will be short definitions explaining the main key ideas.

Calof and Beamish (1995) defined *internationalization* as the process of adapting firms operations (strategy, structure, resources etc.) to international environments. In other words, it is the activity, which firms use in order to operate across national borders.

Foreign operation mode (FOM) is defined as the institutional arrangement by which a company transfers its products, technologies, human skills, or other resources across their national border (Quan 2012).

Mode change means that a company decides to operate in a country with another alter-native mode than it did before. This happens either by increasing or reducing the commitment in the foreign market (Swoboda et al. 2011). 10

Internal factors such as strategy, management and resources are factors usually within a firm´s control (Calof et al. 1995).

External factors such as economic, political and technological trends are factors outside firm´s direct control (Calof et al. 1995).

Small-sized enterprises (SME) employ less than 50 employees and annual turnover stays below 10 million euros. *The medium-sized enterprises* employ less than 250 employees and annual turnover stays below 50 million euros (EU recommendation 2003/361).

An *MNC*, or a multinational corporation, can be understood as a corporation that owns significant equity share of another company (usually 50% or more) in a foreign country. These companies are relatively large compared with national firms, both in home and host countries (Navaretti & Venables 2004).

1.6. Structure of the study

The study is divided into a theoretical and empirical part (see Figure 1). After this introductory chapter the theoretical setting of the thesis is covered. The chapter two consists of five subchapters that explore internationalization, characteristics of SMEs, types of foreign operation modes, conceptualization of operation mode changes and lastly the reasons for mode changes. In this chapter the former research on each field is discussed. The theoretical setting ends with the theoretical framework and hypotheses.

The empirical part of this study is presented in chapters three and four. In chapter three, the study‘s methodology is described along with the, research design, data collection and reliability and validity. In chapter four, the empirical results are presented and analyzed. The objective is to test the hypotheses deduced from earlier research and theory. In the end of this chapter, a summary and conclusions of the study are presented along with managerial implications and possible development for future studies.

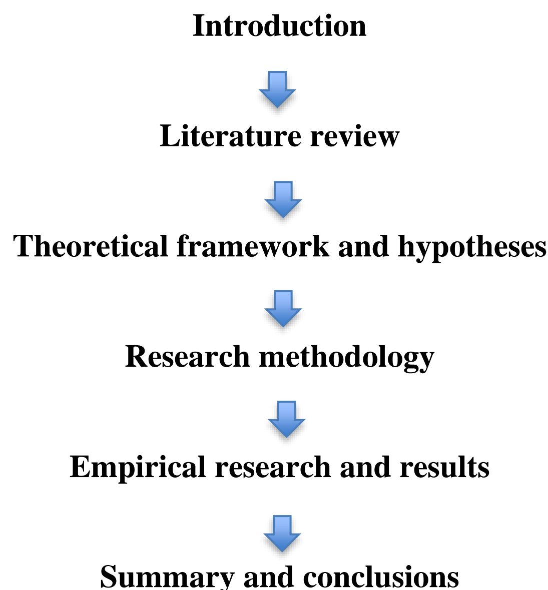

Figure 1 The structure of the thesis

2. LITERATURE REVIEW

2.1. From Internationalization to Globalization

Many scholars have defined internationalization from different points of view. There-fore, this section will present some of the several different definitions in order to get a general idea of what are internationalization and globalization.

According to Gjellerup (2000), *internationalization* is a term that signifies geographical growth of economic activities over national borders. The term started to be used when it eventually replaced imperialism as the dominant organization principle framing cross-border international action in the 1920s. According to Johanson and Wiedersheim-Paul (1975), the term internationalization usually refers to either an attitude towards foreign activities or to the actual executing of foreign activities. Furthermore, these attitudes are the basis for decisions to execute international activities and the experiences from inter-national activities influence these attitudes. These activities are based on the opportunities of exploiting abroad the competitive advantages firms have in domestic markets (Fernandez & Nieto 2005.)

Luostarinen and Welch (1988) defined internationalization as "the process of increasing involvement in international operations". In addition, they stated that in order to evaluate the degree of internationalization, one should evaluate their foreign sales and compare it to their total sales. Johanson and Mattsson (1993) had more relationship-focused perspective; they defined internationalization as a cumulative process where relationships are continually established, developed and even broken in order to achieve the objectives of the company. In addition, Lehtinen and Penttinen (1999) complemented the above mentioned stating that internationalization concerns the relationships between the company and its foreign environment. To conclude, internationalization starts from the development and utilization process of the personnel's cognitive and attitudinal readiness and is manifested into the development and utilization process of different international activities. Lastly, Ahokangas (1998) explained how the research focus has shifted from definition and analyses of international activities to the resource-based perspective. He defined internationalization as

“the process of mobilizing, accumulating and developing resource stocks for international activities”

To summarize all the above definitions, it can be stated that internationalization in a company setting is all those activities, which firms use in order to make their products and services more likeable across their national borders. However, sometimes internationalization can also take a form of de-investments such as dropping a product, selling a foreign production plant or laying off employees involved in their international operations (Calof & Beamish 1995.)

Global strategy has recently emerged as a popular concept among researchers (Ghoshal 1987, Gjellerup 2000, Ruzzier et al. 2006). Perlmutter (1969) defined globalization as “the movement from traditional towards geocentric type or integrated network models”. It is also defined as accelerated growth of certain economic activities across both national and regional borders (Oman 1996.) The term globalization in a company setting generally refers to a stage where the firm’s activities are managed on a global scale instead of few selected countries. Moreover, it means “something more in terms of the scope, content and intensity of mutual connections, capital and management involvement and is therefore a qualitative extension of internationalization” (Ruzzier et al. 2006). In addition, worldwide integration of increasingly competitive markets, corporations confronting global competition and functional integration of geographically spread economic activities are the characteristics of globalization (Gjellerup 2000.)

2.2. Definition and characteristics of small and medium enterprises

Small and medium enterprises (SME) are defined differently among researchers. In other words, there is no globally approved definition for small and medium enterprises. However, in the European Union SME can be understood as a company that keeps their size under a certain standard. As seen below (see Figure 1), the main factors determining whether an enterprise can be classified a SME are staff headcount and either turnover or balance sheet total. Small and medium-sized enterprises employ less than 250 persons and have an annual turnover not surpassing 50 million euros or an annual balance sheet total not surpassing 43 million euros (EU recommendation 2003/361).

In EU, there are programs targeted specifically for SMEs such as research funding, competitiveness and innovation funding and similar national support programs that could otherwise be banned as unfair government support. In addition, SMEs have fewer requirements such as reliefs to the amount of information needed for the financial statement or reduced fees for EU administrative compliance (EU recommendation 2003/361).

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

Figure 2 Determining factors of SME´s

(EU recommendation 2003/361)

Most of the international business literature has traditionally assumed that firms, especially SMEs, internationalize in an incremental manner after first gaining experience and growth from domestic market. The first steps of the firm are typically described as reactive, resulting from occasional export orders. Moreover, internationalization usually starts in foreign markets that are close in terms of physic distance and that initial foreign operation mode develops toward increasing commitment as the internationalization makes progress. Accordingly, firms are moving from one stage to another as they learn more and become less uncertain about foreign markets. Each stage forward involves an increased commitment to the international activities. Companies following this path are known as traditional internationalizers (Calof et al. 1995; Gabrielsson, Gabrielsson & Seppälä 2012).

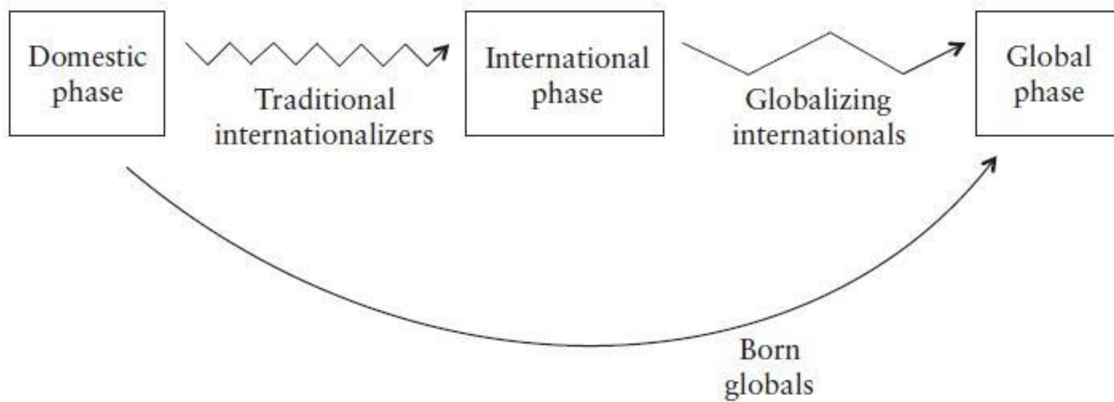

Figure 3 Foreign Expansion Paths of Firms

(Gabrielsson et al. 2012)

However, last decades have brought a growing phenomenon of firms that are international and also tend to adopt global focus right from the beginning. These firms tend to be smaller enterprises with high-risk taking-ability, facing unstable markets with little experience and resources, trying to find and serve the global niche markets with unique products and services (Danskin 2000; Etemad & Wright 2003). These firms can be called either *globalizing internationals* or *born globals*. Globalizing internationals are firms that have rapidly internationalized within their home continent and then continued to expand outside their home continent into global markets (see Figure 2). The arrows represent foreign expansion over time. The straighter the line, the faster the progress is to the next stage and the zigzag represents more gradual progress. Born globals are companies which have global vision right from the beginning, perceiving the world as one marketplace, and therefore proceeding quickly toward the global stage where over half of their sales are generated external to their home continent (Oviatt & McDougall 1994; Gabrielsson et al. 2012). In addition, the competitive advantage of born globals is often said to be related to an advanced knowledge base and therefore born globals are often referred as knowledge-intensive firms (Bell, McNaughton, Young & Crick 2003.)

Previous studies have shown that *innovation,* which is defined as the generation, acceptance and implementation of creative ideas within an organization, is a core component of the successful internationalization of SMEs (Krugman 1979; Verspagen & Wakelin 1997; Kunday & Şengüler 2015). Furthermore, the innovation capability, is positively related to the firm's

performance (Calantone, Cavusgil & Zhao 2002.) The innovation process is based on a company's ability to exploit not only its internal knowledge but also to gain knowledge from external sources through constant cooperation with customers, competitors, and suppliers within the business environment and also through imitation strategies such as purchasing of licenses and patents (Kunday et al. 2015.) Therefore, the development of new knowledge is crucial. Finally, the innovation of SMEs already has an external focus as they use non-internal means of innovation more than large firms, as they lack having resources to manage the whole innovation process by themselves (Lee, Park, Yoon & Park 2010).

With limited resources, SMEs must find the most effective ways to execute and develop their business activities and innovation processes, especially when specialized in a specific niche area. One favored way is to form well-constructed *networks*, which can offer clear benefits; for instance through co-developing products and services, network members are affected by each other's experience, generating learning effects for the future innovations (Bougrain & Haudeville, 2002.) In addition, networks often share flows of information such as strategic choices by other firms and sources to technical assistance, therefore strengthening the competitive advantages of the firm (Lee et al. 2010).

To conclude, the internationalization of SME´s can be far from linear, controlled and time consuming process assumed by the traditional stage theories of internationalization. In addition, the very early phases of the firm´s internationalization tend to have entrepreneurial characteristics, which slowly decrease as the company grows in size, acquires more knowledge and expertise (Etemad et al. 2003).

2.3. Types of foreign operation modes

When firms expand their business activities into new foreign markets, the important issue to regard is the means by which they enter those markets. Therefore, the choice of the most suitable *foreign operation mode* is strategically highly relevant; especially for small and medium sized firms which entire success may depend on it, due to its nature of high uncertainty and risk (Quan 2012.) Although the chosen mode is the core component of the firm´s internationalization strategy and it has a noticeable impact not only to the instant revenues and

costs of the specific market involvement, but also in the longer term to levels of risk and control, it is also an open signpost of the company´s commitment to the foreign market (Benito, Pedersen & Petersen 1999; Petersen et al. 2002; Morschett, Schramm-Klein & Zentes 2010). The internationalization strategy makes sense if the firm´s capabilities and resources match with market conditions (Welch et al. 2007:6.)

The term foreign operation mode or market entry mode simply means a company´s way of operating in foreign markets (Luostarinen et al. 1988.) Root (1977: 5) defined operation mode as "an institutional arrangement that makes possible the entry of a company's products, technology, human skills, management or other resources into a foreign country". These modes can be used either as individual or as packages, meaning that a company may combine more than one in order to enter the particular market (Quan 2012). The purpose of this section is to briefly explain each operation mode.

The foreign market entry modes are categorized based on the level of commitment to foreign target market. Cavusgil, Ghauri and Agarwal (2002) as well as other scholars have made a common distinction between different foreign operation modes and therefore divided those into three categories: exporting modes, contractual modes and investing modes (see Table 1).

Export modes	Contractual modes	Investment modes
• Indirect export • Direct export	• Licensing • Franchising • Management contracts • Contract manufacturing • Project operations • Strategic alliance	• Joint ventures (minority share, 50%-share, majority share) • Wholly owned subsidiaries (Greenfield, acquisitions)

Table 1 Classification of Foreign operation modes

(Adapted from Welch et al.2007)

2.3.1. Export modes

Exporting is one of the several ways of serving foreign customers and it simply signifies the transferring of goods out from the domestic market. It is typically seen as a low resource investment and therefore also as a low-risk alternative (Agarwal & Ramaswami 1992.) While this mode provides operational control, it lacks in providing marketing control that may be essential for market seeking firm. This is because it is generally hard to practice control how the importer will market the product (Cavusgil et al.2002:90).

The *indirect exporting* means exporting through domestic- or foreign intermediaries (see Figure 3). This alternative places the responsibility of sales contacts, negotiations and product delivery on the intermediary. Moreover, in the early stages of exporting, indirect exporting is less expensive because the cost of foreign market penetration is born directly by the intermediary. On the other hand, the intermediary has control over the final pricing and therefore loss profits may result to the manufacturer (Cavusgil et al.2002:90). Welch et al. (2007:255) identified two forms of intermediary arrangements: agents and distributors. In simple, an agent operates on behalf of the exporter in the foreign market, usually on a commission basis. He does not purchase and therefore take title for the product, but seeks to assist the progress of sales of exporter´s goods. A distributor, on the contrary, does the purchase and therefore acts as exporter´s direct customer, operating independently from the exporter.

The *direct exporting* means exporting without any independent intermediaries. In simple, the exporter does business directly with the foreign customer and has full control over the foreign marketing. While this alternative offers potentially greater profits and better protection of trademarks and patents, it also requires greater amount of information, connections and capital. (Cavusgil et al. 2002:92; Welch et al. 2007:264).

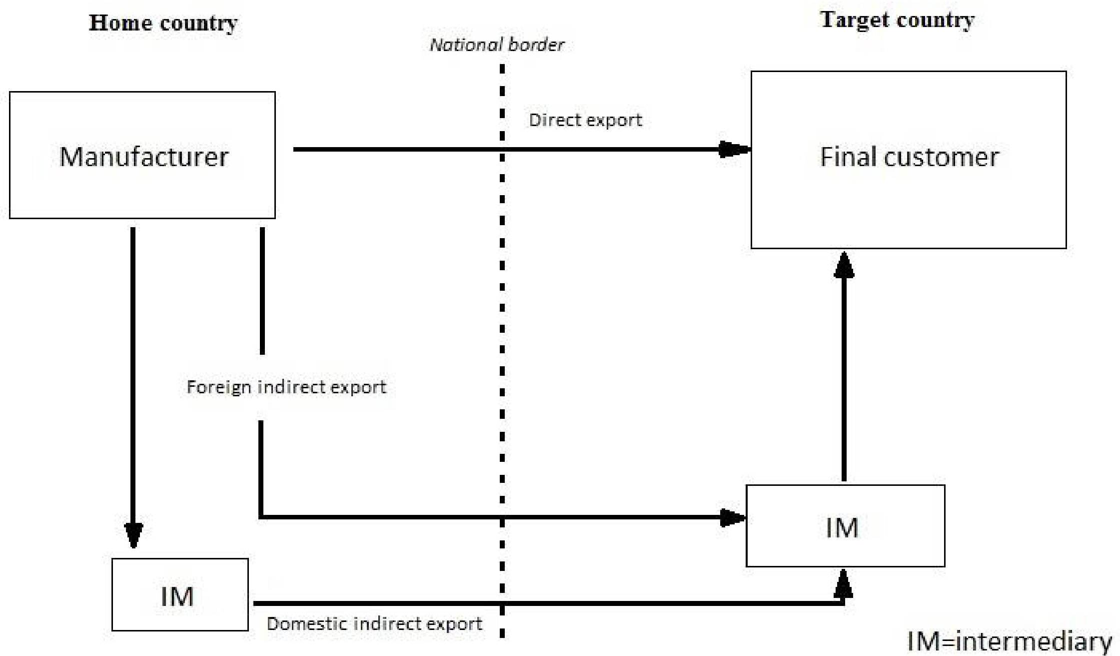

Figure 4 Export operations

(Adapted from Welch et al. 2007:248)

2.3.2. Contractual modes

The contractual entry mode is a term that refers to a variety of contractual agreements between the domestic firm and a foreign company. These agreements include, for instance licensing, franchising, management contracts, subcontracting, turnkey projects and strategic alliances. In simple, the domestic firm has valuable intangible assets such as know-how which it then sells to a foreign company in return of royalties or other forms of payments. Contractual entry modes enable a rapid expansion due to its low resource commitment and the ability to avoid import barriers and investment restrictions (Cavusgil et al. 2002:93: Welch et al. 2007: 111-113).

The *licensing* agreement is a legal agreement, which determines what intellectual property is to be transferred from licensor to licensee, under what period of time and under what conditions. The intellectual property can be either registered publicly, for instance, as a form of patent, trademark and copyright or kept within the firm as know-how. In terms of limited resources, licensing is usually used by smaller firms as the easiest way of penetrating foreign markets. However, obtaining proper protection of intellectual property usually complicates and slows internationalization. For instance, in Japan it may take even seven years in the process from application to granting of patent (Cavusgil et al. 2002:93; Welch et al. 2007:97).

The *franchising* agreement, which is a form of licensing, is a contract between two parties: a franchisor and a franchisee. In simple, the franchisor has a business concept, which it then sells to the franchisee in return of upfront payment, royalties or other compensation. Because the franchisee operates under the franchiser trade name, it must follow the policies and practices set by the franchiser (Cavusgil et al. 2002:94.) In fact, the biggest difference between licensing and franchising lies in the degree of control: in licensing the control is more in the hands of the licensee, whereas individual franchisee is highly restrained, especially in terms of marketing strategy and promotion (Welch et al. 2007:53-54).

A *management contract* is an arrangement where the operational control of the company (contractee) is given to another company (contractor), which then performs the necessary managerial functions in return of a payment. A management contract can include many different functions such as management of personnel, accounting, marketing services and training. While management contracts are mainly used to supplement a joint venture agreements or a turnkey projects, they are also used as a "pure" management contracts, where there is no equity connection or other mode linkages between the two parties of the contract (see Figure 4) (Cavusgil et al. 2002:98; Welch et al. 2007:142).

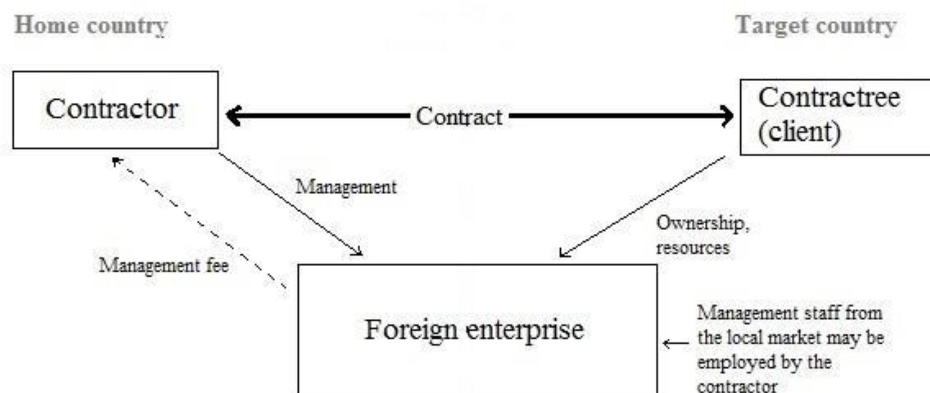

Figure 5 Pure management contract

(Adapted from Welch et al. 2007:142)

As Figure 4 visualizes, the pure management contract is a tripartite arrangement in which the contractor provides managerial services, in return of a negotiated management fee, to a foreign

enterprise owned by the client organization. The client organization in turn provides necessary ownership and resources.

Contract manufacturing or subcontracting is a cross between licensing and investment participation, in which a company (contractor) sets an arrangement with a foreign industrial firm (contractee) to produce a product or to perform certain production phases. The main difference between these alternative ways is that when the outcome is a complete product it is referred as contract manufacturing and when it is only a part of the total product it is referred as subcontracting. However, the sales and marketing of the finished product/component is always undertaken by the contractor (Sharpston 1975; Welch et al. 2007: 161-165).

Cova, Ghauri and Salle (2002) defined *project operations* as a "complex transaction covering a package of products, services and work, specifically designed to create capital assets that produce benefits for a buyer over an extended period of time". These operations involve all those activities involved in construction of different plants and facilities and therefore can include very complex mode combinations. Project participants can take different supply positions in the whole project: acting as the prime contractor and having the overall responsibility of the total project, acting as a major supplier without overall responsibility or acting as subcontractor to a prime or partial contractor. For instance, in *turnkey project* the prime contractor has the total responsibility of delivering a complete project to the buyer. In *partial project* the responsibility and control of the total project is held by the buyer, which means that the project operator only contributes some parts of the total package (Welch et al. 2007: 198-205).

Strategic alliances have been defined as arrangements where two or more companies involve in collaborative activity, but same time remain as independent organizations. Alliances are compounded by the shared feature of ongoing mutual interdependence, a condition in which one party is vulnerable to another whose behavior is not under the control of the first. These arrangements can vary from informal, non-equity based cooperation, to more formal, equity-based and legally structured agreements such as joint ventures. Therefore, there is no generally accepted agreement regarding of what constitutes an alliance (Welch et al. 2007: 273-277)

2.3.3. Foreign direct investment modes

Foreign direct investment (FDI) has been seen as the most powerful way of foreign market penetration, requiring a heavy on-the-ground commitment of various types of resources. Furthermore, it is seen as a peak of the firms' internationalization path. FDI is defined as occurring when a level of ownership via equity in a foreign company reaches a certain level, which is generally greater than 10 percent. Therefore, the investing company acquires a significant influence over the foreign company, participating in the managerial activities, through a long-term investment. Moreover, a short time investment usually means portfolio investment rather than FDI (Welch et al. 2007: 320-322). While FDI offers clear advantages such as lower costs in a foreign market or easier adaptation of products to local customers, it requires more resource commitment and therefore exposes the company to higher risks and increased inflexibility (Cavusgil et al.2002:101.)

In simple, the FDI is executed through two main paths: acquisition of an enterprise, part or full equity share or through the establishment of a new company and operations, with or without partners (Welch et al. 2007: 321.) A broad distinction is made between wholly owned foreign subsidiaries and joint ventures (see Figure 5.).

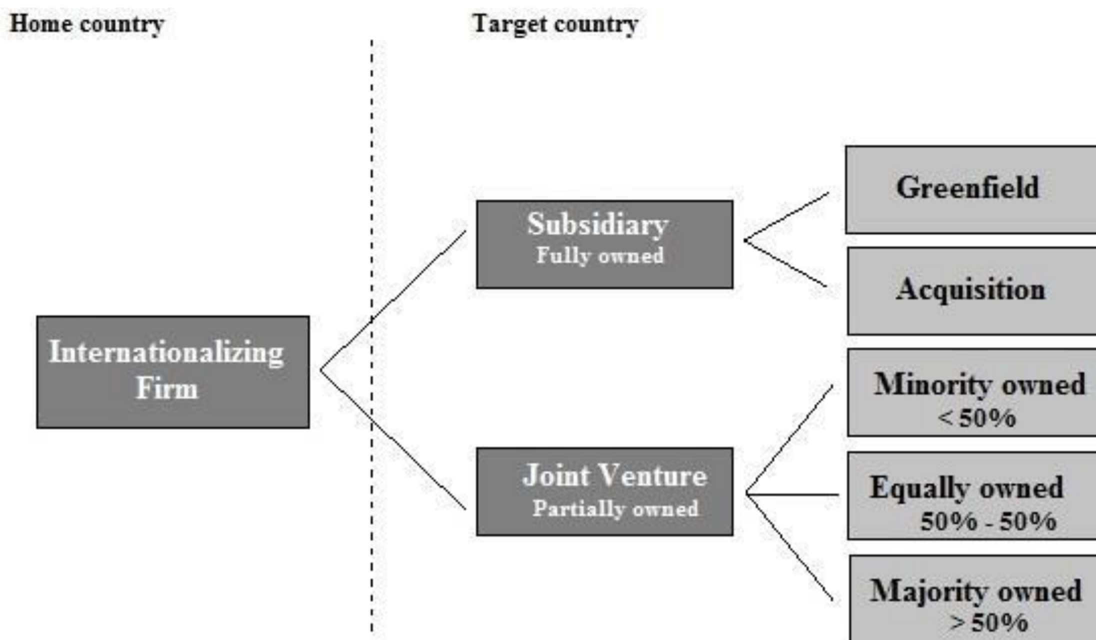

Figure 6 Model of FDI

(Adapted from Pan and Tse 2000)

Entering the foreign market via wholly owned subsidiary is possible either two ways: through a *greenfield investment,* which means that the company sets up an entirely new plant, or via *acquisition* where a company takes over an existing company. In each case the entire enterprise is transferred into the target market. Greenfield investment is a potential option when the cost of adaption is high as well as the cultural distance of the target country. Moreover, acquisitions are used by companies with weak competitive advantages, while companies with strong advantages find greenfield investment more efficient (Cavusgil et al.2002:101-103; Raff, Ryan & Stahler 2009).

Joint ventures involve two or more legally distinct organizations, each of which participate in the decision-making activities of the jointly owned entity. It is an efficient way to share the capital and risk and also get the benefits of each party's strengths. The problems may arise when the amount of participants increase in the decisions-making process and that is why companies prefer to play the dominant role in order to steer the business to the wanted direction (Cavusgil et al.2002:101.) Joint venture is considered to be international if it has operations in more than one country or at least one parent is headquartered outside the country of operation (Geringer & Hebert 1991). As seen in the Figure 5, there are three types of joint ventures; a majority owned, equally owned and minority owned.

2.4. Conceptualization of foreign operation mode changes

In today´s dynamic market place the ability to react to the need of change is crucial. Companies try to adjust their international operations to match with the conditions presented by internal and external pressures. This is done by controlling the input provided for foreign operations.

In simple, either the increase or reduce of a firms foreign market commitment is done by changing foreign operation modes. Calof et al. (1995) defined mode increases as upstream changes of modes while mode reductions were defined as downstream changes of modes. The change of mode means that a company decides to operate in a country with another mode than it did before (Swoboda et al. 2011).

2.4.1. Mode switch

Mode switch, in simple, is a term that signifies the change of an operation mode. It is used for two basic reasons: either as a correction of managerial misjudgments or as an adaptation to new circumstances as foreign market operations makes progress. Mode switch is usually seen as a way of internationalization, meaning that the company increases its commitment in the foreign market, for instance when a company goes from exporting to an in-house operation such as FDI. However, mode switching is also a way of externalization, implying to the downstream changes of modes; for instance conversions of company owned shops into franchised shops. Furthermore, some foreign operation modes are destined for externalization: for instance turnkey operations, which at certain point of time, transfer control of the assets to a local operator. (Welch et al. 2007:361-365; Petersen & Welch 2002).

The change of an operation mode, both internalization and externalization processes, happens either by replacing an existing mode with another alternative mode, known as *inter-mode switch,* or changing within the existing foreign operation mode, known as *intra-mode switching*. To clarify, in the case of intra-mode switches the entrant firm maintains the organizational form (FOM) but a new local operator is appointed. For instance, the entrant company cancels the contract with the local sales agency but later hires a new sales agent (Welch et al. 2007:363).

Regarding studies on mode switching, there are many different *barriers* pointed out which refer to the costs and difficulties associated with changing the firm's current behavior in the foreign markets. These costs and difficulties refer to a broad scale of barriers varying from easy-to-measure costs such as termination of operations or set-up costs, to barely quantifiable costs such as negatively affecting reputation or personal bonds to individuals.

Switching difficulties may refer to the functional changes in foreign operations that eventually result as a resistance at the level of an individual or a group. One of the main reasons why such stiffness could exist is that once the initial operation mode have been adopted, companies develop their organizational resources and routines in light of the particular needs arising from the current mode. As a result, companies tend to stick to the initial operation mode already embraced (Hannan & Freeman 1984). Switching costs refer to either distinct costs such as compensation costs associated with expiration of distributors or to more abstract costs such as learning costs and opportunity costs of sales revenue that was sacrificed as a consequence of dismissing an outside

agent who owned good connections to customers (Welch et al. 2007:369). Moreover, switching barriers can explain why firms sometimes stick with operations that are not performing well. The explanations vary from costs sunk in tangible assets like machinery and plants and intangible assets such as specific human capital, to more subjective or even emotional factors such as personal attachments to an industry, business network or particular individuals (Benito et al. 1999). The different types of switching costs are summarized in Table 2.

Cost categories	Take-down barriers	Set-up barriers
Costs	▪ Termination compensation (severance payment) ▪ Lawsuit expenses	▪ Hiring/recruiting and training costs ▪ Foreign operation learning costs
Revenue losses	▪ Reputation effects among distributors in other markets Loss of customers due to their loyalty to current agent	▪ Loss of customers due to failures in initial phase of own operations ▪ Costs of integrating the acquired local operator
Perceived barriers	▪ Personal bonds to individuals ▪ Loss of prestige for managers responsible for initial mode decision ▪ Risk of career setbacks	▪ Risk associated with ‘‘new’’ foreign operation method perceived as being unacceptably high

Table 2 Types of switching costs

(Adapted from Benito et al. 1999)

To conclude, the main determining factor of the costs of mode switching is somewhat the specific nature of assets assigned to the particular mode of foreign operation. Furthermore, switching costs may also depend on characteristics of firm and on their relationships with the other firms associated with carrying out foreign business activities. In addition, the international experience, the nature and length of its relationships with external partners, the size of the home market, which in turn may help to determine a firm’s commitment to international operations, are also important factors of determining the cost of changing modes (Benito et al. 1999).

2.4.2. Mode combination

When investigating mode changes, another important term to understand is *mode combinations*, which appear when firms incrementally change their foreign operation modes by adding new modes to existing ones (Benito, Petersen & Welch 2009.) Moreover, the role played by individual entry mode usually evolves through time, within and across different markets for the same firm. For instance, licensing might be the initial market entry mode, which then leads to some associated export sales or it could play a supportive role to a foreign joint venture and therefore create an additional income. In addition, the high risk of an individual mode can be modified by adding other modes in an integrated package form (Petersen et al. 2002).

As mentioned above, mode combinations may occur in a variety of forms in order to achieve various objectives such as improving the impact of another mode or achieving results that are not possible through one operation mode. Moreover, while one mode is playing a primary role in ensuring the most important objectives in a foreign market (see Figure 6.), other modes play different types of supporting roles such as additional revenue, management control and contractual control (Petersen et al. 2002). To conclude, the driving forces regarding mode packages differ because of the variation in external factors; for instance market pressures, government regulations, the availability of suitable partners, as well as in internal factors, including control, resource availability, and previous international experience such as foreign operation mode experience (Luostarinen & Welch, 1990).

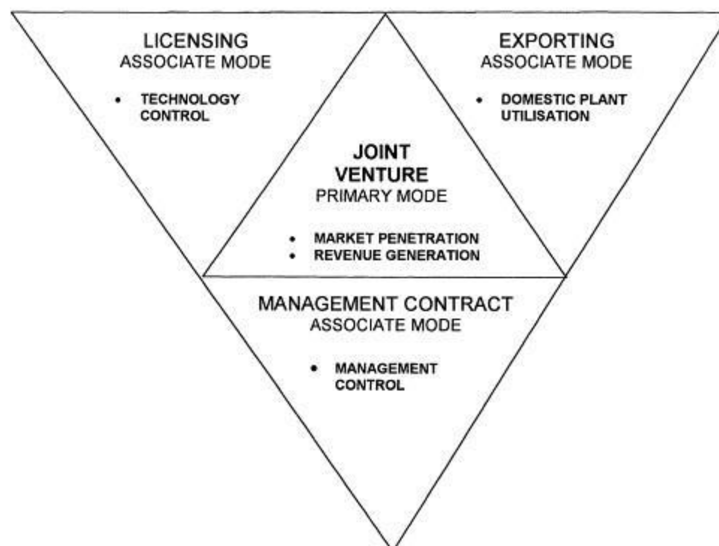

Figure 7 Mode package

(Petersen et al. 2002)

The modes can be combined in several ways, ranging from unrelated activities to a closely coordinated total business package. Petersen and Welch (2002) identified four forms of multiple modes: unrelated, segmented, complementary, and competing.

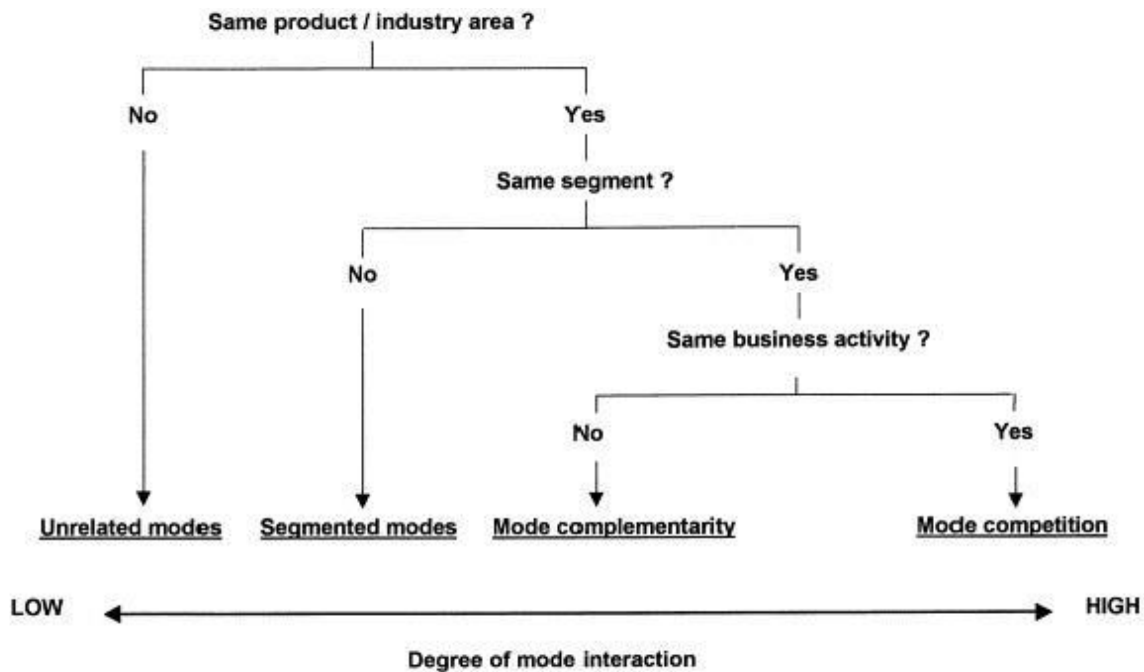

Figure 8 Different types of multiple mode operations.

(Petersen et al. 2002)

Modes used within the same foreign market, but that has no actual connection between their uses are called *unrelated modes*. These mode combinations are used by companies that do business across different industries or markets. Therefore, the operations of large multinationals in a foreign country are likely to be handled by different business units of the same firm. Unlike, unrelated modes, *segmented modes* are used within the same industry or market to serve different segments. For instance, the largest customers of the company may be handled directly, while other smaller customers are handled through distributors. *Complementarity modes* are modes that are working together in an integrated, cohesive manner in order to achieve the objectives of a firm. Moreover, the focus on complementarity modes is on the same segment but is concerned with different activities in the value chain. For instance, separating manufacturing and marketing in foreign operations is a common practice in the global activities of sports clothing and shoe firms such as Nike. Lastly, *competing modes* are formed by more

than one mode that compete with each other. The target is on the same segment and these modes also perform the same activities, but the ownership and location differ. For instance, handling the sales through direct sales and sales via dealers focuses on the same segment and activities, but puts these two modes in competition. In this case, by keeping house accounts served by firms own salespeople in a dealer's sales district enables firm to exercise better con-trol over the independent dealers (Petersen et al. 2002).

2.5. Reasons for foreign operation mode changes

Regarding the previous literature, there are two main approaches trying to explain why companies change their foreign operation modes; *Economic-strategic* approach and the *Behavioral/process* approach (Putzhammer et al. 2020). The Economic-strategic approach focuses on the initial decision on mode of entry into a new country as it is based on the assumption that the chosen entry mode is the most suitable one in the given circumstances and therefore the possible change of mode will happen only if radical changes occur. Moreover, related studies suggests that possible changes of modes only occur in the cases of a substantial shifts in the external or internal environment, compared with the original situation.

In comparison, studies regarding the behavioral/process approach, explore specifically the different stages in the firm’s international expansion and acknowledge the changes in foreign operation modes. Accordingly, such changes are in fact the prerequisite for the particular approach’s theory structure. In these studies, the applied structures contain behavioral aspects like experience, knowledge or networks and how their development over time affects the decisions of operation mode changes in a longitudinal internationalization process (Johanson & Vahlne, 1977; Axarloglou et.al 2007). However, these studies largely disregard economic or strategic reasons for change. The most common concept within this stream of theory is the so-called stages theory, which is based on the assumption that, through increased interaction with foreign markets, the market-specific knowledge of a company accumulates; which in turn leads to step-wise change from low commitment modes to modes of higher commitment (Cavusgil et.al. 1980; Welch & Luostarinen, 1988). In fact, the stages theory is the main form of the pattern oriented approach of analyzing mode changes. While this approach suffers from few key problems such as the fact that firms do not always internationalize in the manner suggested

by the theory, for example born globals, it is still useful for understanding the characteristics of firms at different stages (Johanson et al. 1975; Calof et al. 1995; Swoboda et al. 2011).

According to Swoboda et al. (2011), there is a scarcity of studies into stimuli of mode changes. In fact, before their empirical studies, only the study by Calof and Beamish (1995) provided extended empirical information about the actual stimuli's explaining mode changes. The study by Calof and Beamish consisted of interviews, carried out by open questions to executives from 38 smaller Canadian firms, investigating why they have changed modes in the past. The responses provided fifteen different stimuli for mode change, which were categorized as being *attitude* based, *internal environment* based, *external environment* based, and *performance* based stimuli (see Table 4). The frequencies of those factors were then linked to mode increases and reductions. The empirical study later conducted by Swoboda et al. (2011), by similar procedures employed by Calof et al. (1995), has been built on these findings. Moreover, they used Calof and Beamish's fifteen stimuli of mode change, three related to performance, four to external and six to internal environment, and two to managerial attitudes as a framework to analyze data from 265 small and medium sized German firms (see Table 3.). Before the further analyze and comparison of the results of both studies, each category will be briefly explained.

Attitudes are defined as managerial intentions, beliefs and feelings about market commitment (Calof et al. 1995.) Perlmutter (1969) presented how various attitudes of top management play a role in determining the extent to which a firm is involved in international activity. Moreover, scholars have agreed that even the abstract idea of a new foreign activity, independent of its contribution to the firm's profit and growth must be attractive to its management before the firm will initiate any further commitment to the foreign markets (Simpson, 1973).

Performance can be understood as executives´ evaluation of the firm´s development in a country where the operations took place (Calof et al. 1995.) Organizational performance can be measured by three particular areas of firm outcomes. The first one is the *financial performance* which refers to indicators such as profits, return on assets or return on investment. The second area is *product market performance,* which encompasses sales, market share, etc. The third area, *shareholder return* is associated with factors such as shareholder return and economic value added (Richard, Devinney, Yip & Johnson 2009).

The *internal environment* of a firm consists of factors, such as strategy, management and resources, usually within a firm's control (Calof et al. 1995.) The strategy refers to a pattern of decisions that determines the objectives and goals of a firm and the primary policies and plans for achieving those goals (Andrews 1971.) Resources of a firm include all assets, capabilities, organizational processes, firm attributes, knowledge etc. that makes possible the implementation of strategies (Daft 1983.) Finally, management exercises the use of firms´ resources in the basis on the chosen strategy (Barney 1991.)

The *external environment* refers to the factors outside a firm's direct control. These factors cannot be influenced by management decisions, but they have a direct impact to the entry mode (Calof et al. 1995; Cavusgil et al.2002:41) Through environmental analysis, the most critical economic, political, social, and technological trends can be identified and compared with opportunities, strengths, and threats and weaknesses in order to determine the necessary strategies for the future development of the firms' foreign involvement (Analoui & Karami 2002.)

The findings by Swoboda et al. (2011) suggests that performance is associated more likely with mode decrease instead of increase in terms of direction of change. This finding is similar with Boddewyn's (1979) assumptions about the dominance of performance in divestment research. These results are slightly different as compared to Calof and Beamish's results where they discovered that poor performance was not significantly more important than good performance in terms of mode changes. The internal environment of the firm, which is built on three components: *strategy, resources* and the *new management*, is associated more with mode increases but also with mode reductions. Calof and Beamish's had similar results where strategies and resources were seen as the dominant reasons for mode increase but also as significant antecedents of mode reductions. More specifically, strategic stimuli were associated more with increases, while resources were more important for reductions. However, the role of a new management does not appear to be an important force for SME decision-makers. Regarding the external environment, there is a major contrast between these two studies; the study by Calof and Beamish's suggests that external environment is more often linked to mode increases while study by Swoboda et al. resulted to perceive the external environment as more significant in stimulating mode reductions. Lastly, the both studies suggested that the attitudinal

stimuli is strongly linked to mode increases. Moreover, attitudes were not often named as major reasons for mode reductions.

Even though both of the empirical studies were conducted in different continents and in different decades, the results are pointing to the same direction. As shown by the Figure 8, each of the four categories has more or less impact on mode changes regardless of the direction of change. The thicker the arrow, the greater significance it illustrates. Lastly, the internal environment is the key category regarding downstream changes of modes. However, when Calof et al. found attitudes as the most important factor regarding mode increases, the study by Swoboda et al. prefers the internal environment, more specifically the strategic decisions, still recognizing attitudes as the second most significant category.

Increase of modes				Reduction of modes		
One-step	Two-step	Total		One-step	Two-step	Total
59 (16)	38 (15)	97 (16)	Performance	67 (30)	24 (27)	91 (29)
30	11	41	1. Continual good (poor) performance made it clear to us that a change of mode was necessary	49	18	67
24	25	49	2. In view of our development, the mode change was the next logical step in successful market development	4	1	5
5	2	7	3. The mode was simply not holding its own within our overall operations	14	5	19
200 (54)	132 (53)	332 (54)	Internal environment	90 (40)	31 (35)	121 (39)
			Strategy			
9	15	24	4. We wanted to diversify (reduce) products/markets	3	1	4
59	34	93	5. A change was needed if we were to realize our growth objectives/reduce costs of operations	13	8	21
67	45	112	6. We made a strategic decision that the foreign market is more (less) important in the future	14	5	19
			Resources			
21	15	36	7. It was the decision to integrate more (less) resources because of good (bad) business in the past	18	8	26
37	20	57	8. It was more efficient to serve the market in a new way	36	4	40
7	3	10	9. New management had a different idea than old management about importance of (particular) international business	6	5	11
36 (10)	32 (13)	68 (11)	External environment	47 (21)	31 (35)	78 (25)
4	3	7	10. The contractual situation has changed	6	6	12
2	9	11	11. Regulations/norms in the market have changed	19	7	26
18	8	26	12. Development of demand was more/less than we thought before	22	14	36
12	12	24	13. We were asked to buy (sell) a business (in the sense of an opportunity)	–	4	4
72 (20)	46 (19)	118 (19)	Attitudes	20 (9)	3 (3)	23 (7)
16	10	26	14. Over time, we became more comfortable operating within the market and felt that a change in mode was now appropriate	13	1	14
56	36	92	15. We changed the mode because we had a greater (lower) commitment to the market	7	2	9
367 (100)	248 (100)	615 (100)	Total	224 (100)	89 (100)	313 (100)

Respondents stated the three most important variables for the change decision openly out of the list (percentage in brackets).

Table 3 Major stimuli for mode change

(Swoboda et al. 2011)

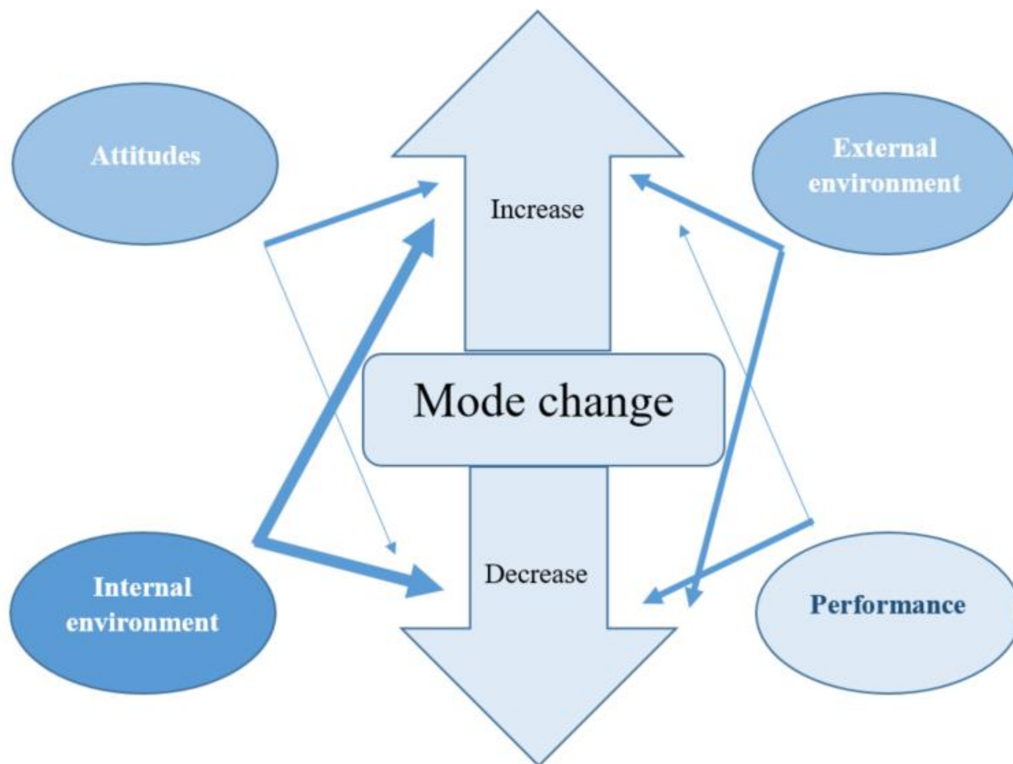

Figure 9 Magnitude of stimuli for mode change

(Adapted from Calof et al. 1995; Swobodja et al. 2011)

2.6. Theoretical framework and hypotheses

Relying on economic–strategic and behavioral approaches, I consider that firms may increase and reduce their foreign commitment. Despite the initial entry mode choices are based on actual and predicted circumstances as perceived by the decision-maker, internal as well as external factors may evolve leading to the current operation mode being subject to change.

Accordingly, I have chosen to use the same framework, employed by Calof et al. (1995) and Swoboda et.al. (2011) to explore mode changes along 6-stage establishment chain. Accordingly, I analyze the direct effects of the predefined stimuli's on the mode change decision and whether a certain stimuli differs in their importance for mode increases and reductions.

The empirical part of the research is three-folded: firstly, by testing the validity of the previous studies by using the exact same set of stimuli's, either endorses or challenges the current conceptualization of particular factors being determinants of mode increases and reductions. Because the internationalization process approach assumes that firms build internal capabilities as they operate in foreign markets, it might be argued that internal factors change as the firm learns and generates knowledge over time. Even though the empirical findings associate mode increase with internal factors, the importance of those factors is given for mode reductions as well (Boddewyn 1979; Swoboda et.al. 2011.) Company might change its mode when drastic changes in firms performance occur. Accordingly, studies have found that firms reduce their investment when they experience a decline in the rate of return and therefore performance based stimuli is associated with mode reductions (Calof et al. 1995; Khan et al. 1996). It has been noted before that an internal decision to increase the current mode occurs when managers perceive an urge to do so. Fletcher (2001) argued that managerial characteristics are drivers of increasing foreign market commitment rather than reducing. Thus, the following hypothesis is set:

H1: a) *Internal environment is the most significant stimuli regarding both directions of mode changes. b) Performance stimuli influences the probability of mode reductions rather than increases c) Attitudes influences the probability of mode increases in preference over reductions.*

Secondly, by analyzing the relationship between depended (investment modes and non-investment modes) and independent variables (*performance, internal environment, external environment* and *attitudes*) and the direction of the change, allows to find if the reasons regarding both directions of mode changes vary between the depended variables. In accordance with Buckley et al. (1990), who highlighted that the companies respond reactively to the external environment when moving towards FDI, I assume that within non-investment modes, the external environment is the most significant factor in terms of mode increases. Thus, the following hypothesis is set:

H2: *In terms of the mode increases, the external environment stimulus is more significant regarding non-investment modes variable rather than investment modes variable.*

Finally, by presenting a new set of 18 stimuli's, from which four factors (*performance, external environment, internal environment* and *partner firm*) are derived with the purpose of discovering new and more precise attributes that cause the mode change decision, contributes something new to the limited empirical knowledge of the matter in question. In accordance with the findings of Buckley et al. (1990), who pointed out that firms switched to more controlled modes when they found exporting through agencies to be unsatisfactory, I assume that reasons regarding the partner firm stimuli contribute more to the upstream change of modes. Thus, the following hypothesis is set:

H3: *Partner firm stimuli influences the probability of mode increases in preference over reductions.*

3. RESEARCH METHODOLOGY

3.1. Research approach

The research approach of this thesis is deductive and it leans on the philosophy of positivism. A research philosophy is a framework that guides how research is conducted based on ideas about reality and the nature of knowledge (Collis and Hussey 2014.) Accordingly, positivism depends on quantifiable observations that lead to statistical analyses and involves the use of existing theory to develop hypotheses. This approach enables me to develop a theoretical framework and test it, thus making it possible to derive specific conclusions (Saunders, Lewis & Thornhill 2009). The theoretical framework is based on former research as well as literature from which the hypotheses are developed.

3.2. Research design

Even though the sample size is relatively small in this case, the research follows the structured model, which advances from systematic data collection that aids answering the research question. Subsequent to the comprehensive examination of theory as well as forming the hypotheses, the empirical research is conducted in order to evaluate whether the hypotheses are supported or not. Consequently, the data is collected through a questionnaire, which is an instrument of research that consists of a list of questions, along with the choice of answers. A questionnaire fits to the purpose of this research due to the small sample size, which should be relatively effortless to gather. Even though the statistical analysis requires a much bigger sample size in order to be meaningful, I will present some parts of the data in numbers, with the purpose of providing only informative results. Therefore, while the aim is to interpret the obtained data through analysis, the purpose is not to claim the findings to be generalizable, but to collect a fairly small set of data and to interpret it as carefully and thoroughly as possible. (Ghauri & Grønhaug 2005)

Taking into account the sample size, a questionnaire is economically the most suitable instrument for data collection (Zikmund 2000.) It was put together based on previous empirical

studies on operation mode changes and consisted of two different sets of multiple-choice questions. Moreover, the first set was formed directly from the list of 15 stimuli's with the exception of splitting the non-specific questions into two parts, thus generating eight more questions. In clarification, the exceptions included determinations such as "buy/sell" that could have been understood in two ways. In any case, the second list in turn consisted of 18 stimuli's that were formed according to the previous studies on the subject. The language of the questionnaire was naturally English, given the fact that the respondents were executives of international companies. Furthermore, the majority of the questions were closed-questions with given response options and the respondents were forced to fill in an answer to every question. Accordingly, a six-point Likert-type scales were used to measure the importance (0 = not important at all to 6 very important) of each of the stimuli regarding a particular mode increase and mode reduction. In the end, one to five core reasons for mode change were collected in an open question sequence.

3.3. Data collection and sample

The data for this research was collected through the questionnaire, which in practice happened by interviewing the executives of each firm either over the phone or through Microsoft Teams. Moreover, in order to make sure that the respondent truly had adequate knowledge of the firm‘s internationalization, the questionnaire was directed only to the chief executive officers. As it turned out, the interviews were the most appropriate way to fully ensure that the strict criteria were met, errorless answering and most importantly, final commitment to participate in the study. The collection of data took place from the end of April 2021 until the end of June 2021. The database from which I got the initial population of firms suitable for the research was D&B Hoovers.

The sample size was designed as 12 companies, with few limitations; half of the sample was planned to be collected from companies whose previous mode of operation before switching to a new one were classified as non-investment modes (export- and contractual modes) and the other half as investment modes (joint ventures and wholly owned subsidiaries). Additionally, in order to equally explore both directions of mode changes, six of the 12 companies were reserved for the cases of mode increases and six for mode reductions. The firms were contacted

by an email followed by a phone call through which their willingness to participate was eventually confirmed. If the firm or the executive did not answer the phone call, one to three more attempts were made.

The population consists of Finnish manufacturing firms that have international operations. In order to qualify for the research, the companies had to meet the following criteria: firstly, the company had to be originated in Finland; secondly, in terms of the size, the company had to fall into the category of SME or due to the difficulty of finding appropriate companies that meet the criteria in full, this condition had to be met at least at the time when the change of mode occurred; thirdly, the company had to be in the business of manufacturing actual products instead of just producing intangible services and lastly, the firm had to have had at least one operation mode change in the timeframe of the last 10 years. If the firm did not meet all of the above presented criteria, it was screened out from the sample. From the initial population of over 10 thousand firms, provided by D&B Hoovers on the basis of the criteria just presented, 321 companies were filtered to extract a sensible list of potential firms to be obtained to the sample. During the first phone calls, the executives were asked if the above-mentioned criteria was met, and if so, a time for the interview was scheduled or the filling of the questionnaire started immediately on the phone.

Within the period of time during which data was collected, an attempt was made to reach all 321 companies from the final list. As a result, 7 firms declined to participate on the basis of not having enough time or interest, 34 were ruled out as they did not meet the entire criteria, which to be clear, consisted of both the previously presented precise cases of operation mode changes and the criteria regarding the characteristics of the company. Surprisingly 277 executives could not be reached. Finally 6 executives agreed to participate, giving the survey a response rate of 1,9%

3.4. Reliability and validity

Reliability is the degree to which measures are free from error and therefore yield consistent results. Accordingly, it encompasses the stability of the measurements as well as consistency of a measurement procedures applied in research. In practice, this means that if the same

phenomenon would be studied again with the same methods, the results should be more or less similar (Lakshmi & Mohideen 2013). As the questionnaire is based on the former studies on the same topic, the reliability of this study is increased.

Regarding the risks for the reliability of the research, there are few to mention. According to Ghauri and Grønhaug (2005), the respondents might understand the questions in a different way compared to the researcher. In order to minimize this risk, the questionnaires were primarily proposed to be filled together with the researcher thus enabling a clarifying discussion of questions. In addition, as all of the respondents were executives of international firms with experience of the subject in question, the reliability is increased.

Other risk regarding the reliability concerns the respondent's sincerity. Moreover, the respondent might give inaccurate answers either on purpose or by accident. For instance, if the respondent does not have enough information, there is a significant risk of him answering by guessing (Ghauri et al. 2005.) Regarding this questionnaire, there should not be any harm of answering sincerely because every respondent was informed of the total confidentiality and anonymity.

The validity of the study refers to the competency of the methods used to measure what was intended to measure. It means that the findings accurately represent the phenomenon studied, and that they are backed by evidence (Saunders et al. 2009). The validity consists of two essential parts: internal and external. The suitability of the measurements can be sought by internal validity that implies how well the methods measured the issues brought up by the theory. The external validity, in turn, is the extent to which results can be generalized to other groups of interest (Lakshmi et al. 2013; Calder, Lynn, Phillips, and Tybout 1982). Regarding this study, the questionnaire was based on previous empirical studies on the same subject. This increases the validity as the same questions have been used preliminarily in similar researches.

Finally, as already disclosed above, an issue worth pointing out is the generalizability of the findings. In fact, this is a significant concern regarding the statistical generalizability of quantitative studies, when the sample size is small. However, such studies are better to explore, explain and provide insights, which in fact is the purpose of this study.

4. EMPIRICAL RESEARCH AND RESULTS

4.1. Description of the data

The characteristics of the data are discussed in this chapter. Accordingly, the sample is analyzed in terms of the company size, the illustration of mode change cases and the importance of reasons for mode change. In the end of this chapter, a summary of the freely answered question regarding the most important factors driving the mode change decision is discussed.

The basic characteristics of the sample are presented in table 5. The final sample size was 6 companies that met the criteria, meaning that the planned sample of 12 companies was not reached. This negatively affects the validity of the data to the extent that further statistical methods are not utilized, because no reasonable conclusions could be drawn from the values they produce. In 50 percent of the companies, the turnover was between the range of 40-49 million € and the average number of employees varied fairly evenly from the range of 1-49 to 200-249.

Average turnover (2020) (Mill.€)	Number of firms	Percentage of firms	Average number of employees (2020)	Number of firms	Percentage of firms
1-9	1	16,67 %	1-49	1	16,67 %
10-19	1	16,67 %	50-99	1	16,67 %
20-29	0	0,00 %	100-149	2	33,33 %
30-39	0	0,00 %	150-199	1	16,67 %
40-49	3	50,00 %	200-249	1	16,67 %
50<	1	16,67 %	250-299	0	0,00 %
Missing	0	0,00 %	Missing	0	0,00 %
Total	6	100,00 %	Total	6	100,00 %

Table 5 Characteristics of the sample.

The operation modes changes were acquired by offering the respondents a table of different kind of operation modes from which they were able to mark both the old mode and new mode. Regarding the dependent variables, only 16,7% of previous/old modes were from the category of investment modes as seen in Table 6. Therefore, it is not possible to draw even roughly

indicative conclusions for Hypothesis 2. Exactly half of the mode changes occurred from direct export to sales subsidiary, one from indirect export to sales subsidiary, one from direct export to franchising/licensing and the last one from manufacturing subsidiary to indirect export. The mode increases accounted for 83%, meaning that there is only one case of mode reduction in the sample. Since the opinion of one person is not sufficient even in an incomplete sample such as this, none of the hypotheses can be evaluated properly.

Old mode	New mode	Number of cases	Percentage of cases	Direction of change
Indirect export	Sales subsidiary	1	16,67 %	increase
Direct export	Franchising/Licensing	1	16,67 %	increase
Direct export	Sales subsidiary	3	50 %	increase
Manufacturing sub.	Indirect export	1	16,67 %	reduction
Total		6	100 %	

Table 6 Change of modes

When looking at the first set of stimuli's in terms of the importance (see Table 7), internal environment resulted as most significant reason in 45,8%, performance in 23,9%, external environment 15,9% and attitudes 14,4% of all increases. Regarding mode reductions, internal environment resulted as 59,3%, performance 25,4%, external environment as 8,5% and attitudes 6,8% of all stimuli's.

However, when interpreting these results one has to consider the number of stimuli in each category (see Table 9). Accordingly, the means are calculated in two different columns (see Table 7 and Table 8); *Means of major reasons* and *Company-specific means (STD) of major reasons*. In the former, the mean value is calculated by dividing the stimulus score by the number of stimuli in each category. In the latter, that value is calculated by dividing the value of the stimulus by the number of respondents.

When it comes to mode increases, mean values give very different result regarding the order of importance. Moreover, on the basis of mean values, performance is the most significant factor with the value of 15,8, followed by attitudes 12,6, internal environment 12,1 and lastly external environment 7. Finally, company-specific means are presented in the last column and standard deviation (STD) of each stimuli indicates that there were some disagreement among

respondents regarding the importance of each stimuli. Moreover, a low standard deviation indicates that the values tend to be close to the mean of the set, while a high standard deviation indicates that the values are spread out over a wider range.

	Frequencies of major reasons		Means of major reasons		Company-specific means (STD) of major reasons	
	Mode reduction	Mode increase	Mode reduction	Mode increase	Mode reduction	Mode increase
Performance	25,4 %	23,9 %	3,8	15,8	15 (-)	12,6 (4,6)
Internal environment	59,3 %	45,8 %	3,5	12,1	35 (-)	24,2 (6,5)
External environment	8,5 %	15,9 %	0,8	7,0	5 (-)	8,4 (4,4)
Attitudes	6,8 %	14,4 %	1,3	12,6	4 (-)	7,6 (10,3)

Table 7 Importance of reasons for mode change (1)

The second and slightly different set of stimuli's consisted of 18 new but partly similar reasons compared to the first list (see Table 8 and Table 10). The biggest difference to mention is the addition of *partner firm* stimuli in replacement for *attitudes*. In terms of the importance, partner firm resulted as most significant reason in 36,9%, external environment 25,3%, internal environment 19,7% and performance 18,2% of all increases. Regarding mode reductions, the frequency was evenly distributed among performance, external environment and internal environment.

However, in terms of mode increases, mean values give different results regarding the order of importance (see Table 8); the internal environment is the most significant factor with the value of 19,5, followed by partner firm 14,6, external environment 7,14 and lastly performance 9.

	Frequencies of major reasons		Means of major reasons		Company-specific means (STD) of major reasons	
	Mode reduction	Mode increase	Mode reduction	Mode increase	Mode reduction	Mode increase
Performance	33,3 %	18,2 %	2,5	9	10 (-)	7,2 (4,6)
External environment	33,3 %	25,3 %	1,4	7,14	10 (-)	10 (6,5)
Internal environment	33,3 %	19,7 %	5,0	19,5	10 (-)	7,8 (4,4)
Partner firm	0,0 %	36,9 %	0,0	14,6	0 (-)	14,6 (10,3)

Table 8 Importance of reasons for mode change (2)

	Increase of modes		Reduction of modes
		Performance	
	11	Continual **good** performance made it clear to us that a change of mode was necessary	1
	9	Continual **poor** performance made it clear to us that a change of mode was necessary	5
	28	In view of our development, the mode change was the next logical step in successful market development	6
	15	The mode was simply not holding its own within our overall operations	3
sum	***63***		***15***
		Internal environment	
	12	We wanted to **diversify** products/markets	0
	2	We wanted to **reduce** products/markets	6
	25	A change was needed if we were to **realize our growth objectives**	6
	8	A change was needed if we were to **reduce costs of operations**	5
	29	We made a strategic decision that the foreign market is **more** important in the future	6
	2	We made a strategic decision that the foreign market is **less** important in the future	0
	11	It was the decision to integrate **more** resources because of **good** business in the past	6
	4	It was the decision to integrate **less** resources because of **bad** business in the past	0
	24	It was more efficient way to serve the market in a new way	6
	4	New management had a different idea than old management about importance of (particular) international business	0
sum	***121***		***35***
		External environment	
	11	The contractual situation has changed	0
	3	Regulations/norms in the market have changed	0
	12	Development of demand was **more** than we though before	5
	8	Development of demand was **less** than we though before	0
	8	We were asked to **buy** a business (in the sense of an opportunity)	0
	0	We were asked to **sell** a business (in the sense of an opportunity)	0
sum	***42***		***5***
		Attitudes	
	18	Over time, we became more comfortable operating within the market and felt that a change in mode was now appropriate	4
	19	We changed the mode because we had a **greater** commitment to the market	0
	1	We changed the mode because we had a **lower** commitment to the market	0
sum	***38***		***4***
total	**264**		**59**

Table 9 Major stimuli for mode change (1)

	Increase of modes		Reduction of modes
		Performance	
	9	Previous entry mode was chosen based on too optimistic sales demand estimates in target country	4
	6	Previous entry mode was chosen based on too pessimistic sales demand estimates in target country	0
	13	Our firm was dissatisfied with the overall performance of previous entry mode	6
	8	Our firm was satisfied with the overall performance of previous entry mode	0
sum	**36**		**10**
		External environment	
	8	Our firm perceived a higher political instability () in target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	0
	5	Our firm perceived a higher legal instability in target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode	0
	6	Our firm perceived a higher economic instability in target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	0
	3	Our firm perceived a higher social instability in target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	0
	9	Our firm perceived a very high competition in target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	5
	3	Our firm perceived a very different culture of target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	0
	16	Our firm perceived a very large market size and growth potential of target country shortly before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	5
sum	**50**		**10**
		Partner firm	
	18	Our firm was dissatisfied with the performance of partner firm	0
	11	There were always conflicts between our firm and target firm regarding the strategic decisions of our joint business.	0
	7	There were extreme conflicts between our firm and target firm regarding the strategic decisions of our joint business.	0
	17	Partner firm was highly incompetent to fulfill its responsibilities	0
	20	Partner firm did not want to grow our joint business	0
sum	**73**		**0**
		Internal environment	
	21	Our firm had gained a high level of target country knowledge before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	5
	18	Our firm had gained more resources before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.	5
sum	**39**		**10**
total	**198**		**30**

Table 10 Major stimuli for mode change (2)

At the end of the questionnaire, the executives were given an opportunity to explain in their own words what were the exact reasons affecting the decision to change operation mode. As seen in Table 11, the reasons consists of answers related to distributors, partner firms, market opportunities and changes in external environment. However, the most noticeable answer in terms of dissimilarity, *impact of digital trend,* was the only factor related to the technological development of markets. In fact, technology as stimuli for mode change was the only stimuli excluded from both set of stimuli's.

Direction of the mode change	
Up	*1. Political situation changed, forcing comptetitors to terminate their operations, thus providing good timing to establish a company* *2. The distributor was in financial challenges and offered the business for us*
Down	*1. A lot of Baltic cheap manufacturers began to enter the competitive field, local manufacturing began to lower the price level and cutomers began to accept it, profitability of production began to fall* *2.Profitability improved by concentrating production and standardizing the product base*
Up	*1. Direct contacts from resellers who wanted to become our resellers* *2. Customers wanted us to have more operations in particular market so that we can keep prices competitive*
Up	*1.Growth potential* *2. As a premium brand, motive of getting closer to the customers* *3. Impact of digital trend* *4. Conflict between partnering firms goals and objectives*
Up	*1. Growth target of the company* *2. Partner was thinking to give up our main businesses in the future* *3. Partner was focusing to other industries in the future*
Up	*1. Distributors unwillingness to develop new business* *2. Own people committed to communicate directly with the customers* *3. Market potential, growth potential*

Table 11 Major stimuli for mode change (freely answered)

As previously declared, due to the insufficiency of sample, meaningful testing of hypotheses is not possible thus no credible conclusions can be drawn. However, the results are presented in Table 12. The evaluation of the hypotheses was made on the basis of the means of major reasons (Table 7 and Table 8), which as a method was sufficient enough given the small sample size. Accordingly, H2 could not be tested even with insufficient data because there were no upward mode change cases regarding the investment modes variable.

		supported	rejected	rejected due to insufficient data
H1				
	a) *Internal environment is the most significant stimuli regarding both directions of mode changes*		x	
	b) Performance stimuli influences the probability of mode reductions rather than increases		x	
	c) Attitudes influences the probability of mode increases in preference over reductions.	x		
H2	*In terms of the mode increases, the external environment stimulus is more significant regarding non-investment modes variable rather than investment modes variable.*			x
H3	*Partner firm stimuli influences the probability of mode increases in preference over reductions.*	x		

Table 12 Evaluation of the hypotheses

4.2. Key findings

I will briefly present the findings regarding mode increases and compare those to the findings by Swoboda et.al. (2011), thus providing answers to the validation of the previous studies. Lastly, I will present the results from the second list of stimuli' and discuss those together with freely written answers.

Order of importance	2011	2021
Performance	3	1
Internal environment	2	3
External environment	***4***	***4***
Attitudes	1	2

Table 13 Order of importance (mode increases)

Firstly, as seen in Table 12, the order of importance differs notably when comparing the results given by this study to the results obtained by Swoboda et.al. (see Table 12): However, when the 2011 study found stimuli of attitudes as the most important factor regarding mode increases, this study placed it in a second place. Furthermore, again the difference is not that significant when it comes to the internal environment, which the previous study found to be the second

most important stimuli, but this study ranked it as third. The biggest difference concerns the performance stimuli, which this study found out to be the most significant factor causing mode increase decisions, while the previous study placed it third. Finally, both studies were in line with the fact that the external environment is the least relevant factor regarding mode increases.

Although the order of importance is different, several similarities were found between these studies. Moreover, looking deeper into the sub-level stimuli's within internal environment (see Table 9), the answer regarding strategy; *We made a strategic decision that the foreign market is more important in the future*, scored the most within this entity. Similarly, Swoboda et.al. also found out this as the most scored reason (see Table 3) of this stimuli regarding mode increases. Surprisingly, the second most important stimuli within internal environment; *A change was needed if we were to realize our growth objectives*, also resulted to be the same in both studies.

Secondly, when it comes to performance, the sub-level stimuli's are again in accordance with the results by Swoboda et.al. Moreover, the answer; *In view of our development, the mode change was the next logical step in successful market development,* scored highest in both studies regarding mode increases.

Thirdly, when looking at the sub-level stimuli's of external environment, the most scored reason; *Development of demand was more than we though before*, turned out to be the same again in both studies regarding mode increases.

Finally, looking deeper into the sub-level stimuli's within attitudes, main reason was found to be the same in both studies; *We changed the mode because we had a greater commitment to the market.*

Next, we discuss the results yielded from the second set of stimuli's (see Table 10), which was designed not to compare with the results from previous empirical studies, but instead provide new and more precise information about factors that cause mode changes. Accordingly, this set of stimuli's differed from the initial set by emphasizing the reasons related to the partner firms. From the total amount of 18 stimuli's, 5 dealt with reasons regarding partner companies. As earlier presented, the internal environment was the most significant stimuli regarding both

directions of mode changes. In addition, this included the sub-level reason that received most points in the entire set; *Our firm had gained a high level of target country knowledge before changing the entry mode in comparison with the time your firm had chosen the previous entry mode.* The mentionable observation to be made concerns the newly presented stimuli *partner firm*, which placed second and also produced the second most scored reason of all sub-level stimuli's from the overall set (see Table 10); *Partner firm did not want to grow our joint business.* Lastly, the cultural development or social instability in target country seems to have minor importance regarding the upstream change of modes.

4.3. Summary and conclusions

The purpose of this thesis was to improve the understanding of how and why small and medium sized enterprises change their foreign operation modes. In order answer to the research question, three sub-objectives were developed. The first sub-objective was to study foreign operation modes. Based on the literature review it is found that there are different types of foreign operation modes like export modes, contractual modes and investing modes. Firms can choose any of these operation modes to enter international markets. Second sub-objective was related to the conceptualization and types of foreign operation mode changes. Based on the prior literature, it is found that mode change refers to the replacement of an existing mode with another alternative mode and there are two types of changes: mode increase and mode decrease. Mode increase means that the following mode requires more commitment than the previous one while mode decrease means that the following mode requires less commitment in the foreign market. The third sub-objective of the thesis was to define the factors that explain mode changes. Based on the literature review it is found that there are four general factors affecting both mode increases and decreases: managerial attitudes, firms performance, firms internal and external environments.

Although the credibility of the empirical part suffered due to insufficient sample, it nevertheless produced interesting information with the help of previous empirical findings on the same subject. First, the findings from the study over ten years ago, presenting managerial attitudes as the most significant stimuli regarding mode increases, can be loosely validated. Moreover, with the exactly same set of stimuli's, this empirical study found attitudes as the second most

important stimuli regarding the mode increase decisions. Any errors here are likely to be explained by the small size of the sample. Secondly, in terms of mode increases, both studies resulted similarly by finding the most important sub-level reason of the entire set; *We made a strategic decision that the foreign market is more important in the future*, to be the same. And thirdly, it can be concluded that external environment is the least relevant factor regarding mode increases. Therefore, the initial conclusions by Calof and Beamish's, which suggests that external environment is more often linked to mode increases, can be loosely rejected.

The second section of the questionnaire, which allowed not only to choose reasons related to the partner firm but also freely write explanations to mode change decisions, provided relevant information. Moreover, the importance of finding the right partner was clearly highlighted both in the closed question and in open-ended sections. Accordingly, it can be concluded that the dissatisfaction with the distributor eventually results as a mode increase decision in order to gain more control of the product. Therefore, the findings of Buckley et al. (1990), stating that firms switch to more controlled modes when they find exporting through agencies to be unsatisfactory, are supported. Lastly, it is safe to conclude that the growth potential of the target country is one of the most significant stimuli's driving the decision to increase foreign commitment.

4.4. Managerial implications

Even though the results of the empirical part of this study slightly differ from the results of the previous studies in terms of the order of importance (Table 12), it is easy to conclude that there are certain stimuli´s that increase the likelihood of mode increase decisions and vice versa, decisions to reduce commitment. In terms of mode increase decisions, the contributing factors are rarely related to the external environment but instead to the firm´s own performance and managerial attitudes. This means that managers should actively monitor their performance, continuously search new partners and dare to increase their international commitment rather than wait clear changes in the external business environment. However, performance as a stimuli has been perceived important for both increases and reductions, which means that changes in performance have to be viewed within the wide scope of stimuli, business aims and perspectives.

For executives this study denotes the crucial aspects to be observed and considered when mode changes are planned or change decisions have to be made. For instance, based on the empirical results as well as the discussions with executives during the interviews, finding a competent partner who knows the local markets and the supply chain of the target country, is a considerable challenge for even experienced companies. The empirical findings presenting issues related to partner firms in general, supports this conclusion.

4.5. Future research suggestions

The actual reasons behind mode changes are complex and dependent on many mediating variables, which are all, to some extent linked to each other. Furthermore, a change in foreign operation mode can be traced to stimuli from external environment, such as a change in target markets taxation, which again affects the firm´s performance. Therefore, a change in strategy appears which again results as the change or modification of the current mode. These four factors, initially formed by Calof and Beamish, could be challenged due to the fact that to some extent, all are linked to each other as mentioned above. A study which focuses on reducing these overlaps is therefore essential.

Given the noticeable weight, a similar study taking into account partner firm as a stimuli for mode change is essential. Moreover, now that the importance regarding mode increases is rouhgly covered, a study that takes into account mode reductions is required.

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