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A RELATIONAL ACCOUNT OF BUSINESS SERVICE INTERNATIONALISATION AND MARKET ENTRY – THEORY AND SOME EVIDENCE

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A relational account of business service internationalisation and market entry – theory and some evidence

by

Johannes Glückler[1]

Abstract

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

Keywords: internationalisation, entry mode, management consulting, network, mixed method; logistic regression

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1. Introduction

The conditions of international service markets have changed quite remarkably over the last years. On the supply side, increasing national competition forces firms to look for growth opportunities outside their home markets. On the demand side, client industries become increasingly international and pull their service providers with them into new markets (1996). A deepening international division of labour, ever more complex production technologies, and an increasing specialisation and segmentation of product markets are the conditions that reinforce future demand for external business and consulting services (Coe 1997). Moreover, national deregulation, trade liberalisation, especially the *General Agreement on Trade in Services* (GATS), integration of economic blocks such as the EU, NAFTA or ASEAN, and diffusion of modern information and communication technologies create preconditions for the international exchange of services (O'Farrell, Wood, and Zheng 1996; Grönroos 1999).

Internationalisation has always been an important growth strategy during the emergence of the management consulting market. In Europe, however, the consulting markets started to experience sustained growth from the beginning of the 1960's (Kipping 1999, 2002). In Britain, surveys of SME service firms report that management consultants least recognised barriers to international activities within the sector of business services. They drew up to 10% of turnover from international business (Keeble, Bryson, and Wood 1992; Bryson 1997). For Germany, Switzerland and Austria, Walger and Scheller (1998) found that two thirds of all consulting firms had international project experience, mostly through cross border travel of professionals. Therefore, consulting exports through temporal international presence seems to be a common means of international consulting business. Compared with trade, foreign direct investment (FDI) and its induced foreign revenues are much more important. Unfortunately, information about the international composition of revenues is not available systematically for the consulting market. Since most firms have the legal status of partnerships they are not obliged to publish business results. Further, it is often difficult for the firms themselves to trace their revenues back to the level of their affiliates: first, because many projects within multinational client firms affect and are carried out in various countries at the same time; and second, because many consulting firms aggregate their business revenues in functional or sectoral profit centres rather than geographical units. Nevertheless, there is some empirical evidence for increasing internationalisation of consulting firms. The top global consultancies, mostly US-based firms, gain more than half and up to 70% of their global revenues outside their home markets (Wet Feet Press 1996; Zeithaml and Bitner 1996). The biggest German consultancies, for instance, already obtain more than a third of their revenues in international markets (Streicher and Lünendonk 2001).

Consulting internationalisation is not limited to big companies only. In a comparative analysis of consulting SMEs in Scotland and the British Southeast, O'Farrell et al. (1996) found that more than half of over two hundred surveyed consulting SMEs operated internationally, again a clearly higher proportion than in any other business service. One of the largest consulting surveys ever, a study on the German, Austrian and Swiss markets supports these observations as approximately 20% of small and more than 50% of mediumsized firms operated foreign affiliates (Walger and Scheller 1998). In sum, the internationalisation of management consulting does not only affect large, multinational firms but also medium and even small sized enterprises. The existing literature suggests, further, that most of the international expansion is facilitated through FDI, i.e. internalisation, rather than exports or cooperative inter-firm networks.

This argument raises the question of how we can account for the growing internationalisation of foreign consulting firms. Since the 1960s, economic and management theory have developed a range of conceptual approaches to explain firm internationalisation. Three accounts are particularly important: the theory of the multinational enterprise, the Uppsala stage theory and the Swedish approach to a network theory of internationalisation. Section two criticizes FDI theories and stage theories of internationalisation for their implicit atomistic perspective on firm decision and international expansion. The conceptual critique is supported by a number of empirical studies that document the explanatory limits of these approaches, especially for service firms. Instead, the paper argues for a relational perspective on firm internationalisation and introduces network theory of internationalisation as an alternative approach that takes inter-firm relations as a starting point for the analysis of firm expansion. Section three lays out the methodology of the empirical research. Section four develops the notion of entry context from the ethnographic fieldwork and explores the opportunities and threats of different organisational forms of entry. Section five develops hypotheses from the fieldwork and formalises a logistic regression model of market entry form a relational perspective. Section six closes with a conclusion.

2. Theory

2.1 Atomism in conventional theories of internationalisation

Among the many concepts of firm internationalisation, two approaches have gained wide reception: the eclectic paradigm as an approach to the theory of the multinational enterprise, and the Uppsala school approach to the internationalisation of small and medium sized firms. The eclectic paradigm is most prominently associated with the work of Dunning (1977; 1988; 2000). His OLI-model is eclectic because it integrates distinct explanatory approaches from different theories into one single framework. The concrete form of international operation that a foreign firm takes in a particular target market is the result of a combination of three advantages: First, a firm must have specific ownership or O-advantages that compensate for the general liability of foreignness as well as competitive position of rival domestic firms in the target market. Second, location or L-advantages of the target market have to be identified and to be evaluated with respect to the firm strategy (Dunning 1977). Third, it has to be assessed whether the O-advantages may best be realised through internalisation (I-advantages) or through external cooperative or market transactions. Given the market imperfections of imperfect good and factor markets, positive transportation costs, heterogeneity of demand and increasing returns to scale, internalisation is an alternative organisational strategy in order to reduce transaction costs (Coase 1937). The internalisation of O-advantages is more efficient than trade, whenever the transaction costs of the market are higher than the costs of hierarchical organisation (Rugman 1980; Bradach and Eccles 1991).

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

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

Undersocialised concepts of market selection

The selection of an international target market is undersocialised with regard to two aspects[2]: first, the selection is conceived as a process of rational decision-making by atomistic firms; second, stage theory suggests a gradient of psychic distance as a pattern of international expansion.

Market selection as rational decision-making. The theory of FDI sees international market selection largely as a normative, efficiency led rational decision. Firms identify their specific competitive advantages and then look for those location specific advantages of a market that provide the best production (or sales) conditions. Hence, markets are systematically screened, compared and assessed with respect to efficiency gains. Finally, a firm always chooses the market that facilitates the best realisation of goals, e.g. highest sales potential, lowest labour cost, highest concentration of specific technological knowledge. Also in stage theory market selection is the result of independent rational decision-making. In order to prevent high levels of uncertainty, firms choose to expand in culturally proximate and often neighboured markets because

[2] Concepts are undersocialised if human action is based solely on external assumption by the researcher (i.e. formal rationality or profit maximisation) and if the influence of and dependence on the social and institutional context are ignored.

the lack of specific market knowledge is easier to compensate than in more remote markets. Here, market risk represents the key parameter of market selection. Increasing experience conveys specific knowledge which in turn allows for gradual intensification of market commitment. FDI as well as stage theory are normative accounts of optimal or rational market selection. Firms compare potential target markets, assess location advantages and choose the best match. Further, both approaches are atomistic since market selection is explained through conditions within the firm and general market characteristics. External firm-specific conditions are ignored.

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

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

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

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

Undersocialised concepts of market entry

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

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

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

Focus on large and manufacturing firms

Apart from the implicit atomism, both approaches are mainly confined to the internationalisation process of large industrial manufacturing firms (Coviello and Munro 1997; Grönroos 1999). Since the internationalisation process discussed here refers to, first, service firms, and second, mostly medium or even small sized firms, the conventional approaches display major limitations when used for explanation. The international expansion of small and medium sized firms often follows a different pattern and cannot be represented by these approaches. For SMEs, the decision to launch operation abroad is more risky than in the case of large firms. Since the required investment is higher relative to the available firm resources an eventual failure in a new market becomes more expensive (Buckley 1993). Erramilli and D'Souza (1995) showed that the likeliness for a service firm to invest abroad increases with growing firm size and decreasing capital intensity of the planned operation. Moreover, SMEs often lack financial and management resources. A shortage of financial resources may often lead to the choice of less appropriate organisational entry forms. Decision processes based on a lack of managerial resources are more spontaneous and tend to be short termed (Buckley 1993). These structural conditions render the launch of an international operation more difficult, especially in the case of the first international establishment. A British study demonstrated that many SMEs failed with their first attempt to expand internationally and only managed to establish foreign operation after repeated trials (Buckley, Newbould, and Turwell 1988). Overall, the theory of FDI proves not particularly helpful in accounting for small and medium sized business service firms (O'Farrell and Wood 1998). Other research also marks the limitations of stage theory and shows that a general pattern of an establishment chain is inappropriate to understand the internationalisation of service firms, especially knowledge-intensive business services[3] (Sharma and Johanson 1987; Westhead et al. 2001; Erramilli 1990).

3. A relational approach to internationalisation theory and market entry

A major consequence of the critique of atomism is a shift in perspective towards the actual relations with other firms such as suppliers, clients, strategic partners etc. Recently, scholars of the Uppsala School have taken up this position and emphasised the use of a network perspective. Johanson and Vahlne (1992) describe the process of foreign market entry as a problem of access to networks of new business relations. The network approach to internationalisation has been developed mainly in the industrial marketing and international business literatures (Johanson and Mattsson 1987, 1993; Sharma and Johanson 1987).

This perspective views the market as a network of exchange relations between producers, suppliers, customers and competitors. These relations may serve very different intentions (Johanson and Mattsson 1987, 37): They may reduce the cost of production or transaction; contribute to the development of new knowledge and competencies; lead to at least partial control over an actor, serve as bridges to unrelated third actors, or help to mobilise partners against a third party. In a dynamic perspective, networks undergo constant change through the breaking up of established contacts and the formation of new ones. In contrast to internationalisation theory the network approach prioritises external relations over internal conditions and assets. In line with the concept of resource dependence (Pfeffer and Salancik 1978), the access to other firms' resources is considered at least as important to realise market opportunities as internal competencies and competitive advantages. Consequently, a firm's position in a network takes a specific strategic value. It becomes a specific, intangible resource. The

[3] In fact, Johanson and Vahlne (1990) have acknowledged this limitation of stage theory themselves and

network approach, then, argues that international market entry is more dependent on a network position than on institutional, economic or cultural conditions of the host market. A business network serves as “bridges to foreign markets” (Sharma and Johanson 1987, 22).

Johanson and Mattson have formulated an alternative approach to analyse international expansion from the perspective of inter-firm relations. This does not necessarily oppose the network approach to conventional internationalisation theory. On the contrary, it promises to be complementary in order to perform a contextual analysis of specific internationalisation paths (Johanson and Mattsson 1987, 1991). They emphasise the role of external resources for gaining opportunities to internationalise. However, network relations do not only enable, but can also inhibit internationalisation (Coviello and Munro 1997). Altogether, the process of network formation and the position within network structures are argued to have an important impact on the kind and direction of international firm expansion. The form of market entry is now conceived as a consequence of evolved patterns of business relationships rather than a result of rationally selected optimal solutions (Blankenburg Holm, Eriksson, and Johanson 1996). Similar to the theory of FDI and stage theory, the network model was developed in the context of industrial manufacturing firms. Although it has only been applied to selected case studies, the empirical findings demonstrate the qualitative influence of existing firm relations on the strategic and organisational decisions of firms in international expansion (Coviello and Munro 1997; Coviello and Martin 1999; Chetty and Blankenburg Holm 2000). The model thus increases the explanatory power of existing accounts.

Knowing, however, that networks do impact internationalisation, we do not yet know whether there are any systematic directions of causation. In what way do which kinds of networks affect which forms of internationalisation and market entry? The processes of

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opened their account towards more recent network approaches to internationalisation.

internationalisation are complex and unfold relatively contingent on the theoretical accounts developed so far (Strandskov 1993). An analysis of the interrelationships between consulting firms and their client and partner organisations as well as the contingent development of their internationalisation require an alternative perspective (O'Farrell, Moffat, and Wood 1995; O'Farrell and Wood 1998). A relational perspective that takes into account the concrete sets of relations between firms promises to be a fruitful approach to the analysis of market entry. The goal of this paper is to examine whether there is any necessary relation between the social context of a firm and its choice of a specific entry form. The following sections describe the research design which uses both qualitative and quantitative techniques to test for the impact of social context on the organisation of entry form.

4. Methodology

The empirical research was carried out in three different European consulting markets, in which the major metropolitan regions were selected for ethnographic fieldwork. First, London is a very international market place for management consulting serving as a gateway to the European market for many North-American firms (Glückler 2004). Second, Madrid represents Spain's single most dominant concentration of consulting firms. Almost half of all firms and over 56% of employed consultants are located in the autonomous region of Madrid. The third case study was conducted in Frankfurt/Rhine-Main, a poly-centric metropolitan region with several core cities. Although the concentration of consulting firms is less pronounced, the metropolitan region still represents the biggest market place for consulting in Germany. In absolute figures, there are approximately 11,000 consulting firms in Greater London, 2,600 in Madrid and 4,600 in Frankfurt.

Since the research focus is on the actual context and process of international market entry, local affiliates and subsidiaries of foreign international firms were the appropriate unit of analysis. Firms were considered foreign when a natural or legal person outside the host market owned at least 10% of the local operations. The threshold of 10% has become conventional to distinguish foreign direct from portfolio investments (OECD 1999; UNCTAD 2000; Nachum and Keeble 2001). Usually the managing directors or presidents of the host market offices are the key individuals who actually launch the foreign operation and develop the new local business. Only there was it possible to obtain rich information on how the establishment of a new operation worked and how business was developed in the new environment.

Since the methodology pursues a mixed-method approach the analysis uses two different sets of data from the case studies. First, over 70 semi-structured interviews were carried out in the three case regions. In London and Madrid fieldwork relied on oral semi-structured interviews. Interviews were carried out between summer 2001 and autumn 2002 and took between one and two hours. All interviewees were presidents, managing directors, or leading senior partners of the host market offices. In contrast, the Frankfurt case was a combined study of an in-depth interview exploration (15 interviews) in which questionnaire items were developed for a subsequent survey of all identified foreign consulting firms in the region (N=110, response rate 49%). Altogether, 111 consulting firms were considered for both qualitative exploration in ethnographic fieldwork and statistical analysis (Table 1). The firms spread relatively equally across the four major specialisations within the management consulting sector, i.e. strategy, information technology, human resources and operations management consulting.

Table 1: Distribution of surveyed firms by consulting service specialisation

specialisation	Frankfurt	London	Madrid	total
strategy	6	6	4	16
Information technology	13	6	3	22
human resources	18	6	9	33
operations	10	10	7	27
related services (niches)	6	0	7	13
total	53	28	30	111

5. Ethnographic fieldwork

5.1 Entry challenge and entry failure – hidden experiences

There are two types of motives or modes of internationalisation in services: client-following and market-seeking (Samie 1999). While the latter suggests proactive strategies and systematic procedures to select a target market and choose an entry form, the former often implies reactive decisions to follow a client into a predetermined market. These broad conceptual modes were also reflected in the fieldwork. Some firms strategically planned international expansion to sustain firm growth. However, most firms were clearly pulled into new markets by their existing clients. They were pulled to the extent that clients increasingly demand their consultants to be international or otherwise abandon cooperation:

> "We do not globalise because we think we get more through that. Instead, our clients say 'we are global, so you have got to be global, too, otherwise we don't work with you'" (Interview F5)

> "In the past, we lost pitches although the clients said we had the best proposals. We did not succeed, however, just because we were not international, then" (Interview F13, translation by the author)

International market entry is not an easy venture. Given the uncertainties affecting consultants in international markets, the launch of a foreign operation is subject to major barriers. Often, the research design in internationalisation research a priori excludes the possibility to learn about unsuccessful international ventures. However, in the case of the Frankfurt case study, two exemplary cases of entry failure entry were revealed through the interviews. Both demonstrate the risks involved and effort necessary to establish in a foreign market. In the first case, a top 25 German management consulting firm had tried to enter Spain in a market-seeking mode. The company, founded in 1992, had grown rapidly and won international client corporations. After three years they expected to sustain their growth by an international expansion. The CEO reported the experience as follows[4]:

> "We had started to go to Spain. We sent a consultant and pursued client acquisition for about two years. We invested a whole lot of money but it is not easy to get a foot in the market. It turned out that one better know the local context. We had to learn the lesson that the Spanish market is less open to consulting than the German one. Only the real global players could succeed […] except that one follows a client just as a competitor of ours has done. Their client went to Spain and sought an SAP implementation so that the consultancy simply followed in the market. Today, this client remains the focus apart from the additional local business. […] Ok, the background was that we had a colleague whose wife was Spanish. Since personal relations play a in important role in Spain and since that lady belonged to the inner circle in Madrid, we thought to send them to Spain. Our colleague had learnt Spanish and his wife was desperate to repatriate to Spain. So, we thought to make use of this situation and develop business there. I think it was 1995 when we decided to invest in this venture. In fact, we had a number of prominent contacts and presentations with large corporations. Yet, we never won a project and after a while we decided not to continue these efforts. Our colleague, by the way, stayed in Spain" (Interview F13, translation by the author)

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

> "We had projects and contacts in the parts and components supplier markets of the automobile industry in Germany and Britain. We reengineered their storehouse and got into contact with people responsible for the logistics planning in the USA. We were hired to do a large distribution survey for that company in the US. In that context they clearly declared that a future consulting project would only work with an American company and not from Germany. So we were urged to open an office in Ann Arbor which went great during the first two years. Then, the management suddenly changed with somebody who was evidently consulting averse. Our Detroit business was 95% with that client firms. We had always tried intensively to diversify and win new clients in the US but the rules of the game seemed different from the European logistics market. Size matters, niches are not sustainable. And we certainly were a niche player." (Interview F12, translation by the author)

While the first case reports the difficulties of winning local clients without current business in the market, the second carries this problem further and demonstrates that a

[4] This case illustrates the advantage of a qualitative research design. The interviewee first reconstructs the business case through the organisational lens. Only when asked to contextualise the international venture, he begins to reveal the deeper social context of the situation and the actual opportunity driving the market

client-following mode of entry may only provide a short-term basis and maximum dependence on a sole client. Winning new clients in a foreign market is one of the key challenges in the internationalisation process. In addition, personal interviews revealed that prior attempts to launch foreign operations failed in a number of instances, too. These incidents support the argument that the process of internationalisation did not at all unravel in a linear way, but rather followed sequences of trial, error and success.

6. Entry form: a trade-off of risks

The organisation of a new international operation may take different forms. It ranges from the establishment of own subsidiaries and affiliates to the acquisition of wholly, majority or minority owned local companies to joint ventures, strategic alliances and loose non-contractual forms of inter-firm cooperation (Samie 1999; Daniels 1995). Empirically, the proportion of loose cooperation networks in the overall volume of international revenues can be assumed to be very limited. Since this research focuses on local offices as the unit of analysis, only foreign direct investments could be considered for analysis. Within the different forms of internalisation, two organisational modes of entry were distinguished. An investment was *greenfield* when an international consultancy set up de-novo subsidiaries or affiliates; it was *brownfield* when the firm entered the market through acquisition, joint venture or majority-participation in local firms. What were the managers' rationales for choosing which kind of organisational form of entry?

Greenfield entry enables the internal transfer and control of professional standards, work routines and organisational culture (cf. Table 2). For many consultants this was a key argument in favour of growing organically in a new market. The core asset of a consulting company is represented in the knowledge of its professionals, the reputation of the firm and the quality of the client network. When firms grow through greenfield

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entry attempts. The analysis of socio-structural processes behind business decisions can only be carved investments they are able to maintain the quality of their recruitment standards and thus to integrate local professionals into the existing organisational and knowledge architecture. An important consequence of organic growth, it was argued, is that the firm ensures internal cohesion and continuity at an international level to their clients and thus sustains corporate reputation. As another advantage a greenfield entry implies a smaller minimum investment in a local venture as compared with M&A form of entry. The sunk costs for renting office space and expatriating professionals can be done step-by-step so that the risk of financial loss can be controlled. The downside to greenfield investment is that internal firm organisation and recruitment as well external market relationships have to be fully developed from scratch without local knowledge. This implies several challenges. First, a greenfield venture has no local business contacts. However, since they are crucial to really winning new clients, the company runs the risk of facing severe barriers to business development which might ruin the whole venture after a while (see above). Second, especially, in developed markets, where competition is high and size becomes a factor of competitiveness, incremental organic growth may just be too slow to build a competitive position. As one interviewee argues:

> "Look at the US market: You launch an office and begin with ten people. You double your headcount every year: 20, 40, 80, 160, 320. So you will not have got far even after five or six years. You're still nobody. So, to make a surge in growth you need to buy a local company. In big markets you only grow by M&A." (interview F4, translation by the author)

Table 2: Greenfield versus brownfield entry: Pros and cons from the interviews

	greenfield	brownfield
opportunities	– internal transfer of professional standards and knowledge	– purchase of existing business relationships and personnel
	– full control over organisation development and international intra-firm coordination	– profits from day one
		– speedy entry and fast growth
		– high potential market share
threats	– slow growth	– post M&A integration failure
	– lack of local contacts	– threat to firm reputation

out through qualitative or mixed method approaches.

– time lag until break-even	– overpriced target company

The advantage of a *brownfield entry* may exactly compensate for the downside of greenfield entry (cf. Table 2). Merger and acquisitions are attractive in order to access a range of client and industry relationships with just one financial transaction. Through purchasing a local company an entrant may get a foot into the business, integrate established professionals and achieve a considerable market share. One consultant justified his decision for an acquisitive market entry by arguing that in his market, human resources (the number of capable and well connected people) was very limited in any country. One would have to buy them out, pay superior premiums, hope that these people assemble a coherent and competitive staff and wait many years for the new firm to grow and generate first profits. New contacts would take time to evolve until they pay off (interview M2). Moreover, another respondent reported the advantage of brownfield investments by emphasising the opportunity to grow faster and gain profits right form the start, whereas de-novo establishments would take a lot of time to reach the point of breakeven. In turn, a brownfield entry bears the risk of purchasing hot air: “compras aire“ (Interview M8). This hot-air argument includes two components: First, since client relationships are key to competitiveness and market success in the consulting business, these external relationships also largely determine the value and takeover price of a target company:

> “What’s a consulting company worth? The computers or the office equipment? No, the value of a consulting firm is determined, first, by its employees. They are highly mobile, however, and fly away if the integration fails after a merger. The second determinant is the client network. So you can avoid making cold calls and saying ‘Hello, you don’t know us, but could we come for a presentation?’” (Interview F4, translation by the author)

Second, as the respondent argues, the competitive resources are fundamentally represented in the human capital of the acquired firm and the relational capital of its client relations. While human capital is highly mobile and sensitive to changes in a firm’s governance and organisational procedures, the relational capital is often extremely people-bound. Consequently, problems in post-acquisition integration may rapidly lead to the exit of key professionals ("efectos de rechazo" , Interview M14), their knowledge and their relational capital. In fact, not all market entries were successful at their first attempt. Instead, various firms had tried to establish operations prior to their actual presence. Respondents referred to numerous examples where takeovers of local firms had resulted to be "disastrous" experiences. Some technology and IT-related consulting services had to internationalise by M&A because of the speed of market growth during the 1990s. Geographical expansion and local acquisitions were the only way to keep up with this speed. With the economic downturn since late 2000, this has changed dramatically again and growth – if at all – has to be managed more carefully. One managing partner in London regretted the timely decision for an M&A. In the due diligence procedure speed had been given more weight than accuracy which led to unforeseen problems of post-merger integration. This company changed their expansion strategy towards organic growth by waiting for enough current business to build in a market from outside before entering (Interview L20).

These contrary lines of argument illustrate to some extent the contingencies of entry mode choice. With respect to the interview sample, the evidence is diverse: numerous acquisitions were reported, many of them failed, market entries were often second or third attempt, most firms chose de-novo entry and established their operation organically, and there were no clear patterns of service specialisation or size that were systematically associated with entry mode. The rationales behind the choice of entry mode varied considerably between interviews. The decision comes down to a trade-off between to kinds of risks: a greenfield investment runs the risk of failing to compensate for the sunk costs of a local office because of missing local business relationships. A brownfield investment avoids this risk exactly by purchasing these relationships. In turn, this is paid by the risk of overpriced target companies and post-merger integration failure. Integration problems can be very harmful and ruin the whole venture if local professionals decide to leave the company and take their knowledge and client base with them.

7. Entry context: atomistic and relational entry

Can we learn anything about the solution to this trade-off from a relational perspective? Apart from the two show cases mentioned above, access to social network contacts and business relationships seemed crucial in many other sample cases. Therefore, the distinction between client-following mode and market-seeking mode is better reframed in terms of a relationship context. In what follows, this paper develops two distinct types of entry contexts from the international fieldwork (Glückler 2004). Whenever an entry process drew on business relations from client or other business partner networks, this context was labelled *relational entry*. In contrast, a smaller number of firms invested in one of the three case-study regions without drawing on any prior contacts or existing network relations. Those conditions in which firms initiated operations actively without using network contacts were labelled *atomistic entry* contexts.

In *relational entry context*, of course, existing client relationships in the home base were key to successful internationalisation. The more a consultancy served internationally operating client firms, the more likely it was to benefit from an opportunity to be pulled abroad. It is important to note, however, that the client-following mode does not say much about whether a firm followed deliberately or from pressure of losing their business in the home market if they had not. As soon as the business volume in a host market exceeded a certain threshold, a local presence was ventured. Market selection as well as entry time were therefore dependent on the client organisations' internationalisation path: "Where our clients want us, that's where we will go." (Interview L17). However, relational entry is not synonymous with the client-following mode in that it also embraces other types of business networks. A second entry path was through current or former employees (alumni) who had moved to other companies abroad and referred business to their employer. One German-based technology consulting company, for instance, was referred to jobs in Indonesia, Egypt and Brazil by just one former employee. These kinds of dense network contacts even facilitated the entry into markets with pronounced cultural dissimilarities and at long geographical distance. This observation poses, again, an empirical challenge to atomistic arguments about psychic distance and cultural proximity. The third type of business networks worked through the so-called piggybacking (Terpstra and Yu 1990; O'Farrell, Wood, and Zheng 1996). In this case, consulting firms entered a market on the back of strategic partners and collaborators. When a service firm had entered a foreign market and required additional capacity or competence to service their new clients, they referred partner firms from their home base into these projects. As such, they served as bridges for consulting firms to new markets. The particular attraction of piggybacking was, first, the access to a whole remote network of clients and business opportunities through just one partner firm abroad, and second, avoiding an early entry risk. The downside, however, was that client access was always mediated through the incumbent firm and therefore indirect.

In an *atomistic entry context*, firms organised their market entry alone rather than through the support of existing business networks. Although the dominant motive, as outline above, was market-seeking some firms pursued a resource-seeking strategy for international expansion in order to improve their level of competence and innovativeness. Atomistic entry confirms the implicit line of argument of conventional internationalisation theory. Firms develop corporate strategies, take optimal decisions and venture into the most profitable markets. Of course, since there seem to be no external relationship constraints or opportunities, the explanatory power of the internationalisation process lies fully within the firm and its resources. Nevertheless, atomistic entry was not very prominent in the sample. Conventional theory tends to champion firm-specific competitive advantage, which is certainly indispensable, over the actual ability to win new clients in a market. However, especially in management consulting, one of the key barriers if not the single key constraint to internationalisation is new business development. Since local business contacts can only be won in a sustainable way through a local presence, consulting firms had to take a substantial risk in opening an office in a target market and then start to canvass potential clients. Furthermore, since the development of a new client in the consulting practice takes from a few month up to a year or longer, these firms had to make considerable financial commitments to their venture in advance. In turn, however, since consulting is a project business, consultancies do usually not build savings for their future business. Hence, the risk of venturing into a new market under atomistic conditions was quite high and demanding: "You must have very large savings in order to finance a market entry over one year in advance. I don't think that many firms can afford this. In fact, we could not" (Interview F10, translation by the author). The following section develops hypotheses about the impact of two contingent factors on the choice of entry form. Using data from the case studies, a logistic regression model is developed in order to generalise a relational argument about entry.

8. A logistic regression model of market entry

8.1 Hypotheses and model

Given the longer presence of some foreign firms it was not possible to reliably assess the actual context at the time of market entry for the complete sample. There is a limited average duration of employees in consulting firms such that the managing partners often change in an operation after a couple of years. But as far as the information on the historical entry contexts were available from the interview partners, atomistic and relational entry contexts were distinguished. Most firms were pulled into new international markets. Two thirds of all firms used existing relations to access new local markets. The decision to internationalise was mostly a reaction to an opportunity from within the existing networks of clients, employees or strategic partners. Only one third of the firms had no contacts to draw on and entered under atomistic conditions. With regard to entry form, 70% of the firms entered through greenfield investments, only a minority through brownfield FDI. A cross tabulation of entry context and entry form demonstrates that relational entry conditions were significantly associated with the tendency to pursue greenfield investments (Table 3). Firms that entered under relational conditions predominantly set up greenfield-operations, whereas under atomistic conditions greenfield and brownfield entry forms were equally distributed.

Commonly, internationalisation theory draws on internal, firm specific advantages in order to explain different modes of entry. However, this study suggests that inter-firm relationships have an important impact on entry mode. The above association of context and form of entry suggests that business networks are crucial for winning local clients. If a market entry occurred under atomistic conditions, local client contacts would have to be won from scratch. Since the generation of a new client base is a lengthy process, atomistic entry contexts may foster brownfield entry. Through the acquisition of local firms, the buying firm aims at taking over the local client network. In turn, firms that enter through existing business networks are exposed to problems of post-merger integration but could settle and grow within their own boundaries. In short, a relational entry context reduces the risk of market failure (the value of the sunk costs) and thus fosters greenfield investment. Therefore, I expect statistical analysis to support the following hypothesis:

Hypothesis 1: If the internationalising consulting firm makes use of networks of trustworthy business relations (relational entry context) a greenfield entry form will become more likely.

Table 3: Context and form of entry in the three case studies

	Entry form		
	greenfield	brownfield	total
Entry context			
relational	48	11	59
atomistic	16	14	30
total	64	25	89

$\chi^2 = 7.731$; $p < 0.01$; $N = 89$

This argument is relatively static. In a dynamic perspective, the constraint of business networks on entry form seemed to weaken. Firms that entered brownfield were present in 13 countries whereas greenfield entrants had only seven foreign operations, on average. Moreover, firms entering under atomistic conditions had 17 foreign operations whereas, again, firms entering in a relational context were present in seven international markets only (Table 4). In consequence, relational entry context and greenfield entry appear to be important drivers in early phases of internationalisation but less decisive in later phases. International experience increases the knowledge and competence of how to conduct due diligence processes and how to manage a post-merger integration process in order to avoid the exit of local personnel and their client contacts. The more international a consulting firm grows the better its management competence in M&A integration and the smaller the relative risk of a market entry. This reasoning suggests the following hypothesis:

Hypothesis 2: Increasing international experience reduces the risk of post-merger integration failure and makes brownfield entry more likely.

Table 4: International experience compared with context and form of entry

	number of firms	number of countries (median)
entry context		
atomistic	33	17
relational	65	7
total	98	8
entry form		
brownfield	29	13
greenfield	67	7
total	96	8

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

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

The dependent variable is entry form (EF). The measure distinguishes between greenfield and brownfield forms of foreign direct investments and takes the value one (EF=1) if entry is greenfield, i.e. foreign direct investment flows into the establishment of de-novo subsidiaries or foreign affiliates. The first independent variable is entry context (EC). It can take the forms of atomistic and relational and is one (EC=1) if entry is relational. The second independent variable is international experience (IE) which serves as a measure of the past experience of an organisation in entering foreign international markets. Since it is difficult to assess the level of experience and competence to internationalise in an organisation directly, the number of countries with foreign operations is used as a quantitative measure. Within the sample, the variable ranges between 1 and 130 countries with a median of 8 countries[5].

[5] mean 18.64; standard deviation 21.36

9. Results

Despite the limited number of observations, the methodological assumptions for a logistic regression model are fulfilled. There are a minimum of 25 observations for both possible values of the dependent variable (Rese 2000, 137) and, since only two dependent variables are used in the model, the size of the sample satisfies the conditions for the model estimations. Table 5 reports the logit coefficients for the dependent variables as well as the test statistics. Because of a slight collinearity[6] between the two independent variables, their explanatory impact is first tested in separate models. All three models are significant or highly significant[7]. Model 1 analyses the effect of entry context on the choice of entry form. Model 2 examines the effect of international experience on entry form. Though model 2 is less significant than model 1, the inclusion of international experience in the combined model improves the overall model 3. Though not fully conclusive, the overall model proves valid with respect to the relevant criteria (Krafft 1997): The hit ratio is better than in the separate models and slightly better than the proportional chance criterion (71.9 %), the model is significant at 0.01 and reaches the highest R^2 among the models. However, it explains only 15.3% of the overall variance in the sample which, of course, limits its explanatory power. On the one hand, this demonstrates that it is difficult to force the contingency of social interaction into a linear stochastic model; on the other the model evidences a significant association between the actual context of market entry and the organisational mode of entry. This points to the fact that networks minimise risks and allow for wholly controlled investments in the setting up of own operations. Moreover, model 2 shows that increasing international experience compensates for the lack of relational access to

[6] The variables entry context and international experience are weakly correlated (Pearson-r = -0.225; $p < 0.05$; N=89). This raises the problem of collinearity of independent variables. It leads to less reliable estimations of the logit coefficients in models of logistic regression (Backhaus et al. 2000, 41). However, due to the weak correlation the estimation error can be expected to be limited and acceptable.

[7] The χ^2-value is calculated by the difference between the –2 log likelihood-value for a model with only one constant and the –2 log likelihood value of the actually constructed (assumed) model. The higher and more significant the χ^2-value the better the explanatory power of the constructed model (Tansey et al. 1996).

a host market. Obviously, multinational firms have enough experience and competencies that are relevant for a successful atomistic entry by acquiring and integrating local companies or setting up own operations.

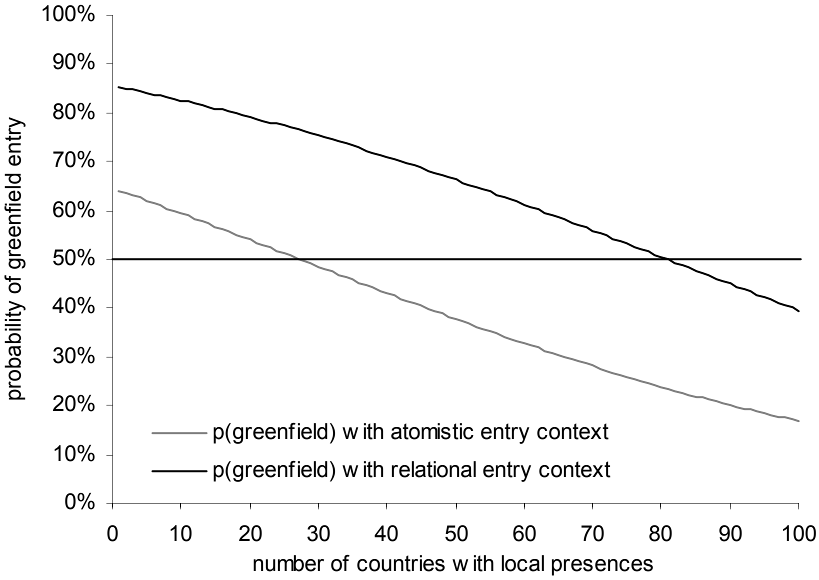
Figure 1 displays the estimated probabilities for a firm to enter greenfield in a foreign market. The graph illustrates that greenfield entry becomes less likely, first, if the firm enters under conditions of atomistic entry context, and second, with increasing multinational presence of a firm. In its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

Table 5: Logistic regression models: Logit coefficients for greenfield entry

independent variables	**Model 1**	**Model 2**	**Model 3**
Constant	0.134	1.414**	0.600
	(0.366)	(0.338)	(0.474)
Entry context (EC)	1.340**		1.175*
	(0.496)		(0.511)
International experience (IE)		-0.029*	-0.022
		(0.014)	(0.015)
-2 Log-Likelihood	98.216	100.998	95.681
Chi-square	7.481**	4.699*	10.015**
R^2 (Nagelkerke)	0.116	0.074	0.153
Hit ratio (%)	71.9	74.2	77.5
N	89	89	89

*p < 0.05; **p < 0.01; standard errors in parentheses

Figure 1: Estimated effects of the model on the probability for a greenfield-investment



10. Discussion and Conclusion

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

Instead of explaining entry mode by firm attributes or firm-specific assets, this research has challenged the choice of entry from the relational environment of that firm. The empirical analysis reveals two significant findings. First, it evidences the systematic influence of social networks on the choice of an organisational mode of market entry and thus supports the arguments of a network approach to internationalisation. Given the trade-off between the risk of business development failure through greenfield entry and the risk of post-merger integration failure through brownfield entry, the analysis confirmed hypothesis 1 that a relational entry context reduces the risk of business development failure by providing direct market contacts. Hence, in the relational entry context firms tended towards greenfield investments in order to avoid the risk of M&A integration failure. Second, hypothesis 2 was confirmed in that the impact of relational entry context is strongest for young and less experienced firms in the course of international expansion. Internationalisation experience obviously reduces the risk of M&A integration failure because firms develop the competences to manage due diligence procedures and post-merger integration. Hence, when multinational firms know how to integrate a local company at higher levels of control and certainty, they take advantage of local knowledge and client base through brownfield investments.

A relational approach to firm internationalisation stresses the importance of the context, in which a firm takes the decision to venture into a new market. For the empirical research, context is defined as the environment of a firm's relationships. This perspective also challenges the hyper-analytical distinction between three separate decisions usually discussed in internationalisation theory: often, the existing network of relationships influences the decision to internationalise, the selection of a target market and the choice of entry form. If internationalisation is a result of the external business relationships of a firm, the three decisions merge into one sole decision.

Finally and in a wider context, this research links to other studies that focus on the impact of relational context on economic decisions and processes. Baker and Faulkner (2004), for instance, find relational context important for the probability of capital loss in the course of investments. If investors draw on pre-existing social ties the probability of loosing capital in an investment drops significantly.

This research is limited to the extent that it has only focused on the quality of external linkages between firms. It has not empirically controlled for international firm-specific competitive advantages. Future research should aim at simultaneously assessing the impact of relational and attributional variables in order to integrate both streams of theories. Moreover, the statistical model was not too robust. Further analysis on larger samples is needed in order to render the presented analysis more reliable and valid. Nevertheless, the results of the statistical model are fully in line with the theoretical argument and thus promise to be a fruitful contribution to the current debate about firm internationalisation in business services.

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