

# THE INTERNATIONAL ENTRY CHOICES OF ITALIAN SMEs IN EMERGING MARKETS: A CASE-BASED ANALYSIS

Chiara Cannavale\*, Elena Laurenza

*Parthenope University of Naples, Italy*

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**Abstract.** *The paper addresses the factors influencing the SMEs' entry choices in international markets and explores two factors: one related to the external environment and one dependent on firms. The first factor is the institutional context as the whole of formal and informal rules of the country target. The second is the market commitment, intended as resources committed in a particular market area: the experience firms get in foreign markets and a general attitude to maintain the international presence for a long period are the main sources of market knowledge.*

*The aim of the study is to understand the effect of company-specific factors and of context-specific factors, namely the market commitment and institutional context, on SMEs' entry choice mode in foreign markets.*

*The paper develops a multiple case study analysis of four small international Italian firms.*

*Built on the institutional theory and on the market commitment construct, the paper offers a conceptual model that shows that the institutional context strongly influences the amount of resources involved in the internationalization process, while the market commitment affects more the complexity – and intensity – of the process.*

**Keywords:** *internationalization, market commitment, institutional context, small firms, entry choice.*

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## 1. Introduction

An internationalized firm has to adopt the appropriate organizational structure to manage operations located in foreign markets. When firms enter international markets, they can choose from several alternatives: they can do it through greenfield investments, exporting, contractual agreements or joint ventures.

The entry choice is a key component of internationalization strategies, and different theoretical and empirical studies have focused on this issue. Different scholars have interpreted this choice as getting different results, and empirical evidence is not easy to interpret and revise. This field of research owes its origins to three main backgrounds: the economic theories, the theories of foreign direct investment and the internalization

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\* *Corresponding author:*

Department of Management and Quantitative Studies, Parthenope University of Naples, Via Generale Parisi, 13  
Naples

E-mail: [chiara.cannavale@uniparthenope.it](mailto:chiara.cannavale@uniparthenope.it)

theories. However, the recent trend has been to adopt a more eclectic approach and to involve strategic and behavioral variables. The traditional contributions given on the entry mode focus on the Transaction Costs Theory (Williamson 1985; 1991), on the monopolistic advantage theory (Hymer 1976; Kindleberger 1969), on the internalization theory (Buckley & Casson 1976) and on the eclectic paradigm by Dunning (1979). These contributions consider the foreign investment decision as a rational process based on costs and advantages of outsourcing activities in foreign markets. More recently, contributions refer to the resource-based perspective (Meyer 2001) and focus on firms' ability to move and to strengthen both internal and external resources and capabilities, which are rare and difficult to imitate or substitute (Barney 1991; 2002). According to this stream, the decision to internationalize is based mostly on internal factors, on the quality and quantity of resources and competencies. However, a strategy is the result of an internal and external analysis: both environmental and firm-specific factors are important in deciding strategic goals and in choosing the right way to get them (Hill and Westbrook 1997). When the strategy is an internationalization strategy, external and internal factors are important for the decisions of where to invest and which kind of investment should the firm should do. A new input to the interpretation of firms' entry choices has derived from the application of the institutional theory and from the consideration of cultural values as something affecting international relationships and managerial practices (Brouthers 2002; Arregle et al. 2006, Brouthers & Brouthers 2001). According to the authors, entry choices are often driven by a combination of transaction costs variables, institutional and cultural characteristics. All operations outside domestic boundaries involve the interaction between different systems of cultural and social values; moreover, the inclusion of cultural variables in international business studies implies that cultural differences between countries increase the costs of firm entries in host countries and inhibit the ability of companies to transfer knowledge and skills (Palich and Gomez-Mejia 1999).

However, literature about the topic is not thorough, above all because previous studies focus on MNEs or use the same theoretical framework to explain SMEs' entry choices in foreign markets. SMEs show particular characteristics that can influence entry choices in international markets: the lacking financial resources, the ownership and management features that seem to affect the level of resources committed and the degree of risk that SMEs can afford in the internationalization process. Furthermore, some studies explain that frameworks developed for MNEs are not always able to explain SMEs' choices, in situations with a high degree of uncertainty and external pressure above all (Erramilli and D'Souza 1995). These studies suggest that the institutional context is suitable to explain SMEs because of their sensitivity to reactions to external challenges and because of their resource scarcity (Brouthers and Nakos 2004).

Even though in more recent studies the institutional theory is one of the most used to explain entry mode choices in the international market, it does not consider the influence on this decision of firms' internal factors, namely the experience, international market knowledge, useful resources and capabilities.

Given that, the present paper is an attempt to answer the following research question: what is the effect of company-specific factors and of context-specific factors, namely the market commitment and institutional context, on SMEs' entry choice mode in foreign markets?

This study wants to contribute to this debate, focusing on two main factors: a) The market commitment, intended as the incremental and sequential commitment of a firm to foreign markets (Millington and Bayliss 1990; Luostarinen and Welch 1990); b) The institutional context, which is considered welcome or hostile based on the evaluation of five factors: (1) the extent to which local regulations influence the activities of foreign firms in the host country (the extent to which the state hinders the development of business); (2) state control (the extent to which the control exercised on companies distorts competition); (3) the restriction on investment (the extent to which investment in the economy are directed by the government); (4) the bureaucracy of the local government, protectionism, fiscal policy and (5) the cultural barrier meant as closeness toward outsiders and the unequal treatment of foreigners (the extent to which foreigners are treated unequally compared to local citizens, together with the cultural boundaries).

The basic idea is that the entry choices of small firms depend on the institutional environment and on market commitment. The institutional environment can limit the entry choices of firms most of all in emerging markets and transition economies. However, firms' actions do not depend just on the external factors, but influence is attributed to firms' involvement in international activities and on their previous experiences (market commitment). The paper begins with a discussion about the institutional theory and the concept of market commitment and its appropriateness to be linked to entry mode strategies, and then it continues by applying it to the SMEs. The methodology section discusses the congruence of using a multiple case study research and the reason for our choice. The section about empirical evidences, using the proposed conceptual framework, presents the case of European firms internationalized in transitioning markets. In the final part of the work, we highlight the results, the theoretical and practical contributions as well as the limitations of the study.

## **2. Institutional Context and Entry Modes**

When firms choose an entry mode, they have to consider the double pressure and should strive to achieve the right balance between internal rules and the adaptation to local environmental needs (DiMaggio and Powell 1983). An entry strategy is legitimate insofar

as it is perceived as legitimate by those who are involved both in the corporate and in the external environment; that is, firms have to respond to the need to achieve legitimacy in both networks (Kostova and Roth 2002), taking into account both internal and external pressures.

The internal pressures drive companies to adopt structures and practices that have proved successful in previous experiences, and which can facilitate the transfer of funds and resources between subsidiaries. The external pressures are represented by local rules, both formal and informal (North 1990) – the unwritten rules that define what is “right” and “wrong.” Firms tend to conform to the rules and regulations at the local level, which are often based on the social expectations and influences, to which firms have to interact in order to gain legitimacy and improve their ability to survive and thrive (Ferreira et al. 2009).

Social legitimacy is connected to the institutional framework (government, business, groups), too. Institutions have a key role in a market economy, supporting the effective functioning of the market mechanism, allowing firms to engage in market transactions without incurring undue costs or risks (Peng et al. 2008). These institutions include, for example, the legal framework, property rights, information systems and regulatory regimes.

Institutional theorists (DiMaggio and Powell 1983; Scott 1995) claim that the organizational actions are driven by the desire of social justification, of a positive judgment of stakeholders (shareholders, customers, governments, public interest groups), which assess the appropriateness or legitimacy of the strategic activities from their point of view. According to institutional theory, strategic and economic activity is embedded in a social context and the regulatory framework motivates the economic actors to seek the legitimacy or the approval of actors on which they depend for access to physical, human, financial, and reputation (Amburgey et al. 1996; Oliver 1996). The institutional environment has a direct influence on internationalization choices and entry modes, posing barriers or facilitating the entrance of foreign investors.

Scholars showed that the host country institutional context produces challenges that stress the firm’s resource base, influencing SMEs’ foreign market entry mode (Schwens et al. 2011). In addition, studies based on institutional theory have demonstrated that SMEs take different entry choices than large MNEs, above all when the firm has to face high levels of risk in the foreign market (Cheng and Yu 2008). The characteristics of the market are very important for SMEs decision-taking, and this is not a surprise if we consider the limited financial, market and knowledge resources of small firms.

Institutional theory represents indeed a solid basis for explaining the internationalization of companies in emerging economies, since the institutional differences are particularly important for companies operating in several institutional contexts, particularly in less stable or more distant contexts.

Looking particularly at emerging markets, they are described as countries that are restructuring their economy, trying to direct it to the market and offer significant investment opportunities, even in terms of technology transfer (Li & Peng 2008). In some of them, however, governments have limited restrictions on foreign direct investment, having reformed the banking sector, reduced bureaucracy, accelerated privatization programs and made many other changes that have affected both the market and the operational strategies of multinational enterprises (Demirbag et al. 2007).

According to Meyer (2009), institutions can be considered “strong” if they support an effective mechanism of the market. On the contrary, institutions can be considered “weak” if they fail to support effective markets (McMillan 2008). The strength of the institutional environment affects firms’ choices: when the institutional framework is weak, companies tend to use cooperative entry modes rather than competitive ones, while in a strong institutional context, acquisitions are preferred (Meyer et al. 2009): countries with weak institutions are characterized by a lack of transparency, a shortage of information, weak financial institutions, higher levels of risks, and all this creates an uncertainty that drives firms to prefer less rigid investments (Delios and Beamish 1999).

### **3. Market Commitment**

Referring to SMEs, the market commitment is closely related to the *Stage Model* (Bell et al. 2004). It is the model of enterprises that traditionally operate in the domestic market and then open gradually to foreign markets: “firms become international in a dominantly slow and gradual manner, long after establishment in their domestic market” (Rialp et al. 2005, p. 137).

The Uppsala School (Johanson and Vahlne 1977) introduced the concept of market commitment referring to the internationalization process. The authors assumed that market commitment consists of two factors. The first defines the resources committed in a particular market area that sometimes can be easily sold or transferred to other purposes. Market commitment is high when these resources are integrated within the firm, while it is low when integration does not occur. Johanson and Vahlne (2009) have revised their own model by introducing market knowledge as a further influencing factor: market knowledge is the result of the experience firms get in a foreign market, and the growth of market knowledge drives a growth in market commitment, which promotes a further enhancement in market knowledge.

Market commitment, substantially, “represents a dynamic force in the internationalisation process” (Luostarinen and Welch 1990, p. 269), and it “is an essential ingredient for successful, long-term relationships.”

Commitment is a wide concept including psychological, attitudinal and temporal elements (Gundlach et al. 1995). Therefore, market commitment could involve not only

resources but also the attitude or the intention of the decision-makers (Lamb and Liesch 2002). Market commitment influences entry choice, because different choices imply a different level of costs, risks and involvement, and it requests a different degree of knowledge and experience (Bilkey and Tesar 1977). It may concern the inclination to build strategic alliances (Cullen et al. 2000), business-to business relationships (Zabkar and Brencic 2004) and cross-border relationships (Styles et al. 2008).

According to the Uppsala School, internationalization is the result of a company's gradual awareness of the opportunities in foreign markets. This vision is based on the strategic role of intangible resources and learning: a firm's transition from a limited exploration of international markets to a high degree of international commitment depends on the acquisition of resources (Kuivalainen et al. 2012, p. 448). International experience has a great influence on the decisions of the entry mode. At the beginning of the internationalization process, companies do not have enough experience and perceive high uncertainty. They overestimate the risks, underestimate the returns and avoid significantly using the resources in the destination country (Anderson and Gatignon 1986); on the contrary, previous experience on foreign market reduces the perception of risks and increases the conviction to overcome obstacles related to host countries (Wrona and Piotr Trapeczynski 2012).

While not applicable to international new ventures (INVs) and born global firms (BGFs), this approach is particularly effective to explain the step-by-step internationalization process of more traditional SMEs: while export does not require any kind of international investment, as the goods are not produced in the country of destination, foreign direct investments require a huge amount of resources. The decision to set up a wholly owned subsidiary provides the benefits of the full control of local activities (Kuo et al. 2012) and full freedom of decision, without having to worry about any potential partners and opportunistic behavior. However, it implies a higher degree of risk and of investment, which are not always affordable for SMEs (Hennart 2000). Cooperative entry modes offer a good alternative: the establishment of joint ventures with foreign partners can facilitate the transfer of knowledge to local partners and reduce administrative costs (Teece 1981). However, the choice of joint venture is not without risk. Foreign partners can behave opportunistically if they get the chance (Hennart 2000), since human beings are subject to bounded rationality and acquiring enough information to predict the behavior and to avoid the potential for opportunism is very difficult. Consequently, the decision to establish a joint venture entails, *ex ante*, high costs for the selection of a suitable partner, the drafting of a contract that sets out the terms of the agreement and ex-post adaptation, cost control and monitoring.

Market commitment does not refer just to the international experience. On the contrary, it depends on many factors. First, the kind of investment impact on the internationalization of the capital structure: if firms decide to do large investments abroad, they will

be obliged to recourse to international financial markets and to international investors, facing higher levels of risks (Cerrato and Depperu 2011). Furthermore, market commitment is affected by managers' previous international experiences and by their education as well. As Chetty Campbell-Hunt notes (2003, p. 801): "in order to attain international success a firm has to not only have the appropriate product and strategy but its decision makers must have the appropriate attitudes as well".

Finally, and most importantly, for SMEs, market commitment depends on the internationalization of the SMEs's business networks and by the relationships that exist with foreign partners. It is a key component of the international profile of the company that can affect the range of opportunities a firm can access and the resources and competences it can leverage in its international activities (Johanson and Mattsson 1988). A small firm that wants to expand abroad will not ignore the relations with the host market economic players, which will represent a source of strategic resources, especially informative. Anand and Delios (1997) suggest that in foreign markets, firms face barriers to knowledge transfer and that cooperative entry modes can help in reducing the socio-cultural barriers and the costs of knowledge transfer (Wang and Schaan 2008).

#### **4. A Framework Explaining Entry Mode Strategies**

As every strategy, internationalization is the result of both internal and external analysis. The factor of institutional environment refers to the external dimensions, while the factor of market commitment refers to the internal dimension. The simultaneous consideration of these two factors allows us to consider both the internal and external factors that affect entry choices decisions. When companies internationalize, they choose between several options: they can cooperate with local partners or start their own businesses, they can decide to do it through green-field investment or by acquiring existing businesses. These three options present the company with a tough strategic choice, since it cannot be changed in a short time and it requires huge commitment resources (Kogut and Singh 1988).

Uncertainty on the foreign market influences the decisions of managers, and, according to the institutional and resource-based approach, firms prefer entering foreign markets through a wholly owned subsidiary when the host country and the country of origin are culturally and institutionally similar (Makino and Neupert 2000). In addition, Meyer et al. (2009) found that companies prefer to form a joint venture or acquire a local company rather than greenfield investments (when the need of local resources is strong) in order to improve competitiveness.

Uncertainty and resources are key elements of entry choices, and in transition economies, foreign investors have to think about alternative ways of entry rather than con-

ventional ones, because the institutional framework of the host country could present obstacles or impose special forms of relationships with local actors.

Following these findings, we consider the difference between hostile and welcome contexts as one of the predictors of firms' entry choices. In addition, recalling what scholars find out about market commitment, we consider a low vs. high market commitment as the second predictor of entry choices.

Figure No. 1 synthesizes our model: institutional context is evaluated on the basis of five factors: (1) the extent to which local regulations influence the activities of foreign firms in the host country (the extent to which the state hinders the development of business); (2) state control (the extent to which the control exercised on companies distorts competition); (3) the restriction on investment (the extent to which investment in the economy are directed by the government); (4) the bureaucracy of the local government, protectionism, fiscal policy and (5) the cultural barrier meant as closeness toward outsiders and the unequal treatment of foreigners (the extent to which foreigners are treated unequally compared to local citizens, together with the cultural boundaries).

The second dimension, i.e., market commitment, is the result of two factors: 1) A possibly mimetic attitude, which would have prompted companies to adopt an entry mode rather than another because it has been successfully used in the experiences of other companies; 2) The focus on previous experience of the company analyzed, i.e., whether it had already consolidated experience in international markets.

<b>Market Commitmen</b>	High	<b>Joint Ventures - Partnerships</b> I	<b>FDI/ Wholly owned subsidiary</b> II
	Low	<b>Indirect Export</b> III	<b>Trade Internationalization</b> IV
		Hostile	Welcome
<b>Institutional Context</b>			

FIGURE No. 1. **Proposed Framework**

Based on the institutional literature, we distinguish the countries covered in the analysis into hostile and welcome ones. According to the collected information, we consider hostile countries to be those that are less open to foreign investments and have pretentious and very strict tax regimes. Considering the transitioning markets, these countries are generally high-context cultures, where the Western are perceived often as culturally distant, sometimes even as a threat (Calza et al. 2009; 2010; 2013). We consider them as welcome countries instead, as these are states where the tax regimes and the interfer-

ences of governments are mild, and where the authorities encourage and attract foreign investments by introducing of a number of exemptions and reducing state holdings. Culture does not represent a barrier, and the interaction with partners and local stakeholders is much easier, because cooperation with a foreign company is seen as more as an opportunity than a risk.

Concerning market commitment, a high market commitment means a general attitude by firms to invest resources in foreign markets. Firms with a high commitment will be inclined to preserve cooperation and to keep their presence in international markets (Gundlach et al. 1995). On the contrary, a low market commitment means the opposite attitude. It is typical of firms that pursue spot opportunities and internationalize for commercial objectives or to strengthen sales performance.

According to the proposed framework, we substantially hypothesize that where contexts are hostile and the commitment is low, firms try to limit the risks deriving from the high institutional uncertainty and the low experience, and the entry choice is expected to imply a low involvement of resources; that is why we hypothesize an inclination toward indirect export. On the contrary, if contexts are welcome, and the market commitment is high, we believe that firms are very experienced and possess a high inclination to persist in foreign markets which, from an institutional point of view, are low-risk. In this situation, we expect firms will choose a stable and long-term-oriented mode, such as foreign direct investment.

In addition to the two opposite situations, we have two intermediate cases. When contexts are hostile, but the commitment is high, we expect firms will have a strong intention to enter the markets because they see opportunities that are probably higher because of the experience they already have. The context is risky, and this can explain the choices of stable but less resource-intensive modes, such as partnership. Joint ventures are sometimes an obliged way because of the laws imposed by local Governments. Last but not least, when the commitment is low, but contexts are welcome, we suppose that firms will act in the host markets to consolidate their knowledge. They usually start from a trade opportunity and try to get a good position in the market, exploiting the facilities it presents.

## **5. Methodology**

This study is based on a qualitative approach employing the case study method. The case study research method is appropriate because it allows for the gathering of better knowledge and a deep understanding of a complex problem, since it considers social processes and knowledge regarding managerial complexity as they occur in practice. The choice of a qualitative approach is strongly related to the topic of entry modes in transitioning markets: it is a field of research that reached multiple and unclear results, and a qualitative research could be useful because it adopts an interpretative approach to the problem,

allowing scholars to understand the dynamics and the real causes of particular phenomena (Denzin and Lincoln 1994). More recently, Gephart (2004) has emphasized the importance of qualitative research, showing how able it is in providing insights and ideas that quantitative research can hardly provide. According to Eisenhardt (1989), we have reviewed the contributions on the topic and have chosen the methodology (Miles and Huberman 1984) that best fits our aim, which is to answer two main questions related to the significant changes in the healthcare industry (Yin 2009).

The study develops an illustrative case study by employing secondary data collected from documentation and archival records contained in official websites, company reports and articles from professional magazines and journals. Both official reports and professional and scientific documents were considered.

The companies analyzed in this illustrative multiple case study are Forall Confezioni S.p.a., Tex – Moda, Carthusia, Ferrero Legno. All these companies are operating in international markets, realizing different strategic choices because they are characterized by a significant heterogeneity in terms of experience, knowledge and resources.

## **6. Research Design**

The aim of the study requires the observation and examination of several aspects, such as the comprehension of internationalization processes, the adoption of specific strategic choices, the degree of company commitment in the internationalization process and the way institutional characteristics can influence the strategic choices of firms.

To better describe cases, we utilized the following steps.

First, we proceeded to case selection conducted by the following several criteria. We selected small and medium Italian enterprises that have expanded or are expanding in transitioning or emerging markets; second, we decided to choose firms from different sectors in order to observe the differences between behaviors. Finally, the selected cases had to be representative and had to be significantly heterogenous in terms of strategy, international experience, international markets knowledge and internationalization degree.

The next step involved data collection. Archival documentation was the main source of data used in the research. Studies, reports, meetings and conference documentation, proposals, newspaper articles and books were reviewed and analyzed. Unfortunately, we were able to interview only one of the cases analyzed. It was an semistructured interview conducted through email. The use of in-depth, email interviewing is rapidly increasing, as it is possible to find in recent literature. The entrepreneur was contacted by email and the questions were included in one letter, together with the interview guide. The answer arrived in a period of two weeks, and so the collected primary data were completed with secondary ones.

The influence of the institutional context was evaluated in terms of the extent to which local regulatory and cultural forces affect the activities of foreign companies in a host country; as market commitment, we evaluated a possible mimetic attitude, which would drive companies to adopt a mode that has been already successful in the past experiences of other companies or the company itself.

The collected data are presented and analyzed in the following section.

## **7. Case Study Analysis**

### ***Forall Confezioni S.p.a.***

The company was established in 1970 in order to reproduce, on the industrial level, high-quality handmade clothes for men. Currently, the group Forall, whose leading brand is PAL ZILERI, has an average production of 1 500 daily units, including jackets and classic trousers, and about 3 000 shirts, knitwear and accessories. Today, Forall distribution covers all major markets in the world, with its showrooms in major international cities.

In the early nineties, the first contacts with the Chinese market were developed through direct requests of importers from Hong Kong, allowing the company to acquire experience and gather information on the local market; furthermore, it favored the assessment of further steps to develop the sales in China. The company mainly wanted to develop branding knowledge by opening shops through the system of the franchising, working by an agreement with a big local operator and establishing trade relations with private operators in Shanghai, Macau and South China (Confindustria Report 2008).

Thanks to the information and the experience that the company received in this early stage, Forall plans to begin to work in a direct way and constitute a joint venture for the production brand *Marco Azzali*, which is a Chinese production operating on an Italian license, in order to commercialize it in Chinese and other international markets, Europe excluded. After a few years of activity, the Chinese market is able to generate a revenue of more than 5 million Euro, accounting for nearly 4% of the company's turnover, while the joint venture with the brand *Marco Azzali* has a turnover of about 5 million euro, with 40 one-brand stores.

With regards to the implementation of the strategy for PAL ZILERI, commercial development has been managed with a series of alliances, starting from proposals that also arise from actors operating in other industries. Aware of the complexity of the Chinese distribution system, the company has been willing to evaluate several proposals, even within a framework able to establish the brand's values, thus avoiding the extreme dependence on local large distributors.

This open and aware approach to the need to integrate forces and skills is even more evident in the case of the start-up of the Marco Azzali brand, which combines FORALL

with an operator with strong know-how in the textile industry and an important company with distribution capabilities and liquidity.

If the first agreements are aimed at acquiring direct information on the purchasing behavior of local consumers, then the agreement with a large public operator and with some local private entrepreneurs sets out a better structuring of the policy towards the Chinese market. In this context FORALL adopted franchising as entry mode able to allow the firm to get a better control of the distribution chain, also encouraged by setting a strong and clear brand image and by the control over the design and the provision of single branding shops.

The training of shop staff completed the policy aimed at making the image of the PAL ZILERI brand “global” and tended to limit the risks associated with the effective implementation of the standards defined by the franchisor.

The franchising agreement, by dividing costs and risks with respect to a structure of its own, promoted the implementation of a flow of information relating to the consumer and his purchasing behavior.

The degree of internationalization is higher for the venture connected to Marco Azza-  
li. Here FORALL offers its collections design know-how, fashion anticipation, market-  
ing and process control for the launch of the new brand, i.e., knowledge not always  
codified but rather incorporated and not immediately transferable. However, it is a brand  
positioned on a different market segment as compared to PAL ZILERI. In this sense,  
the initiative is grafted into the company strategy of not remaining anchored only to an  
exclusive niche of the international clothing market. It does so through a mixed com-  
pany, because the partners are able to provide complementary resources that generate  
undoubted value and new knowledge.

Much of the success of this experience is related to many aspects. The Chinese in  
particular are attracted by the “Made in Italy” brand and the access to Italian products;  
furthermore, from an efficiency point of view, Chinese workers tend to quickly learn  
how to conduct operations.

On the contrary, there have been and are many difficulties and obstacles. Further-  
more, local support is necessary to generate adequate sales and to address the bureau-  
cratic and administrative issues; language is still a relevant obstacle for communication.

There is no doubt that in the recent years, the WFOEs are becoming a tool more  
preferred by foreign investors, because they allow the company to manage the foreign  
investments in China with more immediacy and to import their managerial culture. Nev-  
ertheless, it is also true that the equity joint ventures are often the only choice for the  
foreign investor. This is also because foreign investment in China must respect the cri-  
teria and guidelines of the Foreign Investment Industrial Guidance Catalogue (Intesa San

Paolo Dossier). Those entrepreneurs who have already approached China know that this “Catalogue,” depending on the commodity sector, distinguishes between investments encouraged, banned and limited. For the latter, the Investment Catalogue requires from foreign investors, among other limitations, the obligation to operate through a joint venture with a Chinese partner and the prohibition for the foreign firm to own majority stakes in the joint venture thus formed.

### ***Tex – Moda***

Tex – Moda<sup>1</sup> was founded in Italy in 1970 by Dino Villi, who, after having learned the art of hand sewing and acquiring leadership skills at one of the most important fashion houses, decided to set up one of his own and establish himself as a tailor of suits.

Until 1980, the tailor has created all suits by himself, but later, because of the high volume of requests, he hired four workers.

In 1983, Stefano Villi joined the organization, and he introduced innovative techniques measuring chain analysis in the chain of production.

Thanks to these techniques, the production passed from a daily average of 60 units to 320 units, increasing the number of workers from 18 to 90. This has enabled a relevant reduction of production costs through the exploitation of scale economies allowing the company to offer more competitive prices and increasing the market share.

In 1993, the company began to think about the outsourcing of production in order to maintain its competitiveness in the sector, avoiding any reducing of the quality of its products. In the same period, emerging economies began to rise, thanks to the lower price of some products, while there was an increase in labor and production costs in Italy.

The choice of relocation involved the transfer of the entire productive process directly to Tunisia, maintaining the original organization and Italian technical staff unaltered in order to keep its Italian identity.

The decision was a consequence of both the growing competitiveness in the textile industry and of the increasing cost of labor and other productive inputs, but also for the strong pressure exerted by the major customers of the company, who wanted a foreign delocalization to have lower prices. This decision has been extremely profitable, because from 1993 onward, Tex – Moda continued the internationalization process, beginning to get the French and Spanish market within two years, in fact, the number of employees has increased significantly as well as production (1 000 jackets and 1 000 trousers per day).

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<sup>1</sup> This case study has been developed thanks to the cooperation of the students of International Management, namely Mrs. Camerlingo Rosa, Mrs. Ciaglia Tiziana, Mrs. Di Rosa Raffaella and Mr. Marra Vincenzo, who helped in collecting the data, organizing the interviews and elaborating on the information.

The internationalization of production was carried out as a Greenfield FDI by implementing the production in a new factory. First, delocalization involved the decision to close the four Italian companies given that the whole process, from order acquisition to export, would be run directly from Tunisia. The new company had been organized in such a way as to be a copy of the one present in Italy, with the same production model and management. The technical and organizational staff was Italian, so as to incur the costs of a Tunisian company and to retain the Italian quality and know-how. The choice of the country was the result of careful analysis focused on the study of the socioeconomics of four main areas: Ukraine, Tunisia, Romania and Bulgaria.

The evaluations were carried out through several trips by the entrepreneur in the aforementioned countries in order to directly examine each of them. On an industrial level, evaluated were the manufacturing quality, the level of labor specialization and the related costs of the inputs, the presence of other foreign companies in the sector, the existence and level of competition, the distance of the country from the country of origin. The evaluation also included an analysis of the regulatory and political framework of the country. Particular attention was paid to political stability and economic law, tax laws on foreign investments, the presence of fundamental quality services, such as schools, hospitals and other several infrastructures, the degree of crime and, more generally, the serenity in the way of life, since the whole family of the entrepreneur would have moved to the new country.

At the end of the cognitive investigations, the chosen destination country was Tunisia, for its proximity to the country of origin, the medium-high quality of the product, lower costs of inputs and, above all, it was considered to be a welcome, socially and politically stable country, with the presence of a substantial Italian community established in the territory, with appropriate infrastructure and services.

The favorable economic and regulatory framework was very important for the choice being made as well as the sociocultural conditions were particularly decisive in the choices of internationalization.

Therefore, Tunisia represents a welcome context: the Tunisian government is promoting foreign investment, making considerable efforts to reach a position considered to be “perfect” in the eyes of exporters and investors. Furthermore, there has been and there is a strong cooperation with Italian firms even because of the strong industrial similarities, with increasing opportunities for Italian firms to locate their production in the country. The transition of production from Italy to Tunisia has been one of the most critical stages of the internationalization of the Tex-Moda company: during the period of short settling to start over production, a particular problem was represented by the importation of an Italian production system in a country where staff and labor employees are not particularly specialized. In fact, the greatest difficulty laid in not being able to identify suitable and qualified staff.

## ***Carthusia***

Carthusia is an old and small firm based in Southern Italy, working in the perfume industry. It was founded in 1948, on the island of Capri by the Prior of the Charterhouse, who found the old perfume formulae and revealed them to a chemist from Piemonte in the Northern Italy, creating the smallest perfume laboratory in the world. The firm, thanks to a deep restyling and an innovative and strategic policy, has managed to become an industry leader not only in the whole south of Italy, but also to position itself as a cutting-edge brand in foreign markets. The idea is to create the first chain of artistic perfumery, selective Italian, to export the smells and the colours of Capri Island. Through exports, the firm was able to sell in foreign markets, such as Russia and certain Eastern countries, promoting a brand recognizable around the world.

The firm has begun to sell in Saudi Arabia only in the recent years: the export situation has just begun and it is too early to evaluate performance. The firm avails itself on a distributor located in Dubai. The choice of the distributor carries out logistic tasks (the firm ships to a warehouse and the trader ships them to different countries), and, at the same time, it is a necessity, since it allows performing quick registration practices of the products. In fact, regarding relations with European Union, certain difficulties remain that prevent the adoption of an FTA from the EU-Gulf Cooperation Council (GCC). The six Gulf monarchies, while opposing the inclusion of a clause on respect for human rights desired by Brussels, maintain a position of closing on European demand to reduce export duties. Furthermore, there are increasingly recurrent cases of non-tariff barriers on goods entering the country (InfoMercati Esteri, Saudi Arabia 2015). To the contrary, a Saudi trader who imports goods, equipment, machinery and products for a use limited to the exercise of his business is not required to have the certification of Saudi standards, as upon presentation of the relevant contract one is to demonstrate only the adequacy of the quantity imported and the amount specified in the contract.

From a sociocultural perspective, Saudi Arabia is an absolute monarchy, with a political and institutional system based on Islamic religious law (Sharia) and on a conservative interpretation of Islam (Wahhabi). The chronic immobility of the political system, the uncertainties related to the succession to the throne and high unemployment are the main challenges for the long-term stability of the country. Businessmen in Saudi Arabia should be prepared to adhere to Islamic laws and practices – even if they are not Muslims. Most important are the moments of prayer, in which all activities will stop, and a set of social rules, dietary codes and clothing requirements that will all have to be met.

CARTHUSIA has been conducting a gradual internationalization strategy as the larger part of SMEs. The firm has penetrated a foreign market through a commercial internationalization, and this was done because of the lower experience and knowledge as well

as more limited resources as compared to large firms. Moreover, the firm implements such a strategy through a direct channel in familiar markets and through an indirect channel in the distant and unfamiliar markets.

### ***Ferrero Legno***

Ferrero Legno is an Italian company specialized in wood products. The name of the company actually refers to the original family name and to the passion for wood, which are the two key elements of its identity. The company has its headquarters in Magliano Alpi, in Piedmont, where the Ferrero family started an artisan lab that designed cutting-edge doors, which has gradually transformed into a manufacturing factory.

Ferrero Legno emphasize Italian design as a key element of its competitive advantage, which is also based on continuous innovation aimed at sustainable production. FerreroLegno doors feature a core originating from forests managed in a sustainable way. Panels ensure minimum levels of formaldehyde emission, and almost every product is lacquered and painted with water-based paints. Last but not least, the factory takes energy from a photovoltaic system. Ferrero Legno has gradually opened to international markets, looking for partners who could help the company to present itself and sell its products abroad. Italian furniture is appreciated in the MENA area, and, on the grounds of a necessity to enlarge its market, Ferrero Legno has started to export in Tunisia. Tunisia represents a welcome context: laws allow the commercialization of foreign products, and Italian brands are very appreciated by local customers. The cooperation with Italian firms is well-established and, even from the point of view of industrial specialization, there are many similarities between Italy and Tunisia, with increasing opportunities for Italian firms to delocalize in the country.

Ferrero Legno is not inclined to foreign direct investment. Production is based on the “Made in Italy” value, and commercial activities are managed trying to reduce the risks of uncertainty. That is why, in order to exploit the opportunities arising in Tunisia, without investing too much, Ferrero Legno has exploited the opportunity of a trade partnership with Fino, a trading company specialized in the importation of fine furniture. Fino started its activity in 1935 in Malta, and today, with over 450 square metres of display area, it offers a perfect showplace for fine Italian furniture brands, such as Veneta Cucine, Foster, Ditre Italia, Santa Lucia, Ferrero Legno doors and office furniture by Della Valentina Office and Emmegi.

## **8. Discussion of Results and Limitations of the Study**

Taking up the framework and applying it to the analyzed business cases, the different behaviors can be summarized as follows:

<b>Market Commitmen</b>	High	Joint Ventures - Partnerships I <b>Forall Confezioni SpA China</b>	FDI/ Wholly owned subsidiary II <b>TEX-MODA Tunisia</b>
	Low	Indirect Export III <b>(Carthusia Saudi Arabia)</b>	Trade Internationalization IV <b>(Ferrero Legno Tunisia)</b>
		Hostile	Welcome
<b>Institutional Context</b>			

FIGURE No. 2. Entry choices internationalized firms

In the first square, there are situations where companies show a high commitment to international markets, and they have formed alliances in countries that have a lower acceptance of foreign investment, operating in hostile cultural and institutional contexts. Therefore, the quadrant match Forall Confezioni Spa, because of the difficulties and obstacles linked to the cultural differences, the bureaucratic and administrative issues and the language. Furthermore, the equity joint venture allows the company to overcome the institutional obstacles, linked to the criteria and guidelines of the Foreign Investment Industrial Guidance.

In the second square, there are situations where companies experience positive performance related to a leadership position in the international markets in countries that have a larger acceptance of foreigner and in general of diversity. For this reason, the quadrant match Tex – Moda Tunisi. The firm does not find any problems in the interaction with partners and local stakeholders: while having a different cultural background, compared to their neighbors, they show a greater degree of openness toward foreign investments, which are not seen as a threat, but as a resource to be exploited.

The third square represents instead those companies that due to the lack of adequate resources, even because of the limited size, are not able to choice a challenging entry mode, such as FDI or JV, and have to use the local distributor in order to overcome legal and cultural obstacles. In fact, the company examined, Carthusia, chooses a local distributor above all to overcome the high level of bureaucracy due to the long and heavy registration practices of the products. Furthermore, according to the entrepreneur, the lack of experience and international markets knowledge, as well as the limited resources, have driven the company to opt toward trading companies as a less risky choice.

Finally, in the fourth square, we find companies like Ferrero Legno, which could commit resources and use a consolidated knowledge of international market, but because of the limited knowledge and the perception of uncertainty, they prefer to use a trade entry mode in order to increase sales. In addition, to reach these goals, they prefer to enter the market with a high market potential, where it is not difficult doing business thanks to the openness of regulatory and cultural systems.

Our paper gives an insight into the entry choices of international firms, considering the institutional contexts of the host market and the market commitment of international firms. The idea is that when contexts are welcome (such as in Tunisia), firms can employ more complex entry modes, invest more resources and direct themselves toward a more stable presence in the market. However, the degree of involvement also depends on the experience and inclination of the firm (market commitment), which will prefer foreign direct investments when the commitment is higher, and partnerships or commercial internationalization when the commitment is low. On the contrary, when markets are hostile (such as in Saudi Arabia or China), firms will choose less risky entry modes and invest fewer resources. In particular, firms often hesitate because of the high costs and high degree of bureaucracy of registration processes, the application of different standards that can lead to entry delays. Furthermore, firms face many problems related to the lack of transparency, the volatility of the legal framework and the higher cultural distance, which can all increase the difficulty in managing foreign operations. In those situations, when the commitment is high, firms can decide to internationalize production or other core activities, but they will prefer to cooperate with local partners in order to reduce risks. When the market is hostile and the company has a low level of commitment, internationalization will probably be temporary or at least will involve a minimum of resources, such as for indirect export. This happens even when the commitment is high, and in this case, the choice is probably dependent on the kind of barriers existing in the market.

While interesting and confirmed by several case studies, our framework suffers from some limitations. First, measuring market commitment is not easy. It is a complex construct, which can be interpreted in different ways. Second, the institutional context seems to have a higher influence than market commitment, and this will be explored in the future. The choice of partnership can be, for example, a direct effect of rules and restrictions existing in the host market, and the same can be for indirect export. Last but not least, the analysis is mostly based on a desk analysis of secondary data, and this can lead to misinterpretations. Interviews will be improved in the future provide deeper insights into the cases.

## 9. Conclusions

What determines market entry choices into transitioning countries? Our answer is, on the one hand, that institutions directly influence such entry choices, and, on the other hand, that this effect is also determined by the entrant's commitment in international markets. Our theoretical framework shows that this interaction derives from the simultaneous influence of internal and external firms' characteristics on that strategic choice, in particular on foreign entrants' financial resources as well as international markets knowledge and experience – the commitment of tangible and intangible resources.

According to our analysis, the international entry strategy is a complex plan and it involves goals, resources and policies that will influence firms' international activities. A firm's entry strategy is the whole of several market plans strongly influenced by decisions based on the criteria of institutional distance and the firms' market commitment. There exist two main aspects that influence the companies' international entry choices: external and internal factors.

The external factors influencing the international entry choice include sociocultural influences and political and legal influences, such as political stability, trade barriers and the general attitudes toward foreigners in the host country.

The internal factors include the international commitment of firms, which depends on skills, resources, firms' management abilities, flexibility and commitment as well as the motivations and qualifications of the staff employed.

Firms' international entry choice, in our case study, have been primarily influenced by the following institutional factors: sociocultural influences, such as psychological and cultural distance and similarities, and political and legal influences, such as laws and regulations as well governments' attitudes toward foreign investment.

Concerning the influence of internal factors in our case study, the international entry choices of firms have been primarily influenced by the following factors: their commitment depending on the skill and resources as well as on international market knowledge and previous experience.

Our case study shows that each and every company and their situation should be studied individually in order to identify the main external and internal factors that influence the company's international market selection. In fact, this has been a point in support of conducting an in-depth case study.

In conclusions, firms select entry modes that fit the institutional environment according to their international experience, their markets knowledge and their financial power.

This is evident in emerging economies, where foreign firms have to conform to host country conditions, committing a large amount of resources and where weak institutional frameworks could frustrate the internationalization process.

The classification of foreign entry modes is complicated and it requires to take into consideration all the relevant criteria. Firms can choose to export to neighboring countries because of market similarities, which would reduce risks. When host market regulations and standards require significant adaptation, firms can also establish local production. In other cases, local governments can also promote local production and can therefore give advantages to firms who choose to make direct investments; in other cases, equity joint ventures are strictly required to overcome institutional barriers. Different types of entry modes provide different types of risks, control and flexibility. Entry modes with a high involvement on the foreign market – like direct investment – provides high control but high costs and risks as well. Entry modes with low resource commitment, like direct exporting, provide low costs but low control, too.

According to the four empirical cases of evidence analyzed in this study, empirically small firms act as suggested by the literature and consider both the factors analyzed in the model and those which strongly affects their decisions. Consequently, the following message emerges: an establishment of wholly owned subsidiaries is preferred in institutionally strong countries by a firm with international experience and market knowledge, as it happened for Tex – Moda in Tunisia, a country showing a positive attitude toward foreign investments. In different circumstances, firms should opt for trade internationalization. In particular, firms could choose indirect exports, as it occurs for Carthusia, in institutionally weak countries, where foreign products have to overcome specific and strict standards, except if they are traded by local sellers; on the other hand, direct export could be preferred, as in the case of Ferrero Legno, where there are no institutional barriers or obstacles, but greenfield investments would become too expensive and risky. Finally, firms should opt for cooperative entry modes, partnership and/or joint ventures, as in the case of Forall Confezioni, where they are able to commit resources, international markets knowledge or experience, but the institutional context sets barriers and obstacles that a partnership can more easily to overcome

This study contributes to the previous literature in several ways. First of all, previous studies start from the analysis of firm-specific factors to explain entry mode choices, while few contributions examine host country factors; this aspect becomes particularly important when firms enter emerging economies whose contextual characteristics are as important as the firm-specific factors that could have direct impact on entry mode decisions.

Second, the literature about SMEs' entry choices is characterized by theoretical paucity. Our study tries to fill this gap by avoiding using the same argumentations for small and medium firms as those used for larger firms but by referring to the key characteristics of SMEs, such as the lack of knowledge about international markets, that could be a critical factor influencing the choice of a foreign market entry mode (Johanson & Vahlne 1977).

In addition to the theoretical contribution, this paper has some important practical implications. From a managerial perspective, firms that aim to expand internationally should recruit managers with previous experience, because the perception of risks and decisions about international commitment depend on them and on their awareness. In addition, firms should be careful in observing the legal, social and cultural context of the host country, because these can strongly influence the degree of risks, costs and opportunities related to the mode of entry in the host country.

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