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Disentangling Resource and Mode Escalation in the Context of Emerging Markets. Evidence from a Sample of Manufacturing SMEs

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When establishing presence in foreign markets, smaller firms (SMEs) typically follow a gradual approach to internationalization. They initially enter markets through low-commitment modes (e.g. indirect exports) and after some time, by drawing on market experience, gradually increase investment to medium and high commitment modes (such as joint ventures and other foreign direct investment or FDI modes). But how do Western SMEs approach fast-growing emerging markets? To what extent do they have to adapt and revise modes of operation into these markets? A research using a sample of 197 foreign market activities (foreign operations) initiated by eighty-nine Italian exporting SMEs, operating across four sectors (Food, Furniture, Mechanics/Machinery, and Textile/Clothing) sets up to examine these questions.

The internationalization strategy of smaller firms is characterized by "trial and error" adaptations to strategy and minor incremental investments, often interrupted by sudden de-commitment or exit moves. In emerging markets in particular, SMEs appear to be subject to the disadvantages of institutional voids that are peculiar to these markets. Often SMEs lack the full support of governmental policies and safeguards (such as credit insurance). When operating in EMs SMEs appear to be stuck in a precarious position, where they are prevented from investing the resources necessary for developing sustainable competitive advantage whilst still actively searching for local growth opportunities. As a consequence, the range of strategic options available to SMEs in emerging markets include the changes in mode of presence, starting from indirect export and gradually moving to direct export, strategic alliance and franchising, joint ventures and foreign direct investment (FDI) and/or (de-)commitment of (additional) resources within the initial market entry mode (e.g., additional marketing investments, more dedicated personnel to specific foreign markets, etc.). However, because of institutional voids and resulting shortcomings within local institutions, such as labor market legislation, logistics infrastructure, intellectual property rights protection, market systems (including sales and distribution networks), administration and corruption control, foreign investors incur additional costs related to interfaces with the government sectors such as obtaining permits and getting goods through customs, suffer from information asymmetries when dealing with local market players or from unforeseen contracting costs due to high law enforcement costs.

The study results show that institutional voids discourage SMEs from escalating market presence. However, the effects are different for the means of escalation—through changing the mode of operation or simply committing more resources to a given foreign market. The study finds that SMEs' past performance in the focal market and market experience both moderate the negative impact of institutional voids on market presence escalation but in different ways. Specifically, focal market experience positively moderates the negative effects of institutional voids on mode escalation while past performance positively moderates the negative effects of institutional voids on resource escalation. In particular, well performing SMEs behave in a more a cautious manner when they escalate presence under institutional voids because they do so through increasing resource commitment rather than mode escalation. Yet, experienced SMEs behave in a more risky fashion when they escalate market presence under institutional voids as they do so through mode escalation. In a way, experienced SMEs behave similarly to larger multinational firms (MNEs) by choosing to escalate presence by changing their mode of operation (which is far more risky and resource intensive manner of escalating market presence). Underperforming SMEs faced with high institutional voids cautiously opted for resource commitment increases as an attempt to overcome the negative impact of institutional voids. Perhaps SMEs in emerging markets are opportunistic and believe that escalating resource commitment can mitigate the negative impact of institutional voids with a view to improve performance. On the other side, SMEs with strong past performance under substantial institutional voids seem to opt for more conservative approaches choosing resource de-escalation perhaps as a means to consolidate their past and current gains and lower future risk exposure.

*Original paper

Akbar, Y., Balboni, B., Bortoluzzi, G., Dikova, D., & Tracogna, A. (2018). Disentangling resource and mode escalation in the context of emerging markets. Evidence from a sample of manufacturing SMEs. Journal of International Management, 1-14.