FOREIGN ENTRY STRATEGIES: STRATEGIC ADAPTATION TO VARIOUS FACETS OF THE INSTITUTIONAL ENVIRONMENT

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ABSTRACT

In this paper we develop a comprehensive model of MNEs' foreign entry strategies and theorize how and how much the entry strategy is likely to be determined in the interface between internal and external pressures for both conformity and legitimacy. We develop an adaptation argument, in contrast to a selection rationale, through which we enhance our understanding of the various facets of the institutional environment and the constraints international managers encounter in their internationalization strategies.

Keywords: foreign entry strategies, adaptation, multinational firms, institutional environments

INTRODUCTION

Despite abundant research on entry strategies in International Business (IB) studies, scholars have paid scant attention to the social context within which entry strategies into foreign markets are embedded (Granovetter, 1985). In fact, few studies have contrasted economic and social explanations for entry mode strategy choices. For example, it is unclear how different entry mode strategies reflect the internal, inter-firm, and external environment pressures. It is accepted, however, that the models of interaction between firms and their institutional environments determine firms' adjustment to external constraints and may promote firms' survival, even if the external environments are unknown and cannot be accurately predicted. In the case of multinational enterprises (MNEs), the difficulties are heightened because MNEs are exposed to multiple and distinctly complex foreign business environments (Guisinger, 2001). Guisinger (2000), for example, suggested that the essence of International Business (IB) is the adaptations that firms must undertake when they face unfamiliar, unstable, and complex surroundings in foreign countries. But how do MNEs adapt? To adapt, survive, and grow, MNEs need to respond effectively to internal institutional pressures as well as to the demands imposed by external environments (DiMaggio & Powell, 1983; Kostova & Roth, 2002; Scott, 2003). Hence, each subsidiary must strategically adapt to the various dimensions of the host country's institutional environment (e.g., regulatory, legal, economic, technological, cultural), to the patterns of inter-firm interaction (e.g., industry regulations, cultural norms, anti-trust laws, industry associations) as well as to MNEs' internal norms. As noted by Oliver (1997: 697):

> Firm's institutional environment includes its internal culture as well as broader influences from the state, society, and interfirm relations that define socially acceptable economic behavior.

In this paper we assess the impact of the multiple facets of MNEs' institutional environments (i.e., internal and external) on the selection of foreign entry strategies (see also Davis, Desai & Francis, 2000). We follow recent research suggesting that firms make choices that are influenced by their environments (see also D'Aunno, Sutton & Price, 1991), including other firms operating in the same industry or in the same host market; firms then formulate a strategic response to their environmental conditions (Oliver, 1991). When analyzing external institutional pressures we distinguish two contexts - i.e., home and host country, and inter-firm interfaces. External institutional pressures include regulatory structures, governmental agencies, laws, courts, professions, interest groups, public opinion (Scott, 2003), culture, and economy. Each new subsidiary's set of rules, procedures, practices, norms, values, and structures require legitimacy in light of the host country’s institutional environment. Inter-firm interfaces represent practices of rivalry and imitation whereby firms choose to follow strategies implemented by other firms. Internal institutional pressures apply to the analysis of MNEs' subsidiaries, and refer to conformity pressures from headquarters and other subsidiaries. For example, the structure and internal processes of a new subsidiary need to adapted, or already be similar, to those of other subsidiaries of the same parent MNE in order for the new subsidiary to be considered a complete member of the corporation. The sense of membership, or identification, is fundamental if the new subsidiary is to receive resource inflows from its sisters and headquarters. Therefore, we develop an adaptation, rather than a selection, argument of MNEs' adjustment to the foreign institutional environments to analyze MNEs foreign entry strategy. While traditional selection arguments leave few possibilities for firms' strategic choices, a strategic adaptation rationale is based on how these choices permit overcoming an otherwise overly restrictive and limiting environment.

Furthermore, although we take a strategic perspective, we also acknowledge that strategy is formulated within agents' bounded rationality (Simon, 1957), decision-making, and the direct influence of surrounding agents [i.e., their actions, beliefs, and whom they use as referent others (Shah, 1998)]. Therefore, firms may seldom commit to a definite profit maximizing strategy (DiMaggio & Powell, 1983; Norman, 1988). That is, efficiency rationale or profit maximizing strategic choices may be disregarded in some cases; instead, MNEs may actually be constrained to choose among a more limited set of alternatives than we often realize. By simultaneously examining firms' entry strategies with both institutional and economic lenses, we can better analyze the effects of both *ex ante* and *ex post* institutional forces upon MNEs' entry strategies.

Our study contributes to current research by presenting a more comprehensive and multi-dimensional approach to firms' strategic adaptation to internal and external pressures, in contrast to existing studies that present too much of a piecemeal approach to be illustrative of the complexity involved. By recognizing that varied facets of the institutional environment affect MNEs' decisions differently, we offer a more in-depth analysis of each dimension. Furthermore, in line with recent research (e.g., Xu & Shenkar, 2002), we posit that institutional distance (Kostova, 1999; Kostova & Zaheer, 1999) between home and host countries matters, but possibly more important is the direction of this distance. We suggest, for example, that institutional distance is better conceptualized by considering the pool of prior foreign experiences of the MNEs, rather than merely the difference between home and host countries. Furthermore, while the extant research assumes the existence of a "model" for firms to imitate, we propose that referent models do not always exist; rather, firms are forced to rank order other market players in search of strategies to follow.

We first briefly summarize current research on foreign market entry strategies. In the second section, we review institutional theory as the theoretical foundation for our arguments. In the third section we develop propositions to address MNEs' entry strategies into foreign countries and explore the evolution of MNEs' responses to their environments, in an effort to uncover the rationale behind managers' choices of entry strategies. We also advance the moderating effects of MNEs' international experiences and technological strategies. We conclude with a discussion of much warranted future research.

MULTINATIONAL ENTERPRISES' FOREIGN ENTRY STRATEGIES

Foreign entry strategies have been extensively studied in IB research. Some studies have focused on the *antecedents* or predictors of entry mode choice, others on the *specific factors* that lead to equity investment as the preferred mode of entry, and yet others on the *consequences* of entry modes (see Werner, 2002). Given the focus of this paper, this section describes succinctly the main approaches to explain the *antecedents* of foreign entry strategies. We classify existing research on the antecedents of foreign entry strategies in three main approaches. First, earlier studies on internationalization emphasize the effects of international experience accumulation on the selection of investment location and entry mode (Johanson & Wiedershiem-Paul, 1975; Johanson & Vahlne, 1977, 1990; Cagusvil, 1980; Luostarinen & Welch, 1990; Root, 1994). These studies suggest an evolutionary, sequential, and largely deterministic model of internationalization that evolves with knowledge acquisition, risk perception, commitment of resources, and accumulation of international experience. These studies further prescribe that entry strategies follow a pattern of increasing involvement in foreign operations, from low involvement entry strategies (e.g., exports) to higher commitment strategies (e.g., foreign direct investment through greenfield investments and/or acquisitions).

Second, foreign entry strategies have been studied as the outcome of the internalization of market imperfections and the minimization of transaction costs by organizing exchanges within the MNE (Williamson, 1975, 1991; Rugman, 1981; Hennart, 1982; Dunning, 1988). According to these studies, the best foreign entry strategy minimizes transaction and production costs and overcomes market imperfections (Teece, 1986). The higher the market imperfection (e.g., imperfections in the market for knowledge) the more likely the MNE will internalize those markets and adopt, for example, greenfield entry strategies (Dunning, 1988).

Finally, a third approach to foreign entry strategies is rooted in a social network perspective. The network model of foreign entry strategy suggests that MNEs integrating networks with buyers, suppliers, and competitors have privileged access to markets (Johanson & Mattson, 1988; Ellis, 2000). Cooperating with other firms facilitates market entry, reduces risks and costs, and attenuates political and cultural constraints (Stinchcombe, 1965; Hannan & Freeman, 1989; Henisz, 2000).

These studies lay out the now well-understood main benefits and drawbacks of each entry strategy [see Root (1994) for an extensive review of entry strategies]. The different entry strategies are: exports, contractual agreements (such as licensing agreements), equity joint ventures, partial and wholly owned foreign acquisitions, and greenfield startup investments. Non-equity-based entry strategies offer better protection against country risks and transactional hazards than equity-based strategies (Osland & Cavusgil, 1996), but non-equity strategies, such as export and contractual agreements, enable less organizational learning. In fact, low commitment entry strategies may be preferred to overcome unfamiliarity with the host country environment (Barkema, Bell & Pennings, 1996). For example, the establishment of a subsidiary through the acquisition of a local firm permits fast access to foreign firms' knowledge (e.g., market or technological knowledge), and access to an already established market position. An acquisition also provides some degree of immediate embeddedness and allows the firm to enter a network of ties to suppliers, clients and agents in the host country. Joint ventures have also been noted as vehicles for learning since cooperation with a local partner provides the focal firm an opportunity to utilize the partner's local market knowledge (Tallman & Fladmoe-Lindquist, 2002) and social and business ties. In addition, joint ventures allow technological advancement through the transfer of technologies among partners. In contrast, contractual agreements (i.e., licensing, R&D contracts, alliances, etc.) often involve explicit descriptions of technologies intended to be learned by one party. Finally, a greenfield entry strategy essentially consists of the replication in a foreign target of home country operations. This strategy is based on full control over the foreign subsidiaries and pretty much an ethnocentric orientation whereby directives emanate from corporate headquarters. While this strategy is appropriate when seeking to protect proprietary resources and technologies it is also the one that imposes higher degrees of "foreignness" in the host market.

We analyze which alternative entry strategy the MNE is more likely to select as a function of institutional dimensions. The entry strategy decision is important due to the commitment of resources it entails (Agarwal & Ramaswamy, 1991), and the assumption of risk and readiness for political (Henisz, 2000), social, and cultural (Hofstede, 1980) challenges the firm will encounter. The entry strategy is also important because it represents the first interface for a strategic adaptation to both internal corporate conditions and to host country conditions.

MNEs' INSTITUTIONAL ENVIRONMENTS

Institutional theory typically focuses on the pressures exerted by external institutions on firms' strategies. External institutions may consist of regulatory structures, agencies, laws, courts, professions, interest groups, and public opinion (Oliver, 1991). To build legitimacy, organizations must comply with formal and informal rules, norms, behaviors, and ceremonies set forth by external institutions in the places where they operate (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Oliver, 1991; Kanter, 1997; Kostova & Zaheer, 1999). Hence, institutional theorists emphasizing the value of conformity to the external environment suggest that to survive and prosper, firms need to be similar, or isomorphic, to their environment and surrounding agents (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). Isomorphism through mimicry is a strategic choice whereby one firm in a population enhances its legitimacy (Suchman, 1995; Dacin, 1997), by resembling other incumbent firms facing the same set of environmental conditions (Hawley, 1968; Meyer & Rowan, 1977; DiMaggio & Powell, 1983). In fact, recent research primarily highlights legitimacy arguments and mimicking effects, with the latter operationalized as imitation of incumbent firms or market leaders (Haveman, 1993; DiMaggio & Powell, 1983). This argument is consistent with a growing body of IB research suggesting the efficacy of adaptation and responsiveness to the local market. Firms seek compliance, or adaptation, to the foreign business environment, not necessarily for efficiency, but rather to conform to the "taken-for-granted assumptions about what constitutes appropriate or acceptable economic behavior" (Oliver, 1997: 699). Similarly, MNEs may follow certain foreign entry strategies not because they are the most efficient or economically rational choices but due to host environment requirements (Oliver, 1997) that are socially obligatory (Zukin & DiMaggio, 1990). Alternatively, MNEs may mimic entry strategies chosen by leader firms, firms in the same industry, firms of similar size, or firms that appear particularly successful (Haveman, 1993). Hence, it is also important to observe competitors' foreign entry strategies to understand the strategies of individual firms.

Institutional pressures are not deterministic. Firms' strategies reflect the ability to respond, change, and influence (Oliver, 1991). While institutional theory has traditionally embodied the deterministic effect of institutional rules, ceremonies, myths, and beliefs on how organizations become instilled with value and social meaning, Oliver (1991) argues that firms develop through their strategic responses to institutional pressures. This view parallels Nelson and Winter's (1982) argument of intended strategy, which conceptualizes firms as active agents with the ability to mold their environment. The notion of intended strategy further claims that firms' strategies actually shape the model of adaptation to foreign environments, from which we infer that firms are not imprisoned in an isomorphic determinism (Oliver, 1991, 1997).

Firms adapt to the institutional environment through choosing a foreign entry strategy and a location. For example, Westney (1993:71) notes that "location is a key variable: Japanese firms tend to locate their plants in areas where the institutionalization of U.S. auto industry pattern is weak or non-existent." According to Westney these are areas where unionization is low, the labor force is unaccustomed to assembly line work, or high unemployment from plant closures de-institutionalized existing patterns (see also Shaver, 1998). Thus, in the case of the auto industry, adaptation is reflected in the selection of equity entry strategy and low institutionalized locations.

Foreign entry strategies face dual and potentially conflicting pressures toward compliance to internal norms (corporate normative) and toward adaptation to local environmental requirements (DiMaggio & Powell, 1983). The term “institutional duality” refers to two distinct sets of isomorphic pressures originating from the host country network and from the internal MNE network, and the corresponding need for foreign subsidiaries to hold legitimacy within both networks (Kostova & Roth, 2002). Internal pressures push the new foreign entry and the new subsidiary to resemble prior entries and/or other subsidiaries' structures and internal processes. This similarity will be crucial for resource transfers among subsidiaries. Internal pressures may include hiring expatriates, importing intermediate products instead of acquiring them locally, and partnering with host banks rather than home financial service firms. That is, internal pressures rest on taken-for-granted assumptions embedded in the firm's operations, which result from past experiences, power relations, inertia, common beliefs, and memories. Conversely, external pressures are embodied in formal, informal, and, to a great extent, in locally enacted norms of what is "right" and "wrong." For example, a firm may prefer establishing a subsidiary if the host country's citizens are averse to foreign firms (Root, 1994). Thus, a foreign entry strategy is legitimate insofar as it is perceived by relevant actors in the home or host environment as the "natural way" to enter. To some extent, by seeking local legitimacy, MNEs reduce a possible negative impact of foreignness (Hymer, 1976; Zaheer, 1995).

In sum, the basic idea of institutional theory is that firms tend to conform to the local prevailing "ways of doing things," organizing and behaving. These are based on social expectations and influences by which firms should abide to gain legitimacy and improve their capacity to survive and prosper. In contrast, strategic and international management theories seek to discover strategies that are most efficient for the firm, given internal and external constraints and objectives. Mere conformity to internal and external social pressures is in relative contrast to the optimization of firms' strategic choices.

STRATEGIC ADAPTATION TO VARIOUS FACETS OF INSTITUTIONAL ENVIRONMENTS

Although many studies have analyzed MNEs' foreign entry strategies, only a few have considered both economic factors and social contexts (Granovetter, 1985) to explain entry strategy choices. In Figure 1, we illustrate different facets of institutional environments and their impacts on entry strategy choices. In this section, we do not attempt to provide an entire repertoire of firms' strategic choices, but rather to highlight the dynamics involved when considering each institutional facet. First, while previous research has mainly focused on a simple government-level induced institution (Henisz, 2000, 2003), we consider more detailed macro-institutional factors of the home and host markets' environments as composed of social/cultural, political, legal/regulatory, economic, and technological dimensions. These dimensions interact among themselves and exist in both the home and host markets. Second, we see internal organizational pressures as important factors determining the entry strategy. Internal factors include the norms, values, power and politics, organizational culture, path dependent history and tradition, competencies, and resources of the firm (Nelson & Winter, 1982; Barney, 1991). Third, we stress inter-firm relationships. These are relationships with other home-, host-, or third-country firms (represented by the three circles on the right in Figure 1).

[Insert Figure 1 about here]

Given that MNEs are embedded in a system of inter-related economic and institutional pressures at different levels, it is not likely that any of these pressures will operate in isolation, nor that one will dominate MNEs' strategic choices (Granovetter, 1985; Dacin, 1997). In the following sections we explore how these different dimensions of an MNE's institutional environment may affect strategic choices regarding the selection of foreign market entry strategies. The major propositions advanced in this paper are illustrated in Figure 2.

[Insert Figure 2 about here]

The Institutional Environment of the Host Country & Foreign Entry Strategies

The characteristics of the institutional environment of the host country affect MNEs' entry strategies. A host country's institutional environment is composed of rules, norms, and traditions, some of which are explicitly stated or recorded, while others are not (Meyer & Rowan, 1977). In a well-developed institutional environment, collective sanctions exerted upon norm-violators are severe because the norms are widely accepted and there are effective institutions that either prevent violations or coercively enforce the prevailing norms. Such institutions are necessary for forming successful strategic alliances and joint ventures. Therefore, when the host country encompasses well-developed institutions that guarantee the enforceability of contracts and reduce transaction hazards and opportunism (Williamson, 1985; Meyer, 2001; Henisz, 2000), the MNE is more likely to favor collaborative entry strategies such as strategic alliances and joint ventures. Acquiring better knowledge about the local institutional environment can be realized by finding a local partner (e.g., constituting a joint venture with local partners) and/or by transforming local firms into subsidiaries (i.e., by acquiring an incumbent firm). Entering well-institutionalized markets through partnerships allows the MNE to establish bonds with local agents familiar with local norms, thus increasing the subsidiary's survival prospects. Similarly, an acquisition involves acquiring a firm already embedded in the market and already holding social and business ties to surrounding agents. Conversely, both exports and greenfield investment entry strategies involve bringing "foreignness" into the market, and are more likely to face opposition.

This assertion is interesting for IB research because it entails a significant contrast with the prevailing view of partnerships as inter-organizational models for sharing the hazards associated with unstable and high-risk countries (Henisz, 2000). However, it is consistent with the growth of alliances in Western countries (Dunning, 1995; UNCTAD, 2001), because Western countries are, predictably, more and better institutionalized than less developed countries. Hence, other variables held constant, MNEs are more likely to select collaborative entry strategies when the host market is highly institutionalized.

***Proposition 1a**. MNEs entering highly institutionalized foreign countries are more likely to select joint ventures and acquisitions entry strategies as opposed to export or greenfield entries.*

Decomposing the impact of the host country's institutional environment on entry strategies into normative, cognitive and regulative dimensions (e.g., Xu & Shenkar, 2002), we may expect that each dimension exerts an idiosyncratic influence on MNEs' entry strategies. The regulative aspects of institutional environments, such as rules and regulations, are clearly articulated and can be observed and followed; thus, gaining legitimacy is relatively straightforward, particularly in the presence of an effective regulatory environment. However, the normative and cognitive aspects of institutional environments, such as informal norms and standards, are considerably less perceptible to outsiders, and hence prove to be a more difficult adaptation. For instance, the importance of understanding cognitive norms and cultural idiosyncrasies is often highlighted in tips for "doing business" in Asian countries. In these countries the informal norms of gift offerings, hierarchies and an array of complex traditions are difficult for foreigners to grasp. Also, in Italy, particularly in the south, the "men of honor" tradition and complex social interactions among "families" demonstrate how informal norms construct the social structure of interactions that is challenging for foreign firms to comprehend. Informal norms are unwritten, are tacit, and contrast sharply with formal norms, imposed by the legal and judicial systems. In other instances, the sheer complexity of the governmental apparatus, such as the legal and judicial systems, increases the cognitive difficulties of operating in a foreign country. Notwithstanding, a violation of cognitive and/or normative norms may lead to results as fatal as the violation of legal rules (Xu & Shenkar, 2002). Hence, MNEs are more likely to rely on local partners to learn and incorporate these invisible rules.

The differentiation we build is between cognitive and normative dimensions on the one hand, and the regulative dimension on the other. While the first are implicit, largely tacit and difficult to codify and learn, the second involves explicit norms and regulations that firms must honor. Therefore, it is more necessary for MNEs to rely on local partners or collaborators to understand cognitive and normative dimensions than to understand the actions and implications of regulatory institutions.

Proposition 1b. *MNEs entering normatively and cognitively institutionalized foreign countries are more likely to select collaborative entry strategies such as joint ventures than when entering regulatively institutionalized foreign countries.*

Institutional Distance between Home and Host Countries & Foreign Entry Strategies

Another major driver of entry strategy selection is the perceived institutional difference between host and home country (Kostova, 1999) or between prior entries and the prospective host country (Johanson & Wiedershiem-Paul, 1975). Institutional distance hinders the flow of information between the MNE and the market (Xu & Shenkar, 2002) and may promote the adoption of strategies that are not more efficient but rather more legitimate. For example, if the prospective host country's environment is perceived to be substantially institutionally different from the MNEs' home institutional environments or prior entry experiences in other foreign countries, the MNEs may prefer to commit fewer resources to its operations in the foreign country. Therefore, when entering countries with high institutional distance from the home country or previous experiences, MNEs may select non-equity, and low involvement, entry strategies. The more institutionally distant the host country is, the higher the degree of adaptation needed by MNEs. This is because a larger institutional distance between home and host country requires the need to evaluate, learn and adapt more extensively to local institutional agents and norms. For example, in earlier stages of internationalization, the use of export entry strategy may be appropriate because it favors low risk and low commitment of resources while it allows a period of learning about the host's institutional environment. Partial evidence of this effect was uncovered by Li and Guisinger's (1991) study of failures of foreign-controlled firms in the U.S. and their finding that higher failure rates occurred for firms from culturally dissimilar countries. To the extent that the "license to operate" (Kanter, 1997) requires cooperation with local partners, the MNE may choose non-equity strategies (e.g., exports, licensing) or partnerships (e.g., joint ventures) with local partners.

Proposition 2a. *MNEs entering institutionally distant markets are more likely to select exports or partnership (joint ventures and partial acquisitions) entry strategies, and less likely to choose greenfield startup investments.*

In addition to institutional distance between home and host, one must consider differences in how the distance is structured (Shenkar, 2001; Xu &

Shenkar, 2002). We delineate two basic scenarios for the same institutional distance between two countries (a home and a host country) with asymmetrical effects: (1) the home country has a more developed institutional environment than the host country, or (2) the home country has a more immature institutional market environment than the host country. The effects are not likely to be equivalent for an MNE from a home country with well developed institutions entering a host country with poorly developed institutions, and vice versa (Xu & Shenkar, 2002).

Partnership and networking resources of various kinds are less important for entering institutionally mature countries, such as those of the European Union or the U.S. because these countries already have well established institutions that facilitate internationalization (Henisz, 2000). Developed countries possess well-structured, highly specialized and effective institutions, which smooth the process of MNEs' entry. In addition, because these countries have more sophisticated markets and more developed firms (both domestic and subsidiaries of foreign MNEs), it is likely that foreign firms entering these countries will base their advantage in some form of intangible resource (e.g., knowledge) or capability (Kogut & Zander, 1992; Dunning, 1998). Thus, it is important for MNEs to internally guard their firm-specific advantage(s) to compete in the host country. As a result, these MNEs are more likely to prefer wholly-owned subsidiaries to protect their advantages (Buckley & Casson, 1976; Dunning, 1998). In contrast, when MNEs enter an institutionally primitive market from an institutionally mature market, they are more likely to select collaborative entry strategies to uncover the possible hazards of embedded rules and hidden norms (Johanson & Mattson, 1988; Chen & Chen, 1998).

Proposition 2b. *MNEs from institutionally mature countries entering institutionally primitive countries are more likely to select joint ventures or acquisitions of local firms as entry strategies.*

Proposition 2c. *MNEs from institutionally primitive countries entering institutionally developed countries are more likely to select greenfield entry strategies.*

Inter-firm Interfaces

Organizational ecologists argue that "structural inertia" is an obstacle to flexibility and limits firms' ability to adapt to external pressures (e.g., Hannan & Freeman, 1984; Scott, 2003). Inertia hinders change and favors the replication of past actions, strategies, and behaviors. This suggests that internal (inertial) pressures affect the entry strategy choices of MNEs and encourage them not to break away from known, accepted, and experienced practices. MNEs are likely to replicate organizational structures and foreign entry strategies with which they are familiar--that is, entry strategies utilized in prior entries (Tallman, 1991).

Given such inertial pressures, how do MNEs select entry strategies that appear to increase their likelihood of success? The imitation of incumbent firms is a form of mimetic isomorphism (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Haveman, 1993) that increases the legitimacy of MNEs' operations in the host country, and promotes easier access to resources. A mimicking strategy is particularly effective for MNEs entering an unfamiliar host country for the first time. However, the primary question is which referent(s) firm(s) should be imitated. If there are other MNEs from the same home country already operating in the host country and these MNEs appear to be successful, then it is likely these are good referents to imitate. This is because these MNEs come from a similar (not identical) institutional environment and appear to have successfully adjusted to the host market. As Carroll (1993: 246) stated:

> At some point the evolutionary process likely becomes calculative in that successful firms are readily recognizable and managers can formulate pretty good guesses as to what equilibrium criterion is being favored and the organizational factors that might produce it.

In the absence of home country models, the referent others (Shah, 1998) are other foreign firms from a third country, firms in the same industry, or firms of similar size, that appear to be particularly successful (Haveman, 1993). It is worth noting that host country firms can hardly be considered as referents for foreign entry strategies because they are not involved in entering their own home country. However, host country firms may be utilized to evaluate the appropriate configuration and composition of network of ties needed in the host country, as well as other formal characteristics (e.g., organizational structures) - all of which are to some extent post-entry decisions. We suggest that in the absence of home country referents, firms from a third country are more likely to be used as referent firms. However, mimicking third-country firms is difficult because they are embedded in a different home social context (Granovetter, 1985) and there may be significant ambiguity (Reed & DeFillipi, 1990) in detecting what these referent firms really do. Nevertheless, third-country firms may still provide valuable insights into how to respond to the host institutional environment.

Proposition 3. *MNEs' foreign entry strategies are more likely to resemble those of competing successful firms, such that MNEs will mimic other home* *country MNEs, and in the absence of home country referent firms MNEs will mimic successful third-country MNEs operating in the host country.*

MNE's Internal Institutional Environment

Foreign entry strategies are also determined by the degree of conformity to internal pressures (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Oliver, 1997; Kostova, 1999; Xu & Shenkar, 2002). Internal pressures include existing organizational structures, corporate mission, vision, and goals of the MNE, norms and values, management and dominant coalitions, and organizational culture (see figure 1). For example, MNEs favoring a high degree of control and coordination of subsidiaries are more likely to favor wholly-owned strategies over other foreign entry strategies (Davis et al., 2000) as means of parental isomorphism, to better override internal disruptions and inefficiencies. Tallman and Yip (2000) argued that absolute adaptation to the host country would reduce the MNE "to a loose collection of autonomous businesses that enjoy little synergy while incurring the overheads of a large MNE." Specifically, we may expect the acquisition of existing firms to be more likely to cause disruptions in the overall organization's stability and dominant culture (Prahalad & Bettis, 1986). Conversely, greenfield startup entry strategy permits fuller replication of internal structures and normative values, with less internal disruption.

Relatively small investments in foreign market entry are less likely to have a major internal impact on the firm and hence may be more easily realized through greenfield investments as opposed to the acquisition of a local firm. On the contrary, collaborative entry strategies are more likely to introduce internal disruptions because the participation in equity joint ventures or alliances imposes increased coordination, control, and management demands. Partnership entry strategies permit not only a better fit with existing host institutional pressures, than, for example, greenfield entries, they also offer *partial* control over the subsidiary's operations, and provide the subsidiary with autonomy for local action. Greenfield subsidiaries allow an MNE to maintain full control over its foreign operations, but may be less responsive to host institutional pressures: "as parents exercise increasing control, pressures to maintain internal isomorphism may override pressures for isomorphism in the external environment" (Davis et al., 2000: 243). Hence, MNEs are more likely to select exports or greenfield entry strategies to minimize internal disruptions. Conversely, MNEs are more likely to utilize acquisition of incumbent firms or entering into international alliances when internal pressures toward conformity are less salient.

Proposition 4a*. MNEs are more likely to select joint ventures and acquisition entry strategies when organizational internal isomorphic pressures are lower, and greenfield entry strategies when organizational internal isomorphic pressures are higher.*

Internal pressures are greater when foreign entry decisions involve the MNEs' core businesses than when such decisions involve only peripheral, non-core, activities. The core business holds resources and capabilities, namely knowledge-based and experiential capabilities, which have the greatest value. Most of the MNE's revenue is also likely to come from the core business. In addition, the values, mission, and strategic objectives of the firm are probably based on the core business. For example, for an automaker, the core business may not be the actual manufacture of many components, but rather the assembly, branding and distribution of automobiles. Automakers can then outsource the design, much of the R&D, and the manufacture of, for example, plastic components.

DiMaggio and Powell (1991) and Powell (1991) argued that internal institutional pressures are most likely to generate suboptimal decisions when investments in current resources represent cognitive sunk costs. Examples of cognitive sunk costs include employees' fears about learning new skills, firms' divergence from pre-set missions/visions, top executives' unwillingness to betray corporate traditions, etc. Cognitive sunk costs are associated with social and psychological costs. Therefore, we expect internal institutional pressures to be lower when foreign entry decisions are not essential to the MNE's core businesses. In non-core activities the degree of experimentation, or exploration (March, 1991), may be higher, without causing substantial attrition of established cognitive and normative practices.

Proposition 4b*. MNEs' foreign market entry strategies will be more likely to depart from previously employed entry strategies when the subsidiaries' activity does not represent the core business of the MNE.*

Moderating Effects

In this section, we propose two moderating effects of MNEs' international experience and technological strategies associated with the industry. These two factors seem to carry the most weight on firms' strategic adaptation to a multidimensional institutional environment.

MNEs' international experience. MNEs learn from their international experience. The evolutionary perspective of internationalization developed by the Uppsala school (e.g., Johanson & Vahlne, 1977; Johanson & Wiedershiem-Paul, 1975) suggests that prior experiences accumulated from previous market entries influence future foreign entries. Following this literature, and prior work on the impact of the institutional environment on MNEs' strategies (e.g., Xu & Shenkar, 2002), we suggest that prior learning carries over to subsequent entries and that MNEs' entry strategies reflect expectations originating from prior experiences. International experience becomes salient when MNEs with operations in multiple markets develop a general structural ability to adapt (Tallman & Fladmoe-Lindquist, 2002), even when they encounter relatively unfamiliar territory. International experience may reduce the risks and uncertainties perceived during international expansion because MNEs learn how to manage new foreign entries. The likelihood of the new entry's survival increases as the subsidiary learns local routines, norms, and structures, and absorbs, through experience, the uncertainties of external environments. In summary, through experiential learning MNEs internalize at least some of the external uncertainties in the subsidiary's routines and processes (Nelson & Winter, 1982).

In the initial stage of market entry, both experience and knowledge of host country institutions are low, supporting Johanson and Vahlne's (1977) proposition that an export entry strategy is more likely for low levels of experiential knowledge because exporting entails lower risks. This includes lower risks of unintended diffusion of proprietary knowledge, lower risks of selecting an inadequate partner, or lower risks from failing to abide by the host's norms and regulations. However, the likelihood of failure of the new foreign subsidiary decreases as it becomes progressively more embedded, aware, and knowledgeable of the surrounding host institutional environment. MNEs with more extensive international experience may more easily leverage their resource-based or knowledge-based capabilities to further their internationalization (Tallman & Fladmoe-Lindquist, 2002). More internationally experienced MNEs will be more likely to replicate their home activities in the host country through greenfield startups. Thus, the extent to which the MNE is internationally experienced will determine future entry strategy selections (Henisz, 2003). We suggest a moderating effect of MNEs' international experience on the selection of the entry strategy.

***Proposition 5a**. MNEs' international experience negatively moderates the relationships between the level of institutionalization of the host market and the MNEs' entry strategy; such that, MNEs with more international experience are more likely to select greenfield entry strategies than MNEs with less international experience.*

MNEs with low levels of international experience are likely to prefer low commitment entry strategies in an host country (Johanson & Vahlne, 1977; Luostarinen & Welch, 1990), but they may also engage in high commitment strategies, such as acquisitions or greenfield startup investments. Interestingly, these three very dissimilar choices entail reducing the risks involved in foreign entry and exploiting the firms' existing capabilities. First, export entries require a lower commitment of resources and less assumption of business and country risks. Second, entries through acquisition involve the acquisition of an incumbent and already legitimized firm. Third, greenfield entries rely on exploitation of the MNEs' already existing resources and capabilities and presumably what they know how to do best. Acquisitions, despite the well-known potential post-integration hazards (e.g., Harzing, 2002) are likely to reduce some forms of risk, even in the absence of international experience. At low levels of international experience the acquirer will seek those local firms that seem better embedded in the market. For high levels of international experience the acquirer is better able to evaluate target firms (Reuer & Ragozzino, 2004). Similarly for greenfield startup foreign investments, the focal MNEs will use their knowledge gained from international experience, thus lowering the risks involved. Conversely, for intermediate levels of international experience the focal MNE is likely to seek partners, both local and foreign, to learn new businesses and new markets. Hence, we assert that one of the facets of MNEs' international experience is that it reduces the importance of host country differences (i.e., institutional distance). In sum, MNEs' international experience partly offsets the institutional distance between home and host countries.

Proposition 5b*.* *MNEs' international experience offsets barriers imposed by institutional distance between home and host countries on MNEs' entry strategy such that for both low and high levels of international experience, MNEs are more likely to select either greenfield or acquisition entry strategies than MNEs with intermediate levels of international experience.*

MNEs' technological strategy. MNEs' technological strategy also moderates the relationships between internal institutional environment and entry strategy. Here we consider two different technological learning strategies: exploitation and exploration (March, 1991). First, when the objective of an MNE is to obtain and transfer knowledge from the host market, the MNE pursues *exploration* strategies and selects entry modes that facilitate absorbing host country knowledge (see Kogut, 1991; Porter, 1990; Dunning, 1998). For instance, the acquisition of an incumbent firm provides better chances to explore and acquire technology and knowledge available in the host market. A growing stream of IB research notes that firms internationalize to absorb and develop knowledge from foreign locations (Johanson & Vahlne, 1977, 1990; Bartlett & Ghoshal, 1998; Porter, 1998; Birkinshaw & Hood, 1998; Kogut & Zander, 1993).

Second, we also can imagine an MNE which possesses its own knowledge and technology to exploit in a host market (Hymer, 1976). Especially when host market institutions are not reliable in protecting this knowledge (e.g., patents and proprietary rights poorly protected) from a potential opportunistic partner, joint ventures or alliances become less feasible foreign entry strategies (Teece, 1986). When local institutions do not protect the owner of the knowledge from opportunistic partners, the MNE tends to keep the knowledge internalized and expands through greenfield entries, as existing research suggests.

MNEs pursuing technological exploitation (March, 1991) strategies are generally knowledge intensive and base their relative competitive advantage in a set of valuable resources (Barney, 1991; March, 1991) that require integration across subsidiaries (Kogut & Zander, 1993; Birkinshaw & Hood, 1998). Inter-subsidiary technology integration increases the complexity of internal relations and the need for coordination by headquarters (Bartlett & Ghoshal, 1998), possibly in a hub-and-spoke model. Thus, pursuing inter-subsidiary technology integration pushes subsidiaries to adopt strategies leading to parental mimetic isomorphism, and to select equity entry strategies maintaining internalized firm-specific technological advantages.

Proposition 6. MNEs' technological strategies moderate the relationship between MNE internal institutional environments and entry strategies; that is, MNEs pursuing international technology exploitation are more likely to select greenfield entry strategies over alternative strategies than MNEs pursuing international technology exploration.

DISCUSSION AND CONCLUSION

MNEs select foreign entry strategies that better fit the various facets of current external, internal, and inter-firm institutional contexts. In this paper, we develop a series of propositions to capture the impact of these contexts on MNEs' foreign entry strategies. We suggest a more comprehensive model of how MNEs select their foreign entry strategies and highlight the complexity of entry strategies as a multidimensional strategic choice. We advance several factors that affect foreign entry strategies, including host country institutionalization, asymmetric institutional distance between home and host countries, inter-firm interfaces, and internal institutional pressures. Moreover, by integrating MNEs' international experience, we support the perspective that entry strategies are not totally discrete events, sustaining one of the most commonly advocated advantages of MNEs: their ability to leverage dispersed assets to overcome local firms' superior knowledge of the host market (Hymer, 1976; Kogut & Zander, 1993). In addition, MNEs' strategic choices are influenced by institutional pressures operating at a worldwide level (e.g., the push toward quality standards, the utilization of consulting and management firms). Conceptualizing MNEs as learning entities that are capable of strategic adaptation to environments where they operate, it seems reasonable to suggest that the more internationally experienced MNEs progressively learn to distinguish institutional pressures to which they need to adapt from those they do not. For instance, internationally experienced MNEs are more able to develop locally optimal foreign entry strategies that buffer them from large external misfits. Future research may examine whether this results in the utilization of a uniform script in every foreign entry or in the use of profoundly distinct scripts that are absolutely tailored to each foreign entry.

We further expanded traditional research on the impact of the institutional environment on inter-firm interfaces. In fact, firms' actions occur neither in isolation nor are they driven solely by an "undefined" external environment. In our analysis of home-host country institutional distance, we suggest that the direction of the distance (from more institutionally developed to less institutionally developed countries, for example) may be more relevant than measures of absolute differences between countries for MNEs' strategies. Finally, we argued that when entering unfamiliar environments the selection of the object, or strategy, to imitate may be far from trivial because appropriate referents do not necessarily exist, contrary to what the extant literature seemingly suggests. For example, the identification of a referent firm may be a hazardous task for entries into transition and emerging economies, new technological areas, newly opened markets, and so forth.

We aimed to construct a more comprehensive model of the impact of various facets of the institutional environment on entry strategies. Nevertheless, we do not argue that this is the complete model. Future research may pursue additional factors exerting main or moderating effects on MNEs' selection of foreign entry strategies, as well as disentangle interactions among these factors. For example, it is likely that institutional pressures vary across industries (Henisz, 2003). Strategic industries such as the military, or industries upon which the government imposes legal or ownership boundaries (e.g., transportation, telecommunications, energy, education, and medicare), are more likely to be subject to a higher need to adapt to host institutional requirements. In these cases, foreign entry strategies may require local physical presence and direct investment in host country facilities. Furthermore, direct investment in local facilities may override social pressures such as unfavorable public opinion towards foreign firms, concerns with local development and employment, and a host nationalist political culture.

Future Research

Future research may explore how MNEs' structures change over time (i.e., with accumulated international experience) in response to changing institutional pressures. However, the most important step now is to complement conceptual explorations with empirical quantifications of the degree of institutionalization of host markets. The extant research is lacking concrete measures of institutionalization, in the absence of which it is not surprising that studies of mimicking behaviors predominate (Haveman, 1993).

Future research may also examine how organizational decisions are value-laden choices constrained by the power dynamics and social context of decision making. Top managers commonly make non-rational choices bounded by social judgment, historical limitations, and the inertial force of habit (Simon, 1947). As Ginsberg (1994) observed, strong internal institutional pressures may dominate in the evaluation of current resource allocations and may hinder any changes in the current pattern of resource deployments. Therefore, MNEs' entry strategies should not violate the core values of the MNEs and need to gain support from top managers. However, there is a notable scarcity of studies on how internal politics and power balances among divisions and top management affect the selection of a foreign entry strategy.

Finally, while we use the insights of institutional theory, future contributions may be balanced with other theoretical strands. For example, Kogut and Singh (1988: 412) argue that transaction cost explanations of entry strategy selection "must be qualified by factors stemming from the institutional and cultural context." Transaction costs theory (Williamson, 1985) suggests that whenever the transaction costs of organizing internally are lower than the cost of exchanging in the market, the MNE attempts to enter foreign markets through equity strategies. We note, however, that reducing the transaction costs favors economic rationality and efficiency, but may undermine internal conformity and host legitimacy, paradoxically increasing the subsidiary's likelihood of failure.

We build our propositions in a generalization of what should be *ceteris paribus* clauses, because different external institutional pressures are likely to differentially impact MNEs' strategies. Oliver (1991: 167) noted that "the more institutional pressures are entrenched in a legal or regulatory apparatus, the less likely it is that organizations will resist these pressures". Hence, while multiple facets of the internal and external institutional environment should be considered, some of the facets seem to carry more weight than others. We may also expect organizations to conform easily to external pressures if those pressures are compatible with internal objectives and efficiency criteria.

To conclude, the various facets of institutional environment have a significant impact on firms' foreign entry strategies. Institutional theory is valuable in evaluating parent-subsidiary relationships and MNEs' local responsiveness. These are pillars of MNEs' international strategies. Notwithstanding, studies on entry strategies have often overlooked institutional factors and pressures (Davis et al., 2000; Xu & Shenkar, 2002). Using institutional theory we argue that entry strategy is not always a result of planned strategy or an attempt to achieve the most efficient outcome. For example, while foreign entries through both greenfield startup investments and through exports may be favored when local institutional pressures are low, high resource commitment entry strategies may absorb local uncertainty and enhance legitimacy in the host country. The adoption of intermediate, or hybrid, strategies such as equity joint ventures and strategic alliances may be dependent on the level of institutional development of the host country and on the headquarters' strategy. MNEs' strategies are influenced, but not absolutely determined by, the external environment in which they operate, and the institutional pressures do not necessarily supersede a choice among alternative strategies.

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FIGURE 1. General Model of the Interaction between the MNE and Its Environments

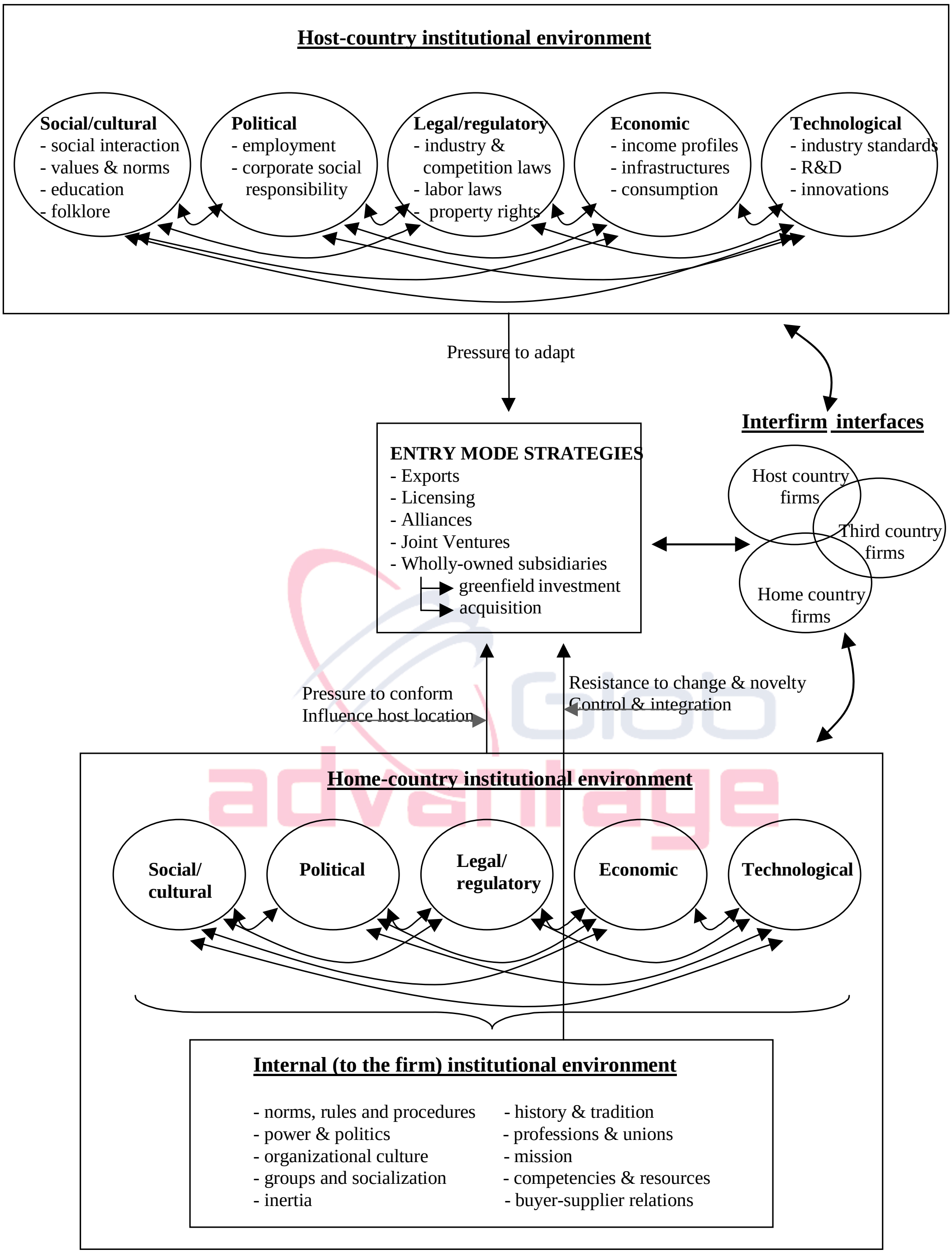

FIGURE 2. Conceptual Model