Internationalization Models and Entry Strategy Adaptation

The Case Study of H_3

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Abstract

In recent years, increasing globalization and competitiveness have led companies to choose to start activities across borders and thus manage to survive and thrive. This growing concern has brought the challenge of internationalization to the strategy of most companies.

The issues raised about the behavior of companies when entering a foreign market, and their entry strategy, are of utmost importance and, therefore, it was found to be relevant to understand how they could be explained.

To this purpose, it was decided to use a methodology of case study with the brand H_3. This brand, due to its characteristics and to its desired rate of growth, needed to further develop its internationalization process.

The analysis of the models of internationalization and entry modes, together with the business and brand characteristics, allowed the assessment of their applicability to explain the international behavior of the brand. The analysis was performed taking into account the determinants of the different models and the brand.

Following this, it was proposed a model of internationalization for the brand. This model combines different models of internationalization reviewed in the literature, adapting them to the particular characteristics of a services company. This model is intended to guide the company throughout the various stages of its internationalization process. The adaptation of the entry strategy was considered taking into account the requirements of the brand and its goals at the international level, making it possible to recommend an entry mode that will enables the company to achieve its growth objectives.

Keywords: Internationalization; Internationalization Models; Entry Modes; International Markets; Franchising; H_3

1. Introduction

Over the latest years, with the growing competitiveness and globalization, there is a rising need for companies to expand their business internationally, to survive and prosper. This growing concern has brought the challenge of internationalization into the day-to-day operations of most companies.

The awareness of this firm strategy and the desire to contribute in the explanation of such phenomena, has led to the main purpose of this article, i.e., the development of an internationalization model and a discussion of entry mode.

To achieve this goal, a case study methodology shall be applied in which theoretical models and modes of entry that have been described in the literature review will be presented with all their characteristics. The case study will follow the brand H_3 that, similarly to what happened with other companies due to their growth, decided to go abroad and compete in foreign countries. The goal is, based on the literature, to propose an internationalization model that fits the company, and that can be used to explain its behaviors.

2. Literature Review

2.1. Internationalization

With the existing globalization and growth, one that wishes to detain some competitive advantage and lead over another, cannot, in the current century, be restricted to the national market. Instead it should aim for ways that allow some sort of advantage internationally (Gamble et al. 2013).

Internationalization can be defined as the "adaptive process of companies' operations (strategy, structure, resources,...) and international environments" (Welch & Luostarinen 1988, p.116). This adaptive process has to take in account the motives and barriers that a company faces in a given market.

The decision to go abroad can be based in several reasons such as: having access to new consumers and reducing the costs hence increasing competitiveness; having access to resources and capacities only available in foreign markets and to disseminate risks by associating different activities along different markets.

The main challenges to the internationalization of a company are associated to the lack of information, functional aspects linked to time or staff shortage to deal with the process of internationalizing the company, marketing barriers and obstacles concerning governmental, institutional and cultural aspects (Gamble et al. 2013).

2.2. Internationalization Models

To explain the behavior of a company, several theoretical models were proposed, differing in the determinants that are considered to explain the actions of companies at an international level:

The Internalization Theory (Buckley & Casson 1976) based its explanation on the internalization of operations, with the aim of reducing transaction costs, in order to maximize profit. Thereby, the entry into foreign markets is elaborated with the objective of internalizing these operations and maximizing profit.

In The Transaction Cost Approach, Williamson (1979) claims that the costs associated to different operations are analyzed to understand if these operations should be executed internally or, on the other hand, by external firms. The internationalization through this model is explained with the desire to reduce the transaction costs associated with certain activities.

In the Resource Based-View, Barney (1991) explains the sustainable competitive advantage of a company from the resources it possesses. The internationalization strategy of a company involves the analysis of the distinctive company's resources itself. It is considered that the company's superiority is achieved through the combination of resources that faster internationalization.

Vernon (1966), in the International Product Life Cycle Theory, justifies the increasing entry in foreign markets with the stages a product faces during his life cycle: punctual exportations, increasing the commitment abroad in countries where cultural distance and risk are inferior and, finally, implementing production facilities in less developed countries, to gain advantage of the labor cost reduction, when the processes are already standardized.

Similar to the International Product Life Cycle Theory, the Uppsala Internationalization Model (Johanson & Wiedersheim-Paul 1975) also explains the internationalization of a company as a gradual process, in which the company acquires knowledge and increases its resources commitment. The set of stages (non-regular exports activities, exports via independent representatives, the installation of a sales subsidiary and the installation of a production subsidiary) that a company goes by in its expansion process, is labeled as "establishment chain."

Johanson & Vahlne (1977), based on the previous model, proposed a dynamic model with aspects of state and aspects of change. The aspects of change were resources commitment decision and the current performance and the aspects of state were the knowledge of the market and the foreign operations and the resources commitment with the foreign market (Figure 1).

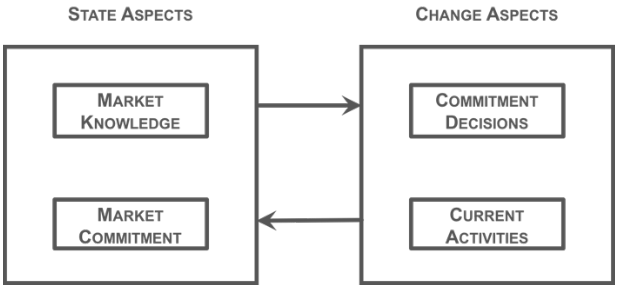

Figure 1. The Basic Mechanism of Internationalization - State and Change Aspects (Johanson & Vahlne 1977)

After, Johanson & Vahlne (1990) claimed that the company cannot be analyzed as an independent factor. Having the Uppsala Internationalization Model in mind, the authors suggest that “market knowledge, market commitment, commitment decisions and current activities” should not be seen in a unilateral, but instead, in a multilateral way, since the company is part of a network, where it establishes relationships. The model goes from intra-organizational to inter-organizational, whereas exploring the capacities and complementary competencies, the networks provide a joint realization of mutual benefits. Therefore, a specific company is dependent from resources controlled by other entities and the access to those resources is obtained by a determined position in the network.

Depending on the degree of company internationalization and the respective market, the Network Model (Johanson & Mattsson 1987), group companies into four different categories, “The Early Starter”, “The Late Starter”, “The Lonely International” and “The International among the Others” (Figure 2).

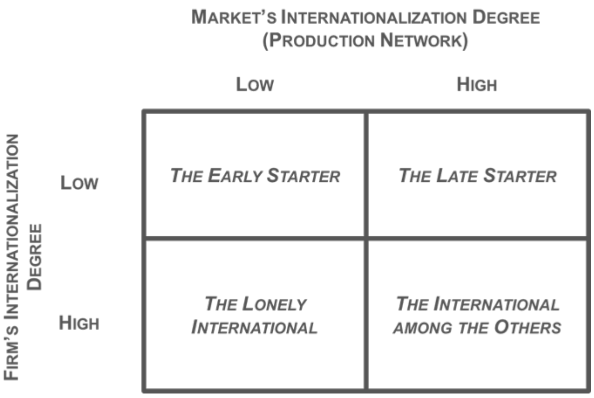

Figure 2. Internationalization Process based on Network Model (Johanson & Mattsson 1987)

Opposed to the Behavioral Theories, the Eclectic Theory (Dunning 1981) assumes that companies have access to a perfect and complete information about the market, being considered a static model. Thereby, the possession of a set of advantages will be decisive in the process of internationalization of a company. The advantages are grouped in firm specific advantages, like the existence of tangible and intangible resources that make them superior to its competitors, independently from its location, the location advantages, which result from the market imperfections, namely the role of the Government, the uncertainty and risk, the capacity of seizing economies of scale and externalities, the abundance of natural resources and human resources with quality and reduced costs, production costs, access to raw materials, business and cultural environment, absence of business barriers and the political and institutional framework. Finally, the internalization advantages correspond to the capacity of internalizing its activity instead of selling the rights, so that other foreign companies are able to explore those advantages.

Although it is possible to explain the behavior of a company through the models previously presented, it should be noted that the institutions (“cognitive, normative and regulative structures and activities that provide stability and meaning to the social behavior. [Which are] transported by diverse supports – cultures, structures and routines – and operate in multiple levels of jurisdiction” (Scott 1995, p. 33)) have influence in the companies’ decisions and their respective behavior. Therefore, through the Institutional Theory it is possible to understand the relationships between the organizations and the involving environment. This theory is based in three different pillars, regulative, normative and cognitive, and, according to Huang & Sternquist (2007), it is a supplementary theory that is not contradictory to the other theories presented and, for that reason, it should be analyzed in the context of internationalization, since the internal and external environment influence the decisions of a company. The same authors claim that with the application to the international context is possible to observe that the pressures of the macro-environment, whether from domestic or host country, and the micro-environment, from the company, influence not only the choice of foreign markets, but also the entry mode.

Finally, Porter (1990) presented a theory (Porter’s Diamond Model) about the competitive advantages to explain the company internationalization. The constant innovation enables a company to highlight itself from its competitors and providing competitive advantage. Porter presented a set of four attributes, named the diamond of national advantage.

- Factor Conditions: labor or infrastructures;
- Demand Conditions: nature of domestic market;
- Related and Support Industries: supplier or other related industries;
- Firm's Strategy, Structure and Rivalry: conditions for nation governance, in which the companies are created, organized and managed and the nature of domestic rivalry.

Porter, in his diamond, also presents the role developed by the government and from chance, as factors that have the capacity of influencing the four determinants. Rugman & Verbeke (1993) adapt the model proposed by Porter, adding these two factors, with their respective influence, in the capacity of a company to gain competitive advantage and also claim that the diamond cannot be only analyzed at a national level, but must present a local, regional, national, foreign and global analysis. This way, the authors distinguish endogenous and exogenous variables, being the first ones the original attributes and the latter the factors introduced (Government and chance).

Rugman & D'Cruz (1993), verified that it would be important to add the international context to the domestic diamond initially proposed. Therefore, the Double Diamond Model associates the international context to the domestic diamond of each country. Since this diamond combines developed and less developed economies in the same diamond, the analysis becomes complicated and it can't be applied to all countries. As result, it was necessary to generalize, emerging the Generalized Double Diamond Model, suggested by Moon et al. (1998), where the domestic diamond evaluates the way in which a country increases its competitiveness by using its own resources, and the international diamond analyses the way a country extends its competitiveness aggregating all the non domestic diamonds of a country. These two diamonds, together, evaluate the competitiveness of a specific country.

Verifying that the diamonds previously suggested emphasize the physical factors, without considering developing countries, where the advantage consists mostly on labor factors, Cho (1994) presents the Nine Factors Model. In this model it is possible to verify the existence of more factors, namely in relation to physical factors.

Lastly, Cho et al. (2009) understood that it would be beneficial to be able to explain the competitive advantage of a country, conciliating the international diamond and the human factors in one unique model. This last model, the Generalized Double Diamond Model, duplicates the model by including an international diamond, associating it to the national diamond, and the Nice Factors Model, with the inclusion of human factors.

The analysis of these models, reveals the existence of determinants associated to each model. Therefore, summarized, in the Table 1, it is possible to find the determinants of each model.

2.3. Entry Modes

After presenting the theoretical models, and the determinants that explain them, it becomes necessary to verify the existing entry modes.

- Exports: characterized by using domestic production in order to sell in foreign markets. There are two types of exportation (direct or indirect), according to whether the company uses or not an intermediary distributor in the domestic country.

	Distance	Knowledge	Transaction Costs	Resources	Institutional Environment	Uncertainty and Risk	Relationship with others firms	Market's Demand	Assets
Internalization Theory	X		X	X	X				
Transaction Cost Approach			X			X			X
Resource Based-View				X					
Eclectic Theory			X	X	X	X			X
Uppssala Model	X	X		X					
Network Perspective		X					X		
International Product Life Cycle Theory	X	X				X			
Institutional Theory					X				
Porter's Diamond				X	X	X	X	X	

Table 1. Determinants present in each Internationalization Model

- Licensing: occurs when a company establishes a contract with one or more local partners. Transferring the right to use certain corporate assets (patent, trademarks, brand's name, technology). This mode of entry occurs when a company has the technological know how, however does not wish to use resources to enter into a certain foreign market.
- Franchising: presents similarities with licensing, but is distinguished by the fact that it has a network structure that demands a greater relationship between the parties (Pedro et al. 2008). This mode of entry is a rapid growth form in which the franchiser provides a package of standardized products, system and management services and the franchisee provides its knowledge of the local market, capital and management staff (Ghauri & Cateora 2010). Figure 3 shows the franchising method of internationalization in four stages.

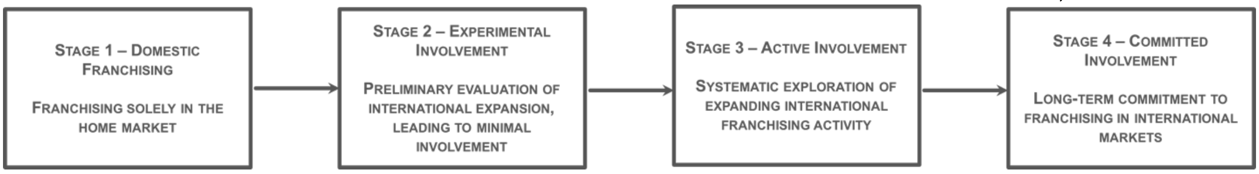

Figure 3. Franchise System Internationalization

- Foreign Direct Investment (FDI): the investment associated with this mode of entry can be taken alone by the company that decides to internationalize the business or through partnerships with other companies, sharing the costs and risks (Osland et al. 2001). In the first case the company has the total responsibility over the operations, it can opt between a *greenfield*, in which it establishes operations from scratch or acquire a subsidiary overseas, already with established activities. If, on the other case, it does not wish to detain the total responsibility over the business, it can establish partnerships through joint ventures or international strategic alliances. The first involve "two or more organizations that share a property, a management, the risks and rewards of a newly-created entity." (Teece 1992 cited by Klotzle 2002, p. 89).

Overall Table 2 presents the different modes of entry compared under: the risk for the company, the return over its activity, the control over the business and its integration in the company.

Similarly to the theoretical internationalization models, the modes of entry also present different determinants that condition company decisions, such as (Erramilli & Rao 1993):

- Amount of capital that the company wishes to invest, both the initial amount at the opening and the resources commitment. The smaller the amount of capital the company is ready to invest, the greater the probability of establishing a mode of entry with partnerships.
- Inseparability of production and consumption, characteristic of which services, promotes cultural differences awareness, implying that the firm adapts the business to local tendencies, which may lead to higher costs and risks. In this manner, 'inseparable' services may force companies to share the responsibility of the business.
- The country risk and the volatility of its environment must be taken in account in the adoption of the entry mode, which must consider the sharing of risks and costs, in order to achieve a better flexibility to respond to the eventual changes in the country in question.
- The size of the company can influence its mode of entry because the greater its size, the easier it will be for the company to succeed internationally, covering the costs and risks globally.

	Exporting	Licensing	*Franchising*	*Joint Venture*	Acquisition	*Greenfield*
Risk	Low	Low	Low	Moderate	Moderate	High
Return	Low	Low	Low	Moderate	High	High
Control	Moderate	Low	Moderate	Moderate	High	High
Integration	Negligible	Negligible	Negligible	Low	High	High

Table 2. Entry Modes' Characteristics (Kumar & Subramanian 1997)

3. Case Study – H_3

The case study allows one to analyze the characteristics of the brand, its concept and both national and international activities. The main aspects will be identified and the brand's international experience shall be presented in order to understand its behavior until now.

3.1. H_3 Characteristics – SWOT Analysis

The H_3 brand, created in 2007 in Portugal, is a burger restaurant chain. It presents a differentiating concept combining two different sectors of the food industry: the fast food and the fast casual. This means that it offers fast meals, at low prices, but with fresh and quality ingredients.

Having in mind the characteristics of the brand, as well as its business, a SWOT analysis of the brand can be made (Figure 4), highlighting the internal (strengths and weaknesses) and external factors (opportunities and threats), with the goal of understanding the capacity of promoting an international business.

Strengths	Weaknesses
• Easy monitoring of the production process and its employees • Fresh and quality ingredients • Consumers can customize their own dishes • Good price/quality relationship • Key partners • Specialization in a mono-product *(Standardization)* • Employees' formation • Trademarks • Localization encourages the concept • Branding	• Limited supply • No service table in the restaurant • Product easy to replicate • Requirement of high quality in products • Market Experience • Price higher than competitors
Opportunities	**Treats**
• Changes in the Portuguese habits • Contraction of the economy • The consumption of *Fast Casual* is increasing • Trend towards selecting healthy food • New concept	• Alternatives with take-away and delivery services • Competitiveness in Fast Food market • Brands with greater international recognition • Growth of gourmet concept (saturation) • Suppliers' dependency

Figure 4. SWOT Analysis

3.2. H_3's International Experience

The brand decided to initiate the process of internationalization, not only because the saturation of the national market but also due to its original plan. Given its growth and its option to stay in the main shopping centers of the country, it was difficult to keep the growth rate same as in the first years in the market. Consequently, given the interest shown by various foreign companies to franchise beyond borders, the brand decided to start its internationalization process.

The entry mode selection and price definition are specifically made for each market, and the decision to enter to a specific market is based, mainly, on options presented by potential partners that provide detailed market research. Thus, based on the options, the brand makes its assessment and takes a decision on which market to start the activity and on what entry mode can be better applied to those markets characteristics. Until now, the brand has been in Poland, Spain, Brazil and Angola.

The entry into Poland was carried with a joint venture with a Polish and a Portuguese company. However, the lack of existing maturity in the fast food market, combined with some errors resulting from inexperience in internationalization led to a lack of control over the restaurant. The brand concluded that the welcoming to the gourmet burger H_3 was associated with the saturation of the traditional offer of burgers, so that the concept is valued, and as the McDonald's also was a recent chain in Poland, there was no such saturation. The food court system was not exactly the same as in Portugal. Finally, different eating habits from the Portuguese hindered the development of the operation.

Spain's case was different, because, after the experience in Poland, the company realized it would be necessary to join a local partner with experience in the local market. Thus, the entry mode was made through a franchise from the group VIPs. The exit decision came from the partner, due to some location errors, aggravated by the Spanish financial crisis, forcing the local partner to end the franchising contract after two years. Nevertheless, the main reason was the sale of the group VIP's to an American investment fund.

It is possible to verify that the brand always makes international adaptations about burgers offer, but not all the changes result from the desire to respond to the culture and needs of consumers. Sometimes these changes appear because it is impossible to access certain ingredients.

Analyzing the process of internationalization is possible to conclude that the brand increasingly values the franchising entry mode, in order to join a local company that knows the market well and carries also catering activities. This was also the case of Angola.

Throughout the process, it was possible to identify the characteristics necessary in a foreign company that could develop the H_3

business in different countries. The features are:

- Being a company that already is engaged in the catering business and is a reputable company, which means that it knows the catering sector and that already has relationships with suppliers and consumers, making it easier to operate and to access distribution networks and suppliers;
- Being a company that does not want to open just a single store in a given market, to take advantage of possible economies of scale, reducing the price of burgers;
- Being a company that works exclusively in the field of catering;
- Presenting a team already formed and dedicated to this area, to reduce the costs of creating the company and training in different areas of management required for this type of business.

Through the analysis of the markets where it existed, or still exists, it is possible to identify the main barriers to internationalization, such as labor laws, the specificities of each market, the procurement of suppliers abroad, since the brand wants the meat produced in the market where it operates, and language. In certain markets were found local lifestyles very different from the Portuguese, and different development levels of distribution chains, which made difficult carrying operations exactly as in Portugal. Finally, the brand found markets where the eating habits forced it to adapt the menu.

Finally, there is the need to evaluate the introduction of a concept with a healthier offer due to market saturation with the traditional fast food chains offers, such as McDonald's. This did not happen in the Polish market, which turned out to be a barrier to the introduction of business in that country.

The brand, which was already present in the Euro zone and the European Union and now lies just outside Europe, realized that there are differences in the negotiation process and these differences are more noticeable in other continents.

Host countries have no requirements, however the different laws and rules require H_3 to adapt its activities and supply to the different market specificities. The restrictions are mainly bureaucratic and the lack of knowledge of these restrictions and excessive tax rules mean that the brand is required to hire lawyers and consultants, leading to higher costs of the operation.

4. Applicability of Internationalization Models to H_3

The determinants that have a higher impact on the brand's international activities are: distance, as in cultural distance, institutional environment, uncertainty and risk, relationships with other companies and the company's assets. Therefore, it is possible to conclude that no model adapts entirely to the brand behavior making it necessary to associate different theories.

Studying the context and the nature of the business of H_3 and the determinants found to be the most relevant for the company's business, it was found that the model of internationalization should combine: the International Product Life Cycle Theory, the Institutional Theory, the Network Model, the Eclectic Theory and Porter's Diamond Model.

It was considered that the other models did not add explaining power to the internationalization decision of the company. As such, bearing in mind the desired parsimony, capable of describing brand activities in a model (Hosmer & Lemeshow 1989), it was decided not to include an excessive number of models that could inhibit the overall evaluation.

By utilizing the proposed model, it is possible to recognize that a company with similar characteristics to H_3 should, initially, analyze the market, either by pre-existing market research or, in case of insufficient research material, create their own study that allows for the understanding of a certain country's culture. Subsequently, the firm should analyze the institutional environment and verify how the laws and rules are set, not just in terms of labor but also regarding the food industry sector, as in the need for licensing the business and staff bonuses. The market analysis provides the means to evaluate the risk of starting a business in a specific market when it comes to cultural terms and institutional environment. The brand should be aware of existing supplier and distribution companies to assure interactions that are able to keep the brand's concept. It will be also necessary to establish connections with a country's shopping centers and understand the existing laws in order to install a restaurant. Finally, as the company does not wish to start a business with a FDI, of exclusive business responsibility, it will be necessary to identify the characteristics of these companies and verify their assets in order to negotiate, bearing in mind the qualities that the brand considers essential for success. It is possible to conclude that

Porter's Diamond Model does not present itself as an isolated step but instead accompanies the brand's internationalization process, which allows the identification of competitive advantages throughout the decision process.

The company's business model may in fact be analyzed separately. In other words, different stages can be established in the presented model, each of which corresponds to a theoretical model (Figure 5), namely:

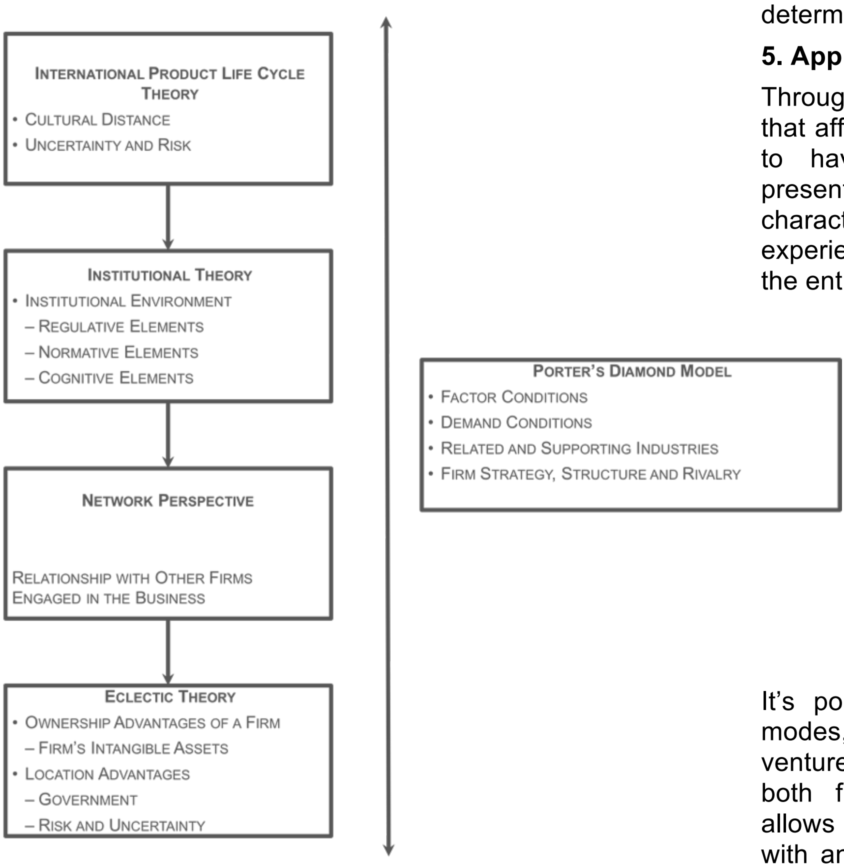

Figure 5. Internationalization Model

- The International Product Life Cycle Theory, with an analysis of the cultural distance and of the risk and uncertainty associated with the business in a specific market.
- The Institutional Theory as it investigates the regulative, normative and cognitive environment of a country, which provides an understanding of the brand's capability to operate in that market, considering the existing laws and regulations.
- Network Model that verifies the existence of firms from which relationships can be established in order to develop the brand concept.
- The Eclectic Theory, in so far as it addresses the analysis of the assets of the potential company and also in the verification of the presence of certain assets considered indispensable for the success of the brand

Finally, as mentioned previously, it is possible to simultaneously include in each stage Porter's Diamond Model, along with its respective extensions, since it evaluates the competitive advantages relative to the national and international value of the diamond with respect to each of the previous determinants.

5. Applicability of Entry Modes to H_3

Through the observation of the determinants that affect the control that a company wants to have on its international business, presented in the literature review, the brand's characteristics and previous international experiences, it's possible to realize which of the entry modes is more adequate.

The brand wants a low risk on the business, not demanding a high resources commitment, which could facilitate the development of their main goal, this is, the improvement of the brand concept and constant innovation, combined with the effort to standardize the processes. Thus, the company also doesn't want a high level of control over the restaurants, which could lead to a resources commitment.

It's possible to verify that the two entry modes, franchising and IDE, through a joint venture, can be adopted by the brand, since both fit these requirements. Franchising allows the operational responsibility to rest with an external company and ensures the desired quality, but at the same time, it does not require the franchiser to commit resources to operations. The H3 brand, as said before, wants the partnering companies to have specific characteristics, so that both service quality and business success are assured. In case these companies don't fully have these qualities, the brand can opt for a joint venture, which allows the entrance in a market without the investment, leaving the operations to the brand's responsibility.

By looking to the determinants that define the entry mode to be used by the company, it is concluded that, in most cases, franchising would be the best option due to it's low risk characteristics, investment and resources commitment.

With the purpose of getting how the company's internationalization should be, it could be used, as an example, the study proposed by McIntyre & Huszagh (1995) (presented in the literature review), since it represents exactly, the company's behavior so far.

In order to facilitate the franchising process of the brand for a particular market, it would be important for the brand to contact a company that is responsible of creating partnerships in the involved country, to find a master franchisor. The responsibility of finding adequate franchisees would rest with this master franchisor, accordingly to the company's requirements.

Despite being franchising the entry mode that the company should adopt, due to its characteristics and its business, that it is possible, in certain attractive markets there are no companies with the desired attributes. In such cases, the brand should adopt joint ventures as an entry mode, since an investment would not be necessary, and the brand would only be responsible for the operation, ensuring the desired standards.

An example of a market in which could be adopted a joint venture is the US market, as due to its size it would be necessary to open a large number of restaurants in a short period of time. This opening would be associated with a large investment and if any company was interested in financing the opening of restaurants, it would be an opportunity to consider, even if the brand had to remain responsible for the operation. The US market is an exception, given its size and characteristics, since, as previously stated, the brand does not want to enter markets with some participation in operations.

Although it can be adopted a joint venture entry mode, this shall not be a permanent situation. The brand may be in a first instance responsible for the operations, but willing to sell them if it is considered that the local company already has the capacity to be responsible for the whole business. This can be justified looking to the Brazilian market case. Although the brand has entered through a joint venture, responsible for the operations at that time, now it wants to sell its part, becoming fully franchised stores.

6. Conclusions and Future Work

Through the analysis of the theoretical internationalization models, more concretely of their determinants, it is possible to understand in what way they are able to explain the brand's international behavior. It was concluded that the International Product Life Cycle Theory, Institutional Theory, Eclectic Paradigm, Network's Perspective and the Porter's Diamond Model, could be used to explain the brands' internationalization process. The proposed model is divided into stages - in which each one is explored through the use of a model analysis - in order to explain in what ways H_3 may decide about internationalization, taking into account its characteristics and the determinants it deems important at the time of such decision. The models' sequence was determined not only by the importance the brand gives to each determinant, but also according to the weight they hold towards the success of the business.

On the other hand, the characterization of the brand's internationalization process leads to better understanding of the way the risk, the resources commitment and the capital H_3 wishes to invest, influence the choice of the entry mode. It was concluded that the franchising system is best suited to the brand's necessities and promotes growth at a desired pace, without the need to invest capital and incur in an elevated risk, compared to other entry modes.

Despite the fact that the market entry decisions are made taking in account the proposals presented, it would be fruitful to conduct an analysis of markets that initially have conditions for the development of brands such as H3's. As such, it would thus be possible to apply the proposed model to a specific market, with the objective of validating and understanding if it would be possible to apply it, without having any market in mind.

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