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Factors Affecting Market Entry Modes of Small and Medium Enterprises (SMEs) to China ---A Multiple Case Study of Thai SMEs

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Abstract
The purpose of this research is to provide a better understanding of the influence of the factors affecting the choice of entry mode to China by small and medium enterprises (SMEs). The most commonly used entry mode theories; the resource-based theory, the transaction cost theory and the institution theory are integrated to develop a conceptual framework to investigate the main factors affecting international entry modes for SMEs to China. A qualitative case study methodology was used. Data was collected through semi-structured interviews with two Thai SMEs in order to gain an in-depth understanding of the topic being investigated. Based on the case studies, the main findings illustrate a clear connection between what existing theories claim to be the internal and external factors affecting the market entry mode choices by SMEs. However, this study found some factors that were in contradiction with the previous theories.
Keywords: Small and Medium Enterprises, Thailand, China, Entry modes, factor

1. Introduction

The international expansion of small and medium enterprises (SMEs) to emerging countries, especially China, has been widely recognized in recent research (Wan & Lowe, 2007; Hollensen, Boyd & Ulrich, 2014). Since China joined the WTO in 2001, which has significantly further opened up the massive Chinese market for more foreign investments and trading. China has witnessed remarkable economic growth and due to its huge population has become a major player in the world economy. Furthermore, it has a huge potential consumer market due to a dramatic expansion of the middle class in China (KPMG, 2004). Therefore, China appears to be one of the most attractive markets for many multinational companies (ibid). In addition, China has recently further liberalized the government regulations and restrictions toward foreign business operation in China. These basically allow foreign firms to pursue their preferred entry mode choices. However, the Chinese market is heterogeneous, large, complex and not easily accessible (MOFCOM, 2013). Therefore, the choice of the entry mode is significantly considered as a frontier issue in the international marketing (Root, 1994). Many scholars on international market entry strategies examined that whilst making the decision regarding foreign market entry mode, there was a wide range of factors that influenced a firm's entry mode decision. The choice of entry modes between exporting, contractual modes (licensing and franchising), joint venture and wholly owned subsidiary were all strategic alternatives for firms (Lin, 2000). (See in figure: 1) These market entry forms can be seen as a continuum of increasing control, resource commitment, risk and return, ranked from a low level of control (exporting) to high level of control (wholly owned subsidiary) (Root, 1994). Therefore, managers need to analyze and determine the most appropriate international strategy to enter a foreign country. For emerging countries, there have been very few studies conducted on the entry mode strategy by SMEs, especially for Thai SMEs. Furthermore, many Thai SMEs are increasingly willing to penetrate and expand their market places internationally, particularly the Chinese market. China has been recently the top export destination for Thai SMEs. Therefore, there is a need for such research because the number of Thai SMEs doing international business is increasing. In addition, most researches attempt to answer the "what" questions which are achieved through surveys. The "how" or "why" questions are not as common and these require case studies and qualitative researches instead of quantitative ones. Therefore, it is a research gap for the author to fill in and contribute to the lack of literature in the field. The research question is "*How do Thai SMEs make the entry mode decision entering China"*. The purpose of this research is to provide an in-depth understanding of the factors affecting the choice of entry mode of SMEs in the specific context of China. Such knowledge combination provides managers with guidelines for choosing the most suitable strategic entry mode to the Chinese market for SMEs in order to make better entry mode decisions in the future.

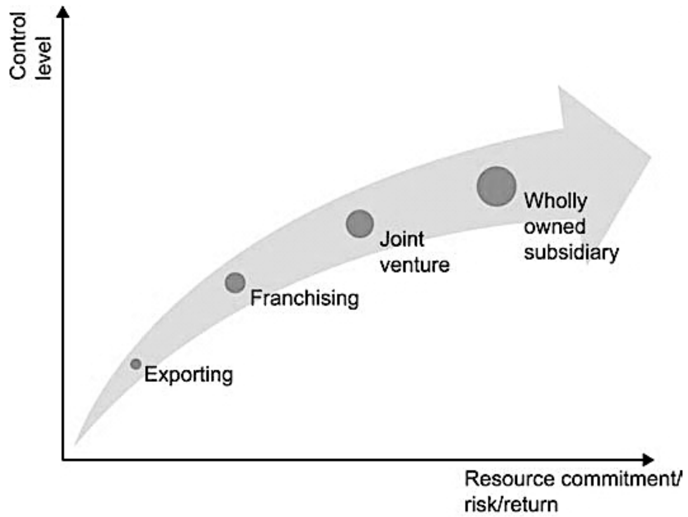

Figure 1: Entry mode characteristics (Lu et al., 2011)

2. Literature review

2.1 *Entry mode theories*

Resource-based theory describes firms from the perspective of their firm-specific resources and capabilities and how firms generate competitive advantages from them (Barney, 1991). Firm-specific resources can be tangible or intangible such as physical assets, financial resources, proprietary technology, knowledge, network and international experience (Sharma & Erramilli, 2004; Barney, 1991). Capabilities enable a firm to transform its resources into products or services that are differentiated from its competitors (Sharma & Erramilli, 2004). If a firm has enough resources and exploit them effectively to contribute to their competitive advantage, a firm can compete and achieve its long-term goals in the foreign markets (ibid). Consequently, this theory primarily focuses on those resources that have the potential to create value or a competitive advantage for the firm which are non-substitutable, incompletely imitable, valuable and rare (Barney, 1991). According to the theory, a firm desires the entry mode that can best utilize its existing resources, or generate new resources in the foreign market (Sharma & Erramilli, 2004).

Transaction cost theory (TCT) describes that a firm is likely to choose the entry mode that balances the level of control and the cost of resource commitment. This leads a firm to find the most efficient and economical way to minimize transaction costs associated with doing business in a foreign market such as information search costs and opportunism costs (Hennart, 1989). In TCT, the choice depends on three dimensions that influence the decision when entering a foreign market, including asset specificity, uncertainty, and frequency (Williamson, 1985; Wilkinson & Nguyen, 2003). *Asset specificity* can be defined as the physical (e.g. products and technologies) and human resources (e.g. knowledge and experience)(Anderson & Gatignon, 1986). Firms with high knowledge tend to exploit their knowledge by themselves. This leads to high level of ownership and control over their foreign business operations (Anderson & Gatignon, 1986). TCT suggests that firms can encounter two types of *uncertainty*, including internal uncertainty and external uncertainty (Anderson & Gatignon, 1986). SMEs with less experience may face difficulties coping with the internal uncertainty, as they may not have efficient systems for managing their foreign operations (Zacharakis, 1997). In addition, some scholars mentioned that cultural distance could create a high internal uncertainty for firms (Hollensen, 2011). This can be explained by the higher uncertainty that managers perceive when they are not familiar with the other countries culture (Anderson & Gatignon, 1986). The second type of uncertainty is external uncertainties. They can be commonly seen as country risks such as technological, political situation, currency changes and economic fluctuation (Anderson & Gatignon, 1986). Brouthers & Nakos (2004) found that SMEs enter countries with high uncertainties tended to select lower control modes, while firms entering low-risk countries tended to select higher control modes. In addition, the intensity of competition also creates environmental uncertainty (Porter, 1980). Firms will prefer to choose lower control modes in a highly competitive environment (Chen& Mujtaba, 2007). Williamson (1985) stated that the *frequency* of transactions occurs when there is the repetition of the same kind of transaction. However, Wilkinson & Nguyen (2003) argued that the frequency of transaction should be considered more widely as a form of market potential limitation (e.g. growth and size). The market size restricts the degree of specialization (labor and capital) in the foreign market. Specialized people and resources (e.g. systems and equipment) cannot be fully and efficiently used when sales levels are low in the market (Stigler, 1951).

Institutional theory helps to understand the difference in institutional environments between home and host countries that may influence the entry mode decision defined by certain rules, norms, and values (Davis et al, 2000). Cultural distance may increase internalization costs such as costs related to collecting information and communication in the host country (Steigner & Sutton, 2011). However, Polesello et al. (2013) argued that in countries with a large cultural distance from the home country, the role of the agent or partner was important, which shows the importance of networking to overcome institutional barriers. Murakami (1996) also mentioned that the institutional environment comprises of government intervention, restriction, and regulations. In addition, the host country risk (i.e. political risk) is also one of the most researched institutional factors in the entry mode literature. To enter a high-risk country, the firm may need the help of a local partner that can provide it with access to knowledge about the foreign market and share risk (Luo, 2001).

2.2 *Conceptual Framework*

There are many factors that are taken into account before making decisions regarding the entry mode choice. The entry mode factors proposed belong to the previous related theories. These theories include the resource-based theory, the transaction cost theory and the institutional theory. By applying those entry mode theories to the SMEs, the factors that have considerable impact on SMEs' foreign expansion according to the previous studies were identified. In this study, these factors can be classified into internal factors and external factors.

- *Internal factors*

(1) *Firm size*. According to the resource base theory, the size of a firm indicates the firm's resource availability such as financial and human resources (Koch, 2001; Hollensen, 1988). Smaller firms generally have more limited resources (Root, 1994). Therefore, SMEs may not have enough management potential and skills to enter a foreign market through an entry mode that require a high level of resource commitment by themselves (Koch, 2001). However, when the firm's resource availability increases, this provides the basis for increased international involvement or resource commitment in the market (Root, 1994). Therefore, SMEs with limited resources prefer to choose lower control and resource commitment modes for their international expansion (Root, 1994; Koch, 2001).

(2) *International experience.* According to TCT, international experience is the accumulated local market knowledge to avoid risks in international market transactions (Chen & Mujtaba, 2007). With more international experience in a foreign market, a firm is more able to forecast its costs and returns, to evaluate the market or customer demands and to better respond to a dynamic environment (Koch, 2001). Therefore, a firm can reduce its costs and the uncertainties in a market. While a firm with less experience in international markets is likely to perceive higher uncertainty and risk involved in the foreign market decision. A firm thus hesitates to commit greater resources in the foreign market (Hollensen, 2011). Therefore, SMEs with higher international experience are more likely to commit greater resources to the foreign market (Chen & Mujtaba, 2007). In addition, Koch (2001) found that experience in using a particular entry mode also influenced the future firm's entry mode.

(3) *Product.* The ability to differentiate firm's products or services over its competitors is an important asset specificity of a firm (Root, 1994; Hollensen, 2011). Products, which are services, are hard to serve from a distant market. Generally, a firm providing services needs to be close or interact to its foreign customers. This is similar to manufactured products that need before and after purchase service. Therefore, a local production is suitable (Root, 1994). Moreover, firms with technology intensive products (e.g. technological know-how and highly invest in R&D), they may have to bear a higher risk of leaking proprietary technology if they use a low control mode. In order to prevent the dissemination of technological know-how, a firm will prefer to choose a high control mode (Root, 1994). Therefore, a high-level of product differentiation and complexity is associated with the adoption of a higher control entry mode (Root, 1994).

(4) *Network.* The networking of firms is an important resource and influences the choice of market entry mode, especially for SMEs (Johanson & Vahlne, 2003; Wan & Lowe, 2007). It is an important key to success when entering emerging countries, especially China (Wan & Lowe, 2007). Having a connection with local partners allows firms to gain knowledge and skills as well as access to markets that require high resources and capabilities (Spence, 2003). Firms may also use their networks to get reliable information, reduce

transaction costs, gain legitimacy and maximize the adaptability to new business environments (Wan & Lowe, 2007). However, it also depends on the firm's ability to acquire and exploit resources from their local networks (Chetty & Agndal, 2007). Polesello et.al (2013) stated that the more the firm engages or cooperates in its international networks, the greater the firm's ability to diminish uncertainties and the effects of cultural distance. These allow the firm to overcome the challenges in the host country and thus choose the entry mode that best fits its resources. Ripollés et al. (2012) argued that a network enables the SME to make higher levels of commitment to the host country.

- *External factors*

(1) *Cultural distance.* Previous research showed that managerial perceptions of cultural distance influence the choice of the foreign market. It is an important source of uncertainty that influences managerial decision (Koch, 2001; Hollensen, 2011). Therefore, firms generally tend to initiate their international activities in countries with similar conditions to their own (Root, 1994). Cultural distance can be referred to as the fundamental differences in norms and values between the firm's home country and host country such as language, business practices, consumer products, preferences, religious, beliefs related to consumption and other aspects (Hollensen, 2011). Johanson and Vahlne (1977) pointed out that the lack of knowledge about the differences in culture hinders the operational decisions. However, Barkema et al. (1996) argued that local partners' knowledge helps diminish the risks of entering culturally distant markets. The greater perceived cultural distance between countries, the company will tend to prefer lower control and resource commitment entry modes (Root, 1994).

(2) *Market potential.* Market potential is generally referred to as the size and growth of a foreign market (Chen & Mujtaba, 2007). The market size and growth are the important host country variables that influence the entry mode decision. The larger the size of the target market, the greater the potential for growth and the greater the incentive will be for a firm to commit greater resources in the foreign market. Therefore, a firm is more likely to choose a higher control entry mode for its long-term presence in the foreign country (Koch, 2001).

(3) *Country risks.* SMEs' perception about the host country risks significantly influences their entry mode choices (Brouthers & Nakos, 2004). Country risks arise from political and economic situations of the host country such as instability of the political system and currency (Agarwal & Ramaswami, 1992). These increase the risk and uncertainty about the future demand condition and hinder a firm from entering the target market (Wrona &Trapczynski, 2012). In these cases, a firm may choose lower control and resource commitment entry modes that they can easily exit the market. (Lin, 2000). Therefore, when country risks are high, a firm should choose a lower degree of control and commitment mode (Brouthers & Nakos, 2004).

(4) *Market barriers.* These mainly include legal and trade barriers such as government restrictions, tariff barriers and distribution access. These barriers significantly hinder foreign firms to enter the host country (Koch, 2001). More and more firms look for international expansion if trade barriers have been removed or decreased (Hollensen et al., 2014). However, if the host country's government puts excessive restrictions on foreign ownership, this will push firms to adopt a lower control entry mode (Brouthers, 2002).

(5) *Intensity of competition.* Intensity of competition is measured by the number of competitors of a firm in a foreign country. The level of competition in the target market affects entry mode strategies (Chen & Mujtaba; 2007). If the intensity of competition is high in the foreign market, the market becomes less profitable and does not encourage high resource commitments (Hollensen, 2011). Therefore, in markets with high intensity of competition, firms prefer to choose lower control and resource commitment entry modes (Hollensen, 2011; Root, 1994).

3. Methodology

The purpose of this study is to gain insightful information in order to have a better understanding on how internal and external factors influence SME's in choosing the right market entry mode. This paper applied a qualitative case study methodology through semi- structured interviews in order to gain an in-depth understanding of the topic being investigated. According to Yin (2003), a case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context, particularly when the boundaries between phenomenon and context are not clearly defined. The data was collected through an email questionnaire and face-to-face interview. The questions provided the qualitative information, using the types of "how and why" questions. Two Thai SMEs were included in this study. The analyses of the two cases are presented by comparing the empirical data with the conceptual framework.

4. Findings

The case studies included two Thai SMEs. The first case is a small-sized firm (referred to as company ABB). The marketing director was interviewed through email questionnaire and then the following up questions were answered through online chatting. Company ABB was established in 2010 and is in the IT industry. Before entering China, company ABB has exported to the United States, Australia and Switzerland for around 3 – 5 years. The second case is a medium-sized firm, which is referred to as company NCC. Company NCC was established in 1996. They manufacture and export Thai aromatic coconuts. Company NCC has exported to more than 10 countries, especially in Europe, Australia and Asia. Each country has its top agent that sells their products in those countries. China is the latest market that company NCC has entered. The entry modes to China used by both companies are direct exports through direct sales (agents/distributors) and indirect exports. Due to the exponential growth in China's e-commerce, they also use this opportunity to expand their sales channel through online sales. Therefore, their entry mode choices can be characterized by low level of control and resource commitment modes to China. The analyses of the two cases are presented by comparing the empirical data with the conceptual framework.

4.1 Internal factors affecting entry mode choice to China

(1) *Firm size.* Due to the fact that both of our case studies are characterized as small and medium-sized firms, the size of firm indicates a low degree of resource availability. Company ABB stated that due to their limitation of financial resources, setting a subsidiary or a high control mode in China is harder to manage and control the raw materials and the operations than in their home country by themselves. Company NCC like company ABB is not ready to enter with a high investment mode to China, as they do not have enough resources. In addition, they found that exporting through the agent is the best method for them now since it fits their capabilities and it is the fastest way to enter the Chinese market. Therefore, the perspectives of both companies of our case studies verified this theory that firm size affects the choice of entry mode (Root, 1994; Koch, 2001).

(2) *International experience.* Company ABB has some international business experience prior to entering Chinese market. They have become more careful when choosing their agents or distributors in the Chinese market. Since their experience in the Chinese market increased, they have more knowledge about the local market. They are likely to commit higher resources in the Chinese market in the near future. The respondent of company NCC mentioned that international experience enhances to evaluate about the Chinese market as well the Chinese preferences. In addition, having previous international experience makes them chose the best entry mode that fits their resources and capabilities. In order to avoid high risk in the Chinese market, they chose to enter with low resource commitment modes. Furthermore, they only have used a particular mode, which is exporting, to enter their target markets. This is also the main reason that they also initially used direct exports through local agents in the Chinese market. Therefore, they all have the same perspective that previous experience in the international markets is an important factor that makes it easier to choose an appropriate entry mode. This verifies with the theory (Koch, 2001; Chen & Mujtaba, 2007)

(3) *Product.* Both companies use high technology and know- how to ensure the high quality of their products. Company ABB stated that a differentiated product could creates competitive advantages. They mentioned that their products have better quality and standard than other companies. Like company ABB, company NCC mentioned that their products were manufactured with high technology and know-how to preserve their products longer than others. They stated that differentiation of the products shows less influence on the entry mode choice. This contradicts with the theory according to Root (1994).

(4) *Network.* The findings show that both companies of our cases strongly agreed that the network is very important for doing business in China. They found their reliable partners through their existing networks. These are the main reasons that they started exporting through agents in China. Company ABB shows that the local partners help them deal with the business issues in China. They keep building networks and maintaining strong relationships with their Chinese partners. In addition, they have the ability to access their business partner resources. These induce cooperation with local partners and increase the availability of resources. They are considering the possibility of setting up a joint venture for their local presence in the near future. Therefore, network does influence the choice of entry mode. Company NCC stated that they mainly gain knowledge and reliable information about the market from their local partners in China. In addition, networks help the company to increase their market sales and channels in China. Therefore, these have some consistency with our existing theory that the choice of entry modes is highly connected with the

selection of a particular foreign entry mode, which fits their resource and capabilities according to Polesello et.al (2013). As well as network enables the SME to make higher levels of resource commitment to the host country according to Ripollés et al. (2012)

4.2 External factors affecting entry mode choice to China

(1) *Cultural distance.* Our data illustrated that both cases considered some culture differences between China and Thailand. The main gaps are particularly language, business practices and consumer preferences. Knowing Chinese language is important in doing business in China. Most of their Chinese partners or clients do not use English and even if they can speak English, they still prefer to use Chinese when communicating. The respondent of company ABB mentioned that it is important to be aware of local preferences and adapt accordingly in the Chinese market. Company NCC also faced with the big difference in the consumer behavior in the beginning of entry to China. Unlike Thai consumers, most Chinese consumers do not know how to consume their products as well as how they are different from the local coconuts. Therefore, cultural distance affects the entry mode choice. This verifies with the theory according to Bedi and Kharbanda (2014)**.**

(2) *Country risk*. Both companies stated that the country risks in terms of political conditions are relatively stable in China. They mentioned that country risk has no importance for their choice of entry modes as they still chose to enter China with low control modes. Therefore, the influence of country risk has no serious effect on the firm's entry mode choices. This contradicts with the theory according to Brouthers and Nakos, (2004).

(3) *Market barriers*. Both respondents stated that the government restrictions and trade barriers have gradually been reduced in China. Moreover, both countries governments support the trade relations between the countries through signing bilateral agreements such as a free trade agreement. These motivate them to sell their products in China. However, both respondents mentioned that the influence of market barriers has no serious effect on the firm's entry mode choice. This contradicts with the theory according to Brouthers (2002).

(4) *Market potential*. The respondents of both companies stated that the Chinese market has very high potential when they initially entered to China. In addition, the respondent of company NCC mentioned that the growth of China's middle class, which is their main target group, is increasing. These factors significantly motivated them to enter the Chinese market. However, for our case studies, it has limited effects on the entry mode decision since both companies still choose the same entry mode as in other destinations. The influence of market potential has no serious effect on the firm's entry mode choice. This contradicts the theory according to Koch (2001).

(5) *Intensity of competition*. The respondents from both investigated SMEs mentioned that before entering into the Chinese market, it was important to evaluate about the competitors, both the local and foreign competitors in the Chinese market. The intensity of competition is very high in the Chinese market especially the local competitors. Our findings from company NCC showed that there were only a few competitors at the beginning so they easily sold their products with the high competitive price in the short period. However, after entering only few months, the number of their competitors substantially increased. Recently, the company has faced fierce price competition and oversupply of the products in the market. The respondent mentioned that intensity of competition affects their entry mode choice to China. This verifies with the previous theory according to Hollensen (2011).

5. Conclusions

In order to answer the main research question, *"How do Thai SMEs make the entry mode decision entering China*? ", the researcher in the present study tried to find out the main factors determining the firm's choice of entry modes. This study established a framework based on three main theories, including the resource-based theory, the transaction cost theory and the institutional theory. The researcher developed a set of possible influential factors affecting the entry mode decision, including internal factors and external factors. Considering the influence of internal factors in our qualitative case studies, the findings show that firm size, international experience and network have the most significant influence on their entry mode decision. The size of firms indicating the availability of resources restricts both companies to choose a higher resource commitment mode when selecting their market entry modes. This is mainly due to the limited of resources especially financial resources. In addition, the theory and both companies argue that previous experience in the international market affects their choice of entry modes. The selected Thai SMEs considered how they have previously entered into other markets. This showed that previous experience of using a specific market entry mode also influence both companies future choice of market entry modes. Furthermore, when a company has gradually experienced in the local markets, this increases the local market knowledge and the chances of committing additional resources in that market. Network, according to our findings, is important for the way to conduct business in China. Networking allows SMEs to find reliable sales agents and customers as well as increase their allocation of resources in the Chinese market. These lead them to choose entry modes such as exporting through sales agents or distributors. In addition, building up networks in China can also be beneficial when considering a higher resource commitment mode such as a joint venture. According to the findings from our cases, the product is not an important internal factor affecting the choice of entry mode. Both of our SMEs applied high technology and know-how to make their product differentiate. However, they still chose to enter China with low control modes to China and other countries. This could be due to limited resources. Concerning the external factors, according to the case studies, cultural distance and intensity of competition significantly influences the choice of entry modes. However, high market potential, low market barriers and low country risk of the Chinese market according to our case studies have less influence on the entry mode choices. These factors motive SMEs to enter into the Chinese market rather than influence the choice of entry mode. Specifically, due to the high market growth of the Chinese market along with the rise of the middle class, these are the main reasons for them to enter China. The results point out that both of our case studies primarily entered into China through entry modes characterized by low levels of control and resource commitment before adopting more resource intense market entry modes, such as a joint ventures. In addition, they all also chose to adopt direct sales through online sales as another way to enter China due to the boom of the Chinese e-commerce market. Our case studies showed the importance of their agents/distributors in China, which is one of the key aspects of success of their products in China. Especially, company NCC, their agent market and also distribute their products around China as well as deal with the critical issues of importing Thai aromatic coconuts to China. Therefore, maintaining a good relationship with their agents/distributors is significantly important when expanding their business to China especially for SMEs with limited resource.

The objective of this study is not to generalize of the research findings but rather to provide a rich understanding of personal experiences and reality through particular cases. The research findings are associated with the specific context and the limited number of case study companies. However, this study can potentially contribute valuable knowledge to the further research in the similar contexts. It should be highlighted that entry mode choice is a complex decision that requires all of the considered factors. In addition, the same factors could be perceived differently by different companies or in different situations. Therefore, managers need to systemically evaluate the main factors that influence the company's choice of foreign entry modes in order to choose the most suitable entry mode choice for the target market.

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