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INTERNATIONAL ENTRY MODE CHOICES AMONG FOREIGN SMALL AND MEDIUM ENTERPRISES (SMEs) - NEW EVIDENCE IN ENTREPRENEURSHIP PERSPECTIVE

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INTRODUCTION

International entry mode research is relatively developed and has been growing for several decades in international business. This is due to the need to answer questions on why and how firms go to invest abroad. Scholars have tried to investigate how and why firms choose certain entry mode to their destinations. Despite of the developments in international business field this research on entry mode from an entrepreneurship perspective (SMEs) hasn't progressed much. This paper aims at bridging this gap by explaining new evidence from an entrepreneurship perspective. The existing empirical literature on foreign direct investment (FDI) entry mode tends to allow a binary choice between wholly owned enterprises (WOEs) and joint ventures (EJVs) or between Greenfield investment and acquisition only. The current study includes four entry modes and investigates whether the modes are available or important to the foreign SMEs as they invest in Kenya.

The choice of foreign entry modes has been the focus of recent theoretical and empirical research in international business but mainly among multinational enterprises (MNEs). For SMEs FDIs it's highly lacking and more so in Kenya. Studying the entry mode is more important in that firms interested in serving foreign markets face a difficult decision in the respect to the choice of entry strategies (Agarwal and Ramaswami, (1980).There is no complete listing of mode structures that exists or available for those choosing to invest. as mentioned earlier some studies have investigated wholly owned subsidiaries (WOs) and joint ventures (JV) while other between contracts and equity modes. A study by Brouthers and Hermart (2007) identified sixteen different modes based on the previous studies. Erramilli and Rao (1990), Identified eleven types of entry modes while Anderson and Gatignion (1986) listed seventeen mode types. Meyer et al (2009) classified entry modes into three types: Green field, acquisition and joint ventures. In summary, it is clear that scholars have investigated and defined entry modes from different levels and perspectives. Some have looked at them at the modes based on the theoretical approaches by the

business that internationally expands among MNCs and on foreign direct investment, while others have studied the local firms. This study looked at the mode of entry choice by foreign firms investing among the SMEs. It also picked four entry mode choices that are commonly preferred by scholars in explaining the entry mode among MNC. They include whole owned, Greenfield, joint ventures and acquisitions. These modes were applied among foreign SMEs in order to study their performance from an enterprise perspective.

Keywords: foreign investment, performance, entrepreneurship, entry mode and small and medium enterprises

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OBJECTIVE

This paper general objective is:

To investigate the entry mode of manufacturing foreign SMEs, investing in Kenya.

The question this paper aimed to respond to was: which are the choices of entry modes that the foreign manufacturing SMEs use when investing in kenya.

BACKGROUND LITERATURE

For many years entry mode has been considered an important issue in international business and is presumed having great impact on MNCs successful expansion overseas (Wind and per mutter, 1997). Many investors when they enter a foreign country are concerned on how to manage and minimize risks and overcome entry and market access barriers. An appropriate entry mode is critical for the success of foreign firms investing abroad. Studies have identified many factors that lead companies to invest in foreign markets. Some of these include, expand market, exploit low –cost labor access natural resources or gain investment incentives in the host country, (Erramili, 1990).

ENTRY MODE FACTORS

According to Brothers and Nakos (2004) the entry mode factors that are critical to SMEs entry into FDI include Greenfield investment, intra-company mergers and acquisition, re-investment earnings and non-equity mode. The FDI entry mode of choice is considered critical strategic decision. The environment under which FDI SMEs operate is found to influence the entry mode choice. In countries with high environmental uncertainty, SMEs may, better off selecting non-equity, high investment entry modes. This strategy not only avoids resource commitment but frees entrants to change partners or renegotiate contract terms and working arrangements relatively easily as circumstances develop and change (Ching-Hui Tsen et al 2007). Manufacturing SMEs tend to use equity entry modes when entering markets where environmental uncertainty is low (Zeng and Xie et al 2009).

In studying the relationship between internationalization and SME performance, Oviatt and McDougall (2005) identified a strong connection entry mode type and performance. They found that non-equity exporting and equity-based foreign direct investment (FDI) modes of entry had on profits as their level of performance. Exporting companies tended to experience a negative impact on profits as their level of internationalization increased, while firms engaging in FDI experienced a nonlinear relationship. Companies with low levels of FDI showed a decline in performance. This tends to indicate that, at least for SMEs, mode of entry may be an important determinant of international performance. Other scholars have made similar observations. For example Crick and Spencer (2005) found that by using wholly owned Greenfield ventures outperform those using joint ventures; using joint ventures outperform those using wholly owned acquisitions. Freeman and Reid (2006) found that using wholly owned Greenfield ventures tended to have higher performance compared to those using wholly owned acquisitions. Finally, Zeng and Xie et al 2009 found that SMEs using equity joint ventures had higher profitability in comparison to both wholly owned operations and contractual joint ventures.

Entry mode literature aims to pay attention to the level of control because it is the most significant determinant of both risk and return. Foreign presence can be divided into high control mode (e.g. wholly owned subsidiary, majority owned subsidiary, e.t.c.); or low control mode (e.g. licensing, export, e.t.c.). The high control mode implies the highest mode of integration, whereas low control entry mode offers the lowest mode of integration (Blomstermo, Sharma, & Sallis, 2006; Ekeledo & Sivakumar, 2004).

METHODOLOGY

The study combined both primary and secondary data the sample size was thirty seven foreign SMEs manufacturing firms in Kenya at the export processing zones. The respondents included the management for they were deemed to be information rich. Primary data was collected by use of questionnaire that was administered to the respondents through the help of a research assistant

The level of firm performance reviewed was based on secondary data obtained from the respondents audited account for the latest three years

RESULTS AND DISCUSSIONS

The Modes of Entry and their Potential Benefits

This was the objective of the study and the data was collected and analyzed based on this objective. International entry mode choice is considered a critical strategic decision (Lu, 2002). The success of SMEs under globalization depends on a large part on the formulation and implementation of strategy (knight, 2000). By exploiting the entry mode behaviour of SMEs one can determine whether they follow similar patterns as their larger counterparts and whether the strategic decision processes that influence success for larger companies have validity in smaller firms. The gist of this paper was to find out the entry modes by SMEs investing in Kenya.

As discussed in the background literature the types of FDI entry mode for manufacturing SME's include green field (new establishments), mergers and acquisitions, joint ventures and wholly owned establishments. As indicated in Table1 the companies adopted various forms of entry into the Kenyan market.

Table 1: Modes of Entry

Modes of entry	Frequency	Percentage
1. New venture establishment	20	54.1
2. Joint venture	8	21.6
3. Mergers	5	13.5
4. Acquisition	4	10.8
Total	**37**	**100.0**

The most common mode of entry was new venture establishment or green field (54.1 percent) where the firms construct new facilities of production, research and development and distribution in the host country. According to Hellensen (2007) the green field investment is the most desirable mode of entry since it creates employment in the host country. The findings agree with her study result since this was recorded as the most preferred mode choice. In Kenya, with a booming population and where employment generation is a prime concern, any FDI which contributes to employment generation should be welcomed. The second popular mode of FDI entry is joint venture standing at 21.6 percent. According to Tiusanen (2010) joint venture investment facilitates acceptance to host country capital and human resources which also gives the form a local image.

Mergers or brown field is the third mode of entry used by the firms and stands as 13.5 per cent. 60% of these firms merged into Kenyan companies. Acquisition accounted for 10.8 per cent. According to both Hellenses (2007) and Tiusanen (2010) acquisition as mode of entry is the least desirable mode of FDI unless FDI is crucial to success of the privatization of loss-making public enterprise and provide fresh foreign capital.

One of the most important decisions regarding the internationalization process of firms is the choice of the entry mode (Quer, Claver, & Andreu, 2007). Several studies have shown that selection of an appropriate entry mode in a foreign market can have significant and far-reaching consequences on a firm's performance and survival (Davidson, 1982; Ekeledo & Sivakumar, 2004; Gaignon & Anderson, 1988; Root, 1998; Terpstra & Sarathy, 1994). This is one of the most critical strategic choices, because it affects the firm's future decisions and operations in the selected country market (Brouthers & Hennart, 2007; Kumar, 2000

The size of a firm has been recognized as an important source of strategic advantage (Tan, Erramilli & Liang, 2001). The relationship between firm size and the use of equity-based entry mode has been widely investigated (Agarwal & Ramaswami, 1992; Brouthers, et al., 1996; Nakos & Brouthers, 2002). For instance, Osborne (1996), analyzing a sample of New Zealand SMEs, discovered that smaller SMEs tended to prefer no equity modes while larger SMEs tended to prefer equity modes.

A number of studies have found a positive relationship between international experience and the use of a particular entry mode. For example, Gankema, Snuit and Van Dijiken (1997) found that when an SME gains experience it moves from exporting to equity investments. Carpenter, Pollock and Leary (2003) argued that executives with significant international experience are more likely to prefer green field investments and acquisitions over joint ventures (Hermann & Datta, 2006).

Performance of Foreign Direct Investing SMEs

The respondents were required to indicate the impact of FDI impact. As indicated in Table2 below 35% of the respondents, indicated that the greatest benefit related to backwards linkages with suppliers.

Table 2: Benefits of FDI entry mode

Benefits	Frequency	Percentage %
1. Backwards linkages with suppliers	13	35
2. Forward linkages with customers	11	29
3. Linkages with competitors	8	21
4. Linkages with technology	6	15
Total	**37**	**100**

This referred to the extent to which the services are outsourced from within the host economy, since it can create new market opportunities for local firms. Such linkages ranged from arms length market to transaction to deep, long-term inter firm relationships. The productivity and efficiency of local suppliers can benefit from this type of spill-over, as a result of detect knowledge transfer and high quality requirements. The forward linkages with customers accounted for 29% and included marketing outlets which are outsourced. The linkages with competitors was the third benefit of the entry mode standing at 21%

where the foreign SMEs set new standards which local firms may seek to compete with. The fourth benefit of the entry mode was the linkages with technology partners standing at 15% where some foreign SMEs initiated common projects with indigenous SME partners, including joint ventures, licensing agreement and strategic alliances, which are an important potential source of technology and know-how for firms in the host country.

Performance

Capital Invested

Capital invested was analysed on the type of FDI. The secondary data was obtained from the responding firms annual audited accounts for three years (2009, 2010, and 2011) the results in Table3 indicated that each of the clusters had a substantial increase of the capital invested in Kenya

From the data collected, the capital invested by the FDI, SMEs increased from US$1.73 million in year 1 to US$305 million in the 3rd year. This indicates that the growth in capital was a substantial 175% indicating a growth in SME's from foreign countries investing in Kenya. The greatest growth was attained in the acquisitions, category at 266% growth US$ million to US$40 million.

Table3 Average capital invested by FDI type

Type of FDI	Frequencies	%	Capital Invested (US$)			
			Year 1	Year 2	Year 3	Average
1. venture Capital establishment	20	54.1	100,000,000	125,000,000	150,000,000	375,000,000
2. Joint venture	8	21.6	32,000,000	48,000,000	60,000,000	132,000,000
3. Mergers	5	13.5	25,000,000	40,000	55,000	120,000,000
4. Acquisitions	4	10.8	16,000	28,000,000	40,000	84,000,000
Total	37	100.0	173,000,000	233.000,000	305,000,000	701,000,000

(SOURCES: Annual respondents audited accounts)

For instance the capital invested in venture capital establishments increased from Kshs. 100 million in year 1 to Kshs 150 million in years 3. The total amount invested by all respondents increased from Kshs 173 million in year 1 to Kshs 305 million. Financial resources are essential to FDI performance. Affluent financial resources give firms a greater degree to freedom to contemplate wide ranging foreign expansion possibilities without necessarily compromising among opportunities, and make the expansion process much smoother and less problematic (Ching-Hui Tsen, et al 2007)

Annual Sales Turnover

The category with the greatest growth in turnover was acquisitions, whose turnover increased by 226%, followed by mergers at 212%. The category with the least growth in sales was Greenfield investments at 150% though it had the highest turnover due to the high number of firms in this category. This shows that FDI SME's all experiencing high performance in terms of sales in Kenya within the 3 years of operation under review. Whether this trend is sustainable can only be determined longer period of time.

The annual sales were analyzed from the secondary data obtained from the firms audited accounts for each of the FDI type. As indicated in Table4 each of the FDI cluster has a substantial annual sales increase for each of the three years.

Table 4 Annual Sales Turnovers

Type of FDI	Frequencies	%	Turnover US			
			Year 1	Year 2	Year 3	Total
1. venture Capital establishment	20	54.1	120,000,000	125,000,000	180,000,000	450,000,000
2. Joint venture	8	21.6	52,000,000	72,000,000	100,000,000	224,000,000
3. Mergers	5	13.5	40,000,000	60,000,000	85,000,000	185,000,000
4. Acquisitions	4	10.8	30,000	45,000,000	68,000,000	142,000,000
Total	**37**	**100.0**	**173,000,000**	**327.000,000**	**433,000,000**	**902,000,000**

(SOURCES: Annual respondents audited accounts)

For instance the annual sales for venture capital establishment increased from Kshs. 120 million in year 1 to Kshs. 180 million in year 2. The total amount of sales for all the respondents increased from Kshs. 142 million in year 1 to Kshs. 433 million in year 3. This indicates that the sales turnover increased by a margin of 204.9% over the three year period for all the firms.

Profitability

The trends in FDI cluster profitability was calculated using the secondary data from the firm's annual audited accounts. As indicated in Table5

Table5

Type of FDI	**Frequencies**	**%**	**Profitability trends**			**Average S.D Variations**
			Year 1 %	Year 2 %	Year 3 %	
1. Venture Capital establishment	20	54.1	19	21	25	21.6
2. Joint venture	8	21.6	18	20	24	21.0
3. Mergers	5	13.5	21	23	25	23.0
4. Acquisitions	4	10.8	19	20	22	20.0
Total	**37**	**100.0**	**19.0**	**18.5**	**28.0**	**21.4**

(SOURCES: Annual respondents audited accounts)

In Table5 all the FDI clusters showed a remarkable increase from year 1 to year 2. For instance, the trends for venture capital establishment increases from 19% in year 1 to 25% in year 3. The overall increase for all FDI clusters increased from 18.5 % in year 2 to 28% in year 3.

The category showing the greatest increase in profitability was Greenfield investment from 19% to 25%. Mergers had the least growth in profitability from 21% to 25% which was an increase of 4 percentage points for the three years. In overall, mergers had the highest profitability on Sewerage at 23% while acquisitions had the lowest average for the 3 years at 20%.

Network

There is a linkage between the foreign firms and the local firms in Kenya (Table 4.11). The common networks are mainly with suppliers of raw materials (54.31 percent), followed by training consultant firms at (13.5 percent), the buyers, sellers and other distributors came third at (10.8 percent). The last in the category was employment firms at (8.1 percent).

Table6

	Frequency	**Percent**
Suppliers of raw materials	20	54.1
Training consultants	5	13.5
Employment firms	3	8.1
Suppliers of raw materials and technical expertise	5	13.5
Suppliers of raw materials and training consultants	4	10.8
Total	**37**	**100**

The findings therefore show that there are linkages that have been created between the foreign firms and the local economy. This is important because studies have shown that collaborative agreements have the most potential to contribute to local industry upgrading. This happens through the process by which foreign investment contributes to the capabilities and resources of local enterprises through resources transfer and or diffusion within both intra-firm and inter-firm networks CoH-kennel (2001).

CONCLUSIONS

The modes of entry considered in this study included new venture establishment, joint venture and mergers and acquisition of the three entry modes only new venture establishment was positively related to performance. This is supported by Woodcock et al (1994) who found that SMEs using wholly owned Greenfield ventures outperform those using joint venture, SMEs using joint ventures outperform those using wholly owned acquisitions and Nitsch et al. (1996) who found that SMEs using wholly owned Greenfield ventures and joint ventures tended to have higher performance compared to those using wholly owned acquisitions. Finally, Pan, Li and Tse (1999) found that SMEs using equity joint ventures had higher profitability in comparison to both wholly owned operations and contractual joint ventures. These findings indicate that SMEs making greater asset-specific investments tended to prefer equity modes of entry, while SMEs making less asset-specific investments tended to prefer non-equity modes. This does not mean that SMEs have more innovative products/services, but merely shows that SMEs make different mode choices contingent on the level of specific investment required.

Most SMEs have limited resources that restrict search and analysis activities. Because of these restrictions, many SMEs tend to prefer non-equity modes of entry. But examining the three key transaction cost issue s discussed in this study can help managers make more successful mode of choice decisions.

Managers need to evaluate:

The level of specific –asset investment required in a new market

The environment uncertainty of the potential target country

The status of internal control systems and processes

If an entry requires high specific-asset investment, then equity modes of entry (joint ventures or wholly owned modes) should be considered; if the specificity of investment is low, non-equity modes (such as licensing or franchising) should be used. If the firm is thinking about doing business in a country where the economic, political and social system is relatively stable and certain, equity modes of entry should be preferred. When there is volatility in the economic, political and/or social environment, non-equity modes may provide a more effective way of dealing with these uncertainties.

Finally, managers need to evaluate their own internal control systems and processes. Firms that possess strong internal control processes may be in a better position to take advantage of equity modes of entry compared to firms with weak internal control systems. Firms without strong systems may benefit from relying on the control systems of partner organizations and can utilize non-equity modes of entry. Hence, by evaluating these three criteria, SME managers can make better entry mode decisions.

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