SME export channel choice in international markets

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ABSTRACT

The Internationalization Process (IP) model claims that firms gradually accumulate knowledge of foreign markets, and that this kind of knowledge determine foreign establishment. Later developments of the model claim that experiences and knowledge of local business relationships are also essential elements of the IP model. The IP model has been found to hold well for incremental resource commitments.

However, while other theories, such as the transaction-cost theories have managed to explain why firms go from integrated to non-integrated channels, the IP model has produced mixed results. This paper tests some of the fundamental IP model factors on a sample of Small and Medium Sized firms. Findings are that factors included in the initial explanation of the IP model explain choice of channel, but that the later developments of the model does not. Implications are that the foreign market knowledge is, and that more incremental experiential knowledge accumulation is not relevant for export channel choice as regards integrated or non-integrated channel.
INTRODUCTION

Determining market channels is usually considered to be a discrete decision made by the expanding firm (e.g., Anderson & Coughlan, 1987; Bello & Gilliland, 1997; Solberg & Nes, 2002). In reality this decision is often limited by knowledge constraints and customer demands. We find an example of this in Gamma’s attempt to enter the Italian market (Hohenthal, 2001). Gamma is an electronics company with around 150 employees that is very export oriented. To handle the service needs of their product Gamma has established service subsidiaries in 13 of their markets. The product is manufactured to fit the specifications of the customer. Every product is different and even small deviations from specifications can create big errors. The main task for the subsidiaries is to install the equipment, train the customer and make sure that everything works. Once in place the product has to be calibrated every four months, which is done by the service teams. The subsidiaries also scan the market for new customers and competitors.

This new deal was initiated by an Italian research institute. Gamma offered the Italian customer a standard system with a five-year service agreement. Specifications and price were considered acceptable for the Italian institute, but the service agreement was a source for dispute. Gamma wanted to handle service from their French subsidiary, but the Italians wanted Gamma to establish a service unit in northern Italy. Gamma did not believe that the market was big enough to merit a subsidiary but they would have to establish one to get into the new market. The options for Gamma were thus limited to one possible channel and they could either take that option or forget about market entry at this point. In the end, Gamma decided not to set up a subsidiary. This is not a unique situation facing internationalizing SMEs. The array of possible channels is usually rather limited.
The firm’s decision of what channel to use may be the result of firm’s knowledge or indeed lack of knowledge about a specific customer and the foreign market in general, such as competitors or cultural differences. A theoretical framework that recognizes how a firm’s knowledge of a foreign market and the influence business relationships may have on the choice of market channel is the Internationalization Process (IP) model (Johanson & Vahlne, 1977, 1990, 2003). This framework postulates that firms will increase their commitment in a market with increased experience. Because firms wish to avoid uncertainty and initially lack foreign market knowledge, the IP model claims that firms expand operations in small sequential steps, starting with no regular export activities and gradually increasing their commitment to the market and finally setting up a manufacturing subsidiary (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975). This outcome of sequential steps, also known as the establishment chain (Johanson & Wiedersheim-Paul, 1975), has been heavily criticized because empirical research has shown that the establishment patterns of firms are less restricted than proposed by the model (Björkman, 1989; Hedlund & Kverneland, 1984; Turnbull, 1987; Welch & Loustarinen, 1988). Even though firms use a variety of establishment patterns when internationalizing, a growing body of research shows that firms gradually develop knowledge from experiences (Barkema, Bell & Pennings, 1996; Barkema, Shenkar, Vermeulen & Bell, 1997; Barkema & Vermeulen, 1998; Delios & Beamish, 1999, 2001; Eriksson, Johanson, Majkgård & Sharma, 1997; Hitt, Dacin, Tyler, & Park, 1997; Madhok, 1996; Zahra, Ireland, & Hitt, 2000). Thus, the model’s fundamental argument that knowledge is developed through experience is generally supported in internationalization research.
Based on the critique of the establishment chain proposition, there is reason to reconsider the explanatory power of the IP model. Perhaps the IP model is best used to explain sequential build up of knowledge, rather than discrete choices of mode of establishment. Experience accumulation goes on before, during, and after the exact time when a decision to establish in a certain mode is made. Despite the extensive acceptance of behavioural-oriented arguments in the foreign entry mode research (export, joint-venture and subsidiary mode) surprisingly few studies are conducted on the determinants of integrated and non-integrated channels (see Aulakh & Kotabe, 1997 for notable exception). Thus, a behavioral-oriented approach to the study of firms’ choices of market channel in foreign markets may prove to be fruitful. It is of particular interest since transaction cost analysis has been able to explain to a large extent why firms choose integrated or non-integrated channels (Hennart 1991). Is it the case, then, that the explanatory power of the IP model does not include the choice between integrated and non-integrated channels? If so, then there is a need to make clear that the IP model offers a different kind of explanation, which explains sequential knowledge accumulation through experience, and nothing else.

The purpose of this article is to test, which IP-related antecedents lead to use of a specific channel in a foreign market. The two alternatives tested here are integrated and non-integrated channels. In order to accomplish this we start with presenting an internationalization process approach to international business and then go on to discuss channel choice from a knowledge perspective. Several hypotheses are developed concerning channel choice and tested on a sample of small- and medium-sized companies (SMEs) from Sweden, Denmark and New Zealand. The data analysis technique is logistic regression, and we follow up with a discussion of the results and some managerial and research implications.
CHANNEL CHOICE AND THE INTERNATIONALIZATION PROCESS

In furthering our understanding of the dynamics of the internationalization of firms, process models have played a significant role (Bilkey & Tesar, 1977; Cavusgil, 1980, 1984; Czinkota, 1982; Johanson & Vahlne, 1977, 1990; Luostarinen, 1980; Reid, 1983). In a review of internationalization process models Andersen (1993) distinguishes between a U-model (Uppsala) by Johanson and Vahlne (1977) and the I-models (Innovation) by Bilkey and Tesar (1977), Cavusgil (1980, 1984), Czinkota (1982) and Reid (1983). This paper is based on the U-model developed by Johanson and Vahlne (1977). The main reason is that the U-model is assumed to be valid for firms of any size while the I-models may be applied to small firms only (Andersen, 1993). The models are similar however, in that they are behavioral in nature and in that experiential knowledge is a prominent factor in the internationalization process. In the following, we use the term the internationalization process model to denote the U-model.

The internationalization process model, with its roots in the behavioral theory of the firm (Cyert & March, 1963) and the theory of the growth of the firm (Penrose, 1959) assumes that because firms initially lack knowledge concerning differences in foreign markets an incremental behavior is adopted to minimize risks and avoid uncertainty when internationalizing (Johanson & Wiedersheim-Paul, 1975). As a consequence it is argued that firms tend to choose countries that are perceived as having a similar institutional environment as their home-markets (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1977). Firms gradually develop knowledge from each individual business activity in foreign markets and this way of overcoming cultural ignorance is a result of knowledge developed from experiences (Penrose, 1959; Johanson & Vahlne, 1977)
However, the internationalization process model has been criticized. Because firms wish to avoid uncertainty and initially lacks of foreign market knowledge the internationalization process model predicts that when a firm enters a new foreign market it will expand its operations in small sequential steps, starting with no regular export activities and gradually increase its commitment by the establishment of agent, joint venture, partially owned subsidiary, to finally set up a wholly owned subsidiary (Johanson & Wiedersheim-Paul, 1975, Johanson & Vahlne, 1977). This outcome of sequential steps also known as the establishment chain (Johanson & Wiedersheim-Paul, 1975) has been heavily criticized since empirical research has shown that firms’ establishment patterns are less restricted than proposed by the model (Hedlund & Kverneland, 1984; Turnbull, 1987; Welch & Loustarinen, 1988; Björkman, 1989). Even though there are differences to the establishment patterns of firms, a growing body of research support that firms gradually develop knowledge from experiences (Barkema et al., 1996; Madhok, 1996; Barkema, Shenkar, Vermeulen & Bell, 1997; Eriksson et al., 1997; Hitt, Dacin, Tyler & Park, 1997; Barkema & Vermeulen, 1998; Delios & Beamish, 1999, 2001; Zahra, Ireland & Hitt, 2000). Thus, it seems that these developments of the internationalization process model suggest that channel choice should be linked to experiential knowledge development in a not so deterministic and sequential way as before. Channel choice will probably be affected by experiential knowledge, but not in the same, sequential way as the original internationalization process model suggests.

An area where there has been considerable development of the internationalization process model concerns the importance of business relationships. There is now a substantial body of literature supporting the view of international business conducted in networks of business relationships (Chen & Chen, 1998; Coviello & Munro, 1997; Blankenburg-Holm, Eriksson &
Johanson, 1996). The literature has emerged as an answer to a call for the study of international business exchange in international business (Toyne, 1989). Also, empirical observations have shown that market transactions often take place within the frame of lasting business relationship between the business partners (Ford, 1990; Håkansson, 1982; Turnbull & Valla, 1986). Market activities have been observed to consist of interactions within long-lasting business relationships (Anderson & Narus, 1990; Hallén 1986). The activities in business relationships is usually a complex process of matching needs that comprise knowledge not only of goods and services being transacted, but also of the wider business context of the firms (Cunningham & Homse, 1986; Hallén et al. 1991). These business relationships are linked to each other, so that they form networks of interdependent business relationships (Blankenburg-Holm et al., 1996). The studies on business relationships can partially be related to studies of international joint ventures, licensing, management contracts and strategic alliances (Beamish & Killings, 1997; Contractor & Lorange, 1988).

Taken together, recent developments of the internationalization process model highlights the importance of experiential knowledge development and business relationships and networks (Eriksson et al., 1997; Johanson & Mattsson, 1987, 1988; Johanson & Vahlne, 1990, 2003). We also need to seriously consider the role of exploration in the internationalisation process (Madhok, 1997). Rather than denouncing the importance of these factors for channel choice, we identify them as important, and potentially also factors that are good at explaining channel choice. In the following, we re-consider channel choice in light of these recent developments of the internationalization process.
We are going to present five hypotheses building on the theoretical framework given in the previous section. We start from the IP-models claims that country knowledge, opportunity seeking, and cultural distance are the central concepts for explaining the international expansion of firms (Johanson & Vahlne, 1977). The paper continues with the subsequent development of the IP-model (Eriksson et al., 1997) that claimed that internationalization knowledge is an important factor in explaining internationalization and the network aspects of customer and competitor knowledge (Johanson & Mattsson, 1987, 1988; Johanson & Vahlne, 1990, 2003).

**Country Knowledge**

In a similar way, the organizational forms (foreign market operation methods) that the internationalization process takes represent a gradual resource commitment. First, the firm export incidentally, then systematically through local intermediaries, and eventually a subsidiary is established. In separate studies Johanson and Wiedersheim-Paul (1975), Davidson (1980) and Gatignon and Anderson (1988) have observed an increasing propensity to select wholly owned subsidiaries as experiential knowledge of the market increases. Klein & Roth (1990) also claim that with greater experience in a foreign market there is a positive incentive for exporters to integrate forward. Therefore we claim that firms with more country experience tend to use integrated channels to capitalize on their knowledge.

H1: Firms with more country experience tend to use integrated channels.
Market Growth

According to Penrose (1959) expectations of future outcomes are the immediate determinant of firm behavior, and this is also a fundamental tenet of the internationalization process model. The commitment decision of firms to a market is based on managers’ perceived ability to estimate present and future outcome of a market. Hence, if the expectation of a market’s potential for future growth is high the estimated risk of using a high commitment mode is reduced and thus the propensity to use an integrated channel increases (Johanson & Vahlne, 1977). Such finding is reported by Calof and Beamish (1995) in their study of patterns of mode change. In their interviews with managers Calof and Beamish found that managers that felt more confident with the market i.e. perceiving it with a potential of being large enough led to increased resource commitments. Agarwal & Ramaswami (1992) also found that firms tend to use integrated channels in markets with higher potential. Therefore we suggest that firms that expect high market growth will position themselves to handle the increase in sales by using an integrated market channel.

H2: Firms that expect a higher market growth will tend to use integrated channels.

Cultural Distance

In the internationalization process model (Bilkey & Tesar, 1977; Johanson & Vahlne, 1977) two dimensions of international expansion are identified: the geographical expansion and the expansion in terms of resource commitment. The process model postulates that as the geographical and cultural distance between the home and the host markets increase, the more difficult it becomes for firms to collect and interpret incoming information properly. This ‘psychic distance’ between the home and the foreign market affects the selection of the
market as well as the choice of foreign market operation method. The cultural distance between the home and the host country influences a firm’s knowledge about a market, where greater dissimilarities between countries increases the difficulties of estimating the risk of conducting business and thus enhance managers’ uncertainty (Carlson, 1966). Studies based on the logic of market uncertainty and organizational knowledge has shown that a high commitment mode such as a subsidiary is less preferred when the cultural distance between home and host country increases. Erramilli (1991) found that in service firms the choice of high commitment mode decreased as the distance increased. Davidson (1980), and Brouthers and Brouthers (2001) show that the usage of licensing and/or joint ventures increases with cultural distance. With increased cultural distance it may be more difficult to establish and manage integrated channels in markets because of cultural dissimilarities. We would therefore claim that firms prefer non-integrated establishment modes when cultural distance increases.

H3: Firms will prefer non-integrated channels in markets at a larger cultural distance.

International Experience

A recent development of the internationalization process model (Eriksson et al., 1997) shows that international experiences generate a firm-specific procedural knowledge of how to internationalise. This type of knowledge is not specific to a particular market but relevant for all markets. Thus, Eriksson et al. (1997) argues that international experience improve a firm’s ability to search and evaluate information from foreign markets. Firms with little international experience may feel less confident in estimating the risk and future returns of a market and thus initially prefer to be less committed to a market (Johanson & Vahlne, 1977; Davidson, 1982). Firms with experience from more international markets will be in a better position to handle sales on a specific market thus making integrated channels more probable. That firms
tend to opt for integrated channels at higher levels of international experience has also been supported by subsequent empirical findings (Gatignon & Anderson, 1988; Erramilli, 1991; Aulakh & Kotabe, 1997). We would thus expect firms with more international business experience to use integrated market channels.

H4: Firms with more international business experience will tend to use integrated channels.

**Customer Knowledge**

From a network perspective establishment on a market is a question of starting a specific business relationship with a new customer in that country and we would therefore expect the firms knowledge of the customer to influence channel choice. Initially, the firm’s knowledge concerning the other specific partner is naturally low. If the relationship continues however, the interaction between the two concerned parties will lead to a situation where they learn the counterparts capabilities and needs and thus developing trust and interdependence between the firms (Håkansson & Snethota 1995; Hohenthal 2001; Håkansson & Johansson 2001). The importance of knowledge and the subsequently development of trust have been illustrated by Lindstrand (2003) when studying business relationship development. The study found that knowledge about the counterpart increased the willingness to invest in the relationship and thus, increase their interdependence. Indeed, if the firm has acquired knowledge about its counterpart we believe that considerable time and effort has been put into the relationship, assuming that the need for coordination between the counterparts has increased (Johanson & Mattsson, 1987). Therefore, we suggest that if a firm has customer knowledge it will more likely use an integrated channel when operating on the market.

H5: Firms with better knowledge of the customer will tend to use integrated channels.
**Competitor Knowledge**

Competitors have not been the main focus within the network literature (Chetty & Wilson, 2003). It has however, been considered as part of the firm’s network and “...the development of cooperative relationships with customers, suppliers or other business partners may be critical for foreign market entry” (Blankenburg-Holm et al., 1996 p. 1049) where one such other business partner is the competitors. The competitor is suggested by Chetty and Wilson (2003) to be an important source of complementary resources but also withhold up-to-date information concerning the market. If we assume an organizational capability (Madhok, 1997) view on the firms action it does not differ on the basic assumption of firm activities when it comes to internationalization. Both views recognize interaction activities as a way of accumulating value to the firm. Where competitors may be an important source of knowledge for the firm (Teece, 1992; Blankenburg-Holm et al., 1996). An integrated channel would increase the firm’s visibility, and as such creating a position within the network (Johanson & Mattsson, 1988). Based on the above argument we suggest that firms that lack of knowledge concerning their competitors will choose an integrated channel to be able to better benefit from the competitors knowledge.

H6: Firms with less knowledge about the competitors in a market tend to use integrated channels.

**METHOD**

To test the hypotheses a questionnaire was sent out to 1830 Small and medium sized firms in three countries, Sweden, New Zealand and Denmark. The countries are chosen because they
are small and therefore depend on international business. The respondents were CEO’s, or in some cases the managers in charge of international operations in small and medium sized New Zealand, Danish and Swedish firms. The sampling frame was the New Zealand, Danish and Swedish Business Directory. All firms which exported more than 10% of total sales, and which had between 50 and 200 employees, were selected from this directory. The net response rate for New Zealand was 20 % (112 firms), for Denmark it was 27% (208 firms) and for Sweden, 35% (174 firms), giving us a total response rate of 27 % or 494 respondents. The average age of the firms was 41 years, and they had been involved in international business on average 25 years. The average size of the firms was 100 employees and these firms conducted international business in an average of 17 countries. Table 1 presents some general background data on the firms, such as age and amount of domestic and international turnover. The data in Table 1 show that the Swedish firms are in general older and have a larger turnover than the other firms whereas the New Zealand firms are the youngest and have the smallest turnover, both domestically and internationally.

(************ insert Table 1 here ************)

On average, the Swedish firms have been involved longer in international business than the Danish and the New Zealand firms (see Table 2 below). The New Zealand firms are on average selling to fewer markets than the Swedish and Danish firms. As for managers international experience, all the respondents reported having 15 years of international business experience.

(************ insert Table 2 here ************)
The research design is a real world scenario in which we asked the respondents to select an ongoing customer relationship. The introductory text in the survey instrument reads as follows: ‘We would like you to select a business assignment were your company (If you work in a firm that is divisionalized or in other ways divided into units, answer for your business unit) is expanding internationally. Preferably, this assignment should be well underway so that you would have already started doing business with the counterparts. If this is not suitable for you, then we would appreciate it if you could choose a recently finished assignment. Examples of this assignment could be:

- A contract with a new distributor or agent in a new country.
- A considerable expansion of business with an existing customer.
- Doing business with one or more new customers within an existing market.
- Entering new country markets with your existing customers.
- Doing business with new customers within a new market.

Choose a business assignment that is important to your firm. Business assignments can be long term and hard to separate from ongoing business activities, but this investigation wants to capture a larger change in ongoing business with a customer or distributor.’

The questionnaire was developed based on our hypotheses, and ten in-depth case studies of foreign-market entry that showed how prior knowledge is connected to the success of an internationalization move (Hohenthal, 2001). The questionnaire was designed to capture knowledge development in international business. Ten test interviews were done to validate the questionnaire. An example of a real field scenario was a paint production facility in China. The firm had located an employee there three years prior to making their first sales. In their 8th year of establishment there, they had built a factory to service the car plant, which was their primary customer.
At the time of response, the assignments had been going on for an average of 3 years. Half of the assignments had been going on for 2 years or less, but some assignments for more than 20 years. The median number of previous assignments in the host country was 1.5, and 75% of the sample was less than 7 assignments in their host country.

Country differences of this sample has been analysed in Hohenthal (2001), Lindbergh (2005), Blomstermo and Sharma (2003), Lindstrand (2002). These analyses performed a number of checks on country differences, and found little or no effects concerning the variables involved in this study.

Measures

Country Experience: Country experience was measured through the respondent’s assessment of whether the country is new to the firm or well known for the firm on a 7-point Likert scale.

Market Growth: Expected market growth was captured by the respondent’s estimation of future market growth. The respondents were asked to estimate on a 7-point Likert scale ranging from 1=None to 7=Very positive.

Cultural Distance: Like Barkema, et al. (1996), we created a cultural similarity/ dissimilarity scale, or a ‘cultural distance’ measurement based on Ronen and Shenkar’s (1985) socio-cultural clustering of countries (countries displaying similarity in religion, language and geography). The scale contains 12 cultural clusters; Nordic, Germanic (including Holland), Anglo Saxon (including South Africa), Latin European (including Belgium), Eastern
European, Independent (Brazil, Japan, India, Israel), Latin America, Far Eastern, Arab, Middle Eastern (Turkey, Iran, Greece), Africa, and Others (the respondent was asked to specify the country in question). The clusters were scaled from 1 to 12 (adapted to the context of Danish, Swedish and New Zealand firms), where the focal firm’s home cultural cluster receives a value of 1 and the cluster farthest away receives a value of 12. The advantage of this measure is that it does not assume that the four factors identified by Hofstede accurately portray national culture, nor does it assume linearity, additivity or normal distribution of the factors’ scores. Denmark, New Zealand and Sweden respectively were excluded from the scale depending on the origin of respondent.

International experience: was measured using by duration and variation of international experience. Duration was measured by the number of years the firm has been doing business outside the home country. The numbers of countries the firms were selling to measured variation.

Customer knowledge: We measured customer knowledge by letting the firm estimate to what extent lack of customer knowledge is an obstacle when executing the business assignment. The respondents were asked to indicate on a seven-point scale (1= serious obstacle 7= no obstacle) to what extent lack of the following types of knowledge was an obstacle; 1) lack of knowledge about the customer’s product, 2) lack of knowledge about the customer’s way of doing business, 3) lack of knowledge about the customer’s production process, and 4) lack of knowledge about the customer’s cooperativeness.

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2 We also used a condensed scale where the countries furthest away (blocs 7-12) got the same value to reflect that relatively few business engagements were carried out in these blocs and that it is difficult for the firms to separate between distant blocs. This did not lead to any significant changes in the resulting model.
**Competitor knowledge:** We measured competitor knowledge by letting the firm estimate to what extent lack of knowledge about your competitors is an obstacle when executing the business assignment. The respondents were asked to indicate on a seven-point scale (1= serious obstacle 7= no obstacle) to what extent lack of the following types of knowledge was an obstacle; 1) lack of knowledge about your competitors product, 2) lack of knowledge about your competitors way of doing business, 3) lack of knowledge about your competitors production, and 4) lack of knowledge about your competitors cooperativeness.

Three control variables were included in this study: firm size, firm age and power distance in the country of origin. Firm size was measured as the number of employees. The larger the investing firm, the greater it ability to handle the risks and costs of activities in a foreign market by themselves (Buckley & Casson, 1976; Kogut & Singh, 1988). Thus, we predicted that bigger firms tend to use more integrated channels. Older firms can also be more prone to using integrated channels since they have a larger stock of experiential knowledge to choose from when internationalising. Cultural characteristics of the home market have also been argued to influence channel choice (Kogut & Singh, 1988). Firms originating in countries with a high power distance are characterised by considerable dependence of subordinates on managers (Hofstede, 1991). To handle this dependence managers will be more inclined to use management tools that allow them considerable control over subordinates. We would therefore expect firms from countries with a higher power distance to choose integrated channels when possible. Power distance was measured according to Hofstede’s index of power distance where Sweden is indexed at 31 (out of a maximum of 100), New Zealand 22 (22/100) and Denmark 18 (18/100) (Hofstede 1991, p. 28).

**Analysis**
Data analysis was carried out in two stages. First a factor and reliability analysis was carried out to reduce the data and check the constructs. We used multiple measures to capture customer and competitor knowledge and we therefore used factor analysis to develop and test the constructs. We then used the factors in the logistic regression. Second, to test the hypotheses we prepared a logistic regression analysis. This seemed to be the most appropriate method for data analysis because we use a dichotomous dependent variable. A correlation test was used to check for multicollinearity. In table 3 it can be seen that there are statistically significant relationships but none large enough to show signs of multicollinearity (Hair, Anderson, Tatham, & Black, 2000).

In table 4, we present the results of the factor analysis for customer knowledge and competitor knowledge with varimax rotation and reliability measures of the scales. The analysis produced a two factor solution with high commonalities and acceptable reliability for the scales (Nunnally, 1978).

The results of the logistic regression analysis are reported in table 5. Overall the logistic regression was significant at a p<0.000 (chi-square 100.59 at 17 df) and showed a high explanatory value with a correct classification rate of 75.4 %, which is substantially higher
than the chance rate. The chance rate is calculated as $C = \alpha^2 + (1-\alpha)^2$, where $C$ is the chance rate and $\alpha$ is the proportion classified as belonging to group 1 (Morrison, 1969). The chance rate in this case is thus: $C = 0.61^2 + (1-0.61)^2$, $C = 52\%$.

The logistic regression provided support for some of our hypotheses. Country knowledge was connected to use of integrated market channels and thus hypothesis 1 was supported. As for hypothesis 2, cultural distance influence on channel choice was significant but in an opposite direction to the hypothesized. Our findings showed that these SMEs did tend to use integrated channels in markets at a higher cultural distance. Hypothesis 3 was also supported: firms that expected a higher market growth opted for integrated channels. Two of the three hypotheses based on the original Johanson & Vahlne (1977) article were thus supported. Firms with more knowledge about the market did choose integrated channels and seeing an opportunity leads to use of integrated channels. That firms use integrated channels in markets at a longer cultural distance contradicts both the IP-model and later T-C based analyses of channels choice (Anderson & Coughlan 1987, Gatignon & Anderson 1986).

Neither of the international experience variables influenced channel choice, and thus hypothesis 4 was rejected. Lack of knowledge about the customer was not found significant and thus hypothesis 5 was not supported. Lack of competitor knowledge was also not significant and thus hypothesis 6 was not supported. As for the control variables, the claim that firms from countries with a higher power distance would use integrated channels was
strongly supported. Firms working in countries further away would thus opt for integrated channels and firms from countries with higher power distance will use more integrated channels. Our findings did not support the control variables size and age.

**DISCUSSION AND IMPLICATIONS**

Our purpose with this paper was to test which IP-related antecedents leads to use of a specific channel in a foreign market. Our results showed that for SMEs, more country experience was connected to use of integrated market channels. We also found that expected market growth lead to use of integrated channels. This is consistent with research based on the transaction cost approach (Agarwal & Ramaswami 1992). Integrated channels make it possible to reap more of the profits from a growing market. At the same time it makes it possible to learn faster about what is going on in the market. We also found that these SMEs tend to use integrated channels in markets at a higher cultural distance. This result was contrary to our stated hypothesis. It can, however be explained through opportunity seeking behaviour. We asked the respondents to choose an important assignment and the difficulty to estimate and understand information properly from culturally dissimilar markets might lead to establishment of integrated channels to get better control of the business.

One of the control variables was significantly correlated with use of integrated market channels, higher power distance did lead to use of more integrated channels. This implies that firms from countries with more authoritarian command structures want to control their international activities. The variation is, however, rather low with only three countries of origin and all three of them on the low end of the scale. The other hypotheses did not find support at a 5 % probability. We can thus say nothing about the role of customer knowledge,
competitor knowledge, international experience, size and age. Overall, our results provide support for that the IP-related factors explain choice of a specific channel. We did, however, not find support for the development of the IP-model (Johanson & Mattsson, 1987; Johanson & Vahlne, 1990, 2003; Eriksson et al. 1997) as explanations for market channel choice.

Returning to the introductory case, we recall that Gamma did not set up a subsidiary in Italy. It seems clear that Gamma’s experience and their knowledge of business relationships with their customers and competitors were not instrumental in their making a decision about setting up a subsidiary there. Apparently, experience accumulation and knowledge of specific business partners in Italy did not make Gamma choose an integrated channel. Instead, the decision not to set up a subsidiary was based on Gamma’s conclusion that they could not achieve sufficient growth in the foreign market, and thereby satisfactory economies of scale. We may infer from the present research that the original IP model offers an explanation of choice of integrated channel. The factor that was found of importance concern market growth, which is a factor that is central to Penrose’s (1959) theory of the growth of the firm, which is a foundation of the IP model, and country knowledge which is also an important concept within the IP model. Cultural distance had the opposite effect on channel choice than the one suggested by the IP model. This may be due to the IP-models inability to explain how strategic considerations might influence market channel choice. Just because the cultural distance makes it more difficult to get information about a market, a firm that sees opportunities in that market might use an integrated channel.

Future research can determine whether experience and knowledge of customers and competitors are of importance when a firm makes more incremental resource commitments, for instance when it goes from direct sales to agent or further to sales subsidiaries. It has
already been found that the equity position in a subsidiary of a foreign investor increases with increasing foreign investor experience (Delios and Beamish, 1999). But little is still known about the role of experience for less resource consuming modes of establishment.

The explanation of choice of channel still needs much research. Makino and Neupert (2000) find support for both transaction cost and national culture as predictors of mode of establishment. Delios and Beamish (1999), on the other hand refute the explanatory power of transaction cost theory, and state that experience is the most important predictor of foreign investor equity increase in a subsidiary. Our study shows weak support for the network-based arguments (knowledge of customers and competitors) to determine firms channel choice but strong support for market growth and national cultural characteristics such as power distance. Perhaps these slightly conflicting results provide reasons to consider an eclectic theory as an explanation to mode of establishment. This is for future research to find out.

For the internationalizing firm, our results suggest that they should be aware of that there are two different modes of learning about foreign markets: One is the learning associated with making a large step discrete investment by setting up a subsidiary, and the other is associated with small step incremental learning with moderate additional resource investment in a foreign market. In the former case, more aggregate market characteristics are learnt, whereas in the latter case, more detailed foreign market network relationships are what is learnt. Research should follow these guidelines when future expansion is considered.
REFERENCES


Table 1. General Background Data on Sample Firms

<table>
<thead>
<tr>
<th>Country</th>
<th>Firm age</th>
<th>Domestic turnover (SEK)&lt;sup&gt;a&lt;/sup&gt;</th>
<th>International turnover (SEK)&lt;sup&gt;b&lt;/sup&gt;</th>
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<td>9</td>
</tr>
<tr>
<td>Sweden</td>
<td>50</td>
<td>76</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>43</td>
<td>28</td>
</tr>
</tbody>
</table>

Note. Median values were chosen because some outliers made mean values inappropriate.

<sup>a</sup>In SEK, translated by the exchange rate by 1998.12.31: 4.7 SEK/1 NZL Dollar, 1.3 SEK/1 DK.

<sup>b</sup>In SEK, translated by the exchange rate by 1998.12.31: 4.7 SEK/1 NZL Dollar, 1.3 SEK/1 DK.
### Table 2. Firms’ International Experience and Managers International Experience

<table>
<thead>
<tr>
<th>Country</th>
<th>No. of years in international business M (Mdn)</th>
<th>No. of countries M (Mdn)</th>
<th>Managers international experience M (Mdn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>21 (18)</td>
<td>18 (12)</td>
<td>15 (15)</td>
</tr>
<tr>
<td>New Zealand</td>
<td>16 (12)</td>
<td>11 (6)</td>
<td>14 (15)</td>
</tr>
<tr>
<td>Sweden</td>
<td>35 (28)</td>
<td>21 (15)</td>
<td>15 (15)</td>
</tr>
<tr>
<td>Total</td>
<td>25 (18)</td>
<td>17 (10)</td>
<td>15 (15)</td>
</tr>
</tbody>
</table>
### Table 1

Correlation Matrix of variables

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Country knowledge</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Customer knowledge</td>
<td>.04</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Competitor knowledge</td>
<td>-.01</td>
<td>.55**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Expected market growth</td>
<td>-.002</td>
<td>.03</td>
<td>.02</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Cultural distance</td>
<td>-.31**</td>
<td>-.06</td>
<td>.00</td>
<td>-.05</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Number of countries</td>
<td>.01</td>
<td>.14**</td>
<td>.07</td>
<td>.13**</td>
<td>.23**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Years abroad</td>
<td>.02</td>
<td>.14**</td>
<td>.12**</td>
<td>-.03</td>
<td>.13**</td>
<td>.41**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Age</td>
<td>-.02</td>
<td>.06</td>
<td>.03</td>
<td>-.05</td>
<td>.06</td>
<td>.13**</td>
<td>.66**</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Employees</td>
<td>.11*</td>
<td>.14**</td>
<td>.07</td>
<td>.06</td>
<td>.35**</td>
<td>.27**</td>
<td>.24**</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. power distance</td>
<td>-.01</td>
<td>.04</td>
<td>.15**</td>
<td>-.07</td>
<td>.06</td>
<td>.15**</td>
<td>.27**</td>
<td>.26**</td>
<td>.22**</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: ** Correlation is significant at the 0.01 level (2-tailed), * significant at the 0.05 level (2-tailed).

### Table 2

Varimax rotated Factor matrix

<table>
<thead>
<tr>
<th>Item</th>
<th>Factor 1</th>
<th>Factor 2</th>
<th>Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>q81</td>
<td></td>
<td></td>
<td>.794</td>
</tr>
<tr>
<td>q82</td>
<td></td>
<td></td>
<td>.769</td>
</tr>
<tr>
<td>q83</td>
<td></td>
<td></td>
<td>.851</td>
</tr>
<tr>
<td>q84</td>
<td></td>
<td></td>
<td>.780</td>
</tr>
<tr>
<td>q817</td>
<td></td>
<td></td>
<td>.774</td>
</tr>
<tr>
<td>q818</td>
<td></td>
<td></td>
<td>.837</td>
</tr>
<tr>
<td>q819</td>
<td></td>
<td></td>
<td>.849</td>
</tr>
<tr>
<td>q820</td>
<td></td>
<td></td>
<td>.857</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.833</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.892</td>
</tr>
</tbody>
</table>
Table 2
Logistic Regression Results

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Parameter Estimates</th>
<th>Standard errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of knowledge about customer</td>
<td>ns</td>
<td>-</td>
</tr>
<tr>
<td>Lack of knowledge about competitors</td>
<td>ns</td>
<td>-</td>
</tr>
<tr>
<td>Expected market growth</td>
<td>0.355**</td>
<td>0.092</td>
</tr>
<tr>
<td>International experience</td>
<td>ns</td>
<td>-</td>
</tr>
<tr>
<td>Power distance</td>
<td>0.166**</td>
<td>0.022</td>
</tr>
<tr>
<td>Cultural distance</td>
<td>0.135**</td>
<td>0.039</td>
</tr>
<tr>
<td>Country knowledge</td>
<td>0.118*</td>
<td>0.055</td>
</tr>
</tbody>
</table>

**Control variables**

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Parameter Estimates</th>
<th>Standard errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>ns</td>
<td>-</td>
</tr>
<tr>
<td>firm age</td>
<td>ns</td>
<td>-</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>-6.558**</td>
<td>0.906</td>
</tr>
</tbody>
</table>

Note: * p<0.05, ** p<0.01, ns=not significant

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