Reshaping Management and Economic Thinking through Integrating Eco-Friendly and Ethical Practices
Proceedings of the 3rd International Conference on Management and Economics

26-27 February 2014
Faculty of Management and Finance, University of Ruhuna, Sri Lanka

Predicting the Entry Mode Choices of the Non-profit Firms Using Eclectic Paradigm: A Proposition Development Study

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Abstract

Non-profit sector which is neither state nor market has grown unprecedentedly during last few decades. Despite the growth, the internationalization of the Nonprofit sector has been relatively absent from mainstream management literature and remains as a significantly less understood sector. Therefore the objective of the study is to examine the factors which influence the entry mode choices in nonprofit internationalization process and develop propositions so that they can be tested by future studies, while keeping eclectic paradigm as the guiding theory. As far as the entry mode choices are concerned study developed four main propositions. First one proposes that irrespective of the size, NPOs prefer shared control modes as long as "natural partners" are available. Next the study proposes that experienced firm will be able to pick the right partner thus experienced firms will prefer shared control modes. Third proposition stated that when natural partners are available internationalizing NPOs will try to mitigate operational risks through a shared control mode. Finally the study looks at the influence coming from host governments, and proposes that as long as NPOs cannot find a "natural partner" they will prefer full control entry modes since it provides more autonomy for the NPO in its operations.

Keywords*: *eclectic theory; entry mode choices; nonprofit organizations

1. Introduction

"Despite the ever-increasing number of international non-governmental organizations (NGOs) and the expansion of existing international NGOs' activities, the phenomenon of the 'internationalization' of NGOs is seldom taken into account by theorists ..." (Siméant, 2005, p. 852).

Even though internationalization of firms is one of the most researched areas in the field of management (Canabal & White, 2008; Werner, 2002),"internationalization of the Nonprofit sector have been relatively absent from mainstream management literature and remains as a significantly less understood sector" (Lambell, Ramia, Nyland, & Michelotti, 2008). Further "even the theorists of globalization have seldom taken the concept of the internationalization of Non Profit Organizations (NPOs) into account" (Siméant, 2005, p. 851). This is particularly challenging for nonprofit organizations because they are distinctive from state and for-profit firms (Hansmann, 1987) not only in their legal form, but also in terms of their missions, products/services offered as well as their funding mechanisms (Crittenden & Crittenden, 1997; Hull & Lio, 2006; Nutt & Backoff, 1992). Thus the area of nonprofit internationalization remains as a relatively and poorly understood sector and provides a great potential for future research (Reid, 2006).

Therefore the objective of the study is to examine the factors which influence the entry mode choices in NPO internationalization process. This will be mainly achieved through revisiting and reevaluation of literature which looks into the influential factors in internationalization of the for-profit sector in a nonprofit context. Even though there are differences among nonprofit sector and mainstream profit sector, this should not eliminate the total possibility of using mainstream management tools (Lewis, 2002; Siméant, 2005), Thus study will be using eclectic paradigm as the guiding theory for the paper, however it is important to be careful, selective and flexible in the process (Lewis, 2006). Here the study will specifically examine the entry mode decision as this is considered to be one of the most important decisions for an internationalizing firm and will develop key propositions, so that future studies can empirically test them. This will enable future NPOs to be more effective in their entry mode choices.

The Nonprofit firm

"A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees." (Hansmann, 1980 p. 835). This does not necessarily means that NPOs are not and should not earn profits (Hansmann, 1987); rather there is a constraint when it comes to profit distribution (Rose-Ackerman, 1997). This in fact a factor, which aided the growth of the NPO sector in a cultural value system with distrust as well as insecurity (Esping-Andersen, 1990). When it comes to goal setting profit oriented entities are directed by the larger objective of making profits (Porter, 1985). NPOs however have much broader and more complicated objectives which make them much more difficult to understand (Nutt & Backoff, 1992), moreover unlike in for-profits, because of the absence of proper ownership; NPOs have to be bottom up oriented in their objective and goal setting (Hansmann, 1987; Speckbacher, 2003). This difference in missions; maximizing profits and maximizing social benefits create the fundamental difference between for-profits and NPOs (Austin, Stevenson, & Wei-Skillern, 2006). Missions of NPOs can include general development, education, agriculture, economic development, democracy, science and technology, environment, human rights, health, etc. (Werker & Ahmed, 2008). Hansmann (1980) also introduces two main bases for categorizing nonprofit firms; financing and control. Finances for a nonprofit firm can come from donations or commercial operations, control on the other hand can also be done by patrons of the mutual nonprofit or by a more expert team in the case of an entrepreneurial nonprofit.

Internationalization process of a firm

"Internationalization is the process of adapting exchange transaction modality to international markets" (Calof & Beamish, 1995 p. 115). Internationalization has also been viewed as a process of increasing involvement and commitment in international operations (Welch & Luostarinen, 1988). Furthermore internationalization can also be viewed as a process by which a firm which had only operations in domestic market expanding its operations across borders (Buckley & Casson, 1998). Internationalization involves several critical decisions by a firm, including decision to internationalize, market selection, entry modes and timing of entry. This particular study will highlight on the entry mode selection decision.

Entry mode

As far as the entry modes are concerned the study will first briefly discuss the concept, its application and the theoretical background. Eclectic paradigm will be explained in this regard since it was used as the guiding theory for illustrating for-profit applications of the entry mode selection. Then the study will evaluate the most relevant factors in entry mode selection by for-profits, in the context of non-profits to build some propositions.

An entry mode is an "institutional arrangement that a firm uses to market its product beyond its boundaries at least during first five years" (Root, 1987, p. 5) or/and "a way of organizing a firm's business activities in a foreign country" (Hill, Hwang, & Kim, 1990, p. 117). A firm is normally motivated to choose the entry mode which provides the highest return on investments (Andersen, 1997) or in other words minimizes the risk (Root, 1987). However, given firm's choices also determined by the availability of resources and desire for control (Anderson & Gatignon, 1986a; Cespedes, Corey, & Rangan, 1988; Stopford & Wells, 1972). Moreover according to certain researchers, control is crucial as well as the most important factor because, it directly influences both the risks and the returns (Barkema, Bell, & Pennings, 1996; Blomstermo, Sharma, & Sallis, 2006). Control refers to the "level of authority a firm may exercise over systems, methods, and decisions of the foreign affiliate" (Ekeledo & Sivakumar, 2004). Either way the selection of a proper entry mode in a foreign market is one of the most crucial decisions for an internationalizing firm and can have significant and long term consequences on its performance and even survival (Anderson & Gatignon, 1986a; Davidson, 1982; Hill et al., 1990).

Degree of Control is the most commonly used base in categorizing entry modes; control is a critical component because it has being identified as something stemming from ownership (Erramilli, 1991). Full control entry modes refers to sole ownerships while shared control modes refer to some form of collaborative modes of operations (Ekeledo & Sivakumar, 2004). Full control entry modes provides organizations with higher risks, higher returns and require full resource commitments while shared control methods require moderate resource commitments at moderate risks but also provides moderate returns (Anderson & Gatignon, 1986a). Therefore selecting a proper entry mode is a delicate act of balancing as well as a tradeoff between these three components (Andersen, 1997).

Eclectic Paradigm

The initial idea of the Eclectic paradigm was presented by Dunning in 1976 at a Noble Symposium, and was further developed, and included three factors, which will influence a firm's entry mode namely, Ownership advantages (OA), Locational Advantages (LA) and Internalization advantages (IA) (Dunning, 1980; Dunning, 1988). The eclectic framework represents a multi-theoretical approach, which used "International trade theory, resource-based theory, transaction cost theory" (Andersen, 1997, p. 35) and institutional theory in order to predict entry mode (Brouthers & Hennart, 2007). This increases the predictive power of the theory; however this might also create situations of overlapping constructs (*ibid*), which according to Itaki (1991) makes concerns of tautology, which researchers need to be mindful of.

LA basically refers to the attractiveness of the market (Davidson, 1980; Dunning, 1988) and can be operationalized using market potential, market risk (Root, 1987), and market similarity (Davidson, 1980; Dunning, 1993). These factors basically influence the choice of the country as well as the possible entry mode for the internationalizing firm (Root, 1987). Market size, infrastructure, economic stability, political stability, educated workforce (Erdener & Shapiro, 2005), exchange rates, regulation and policies of supra-national entities, cultural differences (Dunning, 2000) are examples for LAs.

IA refers to the transaction costs (Williamson, 1979) or cost savings occurred due to using firm's own production plant rather than using external sources (Dunning, 1993). These advantages exists as a result of a firm's decision to do things internally or in other words inside the corporate structure rather than obtaining them from the market (Anderson & Gatignon, 1986a; Dunning, 1988). This may include the entire supply chain management process, starting from sourcing to final distribution (Erramilli & Rao, 1993). However, If and when resources are readily and efficiently available from the market, the internationalizing firm would prefer to benefit from the economies of scale advantages enjoyed by the market, rather than internalizing the activities (Anderson & Gatignon, 1986a; Klein, Frazier, & Roth, 1990). But in the developing markets suppliers who match quality specifications are limited and hard to find (Marinov & Marinova, 1999). Moreover, greater the market reliance higher the risk of opportunistic behavior (Erramilli & Rao, 1993), especially in markets with inadequate institutions to protect intellectual property rights (Haley, 2000). This create contractual risks for the internationalizing firm, in terms of contract enforcing costs, risks of proprietary knowledge being lost and the monitoring costs (Agarwal & Ramaswami, 1992). Thus in these type of markets the entry mode choice will be depend upon the careful evaluation of these costs and benefits.

Ownership advantages (OA) comprises with firm specific assets and competencies, while assets represent firm's resources and experiences, competencies represent the firm's ability to differentiate from the rest of the competition (Dunning, 1993). A given firm has to develop this, firm specific advantages or OAs in order to overcome the liability of foreignness (Erdener & Shapiro, 2005). Possession of these valuable, rare, unique and sustainable resources, make a given firm different from rest of its competition (Dunning, 1993). OAs can be obtained at the country level, industry level as well as at the firm level (Tolentino, 2001). OAs can be operationalized in terms of size of the firm, international experience and the ability to differentiate products (Agarwal & Ramaswami, 1992).

Propositions of the Study

As pointed out above, eclectic theory suggests that larger the size of the firm, greater the tendency for that firm to select a full control entry mode (Anderson & Gatignon, 1986b; Brouthers & Hennart, 2007). This is because larger the size of the firm, greater the resources it commands (Williamson, 1988), and resources are critical ingredients for any firm, not only to expand but also to survive (Wernerfelt, 1984). Full control entry modes comparatively require more resources and this holds true irrespective of the fact of what business you are in (Anderson & Gatignon, 1986a). Further more resources will allow firms to target larger markets. A for-profit firm will want to take the advantage of a larger market by creating a wholly owned subsidiary with greater control (Morschett, Schramm-Klein, & Swoboda, 2010). Larger markets can compensate for higher risks in the forms of much larger and greater returns (Agarwal & Gort, 1996; Agarwal & Ramaswami, 1992).

However compared with for-profit firms NPOs have limited resources (Drucker, 1989). NPOs which are based on donations, are finding these donations decreasing over the years (Salamon, 1999) especially with the economic recession (Benton & Austin, 2010). Resource constraints are one of the major reasons behind NPO partnerships (Yanacopulos, 2005). Moreover, since NPOs are not there to make profits, they will be willing to cooperate with local players as long as both parties have similar objectives. Therefore as far as NPOs are concerned, when there are resources constraints, NPOs have to use shared control modes. Therefore this is the same case as for-profits. But on the other hand even when NPOs are large and have significant amount of resources, they will still favor shared control entry modes provided that they can find the right partner. Because by integrating with the right partner they will be able to improve quality of life of the beneficiaries further (Lindenberg & Dobel, 1999). Finding a right partner is referred to as finding a “natural partner”. “If a local partner has similar interests, objectives and intended beneficiaries, like the internationalizing NPO, then the local partner can be called a natural partner” (Fowler, 1991a, p. 11). Increasing number of NPOs today understand the importance of collaborating with right partners for successful operations (Lindenberg & Dobel, 1999). From a NPO’s point of view if you can pick the right partner, shared control modes will create a better impact in the local community than full control modes.

Study Proposition 1_a: NPOs with significant resource endowments will prefer shared control entry modes.

Study Proposition 1_b: Relationship between levels of resource endowments and preferred level of control will be moderated by the availability of “natural partners”.

International experience is a critical factor explaining the entry mode choice of internationalizing firms. For an example in Zhao, Luo, and Suh (2004), in their meta-analysis identified that, 30 out of the 38 empirical studies on entry modes, measured some form of international experiences. Less experienced firms tend to perceive considerable uncertainty, overstate risks and understate returns (Davidson, 1982), which makes them pick shared control modes (Johanson & Vahlne, 1977). Thus the theory suggests that with more experience, firms will prefer more control and willing to commit more resources (Anderson & Gatignon, 1986b; Davidson, 1980, 1982).

However NPOs have different objectives; as they are more worried about the positive social change they can create through improvement of quality of life. Thus NPOs with more experience would be able to pick the right partners and will be able to manage them in a better way. Therefore the study proposes following proposition.

Study Proposition 2_a: Greater the experience higher the tendency for the internationalizing NPO to select a shared control entry mode.

Study Proposition 2_b: The relationship with experience and favoring a shared control mode will be moderated by the availability of "natural partners".

Root (1987) identified four main types of risks, political risk, ownership risks, operational risks and transfer risks. Due to their mission oriented characteristics of providing better quality of life, NPOs are normally not worried about the above risks the except operational risks. For an example operational risks arising from certain local content requirements, might create conflicts with the development agenda of a NPO (Lindenberg & Dobel, 1999). Classical theory on for-profits suggest that in high risk situations firms would prefer shared control modes over wholly owned subsidiaries with full control (Bradley, 2005; Vernon, 1983). This is because they expect their local players to come to favorable agreements with the local governments (Hill et al., 1990). Moreover less resource commitment means the company can exit quickly if the situation becomes worse (Vernon, 1983).

However this does not work well with NPOs who are primarily there to make changes, thus having government friendly local partner might be an extra problem for an NPO which might even consider benign civil disobedience for the sake of the flourishing of the people (Falkenberg & Falkenberg, 2009). Thus when NPOs feel that their mission is risked because of the local partner, they will prefer full control entry modes. Therefore the study proposes following proposition.

Study Proposition 3_a: Financial related risks do not have an influence on the level of control favored by the internationalizing NPO.

Study Proposition 3_b: When the operational risks are high the internationalizing NPO will favor a shared control entry mode.

Study Proposition 3_c: The relationship with operational risks and favoring a shared control mode will be moderated by the availability of "natural partners".

The relationships between NPOs and Local governments have not always been cooperative and flourishing (Fisher, 1997). In fact governments have at times interpreted NPO activities as challenge to their supremacy (Bratton, 1989; Fowler, 1991b). Furthermore local governments have tried to control NPOs and their activities in recent times (Clarke, 1998). Finally as the worst case scenario, NPOs can be in direct confrontation with local governments (Fowler, 1991b) especially when they operate in sensitive areas like human rights advocacy which certain governments perceive as influences on their sovereignty (Fisher, 1997). For an example according to (Karat, 1984) foreign NPOs are regarded as "anti-nationalist agents" of capitalism and western culture. In this kind of scenarios an internationalizing NPO will be better off in having a local partner as long as the local partner behaves in favor of the development agenda of the internationalizing NPO. Figure 1 provides a summary of the proposed relationships with regard to the entry mode decision of a non-profit firm.

Study Proposition 4_a: *When there is negative local government influence, internationalizing NPO will favor shared control entry modes.*

Study Proposition 4_b: *The relationship with local government influence and favoring shared control entry modes will be moderated by the availability of "natural partners".*

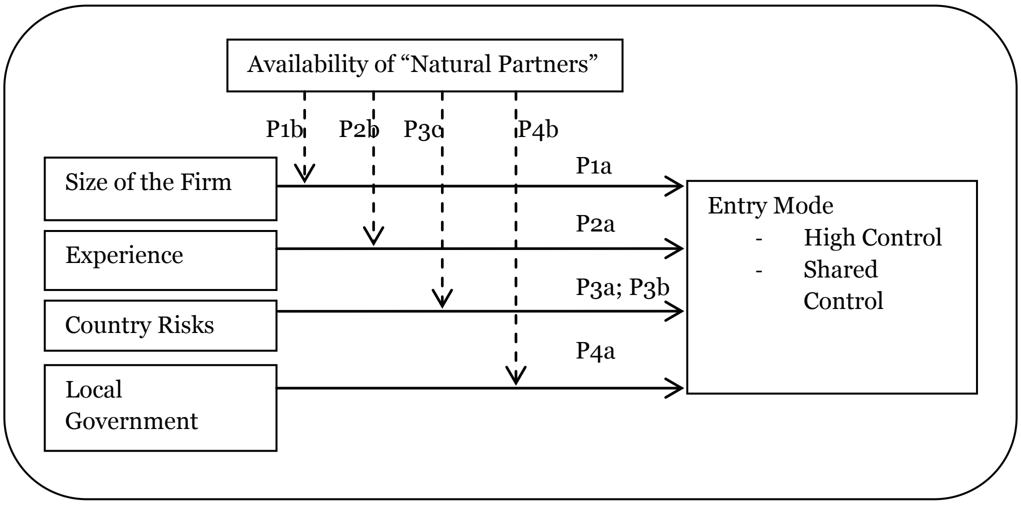

Figure 1: Proposed factors which influence the entry mode selection of a non-profit firm

2. Conclusions and Implications

The main objective of the study was to examine the factors which influence the entry mode selection of the nonprofit firms and develop propositions, so that they can be tested empirically by future studies. The Study begins with arguing that NPOs are different from for-profits and it claims that it has a different internationalization process and faces a different set of internationalization decisions when it comes to selecting entry modes. This was achieved through revisiting and reevaluation of the literature related to for-profit entry mode selection efforts. As discussed earlier, entry mode selection is considered to be one of the most critical internationalization decisions for an NPO to achieve its objectives. Thus this study will provide a starting point, so that NPOs can have a systematic approach for their entry mode selection for more effective operations. Here the study will try to bridge a knowledge gap in the context of NPO internationalization by generating new knowledge relating to this area.

As far as the entry mode choices are concerned study developed four main propositions. First one proposes that irrespective of the size, NPOs prefer shared control modes as long as "natural partners" are available. Next the study proposes that experienced firm will be able to pick the right partner thus experienced firms will prefer shared control modes. Third proposition stated that when natural partners are available internationalizing NPOs will try to mitigate operational risks through a shared control mode. Finally the study looks at the influence coming from host governments, and proposes that as long as NPOs cannot find a "natural partner" they will prefer full control entry modes since it provides more autonomy for the NPO in its operations rather than having a wrong partner.

Researcher likes to highlight the potential to test these propositions empirically, which can be used to develop a model to predict the entry mode strategies of nonprofit organizations. Using exploratory research method such as a case study analysis will help the future researchers to identify any unique factors with regard to entry mode choices of NPOs. Researcher would also like to point out the importance as well as the opportunity to look at other internationalization decisions faced by nonprofit organizations, which was not discussed by the study such as market selection, timing of entry, operations modes, etc. There is also potential for comparison studies where both non-profit and for-profit companies operate. For an example microfinance industry would be an interesting context in this regard.

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