Foreign Market Entry Mode Choice: Hard- And Soft Services

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Abstract

Research from service firms show that one group of studies suggest that entry mode choices by manufacturing firms are generalizable to service firms. Results from another group of studies contradict that view. In this paper we classify services in hard services and soft services, hard services are grouped with manufacturing firms in terms of foreign market entry mode choices. The data consists of 362 international service firms. The findings shows that hard services do not significantly differ from soft services according to foreign market entry mode choices.

Introduction

The service industry are today an important and growing sector in the global economy. Service industries are gradually becoming acknowledged as international growth leaders, both in their supportive role to manufacturing firms and in their own right. However, Erramilli and Rao (1990) note that so little is known about how service industries enter foreign markets.

Some analysts contend that any form of export entry is impossible, because production and consumption of services cannot be separated (Carman and Langerard 1980; Sampson and Snape 1985; Root 1987; Grönroos 1990). This implies that service industries often establish through foreign direct investments owing to the service dominance and the simultaneous production and consumption (Buckley, Pass and Prescott 1992). Other researchers suggest that the factors that influence the choice of entry modes by manufacturing firms are generalizable to services (Weinstein 1977; Terpstra and Yu 1988; Eriksson, Johanson, Majkgård and Sharma 1997).

Erramilli (1990) divided services into hard services and soft services. Hard services (for example insurance, software services etc.) permits separation of production and consumption. In soft services - on the other hand (education, management consulting etc.) it is often difficult to separate production from consumption and that is one reason for export of soft services is difficult (Carman and Langerard 1980). Consequently, hard services there production and consumption of a service can be fully decoupled and soft services for which production and consumption occur simultaneously differ in the internationalization process (Majkgård and Sharma 1998). Hard service industries internationalise presumably the same way that manufacturing industries. Soft service industries differs dramatically (Erramilli 1990; Ekeledo and Sivakumar 1998). On the
other hand, Eriksson, Johanson, Majkgard and Sharma 1997 reports similar findings for hard- and soft services according to the cost of the internationalization process.

The classification of hard and soft services reduces the large diversity of the service sector and uncovers useful insights about foreign market entry mode that extend beyond the individual service industries (Ekeledo and Svakumar 1998).

The purpose of this paper is to analyze factors determining foreign market entry mode choice of service firms. Our framework can also compare the foreign market entry mode choice of hard services and soft services, and highlighting the differences and similarities between them. One contribution of our research can be to identify situations in which generalizability from goods to services may or may not be appropriate. Our conceptual framework are presented in Figure 1.

Figure 1: A model of foreign market entry mode strategies for service firms
Source: Adapted from Ekeledo and Svakumar (1998)

Characteristics of Cervice Firms and Internationalization

Today, the literature often treats international service firms as a heterogeneous group (Lovelock 1983; Bradley 1991). Consumer services are treated differently than business-to-business services (Bienstock, Mentzer and Bird 1997). Several studies of the internationalization of service firms are based on a single group of service firms, e.g., banks and financial firms (Engwall and Wallenstål 1988; Marquardt 1994; Hellman 1996a, 1996b), advertising agencies (Weinstein 1977; Terpstra and Yu 1988), software firms (Bell 1995; Coviello and Munro 1997), broadcasting firms (Gray 1994), retailing (Akehurst and Alexander 1995); hotel industry (Dunning and McQueen 1982) and technical consultancy firms (Sharma and Johanson 1987). Some exceptions exist (e.g., Edvardsson, Edvinsson and Nyström 1992, 1993; Erramilli 1991; Erramilli and Rao 1990, 1993).

Grönroos (1987) and Lovelock (1984) suggest that it is not necessary to consider various service firms as unique and separate from each other. It is more fruitful to recognize the common features of many service firms and develop a more general theory (Bradley 1991). This study is in the line with this thinking.

We can identify two different research fields according to the foreign market entry of service firms. Researchers belonging to the first group suggest that there are differences

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between internationalization of service and internationalization of goods (for example, Carman and Langeard 1980; Root 1987; Bradley 1991). The arguments of this group are based mainly on the following five service characteristics (Shostack 1977; Grönroos 1990; Cowell 1991; Kotler 1997):

- Intangibility: services are invisible.
- Inseparability: simultaneous production/consumption, services cannot be exported.
- Perishability: services cannot be stored and demonstrated.
- Variability: services are less standardized.
- Ownership: ownership cannot be transferred.

Shostack (1977) and Bradley (1991) argue that intangibility is the most critical product-service distinction, from which all other differences emerge. Intangibility implies that there is no physical product to hold internal business units and business partners together. There is greater need for internal marketing and a stable partnership relation. The distinction between services and goods, with respect to tangibility, is not absolute, but rather a continuum. For example, salt is a tangible good and teaching an intangible service, and in between these extremes there exists a range of different offerings (Shostack 1977). Intangibility affects the perception of service quality. Shostack suggests that services should be made tangible for the customer by using concrete, physical evidence.

Inseparability relates to service being produced and consumed simultaneously, implying that it is difficult to perform quality control in traditional ways. Inseparability implies that physical display is impossible and that demonstration gives the service away (Bradley 1991). The customer is often co-producer of the service, which influences his own experience of the outcome. The customer may demand specific adaptations and information exchange to his/her requirements (Edvardsson 1988; Halinen 1994). Grönroos (1990) argues that services are an activity or series of activities rather than a tangible item, and that quality control and marketing must be integrated in production and consumption. Activities require interaction between buyers and sellers, and are more people-intensive than goods (Chase 1978; Grönroos 1990). Root (1987) argues that, because of the inseparability feature, services cannot be exported. Normann (1984) suggests that few services can be exported without also exporting the full "service delivery system". Other service researchers suggest that services with a high degree of intangibility, interaction frequency, and simultaneous production and consumption, e.g., hospital and management consulting, are location-bound and must be available in full from the day of the entry to the foreign market (Vandermerwe and Chadwick 1989, Anand and Delios 1997). Services with a relatively high degree of tangibility and a low demand for physical interaction between producer and customer, e.g., software/diskettes, can be exported, or licensed.

Perishability refers to services that cannot be stored. When demand exceeds capacity, customers are likely to be sent away disappointed, since no inventory is available for backup. Many services are delivered in real time. Customers have to be present to receive the service, for example, management consulting and education.
Variability refers to the service production not being exactly the same for each delivery, depending on who provides the services and when they are provided. In following, services are to a large degree experience-based and dependent on individual perceptions in time and space, and therefore difficult to evaluate before and even after consumption (Darby and Kami 1973). Variability also means that the services are heterogeneous in nature and are asymmetrical between buyer and seller (Nayyar 1993). The service provider supplies different service each time, depending on the specific problem to be solved and his/her mood. Different customers can also experience the same service differently, e.g., ATM. This implies that provision of service guaranties is difficult. A service blueprint, describing service activities in a flow chart, can help to standardize service activities (Shostack 1987).

Ownership implies it is difficult to transfer the ownership of a service, e.g., management consulting, education, etc. In some cases, the service delivery system can be transferred, e.g., fast-food restaurants. The main problem is that patent protection is no available for services (Bradley 1991).

Researchers of the internationalization of service firms have gone on to develop and apply these characteristics to service firms in the international market. Bradley (1995: 435) states that to investigate “how best to approach the international marketing of services, it is necessary to return to the unique characteristics of services: intangibility, inseparability, heterogeneity, perishability and ownership. It is because services are performed, rather than produced, that they have several distinguishable characteristics which present the service firm with many problems.”

The second group of researchers concerned with the internationalization of service firms state that these service characteristics are of minor importance in the internationalization of services. Boddewyn, Halbrich and Perry (1986: 42) argue that “every one of these criteria by itself has been found lacking in fully differentiating a ‘service’ from a ‘non-service.’” They also state that there is no need for a special internationalization theory for service firms, the existing ones can be accommodated through simple modifications (Boddewyn et al. 1986: 54). Buckley et al. (1992) argue that the differences between services and goods should not be overemphasized. It is a question of differences in kind and not in nature. Erramilli (1990: 61) suggests that researchers may play “an important role by borrowing from and adapting, when necessary, the fairly substantial knowledge base in the manufacturing sector.”

Lovelock (1996) states that there is growing recognition that service characteristics are not universally applicable to all services. He argues that in service sectors where customer involvement is tightly controlled there is great opportunity for global standardization. Sundbo (1994) argues that the simultaneous production and consumption characteristic can be bridged by modulization. Modulization is a standardization of services in separate modules which can be combined by the customer. Sampson and Snape (1985), Vandermerwe and Chadwick (1989), and Erramilli (1991) argue that many internationally marketed services are separable, i.e., their production and consumption can be decoupled so that services can be exported. For example, software services and architectural services can be transferred in a document, a diskette or other tangible medium. Today it is even possible to export software development services for service firms in the international market. Bradley (1995: 435) states that to investigate “how best to approach the international marketing of services, it is necessary to return to the unique characteristics of services: intangibility, inseparability, heterogeneity, perishability and ownership. It is because services are performed, rather than produced, that they have several distinguishable characteristics which present the service firm with many problems.”
services and accountancy services via links and satellites from India to U.S. These are
called “hard services”. On the other hand, many services are inseparable, or “soft
services”, e.g., hotels, management consultancy and hospitals require local proximity of
service providers and service buyers (Vandermerwe and Chadwick 1989).

The Data

Since the Central Statistical Bureau in Sweden did not have adequate data on the
international operations of service firms, the selection of cases was made from trade
registers, business newspapers and industry branch registers. The largest service firms
within each service sector were chosen.

As recommended by Gummesson (1977), Erramilli (1990) and Erramilli and Rao
(1993), several service sectors were included in each group of hard- and soft services:
Hard services consists of computer software and data processing, miscellaneous services
engineering, architecture, and soft services consists of legal, advertising, accounting,
education, and management consulting.

All of the questions are of close-ended nature using a five point Likert scale, ranging
from “not at all important” to “very important”. Most of the variables are measured as a
function of the perceptions of the managers. These perceptions may vary according to
variations in their past experience of international operations, level of knowledge about
a country, etc.

In all 774 Swedish service companies with international experience were identified.
They were included in the mail survey. In September 1993, the questionnaires were sent
out to the service firms. In February 1994, after follow-up letters and telephone
reminders, 409 questionnaires had been received from presidents and vice presidents
engaged in international operations. 73 questionnaires were returned as undeliverable,
and 49 firms of the original 774 had no international operations and were not preparing
any such operations either. Consequently, the effective sample is of 652 (774 - 122 =
652) service firms, with a response rate of 62.7% (409/652). In the data base, hard
services consists of 178 service firms (49.2 %) and soft services, 184 service firms
(50.8%), in total 362 firms.

47 questionnaires were later dropped from the analysis for having missing values on
specific variables in the models. The remaining 362 questionnaires supplied good
quality data with few missing values on variables used in the models. In some cases (37
firms out of 362), the service firm had planned their first foreign assignment but had not
yet entered the foreign market. These were also included in the sample.

In order to establish whether the differences between respondents and non-respondents
affected the results, a non-respondent analysis was done. The sample was split, on the
basis of the survey return date, into early and late respondents. An analysis, in which
late respondents are viewed as non-respondents (Armstrong and Overton 1977), shows
that non-respondents did not differ significantly from respondents in terms of size and
service industry classification. The results can thus be regarded as representative for the
non-respondents as well.

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Analysis

Service firms are profit-maximizing organizations. Consequently higher foreign profits could be a reason for going abroad. The managers were asked how important are lower price on services for the firm’s competitiveness today. Table 1 shows that firms supplying hard services rank lower price as an important source of advantage, on the other hand soft services perceive lower price as unimportant. We can assume that on of the four marketing mix variables, price play different roles in hard- and soft services.

<table>
<thead>
<tr>
<th></th>
<th>Hard services</th>
<th>Soft services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unimportant</td>
<td>46(33%)</td>
<td>77(55%)</td>
<td>123</td>
</tr>
<tr>
<td>Important</td>
<td>92(67%)</td>
<td>64(45%)</td>
<td>156</td>
</tr>
<tr>
<td>Total</td>
<td>138(100%)</td>
<td>141(100%)</td>
<td>279</td>
</tr>
</tbody>
</table>

Table 1

_lower Prices as a Source of Advantage in the International Market_

The respondents were requested to specify their answers on a five point scale:

Unimportant = if the response is absolutely or rather unimportant.

Important = if the reason is either absolutely, very, or rather important.

As mentioned before, one group of service researchers argue that local establishment, e.g. close proximity between the service provider and the buyer is important for service industries. Consequently, the managers were asked how important are having subsidiaries abroad for the firm’s competitiveness today. Table 2 shows that firms supplying hard services rank local presence through subsidiary as more important than soft services. For soft services the factor is weak. This interesting finding contradict earlier research by for example Carman and Langeard (1980) and Vandermerwe and Chadwick (1989).

<table>
<thead>
<tr>
<th></th>
<th>Hard services</th>
<th>Soft services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unimportant</td>
<td>34(44%)</td>
<td>72(54%)</td>
<td>106</td>
</tr>
<tr>
<td>Important</td>
<td>44(56%)</td>
<td>61(46%)</td>
<td>105</td>
</tr>
<tr>
<td>Total</td>
<td>78(100%)</td>
<td>133(100%)</td>
<td>211</td>
</tr>
</tbody>
</table>

Table 2

The importance of having subsidiaries abroad for the firm’s competitiveness

The managers were also asked how important are cooperative agreement with a foreign company for the firm’s competitiveness today. Table 3 shows that hard- and soft services rank cooperative agreements as important.

<table>
<thead>
<tr>
<th></th>
<th>Hard services</th>
<th>Soft services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unimportant</td>
<td>29(38%)</td>
<td>43(31%)</td>
<td>72</td>
</tr>
<tr>
<td>Important</td>
<td>48(62%)</td>
<td>95(68%)</td>
<td>143</td>
</tr>
<tr>
<td>Total</td>
<td>77(100%)</td>
<td>138(100%)</td>
<td>215</td>
</tr>
</tbody>
</table>

Table 3

The importance of having cooperative agreement abroad for the firm’s competitiveness
The findings in table 4 and table 5 gives some interesting ideas. We asked the managers to compare cooperation partners and subsidiaries in the foreign market. The scale is five point (1=never, 5=always). The scale have been dicotomized in 1=agree, 2=disagree. Table 4 shows that both hard- and soft services perceive subsidiaries as a better local presence than cooperation partners.

<table>
<thead>
<tr>
<th>Agree</th>
<th>16(25%)</th>
<th>19(15%)</th>
<th>35</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>48(75%)</td>
<td>111(85%)</td>
<td>159</td>
</tr>
<tr>
<td>Total</td>
<td>64(100%)</td>
<td>130(100%)</td>
<td>194</td>
</tr>
</tbody>
</table>

Table 4

Cooperation partners result in better local presence than subsidiaries

In line with table 4, table 5 shows that hard- and soft services perceive subsidiaries as having a wider network of business relationships than cooperation partners.

<table>
<thead>
<tr>
<th>Agree</th>
<th>7(11%)</th>
<th>8(6%)</th>
<th>15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>58(89%)</td>
<td>122(94%)</td>
<td>180</td>
</tr>
<tr>
<td>Total</td>
<td>65(100%)</td>
<td>130(100%)</td>
<td>195</td>
</tr>
</tbody>
</table>

Table 5

Cooperation partners have a wider network than subsidiaries

Services are bought on the basis of trust. Trust develops in interaction between the service provider and the client. The response in table 6 shows that demands from established clients were a reason for going abroad. In the overall sample a majority of the respondents indicate this reason as important.

<table>
<thead>
<tr>
<th>Not important</th>
<th>50(36%)</th>
<th>42(30%)</th>
<th>92</th>
</tr>
</thead>
<tbody>
<tr>
<td>Important</td>
<td>88(64%)</td>
<td>97(70%)</td>
<td>185</td>
</tr>
<tr>
<td>Total</td>
<td>138(100%)</td>
<td>139(100%)</td>
<td>277</td>
</tr>
</tbody>
</table>

Table 6

Demand from the established clients

The major input and output in service firms are intangible assets like knowledge and competence. The network surrounding the firm supply this knowledge. Table 7 below shows that the acquisition of knowledge and competence is an important reason for expanding abroad. There are similar pattern for hard services and for soft services.

<table>
<thead>
<tr>
<th>Not important</th>
<th>27(20%)</th>
<th>35(25%)</th>
<th>62</th>
</tr>
</thead>
<tbody>
<tr>
<td>Important</td>
<td>110(80%)</td>
<td>103(75%)</td>
<td>213</td>
</tr>
<tr>
<td>Total</td>
<td>137(100%)</td>
<td>138(100%)</td>
<td>275</td>
</tr>
</tbody>
</table>

Table 7

in McLoughlin, Damien. and C. Horan (eds.), Proceedings of The 15th Annual IMP Conference, University College, Dublin 1999
We can also assume that competitive factors influence service firms in their foreign market entry decision making process. Increased competition in the domestic market in which the service firms have been active in the past could be a reason for going abroad. However, table 8 shows that this factor is rather weak for both hard- and soft services.

<table>
<thead>
<tr>
<th></th>
<th>Hard services</th>
<th>Soft services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not important</td>
<td>53(71%)</td>
<td>109(80%)</td>
<td>162</td>
</tr>
<tr>
<td>Important</td>
<td>22(29%)</td>
<td>27(20%)</td>
<td>49</td>
</tr>
<tr>
<td>Total</td>
<td>75(100%)</td>
<td>136(100%)</td>
<td>211</td>
</tr>
</tbody>
</table>

**Table 8**

*Increased competition within the domestic market (domestic firms)*

In table 9 we investigate the effect of increased competition in the international market by non-domestic firms. This factor is also rather weak. For both hard- and soft services, this was a weak reason for going abroad.

<table>
<thead>
<tr>
<th></th>
<th>Hard services</th>
<th>Soft services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not important</td>
<td>57(75%)</td>
<td>98(72%)</td>
<td>155</td>
</tr>
<tr>
<td>Important</td>
<td>19(25%)</td>
<td>38(28%)</td>
<td>57</td>
</tr>
<tr>
<td>Total</td>
<td>76(100%)</td>
<td>135(100%)</td>
<td>212</td>
</tr>
</tbody>
</table>

**Table 9**

*Increased competition in the international market (non-domestic firms)*

**Discussion**

Earlier research argue that hard services follow different entry mode strategies than soft services. The main argument is that hard services can be decoupled, e.g. production can be separated from consumption.

Our preliminary study shows no significant differences between hard- and soft services. The findings indicate that the underlying process of internationalization e.g. knowledge development is similar for hard- and soft services, but the manifestation in different foreign market entry mode is slightly different.

In future research, we recommend to test propositions about the dependent variable entry mode across different conditions. Erramilli and Rao (1990) have tried to arrange entry mode in an ordinal scale based on involvement (1=lowest, 9=highest). Later the same researchers Erramilli and Rao (1993) categorized the same entry modes in two groups shared control mode and full control mode but did not include export. In our context export should be included because export can separate hard- and soft services.

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