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Explaining the Internationalization Process of Malaysian Service Firms

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Abstract— **International business literature has paid special attention to the study of internationalisation and entry mode strategies of firms from the manufacturing sector. Very few studies have been conducted that examine the international expansion of firms from the service industry. Today, the increasing involvement of service industries in the development of business activities has attracted significant attention. The rapid growth of the international presence of service firms in the international arena has created a new area of interest for scholars to investigate the issue in greater detail. This paper reflects an initial investigation of the pattern of internationalisation, motivating factors, and the choice of entry strategy made by Malaysian service firms. As a successful developing country with a fast growing economy, the Malaysian government has facilitated and encouraged the presence of its firms in international markets. This research utilizes a case study approach through in-depth interviews with key managers/executives in the selected Malaysian service firms to explain the internationalization pattern and behaviour of these firms. Suggestions for further research are discussed.**

Index Terms— **Internationalization, entry mode choice, Malaysian service firms, Foreign Direct Investment (FDI)**

I. Introduction

In recent decades, the world business environment has changed dramatically through the globalization of economies and liberalization of markets, resulting in a new, furious business setting for firms (Jansson and Sandberg, 2008). Political and economic changes since the late 1980s along with the technological revolution and advancement in communications, transportation and information technology has resulted in the removal of trade barriers that have shaped the world as a global village (Griffin and Pustay, 2007; Hill, 2008). Dicken (1992) has argued that globalization is the result of the behaviour and expansion strategy of multinational corporations (MNCs).

Recently, the fast growth of MNCs in the service sector has changed the domination of manufacturing MNCs over international business. This has attracted considerable attention from researchers (Blomstermo *et al.*, 2006). In 2007 for instance, trade in services comprised 23% of the total of international trade, and 65% of total world outward FDI was contributed by multinational firms from the service sector (UNCTAD, 2008, 2009). At the same time, the share of services in developing countries accounted for more than 87% of outward FDI (UNCTAD, 2009).

II. Malaysia, a New Source of Outward Investment

Malaysia is one of the successful Newly Industrialized Countries (NICs) with a relatively high income and rapid economic growth (Ahmad, 2008). Clairmont (1994) named Malaysia as the 'Unstoppable Tiger'. Malaysia is selected as the setting for this study because first, the service sector is an essential part that contributes to its national economic development. In 2008, 46% of Malaysia's GDP was yielded by service industries and 51% of the labour force was involved in services (CIA, 2009). Second, the outward FDI flows from Malaysia have surpassed its inward FDI flows since 2006. The country is now a major source of outward direct investment. For instance, in 2008, outward FDI flows were more than US$14.06 billion while inward FDI flows accounted for US$8.05 billion. Overall, outward FDI stocks were equivalent to 30% of the GDP of the country (UNCTAD, 2009).

Malaysian companies have gained their competitive advantage from technological skills, knowledge capabilities and the role played by the government in supporting the expansion of the firms (Ahmad, 2008; Ahmad and Kitchen, 2008). The understanding of the international strategies made by Malaysian service firms is crucial as it may assist researchers and policy makers to anticipate future trends and developments in the international market. This study will carry out a preliminary investigation to examine the internationalisation process and business strategies of the leading Malaysian service firms in various industries. The aim of the study is to explain firms' behaviour and the strategic decisions for international expansion, the process for market selection and the strategic choice of entry mode, as derived from their strategic considerations and competitive advantage as well as the environmental forces including industry characteristics and target market factors.

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III. Process And Components Of Internationalization

Through the internationalisation process, firms gradually spread their business operations and activities beyond their national boundaries (Ahmad and Kitchen, 2008). According to Hill (2008), international expansion obliges firms to make three strategic decisions – which target markets to enter, when to enter, and how to enter those selected markets. In addition, a firm has to prepare a marketing plan to penetrate the foreign market and set a control system to monitor its business performance (Koch, 2001a).

Foreign market selection is a complex process and is divided into four stages – country identification, preliminary screening, in-depth screening and final selection (Johansson, 2005; Koch, 2001a). To be successful, firms should identify market opportunities and discover suitable foreign markets (Hohenthal *et al.*, 2003). Kirzner (1973) in his theory of market process assumed that the market is never in equilibrium and there are always gaps between supply and demand. Therefore, firms should recognize these gaps and screen the markets cautiously for investment decisions. According to Hohenthal *et al.* (2003), firms face different cultural, political, economic and institutional settings from their home. Therefore, firms may select markets that are similar to their country of origin to avoid uncertainty in a foreign country (Johanson and Vahlne, 1977).

Timing of entry is another important decision that affects the cost and revenue of investment (Sivakumar, 2002). As Mitra and Golder (2002) suggested, market knowledge plays a vital role in entry timing. If a firm accumulates sufficient information about the economic and cultural environments of foreign markets, it is appropriate to enter those markets. Lack of knowledge and risk avoidance hinders many firms entering unknown and risky boundaries. Thus, if a firm has required knowledge and resources to expand, it will benefit from a first-mover advantage (Griffin and Pustay, 2007). An important matter in international expansion is that depending on the timing of entry, firms face different levels of institutional uncertainty, which affects the efficiency of the entry strategy (Papyrina, 2007).

Entry mode is a form of strategy and commitment of resources that a firm adopts when it decides to enter a foreign market. The choice of an optimal entry mode is among the crucial strategic decisions for firms during the internationalisation process (Chung and Enderwick, 2001; Nakos and Brouthers, 2002; Quer *et al.*, 2007; Root, 1994). Adopting suitable entry modes may help a firm achieve better performance and survival in foreign markets as it involves various risks (Choo and Mazzarol, 2001; Chung and Enderwick, 2001; Ekeledo and Sivakumar, 2004; Root, 1994; Kwon and Konopa, 1993).

Researchers have divided entry mode choices into two aspects: non-equity and equity modes. Non-equity modes are divided into market oriented modes (i.e. direct and indirect exports) and contractual modes (i.e. turnkey projects, contract manufacturing, management contracts, strategic alliances, licensing and franchising). Equity entry modes include partly owned modes or joint venture (JV) and wholly owned subsidiary (WOS) or sole ownership (Kumar and Subramanian, 1997; Lotayif, 2003; Wild *et al.*, 2008). When a firm adopts an equity mode, it has to make the choice between setting up a business from scratch (Greenfield investment) or buying an existing firm (acquisition), or Brownfield – a combination of both strategies (Griffin and Pustay, 2007; Hill, 2008; Wild *et al.*, 2008). Each entry mode strategy has its benefits and drawbacks. Firms may follow various criteria to choose a suitable entry mode. To obtain a high return from foreign operations, firms may require high resource commitment. However, in turn, this increases the risk of international investment. Thus, firms have to exercise higher control over their foreign operations and affiliates (Blomstermo *et al.*, 2006; Ekeledo and Sivakumar, 2004; Kumar and Subramanian, 1997; Lotayif, 2003).

IV. Theoretical Views of Internationalization

In the context of this paper, five main theories that are related to the international expansion of service firms are discussed. These views are as follows:

A. Internationalization theory

According to the internationalization process theory, firms will follow a gradual process to internationalise their operations abroad (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). A firm's behaviour during the establishment of international expansion starts from low resources commitment to a successive greater commitment and control. Firms primarily enter the markets, which are known and have less psychic distance with their home country. This theory assumes that for foreign operation, a firm moves through four stages from no regular export activities, then export via host country agents, followed by export through an overseas sales subsidiary, and finally, overseas production by a wholly owned subsidiary.

Several authors have criticized the internationalization process theory (see Andersson, 2000; Rasmussen and Madsen, 2002; Melin, 1992). The sequence of stages was restricted to a specific country market (Andersen, 1993). The theory ignored contractual entry modes and joint ventures (Root, 1987; Sharma and Erramilli, 2004). In addition, this theory is too deterministic in nature and is only important in the early stages of internationalization as markets become homogenous and psychic distance reduces (Melin, 1992).

B. Networks theory

The networks approach emerged from the late 1980s based on organizational sociology researchers such as Håkansson (1987) and Johanson and Mattson (1988). As Sharma and Blomstermo (2003) suggested, the home country networks are starting point for the international expansion of the firms. Permanent competitive advantage is obtained through synergy. When a firm has permanent competitive advantage, its resources and capabilities are durable, hard to identify and realize, imperfect, transferable and hard to copy. Then, this theory emphasizes the effect of firm-specific resources and business networks on the international strategy of firms.

According to this theory, a network of interorganizational and interpersonal relationships that shape the behaviour of firms to internationalise is the result of the business and social networks rather than through the internalization mechanism of the market (Malhotra *et al.*, 2003). Although the network theory offers a valuable approach towards the role of networking in internationalization, it does not explain the effect of environmental factors.

C. Eclectic paradigm theory

Dunning (1977, 1980 and 1988) in his eclectic paradigm approach known as the OLI (ownership, localization and internalization) model emphasized that a firms' international expansion and entry strategy depends on its ownership advantages (firm resources), location advantages (host country factors) and internalization advantages (relational factors). Based on this viewpoint, if the home market has a location advantage over the target foreign market, exporting is a suitable entry mode. If the host market has a location advantage, firms look at the contractual mode of entry. If the risk of contract with local partners is high, FDI is the appropriate mode. Otherwise, licensing is adopted (Sharma and Erramilli, 2004). Agarwal and Ramaswami (1992) extended the theory to joint venture mode. Dunning (1995) modified his theory by considering the skills and capabilities of the partners, spatial integration between locations, and cooperative structures (Sharma and Erramilli, 2004).

Despite its empirical support, this theory is unable to present an integrated view for the explanation and prediction of entry mode choice. It does not explain why two firms operating in the same business and with similar ownership internationalise. The eclectic model ignores the effect of home country and internal factors such as a firm's assets and product nature on the choice of entering foreign markets. In addition, it assumes that when there is no market failure, FDI does not occur but firms are usually involved in alliances to improve their competitive advantage, or competitive position (Ekeledo and Sivakumar, 2004).

D. Transaction cost theory

According to Anderson and Gatignon (1986), the default mode of operation in foreign markets is low-control modes, i.e. exporting, licensing or minority joint venture, but when firms face high transaction costs related to negotiating, monitoring and implementing a contract, they will favour high control entry modes. According to the transaction cost (TC) theory, competition is perfect, firms are harmonized, and resources can be transferred among firms (Ekeledo and Sivakumar, 2004). When a market is fully competitive, the market will regulate transactions by price mechanisms. This theory assumes that in the market where individuals are usually opportunist, information will be inequitably shared among all trading companies, and asset specificity influences the nature of the transaction (Cheng, 2006; Williamson, 1975; Zacharakis, 1997).

The transaction cost theory is not able to justify the choice of entry mode in the new global business setting. It cannot compare FDI with exporting effectively as it concentrates on market failure conditions that result in FDI. In addition, the theory fails to recognize that strategic concerns can motivate a firm to use a collaborative entry mode. Though this theory explains why a firm may prefer FDI as its entry mode, it overlooks the role of location advantages (Ekeledo and Sivakumar, 2004).

E. Resource-based view to Resource-advantage theories

Wernerfelt (1984) and Barney (1986) believe that firms have a source of competitive advantage caused by their valuable resources such as assets and capabilities. Firms can compete and achieve their long-term goals if they have enough resources and use them effectively (Sharma and Erramilli, 2004). The resource-based view (RBV) theory suggests that a firm's success in the market not only depends on environmental factors but also on the firm's function and influence on the environment (Barney, 1991; Ekeledo and Sivakumar, 2004). This theory argues that firms with valuable resources and capabilities favour high control modes, especially when it follows a global strategy (Ekeledo and Sivakumar, 2004).

Hunt (2002) extended the ideas of RBV in his resource advantage (RA) theory. He argued that because firm resources are heterogeneous and relatively immobile, some firms may gain competitive advantage and superior performance. Furthermore, the specific mode of operation in foreign markets depends on the type of resource advantage (Malhotra *et al.*, 2003). Although some researchers believe that the resource based theory is the best explanation for the international expansion of firms (see Ekeledo and Sivakumar, 2004), it cannot explain the choice of some entry mode strategies (e.g. licensing vs. joint venture). In addition, measuring some intangible assets appears difficult (Malhotra *et al.*, 2003).

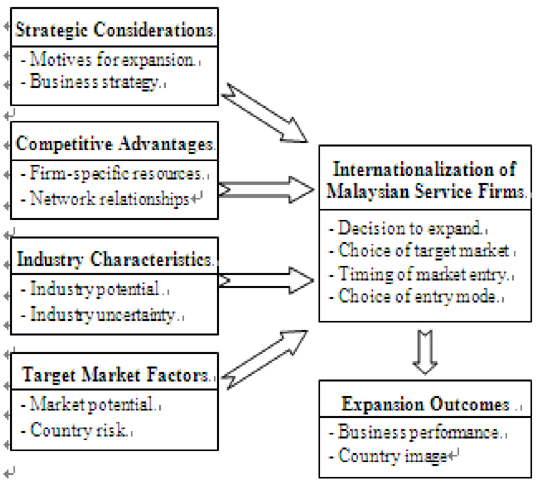
V. Factors Affecting Internationalization of Firms

Generally, business firms do not follow any unique pattern to internationalize their operations because they face different environmental settings. They may enter a particular target market through different entry strategies based on their specific resources, capabilities and strategies. Two types of factors influence the international strategy, market selection and the choice of entry mode, i.e. internal and external factors (see Agarwal and Ramaswami, 1992; Anderson and Gatignon, 1986; Choo and Mazzarol, 2001; Dunning, 1980; Ekeledo and Sivakumar, 1998, 2004; Koch, 2001b; Kwon and Konopa, 1993; Quer *et al.,* 2007; Root, 1994; Wernerfelt, 1984). Internal factors include firm-specific resources and strategic considerations that can be managed by firms. External factors such as country factors and industry factors are usually beyond the firms' control (Ekeledo and Sivakumar, 1998, 2004).

Koch (2001b) suggested that market selection and entry mode choice are determined by several internal factors such as firm resources, the strategic concerns, foreign business experience and networking, and external factors including target market potential and risk, and similarity between home and host markets. In the study of Malaysian MNCs, Ahmad and Kitchen (2008) suggest that international expansion of these firms is affected by ownership advantage factors such as technological capability and business networks.

Based on the pertinent literature, Figure 1 indicates both internal and external factors affecting the international expansion of Malaysian service firms. Although competitive advantage is assumed to be a key factor that enables Malaysian firms to expand, the proposed model of this study takes into account the effect of other factors such as strategic considerations as well as industry and host country factors. The model also investigates the impact of internationalization process on the performance of and country image.

Figure 1: Proposed Model of the Study



VI. Research Methodology

This study applies a qualitative method in the form of a multiple case study to collect comprehensive and holistic primary data from Malaysian service firms that have ventured abroad (Ahmad, 2008; Yin, 2009). The logic behind the selection of the case study method is: first, lack of comprehensive statistical and information data on the international operations of Malaysian service firms. Second, the number of Malaysian firms that have ventured abroad is limited. Therefore, the small sample size hinders running a quantitative study (see Yin, 2009). Third, conducting a case study research results in more useful findings and a better understanding of the behaviour of firms (Reiner *et al.*, 2008).

The primary data is gathered through in-depth interviews with key managers from the selected firms from different industries within the service sector. In addition to primary data, the study will also use secondary data that is extracted from various sources such as the companies' annual reports, paper clippings, magazines, and the statistical reports from the government and its related agencies. Analyzing secondary data provides insight into the historical trends of international activities and foreign investment made by Malaysian firms.

VII. Selected Cases For The Study

While most previous studies only focused on one or a limited number of specific industries, the present study selects multiple samples from various industries within the service sector of the Malaysian economy. The selected cases of the study and justifications are as follows:

A. Air Asia Berhad

Established in 2001, Air Asia has experienced a tremendous growth and is now one of the largest low cost carriers in Asia. It has a vision of becoming a global company. Currently it flies to over 61 domestic and international destinations. Air Asia operates over 400 flights daily from hubs located in Malaysia, Thailand and Indonesia. The successful strategies of Air Asia and its presence in regional markets give it a strong case for representing the transportation industry in this study.

B. Maybank Berhad

Maybank is the largest banking and financial services group in Malaysia. It has been operating since 1960 and was awarded as being the most preferred brand in the country with a high brand value equal to US$ 2.7 billion. The Maybank Group has over 450 offices in 14 countries worldwide. Its unique competitive position among Malaysian banking and finance institutions introduced it as a suitable case of study representing the banking industry.

C. Limkokwing University

Limkokwing University started its operations since 1991 and is a well-known private university in Malaysia. The university has close cooperation with various industries in Malaysia, and has a global vision to become a leading international university. It has three campuses in Malaysia and nine foreign campuses in seven countries on three continents.

D. Sunway Group

The Sunway Group was established in 1974 and operates a wide range of activities including construction, engineering, property development, hotel and resorts, leisure and tourism, healthcare and education. Sunway has expanded its activities beyond the Southeast Asia region as well as China, India and the Caribbean Islands. The competitive position of the group and its international operation in two major industries, i.e. construction and property, and hotel and leisure services, was the reason that it was chosen for being a case for this research.

E. Marrybrown

Founded in 1981, Marrybrown is recognized as the first fast-food franchiser from Malaysia. It has expanded its brand name through over 250 outlets in 13 countries in Asia, the Middle East and Africa. The company is now a global food service provider that competes with American fast-food chains. This case company represents Malaysia's food industry.

F. Parkson

In 1987, Parkson Holdings Berhad was established as a retail and supermarket firm. It is the only Malaysian-based major retail store that has entered foreign markets. Currently it has outlets in China and Vietnam, and has plans for future international expansion. The specialty of Parkson is providing superior quality products for its customers, and it was recognised as the 5th most valuable brand in Malaysia.

G. Astro

Astro All Asia Networks PLC was incorporated in 1996 and is one of the leading Malaysian companies in the communication industry. Astro provides satellite TV programmes for Malaysian citizens and since 2000 it has expanded its operations into Brunei, China, India and Indonesia. The company has a unique competitive position in the entertainment industry. This justifies the choice of Astro as one of the cases for this study.

Obviously, these firms have been selected as case companies based on their leading position in the respective industries, competitive strengths, and their presence in international markets.

VIII. Challenges And Future Research Directions

Using a case study approach on a small and limited size sample may make the generalizability of the results to all service firms impossible. However, according to Yin (2009), the objective of case studies is not to generalize the target population but to help generalize the findings to the theory. In addition, comparing the research findings with those of previous studies may lead to some understanding of the general rules and facts of the international expansion strategies of firms. The study of the internationalization of firms from developing countries is an attractive area of research, and it is useful to examine theoretical views in the context of emerging markets. However, further studies on this subject are encouraged and it is suggested that researchers should consider topics such as the influence of business networks on the international strategies of firms, the impact on the choice of entry mode towards export performance, and the internationalization of firms from other industries.

IX. Conclusion

As the Malaysian economy is growing rapidly, the number of Malaysian firms that enter foreign markets as well as the amount of their resource commitment overseas increases, especially firms from the service sector. There are various factors affecting the expansion strategies of Malaysian service firms, which are explained in this study. Through conducting a multiple case study method, the research will provide useful information about the behaviour and motives of Malaysian service firms entering foreign markets.

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