Internationalization of Service SMEs: An Integrated Perspective from the Engineering Consulting Sector

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ABSTRACT

Internationalization traditionally has been examined using a single theoretical framework in the context of large manufacturing firms. The authors argue that it is more relevant to examine foreign direct investment (FDI) theory (including transaction cost analysis), the stage models of internationalization, or network theory in an integrated and holistic manner. Using case studies of four New Zealand-based engineering consulting firms classified as small or medium-sized enterprises (SMEs), the study identifies and analyzes patterns and influences related to the smaller service firm's decision to internationalize, subsequent internationalization, market selection, and mode of entry. The findings show that SME internationalization in the engineering consulting sector is a complex process, and concepts inherent in FDI theory, the stage models, and the network perspective are all evident. These results support the argument that service internationalization is too broad a concept to be defined exclusively or examined by any one theoretical framework. Implications are drawn for research and practice.

Small and medium-sized enterprises (SMEs) are increasingly active in international markets (Bonaccorsi 1992; Erramilli and D'Souza 1993; Haahti, Hall, and Donckels 1998). As such, the activities and processes surrounding their internationalization are important phenomena to understand from both a research and a managerial perspective. An understanding of SME internationalization is also of interest because small firms differ from larger firms in their managerial style, independence, ownership, and scale/scope of operations (O'Farrell and Hitchins 1988). They are also likely to be limited in financial, management, human, and information resources (Buckley 1989; Erramilli and D'Souza 1993), with different managerial processes and structures that are less rigid, sophisticated, and complex than those in larger firms. As stated by Shuman and Seeger (1986, p. 8),

"Smaller businesses are not smaller versions of big business ... smaller businesses deal with unique size-related issues as well, and they behave differently in their analysis of, and interaction with, their environment."

Therefore, the internationalization literature should recognize and account for the patterns and processes of smaller firms. A similar argument can be made for service organiza-
tions. Similar to smaller firms, service firms are active in international markets (Dunning and Kundu 1995; O'Farrell, Wood, and Zheng 1998). Furthermore, in the same way that smaller firms differ from large firms, services generally are considered different than goods (Zeithaml, Parasuraman, and Berry 1985). For example, Buckley, Pass, and Prescott (1992) note that the distinguishing characteristics of services are their intangibility, inseparability of production and consumption, heterogeneity, and perishability.

In spite of the involvement of both small and service firms in international trade, the internationalization literature traditionally has emphasized the activities of large firms in manufacturing sectors. More important, prior research has tended to examine internationalization in the context of a single theoretical framework (e.g., network theory or patterns of foreign direct investment [FDI]), and as a result, the internationalization concept often is discussed from a unilateral and perhaps myopic perspective. Therefore, we seek to integrate three major areas of internationalization research: FDI theory, the establishment chain or “stage” models of internationalization, and the network perspective on internationalization. We empirically examine the internationalization of SMEs that are also service organizations.

We proceed with a summary of the internationalization literature discussed in the specific context of smaller service firms. This review highlights the need for integrated internationalization research on service SMEs and leads to a statement of research purpose. The literature review is followed by a discussion of the research method and the results of the study. We then present conclusions focusing on implications for research and managerial practice.

Efforts to understand the internationalization concept have been many, and as summarized by Johanson and Vahlne (1990), three general research areas have emerged in the literature:

1. FDI theory,

2. The establishment chain or stage models of internationalization, and

3. The network perspective.

We introduce each of these areas briefly, followed by a summary of the extant internationalization literature on service SMEs.

The general body of FDI theory has emerged from several different theoretical developments. For example, the theories of monopolistic advantage/market imperfections (Caves 1971) and internalization (Rugman 1981) have led to the use of
transaction cost analysis to explain internationalization. This view argues that firms choose their optimal structure for each stage of production by evaluating the costs of economic transactions. Firms therefore choose the organizational form and location for which overall transaction costs are minimized. Transactions perceived to be high risk and requiring significant management time or other resource commitments are more likely to be internalized as part of a hierarchically structured organization. In contrast, the eclectic paradigm (Dunning 1980, 1988) suggests that economic costs are not the only factor influencing internationalization. This theory argues that for a firm to invest in a foreign market (undertake FDI), internalization, ownership-specific, and location-specific advantages must be present.

A second area of internationalization research is that captured by establishment chain theory (commonly referred to as the “stage models” of internationalization). Research in this area argues that international expansion is influenced strongly by managerial learning. One of the most commonly cited theories suggests that internationalization begins with low-risk, indirect exporting to “psychically close” or similar markets (Johanson and Vahlne 1977). This first step to internationalization improves the firms’ foreign market knowledge. Over time and through experience, firms increase their foreign market commitment and expand to more “psychically distant” markets. This expansion further enhances market knowledge, which leads to additional commitment, including equity investment in offshore manufacturing and sales operations.

Other versions of the stage model approach have found that internationalization is reflected in differences in the attitudinal and behavioral commitment of managers. For example, Cavusgil (1984) empirically identifies five stages (preinvolvement, reactive/opportunistic, experimental, active, and committed involvement). Andersen (1993) summarizes this incremental approach as a result of innovation adoption behavior in which the manager’s perceptions and beliefs both influence and are shaped by foreign market involvement.

A third area of internationalization research draws on the theories of social exchange and resource dependency and focuses on firm behavior in the context of interorganizational and interpersonal relationships. Referred to as the “network perspective,” this view argues that organizational boundaries incorporate both formal and informal relationships (Johanson and Mattsson 1988). As a result, it offers an alternative conceptual view of internationalization, because FDI theory does not account for the role and influence of social relationships in business transactions (Johanson and Mattsson 1987). Internationalization also emerges as patterns of behavior in-
fluened by network members, whereas FDI theory assumes rational strategic decision making. Compared with the stage models’ unilateral process, the network perspective introduces a more multilateral element to internationalization (Johanson and Vahlne 1990). That is, though foreign market entry still may occur over time, it is a result of interaction and the development of a multitude of relationships (Johanson and Vahlne 1992).

The areas of internationalization research discussed previously are well developed, with much of the current interest focused on the network perspective. A large portion of the literature also emphasizes manufacturing firms, though service industries increasingly have received attention (Buckley, Pass, and Prescott 1992; Dunning and Kundu 1995; Edvardsson, Edvinsson, and Nystrom 1993; Erramilli 1989, 1991; Erramilli and Rao 1993; Li 1994; Sharma 1988; Sharma and Johanson 1987; Sijbrands and Eppink 1994).

With regard to firm size, however, the general patterns in the extant literature suggest that the primary interest has been in large firm activities. This emphasis is supported by the findings of Coviello and McAuley’s (1999) review of research on the internationalization of SMEs. For example, during the ten-year period ending in mid-1998, Coviello and McAuley (1999) identify only sixteen journal articles specific to the process of SME internationalization (not including the broader literature on SME export practices and performance, FDI characteristics, and so forth). Only five of these studies focus on service firms: three investigate the software sector, one compares traditional service firms and manufacturing organizations, and one examines a variety of business service sectors. Even a recent eight-nation study on SME internationalization (Haahti, Hall, and Donckels 1998) is focused solely on manufacturing firms.

On the basis of these patterns, contemporary research on the internationalization of service SMEs appears quite limited. Coviello and McAuley (1999) also raise the concern that (1) the three general areas of internationalization research tend to be examined independently of one another, and therefore (2) the literature has become overly specialized as different theories compete to explain the concept of internationalization. As discussed by Van de Ven (1989, p. 487), the danger exists, in that “proponents for each theory engage in activities to make their theory better by increasing its internal consistency often at the expense of limiting its scope.” This specialization is of concern, because none of the three theoretical frameworks may be truly distinct. This was first evidenced by Aharoni’s (1966) findings that FDI reflects a staged managerial learning process. In addition, more recently, Lau (1992) found evidence of both internalization and incremen-

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Such findings suggest that FDI theory, the stage models, and the network perspective provide complementary rather than distinct views on the internationalization concept. Only one study has been identified, however, that attempts to examine SME internationalization by integrating all three areas of the literature (Zafarullah, Ali, and Young 1998). In the context of an exploratory study on manufacturing SMEs in Pakistan, their study shows little support for aspects of FDI and the stage models and concludes "the importance of contacts and connections in all aspects of internationalization is supportive of network theory" (Zafarullah, Ali, and Young 1998, p. 21). Unfortunately, though this investigation is unique in its discussion of all three theoretical frameworks, it seems similar to other research that examines more than one theory. That is, Zafarullah, Ali, and Young's (1998) primary intent is to investigate the applicability of individual theories relative to one another. Few, if any, efforts therefore have approached the challenge of understanding SME internationalization in a comprehensive and integrative manner, in spite of findings that suggest this is appropriate.

If internationalization is too dynamic and broad a concept to be defined exclusively by any one area of research, perhaps it encompasses several representations that should be explored with greater coherence. Therefore, the objective of this study is to examine empirically the internationalization of service SMEs in the integrated context of FDI theory, the stage models, and the network perspective on internationalization. By integrating the three major internationalization theories, this research should enable the development of a more holistic and relevant understanding of key managerial processes. Similarly, by focusing on service SMEs, this research offers insight to the internationalization of service firms and SMEs, both of which are underrepresented in the literature.

The investigation involves case research across four SMEs in one service sector. The case approach is deemed most appropriate for this research problem, in that richly detailed information is likely to be obtained. This method also allows for comparison across other case research that examines multiple conceptualizations of internationalization (for example, Zafarullah, Ali, and Young 1998).

The choice of SMEs was governed by the research purpose. Three of the selected sites have between 23 and 55 employees and thus fit within the Organization for Economic Cooperation and Development small business criterion of 200
employees, as well as within Erramilli’s (1989) criterion of 100 employees in a service firm. Although one site is over this limit (250 employees), it falls well within the limit of 500 employees often used to define SMEs (Bonaccorsi 1992; Erramilli 1991). Moreover, all four sites meet generally accepted criteria for small firms (Beamish, Craig, and McLellan 1993), with annual sales ranging from US$4 million to $15 million (at time of data collection). Although this exceeds Erramilli and D’Souza’s (1993) cut-off of US$2.5 million for engineering and architecture firms, the case firms still can be considered SMEs.

One population was used to select the case sites: New Zealand-based engineering consulting firms (ECFs). The choice of a single sector within the service industry recognizes that the internationalization process is embedded in the sectoral context (Melin 1992) and that service organizations can be very different in their nature (Boddewyn, Halbrich, and Perry 1986; Lowendahl 1993; Vandermerwe and Chadwick 1989). Engineering consulting firms were chosen because they are considered technical consulting firms, as well as professional business organizations (Erramilli 1989; Vandermerwe and Chadwick 1989). The results therefore can be compared with the existing literature on technical consultants (Lowendahl 1993; Sharma 1988; Sharma and Johanson 1987) and ECFs (O’Farrell, Wood, and Zheng 1998). Furthermore, because the extant literature on the internationalization of service SMEs has focused primarily on the activities of software firms, it is important to examine another service sector.

Sites were generated on the basis of several different characteristics, as recommended by Eisenhardt (1989). The case firms had slightly differing product and market characteristics, and individual sample elements were senior managers responsible for internationalization activities. Thus, the key informant for three of the case sites was the chief executive/company founder (supported by other relevant managers). The key informant at the fourth site was the senior executive who has been responsible for the company’s internationalization efforts.

Data were collected from multiple sources and focused on identifying the general process and pattern of internationalization, decisions surrounding initial and subsequent internationalization, market selection, mode of entry, and influences on these decisions (including the role of various market relationships). Thus, information was obtained to enable analysis relative to the three theories of internationalization of interest in this investigation. The primary source of information was taped and transcribed interviews, supported by various internal documents. The interviews were con-
RESULTS

Table 1. Case Summaries (at time of data collection)

<table>
<thead>
<tr>
<th>Case Site</th>
<th>Firm Size (employees)</th>
<th>Firm Age (years)</th>
<th>Years Offshore</th>
<th>Percentage Sales from Offshore*</th>
<th>First Foreign Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>250</td>
<td>8</td>
<td>7</td>
<td>30</td>
<td>Cook Islands</td>
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<tr>
<td>2</td>
<td>23</td>
<td>5</td>
<td>3</td>
<td>10-20</td>
<td>India</td>
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<tr>
<td>3</td>
<td>55</td>
<td>25</td>
<td>14</td>
<td>25-30</td>
<td>Papua New Guinea</td>
</tr>
<tr>
<td>4</td>
<td>25</td>
<td>11</td>
<td>4</td>
<td>5</td>
<td>Fiji</td>
</tr>
</tbody>
</table>

*Actual per annum sales levels are confidential.

Conducted over a six-month period, with eight to ten hours spent in each organization. Interviews were open-ended yet semi-structured, with each informant receiving a case protocol and list of questions in advance. After primary and secondary data collection was completed, a biographic case history of internationalization issues was developed for each site. The cases were checked for accuracy by each informant, revised if necessary, and released to the authors for data analysis.

Data analysis involved pattern matching and explanation building, as developed by Yin (1989). This approach was aided by a variety of analytical tools applied within and across the cases, as suggested by Miles and Huberman (1984). For example, checklists, time-ordered matrices, and event listings were used to identify and chronicle critical events pertaining to international decision making and expansion. Because of the historical perspective of the research, all analysis was conducted chronologically; the basic sequence of cause and effect should not be inverted. Furthermore, a major area of the internationalization literature focuses on sequential stages; thus, chronological analysis is relevant. As is consistent with qualitative research methods, no attempt was made to operationalize and measure concepts on an a priori basis. Rather, transcripts were content analyzed, then interpreted and coded as a means for labeling dimensions that emerged in the process of data collection. In most cases, direct quotes from case informants were used, because they best reflect the phenomena under investigation.

This section presents the research findings, beginning with a summary of the firm characteristics. Based on within and cross-case analysis, patterns are presented in four areas: (1) the decision to internationalize, (2) subsequent internationalization, (3) market selection, and (4) mode of entry.

Summary characteristics of the four case firms are highlighted in Table 1. Although specific sales revenues are confidential, total annual sales at time of data collection ranged from US$4 million to $15 million. Overall, these four firms accounted for most of the international business undertaken by the New Zealand engineering consulting sector and were regarded by industry reports as the firms with the greatest international experience.
Prior to internationalization, three of the four case firms possessed internal resources in the form of personnel with significant offshore experience. Using this expertise, both Firms 1 and 2 made early decisions to internationalize and explored avenues for developing their international business through external agencies: the Asian Development Bank (Firm 1) and New Zealand government trade initiatives (Firm 2). Firm 3, in contrast, did not possess similar in-house experience. Its decision to internationalize occurred when a firm in its network of relationships approached Firm 3 for specific technical knowledge to tender for an offshore project. As the key informant at Firm 3 explained,

It was a time when New Zealand consultants were looking over their shoulders at opportunities offshore in developing regions. I know [we] did not think about it consciously. It was an [alliance] with another company called [ ]. They had a strong wish to operate on an international basis. It might only be the circumstances of this company, but we were influenced by [ ] ... this developed out of a very strong personal relationship at the director level of both companies.

The initial opportunities for Firms 1 and 2 arose early in their life cycles and were initiated by other companies seeking their technical expertise and experience. Both firms were in a position to take advantage of the opportunity because they already had decided to develop offshore, possessed the excess capacity required to provide the service, and perceived the project to be low risk. In contrast, though Firms 3 and 4 possessed international expertise and excess capacity, they did not make the decision to pursue offshore business until they were well established. For example, Firm 4 did not consider internationalization until seven years after being founded. At that time, it too was approached by an organization seeking the firm's expertise.

The decision to internationalize was, for Firms 1 and 2, a decision based on (1) the acknowledged, specialized, knowledge-based nature of their service; (2) the underlying desire to spread risk; and (3) the realization that the opportunity for growth in the domestic market was limited. As the key informant in Firm 2 noted,

We [the directors] thought that in the mid- to long-term, we have got to have an offshore presence, because we are a service, it's marketable overseas, so we thought why not? There isn't sufficient demand for our specialty in New Zealand if we want to grow.

Thus, Firms 1 and 2 are considered active in their approach to internationalization, whereas Firms 3 and 4 are more reac-
tive, in that prior to their first offshore activity they were not seeking proactively to internationalize. This is due in part to the timing of their international expansion efforts. For example, when Firm 3 was approached to go offshore in the early 1980s, it already was enjoying a climate of substantial buoyancy for the domestic engineering consulting market. As for Firm 4, the internationalization of competitor firms provided a significant void in the New Zealand market. This firm therefore chose to focus on meeting domestic demand and then respond to international demand as it arose. In contrast to both these cases, Firms 1 and 2 were established in a time of an acknowledged downturn in the domestic market, thus prompting internationalization.

In all four cases, the stimulation for initial offshore business originated in each firm's extensive social and technical networks. As noted by the key informant at Firm 4,

The engineering business is like this, it's nine parts old contacts and one part just walking around and making new contacts. In our case, one of our directors was approached due to his past work in Fiji—he was approached directly.

Similarly, the key informant at Firm 2 commented:

The first client was an English company. I used to work for them and when I came back here [to New Zealand] and they needed someone to work on a specific project in India, they thought of me. They did not have any expertise in the necessary area.

In three firms (Firms 1, 2, and 4), initial networks were based on previous formal relationships between employee and employer, in which the employee worked offshore and gained experience prior to founding or joining one of the case firms. However, the relationships that actually stimulated international expansion were informal and personal in nature, because they resulted from collegial and friendship-based relationships that emerged from the original, formal contacts. In contrast, Firm 3 had no personnel with international experience prior to internationalization, and its initial activity was in response to a request from a firm within their formal network. Note, however, that this opportunity arose because of the friendship between directors in each company.

In summary, the major demand that stimulated internationalization was generated from networks of relationships, both formal and informal as well as technical and social. Although there was some desire to minimize the risk associated with a limited domestic market, none of the firms specifically initiated foreign market expansion as a result of specific.
cost/benefit analysis or explicit desire to achieve, for example, economies of scale.

Two of the case firms (1 and 2) became committed international firms within two years of their establishment. Their founders had decided early on to be internationally active and, thus, focused their efforts on building international contacts and recruiting experienced personnel. Market identification was not, however, a controlled or planned process. Rather, it arose from the opportunities presented by various actors in each firm’s network. Since international expansion began, Firm 1 has served as many as nine markets. Of these, Firm 1 has had ongoing involvement in four. Similarly, Firm 2 has served a total of six markets, with ongoing involvement in three. Market exit appears to reflect the ECF’s project-based service, as well as managerial decisions to seek work actively in markets in which it has an established track record and a strong network of formal and informal relationships.

In contrast to the internationalization of Firms 1 and 2, Firm 3 did not go offshore for 11 years. After Firm 3 first went offshore in 1981, no further expansion occurred until 1986 (though that first contract resulted in business that lasted for 7 years). In 1985, however, Firm 3 was restructured, and this is considered by the key informant to be the driver behind proactive internationalization. Since 1986, Firm 3 has served a total of five foreign markets in addition to New Zealand, four of which are ongoing. Similar to Firms 1 and 2, Firm 3 now has decided to focus on existing markets to build reputation and profile.

Firm 4’s overall pattern of internationalization has been, in comparison, more reactive. It entered its first foreign market at year 7 and has served only two markets outside New Zealand. Both opportunities were generated by a potential client seeking the acknowledged expertise and experience of the firm’s consultants. Management now recognizes the need to expand international operations if the company is to continue to grow. To facilitate this, the organization is changing its structure and work processes and has a stated commitment to recruiting personnel with international experience.

The factors influencing subsequent internationalization decisions for the case firms are much the same as the factors influencing the initial decisions of Firms 1 and 2 (discussed previously). Three notable additions are, however, the importance of (1) government stimulation, (2) client followership, and (3) network contacts with other contractors. Although Firm 1 initially commented that it had not used government assistance, government aid funding was a noted factor in driving the firm to seek offshore contracts. Ulti-
mately, Firm 1 made the decision to move away from aid work and not compete with other New Zealand firms tendering for such contracts in the Asia-Pacific region. Rather, it decided to “go it alone” and seek out projects before they were put up for tender. This necessitated the focused development of networks of relationships, as discussed previously. In the case of Firm 2, government stimulation came in the form of an advisory/education service. Firm 2 also has pursued a strategy of using government contacts to develop its offshore business. This strategy has developed to the point that one of the professionals (the key informant) is involved with New Zealand government trade missions to Asia-Pacific nations.

Client followership is identified in three case firms (Firms 1, 2, and 3). Successfully completed projects stimulated continued demand from clients, especially in the aid for development and host government sectors. In another example, Firm 2 followed a client to Germany for a one-off project. This reflects the nature of ECFs, because projects generated through client followership are often overseas term contracts. Similarly, examples of piggybacking are identified across Firms 1, 2, and 4, in which the ECF acted as subcontractor to another firm, a firm that drove market entry. Again, however, these opportunities arose through network contacts.

Overall, subsequent internationalization of the ECFs has been rapid and facilitated largely by network relationships (with government contacts, clients, and other contractors). Changes in management structure and increased management experience also influence internationalization.

All initial offshore business for the case firms was in the Asia-Pacific region: Cook Islands, India, Papua New Guinea, and Fiji. Also, subsequent markets were primarily in the Asia-Pacific, including Cambodia, Vietnam, Indonesia, the Philippines, and Laos (though Firm 1 entered the United States, and Firm 2 entered Germany and Sweden on a temporary basis for short-term projects). The Asia-Pacific locations were considered by key informants to be geographically close, which therefore maximized the ease of conducting business offshore. As noted by Firm 3 in particular, Papua New Guinea was considered “close enough” to reduce any risk associated with conducting business overseas. This, combined with the seemingly unlimited demand for specialized engineering services in the region, has led to the perception that the Asia-Pacific market is lucrative for ECFs. The key informant at Firm 2 commented:

We are not chasing work in Africa or Afghanistan, but we are chasing a project in Laos, because we know companies who have a presence there.... [We're not chasing projects in Afghanistan and Africa] because we have no
contacts there, we are nobody. It's too far away, and there is more than enough work to do in Asia, and we must make the maximum use of our marketing dollars.

Market selection did not appear to be influenced by sophisticated cost/benefit analysis, government initiatives or requirements, local infrastructures, or psychic distance. This latter point is of particular interest because the Asia-Pacific markets are all psychically distant from New Zealand, in that they have significantly different cultures, political systems, trade practices, and so forth. Overall, however, psychic distance was not considered important because the firms, in a sense, already had overcome this barrier by employing internationally experienced personnel of many different nationalities. Furthermore, because they entered markets through network contacts, psychic distance also was reduced.

To summarize, case analysis shows that the choice of initial and subsequent market(s) was driven mainly by the location of clients and network contacts. Related to this, each firm's strategy was to operate wherever the project opportunities were. However, the key informants also are focused consciously on geographically close markets because of the perceived growth opportunities in the Asia-Pacific region. Therefore, though the firms appear to react opportunistically in their entry in certain markets (e.g., Firm 2's short-term contract in Sweden), they are focused on entrenching their position in established markets. Finally, managers do not perceive psychic distance as a barrier to internationalization in the Asia-Pacific region.

In the entry modes for the case firms, the degree of investment presence and control in foreign markets varies. Although the primary mode of entry is a form of exporting, other mechanisms include joint ventures, partnerships, informal alliances, and the establishment of branch offices.

Firms 1, 2, and 4 began internationalization by achieving a temporary market presence through exporting key personnel on a term basis, personnel who ultimately return to New Zealand. For example, though Firm 2 merged with a small New Zealand-based ECF in 1994 to broaden its domestic skill base, its primary mechanism for internationalization was to export knowledge and expertise by acting as the contractor to a foreign client or, occasionally, as subcontractor for other organizations (i.e., piggybacking). Although the traditional view of exporting implies no physical movement by the service provider, this form of market entry continues to be the most common method to service foreign markets.

Although Firm 3 began internationalization through an alliance with a New Zealand-based firm in Papua New Guinea,
most of its international activity since then has relied on exporting. Firm 3 also develops informal alliances for the duration of specific projects. Since Firm 3 became committed to internationalization, it has targeted two markets: Cambodia and Thailand. Informal relationships have been made with key decision makers in governments of both countries; these contacts arose from Firm 3’s evolving network. To illustrate the nature of some of these relationships, Firm 3’s key informant comments:

It all came out of a chance job we did ... we did a major house design for a New Zealander who was involved with the United Nations in Cambodia. They were looking for someone to do emergency work on the roads to make them passable to repatriate the people, but more importantly to set up a network and transport system so they could actually have democratic elections. There was so much arguing going on internally and nothing was being done, that we were asked to get someone there on the ground. We did, and in the end, he was working as project manager for all emergency works.

The firm took advantage of this opportunity to enter Cambodia and seconded several key staff members to the Cambodian government. Further work in neighboring Thailand has been generated directly from these employees working within the Cambodian government. Of note, however, is that all work in these markets continues to involve exporting, with personnel remaining based in New Zealand in the long term. As noted previously, Firm 4 began internationalization by exporting, but more recently, consideration has been given to allying itself with other organizations. Although not finalized, the opportunity to joint venture has resulted from the firm’s increased international visibility and expertise, and it has been approached by Canadian, British, and Japanese firms in this regard.

There is also some (albeit limited) evidence of FDI by Firm 1. This company recognized the need for private investment in the Philippines power generation market and, as a result, invested considerable resources in personnel training. Initiated by Firm 1, a joint venture was formed with two New Zealand-based investment/finance firms in 1995. Firm 1 is, however, a nonequity partner and contributes only the international expertise and contacts.

Finally, in both the Philippines and Indonesia, Firm 1 has formed a partnership with a local ECF and established offices there. This decision was made for the purpose of meeting host government regulations, and control still is maintained in New Zealand (with key decisions being made by New Zealand-based personnel). Firm 1 also has established a
branch office in Australia. No other investment is apparent in
the form of FDI, mergers, acquisitions, or establishment of a
full-scale subsidiary. Only Firm 3 “invested” key personnel
by seconding employees to the Cambodian government.

In terms of subsequent modes of entry, Firms 1 and 4 both
evolved from exporting to using alliances or joint ventures,
and Firm 1 took the furthest step down the establishment
chain by opening branch offices. However, no similar pattern
is apparent for Firms 2 and 3, and even Firm 1 uses a variety
of mechanisms in parallel, which reflects the nature of the
client and host country requirements.

In general, the small ECF’s mode of operation does not reflect
rational, planned horizontal or vertical integration. The
mode of operation is decided by the project or market and
generally guided by the desire to retain control of service
provision, as well as client requirements, the host govern-
ment regulations, and the extent of the firm’s ability to per-
form the services required. This has led to a variety of
different initiatives by the case firms to secure international
business, though none has been involved with significant eq-
uity investment. Rather, the case firms provide the technical
expertise and experience, and host country governments, for-
eign aid, New Zealand partners, or foreign investors provide
the equity.

This research identifies several factors that influence the ma-
jor internationalization decision areas for ECFs. These are
summarized in Table 2 and discussed in the context of the
three general areas of internationalization research.

Preinternationalization, the case firms exhibited different at-
titudes to international expansion, and the degree to which
each firm sought international business varied. This con-
firms Sharma’s (1988) observation of the active and reactive
strategies for technical consulting firms. Internal characteris-
tics and firm resources (rather than external stimuli) are a
consistent factor driving internationalization; this perhaps is
expected given the “pure” nature of service in these firms. A
dominant force stems from the opportunities and demand
initiated through the firm’s network of relationships, and re-
gardless of whether the firm is an active or reactive interna-
tionalizer, network relationships influence the initial and
subsequent decision to internationalize, as well as market se-
lection. This supports Sharma’s (1988), Edvardsson, Edvin-
sson, and Nystrom’s (1993), and Sijbrands and Eppink’s
(1994) work. Other major influences are the knowledge, ex-
perience, and background of the ECF’s professional service
providers, the international experience of employees, and
the firm’s desire to ensure control of service provision. This
supports Bell’s (1995) and McDougall, Shane, and Oviatt’s

**DISCUSSION**
Table 2. Factors Influencing Initial and Subsequent Internationalization Decisions

<table>
<thead>
<tr>
<th>Influencing Factors</th>
<th>Decision to Internationalize</th>
<th>Choice of Market</th>
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<tbody>
<tr>
<td></td>
<td>Initial Subsequent</td>
<td>Initial Subsequent</td>
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<tr>
<td>Firm Resources</td>
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<tr>
<td>Specialized, knowledge-based nature of service</td>
<td>•</td>
<td>•</td>
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<tr>
<td>Professionals with international experience</td>
<td>•</td>
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<tr>
<td>Networks of formal and informal relationships</td>
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<tr>
<td>Desire to minimize risk/enhance control</td>
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<td>•</td>
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<td>Changes in organizational structure</td>
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<td>Increased management experience</td>
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<td>External Stimuli</td>
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<td>Lack of domestic growth due to competitive domestic market</td>
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<td>Client requirements/followership</td>
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Key: • Active internationalizer, • Reactive internationalizer.

Contribution of FDI Theory

Van Denmerwe and Chadwick (1989) propose that consulting and engineering firms, as an example of a pure service with a high degree of consumer/producer interaction, will favor a fully integrated mode of international operation, such as FDI, mergers, acquisitions, or the establishment of subsidiary operations. Similar arguments are offered by Dunning (1989), Buckley, Pass, and Prescott (1992), and Erramilli and Rao (1993). None of the case firms has entered this level of integration, likely because the capital intensity required to produce the service provided by ECFs is comparatively low, thus decreasing risk and the need for more fully integrated modes of operation. Although one case firm established offices in

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foreign markets as a base for operations, control and all major strategic decisions continued to be made from headquarters in New Zealand. If a partnership or branch office is established, it is for the purpose of meeting statutory government requirements rather than specifically decreasing uncertainty and risk for the case firm or responding to rising costs of integration. Thus, Erramilli and Rao’s (1993) work is not supported.

At the same time, the results show evidence of transaction cost thinking in a manner similar to that found by Zafarullah, Ali, and Young (1998). However, though Zafarullah, Ali, and Young find little hard evidence of economic analysis, the ECFs clearly seek to invest in and capitalize on their ownership-specific advantage of technical knowledge and expertise. Furthermore, they prefer to maintain modes of operation that ensure their knowledge-based work processes are controlled tightly, with information internalized (in support of O’Farrell, Wood, and Zheng 1998). The ECFs also tend to act opportunistically and do what is necessary to secure contracts, maximize control, and minimize risk and costs. Control is retained by remaining in New Zealand and establishing joint ventures or informal alliances overseas.

The financial resources of the service firm (Edvardsson, Edvinsson, and Nystrom 1993) and the drive for economies of scale (Sijbrands and Eppink 1994) have not been shown in this research to influence the initial or subsequent internationalization decisions of the service SME. This can be explained by Sharma’s (1988) argument that the major tasks for technical consultancy firms are planning, thinking, and combining different solutions to a problem. Thus, financial resources are not a significant limiting factor to ECFs (in support of Dunning 1989), and economies of scale are insignificant (in support of Buckley, Pass, and Prescott 1992).

In examining the nature of service and its effect on entry mode, Erramilli and Rao (1993) argue that there will be substantial variation in entry mode choice when firms are characterized by low asset specificity. Overall, the results of this study show only some variation in entry mode, in that a form of exporting is used most commonly. Variations on this approach appear to be a function of client and government requirements. If a specific project or contract requires resources that are outside the capabilities of the case firm, the firm forms temporary alliances to enable it to complete the project. This supports O’Farrell, Wood, and Zheng’s (1998) and Lowendahl’s (1993, p. 176) conclusions that technical consultancy joint ventures were “extremely frequent, yet they often seemed to be designed as temporary co-operative arrangements.” This also is reflected in any piggybacking activities that occur.
The preference for a form of exporting also contradicts Bod- dewyn, Halbrich, and Perry (1986), who argue that exporting per se is only appropriate for service commodities. Furthermore, it challenges Buckley, Pass, and Prescott (1992, p. 43), who argue that foreign involvement by service industries is likely to involve licensing and other contractual agreements and FDI "at the expense of exporting." At the same time, these results support Vandermerwe and Chadwick's (1989) observation that traditional ways of thinking about internationalizing services are falling away and new, hybrid modes of market entry are in evidence.

Similar to the patterns for manufacturing SMEs examined by Zafarullah, Ali, and Young (1998), the research results fail to support fully the argument that firms move through a series of stages, at least in terms of entry mode (in support of Bell 1995; Coviello and Munro 1997; Erramilli 1989; Sharma 1988). Such results are perhaps not surprising, because the ECFs appear to reflect Johanson and Vahlne's (1990) exceptions to their stage model. That is, (1) market knowledge can be gained without the need for experience, (2) the consequences of commitment are small relative to the resources available, and (3) the firm can generalize similar experiences. For example, these service SMEs, wanting to grow their international commitment faster than can be achieved through incremental activity over time, recruit personnel with knowledge of foreign markets and expertise in the client's required area. The case firms also increase these capabilities through maintaining relationships with other players that are active internationally. The ECF's financial commitment to internationalization is relatively small, and it has the excess capability to meet client demand. Thus, it perceives few negative consequences of undertaking international projects. Finally, the skills and expertise required of these service firms are not market-specific but generally can be transferred to many different markets (particularly if focused in the Asia-Pacific region). As a result, though some of the case firms are focused on developing specific markets over time, internationalization also is characterized by an entry–exit behavior that reflects their project-based service.

Although the basic tenets of Johanson and Vahlne's (1977) model are not supported and two of the firms leapfrogged early stages, the ECFs show an evolutionary process of attitudinal change. Thus, there is some support for the models that reflect innovation adoption (e.g., Cavusgil 1984). There is also support for other aspects of the Johanson and Vahlne (1977) model, in that geographic proximity influences market choice (also in support of Buckley, Pass, and Prescott 1992; Coviello and Munro 1997). This, however, is relevant for the active firm's subsequent market choice decisions, whereas initial
market selection is governed primarily by the location of the client that initiated the business relationship (in support of O'Farrell, Wood, and Zheng 1998). At the same time, the findings of this study contradict O'Farrell, Wood and Zheng's (1998) conclusion that international market selection is unsystematic. Although ECFs are influenced by clients or network contacts offering international tender or piggybacking opportunities, market entry is becoming more strategic. This is based on increased knowledge, experience, and the development of strong country networks. As such, market entry decisions are now focused on country rather than project choice.

None of the four firms considered any market more psychologically distant than others. This is a result of their internal and international experience and their ability to recruit personnel and/or use network relationships. Nevertheless, psychic distance influences internationalization decisions, because the ECFs have developed specific strategies to lessen the impact of this factor. This supports the findings for technical consultancy firms (Sharma 1988; Sharma and Johanson 1987) and also the more general literature (Bell 1995).

This research has shown that networks of formal and informal relationships are a major influence on internationalization and therefore supports Sharma and Johanson (1987), Johanson and Mattsson (1988), and Johanson and Vahlne (1992). For example, ECF market selection can be driven by an opportunity that emerges out of a network relationship (as found by O'Farrell, Wood, and Zheng 1998). As such, the firm capitalizes on a location-specific advantage, which arises from using assets tied to a particular foreign location (e.g., a network contact) that the ECF finds valuable when combined with its own assets. These patterns are somewhat similar to those identified by Zafarullah, Ali, and Young (1998) except that the ECF networks go beyond ethnic ties, relatives, and friends to include more diverse and formal connections.

The choice of entry mode also is influenced strongly by network relationships in the form of client preferences, and often, the formal client–service provider exchange relationship emerges from the firms’ informal and formal networks. This supports the link between the firm’s networks and the mode of operation observed by Sharma’s (1988) examination of technical consultancy firms; O'Farrell, Wood, and Zheng's (1998) study of ECFs; and findings in the software industry (Bell 1995; Coviello and Munro 1997). Of note, the importance of client followership in service firms (Bell 1995) is supported for both initial and subsequent internationalization decisions. This conflicts with Li (1994), who finds across ten different service sectors that firms tended to follow the client at the beginning of internationalization and follow the market leader at later stages.
Finally, as a consequence of conducting work with other firms, combined with their acknowledged expertise in specialist areas, personnel at the case firms develop and maintain lasting relationships. Client demand, piggybacking opportunities, and bid information for international contracts for the ECFs came primarily from network relationships that were specific to individuals within the firm, rather than from relationships at the firm level. This finding provides support for McDougall, Shane, and Oviatt (1994), who recommend that examination be narrowed from the level of the firm to that of an individual or small group.

This research involves an empirical examination of the internationalization of knowledge-based service SMEs (specifically New Zealand ECFs) in the context of three major conceptualizations of internationalization: FDI theory, the stage models, and the network perspective. Rather than assess the merits of each theory in an effort to prove one is better than another, this study seeks to identify how all three might be relevant to our understanding of the internationalization of service SMEs.

Overall, the findings show that the internationalization of ECFs is influenced by several key organizational characteristics: (1) a product embodied in skilled personnel, (2) a relatively high degree of client involvement, (3) relatively low capital intensity, and (4) the project-based nature of the business. These characteristics reflect the pure service component of the ECF. The findings also show that none of the three theoretical frameworks fully explains the internationalization of this type of service SME in its own right. Thus, the study offers some support for the argument that the internationalization of service firms is not reflected in the models derived from the observation and investigation of manufacturing firms (Bell 1995; Coviello and Munro 1997; Erramilli 1989; Sharma 1988; Sharma and Johanson 1987; Vandermerwe and Chadwick 1989).

When the results of this study are compared with those of Zafarullah, Ali, and Young’s (1998), two interesting points arise. Certain patterns identified for the service SMEs in this study are similar to those found for manufacturing SMEs. For example, the internationalization of both types of SMEs is influenced strongly by a variety of network relationships. This leads to the question of whether industry influences are less important than those related to size. On the basis of the findings of this study, it might be argued that the internationalization of smaller firms (regardless of sector) reflects the structural, managerial, and resource characteristics of such organizations. This is not necessarily to suggest that small firm internationalization is categorically different from that of larger firms. Rather, it can not be captured easily in the theoretical frameworks developed in the context of large organizations.

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However, the research also shows that the internationalization of engineering consulting SMEs is a more complex process than that previously identified for small manufacturing firms by Zafarullah, Ali, and Young (1998). That is, SME internationalization is not explained solely by network relationships, because concepts inherent in FDI theory, the stage models, and the network perspective are all evident in the internationalization of smaller ECFs, and they also are interrelated. For example, we see support for the network perspective in that

- Internationalization is influenced heavily by the firm’s networks of formal and informal relationships (relationships involving clients, competitors, colleagues, government, friends, and so forth), and
- These network relationships influence initial market selection and also mode of entry.

Similarly, we see evidence of the stage models of internationalization as

- Psychic distance is acknowledged but overcome by leveraging network relationships and/or recruiting personnel with expertise in psychically distant markets,
- Geographic distance is recognized and planned for (though it is not regarded as a barrier to internationalization), and
- Changes in attitudinal commitment and behavior are evident over time.

Finally, aspects of FDI are evident as

- The firms internationalize in a manner that maximizes control, minimizes costs and risk, and internalizes firm-specific assets; and
- Location-specific advantages emerge through various network relationships, and these advantages are both protected and managed as a key cost consideration.

Because all three theoretical frameworks have relevance for ECFs, we argue that comparative approaches to the study of internationalization are not only beneficial but also critical to our understanding of the complexity of the processes and issues faced by managers in smaller service organizations. By examining internationalization in an integrative manner, the limitations inherent in focusing on a single theoretical framework can be overcome, and a more holistic and realistic view of internationalization may be developed.
At the same time, a limitation of this study is that it focuses on a single service sector. With the acknowledged heterogeneity of service firms, it would be inappropriate to generalize the results too widely. We therefore identify future opportunities for research to enhance the generalizability of the current findings. The research context could be extended to other professional business service sectors, both within and outside New Zealand. These sectors include management consultants, other technical consultants in the scientific field, accounting, and legal services. Although they are all professional business service firms, there may be differences between those sectors that are predominantly project-based and those that undertake continuous contracts (e.g., an auditing function). Market exit behavior (in the context of internationalization) is worth investigating across both types of organizations. Beyond professional business service firms, the research could be extended to service sectors with a higher involvement of goods and/or a lower degree of consumer-producer interaction. This would allow for comparison across a variety of service sectors.

Because of the similarities in findings across this study and those of Zafarullah, Ali, and Young (1998), it is also important to study more closely the service/manufacturing dichotomy in the context of internationalization. Further investigations comparing SMEs across different service and manufacturing sectors would be useful. It is also important to investigate and compare these patterns across firms of different sizes to understand more fully the influence of size (and entrepreneurial behavior) on internationalization.

In the specific context of ECFs, this study could be extended to include alternative forms of data collection, with research conducted longitudinally. This would allow for greater breadth in the data generated and provide the opportunity to understand if and how internationalization patterns evolve as the smaller ECF grows and/or becomes more established and experienced. For example, the role of network relationships may change over time, or more explicit FDI and stage model patterns might emerge. Longitudinal research is suggested because of the relatively recent nature of the international activity of the case firms examined in this study. Further research also should examine internationalization, specifically networks, at the level of the individual rather than the firm. This is particularly relevant in the context of entrepreneurial or small organizations.

With respect to managerial practice, this research highlights the need for managers of service-intensive firms to have a comprehensive understanding of the impact of network relationships on their international market development. These relationships are at both the formal business level (e.g., client
relationships) and the informal individual level (e.g., previous employers, colleagues, friends). Although O'Farrell, Wood, and Zheng (1998) conclude that foreign market entry is a relatively casual process for ECFs, this need not be the case. Managers within the firm should appreciate the importance of network management and network growth and, therefore, need to ensure that efforts to develop networks are not neglected. Part of this involves understanding the networks of relationships specific to individuals in the organization, relationships that might be nurtured or leveraged to facilitate internationalization. Following this approach might allow for the growth of the service SME to be managed more strategically than opportunistically. Related to this, management can take a proactive stance on leapfrogging traditional barriers to internationalization by actively recruiting internationally experienced personnel and maintaining the network contacts of these individuals.

Beyond an understanding of the role of networks, it is also clear that opportunities must be evaluated in the context of resource allocation and protection of firm-specific assets. Because of the pure nature of the service embodied in a technical consulting or similar firm, efforts to retain quality and service control are critical and must be balanced against the opportunities presented through network relationships.

Finally, there is a wealth of internationalization knowledge and experience inherent in the case study firms investigated; however, this often is kept within the organization. Similar patterns perhaps could be identified in other service and/or manufacturing sectors. Managers should build actively on the domestic information exchange networks currently in existence to ensure efficient use of the knowledge capital on a sectorwide basis. Many firms with different areas of specialization (that are therefore not direct competitors) are spending considerable time and money on knowledge accumulation and network development. Ideally, these investments could be shared across firms competing in the same geographical market to the benefit of the sector as a whole.


Boddewyn, Jean J., Marsha B. Halbrich, and Anne C. Perry (1986),

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