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## **Limits to International Entry Mode Learning in SMEs**

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## **Limits to International Entry Mode Learning in SMEs**

### **Abstract**

Despite extensive research, the literature is unclear about the circumstances under which a firm learns from its past foreign entry modes and how this experiential learning is related to future mode choices. Building on the internationalization process (IP) model and the idea that some experiential learning is location-bound while other learning is non-location-bound, we develop and test theory to explain how experiential learning about foreign operation modes and markets impact future mode choices in new foreign markets. Overall, we argue that mode-based experiential learning is limited. Through the repeated use of a specific operation mode firms develop routines and processes that are non-location bound and can be replicated in new foreign markets, leading to the use of this same mode type in new locations. But when complemented by experiential learning about a target market/region firms opt for operation modes with greater commitment in new foreign markets. Drawing on a sample of German SMEs and examining four different types of entry modes we find some support. However, we also identify a number of notable exceptions to our theory. In this way we help provide unique new insights informing future IP model, experiential learning, and international entry mode research.

## **Limits to International Entry Mode Learning in SMEs**

Learning through experience is critically important for firms expanding abroad as it can help them deal with liabilities of foreignness (Zaheer, 1995). The concept of experiential learning parallels the more general learning literature (Perkins, 2014), according to which inferences from past experience are encoded to guide future behavior (Levitt & March, 1988). Experiential learning forms a key component of the internationalization process (IP) model – also known as the Uppsala model (Eriksson et al., 1997; Hutzschenreuter & Matt, 2017; Santangelo & Meyer, 2011; 2017). Focusing on learning from prior experiences with the mode of operation and prior experiences in a foreign location (Casillas & Moreno-Menéndez, 2014; Johanson & Vahlne, 1977), the IP model seeks to explain firms' cross-border expansion behavior and changes in firm commitment in these markets (e.g., Johanson & Vahlne, 1977). Over the past 40 years the IP model has come under criticism (e.g., Eriksson et al., 1997; Forsgren, 2002) and has been refined to suggest that outsidership leads to increased liabilities of foreignness when firms enter new markets, but that experiential learning from networks might help ameliorate these challenges (Johanson & Vahlne, 2009; Vahlne & Johanson, 2017). Recently, Hutzschenreuter and Matt (2017) theorized that firms can experientially learn from their internal network of foreign operations reducing liabilities of foreignness in new markets.

While research indicates that experiential learning can be helpful when firms stay in the same country, not all experiential learning is transferrable internationally (Hutzschenreuter & Matt, 2017). Some experiential learning leads to the development of non-location-bound knowledge which can be exploited globally at relatively low costs and without significant levels of adaptation (Clarke, Tamaschke, & Liesch, 2013; Rugman & Verbeke, 1992). This knowledge is independent from the location where the experience occurred facilitating a relatively easy transfer to new locations (Eriksson et al., 1997). In contrast, location-bound knowledge is only exploitable in a (set of similar) location(s) and is not globally transferrable without incurring high costs and significant levels of adaptation (Clarke et al., 2013; Rugman & Verbeke, 1992). This type of knowledge entails aspects that are specifically related to a market such as institutional,

competitor- or client-specific issues in that market. Firms equipped with location-bound knowledge can develop a competitive position *in the respective* host market and intensify the penetration *of that* market based on the knowledge accumulated, but they are constrained in their ability to transfer this knowledge to other locations as different markets have their own peculiarities (Eriksson et al., 1997).

Despite the IP model's popularity (Welch, Nummela, & Liesch, 2016) and its distinction between experiential learning about foreign operation modes *and* foreign markets, the question how and in what circumstances these two types of experiential learning impact firms' foreign market commitment when entering a new location is not fully clear. Because past IP model studies primarily look at changes in commitment in the same market (e.g., Guillén, 2003; Pedersen & Petersen, 1998), it is less relevant whether mode-specific or market-specific knowledge obtained from experiential learning is location-bound or non-location-bound (Clarke et al., 2013; Hutzschenreuter & Matt, 2017). As a result, and although a few studies delve deeper into the IP model's complexities (e.g., Hutzschenreuter & Matt, 2017; Santangelo & Meyer, 2011), a considerable lack of clarity prevails regarding how experiential learning from operation modes feeds forward into firms' foreign market commitment behavior and how this type of experiential learning interacts with market-specific knowledge when firms expand to new locations.

Building on the idea that firms learn from multiple experiential sources and that some experiential learning is location-bound while other learning is non-location-bound, we develop and test theory to explain how the experiential learning outlined in the IP model is related to future mode choices *in new foreign locations*. First, we suggest that through multiple extended use of a specific operation mode, firms learn how to set-up and operate this mode type in an efficient and effective way. Assuming all else is constant, this non-location-bound knowledge results in future uses of the same mode as a way of exploiting these learned processes and routines, reducing uncertainty, and improving firm performance.

In line with the IP model, we suggest that a second important source of experiential learning is through market-specific experiences. Target market/region-specific experience can come from past and/or

current operations in the specific region or other managerial experiences, but reflects the accumulated experience in the region through all sources, not the limited experience from one specific operating mode. Firms with experience in the target area not only gain general internationalization knowledge (Eriksson et al., 1997) but also more idiosyncratic market/region-specific knowledge (Brouthers & Brouthers, 2003; Dow & Larimo, 2009). Our theory suggests that it is through these market/region-specific experiences that firms develop location-bound institutional knowledge which in certain situations can be *combined* with non-location-bound mode-specific knowledge to generate more advanced learning. This combination of experiential learning sources helps firms overcome liabilities of foreignness and the limitations of operation mode learning, leading to the use of higher commitment entry modes in the future.

Taking this approach, we make contributions to the IP model, experiential learning, and international entry mode choice literatures. First, we contribute to the IP model and experiential learning literatures by providing an experiential learning-based explanation of entry into new locations and by testing the notion that experience obtained from a firm's internal network of both operation modes and foreign markets are complementary sources of experiential learning which impact the firm's entry mode commitment in new foreign markets. Unlike extant IP model studies that look at mode commitment in the same country (e.g., Guillén, 2003; Pedersen & Petersen, 1998), we advance an ongoing debate about different types of learning (e.g., Bruneel, Yli-Renko, & Clarysse, 2010; Milanov & Fernhaber, 2014; Oehme & Bort, 2015) and how their interaction is related to firm commitment in new locations. In line with the IP model (Johanson & Vahlne, 1977; 2009; Vahlne & Johanson, 2017) and theory about the location-bound and non-location-bound nature of knowledge (Clarke et al., 2013), our analyses not only address the question how firms learn from past foreign operations, but also under which boundary conditions such learning takes place. This approach allows us to examine the limited learning effect of operation mode experience as well as to forge a stronger link between the latter and market-specific learning which are both fundamental concepts in the IP model.

Second, we contribute to the international entry mode literature by disentangling the concept of operation mode experiential learning. We examine a broader range of modes and experiences enabling us to glean more detailed insights regarding firms' learning from past operation modes. The majority of prior literature examining the relationship between the intensity *or* diversity of mode experience and future mode choice focuses on large MNEs (Chan & Makino, 2007; Guillén, 2003; Lu, 2002; Padmanabhan & Cho, 1999; Vermeulen & Barkema, 2001; Xia, Boal, & Delios, 2009; Yiu & Makino, 2002), and as a consequence FDI operation modes such as wholly owned subsidiaries (WOSs) and equity joint ventures (JVs). This FDI mode focus is problematic because the value of knowledge obtained from a respective operation mode may determine the value of knowledge obtained from other modes (Clarke et al., 2013; Hennart & Slangen, 2015; Shaver, 2013). We explore the limits of international entry mode learning by examining both the intensity *and* diversity of a firm's experience with FDI *and* non-FDI mode types – direct exporting, non-FDI contractual modes, JVs, and WOSs – enabling us to control for different mode types and experiences. This more fine-grained differentiation is particularly relevant for SMEs which tend to restrict their foreign activities to non-FDI modes such as exporting (OECD, 2012). Therefore, our research helps address the question how an increased foreign market commitment in new markets is possible in particular for SMEs and helps to overcome the lack of SME studies in the current literature (Laufs & Schwens, 2014). However, our findings also have relevance beyond SMEs, as learning from non-FDI and FDI operations is important for all firms.

## **THEORY AND HYPOTHESES**

### **Experiential learning from prior foreign operation modes**

Much has been written about learning from operation modes (Chan & Makino, 2007; Guillén, 2003; Lu, 2002; Padmanabhan & Cho, 1999; Vermeulen & Barkema, 2001; Xia et al., 2009; Yiu & Makino, 2002), but this research largely refrains from differentiating between location-bound and non-location-bound learning. We suggest that firms develop both location- and non-location-bound learning from the

repeated use of a foreign operation mode. Location-bound learning helps firms develop knowledge about specific institutional aspects of operating a mode in a respective country. For example, regulations pertaining to the operation of a particular mode may vary between countries. Through experience firms learn how to deal with these institutional peculiarities. Non-location-bound mode learning includes the development of processes and routines for setting up a certain mode and for managing and monitoring mode-specific activities. Through experience with a specific mode type, firms develop knowledge about operating the mode in an efficient and effective manner.

We argue that the latter type of non-location-bound experiential knowledge can be transferred when establishing an operating mode in a new location – an argument that is consistent with Capron and Guillén (2009), who show that firms are able to transfer their experiential learning from past acquisitions when reorganizing a target firm in new (institutionally different) locations. According to the international learning literature, learning from repeatedly adopting the same entry mode type represents deep knowledge as accumulated experience can result in the development and refinement of specific processes and routines on which the organization can draw in subsequent operations (Gao et al., 2008). In the process of learning firms detect errors and correct them to make future choices more effective (Argyris, 1976). In this way, firms refine previous routines which ultimately leads to improved competences for future operations (Levitt & March, 1988; March, 1991). Experiential learning from prior operation modes means that firms gradually sort out less useful knowledge obtained during past operation mode activities. This experiential learning helps firms develop refined processes and routines that make the replication of past operation modes in future locations a good business decision, because such learning helps reduce uncertainties and improve the effectiveness and efficiency of these replicated modes (Vermeulen & Barkema, 2001). Thus, through experience from prior operation modes firms develop non-location-bound knowledge that can be used to establish and operate the same mode type effectively and efficiently in new foreign locations.

Adding these non-location-bound mode learning insights to the IP model is consistent with the recent study by Hutzschenreuter and Matt (2017) and helps explain firms' entry into new foreign locations.



Further, the notion of non-location-bound learning from operation modes as an antecedent to firms' new market entry mode choices adds to existing literature examining transaction cost, firm-specific, and country-specific (institutional) factors (e.g., Brouthers, 2002; Brouthers, Brouthers, & Werner, 2008; Meyer, 2001) as well as complements literature theorizing that firms replicate past modes due to cognitive biases and inertia in decision-making behavior (e.g., Chan & Makino, 2007; Lu, 2002; Oehme & Bort, 2015; Padmanabhan & Cho, 1999; Yiu & Makino, 2002). We argue that non-location-bound learning about prior operation modes takes place, but this learning is limited and largely pertains to improving the efficiency and effectiveness of the respective mode-related tasks rather than learning how to set-up modes with greater levels of commitment in new locations. This learning perspective leads to our first hypothesis:

*Hypothesis 1: The higher an SME's degree of operation mode experience (whether (a) export, (b) non-FDI contractual, (c) JV, or (d) WOS), the greater the SME's propensity to opt for the same mode in a new foreign location.*

### **The complementarity between experiential learning from modes and markets**

Experiential learning from past operation modes also encompasses the acquisition of knowledge about foreign locations where these modes have been established. The IP model suggests that such experiential learning can lead to future incremental changes in foreign market commitment in a respective market (Eriksson et al., 1997; Johanson & Vahlne, 1977). By acquiring knowledge about customers-, competitors-, or other market-specific aspects and through the continuous exposure to the host-country market, the firm becomes more adept at dealing with the rules, norms, and values prevailing in that market. In this way, liabilities of foreignness are reduced and as a consequence firm's (perceived) risks associated with the host market activities are diminished. According to the IP model, firms increase their foreign market commitment when the perceived costs/risks associated with an increased commitment are lower than the maximum tolerable risk related to that foreign market commitment (Johanson & Vahlne, 1977). Therefore, an increase in "experiential knowledge triggers greater resource commitment to a particular market"

(Eriksson et al., 1997, p. 342). Findings from related empirical studies (e.g., Guillén, 2003; Pedersen & Petersen, 1998) reflect this argument.

Yet when firms move to a new location the impact of this experiential learning is less clear. Johanson and Vahlne (1977, p. 24) “observed a similar successive establishment of operations *in new countries*” [italics added]; however, it remains unclear why firms would increase commitment and how such increased commitment may be possible. With regards to the former question, while the original IP model sees commitment decisions in foreign markets largely as a result of the perceived costs (which are lowered by experience) (Eriksson et al., 1997; Erramilli, 1991), it is rather silent on the specific motives leading firms to increase their commitment (Andersen, 1993). We see at least three motivations for firms to increase their foreign market mode commitment. First, high levels of foreign market commitment supply the firm with greater levels of control over the host country market activities (e.g., Zhao et al., 2017). This view is consistent with Guillén (2003) arguing from an IP model perspective that firms may seek to obtain full control over the host country market activities by establishing WOSs to avoid hazards occurring during contractual agreements. Control may be particularly pertinent for SMEs which due to their smaller size may suffer from lower levels of legitimacy, enhancing the potential threat of hazardous behavior by (larger) contractual partners. Second, higher levels of foreign market commitment supply greater levels of market and customer closeness (Yeoh, 2004; Zhao et al., 2017). SMEs tend to operate in niche markets with mostly sophisticated products and services (Yap & Souder, 1994). Increased market and customer closeness provided by higher commitment modes allows for greater coordination between these niche buyers and the SME improving customer service and satisfaction (Blomstermo, Sharma, & Sallis, 2006). Lastly, increased levels of commitment ultimately enhance the rent appropriation potential for firms (e.g., Anderson & Gatignon, 1986). That is, compared with FDI modes, non-FDI modes are often limited in their potential for return (e.g., Zhao, Ma, & Yang, 2017) as firms are unable to exert the same level of control over the host country activities and closely supply the market and customers. Within the category

of FDI modes, full commitment by means of establishing a WOS also provides undivided rent appropriation instead of sharing profits among contractual partners such as in a JV (e.g., Guillén, 2003).

Although these potential benefits might induce SMEs to use higher commitment modes in new foreign markets they may lack the knowledge necessary to overcome liabilities of foreignness in these new markets. A key issue is that experiential learning about foreign locations through past operation modes is severely limited in its ability to reduce liabilities of foreignness for firms when entering a new location because most of this knowledge is location-bound. Locations differ in terms of client-, competitor-, or market-specific issues as well as in terms of formal institutional aspects pertaining, for example, to governmental regulations or general values, norms, and rules applied in a host country (Eriksson et al., 1997; Scott, 1995). Due to these differences, previously developed knowledge about specific institutional or cultural settings may only be of use when firms expand into the same country or at most into countries with the same or similar rules, regulations, and behaviors (Barkema & Drogendijk, 2007; Perkins, 2014). This view is in line with Finkelstein and Haleblan's (2002) point about the limits to learning in more general terms when the former context in which the experience was collected and the new context differ significantly. Likewise, studies suggest that when the new location is institutionally similar to the former location(s) some parts of the knowledge could be used, but when expanding into institutionally dissimilar countries experiential knowledge provides less benefit. For example, Barkema and Drogendijk (2007) show that a firm can use its market knowledge about one country as a stepping stone for expansion into a more distant country; however, this knowledge transfer pertains only to countries from the same cultural bloc. When the former location and the new location are institutionally different, the previously acquired location-bound market-specific knowledge will be of limited help in reducing liabilities of foreignness. According to Eriksson et al. (1997), firms behave similarly as they did in the past when institutional differences are large, which means that they replicate those operation modes they already have operational excellence in as is consistent with the rationale provided in hypothesis 1. But how is an increased market commitment in new and different foreign locations possible?

We theorize that target market/region-specific experience supplements diverse and long-term mode-specific operational experience by helping firms to better estimate potential threats and returns in the respective foreign markets (Anderson & Gatignon, 1986), whereby the overall risk stemming from liabilities of foreignness may be extenuated (Henisz & Delios, 2002). That is, the propensity that firms increase their commitment when entering a new foreign location is enhanced in the presence of target market/region-specific experience because this knowledge helps decrease perceived liabilities of foreignness, making it less risky for the firm to devote additional resources to the new country through increased foreign market commitment. While the aforementioned mechanisms do not exclude the option that a firm may opt for the same mode it already has operational excellence in, we argue that the propensity of a firm to enter new markets with operation modes of greater commitment increases in the presence of target market/region-specific experience, as the firm may be better positioned to achieve greater levels of control over host country activities (Zhao et al., 2017), obtain market and customer closeness (Yeoh, 2004) and reap higher performance benefits (Santangelo & Meyer, 2017) through increased levels of commitment.

The reduction of liabilities of foreignness in the presence of target market/region-specific knowledge occurs for two primary reasons and, coupled with operation mode experience, ultimately leads to an increased propensity for firms to make larger foreign market commitments. First, target market/region-specific experience helps firms become familiar with specific settings and situations as well as with typical problems confronted in similar settings (Eriksson et al., 1997). Through operation mode experience firms have become routinized in intuitively detecting relevant information (Jones & Casulli, 2014) and they have generally learned and are confident how to organize and handle internationalization processes. Likewise, internal information flows, management administration, and coordination across international settings becomes more effective (Luo, 2001) with higher levels of operation mode experience. Building on Hutzschenreuter and Matt (2017), we argue that firms may additionally benefit from their available knowledge obtained from past and/or current operating modes or managerial experience in the specific region. This target market/region-specific experience helps firms to directly tailor the routines and

processes to the operations in a new location whereby mode-specific experience improves overall effectiveness and efficiency of the operations (Yeoh, 2004; Zahra, Ireland, & Hitt, 2000). The combination of both types of experience (mode and market) lowers the perceived risks and costs for the firm associated with doing business at a greater level of foreign market commitment. When these perceived risks and costs are below the maximum tolerable risk associated with a higher commitment mode, the firm will devote more resources to the new location by means of such modes in order to gain more control, achieve greater closeness to the market, and reap better performance benefits.

Second, in line with more recent developments of the IP model (Johanson & Vahlne, 2003; 2009; Vahlne & Johanson, 2017), we argue that target market/region-specific experience provides firms with better network access to organizations and individuals that are highly familiar with regional business practices (Khanna & Palepu, 2000). With this network access firms with lower commitment operation mode experience can more easily spot potential joint venture or acquisition partners as well as identify suppliers and distribution channels while their mode-specific experience provides general knowledge on managing effectively and efficiently in foreign locations. Because this combined knowledge helps reduce liabilities of foreignness, firms may want to take more control over the next foreign operation to improve returns. Thus, target market/region-specific experience can supplement mode-specific experience through improved location-bound institutional knowledge resulting in a reduction of liabilities of foreignness and related risks encouraging the use of modes of entry with greater commitment and returns (Yeoh, 2004; Zahra et al., 2000).

In sum, firms may benefit from both operation mode- and market-specific experiential learning opportunities provided by its internal network. Target market/region-specific experience is a mechanism for a firm to overcome the limits to market-specific knowledge generated through prior operation modes. We argue that both the intensity and diversity of mode-specific experience may result in refinements of organizational processes and procedures (as empirically reflected in the choice of entry modes with greater commitment) if complemented with target market/region-specific experience. Hence, we hypothesize:

*Hypothesis 2: SMEs with a combination of greater mode-specific (whether (a) export, (b) non-FDI contractual, (c) JV, or (d) WOS) and target market/region-specific experience will have an increased propensity to opt for a higher commitment entry mode in a new foreign location.*

## **METHODS**

We test our hypotheses on a sample of German SMEs. German SMEs represent a relevant and interesting research setting, as more than 99% of all German firms are SMEs, employing roughly 60% of the country's employees according to the German Institute for SMEs (IfM, 2017). German SMEs are well suited to empirically validate our research model as they are very active in collecting international experience. This fact manifests in about 36.5% of German SMEs engaging in international business activities (Kay, Holz, & Kranzusch, 2014).

Given that no universally accepted SME definition exists (Lu & Beamish, 2001), we use a demarcation that is consistent with the standards of the country where the research was conducted. To this end, we define SMEs as firms with up to 500 employees as is consistent with the German Institute for SMEs (IfM, 2017) and with prior studies on SME internationalization from Germany (e.g., Maekelburger, Schwens, & Kabst, 2012). Brouthers and Nakos (2004) emphasize that 500 employees is in fact the prevailing threshold to define SMEs. Thus, many SME studies in non-German contexts also apply this criterion.

Our questionnaire was written in English and then translated into German adhering to back-translation standards. We accessed the AMADEUS database to identify SMEs suitable for our study. To qualify for this study, SMEs had to be internationally active and only have up to 500 employees. Based on these criteria, we obtained contact details of 2,021 internationally active SMEs. In early 2014, we mailed paper-based questionnaires to the CEOs of these firms as this group of managers exerts decisive influence on strategic decisions and is likely to be most knowledgeable about their firms' internationalization actions (Maekelburger et al., 2012). After the first wave of questionnaires, we sent out two reminders followed by phone calls. We received 267 responses (13.2% response rate). Because of missing data, our usable sample includes 179 firms.

## Variables

The dependent variable, *entry mode choice*, was obtained by asking respondents to indicate the type of entry mode for their firm's most recent foreign market entry. Respondents were given a choice of 12 different mode types adapted from Brouthers and Nakos (2004) and Maelkelburger et al. (2012). We then created an ordinal variable *entry mode choice* with four categories: 1) (direct) exporting (52 firms), 2) non-FDI contractual (i.e., distribution (30 firms), franchising (0), licensing (0), or other long-term contractual agreements (8 firms)), 3) JVs (i.e., minority/majority greenfield JVs (3/16 firms respectively), minority/majority partial acquisitions (7/5 firms respectively)), and 4) WOS (greenfield ventures with or without production facilities (7/42 firms respectively), and full acquisitions (9 firms)). This classification scheme extends prior research in that it allows us to differentiate not only between non-FDI and FDI entry modes, but also to distinguish between independently operated modes (i.e., direct exporting, WOS) and modes conducted together with partners in the foreign market (i.e., non-FDI contractual, JVs) (Tse, Pan, & Au, 1997). Entry mode choice is ordinally scaled due to the increasing levels of foreign market commitment of the respective modes (Erramilli & D'Souza, 1993).

We included eight independent variables in our analyses representing the intensity and diversity of SMEs' operation mode experience in each of the four entry mode choice categories (i.e., *intensity/diversity of export experience*, *intensity/diversity of non-FDI contractual experience*, *intensity/diversity of JV experience*, *intensity/diversity of WOS experience*). To assess the intensity of operation mode experience, we asked respondents to indicate how many years of experience their firm had with each of the 12 different entry mode types (e.g., Padmanabhan & Cho, 1999). We then added the number of years of experience with each mode in a respective entry mode category to create the four aggregated measures of intensity of operation mode experience. To measure the diversity of operation mode experience, we asked respondents to indicate the number of countries in which their firm had used each of the 12 different entry mode types (e.g., Guillén, 2003). Again, we summed the number of countries for each mode in a respective mode category to create the four aggregated measures of diversity of operation mode experience.

Our moderator variable *target market/region-specific experience* consists of two items. Respondents were asked to indicate their agreement with the statements “Our company had prior and long-standing experience in the target country” and “Our company had prior and long-standing experience in the target region”. Both items were adapted from Petersen et al. (2008) and measured on a 5-point Likert scale (1=fully disagree, 5=fully agree). A principal component factor analysis revealed that both items display high loadings above .9 onto a single factor. Further, the variable displays good reliability (Cronbach’s  $\alpha = .86$ ). We also assessed the discriminant validity of target market/region-specific experience and operation mode experience to avoid potential overlaps between different types of experience. To this end, we conducted two additional principal component factor analyses with the items pertaining to target market/region-specific experience and to intensity (first factor analysis) as well as diversity (second factor analysis) of operation mode experience. The results suggest that target market/region-specific experience is distinct from intensity and diversity of operation mode experience (Hair, Ringle, & Sarstedt, 2011): both target market/region-specific experience items display high loadings ( $> .87$ ) on a common factor, while the cross-loadings on the extracted latent factors pertaining to the different types of operation mode experience are remarkably low ( $< .11$ ) in both factor analyses. Likewise, the operation mode experience items display factor loadings below the threshold of .4 on the extracted factor pertaining to target market/region-specific experience (Ford, MacCallum, & Tait, 1986). This indicates that our measures of experience (intensity/diversity of operation mode experience and target market/region-specific experience) reflect independent variables providing unique insights into different types of experiential learning.

We also included variables in our models that control for alternative explanations for SMEs’ entry mode choices. First, transaction cost variables are related to firms’ entry mode choices (Anderson & Gatignon, 1986; Brouthers & Nakos, 2004; Delios & Beamish, 1999). Thus, we asked respondents to specify their firm’s *research intensity* (i.e., R&D expenditures in proportion of sales for the last fiscal year). Research intensity is an established measure of a firm’s asset specificity (e.g., Delios & Beamish, 1999). Firms with greater asset specificity tend to choose wholly-owned entry modes to avoid potential



opportunism in international transactions (Brouthers & Brouthers, 2003). Further, we included a measure of internal uncertainty based on the *cultural distance* between home and host countries. Research indicates that greater cultural distance increases the internal uncertainty of working with partner organizations (Anderson & Gatignon, 1986). We used the Kogut and Singh (1988) index and obtained the respective scores on nine cultural dimensions from the GLOBE study (House et al., 2004). External uncertainty was assessed by three institutional distance measures put forth by Berry, Guillén, and Zhou (2010). Their approach captures the multidimensional nature of distance by using the scale-invariant Mahalanobis method to calculate dyadic distances on several dimensions derived from institutional theories of cross-national distance. We included controls for *economic distance* (i.e., differences in macroeconomic characteristics and economic development), *political distance* (i.e., differences in democracy, political stability, and trade bloc membership), and *administrative distance* (i.e., differences in language, religion, legal system, and colonial ties) (Berry et al., 2010). We obtained the respective distance values for the year of a firm's most recent foreign market entry, as economic, political, and administrative distances between home and host countries may change over time (Dow & Karunaratna, 2006)<sup>1</sup>.

Second, firm-specific resource endowments are related to entry mode decisions. For example, a shortage of resources may prevent a firm from establishing entry modes requiring greater foreign market commitment (Erramilli & D'Souza, 1993; Nakos & Brouthers, 2002). Thus, we included *firm age* (i.e., the year of data collection less the firm's founding year) as a control, as younger firms face greater resource restrictions than older firms. *Firm size* is another proxy for a firm's resource endowment. Larger firms usually have greater resources and thus prefer entry modes with greater foreign market commitment (Osborne, 1996). We measured firm size as the total number of employees worldwide (e.g., Brouthers & Nakos, 2004) and obtained the respective data from the AMADEUS database.

Third, industry-specific factors are also related to an SME's entry mode choice (Brouthers & Hennart, 2007; Laufs & Schwens, 2014). The services sector is characterized by certain peculiarities such

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<sup>1</sup> We imputed data from the closest available year in case no observation was available for the year of a firm's most recent foreign market entry.

as low capital intensity but high people intensity, which is why service firms tend to make different entry mode choices compared to manufacturing firms (Brouthers & Brouthers, 2003). Thus, we asked respondents to indicate whether their firm primarily operates in manufacturing or services, and included a *service firm* dummy variable (1=service firm, 0=manufacturing firm).

Finally, at the country-level, we specifically considered whether legal restrictions in the most recent host country affected firms' entry mode decisions. We used a measure for *legal restrictions* from Brouthers and Brouthers (2003) assessing whether respondents perceived legal restrictions on the entry method at the time their firm entered the respective host market (1=fully disagree, 5=fully agree).

### **Tests for Non-Response and Common Method Bias**

Non-response bias was assessed following the recommendations of Armstrong and Overton (1977). To this end, we compared early and late respondents (i.e., first and last 10%) for our dependent, independent, moderator, and control variables. A t-test suggested no significant differences between early and late respondents for any of the variables in our analyses ( $p > .05$ ). To further validate that non-response bias does not affect our results, we obtained secondary data for all 2,021 firms contacted. We looked up the firms' number of employees in AMADEUS and compared non-respondents with respondents. This additional analysis underscores that our results do not suffer from non-response bias ( $p = .794$ ).

As most of our measures are self-reported, we undertook several actions to assess and minimize the extent of common method bias (CMB). First, the measurement of the dependent variable (i.e., entry mode choice) and independent variables (i.e., intensity/diversity of operation mode experience) is rather objective than subjective, as respondents had simply to answer which entry mode was chosen in their firm's most recent foreign entry and for how many years and in how many countries mode experience was collected. Objective measures are less susceptible to CMB than conventional self-reported measures (Chang, van Witteloostuijn, & Eden, 2010). Second, the inclusion of interaction effects presumably reduces CMB, as such terms are likely to go beyond a respondent's cognitive map due to their complexity (Chang et al.,

2010). Third, we conducted a confirmatory factor analysis (CFA) where all variables loaded onto one common method factor. The resulting model fit was poor (TLI = .318; CFI = .394; RMSEA = .122). Overall, these findings suggest that CMB is not an issue with our data.

### **Analytical Procedure**

Before turning to the empirical findings, we describe the general procedure we followed to test each of our hypotheses. Testing of hypothesis 1 required two steps. In the first step, we used hierarchical ordered logistic regression analysis (as our dependent variable ‘entry mode choice’ is an ordinal scale with four categories) to estimate the effect of the intensity and diversity of operation mode experience on the dependent variable (mode choice in a new foreign location). However, the results obtained from this regression only suggest a tendency towards lower or higher foreign market commitment in a new location based on the SME’s intensity/diversity of each distinct type of operation mode experience. This means that the results from the ordered logistic regression alone do not allow us to interpret the relationships between the independent variables and *specific* outcomes (i.e., categories) of the dependent variable (Long & Freese, 2014) as theorized in hypothesis 1. Therefore, in a second step, we used the data obtained from the ordered logistic regression to estimate the value and significance of each independent variable’s marginal effect (i.e., the effect a unit change in the independent variable) on *specific* outcomes of the categorical dependent variable (i.e., specific entry modes chosen in a new foreign location) (Wiersema & Bowen, 2009). The latter procedure allows us to assess whether greater intensity/diversity of a specific type of operation mode experience leads to a higher propensity to choose the same mode in a new foreign location as is consistent with our theorizing in hypothesis 1.

Furthermore, the non-linearity of ordered logistic regressions has important ramifications on the evaluation of interaction effects theorized in hypothesis 2, as the sign or magnitude of the corresponding regression coefficients do not equal their marginal effects (Ai & Norton, 2003; Hoetker, 2007). In addition, marginal effects in non-linear models depend on the level of all other variables in the model

(Wiersema & Bowen, 2009). Thus, one cannot estimate a separate marginal effect for an interaction, as the term cannot change independently from the values of its components (Greene, 2010; Williams, 2012).

Given these challenges, we adhere to recent recommendations on how to test moderator hypotheses in logistic regressions: first, we employ hierarchical ordered logistic regression analysis where each model adds an interaction between intensity/diversity of operation mode experience and TE (target market/region-specific experience). We assess each model's fit compared to the baseline model without interactions and the statistical significance of each interaction term (Greene, 2010; Wiersema & Bowen, 2009). Second, we plot the significant interaction effects to facilitate a more comprehensive understanding of each interaction (Hoetker, 2007). To this end, we display the average marginal effects (AME) of the independent variable (i.e., intensity/diversity of mode experience) across the values of the moderating variable (i.e., TE) against the prediction of the dependent variable (i.e., SMEs' propensity to opt for a higher commitment entry mode in a new foreign market) for all significant interactions (Meyer, van Witteloostuijn, & Beugelsdijk, 2017; Williams, 2012). To avoid overstating the interaction results (i.e., the interaction term is statistically significant, but the AMEs are not statistically distinct from zero for values of the moderating variable), we additionally assess the confidence intervals<sup>2</sup> of the AMEs when evaluating the moderator hypotheses (Kingsley, Noordewier, & Vanden Bergh, 2017).

## RESULTS

Table 1 displays the bivariate correlations among the variables as well as their means and standard deviations. On average, the firms in our sample are about 50 years old and have 132 employees. The sampled firms have greater experience with non-FDI operation modes (intensity/diversity of export experience: 19.9 years / 16.0 countries; intensity/diversity of non-FDI contractual experience: 17.3 years / 10.9

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<sup>2</sup> We used bootstrapping (i.e., repeated estimations on samples drawn with replacement from the original sample) to compute the confidence intervals. By this, we reduce the risk of overlooking effects that truly exist only due to our relatively small sample size (Dawson, 2014). The respective figures display the 90% confidence intervals for each AME, as the statistical power of testing interactions is considerably lower compared to main effects (McClelland & Judd, 1993).

countries) compared to FDI operation mode experience (intensity/diversity of JV experience: 5.4 years / 1.4 countries; intensity/diversity of WOS experience: 16.9 years / 4.2 countries). This proportion is consistent with the fact that resource-constraint SMEs often prefer entry modes that require lower foreign market commitment (Laufs & Schwens, 2014). However, the sampled firms used non-FDI and FDI modes almost equally in their most recent entry in a new foreign market: 52 firms chose export, 38 a non-FDI contractual mode, 31 a JV mode, and 58 a WOS mode.

All correlations are below .7, indicating that multicollinearity among the variables is unlikely to distort our results (Anderson et al., 2016). In fact, the highest correlation among variables appearing in the same regression model amounts to  $r = .50$  (firm size and diversity of WOS experience), as we analyze the relationship between intensity as well as diversity of operation mode experience and entry mode choice in separate sets of regression models to avoid multicollinearity. Further, we calculated each variable's variance inflation factor (VIF). In both models, none of the VIFs exceeds the conservative threshold of 2.5 (Panel A: highest VIF = 1.66; Panel B: highest VIF = 1.57) (Allison, 1999).

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Insert Table 1 about here  
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### **Testing of the effects of past operation mode experience on entry mode choice**

Table 2 reports the results of two ordered logistic regression analyses separating the relationships between intensity (Panel A) or diversity (Panel B) of operation mode experience and SMEs' entry mode choice. Model 1 in both panels includes all control variables, the main effects of the independent variables (i.e., intensity/diversity of export, non-FDI contractual, JV, and WOS experience), and the moderator variable (i.e., TE). For intensity of experience (Panel A), the model displays a chi square of 46.476 ( $p=.000$ ) and correctly classifies 45.8 percent of the observations. The adjusted count  $R^2$  suggests that the obtained rate of correct classifications is 19.8% above the number of correct predictions when just choosing the largest marginal (Long & Freese, 2014). The McKelvey and Zavoina  $R^2$  amounts to .243. For diversity of

experience (Panel B), the model displays a chi square of 57.078 ( $p=.000$ ) and correctly classifies 46.4 percent of the observations. The adjusted count  $R^2$  amounts to 20.7%, whereas the McKelvey and Zavoina  $R^2$  is .326. Overall, Model 1 in both Panels A and B indicate good predictive power.

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Insert Table 2 about here  
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Hypothesis 1 suggests that higher intensity/diversity of experience with the four operation mode types (H1a export, H1b non-FDI contractual, H1c JV, H1d WOS) leads to a greater propensity for SMEs to opt for the same mode in a new foreign location. Turning to the regression coefficients of the independent variables in Model 1 (Panels A and B), we find that intensity of export experience ( $-.021$ ;  $p=.012$ ; confidence interval (CI):  $-.038$  to  $-.005$ ) has a significant negative influence on entry mode choice as does the diversity of export experience ( $-.019$ ;  $p=.010$ ; CI:  $-.033$  to  $-.005$ ). These results suggest that SMEs with greater intensity or diversity of export experience have a higher propensity to choose an entry mode with low foreign market commitment in a new foreign location. In contrast, intensity of JV experience ( $.033$ ;  $p=.024$ ; CI:  $.004$  to  $.062$ ), intensity of WOS experience ( $.022$ ;  $p=.018$ ; CI:  $.004$  to  $.041$ ), diversity of JV experience ( $.149$ ;  $p=.005$ ; CI:  $.045$  to  $.253$ ), and diversity of WOS experience ( $.140$ ;  $p=.001$ ; CI:  $.056$  to  $.224$ ) all have a significant positive influence on entry mode choice. These results indicate that firms with greater intensity or diversity of JV as well as WOS experience have a greater propensity to opt for an entry mode with high foreign market commitment. Lastly, the relationship between intensity of non-FDI contractual experience ( $.000$ ;  $p=.972$ ; CI:  $-.016$  to  $.017$ ) and entry mode choice is non-significant as is the case with diversity of non-FDI contractual experience ( $.007$ ;  $p=.418$ ; CI:  $-.010$  to  $.025$ ).

We now use the data obtained from the ordered logistic regression analysis to estimate the average marginal effects (AMEs) and corresponding p-values for the intensity (Table 3) and diversity (Table 4) of each type of operation mode experience (Wiersema & Bowen, 2009). The AMEs display how the predicted probability of choosing a *specific* entry mode in an SME's most recent foreign market entry

changes with a unit increase in intensity (i.e., one additional year) or diversity (i.e., one additional country) of operation mode experience (Williams, 2012).

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Insert Tables 3 & 4 about here  
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To ultimately test the hypothesized relationship between intensity/diversity of experience with each operation mode type and a greater preference to opt for the same mode in a new foreign entry as theorized in hypothesis 1 (H1a export, H1b non-FDI contractual, H1c JV, H1d WOS), *the values along the main diagonals of Tables 3 and 4 are relevant*. Looking at values in the first line and first column of these tables, we find that a unit increase in intensity ( $dy/dx=.004$ ;  $p=.010$ ; CI: .001 to .006) and diversity ( $dy/dx=.003$ ;  $p=.008$ ; CI: .001 to .006) of export experience significantly increases SMEs' propensity to choose export in a new foreign market. These results provide support for hypothesis 1a. Similarly, looking at the values in the fourth line and fourth column in these tables, we find that greater intensity ( $dy/dx=.004$ ;  $p=.016$ ; CI: .001 to .007) or diversity ( $dy/dx=.024$ ;  $p=.001$ ; CI: .010 to .038) of WOS experience increase SMEs' propensity to choose a WOS in a new foreign location. These results lend support for hypothesis 1d. In contrast, the results in the third line and third column about experiential learning from JVs were mixed. The values in Tables 3 and 4 suggest a significant relation only for a unit increase in diversity of JV experience and the propensity to opt for JV in a new foreign market ( $dy/dx=.004$ ;  $p=.036$ ; CI: .000 to .008). However, a unit increase in intensity of JV experience has no significant influence on the propensity to choose a JV in a new foreign market ( $p > .05$ ). Thus, we find only partial support for hypothesis 1c. Finally, looking at the values in the second line and second column of each table we found no support for hypothesis 1b, as neither a unit increase in intensity nor diversity of non-FDI contractual experience has a significant influence on SMEs' propensity to opt for the same mode in a new foreign location ( $p > .05$ ).

While the results on the diagonals of Tables 3 and 4 are relevant for testing hypothesis 1 (i.e. past operation mode experience's effect on the likelihood to choose the same mode in a new location), these tables provide additional insights that warrant reporting. More specifically, the results to the left and right

of the main diagonals show how a unit increase in past operation mode experience increases or decreases a firm's likelihood to make *other* mode choices (than opting for the *same* mode as theorized in hypothesis 1). For example, looking to the right of the main diagonal in Tables 3 and 4 shows that a unit increase in export experience reduces an SME's propensity to opt for JVs (intensity:  $dy/dx = -.001$ ;  $p = .049$ ; diversity:  $dy/dx = -.001$ ;  $p = .031$ ) and WOS modes (intensity:  $dy/dx = -.004$ ;  $p = .011$ ; diversity:  $dy/dx = -.003$ ;  $p = .008$ ) in a new foreign location. That is, an increase in export experience not only makes it more likely that SMEs choose export in a new foreign market (as theorized in H1a), but significantly decreases the likelihood of opting for most higher commitment entry modes. In contrast, Tables 3 and 4 suggest that greater experience with non-FDI contractual agreements does not significantly change a firm's probability to opt for any other mode type (with lower or higher commitment levels). Thus, a unit increase in intensity or diversity of non-FDI contractual experience neither changes a firm's likelihood to opt for non-FDI contractual modes (as hypothesized in H1b) nor its likelihood to opt for any other mode type. For JV modes, the results to the right of the main diagonals suggest that increasing intensity and diversity of JV experience enhance an SME's propensity to opt for higher commitment WOS modes (intensity:  $dy/dx = .006$ ;  $p = .019$ ; diversity:  $dy/dx = .026$ ;  $p = .004$ ). The areas left of the main diagonals indicate that a unit increase in JV experience lowers SMEs' propensity to opt for exporting (intensity:  $dy/dx = -.006$ ;  $p = .023$ ; diversity:  $dy/dx = -.025$ ;  $p = .004$ ) and non-FDI contractual modes (intensity:  $dy/dx = -.001$ ;  $p = .051$ ; diversity:  $dy/dx = -.005$ ;  $p = .037$ ) in new locations. Thus, an increase in JV experience not only enhances the likelihood of again choosing a JV (as partially supported in our testing of H1c), but it significantly lowers the likelihood to choose exporting or non-FDI contractual modes in a new location while it also enhances the likelihood to increase commitment in a new location by choosing a WOS. Lastly, for WOS, the cells left of the main diagonals show that firms with increasing WOS experience have a significantly lower propensity to opt for lower commitment modes such as exporting (intensity:  $dy/dx = -.004$ ;  $p = .014$ ; diversity:  $dy/dx = -.024$ ;



p=.001) and non-FDI contractual (diversity:  $dy/dx = -.005$ ; p=.026). However, a one-unit increase in diversity of WOS experience increases an SME's likelihood of choosing a JV in a new foreign market ( $dy/dx = .004$ ; p=.019) beyond making WOS choices more likely (as tested in H1d).

### **Testing of the moderator effect of target market/region-specific experience**

Next, we turn to hypothesis 2 (H2a export, H2b non-FDI contractual, H2c JV, H2d WOS) which suggests that for each mode type target market/region-specific experience (TE) moderates the relationship between intensity/diversity of operation mode experience and entry mode choice leading to an increased propensity to use higher commitment entry modes in new foreign locations. To test hypotheses 2a-d, we again refer to the ordered logistic regression analyses as displayed in Table 2, Panels A and B. Compared to Model 1 without interactions, Model 2 additionally includes the interaction between intensity/diversity of export experience and TE. For intensity of experience (Panel A) the model's chi-square increases to 54.751 (p=.000) and the McKelvey and Zavoina  $R^2$  improves to .295. Further, the interaction's regression coefficient is significant and positive (.021; p=.006; CI: .006 to .037). Similarly, in Model 2 (Panel B), including the interaction between diversity of export experience and TE increases the chi-square to 67.023 (p=.000) and the McKelvey and Zavoina  $R^2$  increases to .395. The interaction's regression coefficient is significant and positive (.027; p=.007; CI: .008 to .047). The corresponding Figure 1 shows the AMEs of both intensity and diversity of export experience on the probability to choose a mode with greater foreign market commitment than exporting in a new foreign location across the values of TE. Consistent with our theoretical predictions, we find that the AMEs of intensity/diversity of export experience are negative for SMEs with low levels of TE (i.e., such firms are more likely to choose exporting in a new location). The corresponding confidence intervals suggest that the AMEs are statistically different from zero in this area. With increasing levels of TE, the AMEs of intensity/diversity of export experience become less negative and then at higher values of the moderator even positive (i.e., a unit increase in intensity/diversity of export experience positively influences the likelihood of choosing an operation mode with greater foreign

market commitment than exporting if SMEs have high levels of TE). In the latter area, the corresponding confidence intervals suggest that the AMEs are significantly positive. These findings lend support for hypothesis 2a.

Model 3 in Panels A/B includes the interaction between intensity/diversity of non-FDI contractual experience and TE. For the model including the interaction between intensity of non-FDI experience and TE (Panel A), the chi-square amounts to 50.706 ( $p=.000$ ), whereas the McKelvey and Zavoina  $R^2$  is .283. The interaction's regression coefficient is significant and positive (.015;  $p=.048$ ; CI: .000 to .030). For the model including the interaction between diversity of non-FDI contractual experience and TE (Panel B) the chi-square amounts to 58.777 ( $p=.000$ ), whereas the McKelvey and Zavoina  $R^2$  is .336. However, the interaction's regression coefficient is non-significant (.012;  $p=.210$ ; CI: -.007 to .032). Figure 2 displays the significant interaction with respect to how TE increases the AME of intensity of non-FDI contractual experience on the probability to choose a JV or WOS in a new foreign location. While, the plot is consistent with our theoretical expectations (i.e., the AMEs of intensity of non-FDI contractual experience are negative for SMEs with low levels of TE, while they become positive from medium to high TE levels), the confidence intervals for each AME across the values of TE include zero suggesting that the effects are not statistically different from zero. Thus, we reject hypothesis 2b.

We include the interaction between intensity/diversity of JV experience and TE in Model 4 (Panels A and B). The chi-square of the model including the interaction between intensity of JV experience and TE (Panel A) is 46.575 ( $p=.000$ ), while the McKelvey and Zavoina's  $R^2$  is .245. The regression coefficient of the interaction term is non-significant (.005;  $p=.754$ ; CI: -.024 to .033). Panel B shows that for the interaction between diversity of JV experience and TE the model's chi-square amounts to 58.190 ( $p=.000$ ), while the McKelvey and Zavoina's  $R^2$  is .324. Again, the interaction's coefficient is non-significant (-.053;  $p=.285$ ; CI: -.149 to .044). These results indicate that TE does not significantly moderate the relation between intensity or diversity of JV experience on entry mode choice. Thus, hypothesis 2c is rejected.

Lastly, Model 5 (Panels A and B) includes the interaction between intensity/diversity of WOS experience and TE. For intensity (Panel A) the model's chi-square amounts to 51.552 ( $p=.000$ ), whereas the McKelvey and Zavoina  $R^2$  is .290. The interaction's regression coefficient is positive and significant (.019;  $p=.029$ ; CI: .002 to .036). For the interaction between diversity of WOS experience and TE (Panel B), the model's chi-square is 63.678 ( $p=.000$ ), whereas the McKelvey and Zavoina  $R^2$  is .402. The regression coefficient of the interaction term is significant and positive (.093;  $p=.015$ ; CI: .018 to .168). The corresponding Figure 3 shows that TE increases the AMEs of intensity and diversity of WOS experience on the probability to opt for a WOS as the mode with the greatest foreign market commitment. The AMEs of intensity of WOS experience are positive and statistically different from zero from low TE levels onwards. For diversity of WOS experience, they become positive and statistically distinct from zero from medium levels of TE onwards. Overall, these findings support hypothesis 2d.<sup>3</sup>

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 Insert Figures 1, 2, and 3 about here  
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**Robustness tests**

We ran several robustness tests to examine the stability of our results. First, we conducted another test to assess whether multicollinearity biases our findings. To this end, we estimated twenty randomly drawn subsamples of the data (each with 95% of the original sample) to test the stability of the regression coefficients. Unstable coefficients across subsamples would then be an indicator of multicollinearity (Echambadi et al., 2006). However, as Table 5 suggests, the findings do not hint at multicollinearity problems, as the relevant coefficients are stable regarding their size and direction.

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 Insert Table 5 about here  
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<sup>3</sup> A few cases in our sample contained potentially tautological data. For example, a firm indicated that its most recent foreign market entry took place two years ago using export as operation mode. The same firm also specified that it had two years of export experience and had overall made one export entry. To ensure that tautology does not distort our results, we re-ran our regression analyses without these cases. All main and moderating effects remained stable with regard to their sign, size, and direction. Only the p-value for the interaction between intensity of non-FDI contractual experience and TE decreased marginally from .048 to .073.

Following recent recommendations to provide additional evidence that results of hypotheses testing are not idiosyncratic to the selected model specifications (Meyer et al., 2017), we reran our regression analysis using an alternative functional form (i.e., multinomial logistic regression). The obtained results mainly support the findings from the ordered logistic regression analysis.

Finally, there is some suggestion in the literature that equity mode experience might have an inverted U-shape relationship with foreign entry mode choices in new locations due to diminishing learning effects (Barkema & Vermeulen, 1998; Huber, 1991) and greater organizational complexity (Lu & Beamish, 2004), which could particularly cause resource-constrained SMEs to resort to entry modes with lower foreign market commitment. To examine this possibility, we conducted the Lind and Mehlum (2010) tests for U-shaped relations for both types of equity mode experience (i.e., JVs and WOSs). However, the results indicate that neither intensity/diversity of JV experience nor intensity/diversity of WOS experience have a U-shaped relation with the dependent variable.

## **DISCUSSION, LIMITATIONS, AND CONCLUSION**

Drawing on the IP model and literature on the (non-)location-bound nature of experiential learning, we developed and tested theory suggesting that learning from a firm's foreign operation modes is more limited than originally thought when seeking to explain entry into new foreign locations. We note that firms develop two types of knowledge from their operation mode experience - location-bound knowledge about foreign markets and non-location-bound knowledge about operating modes. Our theory maintains that the latter type of knowledge helps firms develop routines and processes that can be employed in new locations leading to the use of the same mode in new foreign locations. We also theorized that target market/region-specific experience helps abrogate the limits to learning from prior operation modes, reducing liabilities of foreignness, ultimately allowing firms to increase foreign market commitment in a new location. Drawing on a sample of German SMEs, and looking at four different operation mode types, our results lend support to these theoretical predictions. However, we also found some notable exceptions. In

this regard, our paper provides new insights for future research on the IP model, experiential learning, and international entry mode choice, as discussed below.

We contribute to the IP model and experiential learning literatures by testing the idea that a firm's internal network of past mode-specific and target market/region-specific experiential learning provides an additional source of knowledge (besides institutional-, transaction cost- or other firm-level constructs) that firms rely on when determining future mode choices in new foreign locations. We theorized and tested the notion that in general firms learn from its past operation mode experiences but that this learning is limited and leads to the development of routines and processes that are non-location bound, inducing firms to use the same mode in new locations. For SMEs using exporting and WOSs we found strong support for this idea. Not only do firms prefer these same modes in the future but they are less inclined to increase commitment and use FDI modes (in the case of exporting) or to decrease commitment towards non-FDI modes (in the case of WOSs). Interestingly however, firms with an increased diversity of WOS experience do have a higher probability to choose a JV in a new foreign location indicating that decreases in commitment as theorized by Santangelo and Meyer (2011) are sometimes also an option for SMEs – at least within the category of FDI modes.

For firms with experiential learning from JVs the results are less clear as we found that future mode choice could be a JV but could also involve an increased commitment and the use of WOSs. One reason for the latter finding might be that SMEs seek to avoid their firm being confronted with too many coordination and monitoring costs incurred by JV engagements and, hence, they may regard JVs as an intermediate stage on their path to high commitment WOSs, in line with the findings obtained by Xia et al. (2009). Furthermore, we found that firms with JV experience were disinclined to use lower commitment modes. These findings contradict the results of some studies suggesting that firms may decrease their foreign market commitment as internationalization evolves further (e.g., Santangelo & Meyer, 2011). It seems that once SMEs manage to collect JV experience they become less inclined to utilize lower commitment modes despite the lower levels of required resources, which is usually the prime reason for SMEs

to opt for foreign operation modes with lower levels of commitment. We encourage future IP model studies to delve deeper into the IP model's notion regarding commitment increase, decrease, maintaining or even termination (Benito, 2005; Clarke & Liesch, 2017) and to explore these (JV) gradual commitment increases.

Our results also reveal that when SMEs operate non-FDI contractual modes they incur multiple other challenges (limits) to learning. We infer from our findings that particularly these types of operation modes – although favorably employed by SMEs as these modes enable firms to preserve vital and valuable resources – are limited in their potential for learning. It appears that non-FDI contractual modes create a paradox, as they require only limited resources, which is particularly beneficial for resource-deprived SMEs, but these modes also constrain the firm in its learning to improve efficiency and effectiveness, obstructing future internationalization paths (Jansson & Sandberg, 2008). Future research may want to explore this paradox further. Why don't firms appear to learn from non-FDI contractual entry modes? Are there potential mechanisms that can be introduced along with these modes to facilitate learning and improve future effectiveness and efficiency of these modes? Are these modes only used in situations where firms do not desire to learn and therefore prefer modes with relatively low commitment?

Despite these mixed results, overall our analyses largely support our theory leading to hypothesis 1 (with the exception of non-FDI contractual modes) showing that learning from past mode experience is limited. This helps us advance past IP model research by not only demonstrating SMEs' propensity to engage in a respective mode, but also their propensity to *not engage* in other mode types.

Recent IP model research also suggests that when entering new locations firms face liabilities of foreignness, because they lack local market knowledge (Johanson & Vahlne, 2009). These liabilities of foreignness can impact mode choices in new locations; firms will be hesitant to use higher commitment entry modes when liabilities are high (Pedersen & Petersen, 1998). We contribute to the IP model and experiential learning literature by showing that mode-specific experiential learning can be complemented by the target market/region-specific experiential learning generated by a firm's internal network and therefore

impact future mode choices in new foreign markets. In this regard, we advance the IP model and extend the learning literature arguing that real learning is more complex than one-way learning, but rather covers different learning channels (e.g., Bruneel et al., 2010; Milanov & Fernhaber, 2014; Oehme & Bort, 2015). The roots of the IP model (Eriksson et al., 1997; Johanson & Vahlne, 1977) suggest that experiential learning from both modes and markets leads to changes in future mode commitments. Yet it is not clear why firms would increase mode commitment or how these two types of experiential learning (mode specific and market specific) complement each other especially given more recent theory about the (non-)location-bound nature of learning (Clarke et al., 2013).

We add to knowledge by providing theoretical arguments about why firms might want to increase commitment in the future. While the IP model suggests that once firms gain market-specific knowledge they increase commitment because of a reduction in perceived risks (e.g., Eriksson et al., 1997), it is not clear why a reduction in risk alone would lead to a change in mode type. This is especially puzzling if the firm has generated knowledge that improves the effectiveness and efficiency of a particular mode type. Our theory suggests that the motive behind such increases in mode commitment are driven by a desire for increased returns made possible by increased control and market closeness provided by higher commitment modes. Thus, we suggest that the reduction in risk is only part of the reason firms will think about increasing market commitment. Gaining other valuable benefits such as a reduction in contractual risks, improved interactions with customers, and increased appropriation of rents all lead to an increased desire for higher commitment modes in the future and helps explain why firms might make mode commitment changes despite having mode-specific capabilities.

Our paper also makes a contribution through its clarification of how increased mode commitment is made possible. The general notion of the complementarity of mode-based and target market/region-specific experiential learning mechanisms which helps firms increase their level of foreign market commitment substantiates prior IP model research, but it also contrasts sharply with literature according to which

firms make the same mode decision repeatedly simply due to inertia or to ease a decision maker's cognitive burden (Lu, 2002). Although we cannot totally rule out the impact of inertia, we advance the latter work as we find that firms *do change modes* at least when entering certain new markets (those in which they have experiential learning-based knowledge). Put more generally we theorize and find that, firms that are able to manage the duality of gaining operational excellence through past employment of operation modes and obtaining target market/region-specific knowledge tend to perceive lower liabilities of foreignness and therefore have a propensity to increase mode commitment in new markets in order to gain more control over and closeness to the market and capture greater profits. This finding offers future research opportunities, for example, by delving deeper into the boundary conditions (such as industry-specific effects) of mode-specific experiential learning, by tracing the patterns of past operation mode choices and past foreign markets entered (as would be consistent with the recent evolutionary IP model perspective (cf. Santangelo & Meyer, 2017; Vahlne & Johanson, 2017)) or by inspecting which firms make 'optimal' entry mode choices based on mode- and market-specific experiential learning. In this regard, JVs and non-FDI contractual modes may deserve special research attention as the interactions between target market/region-specific experience and JV and non-FDI contractual experience were insignificant (in addition to the direct effect results which also revealed some notable exceptions to our theory).

Finally, we contribute to existing entry mode literature by disentangling the concept of experiential learning from prior operation modes and by examining a broader range of modes enabling us to glean more detailed insights. As such, our findings regarding the direct effects of operation mode experience on subsequent mode choices in new foreign markets add to the extant literature primarily examining transaction cost, firm-specific, and country-specific (institutional) factors as antecedents to firms' new foreign market entry mode choices (e.g., Brouthers, 2002; Brouthers et al., 2008; Meyer, 2001). After controlling for transaction cost and other firm/country-specific factors, we find that mode-specific experiential learning is also a significant contributor to entry mode choice. More precisely, we not only look at experiential learning obtained from past FDI operation modes, but we also consider learning from non-FDI operation



modes. Including four types of operating modes extends current mode-based experience research that tends to focus on MNEs and FDI-based operating modes (e.g., Lu, 2002; Padmanabhan & Cho, 1999). Yet evidence suggests that MNEs and SMEs also use non-FDI modes of operation (Johanson & Vahlne, 1977). For example, the descriptive statistics reported in our results section reveal that our sample firms historically used non-FDI operation modes. However, these firms tended to use non-FDI and FDI modes equally in their most recent entry in a new foreign market. Thus, this study helps increase our understanding of how the mode-based experiences a firm accumulate from its past international activities helps create processes and routines that can impact perceptions of liabilities of foreignness and subsequent mode commitment decisions in new foreign locations. Our research helps answer the question how and in what circumstances SMEs are able to enter a new foreign location at greater levels of foreign market commitment and when they reduce the likelihood of making lower commitment modes in new locations. It also reveals that experience can influence the very limits to learning from non-FDI contractual modes. Future scholarship may help by seeking to answer the question whether it is advisable for SMEs to rely on non-FDI contractual modes if future internationalization is anticipated.

### **Limitations**

Despite these important implications, our study tends to suffer from several limitations. Our sample includes only SMEs from Germany. In light of certain particularities of the traditional ‘German Mittelstand’ such as its research intensity, which we control for, our results may not be applicable to SMEs from other countries. Further the implications of limited learning may apply in a different way to larger firms. Therefore, research might want to investigate entry mode related experiential learning for firms from different countries and for larger firms.

The independent and dependent variables included in our study may cause some concern as they are aggregated measures of different entry modes. While our investigation of four different categories of

modes advances extant literature, it might blur important learning differences between, for example, acquisitions and greenfield investments. Our sample size restricted even more fine-grained distinctions, but future research may help determine if such learning differences are a factor by gathering data and testing the learning mechanisms related to more differentiated entry modes. Further, we assumed that firms learn from all entry mode experiences, but could not differentiate between experiences perceived as positive or negative. Future research may look into such potential differences in learning.

The measure of our moderator variable target country/region-specific experience is perception-based and, thus, respondents might have different geographic areas in mind when referring to a “region”. However, recent research recommends measuring geographic concepts (such as distances or regions) with perceptual measures. These studies argue that managers’ subjective perceptions of similarities between countries/regions strongly influence their strategic decisions (e.g., Dow & Karunaratna, 2006; Dow & Larimo, 2011). As managers’ cognitive biases, heuristics, or personal characteristics affect these perceptions (Dow & Larimo, 2009), individual-level measures offer unique insights not available at the objective-level (Sousa & Bradley, 2006).

Because our study is cross-sectional, experience effects that vary over time cannot be captured explicitly by our research design. A longitudinal study would therefore provide additional insights about the effects of experiential learning over time, especially different patterns of operation mode and country choices. Looking at experiential learning studies explaining the beneficial performance implications of repeating strategic decisions, Anand et al. (2016) caution that such findings may be tinged with both learning and experience endogeneity. Unfortunately, no cross-sectional study can completely rule out all causes of endogeneity: measurement error, omitted variables, and simultaneous causality (Kennedy, 2008; Semadeni, Withers, & Trevis Certo, 2014). However, we are confident that our study does not overly suffer from endogeneity problems. Regarding our research design, we were particularly careful to rely on established scales with sufficient reliability and validity as outlined in the measurement section. Further, we included numerous control variables to prevent uncontrolled confounding causes. Lastly, our independent

variables (i.e., prior operation mode experience) and the dependent variable (i.e., entry mode choice in the most recent foreign market) have a natural causal order preventing problems due to simultaneous causality. Nonetheless, we reiterate a recent call in the literature to conduct more experimental research in IB in general and regarding firms' entry mode choices in particular (Zellmer-Bruhn, Caligiuri, & Thomas, 2016) which would enable scholars to provide even stronger (empirical) evidence for causal relationships.

## **Conclusion**

The present study helps expand our knowledge of the limits of international entry mode learning. Our results demonstrate the importance of a more differentiated view of international experiential learning effects, at least in the entry mode choice of SMEs. More specifically, we add to the literature by exploring experiential learning from four different operation mode types and differentiate between non-location-bound and location-bound learning as is consistent with recent advancements of the IP model (Hutzschenreuter & Matt, 2017). We highlight the complementary nature of mode-based and target market/region-specific experiential learning mechanisms in creating knowledge which helps firms overcome mode-based learning limits and therefore implement modes at greater levels of foreign market commitment in the future. In addition to exploring constraints of learning and experience, we make a contribution by focusing on SMEs that have been largely ignored by experiential learning and mode choice literatures. Thus, our study provides new insights about the limitations of experiential learning and the internationalization process of SMEs.

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**Table 1: Descriptive statistics and bivariate correlations**

Variable	M	SD	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1 Entry mode choice	2.53	1.22	1																		
2 Research intensity	4.13	4.92	.02	1																	
3 Cultural distance	2.26	1.08	-.09	-.01	1																
4 Economic distance	4.71	4.18	-.14	-.01	.26*	1															
5 Political distance	116.56	54.01	.02	.04	.27*	.06	1														
6 Administrative distance	16.19	11.02	-.06	.07	.09	.17*	-.08	1													
7 Firm age	50.02	39.90	.12	.01	.15*	.06	.09	-.07	1												
8 Firm size	132.23	108.36	.23*	.20*	-.05	.02	-.04	.05	.20*	1											
9 Service firm	.40	.49	.04	-.19*	.00	-.13	-.10	-.08	-.17*	-.17*	1										
10 Legal restrictions	2.05	1.29	.03	-.08	.21*	.10	.27*	-.02	.11	.08	.05	1									
11 Target market/region exp.	2.33	1.06	.30*	-.01	.04	-.10	-.01	-.10	.08	.16*	.08	.03	1								
12 Intensity export experience	19.94	20.40	-.12	.12	.20*	.11	.18*	-.01	.39*	.07	-.21*	.11	.11	1							
13 Diversity export experience	16.01	23.84	-.08	.09	.14	.07	.12	.03	.10	.09	-.02	.03	.20*	.43*	1						
14 Intensity non-FDI contractual exp.	17.27	21.34	-.03	.19*	.30*	.15*	.20*	.01	.30*	.18*	-.38*	.12	-.02	.44*	.07	1					
15 Diversity non-FDI contractual exp.	10.94	18.15	.08	.18*	.12	.05	.12	.06	.12	.27*	-.25*	.07	.05	.06	.15	.56*	1				
16 Intensity JV experience	5.40	11.03	.24*	.08	.01	.07	.16*	.04	.26*	.08	-.15*	.04	.22*	.16*	.15*	.28*	.15*	1			
17 Diversity JV experience	1.42	3.27	.24*	-.06	-.06	-.00	.10	.10	.01	-.03	-.08	-.09	.16*	.05	.07	.09	.03	.67*	1		
18 Intensity WOS experience	16.89	18.53	.23*	.18*	.17*	.10	.09	-.01	.35*	.40*	-.10	.09	.18*	.33*	.25*	.29*	.19*	.19*	.07	1	
19 Diversity WOS experience	4.18	5.70	.34*	.07	.00	.06	.06	.05	.20*	.50*	.06	.05	.23*	.09	.18*	.04	.13	.17*	.06	.61*	1

Note: Pearson Correlation (listwise deletion); M = arithmetic mean; SD = standard deviation

Significance level: \*.  $p \leq .05$

$n = 179$

**Table 2: Ordered logistic regression (Panel A) – Intensity of operation mode experience**

Variables	Model 1				Model 2				Model 3				Model 4				Model 5			
	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z
Research intensity	-.002	.032	.998	.958	-.007	.032	.993	.841	.002	.032	1.002	.948	-.002	.032	.998	.960	-.005	.032	.995	.872
Cultural distance	-.116	.152	.890	.445	-.102	.153	.903	.505	-.087	.153	.917	.569	-.111	.153	.895	.465	-.141	.154	.869	.360
Economic distance	-.057	.039	.944	.147	-.081	.042	.922	.054	-.066	.040	.937	.101	-.059	.040	.943	.140	-.074	.042	.929	.078
Political distance	.001	.003	1.001	.645	.002	.003	1.002	.518	.001	.003	1.001	.673	.001	.003	1.001	.665	.002	.003	1.002	.555
Administrative distance	-.001	.013	.999	.917	-.001	.013	.999	.931	.000	.013	1.000	.978	-.001	.013	.999	.929	-.002	.013	.998	.891
Firm age	.003	.004	1.003	.533	.002	.004	1.002	.599	.004	.005	1.004	.434	.003	.004	1.003	.517	.002	.004	1.002	.700
Firm size	.002	.002	1.002	.131	.003	.002	1.003	.073	.002	.002	1.002	.230	.002	.002	1.002	.142	.002	.002	1.002	.157
Service firm	.161	.323	1.175	.618	.334	.331	1.397	.313	.192	.325	1.212	.554	.162	.323	1.176	.615	.304	.331	1.355	.359
Legal restrictions	.052	.117	1.054	.655	.013	.118	1.013	.915	.064	.118	1.066	.590	.060	.120	1.062	.617	.015	.119	1.015	.898
Target market/region exp. (TE)	.450	.146	1.568	.002	.029	.207	1.030	.888	.230	.181	1.259	.204	.428	.162	1.534	.008	.086	.218	1.090	.693
Intensity export experience	-.021	.008	.979	.012	-.072	.020	.931	.000	-.023	.008	.977	.007	-.022	.009	.979	.012	-.021	.009	.979	.015
Intensity non-FDI contractual exp.	.000	.009	1.000	.972	.004	.009	1.004	.649	-.031	.018	.969	.083	.000	.009	1.000	.974	.004	.009	1.004	.668
Intensity JV experience	.033	.015	1.034	.024	.029	.015	1.030	.052	.030	.015	1.030	.052	.021	.041	1.021	.609	.031	.015	1.032	.037
Intensity WOS experience	.022	.009	1.023	.018	.024	.010	1.024	.013	.024	.010	1.025	.011	.022	.009	1.023	.019	-.016	.020	.984	.415
Intensity export experience x TE					.021	.008		.006												
Intensity non-FDI contractual exp. x TE									.015	.008		.048								
Intensity JV experience x TE													.005	.015		.754				
Intensity WOS experience x TE																	.019	.009		.029
<i>Fit measures</i>																				
McKelvey & Zavoina R <sup>2</sup>		.243				.295				.283				.245				.290		
Count R <sup>2</sup> (correctly classified)		.458				.480				.475				.464				.480		
Chi <sup>2</sup>		46.476				54.751				50.706				46.575				51.552		
Prob > Chi <sup>2</sup>		.000				.000				.000				.000				.000		

Dependent variable: entry mode choice (1 = Export; 2 = non-FDI contractual; 3 = JV; 4 = WOS)

n = 179

Note: OR = odds ratio; SE = standard error

**Table 2 (continued): Ordered logistic regression (Panel B) – Diversity of operation mode experience**

Variables	Model 1				Model 2				Model 3				Model 4				Model 5			
	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z	Coef.	SE	OR	P >  z
Research intensity	.006	.032	1.006	.856	.012	.032	1.012	.716	.012	.032	1.012	.713	.007	.032	1.007	.826	.009	.032	1.009	.778
Cultural distance	-.062	.145	.940	.669	-.022	.149	.978	.882	-.067	.144	.935	.642	-.074	.146	.929	.612	-.064	.147	.938	.661
Economic distance	-.065	.040	.937	.101	-.084	.042	.919	.044	-.068	.040	.934	.084	-.062	.040	.940	.122	-.082	.043	.921	.056
Political distance	.000	.003	1.000	.910	.002	.003	1.002	.539	-.000	.003	1.000	.952	.000	.003	1.000	.883	.001	.003	1.001	.812
Administrative distance	-.009	.013	.991	.502	-.004	.014	.996	.753	-.007	.014	.993	.597	-.009	.013	.991	.505	-.010	.014	.990	.445
Firm age	.002	.004	1.002	.598	.002	.004	1.002	.688	.003	.004	1.003	.486	.003	.004	1.003	.513	.001	.004	1.001	.706
Firm size	.001	.002	1.001	.648	.002	.002	1.002	.284	.001	.002	1.001	.772	.001	.002	1.001	.686	.001	.002	1.001	.498
Service firm	.106	.320	1.112	.740	.157	.325	1.170	.628	.096	.322	1.101	.766	.100	.320	1.105	.754	.202	.326	1.224	.536
Legal restrictions	.080	.118	1.083	.501	.022	.120	1.022	.858	.091	.119	1.095	.444	.074	.119	1.077	.534	.066	.120	1.068	.583
Target market/region exp. (TE)	.412	.148	1.510	.005	.077	.186	1.080	.678	.313	.167	1.368	.061	.486	.164	1.626	.003	.055	.204	1.057	.787
Diversity export experience	-.019	.007	.981	.010	-.096	.029	.909	.001	-.020	.007	.980	.007	-.018	.007	.982	.010	-.023	.008	.977	.004
Diversity non-FDI contractual exp.	.007	.009	1.007	.418	.002	.009	1.002	.852	-.021	.023	.980	.379	.007	.009	1.007	.421	.005	.009	1.005	.588
Diversity JV experience	.149	.053	1.161	.005	.141	.053	1.151	.008	.150	.053	1.161	.005	.289	.145	1.335	.047	.155	.054	1.168	.004
Diversity WOS experience	.140	.043	1.150	.001	.111	.041	1.118	.007	.132	.043	1.141	.002	.140	.043	1.151	.001	-.089	.098	.915	.367
Diversity export experience x TE					.027	.010		.007												
Diversity non-FDI contractual exp. x TE									.012	.010		.210								
Diversity JV experience x TE													-.053	.049		.285				
Diversity WOS experience x TE																	.093	.038		.015
<i>Fit measures</i>																				
McKelvey & Zavoina R <sup>2</sup>		.326				.395				.336				.324				.402		
Count R <sup>2</sup> (correctly classified)		.464				.486				.469				.464				.497		
Chi <sup>2</sup>		57.078				67.023				58.777				58.190				63.678		
Prob > Chi <sup>2</sup>		.000				.000				.000				.000				.000		

Dependent variable: entry mode choice (1 = Export; 2 = non-FDI contractual; 3 = JV; 4 = WOS)

n = 179

Note: OR = odds ratio; SE = standard error

**Table 3: Average marginal effects (AMEs) – Intensity of operation mode experience**

		AMEs on the probability of			
		Export	non-FDI contractual	JV	WOS
Intensity export experience	dy/dx	.004	.001	-.001	-.004
	P >  z	.010	.053	.049	.011
Intensity non-FDI contractual exp.	dy/dx	-.000	-.000	.000	.000
	P >  z	.972	.972	.972	.972
Intensity JV experience	dy/dx	-.006	-.001	.001	.006
	P >  z	.023	.051	.099	.019
Intensity WOS experience	dy/dx	-.004	-.001	.001	.004
	P >  z	.014	.061	.054	.016

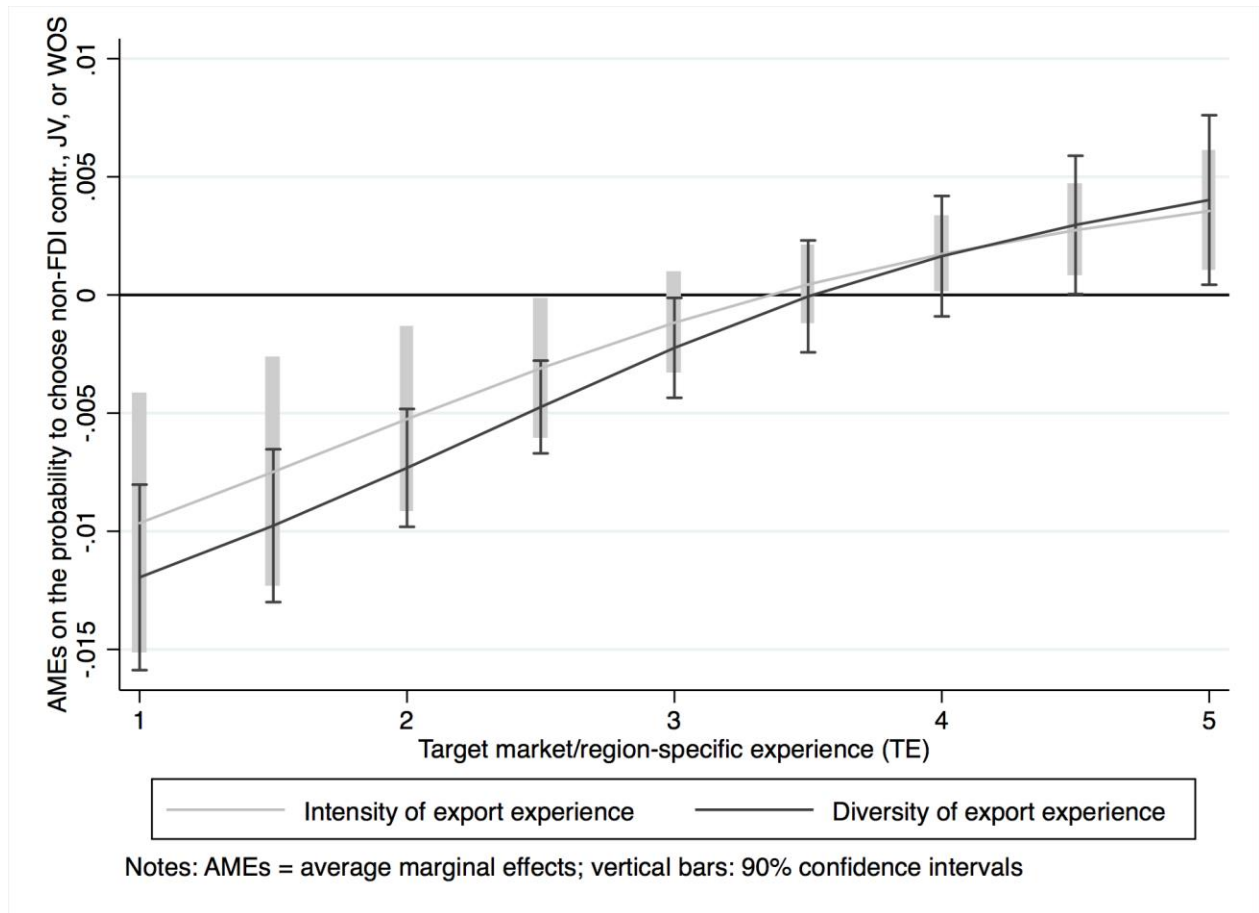
**Table 4: Average marginal effects (AMEs) – Diversity of operation mode experience**

		AMEs on the probability of			
		Export	non-FDI contractual	JV	WOS
Diversity export experience	dy/dx	.003	.001	-.001	-.003
	P >  z	.008	.061	.031	.008
Diversity non-FDI contractual exp.	dy/dx	-.001	-.000	.000	.001
	P >  z	.418	.428	.428	.416
Diversity JV experience	dy/dx	-.025	-.005	.004	.026
	P >  z	.004	.037	.036	.004
Diversity WOS experience	dy/dx	-.024	-.005	.004	.024
	P >  z	.001	.026	.019	.001

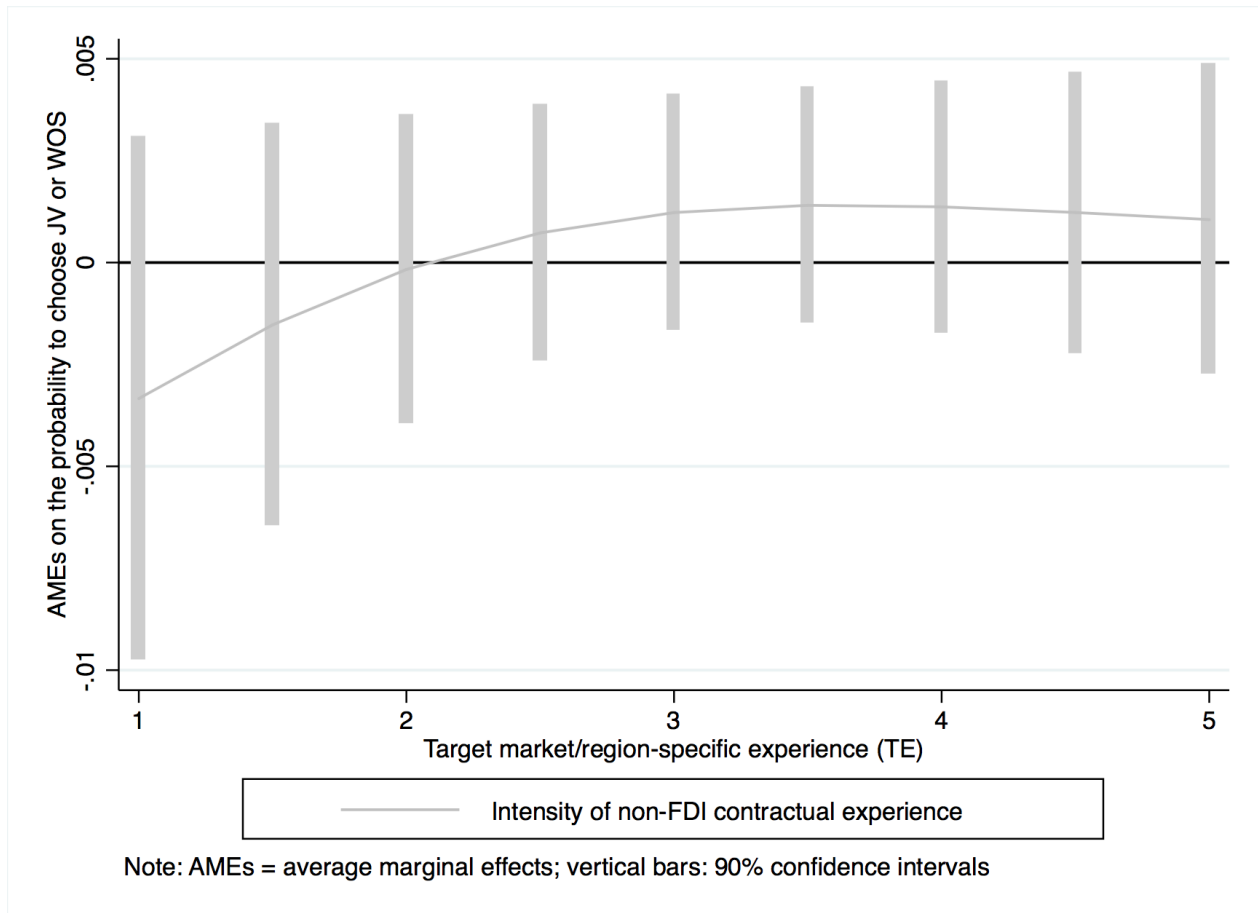
**Table 5: Additional test for multicollinearity**

	Coef.	
	min.	max.
<b>Panel A</b>		
Intensity export experience	-.018	-.016
Intensity JV experience	.033	.039
Intensity WOS experience	.018	.023
Intensity export experience x TE	.021	.030
Intensity non-FDI contractual exp. x TE	.014	.020
Intensity WOS experience x TE	.020	.024
<b>Panel B</b>		
Diversity export experience	-.018	-.014
Diversity JV experience	.015	.017
Diversity WOS experience	.131	.193
Diversity export experience x TE	.027	.033
Diversity WOS experience x TE	.093	.123

**Figure 1: Average marginal effects (AMEs) of intensity/diversity of export experience across values of target market/region-specific experience**



**Figure 2: Average marginal effects (AMEs) of intensity of non-FDI contractual experience across values of target market/region-specific experience**





**Figure 3: Average marginal effects (AMEs) of intensity/diversity of WOS experience across values of target market/region-specific experience**

