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## **THE BANDWAGON EFFECT OF LEADERS' ENTRY STRATEGIES ON FOLLOWERS' ENTRY STRATEGIES**

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**Abstract:** Firms, which have to compete with global firms in domestic market, try to internationalize for gaining competitive advantage. The aim of this study is to recommend a conceptual framework to explain the dynamics of internationalization process of leader and follower firms that internationalize from an emerging country. In this study, author tries to figure out the determinants of entry mode decisions of follower firms. In addition, bandwagon effect of leaders' entry mode strategies on followers' entry mode decisions should be investigated in this study. Multiple theories are used to explain the internationalization process of developing countries. Propositions are given to present the bandwagon effect of leaders' entry strategies on followers' entry strategies. According to the conceptual model, leaders' entry strategies create a bandwagon effect on followers' entry strategies. Especially follower firms follow leader firms that form the reference group and learn from them. Other than previous studies, in the study this mechanism is explained with bandwagon effect. It is hoped that this study is helpful to enlighten the problem of determining the dynamics of internationalization process of emerging country firms. Moreover, this study integrates the international business and institutional theory literature with bandwagon effect and reference groups. The conceptual framework that is given in this study is beneficial for follower firms, which have to learn from leaders and provides academic contribution.

**Keywords:** Foreign direct investments, entry mode, bandwagon effect, emerging country

### **Introduction**

Internationalization process and entry mode decisions are important and most studied research areas in business and strategy literature (Griffith, 2008). In this context, there are many studies about firms' foreign direct investments from developed countries (Swoboda, Elsner, & Olejnik, 2015; Górecka & Szałucka, 2013; Xia, Tan, & Tan, 2008; Zheng, 2012; Zhao, Luo, & Suh, 2004 etc). Most of these studies generally focused on the factors that affects developed countries' firms' foreign direct investments decisions or the effect of different entry mode decisions on firm's performance. However, there are limited studies about the motivations that affect foreign direct investment decisions of firms which domestically in an emerging country. In this study, author tries to recommend a conceptual framework to explain the dynamics of internationalization process of leader and follower firms from an emerging country. To clarify this process author firstly presents important issues of internationalization and give information about internationalization motivation theories. Then, the other issues such as entry mode, reference groups and institutional factors are explained to recommend a conceptual framework.

Firstly, Hymer's internationalization theory is criticized on the inability to explain the internationalization motivation of multinational firms. According to Hymer, the fundamental reason of internationalization of multinational firms is their monopolistic power and these firms generally prefer wholly owned subsidiary entry mode (Ulaş, 2009). Contrary to this, Dunning's OLI Paradigm, which known as eclectic paradigm and integrates more than one theories, explain internationalization process of multinational firms depending on their Ownership, Location and Internalization advantages. Ownership advantages are tangible and intangible advantages that comes from unique resources like product innovations, patents, national resources, brand name, technology, organization structure, marketing and sale power. Location advantages, which include economic, politic, cultural or social advantages, emerges when host country more attractive and advantageous than home

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country. Lastly, internalization advantages refer to firms' researches, developments, and its tacit and technological knowledge by vertical integration (Dunning, 1979).

In the context of emerging countries, there is an important discussion between Dunning's OLI paradigm and Mathews' LLL model in the international business literature. Dunning's OLI paradigm is widely accepted in explaining the process of firm that internationalize from a developed country. However, according to Mathews (2002a), it is not enough to explain the process of internationalization of firms from emerging countries throughout ownership, location and internalization advantages. Many of firms in emerging countries already do not have these advantages so OLI paradigm cannot provide success in international markets. Mathews' LLL model describes the emerging country originated firms' internationalization process throughout Linkage, Leverage and Learning stages. Emerging country-originated firms firstly makes some connections to capture the resources that they do not have in linkage stage. After that, firms use this linkage as leverage and make business agreements in leverage stage. Lastly, firms learn the dynamics of international markets and resources of competitive advantages in the learning stage (Mathews, 2002b).

In the discussion of OLI paradigm and LLL model, Narula (2006) supports OLI paradigm and suggest that Mathews' claims about OLI paradigm are invalid and OLI paradigm is sufficient for explaining the internationalization of multinational firms. In addition, Narula argue that Mathews do not understand OLI paradigm exactly. Unlike Narula, Dunning (2006) do not ignore Mathews' LLL model and accepts it as a complementary of OLI paradigm. According to Mathews (2006), OLI paradigm that depends on transaction cost theory, is not enough to explain the later entrants' (followers) internationalization process and LLL model that is based upon resources based view, can support OLI paradigm in this context. Recent studies like Amighini, Sanfilippo and Rabelotti (2007) suggest that there is a need for multiple theories to explain the internationalization process.

Besides these internationalization motivations there are other important factors that affects the internationalization of multinationals. Firstly, entry mode decisions are one of mostly important research areas in international business literature (Górecka & Szałucka, 2013). Moreover, the effect of reference groups in entry mode decisions of multinational firms should be investigated. Especially firms from emerging countries can be influenced by the isomorphic or mimetic effects of reference groups on entry mode choices (Zheng, 2012). At this point reference group make bandwagon effect on other groups. Multinational firms, which have to operate in many countries, have to overcome difficulties of varied cultural, economic, politic conditions in these countries. Lastly institutional factors as cultural, economic and corruption distances figures out the differences of home and host countries. The differences between institutional structures of home and host countries can cause institutional duality and affect the entry mode decisions of multinational firms (Hillman & Wan, 2005).

## **Entry Mode**

The choice of a foreign market entry mode is a crucial decision that has been widely analyzed in the literature (Swoboda et al, 2015). Górecka and Szałucka (2013) suggest that the choice of entry mode is one of the important elements of international market entry strategic models. Moreover, entry mode is considered as an important determinant of firm performance and the existing literature has investigated whether some investment modes provide better performance than others do (Zheng & Qu, 2015). There are different definitions of entry mode choices in the literature. For example, for Williams, Martinez, Gastelaars, Galesloot & Van De Kerke (2011), entry modes can be classified in two broad categories that are full-control and shared-control. In full-control modes there is a controlling stake and include Greenfield investments or cross border acquisition, whereas different types of joint ventures entails sharing of control and ownership. According to De Villa, Rajwani & Lawton (2015), foreign market entry modes are institutional arrangements of international business transactions that include exporting, contractual agreements, joint ventures, and wholly owned operations. Swoboda et al (2015) claim that preferred entry mode is negatively affected by political and cultural distance and positively affected by international experience, and internalization speed. With the moderating effects of external institutional environment and internationalization knowledge, preferred entry mode transforms to choice of entry mode (Swoboda et al, 2015).

Griffith (2008) suggests that international entry mode decision researches are the most studied field in international business dynamics and strategy. The findings, however, are very mixed, especially with respect to transaction-cost-related factors in determining the ownership-based entry mode choice (Zhao et al, 2004). Most studies, which explain the MNE's entry mode decisions, transaction cost theory (Zhao et al, 2004; Stevens & Makarius, 2015), institutional theory (Ang, Benischke & Doh, 2015; Chung, Xiao, Lee & Kang, 2015; Xavier & Genç, 2012), agency theory (Lien & Filatotchev, 2015; Wang, Chung & Lim, 2015) and mixed theories (Anil, Tatoglu & Ozkasap, 2014; Arslan & Wang, 2015, DeVilla et al, 2015). Moreover the studies that examine the international entry mode decisions between home and host countries generally focus on cultural distance

(Beugelsdijk, Maseland, Onrust, Hoorn & Slangen, 2015; Chua, Roth & Lemoine, 2015), corruption distance (Godinez & Lui, 2015, Cuervo-Cazurra, 2016) or other distances (Choi & Yenyurt, 2015, Cuervo-Cazurra & Genç, 2012; Knight & Liesch, 2016; Ojala, 2015). According to Egan (2013), there are three types of researches use entry mode as a dependent variable. First type is related with firm investment characteristics, second type of researches investigates cultural relationships and the last type of internalization research depends on institutional factors (Egan, 2013). Today many emerging economy companies need to internalize because of globalization (Hariharan & Rangan, 2011). However, the studies about MNE's entry mode decisions in emerging countries are limited (Alvarez & Marin, 2010; Egan, 2013; Tian, Lo & Song, 2015).

## **Reference Groups**

According to Zheng (2012), the effect of the strategic or reference groups in MNE's entry mode choice in an emerging market is important to analyze. Ang et al (2015) claim that foreign market entrants may benefit from the legitimacy that has been obtained by other foreign firms, which form legitimized reference groups. To gain advance position in competition, firms form these strategic groups and develops barriers to new competitions. The firms, which are member of the same subgroups of industry, are likely to respond in the same way to competition (Caves & Porter, 1977). Peteraf (1993) claims that in the strategic management literature researchers give significant attention to the concept of strategic groups. Moreover, grouping firms as strategic groups can provide a useful analytical tool for understanding competition dynamics, especially in analyzing complex industries (Fiegenbaum & Thomas, 1995). In addition, Dranove, Peteraf, and Shanley (1998) suggest that a strategic group exists if characteristics of this strategic group affect firm performance independent from firm level and industry level effects.

In strategic management literature some of strategic group studies depend on the rivalry level in different industries (Fiegenbaum & Thomas, 1995; Peteraf, 1993) and some of other strategic group studies depend on strategic groups and firm performance (Dranove et al, 2015). There is a growing literature about strategic groups in entry mode choices (Ang et al, 2015; Francioni, Mussoa, & Vardiabasis, 2013; Mukundhan & Nandakumar, 2013; Xia et al, 2008; Zheng, 2012). Most of these studies investigate the isomorphic or mimetic effects of reference groups on entry mode choices. For example, Zheng (2012) develops a theoretical framework for reference group choice in entry mode decisions depending on isomorphic influences. Francioni et al (2013) examine the internationalization of Small and Medium Sized Enterprises (SMEs) in the mechanical manufacturing sector and try to identify various groups of companies exhibiting similar behaviors. Another interesting study, which is about the mimetic entry and bandwagon effect, analyzes the rise and decline of international equity joint venture in China (Xia et al, 2008).

## **Bandwagon Effect**

Bandwagons are diffusion processes whereby organizations adopt an innovation, because of a bandwagon pressure caused by the sheer number of organizations that have already adopted an innovation. The two types of theories that explain bandwagon effects are rational-efficiency theories and theories of fads. According to rational-efficiency theories, bandwagon effects are related with the complete information and when the number of adopters of an innovation increases, its costs decrease or its returns increase, causing more adoptions. However, in fad theories there are two types of theories explain bandwagon pressures. One type of fad theories is institutional bandwagon pressures on organizations arising from the threat of lost legitimacy. Another type of theory describes competitive bandwagon pressures on organizations arising from the threat of lost competitive advantage (Abrahamson & Rosenkopf, 1993). Xia et al (2008) suggest that the concept of bandwagon effect is useful for explaining the changes of a dominant strategy when large numbers of firms adopt a new structure or practice in rapid succession. When new entries adopt the structure there will be positive bandwagon effect, but when the emergence of new entry strategies leads to decline in previously dominant ones there will be negative bandwagon effect (Xia et al, 2008).

The studies about bandwagon effect in entry mode choice are mostly investigated with institutional pressures and mimetic isomorphism (Delerue & Lejeune, 2011; Xia et al, 2008; Yang & Hyland, 2012). Some other studies examine the investment decisions' bandwagon effects (Henderson & Cool, 2003a; 2003b) or investigate the relationship between firm positioning and bandwagon effect (Boone, Wezel, & Witteloostuijn, 2013; Gans & King, 2004; Goldenberg, Libai & Muller, 2010). There are also some studies related with learning bandwagon mechanisms in foreign entry location choice (Belberbos, Olfeen & Zou, 2011; Mulotte, Dussauge, & Mitchell, 2013). Especially, the bandwagon mechanism of social learning comes from firm-level uncertainty. Firms under uncertainty will have tendency to mimic the behavior of reference groups and at this point bandwagon mechanism implies that firms select whom they will follow (Belberbos et al, 2011).

### Institutional Factors

In the literature the studies that examine the international entry mode decisions between home and host countries generally focus on cultural distance (Beugelsdijk, Maseland, Onrust, Hoorn & Slangen, 2015; Chua, Roth & Lemoine, 2015 etc.), economic distance (Choi & Yenyurt, 2015; Drogendijk & Martin, 2015 etc.), corruption distance (Godinez & Lui, 2015, Cuervo-Cazurra, 2016 etc.) or other distances (Cuervo-Cazurra & Genç, 2012; Knight & Liesch, 2016; Ojala, 2015). The role of institutional factors, which are important dynamic of international business environment, are investigated in literature (Brouthers & Brouthers, 2000; Huang & Sternquist, 2007; Shaner & Maznevski, 2011 etc.). Like Demirbağ, Mc Guinness & Altay (2010), Brouthers and Brouthers; Brouthers (2002), some of the institutional environment studies focus on institutional factors that affect the entry mode decisions of firms. According to Huang and Sternquist (2007), institutional theory can be used to explain international retailers' entry time strategies. Some other studies like Shaner and Maznevski (2011), Kang and Jiang (2012), Powell and Rhee (2013) mainly focus the relationship between institutional factors and multinational firms. Wu and Chen (2014) have more macro perspective and investigate the effect of multinational firms to the development of home country.

DiMaggio and Powell (1983) claim that firms that operate in the same institutional environment like each other because of isomorphism to gain legitimacy. Like Dimaggio and Powell (1983), Meyer, Estrin, Bhaumik & Peng (2008); Cheng & Yu (2008) suggests that institutional pressures and isomorphism mechanisms affects multinational firms. Especially in emerging countries, firms that operate with the same institutional pressures should gain legitimacy to survive. Because of firms generally have to face with many economical and political uncertainties; they tend to like legitimated firms mimetically (Dimaggio & Powell, 1993). In other words, many follower firms learn from legitimated firms in internationalization process and they have to behave like these legitimated leader firms.

### Recommended Conceptual Model

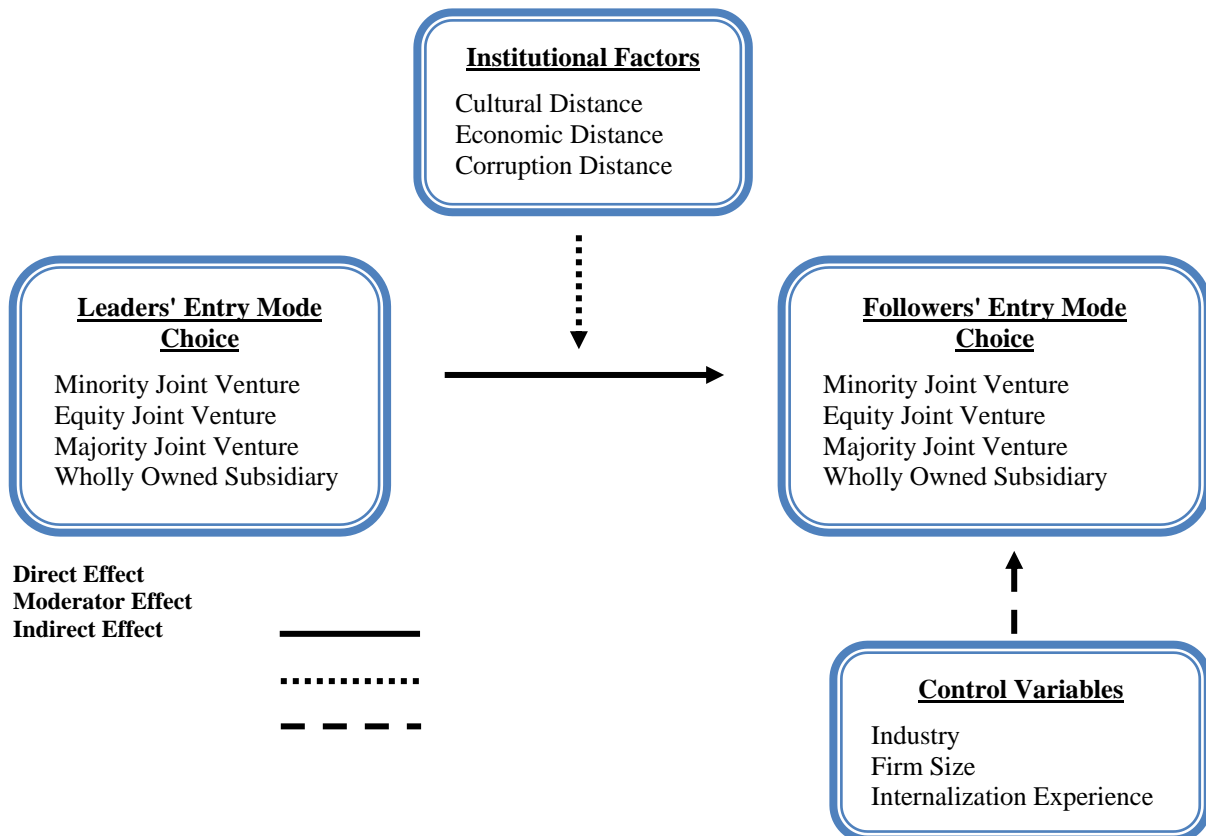


Figure 1. Recommended conceptual model

Entry timing and entry mode strategies are very important issues for the success of firms in global market (Fosfuri et al, 2013). For instance, early entering has some advantages like preempting scarce assets, switching costs and some disadvantages like free-rider effects, incumbent inertia. When firms use early entering advantages effectively, they generally form the leaders' reference group (Lieberman and Montgomery, 1998). In this study, author suggests that leaders' entry mode choice causes a bandwagon effect, in other words mimetic

tendency of followers. Entry mode choices of minority joint venture emerge when a firm has less than 50 % equity (Pan and Tse, 2000). We expect leaders' entry mode choice of minority joint venture have a positive bandwagon effect on followers' entry mode choice of minority joint venture.

**Proposition 1:** Leaders' entry mode choice of minority joint venture will affect followers' entry mode choice of minority joint venture with the moderation of institutional factors.

**Proposition 1a:** Leaders' entry mode choice of minority joint venture will affect followers' entry mode choice of minority joint venture with the moderation of cultural distance. This moderation effect increases when cultural distance decreases.

**Proposition 1b:** Leaders' entry mode choice of minority joint venture will affect followers' entry mode choice of minority joint venture with the moderation of economic distance. This moderation effect increases when economic distance decreases.

**Proposition 1c:** Leaders' entry mode choice of minority joint venture will affect followers' entry mode choice of minority joint venture with the moderation of corruption distance. This moderation effect increases when corruption distance decreases.

Entry mode choices of equity joint venture emerge when a firm has 50 % equity and according to transaction cost economies, firms can increase their ownership to reduce the costs of transactions and to prevent the loss for tacit knowledge (De Villa et al, 2015). We expect leaders' entry mode choice of equity joint venture have a positive bandwagon effect on followers' entry mode choice of equity joint venture as shown below.

**Proposition 2:** Leaders' entry mode choice of equity joint venture will affect followers' entry mode choice of equity joint venture.

**Proposition 2a:** Leaders' entry mode choice of equity joint venture will affect followers' entry mode choice of equity joint venture with the moderation of cultural distance. This moderation effect increases when cultural distance decreases.

**Proposition 2b:** Leaders' entry mode choice of equity joint venture will affect followers' entry mode choice of equity joint venture with the moderation of economic distance. This moderation effect increases when economic distance decreases.

**Proposition 2c:** Leaders' entry mode choice of equity joint venture will affect followers' entry mode choice of equity joint venture with the moderation of corruption distance. This moderation effect increases when corruption distance decreases.

Entry mode choices of majority equity joint venture emerge when a firm has more than 50 % equity and less than 100 % equity. Lian and Filatotchev (2015) suggest that by holding a controlling stake in their foreign subsidiaries, firms have benefit of better monitoring their investments and enjoy better legal protection, thus effectively deterring their local business partners from opportunism. We expect leaders' entry mode choice of majority joint venture have a positive bandwagon effect on followers' entry mode choice of majority joint venture.

**Proposition 3:** Leaders' entry mode choice of majority joint venture will affect followers' entry mode choice of majority joint venture.

**Proposition 3a:** Leaders' entry mode choice of majority joint venture will affect followers' entry mode choice of majority joint venture with the moderation of cultural distance. This moderation effect increases when cultural distance decreases.

**Proposition 3b:** Leaders' entry mode choice of majority joint venture will affect followers' entry mode choice of majority joint venture with the moderation of economic distance. This moderation effect increases when economic distance decreases.

**Proposition 3c:** Leaders' entry mode choice of majority joint venture will affect followers' entry mode choice of majority joint venture with the moderation of corruption distance. This moderation effect increases when corruption distance decreases.

Entry mode choices of wholly owned subsidiary emerge when a firm has 100 % equity and these entry modes include Greenfield investment, which refers to start up investment for new facilities in foreign markets, and

acquisitions that refers to the significant purchase of stock in an already existing firm to enable control (De Villa et al, 2015). Lastly, we expect leaders' entry mode choice of wholly owned subsidiary have a positive bandwagon effect on followers' entry mode choice of wholly owned subsidiary.

**Proposition 4:** Leaders' entry mode choice of wholly owned subsidiary will affect followers' entry mode choice of wholly owned subsidiary.

**Proposition 4a:** Leaders' entry mode choice of wholly owned subsidiary will affect followers' entry mode choice of wholly owned subsidiary with the moderation of cultural distance. This moderation effect increases when cultural distance decreases.

**Proposition 4b:** Leaders' entry mode choice of wholly owned subsidiary will affect followers' entry mode choice of wholly owned subsidiary with the moderation of economic distance. This moderation effect increases when economic distance decreases.

**Proposition 4c:** Leaders' entry mode choice of wholly owned subsidiary will affect followers' entry mode choice of wholly owned subsidiary with the moderation of corruption distance. This moderation effect increases when corruption distance decreases.

### Research Contributions and Limitations

With this study, author aims to expand the literature of international business and institutional theory throughout developing a model of the bandwagon effect of leaders' entry strategies on followers' entry strategies along with the moderator effect of institutional factors. In emerging countries, many of the firms have to compete in global arena and they try to sense and catch the opportunities of internalization. Especially follower firms follow leaders firms that form reference group and learn from them. Other than previous studies, in this study this mechanism is explained with bandwagon effect. As a result of this study, leader firms' internationalization figure out with their advantages, but follower firms have to learn from them, use the information they gained as leverage as do in a bandwagon.

As mentioned before, there are many studies about firms' foreign direct investments from developed countries (Swoboda, Elsner, & Olejnik, 2015; Górecka & Szałucka, 2013; Xia, Tan, & Tan, 2008; Zheng, 2012; Zhao, Luo, & Suh, 2004 etc). However, the studies concerning emerging countries are limited and there are serious discussions about the motivations of firms' internationalization from an emerging country. Author hopes that this study is helpful to enlighten the problem of determining the dynamics of internationalization process of emerging country firms. Moreover, this study integrates the international business and institutional theory literature with bandwagon effect and reference groups. The conceptual framework that is given in this study is beneficial for follower firms, which have to learn from leaders and provides academic contribution.

The first limitation of the research is that it is a qualitative study and has all limitations of qualitative studies. The other limitation of this study is that it has no support of empirical data. These empirical data can be taken from secondary data of multinational firms from emerging countries. Because of that, one the next studies can be empirical analysis of this subject in an emerging country. Another example of next studies can be comparative analysis from different countries. In addition, various types of independent or moderator variables can be tested to discover the internationalization of firms that come from an emerging country. Lastly, panel data analysis will be useful to determine the differences of firms' foreign direct investments in different countries.

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