Abstract

The extant literature on internationalisation has largely been concerned with analysing firm internationalisation strategy and entry mode choice from the perspective of a manufacturing firm. Over the last decade the growth of services, and their internationalisation, has attracted considerable attention from academics, with the focus being on particular characteristics that distinguish services from goods. However, as the composition of a firm’s product usually contains both good and service characteristics, this paper argues that it is misleading to categorise a product simply as a ‘good’ and/or a ‘service’. Rather, it is important to understand the extent of service components that embody, or are embedded in, a product offering. Such embeddedness often impacts on the manner in which a firm internationalises. It is argued that the higher the degree of service embeddedness in a product the greater the possibility of a direct market entry and vice versa. Based on a number of case studies the paper examines the impact of service embeddedness on the entry mode choice of Australian manufacturers in the UK.

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INTRODUCTION

Early research into the internationalisation process of firms was largely characterised by an emphasis on manufacturers producing tangible goods (Dunning, 1979; Hymer, 1976; Vernon, 1966, 1979). Research into the internationalisation of services has emphasised the unique characteristics of certain services and, in the process, tends to oversimplify the nature of goods. In particular, the degree of separability of production and consumption has been highlighted as a key indicator of how a service can be delivered in overseas markets (Erramilli and Rao, 1993; Roberts, 1999). Researchers have concluded that individual services can contain either separable or inseparable production and consumption, thereby making a simple distinction between a service and a good’s entry mode choice difficult to justify (Erramilli and Rao, 1993; Robert, 1999; Vandermerwe and Chadwick, 1989) as services produced and consumed separately invite direct comparison with manufactured goods.

Taking this level of product distinction still further, other researchers have stated that there are very few ‘pure’ goods or services with many goods embedding services in their delivery and use (Daniels, 2000; Dunning, 1989; Giarini, 1994; Gronroos, 1990, 1999; Illeris, 1996; Levitt, 1972). Hence, the notion of embedded services has emerged, emphasising the service element contained in manufactured goods. Embedded services are service components integral to the core of a product (Giarini, 1994). These service components may contain different degrees of separability which may be compatible or incompatible with the manufactured good they are embedded with.

In order to investigate this issue and allow a more sophisticated understanding of how service embeddedness impacts on firm internationalisation, this paper examines several Australian firms operating in the UK. The research deepens the analysis of the internationalisation of firms by examining whether the value-added service components of a manufactured good may determine the modus operandi chosen by firms to enter into international markets. A total of eighteen Australian manufacturing firms operating in the UK have been identified for a case study. For each of the firms the research examines the extent of their investment in the UK and, specifically, how the nature of their product composition may influence their choice of entry mode.

SERVICE EMBEDDEDNESS AND INTERNATIONALISATION: AN OVERVIEW

Researchers have defined services both from the perspective of an experience (Shostack, 1977) and from the perspective of ‘actions’ that bring about a change in a person or a good (Hill, 1977). Common characteristics such as intangibility, inseparability, variability and perishability (Berry, 1984; Eiglier et, al, 1977; Gabbott and Hogg, 1994; Gronroos, 1978, 1990) have been used to make a distinction between services and goods. Other researchers (Dunning, 1989; Hirsch, 1988, 1989; Wyckham, et al, 1975) have questioned whether all types of services display these characteristics and, in particular, whether these characteristics can also relate to goods.

Expanding on this, researchers have proposed that rather than a simple distinction between goods and services there is a product continuum (Dunning, 1989; Levitt, 1972; Rathmell, 1966; Shostack, 1977). The justification for a continuum is that there are very few pure goods and services and most products contain both good and service characteristics (Daniels, 2000, Giarini, 1994; Illeris, 1996).

A manufactured good is usually embedded with a variety of additional or supplementary service elements (Anderson and Narus, 1995; Gronroos, 1990; Lovelock and Yip, 1996). Most businesses offer their customers a package that includes a variety of service-related activities. The customer, to remedy defects or to increase the lifespan of the good, performs these post-purchase services to ensure proper use of the product (Holbrook, 1999; Porter, 1985; Stabell & Fjeldstad, 1998;
Robinson, et. al, 2002; Walter and Lancaster, 2000). According to Aharoni, (2000); Giarini, (1994); Levitt, (1972) and Lichtenthal & Long, (1998) the more complex the operation of the good, the higher the service component embedded in it and the greater the probability that consumers would purchase the good based on specific post sales services such as a installation, maintenance and advice that are deemed indispensable to the good itself.

Embedded services are responsible for extending the value of a good beyond its tangible features to include its overall performance. Researchers have used terms like ‘extended product’ or ‘product package’ to describe embedded service components that add value to a good (Carmen and Langeard, 1980; Eiglier et al, 1977; Gronroos, 2000; Levitt, 1972; Lovelock and Yip, 1996). Dunning (1989) links the concept of embedded services directly with a firm’s maintenance or achievement of a competitive advantage, thereby implying their value added capabilities by contributing to a firm’s ownership advantage, which is a central component of the eclectic paradigm. This is also emphasised by Gronroos (1999:293) when he states

what we see today is that a growing number of manufacturing businesses have to vitalise the service elements of their offerings or add new services goods based offerings in order to stay competitive.

Many researchers (Coviello and Martin, 1999; Ekeledo and Sivakumar, 1998; Erramilli and Rao, 1993; Roberts, 1999; Stare, 2002) on the internationalisation process of firms have observed that theories developed to explain a firm’s internationalisation process have been largely based on the internationalisation behaviour of large manufacturing firms. These theories typically assume a form of exporting activity before the firm undertakes any direct foreign market presence (Johanson and Wiedershiem-Paul, 1975; Johanson and Vahline, 1977, 1990; Vernon, 1966, 1979).

Researchers into the internationalisation of services (Erramilli and Rao, 1993; Gronroos, 1998; Vandermerwe and Chadwick, 1989) however, argue that the successful delivery of certain types of services requires some form of direct interaction between the user of the service and the provider of the service. Accordingly, the firm may not have the option of being able to export, as these types of service products simply cannot be delivered to the consumer in this manner (Cardone-Riportella, and Cazorla-Papis, 2001; Cicic, et al, 1999; Clark, et al 1996; Erramilli, 1990). This may mean that the firm has to enter foreign markets directly to fulfil the needs of its customers.

The requirement that certain service activities necessitate direct interaction between the user and provider of the service has been considered an important determinant of service product internationalisation (Buckley, et al, 1992; Coviello and Martin, 1999; Dunning, 1989). The location of foreign direct investment service operations is determined by the necessity for closeness to customers and the firm’s capacity for adaption to customer requirements. As the incidence of contact is high in such situations, pressure is placed on the firm to locate activities in close proximity to the consumer (Buckley et al, 1992; Hirsch, 1989). Researchers have determined that products requiring close proximity to customers for effective service delivery have to enter markets directly (Coviello and Martin, 1999; Dunning, 1989; Gronroos, 1990, 1999). Consequently, incremental or staged entry approaches, at least one that commences with exporting, is not always a feasible option. Welch and Luostarinen (1988) call this variation on the standard model ‘leapfrogging’.

However, Erramilli and Rao, (1993) and Stare, (2002) acknowledging the notion of separability of services, have stated that a firm producing a product with separable production and consumption will be able to export and incrementally increase its market presence to direct entry. Alternatively, a firm producing a product with a high degree of inseparability between the process of production and consumption may have to internationalise with a more direct mode of entry, as this type of product requires a close degree of interaction between the provider and the user (Bryson, 2002; Cardone-Riportella and Cazorla-Papis, 2001; Erramilli and Rao, 1993).

Based on this analysis a conceptual model, highlighted in Figure 1 has been developed. The model depicts the relationship between the degree of separability, service embeddedness and a
firm's choice of entry mode when it internationalises. The model seeks to portray the manner in which the degree of separability may assist in determining the entry mode the firm chooses to serve foreign markets. At one level, inseparable production and consumption will require the firm to interact directly with its consumers for that service to be successfully delivered. Consequently, this may mean that the firm will have to consider a direct entry mode into foreign markets as this degree of separability may be incompatible with the manufactured good the service is embedded with. Alternatively, products with embedded services containing separable production and consumption may have a greater number of entry mode options, as interaction between the firm and its consumers is not a precondition for the successful delivery of these service activities and this level or degree of separability is consistent with the manufactured good the service is embedded with.

Figure 1 about here

METHODOLOGY

The study uses data collected in 1992 that investigated the internationalisation of Australian manufacturers in Europe. Organisations such as Australian Business into Europe (ABIE), the Australian Trade Commission (Austrade) offices in Britain and in Australia identified 25 Australian-owned manufactures in Britain. 18 of the 25 firms agreed to participate in the study. A case study approach was adopted as this allowed the researchers to focus on understanding the dynamics of firm strategy (Yin, 1994). It allowed the inclusion of 'how and why' questions and, as a consequence, a rich information set was accumulated. A qualitative method was used based on face-to-face interviews which took about 45mins and was recorded on audiotape.

All 18 CEOs were interviewed. The CEOs were chosen as they are the managers most likely to appreciate the strategic reasons behind the entry mode chosen to serve the UK. The CEOs were encouraged to elaborate and exemplify their answers. The firms varied greatly in size but had an average of around 500 employees. They produced a diverse range of products including food and beverages, chemicals, building and construction items and household products. Most of the businesses surveyed (60%) had been established since 1980. In all cases, the British operations were the subsidiaries of Australian parent firms.

Table One, gives an overview of the firms and their product (s). The table is an attempt to analyse the product composition by breaking down each firm’s product into a good and service component and then determining the nature of the service embeddedness of each product and how this may impact of the firm’s entry mode. The manufactured good characteristics are shown in Column II. In those cases where interviewees identified the service characteristics of their firm's product, these are listed as ‘embedded services’ in Column III. Column IV indicates whether the embedded service offering can be classified as separable or inseparable. Columns V and VI detail whether service embeddedness had influenced the firm’s choice of entry mode.

Based on the analysis of the literature, the following proposition has been developed and will form the basis of the analysis of the results: ‘A firm that provides a service with inseparable production and consumption, embedded in a good will internationalise by entering foreign markets directly’.

Table 1 about here

FINDINGS

As Column III indicates, 12 firms detailed a service component that they regarded as an important part of their overall product package. These service components ranged from the installation of a manufactured product (# 1, 3 & 17) to specialist advice that supported the firm’s manufactured
product (#2, 5, 8, 11, 12, 14, 15, & 18). For 4 of the firms, (#11, 12, 15 & 18) this specialist advice involved the firm directly interacting with its consumers. In one case (#5) it involved interacting with alliance partners who were responsible for installing the manufactured product. Column IV details whether the embedded service components can be classified as separable or inseparable. Of the 12 embedded service components, 10 were identified as ‘inseparable’ as they required the provider to interact directly with the user for the service to be successfully delivered.

In relation to the proposition developed, respondents were asked to explain if the products currently produced by the firm could have been exported from Australia rather than manufactured in the UK. Column V details the responses from 10 firms for which it was evident that the service component of their product package was the main motivation for determining the entry mode chosen to enter the UK market. In each case the firm stated that, despite their classification as manufacturers of tangible ‘goods’, they regarded this particular good as being one component of a larger ‘product package’ that included a number of service activities that required the firm to interact directly with its customers. In the case of firms #3 & 17, which manufacture garage doors, their product package includes not only the manufacture of a good to customers’ specifications, but also the installation (a service) of the door within a desired time frame. Both firms see the provision of the service component of their product package as a key factor in their success:

“We tend to be more service oriented than English companies. We deliver on a two day basis—if a customer is having trouble we will be there within 48 hours” (#17)

“Australian back-up service is superior to the UK standard” (#. 3)

In both cases the service commitment is perceived to be a key justification for adopting a direct entry mode rather than simply exporting a manufactured product from the home market:

“If there is a problem, customers can come directly to us. It would be much slower to go back to a distributor who goes to us” (#17)

In these cases the embedded service implies the product cannot be exported successfully. Consequently, the firm has entered the market directly by establishing subsidiary operations.

This additional service-related value also applied to other firms:

“A problem with producing in Australia is the time delay. Very often installers need an answer to a problem immediately. The installer has a lot of responsibility. His work protects the business from burning down”. (#5)

An appreciation of the service component of ‘installation’ of a manufactured product is evident across a number of the firms. For this service to be successfully delivered to customers, the firm must, in some way, directly interact with them. Consequently, production and consumption of the service-related activities applying to ‘installation’ are inseparable. One firm stated it would be ‘impossible’ to conceive of any other mode other than a local production facility to service the market-

“The customers would not be able to get us to do the development work on their behalf. We couldn’t advise them on how to simplify their electrical systems. Our engineers talk to theirs a lot. This sort of free service is essential to marketing. It is not just a supply operation” (#18)

The second question of relevance to the proposition is the possibility of expansion into other geographic markets from each firm’s UK base. The responses are detailed in Column VI. In this case 10 firms indicated that such strategy was under consideration and nominated the service components of their product package as a key determinant that would imply establishing local facilities funded by FDI rather than exporting from their UK subsidiaries. It is reflected in the comment made by one of the respondents:
“The critical factor is sales and service. The manufacturing component is fairly low. The major limit on the company’s growth is not manufacturing capacity but availability of sales/support people to visit the customer’s premises to fix problems” (# 11)

This observation was apparent in the response of one CEO, who identified the problem of responding to customer demands for service and commented,

‘we set two weeks as the maximum time from order to installation” (#.3).

These circumstances restrain the firm from adopting any arm’s length arrangements such as exporting. As one of the respondents indicated:

“…limits apply to how far we can extend our service. It only takes a day to get our people to any one customer in Europe. Only limits to staffing preclude us doing the same in Africa, India etc” (# 5)

DISCUSSION

The research shows support for the proposition - ‘A firm that provides a service with inseparable production and consumption embedded in a good will internationalise by entering foreign markets directly’. There are several factors that explain the usefulness of the proposition. The research highlights the importance firms place on value-added services that complement the manufactured good they produce. As Column III indicates, many of the CEOs interviewed saw their product as a package containing a variety of embedded service components that were essential to the use of the goods. This is consistent with the existing literature (Anderson and Narus, 1995; Daniels, 2000; Giarini, 1994; Gronroos, 1999; Illeris, 1996) that emphasises that manufactured products are typically surrounded by supplementary or embedded services.

The results of the research also highlight some consistencies with existing literature on how product characteristics affect a firm’s internationalisation strategy. Previous research (Cicic, et al, 1999; Erramilli and Rao, 1993; Grubal, 1987; Roberts, 1999; Sampson and Snape, 1985) has found that the concept of inseparability applies to certain types of products and is not a characteristic identifiable across all service types.

Researchers (Bryson, 2002; Cicic et al, 1999; Erramilli and Rao, 1990, 1993; Stare, 2002) have also concluded that the inseparability of production and consumption, or a high level of interaction between the provider and the user, may require a direct presence in a foreign market. Cardone-Riportella and Cazorla-Papis (2001), refined this observation further when they argued that products that require progressively higher levels of interaction were restricted to entering international markets by direct entry mode methods. Similarly, Buckley et al, (1977) and Buckley (1982) found that firms that produce products with ‘high’ service elements find that market entry is restricted to a more direct mode. Columns IV, V and VI highlight that firms that identified their embedded services as ‘inseparable’ reported that this factor determined their choice of foreign market entry mode. All 10 firms stated that their entry mode selection was largely a consequence of the inseparable service component embedded as part of their product package. For these services to be successfully delivered, a direct entry mode was required to access the market, so that the provider of the service (the firm) and the user of the service (the consumer) could interact with each other. Column V shows that where an inseparable service component was identified, a direct entry mode was chosen. This analysis was also extended to entry mode choices for future expansion which is detailed in Column VI.

Although previous research has emphasised how the inseparability of a service may determine a firm’s entry mode, the focus of this research (Cardone-Riportella and Cazorla-Papis, 2001; Coviello and Martin, 1999; Erramilli and Rao, 1993; Roberts, 1999; Stare, 2002) was on analysing the behaviour of firms producing service products. By highlighting the extent of embeddedness
contained in each firm’s product package, the current data looks beyond the dichotomous product categories traditionally associated with the analysis of the internationalisation of firms, to a more comprehensive appraisal of product composition in manufactured goods and the role it plays in the determination of a firm’s entry mode choice.

The results support the research proposition by highlighting that there is a correlation between the inseparability of a product’s embedded service and the choice of entry mode to enable the service to be successfully delivered to the user. As all the firms involved in the case study were manufacturers of tangible goods, with various degrees or levels of embedded service support, the data also provides support for the concept of a product continuum (Dunning, 1989; Rathmell, 1966; Shostack, 1977) with various combinations of manufactured goods being embedded with service inputs. Although these product continuums were largely developed from a marketing viewpoint, the data provides a basis for analysis from the perspective of internationalisation of the firm, especially its entry mode choices.

LIMITATIONS

Several limitations exist in the results. First, the firm’s data has only been sourced from one country. Second, the data was collected in 1992, raising the possibility that new factors have emerged to influence the effect of service embeddedness. Third, the data is from manufacturing firms only. A more detailed analysis would require a comparison of service firms producing services with varying degrees of separability. It is also possible that the embedded services are specific to particular industries, which may explain their presence in the product packages of some firms but not others that took part in the case study. Additional research and analysis into industries or products that may require supplementary services more than others, would give more insights into this area.

ACADEMIC IMPLICATIONS

The research will enhance the literature on the internationalisation process of firms by giving due emphasis to the concept of service embeddedness in international products and how this may influence the internationalisation process of the firm. The major theories developed to explain the internationalisation of firms have been focused on the manufacturing sector. Service firm internationalisation research has been based on the applicability of these theories to service industries. Several researchers have highlighted that characteristics unique to certain services may mean that these internationalisation theories have little or no relevance to specific service sectors. Consequently, the research aims to look beyond a simple distinction between goods and services to a more comprehensive model of firm internationalisation. It also generates a better understanding of the manner in which firms have internationalised. The goal for future research will be to use the conceptual model as a basis for empirical studies.

CONCLUSION

A distinction between goods and services is often highlighted by reference to the qualities of services (Berry, 1980; Gabbott and Hogg, 1994; Hill, 1977; Lovelock; 1983; Shostack, 1977) that differentiate them from goods. However, other researchers have questioned whether the distinction between goods and services is necessary or helpful. They argue that ‘products’ may contain elements of both goods and services (Daniels, 2000; Dunning, 1989; Illeris, 1996; Levitt, 1972; Rathmell, 1966). Consequently, the concept of ‘products’ embedded with various degrees of service characteristics has been developed. The embedded service offering consists of service components in a product that adds utility and value (Hirsch, 1989; Walter and Lancaster, 2000; Webster, 1994).
The impact of these ‘embedded’ services on a firm’s internationalisation process has received very little attention. Although the focus of internationalisation theory has been developed from a manufacturing perspective, service internationalisation received increasing focus over the last decade and has been largely based on the proposition that service products are fundamentally different to manufactured products. However, this paper has proposed that there is a continuum from soft service to hard good and the degree of separability of the service element embedded in a product may impact on the way a firm enters international markets. The evidence from the case studies suggests that when a firm’s embedded service components are inseparable, it may determine the entry mode choice the firm uses when it decides to internationalise its operations and when it seeks to further expand into other international markets.
REFERENCES


Table 1: Embeddedness and Internationalisation

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N/A = Not Applicable
Figure 1: Conceptual Model Influence of Service Embeddedness in Entry Mode Choice

- Degree of separability
- Choice of market entry mode
- Service embeddedness of product offering