CHAPTER 2: LITERATURE REVIEW

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2.1 Characteristics of services

Services are defined as 'an activity or series of activities of a more or less intangible nature that normally, but not necessarily, take place in interactions between the customer and service employees and / or physical resources or goods and / or systems of the service provider, which are provided as solutions to customer problems (Gronroos, 1990, p 27). An analysis of this definition shows that services are characterized by intangibility, and inseparability of production and consumption, which, in turn, are related to penshability and heterogeneity. These four characteristics are central to the analysis of the international operations of service firms (Bouquet et al., 2004, Aharoni, 2000).

Several key differences between manufactured goods and services are now well accepted in the literature. The differences have been classified into four generic types: (a) Simultaneity of production and consumption (inseparability), (b) Intangibility, (c) Heterogeneity (variability) and (d) Penshability of output (Knight, 1999, Langford and Cosenza, 1998; Zeithaml, 1981, Berry, 1980). Two of these characteristics are especially relevant in an export context, namely inseparability and intangibility.

The inseparability nature of services means production and consumption often take place simultaneously. Advising the technical aspects of a new manufacturing process, machine design etc., for example, illustrates how the core service
(customized, complex technical advice) is ‘consumed’ by the client at the same time it is ‘manufactured’ by the consultant. It also means a degree of frequent and intimate contact is required between the service provider (e.g., project manager, engineering consultant) and the client for the service to be ‘manufactured.’ Such services are frequently referred to as high contact services. A high degree of provider-client contact often requires the service firm to have a local presence on foreign soil, and to deal first-hand with significant business and personal cultural issues (e.g., language, customs, communications symbols, bureaucratic hurdles).

The second key characteristic, intangibility, refers to the fact that unlike manufactured goods, which are physical objects, services are performances (engineering consulting project) or experiences (sport, tourism, concert), or some form of intellectual property encased in a physical package (software, online training programme). Furthermore, they may be equipment based (telecommunications) or people based (project management). In most cases, the service cannot be touched, physically transported or stockpiled in inventory. This ‘intangible / ephemeral’ nature of most services, combined with the complex technical / scientific nature of most professional services (engineering, IT, mining, consulting, project management, etc.), means many clients do not possess the technical / scientific ‘know-how’ to confidently evaluate the quality of the advice they purchase. Thus clients in high contact services often evaluate quality and satisfaction based on tangible cues (i.e., surrogates) such as brand reputation, country of origin, relational skills exhibited by an individual service provider during the delivery of the service, and the degree of cultural sensitivity displayed.
Services with a high degree of intangibility and buyer-seller interaction frequency, and simultaneous production and consumption, are location-bound and must be available in-full from the day of foreign market entry (Anand and Delios, 1997, Vandermerwe and Chadwick, 1989) Physical display is often impossible, and demonstration risks giving the service away Because services are to a large degree experience-based and dependent on individual perceptions in time and space, they are difficult to evaluate before and even after consumption, thus it is difficult to perform quality control in traditional ways (Darby and Karni, 1973) With customer as co-producer, service outcomes are highly variable, making provision of service guarantees difficult (Nayyar, 1993) Finally, because many services cannot be stored, buffering demand fluctuations through holding inventory is impossible

2.2 Classification of Services

Not only are there important differences between manufactured goods and services, there are also significant differences within the service sector In recognition of this, a number of classification schemes have been developed that distinguish between service firms Various methods of classifying services are present in the literature, for example Lovelock’s (1983) classification scheme to serve common marketing strategies, Erramilli’s (1990) hard service / soft service scheme, Lovelock and Yip’s (1996) people processing, possession-processing and information processing services scheme etc
2.2.1 Four cell typology of service types by Patterson and Cicic

Patterson and Cicic (1995) offer a useful classification scheme for internationally traded services which highlight different characteristics among services based on two key dimensions: degree of tangibility and degree of face-to-face contact required for service manufacture and delivery.

The result is a four cells typology of service types (see Figure 2.1) location-free professional services (I), location-bound customized services (II), standardized service packages (III), and value-added customized services (IV).

The firms in Cell I (Figure 2.1) are location-free in the sense that the market entry strategy involves key personnel (civil engineer, project manager, environmental scientist) traveling to a foreign country for a relatively short period to complete a project and then returning home. A permanent presence (foreign direct investment) is not required on foreign soil. Such services are generally low-medium contact, less customized (e.g., short-term management or engineering consultancy assignments, off-the-shelf marketing research surveys, some financial services) as opposed to highly customized services. Thus these services can be said to be 'exported' in a traditional sense.

Firms in Cell II are major bid and tender projects (e.g., longer-term engineering, project management, business consultancy project) where the service is highly customized to client needs and there is considerable personal interaction required between client and service provider over an extended period of time. They tend to be professional services requiring a high degree of executional latitude and
situational adaptation. Because of the longer-term nature of these projects and the amount of face-to-face contact, these firms invariably are required to establish a permanent presence in the foreign market.

<table>
<thead>
<tr>
<th>Degree of Tangibility</th>
<th>Degree of face-to-face contact</th>
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<tr>
<td></td>
<td>Low</td>
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<td>Pure Services</td>
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<tr>
<td>(I) Location-Free Professional Services</td>
<td>Typical examples: Executive recruitment, Finance &amp; Insurance, Information technology, Product design service, Market research</td>
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<td></td>
<td>High</td>
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<tr>
<td>(II) Location-Bound Customized Services</td>
<td>Typical examples: Engineering &amp; Management consulting, Project management, Legal services, Human Resource consulting etc</td>
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<td>Services Bundled with Goods</td>
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<tr>
<td>(III) Standardized Service Packages</td>
<td>Typical examples: Software development, Installation / testing of new hardware / equipment, Distance education</td>
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<tr>
<td>(IV) Value-Added Customized Service</td>
<td>Typical examples: On-site training, Facilities management, Catering, Software training and support</td>
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**Figure 2.1:** Types of International Services based on Degree of tangibility and Degree of face-to-face contact. Source: Patterson and Cicic (1995)
2.2.2 Three groups classification by Lovelock and Yip

Lovelock and Yip (1996) propose the classification of services into three groups

(a) *People-processing services* are those that involve tangible action to customers (e.g. restaurants, health care), thus necessitating a local presence by the international marketer.

(b) *Possession-processing services* involve intangible actions to merchandise in an effort to enhance the value of the merchandise to the customer (e.g. transportation, appliance repair), and the customer is not involved in the process.

(c) *Information-based services* are those that provide some value for the customer as a result of the collection, analysis and manipulation of data (e.g. accounting, insurance) and only minimally involve the customer.

According to Samiee (1999) the above classification method is articulate and thought provoking, but these categories are not mutually exclusive and exhaustive for all services. For example, conventional retail trade and custom tailor services are difficult to classify under this scheme. Store-type retailing is an action that involves the customer but the customer is not transported, diagnosed with a disease or fed. The retail process merely enables the customer to take possession of the goods or services. Of course, there are social and entertainment aspects of store-type retailing, and if these were the primary motivations for patronage, then retailing might qualify as a people-processing service.
2.2.3 Four category classification proposed by Clark et al.

Clark et al. (1996) offer a classification method for services based on four categories. The four categories described by them are.

1. **Contact-based services** – these are services where direct contact between service provider and client is required but no permanent physical presence is established (e.g. consulting, accountancy, temporary labour).

2. **Vehicle-based services** – a service delivered via an ‘international’ vehicle (e.g. TV broadcasting, telecommunications).

3. **Asset-based services** – services physically located in the overseas market (e.g. bank branches, hotels, restaurants).

4. **Object-based services** – services embedded in a physical object (e.g. CDs, machinery repairs, etc).

As per Samiee (1999) there are clearly many overlaps in this classification system, since one firm may offer services falling into two categories. For example a firm may offer an “object-based” service in the form of computer software plus a contact service in the form of a help line. In this case a third option of delivery via the Internet – a vehicle service – is also possible.

2.2.4 Hard and Soft services

Erramilli (1990) makes a distinction between hard and soft services. This hard and soft service classification scheme meaningfully reduces the large diversity of the service sector and uncovers useful insights about internationalization process of service firms.
In order to understand this distinction we once again review the important characteristics of services

Hard services are those where production and consumption can be decoupled. For example, software services and architectural services can be transferred in a document, a CD, or some other tangible medium. They can often be standardized, making mass production feasible. With soft services, where production and consumption occur simultaneously, decoupling is not viable. The soft-service provider must be present abroad from their first day of foreign operations. As Palmer and Cole (1995) note, suppliers of soft services are an integral part of their product, requiring higher control over the production process. For example, hotels, management consultancies, and hospitals require local proximity of service providers and service buyers.

2.2.5 Other classification schemes

For the purpose of classifying international transaction in services the most commonly used classification is provided by Sampson and Snape (1985) and modified by Sapir and Winter (1994). This classification, which is based on the constraints on the physical location of producer and consumer in realising the transaction, has been adopted by World Trade Organisation (WTO) under the General agreement on Trade in Services (GATS). The Agreement applies to four "modes of supply”

- Mode 1: cross-border supply of service (i.e., not requiring the physical movement of supplier or customer)
• **Mode 2** provision implying movement of the consumer to the location of the supplier,

• **Mode 3** services sold in the territory of a Member by (legal) entities that have established a presence there but originate in the territory of another Member, and

• **Mode 4** provision of services requiring the temporary movement of natural persons

Bhagwati (1984) argues that services can be divided into two categories, first, those that necessarily require the physical proximity of the user and the provider, and second, those that do not essentially require this though it may be useful. Services that require essential physical proximity have been further categorized into three groups that are

a) **Mobile provider and immobile user,** e.g., shifting labour to the construction site in another country

b) **Mobile user and immobile provider,** e.g., hospital services

c) **Mobile user and mobile provider,** e.g., lectures, haircuts, etc

### 2.3 Internationalization of Services

Internationalization is considered to be the process through which a firm moves from operating solely in its domestic marketplace to international markets (Andersen, 1993, Buckley and Casson, 1998; O'Farrell, 1998). Welch and Luostari anden (1988, p 36) define internationalization as 'the process of increasing involvement in international
operations', whereas Calof and Beamish (1995, p 116) define internationalization as ‘the process of adapting firm’s operations (strategy, structure, resources, etc.) to international environments’

Vandermerwe and Chadwick's (1989) observe that traditional ways of thinking about internationalizing services are falling away and new, hybrid modes of market entry are in evidence. According to Covello and Martin (1999) “consultancy service firm’s primary mechanism for internationalization was to export knowledge and expertise by acting as the contractor to a foreign client or, occasionally, as subcontractor for other organizations (i.e., piggybacking). Although the traditional view of exporting implies physical movement by the service provider, this form of market entry continues to be the most common method to service foreign markets.” Consultancy service firms may export by achieving a temporary market presence through exporting key personnel (and know-how) on a term basis, personnel who ultimately return to the home country after completion of specific projects.

According to Sampson and Snape (1985) consulting is a location-bound service that requires physical co-presence of consultant and client. Services with a high degree of intangibility and buyer-seller interaction frequency, and simultaneous production and consumption, are location-bound and must be available in-full from the day of foreign market entry (Vandermerwe and Chadwick, 1989). As a consequence, technical consulting services are hard to trade internationally and exports may not represent a sustainable form of international operation (Vandermerwe and Chadwick 1989, Buckley, Pass, and Prescott 1992, Erramilli and D’Souza 1995). Only the travel of consulting professionals permits a temporary provision of services.
across borders, Vandermerwe and Chadwick (1989) propose that consulting and engineering firms, as an example of a pure service with a high degree of consumer-producer interaction, will favor a fully integrated mode of international operation, such as FDI, mergers, acquisitions, or the establishment of subsidiary operations.

2.4 Theories of Internationalization

Efforts to understand the internationalization concept have been many, and as summarized by Johanson and Vahlne (1990), three general research areas have emerged in the literature namely (1) FDI theory, (2) The establishment chain or stage models of internationalization and (3) The network perspective.

2.4.1 FDI Theory

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

The eclectic paradigm, most prominently associated with the work of Dunning (1977, 1988, 2000) His OLI-model is eclectic because it integrates distinct explanatory approaches from different theories into one single framework. The concrete form of international operation that a foreign firm takes in a particular target market is the result of a combination of three advantages.

First, a firm must have specific ownership or O-advantages that compensate for the general liability of foreignness as well as competitive position of rival domestic firms in the target market. Such Firm Specific Advantages (FSAs) may be in the form of technology / know-how, economies of scale and scope, patent rights, brand name, exclusive rights to scarce natural resources etc. These Firm Specific Advantages either generate higher revenues and / or lower costs as compared to rival domestic firms that offset the cost of operating at a foreign location.

Second, location or L-advantages of the target market have to be identified and to be evaluated with respect to the firm strategy (Dunning 1977) The target market or Country Specific Advantages (CSAs) may be (1) economic - quantity and quality of the factors of production, size and scope of the market, transport and communications costs, and so on, (2) Social / Cultural advantages include psychic distance between the home and host country, general attitude towards foreigners, language and cultural
differences, and so on. (3) Political advantages include government policies, non-tariff barriers, regulations regarding repatriation of earnings, and so on.

Third, it has to be assessed whether the O-advantages may best be realized through internalization (I-advantages) or through external cooperative or market transactions. The OLI model argues that external, arm's length markets are either imperfect or in some cases nonexistent. As a result, the Multi National Enterprise (MNE) can substitute its own internal market and reap some efficiency savings. For example, a firm can go abroad by simply exporting its products to foreign markets, however, uncertainty, search costs, and tariff barriers are additional costs that will deter such trade. Similarly, the firm could license a foreigner to distribute the product but the firm must worry about opportunistic behavior by the licensee.

The OLI model predicts that the hierarchy (the vertically or horizontally integrated firm based on internal markets) is a superior method of organizing transactions than the market (trade between unrelated firms) whenever external markets are nonexistent or imperfect.

Given the market imperfections of imperfect good and factor markets, positive transportation costs, heterogeneity of demand and increasing returns to scale, internalization is an alternative organizational strategy in order to reduce transaction costs (Coase 1937). The internalization of O-advantages is more efficient than trade, whenever the transaction costs of the market are higher than the costs of hierarchical organization (Rugman 1980).
We can think of modes of entry as along a line (see figure 2.2). On the left end is the 100% external market (exporting at arm's length between unrelated parties) where governance costs and the firm's control level should be low but transactions costs high. At the other extreme is the 100% internal market, the wholly owned subsidiary (WOS), where governance costs and control are high but transactions costs are low. Moving from left to right, the modes of entry become more expensive in terms of commitment levels but offer more control. Transactions costs fall and governance costs rise as we move from left to right.

2.4.2 The establishment chain or stage theory of internationalization

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

Stage theory argues that psychic distance affects the geographical pattern of international expansion. Psychic distance is defined as "the sum of factors preventing the flow of information from and to the market" (Johanson and Vahlne 1977, p 24), as for example, differences in language, education, business practice, culture or industrial development (Gertler 1997). Given the uncertainty of an operation in a market with cultural, legal and business institutions very different from the home country, early international activity will head for more similar, often neighbouring markets. Hence, stage theory conceives an expansion of international activities from countries with a high level of psychic proximity to those with more psychic distance (Bell 1995, Buckley and Casson 1998).

Other versions of the stage model approach have found that internationalization is reflected in differences in the attitudinal and behavioral commitment of managers. For example, Cavusgil (1984) empirically identifies five stages (pre-involvement, reactive / opportunistic, experimental, active, and committed involvement). Andersen (1993) summarizes this incremental approach as a result of innovation adoption behavior in which manager's perceptions and beliefs both influence and are shaped by foreign market involvement.
In the so-called Uppsala School (Johanson and Wiedersheim-Paul 1975, Johanson and Vahlne 1977, 1990, 1992), Johanson and Vahlne (1977) conceive of firm internationalization as a process of gradual increase of commitment to a foreign market. Based on empirical observations from the early 1970s, they argue that local experiential knowledge causes incremental advances of market knowledge and thus provokes an establishment chain of international organization. The process of internationalization unfolds as a sequence of stages, where firms stepwise gain experience, build management competence, and reduce uncertainty in order to incrementally increase investments in a target market (Johanson and Vahlne 1977, Erramilli 1991).

The theory suggests that firms follow a number of sequential stages in their process of internationalization. The first contact with foreign markets is initiated through direct orders from the foreign market but still there may not be regular export activities. With the increasing number of orders, firms start to make agreements with agents or use licensing to maintain supply to the new market and to keep the costs and commitment for the involvement low. The third step describes the establishment of sales subsidiaries before finally advancing to the last stage of starting manufacturing activities in the foreign market.

The individual stages and sequences of stages are conceptualized differently in a number of approaches. However, most approaches to stage theory claim a gradual intensification of operations from indirect export to direct export and licensing arrangements to own international production.
In conclusion, stage theory focuses on the process of an international engagement. It emphasizes learning and experience and suggests an incremental increase of activities as a consequence of market-specific knowledge that can only be acquired through experience and not through reading or consulting.

### 2.4.3. Network perspective

A third area of internationalization research draws on the theories of social exchange and resource dependency and focuses on firm behavior in the context of inter-organizational and interpersonal relationships. Referred to as the "network perspective," this view argues that organizational boundaries incorporate both formal and informal relationships (Johanson and Mattsson 1988). As a result, it offers an alternative conceptual view of internationalization, because FDI theory does not account for the role and influence of social relationships in business transactions (Johanson and Mattsson 1987).

The Network Model of internationalization proposed by Johanson and Mattsson (1988) is based on the underlying view that the industrial system is a network of direct and indirect relationships between firms, including their suppliers and customers, in which firms are dependent on each other and the required coordination maintained through interaction. These relationships influence the decision for market strategies as well as they ensure the functioning of the market in general.
According to Johanson and Mattson (1988) internationalization of firms takes place in a business network setting. Johanson and Mattson's (1988) define business networks as long-term business relationships that a firm has with its customers, distributors, suppliers, competitors and government - the actors in a business network. They regard a business relationship to be a relationship between firms that jointly conduct business, and which is of mutual benefit to those involved in it. Indeed, a large amount of internationalization activity is associated with networking because it involves building relationships with foreign intermediaries, customers, alliance partners, suppliers, and government officials.

The model assumes that firms are dependent on the resources controlled by others and accesses them through their position in the network. Establishing a position is time and resource consuming but determines future opportunities and constraints. Therefore, Johansson and Mattson (1988) describe the position of a firm in the network as a "market asset".

The Network perspective considers internationalization to be the attempt of a firm to establish and develop its position in the network through international extension, penetration, and international integration. This model determines the degree of internationalization by the extent to which the company holds certain positions in different national networks, and the degree of relevance and integration of those positions. Internationalization means an increase in the number and strength of relationships between different parts of the global network.
This perspective views the market as a network of exchange relations between producers, suppliers, customers and competitors. These relations may serve very different intentions (Johanson and Mattsson 1987, p 37). They may reduce the cost of production or transaction, contribute to the development of new knowledge and competencies, lead to at least partial control over an actor, serve as bridges to unrelated third actors, or help to mobilize partners against a third party.

The role of information and knowledge is important in the internationalization process. Use of business networks (Johanson and Vahlne, 1990) improves understanding of new markets and how to overcome the institutional and cultural barriers in order to conduct business there. If a firm is not involved in a network then it has little knowledge about actors, relations, structures and processes. Since a firm's main channel for learning about its network is through its partners, it has to interact with them to gain this knowledge (Andersson, 1997). Networks provide access to various sources of information, thus offering more opportunities to learn than relying on knowledge from within the firm.

In contrast to internationalization theory, the network approach prioritizes external relations over internal conditions and assets. In line with the concept of resource dependence, the access to other firms' resources is considered at least as important to realize market opportunities as internal competencies and competitive advantages. Consequently, a firm's position in a network takes a specific strategic value. It becomes a specific, intangible resource. The network approach, then, argues that international market entry is more dependent on a network position than on institutional, economic or cultural conditions of the host market. A business network...
serves as “bridges to foreign markets” (Sharma and Johanson 1987, p 22) and the form of market entry is now conceived as a consequence of evolved patterns of business relationships rather than a result of rationally selected optimal solutions (Blankenburg, Eriksson, and Johanson 1996)

The network perspective assumes that extensive knowledge is required on the counterpart in terms of trustworthiness, resources, organization and development possibilities. Large number of individuals interacting is a time consuming effort and explains why many relationships are established over years. Exchanges are normally performed between existing relationships and are thus considered to be stable. Nevertheless, the authors recognize that these relationships are changing and companies try to maintain, develop or change them to maximize their own needs and objectives suitable for the survival and growth of the firm. Entering a new market means building new relationships and eventually breaking existing ones. The extent to which the entry into the new market is successful depends on the position of the firm in the network and the strength of the relationship with the counterpart.

2.5 Psychic distance

Stage theory argues that psychic distance affects the geographical pattern of international expansion. Psychic distance is defined as “the sum of factors preventing the flow of information from and to the market” (Johanson and Vahlne 1977, p 24), as for example, differences in language, education, business practice, culture or industrial development (Gertler 1997). Given the uncertainty of operating in a market with cultural, legal and business institutions very different from the home country, early
international activity will head for more similar, often neighbouring markets. Hence, stage theory conceives an expansion of international activities from countries with a high level of psychic proximity to those with more psychic distance (Bell 1995, Buckley and Casson 1998).

Empirical studies on different business service sectors question this argument (Sharma and Johanson 1987; Bell 1995; Coviello and Martin 1999, Gluckler 2004). They show that actual geographical patterns of expansion do not necessarily follow a gradient of psychic distance. Instead, their evidence suggests that those markets promising highest growth or sales potential are often targeted first.

In the case of technical, engineering and management consulting firms the argument of psychic distance may prove to be ambivalent. On the one hand, Sharma and Johanson (1987) argue that the market selection of business service firms is independent from the problem of psychic distance because the necessary investments are lower and less market specific when compared with manufacturing. While manufacturing firms have pronounced sunk costs through the installation of machinery and production facilities, a consulting firm may start operation with some rented office space. The limited specific investments lower the risk of a local market operation and thus also permit international operation in more remote markets with higher psychic distance.

On the other hand, the marketing and provision of management services requires fundamental knowledge of local business culture, local and sectoral market conditions and management methods (Wood 2002). Therefore, market specific
adaptation is far more decisive for consulting firms than for standardized manufacturing products. "Offering an advanced management service in another country requires perfect knowledge of the client and environment, in order for this service to be unique and its success or failure will be influenced considerably by the success or failure of the process of cultural adaptation carried out" (Rubalcaba 1999, p 290).

Consequently, it may be expected that psychic distance could indeed play an important role in consulting internationalization (Gluckler 2004). Indian service firms have pronounced international consulting activities in neighbouring countries like Nepal, Bhutan, Sri Lanka, Bangladesh as well as in the Middle East and African countries. UK and France have major international consulting activities in countries of former colonies, German consulting firms are particularly present in Austria and Switzerland and Spanish consultants have engaged quite intensively in South American markets.

However, these incidents are not enough to analyze the logic of market selection as a function of psychic distance. Bell (1995) found that business service firms choose their markets only indirectly on the back of their clients. In the course of following a client, many business service firms reacted to the internationalization path of their existing clients or new offers of foreign clients in their respective markets. In turn, Bell could not confirm the gradient of psychic distance as explanatory for market selection (Bell 1995, p 67).
2.6 Barriers to Trade in services

Since services trade often requires (temporary) movement of provider or consumer, restrictions on services mostly arise from regulations and discriminating requirements regarding this movement. Most service industries are highly regulated by national governments so that non-tariff barriers may be inadvertent and also specifically designed to exclude foreign competition. Alternatively, foreign suppliers may have to pay an "entry fee" or may be subject to market share restrictions. Policy instruments that restrict trade in services may include measures such as quotas, local content restrictions, prohibitions, subsidies, tariffs, taxes, technical standards, licensing and procurement.

Hoekman and Braga (1997) discuss some of the important barriers to trade in services. In case of some services, trade is prohibited while in others there are important restrictions imposed. Prohibitions to trade occur in case where foreign access to service markets is completely forbidden, e.g., in case of transportation of goods within a country and basic telecommunication service providers. But restrictions to trade take the following forms:

(a) Quantity-based barriers.
(b) Price-based barriers.
(c) Barriers that impose physical or corporate presence in a domestic market.
(d) Procedures of government procurement and subsidisation.
(e) Barriers related to standards, certifications and industry-specific regulations.
Quantitative restrictions (QRs) are often used to restrict international trade in services, but unlike in the case of goods they are applied to providers of services rather than services per se. Along with QRs, price controls are also used to ensure that prices are not set at either market clearing levels or at the monopoly level. Some of the services subject to price controls in many countries are financial services, telecommunications and air transportation.

Alternatively, tariffs are imposed to restrict trade in services that occur via the cross-border movement of natural persons, e.g., visa fees, entry-exit taxes, or port taxes etc. But tariffs form a potential trade barrier for those services that are either embodied in goods e.g., films, television programs, etc. or for goods that are necessary inputs into the production of services, e.g., computers, telecommunication equipment, etc. Along with tariffs, service industries are also sometimes supported through explicit or implicit subsidies, especially in construction, communication and transport, which make it difficult for trade to occur.

Other important barriers to trade are standards, provision of licensing and procurement. In the service context, standard-type restrictions include non-recognition of imported services or services procured abroad (e.g., diplomas or degrees obtained from foreign country). Certification or licensing may required in case of professional and certain business services. These licensees are generally accorded by the government or professional business bodies and may limit entry into the industry. The government procurement policy may also be designed to discriminate in favour of domestic service providers. Examples of such services are education, data processing and non-medical professional services.
2.7 Role of Social Networks and Personal Relationships

An important aspect is the role of social networks and personal relationships of the senior managers contributing to the internationalization process of the firm. Scholl (2006) acknowledges the role of personal relationships in the internationalization of firms. According to Scholl (2006, p. 22), social networks and personal relationships contribute to the process of internationalization in terms of access to privileged resources such as information on business opportunities and potential partners. In this respect, Scholl (2006, p. 24) provides a framework for the initiation of internationalization as a result of social networks (refer figure 2.3). In the search for new international business partners, decision-makers seek to avoid high search costs, due to uncertainties and complexity, and try to minimize these costs by relying on their personal network, which also seems to be 'the line of least resistance' (Ellis, 2000, p. 462).

Peng and Luo (2000) assert that managers within the focal firm translate their micro personal links with managers in other firms into improved macro organizational performance, in this case international growth. Loane and Bell (2006) suggest "firms internalize new network connections by acquiring additional management team members who had particular network resources required by the firm". Usually, senior managers have prior work experience in multinational corporations and leverage their personal contacts and experience to facilitate the firm's entry into international markets (Axinn, 1988; Ellis, 2000).
In his study of management consulting firms Gluckler (2006) demonstrates that social networks are the most frequent cause of international market entry. Gluckler (2004) refers to three types of relational (foreign market) entry contexts for consulting firms: "the first being client following, second being business referrals by current or former employees, and the third type through the so-called piggybacking. In this case, consulting firms enter a market on the back of strategic partners and collaborators."
2.7.1 Prior Personal & Social ties and International experience of managers

An important aspect is the role of the entrepreneur or the owner-manager of the professional service firm as well as the management in general contributing to the internationalization process with their prior personal/social ties (Ellis 2000, Scholl 2006). Owner-managers or other members of management develop personal contacts and experience through foreign travel or work experience in foreign markets. Usually owner-managers or senior members of management have prior work experience in multinational corporations and leverage their personal contacts and experience to facilitate the firm’s entry into international markets (Axinn 1988, Ellis 2000).

Oviatt and McDougall (1994, 1995) note that there are a lot of well-trained professionals who have had extensive experiences with international operations in other multinational companies. These experiences are useful in assembling resources, gaining access to existing international networks, and configuring firm’s value chain. Researchers (e.g., Reuber and Fischer, 1997) have identified other benefits of international experience, such as gaining access to strategic partners. This access is conducive to higher foreign sales.

According to Oviatt and McDougall's (1994, 1995) prior international experience makes managers more aware of the challenges associated with conducting businesses on a global scale. Consistent with this proposition, McDougall et al. (2003) empirically find that international experience is conducive to early internationalization. No doubt some managers become aware of these issues and learn
a great deal about the international business environment and how to structure their operations to create value

2.8 Export motivations

An important stream of research concentrates on investigating whether or not firms take the initiative to seek, identify and exploit export market opportunities. In this regard, a distinction has been pursued between proactive and reactive export stimuli (Johnston and Czinkota, 1982, Leonidou, 1988, Katsikeas, 1996). Study of export stimuli can explain to a large extent why some firms are involved and succeed in exporting, as opposed to others that do not export at all and remain inactive. The research intends to investigate the principle motivations among Indian engineering consultancy service firms who are already exporting.

(i) **Proactive stimuli** are those associated with the firm’s aggressive behaviour and deliberate search for export opportunities (pull factors). The review of the export motivation empirical literature reveals a wide range of factors that can play an important role in stimulating export activity. These factors pertain to attractive profit and growth opportunities overseas, managerial commitment, export promotion programmes, export incentives, existence of transferable competitive advantage / price advantage and so on.

(ii) **Reactive stimuli** are those connected with the firm’s reaction to changing conditions and reflect a passive attitude in looking for foreign market opportunities (push factors). Major factors of this type may be adverse domestic market conditions,
opportunity to increase the number of country markets and reduce the market-related
risk, globalization of existing clients, favourable currency movements and so on

The services exporting literature also distinguishes motivations for exporting
as *client following* where firms internationalize by following clients who have
internationalized, building upon domestically developed cooperation or *market
seeking* where firms choose to internationalize in search of new markets by services
firms (Erramilli and Rao, 1990, Majgård and Sharma, 1998)

According to Johnston and Czinkota (1982) “firm’s export decision making
may be driven by both proactive and reactive elements simultaneously” Empirical
evidence indicates that regular exporters develop better capability not only to look for
attractive foreign market opportunities, but also to respond effectively to a wider range
of signals that can stimulate export activity, as contrasted with firms that are non-
exporters or involved in sporadic exporting. Therefore, according to Katsikeas (1996)
it is possible that the factors stimulating the export decision of regular exporters are of
a more proactive / less reactive nature

2.8.1 *Client following and Market seeking motives*

There are two types of motives of internationalization in services: *client following*
and *market seeking* (Sanue 1999) While the latter suggests proactive strategies and
systematic procedures to select a target market and choose an entry form, the former
often implies reactive decisions to follow a client into a predetermined market
The theory of FDI sees international market selection largely as efficiency-led rational decision. Firms identify their specific competitive advantages and then look for those location-specific advantages of a market that provide the best production (or sales) conditions. Hence, markets are systematically screened, compared and assessed with respect to efficiency gains. Finally, a firm always chooses the market that facilitates the best realization of goals, e.g., highest sales potential, lowest labour cost, highest concentration of specific technological knowledge, etc.

Also, in the stage theory market selection is the result of independent rational decision-making. In order to prevent high levels of uncertainty, firms choose to expand in culturally proximate and often neighbourhood markets because the lack of specific market knowledge is easier to compensate than in more remote markets. Here, market risk represents the key parameter of market selection. Increasing experience conveys specific knowledge, which in turn allows for gradual intensification of market commitment. FDI as well as stage theory are normative accounts of optimal or rational market selection. Firms compare potential target markets, assess location advantages and choose the best match. Further, both approaches are atomistic (Gluckler 2004, p. 4) since market selection is explained through conditions within the firm and general market characteristics (external firm-specific conditions) are ignored.

Empirical studies do not provide strong support for these concepts (Coviello and Martin 1999). In a study on British consulting firms O’Farrell and Wood (1998) found that service firms hardly pursued any form of systematic market assessment or formal process of decision-making. Market selection as well entry form was mainly constrained by inter-firm relations with clients or strategic partners. Only 6 per cent of
the firms had active strategies of comparative market selection (O'Farrell, Wood, and Zheng 1996, p 114) Reactive internationalization implies that market selection is not the result of rational decision-making processes but of contextual business relations. A study on German medium sized manufacturing firms showed that social networks and personal relationships rather than rational market screening procedures were decisive for the actual choice of a target market (Gluckler 2004, p 7). These findings suggest that conventional theories underestimate the relevance of concrete social networks.

2.9 Service quality perception in an international context

Services are to a large degree experience-based and dependent on individual perceptions in time and space, they are difficult to evaluate before and even after consumption, thus, it is difficult to perform quality control in traditional ways (Darby and Kami, 1973). Physical display is often impossible, and demonstration risks giving the service away. With customer as co-producer, service outcomes are highly variable, making provision of service guarantees difficult (Nayyar, 1993).

For services such as professional consultancy services that are high in crecence properties, consumers endeavour to judge a service by its tangible cues (Lovelock et al., 2001), be it the service-scape, the physical appearance of the service personnel or the personality and behavior of individual professionals (Ellis and Watterson, 2001). Service marketers attempt to create abstract association and enhance "realities" by manipulating tangible cues (Berry, 1980) and then link these abstractions to physical items (Shostack, 1977). For services with a low degree of tangibility, a well managed service-scape (e.g. the professionalism exuded by the engineering consultancy office
or the thoroughness of their technical drawings) and physical evidence will influence the client’s perceptions of the firm, which in turn will yield more positive perceptions of performance (Ellis and Watterson, 2001).

Cultural sensitivity (i.e. “a general open-mindedness with respect to different cultures and the willingness to understand the ways in which cultures differ”, Hanch and LaBahan, 1998) has an impact on the perceived performance of the service personnel.

Thus the tangible cues provided by a professional service firm may include professionalism, individual consultant’s knowledge and personality, quality of presentations to the client, cultural sensitivity, communication messages, existing client references and so on. While physical items such as service personnel’s appearance and office design might be easy to duplicate, service-scape and the individual professionals’ personality are not.

Important tangible cues can generally be considered non-imitable due to their uniqueness. According to La et al. (2005, p. 386) “Tangible cues associated with services (characterized by a low degree of tangibility) are a significant determinant of export performance.” Hence it is expected that tangible cues provided by small and medium Indian professional consultancy service firms greatly influences client’s service quality perception regarding them and hence is a significant determinant of their success in an international market.
2.10 Country of Origin effect on internationalization of services

Highly intangible services are mostly performances (e.g., management consultancy project, engineering services, environmental impact study), where it is difficult for the potential buyer (importer) to assess quality in advance of purchase, and sometimes even post-purchase. Since the buyer cannot inspect or sample the service before purchase, they are forced to rely on the exporter’s track record, country of origin image, reputation, word of mouth, and other communication messages to assess prospective quality. For example, Tata Consulting Services have won many overseas government consultancy contracts largely on the basis of its corporate image and track record in certain areas of consulting. With highly intangible services, it is also much more difficult to achieve meaningful product differentiation. It is not as easy for Accenture or KMPG to differentiate themselves from Ernst & Young as it might be for IBM to distinguish itself from Honeywell where the potential buyer can compare not only their reputations, but also technical specifications and performance characteristics.

Many researchers have suggested that the country of origin (COO) effect is a salient factor in consumer product evaluation and one of the potential cues influencing product perceptions and purchase intentions (Peterson and Jolibert, 1995; Tse and Gorn, 1993; Roth and Romeo, 1992). COO can serve as “a useful extrinsic cue and as a surrogate for difficult-to-evaluate intrinsic characteristics such as quality and performance” for services (see Han and Terpstra, 1988; Parameswaran and Pisharodi,
After reviewing the existing literature Javalgi et al (2001) conclude that country of origin research applies to services besides manufactured goods.

Although the influence of country stereotyping effect on a corporate performance has not been examined in the literature, country of origin may play a significant role in providing tangible cues to shape the service perception and to assess its quality in an international context, especially for credence services like consulting that are often intrinsically difficult to evaluate. This quality perception is then a key antecedent for improved export performance. This contention is also based on the findings of Peterson and Jolibert's (1995) study in which COO had a stronger impact on quality perception than on purchase intention. In general, consumers do link some nations' expertise in producing certain type of products, such as French wines and perfumes, Italian fashions, Japanese consumer electronics etc. These kinds of associations are also relevant in the services field, especially when brand names are not well known.

According to La et al (2005, p 385) "A positive country of origin effect enhances the firm's image, which in turn strengthens perception of performance." If country of origin plays a significant role in providing tangible cues to shape the service perception and to assess its quality in an international context, then Indian professional consultancy service firms may be at an advantage. This is because India has acquired an image of being service providers to the world (mainly in information technology areas) with a large pool of English speaking, technically qualified personnel. Also this view is reinforced due to presence of large expatriate Indian population in the west (especially USA) engaged in high-end professions like software.
development, engineering, R&D, medicine, higher education, legal etc. On the other hand India as a nation is perceived by the world at large, as a developing nation that does not have access to state of the art technology and business practices.