

# Decision Making in the Internationalization of the Service Industry and the Applicability of Manufacturing Industry Internationalization Theories

-- A Literature Review-Based Consideration

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**Abstract:** This study examines the decision-making process of service industry internationalization and the applicability of manufacturing industry internationalization theories through a literature review. With advancements in technology and relaxed regulations from the 1993 GATT Agreement, service companies are becoming key players in business internationalization. Service marketing research has focused on understanding the definition and characteristics of services, such as intangibility, simultaneity of production and consumption, perishability, and heterogeneity. Existing research primarily addresses why service companies seek overseas markets and whether manufacturing internationalization models apply to them. This study reviews both environmental and internal company factors influencing decision-making for overseas expansion and analyzes the applicability of manufacturing theories to service industries, suggesting the need for classification based on service characteristics.

**Keywords:** Internationalization, Service industry, Foreign Direct Investment.

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## 1. Introduction

With advancements in technology and the relaxation of regulations on the service industry by the 1993 GATT Agreement (General Agreement on Tariffs and Trade), the main players in the phenomenon of business internationalization are shifting from manufacturing companies to service companies.

Marketing research targeting such service sectors, known as "service marketing research," has devoted much time and effort to understanding "what is a service" and "extracting the characteristics of services." The characteristics of services that have been long discussed in service marketing theory can primarily be summarized as intangibility, simultaneity of production and consumption, perishability, and heterogeneity. Services are activities rather than tangible objects, making it impossible to verify them in a concrete form before purchase (intangibility). Services are produced and consumed simultaneously, unlike tangible goods, where production and consumption times can be separated, requiring consumer participation in their production (simultaneity of production and consumption). Services vanish at the moment of consumption and do not have the permanence of tangible goods, making them susceptible to fluctuations in demand as they cannot be stored (perishability). Services often depend on people, leading to quality variations at different times of production, making it challenging to maintain homogeneous quality (heterogeneity).

One of the main concerns of existing research on the internationalization of the service industry is the difference from the internationalization of manufacturing companies. These studies can be categorized into those that aim to clarify why service companies seek overseas markets and those that investigate whether existing theories modeling the internationalization behavior of manufacturing companies

can be applied to the internationalization behavior of service companies.

This study aims to organize research on decision-making regarding overseas expansion in the service industry and the applicability of internationalization theories from manufacturing companies, and to present future challenges for the internationalization of the service industry.

## 2. Research on Decision Making for Overseas Expansion

As previously mentioned, when service industries expand overseas, they face constraints due to the "characteristics of services," such as intangibility, simultaneity of production and consumption, heterogeneity, and perishability. Despite these anticipated difficulties, why do service companies venture abroad? The research on decision making for overseas expansion aims to clarify the factors influencing these decisions. This research can be further categorized into the environmental factors approach and the internal company factors approach.

### 2.1. Environmental Factors Approach

Weinstein (1977) targeted American advertising agencies that had expanded overseas and categorized their motives into 16 factors, which he ranked. Table 1 shows these factors. He further divided the 16 factors into four groups based on interrelatedness: Offensive, Defensive, Client Service, and Interest of a Senior Executive. He examined the motives for overseas expansion before and after 1950. The results indicated that before 1950, the transition of clients from the US to overseas markets triggered the internationalization of advertising agencies. After 1950, top executives recognized overseas investment opportunities as offensive opportunities, and the international expansion of competitors and the demands of current clients played significant roles in

internationalization.

**Table 1.** Motivating Factors

Motivational Statement	Rank	Motivational Group
Initial interest shown by a senior executive	1	Executive Interest
Desire to serve current clients moving into markets this office could serve	2	Client Service
Desire to take advantage of a market with a large and growing potential	3	Offensive
Feeling that clients committed to using this office will make it a reasonably safe investment	4	Client Service
Desire to be known as a multinational agency	5	Offensive
Establish company name in markets that will be important in the future	6	Offensive
The rapid overseas expansion of other agencies	7	Defensive
Proposal from a prospective partner	8	Client Service
The success of previous overseas investments	9	Defensive
Competition from U.S. agencies already in the market	10	Defensive
Request from a client	11	Client Service
Desire to improve picture presented in financial statement	12	Offensive
Expected return on this investment was greater than available on alternative investment	13	Defensive
Defensive move to prevent erosion of current client-agency relationship	14	Defensive
Competition from non-U.S. agencies already in the market	15	Defensive
Desire to lessen U.S. tax liability	16	Defensive
Source(s): Weinstein (1977), p.84		

Erramilli (1990) analyzed various service industries to see how the motives of client following and market seeking differed across industries. The results showed that client following was comparatively important for banks, advertising agencies, and accounting firms.

Bell (1995) stated that factors like unsolicited orders and enquiries from abroad induced initial international expansion in software companies. He further mentioned that client following factors influenced not only market selection but also entry mode choice for service companies.

Li and Guisinger (1992) considered multiple existing theories and the characteristics of services to extract seven factors influencing the decision to expand overseas: market size of the host country, business presence in the home country, cultural distance, openness of the host country, international competitive advantage, oligopolistic reaction, and growth potential of company size. They compared nine diverse service industries in Japan, Europe, and North America over two periods (1976-1980 and 1980-1986) using data from the United Nations Center on Transnational Corporations. Table 2 shows the results for each country. The analysis found that only oligopolistic reaction and the openness of the host country consistently appeared as decision factors in both periods and regions.

**Table 2.** Factors Influencing Foreign Investment Decisions

Period	U. S	Japan	Europe
1976-1980	Openness of the country of entry, Oligopolistic response, Business presence in home country	Openness of the country of entry, Oligopolistic response, Business presence in home country, International competitive advantage	Openness of the country of entry, Oligopolistic response, Market size, Business presence in home country, Growth potential of company size
1980-1986	Openness of the country of entry, Oligopolistic response, International competitive advantage	Openness of the country of entry, Oligopolistic response, Market size	Openness of the country of entry, Oligopolistic response, Market size, Business presence in home country, Growth potential of company size
Source(s): Li and Guisinger (1992), pp. 10-12			

From these results, they argued that the importance of decision factors for internationalization varies depending on the host country and the time of expansion. Additionally, the most important factors influencing international expansion were oligopolistic reaction and the host country's government policies.

Regarding factors influencing the decision to internationalize for service companies, Bojorkman and Kock (1997), and Coviello and Munro (1995) conducted research from the perspective of networks. Coviello and Munro (1995) conducted a case study of four software companies in New Zealand, examining the use of network relationships for international market entry and international marketing activities. They found that opportunities arising through formal (business relations) and informal (family, friends) networks led to international expansion rather than decisions made solely by the management.

In summary, the environmental factors influencing the decision to expand internationally were examined. For some service industries, client following, a factor not typically seen in manufacturing companies, was a crucial factor in initial overseas expansion. However, the motives for internationalization were found to be multifaceted and not solely explainable by client following factors.

These environmental factors approach studies point out the limitation of not being able to explain why some companies can expand internationally under the same environmental conditions while others cannot. To address this issue, some studies have examined the perspective of the companies themselves as internationalizing entities. The next section will review these studies.

## 2.2. Internal Company Factors Approach

In contrast to the environmental factors examined in the previous section, research has also been conducted to clarify the factors influencing the decision-making for overseas expansion from the internal company perspective.

Winsted and Patterson (1998) analyzed data from 647 engineering consulting firms to examine the differences between service companies that expanded overseas and those

that did not. The results indicated that, first, non-exporting companies perceive a lack of know-how and resources as significant barriers to internationalization. Second, both exporting and non-exporting companies recognize issues of environmental adaptation, costs, and uncertainty as factors in overseas expansion. Third, exporting companies have a more positive attitude towards the suitability of their services for overseas markets and the benefits of internationalization compared to non-exporting companies. Fourth, intensified domestic market competition impacts exporting companies more than non-exporting companies.

These findings revealed that the differences in decision-making for internationalization between companies that expanded overseas and those that did not lie in the perceived barriers to export, attitudes towards export, and recognition of intensified domestic competition. Additionally, the most crucial factor prompting exporting companies to internationalize was the recognition of high suitability of their services for overseas markets, followed by market opportunities, managerial objectives, and lastly, client following.

Cort et al. (2007) analyzed data from 152 professional service firms in the United States to identify factors influencing managers' motivations for internationalization. The results showed that the uniqueness of the services provided negatively impacted managers' motivations for internationalization. Managers perceived that their unique services would make successful internationalization challenging, thus negatively influencing the decision to expand overseas.

In summary, the internal company factors approach research highlights that from the perspective of companies as the subjects of internationalization, the ability to adapt their services to overseas markets is a crucial factor in the decision-making for internationalization of service companies. Notably, Winsted and Patterson (1998) emphasized the difference between service companies that expanded overseas and those that did not lie in their ability to adapt their services to foreign markets. However, the question of how service companies adapt their services to overseas markets and why it is possible remains unanswered, posing a challenge for future research.

### **3. Research on the Applicability of Manufacturing Industry Internationalization Theories**

In the study of the internationalization of the service industry, the central debate has been around the question, "Are existing theories modeling the internationalization behavior of manufacturing companies applicable?" Groups like Agarwal and Ramaswami (1992), Terpstra and Yu (1988), and Weinstein (1977) argue that these theories are applicable, while groups like Erramilli (1990, 1991) and Erramilli and Rao (1990, 1993) argue that significant modifications are needed. This section reviews these studies to clarify the factors behind the opposing views.

#### **3.1. Positive Stance on the Application of Existing Manufacturing Theories**

Weinstein (1977) analyzed data from 150 American advertising agencies to examine external and internal environmental factors influencing overseas investment

behavior. The study found that before 1950, direct foreign investments were more common, but after 1950, joint ventures (with a 55% investment ratio) became more prevalent as companies gained more experience and grew larger. Although manufacturing companies tend to invest directly overseas more frequently than advertising agencies, the latter also shifted from initial direct foreign investments to joint ventures, similar to manufacturing companies. Based on these findings, Weinstein argued that the overseas investment behavior of advertising agencies does not differ from that of manufacturing companies.

Terpstra and Yu (1988) conducted an empirical analysis of the top 20 large American advertising agencies to examine the impact of location and company advantages on overseas investment behavior. The results indicated that American advertising agencies, first, expand into countries with larger market sizes; second, geographical distance does not have a significant impact; third, larger companies have a higher tendency to expand overseas; fourth, companies with accumulated overseas experience have a higher tendency to expand internationally; fifth, they respond oligopolistically to international expansion; and sixth, they expand overseas following existing clients from their home country.

Based on these findings, they, similar to Boddewyn et al. (1986), argued that the foreign direct investment (FDI) theory modeled on manufacturing companies is also applicable to the service industry. They also claimed that Dunning's eclectic paradigm theory is applicable. However, they noted that oligopolistic reaction has a greater impact on the overseas investment activities of service companies compared to manufacturing companies. Additionally, they foresaw that market internationalization and international competition in advertising agencies would accelerate internationalization, and client following would continue to drive overseas expansion.

Agarwal and Ramaswami (1992) analyzed data from 97 American rental service companies to examine how ownership advantage, location advantage, and internalization advantage factors in Dunning's (1988) eclectic paradigm framework influence entry mode choice. The analysis revealed six key findings. First, companies with less international experience and smaller size tend to choose potentially high markets through joint ventures. Second, companies capable of product differentiation recognize that high-risk markets may erode their advantages. Third, companies are interested in high-potential markets but tend to avoid investments due to the presence of investment risks. Fourth, when the recovery profit through alternative entry modes is high, companies avoid export entry modes. When risks remain high through alternative entry modes, companies lean towards export entry modes. Fifth, companies with differentiated product development capabilities tend to internationalize through joint ventures in high-potential and high-contract-risk markets. Sixth, companies with differentiated product development capabilities lean towards sole investment entry modes in high-contract-risk markets. The results suggest that companies are sensitive to investment and contract risks, but high product differentiation capabilities can offset these risks. Interestingly, it indicates that companies exert market power through product differentiation advantages rather than size.

These studies attempted to apply variables from foreign direct investment theory and eclectic theory to service

companies, concluding that the internationalization behavior of service industries does not differ from that of manufacturing companies. However, a notable critique is that these studies targeted single service companies despite the diverse nature of the service industry and discussed without considering the characteristics of services.

### **3.2. Negative Stance on the Application of Existing Manufacturing Theories**

Contrary to the positive stance, scholars who argue for the need to modify existing manufacturing theories have analyzed a variety of service industries, not just single service companies, to study the internationalization behavior of the service industry.

Erramilli (1990) focused on the simultaneity of production and consumption among the characteristics of services, classifying service industries into "hard services" and "soft services." He stated that the forms of internationalization differ between these two types of service industries based on their characteristics.

"Hard services" are provided in tangible forms, like DVDs or blueprints, that can be offered to customers. In other words, production and consumption are separated, making it possible to export products produced in one country to another. Representative services include design services, packaged software, engineering design, R&D services, and some banking services.

On the other hand, "soft services" cannot separate production from consumption, making it impossible to export them to other countries. As such, the methods of entering overseas markets for soft services are limited to forms like contracts, licensing, franchising, or direct foreign investment. Representative services include healthcare, advertising, hospitality, fast food, car rental, and management consulting.

Additionally, Erramilli pointed out that even within the same industry, the entry modes differ. For example, within the computer industry, software service companies fall under hard services, while data processing service companies fall under soft services. He highlighted that the choice of entry mode is influenced by whether production and consumption can be separated, even within the same industry. This finding reveals that service companies' forms of internationalization differ based on the characteristics of the services they provide.

Erramilli (1991) analyzed data from 157 American service companies to examine the impact of experience on market selection and entry mode choice. The results indicated that, first, for market selection, service companies with less experience tend to choose culturally closer locations, but as experience accumulates, they expand to culturally distant locations. Additionally, the breadth of experience has a greater impact on market selection than the length of experience. Second, for entry mode choice, service companies initially choose high-control modes when they first internationalize with little experience. As experience accumulates, they shift to low-control modes but eventually return to high-control modes with further experience accumulation.

Erramilli and Rao (1990) analyzed survey data from 175 diverse American service industries to examine how the client following motive, a characteristic of service industries not seen in manufacturing companies, influences entry mode choice. The results showed that, first, client-following-driven

internationalization tends to choose more aggressive entry modes, such as sole investment without partners, compared to providing services to local market customers. Second, companies expanding internationally through market seeking tend to prefer cooperation with external partners.

Erramilli and Rao (1993) analyzed how factors such as simultaneity of production and consumption, capital intensity, cultural distance, company size, and country risk influence entry mode choice from the perspective of asset specificity. The results indicated that, generally, service companies with low asset specificity prefer shared-control entry modes. Furthermore, the tendency for shared-control entry modes strengthens when services cannot separate production and consumption, when the risk of the host country increases, and when the company size is small. These studies from a negative stance on the application of existing manufacturing theories highlight that the internationalization behavior of service companies differs from that of manufacturing companies due to the characteristics of services and the diverse nature of service industries.

This section reviewed the debate on the applicability of existing manufacturing theories. The existing research assumes service industries as the residual sector of tertiary industries based on industrial structure classification criteria. Since the industrial structure classification aims to analyze the actual and changing composition of industries, it does not consider the concept of services, resulting in subtle differences in the characteristics of services across different service sectors. Consequently, existing theories may be applicable in some service sectors but not in others, causing the opposition between the two stances. For example, as Erramilli (1991) pointed out, discussing hard services, which do not sell the utility of service activities themselves, as service industries can be problematic.

## **4. Challenges in the Study of Internationalization of the Service Industry**

Above, the studies discussing the internationalization of the service industry have been categorized into two types for analysis. Below, with the central questions of "Why can service companies expand internationally?" and "Within the service industry, why can some companies internationalize while others cannot?" I will organize the implications from existing research.

First, regarding the factors influencing the decision-making of service companies to expand internationally, we examined studies focusing on environmental factors and those focusing on internal company factors. From the perspective of this paper's central questions, focusing on internal company factors, the difference between companies in the service industry that expanded internationally and those that did not lies in their "ability to adapt their services to foreign markets." However, the specific nature of this ability and how companies bring and adapt their services internationally remain as challenges to be addressed.

Second, regarding the debate on the applicability of internationalization theories of manufacturing companies, the opposing factors in this debate are due to studying the tertiary industry as the "residual sector" within the industrial structure classification aimed at analyzing the actual and changing composition of industries. Since this tertiary industry

classification does not consider the concept of services, "the characteristics of services" subtly differ across various fields within the service industry. Therefore, existing theories of manufacturing companies may be applicable in some service sectors but not in others. To resolve such issues, it is necessary to classify and discuss the service industry based on "the characteristics of services."

## 5. Conclusion

This study reviewed the internationalization of the service industry, focusing on decision-making processes and the applicability of manufacturing industry theories. Successful internationalization for service companies depends on their ability to adapt services to foreign markets, yet the specifics of this adaptability remain underexplored. Additionally, existing theories for manufacturing firms do not universally apply to the diverse service sectors due to distinct characteristics. To better guide service companies in their internationalization efforts, future research should refine these theories to consider both external environmental factors and internal company capabilities, ensuring a comprehensive approach to understanding and facilitating service industry internationalization.

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