

# Identifying Factors Influencing Entry Mode Selection in Food Industry of Small and Medium-sized Enterprises (SMEs) in Iran

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## Abstract

As internationalization increases in today's business society, it becomes ever more important for individual business to keep us with the development. The way a company ventures from its domestic market to new geographical markets and selecting the right entry modes are important decision that demands a lot of resources and planning. In the process of selecting entry modes a wide range of factors must be taken into consideration before making the final decision. To provide a better understanding of the impact of some internal and external factors on Iranian SMEs in food industry we chose a conceptual framework from Root and studied its variables in our sample. This model states that a) target country market factors, b) target country environmental factors c) target country production factors and d) home country factors as external factors and e) country production and f) company resource/commitment factors as internal factors have impact on the process of choosing entry modes. In order to collect data we use questionnaire. Our findings illustrated that all of the factors were mentioned in Root's model had impact on selecting entry modes to a foreign country.

**Keywords:** small and medium-sized enterprises, internationalization, entry modes, internal factors, external factors

## 1. Introduction

Nowadays globalization is turned into one of the most important challenge of enterprises and they attempt to find new markets for their products even beyond geographical borders. One of the most important problems in this field is selecting foreign markets and their entry mode. Whereas in the present world the issue of international trade is inevitable, obligation of such activities made enterprises to carefully study internal and external environment of competition. Enterprises greatly attention to this issue that for being successful in competitive environment, it is required to enter correct place by correct mode. To obtain this goal it is necessary to have enough recognition of entry modes. Being familiar with these methods, enables managers that by considering internal and external condition of enterprise, should select the best entry mode and obtain their goals. According to statistics of Ministry of Industries there is 7370 active food industries unit in Iran producing more than 25 million ton agricultural products. With respect to level of production, this industry fall within second productive industry of Iran covering one third of productions of Iran. On the strength of statistics of Ministry of Commerce, Trade Development Organization, Customs Department and Food News Site that is regarded as news agency for food industries, there are less than 1000 exporting units in food industries that due to absence of exact statistics, there are many small enterprises that sometimes export their products and stop working for long term. These statistics show importance of food industries in production of Iran and it is required pay more attention toward problems of this industry. With respect to this fact that reports of Ministry of Industries, show there are 94% of SME in Iran, it is required to recognize factors influencing activity, requirements and impediments of this industry.

### 1.1 Internationalization

Researchers defined internationalization as process in which enterprises increase their involvement at internationalization process (Welch & Luostarinen, 1988, Johansson & Vahlne, 2009). Some researchers defined internationalization as process in which enterprises increase their awareness of direct and indirect influence of

international exchanges and create relationship with foreign markets. Calof & Beamish (1995) referred to internationalization as process of adapting operations of enterprise (strategy, structure, resource) with international environment. Process of internationalization show that how a firm attends at international field and is a gradual process (Calof & Beamish, 1995:116). Generally an enterprise begins its activity from local market and gradually develops it to other markets (Ronkainen & Czinkota, 2004:57). All enterprises do not follow from same pattern and each of them adapts their strategies to internationalization depending on their conditions and facilities. Among internationalization studies, the internationalization model of Uppsala is the most well-known model. This theory insists on 4 topics that enterprises face while involving in internationalization process including: market knowledge, market commitment, decisions related to commitment, method of fulfilling current activities; in which, all of these 4 factors are correlated within one cycle. This model describes that present status of enterprise is regarded as important factor for determining further changes and next stage. Status aspects are determined through commitment of enterprise to external market, knowledge about different type of markets and local operation. Change aspects are including: decisions related to commitment and method of fulfilling current activities. Johanson and Vahlne (2009) studied internationalization process with respect to ever-growing or cumulative learning and concluded that knowledge is obtained through experience of market which increases commitment of company. Uppsala model challenged network theoreticians during recent years. They raised this issue that modern or high tech enterprises do not apply from gradual entry processes; rather they apply from more prompt process of internationalization through experience and resources of network partners (Johanson & Vahlne 2009: 1412). Literature related to network model deals with this discussion that enterprises don't operate within seclusion environment; rather they operate through having different relationship with suppliers, customers, rivals and others. These relations are created by a network of relations with internal dependency (Dehdashti Shahrokh 104: 2007). Network creation is regarded as a resource for obtaining knowledge of market; in which without having such network, it takes long time to obtain such information. Therefore, networks are mechanisms for more quick and simple internationalization (Mitgwe 2006: 16). Innovation based models study the process of internationalization of enterprises, through innovative approach. According to this model, the issue of internationalization is regarded as learning process for accepting innovation or a new idea. Within innovation models each successive stage is regarded as an innovation which shows internationalization process on step by step stage and like Uppsala model insists on ever-growing and cumulative nature of internationalization process (Dehdashti Shahrokh 109: 2007). International entrepreneurship is an international study in relation to behavior of entrepreneurs and insists on activity of entrepreneurs in relation to understanding situations for obtaining new products and service and analyzes its different modes. McDougall & Oviatt (2005) defined international entrepreneurship as finding, showing reaction, evaluation and utilization of situations as a result of products and service beyond borders of countries (McDougall & Oviatt, 2005: 539-540). International entrepreneurship theory refers that entrepreneurship behavior of people is basis for their entry to international markets. Another definition of International entrepreneurship was offered by Stevenson & Jarillo (1990) as: managed value creation process; in which, person shows innovative, active and risky behavior to benefit from international business situations of international market (Stevenson & Jarillo, 1990: 23).

### *1.2 Factors Influencing on Selecting Entry Mode to International Markets*

Enterprises in order to enter external markets apply from different methods and there many factors greatly influencing on this decision. Recognizing these factors is very important for enterprises; therefore, several studies are performed with the goal of recognizing and classifying these factors. Common point of these studies is classifying these factors into internal and external factors. Internal factors are factors influencing on decisions of organization in relation to mode of entering to external markets. External factors are factors out of direct control of organization that are able to influence selecting entry mode to market. Root in year 1994 referred that finding out how external factors influence selecting entry mode to market depends on internal factors (figure 1).

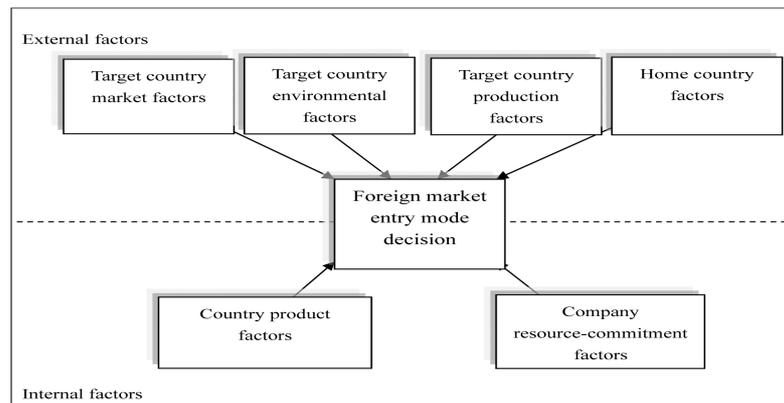


Figure 1. Factors influencing on selecting entry mode with respect to approach of Puljeva & Widen 2007: 12

Internal factors in Root's model are:

*Country product factors:* Root referred that very distinguishing product with specified benefits in comparison to competitive product, offers considerable pricing value to the seller. In contrast, non-distinguishing product should compete for minimum possible price. Therefore, some products are manufactured and exported; however, some non-distinguishing products are able to produce in appropriate place by using methods including: production contract or investment in stock of enterprises.

*Company resource-commitments factors:* Root mentioned that resources of enterprise including: management, capital, technology, production skills, marketing skills influences on selecting entry mode to market and more broad accessible resources, enterprise is more free for making decision. Within limited resources, enterprise only selects solutions requiring fewer resources and commitment.

External Factors are including:

*Target country market factors:* Current size of market and its anticipation in future has great influence on entry mode. Root stated that another aspect of target market is its competitive structure. Complete competitive market is more appropriate for complete exclusive or multi exclusive market; in which, entering it requires selecting suitable investment method to enable enterprise for over-coming dominant enterprises.

*Target country production factors:* Root stated that quality, quantity, cost of raw materials, workforce, other production factors in target market, economic infrastructures and cost of using them in target country (transfer, communication etc) has considerable influence on decisions for entry to market.

*Target country environmental factors:* Root stated that political, economic, cultural and social property of target market has considerable influence on selecting entry mode to market and the most important of them is governmental regulations and policies in relation to international business. Another environmental factor is geographical distance. Properties including: national gross production, interest rate, per capita income has close relationship with size of market of target country. Cultural distance has great importance; since, enterprises prefer to be more close to culture of target country.

*Home country factors:* Market, product and environmental factors of origin country influence on selecting entry mode to external markets. Having great local market enables enterprise to growth enough before entering international market. Competitive structure of origin market influences on entry mode. Enterprises in exclusive industry prefer to imitate their rivals. Finally another 2 factors related to origin country are including: firstly, great cost of production in origin country that encourages target country to pay more attention method of production in target country and issuing license, production contract and investment easier. Secondly, policy of government in relation to export and foreign investment by internal enterprises (Puljeva & Widen 2007: 12-13).

Koch offered a comprehensive model in relation to process of selecting market and selecting entry mode to external market in year 2001 and based on Root model, classified all influencing factors into internal and external factors. Internal factors influencing on selecting entry mode to external market based on Koch model are including: size of enterprise and its resources showing accessible resources of enterprise, place of management control in making decision, attitude of management toward risk, share of target market, method of calculating profit and loss or costs, profitability goals such as: low but guaranteed profit, quick flow of profit and previous record of using entry modes to market. In continuation Koch referred to several external factors influencing on

entry mode to international markets including: applicability of entry modes in another countries which are prohibited by law of some countries, business environment properties of foreign countries, growth rate of market, necessity of creating mental image of brand as a progressive issue in market, suitable entry modes to external markets, impediments of market including: tariff, share based on importing product, governmental and trading rules (Koch 2001: 353). Brahno and Shilt offered a similar model in year 2001 which described internal and external factors for selecting suitable distribution method (Backlund & Suikky 2005: 16).

### 1.3 Entry Mode to International Markets

There are several entry modes to global markets that enterprises select one of them according to their resources, products, conditions of internal market, available opportunities in global market, previous experiences. Each mode has its own advantages and disadvantages and person making decision should select appropriate mode by regarding different aspects. Several researchers have classified different entry modes, for example, Brassington and Pettitt neglect different forms of counter trade and they observe modes for payment (Backlund & Suikky 2005: 18). In addition regard strategic alliance as a separate entry mode; meanwhile, Bradley (2005) refer to conferring franchise, joint venture and management contract as different forms of strategic alliance (Bradley, 2005: 275). Table 1 introduces some entry modes to international markets with short description, advantage and disadvantage for each method.

Table 1. Different entry modes to foreign markets

<i>Entry modes</i>	<i>Different mode</i>	<i>Advantage</i>	<i>Disadvantage</i>
Export	<i>Indirect</i> : the simplest entry mode to a foreign market is using a mediator for transferring product to abroad (Daneils & Radbaugh, 2008: 603). Generally in elementary stage, it is used from international activity	* Quick entering to market without requiring to make investment * Low risk	* Low profitability
	<i>Direct</i> : directly exporting products of enterprise by enterprise itself or its representatives	* High ability of controlling product * High profitability	* Expensive cost * Time consuming
Strategic Alliances	<i>Lisencing</i> : concluding contract with a foreign enterprise for assigning privilege of using a production process, brand, trading secrets in return of receiving money as remuneration (Kotler 2009: 448)	* Low risk * Quick obtaining to superior technology * Improving service in local market	* Potential rival * Nearly low profitability
	<i>Franchising</i> : special mode of conferring license in relation to thinking and intangible assets; in which, enterprise offering privilege confers right of using intangible assets such as: trading name in the field of service and retailing (Selden, Gipson & Parker, 2008)	* More control over process * Obtaining benefits of stabilized business * Nearly high rate of capital return	* Great requirement to control * Unsuitable influence of inappropriate activity of person having license on validity of brand
	<i>Joint venture</i> : bilateral agreement for establishing a new common and independent enterprise with the goal of benefiting technical knowledge or market of both parties and over-coming political and economic impediments. Generally one party supplies technical knowledge and capital and another party prepares physical facilities including: land, building, human workforce (Haghighi 2009: 236-237)	* Considerable decrease in political and economic risk * Access to advanced technology * Benefiting local support * More control over production and marketing	* Requirement to great initial investment * Probability of cultural paradox * New rival for enterprise holder of technology

	<i>Management contract:</i> assigning management knowledge when enterprises have enough capital and knowledge for establishing business and only require set of management knowledge and to obtain this goal they assist skilful enterprises (Spencer 1994: 130)	<ul style="list-style-type: none"> <li>* Low requirement to initial investment</li> <li>* Lack of risk for dispossession</li> <li>* Quick benefiting from advantages</li> </ul>	<ul style="list-style-type: none"> <li>* Lower income toward other modes</li> <li>* Lack of requirement to management service after expiration of contract due to obtaining experience</li> </ul>
Foreign Direct Investment	<p><i>Acquisition:</i> a foreign enterprise purchase a local enterprise either in whole or part (Kim &amp; Lyn 1990: 48)</p> <p>Subsidiary branch: establishing a branch in abroad (Kim &amp; Lyn 1990: 49)</p> <p><i>Production collaboration:</i> cooperation of a foreign enterprise with a country for establishing productive business. Upon termination of contract the foreign enterprise pays partnership share of local government and operates as independent enterprise (Kim &amp; Lyn 1990: 49)</p>	<ul style="list-style-type: none"> <li>* Developing market</li> <li>* Using cheap workforce</li> <li>* Better access to cheap raw materials</li> <li>* Releasing tariff and limitations</li> <li>* Educating skilful human workforce</li> <li>* Creation of employment opportunities</li> <li>* Developing subsidiary industries</li> <li>* Increasing income due to tax</li> </ul>	<ul style="list-style-type: none"> <li>* Negative change in consumption pattern</li> <li>* Destructive cultural influences</li> <li>* Political influence of superpowers</li> <li>* Not observing national benefits</li> <li>* Prevention from growth of poor local units</li> </ul>

#### 1.4 Small and Medium Sized Enterprises (SMEs)

SME is the phenomena of modern world. These enterprises are established following up requirement to small, dynamic and flexible organizations to meet ever-growing changes. Most of these enterprises are based on entrepreneurship and attempt to find better solutions for fulfilling affairs. There is no exact definition of SME and this term covers different type of enterprises. Definition of SME generally refers to number of employees in such enterprises, method of management and formulating strategy (Ghanatabadi 2005: 43). Some definitions are greatly dependent upon intensity of quantitative and operational criterions for describing nature of such enterprises including: number of employees, annual sale, value of asset and added value (Analouei and Karami 2008). The best definition of SME was offered by Bolten Committee in year 1971 referring that SME is a type of enterprise which has low partial ratio in a competitive market, is not able to influence on price, or in case of being non-profit making organization it has low influence over its field and management greatly intervene at all aspects of making decision. Within a trading organization, managers are either owners or partners, are finally independent or manager/owner has effective control over business activities; although, manager probably has limited freedom for fulfilling his commitments. European Union has introduced business according to number of employees including: micro enterprise with 9 employees, small enterprise with 10 to 99 employees, medium enterprise with 100 to 499 employees. European Commission carried out research in relation to enterprises with employees less than 250 persons and concluded that enterprise with annual cash flow less than 50 million Euro or annual balance sheet less than 43 million Euros is called SME (UC Economic Report, 2005: 5). Some common properties of SME in all definitions are including: limited resources, informal managerial style, flexibility and more organic organizational structure (Hollensen 2004: 417). Quick flexibility and reaction of SME permit them to quickly show reaction against environmental changes. According to global statistics, SME cover nearly 80% of global trade and created 50% to 60% employment opportunities all through the world (UNIDO 2002). Rate of establishing new enterprises is regarded as criterion for dynamic economy, important resource of employment and obtaining competitive advantage; in which, most of these newly established enterprises are SME (Islam Masum & Fernadez 2008: 5). On the other hand, global movement from mass marketing to concentrating on part of market encouraged small enterprises to stabilize their status as activists of small sectors (Dehdashti Shahrokh 2003: 9). Before an enterprise starts internationalization, a person of thing should start strategy for internationalization process either from inner or outer of organization. Preference and determination of enterprise for internationalization is influenced by available situations in global markets. In fact, selecting suitable strategy for internationalization of process is very challenging at SME (Knight & Kim 2009: 258). There are 2 methods for analyzing decision of SME for obtaining internationalization. When enterprise plans to be internationalized, the management team should be aware to fulfill type of activities in order to prevent from situations of market. These encouragements for internationalization are called proactive factors.

Encouragement factors that are created to show reaction against changes of market and passive approach against market situations are called reactive factors (Islam Masum & Fernandez 2008: 8).

## 2. Research Method and Data Analysis

### 2.1 Sampling & Collecting Data

Statistical universe of this research is all managers, foreign commerce experts and manufacturers of foods selling part of their products to international markets. To collect required data, a questionnaire was designed and sent to 120 enterprises. After following up, 83 questionnaires were returned which showed that 69% of respondents have answered to the questionnaire. 3 questionnaires were not analyzed due to incomplete response to some of its questions. Final analysis was performed over 80 questionnaires. This study applies from questionnaire having 31 questions; in which, 6 questions dealt with assessing job position, education, work record, level of export, income of enterprise from international activity, entry mode for entering to foreign markets and 25 questions dealt with assessing 6 research hypothesis. Alpha Cronbach of questionnaire was 0.70 which shows acceptable level of validity. In order to analyze hypothesis and studying conceptual model, first of all it is required to study sample demography in short. Table 2 offers summary of general questions available in questionnaire. Number 1 at the end of table refers to export, number 2 refers to conferring license, number 3 refers to establishing productive unit of enterprise, number 4 refers to sale subsidiary of enterprise and number 5 refers to joint venture.

Table 2. Summary of general questions available in questionnaire

Variables	Choices	Frequency	Percentage
Job position	Managing director	4	5
	Commercial manager	12	15
	Sale manager	8	10
	Export manager	8	10
	Marketing manager	7	8.75
	Marketing expert	12	15
	Sale supervisor	5	6.25
	Export expert	8	10
	Marketing supervisor	3	3.75
	Marketing expert	13	16.25
	Education	Bachelor's degree	55
Master's degree and over		25	31.25
Work record	5 years	26	32.5
	5-10 years	23	28.75
	11-16 years	27	33.75
	16 years and over	4	5
Level of export to total production	Less than 5%	10	12.5
	5%-25%	56	70
	25%-50%	12	15
	50%-75%	2	2.5
Income of international activities to total income	Less than 5%	2	2.5
	5%-25%	65	81.25
	25%-50%	11	13.75
	50%-75%	2	2.5
Using different entry modes	1	53	66.25
	1,3	3	3.75
	1,4	12	15
	1,5	2	2.5
	1,3,4	6	7.5
	1,2,3	2	2.5
	1,4,5	2	2.5

### 3. Results

To test hypothesis and select suitable method, first of all we test normal universe by using Kolmogorov-Smirnov test. At significance level of 0.05 it is observed that normal data is rejected and by observing hypothesis, we test research hypothesis by using Wilcoxon signed-rank test.

H0: average desired variable is 2 and less.

H1: average desired variable is not 2.

#### 3.1 Research Hypothesis

1<sup>th</sup> Hypothesis: Home country factors influence on selecting entry mode to international market

2<sup>th</sup> Hypothesis: Target country production factors influence on selecting entry mode to international market

3<sup>th</sup> Hypothesis: Target country environmental factors influence on selecting entry mode to international market

4<sup>th</sup> Hypothesis: Target country market factors influence on selecting entry mode to international market

5<sup>th</sup> Hypothesis: Company resource/commitment factors influence on selecting entry mode to international market

6<sup>th</sup> Hypothesis: Country products factors influence on selecting entry mode to international market

Table 3 offers summary for result of hypothesis test.

Table 3. Summary of results

Hypothesis	Z	P-value
Home country factors	2.2689	0.9884
Target country production factors	7.2136	1
Target country environmental factors	6.4057	1
Target country market factors	8.0736	1
Company resource/commitment factors	4.4292	1
Country products factors	7.5373	1

By comparing P-value at significance level of 0.05 it is observed that H0 for all research hypotheses is accepted i.e. all factors of Root model with respect to sample enterprises influence on selecting entry mode to foreign market. In order to study whether importance of these factors is equal for process of selecting entry mode or not, it is used from comparing equal average hypothesis through freedman test. Results of freedman test are including:

Table 4. Results of freedman test

Hypothesis	Average rank
1 <sup>th</sup> hypothesis	2.35
5 <sup>th</sup> hypothesis	2.75
3 <sup>th</sup> hypothesis	3.41
2 <sup>th</sup> hypothesis	3.87
6 <sup>th</sup> hypothesis	4.21
4 <sup>th</sup> hypothesis	4.41

### 4. Discussion

Food industry cover one third of total productions of Iran which falls within second rank of heavy industries. This issue refers to great importance of this industry in developing production of Iran; however, this industry has several problems. According to potential ability of food industry in Iran and necessity of entering to global markets and finding suitable place, carrying out research is very influencing for improving this industry. On the strength of findings of research, all enterprises were asked whether they apply from export for entering to foreign market or use export next to other methods. Findings of general section of questionnaire reveal that considerable number of enterprises (82.5%) export less than 25% of their products; therefore, their income as a result of international activities is less than 25%. This issue reveals that international activity is neglected by manufacturers. Impediments of SME for entering global markets are including: lack of having enough

information, difficulty of communication with foreigners, lack of having technical knowledge related to activity, lack of having information related to documents and working procedures and fearing of some ambiguous items. Some of the most important reasons of not welcoming entrance to international level are lack of having clear and exact information in relation to global and internal markets. Some foreign institutes prepare required information of enterprises; however, great cost of using such information for Iranian enterprises is not appropriate. Therefore, active SME in food industry require having center with up-to-date and trusted information about global markets. Some enterprises have powerful financial resource and experience by having management of persons fully aware of foreign activities; however, they do not prefer to use joint venture method. Through establishing support mechanisms of SME, suitable grounds are created for activity of enterprises at international level. Therefore, government of Iran should increase its support for Iranian enterprises preferring to enter international activity and stabilize their status at global markets. These supports are including: export bonus, tax exemption, offering loan, required guarantees for activity at international level and preparing safe environment for international activity that in addition to encouraging activists groups to export operation to prepare suitable grounds for attracting foreign investment. Recognizing available situations in global market is regarded as encouragement for enterprise to operate at international level. It seems that poor performance of SME is due to being unaware of potential resources of activity at international level. Some exporter enterprises due to having access to some resources as SME, access to small markets and identify profitability business, prepare correct and exact information in relation productive units in other countries. Iran due to its good climate condition and selecting appropriate policies has ability of preparing reasonable raw materials for food industry. The main problem of Iranian enterprises in this field is not having enough attention to expectation of global punctilious customers, so that many SMEs exporting food industry are turned into suppliers of raw materials for foreign enterprises such as exporting: dry foods, Iranian confectionary on wholesale basis and the main profit of this activity is obtained by mediators.

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