How Can International Firms Select Beneficial Foreign Locations for their International Operations?

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INTRODUCTION

Overall, the international business (IB) phenomenon has received growing research attention during the last decade; one reason for being that increasing interest relates to the significant contribution of the international business movement to the economic development in both home and host countries (Calle Pardo 2001; Jansen and Stockman 2004; Leo and Neil 1991; OECD 2002)

According to the 'eclectic paradigm of international production' proposed by Dunning (1980, 1988), firms which decide to internationalize their business activities and have international operations confront a very critical, challenging and strategic decision which relates to deciding about the foreign location or country for their international operations. Once the country has been selected, international firms have to choose the most appropriate entry mode strategy to enter that selected foreign market such as exporting, franchising, licensing, joint venture and wholly owned subsidiary (Edwards and Buckley 1998; Buckley and Casson 1998; Hill et al. 1990)

Recent researchers in the area of the performance of international firms have found empirically that the host country characteristics of international operations are a critical determinant of the success or failure of international firms (Christmann et al .1999; Dimitratos 2002; Liu Yingli et al. 1999; Vanhonacker and Pan 1997). Accordingly, international firms have to select a beneficial foreign location for their international operations to avoid their forcible withdrawal from the foreign marketplace. As a result, based on Dunning's (1980, 1988) model and on the empirical findings of research on the performance of international firms, there is no doubt that selecting the foreign location for the international operation is one of the highly multifaceted, critical and risky strategic decisions facing internationalizing firms; the decision must be made mindfully because the failure to select the right location would cause painful injury to the firm and lead to serious financial losses (Goldstein 1985).

Research into the location decision of international firms has examined widely motivations of firms locating their foreign operations in particular countries. In other words, most of the extant studies on the location decision in international business have focused on uncovering important factors that influence the perceived attractiveness of a country for inward foreign direct investments, such as access to markets, infrastructure facilities, the presence of competitors, political and economic stability, foreign investments polices, market size, market growth, access to raw materials and low-cost labour (Bhatnagar et al. 2003; Boddewyn and Brewer 1994; Edwards and Buckley 1998; Edwards and Buckley 1997; Glaister and Tatoglu 1998; Johanson and Vahlne 1977; Kim and Hwang 1992; Nonanka 1994; Root and Ahmed 1979; Terpstra and Yu 1988; William 1980; Yang et al. 2002). Nevertheless, the existing literature has not provided insights into the best decision-making approach for selecting a beneficial foreign location for international operations. Therefore, this paper aims to present and evaluate the most dominant strategic decision-making approaches and responds to the study central question: viz., 'what is the most appropriate decision-making approach for the selection of beneficial foreign location for international operations'?

This paper begins with a review of the current literature on the strategic decision-making theories as well as the research on international location decision-making is also reviewed. Subsequently, it discusses and evaluates the effectiveness and appropriateness of the examined

decision-making approaches in selecting the beneficial foreign locations for international operations. Finally, a suggested conceptual framework for the selection of beneficial foreign locations for international operations is presented.

AN OVERVIEW OF STRATEGIC DECISION-MAKING APPROACHES

The present literature on organizational decision-making has concentrated on two dominant decision theories: the rational decision theory and behavioural decision theory. The rational decision theory (RDT) or economic decision theory (EDT) is known also in the literature by other various terms such as normative, rational action, classical, economic, classical economic theory, perspective, rational choice, theory of profit and utility maximization and purposive actor theory. Similarly, the behavioural decision theory (BDT) has other names such as bounded rational, descriptive and stratifying behaviour theory. More specifically, in the context of strategic decision-making, the rational decision theory is widely known as maximizing behaviour, while the behavioural decision theory is recognized as satisficing behaviour (Harrison and Pelletier 1997). The assumptions of each theory are discussed in detail later.

The Rational Decision Theory (RDT)

The rational or economic decision theory is the first decision theory to be introduced in the decision-making literature. The theory is described as the quantitative method of decision-making (Harrsion 1993, IIori and Irefin 1997). The foundations of the rational decision theory (RDT) go back to the intensive work on the mathematical theory of 'games of strategy' originally developed by Von Neumann and Morgenstern (1953) and continued by Luce and Raiffa (1957). According to Straffin (1993) game theory is the rational analysis of situations of conflict and cooperation. A game is viewed to be any situation which meets the following requirements:

- There are at least two players. A player may be an individual or company, a nation, or even biological species.
- Each player has a number of possible strategies and courses of action.
- The outcome of the game will be determined by the strategies selected by each player.
- Numerical payoffs are assigned to each possible outcome of the game, one to each player. These payoffs represent the value of the outcome to the different players.

In essence, the theory of games relies on several assumptions (Luce and Raiffa 1957; Von Neumann and Morgenstern 1953). First, it is assumed that the possible outcomes of any given situation are well-identified and each individual has a consistent pattern of action and preference among them; these can be represented numerically by utility functions. Based on the utility functions, it is assumed that the player selects the lottery with the largest utility. Put another way, an individual prefers the outcome with highest utility or payoff. Second, it is assumed also that the variables that control possible outcomes are well identified; that is, all the variables and the values of given alternatives can be identified precisely. In conclusion, game theory assumes that game players are rational in their decision-making and may be relevant to decision-making in organizations. Likewise, each player knows the preference pattern of the other players and strives to maximize his utility or payoff.

According to Allison (1971), the rational decision model implies that the decision-maker thoughtfully defines the problem and determines one's own preferences as represented in numerical terms of the value of payoff or utility of a given set of alternatives. Another assumption is that the decision-maker gathers information about the specified alternative courses of actions, considers the possible outcomes of each alternative, determines the relative likelihood of occurrences evaluates and ranks all outcomes according to the predetermined preferences and, finally, selects the optimal alternative which has the maximized payoff.

The assumptions and ideologies of the economic rationalist have received great acceptance among the managers in business organizations, wherein their main goals are profits, sales and growth in resources (Kaufman 1990). Levin and Kirkpatrick (1975) claim that the rational decision approach is appropriate when the problem situation is new and complex and managers have no prior experience to rely on. Thus, it is unlikely they can reach a good solution without the assistance of a quantitative analysis such as provided by the rational model. In addition, the rational decision model is more suitable when the problem is repetitive, well-defined and made under certainty (Cyert et al. 1956).

Behavioural Decision Theory (BDT)

In spite of the fact that the rational decision approach is fundamental to several economic models and theories, organization behaviour scholars have not accepted this approach to organizational decision- making (Eisenhardt and Zbaracki 1992). The organizational theorists have criticized and challenged the assumptions of the economic rational school from different angles. Consequently, that has led to the emergence of the behavioural decision school.

Cyert et al. (1956) criticized the economic rational decision process and identified other important components that are missing from the economic model. In fact, Cyert et al. (1956) required incorporation into the economic model:

- Alternatives are not generally 'given', but should be researched; hence, it is essential to include the search for alternatives as an important part of the process.
- Information as to what consequences are attached to each alternative; which they are rarely 'given', the search for consequences is an important segment of the decision-making task.
- Evaluation for alternatives is not usually made in terms of one clear, single, criterion such as profit; thus, other intangible criteria also need to be considered. Making an evaluation based only on profit is difficult, if not impossible. Instead of searching for the 'best' alternative, the decision maker is usually concerned with finding a satisfactory alternative-one that will achieve a specified goal and at the same time satisfy a number of assisting conditions.
- In the real world, it is hard to recognise that the problem itself is 'given' and well-defined; thus, exploring significant problems that organization should consider is an important organization's task.

Furthermore, Simon (1955, 1957a) avers that the rational decision approach requires a complete knowledge and expectation of the consequences while, in reality, knowledge of consequences is always fragmentary. Likewise, in real decision-making behaviour not all alternatives are known and specified as assumed by the rationalist. However, only a few possible alternatives come to mind. Moreover, the classical criterion of rationality is not applicable to situations which involve uncertainty (Simon 1957b). These perceptions have led to the concept of bounded rationality or satisficing, suggested by Hebert Simon (March and Simon 1958; Simon 1957b) and which represents the heart of the behavioural decision theory (BDT).

Simon's bounded rationality approach (Simon 1957b) assumes that the capacity of human sense for creating and solving complex problems is very limited compared with the size of the problems that require objective rational behaviour to reach solutions. Therefore, decision-makers often lack complete information about the problem situation, the relevant criteria and the system of preferences. Time, cost and cognitive limitations hamper the decision-makers' efforts accurately to estimate the optimal choice from the available information. Often, these limitations do not allow decision-makers to reach the best or optimal decisions assumed in the rational decision model.

In their recent book 'Economics, bounded rationality and the cognitive revolution' (Simon et al. 1992) explained the concept of the decision approach. The concept of bounded rationality does not mean that human behaviour is intentionally irrational despite that it is sometimes; rather it is not based on a complete knowledge and humans statistically are not capable of choosing the optimal alternative with maximized payoff or utility. In effect, they select a satisficing choice rather than

optimal one; that is, they are 'bounded rational' rather than 'boundless rational' as described in the economic rational decision theory. Simon (1979, p.503) called this mode or strategy of decision-making the "satisficing mode of selection".

Earlier critiques and empirical findings identified the rigid grounds of the field of behavioural decision theory (BDT), which adopts the descriptive decision-making approach and describes how decisions are actually made rather than how they should be made, as adopted by the economic rational decision theory. Behavioural decision theorists have criticised the rational decision school by arguing that humans are limited cognitive information processors and they do not utilise available information; they do not follow the assumptions of normative theory in responding to uncertainties and likelihoods, nor they do not make rational trade-off among conflicting values, nor they do not always follow the maximizing or rational decision approach process (Cyert and March 1963; Simon 1978).

Because humans do not possess the required knowledge and statistical skills that are necessary to behave rationally, as proposed by the economic rational decision models, they develop a number of cognitive 'heuristics' that enable them to behave and make decisions that are definitely reasonable despite their own cognitive limitations (Kahneman and Tversky 1982). Heuristics refers to simplifying strategies or rules of thumb that people confide in when they make decisions. They are the fundamental rules that substantially guide the people in their judgments and they are significant tools for facing the complex nature of the environment surrounding decision-making (Bazerman 1986).

In the context of strategic decision-making, the satisficing behaviour approach or the bounded rationality theory assumes that, in the organization, the managerial objectives are well-defined and the rational decision-maker collects information about the objectives from various environmental sources. The collected, specified information within the organisation is used to identify a set of appropriate alternatives from which to make a satisficing choice. But the amount of information and consequent number of alternatives are bounded: first, by the lack of complete information; second, by inevitable time and cost constraints; and, finally, by the cognitive limitations of the decision maker (Harrison 1999, Harrison and Pelletier 1997). Thus, the strategic decision-maker should consider these constraints thoughtfully because they affect significantly the success of a strategic decision in any organization (Harrison 2000).

Extraordinary acceptance for the satisficing behaviour approach among the scholars in strategic decision-making has been found. For instance, the study by Mintzberg et al. (1976) contributed significantly to the academic body of knowledge on strategic decision-making in organizations. In the case study oriented research, they examined twenty five strategic decision processes for the purpose of understanding the structure of the decision processes. They challenged the rational model by concluding that not all alternatives were known, not all the consequences were mindfully considered and not all preferences are used by decision-makers as claimed by the economic rational approach; thus, decision-makers were bounded with constraints.

Similarly, the behavioural scholars argue that making decisions under uncertainty is fundamental to organisational life; indeed, dealing with uncertain situations is a common problem that all organisations share (Mintzberg 1983). Hence, it is practically impossible to choose the best alternative when uncertainty exists and consequences are ambiguous. As a result, high levels of uncertainty tend to suggest that maximizing behaviour suggested by the satisficing concept is an unrealisable choice (Tarter and Hoy 1998).

Thus, Petit (1966) alerted researchers to the fact that effective managerial decision-making requires a clear cognition of several boundaries and the rational decision-maker has distinctly limited boundary within which socially responsible decisions must be selected from among alternatives. Evidence from Katona (1951) confirms this idea inasmuch as, in the face of complexity, managers usually struggle to reach for satisfactory levels of profits or payoffs rather than maximum profits.

AN OVERVIEW OF INTERNATIONAL BUSINESS LOCATION DECISION

Conditions of International Business Location Decision

Several previous and recent empirical studies on location decision-making in international business have affirmed that the decision relates to having foreign direct investment (FDI) entails high levels of risk and uncertainty which are serious obstacles in the route of internationalization of firms (Sharon 1996; Pahud de Mortanges and Allers 1996; Mudambi and Navarra 2003; Murtaza 2003; Kobrin 1979). Hence, a good location strategy should be designed to minimize the risk and uncertainty associated with international location decision so as to select the most advantageous foreign location (Robert and Thomas 1980).

Murtaza (2003) categorized the global risk factors into three categories: economic, political and social factors. Economic factors are often numeric such as export-related risk, import-related risk, reserves-related risk and GDP-related risk. Political and social risk factors are mostly subjective and tend to reshape the social environment of a particular country; such as, culture, revolutionary activities, cross-national guerrilla wars, boycotts, religious turmoil, international terrorism, political corruption and leadership conflicts. Therefore, international firms have to be very knowledgeable about the foreign country's economic, political and social risk; a lack of knowledge about these conditions decreases the likelihood of selecting that country as the final, preferred choice during the location selection process (Benito and Gripsrud 1991).

Research on International Business Location Decision

The international business literature has focused mainly on exploring why international firms locate their international operations in certain countries (Bhatnagar et al. 2003; Boddewyn and Brewer 1994; Edwards and Buckley 1998; Edwards and Buckley 1997; Glaister and Tatoglu 1998; Johanson and Vahlne 1977; Kim and Hwang 1992; Nonanka 1994; Root and Ahmed 1979; Terpstra and Yu 1988; William 1980; Yang et al. 2002). In other words, most of the studies on international location decision have been directed toward investigating the locational determinants or factors; strategic decision-making process relating to the selection of foreign locations for international operations was not well underlined in the international business literature. For instance, the Uppsala model by Johanson and Vahlne (1977) demonstrated that 'psychic distance' determines the locational choice. Psychic distance was defined as the costs of obtaining significant information about business conditions in other countries, the perception of risk and uncertainty involved in international operations and the resources required to access foreign networks. The model asserts that the costs expended in overcoming 'psychic distance' decrease over time due to the experience achieved by the firm. Therefore, firms often first enter neighbouring markets because of their historical familiarity, and then expand to other foreign markets.

Other studies have stressed the global strategic focus of multinational corporations (MNCs) in the locational choice. Kim and Hwang (1992) affirmed that some MNCs establish subsidiaries abroad to check the cash flow of potential global competitors. Terpstra and Yu (1988) found that the size and growth of markets are important determinants of foreign investment. Consequently, a government can influence locational decisions by limiting the demand conditions through the supply of infrastructure, and taxation policies. Boddewyn and Brewer (1994) addressed the significant influence of the government taxation and industry regulations on the locational decision. A recent cross-national study conducted to compare the location factors of plant location between Singapore and Malaysia, concluded that infrastructure, suppliers and markets have significant impact upon the plant location decision in both countries (Bhatnagar et al. 2003). William (1980) identified some country specific factors which influence the location decision of the international firms; viz., market size and growth, tariff and non-tariff barriers to trade, input costs, geographic proximity and legal, political and economic conditions.

CONCLUSION AND PROPOSITION OF CONCEPTUAL FRAMEWORK

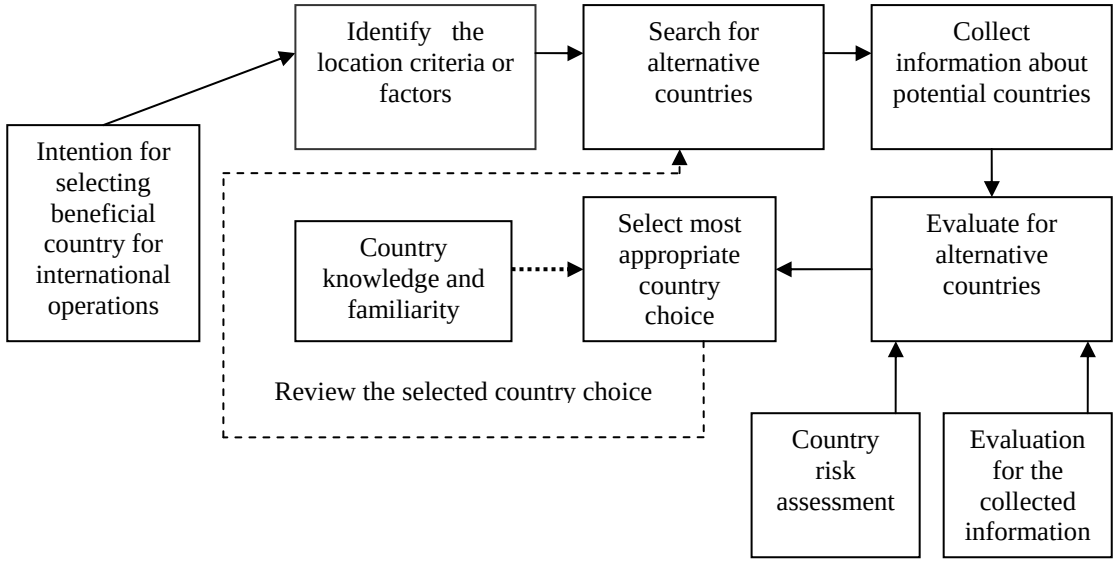
Unquestionably, the location decision concerning having foreign direct investments abroad involves immense risk and uncertainty for international firms. Therefore, the location problem of undertaking foreign direct investments is unstructured and characterized with high level of ambiguity. The maximizing behaviour decision approach requires complete control over the factors influencing the decision problem, and that degree of certainty does not exist in reality with the case of foreign direct investment decisions. Economic, social and political risk factors have a significant impact on the foreign direct investment activity because some of these factors are manageable and predictable, while others are uncontrollable and variable. In addition, foreign location alternatives are usually searched and developed by senior managers of firms based on their international business experiences or based on recommendations from other business experts and that in turn limits the number of potential country alternatives. Furthermore, achievement of complete knowledge and information about the prospective countries as assumed by the maximizing behaviour approach is not attainable and accessible in the international business-location problem due to the time and cost constraints, the global risk factors and the cognitive limitations of the decision-makers as human beings. As a result, the variability in the international business environment caused by the country risk, the time, the cost and cognitive limitations, make it difficult for decision-makers in firms to arrive at an optimal foreign location choice; although, they can achieve a satisfactory foreign location.

In conclusion, practical decision-makers go for the premise which dominates most of the strategic decision- making literature and, in accordance with the conditions of the location problem in international business, which suggests that the satisficing behaviour approach is the best decision-making approach for the selection of a beneficial foreign location for international operations. In addition, international firms can not reach an optimal or perfect foreign location choice within the unpredictable international business environment, or within the available time, cost and cognitive limitations. Accordingly, based on the former discussion about strategic decision-making approaches and international location decision factors a 'conceptual framework', as shown in Figure 1, is suggested to assist the selection of beneficial foreign locations for international operations; it relies on the satisficing behaviour decision-making approach and consideration of unpredictability in the global business environment and the country knowledge as imperative factors influencing the selection of beneficial country.

The proposed conceptual framework suggests that international firms identify their preferred location factors or criteria and the subsequent search for prospective countries should be carried out. Firms should collect information about the identified country alternatives in accordance with the pre-determined location factors. Consequently, comprehensive evaluation for the collected information and for the economic, political and social risk of each potential country required to be undertaken.

The final country choice should be selected relying on the outcomes of the comprehensive evaluation action and the decision-maker's knowledge about potential countries. In theory, the suggested conceptual framework contributes significantly to the growing academic literature on strategic decision-making in international business relating to the selection of beneficial foreign location for international operations. In practice, the conceptual framework, as a strategic decision-making tool, would assist the business decision-makers of firms seeking internationalization to improve the effectiveness of their strategic decision-making process in relation to the selection of foreign locations for international operations and; hence, for better and successful international expansion.

Figure 1 Proposed conceptual framework for the selection of beneficial countries for international operations



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