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# INTERNATIONALIZATION OF CONSTRUCTION FIRMS: WHAT STRATEGY DO THEY FOLLOW?

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**Abstract.** Globalization of markets and economic changes force companies to respond adequately and expand their activities abroad. The paper aims to adopt different approaches, developed in internationalization theory, and to present a conceptual framework focused on business internationalization strategy. The interrelations of strategic goals, organizational competencies and competitive advantage are investigated. The qualitative research method was applied and in depth interviews with the managers of construction companies were performed. The obtained results of research revealed that cooperation strategies involving customers, suppliers and competitors are seen as the main precondition for internationalization of companies. The success of cooperation strategies is based on obtained human resources, technical and management skills of companies. The author of research has elaborated proposals, which are useful for further internationalization of business. The presented paper provides new insights into the scientific theory development

**Keywords**: Strategy, competitive advantage, construction companies, strategic goals, competencies, cooperation.

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## 1. Introduction

Globalization, technological changes, intense competition, fluctuating demand of consumers, economic and political changes impact managers' decisions and encourage taking greater risks and applying appropriate strategies. Notably, growing internationalization and evolving globalization have become distinctive features of the economy. A phenomenon of internationalization has been researched by various scholars in recent years. An exhaustive research has been focused on the international strategies of the firms, the factors, motives and the forms of internationalization. On the other hand, the different approaches aiming to explain circumstances, which allow companies to use opportunities in the market and to gain competitive advantage over competitors, have been developed in the scientific literature.

Small and medium size enterprises (SMEs) play a significant role in the growth of any country's economy. Hence, internationalization of the SMEs is seen as one of the important research objectives in the scientific literature. On the other hand, international entrepreneurship approach was adopted by scholars aiming to explore various industries, but not construction industry (Abdul Aziz 2010). Taking into consideration the fact, that construction industry is the important contributor to Lithuania's economy (Korsakienė, Tvaronavičienė 2012); the paper aims to investigate strategic models or patterns adopted by construction SMEs. The remainder of the paper is organised as follows. In section 2 the concept of internationalization is provided. In section 3 the overview of different approaches toward strategy is analysed. In section 4 the methodology is presented. In section 5 main results are discussed. The final part provides discussion and concludes.

## 2. The concept of internationalization

The researches linked to internationalization of the firms are seen as the growing trend in scientific literature. Internationalization is a synonym of the geographical expansion of economic activities over a national country's border. On the other hand, a lot of attempts were made in order to clarify the "internationalization" concept. Hence, the studies focused on internationalization concept definition put emphasis on different aspects and take different approaches.

The definition provided by Welch and Loustarinen imply that internationalization is "the process of increasing involvement in international operations" (Welch, Luostarinen 1988). Hence, the firms gradually and sequentially become involved in international markets. On the other hand, the process of the firm's internationalization has been widely researched over the last four decades. The scholars explained it as a result of the globalization of industries (Petersen *et al.* 2001). Hence, domestic firms can be subject to an increased pressure to internationalize rapidly in order to respond to the actions from global competitors A main underlying premise adopted by the scholars is that domestic firms are driven into internationalization process even though they lack knowledge about international ventures.

Meanwhile, other scholars put emphasis on a changing state of the firm. For instance, Buckley and Ghauri (1993) distinguish that the growth of the firm provides a background to internationalization. Hence, the interrelationships of internationalization and the growth of the firm are emphasized. On the other hand, the scholars conclude that internationalization activities are different from domestic activities because "they entail exchange between firms located in different countries" (Agndal 2004).

The early studies of internationalization have laid theoretical backgrounds for incremental models, suggesting that the firms internationalize in small and incremental steps in nearby countries similar in terms of culture, institutions and language (Johanson, Vahlne 1977). Notably, a basic assumption of the incremental models is that the firms start international activities by first using sales agents and then making foreign direct investments (Johanson, Wiedersheim-Paul 1975; Johanson, Mattsson 1993). On the other hand, the models embrace the resource commitment to the foreign markets, market commitment, decisions to commit resources and the performance of current business activities. However, the scholars state that the incremental models are focused on traditional cross-border behavior, not on accelerated internationalization or on entrepreneurial behavior (Oviatt, McDougall 2005). Hence, the researches carried out by various scholars conclude that incremental expansion patterns reduce the failure rate of internationalization but may not increase the firm's overall profitability (Barkema, Drogendijk 2007).

The networks of business relationships explained by Johanson and Vahlne (1990) adopt the premise that the firms establish and develop various networks in order to facilitate internationalization process. The network theory embraces actors, activities and resources whose interaction influences the firm's establishment process in a foreign market. For instance, Chetty and Blankenburg-Holm (2000) conclude that internationalization takes place in three ways: through creating relationships with partner in new countries, through rising commitment in already established foreign networks and through integrating their positions in networks in various countries. Hence, the firm's position in the network and relationships with the current market impact the success of entering into new markets. On the other hand, it is common to develop networks among firms with the same technological, market and production characteristics. The researches carried out in emerging markets conclude that the firms affiliated to the networks could gain a critical source of knowledge for internationalization from current international activities taking place in the networks. Meanwhile, the access to such knowledge will facilitate the acquisitions of business and institutional knowledge compatible with the firms' internal resources and competencies (Ellango, Pattnaik 2007).

Taking into consideration the various approaches to internationalization, the author of this paper adopt the view that internationalization is expansion of firm's activities to foreign markets and could result from punctual and independent action.

## 3. The approaches to strategy

The idea that the firms, striving to adapt to the changing business environment, have to develop a viable strategy has been presented by various scholars. On the other hand, the definitions of strategy have been proposed taking into consideration different views. For instance, strategy is defined as "the determination of the long-run goals and objectives of an enterprise and the adoption of courses of action and the allocation of resource necessary for carrying out these goals" (Chandler 1962). Meanwhile, Porter (1996) has raised the idea of strategy as a way, which helps to achieve competitive advantage. He states that "competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value" (Porter 1996). The main underlying premise proposed by Porter is that competitive advantage is achieved by offering higher added value to the customer, which is considerably higher than the costs of production.

Mintzberg (2007) explains strategy as "a pattern in a stream of decisions". According to Mintzberg (2007), strategies do not always follow a deliberately chosen plan, but can emerge in more ad hoc ways. These definitions outline the main important elements of strategy. Hence, the approach that "strategy" is umbrella term, embracing different elements, is adopted in this paper. Notably, different approaches and views toward these elements prevail in scientific literature. The scholars have put a lot of attempts in order to clarify what determines success and failure of the firms both in national and international markets. Therefore, the researches in strategic management field suggest different streams, explaining how strategic decisions of the firms could contribute to the long-lasting success.

Transaction costs theory proposed by Coase has important implications for strategic management and state that strategic opportunities arise from reducing transaction costs (Foss, K. and Foss, N.J. 2005). Therefore, transaction costs and value creation appear to be linked and contribute to the long term competitive advantage.

Meanwhile, Porter (1980) has presented industry-based view and argues that conditions within an industry determine competitive advantage of the firm. The main ideas, proposed by Porter (1980) are based on the five forces framework, which helps to determine the attractiveness of an industry in terms of the threat of entry, the threat of substitutes, the power of buyers, and the power of suppliers and the extent of rivalry between competitors. Consequently, the researchers have focused on the analysis of the industry with the aim to evaluate the competitive position of the firm and propose necessary actions in order to improve it. On the other hand, the focus of scholars on a firm's competitive advantage and ability to change rather than occupy a position in the market has impacted the development of resource-based approach.

The main underlying premise of resource-based view is that the firm has to advance its resources and capabilities constantly in order to gain and maintain competitive advantage over competitors (Barney 2001). On the other hand, resource-based view focuses on internal organization and is a compliment to the traditional approach of strategy based on industry structure and strategic positioning within that structure (Einserhardt, Martin 2000). The resource-based view assumes that competitive advantage of the firm is determined by valuable, rare, inimitable and non-substitutable resources and capabilities. Hence, the proponents of resource-based view argue that the relationships between competitive advantage and performance of the firm are obviously direct. On the other hand, the limitations of resource-based view are linked to its application in dynamic markets. Hence, the emphasis has shifted towards dynamic capabilities by which firms "integrate build and reconfigure internal and external competencies to address rapidly changing environment" (Einserhardt, Martin 2000). The idea of dynamic capabilities implies that long-term competitive advantage of the firm is linked to the resource configuration that managers build using dynamic capabilities, but not dynamic capabilities per se.

Notably, several trends within the scientific literature, developed on resource-based theory, have emerged. For instance, resource-based view, knowledge-based view and relational view are distinguished (Acedo *et al.* 2006). The researches focused on knowledge-based view assume that both tacit and explicit knowledge is preeminent resource of the firm and that organizational capabilities involve integration of multiple knowledge bases. Notably, the scholars put emphasis on the tacit knowledge, raising complex issues regarding its transfer both inside and outside the firm (Grant 1996). Hence, knowledge integration includes the efficiency of integration, the scope of integration and the flexibility of integration. Meanwhile, relational view adopts the idea that network of firms can develop relationships impacting competitive advantage. Notably, relational view argues that a firm in isolation, irrespective of its resources and capabilities can't earn supernormal rents (Dyer, Singh 1998). To put it other way, relational rents are developed and earned by partnering firms. Hence, the firm develops valuable resources by managing relationships with suppliers, customers, governmental organizations and universities.

The institution-based view assumes that dynamic interactions between organizations exist and considers strategic choices as the outcome of such interactions. Hence, the proponents of institution-based view argue that strategic choices are driven not only by industry conditions and capabilities of the firm, but are also "a reflection of the formal and informal constrains of a particular institutional framework that managers confront" (Peng *et al.* 2008). Notably, institution-based view is relevant to both developed and emerging economies. However, institution-based view as a phenomenon, common to emerging economies, has been widely accepted in the scientific literature. Notably, the difference in institutional frameworks encouraged focusing the researches in addition to industry and resource based factors.

## 4. Methodology

The above discussion leads to several research questions. The first relates to the relationships among strategic goals, organizational competencies and competitive advantage by internationalizing the firms. The second question is being raised if strategic goals, organizational competencies and sources of competitive advantage affect internationalization patterns. The investigation is based on the presented models and approaches. In order to carry out the investigation a qualitative approach was adopted. This approach seeks to reveal why the phenomenon has occurred in particular cases. The case firms were selected from construction industry of Lithuania, taking into account their membership in the Lithuanian Builders Association. Taking into consideration the fact that industry is predominated by huge number of small and medium size firms, the target group of research has been determined as the small and medium size companies (SMEs) with the number of employees less than 250 employees.

**Table 1.** The profiles of the firms

| Firms | Year of establishment | Number of employees | Target countries | Entry modes | Target segments |
|---|---|---|---|---|---|
| A | 1993 | 120 | Russia (2000), Belarus (2001) | Joint venture, Subsidiary | Engineering construction |
| B | 1992 | 220 | Russia (2010) | Representative | General contractor |
| C | 1995<br>2008 (merger) | 250 | Latvia (2008), Estonia (2008), Russia (2009) | Representative | Engineering construction |
| D | 1996 | 180 | EU (2005)<br>Russia (2007)<br>Belarus (2007)<br>Ukraine (2007) | Export<br>Representative office<br>Representative | Engineering construction |
| E | 1992 | 136 | EU (2005)<br>Russia (2005)<br>Belarus (2006) | Export<br>Representative | Engineering construction |
| F | 1960 | 250 | Russia (2001)<br>EU (N/A) | Export,<br>Representative | Construction materials |
| G | 1989 | 200 | Russia (2005-2006) | Export | General contractor |
| H | 1992 | 150 | Belarus (2011) | Representative | Engineering construction |

*Source:* developed by author

The construction industry of Lithuania was growing in 2000-2008. The observations of statistical data allow concluding that value added at constant prices increased almost 3.5 times. Hence, construction industry was regarded as one of the engines of the economic growth (Banaitienė *et al.* 2011). However, the decline of industry was observed in the period of financial crisis, which impacted the sharp decrease of firms' production volumes. For instance, the gross value added of construction decreased by 43.3%. Hence, the competitive environment of construction companies is seen as unstable due to the changes of consumers' demand and high bargaining power. The firms have to deal with quality improvement, reduction of costs and management issues both at the project and firm level. On the other hand, Lithuania's economy is seen as a very limited for further growth of the firms. Therefore, internationalization has to be regarded as common growth strategies of the firms (Ojala 2009).

According to the recommendations proposed in scientific literature (Yin 1994), the primary data were collected through semi-structured interviews of up to 90 minutes length with the CEOs, owners or the persons in charge of international activities. The interviewees were asked to describe their business in general and as related to the internationalization activities. These questions were divided into the themes and following issues: 1) strategic objectives of the firms, 2) competencies obtained by the firms both in local and international markets, 3) sources of competitive advantage and 4) strategies applied by the firms. The table 1 summarizes information of all case studies. The firms were codified by letters from "A" to "H" in order to keep confidentiality. Notably, all firms were established in 1989-1992 except the firm C (established in 2008) and firm F (established in 1960).

## 5. Analysis of results

*Exploration of strategic objectives*

The objectives of the case firms to internationalize the business can be described as economic and less economic in nature. However, less economic objectives in nature also contribute to the economic welfare of the firms. In total all the case firms indicated that the main strategic objectives such as, to increase profitability, to increase turnover and desire to reduce risk of business are the main drivers of internationalization. Four of eight case firms (firms A, C, D, E, F) indicated the objective to increase productivity level by expanding internationally. On the other hand, the firms C, D, E, F stressed less economic in nature objectives - to develop human resources. The emphasis was put on the international experience of both CEOs and line managers and carrier opportunities of firms' employees.

The interviewees indicated that global financial crisis, small domestic market of Lithuania and competitive pressure in domestic market have negatively resulted in profit margins. For instance, the interviewee from the firm H explained: *We have observed opportunities in Belarus market several years and it was reasonable taking into consideration our objectives to increase the firm's workloads. We saw a positive experience of our partners – contracting firms.*

Hence, taking into consideration that seven out of eight observed firms have been competing in the national market twenty and more years, the objective to internationalize was linked to the strategic decisions to maintain or enhance competitive position in the construction market. Notably, the firm C was established by merging four independently operating firms in 2008. On the other hand, taking into consideration that all the case firms are private limited firms, the strategic objectives were impacted by the perceptions and objectives of the entrepreneurs. Hence, the ownership of the firm is seen as one of the drivers for internationalization. For instance, the firm F joined Russian corporation, a leader in production of construction materials, in 2001. Hence, the objectives of parent company fostered company's internationalization.

*Exploration of competencies and competitive advantage*

The findings from the eight case firms revealed that internationalization was influenced by experience in the local market, quality of works and productivity. The experience of the firms allows developing organizational routines impacting competitive advantage over new competitors in the market. The interviewees indicated that availability of skilled labour and unique technological competencies were important motives for internationalization. The interviewee from the firm B explained: *We have been forced to seek opportunities in Russian market striving to maintain our workforce. The financial crisis impacted construction industry a lot and many skilled workers emigrated…*

Notably, an experience in construction industry is knowledge-based advantage. Hence, the case firms emphasize managerial and technical capabilities. Five of eight case firms have developed their technical capabilities due to the narrow specialization and focus on the niche markets. The firms aim to provide consulting, design, construction and renovation of engineering networks (firms A, C, D, E, H) or production of construction materials (D, E, F). Despite the fierce competition in the market these firms established strong and stable positions in their home market. The interviewee from the firm D commented on the firm's competencies: *We apply the most advanced technologies for wastewater treatment equipment and it is logical… Since the firm's establishment we aimed to produce unique products and satisfy our customers. Finally, our capacity impacted expansion to international markets.*

Hence, constant implementation of innovations and quality improvement are seen as the sources of competitive advantage in the six case firms. Notably, implementation of innovations impact costs and time of construction projects and contributes to the firms' profitability. The observed firms stressed the importance to establish long-term relations with the main customers and suppliers. For instance, the firms A, C, D, E, F, H have established long-term relationships with general contractors.

*Exploration of strategies*
The observed firms exhibited common characteristics, regarding their approaches to internationalization. Firstly, they gained an experience in the national market. This was primarily due to the peculiarities of construction industry, which requires strong technical expertise and recognition of customers. Once, the firms established themselves in the national market, they recognized the opportunities in international markets.

In the case of the firm A, the strategy was facilitated by the previous networks and experience of the owners. The firm internationalized earlier than the other seven firms that is between 7-8 years after business start-up. On the other hand, the interviewee stressed that internationalization was planned. The relationships with foreign firms were established at the earliest stages of the firm's development. For instance, the interviewee indicated that the firm supply construction materials from Russian suppliers. Notably, the nationality of the owners was also one of the influential factors to internationalize. Hence, previous work experience and nationality impacted the patterns of market selection (namely, Russia and Belarus) and market entry strategies via established joint venture and subsidiary.

The other three firms (C, D, E) internationalized a little later, that is between 9-13 years after business start-up. The firms' strategies were facilitated by the networks established with the local partner firms and the international contacts established in international exhibition. The interviewees stressed that internationalization of some partner firms (namely, customers or suppliers) was the main motive to follow them in international markets and is considered to be ad hoc. In the case of firm D, the internationalization was planned, that is the firm expanded production capacity in local market and entered foreign markets via exporting, representatives and establishment of representative offices. Notably, the firm D targeted several markets at one time. Similar approach was adopted by the firm F.

In the case of the firm G, the internationalization was facilitated by the national tenderer. The firm was the general contractor in Kaliningrad region (Russia) in 2005-2006. On the other hand, the internationalization wasn't planned as a strategy and the firm exploited only short-term opportunities. The representative of the firm G commented: *We had a big project in Kaliningrad region (Russia) in 2005-2006, but our contractor was Lithuanian public institution ….. However, when the project was finished we did not take a risk to expand further. Meantime construction market in Lithuania was growing. Now, we observe situation in neighboring countries again.*

The two firms (B, H) internationalized between 18-19 years after business start-up and opted to international markets via representatives. The managers' perception of institutional constrains in developing countries (namely Belarus and Russia) affected the strategy patterns. The interviewees indicated that both Russian and Belarus markets are attractive in terms of size and growth. However, the differences exist in lows and regulations. For instance the bureaucracy and different norms of construction projects, market regulation in Belarus are seen as the main obstacles for the development of the firms.

## Discussion and conclusions

Notably, the research has investigated the strategy patterns of eight Lithuanian construction companies. All case firms were well-established firms with particular experience in their home market. The firms were selected taking into consideration their experience in international markets. The above research indicates that Lithuanian construction SMEs adopt the approaches, having features of both stage and networking theories.

In total all the case firms first internationalized into the neighboring countries. Taking into consideration market opportunities, the developing countries are seen as the focus of interest. Hence, internationalization to such countries as Belarus and Russia (namely Kaliningrad region) is seen as the natural development of firms' domestic activities. The internationalization process is facilitated by the understanding of culture and language skills that is relevant for the managers of older generation. On the other hand, firms having the capacity to produce construction materials focus on the EU countries, namely Baltic countries, Scandinavian countries and Poland. Hence, internationalization of the firms corresponds to the psychic distance concept, proposed by Johanson and Vahlne (1977) and defined as "the sum of factors preventing the flow of information from and to the market".

However, the development of networks was seen as another success factor of the firms' internationalization. One of the distinctive features of analyzed firms is that networking activities were developed in their home country. In total all the case firms first established long-lasting relationships with suppliers and customers. Hence, the established networks in home country facilitated the development of new relationships with actors belonging to other networks in the foreign countries. Notably, such relationships acted as a bridge to foreign markets and correspond to the network approach of internationalization (Johanson, Mattsson 1993). On the other hand it is possible to distinguish active and passive networking (Ojala 2009). Majority of observed firms adopted the approach of passive networking in international markets when the initiative was taken by other actor such as the intermediate, supplier or customer. The narrow technical expertise of the firms and the focus on the niche markets are seen as the main factors of passive networking. Therefore, the internationalization of these firms is seen as unplanned, reactive and opportunistic and corresponds to the findings of other scholars (Westhead *et al.* 2002). Meanwhile, the firms involved to some extent in the production of construction materials adopted both passive and active networking.

The research has attempted to find out the relationships among the firms' objectives, competencies and the sources of competitive advantage. The firms, which set both economic and less economic objectives, appear developed distinctive managerial, technical and technological competencies. On the other hand, acquired knowledge and information of the firms can be linked to the investments in building management understanding, changed hiring policies of the firms and partnering with others. The successful firms provide high quality services, higher standards and reduce unproductive time of projects. Notably, the aim of the firms to maintain high quality standards requires setting tight control of labour and materials inputs. Therefore, the management of the relationships in the supply chain is of the highest importance and contributes to the superior performance of the firms. These findings are similar to the findings of other research works (Piercy *et al.* 1998). On the other hand, the firms' objectives, competencies and the sources of competitive advantage impact the firms' approaches and patterns of international strategy.

The surveyed firms had different views toward international strategy. Two out of eight case firms focused mainly on the national market and after changes in the environment considered an international expansion. One firm is considering becoming an international again. On the other hand, majority of the firms used international strategies described as of low involvement. Notably, these are common internationalization strategies used by the SMEs. The limited resources, namely human and financial resources of the SMEs are seen as one of the obstacles for further expansion. Majority of the analyzed firms except one adopted specialized internationalization strategies and reflected risk-aversion tendency. These findings correspond to the observations provided by other scholars (George *et al*. 2005), stating that ownership and divergence of interests might induce conservatism that undermines the SMEs ability to exploit opportunities internationally. On the other hand, one of the case firms demonstrates the fact that nationality of the owners and previous work experience impacts greater exposure to international environment.

The obtained results allow providing suggestions for policy makers. The internationalization of SMEs to international markets requires active assistance of government and policy makers. Moreover, internationalization to developing countries with different institutional constraints should be supported by developing assistance programmes and initiatives. For instance, the assistance through various initiatives allowing acquiring information about international markets has significant implications. The support programmes should take into consideration strategic issues of internationalization and management development.

The limitations of the presented research are related with the focus on a single industry and a single country. Thus further validations regarding different industries and countries are required. Based on the findings of this research further research should therefore concentrate on a deeper analysis of differences between strategy patterns in developing and developed countries.

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