



JÖNKÖPING INTERNATIONAL BUSINESS SCHOOL

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How Organizational Knowledge can affect the choice of entry mode

- A case study of an Italian company planning to enter the Chinese market

Paper within Bachelor Thesis in Business Administration

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Summary

This is a bachelor thesis within strategic management and knowledge management. It is a case study of a family-owned Italian Olive oil company, Frantoi Celetti e Cultivar, here referred to as FCC. FCC has built a thorough olive oil competence throughout the years and has decided to exploit its business on the Chinese market.

After careful considerations, FCC has chosen to enter the Chinese market by building an alliance with a Chinese firm that has some experience of olive oil production. This Chinese olive oil supplier will be contracted to produce Monocultivar Extra Virgin Olive Oil according to FCC's strict directions. The oil produced in China is planned to be distributed on the Chinese market through FCC's new Chinese restaurants, through exclusive retailers and eventually probably also via the firm's website on the Internet.

To be successful on the Chinese market, FCC must succeed in transferring relevant production knowledge to the Chinese producer, and this production knowledge is difficult to transfer, as it contains a lot of tacit knowledge that is hard to articulate. FCC must also get access to valuable knowledge that the allied partner has about the Chinese business climate, Chinese values and tastes, Chinese networks etc. FCC's founder and CEO plans to be present in China during the start-up period. By this way the partners can attain the close friendship, trust and commitment that are needed for the knowledge exchange to take place. The idea is to create a win-win situation where the partners have a mutual goal, which is to produce high quality monocultivar olive oil.

It is important for FCC that competitors do not get access to the valuable production knowledge, which actually is FCC's core competence. The complexity of the organizational knowledge is the hindrance for competitors to steal and make use of the valuable knowledge. That is because to achieve competitive advantage from the production knowledge, several other knowledge areas are also required simultaneously. For example knowledge about where and how to plant olives, how to contract suppliers that are promising for the purpose, how to produce the oil and where to sell it, knowledge of the best distribution chain, are all knowledge areas that are dependent and related to each other. One single piece of knowledge in itself will not make any revenues. FCC uses the knowledge and experience throughout all the distribution chain of its products, from the start of production of olive oil to the sales to the end customer.

The problem discussion concerns how FCC's organizational knowledge can have influenced FCC's choice of entry mode into the Chinese market. The firm's knowledge that will be needed for gaining competitive advantage in China is not exactly the same as was needed in Italy. Therefore, FCC seeks to exchange knowledge with someone who has local knowledge in China.

The purpose of this thesis is to reach a deeper understanding of the complexity concerning how the organizational knowledge that is needed for FCC's competitive advantage in China, can affect the choice of entry mode.

In order to answer the purpose of the thesis, a qualitative approach has been used. In depth, unstructured interviews have been conducted with FCC at four different occasions. The data gathered has then been analyzed by using theoretical framework.

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1 Introduction

In this chapter we will provide the reader with an introduction to the field of interest. This will include a general background and problem discussion leading to the purpose of the report. The chapter will also deal with definitions of key concepts used in the report.

“Internationalization is increasingly, not only about exploiting existing capabilities in new national markets, but about developing strategic capabilities by drawing on the capabilities elsewhere in the world” (Johnson, et al, 2006, p. 298).

It is obvious that when a firm plans to enter a foreign market, it must choose the entry mode that best can transfer the resources and capabilities from the home country operations to its foreign operations, without eroding their value. That is without reducing the firm’s ability to generate a competitive advantage (Krishna Erramilli et al, 2002).

There is a vast array of alternatives that a firm can choose between as it organizes its activities on new markets, such as non-equity contractual modes, and equity-based cooperative enterprises, and wholly owned subsidiaries (Hill and Kim 1988).

Lu and Beamish (2001) suggest that the type of entry mode is significantly related to small- and medium-sized enterprise (SME) performance. This means that choosing the right entry mode when going into new markets can be of great importance for SMEs. In optimizing the choice of entry mode, multinational enterprise (MNE) managers must simultaneously and indivisibly assess several factors, such as risk, return, control and resource effects (Luo, Y. 2001).

What entry mode that a multinational company chooses has implications for how much resources the company must commit to its foreign operations, the risk that the company must bear, and the degree of control that the company can exercise over the operations on the new market. By control we mean authority over operational and strategic decision-making (Hill and Kim 1988).

This thesis focuses specifically on the competitive intangible resources’ effects on the choice of entry-mode. Such resources include the knowledge and the know-how that builds the ground for the capabilities and competencies that is needed for the competitive advantage on the new market.

“Knowledge, competence and related intangibles have emerged as the key drivers of competitive advantage in developed nations. This is not just because of the importance of knowledge itself, but because of the rapid expansion of goods and factor markets, leaving intangible assets as the main basis of competitive differentiation in many sectors” (Teece, 1998, p.76).

Knowledge as a competitive advantage

Knowledge management (KM) has come to play an important role for global competition in leading companies of today. Organizations try to reshape themselves in order to increase their ability to manage knowledge sharing and knowledge transfer both within and across organizational boundaries declare Corso, Martini, Paolucci and Pellegrini (2001). Firms that seek competitive advantage need not only create distinctive intangible assets, it must also

exploit the knowledge efficiently (Nelson and Winter, 1982). The questions concerning if and how to transfer underlying knowledge across borders is crucial for multinational firms, Martin and Salomon (2003) suggest.

Firms that manage to accumulate intangible knowledge-based resources are better suited to expand internationally. However, according to Martin and Salomon, 2003, possession of an advantage that is knowledge-based does not at all guarantee that a firm can exploit the sources of such an advantage in its foreign operations.

Different entry modes

According to Johnson, Scholes and Whittington, 2006, different organizations choose different development methods for their development strategies. “A *development method* is the means by which any strategic direction will be pursued”, p.348. The development methods can be divided into three different types; internal development, acquisitions and alliances (or joint development). Internationalizing firms must decide the right mode of entry into foreign markets in order to make the best use of its resources. Modes of entry can be explained as alternative routes on hand to an organization for transferring resources from the home country to a new market (Anderson and Gatignon 1986; Hill et al. 1990). The varieties of modes are exports, licensing, Greenfield investments or wholly owned subsidiaries, acquisitions, and different types of joint venture. There are other forms such as franchising management contracts, turnkey contracts, subcontracting or associations, and consortiums that lie in a grey area between arms-length exports and wholly or majority-owned foreign subsidiaries (Hennart, 1989).

China’s influence on Italy’s industries of today

In Italy there is still a dominance of traditional and mature industries (e.g. food, furniture, leather and shoes), which implies that the country has its competitive advantages and core competencies in markets that usually are reserved for countries with lower production costs. Therefore, the increasing competition from China puts pressure on the Italians to perform better and to cut costs to increase their competitiveness (Alberti, personal communication, 2006). In Italy, most companies are small family-owned businesses, and that makes the threat from China even more serious since small companies are more vulnerable.

Recent debates have emphasized the weaknesses of family firms in the global competition. It has been said that small enterprises do not have the capital needed for large investments which restrains them from growth. Moreover these firms lack both the capital and competence needed for research and development. Some people mean that this is one of the reasons behind the decline in Italy’s competitive advantage during the last years. Furthermore, a large part of the Italian industry is constituted by low-technology products. The chemical and the electronic industry have collapsed many years ago, and the car industry with Fiat is currently experiencing a deep crisis.

Many Italian companies choose to face these threats by cooperating with China and moving part of their production there to take advantage of the lower costs in particular, and to get access to the Chinese market (Alberti, personal communication, 2006). Entering the Chinese market is a huge opportunity for Italian companies and can give them another source of income, which implies that the risk they take when they only operate in Italy would then be reduced.

1.1 Problem discussion

For many firms in Italy it is the intellectual assets that have been the source to competitive advantage. This is especially true when it comes to firms that are based on craftsmanship, design and art, which historically have contributed greatly to the Italian industry. Since the threat from China and other low-cost countries is imminent for many Italian firms, the possibility to use the organizational knowledge on new markets can seem promising. When an Italian firm decides to exploit its competencies and its organizational knowledge on a foreign market, in order to respond to the threats from China, it is valuable for that firm to have a fairly true and accurate picture of the organizational knowledge that is needed to be competitive on the new market.

Organizational knowledge sometimes has evolved during long time within and between people under specific conditions which makes it complex and not always easy to describe, transfer or teach. It involves several aspects and levels of knowledge and how these accumulate to the essential competitive knowledge that is needed to compete on the market.

The dynamic capabilities of a multinational enterprise determine its capability to use and create its embedded resources in the quest of a sustained competitive advantage (Luo, 2002). This means that it is not enough to understand what organizational knowledge that the firm has and how to transfer that to new locations. It is also about building on that knowledge so that it is relevant for sustaining competitive advantage on the new market.

When a firm seeks to enter a new foreign market, one of the issues for the managers to solve, is how the firm should enter that new market. When the organizational knowledge is a source of competitive advantage, the managers must find out what entry mode is most suitable from the perspective of the organizational knowledge. The entry mode can either facilitate or complicate the desired organizational knowledge on the new market. Since the organizational knowledge is a complex phenomenon, embedded in certain contexts and individuals, it can be problematic to picture it. However, being able to understand the value of the organizational knowledge for competitive advantage is especially important in the process of starting business in a new country. That is because during this process of going to a new location, some of the old truths suddenly can become meaningless. At the same time, new knowledge that maybe not even yet is identified by the company may be needed in order to survive on that new market.

From this perspective, this study aims at investigate a specific case with a firm that intends to start business in China, drawing on its intellectual capital.

- ✓ What knowledge does the firm has that has been useful for competitive advantage on the Italian market?
- ✓ What knowledge has to be transferred to the new business?
- ✓ What knowledge is currently missing in the firm in order to succeed on the new market?

By trying to answer these questions, this study hopes to reach a deeper understanding of how complex the organizational knowledge is, and how that can have an effect on the choice of entry mode.

1.2 Purpose

The purpose of this thesis is to reach a deeper understanding of the complexity concerning how the organizational knowledge that is needed for FCC's competitive advantage in China, can affect the choice of entry mode.

1.3 Definitions of key concepts

Opportunism: is when someone is “taking advantage of opportunities without regard for the consequences for others” (wordnet.princeton.edu/perl/webwn). In this case opportunism can be explained as when someone uses the information that is possessed by a firm unethically, for example if competitors steal the idea or the information from a firm with the purpose of creating money for its own benefit, not considering who originally came up with the idea or the know-how. Opportunism means that some parties to an agreement may choose to act out of self-interest and shirk their contractual responsibilities (Williamson, 1985)

Organizational knowledge: Haridimos & Efi .973, (2001) define organizational knowledge as “the capability members of an organization have developed to draw distinctions in the process of carrying out their work, in particular concrete contexts, by enacting sets of generalizations whose application depends on historically evolved collective understandings”. Organizational knowledge is explained by Johnson et al. pg. 133. (2006) to be “the collective and shared experience accumulated through systems, routines and activities of sharing across the organization”.

Dynamic capability: Johnson et al. pg. 132, explain Dynamic Capabilities as “an organization's abilities to develop and change competences to meet the needs of rapidly changing environments” (2006).

Monocultivar Extra Virgin Olive Oil: Monocultivar Extra Virgin Olive Oil is the highest degree of quality in the area of olive oil. It is made from one single variety of olives and is not blended, something that is considered to increase the quality even further. According to the International Olive Oil Council (2006) an olive oil must have a level of acidity lower than 0.8 per cent and most important, the oil must be totally perfect without any kind of defects. It also must be flavored in order to be classified as an extra virgin olive oil.

2 Frame of reference

In this chapter we will describe how we have approached our investigated area, and how information has been gathered in the field of interest in order to fulfill the purpose of this thesis.

The objective of this theoretical framework is to review different explanations of factors that can influence a company's choice of entry mode, resulting from the company's organizational knowledge. To be able to answer the purpose of this thesis, the theoretical framework will include the following aspects:

1. *The knowledge, competence and capabilities that are used by an organization to attain competitive advantage will be examined in the first theoretical section.*
2. *Thereafter, different types and different levels of knowledge will be presented.*
3. *The third section will focus on how different types of knowledge can be transferred.*
4. *The fourth section considers how to protect sensitive knowledge from competitors.*
5. *The last section will pay attention to different types of entry modes into new markets.*

The information about the above theoretical fields has been gathered mostly from academic journals electronically available through the databases at the library of Jönköping University. Some information also comes from printed literature in the fields of interest.

Brief information on the industry where FCC competes and the main characteristics of the product that FCC produces is put in an appendix. This information has been gathered through interviews with Professor Regalland and through information from the International Olive Oil Council in Italy.

2.1 The resource-based view

In the purpose of this thesis, the focus lies on how the strategic capabilities, and especially the competence and the knowledge of the firm can have an impact on the method of the strategic development when a firm enters a new market. Theory grounded in the resource-based view will be applied in this study; since it gives a picture of how the internal resources and especially the intangible ones are important for the firm's strategies.

The resource-based view suggests that firms possess resources, both such that enable them to achieve competitive advantage, and such that leads to superior long-term performance (Barney, 1999; Grant, 1991). The resource based view explains the competitive advantage of a firm as the distinctiveness of its capabilities (Johnson et. Al, 2006). The same author also state that the competitive advantage of organizations of today is less likely to come from physical resources and more likely to come from the way things are done within the organization and from the experience that it has accumulated. Therefore, the organizational knowledge can be the basis of a firm's strategic capability.

Johnson et al, 2006, p. 17, explain that the strategic position of a firm "is concerned with the impact on strategy of the external environment, an organization's strategic capability (resources and competences) and the expectations and influence of stakeholders.

Johnson et al (2006) suggest that the strategic capability of a firm can be thought of as the strengths and weaknesses of a firm, and how these can be seen as competitive advantages

or disadvantages. In this way the internal influences and constraints on strategic choices that are to be made can be understood. Johnson et al clarify that it is the *combination* of both resources and competences that together provides the necessary advantages that competitors cannot easily imitate. Such resources are often high levels of competence that are developed within particular activities, and it is often referred to as *core competences*, according to Johnson et. Al. The concept of core competence will soon be further elaborated on.

The transaction cost (TC) approach is micro-analytic, it focuses on a single transaction as the unit of analysis, and it views the firm as an historical entity. Therefore, the entire reservoir of organizational knowledge built over time by different kinds of experiential knowledge relating to each other in diverse ways cannot be captured in this approach (Malhotra, 2003).

The resource-based view and the idea that the competitive advantage of a firm comes from capabilities or know-how rather than from physical assets, just as Barney, Grant and other authors have suggested, provides explanation of *why* it is interesting to study *how* the organizational knowledge can affect a firm's strategic decision of choosing entry mode.

We agree with Malhotra who states that the TC approach is not useful enough in trying to understand the source of competitive advantage of a firm. The TC approach does not at all include and capture the accumulated organizational knowledge needed for competitive advantage. Such organizational knowledge is, as we see it, built over time in multiple levels and ways. It is impossible to draw any conclusions of how one single transaction contributes to the competitive advantage of a firm. That is the reason why we have chosen to adapt the resource based view and not the TC approach in trying to understand the phenomenon of competitive advantage of a firm and how that can affect the choice of entry mode. The resource based view gives a fuller explanation of how a firm's competitive advantage is deep-rooted in the organizational knowledge of the firm. In the theory section below named "levels of knowledge", the combination, the relation and the importance of different types and levels of knowledge will be further discussed. But first we will look at the theoretical concept of "core competence".

2.1.1 Core competence

According to Prahalad and Hamel (1990) a company's core competence needs to fulfill three characteristics. These involve the fact that the competence needs to be hard for competitors to imitate, give the company access to a wide variety of markets and contribute to a superior customer value. A core competence can, for example, be specific and highly valuable *knowledge* of an organization. Markides and Williamson (1994) define core competencies as a pool consisting of experience, knowledge, and systems that all together can act as catalysts in creating and accumulating new strategic assets.

Teece, Pisano, and Shuen (1997) brings the discussion about core competence a bit further by concluding that core competencies have got to be derived from examining the range of the organization's and its competitors *products and services*. Just as have been mentioned by previous theories, these three authors too suggest that the value of core competences can be enhanced by combining them with the appropriate complementary assets. Based on this definition, the core competence of a firm can differ from one market to another depending on which products are offered on the specific market. Finally Hafeez, Zhang & Malak (2002) define core competencies as the *physical, intellectual, and cultural resources* of the firm.

According to Barney (1999) resources are most difficult to imitate if they are:

1. Path dependent (meaning that the resources have a specific history that tends towards organizations having highly specialized skills).
2. Causally ambiguous (when the actions needed to create these resources are not fully known).
3. Socially complex (when some resources are complicated to change under the short-term, such as the organizational culture or the corporate reputation).

Espedal (2005) challenges the conventional assumption that core competence only has to be developed internally, an opinion which is not consistent with the resource-based view of the firm and human capital theory. Espedal instead suggests that a mix of internal and external developmental resources is needed in the creation of management's development of *dynamic capability*, one of the main sources of the firm's competitive advantage. Furthermore Espedal argues that, it is the group of employees of the firm who have valuable and unique skills and capabilities, which actually is the main source of competitive advantage. Other authors that share the assumption that competitive advantage is derived from different knowledge elements, not only from firm specific knowledge, are: Davenport, Prusak, & Wilson (2003), Nonaka, (1998), Nahapiet & Ghoshal (1998).

This section of the theoretical framework provides explanation to how the resources of a firm, which was discussed in the previous section, can become a source to long-time competitive advantage. All the theories presented here adds to an understanding of that competitive advantage in the long run has to do with the complexity of the organizational knowledge, systems and experience. It is when the complexity is high that the possibility to contribution to long-term competitive advantage is highest. The theoretical framework of core competence seems to be divided in different thoughts regarding how the competences are developed and where it resides. We will adopt the notion that core competences can be derived both by internal resources and external ones, as argued by Espedal, Davenport, Prusak & Wilson, Nonaka and Nahapiet & Ghoshal. We strongly believe that the dynamic capability is part of the organizational knowledge. Without having the ability to include new information and knowledge from external sources to the firm, the organizational knowledge will cease to develop and be useful for competitive advantage. Espedals suggestion that the core competences resides mostly in the ones of the organization who have valuable and unique skills and capabilities will be elaborated on. The question on whether and how such knowledge or competence can sustain in the long run will be illuminated by theory about the dynamic capability that follows below.

2.1.2 Dynamic capability

The capability to reshape and reorganize the organizational capacity is a competence that probably requires willingness to do so, experience of having done so, and knowledge of how to do so. For a firm that enters a completely new market with a product that is not previously marketed there, such capability to change when environment requires can maybe be considered to be a critical organizational capability. That is the reason why this study includes theory about dynamic capability.

Dynamic capability (Teece et al. 1997) can be explained as the capacity a firm has to extract rents from its current resources but also the capacity to build new competencies in a changing environment. Thus, the dynamic capability of a firm involves both capacity exploitation and capacity building. Teece et al explain that the path dependencies are even greater than before when conditions of increasing returns exist. It is the stability of market demand and the ease of expanding internally (replicability) and the possibility for competitors to replication (imitatability) that eventually decides whether or not the firm's competitive advantage

will be eroded, according to Teece et al. The implications of the dynamic capability framework are that wealth creation in changing situations depends on building and sharpen the internal technological, organizational and managerial processes that reside inside the firm.

Luo, Y. (2002) describes capability exploitation as the extent to which a firm can exploit rent-generating resources that are firm specific and difficult to imitate, and which are also able to generate abnormal returns. Capability building is rather the extent to which a firm carries out building of new capabilities through for example learning from other firms, or by creating new skills or revitalizing the existing organizational skills in new situations. According to Luo, both these capabilities are important in today's unstable business environments. Luo addresses the dynamic capability perspective in the context of international expansion. This author claims that the dynamic capabilities decide a multinational enterprise's (MNE) capability to use and create its embedded resources in the quest of a sustained competitive advantage. In a study by Luo, 167 MNE subsidiaries in China are used for validating that both capability exploitation and capability building are affected by environmental hazards (e.g. environmental complexity and structural uncertainty in the host country) and organizational dynamics (e.g. entry mode and market orientation). Luo explains that the business cultural specificity in the host country (its culture's uniqueness) hamper the capability exploitation but not the capability building. Capability exploitation is connected to the use of wholly owned entry mode, while on the other hand capability building is associated with the joint venture mode. Moreover, Luo states that MNEs that seek local market expansion deploy more capability exploitation and building than the SMEs that seek export market growth. The threats of environmental hazards on capability building are eased when the MNEs adopt the joint venture entry mode.

Chang (1995) claims that the resource deployment of an MNE gradually increases as a result of the augmented accumulated knowledge and experience in the host market.

Ghoshal (1987) explain that even though an emerging market may provide an MNE with the opportunity to learn, it can end up in a situation where the organizational learns along the wrong trajectory. This can result in "competency traps". The only way to avoid such traps is to coordinate and integrate the capability exploitation and capability building so that they together build a unified decision framework. However, firms are more cautious in deploying dynamic capabilities in situations where environmental complexity, structural uncertainty, and cultural specificity are high.

The proposal by Teece et al saying that it is the firm's ability to build and sharpen the internal technological, organizational and managerial processes that reside inside the firm, that eventually will lead to a competitive advantage in changing situations, is interesting in this specific case. We believe so because firms that has decided to enter new markets, may not be fully aware of the importance of their dynamic capability. That is if they are able to change to better fit new circumstances. The dynamic capability can very well be just as important as the ability to transferring its current knowledge to new locations. When we look at the dynamic capability theory, we find that dynamic capability is not only essential for succeeding on a new market. We also find that different matters, such as business cultural specificity, on the new market will affect the possibility to deploy the dynamic capability, as said by Lou. Lou also describes how different intentions with the exploitation, such as market orientation, suggests different entry modes in order to be able to exploit and build capability.

Chang's theoretical contribution with the explanation of how resources can be deployed increasingly as the experience of the new host market grows is interesting in understanding how the organizational knowledge

can affect the entry mode of a firm. Finally Ghoshal provides clarification of why it is important to think of the organizational knowledge from an entry mode perspective: Ghoshal mean that the capability exploitation and the capability building have to be coordinated and integrated in order to avoid competency traps, (when the firm learns along the wrong trajectory). So if a firm that intends to exploit its competencies on a new market does not have a clear picture of its organizational knowledge and how that has to be developed, the risk of not having a good decision framework for the entry mode is big. Therefore, wholly owned subsidiaries are related to capability exploitation, and joint venture modes are associated with capability building.

2.2 Different knowledge types and knowledge levels

The knowledge in an organization could be divided in two different parts; tacit and explicit. Furthermore, the knowledge in an organization can be classified to belong to different levels; individual, team and organizational levels. In this section of the theory, differences and connections between tacit and explicit knowledge will be identified. Furthermore, the different knowledge levels will be explained. This part of the theory goes into why the subjective side of knowledge affects the outcome of that knowledge, which is important for understanding how the competitive advantage of a firm is influenced by intangible assets at different levels of the firm. In that way the strategic decisions by managers will also be influenced by the subjective knowledge.

2.2.1 Tacit and explicit knowledge

Research in strategic management, as well as in international business, indicated that the basis of a firm's competitive advantage is knowledge (Buckley & Casson, 1976; Grant, 1996; Kogut & Zander, 1993). Grant (1996), states that knowledge has emerged as the most strategically significant resource of the firm. Tacit knowledge is particularly critical and is considered a crucial source for a firm's core competence (Kogut & Zander, 1993; Teece, 1982).

Polanyi (1966) argued that science not only had an objective side, but also a subjective side. He has characterized tacit knowledge by saying that "we know more than we can say". It is exemplified by e.g. acts of knowledge in which the persons performing an act successfully may not be able to fully account for their achievement (Mooradian, 2005). An example is when a doctor diagnoses a patient by looking at an x-ray but cannot explain how he or she recognized that that x-ray is abnormal. The doctor just knows because of experience and training. Similarly, when a person identifies the face of a past acquaintance, he may express his recognition with the explanation that he knows the person, but she cannot fully describe how the perceived features of that person's face lead to her recognition of him (Mooradian, 2005).

Furthermore, Polanyi (1966) made it clear that implicit knowledge, also known as subsidiary knowledge, is knowledge that gives birth to the so-called focal knowledge, also known as explicit knowledge. Without the existence of implicit knowledge, explicit knowledge would not exist. Implicit knowledge enables, causes, grounds and brings about the explicit knowledge, and it is not consciously accessed in the moment of knowing (Mooradian, 2005).

Tacit knowledge is personal, context-specific and hard to formalize and communicate. Explicit knowledge, on the other hand, is knowledge that can be transmitted easily in a formal and systematic language. Due to the characteristics of the tacit knowledge, it changes when

trying to convert it into explicit knowledge. In the converting process something gets lost due to the fact that the translation of tacit knowledge into explicit knowledge takes place using metaphorical and allegorical language (Nonaka & Takeuchi, 1995).

A great challenge for all organizations that wish to spread knowledge throughout the organization is the capturing of tacit knowledge. Tacit knowledge is treated as something that lies beneath the surface and needs to be detected and captured. The explicit knowledge is instead treated as a kind of surface pool, something that is on the surface itself and is therefore easier to detect and spread throughout the organization. However, the surface pool only represents a part of the organizational knowledge (Mooradian, 2005).

Mooradian (2005) says that all kinds of explicit knowledge depend on tacit knowledge. Explicit knowledge could be seen as an extension or projection of tacit knowledge to a new level of awareness. Therefore, if there is a need and value to identify the tacit knowledge, it is in the relation of making explicit knowledge understandable, since without the tacit knowledge, the explicit knowledge cannot be understood. In a business context the knowledge of people can best be described as explicit. E.g. if a documented procedure is not adequate and would need to be supplemented with certain steps that can be followed and taught to others, this may be both easy to articulate and easy to document.

Therefore, this is explicit knowledge even though it has not been formally amended. However, the tacit knowledge is instead the workers' understanding of the goals and context of the business, and also the procedures it employs, and the workers adaptation of this knowledge or understanding to the circumstances in ways to bring understanding and correcting of the shortages in the procedure (Mooradian, 2005).

According to Eden & Yongjian (2006) tacit knowledge from critical capabilities is highly important for companies operating in emerging countries, due to "an increasing pressure" to compete with highly industrialized countries in the market. The critical knowledge is a crucial aspect that is reflected on their success on the market and their faith is dependent on their ability to obtain this knowledge. In the conclusion made by Eden & Yongjian (2006) they state that in a successful acquisition of tacit knowledge, expatriate's individual embeddedness and the recipient characteristics play critical roles. These recipient features involve the recipients' collaborativeness, readiness and the comprehensiveness of the knowledge acquisition.

This part of the theory is useful for understanding that knowledge is different. Some knowledge is easy to teach and some is difficult to teach. Evaluating the existence of tacit knowledge is something that is of great importance for any company that wishes to transfer knowledge to another part of the organization or to a cooperation partner. The reason for this is that transfer knowledge that involves tacit knowledge requires more time both before and after the transfer. Furthermore it is more costly to transfer knowledge that is to a large extent tacit. Questions a firm might ask when it plans to exchange knowledge are, what explicit knowledge do we have and what tacit knowledge is needed to understand that explicit knowledge. How does the tacit knowledge emerge, and how can we create it for new partners or new parts of the firm? How do we have to help and support after transferring the knowledge? To further understand what is meant by tacit and explicit knowledge, the theory part of this thesis will now turn to where the knowledge resides, and how it can be dependent on the relation to the context, and why this is important for the generation of value for the firm.

2.2.2 Levels of knowledge

Malhotra (2003) suggests that the knowledge of a firm is a combination of diverse knowledge types. That combination can help reducing the risk of business partners stealing or misusing that knowledge. Furthermore, this influences the choice of entry-mode. In the cases where the source for competitive advantage is constituted by a combination of multiple experimental knowledge held by individuals or teams, the threat of opportunism is much smaller than if the organizational knowledge easily can be codified and understood, for example basic technical knowledge. Therefore, in such cases, when it is difficult to misappropriate of the knowledge, mode of entry is often unimportant. Malhotra suggest that for examining entry mode decisions at firms, they should be conceptualized as a knowledge entity.

Malhotra (2003) says that to be able to explain the role that opportunism plays in an entry mode decision, the relationship between knowledge and opportunism must be understood. This author identifies a mixture of different knowledge-types and classifies them at the level of the individual, the team and the organization. The mixture involves both explicit and tacit knowledge and constitutes the source of advantage for a firm, and the way it is combined and related has an impact on the mitigation. If the knowledge mitigates the entry mode is not so important for the knowledge protection according to Malhotra (2003).

One type of knowledge that to a great extent can be codified and transmitted is basic technical knowledge (*individually held knowledge*). This is used for firms as a basis in competition. It consists of facts, obvious propositions and symbols. It can constitute building blocks with the fundamental concepts available and understandable to everybody. This type of knowledge can be transmitted without loss of integrity when the syntactical, or structural, rules for translating that knowledge are known. However, it is not until the basic technical knowledge is combined with individual experiential technical knowledge and skills in solving a problem at a particular location at a specific time that the knowledge makes it a competitive advantage for the firm. This combination is both very idiosyncratic and largely tacit (Malhotra, 2003).

Personal connections or relationships with customers and business partners are critical for firms entering new markets. Also employees with long experience of the host country have knowledge about the culture, local laws and business practices including professional regulations, environmental regulations and tax laws. A firm that has good relationships with experienced local employees is in an advantageous position since much of the groundwork is already done when entering the new country (Malhotra, 2003).

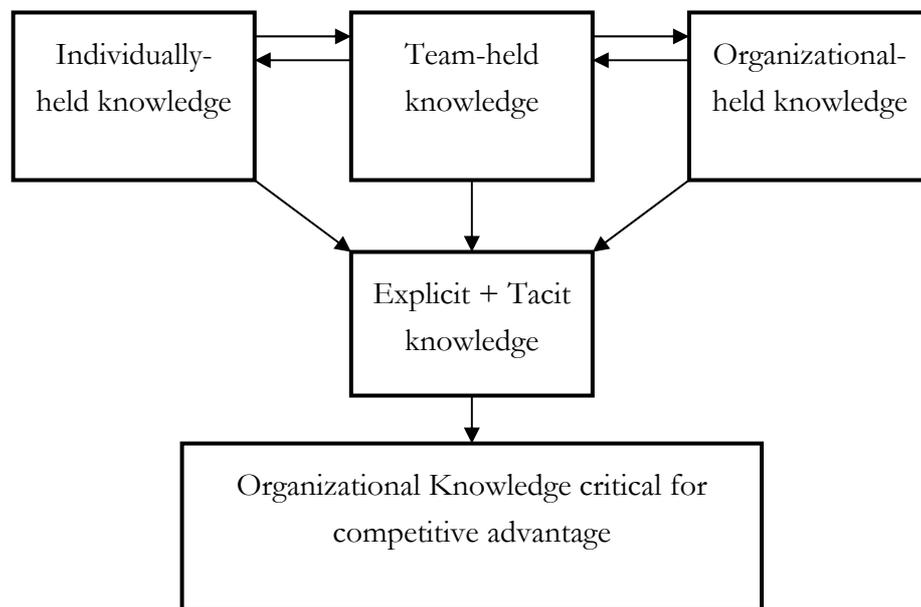
Malhotra (2003) states that in the process of creating a service or a product and its delivery, individually held experiential and technical knowledge must be effectively used in combination with the team's experience of working together (*team-held knowledge*). Both explicit and experiential knowledge originate at the individual level, and it is developed further when it is used in a team level in a process of a project execution. A team-held knowledge is certainly complicated to replicate. Therefore, team-held knowledge is hard to expropriate and disseminate. When individually held and team-held knowledge is combined to generate value or a source of advantage for a firm, such value is difficult to copy, therefore, the threat of expropriation of it is largely mitigated (Malhotra, 2003).

Over time organizations comes to hold a breadth of technical experience and a reservoir of relationships (*organizationally held knowledge*). This happens as the firm continuously develops

routines and coordinating methods that constitute a structure to organize and manage big projects, says Malhotra, 2003. Furthermore, Spender (1996) suggest that such collective knowledge that underpins how things are done in an organization is important for both individuals and teams to be socialized within the organizational context. In this way, organizational knowledge embedded in individuals and teams is both valuable and effectively used. Therefore, it is also difficult to appropriate such knowledge for generation of the same value if applied in a new, different, context according to Malhotra (2003).

A firm that is planning to enter a new market must assess the risk of business partners stealing or misusing its knowledge. When it is difficult for partners to misappropriate of the knowledge, which happens if the value generation of the knowledge is very dependent on the context, the entry mode is not so important. It can be useful to think of the organizational knowledge as layers or levels, which all contains both tacit and explicit knowledge in various extent; individual, team and organization. The idea is to see how they relate to each other and need each other to be valuable for the competitive advantage. In this way it is easier to determine whether the knowledge mitigates or not. When individually held knowledge and team held knowledge combine to generate value for a firm, that value is difficult to imitate. Organizationally held knowledge such as technical experience and a reservoir of relationships, routines and coordinating methods used for organizing also contribute to that the knowledge is embedded. In this way the context can matter very much for the generation of value of organizational knowledge.

To easier understand how the knowledge areas are connected we have chosen to construct our own model, which can be seen below. We want to emphasize that this model is our own interpretation of the connections between different types and levels of knowledge that altogether combine to the organizational knowledge of a firm that is essential for the competitive advantage.



The picture above shows that the organizational knowledge that is critical for competitive advantage is affected both by individually held knowledge and team held knowledge. Furthermore explicit and tacit knowledge must be combined to achieve useful knowledge for

the competitive advantage.

2.3 Knowledge transfer

There are many aspects influencing the success of a knowledge transfer. Here the concept of knowledge transfer capacity will be clarified, as well as the impact on knowledge transfer of trust and reputation and relational capital. Difficulties and problems related to knowledge transfer will be discussed, which is indeed important information for a firm that is about to make strategic decisions on entry-modes. A firm that needs to transfer important knowledge to Chinese allied, must consider its own knowledge about and capacity of transferring such knowledge. Questions such a firm may ask would for example be: do we have experience of this type of transfer, do we understand where the knowledge that needs to be transferred resides, how it has been developed, and how we can teach it, how the recipient can receive it etc.

2.3.1 Knowledge transfer capacity

Martin and Salomon (2003) introduced the concept of knowledge transfer capacity. This concept explains how organizations differ in their relative abilities to transfer knowledge across borders. They argue that (p. 363) “while possession of knowledge-based assets endows a firm with the potential to benefit following their transfer abroad, a distinct ability to transfer tacit knowledge efficiently is required to make the expansion possible”. Some firms may be good at creating knowledge, other firms may be better off in understanding, articulating and transferring the knowledge.

Knowledge transfer events involve a source, or a transferor, and a recipient, or transferee. (Gupta and Govindarajan, 2000) The knowledge transfer capacity is highest when source transfer capacity and the absorptive capacity are high simultaneously (Martin and Salomon, 2003).

The source transfer capacity includes three parts. First is the firm’s ability to identify and articulate potential uses of its own knowledge and the circumstances required for this knowledge to be effectively used. Second, a source firm needs to have the skills to assess the needs and capabilities and the readiness of the recipient firm. Also the source firm should assess and understand the recipient’s strengths and weaknesses in the absorption and use of the knowledge. This understanding of the recipient helps the source firm in planning how the knowledge should best be conveyed and gives an idea of what to expect. Third, the source should act as a capable sender and transmit the underlying information in suitable form. Furthermore, it should be appropriately arrayed and timed and also targeted to the proper recipient(s) (Martin and Salomon, 2003).

The recipient transfer capacity is explained by Martin and Salomon, 2003 as the transferee’s ability to absorb and retain know-how or knowledge from a willing source. To absorb knowledge a firm must be able to evaluate external knowledge, but also retaining it and spreading it within the firm and motivating and monitoring the continued use of it.

This part of the theory provided by Martin and Salomon suggest that it is the knowledge-based assets that endows a firm with the possibility to benefit from such assets abroad, but to make a foreign expansion possible, the firm must also have the ability to transfer its tacit knowledge to its new markets. The firm’s transfer capacity includes an ability to identify and articulate the potential uses of its knowledge, as well as the circumstances needed for that knowledge to be effectively used. Furthermore, the firm needs to be able to understand the recipient’s needs and capabilities and readiness, and also its weaknesses and strengths in the

absorption and use of the knowledge. Then the firm must know how to suitably select and transmit the underlying information in an appropriate form. This theory about a firm's transfer capacity provides explanation of what capabilities are needed to benefit from its organizational knowledge on a new market. Therefore this is valuable for the purpose of the thesis.

2.3.2 Transfer of organizational knowledge

Organizations that are able to make good use of their collective knowledge and expertise are likely to be more efficient, effective and innovative in the marketplace (Argote, 1999; Grant, 1996). However, knowledge transfer in practice has proven to be a difficult challenge (Argote, Ingram, Levine, Moreland, 2000; Szulanski 1996). Knowledge transfer can be explained as the practical problem of getting a package of knowledge from one part of the organization to another part. It is not just a communication problem, because a large amount of the knowledge in an organization is tacit or hard to articulate (Nonaka & Takeuchi, 1995).

Knowledge transfer is a complex process due to the fact that knowledge belongs to organizational members, tools, tasks and their sub networks (Argote & Ingram, 2000). The geographical size and spread make the location of existent organizational knowledge and its transfer to the place where it is needed really difficult (Davenport & Prusak, 1998).

Single existence of knowledge anywhere in the organization does not generate great benefits. That is because such knowledge becomes a valuable organizational resource only when it is accessible. Valuable resources will increase by means of the level of accessibility (Davenport and Prusak, 1998).

Since this thesis focuses on how the organizational knowledge of a firm may affect its entry mode decision, it is important to understand the complexity that is related to the organizational knowledge. If a firm is able to view its organizational knowledge from different angles it may be more plausible that such knowledge can be transferred to new locations. The above theories suggest that organizational knowledge involves both explicit and tacit parts, it belongs to organizational members, tools, tasks and their sub networks, and it is spread geographically. Still, it is only a valuable resource when it is accessible.

2.3.3 Transfer of tacit knowledge

Buckley and Casson (1976) state that the internalization theory focuses on the economics related to leveraging existing intangible assets for deployment abroad. One of the most fundamental premises of internalization research on multinational firms suggests that to succeed, a firm must have advantageous knowledge-based assets that are also intangible (Buckley and Casson, 1976). The internalization view implies that knowledge-based assets can be exploited in various locations at only small or even no costs (Caves, 1971, 1996).

Martin and Salomon, 2003, mean that recent work in the knowledge-based literature suggests that depending on the level of tacit knowledge in the knowledge-based resource, the chances and the manner of supporting corporate expansion will differ. Grant (1996, p 114) said that "if most of the knowledge relevant to production is tacit, then transfer of knowledge between organizational members is exceptionally difficult".

Martin and Salomon explain that transferring knowledge-based assets to foreign countries cannot be taken for granted. The "tacitness" of knowledge can impede the transfer re-

quired for foreign production so that it constrains also the choice of entry mode, these authors say. They mean that the suitability of entry mode is affected by the level of tacitness. Simonin (1999b, 463) concluded: "tacitness emerges as the most significant determinant of knowledge transferability".

Martin and Salomon (2003) also state that firms in the upper extreme within a tacitness range face the situation of prospects for tapping foreign markets exist, while at the same time the obstacles to foreign production are the greatest, as for such a situation, transfer costs rise fast. The intermediate level of tacit knowledge is most plausible for transferring of knowledge-based assets abroad according to these authors.

Galbraith (1990) suggested that tacitness does not only increases the amount of time that is required to transfer a specific technology but also the time required *after* the initial transfer in order to be as effective as possible in the new location.

Tacit knowledge takes time to explain and learn. Therefore, it tends to slow the transfer of manufacturing capabilities (Zander & Kogut, 1995) and new product development projects (Hansen, 1999).

Since tacit knowledge is not only highly personal, it is also deeply rooted in an individual's involvement within a specific context, transferring tacit knowledge may require numerous individual exchanges (Nonaka, 1994). Identifying the relevant tacit knowledge is a must for firms attempting to transfer knowledge in order to be successful with the knowledge transfer. Therefore, a predictor of future success or failure is the extent to which this identifying is possible (Mooradian, 2005).

As tacit knowledge character increases, knowledge becomes less "teachable," less codifying, and then less transferable. This knowledge transference is complex and difficult for several reasons. It has a complex nature and the acquisition may be gained by means of experience with a test and error method. The teaching and learning, if at all possible, is developed by e.g. demonstration, observation, imitation and feedback, which are activities that need close personal contact for a long period of time. Organizational learning generates tacit knowledge that is collective and even more difficult to transfer. Although expatriate staff can serve as a sort of substitute for tacit knowledge transference, it becomes a very costly process, because tacit knowledge might be collective and needs the transference of a large amount of individuals from the head company, which might not be practical or even possible (Ordonez de Pablos, 2004).

We do not agree with the fundamental internalization view that knowledge-based assets that a firm possesses can be exploited in various locations at only small or even no costs. We rather agree with Martin and Salomon; Grant; Simonin, on that factors such as the level of tacit knowledge do determine how big the chances and the costs are to support corporate expansion. Martin and Salomon say that the suitability of entry mode is affected by the level of tacitness, which is important information for the purpose of this thesis. As the tacitness-level raises, the obstacles to foreign production raise and so do the transfer costs, these authors suggest. This is also in line with Ordonez de Pablo's suggestion that teaching and learning of tacit knowledge requires close personal contacts for long periods of time.

Costs rise also because it is more time-consuming to transfer high levels of tacit knowledge both during and after the transfer, Galbraith, Zander & Kogut, Hansen informs. Such knowledge transfer may require numerous individual exchanges according to Nonaka. Mooradian suggest that one predictor of future success is whether or not a firm is able to identify the relevant tacit knowledge. We believe that this is important be-

cause when a company is expanding globally it might be eager to get started as soon as possible, but when high levels of tacit knowledge transfer is included, it might take more time than expected to transfer the knowledge that needs to be transferred. We also believe that the planning phase can take long time and be costly and complex. This is when the firm plans how to enter the new market to best make use of its current knowledge and at the same time build new competencies that is needed. We think that all this is especially applicable for an Italian firm that has built its competitive advantage on craftsmanship and art that has evolved during long time. That is because this type of traditional Italian industrial knowledge involves a big deal of tacit knowledge that can be tricky and costly to transfer to a new market.

2.3.4 The impact of trust and reputation on knowledge-transfer

Not being aware of influential aspects could mean that the knowledge transfer fails due to lack of attention. One of these aspects is the impact of trust and reputation.

According to Porter et al. (1974) commitment is the trading partners' willingness to exert effort on behalf of the relationship. Cummings (1984) says that a high commitment level enables two parties to achieve both joint goals and individual goals simultaneously without opportunistic behavior. Mohr and Spekman (1994), state that commitment suggests that partners take a more future oriented view of their relationship, in order build a relationship that can withstand unanticipated problems.

Relational capital that is trust-based can contribute to a freer and greater exchange of know-how and information between committed exchange-partners (Kale et al. 2000).

Also Leyland (2005) suggests that trust between the parties involved and understanding of the reputation (both knowledge-provider reputation and knowledge-recipient reputation) has a particularly important role in facilitating knowledge transfer. Leyland (2005) believes that a successful transfer of organizational practices requires an examination of how the employees' assessment of information will affect these individuals' attitudes and actions.

Leyland (2005) means that this knowledge helps to understand how trust and reputation may result in certain knowledge transfer patterns. Therefore, it is important for management to understand how relationships impact knowledge transfer. Leyland (2005) says that finding ways to assess others is a base for the notion of trust. Historically, this has been done by face-to face interaction, but nowadays virtual communication is extensively used.

Virtual communication may facilitate a lot more knowledge transfer opportunities, but some basis of trust must be established in order for such knowledge exchange to actually occur. Access to information does not always guarantee its use. There are two sides of this. Sometimes embeddedness (allows strangers to feel comfortable with strangers and develop trust) is needed for parties to feel trust and to change information, and then face-to-face contact is required (Leyland, 2005).

However, it can also be that in a crisis situation trust can be developed through virtual communication. That is because if one party has something that is critical for the performance of the other party, these parties may be less cautious and also more willing to deal with a stranger. Transfer of knowledge will only occur when both the receiver and the provider firstly, are willing to show confidence in each other's intentions, and also have similar interests. For this to happen, the parties must both trust each other and be sure that the appropriate reputations actually are in place. In the light of this knowledge, management

should pay attention to understand individual employees' actions (Leyland, 2005).

Relational capital can be defined as mutual trust, respect, and friendship that exist in close interaction between individuals of alliance partners. Such capital may significantly increase the capability to manage the dual objectives of protecting its own core proprietary assets and at the same time learning from the alliance partner (Lee et al, 2007).

Lee et al. (2007) argue that a high knowledge ambiguity suggests that the firm need to build up relational capital to be able to facilitate knowledge exchange. That is why firms with high levels of knowledge ambiguity have greater relational capital.

Levin's & Cross's research (2004) offer two main insights that may support practitioners in the effort of managing transfer of knowledge. They offer evidence that benevolence-based trust consistently matters in knowledge exchange and also that competence-based trust matters most when the exchange involves tacit knowledge. Awareness of this may for example help executives in targeting suitable points where investments in interventions designed to promote trust are likely to payoff to the organization.

In research there are many studies that show how important strong ties are for conduit of useful knowledge (Ghoshal, Korine, Szulanski, 1994; Szulanski, 1996). Tie strength is a concept describing how weak or strong a relationship between two parties is. The phrase characterizes the closeness and the interaction frequency between a knowledge seeker and a knowledge source (Hansen, 1999). Levin's & Cross' (2004) results suggest that both individuals and organizations could benefit from developing trusted weak ties, not just strong ties, although this strategy does carry the risk of misplaced trust. Since weak ties are less costly to maintain this is interesting findings for managers (Hansen, 1999). The benefits of perceived trustworthiness plus weak ties makes it fruitful to focus on ways to improve trust, since this could be a relatively inexpensive and pragmatic way to improve flows of useful knowledge and advice in organizations. Training for and assessing trustworthy behavior can be done by e.g. evaluation procedures or by investing in processes intended to create a shared vision and language (Levin & Cross, 2004)

These theories say that says that, in order to build relationships that can withstand unanticipated problems, alliance partners should take a more future oriented view of their relationship (More and Spekman). For this to happen, says Cummings, the partners need to feel a high commitment level, which enables the parties to achieve both joint goals and individual goals simultaneously, without that opportunistic behavior occurs. Furthermore, if a firm can build a trust-based relational capital, the chances increases to enhance exchanges in know-how and information between the committed exchange partners, says Kale et al. and also Leyland. Leyland means that a firm must be able to examine how the employee's assessment of information will affect their attitudes and actions, since finding ways to asses others is a base needed to perceive trust.

Face-to face interaction is not the only way to achieve this, but nowadays also virtual communication may be used to increase knowledge transfer opportunities. If a trust base is initiated by face-to face contacts, this trust base can be developed for example during a crisis by the use of virtual communication. Levin's and Cross's suggestion on that trusted weak ties can be a cost-effective way to support strong ties, is consistent with this notion. A firm needs the relational capital, with trust, respect and friendship that is a result from close interaction with partners in order to manage the dual objectives of protecting core proprietary assets and at the same time learn from alliance partners. This is why firms with high levels of knowledge ambiguity have the greatest relational capital says Leyland.

Levin's & Cross's also explain that benevolence based trust is always important, for all types of knowledge

transfer, but the competence based trust is extra influential when the knowledge has tacit characteristics. This knowledge implies that a firm seeking to exploit its capabilities abroad also needs to think about what kind of trust is missing and how it can be achieved.

Drawing on the view of Levin & Cross, we suggest that a firm aiming at transfer its knowledge or know-how to partners abroad is better off if it has experience of creating a shared vision and a shared language.

All these theories provide useful information about knowledge, skills and abilities that a firm needs in order to be able to exchange knowledge with its new alliance partners abroad. That is why this section contributes to the answer of the purpose.

2.4 Protecting the knowledge that is to be transferred

“Imitation is simply replication performed by a competitor. If self-replication is difficult, imitation is likely to be even harder. In competitive markets, says Teece, 1998 p. 66, “it is the ease of imitation that determines the sustainability of competitive advantage”.

The knowledge protection mechanism consists of policies and rules helping to control and monitor the knowledge sharing and the creation process. If the knowledge protection mechanism is strong, the firm “will be more willing and able to trust, communicate with, and make commitment to its alliance partners” p.63 (Lee et al, 2007). Lee et al. also suggest that knowledge protection is the antecedent of the firm’s building of a relational capital. That is because the knowledge protection mechanism will make it possible to balance the flows of knowledge in and out of the firm. Without knowledge protection it is impossible to prevent that knowledge leaks to partners, Lee et al argue.

The risk of dissemination can be explained as the risk that specific advantage of the firm, such as know-how in technology or marketing, can be expropriated by a joint venture partner or a licensee. For example, if a firm grants a license to a foreign company to employ firm-specific know-how to manufacture products, the firm granting that license runs the risk of that the licensee, or someone hired by that licensee, could use that know-how for purposes that are not in line with what was intended (Hill and Kim 1988).

When an organization’s competitive advantage is primarily based on proprietary know-how, protecting that know-how against expropriation by for example licensing or joint venture partners is first priority. Once such critical know-how has gone, so has the competitive advantage of the firm. The risk of dissemination can be proposed to be smaller in the case of a joint-venture compared to the case of a licensing partner. In situations with knowledge-intensive industries, wholly owned subsidiaries will be favored as an entry-mode into new markets. The reason for that wholly owned subsidiary is not so risky from a dissemination point of view, is that the internal organization fosters a kind of atmosphere that is in line with the goals and also the values between the members of the firm. However, there is also a possibility that a key employee of a wholly owned enterprise leaves the firm with the firm-specific know-how she or he has and eventually join another competitive firm (Hill and Kim 1988).

When a firm participates in alliances, there is a probability of unilaterally or disproportionately losing the firm’s core capabilities or skills to an alliance partner. Thus, firms in alliances must balance between trying to learn and trying to protect (Kale et al., 2000).

Lee et al, 2007, explain that to understand the knowledge protection process in strategic al-

liances, it is important to consider both knowledge-specific variables and relation-specific variables that impact and are influenced by this process. These authors suggest that in enhancing alliance performance, it is important to build up the knowledge protection mechanism and build up the relational capital simultaneously. Furthermore, Lee et al. argue that knowledge protection is a kind of organizational capability, useful for sustaining the competitive advantage and for increasing the alliance performance.

The risk related to dissemination of know-how is highest in the cases of licensing, thereafter comes the case of a joint venture with somewhat lower risk, and it is the wholly owned subsidiary that brings the lowest risk of dissemination. This statement by Hill and Kim's has direct implications for what type of entry-mode is best for different levels of proprietary know-how. Furthermore, again the importance of a balance between learning and protecting knowledge is brought up by Kale et al. According to Lee et al, there are two variables that impact and are influenced by the knowledge protection process; knowledge-specific variables and relation-specific variables. We believe that this is useful information when assessing how the knowledge of a firm can affect entry-modes, since we see the relation-specific variables as organizational knowledge also.

Transaction cost theory and opportunism

Transaction cost (TC) theory suggests that the transactional characteristics of knowledge make its transfer vulnerable to opportunism from licensees or partners in contractual modes (Teece, 1981; Anderson and Gatignon, 1986). Protection of the knowledge from this threat is therefore a primary driver when the entry-mode choice is to be made, and the consequences are a higher propensity for firms to choose high-control modes of entry, for example wholly owned or majority-owned ventures, according to this theory. (Malhotra, 2003).

According to Kogut and Zander (1993) the TC explanation for the organizations' choice of entry is not enough. These authors mean that firms differ in their capabilities both to understand and to apply knowledge. Therefore it will be the relative efficiency to competitors of how to *transmit* knowledge internally or between firms that decide whether or not it is more cost effective to transfer knowledge within the firm, such as in a wholly owned subsidiary. By this way, these authors explain, cost arise more on account of differential capabilities instead of transaction costs growing out of opportunism, e.g. misappropriation or dissipation of technology (Kogut and Zander, 1993). Also Love (1995) agreed on that opportunism is unnecessary and rather suggested that the coding and teaching of tacit knowledge induce so large transaction costs and thus cause a preference for intra-firm transfer.

McFetridge (1995) argued that reducing the incentive for opportunism is the reason for creating unified governance structures with cooperation and flexibility.

Malhotra (2003) does not agree that the TC theory provides enough understanding about the knowledge construct, but mean that it rather oversimplifies it by using only characteristics of generic attributes of tacitness and proprietariness. Tacit knowledge is hard to copy and put on paper, and proprietary knowledge is a firm-specific advantage relative to host-country firms, enjoyed by firms as they enter new markets. Malhotra says that questions such as what the knowledge is about or where it is held, or what forms it takes for it to make up a source of advantage for the organization, is not dealt with, even though such information is needed to evaluate the risk from an opportunistic threat from licensees or business partners.

To summarize these two perspectives, the first one, originating in TC theory, is explaining the large extent

of entry modes that are done within the firm boundary, as depending on the will to overcome the risk of costs coming from opportunistic behavior. The second perspective presented by Kogut and Zander, Malhotra and Love suggests that it is rather the costs from transferring the knowledge or the capability to transfer knowledge that decides what entry mode is right. Malhotra especially emphasizes the TC explanation of the organization's choice of entry is oversimplified. Malhotra's argumentation for that several aspects need to be included in the basic data for decision making about entry mode adds to our idea that understanding the organizational knowledge is important for the choice of entry mode.

Transfer of organizational capability

The *Organizational capability* (OC) perspective defines the value of a firm's resources or capabilities in terms of its contribution to the competitive advantage (Collis and Montgomery, 1995; Madhok, 1997). Madhok, 1997, discusses the Organizational Capability, OC, and explains that imperfect irritability results from embeddedness, which is when the firm's capability is deeply embedded within the firm's routines and therefore becomes specific to a firm. Furthermore, embedded knowledge is not owned by only one specific individual, says Lam (1997), but is instead embedded in team relationships and social interactions within a firm. Therefore, it cannot easily be coded in a systematic way. Transfer of such knowledge can only be done through intimate social interaction which requires established routines and organizational processes, says Lam. Madhok, 1997, suggests that internal modes are more suitable than market modes to transfer imperfectly irritable capabilities.

Krishna Erramilli et al, 2002, has investigated the question of when it is suitable to transfer resources and capabilities via franchising, which can be called a quasi-market mode, and when it is better to use a Management-Service-Contract (MSC), which can be called a quasi-internal mode). This author also provides support for the OC-based suggestion that imperfectly irritable capabilities, like Organizational Competence and Quality Competence, cannot be transferred effectively through market modes. Organizational Competence is defined as a range of organizational skills and resources that enable a firm to compete better, including e.g. corporate culture, empowerment, operating policies and procedures and systems. Quality Competence is the resources and skills that a firm needs to offer high quality and to ensure customer satisfaction (Krishna Erramilli et al, 2002).

Moreover, Krishna Erramilli et al, 2002, explain that the transfer of easy- to-replicate capabilities does not influence the choice of non-equity mode. Such capabilities can be transferred just as effectively by using internal non-equity mode (MSC) as using the market non-equity mode (franchising). This is not consistent with the studies presented by Kogut and Zander, 1993; Arora and Fosfuri, 2000, which contrasts internal equity modes (wholly-owned subsidiaries) with market non-equity modes (licensing). In their studies the market non-equity mode, franchising, is clearly favored if it is codified know-how that is to be transferred.

However, when the capabilities of a firm are irritable, the internal and market modes of transferring those capabilities are perhaps equally useful, says Krishna Erramilli et al (2002), even if the additional risks and costs associated with the internal modes often favor the market modes.

Different studies have empirically examined firms' entry-mode choices. For example (Henkart, 1987; Kogut and Zander, 1993; Arora and Fosfuri, 2000), have compared equity-based and internal modes, such as wholly-owned subsidiary, with non-equity based and market modes, such as licensing, in the manufacturing sector. These authors find evidence

for that firms do favor internal modes, e.g. wholly owned subsidiaries or joint ventures, when they aim at transferring tacit, imperfectly irritable, capabilities. Market modes, such as licensing, are chosen when the firm needs to transfer codified, readily irritable, capabilities, according to these authors. According to Krishna Erramilli et al, 2002, imperfect irritability does not just protect the firm from competitors, but also stop efforts to transfer the required capabilities to contacts and collaborators in the new, host market. In this way imperfect irritability forces the firm to take on internal modes of entry, says Krishna Erramilli et al. This is also consistent with the findings that difficult-to-codify tacit know-how is transferred internally by Kogut and Zander, 1993 and Arora and Fosfuri, 2000.

This theoretical part adds to the notion that capabilities that are necessary for competitive advantage may be embedded in team relationships and social interactions within a firm, and therefore it may not be owned by a specific individual. Such knowledge is imperfectly irritable. Transferring such knowledge requires intimate social interaction with the firm's established routines and organizational processes, says Lam. Madhok and Krishna Erramilli suggests that such knowledge be transferred with internal equity entry modes. Moreover, Krishna Erramilli's suggestion that irritable capabilities can be equally efficient transferred by market modes or internal modes, is interesting for this study, since this means that a firm's apprehension of its own capabilities can play an important role for the success of the entry-mode choice.

2.5 Strategic development methods and entry modes

Now the theory shifts its focus from internal matters to external ones. As have been mentioned throughout the frame of reference, the knowledge and capability that the firm possess, which are internal sources of competitive advantage, included in the strategic position of a firm, can have impact on strategic choices of development methods. A firm planning to enter a new market needs to make complicated evaluations of the most effective and cost efficient entry-mode to the new market. In doing this evaluation, one of the aspects will be to relate the internal characteristics, weaknesses and strengths of the organizational knowledge with the external opportunities and threats associated with different entry modes. The first part of this section explains some reasons for and some obstacles to adopt international sourcing.

2.5.1 International sourcing (IS)

The term International sourcing (IS) refers to when a domestic company purchases material or other components outside the national border. This can be done in several ways depending on the situation of the company in question. It can be due to its geographical location and extension of the supply chain and international distribution of its manufacturing facilities. Also, the presence of a strategy where manufacturing choices are linked to procurement and sales decisions may affect the IS. A special combination of factors such as obtaining scarce resources, cheaper resources, the possibility to reach international markets etc is required in order to fit each company individually (Nassimbeni, 2004).

Sourcing abroad means a change in working and it is crucial for the performance of business to be aware of the difficulties that possibly can appear. The most common obstacles when using IS are problems related to cultural and linguistic differences, contractual uncertainties and political instability of some foreign countries. There will most probably also arise additional costs due to transportation, intermediation and for the personnel that needs to work with the international transactions, import taxes, logistics etc. This is also an important part when considering and planning for IS (Nassimbeni, 2004).

In an earlier qualitative study concerning IS dynamics in Italy, done 2004 by G. Nassimbene, 78 Italian companies were analyzed. It reached the conclusion that the main motivations for companies to IS are; access to less expensive resources and intensification of global competition, their commercial presence on new markets and access to distinctive resources. It also reached the conclusion that the main obstacle is to managing logistics, followed by the difficulty of evaluating the capabilities of foreign suppliers and then developing good relations with them. Obstacles of moderate importance consisted of bureaucratic problems, differences in culture and language, political instability of some foreign countries and hardness to find skilled personnel to lead IS activities. The main criteria's when it comes to supplier selection is the quality, price and reliability of deliveries (Nassimbeni, 2004).

The theory presented by Nassimbene is useful for this study since it explains why Italian firms choose to source internationally. It is the access to less expensive resources, the intensification of global competition, and also to achieve a commercial presence on new markets, and access to distinctive resources. For the same category, the obstacles to IS were found to be managing logistics, followed by the difficulty of evaluating the capabilities of foreign suppliers and last developing good relations with them. This information is valuable when answering the purpose of the thesis, since it can help in the process of finding out what competence a firm can have and what competence a firm can seek in order to be able to create value on the new market.

2.5.2 Strategic development methods – entry modes

“A development method is the means by which any strategic direction will be pursued” Johnson, Scholes and Whittington, 2006, p.348. Such development methods can be divided into three different types; internal development, acquisitions and alliances (or joint development). These will be presented below.

The ability to control internal production and distribution processes, as well as economic and political factors strongly determines the particular choice of entry mode according to the entry mode literature. Depending on how the company chose to enter the new market there will be different control possibilities. The definition of the word control is the ability the firm has to influence the management systems to the firm, so that it can improve the competitive position, and maximize the returns on firm-specific assets. The level of control is the highest in the case of wholly owned subsidiaries, and lowest in the case of licensing. For joint ventures, the level of control is affected by how the ownership has been divided and the level of parties involved (Hill et al., 1990).

When multinational enterprises evaluate different entry-modes for new markets, the requirements of the operational context and the current knowledge base must be considered to be compatible. The entry-mode that the organization chooses is influenced by the costs of replicating knowledge within the organization relative to its market transactions. Therefore, the cost of developing and deploying the requisite capabilities needed in-house is critical (Collis, 1991). Firms that enter foreign markets do not only do so for exploiting their existing rent-generating resources. They will also develop new resources and build new capabilities through knowledge acquisition and learning (Luo, Y. 2001)

Internal development

Internal development is when the strategies build on and develop the organizations own capabilities (Johnson, Scholes and Whittington, 2006). Luo, Y, 2001, suggest that the likelihood of choosing a wholly-owned mode is greater when the MNE's has an experience of

the host-country. Also when the firm needs knowledge-protection or global interaction, the wholly-owned alternative is more suitable according to Luo.

Superior knowledge and experience that a firm has about a host country suggests a preference for the wholly-owned entry mode (Doz and Prahalad, 1991; Hamel, 1991; Zander and Kogut, 1995). Also Lin (2000) argues that experiential knowledge has an immense impact on the choice of entry mode in China, an emerging market with high environmental uncertainty, but also high market potential.

Many manufacturers do not want to use agents in the development of new markets, but rather chooses direct involvement. It can for example be that the direct involvement that is a result of having e.g. an own sales force, can be valuable in gaining a good understanding of the new market. This market knowledge can become a core competence in the competition with competitors that are distant from the customers in the new market (Johnson, Scholes and Whittington, 2006).

It can also be a situation where a firm produces products that are highly technical either in method of manufacture or in design. In such a situation, the firm may choose to develop new products themselves, since the development process itself is a source to the necessary capabilities that are needed for successful competition on a market. Another important reason for using internal development, especially for small firms, is to spread the cost over time, rather than acquiring other companies, which may require substantial expenditure at one point in time. Moreover, reasons to use internal development as an entry mode may be caused by a difficulty for a foreign firm to find suitable firms to acquire (Johnson, Scholes and Whittington, 2006).

Mergers and acquisitions

Acquisition is explained by Johnson, Scholes and Whittington, 2006, pg. 349, “where strategies are developed by taking over ownership of another organization”. Many companies’ key motive to acquire another company is that the process of an internal development would become too slow, and using internal development would therefore be impossible for successfully enter the new market. Another motive to use acquisitions is that it can reduce the risk of competitors’ reactions, while a new firm entering a static and steady market, may cause excess capacity and an imbalance between supply and demand (Johnson, Scholes and Whittington, 2006).

An acquisition can be a means to exploit the firm’s core competences in new arenas, such as in a case of global expansion. But acquisition can also be an opportunity to address the lack of resources or competences that are required in order to compete successfully. It can also be that the necessary innovation or organizational learning from internal development would be too slow compared to acquiring an already established company that have achieved important expertise or efficiencies that are needed quickly (Johnson, Scholes and Whittington, 2006).

Strategic alliance and joint development:

Multinational enterprisers (MNEs) are now using a multitude of forms in extending their organizations all over the globe. In today’s environment MNE’s often tries to collaborate, since they feel that it is not enough to rely only on their own capabilities. They see the collaboration as a way to complement and reinforce their knowledge (Madhok, 1997).

In order to develop firm capabilities, collaborations are formed. Therefore, the collaborative mode can not only be seen as a cost-efficient alternative to the more costly wholly-owned subsidiary, but rather a better alternative to knowledge acquisition (Luo, Y. 2001).

According to Johnson, Scholes and Whittington, 2006, pg. 353, “A strategic alliance is where two or more organizations share resources and activities to pursue a strategy”. Johnson, Scholes and Whittington explain that this type of joint development of new strategies is becoming more and more popular. The reason is that the increasing complexity in environments makes it impossible for many organizations to compete only by the internal resources and competences. Therefore organizations may search for skills or materials, innovation or finance or maybe access to markets through cooperation rather than ownership. However, about half of the alliances will fail, say these authors. The variation is big among alliances; examples are two-partner alliances co-producing some product and a large alliance including multiple partners that provide very complex products or solutions. One type of alliance is joint ventures. In this form of relationship the organizations remain independent, but together they set up a *joint venture* which is jointly owned by two or more firms. This is a favored means of collaborative ventures in China, where local firms usually provide entry to the markets and the western companies offer technology, management expertise and finance (Johnson, Scholes and Whittington (2006). Contracting suppliers is one type of a strategic alliance.

When the firm is faced with contextual risk or uncertainties, the joint-venture mode is preferred, which points to that learning from a partner enhances an organizations capabilities in a dynamic environment (Doz and Prahalad, 1991; Hamel, 1991; Zander and Kogut, 1995)

Gulati, 1995a, explain that strategic alliances are inter-firm cooperative arrangements aimed at achieving firms' strategic objectives. Examples of strategic alliances include for example joint ventures, joint R&D, minority equity alliances, and joint marketing. Strategic alliances as a cooperative strategy have recently become increasingly important (Doz and Hamel, 1998). Lu and Beamish (2001) argue that when SMEs expand into international markets, an effective strategy in overcoming the deficiencies of SME's resources and capabilities is to form alliances with partners with local knowledge.

Also Heimeriks and Duysters (2007) suggest that strategic alliances increasingly have taken the place as a cornerstone of many firms' competitive strategy. They clarifies that this co-operation method is used as a means to entering new markets, sharing development costs and for providing more complete solutions to the customer. However, the performance differs among firms in strategic alliances. While there are many firms that are effective in undertake alliances, others suffer from failures. Heimeriks and Duysters claim that experience and alliance capabilities are important qualifications of the alliance performance. To optimize the firm-wide alliance capability, and to learn from experience of previous alliances, firms must commit to dispersing alliance knowledge. For this firms need deliberate learning mechanisms, for example alliance departments or alliance managers. Firms that do not share the lessons learned, risk to fail since critical knowledge stays only in those who have learned the lesson.

3 Method

In this chapter will we explain the quantitative and the qualitative methods of research, and also the one method we have chosen. We will also explain how the interviews were conducted and analyzed. We will also deal with which kinds of instruments were used.

3.1 The qualitative vs. the quantitative approach

The quantitative approach is based on a large sample of hard data which is transformed into numbers in order to make a statistical analysis (Trost, 2005). The approach goes wide instead of deep into the subject matter, and approaches the studied field from the outside. Since a large sample is used in this method, the information about the subject analyzed is very brief. The quantitative method is performed in a systematic way with structured surveys and fixed questionnaires which help the researcher to transform the answers into statistical data. When using this approach the question why cannot be answered (Holme & Solvang, 1997).

The qualitative approach is a deeper approach used in order to obtain a deeper understanding of the subject matter (Trost, 2005). The researcher looks for patterns which are then analyzed and concluded in the field of study. This approach is used when the aim is to answer the question why and there is no want to generalize the data obtained (Svenning, 2003). This approach should be considered to be the more time consuming one since it requires an in-dept investigation of the field. Therefore, the sample used is small and the gathered information is highly limited (Holme & Solvang, 1997). In-dept interviews and observations are the most common ways of performing this approach (Svenning, 2003). The researcher and subject of investigation have the possibility to question and answer freely, which means that the questionnaires are not fixed. The field of study is examined from the inside (Holme & Solvang, 1997).

One of the major advantages with the qualitative approach is the fact that it reflects the entire subject of interest. Interviews performed after this kind of method gives the investigator a possibility to develop a deeper sense of understanding for the company investigated. Due to this fact, the knowledge and experience of the investigator will also be reflected in the results of the study, that is, the result can be biased due to the lack of knowledge or viewpoint of the researcher. This should be considered to be one of the major disadvantages with the qualitative method (Holme & Solvang, 1997).

3.2 Method chosen

The chosen method should be based on which approach better suits the purpose of the investigation. In this thesis, the qualitative approach has been chosen due to the fact that the purpose requires an in-dept investigation and a deep understanding of the subject area. Generalizations are not the aim with this thesis since the situation for FCC will most probably differ from other companies. In order to answer the purpose of this report, the qualitative method has therefore been chosen.

This is the most appropriate approach to use since we want to obtain a deeper understanding of the complexity of FCC's knowledge that constitutes the core competence, and how this can affect their choice of entry mode when FCC enters the Chinese market. It is very

complex to define core competence as knowledge, since it is compounded by many separate parts of knowledge and competencies. Also, different firms have different competencies and knowledge that is valuable for their competitive advantage. Thus a deep investigation of a specific case is required. Therefore, it would not be possible to use standard questionnaires, which are used for quantitative studies, to obtain the deep understanding of this type of a complex issue.

This is why we have chosen to perform the investigation through a number of in-dept interviews with an Italian company that aims to start production and sales in China. The information obtained will be analyzed for the purpose of finding conclusions in the perspective of the theory chosen. Since it is normally very hard to get Italian companies to share the information needed, we discussed the purpose chosen with a professor within the area of strategic management, Prof. Alberti, Milano, in order to make the most of the opportunity.

The case-based type of study provides possibilities to capture the issues of the knowledge that is to be transferred in a historical context of the firm, which include for example the sources of advantage that has been accumulating ever since the firm started. A typical Italian firm is built on craftsmanship resulting from prolonged experience and knowledge. When this knowledge becomes the core competence of the firm, it is not easily revealed or understood or copied. The purpose of this thesis needs a qualitative method since that can facilitate a richer understanding of specific business and firm characters that contribute to the competitive advantage and the types of entry-modes that are suitable for the firm of focus.

The purpose of this thesis is to reach a deeper understanding of the complexity concerning how the organizational knowledge that is needed for FCC's competitive advantage in China, can affect the choice of entry mode.

Due to the fact that the thesis is written as a case-study, FCC is the sample used in the investigation. To understand the problems with knowledge transfer, a profound examination of the production process was needed in order to understand exactly which knowledge was the most difficult to transfer.

The in-dept interviews have provided insight about FCC characteristics, which have been analyzed in the light of useful and relevant theory in the field. We want to provide new and important insight from a unique event in the business world, for this reason the case study approach is most rewarding.

How the interest of this subject and the purpose of this thesis evolved

While one of the authors of this thesis, Bryntesson got in contact with the Italian olive oil company FCC during her business studies in Milan, Italy, she got the idea of using this company as a source of empirical knowledge in this bachelor thesis. As the first interview with FCC took place, Bryntesson, understood that this firm was just starting a new strategic development, suggesting that FCC capitalize on its capabilities and competencies by going into the Chinese market, as a counteract to the current threats from this low-cost country on the Italian manufacturing industry. Questions such as what knowledge is the source of competitive advantage and how does it need to be protected while going to China were brought up. The mode of entry was not yet decided at this point in time. After some time and a lot of reading of theories, we finally decided that we wanted to reach a deeper under-

standing of the complexity concerning how the organizational knowledge that is needed for FCC's competitive advantage in China, could affect the choice of entry mode.

When this organizational knowledge will be described in this thesis, we have tried to find out how the owners and entrepreneurs of FCC see their organizational knowledge and related that viewpoint to theory of the matter.

Before this thesis was finished, FCC had come to the point where a contract with a Chinese supplier was nearly signed.

The authors of this thesis believe that the perception that an entrepreneur has on the firm's knowledge and how that knowledge can relate to the decision of entry-mode, is interesting information for the fields of knowledge within strategic management and knowledge management. That is because the theoretical knowledge that connects organizational knowledge with choice of entry-mode seems to be rather limited.

FCC – Frantoi Celletti e Cultivar

This thesis is a case study of Frantoi Celletti e Cultivar, which will here be referred to as FCC, a family owned Italian olive oil company in Milan that has decided to enter the Chinese market. By using their knowledge of the genuine Italian olive oil production process, FCC intends to maintain their very high product quality when going into the Chinese markets.

Beijing Regalland Convention & Exhibition Co., Ltd. is one of the specialized exhibition & convention companies in China. Regalland has arranged three professional olive oil exhibitions in Beijing, China, during the last years. It says that in China, there is a requirement that the products sold on the market must have locally produced contents. In order to get access to the market and to bring the production-costs down, FCC has decided that all the olive oil intended for sales on the Chinese market is going to be produced in China. FCC believes that the risks related to selling olive oil only in Italy will be spread when FCC enters China. But the decision to enter the Chinese market was also based on the cost advantages offered (G. Celletti, Interview Oct 4th 2006) and to reach a new market where the demand for high quality Italian olive oil is growing to enormous amounts every year (Regalland, 2006).

FCC prepares to start new Italian restaurants in China in order to get a channel for sales of the olive oil to the Chinese. Regalland, 2006, claims that the customer segment of rich Chinese who require outstanding quality is growing. This customer segment is the focus for the new Chinese restaurants. Furthermore, FCC explains that they probably also will start distribution to exclusive retailers in China, as well as sales via the Chinese Web.

One of FCC's key issues in the process of entering the Chinese market is to assure that the high quality will be remained also on this big market. According to G. Celletti (Interview Oct. 4th, 2006) the knowledge of the Italian manufacturing process is the key to the high quality level.

For this to become true, FCC must successfully transfer significant parts of their *production knowledge* to the new supplier in China. Such a transfer of the production knowledge has not really been carried out by FCC before, since the Italian olive oil suppliers that learnt how to produce according to FCC's instructions, had long previous experience of producing good quality olive oil. The intended new Chinese producer has little or no such experi-

ence, since the Chinese tradition is to use oil from seeds. If FCC would fail in transferring its production knowledge, the competitive advantage of supplying the Chinese market with better olive oil that is currently available for the Chinese will be lost. Both the cost of transferring that knowledge and the efficiency of the knowledge transfer must be taken into consideration when planning for and choosing the entry mode to China.

Also the knowledge and experience that is required throughout the *distribution chain* needs to be transferred and used in China since FCC's marketing, selling and cooking the food etc also belong to their business concept. FCC believes that it is important to keep their concept when it comes to using their knowledge throughout its distribution chain. Since they are used to have control over the production process and distributing the oil through their restaurants, through the internet, and through exclusive retailers, their aim is to be able to do the same in the Chinese market (G. Celletti, Interview Oct 4th, 2006).

Another key issue in the process of entering the Chinese market is so *protect the competitive knowledge* so that competitors cannot use it; therefore, protecting its knowledge from opportunism is also an important aspect that deserves to be included in the decision of entry-mode. "There is a widespread consensus that we are moving towards an economy where knowledge will be a fundamentally more important determinant of competitive advantage than access to raw materials and cheap labor" (Lee et al, 2007, pg.58). In this new type of economy, knowledge protection can be proposed to be as critical as innovation for the firms' competitive advantage. In order to be globally competitive, organizations need to form organizational arrangements that enable protection of their knowledge, according to Lee et al.

Still one key issue for FCC when entering the Chinese market is how FCC can *gain competitive knowledge* that is currently missing in the organization. For example, FCC lacks knowledge of the Chinese business climate, distribution channels, business networks, laws and regulations, cultural implications on its business, customers' taste and preferences etc. When FCC considers its entry-mode, it must also think about how to best be able to develop its current knowledge and attain the new knowledge needed in order to attain a competitive capability. Organizational capability is not only a source of competitive advantage, but can also be a constraint (Madhok, 1997).

We will focus on how the knowledge that FCC has, and which is needed for competitive advantage in China, can affect FCC's decision on what entry mode to use. Therefore this thesis tries to capture how FCC perceives its own knowledge embedded in their capabilities and competencies. Why is that knowledge important for competitive advantage, and what knowledge is currently missing, and how does this influence the choice of entry mode? As the dynamic capability framework suggest, the embeddings of FCC's resources is important for the competitive advantage on the Chinese market, so this will also be discussed in order to understand how the capabilities and the knowledge within FCC can have influenced FCC's decision on entry mode. This study does not aim to give a full objective view of the organizational knowledge of FCC. It rather tries to capture how FCC perceive their own organizational knowledge that is needed for competitive advantage on the Chinese market, and how this knowledge can have influenced FCC's choice of entry mode.

3.3 Collection of data

There are two types of data available for this kind study, secondary and primary data. The secondary data is data that previously has been collected and might therefore not be specific for the purpose in question. It is gathered from various sources, such as academic articles, internet sources and books. Primary data, on the other hand, is data collected with an aim to answer the specific purpose of this report. Primary data is obtained through interviews, surveys and other types of knowledge gathering techniques.

In this case, the primary data was collected mainly from in-dept interviews with FCC. Each interview was performed in a time frame of approximately 45 minutes. Four such interviews have been performed for this thesis, and these have been recorded, written down and analyzed. Single unanswered questions that have come up during the investigation have been answered through e-mail and phone. The questions used during the interviews were sent to Prof. Alberti, professor in Strategic Management (at LIUC Carlo Cattaneo Università in Castellanza, Italy) in order to get them evaluated. Unfortunately, we did not receive a response concerning these questions.

The secondary data, in this thesis, have been conducted through academic articles, books and Internet sources. Also, some information has been gathered with advice from Prof. Alberti who earlier on has used these sources in his field of work, Strategic Management. We developed a pre-understanding within the topic of transferring knowledge before forming the interview questions and conducting the interviews. Personal communication with Prof. Alberti was kept up through e-mail during the fall in order to get valuable information within his line of research.

3.3.1 The interviews

Since the qualitative method was chosen, the interviews were also based on this approach. This means that the interview questions were open and formed to reflect the perspective of the person interviewed. The questions provided the possibility to get a wide perspective of the core subject. This added to the likelihood that the interviews' result would eventually reflect the reality. Analyzing the answers and using the qualitative method, we were able to go deep into the subject matter and develop a deeper understanding of FCC's viewpoint in the topic.

The person interviewed is project-manager (PM) of FCC and is responsible for the project of entering the Chinese market. He is also son to the founder of FCC. The PM's experience of the knowledge the firm has included also private information from his father about the premises of the firm, the olive oil and the competition in the industry. Unfortunately we could not achieve an interview with the father and founder, since during the time of the interviews he was spending time in China, planning for FCC's coming market-entry. Anyhow, we can assume that the son, since he is appointed responsible for the project, is being well aware of how the knowledge, that is the source of competitive advantage, has evolved over time. Also, he should have the important knowledge of the potential entry-modes for FCC into China. However, of course it would have added to the reliability and trustworthiness of the study if also the father could have transmitted his views of these matters.

The interviews were held on three occasions, October 4th, November 11th and November 15th. We believe that the time that flew between the three interview occasions was valuable.

That is because the time made it possible for the Project Manager to reflect of the last interview and think of new aspects that he might have forgot to tell about. Also the fact that the interviews were separated in time made the interviews more trustworthy since the answers were not directly affected by the last interview.

Furthermore, since the interviews were conducted in English while the interviewer was Swedish and the interviewee was Italian, it can be assumed that the whole picture of what the project manager wanted to describe did not appear correctly. But since the interviews were recorded and written down in text afterwards, some of these misunderstandings could be avoided. Also, an Italian friend of the interviewer listened to the tapes with the permission of the project leader, to assure that the interviewee could be as correctly understood as possible.

The interviews have been recorded, written down and analyzed. It has after this process been sent to Mr. Gerardo Celletti for correction in case misinterpretations or misunderstandings were made.

3.4 Drawbacks with the method

General drawbacks with the qualitative method

Using the qualitative method, the information gathered through interviews can to some extent be biased since the information will be reflected based on the perspective of the person interviewed. Also, the information reported in the thesis will be based on the authors' viewpoint of the subject matter since it is not a structured method such as the quantitative approach.

Sensitive information is withheld

Due to the fact that a lot of sensitive information has been revealed, we have been asked not to display some of this information in the report. The information mostly concerns financial aspects and who the important Chinese contacts are. But we also assume that our contact at FCC has not told us everything he knows about FCC's organizational knowledge, because he has expressed that he is very cautious about sensitive information being revealed to competitors.

Biases due to language differences

What also needs to be taken into consideration is the fact that we are Swedes performing interviews in English with an Italian. Therefore, the interpretation of the answers and questions during these interviews are of high importance. We believe that this could be a possible drawback since the cultures and languages differ as well as the way of communicating. We made several in-dept interviews within a relatively wide time reference to be able to decrease the interpretation bias. We believe that performing several interviews containing questions from previous interviews is useful in order to clear certain aspects up and to delete possible misunderstandings.

Biases due to few interview occasions and few individuals participating

One drawback with our method is that we only had the opportunity to interview one of the two most involved persons in the project, due to the fact that the project had already begun

when we started the study, and Mr. Gino Celletti spent a lot of time in China during this investigation. If we had the possibility to perform in-dept interviews also with Mr. Gino Celletti, we believe that the result from the study would have been more accurate since also his perspective of the subject matter would have been included.

During the time between our interviews, FCC has been going through a process of finding more and more evidence on what entry mode is best, since there have been ongoing negotiations with possible Chinese suppliers and partners. Therefore it had been valuable with even more interview occasions, since FCC's perception of their organizational knowledge needed for competitive advantage changed during this process. This depended on that new information was continuously gathered from the CEO in China.

Previous information about the firm FCC

The interview time could have been more well-structured if we have had some information about FCC from the beginning. Since we had to start from scratch, some interview time was wasted. However, that is a problem with smaller firms that is not officially known. We had no information of the firm FCC before we first got in contact with them, so therefore it took some interview time just to find out how we could use their information for our purpose. If we had known before the first interview what problem FCC was facing, more accurate questions could have been asked earlier. However, all the information we got about what FCC perceive that they know, their experience and capabilities, is valuable. Also, it was interesting that their fear that competitors would steal their knowledge decreased during this process. If more interview-occasions could have been arranged, more information on why FCC changed its mind of both what capabilities would be needed on the Chinese market and what entry mode that was most suitable could have been collected.

Theory from large firms used on a small firm

Much of the theory used is based on research from much larger organizations than the firm FCC that is used in this case study. This can mean that the theory is just not suitable, but we have found it hard to find theoretical evidence considered small firms for the use in this study. We do not know how this has affected the outcome of this study. However, we believe that it can be valuable to use the outlines for how organizational knowledge can be assessed, different types of knowledge and different knowledge levels also on a small firm. Also, the entry-mode choices are of course the same for small firms, theoretically, even though small firms often must exclude the more costly, wholly owned choices even though they would sometimes be preferred.

The most important drawback with this method was probably that only one person from this study, Bryntesson, made the interviews, and only one person at FCC, the project leader Mr. Gerardo Celetti, gave the interviews. This mean that we only got one person's subjective picture of what FCC knows that is valuable for competitive advantage in China, and one person's suggestion of why a contracted alliance partner finally was chosen as an entry mode. Moreover, if two persons from the study would have made the interview together, a biased view on what the project leader actually meant with the answers could have been avoided to some extent.

3.5 Analysis of the collected data

The interviews have provided information about FCC and the complex organizational knowledge that is a source to competitive advantage. The aim of the report is attain a deeper understanding of what constitutes a firm's organizational knowledge needed to compete on a market, and how that knowledge can affect the entry mode choice. The empirical findings from the interviews with FCC have been analyzed from the perspective of the theoretical framework presented in this thesis. The conclusion is made from the comparison of the frame of reference and the empirical findings, and is based on the analysis.

3.6 Reliability and Validity

Reliability deals with the level of trustworthiness of the results found, that is, the empirical part of the thesis. The concept of reliability also considers the interpretations of the empirical findings. There are many aspects which can affect the reliability of a thesis e.g. misunderstandings during interviews, the environment, the interviewer and the person being interviewed. The reliability concept is more important when using the quantitative approach since the researchers then have the aim to generalize and will apply the "model" to many different cases. On the other hand, when using a qualitative approach, the investigators are aiming of providing examples (Svenning, 2003).

Validity is known as the connection between the frame of reference and the empirical findings. The frame of reference and the knowledge obtained during the investigation is hard to transform into concrete and valuable questions to use during the interviews. In order to use the collected data in the right way and to be able to make the right interpretations, the collected data has to be aligned with the purpose of the investigation and give a realistic picture of the situation (Svenning, 2003).

The thesis has been structured as stated in the method in order to make it reliable. As mentioned before, this thesis has a qualitative approach and the aim is not to make generalizations. This implies that the results stated are highly dependent on the specific situation faced by FCC, and might not be applicable to other situations. Since the thesis is written as a case study, it is in the interest of FCC to give accurate information during the interviews. Otherwise the results from the analysis and the conclusion of the study would be totally useless for the company. Also, the reliability of the thesis is increased due to the fact that a professor in Strategic Management, Prof. Alberti, has been consulted regarding some of the aspects in the report. Prof. Alberti has history of research in the field of Strategic Management in combination with the "Made in Italy" label and problems that are usually faced by the Italian companies. He has been studying the field for several years and we strongly believe that his guidance has increased the reliability of the report.

In order to increase the validity of the thesis, important knowledge in the area of investigation was obtained before performing the interviews. Many sources were used in order to give a broader and more stable base for the interview questions. Based on this knowledge, the interview questions were open and easy to understand in order to avoid misunderstandings. By not using leading questions but open ones, there is a lower risk to affect the person being interviewed when answering the questions which increase the reliability of the report. Also, by having open questions the respondent is not as easily affected by the interviewer, something that we believe further increases the validity and reliability of the report. During the first interview some questions were asked solely for the use of providing us with a

broader base and a deeper understanding of the company and its situation, once again to avoid misunderstandings.

4 Empirical Results

In this chapter our empirical findings are reviewed. We will present FCC's view on the Italian and Chinese olive oil industry as well as the opportunity FCC sees that it has to use its knowledge to expand to the Chinese market. The organizational knowledge will be considered but also the knowledge that is currently missing to succeed on the Chinese market. Further, we will explain FCC's view on the knowledge transfer, and the entry mode choices it considers.

4.1 The first interview: FCC and the Chinese market

4.1.1 FCC

FCC was founded in 1989 by Gino Celletti, a man that came from the pharmaceutical industry and is today a well known olive oil entrepreneur within his sales region. FCC acts as a retailer, distributing only olive oil of a premium quality, produced by carefully chosen suppliers in Italy, contracted to follow FCC's strict production instructions. The competence that the company has developed through the years within olive oil production, distribution and sales, can be seen as a unique capability allowing FCC to enhance its competitive advantage. According to FCC, only a small percentage of the world production of olive oil is of such a high quality as the one that FCC offers. Today, FCC sells olive-oil directly to Italian consumers through their restaurant in Milan, but FCC also distributes its olive oil to European consumers via their web-page. Furthermore, FCC distributes oil to exclusive retailers in London. As the market developed and became more sophisticated, FCC started focusing on the very expensive kind of olive oil with a very high quality, Monocultivar Extra Virgin Olive Oil (Public relator and project manager, Interview Oct 4th, 2006).

The thing that distinguishes FCC from other olive oil companies is first the very high quality which results from thorough processes and procedures in the production. Secondly the way FCC sells and distributes the high quality olive oil is a bit different from most other retailers. FCC has its unique restaurant in Milan that has specialized in providing the ultimate dishes using carefully chosen olive-oil for each dish that is served. In this restaurant the olive oil is marketed and sold. Also courses are held by the founder of FCC to deepen the knowledge of olive oil with interested persons. Only few carefully selected distributors are hired to sell the FCC olive oil through their olive oil shops in Italy. The respect FCC has got for the knowledge and competence within the field has helped FCC to get new contacts needed for succeeding in the business (Public relator and project manager, Interview Oct 4th, 2006).

4.1.2 Threats and opportunities facing the Italian olive oil industry

The olive oil industry in Italy is currently being affected by low price brands owned by foreign distributors producing in low-cost countries. Spain is especially catching market shares in Italy, but the threat from China is coming to. The extensive knowledge about how to produce really high quality olive oil is valuable only if the market demand is large enough.

In Italy there is a limited market for such high quality and costly oil. In China that demand is growing with a high speed and this is an opportunity for FCC. FCC believes that there are a huge amount of Chinese people that have enough money to spend, and that they want the best olive oil available. In China there are a lot of people who are willing to pay for the high quality, and as an expanding country there will be even more in the future. Entering this market is important for FCC. But to be successful FCC says that they need to enter the market in the right way and very quickly in order not to loose too much money in the process of moving production (Public relator and project manager, Interview Oct 4th 2006)

4.1.3 FCC's knowledge and competencies

FCC's competence and experience in finding the right soil for the right olives, finding the producers that have the right skills and the right understandings, teaching the right way process and handle the olives during the different production processes and finally finding suitable retailers are among the necessary competitive advantages needed for competing on any market that requires the very best olive oil. This knowledge has developed during many years. Probably you could say that some knowledge has been inherited from the Italian countryside where the founder family has been grown up. But most of the knowledge has been collected deliberately through the founder of FCC who developed a deep interest for olive oil, its processing and production and the world market for it. FCC's founder has been collecting as much knowledge as possible within the field (G. Celletti, Interview Oct 4th, 2006).

During the years, Mr. Gino Celletti, the founder, gained more and more knowledge about the area of olive oil and also started giving courses. Today, he is considered to be the Master of Olive Oil in Italy and is well-known across the world market for these products. The deep knowledge about Monocultivar Extra Virgin Olive Oil has helped the company to produce the very high quality (G. Celletti, Interview Oct 4th, 2006)

Now also the founder's son has the intention to carry on with this work by taking relevant courses and studies and engage in readings about how to use today's technology to produce as good olive oil as possible at the lowest possible cost. The company has received a contract for which the CEO of FCC, Mr. Gino Celletti, will be the leader of a county fair, or expo, in Beijing during the upcoming 5 years due to the fact that he is considered to be one of the best within the area of olive oil (Public relator and project manager, Interview Oct 4th, 2006).

4.1.4 Thoughts about entry mode choices

FCC has found an already existing suitable production plant for their planned olive oil production in China. However, according to FCC, the produced quality by the Chinese is at the moment not considered to be good. The company recognizes a great opportunity by having "their own" production plant in China in order to manage and control the entire production. The entry mode to reach the China market is believed to affect the knowledge transfer for FCC and thus, this decision has to be made carefully. (G. Celletti, Interview Oct 4th, 2006).

FCC has recently been negotiating with a Chinese supplier about how to *contract* the production of top quality olive oil to be used for the sales on the Chinese market. The in-

tended contract will among other things include instructions of how to produce according to FCC's quality requirements. (G. Celletti, Interview Oct 4th, 2006).

FCC wants to keep their quality concept and stress the importance of keeping the current production process. They also want to keep as much of the knowledge about their products inside the company since they see it as their core competence and thereby also their competitive advantage. The company is planning to open a restaurant to advertise their oil and use as a distribution channel in China (Public relator and project manager, Interview Oct 4th, 2006).

4.1.5 Main task when entering China: remaining quality and be first

When asking about opportunities and threats that are expected on the Chinese market, the answer is that there are a lot of opportunities since there seems to be a great demand for the company's high quality product, a product which at the moment is not available in China. FCC considers the biggest threat to be losing time. Therefore FCC says that they have to enter the Chinese market quickly and do it right the first time in order not to lose too much money (Public relator and project manager, Interview Oct 4th, 2006).

The main opportunity when moving to China is to produce olive oil of a better quality than what is currently provided in China. The main threat is not to succeed with the high quality requirements, or to succeed too late so that someone else comes first into the gigantic Chinese market. Frantoi Celletti e Cultivar's CEO and founder was contacted during the last years by the Chinese embassy and consulate and were asked to enter the Chinese market, since the Chinese people wanted the presence of a high quality olive oil in the country. When entering China, the company wants to raise the level of quality even further and aims at the very top exclusive customer group (Public relator and project manager, Interview Oct 4th, 2006).

Concerning the high quality of the Monocultivar Extra Virgin Olive Oil, there are Italian producers who have tried to achieve the high quality and failed although they were well familiar with the Italian production process. This proves that the level of implicit knowledge involved in the process is high. Therefore there are risks related to the possibility to teach the Chinese producers to produce in the correct way (Public relator and project manager, Interview Oct 4th, 2006).

The company believes that the level of quality is greatly affected not only by the manufacturing process, but also by the original quality of the olives. As mentioned before, the quality of the olives are highly depended on the surrounding climate. There are certain types of olive trees that are better suited for growing in China and some that are not. FCC has found a region called Penglai, where the climate resembles the one in Italy, and therefore would be suitable for some of the olive trees they have chosen to use in their production. The production mill that is considered to produce FCC's future Chinese production has been used for production to Chinese olive oil companies, but the production quality at the moment is considered to be far from good. The Chinese producers are well aware of the low quality currently produced (Public relator and project manager, Interview Oct 4th, 2006).

4.1.6 Assuring that the production knowledge can be transferred to China

As already mentioned, FCC considers its knowledge and competence in producing and supplying superior olive oil to be vital for its current and future success. Therefore, FCC has to assure that this competence can be transferred to China. Without this competence the outcome of the Chinese production will be low quality olive oil that is already available on the Chinese market. The knowledge in the olive oil production process is needed to be sure to provide very fine olive oil. In this way the knowledge is the core competence also on the Chinese market. The demand for this high quality olive oil on the Chinese market can only be met by FCC if it manages to produce top quality oil (Public relator and project manager, Interview Oct 4th, 2006).

4.2 The second interview: contracting a Chinese supplier

FCC has been considering starting its own business line in China, since that would prevent other firms to steal the organizational knowledge that is the key to competitive advantage. But during the process of thinking through the consequences of a fully owned subsidiary, FCC has finally decided not to set up an own production mill in China. FCC will rather use the same strategy as they do on the Italian market. The strategy used on the Italian market involves choosing the producers according to the cultivar and the product quality, and create long-term contracts with suitable producers. When a contract is formed with an olive oil producer, this producer is bound to produce the way that FCC requires, with the processes and steps that FCC sees as important in order to obtain the highest quality. In the beginning of the production in a “new” production mill with a newly contracted supplier, FCC intends to be present to see to that the specific production processes are followed according to the requirements by FCC. During this phase it is important that FCC contributes with the knowledge needed. After a while, the production mill is able to follow the steps from collecting to the bottle with help from FCC (Public relator and project manager, Interview Nov 4th, 2006).

The production mills that are contracted by FCC are under the control of the company and the situation for the company is similar to as if they were owned by FCC. FCC is in total control of the production at the mill. If the required quality is not obtained during the production process, the cooperation comes to an end. A producer that one year has a great quality and the year after is not able to reach the same quality level is quickly replaced with another producer. FCC is frequently searching for new monocultivars to use and new producers to help them produce the oil (Public relator and project manager, Interview Nov 4th, 2006).

When entering China, the company will have to act quickly in order not to lose too much time. They believe that it will be easier to work with the Chinese producers than the Italian producers since the Chinese do not have a background in the field of olive oil and therefore will not question the features and requirements of the production process demanded (Public relator and project manager, Interview Nov 4th, 2006).

As mentioned before, FCC stresses the importance of remaining the existing production process and culture when entering China in order to maintain the high product quality (Public relator and project manager, Interview Nov 4th, 2006).

4.3 The third interview: the knowledge required for production

To be able to answer the purpose of this thesis, the authors have chosen to try to understand how the important knowledge in FCC's olive oil production is compounded. Do any parts of this knowledge contain high levels of tacit knowledge that is difficult to transmit to new producers in China? As FCC states that remaining the production processes the "FCC way" is crucial for succeeding in producing the high quality requested in China, we consider that a deep understanding of this is needed to picture the core competence of just this specific company. Down below we will share the information about how FCC sees their knowledge within olive oil production.

4.3.1 The different production steps and the knowledge involved

The manufacturing process used by FCC to achieve a Monocultivar Extra Virgin Olive Oil can be parted in 4 different steps. Choose the olives to collect, collect them, take them to the mill, and start producing the oil. The first step is the most difficult one and includes a lot of tacit or implicit knowledge. Concerning the actual manufacturing process, there are a lot of highly sensitive steps that have to be followed in order to get a high quality olive oil. First the olives are collected by hand since this is associated with a higher quality due to the fact that the olives are not being damaged by the collecting machine. One problem that can be found when doing this is that the olives are put together and start heating each other. If this happens, the oil will be destroyed and not usable. Therefore, the collecting part needs to be strictly controlled (Public relator and project manager, Interview Nov 11th, 2006).

The second step in the actual manufacturing process has two different choices. Either you use the old traditional way of producing, which means that you will have a much lower quality, or you use the continuous process which means that the olives are never in contact with any kind of oxygen. Oxygen should be considered to be the biggest threat towards a high quality olive oil. FCC has, due to the fact that they want to have a very high quality, chosen to use the continuous process (Public relator and project manager, Interview Nov 11th, 2006).

When the olives have been collected and taken to the production mill, the first thing is to wash the olives. The first kind of wash removes the shells of the olives and the second is to wash them. Depending on the kind of cultivar, that is, which kind of olive you are using, there might also be another kind of wash that takes away the wax on the outside of the olives. Some olives have a higher degree of wax than others, and this step then has to be included. In order to make this decision a lot of knowledge about the olives is required (Public relator and project manager, Interview Nov 11th, 2006).

After the washing the crushing part follows in the mill. This is when the olives are crushed in order to obtain the oil hidden inside them. Depending on the kind of olive and its characteristics, different crushing methods are used. Some of them make the olive oil bitterer, others make it sweeter. Therefore, also in this part of the process, great knowledge is required about the olives being used. The decision of which crushing process to use is also dependent on which kind of oil you want to obtain. If you have a sweet kind of olive, and you want to keep it sweet, you have to use that kind of process, but it also needs to be taken into consideration not to make it too sweet. The crushing process has to be done in less than an hour in order to keep the good quality of the cultivar (Public relator and pro-

ject manager, Interview Nov 11th, 2006).

The third step in the process is where the pulp is separated from the olive. In order to do this a so-called gramolator is used which turn the pulp around several times. Then the pulp has to be left for a while to “link” with the oil (Public relator and project manager, Interview Nov 11th, 2006).

The centrifugation process is the next in the manufacturing process. This is where the oil is separated from the so-called salsa (pulp without oil inside). The machine turn a definite amount of times, also this depending on which kind of olive is used and which kind of oil you want to obtain. Some olives have a higher degree of water inside and therefore have to be turned an extra time. Doing this with an already relatively dry olive would destroy the oil obtained (Public relator and project manager, Interview Nov 11th, 2006).

The filtering step is the last one before bottling the olive oil. The olive oil has to rest for not more than a day. The product is then filtered and put in bottles (Public relator and project manager, Interview Nov 11th, 2006).

4.4 The fourth interview: knowledge and passion for olive oil

According to Celletti, the first step, choosing the right cultivar and place to plant, is the most important one in order to obtain a good olive oil, and the one that includes the most tacit knowledge. Also, the different steps in the actual manufacturing process vary according to which kind of cultivar is chosen, and the characteristics of that olive. This is also one of the crucial parts that need to be considered. Also this step includes a lot of tacit knowledge. In order to call the olive oil Monocultivar Extra Virgin Olive Oil it has to be totally without defects. The most sensitive part when considering the avoidance of defects is the collecting and the parts of production where the olive oil easily get too warm or might get in contact with oxygen (Public relator and project manager, Interview Nov 15th, 2006).

During the years Mr. Gino Celletti has developed a deep knowledge in the area of olive oil. This is something you learn over a long period of time. On top of the great knowledge in the area, Mr. Gino Celletti also has a finger top feeling concerning which cultivars to choose, how they will taste in combination with different dishes etc (Public relator and project manager, Interview Nov 15th, 2006).

Mr Gino Celletti also has a deep passion and interest in the field of knowledge that comprises olive oil production. This can be seen as one of the basis for his knowledge. To transfer this feeling for the olive oils and the passion and love for it are among the tasks that are needed in order to succeed with the knowledge transfer, Mr. Gino Celetti’s son and project manager explains. That is because such underlying assumptions of olive oil that lies at the core within FCC can, if they are transferred to the Chinese producers, help them to more easily obtain the explicit knowledge and also other kinds of knowledge that is needed for the production but which is harder to learn quickly. To facilitate the transfer of the production knowledge needed to the Chinese producers, FCC plans to be present in China during the time of the start up of the FCC production. FCC wants to be able to take action in the current situation and make sure that the startup is going as planned.

As mentioned above in the explanation of the production process, there are many steps that require a great knowledge in the area in order to be able to use the correct process of

production. Using the wrong process for a great olive can result in a horrible olive oil. This should be considered one of the most important areas of knowledge of FCC. Also the son, Mr. Gerardo Celletti is continuously developing his knowledge in the area. Mr. Gerardo Celletti has been involved in the company and in the world of olive oil since many years, but still does not have the great knowledge which Mr. Gino Celletti has, according to himself. It takes years to develop, understand and to be able to use the acquired knowledge in a correct way. The production of olive oil should be considered an art, Gina Celetti explains. Even when knowing *how* Michelangelo did when he created his most famous paintings, it is hard to do it on your own. He means that it is the same scenario concerning olive oil and that it is not only about the technique. (Public relator and project manager, Interview Nov 15th, 2006).

The CEO has successful experience from transferring production knowledge to Italian olive oil producers. The project leader says that this can help tremendously in the transfer of knowledge to China, since the CEO already knows about the different difficulties and problems that can arise during such a process. FCC's project leader also believes that it is a great advantage that the Chinese producers do not have a history of producing olive oil. He means that it is easier to teach correctly from the beginning when the persons who learn do not have to change knowledge already obtained. However, it is the first time for the CEO to teach someone from the very beginning to the very end of the production process, and also this has to be done in a short period of time when entering China (Public relator and project manager, Interview Nov 15th, 2006).

5 Analysis and Interpretation

In order to answer the purpose of the thesis, in this chapter we will analyze and interpret the information collected through the interviews with FCC.

In this report we wanted reach a deeper understanding of the complexity concerning how the organizational knowledge that is needed for FCC's competitive advantage in China, can have an effect on the choice of entry mode. In order to do so, we have gathered theoretical information about organizational knowledge and also about different entry modes. In this section of the thesis, we will analyze the empirical data by relating it to the theories presented.

5.1 The resource based view and the core competence of FCC

Intangible assets as a source to competitive advantage

The empirical result from this study provides an example of how the distinctive capabilities and the know-how of FCC have contributed to FCC's competitive advantage. This adds to the suggestion presented by Barney, Grant, Johnson et al and others, who have stressed that competitive advantage tends to comes from know-how or capabilities rather than from physical assets. Through the interviews with FCC it has been made clear that it is the deep knowledge of how to produce and sell olive oil of a very high quality that has been the source to competitive advantage of FCC. It is this knowledge that has discerned FCC from its competitors. This knowledge has been developing during long time and is complex in its

nature. This knowledge can be expressed as the firm's core competence.

The organizational knowledge and capabilities as the core competence

Markides and Williamson define core competencies as a pool consisting of experience, knowledge and systems that together act as catalysts in creating and accumulating new strategic assets. Accordingly we can draw the conclusion that it is FCC's experience of, knowledge about, and the systems built over time, of how to create good olive oil, that has eventually made up a core competence for FCC. Hafeez, Zhang & Malak say that core competencies are the physical, intellectual and cultural resources of the firm.

We can agree also with these authors, since we have learnt from this study that FCC's intellectual resources in the of olive oil has resulted not only in a competitive advantage through a higher product quality, but also in a designation of FCC's founder to be expert in the field of knowledge and responsible for a yearly olive oil exhibition in China. Also, the cultural resources can be included in the core competence, as the Italian culture and interest in fine olive oil is one of the premises for adopting the relevant knowledge in olive oil production and sales. However, we have found no evidence for that there are physical resources included in FCC's core competence, or in their organizational knowledge needed for competitive advantage. This means that in a relative short amount of time, physical resources needed for competitive advantage can be exchanged. On the other hand, the cultural, intellectual, experience, knowledge and systems needed to bring the high quality monocultivar olive oil, is difficult to change, create or imitate in the short term. These are at the core of FCC's competitive advantage.

Teece, Picano and Shuen stresses that the firm's and the competitors' products and services need to be assessed in order to fully understand the core competence which is the source to a competitive advantage over time. This is a good test, as we see it. Through the interviews with FCC it has been made clear that the type of olive oil produced by FCC, according to them, is different and of a uniquely high compared to competitors' olive oil. This is true both for Italy and for China. Especially in China, the olive oil quality is remarkably low, which gives FCC's core competence even higher value on the Chinese market, as long as there is a demand for high quality, as FCC confesses.

Prahalad and Hamel say that the company's core competence needs to fulfill three characteristics: be hard to imitate, give the company access to a wide variety of markets and contribute to a superior customer value. These requirements are all fulfilled by FCC's core competence. Barney clarifies that to be difficult to imitate, the resources have to be path dependent. The highly specialized skills that FCC has developed through long time can definitely be considered to be path dependent. Furthermore Barney says that the source to competitive advantage has to be causally ambiguous, which means that the actions needed to create these advantages are not fully known. This is true for FCC because the valuable knowledge resides within few persons of FCC and the knowledge cannot easily be explored, since they include a lot of tacit or implicit knowledge. Furthermore the knowledge from different areas of production and sales is dependent on each other to be useful on any market. Moreover the knowledge of how to produce and sell high quality olive oil is socially complex, which is the third requirement of Barney for a resource to be a source to long term competitive advantage or a core competence. It is socially complex because the social contacts created by FCC and the reputation within the industry cannot be replicated under the short term.

In FCC's case, they believe that they will have the same core competence on the Chinese market as on the Italian market. The core competence that FCC has today, will act as a catalyst, as Markides and Williamson express it, as FCC extends its business to include production and sales in China. However, we believe that the possibilities to draw advantages from the core competence in China may be different than in Italy. Therefore, we adopt Espedahl's suggestion of that it is important to include new information and knowledge from external sources to the firm as the context changes. Dynamic capability (Tece et al.) is about using its current organizational capacity, and at the same time building new capacities and competencies as the environment changes. It is about being able to learn from new situations and adapt to it.

Dynamic capability

Espedahl means that without a capacity to reorganize and rebuild and sharpen the different processes that resides within the firm, the core competence may possibly not be useful in new situations. The Dynamic capability can be considered to be a critical aspect of the organizational knowledge of FCC.

We believe that some dynamic capability is gained through every new change that a firm is undergoing. For example, FCC has proved to be willing to learn and adapt to new circumstances when the founder has continually and deliberately searched for new information and knowledge about olive oil. FCC has also given courses in olive oil, by different methods tried to deepen its knowledge within the subject. FCC has also experienced new and changed situations every time they have contracted and trained new different olive oil suppliers in Italy of how to produce better olive oil. Probably FCC has gained a dynamic capability to some extent through these changes. The change capacity, as Espedahl expresses it, may very well be the reason for FCC's interest about starting business in China. Without the confidence of being able to handle new and strange situations, FCC would not have even thought about going into China.

However, when FCC enters China there are many knowledge areas that are yet unknown to FCC that may well be needed to succeed with production and sales. It is not very clear from the interviews whether FCC is fully aware of its knowledge weaknesses. For example, the Chinese culture, the Chinese tastes and preferences, the producer's previous experience are to some extent unknown for FCC when they enter China.

Furthermore, it is mostly one person that needs to adopt a lot of new information and knowledge and use it for implementation in FCC's routines and processes. That is the founder. It is the willingness he has to be receptive, and the experience and knowledge he has of being receptive, that ultimately will determine if the dynamic capability is good enough and develops enough in China. Without receptiveness it will not be possible to use the new situation for building and sharpen the internal technological, organizational and managerial processes that FCC has. We believe that the change that the founder made in his life, as he first came from the pharmaceutical industry and changed into being a well-known olive oil entrepreneur show dynamic capability. Further on, to put oneself among the best in the world of producing the very top of monocultivar olive oil, as his son expresses it, in relatively short time, is of course a good sign of a strong dynamic capability.

We suggest that it is likely that the dynamic capability will develop tremendously during the start up period in China. Lou states that as the business cultural specificity on a new market is high, the exploitation of a subsidiary can be hampered, but at the same time the company

will build its dynamic capability. Capability building is especially connected to joint venture modes of entry, says Lou. The inverse is true for wholly owned subsidiaries. This can be a reason for why FCC has chosen not to start a wholly owned subsidiary. Maybe FCC sees that it has to learn a lot to succeed on the new market, and that learning is difficult if not cooperating close with the Chinese. A joint venture is in a way similar to a contracted supplier, since there is a long-lasting intention with the cooperation in both cases.

Chang also claims that the resource deployment can be expected to increase as the augmented accumulated knowledge and experience of the host market develops. Also this theory suggest that FCC might need to cooperate with Chinese people in entering China to survive the first period, when FCC will not be able to fully use its organizational knowledge for competing on the new market.

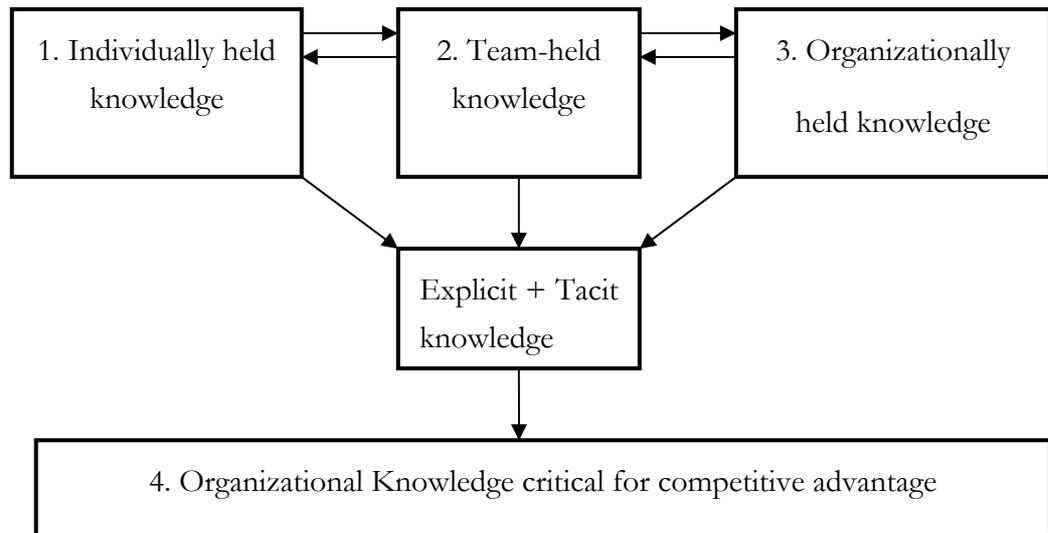
Furthermore, we refer to Espedal's statement that a dynamic capability of the firm is important if the core competence is to be developed in order to fit the environment's changing demands.

Due to this, we also believe that extra knowledge has been obtained externally. Nonaka (1998) among others believes that a competitive advantage has been derived from different knowledge elements and does not solely include firm specific knowledge. The area of olive oil, production processes etc are developing further all the time and in order to keep up with the technology and be able to keep the high product quality it is important to acquire knowledge also from these external sources.

Teece, Pisano and Shuen (1997) state that a core competence can in combination with complementary assets be enhanced. Further, they state, as well as Markides and Williamson (1994), that the core competence should be used and combined with other resources to act as a catalyst to create new valuable resources for the firm. In FCC's case the complementary assets could be considered to be the new Chinese network and the explicit knowledge that is part of the production process since it is in combination with this knowledge that the tacit knowledge result in a high product quality. Other complementary assets could be the knowledge within areas such as running a restaurant to show how to serve the olive oils with different food, and how to sell the olive oil from the net, or how to select the right olive trees for a specific soil etc. To continually try to create new resources and development of it can be considered to be ways of preventing the core competence from stagnate. The strengths of the core competence is in this way enhanced by the complementary knowledge areas of FCC.

As mentioned in the theory part, it is the complexity of the organizational knowledge that finally constitutes if it is valuable in the long run or not, and whether it is possible to imitate or not. In the next section we go into how different knowledge aspects are connected to each other to create synergies valuable for the competitive advantage of FCC.

5.2 Different knowledge types and knowledge levels



1. Individually held knowledge at FCC:

Explicit: Basic technical knowledge in production. This is easily codified and transmitted when the structural rules for translating that knowledge is known, as Malhotra explains.

Implicit or tacit: the knowledge that is a result of experience and skill that have grown over time. For example finding the right soil for the right olives, finding the producers that have the right skills and the right understandings, teaching the right way to process and handle the olives during the different production processes and finally finding suitable retailers is knowledge that is very much based on tacit knowledge that cannot be changed or understood easily in a short period of time. This experiential knowledge is needed in order to make good use of the explicit knowledge that can be taught. This combination of tacit and explicit knowledge is characteristic for FCC's organizational knowledge that is relevant for competitive advantage.

In the introduction of this thesis we bring up Martin's and Salomon's statement about that firms which have the ability to accumulate their intangible knowledge are better of to expand internationally. These authors mean that many times firms with a knowledge-based resource fails in exploiting that resource in its foreign operations. In FCC's case the knowledge of how to produce very fine olive oil have indeed accumulated through experience and interest during many years. However, this has only happened in Italy and furthermore there are only few persons at FCC that have this thorough understanding of olive oil production today. Now it is absolutely necessary that this accumulated knowledge can be transmitted to China without the loss of this knowledge in Italy. The plan for FCC is that the founder leaves Italy for the upstart in China. If this will take months or years is unknown to us. But during that time the project leader and the son of the founder will remain in Italy to keep the business going there. We believe that the founder, during the close eve-

ryday cooperation with the new Chinese supplier in the upstart phase, can create the right conditions for transmitting necessary tacit knowledge. Trust between the partners, interest of the subject etc is required for new persons to obtain necessary information and knowledge. We believe that the possibility to use a source of accumulated intangible knowledge (the founder) during longer time can be fruitful in the project. Therefore, FCC's choice to find an allied partner who will gain from good cooperations can probably partly be explained by the need for a successful transmit of necessary tacit knowledge from FCC to China. In the case of a fully greenfield operation, FCC could have missed necessary knowledge about China, Chinese business conventions, Chinese taste, Chinese networks etc.

By spending time with the new Chinese allied, the founder can gain new valuable knowledge that can add to the organizational knowledge and be brought to Italy and the key persons there. Coordinating and integrating the capability building and the capability exploitation is the key to success in a foreign country, according to Ghoshal. This can happen as the knowledge sharing between the two parties, FCC and the Chinese supplier, will take place mutually with this type of entry mode and strategy.

2. Team held knowledge at FCC:

The individual tacit and explicit knowledge explained above used in combination with the team's experience of working together. For example, the persons that are involved in the project of entering China have previous experience of working together with olive oil production in Italy. They know how to generate value to the firm by cooperating with for example suppliers and distributors. However, in China a lot of the team held knowledge will be lost, since there the teams will be different. The production will be constituted by new teams that must learn from the way FCC has been doing the things in Italy.

3. Organizationally held knowledge:

The routines, processes and methods that FCC has developed during time concerning how to produce the fine olive oil. This knowledge is difficult to appropriate for generation of the same value if applied in new, different contexts, as suggested by Malhotra. For example the new team in China that is to produce the fine olive oil may not share the assumptions of how the olives best should be handled.

The networks that FCC's founder and project leader has built is a source to team held knowledge and also to organizationally knowledge, as the persons in the network has learnt to cooperate to find ways to the Chinese customers. The reservoir of relationships is an important source to competitive advantage. The founder of FCC that has been granted big responsibility for the olive oil exhibitions in Shanghai the forthcoming years, is developing the organizational knowledge by building the social network within the olive oil industry in China.

The choice to enter China in cooperation with a Chinese allied, is good for gaining new knowledge to the organizational knowledge at FCC.

4. Organizational Knowledge critical for competitive advantage

There is a lot of knowledge at FCC that is not critical for competitive advantage. To make a good basis for the decision about the best entry-mode, a firm could make use of a simple map of its competencies and capabilities that it has. Therefore, we made the picture above. By using this picture we try to understand how FCC has included their organizational

knowledge in the decision FCC has made about entry mode to China.

5. Organizational Knowledge critical for competitive advantage in Italy and in China

Currently FCC has knowledge about:

1. What olive trees are best for monocultivar olive oil
2. What soil to plant such trees in
3. The production of monocultivar olive oil
4. How to find and contract oil producers
5. How to build relational capital (which is necessary for FCC as their core competence is including much ambiguity and tacit knowledge)
6. How to transmit production knowledge to producers in Italy (includes demonstration, observation, imitation and feedback which needs close personal contact)
7. How to get new information about the development in the industry
8. How to include new persons and companies in the business network
9. Dynamic capability, being able to change as it is required
10. How to participate with its knowledge on a trade fair in China
11. How to sell olive oil in their restaurant, to retailers, via the Internet site in Italy
12. The Italian business circumstances, such as law, tax, conventions etc.
13. The Italian olive oil industry

Knowledge that FCC possibly does not have enough of:

1. The knowledge of how to identify and articulate uses of its own knowledge
2. Knowledge of how to transmit the production knowledge to Chinese oil producers (including transmitting underlying information in suitable form, appropriately arrayed and timed and targeted to the proper recipients)
3. Knowledge of how to assess the needs and capabilities and the readiness of the recipient firm, the supplier
4. Knowledge of how to build good relations with the Chinese supplier
5. Knowledge of the Chinese business circumstances, such as law, tax, conventions etc.
6. Knowledge about the Chinese olive oil industry
7. Knowledge about how to sell olive oil in an own Chinese restaurant, to Chinese retailers, via the Internet site in China
8. Knowledge about how to display its products and its knowledge on a trade fair in

Beijing

9. Knowledge of the costs to transfer knowledge to China (transferring tacit knowledge can be costly and time-consuming also after the transfer)
10. Relational capital with alliance partner (mutual trust, respect and friendship which is important for managing the dual objective of protecting the sensitive knowledge from competitors and at the same time learn from the alliance partner)
11. Language competences so that FCC can create a shared vision and language even though the Chinese supplier has a foreign native language
12. Capability about how to use policies and rules to help protecting and monitoring knowledge sharing so that knowledge does not leak to competitors
13. Knowledge about managing logistics in China

5.3 Tacit and explicit knowledge in the production process

In order to fully understand which parts of the production process includes the highest degree of tacit knowledge and therefore will be harder to transfer, we have analyzed the different parts of the production process.

The first step of production includes choosing the olives to collect. According to Nonaka & Takeuchi (1995) this part would include a high degree of tacit knowledge since they define the concept as personal, context-specific, hard to formalize and communicate. The second production process is to collect the olives. Tacit knowledge is considered to be knowledge that is particularly critical and is a crucial source for a firm's core competence (Kogut & Zander, 1993; Teece, 1982). Since the collecting part is crucial to be done properly in order for a sustained core competence and in order to avoid defects, it can be considered to be tacit according to the definition made by Kogut & Zander (1993) and Teece (1982).

On the other hand, explicit knowledge can be seen as steps that can be followed and taught to others, stated by Mooradian (2005). This means that also the definition of explicit knowledge is applicable to this knowledge. After the olive collectors have learned how to avoid the heating, this mistake will hopefully not be done and the steps can be followed relatively easy. Since the knowledge also corresponds to the definition of Mooradian (2005) we believe that the biggest part of this production step is indeed explicit. Further, the assumption that the step is easy to communicate also requires that the knowledge transfer have been done effectively and properly, since explicit knowledge rests on the base of tacit knowledge and can be seen as an extension or projection of tacit knowledge to a new level of awareness (Mooradian, 2005).

After the collection of olives they are brought to the mill, which is the third step. This part of the process we consider to be explicit since explicit knowledge is considered to be knowledge that can be transmitted easily in a formal and systematic language (Nonaka & Takeuchi, 1995). The production of olive oil starts when the olives have arrived to the mill. Most of the steps included in the actual production process are very sensitive and includes a high degree of tacit knowledge since judgments about which production process should be used for certain cultivars must be made. This decision is one of the most important ones

that will be reflected in the quality of the final product. Therefore, according to the statement that tacit knowledge is particularly critical and is a crucial source for a firm's core competence (Kogut & Zander, 1993; Teece, 1982) we believe that FCC's production knowledge is both built on a great deal of tacit knowledge and a true source to competitive advantage, as the outcome in quality can differ much depending on the knowledge of the producers.

The first step in the actual production process is the washing, a step that requires great knowledge about the kind of olives that are being used. A lot of experience is needed to know which olives need which type of washing treatment. Due to this, we consider the washing process to include tacit as well as explicit knowledge, where the experience needed being the tacit knowledge. The crushing process contains a high degree of experience that is needed in order to know which crushing methods are requested for the different olives, something we consider to be tacit knowledge. The next production step is the separation of pulp and oil, which is totally handled by a machine. This process is not dependent on the kind of cultivar. Therefore, we consider this to be pure explicit knowledge.

Following there is the centrifugation process. In this part of the production, knowledge and experience of which olives need more or less time in the centrifugation is needed since it greatly affects the taste of the olive oil produced. We consider this part to include tacit knowledge to some extent, as well as explicit. In this particular step, the tacit knowledge is involved in the decision that has to be made concerning which centrifugation program is best suited.

We believe that there is also an explicit part included in this step of production, meaning that once the producers have learned which program to use for a certain cultivar, this step is relatively easy. Although, if production of different cultivars take place at the same time, the "habit" of using a particular program is excluded and this makes the step a little bit more complicated. If the production mill uses only one kind of cultivar, they do not have to understand why that certain program is used for the cultivar in question. Last is the filtering step, along with the bottling, which is done in the same way no matter the kind of cultivar. Therefore, we consider these to contain explicit knowledge.

Even if we consider some of these productions steps to be pure explicit knowledge, there is always a need for some implicit or tacit knowledge for understanding the explicit knowledge, as stated by Polanyi and Mooradian. This means that the Chinese supplier does need to have some previous experience of olive oil production in order to be able to use the explicit information of how FCC wants to produce its olive oil. Therefore it can be timesaving for FCC to cooperate with a Chinese partner that already has produced olive oil before. On the other hand, it can be that the Chinese partner is very convinced of how olive oil should be produced. That could require a cultural change which could be difficult to manage in a short time.

5.4 Knowledge transfer

The tacit knowledge as a prerequisite for obtaining explicit knowledge

The explicit knowledge that is part of the production process can easily be transmitted and communicated to the new producers according to the definition made by Nonaka & Takeuchi (1995). On the other hand, according to Mooradian (2005) all kinds of explicit

knowledge depend on tacit knowledge, which might increase the difficulty of transferring also the explicit knowledge to the new producers. This is why we believe that FCC could have use of identifying what tacit knowledge is needed for the new producer in China in order to be able to receive the explicit knowledge that FCC intends to transfer. Furthermore, Nonaka & Takeuchi (1995) state that tacit knowledge changes when trying to convert it into explicit knowledge. This all may mean, that the knowledge that FCC previously has succeeded to transfer to Italian producers may be more difficult to transfer to Chinese producers. That is because the Chinese producers may have a different tacit knowledge as a ground for obtaining the production knowledge as FCC wishes to convey. We can assume that there are similarities in the tacit knowledge about olive oil production for Italians that somehow differs from the tacit knowledge that Chinese have about olive oil. The reason is the path dependency and the history of Italy being an olive oil producer during hundreds of years, while this production is relatively new in China.

Grant says that “if most of the knowledge relevant to production is tacit, then transfer of knowledge between organizational members is exceptionally difficult”. We relate this to what Mr. Gerardo Celetti, the project manager, said in the interviews: “The production of olive oil should be considered an art. Even when knowing *how* Michelangelo did when he created his most famous paintings, it is hard to do it on your own. He means that it is the same scenario concerning olive oil and that it is not only about the technique”. By this statement, it is very clear that FCC is well aware of the difficulty of transferring the production knowledge.

However, converting the tacit knowledge into explicit knowledge would mean that FCC is risking losing their core competence since it would imply that the tacit knowledge has been converted into explicit and therefore is able to copy and easy to imitate by competitors. This is interesting from the entry mode point of view. If FCC chooses to cooperate with someone that has an interest in and understand the meaning of increasing the olive oil quality, it is also important for the contracted Chinese supplier to keep part of the tacit or implicit knowledge hidden from competitors. On the other hand, when the contract is finished, the supplier could choose to use the valuable knowledge for own purposes. But to prosper from the production of fine olive oil, other knowledge is needed, for example knowledge about the retailer network, etc. We believe that it is the accumulated knowledge from several related areas that bring the ultimately can bring a success. Only deep knowledge from the production procedures would possibly be worth less than the total accumulated knowledge from the whole supply chain, which has been built through years at FCC.

Eden & Yongjian, 2006, state that tacit knowledge from critical capabilities is highly important for companies operating in emerging countries. According to this definition, we believe that if the tacit knowledge is not successfully transferred to the Chinese producers this will be reflected in FCC’s success on the Chinese market. If FCC would not be able to transfer an accurate production process, this would result in a low product quality.

Embeddedness and collaborativeness important for transfer of tacit knowledge

Referring to Eden & Yongjian (2006), we also suggest that the transfer of tacit knowledge is dependent on FCC’s individual embeddedness and the Chinese producers’ characteristics such as their collaborativeness. If FCC is right about that the Chinese producer is well aware of its currently low product quality, this might enhance their willingness to cooperate for improving the production process according to FCC’s requirements. In other words,

the collaborativeness can be assumed to be good when there is an already identified need for change and a willingness to change in order to attain higher oil quality. Furthermore, it can be helpful that Mr. Gino Celetti has spent much time in China and has attained a general acknowledgement in olive oil knowledge. As mentioned before, he has been appointed responsible for olive oil information at a convention center at the yearly olive oil exhibition. In this way Mr. Celetti has become embedded in the Chinese olive oil industry and has shown an interest for the Chinese olive oil industry. This adds to the possibility to reach the Chinese producer with his knowledge. This all implies a good basic condition for transfer of tacit knowledge from FCC to the contracted supplier in China.

Geographical spread affects the transferability of knowledge

The geographical spread and size affect the transfer of the organizational knowledge to the new area more complex (Davenport & Prusak, 1998). Geographically, FCC will face new difficulties as the previous experiences of transferring production knowledge to suppliers have occurred in the home country Italy. This suggests that the choice FCC mad about only use one supplier to start with facilitates the knowledge transfer, especially since Mr. Gino Celetti himself will spend time with this supplier in the startup. On the other hand, FCC might in the future want to work with several producers in China and this could possibly increase the complexity of the transfer to new producers later on.

Hansen and Zander & Kogut mention that since it is very hard to learn and explain the tacit knowledge, its not teachable, it has a tendency to slow the transfer of new product development and manufacturing capabilities. FCC does not want to risk loosing too much time when transferring the knowledge to the new producers since this involve loosing a lot of money. Anyhow, FCC has a lot of tacit knowledge that possibly needs to be converted into explicit knowledge. This means that FCC's transfer of production knowledge might take more time than expected.

Evaluation of employee's judgment of information

When organizational practices have been transferred, an evaluation of how the employee's judgments of information affect the attitudes and actions has to be made (Leyland, 2005). This implies that after the transfer of common practices have been performed, FCC needs to evaluate how the Chinese producers have understood and captured these practices. These common practices include the way the company work and handle relationships in the organization. Close relationships based on trust will facilitate the transfer of such practices as well as the knowledge transfer (Buckley, Clegg & Tan, 2006).

Leyland (2005) believes that an evaluation of these practices would help in understanding of how the relationships will affect the knowledge transfer. The result from the transfer of common organizational practices will most probably reflect the result of the knowledge transfer. Since tacit knowledge is highly personal (Nonaka & Takeuchi, 1995) it will have been formed by the Chinese themselves. Argote (1999) on the other hand believes that knowledge is collective which would imply that such an evaluation would be unnecessary. Nonaka & Takeuchi (1995) further states that tacit knowledge changes when it is converted into explicit knowledge, something that according to them is necessary in order to make a transfer possible. This would also mean that an evaluation of the common practices would indeed reflect the result of the knowledge transfer. The front figures of FCC have themselves stated that some of their knowledge is very hard to transfer and believe that the knowledge certainly is tacit. The fact that they believe this would also imply that they agree

with the statement that it is highly personal. Therefore, in the context of FCC such an evaluation might be useful in order to assure that the Chinese producers have captured and understood the most vital parts in the same way as intended. If not, it would also be reflected in the result of the knowledge transfer meaning that the most vital parts of the process can be lost in the transfer. When FCC chooses to engage in a long-time contract with a supplier and spend a lot of time together with this supplier, it can be possible to continuously carry out evaluations of the employee's judgment of the information they have got and the common practices. This can help in assuring that the close relationship and trust that is needed for tacit knowledge transfer is good enough.

Trust, respect and commitment in relational capital

Several researchers and authors have stressed the importance of trust and commitment in relations that need to exchange know-how and information. One way to reach high commitment is to take on a future oriented view of the relationship says More and Spekman. We suppose that this is one of the ideas with creating a long-term contract with only one supplier. This can be a good ground for building lasting commitment between FCC and the supplier. FCC is probably very well aware of that if they cannot create a high commitment level the exchange of knowledge will not take place as wished. Of course the commitment level can be enhanced as the founder from FCC and the supplier will cooperate in a close manner over a long period of time. As Cummings explains, the idea of the knowledge exchange is that both joint goals and individual goals simultaneously can be met. For this to happen, the founder has to understand the supplier personally at an individual level, which cannot happen without close interaction during the learning phase. After the start-up, when the parties know each other better, when they have a shared vision and a shared language, it would probably be possible to develop the trust base even further with the use of virtual communication and internet technology. This can be valuable when crisis occurs and the founder is not any longer present. This type of communication is possible after trust has been built during the face-to-face interactions, and this may mean a more inexpensive and pragmatic way to exchange useful advices and knowledge in the future.

Leyland (2005) points out that face-to-face interaction can be important when building new relationships and trust. Shared goals and interests of both the provider and receiver of knowledge will facilitate a transfer, says Leyland. FCC's goal with the production is to receive a very high product quality and meet the demand of the Chinese olive oil market. The producers, as mentioned before, are well aware of their currently low oil quality and can be assumed to be eager to learn how to produce a high quality olive oil. Therefore, we believe that the high quality goal is shared by both FCC and the Chinese producers. In contrary, if the Chinese producers are only aiming at making a living and have no interest in the high quality, this will, according to what Leyland suggests, make the transfer of knowledge much more difficult. We can imagine that FCC deliberately has chosen a supplier that admits its low quality and is aiming at increasing the quality level of the olive oil produced. By creating an alliance with a supplier that is committed to the same goal as FCC, the conditions for succeeding with the Chinese business increase. This supplier is supposedly interested in receiving the production knowledge that FCC has, which means that FCC is respected and trusted by the new supplier in China.

When practicing knowledge transfer, benevolence-based trust is always important. But when the knowledge transfer also involves a big part of tacit knowledge, competence-based trust is a crucial part says Levin & Cross. Therefore, a relationship with the Chinese pro-

ducers have to be based on the Chinese trust in that the front persons of FCC know what they are doing and have a great competence in the subject matter. In contrary, the Chinese producers know that they are producing a low quality at the moment. We also assume that the Chinese are aware of the fact that Mr. Gino Celletti has been awarded multiple times for his great quality and that he is the leader of an olive oil county fair in Beijing. We believe this would ease the process of building trust in their competence. Moreover, FCC must trust that the contracted Chinese supplier has enough competence for learning how to produce the very high quality that is required.

The fact that FCC's core competence is including much knowledge ambiguity and tacit knowledge, and that transmitting this knowledge to new suppliers has been necessary for FCC's business, is probably evidence for that FCC has built a great relational capital.

Protecting the knowledge transferred

According to Davenport and Prusak (1998), the knowledge within an organization becomes more valuable in relation to the accessibility of it. On the other hand, when the knowledge is considered to be a core competence and it becomes highly accessible, it means that the requirements stated by Prahalad and Hamel (1990) for a core competence might not be met any longer. If FCC easily can spread the knowledge throughout the company, it also implies that it easily can be spread *outside* the company. Therefore, the requirement that a core competence should be hard to imitate is no longer met. FCC would, if this happened, loose their competitive advantage on the market, something that cannot be risked. In contrary, if the explicit knowledge associated with the production process was spread throughout the organization and allied parties, the value would increase. As mentioned before, explicit knowledge can only be understood when the tacit knowledge is identified and used for understanding of the explicit knowledge. One possible solution could be that FCC chooses certain parts of the tacit knowledge to convert into explicit knowledge and to transmit to the ones that need it. In this way they can keep the most sensitive and valuable knowledge within the core of the company. The risk of loosing their core competence would therefore be reduced.

In this case, we believe that it is more plausible that the complexity of the organizational knowledge makes it safe from misappropriation. That is because the different knowledge areas that together makes the critical core competence are dependent upon each other, which means that if parts of this knowledge leaks to competitors it will not be very useful. For competitive advantage, the wholeness of the organizational knowledge is needed, as we see it.

An important aspect when transferring the knowledge to the Chinese producers is not only having one of the two front persons in the project present the first few months, but also to have someone who can control the quality level during the actual production process. Controlling the quality during the process will be less costly than to obtain a low quality in the end and not be able to use it. One possible solution for this is to transfer the necessary tacit knowledge needed to evaluate the quality to the Chinese person who is responsible for the actual production step. A piece of tacit knowledge on its own should not be considered to be a threat to loosing control over the company's core competence as long as the persons obtaining the different parts of tacit knowledge differ along the production process.

Lee et al states that if the knowledge protection in a company is strong, it will be willing to "trust, communicate with, and make commitment to its alliance partners". Knowledge pro-

tection is also the antecedent of the firm's building of relational capital. This is why we believe that FCC during the years has been building its relational capital. We believe that this can be a reason for why FCC dares to take the risk to share company secret know-how: FCC trusts that it can build the relationships needed for keeping the important secrets inside the company, which is about fostering an atmosphere that is in line with the shared goals and values. However, there is always a possibility that a key employee leaves with the firm-specific know-how and joins a competitive firm. This situation could happen with any entry-mode. Therefore the relational aspects influences the protection of the critical organizational knowledge no matter what entry-mode is chosen, according to us.

When FCC participates in the alliance with the supplier in China, FCC will need to balance between trying to learn and protect knowledge, just as Kale et al. has suggested. But this situation is also about teaching and sharing knowledge.

The Transaction Cost, (TC), theory's explanation of the large extent of entry modes that are done within the firm boundary as depending on the will to overcome costs coming from opportunistic behavior of competitors is not reflecting the situation for FCC, according to us. That is because the complexity of the organizational knowledge of FCC is requiring that the entry mode choice is made with respect to this complexity. How to transfer the right knowledge to China, and how to keep the critical knowledge within the company, and how to attain new necessary knowledge from the Chinese supplier and its network, are all matters to be included in the decision framework. Therefore we agree with Malhotra, Kogut and Zander and Love who says that the TC explanation oversimplifies the reasons for firms to choose wholly-owned entry modes. When looking at the case of FCC, it is clear that the organizational knowledge and know-how that must be transferred to China is ambiguous, socially complex and dependent on FCC's historical knowledge and assumptions. Therefore it is not very easy to copy for misappropriation. On the same time, it will both be difficult and costly to transfer to members in the alliance, since it will require close collaboration during long time.

5.5 Strategic development and entry mode choice

Krishna Erramilli et al, and Lam suggest that market modes are not recommended for transferring organizational competence and quality competence. That is because transferring such knowledge requires intimate social interaction with the firm's established routines and organizational processes. Internal equity modes would be more appropriate for transferring such knowledge, according to these authors. We suggest that in the case of FCC, it is the quality competence that is the most important knowledge. This knowledge includes a lot of tacit knowledge, as has been revealed through the interviews with FCC. However, according to Krishna Erramilli et al, Kogut and Zander, Arora and Fosfuri, the most common entry mode choice for firms that intend to transfer tacit, imperfectly irritable capabilities is the internal, equity based entry mode. That is because it will be too complicated to transfer such knowledge through market modes.

In the case of FCC, we do not know exactly how big part of the knowledge that is to be transferred is tacit. But we know from the interviews that it is a good part of the total knowledge. FCC has chosen an entry mode that is not a pure market mode, since it relies on collaboration and a contract which implies that there are common goals and purposes. But from the beginning FCC considered using an equity mode in entering China. We sug-

gest that it is possible that FCC discovered that the knowledge that was missing was just as important. That missing knowledge could be attained through an allied partner. We believe that the enduring cooperation with a contracted supplier can provide similar conditions for exchanging knowledge as internal equity modes. But at the same time the competence of the Chinese supplier will provide new valuable knowledge to FCC, which had not been possible with the internal equity mode of entry. We believe that FCC can manage to partly create a culture and an empowerment, operating policies and procedures with the Chinese supplier during the time of close cooperation.

If the knowledge that needs to be transferred to China had been irritable, then the market non-equity mode would probably have been a less costly alternative.

Nasimbene present theory about why Italian firms chose to source internationally. Italian firms wants access to less expensive resources, they also wants to face the intensification of global competition and they want commercial presence on new markets. This is exactly why FCC has decided to enter China. The main criteria when it comes to supplier selection are quality, price and reliability of deliveries, according to Nasimbene. This is also true for FCC.

The choices for FCC in entering China can be divided in three parts: internal development, acquisitions and alliances or joint venture.

Internal development, wholly owned equity mode

Internal or organic development is a strategy that builds on and develops the organizations own capabilities. This entry-mode is more common when the organization has an experience the host-country. It is also more common when the firm needs knowledge-protection or global interaction. We propose that the reasons for starting a wholly owned subsidiary in China were big enough for FCC. FCC's experience of China is all too small for taking the risk to independently run a business there. Also the need for knowledge-protection is not too great to cooperate with an external party, since the knowledge that needs to be protected is not very useful without other knowledge areas, which will not be conveyed. Furthermore, the core competence is a bit difficult to steal since a great deal of tacit knowledge is needed for receiving the explicit knowledge in the core competence. Besides, we suggest that FCC does not consider new product development outside their company to be a problem, or even possible, as they believe that their production knowledge in monocultivar olive oil is so very good, therefore they do not believe that they risk loosing any new production knowledge to persons outside the house.

Mergers and acquisitions

The reason for acquiring another company in China could be to reduce the risk of competitors' reaction. However, by cooperate with a firm FCC also in a way can mislead the competitors. That is because these can not know the intention with the new oil production of FCC and the Chinese supplier. Another reason to acquire an already existing firm could be the need for that firm's competence. Also in this case, we suggest that this can be attained also by close cooperation with the contracted supplier. Again, as long as the Chinese supplier and FCC have the same objectives, the knowledge exchange can be mutual. The Chinese supplier will learn how to produce monocultivar olive oil, and FCC will learn about Chinese business networks, logistics, laws and regulations unknown to FCC.

Strategic alliance or joint development:

Collaboration can be a way to extend an organization and at the same time complement and reinforce the organizational knowledge, says Madhok. Even if FCC does not explicitly say that they want to complement and reinforce the organizational knowledge, we suggest that the actions that FCC takes show that FCC certainly tries to reinforce their organizational knowledge, for example by planning to spend much time with the new partner in China, and by participating and by being responsible for a Chinese trade show about olive oil etc.

We agree with Luo about that the reasons for using a collaborative mode of entry should not only be seen as the most cost-efficient alternative to the more costly wholly owned subsidiary. Rather it should be seen as the best alternative to knowledge acquisition. We propose that in the extremely complex environment of today it is almost impossible to compete with only its own knowledge and resources. It is clear from the interviews with FCC that by finding a suitable supplier with a good production mill to cooperate with, FCC can get access to the Chinese market. Probably this is also the best way for achieve the knowledge that is currently missing within FCC to be competitive in China. In this case with FCC, the strategic alliance is only a two-partner alliance co-producing a product. We have no information about that FCC and the other partner plan to create a joint-venture, but it is possible that they do. Joint ventures are a favored means to collaborate with Chinese firms. By using the strategic alliance form of entry mode, FCC can better manage the contextual risks and uncertainties. That is because FCC can learn from its partner about contextual matters that lies out of FCC's knowledge. By forming an alliance with a partner with local knowledge, FCC can overcome the deficiencies of FCC's knowledge and capabilities. When FCC learns from its experience of the alliance with the Chinese supplier, FCC will add to its alliance capability, which started to build when the first alliance with an Italian supplier was created many years ago.

FCC says in the interview that they plan to open a restaurant in Beijing to sell and advertise the olive oil produced in China. We have no information of if this venture will be wholly-owned by FCC or if it will be a joint venture or a strategic alliance with a Chinese partner. But also this kind of business requires that knowledge can be transferred from FCC to the new location in Beijing.

6 Conclusion

In this chapter conclusions are drawn based on the results from the analysis in order to answer the purpose of the thesis.

In this thesis we try to get a deeper understanding of the complexity of the organizational knowledge of a firm. Moreover, we try to understand how such knowledge can have an affect on the choice of entry mode when the firm exploits its business on a new market. We have used an Italian olive oil company, FCC, as a case example. FCC is planning to exploit its business and enter the Chinese market. Their aim is to supply the growing segment of rich Chinese with top quality olive oil that will be produced in China. Through deep interviews we have gathered information of how this firm sees its organizational knowledge and how that contributes to the firm's competitive advantage. FCC is planning to enter China by contracting a Chinese supplier. By forming this sort of strategic alliance, FCC believes that it will be possible to create the long-term and close relations that will be needed in order to exchange the relevant knowledge. FCC must transmit the relevant production knowledge, which includes a lot of tacit knowledge which is difficult and take time to transfer. This knowledge has been critical for FCC's competitive advantage in Italy, and the same knowledge will be critical on the Chinese market. If FCC cannot transfer this knowledge to the Chinese, the customers' quality requirements will not be met. This production knowledge is included in FCC's core competence. The value of this competence can possibly be even larger on the Chinese market, depending on the growing demand for fine olive oil in China.

The organizational knowledge is complex and includes knowledge within many dispersed areas. We suggest that all these pieces of knowledge and capabilities are not useful on their own, but need the other ones to bring competitive advantage to the firm. Therefore, the risk of sharing confidential production knowledge with a partner that is not owned by FCC is not as risky as it first seems. That can be one of the reasons why FCC changed its mind about starting an own subsidiary in China. After spending some time in China, FCC decided to enter the new country by cooperating with a contracted supplier. Moreover, the knowledge that FCC does not currently have enough of can be attained through their alliance partner in China. We suggest that the Choice of entry mode is just as much about what knowledge is missing in the organization as about what knowledge it has.

One of the risky parts of entering China is that the Chinese does not have the same background knowledge, or tacit knowledge, as the Italians has about olive oil. That may mean that transferring the relevant production knowledge may take more time than can be anticipated. Also the language differences can be a hindrance. This can be problematic as FCC has declared that the procedure of entering China has to be quick. Otherwise FCC risks not being first with the monocultivar olive oil.

One of the reasons for choosing the strategic alliance as an entry mode can be that in order to transfer tacit knowledge, commitment, trust and reputation is important. By building an alliance that has a long-lasting contract built on mutual objectives and goals, there is a basis for creating synergies from the knowledge of the two firms. The idea is to reach a future oriented win-win situation, where both joint goals and individual goals can be met. Both

FCC and the Chinese supplier will gain from producing very high quality olive oil.

This study implies that the reason for FCC to choose the strategic alliance using a long-term contract as an entry-mode to China depends first on FCC's capability in transferring the necessary production knowledge to partners or members in China, secondly from the possibility to attaining new knowledge from outside the firm, and thirdly on protecting the knowledge that must not leak to competitors.

7 Recommendations for further research

In this chapter we recommend areas for further investigation related to the subject matter of this thesis.

We suggest that the impact of organizational knowledge on entry-mode choices be further researched, since there is a lack of knowledge in this particular field of interest. Especially the diverse types of strategic alliances and the knowledge reasons for why these are created, would be interesting, since the strategic alliance as entry-mode is increasing globally. The reason for this is apparently the complexity in today's competitive environment. It seems like no single company can do on its own any longer. Cooperation in various forms is needed to survive. More knowledge is needed everywhere. The connection between the two phenomena is interesting.

8 Appendix

8.1 The monocultivar olive oil and the industry of FCC

This will give a brief explanation of some background to the requirements for using the label Extra Virgin Olive Oil in order to understand how complex the process of producing the oil really is.

As mentioned before in the chapter definitions, the Monocultivar Extra Virgin Olive Oil has the highest degree of quality in the product area, and is the most flavorful and natural olive oil (International Olive Oil Council, 2006). According to the International Olive Oil Council (2006) the Extra Virgin Olive Oil has to be totally free from defects and have a certain flavor. It has to have a perfect aroma and a great flavor. Other requirements in order to classify an olive oil as Extra Virgin are the fact that it cannot contain a higher level of acidity than 0.8 per cent. If an olive oil is classified as only Virgin it means that the oil has parts of the flavor required, but it also contains defects from production.

The aroma and taste of an Extra Virgin Olive Oil is dependent on many factors such as the variety of olive, climate and growing conditions, soil conditions, method and time of olive harvest and the care which with the olive oil is transformed into the final product, bottled and stored. Monocultivar Extra Virgin Olive Oil contains only one variety of olive per olive oil. This is known to increase the aroma, the flavor and the quality of the olive oil which makes the Monocultivar Extra Virgin Olive Oil the highest degree of quality in the area of olive oil. Virgin means that the olive is unprocessed (International Olive Oil Council, 2006).

The quality should be considered to be subjective, since it is decided by the International Olive Oil Council and their members' tastes. The level of acidity and testing for defects is made by persons with a long history in olive oil testing. The testing sessions are similar to when tasting wine and a defect from production is easily detected. When the olive oil has met the requirements regarding no defects and the level of acidity, it is considered to be Extra Virgin Olive Oil. Which brand or products that is the best among these approved ones is highly subjective. Therefore, the best quality is dependent on the taste of the tester. Many people in the industry and from the International Olive Oil Council test the approved products in order to decide their quality and together their opinion is stated as the rating of quality (International Olive Oil Council, 2006).

The Chinese do not have a tradition in using and producing olive oil which might have a negative influence on the efficiency of a knowledge transfer. Due to this fact, it is important to know about the pre-requisites of the current Chinese olive oil production and the demand on the Chinese market.

According to Regalland (2006), China is not well-suited for mass production of olive oil due to its geographical environment. Although, it has the semi-tropical climate, which means that there are *some* regions in the country where it is possible to grow olive trees. In these areas, olive trees have been planted since 40 years but the Chinese seriously lack the knowledge of olive planting technology which is restricting the industry enormously.

According to the International Olive Oil Council, China will within the next decade become the world's largest consumer of olive oil. In the year of 2004, approximately 3,000

tons of olive oil were consumed. In the recent years the Chinese people's consumption of olive oil has increased tremendously due to higher incomes and a greater knowledge about the health aspects of olive oil and the quality of life it can offer.

The production process could be considered to be the key to a high quality and to getting the produced olive oil approved for the quality label extra virgin. Therefore, a company with their core competence within this area would have an advantage on the olive oil market.

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