

3

Internationalization theories

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Learning objectives

After studying this chapter you should be able to do the following:

- Analyse and compare the three theories explaining a firm's internationalization process:
 - 1 the Uppsala internationalization model;
 - 2 the transaction cost theory; and
 - 3 the network model.
- Explain the most important determinants for the internationalization process of SMEs.
- Discuss the different factors which influence internationalization of services.
- Explain and discuss the relevance of the network model for an SME serving as a subcontractor.
- Explain the term 'Born Global' and its connection to Internet marketing.

3.1 Introduction

Having discussed the barriers to starting internationalization in Chapter 2, we will begin this chapter by presenting the different theoretical approaches to international marketing and then choose three models for further discussion in sections 3.2, 3.3 and 3.4.

Historical development of internationalization

Much of the early literature on internationalization was inspired by general marketing theories. Later on, internationalization dealt with the choice between exporting and FDI (foreign direct investment). During the past 10–15 years there has been much focus on internationalization in networks, by which the firm has different relationships not only with customers but also with other actors in the environment.

The traditional marketing approach

The Penrosian tradition (Penrose, 1959; Prahalad and Hamel, 1990) reflects the traditional marketing focus on the firm's core competences combined with opportunities in the foreign environment.

The cost-based view of this tradition suggested that the firm must possess a 'compensating advantage' in order to overcome the 'cost of foreignness' (Kindleberger, 1969; Hymer, 1976). This led to the identification of technological and marketing skills as the key elements in successful foreign entry.

'Life cycle' concept for international trade

Sequential modes of internationalization were introduced by Vernon's 'product cycle hypothesis' (1966), in which firms go through an exporting phase before switching first to market-seeking FDI, and then to cost-oriented FDI. Technology and marketing factors combine to explain standardization, which drives location decisions.

Vernon's hypothesis is that producers in advanced countries (ACs) are 'closer' to the markets than producers elsewhere; consequently the first production facilities for these products will be in the ACs. As demand expands a certain degree of standardization usually takes place. 'Economies of scale', through mass production, become more important. Concern about production cost replaces concern about product adaptations. With standardized products the less developed countries (LDCs) may offer competitive advantages as production locations. One example of this is the movement of production locations for personal computers from ACs to LDCs.

The Uppsala Internationalization model

The Scandinavian 'stages' models of entry suggest a sequential pattern of entry into successive foreign markets, coupled with a progressive deepening of commitment to each market. Increasing commitment is particularly important in the thinking of the Uppsala School (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). The main consequence of this **Uppsala Internationalization model** is that firms tend to intensify their commitment towards foreign markets as their experience grows. See also Section 3.2.

Uppsala Internationalization model

Additional market commitments are made in small incremental steps: choosing additional geographic markets with small psychic distances, combined with choosing entry modes with few additional risks.

The internationalization/transaction cost approach

In the early 1970s intermediate forms of internationalization such as licensing were not considered interesting. Buckley and Casson (1976) expanded the choice to include licensing as a means of reaching customers abroad. But in their perspective the multinational firm would usually prefer to 'internalize' transactions via direct equity investment rather than license its capability. Joint ventures were not explicitly considered to be in the spectrum of governance choices until the mid-1980s (Contractor and Lorange, 1988; Kogut, 1988).

Buckley and Casson's focus on market-based (externalization) versus firm-based (internalization) solutions highlighted the strategic significance of licensing in market entry. Internationalization involves two interdependent decisions – location and mode of control.

The internalization perspective is closely related to the transaction cost (TC) theory (Williamson, 1975). The paradigmatic question in internalization theory is that, upon deciding to enter a foreign market, should a firm do so through internalization within its own boundaries (a subsidiary) or through some form of collaboration with an external partner (externalization)? The internalization and TC perspectives are both concerned with the minimization of TC and the conditions underlying market failure. The intention is to analyse the characteristics of a transaction in order to decide on the most efficient, i.e. TC minimizing, governance mode. The internalization theory can be considered the TC theory of the multinational corporation (Rugman, 1986; Madhok, 1998).

Dunning's eclectic approach

In his eclectic Ownership-Location-Internalization (OLI) framework Dunning (1988) discussed the importance of locational variables in foreign investment decisions. The word 'eclectic' represents the idea that a full explanation of the transnational activities of firms needs to draw on several strands of economic theory. According to Dunning the propensity of a firm to engage itself in international production increases if the following three conditions are being satisfied:

- 1 *Ownership advantages*: A firm that owns foreign production facilities has bigger ownership advantages compared to firms of other nationalities. These 'advantages' may consist of intangible assets, such as know-how.
- 2 *Locational advantages*: It must be profitable for the firm to continue these assets with factor endowments (labour, energy, materials, components, transport and communication channels) in the foreign markets. If not, the foreign markets would be served by exports.
- 3 *Internalization advantages*: It must be more profitable for the firm to use its advantages rather than selling them, or the right to use them, to a foreign firm.

The network approach

The basic assumption in the network approach is that the international firm cannot be analysed as an isolated actor but has to be viewed in relation to other actors in the international environment. Thus the individual firm is dependent on resources controlled by others. The relationships of a firm within a domestic network can be used as connections to other networks in other countries (Johanson and Mattson, 1988).

In the following three sections (sections 3.2 to 3.4) we will concentrate on three of the approaches presented above.

The difference between 'cultural distance' and 'psychic distance'

Cultural distance (used in Chapter 6) refers to the (macro) cultural level of a country and is defined as the degree to which (factual) cultural values in one country are different from those in another country, i.e. 'distance' between countries.

Psychic distance (used in this chapter) can be defined as the individual manager's perception of the differences between the home and the foreign market and it is a highly subjective interpretation of reality. Therefore, psychic distance cannot be measured with factual indicators, such as publicly available statistics on level of education, religion, language and so forth. The distinction between the two concepts is important for managers. By assessing psychic distance at the individual level, it is possible to take appropriate steps to reduce the manager's psychic distance towards foreign markets (Sousa and Bradley, 2005, 2006).

Psychic distance
Differences in language, culture and political system, which disturb the flow between the firm and the market.

3.2 The Uppsala internationalization model

The stage model

During the 1970s a number of Swedish researchers at the University of Uppsala (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977) focused their interest on the internationalization process. Studying the internationalization of Swedish manufacturing firms, they developed a model of the firm's choice of market and form of entry when going abroad. Their work was influenced by Aharoni's seminal (1966) study.

With these basic assumptions in mind, the Uppsala researchers interpreted the patterns in the internationalization process they had observed in Swedish manufacturing firms. They had noted, first of all, that companies appeared to begin their operations abroad in fairly nearby markets and only gradually penetrated more far-flung markets. Second, it appeared that companies entered new markets through exports. It was very rare for companies to enter new markets with sales organizations or manufacturing subsidiaries of their own. Wholly-owned or majority-owned operations were established only after several years of exports to the same market.

Johanson and Wiedersheim-Paul (1975) distinguish between four different modes of entering an international market, where the successive stages represent higher degrees of international involvement/market commitment:

- Stage 1: No regular export activities (sporadic export).
- Stage 2: Export via independent representatives (export modes).
- Stage 3: Establishment of a foreign sales subsidiary.
- Stage 4: Foreign production/manufacturing units.

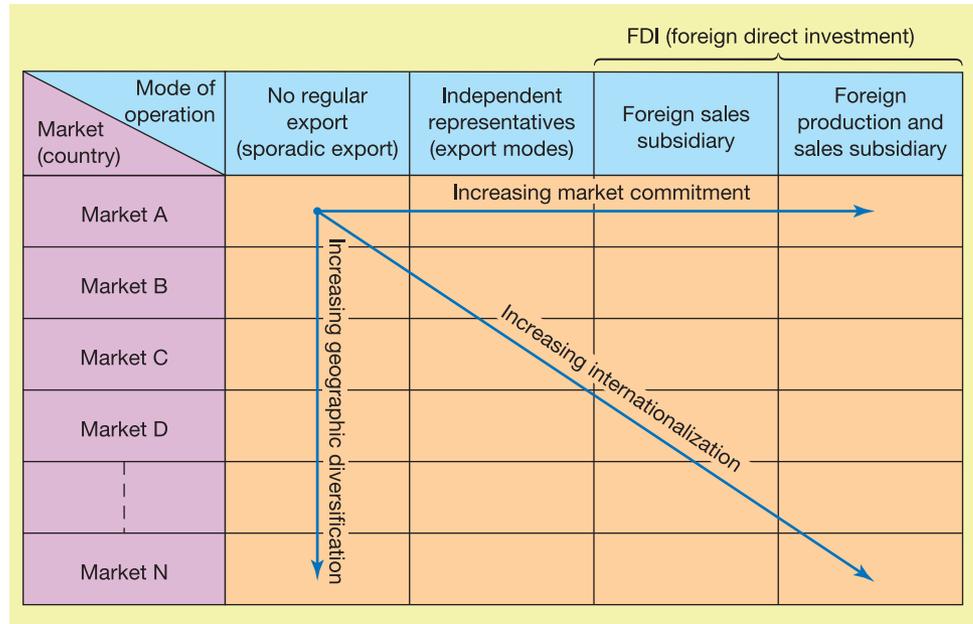
The assumption that the internationalization of a firm develops step by step was originally supported by evidence from a case study of four Swedish firms. The sequence of stages was restricted to a specific country market. This market commitment dimension is shown in Figure 3.1.

The concept of market commitment is assumed to contain two factors – the amount of resources committed and the degree of commitment. The amount of resources could be operationalized to the size of investment in the market (marketing, organization, personnel, etc.), while the degree of commitment refers to the difficulty of finding an alternative use for the resources and transferring them to the alternative use.

International activities require both general knowledge and market-specific knowledge. Market-specific knowledge is assumed to be gained mainly through experience in the market, whereas knowledge of the operations can be transferred from one country to another; the latter will thus facilitate the geographic diversification in Figure 3.1. A direct relation between market knowledge and market commitment is postulated: knowledge can be considered as a dimension of human resources. Consequently, the better knowledge about a market, the more valuable are the resources and the stronger the commitment to the market.

Figure 3.1 implies that additional market commitment as a rule will be made in small incremental steps, both in the market commitment dimension and in the geographical dimension. There are, however, three exceptions. First, firms that have large resources experience small consequences of their commitments and can take larger internationalization steps. Second, when market conditions are stable and homogeneous, relevant market knowledge can be gained in ways other than experience. Third, when the firm has considerable experience from markets with similar conditions, it

Figure 3.1 Internationalization of the firm: an incremental (organic) approach



Source: Adapted from Forsgren and Johanson, 1975, p. 16.

may be able to generalize this experience to any specific market (Johanson and Vahlne, 1990).

The geographical dimension in Figure 3.1 shows that firms enter new markets with successively greater psychic distance. Psychic distance is defined in terms of factors such as differences in language, culture and political systems, which disturb the flow of information between the firm and the market. Thus firms start internationalization by going to those markets they can most easily understand. There they will see opportunities, and there the perceived market uncertainty is low (Brewer, 2007).

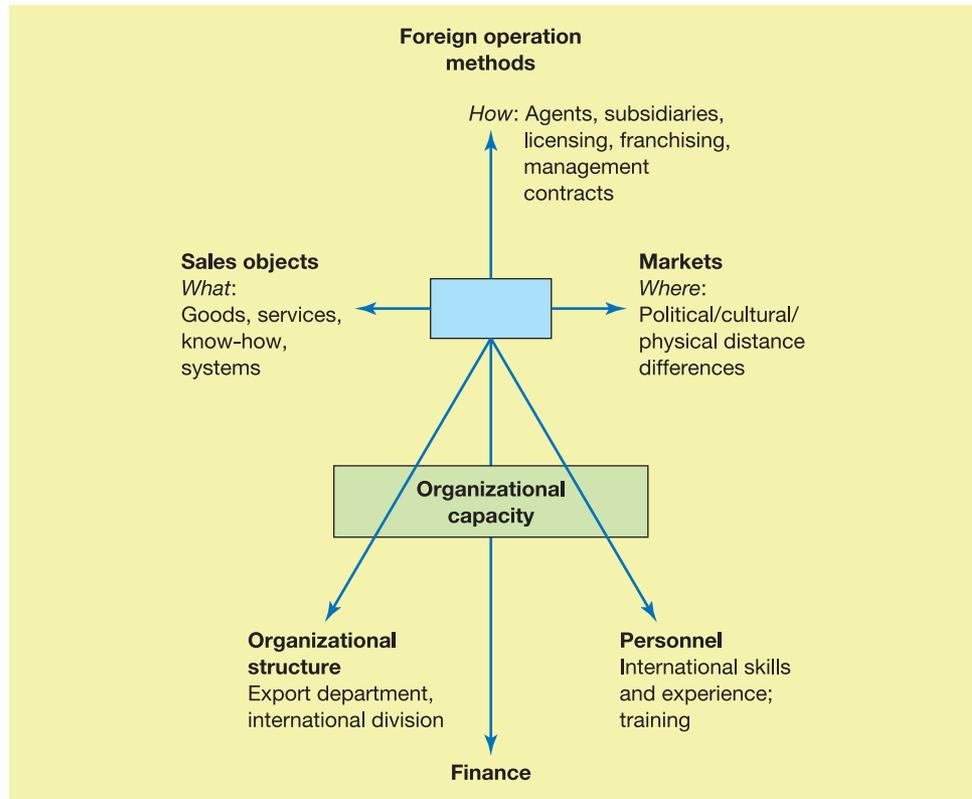
The original stage model has been extended by Welch and Loustarinen (1988), who operate with six dimensions of internationalization (see Figure 3.2):

- 1 *sales objects* (what?): goods, services, know-how and systems;
- 2 *operations methods* (how?): agents, subsidiaries, licensing, franchising management contracts;
- 3 *markets* (where?): political/cultural/psychic/physical distance differences between markets;
- 4 *organizational structure*: export department, international division;
- 5 *finance*: availability of international finance sources to support the international activities;
- 6 *personnel*: international skills, experience and training.

3.3 The transaction cost analysis (TCA) model

The foundation for this model was made by Coase (1937). He argued that 'a firm will tend to expand until the cost of organizing an extra transaction within the firm will become equal to the cost of carrying out the same transaction by means of an exchange on the open market' (p. 395). It is a theory which predicts that a firm will perform

Figure 3.2 Dimensions of internationalization



Source: Welch and Loustarinen, 1988. Reproduced with permission from The Braybrooke Press Ltd.

internally those activities it can undertake at lower cost through establishing an internal ('hierarchical') management control and implementation system while relying on the market for activities in which independent outsiders (such as export intermediaries, agents or distributors) have a cost advantage.

Transaction costs emerge when markets fail to operate under the requirements of perfect competition ('friction free'); the cost of operating in such markets (i.e. the transaction cost) would be zero, and there would be little or no incentive to impose any impediments to free market exchange. However, in the real world there is always some kind of 'friction' between buyer and seller, resulting in transaction costs (see Figure 3.3).

The friction between buyer and seller can often be explained by **opportunistic behaviour**. Williamson (1985) defines it as a 'self-interest seeking with guile'. It includes methods of misleading, distortion, disguise, and confusion. To protect against the hazards of opportunism, the parties may employ a variety of safeguards or governance structures. The term 'safeguard' (or alternatively 'governance structure') as used here can be defined as a control mechanism, which has the objective of bringing about the perception of fairness or equity among transactors. The purpose of safeguards is to provide, at minimum cost, the control and 'trust' that is necessary for transactors to believe that engaging in the exchange will make them better off. The most prominent safeguard is the legal contract. A legal contract specifies the obligations of each party and allows a transactor to go to a third party (i.e. a court) to sanction an opportunistic trading partner.

The **transaction cost analysis** (TCA) framework argues that cost minimization explains structural decisions. Firms **internalize**, that is, integrate vertically, to reduce

Transaction costs

The 'friction' between buyer and seller, which is explained by opportunistic behaviour.

Opportunistic behaviour

Self-interest with guile – misleading, distortion, disguise and confusion.

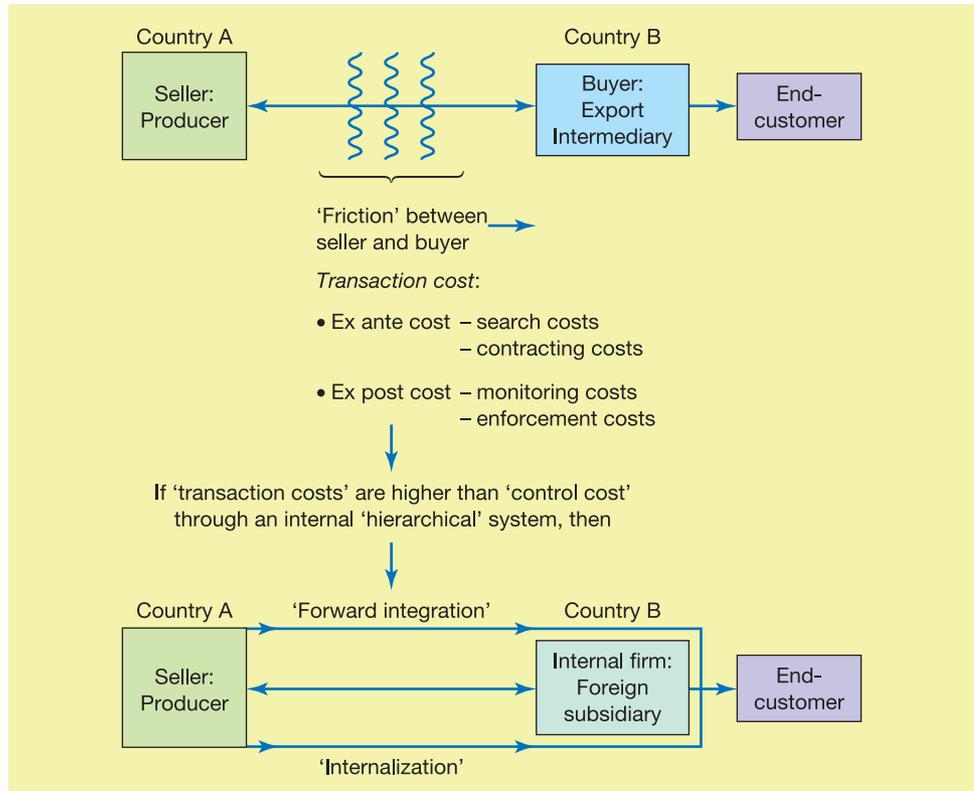
Transaction cost analysis

Transaction cost analysis concludes that if the 'friction' between buyer and seller is higher than through an internal hierarchical system then the firm should internalize.

Internalize

Integrate an external partner into one's own organization.

Figure 3.3 The principles of the TCA model



transaction costs. Transaction costs can be divided into *different forms of costs* related to the transactional relationship between buyer and seller. The underlying condition for the following description of the cost elements is this equation:

$$\text{transaction cost} = \text{ex ante costs} + \text{ex post costs} = (\text{search costs} + \text{contracting costs}) + (\text{monitoring costs} + \text{enforcement costs})$$

Ex ante costs

- *Search costs*: include the cost of gathering information to identify and evaluate potential export intermediaries. Although such costs can be prohibitive to many exporters, knowledge about foreign markets is critical to export success. The search costs for distant, unfamiliar markets, where available (published) market information is lacking and organizational forms are different, can be especially prohibitive (e.g. exports from the United Kingdom to China). In comparison, the search costs for nearby, familiar markets may be more acceptable (e.g. export from United Kingdom to Germany).
- *Contracting costs*: refer to the costs associated with negotiating and writing an agreement between seller (producer) and buyer (export intermediary).

Ex post costs

- *Monitoring costs*: refer to the costs associated with monitoring the agreement to ensure that both seller and buyer fulfil the predetermined set of obligations.

- *Enforcement costs*: refer to the costs associated with the sanctioning of a trading partner who does not perform in accordance with the agreement.

A fundamental assumption of transaction cost theory is that firms will attempt to minimize the combination of these costs when undertaking transactions. Thus, when considering the most efficient form of organizing export functions, transaction cost theory suggests that firms will choose the solution that minimizes the sum of ex ante and ex post costs.

Williamson (1975) based his analysis on the assumption of transaction costs and the different forms of governance structure under which transactions take place. In his original work, Williamson identified two main alternatives of governance markets: externalization and internalization ('hierarchies'). In the case of **externalization**, market transactions are by definition external to the firm and the price mechanism conveys all the necessary governance information. In the case of **internalization**, the international firm creates a kind of internal market in which the hierarchical governance is defined by a set of 'internal' contracts.

Externalization and internalization of transactions are equated with intermediaries (agents, distributors) and sales subsidiaries (or other governance structures involving ownership control) respectively.

In this way, Williamson's framework provides the basis for a variety of research into the organization of international activity and the choice of international market entry mode. We will return to this issue in Part III of this book.

The conclusion of the transaction cost theory is:

If the transaction costs (defined above) through externalization (e.g. through an importer or agent) are higher than the control cost through an internal hierarchical system, then the firm should seek internalization of activities, i.e. implementing the global marketing strategy in wholly-owned subsidiaries. Or more popularly explained: if the 'friction' between buyer and seller is too high then the firm should rather internalize, in the form of its own subsidiaries.

Limitations of the TCA framework

Narrow assumptions of human nature

Ghoshal and Moran (1996) have criticized the original work of Williamson as having too narrow assumptions of human nature (opportunism and its equally narrow interpretation of economic objectives). They also wonder why the theory's mainstream development has remained immune to such important contributions as Ouchi's (1980) insight on social control. Ouchi (1980) points to the relevance of intermediate forms (between markets and hierarchies), such as the clan, where governance is based on a win-win situation (in contrast to a zero-sum game situation).

Sometimes firms would even build trust with their externalized agents and distributors by turning them into partners. In this way the firms would avoid large investments in subsidiaries around the world.

Excluding 'internal' transaction costs

The TCA framework also seems to ignore the 'internal' transaction cost, assuming zero friction within a multinational firm. One can imagine severe friction (resulting in transaction cost) between the head office of a firm and its sales subsidiaries when internal transfer prices have to be settled.

Externalization

Doing business through an external partner (importer, agent, distributor).

Internalization

Doing business through own internal system (own subsidiaries).

Relevance of 'intermediate' forms for SMEs

One can also question the relevance of the TCA framework to the internationalization process of SMEs (Christensen and Lindmark, 1993). The lack of resources and knowledge in SMEs is a major force for the externalization of activities. But since the use of markets often raises contractual problems, markets in many instances are not real alternatives to hierarchies for SMEs. Instead, the SMEs have to rely on intermediate forms of governance, such as contractual relations and relations based on clan-like systems created by a mutual orientation of investments, skills and trust building. Therefore SMEs are often highly dependent on the cooperative environment available. Such an approach will be presented and discussed in the next section.

Importance of 'production cost' is understated

It can be argued that the importance of transaction cost is overstated and that the importance of production cost has not been taken into consideration. Production cost is the cost of performing a particular task/function in the value chain, such as R&D costs, manufacturing costs and marketing costs. According to Williamson (1985), the most efficient choice of internationalization mode is one that will help *minimize the sum of production and transaction costs*.

3.4 The network model

Basic concept

Business networks

Actors are autonomous and linked to each other through relationships, which are flexible and may alter accordingly to rapid changes in the environment. The 'glue' that keeps the relationships together are based on technical, economic, legal and especially personal ties.

Network model

The relationships of a firm in a domestic network can be used as bridges to other networks in other countries.

Business networks are a mode of handling activity interdependences between several business actors. As we have seen, other modes of handling or governing interdependences in a business field are markets and hierarchies.

The **network model** differs from the market with regard to relations between actors. In a market model, actors have no specific relations to each other. The interdependences are regulated through the market price mechanism. In contrast, in the business network the actors are linked to each other through exchange relationships, and their needs and capabilities are mediated through the interaction taking place in the relationships.

The industrial network differs from the hierarchy in the way that the actors are autonomous and handle their interdependences bilaterally rather than via a coordinating unit on a higher level. Whereas a hierarchy is organized and controlled as one unit from the top, the business network is organized by each actor's willingness to engage in exchange relationships with some of the other actors in the network. The networks are more loosely coupled than are hierarchies; they can change shape more easily. Any actor in the network can engage in new relationships or break off old ones, thereby modifying its structure. Thus business networks can be expected to be more flexible in response to changing conditions in turbulent business fields, such as those where technical change is very rapid.

It can be concluded that business networks will emerge in fields where coordination between specific actors can give strong gains and where conditions are changing rapidly. Thus the network approach implies a move away from the firm as the unit of analysis, towards exchange between firms and between a group of firms and other groups of firms as the main object of study. However, it also implies a move away from transactions towards more lasting exchange relationships constituting a structure within which international business takes place and evolves.

Evidently, business relationships and consequently industrial networks are subtle phenomena, which cannot easily be observed by an outsider: that is, a potential entrant. The actors are tied to each other through a number of different bonds: technical, social, cognitive, administrative, legal, economic, etc.

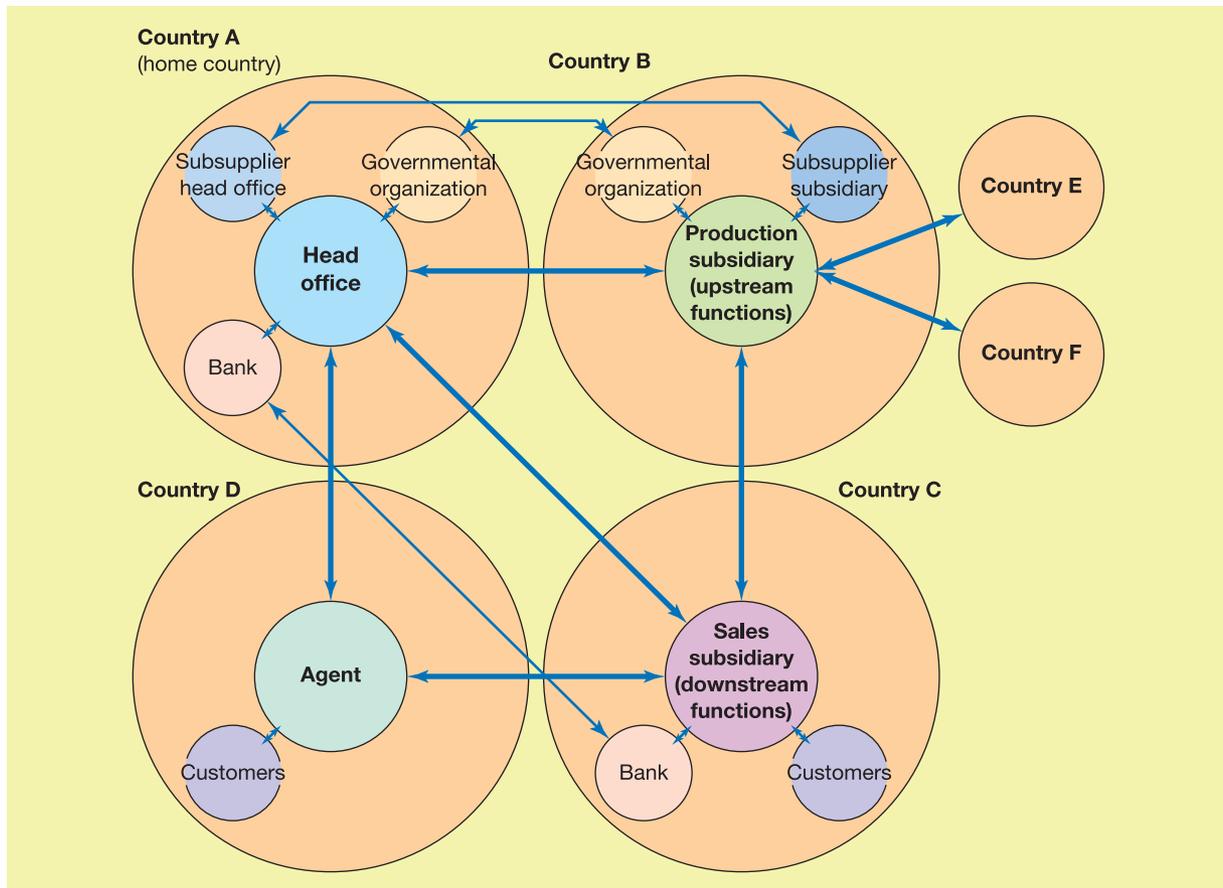
A basic assumption in the network model is that the individual firm is dependent on resources controlled by other firms. The companies get access to these external resources through their network positions. Since the development of positions takes time and depends on resource accumulations, a firm must establish and develop positions in relation to counterparts in foreign networks.

To enter a network from outside requires that other actors be motivated to engage in interaction, something which is resource demanding and may require several firms to make adaptations in their ways of performing business. Thus foreign market or network entry of the firm may very well be the result of interaction initiatives taken by other firms that are insiders in the network in the specific country. However, the chances of being the object of such initiatives are much greater for an insider.

The networks in a country may well extend far beyond country borders. In relation to the internationalization of the firm, the network view argues that the internationalizing firm is initially engaged in a network which is primarily domestic.

The relationships of a firm in a domestic network can be used as bridges to other networks in other countries. In some cases the customer demands that the supplier follows it abroad if the supplier wants to keep the business at home. An example of an international network is shown in Figure 3.4. It appears that one of the subsuppliers

Figure 3.4 An example of an international network



established a subsidiary in Country B. Here the production subsidiary is served by the local company of the subsupplier. Countries E and F, and partly Country C, are sourced from the production subsidiary in Country B. Generally it can be assumed that direct or indirect bridges exist between firms and different country networks. Such bridges can be important both in the initial steps abroad and in the subsequent entry of new markets.

The character of the ties in a network is partly a matter of the firms involved. This is primarily the case with technical, economic and legal ties. To an important extent, however, the ties are formed between the persons engaged in the business relationships. This is the case with social and cognitive ties. Industries as well as countries may differ with regard to the relative importance of firm and personal relationships. But it can be expected that the personal influence on relationships is strongest in the early establishment of relationships. Later in the process routines and systems will become more important.

When entering a network, the internationalization process of the firm will often proceed more quickly. In particular, SMEs in high-tech industries tend to go directly to more distant markets and to set up their own subsidiaries more rapidly. One reason seems to be that the entrepreneurs behind those companies have networks of colleagues dealing with the new technology. Internationalization, in these cases, is an exploitation of the advantage that this network constitutes.

3.5 Born globals

Introduction

In recent years research has identified an increasing number of firms that certainly do not follow the traditional stages pattern in their internationalization process. In contrast, they aim at international markets or maybe even the global market right from their birth.

Born global

A firm that from its 'birth' globalizes rapidly without any preceding long term internationalization period.

A '**born global**' can be defined as: 'a firm that from its inception pursue a vision of becoming global and globalize rapidly without any preceding long term domestic or internationalization period' (Oviatt and McDougall, 1994; Gabrielsson and Kirpalani, 2004).

Born globals represent an interesting case of firms operating under time and space compression conditions that have allowed them to assume a global geographic scope since their start up. This 'time–space compression' phenomenon (Harvey, 1996) means that geographical processes can be reduced and compressed into 'here and now' trade and information exchange over the globe – if available infrastructure, communication and IT devices are put in place together with skilled people. The global financial market is a good example of the phenomenon (Törnroos, 2002).

Oviatt and McDougall (1994) grouped born globals (or 'international new ventures' as they call them) into four different categories, dependent on the number of value chain activities performed combined with the number of countries involved. For example, they distinguish the 'export/import start-up' from the 'global start-up', whereby the latter – contrary to the former – involves many activities coordinated across many countries.

Born globals are typically characterized by being SMEs with less than 500 employees and annual sales under \$100 million – and reliance on cutting-edge technology in the development of relatively unique product or process innovations. But the most distinguishing feature of born global firms is that they tend to be managed by

entrepreneurial visionaries who view the world as a single, borderless marketplace from the time of the firm's founding. Born globals are small, technology-oriented companies that operate in international markets from the earliest days of their establishment. There is growing evidence of the emergence of born globals in numerous countries of the developed world.

More recently the concept of *born-again global firms* has been proposed, i.e. long-established firms that previously focused on their domestic markets but that suddenly embrace rapid and dedicated internationalization (Bell *et al.*, 2001). Furthermore, it seems that there can be *true-born globals* (focusing on both low- and high distance markets) and apparently born-globals, that is *born-internationals*, which are mainly focusing on low-distance markets (Kuivalainen *et al.*, 2007).

The born global phenomenon suggests a new challenge to traditional theories of internationalization.

Born globals are challenging traditional theories

Born globals may be similar to the 'late starter' or the 'international among others' (Johanson and Mattson, 1988). In the latter situation both the environment and the firm are highly internationalized. Johanson and Mattson (1988) point out that internationalization processes of firms will be much faster in internationalized market conditions, among other reasons because the need for coordination and integration across borders is high. Since relevant partners/distributors will often be occupied in neighbouring markets, firms do not necessarily follow a 'rings in the water' approach to market selection. In the same vein their 'establishment chain' need not follow the traditional picture because strategic alliances, joint ventures, etc., are much more prevalent; firms seek partners with supplementary skills and resources. In other words internationalization processes of firms will be much more individual and situation specific in internationalized markets.

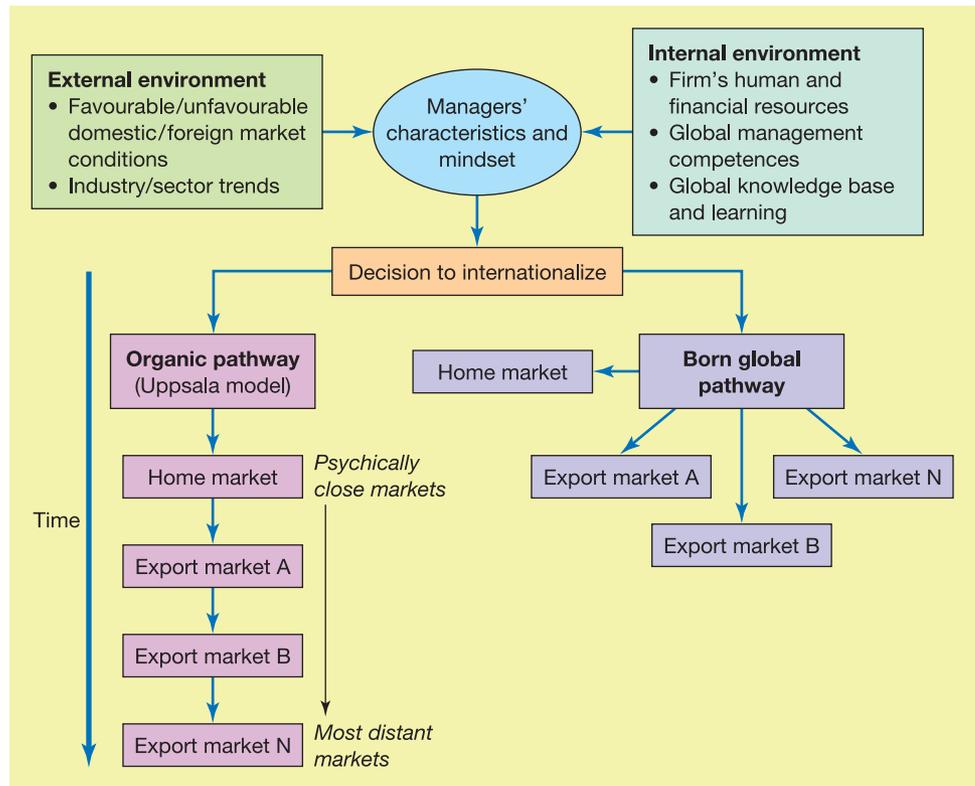
Many industries are characterized by *global sourcing activities* and also by networks across borders. The consequence is that innovative products can very quickly spread to new markets all over the world – because the needs and wants of buyers become more homogeneous. Hence the internationalization process of subcontractors may be quite diverse and different from the stages models. In other words, the new market conditions pull the firms into many markets very fast. Finally, financial markets have also become international, which means that an entrepreneur in any country may seek financial sources all over the world.

In the case of born globals we may argue that the background of the decision maker (founder) has a large influence on the internationalization path followed (Freeman and Cavusgil, 2007). Market knowledge, personal networking of the entrepreneur or international contacts and experience transmitted from former occupations, relations and education are examples of such international skills obtained prior to the birth of the firm. Factors such as education, experience from living abroad, experience of other internationally oriented jobs, etc., mould the mind of the founder and decrease the psychic distances to specific product markets significantly; the previous experience and knowledge of the founder extends the network across national borders, opening possibilities for new business ventures (Madsen and Servais, 1997).

Often born globals govern their sales and marketing activities through a specialized network in which they seek partners that complement their own competences; this is necessary because of their limited resources.

In many ways the slow organic (Uppsala-model) process and the accelerated 'born global' pathways are the opposites of one another, at the two extremes of a spectrum (see Figure 3.5). They also often represent the choice of doing it alone (the organic

Figure 3.5 Two extreme pathways of internationalization: the 'organic' versus 'born global'



Source: Adapted from Åijö et al. (2005), p. 6.

pathway), while the 'born global' pathway is based on different types of cooperation and partnerships in order to facilitate rapid growth and internationalization.

In spite of the different time frames and prerequisites for the pathways, there are also some common characteristics in all models. Internationalization is seen as a process where knowledge and learning go hand in hand, even in rapid internationalization. Past knowledge contributes to current knowledge of the company. Firms aiming for the 'born global' pathway do not have time to develop these skills in the organic way (inside the firm), they need to possess them beforehand or to be able to acquire them underway, i.e. through collaborating with other firms already possessing these supplementary competences.

Most often 'born globals' must choose a business area with homogeneous and minimal adaptation of the marketing mix. The argument is that these small firms cannot take a multi-domestic approach as can large firms, simply because they do not have sufficient scale in operations worldwide. They are vulnerable because they are dependent on a single product (niche market) that they have to commercialize in lead markets first, no matter where such markets are situated geographically. The reason is that such markets are the key to broad and rapid market access, which is important because these firms often incur relatively high fixed R&D costs, which occur 'up front', i.e. before any sales are made. Since this is the key factor influencing the choice of the initial market the importance of psychic distance as a market selection criterion is reduced. In order to survive, firms must quickly catch the growth track to cover the initial expenses. Finally, competition for a typical 'born global' is very intense and its products may become obsolete rather quickly (e.g. in the case of software). If a company

is to take full advantage of the market potential during its ‘global window of opportunity’, it may be forced to penetrate simultaneously all major markets (Åijö *et al.*, 2005).

3.6 Summary

The main conclusions of this chapter are summarized in Table 3.1.

Born globals represent a relatively new research field in international marketing. Born globals share some fundamental similarities: they possess unique assets, focus on narrow global market segments, are strongly customer oriented, and the entrepreneur’s vision and competences are of crucial importance. In the end, for these firms, being global does not seem to be an option but a necessity. They are pushed into globalization by global customers and too small national/regional market segments. They can sustain their immediate global reach thanks to entrepreneurial vision and competences, and a deep awareness and knowledge of their competitive advantage in foreign markets.

Table 3.1 Summary of the three models explaining the internationalization process of the firm

	Uppsala internationalization model	Transaction cost analysis model	Network model
<i>Unit of analysis</i>	The firm	The transaction or set of transactions	Multiple interorganizational relationships between firms Relationships between one group of firms and other groups of firms
<i>Basic assumptions about firms’ behaviour</i>	The model is based on behavioural theories and an incremental decision-making process with little influence from competitive market factors. A gradual learning-by-doing process from simple export to Foreign Direct Investment (FDI)	In the real world there is ‘friction’/transactional difficulties between buyer and seller. This friction is mainly caused by opportunistic behaviour: the self-conscious attention of the single manager (i.e. seeking of self-interest with guile)	The ‘glue’ that keeps the network (relationships) together is based on technical, economic, legal and especially personal ties. Managers’ personal influence on relationships is strongest in the early phases of the establishment of relationships. Later in the process routines and systems will become more important
<i>Explanatory variables affecting the development process</i>	The firm’s knowledge/ market commitment Psychic distance between home country and the firm’s international markets	Transactional difficulties and transaction costs increase when transactions are characterized by asset specificity, uncertainty, frequency of transaction	The individual firms are autonomous. The individual firm is dependent on resources controlled by other firms Business networks will emerge in fields where there is frequent coordination between specific actors and where conditions are changing rapidly
<i>Normative implications for international marketers</i>	Additional market commitments should be made in small incremental steps: – Choose new geographic markets with small psychic distances from existing markets – Choose an ‘entry mode’ with few marginal risks	Under the above-mentioned conditions (i.e. prohibitively high transaction costs), firms should seek internalization of activities (i.e. implement the global marketing strategy in wholly-owned subsidiaries). Overall, the firm should select the entry mode for which transaction costs are minimized	The relationships of a firm in a domestic network can be used as bridges to other networks in other countries. Such direct or indirect bridges to different country networks can be important in the initial steps abroad and in the subsequent entry of new markets. Sometimes an SME can be forced to enter foreign networks: for example, if a customer requires that the subsupplier (an SME) follows it abroad.

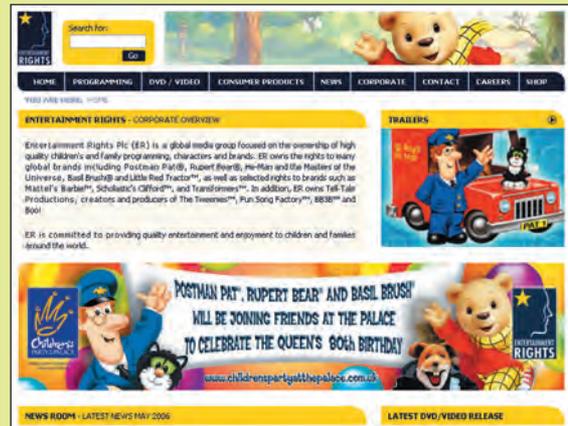
CASE
STUDY
3.1

Entertainment Rights: Internationalization of 'Postman Pat'

Entertainment Rights (ER) (www.entertainmentrights.com) is a global media group focusing on the ownership and development of children's brands. ER maintains a portfolio of more than 4,300 episodes of live-action and animated children's television programming (Postman Pat, Basil Brush, Rupert Bear – Follow the Magic, Jim Jam & Sunny). ER's wholly-owned subsidiary Tell-Tale Productions, created and produced *The Tweenies*, one of the UK's most successful pre-school brands. Through Tell-Tale Productions (acquired in 2004) ER also produces such original programming as Fun Song Factory and BB3B. That same year ER acquired the Filmation library of classic contemporary programming including Fat Albert, She-Ra Princess of Power and He-Man and the Masters of the Universe. Entertainment Rights also has Licensing and Merchandising operations as well as its own Home Entertainment division.

In 2005 ER acquired a majority interest in the classic Rupert Bear character from Express Newspapers, a unit of Northern and Shell.

More recently, in January 2007, ER announced the acquisition of Classic Media Inc., the US-based owner of an extensive children's portfolio of children's and family brands such as Rudolph the Red Nose Reindeer, Lassie, Caspar the Friendly Ghost and the award-winning Veggie Tales. This adds a further 4,400 episodes to the programme library.



ER has grown rapidly. Annual revenues have increased from £1.8 million in 1999 to £30.7 million in 2005, the last reported financial year. The financial development of ER in the last three years is shown in Table 1.

In 2005 the total revenues across regions were as follows:

	% of total revenues in 2005
Europe:	
UK	59
Rest of Europe	26
North & South America	8
Rest of World	7
Total	100

Table 1 Financial development in the last three years (£000)

	2006	2005	2004
Operating revenue (revenue/sales)	29,747	30,735	25,467
Gross operating profit	16,949	14,270	9,967
Total income (EBIT)	10,227	7,502	3,203
Pre-tax income (EBT)	7,829	5,956	2,186
Total net income	6,203	5,387	2,202

Source: Financial reports of Entertainment Rights and CoreData, Inc., International Institutional Database.

The total revenues across products were as follows:

	<i>% of total revenues in 2004</i>
Television & production	57
Home entertainment	34
Consumer products	9
Total	100

The total number of employees is around 80.

Postman Pat

Set in the fictional Yorkshire village of Greendale, Postman Pat and his faithful companion, Jess the Cat, began delivering post on BBC1 25 years ago in September 1981. Postman Pat continues to air on the BBC in the United Kingdom with episodes licensed and the broadcast platform secured beyond 2010. The target viewer group for the show is the pre-school age (2–6 years).

Postman Pat and the TV shows have now been shown in more than 100 countries around the world. With sales in so many international markets, it is important that the brand awareness created by the TV platform is leveraged through the development of a strong licensing and merchandising line – a business imperative for ER. For example, in the United Kingdom ER has succeeded in the licensing of toy lines to leading retailers. In 2004 Marks & Spencer acquired the rights for using the characters in 70 of its top stores. The programme included a range of nightwear, underwear, slippers, watches



and puzzles for children aged 3–6. Postman Pat and Jess the Cat proved to be an irresistible gift buy for parents, grandparents, guardians and others.

Source: www.entertainmentrights.com; 'Marks & Spencer takes on Postman Pat', Weekly E-news, Issue 76, 14 September 2004, www.licensmag.com.

Questions

- 1 List the criteria, that Entertainment Rights should use for choosing new international markets.
- 2 If you were to advise ER would you recommend them to use the 'organic' or 'born global' pathway for the internationalization of Postman Pat?
- 3 What values/benefits can ER transfer to the license partners for consumer products apart from using the Postman Pat characters?

For further exercises and cases, see this book's website at www.pearsoned.co.uk/hollensen



Questions for discussion

- 1 Explain why internationalization is an ongoing process in constant need of evaluation.
- 2 Explain the main differences between the three theories of internationalization: the Uppsala model, the transaction cost theory and the network model.
- 3 What is meant by the concept of 'psychological' or 'psychic distance'?

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