

# 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:
  - the Uppsala internationalization model;
  - the transaction cost theory; and
  - 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 we will 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 'life cycle' concept is illustrated in Figure 15.3, later in this book.

### 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 regarding 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 7) 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

#### Psychic distance

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

appropriate steps to reduce the manager's psychic distance towards foreign markets (Sousa and Bradley, 2005, 2006).

## 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.

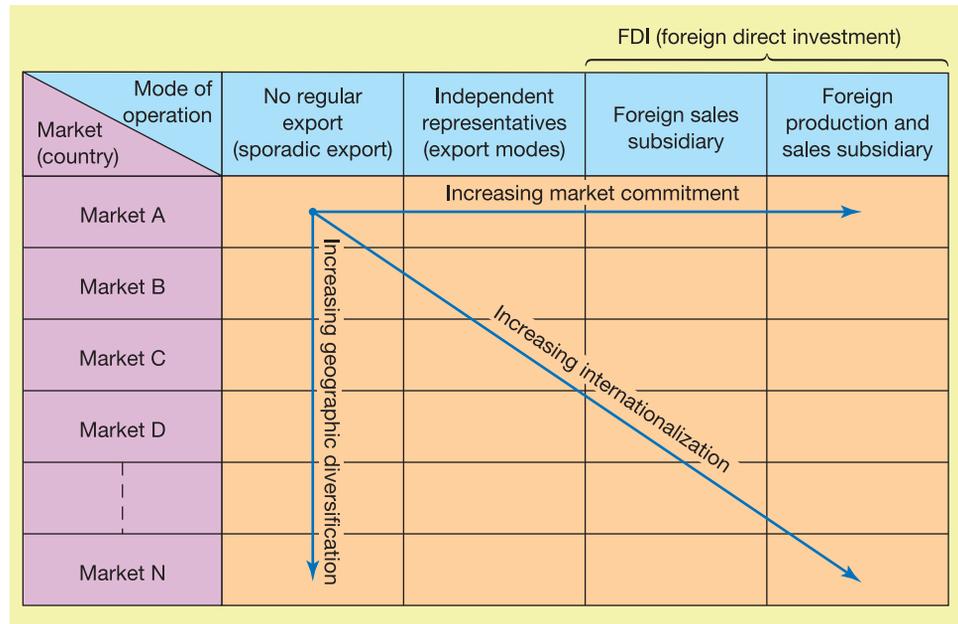
The assumption that the internationalization of a firm develops step by step was originally supported by evidence from a case study of four Swedish firms. The sequence of stages was restricted to a specific country market. This market commitment dimension is shown in Figure 3.1.

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

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



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

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 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.

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

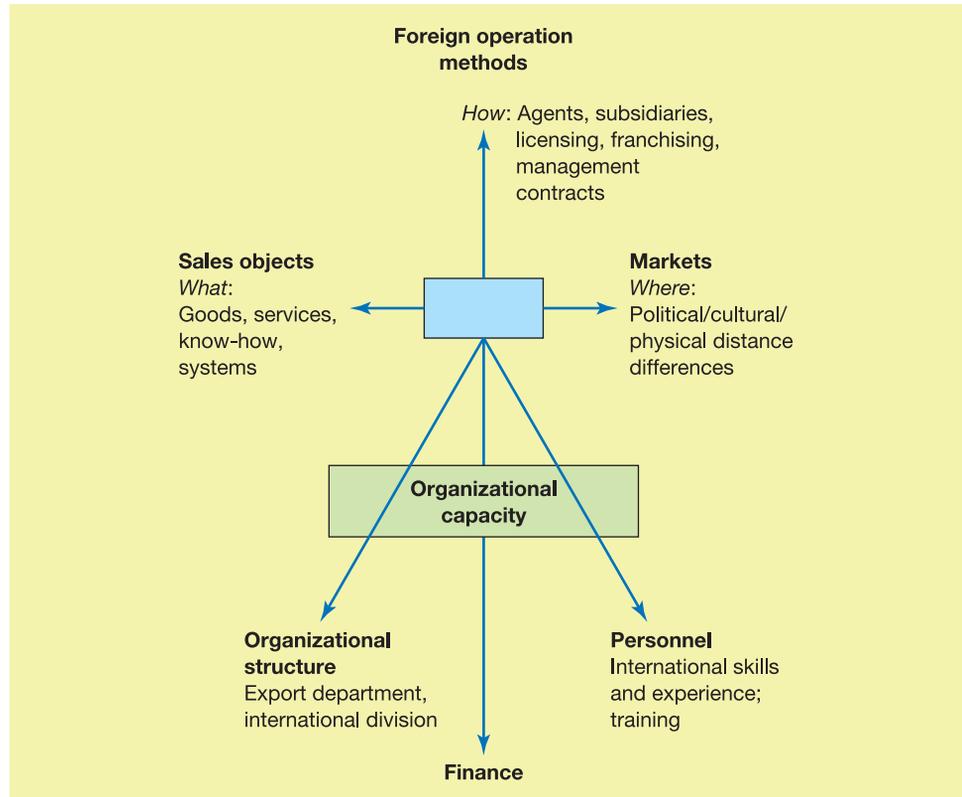
- *sales objects* (what?): goods, services, know-how and systems;
- *operations methods* (how?): agents, subsidiaries, licensing, franchising management contracts;
- *markets* (where?): political/cultural/psychic/physical distance differences between markets;
- *organizational structure*: export department,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

### Critical views of the original Uppsala model

Various criticisms of the Uppsala model have been put forward. One criticism is that the model is too deterministic (Reid, 1983; Turnbull, 1987).

**Psychic distance**  
The perceived degree of similarity or difference between two markets, according to cultural and business issues.

Figure 3.2 Dimensions of internationalization



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

It has also been argued that the model does not take into account interdependencies between different country markets (Johanson and Mattson, 1986). It seems reasonable to consider a firm more internationalized if it views and handles different country markets as interdependent than if it views them as completely separate entities.

Studies have shown that the internationalization process model is not valid for service industries. In research into the internationalization of Swedish technical consultants – a typical service industry – it has been demonstrated that the cumulative reinforcement of foreign commitments implied by the process model is absent (Sharma and Johanson, 1987).

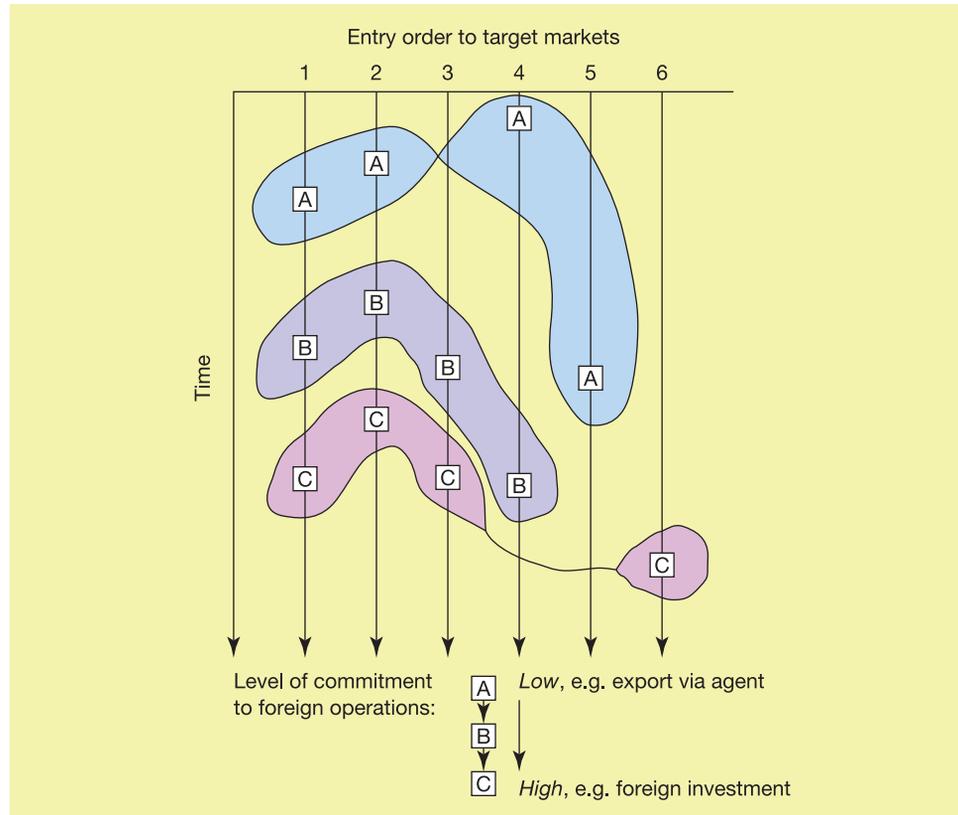
The criticism has been supported by the fact that the internationalization process of new entrants in certain industries has recently become more spectacular. Firms have lately seemed prone to *leapfrog* stages in the establishment chain, entering ‘distant’ markets in terms of psychic distance at an early stage, and the pace of the internationalization process generally seems to have speeded up.

Nordström’s preliminary (1990) results seem to confirm this argument. The United Kingdom, Germany and the United States have become a more common target for the very first establishment of sales subsidiaries by Swedish firms than their Scandinavian neighbours.

The leapfrogging tendency not only involves entering distant markets. We can also expect a company to leapfrog some intermediate entry modes (foreign operation methods) in order to move away from the sequentialist pattern and more directly to some kind of foreign investment (Figure 3.3).

In market No. 1 the firm follows the mainstream evolutionary pattern, but in market No. 6 the firm has learned from the use of different operation methods in previous

**Figure 3.3** Internationalization pattern of the firm as a sum of target country patterns



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

markets, and therefore chooses to leapfrog some stages and go directly to foreign investment.

Others have claimed that the Uppsala model is not valid in situations of highly internationalized firms and industries. In these cases, competitive forces and factors override psychic distance as the principal explanatory factor for the firm's process of internationalization. Furthermore, if knowledge of transactions can be transferred from one country to another, firms with extensive international experience are likely to perceive the psychic distance to a new country as shorter than firms with little international experience.

Nordström (1990) argues that the world has become much more homogeneous and that consequently psychic distance has decreased.

Firms today also have quicker and easier access to knowledge about doing business abroad. It is no longer necessary to build up knowledge in-house in a slow and gradual, trial-and-error process. Several factors contribute to this. For example, universities, business schools and management training centres all over the world are putting more and more emphasis on international business.

Probably even more important, the absolute number of people with experience of doing business abroad has increased. Hence it has become easier to hire people with the experience and knowledge needed, rather than develop it in-house. The number of people with experience of doing business abroad has increased over time as an effect of continuous growth in world trade and foreign direct investment.

The spectacular development of information technologies, in terms of both absolute performance and diminishing price/performance ratios, has made it easier for a firm to become acquainted with foreign markets, thus making a ‘leapfrog’ strategy more realistic (see also section 3.6 on Internet-based ‘Born Globals’).

In spite of the criticisms the Uppsala model has gained strong support in studies of a wide spectrum of countries and situations. The empirical research confirms that commitment and experience are important factors explaining international business behaviour. In particular, the model receives strong support regarding export behaviour, and the relevance of cultural distance has also been confirmed.

### 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 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

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

**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 3.4).

#### Opportunistic behaviour

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

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.

#### TCA

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.

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

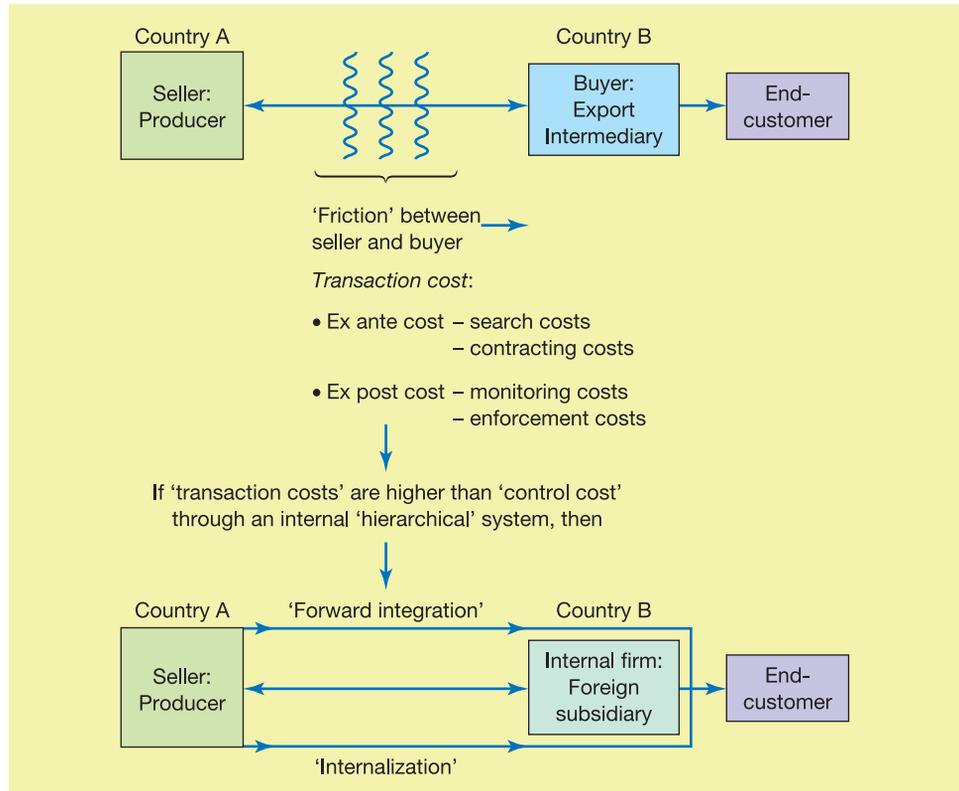
Transaction costs can be divided into *different forms of costs* related to the transactional relationship between buyer and seller. The underlying condition for the following description of the cost elements is this equation:

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

#### Internalize

Integrate an external partner into one’s own organization.

Figure 3.4 The principles of the TCA model



### 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.

**Externalization**

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

**Internalization**

Doing business through own internal system (own subsidiaries).

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.

### 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 network

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

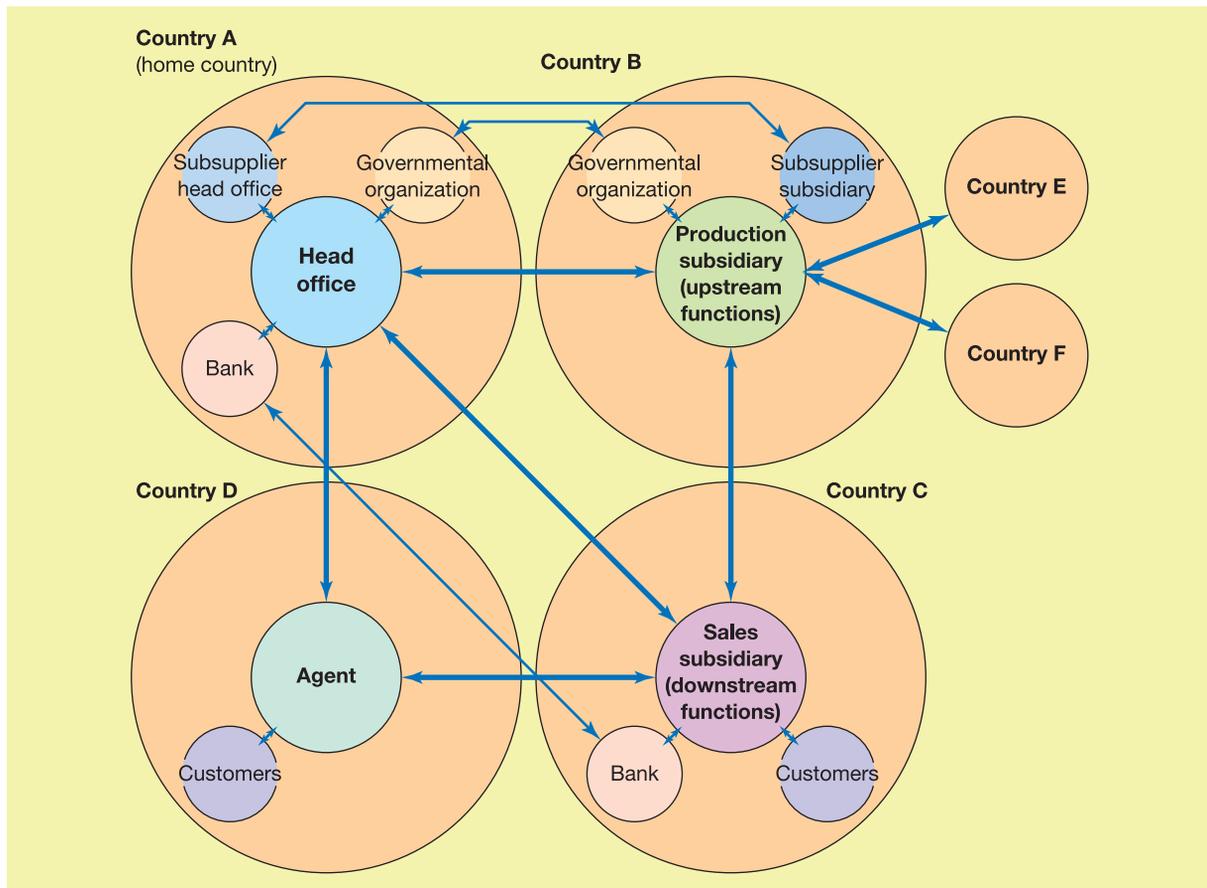
time and depends on resource accumulations, a firm must establish and develop positions in relation to counterparts in foreign networks.

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 3.5. It appears that one of the subsuppliers 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.

Figure 3.5 An example of an international network



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.

### Four cases of internationalization

The Uppsala internationalization model treated internationalization independently of the situation and the competition in the market. In the following we will try to combine these two important aspects. A 'production net' contains relationships between those firms whose activities together produce functions linked to a specific area. The firm's degree of internationalization shows the extent to which the firm has positions in different national nets, how strong those positions are, and how integrated they are.

The network model also has consequences for the meaning of internationalization of the market. A production net can be more or less internationalized. A high degree of internationalization of a production net implies that there are many and strong relationships between the different national sections of the global production net. A low degree of internationalization means that the national nets have few relationships with each other.

We will distinguish between four different situations, characterized by, on the one hand, a low or a high degree of internationalization of the firm and, on the other, a low or high degree of internationalization of the market (the production network) (Figure 3.6).

#### The early starter

In this situation competitors, customers, suppliers and other firms in the domestic market as well as in foreign markets have no important international relationships.

The people behind the Uppsala internationalization model have described this situation and its transition to the lonely international (section 3.2). Gradual and slow involvement in the market via an agent, leading to a sales subsidiary and then a manufacturing subsidiary, is primarily a process by which market knowledge gives the basis for stronger commitments.

#### The lonely international

In this situation the firm has experience of relationships with others in foreign countries. It has acquired knowledge and means to handle environments that differ with respect to culture, institutions and so on. The knowledge situation is also more favourable when establishing the firm in a new national net.

Initiatives to further internationalization do not come from other parties in the production nets, as the firm's suppliers, customers and competitors are less internationalized. On the contrary, the lonely international has the competences to promote inter-

Figure 3.6 Four cases of internationalization of a firm

		Degree of internationalization of the market	
		<i>Low</i>	<i>High</i>
Degree of internationalization of the firm	<i>Low</i>	The early starter	The late starter
	<i>High</i>	The lonely international	The international among others

Source: Johanson and Mattsson, 1988 p. 298. Reprinted by permission of Thomson Publishing Services.

nationalization of its production net and, consequently, the firms engaged in it. The firm's relationships with, and in, other national nets may function as a bridge to those nets for its suppliers and customers.

### The late starter

In a situation with international customers and competitors, the less internationalized firm can be 'pulled out' of the domestic market by its customers or complementary suppliers to the customers. Sometimes the step abroad can be rather large in the beginning.

How will the firm go abroad in this situation? Here we will differentiate between SMEs and LSEs.

SMEs going abroad in an internationalized world probably have to be highly specialized and adjusted to solutions in specific sections of the production nets. Starting production abroad is probably a question of what bonds are important to the customers, and in this matter SMEs are very flexible.

LSEs that have become large in the domestic market are often less specialized than small firms, and their situation is often more complex than that of the small firm. One possibility is to get established in a foreign production net through acquisition or joint venture.

In general, it is probably more difficult for a firm that has become large at home to find a niche in highly internationalized nets. It cannot, as the small firm can, adjust in the flexible way, which may be necessary in such a net.

Compared to the early starter, the late starter often finds it difficult to establish new positions in a tightly structured net. The best distributors are already linked to competitors. Competitors can, more or less legally, make the late newcomer unprofitable by predatory pricing. When we compare early and late starters we can see how important timing is in global marketing.

### The international among others

In this situation the firm has the possibility of using positions in one net to bridge over to other nets, with regard to both extensions and penetration. There is a strong need for coordination of the international activities along the value chain (e.g. R&D, production and marketing/sales). Operations in one market may make it possible to utilise production capacity for sales in other markets. This may lead to production coordination by product specialization and increased intra-firm trade across borders.

Establishment of sales subsidiaries is probably speeded up by high internationalization because the international knowledge level is higher and there is a stronger need to coordinate sales and marketing activities in different markets.

*The relevance of the network model for the SME serving as a subcontractor*

Until now a network has been connected with development of mutual trust and interests between firms in the network. In the following, domination and control characteristics will form the starting point for the formation of a more power-balanced network.

In the SME context it is clear that where, for example, a small firm derives a significant proportion of its turnover and profits from acting as a subcontractor to another, often larger firm, the small firm becomes dependent on the latter. In turn, the large firm may acquire power over its subcontractor. This power can be measured in terms of the larger company's influence on decision making within the smaller firm in areas such as pricing and investment.

Exchange networks are based on control, coordination and cooperation. By 'control' is understood quasi-hierarchical relationships allowing one company to dominate another: for example, the relationship that traditionally obtains in the car industry between the major manufacturers and their subcontractors. By 'coordination' is understood a situation in which a 'leading' or 'hub' firm in the network orchestrates the value-adding chain. This allows firms to specialize in those components of the value chain in which they have competitive advantage, abandoning and farming out those activities in which they are disadvantaged to network partners that do have strengths in these areas.

'Cooperation' is the result of increasing specialization in small market niches, which has tended to encourage interdependency between firms in the value-added chain. Whereas in many subcontracting relationships in the past the subcontractor simply followed instructions of the dominating firm on design and manufacture, the need to adjust to ever-quicker changes in the marketplace can have the effect of making the subcontractor a more equal partner in the whole design to production process. The nature of the relationship between subcontractor and buyer thereby changes. Greater trust is required to make the partnership a success. Greater coordination is also required, creating a role for companies that simply 'manage' the value chain. In order to meet the pressures of these new circumstances the small firm will depend on the nature and number of its links to other firms. As a result the need for and value of networking have increased.

Where the network is dominated by a single firm and relationships are of the 'traditional' subcontracting kind, competition on price (or prices simply being imposed by the dominating firm) is the rule. Also, cooperating firms know that, while optimal networking is an effective strategy to reduce risk, less optimal networking will increase risk by increasing their dependence on, for example, a potentially unreliable supplier. To overcome the danger of dependence, 'traditional' risk reduction strategies can be implemented, such as the implementation of multiple sourcing by the purchasing company, or client diversification by the selling company.

### 3.5 Internationalization of SMEs

In the face of globalization threats many SMEs attempt to expand their sales into foreign markets. International expansion provides new and potentially more profitable

markets; helps increase the firm's competitiveness; and facilitates access to new product ideas, manufacturing innovations and the latest technology.

At the macro environment and industry levels, globalization gives rise to market turbulence, increased competition from (especially) multinational firms, loss of protected markets due to trade liberalization, and the emergence of international marketing opportunities, all of which can affect the operations and performance of the SME. In such an environment possession by management of an entrepreneurial orientation is expected to provide certain benefits.

It may be more appropriate to take a holistic view of the very small, entrepreneurial, or start-up firm's cross-border business activities, rather than to focus on discrete entry mode types. The challenge facing most entrepreneurial firms is to establish and develop a viable, competitive and sustainable business, usually with limited resources, and often by adopting flexible, imaginative and innovative business practices. International business activity for many firms, and particularly high-technology firms, may be an integral part of that process. In that respect too, internationalization is a firm-specific behaviour, in relation to and encompassing its international business activities.

The assumption made here therefore is that internationalization, for entrepreneurial firms, is a growth and development process. It may involve one or a number of value chain activities, some of which may be more internationalized, or more frequently subject to internationalization, than others. Internationalization may be part of the process, but for very small and very young firms internationalization is more likely to occur, in the first instance, through links and transactions with organizations and individuals in the external environment. The process may include both inward and outward links – see Table 3.1 (below) and Figure 2.2 (earlier) – and these are likely to reflect the firms' current areas of competence and expertise, and/or its current level of needs and perceived inadequacies.

**Table 3.1** SMEs Inward–outward cross-border business activities

	Inward	Outward
<b>R&amp;D</b>	Contract-in R&D License-in technology from overseas-based firms	License-out technology to overseas-based firm Contract-out R&D to overseas-based firm
<b>Production</b>	Technical service or consultancy performed in the home country for overseas-based clients Contract-in manufacture for overseas-based firms	Contract-out manufacture to overseas-based firm Technical service or consultancy performed overseas Minority investment in overseas production Majority investment in overseas production
<b>Marketing and distribution</b>	Import from overseas-based supplier Import with distribution in the home country Management or marketing service or consultancy performed in the home country for overseas-based clients	Exporting through home country-based intermediary Exporting through foreign-based agent/distributor Exporting through overseas-based sales representative or branch Management or marketing services or consultancy performed overseas

Source: adapted from Jones (2001), p. 197.

Initial international expansion may involve specific combinations of inward/outward value chain activities, which are not necessarily directly reciprocal. Efficiency and synergy in linkage combinations is an important concern for internationalizing firms.

The element of *time* is considered more important here than development stages, that, even if specifically determined, would vary considerably between firms.

### Importance of personal factors

International entrepreneurship argues that the founders of international new ventures are more 'alert' to the possibilities of combining resources from different national markets because of the competences they have developed from their earlier activities.

Research results by Manolova and Brush (2002) indicate that owners/founders are likely to draw on their international experience, skills, or overall competences when internationalizing their own firms. Therefore, for managers with these sets of skills and positive environmental perceptions, the process of internationalization has 'less uncertainty', and hence is more likely to be pursued than it is for managers without comparable skills or perceptions.

Manolova and Bush (2002) clearly indicate that 'personal factors' matter with respect to SME internationalization but, more importantly, 'some personal factors matter more than others'. Owners/founders or managers who have more positive perceptions of the international environment would also be more likely to internationalize their own small businesses.

The most important finding from Manolova and Bush (2002) is that internationalization is not a function of 'demographics', but is instead a function of 'perceptions'. If the owner/founder or manager perceives that there is a lower level of environmental uncertainty in a particular international market, or perceives that there is the requisite skill set to internationalize, then chances are high that the small firm will be pursuing a strategy of internationalization. Additionally, the findings show that public policy directives, as well as education and training programmes, need to recognize that there are significant differences in small firm internationalization that are based upon the technology sector. Knowledge of these differences can be used to guide the development of small firm internationalization initiatives that match sector characteristics.

Entrepreneurial orientation is associated with opportunity seeking, risk taking, and decision action catalyzed by a strong leader or an organization possessed of a particular value system. SMEs with an entrepreneurial orientation engage in product market innovations, undertake relatively risky ventures, and initiate proactive innovations.

Innovativeness refers to a corporate environment that promotes and supports novel ideas, experimentation and creative processes that may lead to new products, techniques or technologies. Risk taking reflects the propensity to devote resources to projects that entail a substantial possibility of failure, along with chances for high returns. Proactiveness is the opposite of reactivity and implies taking initiative, aggressively pursuing ventures, and being at the forefront of efforts to shape the environment in ways that benefit the firm. Autonomy suggests the independent action of a person or a team in giving birth to an idea or a vision and then carrying it through to fruition. Finally, competitive aggressiveness refers to the firm's tendency to challenge its competitors intensely and directly in order to outperform them in the marketplace.

However, SMEs may lack the resources to compete head to head with larger rivals at home and invasions from abroad. Globalization may pose many challenges and can make the business milieu substantially more hostile for smaller firms. But all in all, given the turbulence posed by globalization, it is expected that SMEs with an entrepreneurial orientation will fare better than those that lack such an orientation.

Technology acquisition is one way of enabling the firm to compete more effectively or launch products that better satisfy customer needs. Innovation arising from acquired technology is a key source of competitive advantage, particularly in turbulent environments, that can enable firms to market new or improved goods faster than competitors. Technology acquisition can give rise to products that are better adapted to the specific needs of foreign markets. Firms can gain additional benefits by responding to the forces of globalization. SMEs that respond by appropriately adapting their marketing and other strategies to globalization demands are likely to perform better than firms, which do not. Nature and pace of internationalization are conditioned by product, industry, and other external environmental variables, as well as by firm-specific factors. Therefore, at any given point in time, SMEs will be in a state of internationalization, which will be subject to both backward and forward momentum, instead of progressing through stages, as in the Uppsala model.

The SME's internationalization is unlikely to come off well unless the firm prepares in advance. Advance planning has often been regarded as important to the success of new ventures. Such planning is especially important in international ventures, in which the business environment can be considerably more complex than at home. Thus *internationalization preparation* describes a firm's efforts to prepare in advance as it seeks to expand into foreign markets. Such preparation involves conducting international market research; committing human, financial and other resources to supporting the international venture; and adapting products to suit the needs of target foreign markets.

In the next section we will look at a special case of SME internationalization – the so-called 'Born Globals'.

## 3.6 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.

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; Gabriellsson 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 global

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

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).

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

### Born globals are challenging traditional theories

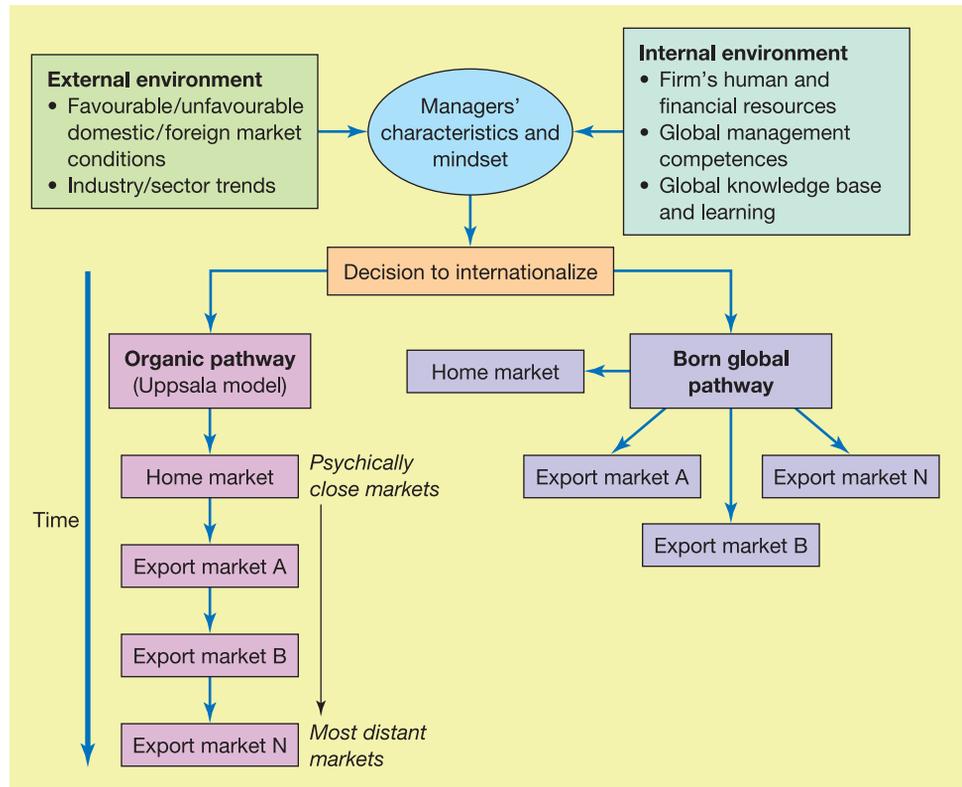
Born globals may be similar to the 'late starter' or the 'international among others' (Johanson and Mattson, 1988). In the latter situation both the environment and the firm are highly internationalized. Johanson and Mattson (1988) point out that internationalization processes of firms will be much faster 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 assume that the background of the decision maker (founder) has a large influence on the internationalization path followed. 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

**Figure 3.7** Two extreme pathways of internationalization: the 'organic' versus 'born global'

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

spectrum (see Figure 3.7). They also often represent the choice of doing it alone (the organic 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).

### Factors giving rise to the emergence of born globals

The number and influence of born-global firms in international trade is likely to increase (Knight *et al.*, 2004). Several trends may explain the increasing importance of born globals and help explain why such companies can successfully enter international markets.

#### Increasing role of niche markets

There is a growing demand among customers in mature economies for specialized or customized products. With the globalization of markets and increasing worldwide competition from large multinationals, many smaller firms may have no choice but to specialize in the supplying of products that occupy a relatively narrow global niche.

#### Advances in process/technology production

Improvements in microprocessor-based technology imply that low-scale, batch-type production can be economical. New machine tools now permit the manufacture of complex, non-standard parts and components with relative ease. New technologies allow small companies to achieve comparable footing with large multinationals in the production of sophisticated products for sale around the world. Technology allows small importers to streamline production in ways that make their products highly competitive in the global marketplace. Furthermore, technology is facilitating the production of widely diverse products on an ever-smaller scale. The consequence of this is increasing specialization in many industries – more and more consumer goods will likely be tailor made to fit ever more diverse preferences.

#### Flexibility of SMEs/born globals

The advantages of small companies – quicker response time, *flexibility*, adaptability, and so on – facilitate the international endeavours of born globals. SMEs are more flexible and quicker to adapt to foreign tastes and international standards.

#### Global networks

Successful international commerce today is increasingly facilitated through partnerships with foreign businesses – distributors, trading companies, subcontractors, as well as more traditional buyers and sellers. Inexperienced managers can improve their chances for succeeding in international business if they take the time to build mutually beneficial, long-term alliances with foreign partners.

#### Advances and speed in information technology

A very important trend in favour of born globals is the recent advance in *communications technology*, which has accelerated the speed of information flows. Gone are the days of large, vertically integrated firms where information flows were expensive and took a considerable time to be shared. With the invention of the Internet and other telecommunication aids such as mobile phones, e-mail and other computer-supported technologies such as electronic data interchange (EDI), managers even in small firms can efficiently manage operations across borders. Information is now readily and more quickly accessible to everyone. Everything gets smaller and faster and reaches more people and places around the globe.

Another important trend is the *globalization of technology*. Joint research and development platforms, international technology transfers, and the cross-border education and exchange of students in science, engineering and business have all exploded in recent years. As such, new and better approaches to manufacturing, product innovation and general operations have become much more readily available to smaller firms.

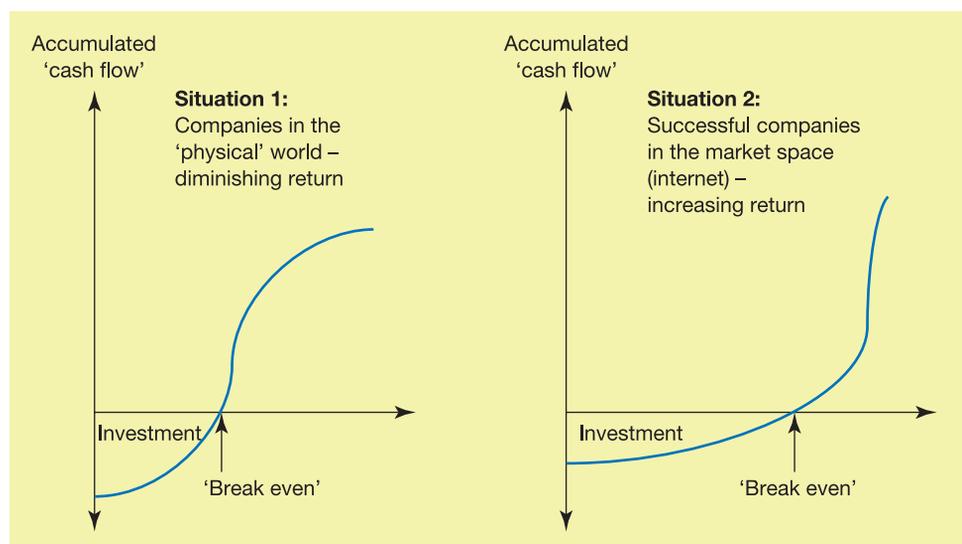
### Internet-based Born Globals

The Internet revolution offers new opportunities for young SMEs to establish a global sales platform by developing e-commerce websites. Today many new and small firms are born globals in the way that they are ‘start-ups’ on the Internet and they sell to a global audience via a centralized e-commerce website. However, after some time many of these firms realize they cannot expand global sales to the next level without having some localized e-commerce websites. If we compare the flow of financial results in physical (‘bricks and mortar’) companies with Internet-based companies we will often see a result such as that shown in Figure 3.8.

In the ‘physical’ companies we will often see the ‘law of diminishing returns to scale’ in function. This happens where the variable costs are relatively high compared to fixed costs of the company. We are learning that the law of diminishing returns does not always apply. In many cases the optimal production point is no longer determined by factory size, but by the point at which total market demand is satisfied. This occurs in markets in which fixed costs are much higher than variable costs. This is the case for products in digital form, where a single copy (of software, for instance) can satisfy total market needs, and for products with very high investment in intellectual content, such as pharmaceuticals.

In the successful Internet companies, gains associated with increasing shares of markets do not diminish with time but actually increase. This increase creates ‘increasing returns to scale’. In this environment companies must *win market shares rapidly*, which has driven many to create new strategies for market share capture. AOL Time Warner distributed CDs with software in everything from magazine inserts to fast-food giveaways, making its trial offer almost irresistible to millions of networks users.

Figure 3.8 Models of economic efficiency



Funding the large investments required to capture significant market share in the Internet economy does not come cheaply, especially if many companies are competing for the same market space. A substantial part of the investment must be made up front, sometimes years before revenues begin to outpace operating cost.

In a global economy companies must also be prepared, almost from the start, to serve larger market segments. Neither proposition is cheap. Amazon.com has achieved market dominance, but not without investing a half-billion dollars a year in sales and marketing.

Amazon.com is perhaps an example of Situation 2 in Figure 3.8 but, despite considerably increasing sales, it reached break-even only in the third quarter of 2003, after initiating operations in 1995. Many companies must also rethink their alliance strategies. No longer are alliances primarily about efficiency: 'How can I outsource certain functions to improve performance?' Now the emphasis is on gaining access to markets to exploit network effects, and on creating product and service synergies by aligning with larger, already dominant companies. For example, companies such as American Broadcasting Company (ABC) are partnering with Time Warner for access to its customer base and expected synergies with its offerings. Access has proved so valuable that companies are now paying a lot to such firms for the ability to reach their customers.

Generally, it seems that service- and information-based internet-companies have internationalized more rapidly than electronic retailers or manufacturers selling tangible product. Therefore, internet-based companies tend to serve a greater number of international markets than do the electronic retailers or manufacturers (Kim, 2003).

### 3.7 Internationalization of services

As goods go through increasingly more complex value chains to increase firms' relative competitive advantage, services will play a more important role in their marketing. Services themselves are also getting more complex as information technology enables unlimited variations for both sales and after-sales support for target markets.

In the literature on international marketing of services an internationalization strategy is often considered more risky for service firms than for manufacturers. The main reason for this is that in many services the producer and the production facilities are part of the service, which requires that the firm has greater control of its resources than would otherwise be the case. In traditional international marketing models focusing on the needs of manufacturing firms, the internationalization process can start on a minor scale using indirect export channels followed by a step-by-step move towards more direct channels. This enables the firm gradually to increase its understanding of quality expectations, personnel requirements, distribution and media structures, and buying behaviour peculiarities on the foreign market. For service firms the situation is different. They immediately face all this and other problems related to entering a foreign market. A service firm has to find an entry mode and a strategy that helps it to cope with this situation as well as possible. The choice, of course, depends on the type of service and market.

First let us look at some characteristics of services.

#### Characteristics of services

A service is a complicated phenomenon. The word has many meanings, ranging from personal service to service as a product. Services are not things, they are processes or

activities, and these activities are intangible in nature. The term can be even broader in scope. A machine, or almost any physical product, can be turned into a service to a customer if the seller makes efforts to tailor the solution to meet the most detailed demands of that customer. A machine is still a physical good, of course, but the way of treating the customer with an appropriately designed machine is a service.

Most often a service involves interactions of some sort with the service provider. However, there are situations where the customer as an individual does not interact with the service firm.

For most services, *three* basic characteristics can be identified.

- 1 **Services are at least to some extent produced and consumed simultaneously.** Services are produced and consumed simultaneously (this is also called the ‘inseparability’ characteristic) – it is difficult to manage quality control and to do marketing in the traditional sense, since there is no preproduced quality to control before the service is sold and consumed.

One should realize that *it is the visible part of the service process that matters in the customer’s mind*. As far as the rest is concerned, a customer can only experience the result; but the visible activities are experienced and evaluated in every detail. Quality control and marketing must therefore take place at the time and place of simultaneous service production and consumption.

Most definitions of services imply that services do not result in *ownership* of anything. Normally this is true. When we use the services of an airline we are entitled, for example, to be transported from one place to another, but when we arrive at our destination there is nothing left but the remaining part of the ticket and the boarding card.

Because of this it is not possible to keep services in stock in the same way as goods. If an aeroplane leaves the airport half-full the empty seats cannot be sold the next day; they are lost. Instead, capacity planning becomes a critical issue. Even though services cannot be kept in stock, one can try to *keep customers in stock*. For example, if a restaurant is full, it is always possible to try to keep the customer waiting in the bar until there is a free table.

- 2 **The customer participates in the service production process, at least to some extent.** The customer is not only a receiver of the service; the customer also participates in the service process as a production resource in an interaction with the firm’s personnel. Therefore service to one customer is not exactly the same as the ‘same’ service to the next customer.

In many cases what the customer wants and expects is not known in detail at the beginning of the service process (service production process) or, consequently, what resources are needed, to what extent and in what configuration they should be used. A bank customer may only realize what his needs actually are during interactions with a teller or a loan officer. Thus the firm has to adjust its resources and its ways of using its resources accordingly. Customer-perceived value follows from a successful and customer-oriented management of resources relative to customer sacrifice, not from a preproduced bundle of features.

- 3 **Services are processes consisting of activities or a series of activities rather than things.** One important characteristic of services is their *process* nature. Services are processes consisting of a series of activities where a number of different types of resources – people as well as other kinds of resources – are used, often in direct interactions with the customer, so that a solution is found to a customer’s problem. Because the customer participates in the process, the process, especially the part in which the customer is participating, becomes part of the solution.

In order to understand service management and the marketing of services it is critical that one realises that the consumption of a service is *process consumption* rather than *outcome consumption*. The consumer or user perceives the service process (or service production process) as part of the service consumption, not simply the outcome of that process, as in traditional marketing of physical goods. When consuming a physical product customers make use of the product itself; that is they consume the outcome of the production process. In contrast, when consuming services customers perceive the process of producing the service to a greater or smaller degree, but always to a critical extent, as well as taking part in the process.

## Factors to consider in the internationalization of services

### Information technologies

Through information technologies service marketers can interact with customers to anticipate and serve their needs. Improving the service offering, providing alternative service delivery choices and communicating with the customer all foster better relationships with customers. The use of computerized communication allows the service marketer to establish an ongoing relationship with the customer at each stage of the consumption process. Online databases of customers can show consumption patterns and help track demand fluctuations. Automated service delivery mechanisms can provide a means for varying levels of self-service. In short, international services marketers need to examine information technologies to discover better ways to manage customer relationships.

The proliferation of information technology has made it possible for international service firms to serve customers 24 hours a day and seven days a week (commonly known as 24/7). Information technologies change the scale and the economics of service organizations. Home-based service organizations are now able to serve the needs of clients all over the world with a combination of computers, telephones, fax machines and electronic mail. In future it will be easy for groups of home-based service organizations to form flexible networks that quickly adapt to customer needs. However, even a firm that chooses to internationalize using electronic marketing cannot manage its service operations totally on its own. On foreign markets it has, for example, to rely on at least postal and delivery services. The possibility for the service firm to control such network partners may be very limited.

### Cultural issues

Cultural issues will necessarily have a significant impact on the acceptability and adoption pattern of services. Since services inherently involve some level of human interaction the likelihood of cultural incompatibility is greater. For example, nations that culturally define the housewife's role as the family caretaker will probably not be very keen on using day-care centres.

However we design our service and whatever means of serving the market we choose there will be a need to adjust to *local cultural preferences*. Some means of internationalization – franchising, for example – provide an easier route to delivering culturally sensitive services by drawing on local management knowledge. Consumer services are likely to require greater cultural adaptation than do business-to-business services.

However, we cannot ignore culture and all firms providing services internationally should consider the provision of appropriate cultural training to staff, the use of local

employees and, where needed, changes to the service offering itself. Without these provisions the company runs the risk of losing business to local companies or more culturally aware international service providers. Service businesses may be 'about people', but the technology and systems remain important. Even the best people struggle to deliver when systems are not in place to facilitate delivery.

Services do not necessarily require a physical presence. For established service businesses, confronting the competition from competitors trading via the Internet (or, in some industries, digital television) presents a major challenge, especially for those firms that have extensive investments in property and staff around the globe.

### **Geographic locations**

The strategic issue of location can be divided into two main aspects, that of where generally to locate a hospitality operation and then the specific issue of selecting suitable sites. In the hospitality industry the key factor in the location decision is demand. In simple terms, operations are located where demand is highest, and sited so that such demand can easily access the provision. Strategic success derives from matching the type and size of the business with the site available.

The factors that influence location in the accommodation and food service sectors are different. Hotels are primarily located near where people are travelling or at destinations that require them to stay away from home.

### **Standardization versus customization**

An important strategic issue in marketing services internationally is the extent to which each service might be standardized. In addition to the necessity for customer contact for many service categories, many host government regulations in numerous services sectors make standardization very difficult. Accounting and financial services markets are governed by very different rules around the world.

With globalization, the impact of cultural adaptation will need to be central to the study of operational topic areas such as joint venturing, materials management, purchasing, new product development, layout and process design, supervision and motivation, training, workforce scheduling, environmental management, and labour–management relations. These are all key areas of front-room and back-room management that are likely to require adaptation from country to country as services are globalized.

Local workers will need to be trained in their native language. The globalization of front-room operations with its verbal customer contact still depends heavily on cultural adaptation of the service. The experience of The Walt Disney Company in its opening of Disneyland Paris is an example of the problems of controlling the customer contact experience in a foreign culture. Some concessions to French culture were made, such as adopting both the French and English languages for the park. However, a more troubling problem was training independently minded French nationals to act out the roles of Disney characters and perform their duties in a courteous manner. When the service is defined by the customer contact experience then translating the required human behaviour of service personnel across national boundaries becomes a challenge.

Common customer needs for services vary more widely across nations than is the case for products, and addressing them requires localized solutions.

Retailing provides an excellent example of a service business that is difficult to standardize. Despite much talk about the internationalization of retail trade, local retailing regulations vary considerably, not only across countries (including within the European Union), but also within the provinces of each country.

## Implications for international marketing of services

It is possible to distinguish between five main strategies for internationalizing services. These are not mutually exclusive, and in some cases some will also work well for manufactured goods (Grönroos, 1999):

- 1 direct export;
  - 2 systems export/following the large customers abroad;
  - 3 direct entry/own subsidiary;
  - 4 indirect entry/intermediate mode;
  - 5 electronic marketing/Internet.
- 1 **Direct export** of services may basically take place on industrial markets. Consultants and firms repairing and maintaining valuable equipment may have their base in the domestic market and whenever needed move the resources and system required to produce the service to the client abroad. Repair services on valuable equipment are often exported in this way. Some consultants work in a similar fashion. No step-by-step learning can take place as the service has to be produced immediately. Because of this, the risk of making mistakes can be substantial.
  - 2 **Systems export/following the large customers abroad** is a joint export by two or more firms whose solutions complement each other. A service firm may support a goods-exporting firm or another firm. For example, when a manufacturer delivers equipment or turnkey factories to international buyers a need for engineering services, distribution, cleaning, security and other services is often present. This gives service firms an opportunity to expand their markets abroad. As the literature suggests, systems export is the traditional mode for service export. For example, advertising agencies and banks have extended their accessibility abroad because of their clients' activities in international markets. In systems export the services are mainly marketed in industrial markets abroad. For example, law firms expand into multiple cities in an attempt to align themselves with their corporate accounts, service companies are pushed by their customers to operate in the same countries as their clients. The truly global company wants and demands truly global service of its travel agents, its auditors, its consultants and others. The weakness of this strategy for a company already committed to overseas operations is that it ignores the possible vast markets where clients are not represented.
  - 3 **Direct entry/own subsidiary** means that the service firm establishes a service-producing organization of its own on the foreign market. For manufactured goods in the first stage of a learning process a sales office can be such an organization. For a service firm, a local organization normally has to be able to produce and deliver the service from the beginning. The time for learning becomes short. Almost from day one the firm has to be able to cope with problems with production, human resource management and consumer behaviour. In addition, the national government may consider the new, international service provider a threat to local firms and even to national pride.
  - 4 **Indirect entry/intermediate mode** is used when the service firm wants to avoid establishing a local operation that is totally or partly owned by itself but wants to establish a permanent operation in the foreign market.
    - Licensing agreements give a local firm exclusive rights to use the professional concept of the firm. This of course requires that exclusive rights can be guaranteed.
    - Franchising is a concept often used by restaurant and food service industries for indirect entry into a foreign market. Local service firms get the exclusive right to

a marketing concept, which may also include rights to a certain operational mode, and in this way the concept can be replicated as much as existing demand allows throughout the foreign market. The internationalizing firm as the franchisor gets the local knowledge that the franchisees possess, whereas franchisees get an opportunity to grow with a new and perhaps well-established concept. With a reasonably standardized service offering, it would also be possible to franchise a consultancy overseas.

- Another form of indirect entry is *management contracts*, which are often used, for example, in the hotel business. As far as the need for market knowledge is concerned, indirect entry is probably the least risky of the internationalization strategies discussed so far. Conversely, the internationalizing firm's control over the foreign operations is normally more limited when using this entry strategy (own subsidiary).
- 5 **Electronic marketing/Internet** as an internationalizing strategy means that the service firm extends its accessibility through the use of advanced electronic technology. The Internet provides firms with a way of communicating their offerings and putting them up for sale, and a way of collecting data about the buying habits and patterns of customers and using network partners to arrange delivery and payment. The electronic bookstore Amazon.com is a good example of a firm internationalizing its services using electronic marketing. When launching the concept it had to take into account the interest in its services that would automatically develop outside national borders. TV shops (satellite television) are examples of other ways of internationalizing services using advanced technology. When using electronic marketing the firm is not bound to any particular location. The service can be administered from anywhere on the globe and still reach customers throughout a vast international market via Internet connections or exposure to satellite television broadcasting.

### 3.8 Summary

The main conclusions of this chapter are summarized in Table 3.2.

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.

In this chapter, the importance of the personal factors in the internationalization process of SMEs is emphasized.

For internationalization of services the following five main strategies were identified: (1) direct export; (2) systems export/following the large customers abroad; (3) direct entry/own subsidiary; (4) indirect entry/intermediate mode; (5) electronic marketing/Internet.

**Table 3.2** 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	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 characterised 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)	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. As an example see case study 13.1 on LM Glasfiber

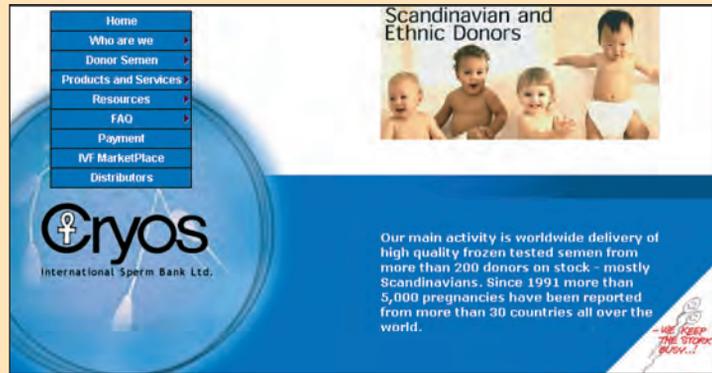
**CASE STUDY 3.1**

**Cryos: They keep the stork busy around the world**

The market for babies stretches across the globe and it is created by a deep and persistent demand from people who have been denied the blessings of reproduction. Recent statistics indicate that 8 per cent of couples are infertile ([www.repromedltd.com](http://www.repromedltd.com)). Some decide they will live their lives together without children of their own. Others may pursue adoption – a

procedure made more difficult because of the number of single women who choose to keep their children. A third option is for the couple to consult with their physician and to undergo artificial insemination using donor semen. It is many couples' deeply felt wish to have children that is the basis for the Danish-based Cryos International Sperm Bank.

Take artificial insemination. Sperm banking is now global; clients are no longer limited to the small donor pools at local sperm banks. For sperm banks technology plays a major role in the globalization drive. Concern about genetic defects and infectious diseases has led to sophisticated and expensive means of testing donations. Storage and transport methods have also grown more complicated. The improvements add to the investment required to operate a sperm bank. That, in turn, promotes consolidation in the industry.



### History

Cryos International Sperm Bank was established in 1987 in Aarhus, Denmark, by Ole Schou. 'Cryos' is Greek and means 'ice' (from *crystallos*). The word is also known from 'cryobiology'. In English a sperm bank is often called a 'cryobank'.

The office and laboratory were initially established as a service both for men who were going to have a vasectomy and for cancer patients who wanted to have their sperm frozen before chemotherapy or radiation, which might make them infertile.

In 1990 the donor programme was established, and the first donor semen was released and delivered after six months' quarantine in May 1991. Demand increased very quickly. Clinics in Denmark started to receive semen from Cryos, quickly followed by clinics in Norway, Finland, Iceland, the United Kingdom, Greece, Germany, Italy, Switzerland, Belgium, and other countries. The clinics were particularly satisfied with the good quality of semen, resulting in high pregnancy results (between 20 and 30 per cent per cyclus) and the professional service, with immediate supply from a relatively high selection of different donors.

In 1994 two new departments were opened, in the cities of Copenhagen and Odense, and Cryos had clients in 19 countries in Europe, Australia, Asia, Africa and North America.

In 1995 Cryos started distributing other sperm-related products such as preparation media. The same year Cryos started its own production of the culture media 'SpermWash'.

### The value chain

Today, Cryos can deliver sperm-related products to clinics or distributors in nearly 50 countries and donor semen to clinics in more than 40 countries.

### The 'suppliers'

On average, across all age groups, it can take up to 13 straws to conceive a child. (An amount of sperm enough for one insemination is stored in a sealed plastic straw.) In Denmark, there are 250 donors, some who begin donating in their 20s. The cut-off age is 40. The average donor continues in the programme for five years and can provide sperm several times a week. Donors get about \$80 a straw.

If their sperm does not sell, they are removed from the donor pool, Rodgaard said. He added that each donor on average is responsible for conceiving 20 to 30 babies throughout the world.

### The Cryos business today

Cryos has become the largest sperm bank in the world, with more than 200 donors and almost 10,000 units of semen distributed each year, resulting in nearly 1,000 pregnancies.

Cryos employs a total of 30 people: six medical doctors, two biologists and 22 authorized laboratory technicians. An additional six people are employed in sales and administration.

The freezing of patients' own sperm has continued, involving several hundred patient deposits. Cryos's revenue in 2005 was around €2 million.

Of the income from donor semen 5 per cent is reserved for scientific and development purposes.

Cryos will continue to offer a high-quality service related to its area of knowledge including donor semen, patient deposits and other semen-related clinical products. Furthermore, Cryos will continue to try to develop new and improved sperm-related knowledge and/or equipment for clinical use.

Using air freight and proprietary freezing techniques, Cryos can deliver to almost any customer

in the world within 72 hours. The sperm travels in liquid-nitrogen tanks that, without refilling, can last a week. The quality of the sperm can be validated through laboratory tests.

### The US market

In 2001 Cryos opened a branch in the United States (Scandinavian Cryobank) in order to meet the specific market situation and the growing demand for Scandinavian donors. The sperm bank market in the United States is very different from that in other markets around the world, because it is not the clinics but the patients who choose a sperm bank and select the donor. The service includes patient access to donor lists, extended profiles, a patient phone service, etc., all of which could not be organized within the 'clinic-only service' concept of Cryos.

Scandinavian Cryobank is charging the United States the equivalent of \$275 for one injection of potent sperm delivered in a sealed plastic straw.

### Marketing to Americans

About 5 million people in the United States are infertile, and half seek treatment to have a baby. Donor eggs are used by about 10 per cent of couples in treatment. While there are strict guidelines for screening the health of donor sperm, there are no government mechanisms in place to track actual use of the sperm, which can be frozen and stored for decades.

In the United States infertility treatment is a \$1 billion-a-year industry and growing. The US market for donor sperm is estimated at around €100 million per annum.

While Denmark has its range of ethnic groups, the company has selected only 50 sperm donors for the United States, based partly on ethnicity but also on stringent New York laws written to protect the health of the embryo against transmission of diseases.

In 2001, together with opening of the American sister company, Scandinavian Cryobank, a new extensive homepage for the US market ([www.scandinaviancryobank.com](http://www.scandinaviancryobank.com)) was introduced with direct access to updated donor lists, online pregnancy reporting, a full product range with detailed information, prices and photos, online. The classic Danish look – tall, slender and athletic with soft facial features, light skin, small nose, blue eyes, fair hair – is preferred. Many donors have blond hair, but an equal number have light brown hair. Redheads are not big sellers.

While the Scandinavian Cryobank charges one price for all its donors, a number of US companies charge more for sperm from a donor with a post-doctoral, medical or legal degree.

In 2003, the company opened a New York office and began marketing Scandinavian sperm to infertility doctors and their patients with a sleek albeit controversial slogan: "Congratulations, it's a Viking!" Another advertisement shows a blond, blue-eyed baby and talks about his ancestors who beat Columbus to North America. It is very much an on-line business; people shop around and look through donor lists on the Internet to find a donor that appeals to them.

### Competition

Cryos's sperm generally costs less than US varieties, but still the company may find competing with US rivals difficult. The major reason is that US sperm banks are far more willing than Cryos and other overseas counterparts to reveal information about donors.

One of the main competitors, Xytex Corp., based in Augusta, Georgia, provides clients not only with photos of the donor and the offspring he's helped produce, but also with detailed biographical and physical information, including religion and educational background. The company even shows video footage of some donors. With seven sperm banks operating in the United States, from South Carolina to San Francisco, Xytex has another important advantage: steady access to donors of ethnic backgrounds, including Asians and African-Americans. This is important, because customers usually have a preference. In contrast, Cryos relies on three collection points in Denmark, ensuring that most of its donors will be white and of European descent.

Xytex provides physical, medical and social information about a donor to the patient. Donors are described by basic physical traits (hair and eye colour, height, weight, race, ethnic origin, skin tone and blood type), social traits (education, occupation, hobbies, special interests and skills), and medical histories on the donor and his family. In addition, donors provide a personal essay and physical and social information about their families.

In 1994 Xytex was the first sperm bank in the country to introduce photographs of its donors. Donors may choose to have their pictures taken to provide to the patient, or may voluntarily provide a childhood photograph. In general, the sperm banks are now expanding the information on their donors

to include everything from physical traits to personality and temperament, which raises a number of issues that infertility specialists and ethicists say must be addressed.

The CEO of Cryos, Ole Schou, is considering the global launch of a franchising system focusing on quality so that the concept of Cryos can be copied in other clinics around the world. The franchising system involves a very comprehensive package of laboratory standards, control systems, training systems, franchising contracts, marketing plans, investment, financing, computer systems, etc.

Sources: Spar, D.L. (2006) 'Where Babies come from – Supply and Demand in an Infant Marketplace', *Harvard Business Review*, February, pp. 133–42; Talan, J. (2005) 'For prospective parents in the market for a blonde-haired, blue-eyed tot, Danish sperm makes the sale', *Newsday*, 5 June 2005.

### Questions

- 1 Would you characterize Cryos as a 'Born Global'? Why/why not?
- 2 What do you think about Ole Schou's ideas of a 'global franchising system'?
- 3 What ethical and moral issues are involved for Cryos in selling sperm worldwide?

## CASE STUDY 3.2

### Entertainment Rights: Internationalization of 'Postman Pat'

Entertainment Rights (ER) ([www.entertainmentrights.com](http://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 Filmlion 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	0
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)

	2005	2004	2003
Operating revenue (revenue/sales)	30,735	25,467	29,453
Cost of sales	10,695	9,867	15,250
Gross operating profit	14,270	9,967	8,827
Selling, gen. and administrative expense	6,768	6,764	10,582
Interest income	314	157	24
Other income, net	-692	0	2,360
Special income/charges	300	-16	21
Total income (EBIT)	7,502	3,203	605
Interest expense	1,860	1,174	1,067
Pre-tax income (EBT)	5,956	2,186	-417
Total net income	5,387	2,202	-417

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](http://www.entertainmentrights.com); 'Marks & Spencer takes on Postman Pat', Weekly E-news, Issue 76, 14 September 2004, [www.licensmag.com](http://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?

VIDEO  
CASE STUDY  
3.3

download from  
[www.pearsoned.co.uk/hollensen](http://www.pearsoned.co.uk/hollensen)

## Reebok

Reebok ([www.reebok.com](http://www.reebok.com) / [www.adidas-group.com](http://www.adidas-group.com)) specializes in the design, marketing and distribution of sports and fitness products including footwear, apparel and accessories, as well as footwear and apparel for non-athletic use. In August 2005 Adidas said it would buy Reebok for \$3.8 billion, giving the company about 20% of the US market and the potential to challenge market leader Nike.

### Questions

- 1 Which of the internationalization theories is best for explaining the Adidas acquisition of Reebok?
- 2 What could be the motives behind Adidas' acquisition of Reebok?
- 3 Which of the three internationalization theories is best for explaining whether Reebok follows the establishment of its retailers, for example Foot Locker, in international markets?
- 4 Is Reebok able to copy its US marketing approach (connecting to the youth segment through famous rappers, like 50 Cent) in other international markets?

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