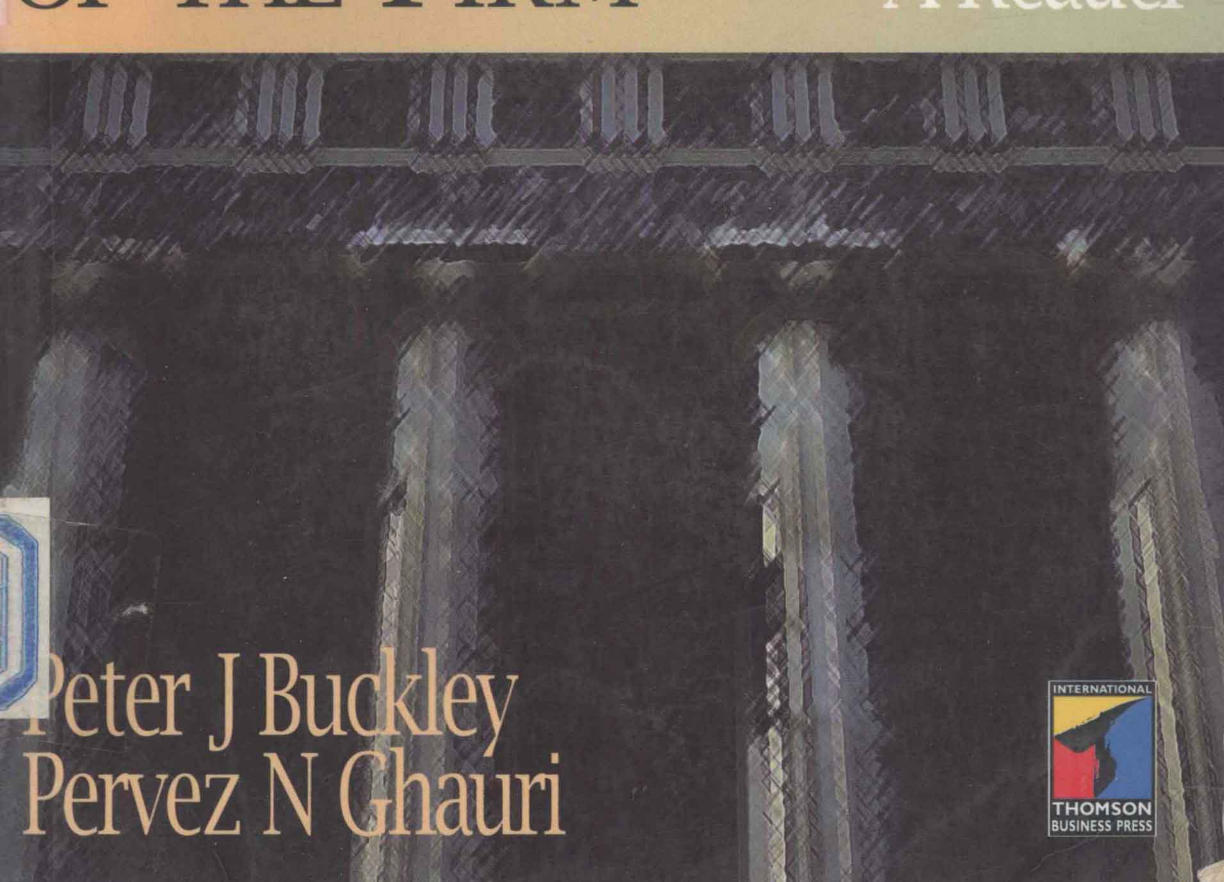
second edition

The Internationalization of the Firm

A Reader



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Second Edition

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Introduction and Overview

Peter J. Buckley and Pervez N. Ghauri

The internationalization of the firm has been a key issue in international business research right from the outset. Internationalizing means changing state and thus implies dynamic change. The growth of the firm is the background to internationalization and to some degree the distinction between internationalization and growth is false. The crossing of national boundaries in the process of growth may be argued to be a meaningless threshold (Buckley, 1993). However, there are features which are unique to internationalization, or, at least, there are significant degrees of difference between growth at home and internationalization. This volume seeks to explore these differences.

The rate and direction of internationalization have been the subject of many studies, some of which are represented here. Moreover, this area has not been without controversy. Do firms internationalize by a gradual, incremental process going through a number of definite stages? Is this 'stages of internationalization' model valid for established multinational firms or only for naive, small firms with little international experience? How far can firms use their experience (learning) to miss out stages in this process and move directly to a deep form of involvement in the foreign market? On how many fronts can a firm pursue internationalization? Should it proceed step by step, going first to nearby countries in terms of physical and cultural distance? Do established multinational firms need to obey any such rules? These and other questions were in the minds of the researchers who undertook the studies which follow and their efforts have illuminated our understanding of the forces at work. Naturally, definitive conclusions have not always been reached.

The relationship between internationalization and forms of foreign market servicing is a close one. The conditions under which a firm will choose exporting, licensing or foreign investment interact with internationalization. The management and control of the activities and organization of the multinational firm are also a crucial part of the conceptualization of internationalization. The impact of cultural differences, too, is a critical issue in this process.

This collection then covers: key works (introducing the product cycle, internalization and stages of development models), studies of the internationalization process, methods of foreign market servicing, work on the organization of multinational firms and the impact of culture on internationalization.

1 KEY WORKS

The first part of this collection covers key articles introducing basic concepts which have had a fundamental effect on subsequent research and writing.

The first reading in this volume is an abridgement (by Peter Buckley) of Yair Aharoni's 1966 study of the foreign investment decision process. The foreign investment decision is analysed as a complex social process which is influenced by social relationships both within and outside the firm. Aharoni provides a rich description of individual and organizational behaviour over time and shows the crucial effect of perception and uncertainty in the course of this process. A holistic understanding of all the stages is necessary to comprehend the decision. Although Aharoni analyses the decision as a succession of stages, he is at pains to point out that in real life these stages are ill defined and messy. This piece emphasizes the importance of the initiating force and explains many elements which may wrongly be labelled 'irrational'. Aharoni's work laid a firm foundation for studies of decision processes in multinational firms.

The second chapter is a work which can justly claim the epithet 'seminal', Raymond Vernon's 1966 article 'International investment and international trade in the product cycle'. The argument of this paper is that firms are highly stimulated by their local environment and are more likely to innovate when their immediate surroundings are more conducive to the creation of (particular) new techniques or products. For internationalization to occur these innovations must be transferable to other economies. In adapting to its market, the firm moves through stages from innovation to standardization and maturity according to the developing forces of supply and demand for its product. This model of sequential decision making has had a great influence on internationalization theory. The model was originally developed to explain US investment in Europe and also in cheap labour countries. Its usefulness goes beyond Vernon's reappraisal of its efficacy under changed world conditions (1979) or the sting of its critics (e.g. Giddy, 1978). Its relevance arises from the fact that the dynamic of the model lies in the interaction of the evolving forces of demand (taste) patterns and production possibilities. In some ways, its powerful, yet simple, dynamic resting on the changing equilibria of demand and supply over time, has never been bettered. The twin rationales of cost imperatives and market pull are simply explained in Vernon's model. Its programmatic nature may have straight-jacketed later analyses into a unilinear internationalization path. Although its validity for the explanation of the behaviour modern multinationals may be questioned, this article spawned much of the empirical literature on international marketing.

The third article has been the focus of ideas for many subsequent researchers. Johanson and Wiedersheim-Paul examine the internationalization of four Swedish firms. For this admittedly small sample they find a regular process of gradual incremental change. The firm progresses from no regular exports to export through independent representatives and the establishment of sales subsidiaries to the establishment of production facilities. Flows of information between the firm and the market are (as in Vernon's model) crucial in this process and the cultural distance between spatially separated units of the firm is termed psychic distance. The establishment profiles of the four firms are mapped across a number of countries in time and the gradualist pattern is confirmed. This path-breaking article gave rise to considerable controversy centred on the general applicability of the findings and the underlying theory. Suggestions have been made that experienced firms can 'jump' stages and transfer learning from one market to another without having to go through each stage in each separate foreign market. The knowledge collection and planning processes of large multinationals can, some authors feel, obviate the need for incremental learning. Some empirical findings suggest a less gradualist and one-directional expansion path. The theory has also been questioned in its classification of stage or stages of involvement ranked in order of 'depth'. Is a licensing deal a deeper form of involvement than a foreign agency agreement? Methodologically, looking back in time a successful firm eliminates firms which have failed at an earlier stage, i.e. it induces a bias towards longer routes of establishment (see Hedlund and Kverneland, 1983). More carefully designed experiments are required to establish the conditions under which stages approach is valid. Nevertheless, the article reprinted here is a classic piece of empirical research with wide implications for internationalization.

It was followed, in 1977, by the piece by Johanson and Vahlne, reproduced here as Chapter 4. This chapter examines the internationalization process by investigating the development of knowledge and the building of a commitment within the firm to foreign markets. The twin notions of increasing knowledge about foreign markets as a means of reducing uncertainty and the creation of a commitment to foreign ventures had been examined in a key study by Aharoni (1966) (see Chapter 1) and the authors here tie these notions to the framework of the behavioural theory of the firm. Internationalization is again envisaged as the product of a series of incremental decisions. Decisions taken at a point in time affect subsequent steps in the process. Psychic distance is invoked and is defined as 'the sum of the factors preventing the flow of information from and to the market'. The decision-making process is dependent on the firm's previous experience. Again, the empirical evidence is based on a very small number of companies. Four Swedish companies are examined from Chapter 2, a case study of the Swedish pharmaceutical firm Pharmacia is introduced and other industry studies are quoted (special steel, pulp and paper and nine further cases). Casual empirical evidence from other countries is also adduced (Hornell & Vahlne, 1986). The two notions of market commitment and market knowledge entered the literature as key elements of internationalization.

The dominant paradigm in research on the multinational firm is the internalization approach. Chapter 5 is an early summary of the theoretical work in this tradition by Buckley and Casson whose book the *Future of the Multinational Enterprise* (1976) was a basic contribution. This chapter attempts to explain the division of national markets (and therefore of the world market) between domestic firms and foreign multinationals. It does so by reference to two effects: the location effect and the ownership effect. The location effect determines where value adding activities take place and the ownership effect explains who owns and controls those activities. The concepts of least cost location and growth by internalization of markets are thus introduced to internationalization theory. Firms grow by replacing the (imperfect) external market and earn a return from so doing until the point at which the benefits of further internalization are outweighed by the costs. The types of benefit and cost of growth by internalization are listed and it is suggested that certain types of market are more likely to be internalized than others, given the configuration of the world economy. These ideas were expanded in Buckley and Casson (1985), Casson (1987) and Buckley (1988, 1989, 1990). Thus the direction of internationalization can be predicted by predicting changes in cost and market conditions. These factors are classified as industry specific, region specific, firm specific and nation specific.

John Dunning has produced a massive corpus of work in international business. From them, we have chosen a piece originally written in 1977 (Chapter 6), which presents the key elements of Dunning's 'eclectic paradigm'. This approach uses three sets of explanatory factors to analyse international business issues – locational factors, internalization factors and ownership factors. Essentially, firms transfer their ownership-specific assets to combine with the most favourable sets of traditionally fixed elements in the global economy, and they do this, where appropriate, internally, in order to retain control of the revenue generation. Later versions of the eclectic approach refined this position and extended its taxonomy and it has become familiar to many generations of researchers and students as a set of key organizing principles in international business.

2 THE INTERNATIONALIZATION PROCESS

We have already introduced a pioneering study of the internationalization process in 'antecedents' (Chapter 3). Over the period from the late 1950s there has been growing interest in the internationalization process of firms. This is exemplified by the readings in this volume where we can see the gradual development of research in this area. Starting from Dunning (1958), Vernon (Chapter 2), Servan-Schreiber (1969) and Horst (1972), through Chapters 3 and 4, and Luostarinen (1979) we have seen how the focus has shifted from the decision to export to a more longitudinal approach, namely, the internationalization process. Chapter 7 is a good example of this development. This chapter points out that although widely used, the term internationalization has not been clearly defined. It should, according to the reading, be broadened to include both the inward and outward aspects of the process. As well as the longitudinal character of the research, the study also draws our attention to other aspects such as the impact of individuals and the evolution of communication patterns. It seems that more research is necessary both on the process and the analysis of the decision and that these should be integrated. Chapter 7 by Welch and Luostarinen surveys this literature. It presents a strong defence of the concept of internationalization as a sequential process. It adduces evidence from Luostarinen's study of Finnish firms (1979) and alludes to studies of Japanese companies and those from business history (a source mostly neglected by the chapters in this volume) to support evidence of sequential development. It also suggests *contra* Hedlund and Kverneland (1983) that jumps in the stage pattern in *any one foreign market* may result from learning across the firm, i.e. from other foreign markets. Thus overall foreign knowledge may diffuse through the firm and allow more rapid penetration of foreign markets tackled at a later date. More recently, the internationalization of industrial firms has been explained through networks and relationships between firms. The network model has been largely developed at Uppsala (Hagg and Johanson, 1982; Johanson and Mattsson, 1988; Thorelli, 1986; Ghauri, 1989). According to this approach firms internationalize because other firms in their national network internationalize. The industrial system is composed of firms engaged in production, distribution and use of goods and services. The relationships between the firms are described as a network. The firms within the network are dependent on each other, and their activities therefore need to be coordinated. These networks are either stable or they are changing, but the transactions take place within the framework of these established relationships. In the process, however, some new relationships are developed and some old ones are disrupted because of the competitive activities of different actors.

Thus, although there are competitive relationships, interdependencies are stressed in the network approach. The firms have to develop and maintain relationships with other firms in the network. This process of developing and maintaining relationships is of a cumulative nature and the firms are striving to establish a prominent position in their networks. At each point the firm has a position in the network which explains its relationship to the other firms. Here one basic assumption is that the firm is dependent on external resources controlled by other firms. Therefore, it is dependent on its network in foreign markets while internationalizing. The firm thus has to work for international integration. The network approach also influences the internationalization of the market – for example, a production net can be more or less internationalized. A higher degree of internationalization means that there are strong relationships between different national networks. These relationships developed by the firm are thus considered as market investments. Moreover, the firms which are highly internationalized would prefer to have a number of activities performed externally by sub-contractors and can still have the desired control arising from these relationships.

Chapter 8 examines the direct investment behaviour by small and medium-sized enterprises. It gives the theoretical background to the analysis of such investment from a number of viewpoints, both theoretical and empirical. The special factors influencing foreign direct investment by smaller firms are drawn out and key constraints are found to be the relationship between firm and market, shortages of capital and management time and the role of uncertainty. In passing, the evolutionary approach to internationalization is discussed.

Chapter 9 by Coviello and Munro on network relationships and the internationalization process of small software firms takes the analyses of the problems of smaller firms further and examines the influence of networking on the internationalization of smaller firms. Using 'multi-site case research' it integrates the traditional incremental model of internationalization with the network perspective. Their findings are that in smaller software firms, perhaps due to the dynamic nature of the industry, the internationalization process is accelerated but is heavily influenced by the firms' formal and informal network of relationships. Drawing managerial implications, they advise smaller firms to build the impact of networking and its merits into their foreign market entry strategy.

The next reading by Benito and Gripsrud discusses again the incremental model and questions whether there is a general expansion pattern of FDIs across industries. They develop two hypotheses regarding the location of FDIs. After testing these hypotheses on Norwegian manufacturing firms, they conclude that there is no support for the assumption that FDI first takes place in culturally closer (psychic distance) countries and at a later stage are spread to more distant markets. Moreover, for a given company, an expansion into more distant countries is not found as the number of investments increases. Instead, their study reveals that location choices are discrete rational choices and not a cultural learning process. This does not preclude experience effects, but it is the nature of the business that defines the feasible location for each FDI.

The service sector is often neglected in studies of international business. It is either completely ignored, or treated as a footnote to special cases of analyses designed for manufacturing. Chapter 11 examines the key aspects of services as they impinge upon international business theory and operations. It focuses in particular on the foreign market servicing choices of service forms using an eclectic paradigm type of organizing framework in which ownership, location and internalization factors are analysed. Tradeability of the service and the degree of separation between the producer and consumer emerge as key elements in internationalization strategies and the piece also emphasizes the 'people' element in service provision.

Chapter 12 by Clark, Pugh and Mallory, examines empirically the process of internationalization in 25 UK based organizations. It pays particular attention to the knowledge requirements, sources and needs underlying the internationalization process (see also Buckley and Carter 1998). The flows of knowledge within the firm – both market-specific and generalized knowledge from operating internationally – influence the choices and shifts between modes of foreign market servicing (see also Calof and Beamish 1995). The article further emphasizes the importance of switches within modes and (in Figure 1, p. 168) presents a model of shifts in foreign market servicing which encompasses shifts between modes (including retrenchment) and shifts within modes. This piece leads logically to Part III on methods of foreign market servicing.

3 METHODS OF FOREIGN MARKET SERVICING

There are three generic methods by which a firm can penetrate a particular foreign market: exporting, licensing or direct investment. Each of these methods are, in practice, very important. The readings here are representative of a huge literature on each of exporting, licensing, joint ventures and foreign direct investment. For a review of this literature see Young *et al.* (1989). Chapter 13 by Anderson and Gatignon is a widely cited analysis of modes of foreign entry using transaction cost theory. This chapter shows that entry modes are best analysed by comparison with concrete alternatives and that the 'default' hypothesis – that, other things being equal, low resource commitment is preferable – gives a testable anchor to the analysis. The list of hypothesis advanced in this piece provide a useful checklist of key factors in the choice of entry mode.

Exporting may be regarded as the most straightforward way of selling in a foreign market, avoiding, as it does, most of the costs of doing business abroad. It is separated from the other two main forms of foreign market servicing by the location factor in that the bulk of the value adding activities take place in the home (not the foreign) market. Exporting may attract tax advantages and the associated risks are low because usually little capital is involved. However, the fixed costs of exporting (including making contact, negotiating prices, arranging shipping, adaptation of product and promotion) mean that a small volume of export sales can be uneconomic. Costs of product adaptation, tariff and non-tariff barriers and transport costs may dictate local operations rather than exporting. A number of studies investigate export behaviour of all types of firms. The second reading in this section by Cavusgil (Chapter 14) utilizes an alternative approach and attempts to delineate differences among exporting firms when firms are classified by their degree of internationalization. It identifies three types of exporter; experimental exporters, active exporters and committed exporters. These firms are then compared with each other in respect of measurable company characteristics. These characteristics include domestic environment, nature of international business involvement, marketing policy aspects, and export market research practices. The database for the investigation is a series of interviews with 70 systematically selected American firms. The study builds upon the sequential nature of internationalization (see Chapter 3) and associates this sequential exporting with the three stages of internationalization identified. The reading reveals significant differences among the three types of exporters and provides further insight into the export marketing behaviour of firms. It provides a useful background for designing a more comprehensive investigation of the issues and suggests that future investigations may also consider classifying firms by alternative criteria in addition to stages of internationalization.

International licensing appears to combine the best of both worlds – the advantage in technology and skills of the licensing multinational plus the local knowledge of the licensee. However, licensing accounts for only 7% of the total foreign sales of British companies (Buckley and Prescott, 1989) and approximately the same proportion in the other major trading nations. The reasons lie in the costs and difficulties of designing and maintaining contractual arrangements. These transaction costs centre on the identifiability of the advantage, policing costs (constraining the licensee from using the knowledge in 'ways which have not been paid for'), the danger of creating a competitor, problems in the market for licences (including the buyer uncertainty problem; that the buyer does not know what to pay for the knowledge he needs until he has it, but when he has it he has no need to pay for it!) and the search costs in bringing buyer and seller together (Buckley and Davies, 1981). In other instances, the market structure may militate in favour of licensing as a form of market entry – cross-licensing in oligopolistic industries may be preferable to head-to-head competition. Licensing may also be a second best choice when exporting or direct investment are ruled out by government policy, intra-firm scarcities or risk profiles. Licensing may also be useful to extend the life of an idea or technology, or to reach small or difficult foreign markets. In the theory of international business, the choice between licensing and direct investment is crucial in illustrating the choice between a market (external) solution – licensing, and an internal solution – direct investment (Buckley and Casson, 1976; 1985).

Chapter 15 by Welch is unusual in that it attempts to quantify the costs of licensing and therefore captures the importance and magnitude of transaction costs. This piece is important not only for its insights into the licensing process but also for its meticulous interrogation of some valuable primary data. These data are suggestive of a number of interesting hypotheses but the piece also provides one of the few extant attempts to measure cost magnitudes. The survey of literature provides a useful backdrop to the empirical issues related to the importance of patents, know-how and other forms of proprietary knowledge and the difficulties for firms in appropriating benefits from the international exploitation of technological advances. It also covers the search costs of finding a licensee and the negotiation costs, which it pulls together (in the important Table 8). Licensing is also compared and contrasted to foreign direct investment. It is shown to be a potentially important part of the international operations of companies.

The foreign investment decision is a crucial step in internationalization. In fact foreign direct investment is often treated as if it were synonymous with internationalization. Just as there are many forms of contractual arrangements for conducting international business, of which licensing is just one (Buckley, 1989) so there are many forms of foreign direct investment. The major motives for conducting foreign direct investment are market orientated, cost orientated and for the control of key inputs.

Joint ventures are an important form of foreign direct investment and are currently subject to a great deal of theoretical and empirical scrutiny (Contractor and Lorange, 1988; Beamish and Killing, 1997). They are an important means of entry into markets which are difficult for foreign firms to penetrate because of legal, regulatory or cultural barriers. Japan is a case in point. Buckley, Sparkes and Mirza (1985) examine joint ventures for a sample of European firms. This article also notes the strategic importance of penetrating certain large foreign markets. It enables learning to occur which can be transferred to all parts of the company (including home operations), it enables competition to be met head-on and it closes down an opportunity for competitors to have a free ride in one market (the home market in the case of Japanese firms). Thus foreign direct investment and joint ventures must be seen as part of a global competitive game.

Chapter 16 by Harrigan relates joint venture activity to global strategies and proposes a framework for predicting whether firms will cooperate in forming joint ventures or other forms of interfirm cooperation. It also suggests which factors/forces destabilize cooperative joint ventures and suggests that under certain conditions joint ventures are most appropriate for strategic needs. Joint ventures are considered to be a better way to internationalize and may be used as pre-emptive manoeuvres to ensure that access to distribution channels, suppliers and technology in promising industries are not foreclosed. They are also ways of ensuring that potential entrants do not team up with competitors.

The entry of China into the world economy in the mid to late 1990s has resulted in China becoming a major host country for foreign multinationals. Most of these foreign investments are joint ventures with Chinese capital. The management, ownership and control is of vital importance, not only for Chinese development, but also for the integration of China into the global economy. The conduct of these ventures has important lessons which can be generalized beyond China. Child, Yan and Lu (1997), examined international joint ventures in China. They found that to predict relative levels of foreign and Chinese parent company control in joint ventures, it is necessary to utilize a broader definition of ownership than the purely legal one and to include the provision of non-capital resources and inputs on a non-contractual basis (this includes inputs into product design, production technology, management systems and management resources). Thus, if foreign firms wish to enhance their control over their Chinese joint ventures, they should have a high equity share and provide continuing non-contractual support to the venture. Reliance on purely legal contracts may have a negative connotation. Respect for social and political norms is also a vital precondition for success in China.

Chapter 17 by Parkhe on strategic alliances argues that the emergence and maintainance of cooperation between international alliance partners is related to the diversity in the partners' characteristics. The chapter develops a multilevel typology of interfirm diversity and examines its impact on alliance longevity and effectiveness. As has been shown in a number of earlier studies (e.g. Harrigan 1988), interfirm diversity severely impedes the ability of companies to work jointly and effectively. Taking that as a starting point, this chapter examines the impact of diversity on alliance outcomes and illustrates that deliberate learning/adaptation actions by firms can deter alliance failures and promote longevity. The paper points out that there is a need for longitudinal studies focusing on the phases of alliance development. Further, it draws attention to the crucial aspect of learning among alliance partners. It proposes that the ability of a firm to diagnose important differences between partners and to design a productive partnership through novel solutions, accommodating these differences, is likely to become imperative in achieving alliance longevity.

4 ORGANIZING THE MULTINATIONAL FIRM

A number of studies are available on the organization and management of the multinational firm. Studies such as 'Strategic Management in Multinational Companies' (Doz, 1986), 'Managing the Multinational Subsidiary' (Hulbert and Brandt, 1980) and Hedlund and Aman (1984) are worth mentioning. In this section, however, we have selected a number of readings which have been particularly innovative. Prahalad and Doz (1981) deal with the problems of maintaining strategic control over subsidiaries in a multinational firm. The authors argue that the nature of control in this relationship changes over time (see also Ghauri, Chapter 20). As resources such as capital, technology and management are invested in the subsidiary, the head office, over time, cannot control these resources by influencing the subsidiary. The authors present a conceptual framework to define organizational context, and argue that it can be used as a means of control. They also classify multinational corporations in four categories: (1) fragmented, (2) dependent, (3) autonomous, and (4) integrated. However, the conclusion is that HQ's ability to control cannot be taken for granted.

In Chapter 18, Kogut and Kulatilaka present strategic (foreign) investments as real options. Although the analysis is not fully developed in the reading, this notion has great potential in international business – joint ventures, for instance, may be analysed as options on future, deeper involvement in volatile markets (Buckley and Casson 1997; 1998). Kogut and Kulatilaka also examine organizational capabilities and core competences as strategic investments with long-term payoffs. Platform investments are seen as real options with future flexibility designed and planned into the investment. The conclusion points to vicious and virtuous circles in the life cycle of companies and the authors note that 'flexibility is of no value in the absence of resources required for execution' (p. 293). Real options thinking requires a new targeted long-term strategic planning. The incorporation of uncertainty into models of mode choice is a challenging task which is likely to drive much future research on internationalization (see Chi and McGuire, 1996; Rivoli and Salorio, 1996).

The classical study by Bartlett and Ghoshal on 'Organising for Worldwide Effectiveness: The Transnational Solution', which led to their best seller book, *Managing Across Borders: The Transnational Solution* (1989), discusses the enormous success of newcomers, Japanese companies, and the way in which they have forced Western firms to rethink their organizational strategies. On the other hand, the managers in Japan have focused on the forces of localization. At the same time both Western and Japanese firms are worried about barriers of trade. The growing demand of host governments for local investments and changing manufacturing technologies are making small-scale production and tailored products more feasible. The authors claim that all these changes demand more than efficient central management and flexible operations. Given a number of examples from companies like Philips, Ericsson and Matsushita, they conclude that dynamic interdependence is the basis of a transnational company – one that can think globally and act locally. They suggest that to deal with these new challenges, what is needed is a gradual approach that both protects and builds on the company's administrative heritage plus flexible, central and local management capabilities.

The next contribution (by Ghauri) on the management of headquarters–subsidiary relationships questions the existing literature on FDIs which deals with global management using traditional approaches. It presents evolutionary phenomena where foreign operations become more influential and independent from the parent firm. The paper suggests that a foreign subsidiary has a three-dimensional relationship: with the head office, with local authorities and with the local network. Presenting empirical evidence from Swedish firms and their subsidiaries in South East Asia, it claims that a new relationship pattern is emerging, where the foreign subsidiaries become more influential than the parent firms. They make their own decisions in regard to the purchasing of raw material and components, products and product decisions and in relationship with other actors in their network. Moreover, the paper suggests an emergence of a 'centre-to-centre' relationship, where some regional subsidiaries communicate directly with others, without the consent of their head office.

Chapter 21 by Hood, Young and Lal explores the strategic intentions of Japanese firms, which have manufacturing subsidiaries in Europe. Their strategies and performance are reviewed and evaluated. Empirical evidence is provided from Japanese manufacturing plants working in the UK. The focus is on the relationship between the strategic intentions behind the establishment of manufacturing plants in Europe and the directions in which these plants have evolved. It is suggested that Japanese companies are moving towards more added value investments and are developing multiple SMEs as component suppliers. It is accepted that this may be driven by local 'local content' requirements, but in a more strategic sense it is an intrinsic part of the Japanese competitive style. The study thus concludes that the net outcome of Japanese companies entering the UK appears to be positive on all accounts which explains the increasing interest of local governments in attracting foreign direct investments.

5 THE IMPACT OF CULTURE ON INTERNATIONALIZATION

Chapter 22 by Hallén and Wiedersheim-Paul, deals with psychic distance and buyer–seller interaction. The authors claim that the gap between buyers and sellers is two-dimensional. First, the 'hard' dimension such as the physical distance and second, the soft dimension connected with differences in attitudes and perceptions caused for instance, by differences in cultural environments (in a wide sense) between buyers and sellers. Although the reading addresses buyers and sellers, the approach is wide-ranging and can be applied to comparative management and management in multinational firms. The 'soft' dimension of distance is of particular importance in international marketing and management. As inter-firm relationships (such as that between head office and subsidiary) develop, mutual understanding between the units reduces this psychic gap.

Chapter 23 by Kogut and Singh examines the influence of national culture on entry modes. It finds strong support for the idea that cultural distance (see Chapter 22) and attitudes towards uncertainty avoidance (see Chapter 24) influence the choice of entry mode. It therefore provides an excellent bridge between the readings collected in Part III of this volume and those in Part V.

Expanding the results of his fundamental study (Hofstede 1980), Hofstede emphasizes the importance of culture on international business in the next reading. He distinguishes national cultures from organizational cultures. Using a huge database from 50 different countries, he discusses the validity of management theories across borders. A special emphasis is given to East Asian cultures explaining the recent economic growth of these countries. The four dimensions – 1) power distance, 2) individualism, 3) masculinity versus femininity, and 4) uncertainty avoidance – are discussed at length. A fifth dimension, long-term versus short-term orientation, is introduced to explain East Asian cultures. The study concludes that existing management theories have a limited validity across cultures, not only because many companies operate in different countries, but also because they operate in different lines of businesses. The managers thus have to see the relativity of their own cultural framework with that of others. The paper calls for improved inter-cultural management skills focusing on *working* rather than on *living* in other countries.

The next study on psychic distance by O'Grady and Lane discusses its impact on the mode of entry chosen by firms. They question the validity of the incremental approach based on psychic distance. Providing evidence from 32 Canadian firms, they state that only 22% were functioning successfully in the most (psychically) closest country, USA. They suggest that the paradox is that the psychically close countries become difficult to manage precisely because of this closeness. The closeness prevents managers learning about critical differences. In giving the example of USA and Canada they suggest that closeness does not mean similarity in culture. They claim that they found significant differences in values and attitudes between the two countries, that on the surface appear to have few differences.

6 SUMMARY

The analysis of internationalization has been a vital driving force in international business research. Seemingly disparate pieces of research based on product cycle models (Vernon, Chapter 2), stages of internationalization (Johanson and Wiedersheim-Paul, Chapter 3, Johanson and Vahlne, Chapter 4), studies of small firm or first-time foreign investors (Buckley, Newbould and Thurwell, 1988; Buckley, Berkova and Newbould, 1983, Chapter 6), network approaches to internationalization (Johanson and Mattsson, 1986), internalization theory (Buckley and Casson, 1976; 1985), the international marketing and purchasing approach (Paliwoda and Turnbull, 1986; Turnbull and Valla, 1989) and studies critical of stages theories are now being crystallized into a coherent view of internationalization. Such a view has evolutionary stages elements as part of its make up. But these stages are now much more circumscribed in context and flexible in nature than the extrapolation of early studies would suggest. They also require more attention to be paid to management knowledge by the firm. For naive, first-time investors or internationally inexperienced larger firms, a strategy of creeping incrementalism may still be valid. However, for larger, diversified multinationals, a global planning horizon is now much nearer as several readings above demonstrate. The choice of methods of doing business abroad is now much wider than even 20 years ago and choices can be tailored to the precise needs of internationalizing firms. This flexibility (often gained through experience) may well, in many cases, obviate the need for incremental learning and feedback through stages. We should not, however, underestimate the importance of gradual learning, even for the most experienced and internationally diversified firms.

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