Chapter 3 Internationalization theories
Learning objectives

- 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
Learning objectives (2)

- 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
Historic development of internationalization

- Traditional marketing approach
- ‘Life cycle’ concept for international trade
- The Uppsala internationalization model
- Internationalization/transaction cost approach
- Dunning’s eclectic approach
- The network approach
The Uppsala internationalization model

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

Source: adapted from Forsgren and Johanson (1975, p. 16)
Exceptions to the use of incremental steps towards market commitment

- Firms with large resources can take larger internationalization steps
- When market conditions are stable and homogeneous, relevant market knowledge can be gained in ways other than experience
- When the firm has considerable experience from markets with similar conditions, it may be able to generalize this experience to any market
What term refers to differences in language, culture and political system, which disturb the flow between the firm and the market?

**Psychic distance**
Figure 3.2  Dimensions of internationalization

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


The transaction cost analysis (TCA) model

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.
What is this?

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

Transaction costs
What is this?

What term is used to describe behaviour that is characterized by self-interest with guile and includes methods of misleading, distortion, disguise and confusion?

Opportunistic behaviour
Transaction cost analysis framework

- Cost minimization explains structural decisions
- Firms internalize (vertically integrate) to reduce transaction costs
Figure 3.4 Principles of the TCA Model

*Transaction cost:*
- Ex ante cost – search costs
  - contracting costs
- Ex post cost – monitoring costs
  - enforcement costs

If ‘transaction costs’ are higher than ‘control cost’ through an internal ‘hierarchical’ system, then

Country A

‘Forward integration’

Country B

‘Internalization’

Seller: Producer

Internal firm: Foreign subsidiary

Buyer: Export Intermediary

End-customer

End-customer

Seller: Producer

‘Friction’ between seller and buyer
Cost elements of the TCA model

**Ex ante costs**
- Search costs
- Contracting costs

**Ex post costs**
- Monitoring costs
- Enforcement costs

Transaction costs = ex ante costs (search + contracting costs) + ex post costs (monitoring + enforcement costs)
What is this?

When firms do business using an importer, agent or distributor it is called ______.

Externalization
When firms implement a global marketing strategy using their own subsidiaries, it is called \textit{Internalization}. 
Limitations of the TCA framework

- Narrow assumptions of human nature
- Excluding ‘internal’ transaction costs
- Relevance of ‘intermediate forms’ for SMEs
- Importance of ‘production cost’ is understated
The network model

- The relationships of a firm in a domestic network can be used as bridges to other networks in other countries.
Figure 3.5 An example of an international network
Figure 3.6 Four cases of internationalization of a firm

Source: Johanson and Mattson (1988, p. 298). Reprinted by permission of Taylor & Francis
Importance of personal factors

- Positive perceptions of global environment
- Entrepreneurial orientation
- Innovativeness
Internationalization preparation

- Conducting international market research
- Committing resources to support venture
- Adapting products to target foreign markets
<table>
<thead>
<tr>
<th></th>
<th>Inward</th>
<th>Outward</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>R&amp;D</strong></td>
<td>Contract-in R&amp;D</td>
<td>License-out technology to overseas-based firm</td>
</tr>
<tr>
<td></td>
<td>License-in technology from overseas-based firms</td>
<td>Contract-out R&amp;D to overseas-based firm</td>
</tr>
<tr>
<td><strong>Production</strong></td>
<td>Technical service or consultancy performed in the home country for overseas-based clients</td>
<td>Contract-out manufacture to overseas-based firm</td>
</tr>
<tr>
<td></td>
<td>Contract-in manufacture for overseas-based firms</td>
<td>Technical service or consultancy performed overseas</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Minority investment in overseas production</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Majority investment in overseas production</td>
</tr>
<tr>
<td><strong>Marketing and distribution</strong></td>
<td>Import from overseas-based supplier</td>
<td>Exporting through home country-based intermediary</td>
</tr>
<tr>
<td></td>
<td>Import with distribution in the home country</td>
<td>Exporting through foreign-based agent/distributor</td>
</tr>
<tr>
<td></td>
<td>Management or marketing service or consultancy performed in the home country for overseas-based clients</td>
<td>Exporting through overseas-based sales representative or branch</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Management or marketing services or consultancy performed overseas</td>
</tr>
</tbody>
</table>

*Source: adapted from Jones (2001, p. 197).*
What term refers to a firm that from its ‘birth’ globalizes rapidly without any preceding long-term internationalization period?

Born global
Characteristics of born globals

- SMEs with less than 500 employees
- Annual sales under $100 million
- Reliance on cutting-edge technology
- Managed by entrepreneurial visionaries
Figure 3.7 Two extreme pathways of internationalization: the organic versus born global

Source: adapted from Âijö et al. (2005, p. 6)
Factors supporting born globals

- Role of niche markets
- Advances in process/technology production
- Flexibility of SMEs/born globals
- Global networks
- Advances and speed in information technology
Internationalization of services

1. Simultaneous production and consumption
2. Customer participation in production process
3. Services as series of activities/processes
Factors to consider in the internationalization of services

- Information technologies
- Cultural issues
- Geographic locations
- Standardization versus customization
Strategies for internationalizing services

1. Direct export
2. Systems export
3. Direct entry
4. Indirect entry
5. Electronic marketing
### Table 3.2 Summary of the three models explaining the internationalization process of the firm

<table>
<thead>
<tr>
<th></th>
<th>Uppsala internationalization model</th>
<th>Transaction cost analysis model</th>
<th>Network model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unit of analysis</strong></td>
<td>The firm</td>
<td>The transaction or set of transactions</td>
<td>Multiple inter-organizational relationships between firms</td>
</tr>
<tr>
<td></td>
<td><strong>Basic assumptions about firms’ behaviour</strong></td>
<td>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)</td>
<td>Relationships between one group of firms and other groups of firms</td>
</tr>
<tr>
<td></td>
<td>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</td>
<td></td>
<td>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</td>
</tr>
<tr>
<td><strong>Explanatory variables affecting the development process</strong></td>
<td>The firm’s knowledge/market commitment</td>
<td>Transactional difficulties and transaction costs increase when transactions are characterized by asset specificity, uncertainty, frequency of transaction</td>
<td>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</td>
</tr>
<tr>
<td></td>
<td>Psychic distance between home country and the firm’s international markets</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Normative implications for international marketers</strong></td>
<td>Additional market commitments should be made in small incremental steps; choose new geographic markets with small psychic distances from existing markets</td>
<td>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)</td>
<td>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 sub-supplier (an SME) follows it abroad. As an example see Case Study 13.2 on LM Glasfiber</td>
</tr>
</tbody>
</table>
CASE STUDY 3.1

Cryos: they keep the stork busy around the world

Worldwide network of sperm banks

- Click on the yellow dots to visit our departments around the world.

Cryos International is a worldwide network of sperm banks and distributors of clinical sperm related products.

- Denmark
- India
- New York

Supply of high quality frozen tested donor semen to more than 60 countries all over the world.

- 1,333 pregnancies since 1991
- Anonymous and Non-anonymous donors
- Extended profiles

The Cryos International sperm bank network offer a selection of nearly 500 donors of different races and attractiveness.

- WE KEEP THE STORK BUSY...!
Products

SpermFilter
SpermFilter® is a silane-silica based density gradient medium used in ART for separation and purification of highly motile human spermatozoa.

SpermWash
SpermWash® culture medium is used for semen preparation by “swim-up” for IUI or IVF, for washing of spermatozoa and/or for diluting stock solution of density-gradients.

SpermCryo All-round
SpermCryo™ is a highly concentrated cryoprotective medium used for freezing of human semen.

COA Request
Downloads of certificate of analysis for the above media.

IUI catheters
IUI catheters for insemination of purified spermatozoa into the uterine cavity.

Counting Chambers
Counting chambers for clinical or scientific semen analysis.

Incubator
Incubators for incubation of media and for “swim-up” preparation.

CBS high security straws
Accessories that have been developed especially for the freezing of human embryos and semen.
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

Classic media: internationalization of Postman Pat

© J.F.T.L Images/Alamy.
QUESTIONS

1. List the criteria that you should use for choosing new international markets.

2. If you were to advise CM would you recommend them to use the ‘organic’ or ‘born global’ pathway for the internationalization of Postman Pat?

3. What values/benefits can CM transfer to the license partners for consumer products apart from using the Postman Pat characters?
VIDEO CASE STUDY 3.3 Reebok

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?
Question for discussion

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