Internationalization of the Business Firm: A Literature Review*

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Abstract

The firm theory of internationalization remains open to new theoretical propositions. As a result, there is still some confusion among scholars about these issues. This paper revises the main contributions in the academic world concerning the debate on the internationalization of the firm. We do a brief diagnosis of the international currents of thought and their impact on the unfinished debate about the advancement of the theory of internationalization of the firm. Finally, we offer an agenda of topics that might be analyzed in relation to the case of Mexico.

Keywords: internationalization; internalization; multinational; resource-based; learning.

Resumen

La teoría de la internacionalización de la empresa permanece como un debate pendiente, creando confusión en el mundo académico. Este artículo hace revisión de las principales corrientes de pensamiento que han intentado explicar el fenómeno de la internacionalización de las empresas. Hacemos una breve historia de las corrientes de pensamiento y de su impacto en el aun inacabado debate sobre cómo avanzar la teoría de la internacionalización de la empresa. Finalmente, ofrecemos una agenda de investigación que toma en cuenta las particularidades de las instituciones y el contexto mexicanos.

Palabras clave: internacionalización; internalización; multinacional; enfoque-de-recursos; aprendizaje.

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1. Introduction

The term internationalization remains an intimidating and unexplained term for most business managers and academic people alike. We will attempt to describe the term internationalization, through its history, as it starts in 1960s, with the very academicians that helped coined this related terms and concepts, in the economics and business literature alike. Simply, we will define internationalization, as it applies to a business firm, company or enterprise, as its involvement in business practices or activities, across borders, that is, across nation-states.

It might help to mention the definition of internationalization of Albaum et al. (1994) that as applied to a business firm, can be viewed as a process, an end-result and/or as a way of thinking. More formally: "the successive development in a firm's international engagement in terms of the geographical spreading in markets, products, and operations forms". Internationalization, as a subject of study has been included in marketing, business management, economic and business strategy texts, to mention as long as the international is brought to terms.

We are limiting our interest to internationalization of the business firm, because of the popularity of the term among politicians, managers, administrators, among others. This way, subjects like internationalization of a university, internationalization of nuclear disarmament, internationalization of an academic program (e.g. MBA), and similar others are beyond the subject of this paper.

Also, in this paper, we are not limiting our interest to large business firms, small and medium-sized (SME) or to the so called multinational company (MNC). Even more, we are not limiting our area of interest to a particular point in time, like first foreign market entry, or first foreign direct investment (FDI). That limitation would exclude from our area of study the on-going process internationalization itself. Researchers observe among their data set, and pick up events to make out a story, or simply to make appoint along their line of reasoning. Therefore, we do believe that "ways of thinking" as an element of application of internationalization (Baum et al. 1994) will be left of the inferences that our readers make along the text in question.

2. Literature review

In this paper we first review several schools of thought under the general title of Foreign Direct Investment Theory, because their premise is that if there is no Foreign Direct Investment (FDI) involved we are not speaking about a truly international firm, that is, a Multinational Company (MNC). Within this current of thought we include the Internalization current of thought that develops into a coherent MNC theory. Then we comment on the "independent" schools, that is the Foreign Investment Decision-making School and the Life Cycle of Product and Trade Investment School. Next, we review the "popular" Upsala Internationalization Stages School, which is based on research done in a small developed country. Finally, we review the Resource-Based and the Knowledge-Based Schools, which rigorously should be treated as one single school, although the second one has produced most of new developments in research and concepts.

2.1. Foreign direct investment theory/industrial economics school

It was Hymer (1960, 1976) that first recognized that (American) companies involved in direct foreign investments (FDI), for reasons other than interest rate differentials across borders. It was one of Hymer's contributions to the theory of international management his conclusion that (American) firms were in fact elaborating monopolistic mechanisms, to face their competition and, that they frequently succeeded in keeping their (monopolistic) advantages for longer time than perfect competition assumptions allowed. It took 16 years for Hymer's PhD thesis to get published, but the study of international business had already started. Then, we have to acknowledge that a first definition of international firm comes handy.

Although Hymer (1960, 1976) was clearly limiting his study to the (American) company with international operations, it should be observed that only firms that commit to a FDI are of interest in his research, and it is precisely this firm that qualifies as a MNC. Also, Hymer (1968) introduces the concept of internalization into the study of international business, which adapts from Coase (1937), and which involves the keeping the control of the FDI through an organizational arrangement, namely a subsidiary or affiliated company. Internalization of international operations might be a confusing concept, due to fact that this term is also used in psychology to mean the assimilation of activities into day to day behaviour. Also, the parallel concept of externalization (now widely known as subcontracting) must be acknowledged as another contribution of Hymer (1960, 1968, 1976). To Hymer, externalization represents an organizational behaviour by which the MNCs extends, rather than relinquish, control over production' (see Strange, R. and Newton, J., 2006).

2.2. Foreign direct investment theory/internalization school

Several years after the seminal work of Hymer and Caves, Buckley and Casson (1976) advocate that research of the international firm centers around MNCs, practically excluding from this area of study small and medium-sized enterprises (SMEs) and giving way to the segregation of the firms which qualify as MNCs due to their capability to engage in FDIs and on the other hand, all other firms, mostly SMEs whose international operations are not FDIs, mostly due to their limited financial constraints, in turn, in large part, due to size and age . The arrogance of a large sector of the academic community, when trying to appropriate the merit of developing the study of international (big) business is shown in writing like those of Rugman (1981) which goes as follows: "In the past ten years or so it has become academically respectable to study the multinational enterprise. There is now a sufficient body of high quality analytical work available to develop a theory of the MNE". We have to remark that although a majority of internalist theoreticians invoke their building the theory of the MNC (or the theory of the FDI), a few of them gave a more limited and focused approach of internalization, which was aimed to produce a recommendation of the most likely location of the FDI (a production facility). This called "paradigm" was named as the Eclectic approach (see Dunning, 1981).

Previously, we mentioned that Coase (1937) inspired Hymer to incorporate the internalization concept into the study of international operations. Specifically, Coase in his 1937 article wrote that a firm in its domestic market may bypass the market outside the company and use prices within the firm in an effort to avoid excessive transaction costs which are charged in the market "outside the company". According to Rugman (1980), although Hymer "applied the theory of industrial organization and imperfect markets to explain the existence of the MNC, it was only with Buckley and Casson (1976) that internalization is applied not only in imperfect market of final products but also of secondary products, including technological artefacts.

According to Rugman (1981), the MNC is an efficient response to risks embedded in exporting and/or licensing, through an implementation of an internal market within the firm, making use of knowledge and technology advantages of the MNC over its foreign competition.

In the mid eighties, internalization advocates started using a set of tools of economic analysis (Williamson, 1985; Anderson and Gatignon, 1986). This Transaction Cost Economy (TCE), meant much more than a set of tools of analysis. During a period of approximately, Williamson had built an impressive theoretical model of approaching organizational issues. TCE was built around five principles:

1) The transaction is the unit of analysis
2) Any problem can be posed as a contracting problem
3) Transaction cost economies are realized by assigning transaction to governance structures
4) Implementing TCE mainly involves a comparative institutional assessment of discrete alternatives, and
5) Any attempt to deal seriously with the study of economic organization must come to terms with the combined ramifications of bounded rationality and opportunism in conjunction with a condition of asset specificity (Williamson, 1985, pp. 41-42).

An acceptance of Williamson's opportunistic human nature has given way to a harsh debate throughout the years, because trust, in the usual sense, had to be excluded from the model due to analysis unsuitability (Williamson, 1985). Anderson and Gatignon (1986) posed a model whereby entry mode degree of control led to long term efficiency. It is indeed efficiency at the core of the issue with TCE. Williamson when confronting strategy versus efficient, as alternative avenues to long term profitability, remarks that "students of economic organization are better advised to focus on more mundane issues of an economizing kind" (Williamson, 1991, pp. 76).

2.3. Foreign Investment Decision-making School

In the late sixties, a somewhat independent current of thought was developed by Aharoni (1966). It centers around management decision-making on foreign market entry decisions, and suggests that there are stages to be followed when going abroad, namely: licensing, exporting, foreign marketing facilities, foreign assembly and packaging, joint ventures and full scale production and marketing facilities). Not surprisingly, this very pragmatic research was based on case studies of the international operations of (Israeli) companies. Rooted in the behavioural science (Cyert and March, 1963), we are presented with five elements in the process of making the foreign investment decision, as follows:

1) We have the organization and the environment in which the decision takes place; then, we have the time dimension, and we are being taught that there is no specific point in time when the investment decision takes place; a third element is uncertainty, and it surprises no one to learn uncertainty creates anxiety and an urge to avoid such feeling of doubt and unreliability; a fourth element is goals of the decision makers, which presupposes a model of behaviour; and finally, there are constraints, that is, limitations to which managers are subjected, as a certain conditions under which such constraints change. Aharoni emphasizes that it is the first time decision to go abroad the crucial one, when the organization is about to gain experience in the process of making a foreign investment. Along the process there are initiating forces that ignite the process, and then at some time a decision to invest is taken, by somebody, but Aharoni concludes that it is practically impossible to find the specific when and who. Even more, additional investigations might reveal new facts and the original

decision might be changed. While highly revealing, Aharoni (1966) influence eventually waned within a few years, but his research remains an icon that parallels the contradictions of learning through business cases.

2.4. Life cycle of products and trade investment school

Another research that brought a long lasting influence is the Vernon model of international investment and international trade in the product cycle, which is an amalgam of the marketing concept of the life cycle of products and related investment and trade (Vernon, 1966). The product cycle takes as research unit the industry and the concept represents a familiar one to most managers which have gone throughout the whole of a product cycle. It starts with the new products, that is, the introduction phase of a process. Vernon points out that we must abandon the simplifying notion that knowledge is a universal free good, and introduce it as an independent variable in the decision to trade and invest. At a first stage there is flexibility in product design, inputs location and marketing communication. Newness brings a somewhat price-elastic demand for new products. When the product matures, there comes larger commitments in terms of design, inputs, technology, but production tends to remain domestic. If a decision to invest abroad becomes relevant, Vernon (1966) is of the opinion that facts support no "rational" model. Threat to status quo by domestic producers seems to count as a factor in the decision to invest abroad. As the products becomes a standardized one, the so called less developed countries may offer competitive advantage a production location. Vernon even speculates on the probable exports coming from less developed countries.

2.5. The Upsala Internationalization Stages School

In the mid seventies Swedish professors Johanson and Wiedersheim-Paul(1975) bring into scene the University of Upsala behaviourist school of thought. These scholars describe the internationalization of four Swedish firms: Sandvik, Atlas Copco, Facit and Volvo. A longitudinal approach is followed, with a description and analysis of international operations of these firms in 20 countries, during periods that span from 50 to more than 100 years. Based on observations (historical records and interviews) the researchers built detailed case stories and profiles of each of the four firms around the establishment of agents, sales subsidiaries, manufacturing subsidiaries and both sales and manufacturing subsidiaries. They built what was called an establishment chain, a sequential internationalization process consisting of: no regular export activities; export via independent representatives (agents); sales subsidiaries; and manufacturing facilities. But, Johanson and Wiedersheim-Paul (1975) mention that they do not expect the development always to follow the whole chain. The reasons for such bypass are twofold: first, that several markets are not large enough, and second, that it can be expected to be jumps in the sequence in the case of companies with extensive experience (e.g. in other foreign markets). Also, these authors advance the concept of psychic distance, which refers to factors that prevent or disturb the flow of information between the companies and the market. Examples of these factors are: differences of language, in culture, in political systems, in level of education, in level of economic development, etc. Also, it is expected that psychic distance be correlated (even strongly correlated).

The pioneer 1975 article by Johanson and Wiedersheim was followed by a formalization of the Upsala School model of internationalization by the professors Johanson and Vahlne (1977). This model focuses on the development of the individual firm, particularly on its gradual acquisition, integration, and use of knowledge about foreign markets and its operational mode. This should derive into an increasing commitment of the firm to foreign markets. The Upsala model is based on two main assumptions, namely, that lack o knowledge of foreign markets represents an serious obstacle to the development of international operations of the firm in question, then, a second assumption is that the necessary knowledge can be acquired. The Swedish teams of researchers recognized their debt to the work of Cyert and March (1963), mainly because these American academicians emphasized the importance of incrementality. Changes in the firm and its environment make evident new problems and opportunities, and because there are prefabricated solutions to these new problems, management evolves and learns in the process, bit by bit.

The feature that intuitively surprised many about the Swedish common sense model was its dynamic nature, which sets it apart from the advocates of internalization. With the Johanson and Vahlne (1977) model there is a continuous forward and backward flow of mutual influence between two "state of internationalization variables" (market knowledge and market commitment) and "change of the state of internationalization variables" (commitment decisions and current activities). The state variables then, are nothing but resources committed to foreign markets. These, in turn, create a change in perception of opportunities and risks, which feeds back into market knowledge (learning) and commitment.

The level of acceptance of this common sense approach endured and outlasted its creators, who in some way abandoned their model for lack of complexity. The Upsala School eventually "evolved" from behaviourist into networking. Johanson and Mattson (1988) advocated for research into the renewed impulse brought about by the relationship network, where firms serving foreign markets relied on their partners from "strategic alliances".

2.6. The Resource-Based School

What sets apart the RBV scholars is their coherence with the essence of what is taught at a Business School around the world. That is, RBV relies on firms being different in their assets, their bundle of resources, in Penrose words. Becoming a different economic being is at the heart of business strategy. Well, in the business contest managers aim at being different and better and profit from this very difference. The whole idea of the bundle of resources as potential for competitive difference was the merit of Wernerfelt (1984) seminal article on RBV. Simple as it sounds, resources and products are two sides of the same coin most products require the services of several resources and most resources can be used in several products. Wernerfelt mentions that it is looking at firms as resources endowment, we may come to certain type of assets like technological skills, which challenge the declining returns requisite of traditional economics factor analysis. Eventually, the non-financial linkages might produce advantages among multiproduct firms. It is all in the posing of the resource (input) perspective, instead of the product (output) perspective. Again, Wernerfelt (1984) mentions that by resource we may mean anything that could be thought of as a strength or weaknesses of a given firm, defined as those tangible or intangible assets tied semi permanently to the firm. Examples of resources are: brand names, in-house knowledge of technology, employment of skilled personnel, business contacts, efficient procedures, etc. It might be said that the rest is history, but as Wernerfelt (1995) point out, it took at least 5 more years for academics and managers to be influenced by the original 1984 paper.

Barney (1991) proposes four empirical indicators to measure the potential of firm resources to generate sustained competitive advantage, namely: value, rareness, inability o being duplicated or copied, and substitutability. Barney challenges two simplifying assumptions adopted by many strategy researchers: first, those firms within an industry (or firms within what they call a strategic group) are identical in terms of the strategically relevant resources they control, and second, that these resource heterogeneity, if and whenever, developed will be short lived. Barney (1991) proposes that a firm should be considered to have a competitive advantage whenever it is implementing a value creating strategy that at the time is not implemented by any of its current or potential competitors. Then, having a sustained competitive advantage, being implemented by a current or potential rival and these other firms should be unable to duplicate the implemented strategy and extract whatever benefits from it.

Eventually, Grant (1991) was to remark that organizational routines might be among the resources that are hard if not “impossible” to duplicate. Peteraf (1993) undertook a more formal analysis of competitive advantage elements, resulting in four cornerstones of such competitive advantage, namely: heterogeneity (producing monopoly or Ricardian rents), ex-post limits to competition (which allow to sustain rents), ex-ante limits to competition (which produce rents not offset by costs), and imperfect mobility (which sustained rents within the firm).

The debate continues in the methodological ground, where advocates of RBV theory have challenged OE theory rivals. Particularly relevant are the work of Conner and Prahalad (1996) and that of Combs and Ketchen, Jr. (1999) with “proof” that RBV renders better performance when managers capitalize on firm’s capabilities and endowments, instead but preventing "opportunism" as a threat to such performance, as advocated by OE theory.

RBV theory has incorporated knowledge and learning elements, including a tacit dimension (see Grant, 1991), and its advocated have call their approach Knowledge-Based Theory (KBT).

There is definitely thorough compatibly, and we will not discuss further. Only, we can mention that both RBV and KBT represent a potentially relevant approach to strategy decision-making, in general, and to internationalization theory, in particular.

2.7. On Vogue and Swings in Internationalization Theories

As mentioned by Hoskisson et al. (1999), the academic production evolves into a swing of pendulum vogue, as consequence of new quests for explanation concerning the internationalization of the firm, as one of strategically sensitive decisions.

One of such swings in the direction into internal or introspective search for understanding of the firm decision-making within the confines of such firm. The very first movement of strategic decision-making studies, based on case research, practitioner oriented feed from the internal questioning of strengths and weaknesses. These had a swing of the pendulum away from internal, into the industry organization studies. Caves (1971) was an intellectual heir of Hymer, unintentional founding father of the monopolistic advantages studies of MNCs, antecedent of the Industrial organization studies, produced valuable work on differentiation approaches of potential monopolists, including international monopolists. It should be noted that this Caves was director of the PhD thesis of Michael Porter, a widely known professor, consultant and entrepreneur, eventually the founding father of the Organizational Economics (OE) School, rival to Resource-Based View (RBV) School. As of today, it is difficult what school will eventually "succeed" in the preference of the academic world. But, these schools represent opposite swings of the pendulum. Porter (1985, 1990) remains a champion of business strategy practitioners, and his 5-forces model of competitive analysis and generic strategies set are widely known and used in the classroom and boardroom across borders, literally.

Both RBT and /KBT are interior oriented strategic management and their origin goes back to the writing of Penrose (1959, see also Rugman and Verbeke, 2002), one of the most profound strategic thinker, still misunderstood, like Hymer (1960, 1976, 1968).

3. Some observations on mexican research in internationalization theory

There is indeed some research work on Internationalization Theory in the Mexican context. Nevertheless, it should be remarked that work on larger firms deals with a microcosm of little pedagogical value. Research work like that of Salas-Porras (1998) relies on sources of doubtful validity, because when the Mexican researcher interviews Public Relation officers, the results will bear little resemblance to the decision-making world of CEOs and their management teams. A similar outcome results when we deal with unreliable (private and public) databases whose composition are difficult to ascertain, when they are available at all.

Sometimes, the creativity of the researcher might render CEOs and other top management members accessible. Such is the case of Carrillo-Rivera (2003) that accessed up to 400 managers through seminars, sponsored by a large Mexican university.

The fact remains that a large portion of internationalizing and internationalized firms in Mexico are foreign-based, so that the strategy decision-making involved must be acknowledge. This means that strategic issues are to be researched at the point of origin, that at the (foreign) corporate headquarters. This is an argument that acknowledges the importance of the study of foreign subsidiaries in Mexico to foreigners, including foreign politicians and foreign business communities. Then, where is the academic research on Mexican-firms' foreign subsidiaries are scarcely researched.

Although this work relies on research done mostly by American, English and European researchers, it is a fact that Mexican research on internationalization of the firm is scant, rare and subject to scrutiny as to academic rigor involved. We would have liked that Mexican researchers' names would have occurred more often but that was just the case.

4. Conclusions

Somewhat more than 50 years on academic research on internationalization of the firm, but an understanding starts to emerge and the debate is today clearer than at the turn of last millennium. On the one hand, a Resource-Based View/Theory in hand with Knowledge-Based Theory approaches centered on the development of competitive capabilities as means to carve (sustained or temporary) advantage in international markets, gaining rents unthinkable classical economics, due to a turbulent environment which prevents equilibrium, no matter how purists "turn their clothes". On the other hand, we have Organization Economics (OE), heirs of Industrial Economics (IE) in hand with Transaction Cost advocates that claim the legitimacy that bring to bear the intellectual umbrella of at least two former Nobel prize awardees, Coase (1937) and Williamson (1985), that promises the most efficient avenue to internationalization and an eventual return to equilibrium once opportunism is under control. We close this review with the observation that the debate goes on. Sometimes the emphasis is on the exogenous elements to the firm, and some other times, the emphasis shifts to the endogenous elements of the firm. What remains to be seen is whether we will see a synthesis of shools and for the moment being, it serves our interest to acknowledge the whole range of available options to analyse, understand and apply in both the academic and the managerial worlds.

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