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A DYNAMIC PROPOSAL

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INTERNATIONALISATION PROCESS AND FORMS OF MARKET PENETRATION: A DYNAMIC PROPOSAL

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The reality of international markets has undergone important transformations in the last two decades. The growing level of interrelationship existing among national economies, the prominent role acquired by more dynamic sources of competitive advantage, the obligatory use of more complex mechanisms of competition or the alterations occurring in the forms of organisation of business activities are some of the most outstanding changes. This is a broad and intensive mutation affecting the company and its environment. As a consequence, new criteria, approaches and instruments have to be applied to the analysis of those emerging realities, to gain a greater insight into their meaning.

Those alterations have had direct repercussions on the ways in which the company internationalisation process is presented. There are three most important changes to highlight:

- Firstly, the lead role acquired in international markets by small and medium-sized companies, which, through very different methods have extended their range of activity beyond national frontiers, showing that this possibility is not just reserved for multinational units.

- Secondly, the proliferation of new institutional formulas of international projection. The old predominance of the parent-subsidiary relationship which governed the internationalisation process in the fifties and sixties has given way to a wide variety of options, of new mixed and contractual formulas which make for a more agile, flexible display of competitive capacities in changing contexts - Davidson and McFetridge (1985) or McKiernan (1992)-.

- Finally, and in accord with the above-mentioned alterations, the internationalisation process has ceased to be seen as a lone adventure for the company, and is, more and more, a case of becoming part of a network of intercompany agreements which transcend frontiers- Turnbull and Valla (1986) or Forsgren (1989)-. The direct paths to international projection have been replaced by new methods of cooperation, so that the choice of partners, of the scope of agreements and contractual formulas have become key aspects in companies' international strategy.

The above-mentioned alterations are sufficiently important to promote a change in the way the internationalisation process is understood. It is no longer possible to associate such a process, exclusively, with operations of an investment nature- the setting up of subsidiaries-; nor to restrict it to formulas for active projection abroad. Instead, it must be interpreted, in a broad sense, as that process through which the company establishes its links, more or less stable, with international markets, in whatever direction, at whatever level, and under whatever formula they may be presented¹. Internationalisation begins at the moment when the overseas market becomes a compulsory reference point for the firm's strategic decisions: covering a wide band of possible activities ranging from active exporting to overseas investment and including all the intermediate mixed and contractual formulas².

Understood thus, internationalisation must be seen as a complex process, admitting of diverse institutional formulas, depending upon the level of commitment acquired by the company; formulas and levels of commitment which

¹ This meaning coincides with the one suggested by Welch and Luostarinen (1988), who associate internationalisation with the "process of the company's growing involvement in international operations"; and comment on the need to consider the two directions -inward and outward- of the relationship, page 36.

² The analysis of the internationalisation process must necessarily begin with formulas of exporting projection; since, more and more, the latter involve the commitment of company assets in foreign markets. A more lengthy development of this view can be found in Alonso (1993).

are likely to change with time, as the company establishes its presence on the foreign stage. This changing and ever-more complex reality has not always been adequately reflected in the existing doctrine of international business.

1.- THEORIES OF DIRECT INVESTMENT

1.1.- Basic approaches

Even when it cannot be said that there is a rounded theory on the internationalisation process, the main doctrinal contributions centre their explanation on factors related to the characteristics of companies and on imperfections of the markets in which they operate.

These are the factors mentioned in Hymer's interpretation (1976), upon which is based a large part of the most persuasive contributions on direct investment abroad. In its basic version, Hymer's hypothesis can be expressed as follows: the firm which moves abroad must have some type of advantage, of a quasi-monopolistic nature, to enable it to compete with local firms, who are supposedly more established and have a better knowledge of their respective markets. Such advantages may have diverse origins - technological, organisational or commercial-, but for them to give rise to direct investment, they must be specific to the investing company and easily transferable beyond national frontiers. They must also be of sufficient magnitude and durability to offset the competitive erosion of local firms,

The basis of direct overseas investment appears, in this case, related to the firm's ability to internalise and profit from certain imperfections in the market. Hymer centred his attention on those imperfections of a "structural" nature, extending the concept of entry barriers to an international context: the specific advantages of the multinational appear to be linked to the exercise of market

power and thus reveal the characteristics of a monopolistic or monopsonic advantage.

Nevertheless, as Dunning and Rugman (1985) noticed, such a condition is not necessary to explain the existence of multinationals: they can spring from "natural" market imperfections, that is, those related to the market's inability to carry out- or to do so efficiently- certain transactions³. It is on an analysis of this type of imperfection that the main developments subsequent to Hymer have been centred.

And, consequently, the two most recognised approaches give a leading role to the analysis of the transaction costs which the company incurs when it moves assets beyond national frontiers. In one case- the internalisation theory-, to build on them, and on locational costs, the explanation of the investing phenomenon; in the other - the eclectic approach-, to integrate them into a wider consideration of the decision to go international.

The first hypothesis- the internalisation theory- means extending to the international arena the enterprise contractual theory, the origin of which dates back to Coase (1937)⁴. The central idea of this approach is that the firm, as an organisational structure, is born to integrate under a hierarchical principle those transactions that the market carries out in an inefficient or costly way. Buckley and Casson (1976) observed that a large part of specific intermediate goods transactions, particularly intangible assets- knowhow, technology, managing and

³ Though the two types of imperfections may be related, the distinction is important: in the first case, the multinational, when market imperfections become endogenous, can strengthen the existing levels of inefficiency; in the second case, nonetheless, the firm tries to elude some limitations of the market, by seeking in organisation a more efficient alternative for certain transactions. See Casson (1987).

⁴ The application of this approach to the multinational was initially carried out by Buckley and Casson (1976), and later developed by such authors as Casson (1979, 1982, 1987), Buckley and Casson (1985), Caves (1982), Rugman (1981, 1986), Teece (1981 and 1985) or Hennart (1977, 1982, 1986) among others.

marketing ability-, showed these characteristics, so that they were inefficiently carried out through the market: thus the firm attempts to integrate these operations under the hierarchy of its organisation⁵. If these transactions were carried out beyond national frontiers the dynamic of internalisation described above would lead to the company's growing international expansion. The process will continue as long as the transaction costs which are avoided are higher than those deriving from the organisational integration of such transactions⁶

So, from the point of view of this theory, the internationalisation process is based on two fundamental axioms: "(1) Firms choose the least cost location for each activity they perform, and (2) firms grow by internalising markets up to the point where the benefits of further internalization are outweighed by the costs"⁷ This hypothesis was born with the idea of becoming a general theory of foreign investment; there is no aspect which may influence internationalisation- or affect the market structures or the characteristics of the firm- which cannot be evaluated from the viewpoint of location and/or transaction costs. So, most of the other hypotheses could be integrated within this interpretation -Rugman (1980)-. Nonetheless, that same generality is a drawback when we wish to give the theory an empirical content⁸. In fact, its greatest interpretative use is to be seen in the case of vertically integrated industries, which are technology and/or knowhow-intensive, and with strong demands for customization and pre-and post-sales services.

⁵ This is a question of operations with high transaction costs deriving from the difficulty of finding a suitable price, of defining the contractual commitments of the parties, of making sure they are carried out or evaluating the risk if they are not.

⁶ As Hennart (1986) points out: "Whether firms displace markets depends on their ability to reduce internal organization cost below market transaction costs", page 801.

⁷ Buckley (1988), pages 181 and 182.

⁸ Buckley (1988) is aware of these difficulties, so he suggests an indirect path, by means of partial hypotheses, to test the theory.

The second attempt to construct a general theory of the multinational company stems from a more pragmatic option: the one resulting from an aggregate of the different elements considered in the previously existing partial approaches⁹. This proposal, which is voluntarily integrating, has been described by its promoter, Dunning (1979) as an eclectic approach. Specifically, there are three factors deemed necessary to explain the ability and willingness of the company to become international:

- a) Firstly, the firm must have a specific advantage, generally linked to intangible assets, which, at least for a time is not available to local competitors.
- b) Assuming the above, the firm will have to decide whether to opt for internalising those advantages, by profiting from them in the new markets- through exports or investment-, or whether to cede them to other firms -already located in those markets- through a contract or licence.
- c) Given the above conditions, if the firm is to opt for an investment formula, it must be profitable to exploit those advantages along with some location factor belonging to the end delivery market, since, otherwise, it would opt for exporting instead of investment.

Thus, the eclectic approach brings together in just one proposal the firm's specific advantages, the advantages of internalisation and those stemming from the cost conditions of the receiving market¹⁰. This integration effort even when

⁹ Dunning (1979) sums it up thus: "The industrial organisation approach does not explain where the specific advantages of the company will be exploited, the location approach does not explain how foreign firms can compete with local firms in their own markets", page 273.

¹⁰ As Dunning (1988) mentions: "It is then the juxtaposition of the ownweship-specific advantages of firms contemplating foreign production, or an increase in foreign production, the propensity to internalise the cross-border markets for these, and the attractions of a foreign location for production which is the gist of

it may have inspired the applied work, has given rise to new conceptual problems, stemming from the debatable theoretical justification for the factor segregation carried out. Particularly debatable is the distinction between firm-specific advantages and advantages derived from internalisation: the process of generation and acquisition of the former can hardly be conceived of without considering the internalisation dynamic which causes them and integrates them in the heart of the firm¹¹. These imprecisions, along with their deliberate pragmatism, explain why the eclectic approach is considered by some, rather than as a rounded theory, as a paradigm -Cantwell (1988)- or, more critically, as a mere taxonomy of factors promoting foreign investment -Itaki (1991)-.

1.2.- Some limitations

Despite the undoubted capacity for suggestion of the two approaches we have referred to, there are factors which make it difficult to fit them in with the complex nature shown at present by internationalisation processes. There are three basic aspects to be stressed:

- Firstly, they are theories strongly biased towards explaining direct investment overseas, and devote less attention to specific questions of other alternative methods of international projection. Thus, subsequent developments are needed to deal with the diversity of formulas through which the internationalisation process is seen at the present time.

- Secondly, they are theories of a predominantly static nature: they investigate the reasons for investment, but say little about how this process is developed over

the eclectic paradigm of international production", page 5.

¹¹ This is an element which differentiates the two approaches mentioned. For the internalisation theory, considering these two factors in a differentiated way means double accounting -Buckley (1988), page 183-; whilst, on the contrary, the promoter of the eclectic theory considers such a distinction as not only useful but also logically right -Dunning (1988) page 3.

time. There is clear evidence, however, that a large part of the capacities required for internationalisation are acquired by the firm through a learning process, cumulative in nature, so that the time dimension has extraordinary importance. This had already been noticed some time ago by Horst (1972), and had been recently registered by Buckley (1988)¹².

- Finally, his insistence on the specific advantages of the firm and/or on the vertical integration of operations makes these theories particularly suitable for explaining the behaviour of large units, well established internationally, but says little about the formulas of cooperation between firms to which small and medium-sized firms often have recourse.

To sum up, we are dealing with static approaches which have as their favourite theme large-sized companies, well established in international markets. Thus, to study the sequence followed by small and medium-sized firms it is useful to consider the contribution made from a different tradition: the theory of the phases of development.

2. THE INTERNATIONALISATION PROCESS

2.1. The phases of development

The study of a series of European multinationals-particularly Nordic ones- led some authors, followers of the Uppsala school, to attribute to the internationalisation process a fundamentally evolutionary nature: the firm rises to higher levels of international commitment, after becoming established and

¹² This author, in his recent revision of the theory, concludes that the "introduction of dynamic elements is a matter of urgency" though recognising that it is "a difficult task", page 191.

accumulating experience in the previous stages¹³. Subsequently, this gradualist view was enriched by the analysis of the international experience of companies originating in other geographical areas and countries¹⁴.

This hypothesis finds its basis in a behavioral conception of the firm: to the latter is attributed the nature of an active agent, possessing imperfect information, drawing up strategies, in an uncertain environment on the basis of its own capacities and the possibilities offered by the medium it is operating in¹⁵. In these conditions, the internationalisation process adopts a gradual sequence, stemming from the effect that learning and the level of international commitment has in reducing the uncertainty with which the firm operates in foreign markets. The firm travels through stages of an increasing level of international commitment as it gradually acquires, assimilates and uses the knowledge on foreign markets and operations. As Welsh and Luostarinen (1988) point out: "The learning-by-doing process explains much in the evolutionary patterns of internationalisation revealed in research"¹⁶. The accumulated experience permits a more suitable perception of the opportunities and risks, by reducing the effects generated by the firm's

¹³ The first studies which reflect on this evolutionary sequence of internationalisation are those by Johanson and Wiedersheim-Paul (1975), Johanson and Vahlne (1977) and Luostarinen (1979).

¹⁴ Particularly, study has been made of American, European and Australian firms. See, among others, Bilkey and Tesar (1977), Welch and Wiedersheim-Paul (1980), Cavusgil (1980 and 1984), Piercy (1981), Denis and Depelteau (1985), Juul and Walters (1987) or Hornell and Vahlne (1982).

¹⁵ In line with the tradition developed by Cyert and March (1963) or Aharoni (1966).

¹⁶ Welch and Luostarinen (1988), page 166. Like Penrose (1959), two possible types of learning are distinguished: one of an objective nature, which is- or may be- easily codifiable and transferable; and the other of a more tacit and idiosyncratic nature, linked to experience, which can only be acquired through a process of practical learning. It is the latter which conditions the gradual sequence of the internationalisation process.

unfamiliarity with the conditions of its environment¹⁷

The sequence described has its reflection in the organisational field: the growing level of international commitment is seen in the institutional formulas through which the firm travels as it progresses in its accumulated experience. It begins by selling abroad through independent representatives before setting up a sales subsidiary, and it usually has its own marketing network and sales subsidiaries before deciding to install a production subsidiary¹⁸. In turn, these organisational forms are associated with dissimilar levels of international commitment and risk, owing to the different asset levels involved in each case. So the firm, to avoid uncertainty as much as possible, tries to move between neighbouring options in its level of international commitment, giving each of its decisions a preferentially incremental nature.

And while advancing in the level of international commitment, the type of operation through which the firm is projected abroad becomes more complex. At the beginning, activity is normally limited to merely having the product available for export; later on, this action is accompanied by the provision of commercial and technical services which broaden the definition of the good being offered, and, finally, there is the offer of complete systems and packages to deal with needs or solve problems - Luostarinen (1979). So the process brings more depth and diversity to the company's operational methods in the international field.

From the gradual nature of the process there also derives a consequence involving the choice of the preferred areas of geographical projection. In trying to avoid risks and uncertainty as much as possible, the firm will tend to project itself

¹⁷ As Johanson and Wierdersheim-Paul (1975) point out: "We also assume that the most important obstacles to internationalisation are lack of knowledge and resources. These obstacles are reduced through incremental decision-making and learning about foreign markets and operations", page 306.

¹⁸ As Johanson and Vahlne (1977) comment: "Sales subsidiaries are preceded in virtually all cases by selling via an agent; similarly, local production is generally preceded by sales subsidiaries", page 24.

initially towards those markets which it knows best, the nearest in geographical and cultural terms, that is, those from which it is least "psychologically distant". Under this latter heading a whole group of differentiating factors is grouped - language, educational levels, business habits, market climates, institutional frameworks or degrees of industrial development- which affect the levels of certainty with which one country's company operates in another¹⁹.

The prescriptions of this approach have their most notable exceptions in one of the three following cases. In the first place, when the firm has enough resources to lessen the relative evaluation of risk involved in the international commitment taken on. It is the case of a large company, for which a decision to go international supposes a smaller relative effort than for a firm of lesser size. Secondly, when the markets are highly stable, and/or homogeneous, which makes it easier for the firm to reduce the risk stemming from operating in the international environment. And, finally, when the company is strongly established in international markets, which enables it to put into the new projects the experience acquired in previous markets.

2.2. - Limitations of the approach

The theory of phases of development offers an interpretation of the process which is particularly useful for referring to the international experience of small and medium-sized firms; or for those who are at the early stages of the internationalisation process -Forsgren (1989)-. It is easier for the large firm or the highly internationalised one to omit the suggested gradualism; but it is not the same with one lacking international experience or with limited resources.

Otherwise, this approach provides several new aspects regarding preceding

¹⁹ Although the concept has precedents, the first to use it with regard to the dynamic of internationalisation was Wiedersheim-Paul (1972). See also Johanson and Wiedersheim-Paul (1975), page 307.

theories²⁰ There are three to be highlighted here: firstly, their insistence on the dynamic of the internationalisation process, not taken into consideration in the alternative proposals; secondly, the complete, integrated consideration of the different formulas - exporting, licence and investment- which a company has for entering markets, by presenting them as not strictly alternative options, but sequentially complementary ones; and, thirdly, the attention given to the role played by the perception of risks and opportunities in business decisions²¹. All these aspects are important bearing in mind the changes registered in the different ways of entry into foreign markets, and the proliferation of mixed formulas, of a contractual nature, used by companies in recent times.

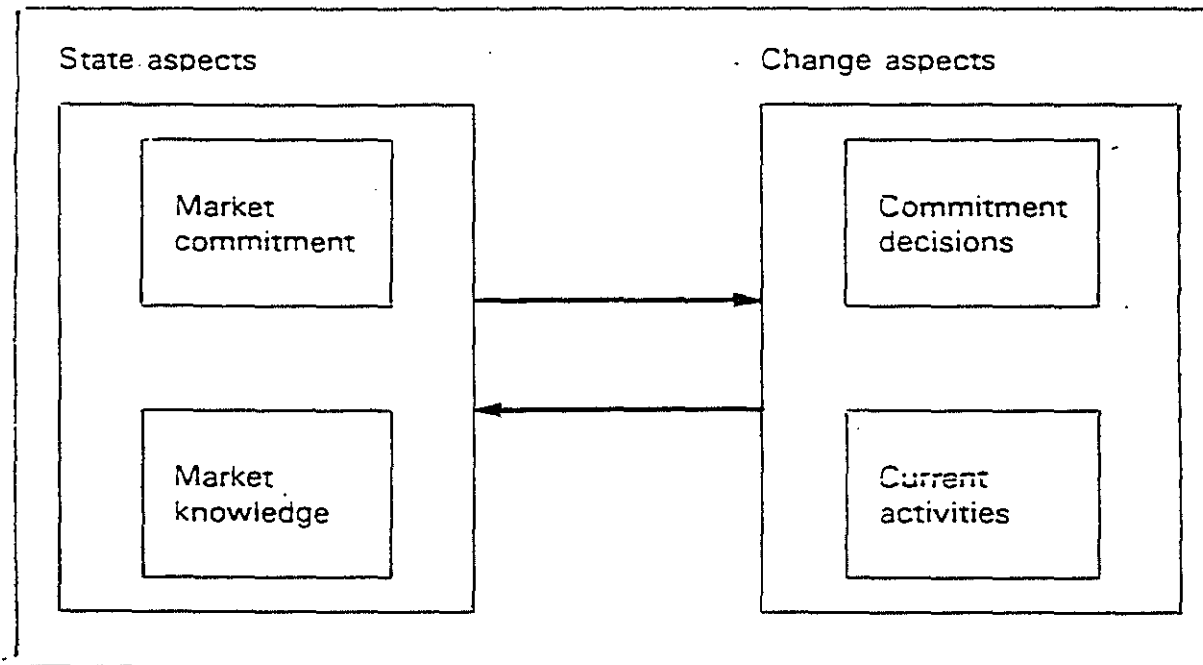
Now, having pointed out its contributions, reference must also be made to two of its deficiencies. The first one refers to the rather unclear nature of the proposed relationships, which hinders its transfer to operative variables. Johanson and Vahlne (1977) tried to clarify the model via a definition of the variables involved and the sense of the proposed causality. In this way, they made a distinction between state and change aspects of internationalisation. Among the former are accumulated knowledge of foreign operations and the commitment acquired with the market (measured by the volume and degree of irreversibility of the resources committed). Among the changing aspects are decisions adopted on the resources that they wish to commit abroad and the dynamic of current activities (graph 1). Thus, the levels of knowledge and commitment acquired in international markets affect company decisions and forms of behaviour; and these, in turn, influence the levels of knowledge and international commitment.

Despite this attempt at clarification, numerous theoretical problems persist in the

²⁰ A presentation of these aspects can be found in Johanson and Vahlne (1990) and Alonso (1993).

²¹ In the first two notes this approach coincides with Vernon's proposal about the product life cycle. But, in this latter case, the internationalising dynamic is made to rest on objective factors - the technological life of the product-, and not on the capacities and aptitudes of the firm's management.

GRAPH 1: THE INTERNATIONALISATION PROCESS



SOURCE: JOHANSON Y VAHLNE (1977)

model. In the first place, it was impossible to avoid a certain circularity in the proposal: the results of a cycle are constituted in inputs of the next cycle. The centre of the explanation is based on the bidirectional relationship postulated between the growing knowledge of the markets and the greater international commitment. Nonetheless, both variables are related to the resources displaced to those markets, so there remains a factor which to a certain extent is tautological in the proposal²². And, along with that there is still no revelation of the reasons to explain that a firm changes its level of international commitment or the preferred way of international projection. The evolutionary direction of the process is argued but there are no criteria to explain the transition from one phase to another.

Otherwise, a precise definition is lacking of the stages suggested, the object of a highly varied classification, according to the authors ²³. It also lacks an agreed procedure for estimating the level of the company's international commitment, linked in some cases with ways of penetrating markets- Johanson and Vahlne (1977), for example-, and in others with some expressive measurement of the business figures in overseas markets -Cavusgil (1984), for example-. Thus, there exists a capacity for suggestion in the model which exceeds the analytical precision with which it is constructed: It is the "deceptive allure of development models" which Stubbart (1992) observed²⁴.

The second limitation derives from its excessively linear view of the

²² See in this respect Andersen (1993). Perhaps the attempt to avoid this circularity is what makes Johanson and Vahlne reduce the explanatory variables to just one: the knowledge acquired by the firm, page 17.

²³ See, for example, the different proposition of Wiedersheim-Paul et al. (1978), Pavord y Bogart (1975), Cavusgil (1980) and (1984), Bilkey and Tesar (1977), Johanson and Wiedersheim-Paul (1975) or Czinkota (1982).

²⁴ To this characteristic another from its critics should be added: "In conclusion, it can be said that the stages theory has merit in its use as a framework for classification purposes rather than for an understanding of the internationalization process itself", Turnbull (1987), page 37.

internationalisation process, which is hardly compatible with the complexity of the present-day world and with the diversity of opinions faced by the company. In fact, when the prescriptions of the theory of development phases are taken to extremes, the proposed stages come to be seen as a sort of obligatory sequence, the best path along which the international life of the firm has to run. The theory thus creates its own normative derivations, and bases itself, in its simplest, most radical form on a deterministic proposal, in which there is hardly room for individual firm-specific elements, or for the contingent factors making up the environment. Both components turn out to be, nevertheless, of proven importance in determining company strategy -Reid (1983) and Turnbull (1987)-²⁵.

This determinism and the lack of a theoretical definition of the proposal have affected the ability to test it, and there is no unanimity about it. Despite the fact that the evidence largely points to the importance of the time sequence in the internationalisation process, there is no lack of critical comment on the sequence of stages- Turnbull (1987) or Ayal and Raben (1987)- or of the market's dynamic of choice proposed- Sullivan and Bauerschmidt (1990) or Papadopoulos and Denis (1988)-. The difficulty in transferring the model to operative variables and to clear causal relationships, the debatable link between proven relationships and the theory's prescriptions and the recourse to testing formulas which are not always adequate- based on the cross-section analysis of company samples- makes it difficult for the confirmatory results to be obtained free of error in order to validate the model²⁶.

Nevertheless, these criticisms do not totally invalidate the theory; instead, they express the reservations with which some of its applications should be regarded. In fact, Johanson and Vahlne (1990) insist that both the suggested stages and the

²⁵ It is the weight of these factors that justifies the presence in the markets both of opportunist behaviour, according to changing market conditions, and planned behaviour, attempting to forecast the trend in the environment. See Millington and Bayliss (1990).

²⁶ See, regarding this, Alonso (1993) or Andersen (1993)

psychological difference are mere manifestations of the model, indicators with which the latter attempts to become operative, and that other different patterns and indicators cannot be excluded²⁷. The warning is relevant, but it should not be ignored that a great deal of the confusion has been originated by the selfsame defenders of the model, in not separating their basic propositions from what are their possible applications. What is left of the proposal once we question the stages in which the suggested process materialises? or what effect does psychological proximity of the markets have when the sequence of geographical expansion breaks its supposed gradualism? If what one wishes is to rescue the model's capacity for suggestion it will have to be submitted to a necessary reconsideration: it will have to be presented from new bases, avoiding its original limitations and rigidities.

3- INNOVATING IN THE NETWORK

The suggested revision has to affect, at least, the existing concept on two complementary aspects: the factors governing the company's international dynamic and the nature of the markets on which the latter is projected.

3.1. Internationalisation as innovation

The flexibilisation process as suggested involves, in the first place, abandoning the supposedly obligatory character of the stages proposed. The present level of interpenetration and homogeneity of the markets makes it less necessary for the firm to have the slow build up of experience suggested by the theory. To a large

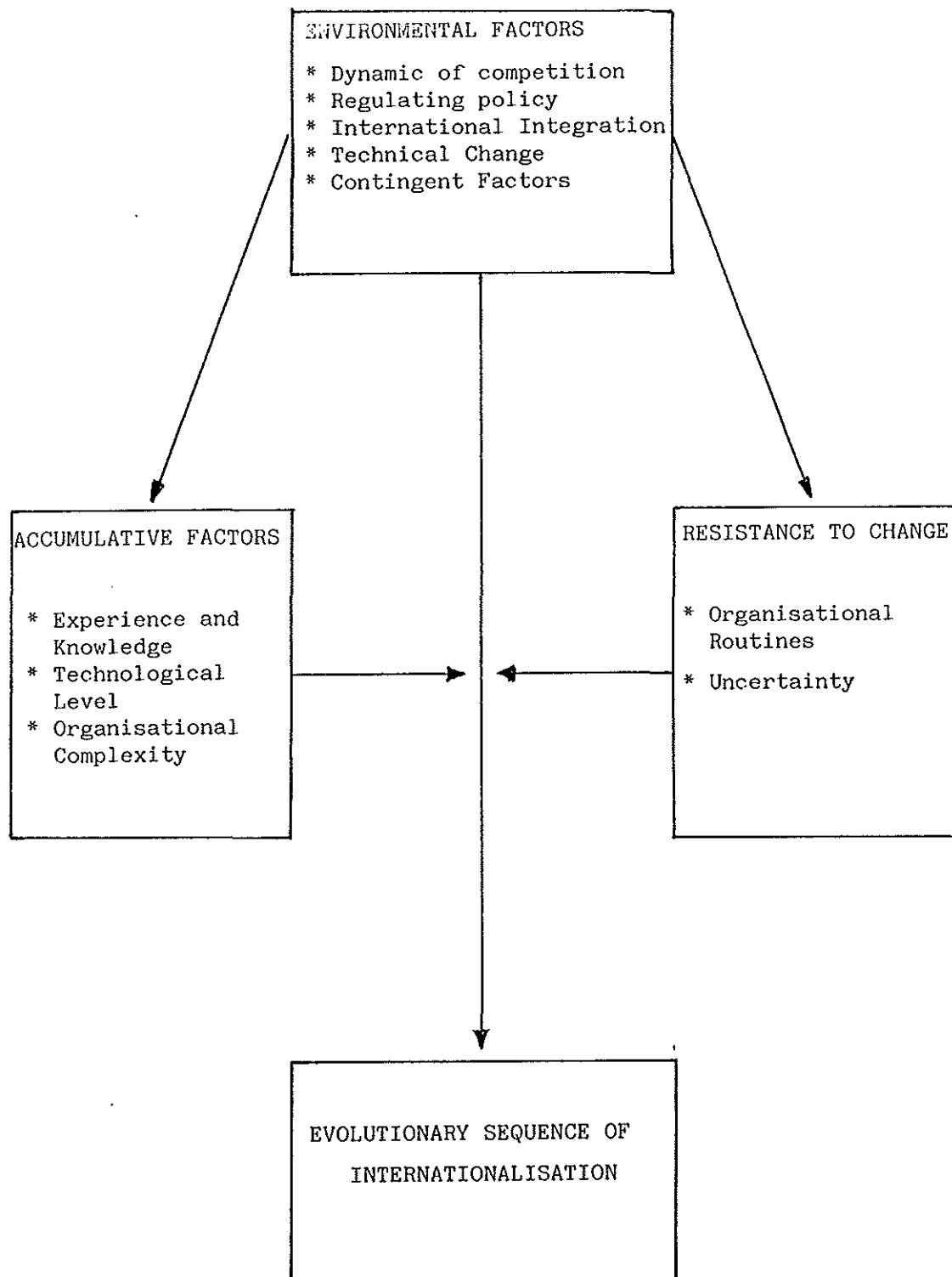
²⁷ Johanson and Vahlne (1990), page 13. As these same authors comment, referring to the determinism of the proposal: "This argument is quite plausible but should perhaps not be primarily an argument against the process model -unless it is directed at the manifestations of the model -but rather an argument for development and differentiation of the model", page 14.

extent the growing globalisation of markets is translated into a progressive reduction of the psychological distance, at least in the developed world. And, in a complementary fashion, the more dynamic climate of competition leads the firm to seek more immediate and flexible mechanisms for occupying the markets. This is a trend which particularly affects highly product-innovating industries, since it forces them to profit from their technological effort in the shortest possible time. Thus, new methods of foreign penetration are born, as a consequence of the development of innovating formulas of a mixed, contractual nature; while the sequence followed by the firm in its international projection becomes more flexible and shorter -Hedlund and Kverneland (1984), Young (1987), Lindqvist (1988) Nordström (1990) or Forsgren (1989).

Now, if there is a modification of the forms by which the internationalisation process is presented, there still remains, the logic of its gradual and basically irreversible sequence. It is led to that by the contradictory dynamic of the factors sustaining the process of company expansion. In fact, the cumulative dynamic followed by certain assets, on which the development of the firm is based- technological capacities or experience and level of business knowledge,- comes into conflict with forces resistant to change- organisational routines and risk perception- giving the resulting process its discrete sequence, of progression through successive stages of stability and change (graph 2). This process takes place in a changing environment, in which opportunities and risks emerge in a way which can only partially be forecast by the firm. Thus, in the firm's behaviour, factors subject to different dynamics have their influence, with a combination of cumulative sequence, chance and inertial resistance; all within a specific framework, governed by conditions of competition in the industry²⁸.

²⁸ The characteristics of the market condition the firm's internationalisation: the demands of the internationalisation process are not the same in a sector highly fragmented internationally, such as textiles, as in one which is highly oligopolised, such as the car industry. And these dissimilar characteristics influence the time sequence through which the international learning process of the firm develops.

GRAPH 2: FACTORS IN THE INTERNATIONALISATION PROCESS



This view makes internationalisation similar to the process followed by the firm in other areas of activity. The analogy which can be established with the process of generation and assimilation of technological capacities is particularly inspiring²⁹. In fact, increasing the level of international commitment means for the firm taking an innovatory decision, so it is not odd if both processes have some traits in common³⁰. Three are of special importance for what we wish to argue here.

- Firstly, in both cases we are dealing with creative decisions adopted in accordance with the conditions imposed by the market and with the possibilities, always restricted, of an organisation acting in uncertain conditions. Neither the development of technological capacities nor the increase in the international commitment are, in their essence, spontaneous processes: they need deliberate decisions. And they are decisions adopted in conditions of uncertainty: there is no complete knowledge of the results deriving from the chosen option. Consequently, as is underlined by the specialised studies, the attitude of the decision-makers have a central role in promoting the process.

- Secondly, and even when a deterministic approach is not accepted, it is necessary to recognise that in both processes factors intervene which are governed by a manifestly cumulative sequence. Since the two processes benefit from the time dynamic characteristic of learning processes: it will be easier for the firm to achieve growing levels of international commitment as it starts from higher internationalisation levels.

- And, thirdly, both processes are far from following both a determinist route -as could be derived from a simplifying view of its cumulative nature- and from a completely chance or uncertain one -which could be the result of the deliberate

²⁹ Alonso (1993)

³⁰ From a different viewpoint, this analogy had been explored by Simmonds and Smith (1968) and Lee and Brasch (1978), to determine the spontaneous or induced nature of exporting activity.

character of the supporting decisions-. The latter, with the degrees of freedom that may be desired, operate against a background of options conditioned by the past sequence followed by the firm. One could thus talk of a type of internationalising route along which the firm travels; a type of path which opens out in successive ramifications in time, with routes which are neither completely foreseeable nor absolutely random. Thus, the framework of options in each one of them is limited, in accordance with the accumulated experience and the previously travelled path.

From the whole of these traits perhaps a more complex view of the internationalisation process is obtained, in which the latter appears as an open path, though conditioned by previous experience. From a dynamic viewpoint, we are dealing with a process which is rather autogenous, since it is based on the capacities and strengths corresponding to the firm - in relation to the environment-; and predominantly irreversible, not so much because of the institutional formulas chosen in each case as because of the sequence of levels of international commitment which the latter involve.

3.2.- The market as a complex network

So far, the internationalisation process has been considered as a path which the firm takes alone, according to its assets and competing with rival agents. In this approach the revised theories, explicitly or implicitly, coincide: so, they insist on the firm's specific advantages, as the leading figure in the internationalisation process. Behind this concept is a highly mythical view of the market: the latter is conceived as an empty space, a sort of locus logico where independent agents interact and confront each other. Opposed to this image applied research has underlined the role that stable interfirm relations have in the development of competitive action. Networks of relationships, commitments and inter-firm agreements coexist in the market, and these are maintained in a markedly lasting manner beyond the time when a specific transaction takes place- Håkansson

(1982), Turnbull and Valla (1986) or Forsgren (1989)-. The reality of the market is more akin to a system of nets, linked at different levels, than an atomised space.

Admitting the presence of agreements and commitments between firms does not imply questioning the crowd dynamic of the market, but, rather, perhaps, changing its logic: confrontation is not produced so much between independent units as between networks of firms, between interrelated groups. In fact, in a market several subsystems compete, each of them made up of a group of firms linked through shared commitments. The same firm may belong circumstantially to more than one subsystem, but the latter differ radically among themselves in the basic nucleus of participating firms, and through the relationships and hierarchies established in their midst.

This image is in accord with the behaviour of the firm in the markets. In fact, for the development of their functions the firm establishes relationships with a broad group of independent agents: input suppliers, those providing technical assistance, advisers and experts, privileged customers and units collaborating in specific areas. The firm attempts to stabilise the framework of these basic relationships, with the aim of achieving the maximum certainty and conformity in its commitments. Stability will be even more necessary according to how specific, frequent and irreplaceable the transaction is. Some of them may become integrated in the firm's hierarchy; but many others will continue to be entrusted to independent agents. Now, this does not mean that the firm must build ex-novo the relationships with each new transaction; nor that its decision is limited to a sole parameter- an occasional price advantage from a supplier-, according to the naive view of the market suggested by economic theory. Rather, the firm tries to make a careful selection of its collaborators, taking into account, as well as price, other equally important aspects, such as quality, suitability and opportunity of the service, or the willingness, trust and understanding shown by the partner. Thus, loyalties and commitments are created between firms; and stable relationships are established, founded mainly on shared demands and confidence.

The formulas for company cooperation referred to are located in this huge space which exists between the free market and the organisational hierarchy - Jacquemin (1989). The agreements signed, however formal or informal they may be, allow the units involved greater independence and more equal relationships than those stemming from incorporating their relationships within a company unit; at the same time they provide the transactions with greater stability than could be obtained from their free contracting in the market, by avoiding, more efficiently, possible opportunist behaviour. Therefore, in a very generic fashion, a firm will seek formulas of cooperation when the transaction costs involved in the agreement are lower both than those deriving from setting up an integrated company - internalisation costs- and those stemming from leaving those transactions to the complete free will of the market.

The range of relationships of this type used by the firm in the markets is very wide. In some cases they are formalised relationships, on a contractual basis, while in others they are simple implicit agreements, verbal commitments or merely repeated routines; some are exclusively binding on agents, others, however, allow the parties broad margins of independence; in some cases it is an asymmetrical relationship, in others, however, a link between equals. And if the nature of the relationships is diverse, the importance acquired by the latter for the agents is also variable -depending on the quality and frequency of the transaction-; the type of link they offer -technological, commercial, legal or merely personal-, and the function of the firm concerned -financing, supplying, technology, marketing ...-. On the whole it is a complete network of hierarchical relationships into which the firm is integrated.

So, when a firm tries to enter a new market it has to set up the necessary network of commitments to establish its activity. Constructing this network is not, however, a simple task. The existing agreements are not immediately visible to a unit not connected to them. Experience is required to check the willingness of agents and the quality of their services. The more different and unknown the market, greater are the difficulties. The firm, consequently, sets up its network of

commitments gradually, as its experience and degree of establishment in the market increases. Through this sequential process of trial and error, the company selects its partners, the scope of its agreements and the contractual formulas which, in each case are needed. On the solidity and quality of this network to a great extent will depend the possibilities for action of the firm - Porter y Fuller (1988) or Jacquemin (1990)-.

The view of markets presented substantially modifies the concept of internationalisation. This can no longer be seen as a solitary path, but as the result of the firm's integration in a system of relationships extending beyond national frontiers. The big challenge for the firm is the successful building of the network of commitments which will best enable it to establish and reinforce its international presence. Thus it is recognised that a firm's competitive capacities do not just depend upon its assets, but also upon the type of relationships it is able to establish with its environment³¹. And, correspondingly, internationalisation is identified with a strategic management process of interdependences- Johanson and Vahlne (1990)-.

The function assigned to each of this network of agreements will crucially depend upon the firm's capacities and resources and the level of international integration shown by the market. It is reasonable to suppose that the fewer the assets, the greater will be the leading role acquired in its international strategy by the system of agreements which the firm establishes with its environment. And, meanwhile, the more internationalised are the networks which make up a market, the easier it will be to externalise part of its transactions, without the firm losing control of its intangible assets -Johanson and Mattsson (1988)-. On the contrary, the internalisation path will be based in a more autonomous way on its own assets as these are greater and the level of market integration is lower. The latter is the

³¹ As Perlmutter and Heenan remind us, quoting Thomas the biologist, "the survival of the best adapted does not mean that in nature teeth and claws prevail (...), it does not mean that only the strongest, wiliest or the most dominant are the winners. According to Thomas, the best adapted (the survivors) are those who cooperate with other living formulas", page 58.

framework to which, implicitly, the theories revised in the two previous sections refer- internalisation, the eclectic theory and the Uppsala proposal-³²

Concurring with the above, internationalisation acquires greater complexity: it involves not only an intraorganisational commitment, but also an interorganisational one; and it no longer, necessarily, follows a linear sequence, but a multiple, ramified one, with varied options of international presence being manifested. Specifically, different functions of the same firm can be implicated, each of them in a different formula of international commitment. Thus, for example, the same firm may keep its input suppliers in the domestic market, guarantee its technological supplies through its share in a mixed company abroad, have an international management contract and market its products by means of a piggyback system. The possibilities of combining institutional formulas in the same firm are multiple; just as the levels of international commitment which each one involves are different.

Nevertheless, the fact that the formulas for international commitment are varied does not mean that the firm does not have available a general strategy which gives coherence to the diverse options and commitments partially adopted. All of them are integrated in a broader project, which is what defines international strategy. But, the latter is not expressed in a sole institutional formula, but in a complex of integrated formulas, according to the systems of agreements the firm initiates. The evolutionary nature of the internationalisation process is maintained, and this is manifested not just in the sequence following the generation of its own capacities within the firm, but, also, in how dynamically the network of international relationships is displayed.

³² The case which most comfortably fits the Uppsala theory would be that of the firm which begins its internationalisation process in a market which is not very integrated internationally: an "early starter", in Johanson and Mattssons' (1988) terms. Moreover, the internalisation theory and the eclectic approach best express the case of a firm well established in an equally fragmented market: a "lonely international". There is, therefore, a lack of a further development of the internationalisation theory in integrated environments.

4.- AN APPLICATION OF TRANSACTION COSTS

4.1.- Previous assumptions

A balance sheet of what has been put forward so far reveals a situation which is largely unsatisfactory. We have a fruitful hypothesis of internationalisation -the theory of internalisation and/or the eclectic theory-, but predominantly static and restricted in the scope of its favourite field of attention; and, also, there exists a proposal with a dynamic content- the theory of development phases-, which rightly points out the role of experience in company decision-making, but lacks an adequate analytical structure to eliminate some of its original indeterminate areas. Both, however, project an excessively linear image of the internationalisation process: they do not consider either the complex range of options offered simultaneously in a firm, nor the interorganisational nature the process involves.

The present section starts from the need to find a theoretical space to recover the most fruitful aspects of the different interpretations commented on. More specifically, its aim is to contribute to the necessary construction of an approach from which to investigate the factors influencing the choice of ways of projecting the firm in foreign markets. The level at which the argument takes place is still highly abstract, but it enables some conclusions of interest to be obtained, by applying for this purpose, a dynamic version of the analysis of transaction costs.

Before taking our task any further one must warn that in no way are we claiming to hide the differences which may exist among the proposals referred to. Quite the contrary, it is recognised that such differences exist, both in the assumptions and in some of their respective prescriptions. Perhaps the most important discrepancy, in terms of what we are considering here, affects the concept one has of the firm. Both in the internalisation theory and the eclectic one it is recognised that the firm is an agent operating with awareness of the effects

deriving from its choice; it is, therefore, a rationalising agent which adopts a maximising form of behaviour, even when operating in conditions of slight uncertainty. On the contrary, in the case of the evolution theory, the firm is supposed to operate in an uncertain world, where it is unaware of the effect of its decisions, so an important role is reserved for the dynamic of choice and learning with regard to the medium. Undoubtedly, this different concept has marked implications in the makeup of the respective theories.

For the present essay a relatively admitted eclectic position will be adopted for the purpose: in the medium term the market ends up by penalising non-maximising behaviour³³. Thus, even if it is a simplification, it can be assumed that the firm will seek to maximise its performance- or minimise its costs- in an uncertain environment- maximisation subject to risk-; but, according to the theory of development phases, it is accepted that previous accumulated experience involves a reduction of the risk level with which such decisions are adopted.

The choice of transaction costs as the starting point is not arbitrary, if we bear in mind, firstly, that that theory offers a stimulating conceptual framework to explain the firm's organisation processes; and, secondly, it provides a theoretical field in which it is possible to have a dialogue - though not full agreement- among the different contributions mentioned.

In fact, the transition costs theory has provided a useful approach for the analysis of the criteria backing a particular form of the firm's overseas projection - Anderson and Gatignon (1986), Reid (1983), Klein (1989), Hennart (1989), Hill and Kim (1988) or Hill, Hwang and Kim (1990)-. Though the analysis has been maintained on a highly general plane, it offered a set of valuable propositions which

³³ In reality, this position, suggested by Williamson (1975), means a covert acceptance of the substantial rationality of agents. It is accepted that the rational way in which agents operate is purely procedural, but a principle is introduced in an intelligent way and with nuances, -the crowd-, which, finally, leads the former to act as if operating with completely rational criteria. See Brosseau (1993), page 20.

could be empirically tested. Generally, the works start by discriminating between different forms of overseas projection -preferably two- to discuss and, subsequently, estimate the factors leading the firm to decide between them. Thus, has been investigated the option between licence and subsidiary by Davidson and McFetridge (1985); between subsidiary and joint venture by Hennart (1988) or Kogut and Sinh (1988); or between integrated and independent commercial networks- Anderson and Cughlan (1987), Heide and John (1988), Klein (1989) or Klein, Frazier and Roth (1990)-.

Despite this effort, little advance has been made in the dynamic consideration of the problem: most of the above-mentioned works restrict themselves to a static application of transaction costs³⁴. The internationalisation process, however, requires a suitable theoretical framework to register the dynamic factors which constitute it. Such a purpose was to be found, as Buckley (1988) reminds us, in the origins of the internalisation theory, since with it an attempt was made to build a dynamic model of company growth. Nevertheless, in practice, that claim was forgotten, since the capacities that are the object of internalisation were considered as given, the problem was restricted to deciding the most efficient form of transaction for previously existing assets. In opposition to this concept, it is worth repeating that internationalisation is not just a way of exploiting an already existing advantage, but also -and, perhaps, rather-, a way to acquire an advantage, to create new resources and capacities in the firm³⁵. Therefore it is necessary to insist on a dynamic application of transaction costs. So, in fact, in time there is a change in the assets on which company expansion is based, just as, logically, there is a change in the costs related to a transaction as the firm becomes established and accumulates experience in a particular market.

It may be considered, for this essay's purposes, that the assets which the firm's

³⁴ An exception is, in this line, the work by Hill and Kim (1988).

³⁵ As Itaki (1991) mentions: "the internalization and integration generate an advantage and the advantage promotes further internalization and integration", page 448.

international action are based on are related in a generic way with some intangible resource, whether linked to production technology and/or marketing technology³⁶. The latter will be an important aspect when deciding between having independent or integrated channels of distribution overseas. The choice will depend upon the effect it may have for preserving and developing the indicated asset - which is related to the reputation of the brand or the corporate image, for example - to externalise commercial activities in the end market. Where the advantage is based on production technology, the firm faces the possibility of externalising the transactions related to those assets- by means of a licence- or of its integration in the firm's organisational hierarchy- through direct overseas investment-.

To progress in the analysis, in this case we will start from previous simplifying assumptions which may have been relaxed in subsequent developments. Basically they are the following:

- Firstly, in the internationalisation process there is involvement both of the advantages related to choice of the most efficient form of transaction - in its extreme version, internalisation vs externalisation-, and those deriving from the most suitable location of activities, and which basically affect production and transport costs³⁷. With the aim of avoiding the distortion that these latter factors may generate, there will only be a comparison of options in the same location conditions. And, therefore, exporting will be treated separately, on the one hand, with its different possible marketing channels; and licence and investment on the other, with its different levels of activity internalisation. In this way, productive conditions -factor costs and transport- are guaranteed to be similar between the options studied³⁸.

³⁶ It is common to consider, in an additional manner, a possible advantage in management technology. Here, however, that possibility will not be considered.

³⁷ Even when these are differentiated, location and transaction costs are related.

³⁸ See Hennart (1989).

- Secondly, in this version demand-related aspects will not be considered. That is, it will be supposed that consumers are indifferent to how the products reach the market. Thus they will not discriminate among imported products on the basis of the chosen distribution channel; and they will continue to show such behaviour whatever may be the origin of the producer firm's capital. Likewise, we will not take into account income deriving from the respective options, and which will change with the strategic possibilities which each of them will give the firm. The exclusion of this aspect is due to mere reasons of exposition, since it must be understood that the option finally taken by the firm has to be the result of simultaneous consideration not just of costs, but also of the profitability associated with each of the options³⁹.

- Finally, and bearing in mind how imperfect is the market for the transaction of intangible assets- technological, management or marketing ones-, the firm will attempt to find the channel which will allow it a greater guarantee for sustaining and developing its advantage. This will make it pursue the most complete forms of integration possible in international scenarios. A conclusion derived from the cumulative nature of assets- capacities and resources- on which the firm's international expansion is based: when an asset is cumulative the market is not the best medium for organising its transactions. The advantages of integrated formulas -including those of a strategic nature- are so high that open formulas will only be made use of when organisational costs are high -or when the integration capacity of the activities within the firm are low- and/or when market conditions involve a low risk for sustaining and promoting the advantage⁴⁰. In short, when

³⁹ And, therefore, the search for income associated with market power may be one of the aims justifying the option via more integrated formulas of international projection.

⁴⁰ This assumption is the opposite of the one normally used in analysing transaction costs. In general, it is usually considered that the firm will entrust its transactions to the market, except if transaction costs are very high. Nevertheless, it seems more realistic to start from the opposite principle: the firm will try to control the whole process, except when it is too costly. That is, faced with the conventional maxim that: "in the beginning was the market", we will start, on this occasion, from the alternative and equally debatable assumption: "in the beginning

internalisation costs are high and more than transaction costs.

This last assumption gives rise to a first proposition:

H1: In moving into international markets, the firm will seek to find the most integrated formulas allowed it by its resources and the market situation. And it will only resort to externalising part of its transactions when integration costs are high and the specific nature of its assets is low.

This hypothesis means admitting that when internalisation costs are reduced, firms prefer integrated formulas, even despite the low specific nature of their assets and, therefore, their reduced transaction costs. A different situation arises when internalisation costs are high, in which case only firms with highly specified assets -and, therefore, high transaction costs- will opt for integrated formulas⁴¹.

The state of the environment similarly conditions the perception of risk accompanying the externalisation of company activities. One should suppose that the denser the network of intercompany agreements in the market, the easier it will be for the firm to admit the externalisation of part of its activities. This gives rise to a new conclusion:

H2: The more internationally integrated the market and the denser and more structured the network of interfirm agreements in its midst, the greater will be the firm's propensity to use open forms of organisation in overseas markets. And, inversely, the more fragmented the market, the greater will be the recourse by the firm to integrated formulas of international presence.

To carry out the analysis, two extreme options were considered in each of the

was the organisation". For a reference to the arbitrary nature of the conventional assumption, see Williamson (1975), page 37. In the same line, see Krishna Erramilli and Rao (1993) and Gatignon and Anderson (1988).

⁴¹ This position coincides with that argued by Krisna Erramilli and Rao (1993).

chosen forms of international projection⁴². And, thus, if the firm chooses to maintain production in the domestic market, the relevant decision affects the degree of control it wishes to exercise over its marketing activities abroad. The two options considered will be: the use of outside ways or the firm's direct involvement in marketing activities. Furthermore, if it decides to produce in the end market, the two basic options will be: to transfer the advantage to another firm, via a licence, or to create its own subsidiary in the end market.

4.2. Basic development

When the firm decides the organisational form in which to attempt to project itself in the international market it faces two types of cost with an opposite sign. When choosing a formula integrated in the firm's hierarchy, it will avoid transaction costs related to free contracting of market exchanges; but, in return, it will incur different types of costs linked to the internalisation of these tasks.

Moreover, and in accordance with an accepted distinction, transaction costs may be of two types: those related to information seeking, choice of spokesmen and negotiating the terms of the contract- ex-ante costs-; and those related to the risks deriving from not fulfilling the contract - ex-post costs⁴³. The firm will attempt to integrate a particular operation in its organisational hierarchy as long as savings in transaction costs - ex-ante and post-ante- are higher than internalisation costs involved in this decision⁴⁴.

⁴² The necessary recourse to dichotomic forms of reasoning constitutes a limitation in the operative development of the transaction costs analysis. Nonetheless, given the tentative nature of this essay, this procedure will not be questioned. See Williamson (1985), page 203 or Heide and John (1988).

⁴³ See, among others, Hennart (1982) or Hill and Kim (1993).

⁴⁴ As Buckley (1990) points out, "the firm grows by replacing or creating adjacent markets in accordance with the positive balance between the benefits of internalisation and the costs deriving from the decision", page 660. See, also, Hill, Hwang and Kim (1990).

These decisions may be represented by a graph⁴⁵. As has been described, transaction costs are the result of the total negotiation costs, T_a , and costs related to the possible non-fulfilment of the contract, T_p :

$$TTC = T_a + T_p$$

Both aspects are, however, related.

In fact, the ex-post costs will depend on the likelihood of opportunist behaviour arising, affecting the firm's advantage - the "dissipation problem" which Rugman notes-. So,

$$T_p = p(v)$$

The shape of the curve will depend upon the nature of the assets on which the firm's advantage is founded, v . In turn, the likelihood of opportunist behaviour, p , will depend on the previous effort made in defining the contract, so that as T_a increases T_p must diminish. The shape of the curve T_p will be rising - the greater the likelihood, the greater the costs, though with reduced earnings, stating that the greater increases in losses are registered in the first margins of likelihood of opportunist behaviour (graph 3).

Moreover, ex-ante costs will have the shape of a negative-slope curve: as the costs involved in drawing up the contract grow, the likelihood of opportunist behaviour declines. Nevertheless, this aim is achieved with decreasing earnings: each time greater ex-ante costs are incurred to achieve reductions in the likelihood of opportunist behaviour. The curve is, therefore, asymptotic on the vertical axis: however much negotiation costs rise, they will never completely eliminate the likelihood of opportunist behaviour, given the conditions of uncertainty and limited rationality in which the firm operates.

⁴⁵ The form of presentation is based upon Hill and Kim (1993).

What is more, when the firm decides to internalise a particular activity, it incurs costs, which are the result of submitting the transaction to an organisational hierarchy. This occurs when a firm integrates under its organisation the tasks of distribution and marketing in the overseas market -its own networks-; or when it decides to create a subsidiary, instead of transferring the technological advantage through a patent to another firm. Thus, there will be internalisation costs, IC:

$$IC = CM + CTr + CC + CF$$

where CM are the costs of learning about the new market in which they are setting up; CTr the costs of transferring company knowhow, whether in the technological field, or the commercial; CC the costs of controlling the new activities integrated in the firm; and CF the flexibility costs deriving from the chosen option, which are in inverse relation to the reversibility or capacity for change, at low cost, of the investment made.

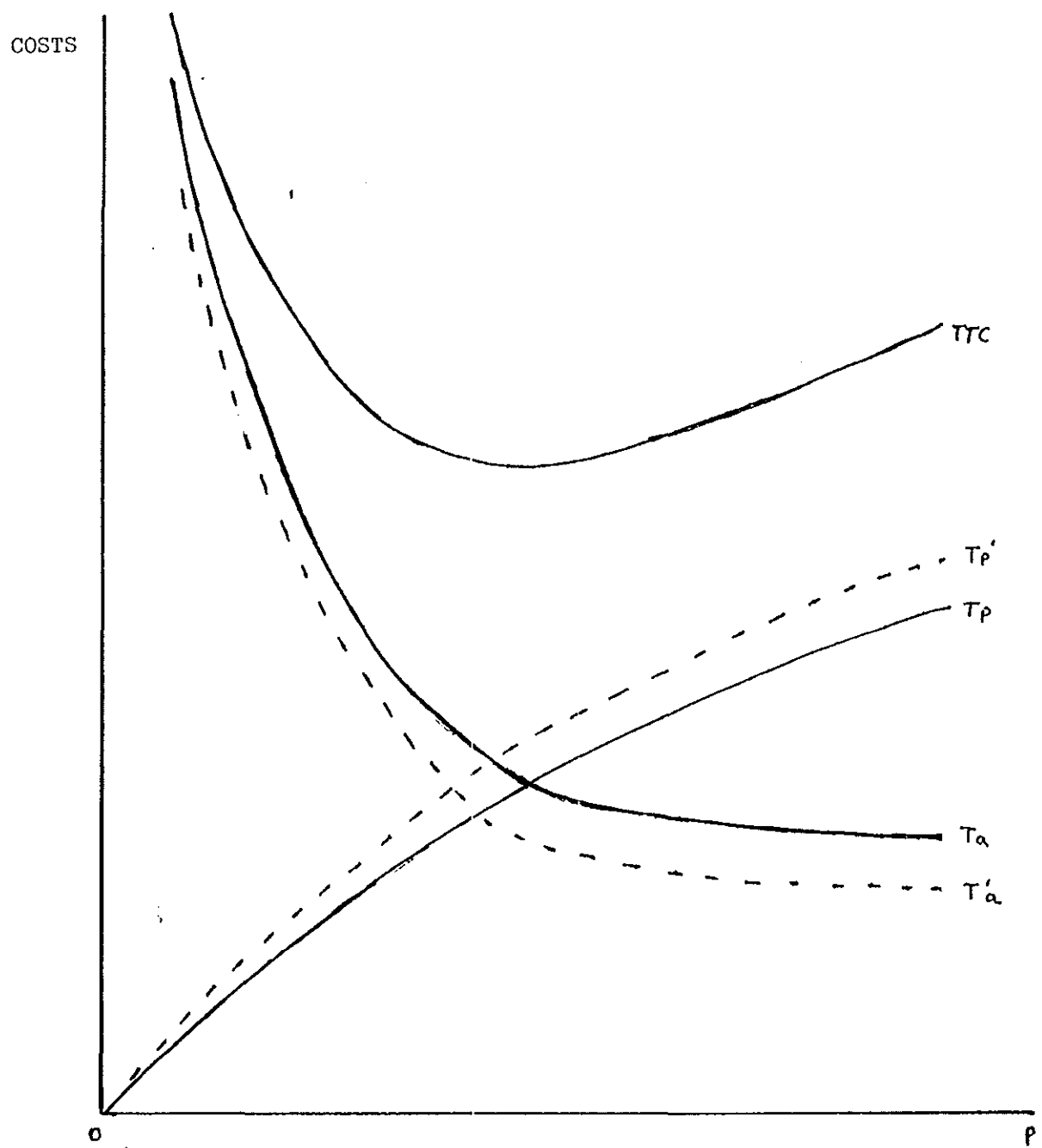
So, the firm will show a tendency to externalise part of its activities when:

$$Ta + Tp < CM + CTr + CC + CF$$

In evaluating these components, a possible difference arises between the advantage based on production technology and the one determining marketing technology, since control costs are higher in the latter case⁴⁶. In fact, the very nature of technological assets involves the firm in certain operational demands which it tries to profit from; the same thing does not apply with marketing assets, which to a great extent require systems of control less susceptible to being objective, and much more personalised, since they affect human relationships, messages and mean of communication. This means higher control costs and, in general, higher costs of internalisation. The firm which bases its advantages on a highly specific marketing asset may choose to take on these higher costs, with

⁴⁶ This is more carefully reasoned by Hill and Kim (1993).

GRAPH 3: TRANSACTION COSTS



the aim of guaranteeing durability and development of the transferred assets -brand, trade-mark, reputation, etc.-. However, if the asset is not highly specific, the costs of internalisation will act as a dissuasive element for the integration process.

So it is possible to draw an additional conclusion

H3: In equal conditions formulas with greater control will be used in a higher proportion when the firm's advantage is based on technological factors than when it is based on marketing-related assets. This means that use of more open control factors is more frequent in the move to export-based internationalisation than when it involves the movement of production capacity- based on technological resources- to the end market.

In determining negotiation costs, a key role belongs to management willingness in the face of risk. An increase in the capacity for risk acceptance gives rise to movement towards the curve's point of origin - T_a to T_a' :- which expresses that, to achieve a similar likelihood of opportunist behaviour, lower negotiation costs are needed. Likewise, in determining the T_p curve, as we have said, the nature of the assets in play in the transaction is crucial: the more exclusive are the assets, the more the curve is displaced upwards - T_p to T_p' -, to express the higher losses that could stem from opportunist behaviour.

From the above two additional conclusions can be drawn, related to the specific nature of the assets involved in the transaction.

H4: The transaction costs are higher when involving specific assets, products or processes, so, in those cases, methods of penetration allowing greater control will tend to be more efficient.

As far as knowledge is concerned, the exclusive nature of the assets seems linked to the difficulty involved in substituting, imitating or transferring them. Intangible, relatively immobile assets, such as skills, tacit awareness, organisational routines, management culture or reputation, among others, usually have these

characteristics. In general, idiosyncratic assets, generated through one's own experience and active life in the company, constitute the most difficult assets to externalise. And, to the extent that the firm's advantage is based on these factors, which are related to their organisational and learning capacities, the firm will try to opt for integrated formulas for international projection. On the contrary, when the firm bases its advantage on less specific knowledge, which is more public and transferable, it will be easier to choose more open control formulas, except when the integration costs are very low.

H5: Transaction costs increase when activities require assets in human relations form, since these are always more difficult to codify and transfer. So, in their relationships with the market, the firm which needs high technical skills in its staff, customization or highly intensive pre and post-sales services will opt for more integrated control formulas -Coughlan (1985)-.

In fact, in these cases, it may be difficult for the firm to set up objective control mechanisms in the international field; thus, they may choose subjective control formulas, linked to authority, by means of integrating transactions in the midst of the firm's organisational hierarchy.

Environmental conditions similarly influence transaction costs. And, therefore:

H6: Transaction costs are less when the level of knowledge of the market is higher and the degree of uncertainty related to negotiating the transaction is lower; so, open formulas will be more frequent in known, stable environments.

A particular way of reducing the risk is to choose the psychologically closest markets, that is, those most similar and best known. Psychological distance creates information costs and increases the agents' perception of risk and uncertainty. Thus, the previous hypothesis could be expressed in the following

way:

H7: Transaction costs are lower in the case of markets of high psychological proximity, so that, in this case, use of high control formulas is less necessary.

This last conclusion must, however, be related to another with the opposite effect, which points to higher integration costs deriving from performing in uncertain or changeable environments:

H8: Internalisation costs - particularly costs related to organisational flexibility - will be increased in unknown or uncertain environments, which will make it easier to choose, in those contexts, less integrated, more agile and flexible formulas.

The presence of the last two conclusions shows up the ambiguity produced by the environmental effect on business decisions. Thus, it may be supposed that the firm which has highly specific assets may attempt to opt for integrated formulas, whatever the degree of environmental uncertainty may be, except when internalisation costs are excessive. In fact, the firm will be able to avoid the most unstable markets, but if it decides to set up in them, it will do so through integrated formulas, to save its assets from the uncertainty of the environment. It will do the same when operating in known, stable environments, where internalisation costs are less. On the contrary, if the firm has a limited supply of specific assets, it may choose more open formulas in uncertain environments, with the purpose of reducing internalisation costs as much as possible; reserving the most integrated formulas for cases of known, stable environments, where organisational flexibility is less needed. The option is not clear, however, when the firm has an intermediate level of specific assets, since environmental uncertainty affects both transaction costs and internalisation costs.

This set of possibilities is not completely in accordance with the prescriptions

deriving from the theory of development phases, since it is not clear that, in all cases, a choice has to be made of integrated formulas, as the firm acquires international experience and there is a decrease in the uncertainty with which it operates in the market. Nevertheless, some possible discrepancies are the result of the partial and predominantly static nature of the treatment which has been given up to now, so it is worth continuing with the analysis.

4.3.- A dynamic view

For this we must bear in mind the dynamic possibilities of the model. This is because the selfsame components of transaction costs and internalisation costs change over time, though with different implications on the balances indicated.

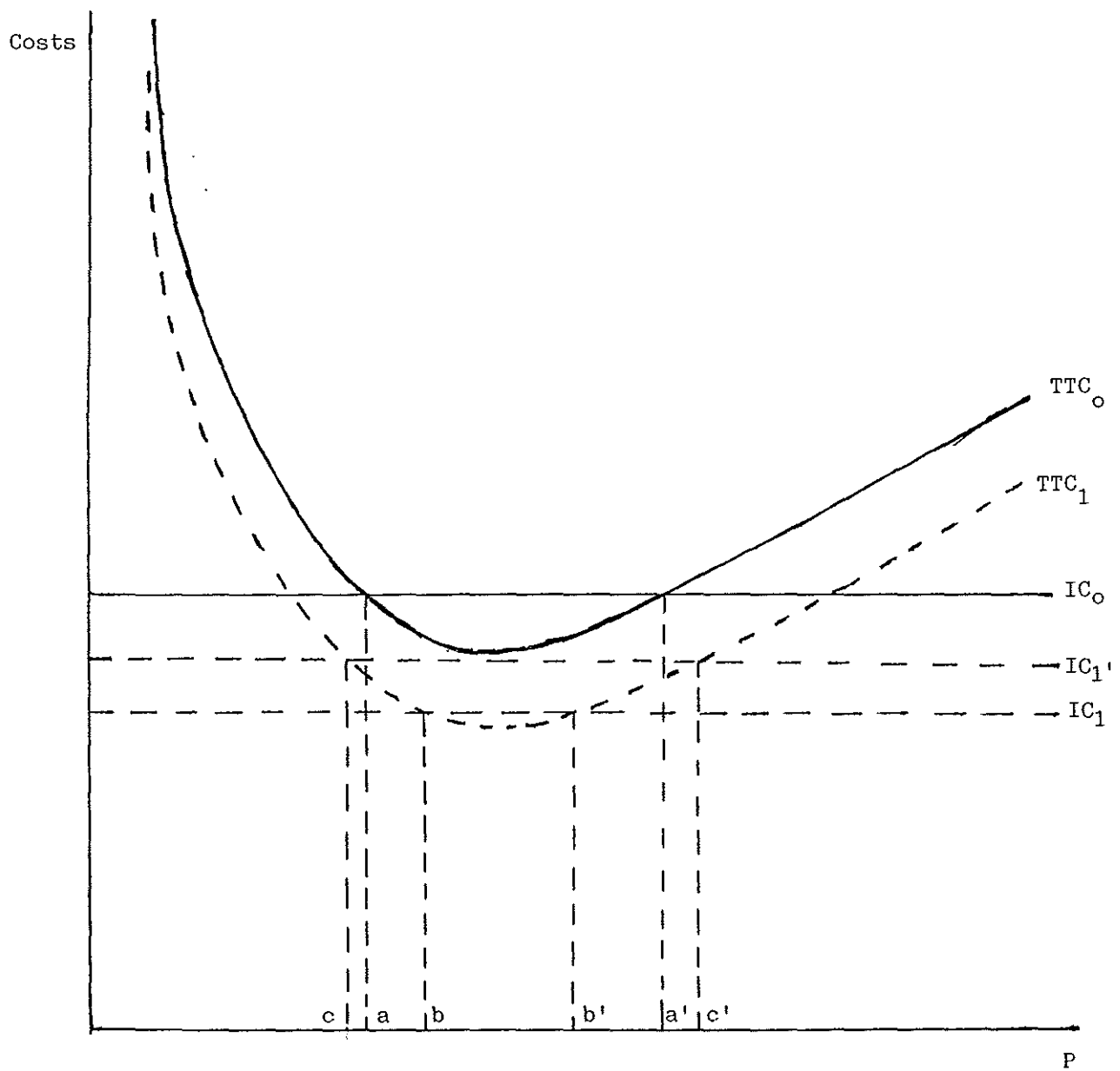
And therefore, in time, we will see:

- Firstly, and as has been pointed out, a reduction of the risk perceived by the firm as it increases its international experience in the end market. This means a displacement of the curve T_a towards the origin, as an expression of the reduced costs needed for negotiating agreements.

- And, secondly, a progressive reduction of costs related to internalising activities, since some of their components - familiarisation with the new environment or transfer costs-, albeit important in the early stages of the international project, will tend to have reduced significance as the firm becomes established in the new markets.

The resulting effect will crucially depend upon the rate at which these two factors evolve (graph 4). If internalisation costs are reduced at a greater rate than transaction costs, the firm will maintain its preference for integrated forms of international projection - TTC_0 to TTC_1 and IC_0 to IC_1 -. In the contrary case, the firm might consider the option of leaving these transactions to the market, via

GRAPH 4: TRANSACTION COSTS



a a' , b b' and c c' : neighbourhood of externalisation

licences or an agreement with outside marketing channels, due to the neighbourhood increasing of externalisation- IC_0 to IC_1 '-. That is to say:

$dTTC/dt > dIC/dt$: favours more integrated formulas

$dTTC/dt < dIC/dt$: favours more open formulas

Once more, the possibility arises of the increase in international experience and the consequent reduction of uncertainty levels leading to more open formulas of international penetration, contravening the prescriptions of the theory of development phases. It does not appear that this trend in time towards regression in the forms of international integration is frequent -Davidson (1982), Gatignon and Anderson (1988) or Erramilli (1991)-. To understand its exceptional character it is worth bearing in mind some additional dynamic factors.

The first refers to the fact that internalisation of activities itself is a source of new business assets, which it is expensive to break up by means of their reverting to the market. And, thus, for example, when a firm sets up its networks for marketing abroad, it promotes the development of new capacities, involving knowledge of the market, the image acquired, human capital generated in these tasks or the organisational and management routines developed. And the same thing happens when investing abroad: the very existence of the subsidiary finally creates new assets which make their subsequent externalisation costly. Expressed another way, decisions, once taken, tend to be confirmed over time; which, indirectly, points to the cost of an unsuitable decision. This trend is revealed as an upward displacement of the T_p curve, as an expression of the higher losses which would be generated from opportunist behaviour. This trend towards reinforcing internationalisation process will be even more noticeable to the extent that in time the assets on which the firm's international action is based become more accumulative. From these considerations an additional conclusion can be drawn:

H9: With all other conditions equal, it is easier for the firm to move towards growing levels of internalisation than to follow the opposite process; the

former will take place more easily in the case of the devaluation over time of the firm's assets and/or a reduction of market uncertainties.

This conclusion is in accord with the cumulative nature which international experience is supposed to have, a basic asset which the firm's overseas projection is based on. The market has the form of an imperfect medium for organising transactions involving this type of asset, cumulative and idiosyncratic in character; so the firm will attempt to capitalise internally on the promotion of those capacities, especially when they are important for competitive advantage. Setting up in the international market will require bearing in mind the cumulative and dynamic nature of management, technological and marketing capacities originating in the firm's own sequence of activity.

The second dynamic factor, already mentioned, refers to the deterioration caused by time to the firm's assets. In this case, it is convenient to distinguish, however, between technological assets and marketing-related ones.

a) Technological assets

Let us suppose that the firm bases its advantage on technological assets, so that it tries to decide between the option of externalising these assets in the new market, through the concession of a licence, or of keeping them integrated under the firm's organisational structure, through the creation of a subsidiary. The march of time will have an erosive effect on the firm's technological advantage, as new innovations are registered by rival units. This will be reflected in the falling trend of the T_p curve as we move on in time. Such a process opens up the possibility of the firm opting for less integrated internationalisation formulas. This gives rise to a new conclusion:

H10: The more mature the product or process technology, the less necessary it is for the firm to use forms of control to project itself towards international markets.

In fact, as technology becomes more public, explicit and mature, the easier it will be for the firm to find formulas for its transfer - by externalising the transaction-, either through a licence or by means of transferring its goods to physical form, through exports.

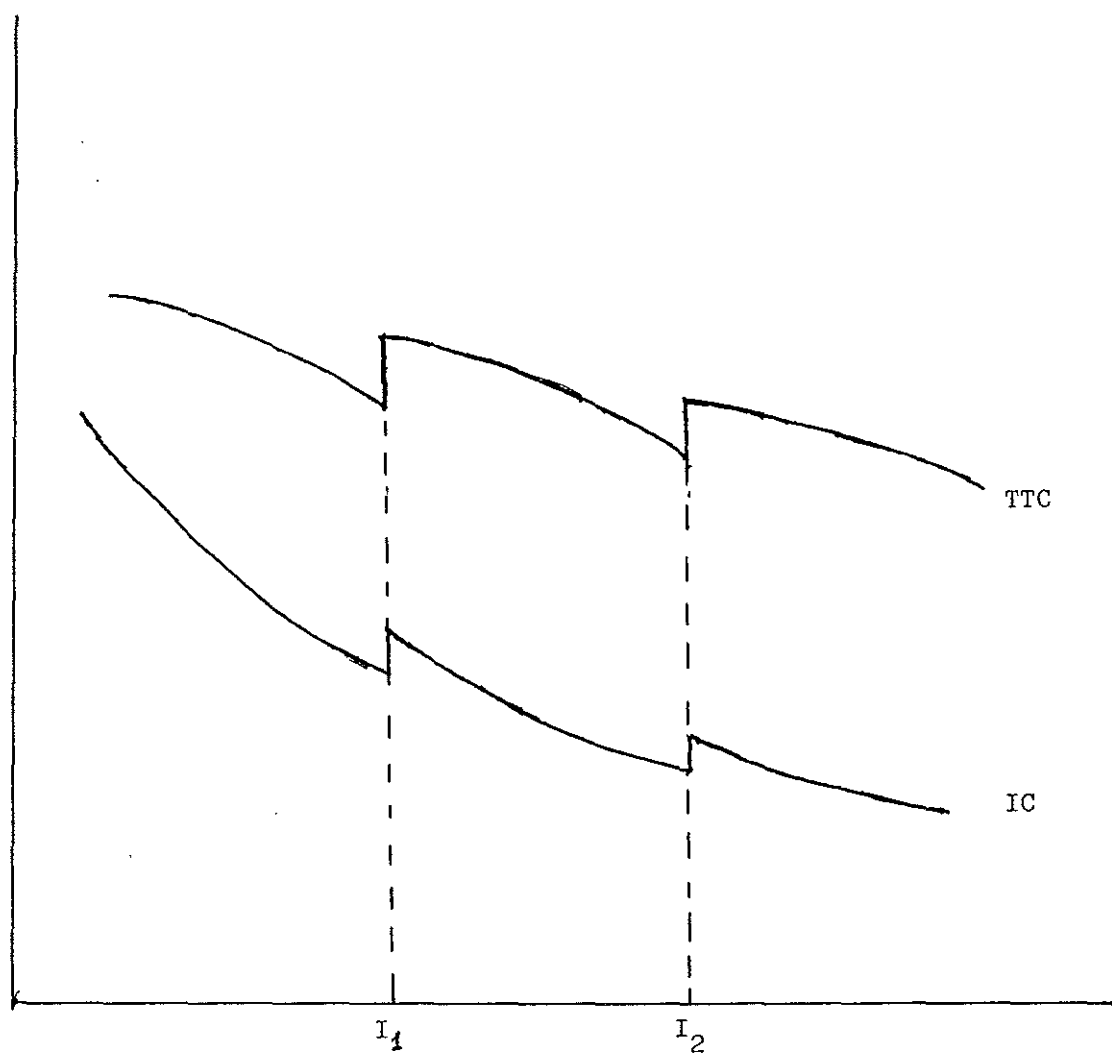
In terms of time it can be said that deterioration of technological advantage will be less when it is based on tacit knowledge, which is difficult to transfer or copy. Thus, the falling trend of transaction costs over time will be reduced. From which we can deduce:

H11: Penetration methods using greater control are more efficient for assets, products or processes which are not very structured or hardly understood; those based on tacit knowledge and difficult to codify or transfer.

Now, in face of the deterioration caused by time, the firm may initiate an active R&D program geared to renovating and broadening its technological assets. The promotion of new resources will have the opposite effect to the one mentioned above. The outcome will crucially depend on the firm's capacity for unleashing its technological resources, compared to the deterioration produced in them by dissemination mechanisms. Technological innovation will have the effect of increasing transaction costs, by interrupting their falling trend over time. And, in parallel fashion, these innovations raise internalisation costs derived from the process of adjustment to the new procedures generated -IC to IC'-.

Nonetheless, this latter effect has to be slight, since a large part of internalisation costs remain unchanged. So the innovation process is expected to have more effect on transaction than internalisation costs, favouring the transition towards greater control formulas (graph 5).

GRAPH 5: EVOLUTION OF TRANSACTION COSTS



I_1 y I_2 : Innovatory breakdowns

b) Marketing-related assets

If the advantage is based on marketing technology the asset deterioration will probably not take place at the same rate. Even more, it seems reasonable to assume that, as the firm's presence in the markets increases, the greater will be the firm's marketing assets, name and reputation in the market⁴⁷. This will raise the firm's transaction costs, by making its option of externalised formulas more difficult.

H12: With all other conditions being equal, the regression towards more open penetration formulas is produced more easily when the firm bases its advantage on technological assets than when doing so on marketing-related ones.

5. FINAL CONSIDERATIONS

The set of the different forces and trends considered here is, as has been seen, partially indeterminate. We do not mean by that that there is a lack of criteria for analysing the various options, rather that the factors influencing their determination have different signs, which forces us to a specific analysis, in each situation, of the firm and its environment.

To place the analysis in context, it must also be borne in mind that transaction costs are no more than one of the components intervening in the selection process of ways of penetrating international markets. An eclectic consideration of the factors to be borne in mind, stresses at least three more not considered in the previous exercise⁴⁸.

⁴⁷ Expressed another way, it is assumed that the firm's asset deterioration produced as a result of dissemination processes is greater in the case of technological assets than in marketing ones.

⁴⁸ See Hill, Hwang and Kim (1990). A more integrated approach to the strategic content in the different forms of penetration can be found in Kim and Hwang

- In the first place those costs not strictly related to the analysis of the transaction, and which, nevertheless, are important in determining the chosen formula for internationalisation. Such is the case of production costs or transport costs, which could be included under the generic title of location costs. The processes of international delocation and relocation of productive activities, in search of lower costs, indicates the importance of these components when deciding the firm's forms of international projection.

In second place, the chosen form of penetration will depend crucially upon the international strategy pursued by the firm. And, thus, it will be very difficult to opt for high control methods of penetration if, for instance, what is being pursued is a strategy of high market dispersion; and, inversely, it will be more difficult for the firm to externalise production or marketing activities in the end market if what it chooses is a strategy highly concentrated on markets and segments. In short, the choice of forms of market penetration is one part - and a basic part- of the firm's international strategy; and has to be in accordance with the aims pursued by such a strategy⁴⁹.

- And, thirdly, the forms of penetration depend upon the conditions and climate of competition of the market where the firm operates. Use by rival units of integrated formulas of penetration may force the firm to follow the same mode of behaviour, as an oligopolistic reaction -Knickerbocker (1973).

The option to be finally taken will be the result of the joint and simultaneous consideration of an aggregate of situational, strategic and cost variables.

The consideration of this set of factors confirms that the form of market entry is a complex problem, difficult to reduce to a limited set of variables, subject to a determinist option. The firm's experience, moreover, makes a purer study of the

(1992).

⁴⁹ See in this respect Alonso and Donoso (1993).

phenomenon more difficult since, as a large part of international literature has shown, few firms make a completely conscious, deliberate and rational choice of their options in international markets.

Finally, it must be underlined that the analysis which has been made here is still a very modest one: the options in play have been severely limited and notably restrictive starting assumptions have been applied. The hypotheses that are hinted at thus have no more than a merely heuristic value which they generate from the chosen analytical framework. Even then, their capacity for suggestion reveals the possibilities offered by an analysis such as the one made here.

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