Internationalization of Firms and of Markets – some Management Implications

By Lars-Gunnar Mattsson*)

Summary

Present and future development patterns in the firm's environment indicate that management of internationalization processes is of vital importance. Such processes involve long-term development of relationships to other firms. Management thinking and management systems must include also investments in such intangible assets.

The network approach suggested in this article could be a helpful management tool for such a reorientation.

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large number of firms for which this descpription is valid. Even if internationalization of markets and of firms hardly is a new phenomen there seems to be some new aspects of both real world development and theoretical treatment of internationalization that might make this article worthwhile to write and, hopefully, to read. Among the most important aspects of the real-world development are increased protectionism in various forms, changes in the relative importance of different economic regions and industries, faster pace in technical development, relativt decrease in home country manufacturing value added for many multinational corporations, increasing importance for internationally active firms in most markets. As to the theoretical treatment of internationalization I refer, selfishly, to the development by Swedish researchers of a network approach to the study of markets that seems to be potentially useful for the analysis of internationalization of firms in internationalized markets.
First, I will briefly describe a network approach and how internationalization of markets and of firms can be interpreted according to this approach. Then I will briefly comment on the real-world developments mentioned above and discuss how they influence the resource-dependency patterns for the firms. Finally, some management implications will be suggested.

Markets as Networks – A Resource Dependency Perspective[1)]

The market is regarded as a network of relationships between firms. Individual firms perform activities, using both their own resources and

1) This part of the paper is mostly based on Johanson, J. & Mattsson, L-G, "Internationalization in Industrial Systems – A Network Approach". Paper presented at the Prince Bertil Symposium on Strategics in Global Competition, Stockholm School of Economics, November 7–9, 1984. It will be published in N. Hood & J-E. Vahlne (eds), Strategies in Global Competition, J. Wiley & Sons (forthcoming). Other references are Hägg, I. & Johanson, J. (red.) *Företag i nätverk*, SNS, Stockholm, 1982 and Hammarkvist, K-O, Håkansson, H. & Mattsson, L-G, *Marknadsföring för konkurrenskraft*, Liber, Malmö, 1982.

other firms' resources. Since each firm's activities takes place in a context where other firms perform complementary activities there is a need for coordination between the firms. In the traditional market model this coordinaton takes place through the price mechanism. In a planned economy, coordination takes place through a central plan. In a network, coordination takes place through the relationships that firms develop to each other. Firms interact and develop bonds to each other of various kinds (such as technical, social, legal, etc.). It takes time and efforts to develop relationships. These relationships can be regarded as assets both for the handling of short term revenue-generating activities and for the firm's long term commercial and technical development. Thus the particular network approach that is used here has a resource-depedence perspective. The individual firm is dependent on external resources for its survival, adjustment and development. The basic task of management is to acquire, develop and organize the firm's internal resources and to devise strategies and organizational systems to get access, through interaction, to external resources that are controlled by suppliers, distributors, users, competitors, etc.

The internationalization of a firm can be described in three dimensions: 1) *international extension* (i.e. the number of foreign markets that the firm's activities relate to), 2) *international penetration* (i.e. the size of the firm's resource commitments in foreign markets, e.g. investments in sales or manufacturing subsidiaries, in cooperative ventures or in commercial relationships to other firms), 3) *international integration* (i.e. the degree to which the firm coordinates its activities and resources between different countries). Thus the firm is more internationalized 1) the higher the number of countries it relates to through export or direct investments, 2) the higher the proportion of its resources that are located in other markets than the home market and 3) the more it coordinates its activities between different countries rather than treats each market as a separate entity.

The internationalization of the markets can then be described as the increases in interdependence between national markets created by all the firms' international extension, penetration and integration. In a highly internationalized market, the individual firm is related to other firms that are highly internationalized. The initial conditions as to the degree of internationalization of the firm and of the market is here assumed to be an important determinant of further internationalization moves by the firm. It is for instance a different situation for a firm who extends internationally in a highly international market if the firm itself is highly internationalized or not. We can call the former case "International Among Others" and the latter case "Late Starter". For the "International Among Others" it is possible to build on both internal and external resorces in many countries and the move to still another country is a rather marginal change while for the "Late Starter" the change is more substantial and it cannot build on already established relationships in the international markets to the same extent.

Some Real-World Developments

Protectionism is related to restrictions on the free flow of goods, services, capital and knowledge. Activities performed outside a specific country are discriminated against. Barriers to trade are created or upheld. To be able to sell a product a firm might have to manufacture inside the country or at least to have a "local content". The seller might have to accept payment in goods rather than money. Protectionism can be coupled to industrial policies, aiming at technology import and development of a domestic industry. Foreign firms that adjust to protectionism usually have to design rather complex structures to handle the relationships including local manufacturing, local sourcing, technology transfer, joint ventures and counter trade.

Changes in importance of different economic regions and industries influence the localization of growth and decline of economic activities. This means that the relative importance of some network relationships change. If e.g., as has been true for many Swedish firms, growing economic regions and industries do not belong to those parts of the network where Swedish firms traditionally have strong relationships and important resource commitments, there is an urgent need to develop new relationships. The efforts to extend and to penetrate in South-East Asia and in new technological fields are examples of such adjustments of an investment nature.

Another example is that the stagnation of certain industries and regions means that demand for capital goods declines but that new opportunities arise to sell products, supplies and services that make present installations more effective.

Faster pace in technological development means that the individual firm finds that its products and processes are becoming obsolete faster, that the technological inputs come from many different industries and that the individual firm must relate to many new and "different" suppliers. The faster rate of change also means that the resources for diffusion of new products and processes become more crucial. A specific new product or process must diffuse quicker if the seller shall be able to get a sufficient return on his R&D investment before the next "generation" arrives.

The relative decrease in value added by manufacturing at home as a share of the end-user's price for products sold by multinational firms has several causes. First, many multinational firms have increased their manufacturing investments abroad more than at home. Second, there has been an increase in the productivity of manufacturing. Third, there has been an increase in "local content" requirements by local customers or local governments. Fourth, manufacturing firms have, for several reasons, developed various types of systems selling strategies which by definition means that they extend their offer to include components manufactured by other firms and increased the software content of their sales volume. Fifth, there is a general tendency that distribution and service activities become relatively more important when firms sell on more "distant" markets, when "after-sales" activities grow in importance, when the cost of capital to carry inventories increases, when sellers try to reach out to a larger number of buyers by using distributors and, by definition, when manufacturing becomes more efficient.

This tendency is important because it means that the internationally active manufacturer becomes more dependent on other manufacturing firms as sub-suppliers or as complementary members of systems selling consortia. The manufacturer will also become more dependent on other firms specializing in distribution and services, and has to develop its own resources for distribution and services.

The final tendency I would like to comment on is the *increasing internationalization of the firm's markets.* This creates interdependencies between the firm's activities on different national markets. Major competitors, suppliers and sometimes also major customers, are internationally active. Extension, penetration and integration of a firm must then be analysed in a wider context than that firm's relations to each of the separate markets.

Changes in the Resource-Dependency Patterns

In the outline of a network approach presented above, I stressed the firm's dependence on external resources to which the firm gets access through exchange activities within relationships between firms. These external resources are not available on any "open market". Internal resources of both a tangible and intangible nature are used for these exchange activities. In figure 1, I show the structure of such relationships in the dimensions "international/external" and "distance from home market".

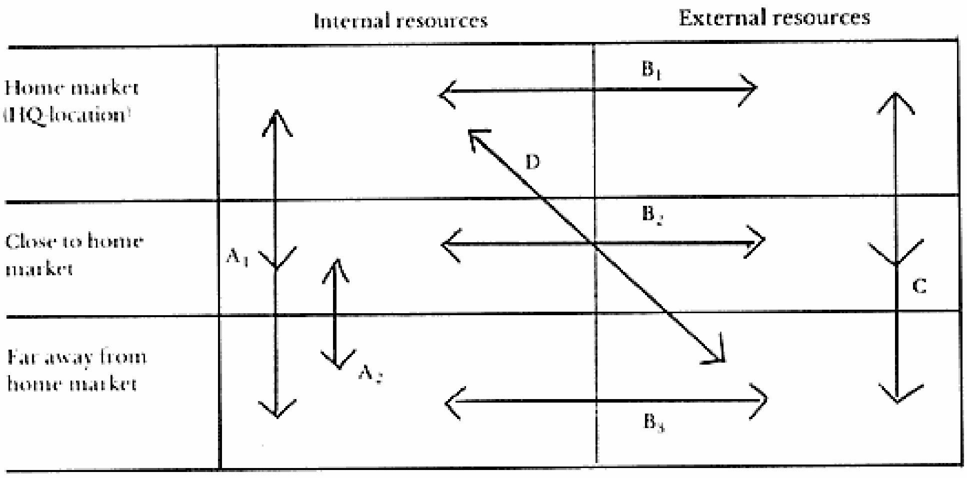

Figure 1. Different types of relationships to handle resource inter-dependencies.

The more internationalized a firm becomes the more it develops its internal resources abroad and the farther out it reaches. (A_1-arrow). On each market it has to establish relationships with external resources, symbolized by the B_i-arrows. The more internationalized the markets become the more important will be the external interdependencies across national boundaries, i.e. the C-arrow. To handle this internationalization of the market, the firm has to develop relations both to handle lateral coordination between foreign markets (A_2-arrow) and relationships between internal resources at HQ and external resources on foreign markets (D-arrow).

The real-world tendencies listed above seem to indicate a growing importance to develop and use internal resources far away, and external resources on foreign markets both through exchange with internal resources on the same market and internal resources at the HQ-location.

There is also another dimension of the resources that seems to be important to discuss, i.e. the functional use of the resources. Figure 2 is used to illustrate this.

	Manufacturing		R&D		Marketing/ Distribution	
	Internal	External	Internal	Extrernal	Internal	External
Home market						
Foreign market						

Figure 2. Resources used by internationally active firms; location, function and internal/external.

All the resources in fig. 2 are used by highly internationalized firms, but when the international competitiveness of a firm or of an industry of a specific national origin is analyzed there seems often to be a (too) strong emphasis on internal manufacturing resources at home, international R&D at home and internal marketing/distribution abroad. The real-world tendencies suggest that all the 12 types of resources are important and that especially external manufacturing resources, external R&D resources on foreign markets and external marketing/distribution resources on foreign markets are of increasing importance.

It is interesting to note that in the general economic debate of the competitiveness of Swedish industry, one is mainly pre-occupied by comparisons between countries of cost to use manufacturing and R&D resources in the home market. For highly internationalized firms that is a much too narrow view of which resources influence a firm's ability to compete successfully.

If we combine the analyses related to figure 1 and figure 2 we arrive at the conclusion that access to external resources of a non-manufacturing type on foreign, often "far away" markets, are of increasing importance. To develop and handle this external resource structure, the firm has to develop its internal resources both at headquarters (at home) and in the foreign markets. This internal resource development is necessary since the external resources become available through exchange within relationships.

Some Management Implications

Relationships in networks take time and effort to develop. They imply commitment of resources and are themselves a kind of asset for the firms that share the relationship. Thus it follows from the network approach that relationship-building activities are of an investment nature. In a more internationalized world that is characterized by tendencies that I discussed above, it is evident that strategies and control systems must take these activities more into consideration. However, both planning and control systems usually neglect the investment nature of marketing (and purchasing) activities. Manufacturing cost analysis is usually much more developed than distribution costs analysis.

Since the relationships on foreign markets become relatively more important from a long-term development point of view, it is important to organize the firm in such a way that the opportunities offered by exchange with foreign customers, suppliers etc. can be used in the development activities linked to headquarters. Especially if the firm reaches its market through distributors, the distance between the

foreign user and the firm's center for development will be too long if the firm does not make specific arrangements.
Another implication is that purchasing activities are as important as selling activities. A relationship is built by two parties and the decline in the relative importance of the firm's own manufacturing value added implies that the competetive strength of the firm to a large extent depends on its skill in developing relationships to suppliers of products and services. It follows then that import is equally important as export if we want to understand the basis for a firm's development in an increasingly international world.
The above mentioned implications are often not easy to accept by managers at headquarters. They do not want to be so dependent on other firms, they do not want to regard marketing and distribution activities as investment activities, they want the center of action to be at headquarters. If it is a manufacturing firm, they would like to see the manufacturing efficiency and R&D innovativeness as the major bases for the firms future success. It is difficult to accept that services, distribution systems, sales of spare parts and supplies etc. might be the major sources of revenue. It is also often difficult, when short-term profit and short-term return on capital are endangered, to allow activities aimed at a long-term build-up of network relationships.
In an internationalized world, the traditional economic theories based on comparative analyses of resource structures in different countries will become less valid. The internationalized firms will use resources on many markets and they get access to these resources to a large extent through specific relationships to other firms rather than at a price on production factor markets.
This leaves managers with an increasingly important task: to develop and implement strategies for control of external resources. Since this control is achieved through interaction, the firm must develop and use internal resources as well. This will require important investments, much of it of an intangible nature.
The need to communicate across long cultural distances will increase, as the A- and D-arrows in figure 1 symbolize. Especially the relation between internal resources at home and important external resources "far away" will become of crucial importance and require that headquarter mangers have sufficient international experience and an international attitude.

It is my opinion that the major research efforts in the area of management of increasingly international firms in increasingly international environments should have descriptive rather than directly normative objectives. Empirical studies of internationalization are needed to develop conceptual, descriptive models.