The Impact of Foreign Owners' Networks on their Subsidiaries' Internationalization: Four Estonian Cases

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Abstract

The paper aims to show how firms' and their foreign owners' network relationships and other characteristics influence the internationalization of foreign-owned companies. It includes four case descriptions, each illustrating one internationalization path — a) fast, successful, b) quickening, c) reversing and d) slow, unsuccessful internationalization — and ends with some research implications.

Keywords: internationalization, networks, foreign subsidiaries, Estonia, case study

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Introduction

During the last four decades, the internationalization process has been widely researched. Some research streams have described its stages, while the others have stressed the importance of network relationships, foreign direct investments (FDI), managers' entrepreneurial behavior and several other aspects. Still, when examined independently, different research streams cannot fully explain this complex process. Consequently, future research should attempt to develop an all-inclusive perspective (Coviello and McAuley 1999) to increase the likelihood of developing theory with better predictive ability (Jones and Coviello 2002).

Up till now, despite the subject's importance, the mechanism of the impact of FDI on foreign-owned companies' internationalization has received relatively little attention: some authors have just shown that foreign-owned firms export more than locally-owned ones or pointed to some benefits a foreign subsidiary should enjoy (like easier financing or market access) due to being foreign-owned (for an overview of such literature, see, for example, Vissak 2003). Logically, formerly unsuccessful firms with passive managers and weak foreign owners should internationalize differently from those whose foreign owners are strong, the initial situation favorable and the managers active, but these aspects have not been considerably studied. Including this subject should improve the understanding of the impact of foreign owners' networks on the internationalization process.

The paper aims to show how the firms' and their foreign owners' network relationships and other characteristics influence the internationalization of foreign-owned companies. It begins with a short literature review and tries to find some common ideas of different approaches. Based on these, four conclusions are made and a general theoretical framework built demonstrating the impact of network relationships and other characteristics on the internationalization of foreign-owned companies. Short examples from Estonia are presented to illustrate each of the four variants: a) fast, successful, b) quickening, c) reversing and d) slow, unsuccessful internationalization. The paper ends with research implications.

Literature Review

The following literature review presents some main conclusions of several well-known research streams examining internationalization and the role of networks. These are used for constructing the theoretical framework.

1. The approaches focused on internationalization:
   - The **Uppsala** (or the **U-** or the **internationalization process**) **model** (Johanson and Vahlne 1977, 1990; Johanson and Wiedersheim-Paul 1975; Vahlne and Johanson 2002) assumes that internationalization is usually a long, slow and incremental process driven by experiential market knowledge. The acquisition of knowledge is gradual. Consequently, companies pass through steps from no regular export activities to export via independent representatives/agents, overseas sales and production/manufacturing subsidiaries. They first begin exporting to neighboring countries or the comparatively well-known and similar ones, and after that, these firms try to enter farther markets. The U- model states that enterprises can internationalize more easily if they are large or resourceful, have considerable experience in similar markets and if market conditions are stable.
   - **Innovation-related internationalization (I-) models** state that besides knowledge, several other internal and external actors and factors, like other firms, government agencies, top managers, the companies' competitive advantages and general economic conditions, impact internationalization (for an overview, see Bilkey 1978). Foreign-owned firms' internationalization might differ from that of their domestic counterparts: the headquarters might take the initial decision to start exporting and organize sales through a global marketing network (Wiedersheim-Paul, Olson and Welch 1978). Still, in general, foreign market expansion is incremental and dependent on an enterprise's experiential learning and uncertainty regarding the decision to internationalize (Morgan and Katsikeas 1997).
   - The authors of the **Finnish model** (Gabrielsson, Kirpalani and Luostarinen (2002) have also called it the target country internationalization process model) agree that at first, firms tend to penetrate closest countries. As they gain confidence, they might start seeking more distant

markets and change the method of operating (Welch and Luostarinen 1988). They also imply that inward internationalization (like imports and inward FDI) might precede and influence the development of outward activities and vice versa (Korhonen 1999). In addition, the model shows that a firm does not inevitably have to move to the last step of development: the reverse of the process, or de-internationalization, may occur at any of the stages (Welch and Luostarinen 1988). This may be followed again by advancing steps: in other words, re-internationalization (Luostarinen 1994).

- The literature on **born globals** implies that some companies "leapfrog" into internationalization despite being young and small, having constrained resources, most volatile markets and, by definition, little or no experience in any market (Oviatt and McDougall 1994). Consequently, the U-model cannot explain the internationalization of such firms. A new term, born-again global, refers to the enterprises that are well established in their domestic markets having apparently no great motivation to internationalize, but which have suddenly done it. Mostly, this has been caused by a critical incident: for example, takeover by another enterprise, acquisition of a company with international connections or the internationalization of a domestic client (Bell, McNaughton and Young 2001).

2. The approaches emphasizing the importance of networks (and firms' behavior in them):

- The authors of the **network approach** have demonstrated that through network relationships, a firm can increase its ability to innovate and develop its technology (Håkansson and Snehota 2000), acquire brands, skills and local market knowledge (Adarkar et al. 2001) without necessarily going through the same experiences (Eriksson et al. 1998). This, in turn, can be crucial for its **internationalization**. As a result, a typical internationalization sequence has changed from gradual expansion to expansion in leaps by joining the nets (Hertz 1996). On the other hand, network relationships can sometimes also inhibit this process, instead of quickening it (Ford 1998).
- From the **literature on multinationals as inter-organizational networks** it can be concluded that in the parent company's network, subsidiaries have different roles. The subsidiary role and activities depend on several host country, parent company and subsidiary factors (Birkinshaw and Hood 1998). Some subsidiaries can develop a more central position in the corporation and be more integrated with it (Andersson, Furu and Holmström 1999) if they have the necessary distinctive and valuable capabilities that the rest of the multinational does not have, and are committed enough to win the position (Birkinshaw 1993b).
- The **literature on international entrepreneurship** shows that in addition to internationalization (it is also an entrepreneurial action), entrepreneurial behavior can fuel the development of value-added activities in the subsidiary and these, in turn, enhance credibility with the parent company, commitment of the firm's management to a clear strategic vision and valuable organizational and managerial capabilities (Birkinshaw 1993a). The managers' role is very important: they decide whether the enterprise will pursue internationalization opportunities that their network counterparts initiate. Sometimes they can even inhibit the firm's internationalization, although the network wants it to internationalize (Chetty and Blankenburg Holm 2000).
- Substantial **research** has been made **on the relationships between FDI and host country exports**. Several authors have shown that foreign subsidiaries are usually more international (they export more) than locally owned firms. This is caused by the following two reasons (Blomström 1990; Dunning 1994; Lauter and Rehman 1999): 1) subsidiaries have better business contacts abroad, higher management and marketing skills, superior technology, greater general know-how and the right to use their parents' brand names; 2) the owners can help them to set up a distribution network, follow industrial norms, safety standards and consumer tastes; deal with product design, packaging, distribution, servicing and shaping a new product image.

From the above, four **main conclusions** for further examination can be drawn.

- The companies lacking resources and (their foreign owners') network relationships internationalize slowly. Still, in a favorable business environment, a larger, experienced firm that has sufficient resources and/or belongs to a supportive business network may do it faster.
- An internationalization process may include both de- and re-internationalization.

- The enterprises linked to a (foreign owner's) network might considerably quicken their internationalization as they obtain the necessary resources, develop their capabilities and gain market access. Still, sometimes a network membership can inhibit this process.
- The course of a firm's internationalization process could depend on its role and a level of autonomy in the foreign owner's network, determined by its own and its foreign owner's characteristics. The managers' cooperative, innovative and active behavior should lead to a more important role and more successful internationalization.

The Framework: Construction and Four Examples

Four cardinally different **internationalization paths** — a) fast, successful, b) quickening, c) reversing and d) slow, unsuccessful — can be constructed from the above conclusions. It can be proposed that a firm might internationalize successfully if it has sufficient knowledge, resources, contacts and experience before involving a foreign investor, if its network relationships are close and helpful, the business environment favorable and the managers are highly interested in the company's internationalization. A strong, successful foreign owner with helpful network relationships and interested managers might quicken the process even further (type a: fast, successful internationalization; see Figure 1). On the other hand, a weak foreign owner with inhibiting network relationships and uninterested managers might, slow the internationalization process down, even if the subsidiary itself has been quite successful in the past (type c: reversing internationalization).

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Insert Figure 1

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A company's internationalization might be unsuccessful if it lacks the necessary knowledge, resources, contacts and experience; its network relationships are frail or inhibiting; managers passive and the business environment unfavorable. A weak, unsuccessful foreign owner with inhibiting network relationships and uninterested managers might slow the process down even more or lead the firm to de-internationalization (type d: slow, unsuccessful internationalization; see Figure 2). At the same time, a (new), stronger owner might help a subsidiary to (re-)internationalize, even if it has not been successful before outside its domestic market (type b: quickening internationalization).

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Insert Figure 2

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In Table 1, four short examples — Norma, Mootorreisi Group, AMP Eesti and Eesti Tubakas — are provided to illustrate these four internationalization paths. **Case study methodology** was chosen because it allows to combine previously developed theories with new empirically derived insights (Yin 1994), transcend the local boundaries of the investigated cases, capture new layers of reality and develop novel, testable and empirically valid theoretical and practical insights (Eisenhardt 1989; Tsoukas 1989; Voss, Tsikriktis and Frolich 2002). All the mini-cases are based on public information, including newspapers, the companies' homepages and annual reports (in the case of Mootorreisi Group, some previous interview material was also used). From the examples it can be concluded that several factors have influenced the firms' internationalization. Norma and Mootorreisi Group clearly benefited from involving foreign investors and actively participating in their networks. AMP Eesti clearly lost when its foreign owner was taken over by a corporation with a different business strategy. The internationalization of Eesti Tubakas failed mainly because of radical changes in its business environment, not so much because of its managers or the owner's actions.

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Insert Table 1

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The research streams, examined in this paper, do not contradict the four above-mentioned internationalization paths. The U-model's idea of slow internationalization and the trend toward distant markets and more complicated foreign entry modes is in accordance with type b: quickening internationalization. In addition, the model accepts a possibility of quicker internationalization by larger and experienced companies with sufficient resources that was classified as type a: fast, successful internationalization.

The I-models' propositions that individual decision makers and their attitudes influence internationalization have also been integrated. If the managers are interested in the firm's internationalization, the process should be quicker than in the case they oppose to it. Moreover, the proposed matrix includes the role of foreign owners. They could both quicken and slow down their subsidiaries' internationalization process.

The Finnish model's idea that inward internationalization can considerably impact firms' outward internationalization also supports the division of enterprises. It may largely depend on the foreign investors whether a company should be placed in the upper (types a and b) or lower (types c and d) part of the table. The idea that enterprises may de- and re-internationalize is also in accordance with the latter idea. In the cases of reversing and slow, unsuccessful internationalization, an enterprise might de-internationalize. On the other hand, after involving another foreign owner that is more interested in the company's internationalization, it might re-internationalize and be classified as type b: quickening internationalization.

The conclusion of the literature on born globals that some firms can internationalize very quickly after their foundation (despite their smallness, lack of resources and market experience) matches the internationalization path described as type a: fast, successful internationalization. Involving a highly supportive foreign investor with close network relationships might quicken the process even more. Similarly, the other critical incidents might explain both the classification of a company under a certain type and its movement from one square to another.

The matrix also includes the importance of networks, including foreign owners. Whether a firm's direct network partners and their partners help a company to obtain resources, acquire access to foreign markets and develop its capabilities, determines if it internationalizes quickly or slowly both before and after the foreign investment. Before involving foreign investors, the enterprises classified as type a: fast, successful and type c: reversing internationalization should internationalize faster — for example, enter more distant markets from the beginning or skip some less complicated entry modes — than the companies belonging to the other types that lack the support from their network partners. The foreign owner's networks, in turn, influence a firm's internationalization after the involvement of foreign investors. They might both advance (types a and b) and inhibit (types c and d) this process.

A subsidiary's role in its foreign owner's network might also determine whether it should be placed in the upper (it develops higher value-added activities, exceptional managerial expertise and autonomy and the head office supports its internationalization) or the lower part of the table. In the latter case, the foreign owner might control the company tighter and restrict its access to certain foreign markets or market segments. Here, the subsidiary's managers' role might also be important. They can find new network partners and through them, acquire skills and gain access to external resources, capabilities and foreign market opportunities. They can also try to reach a higher autonomy in the corporation. On the other hand, in some subsidiaries, the managers might be passive and inhibit a firm's internationalization.

Conclusions and Recommendations for Future Research

All the research streams examined in this paper have investigated at least some aspects of internationalization: the process itself, the role of networks or the characteristics of firms and their foreign owners. Based on the theoretical discussion, four conclusions were made. First, the internationalization of the companies not belonging to (their foreign owners') networks is slow. The larger, experienced firms with sufficient resources and supportive network relationships can do it faster. Second, this process may include de- and re-internationalization. Third, by joining a (foreign owner's) network, enterprises could considerably quicken their internationalization as they can obtain the necessary resources, develop their capabilities and gain market access. On the other hand, sometimes these relationships may inhibit the process. Fourth, a firm's role and a level of autonomy in the foreign owner's network, determined by its and its foreign owner's characteristics, may considerably influence the course of its internationalization process. The firms with entrepreneurial managers should internationalize successfully. Consequently, it is important for managers to actively seek internationalization opportunities and create network relationships.

Based on the above conclusions, a concept of four different internationalization paths was proposed. First, if the enterprise and its owner are strong and successful, their network relationships helpful, the business environment favorable and the managers interested in internationalization, a foreign-owned company could internationalize quickly, both before and after the foreign investment (type a: fast, successful internationalization). Second, a formerly unsuccessful firm might internationalize fast after finding a strong foreign owner with helpful network relationships and interested managers (type b: quickening internationalization). Third, if the enterprise is formerly successful, but the owner and its network constrain it, this may slow down its internationalization process or even lead to de-internationalization (type c: reversing internationalization). Fourth, if a company has had no (considerable) international activities before the FDI, the business environment is unfavorable and the foreign owner and its network partners are weak and uninterested, the firm might de-internationalize or remain (mainly) domestic (type d: slow, unsuccessful internationalization).

The four above-mentioned internationalization paths (and the acceptance of situations-in-between) do not contradict to the research streams, examined in this paper. Some approaches' ideas describe the situation in one of the four types while the other studies help to determine to which half of the table an enterprise belongs. It can be also concluded that despite its simplicity and a limited amount of empirical work, the concept can escape some of the critique to the former approaches. It can accommodate the whole internationalization process with different entry modes, dimensions, firm and country types and the factors and actors influencing it. It includes "leapfrogging" behavior, de- and re-internationalization and the possibility of movement from one square (internationalization path type) to another. Thus, practically every imaginable internationalization path can be examined by using this table. If necessary, additional variables could be easily added. In principle, it could be even used for predictions, giving some managerial advice or offering some suggestions for shaping a country's economic policy.

There are several possible directions for future research. It could concentrate more on the indirect impact of FDI inflows (the influence on the local firms which subcontract for foreign-owned enterprises or are tied with them in any other way), examine the characteristics of foreign owners more closely or try to develop the framework further. For example, scales could be added or the rules for classifying firms into certain types worked out (for instance, when is it possible to say that a firm has internationalized successfully). It would be also interesting to analyze more thoroughly the enterprises remaining in the home market despite having the necessary prerequisites – like knowledge, technology and contacts – for successful internationalization. Finally, more attention should be paid to the negative impacts of foreign direct investments on foreign subsidiaries' internationalization. Only then, is it possible to offer specific suggestions to managers on what to do in certain situations and indicate what changes host countries should make, in order to attract more FDI, reduce their foreign trade deficit or achieve other aims.

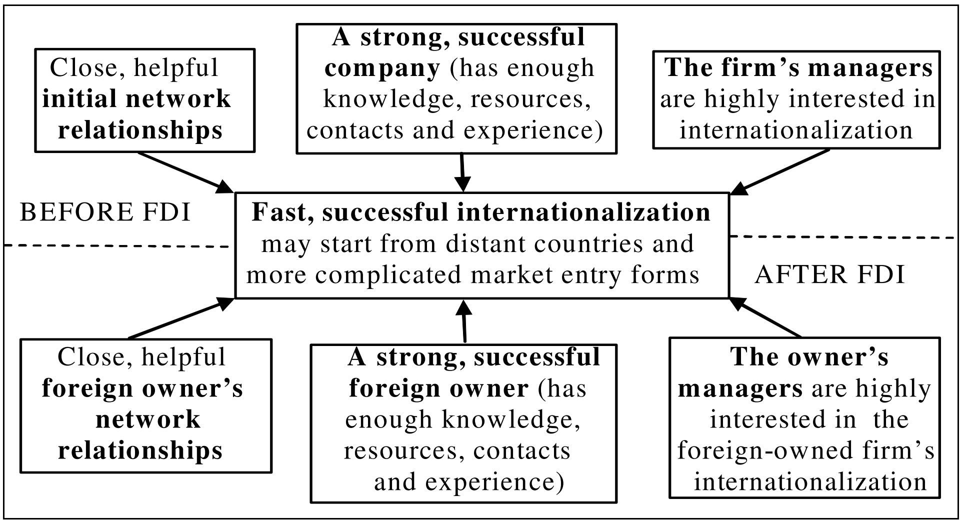

Figure 1. Fast, successful internationalization

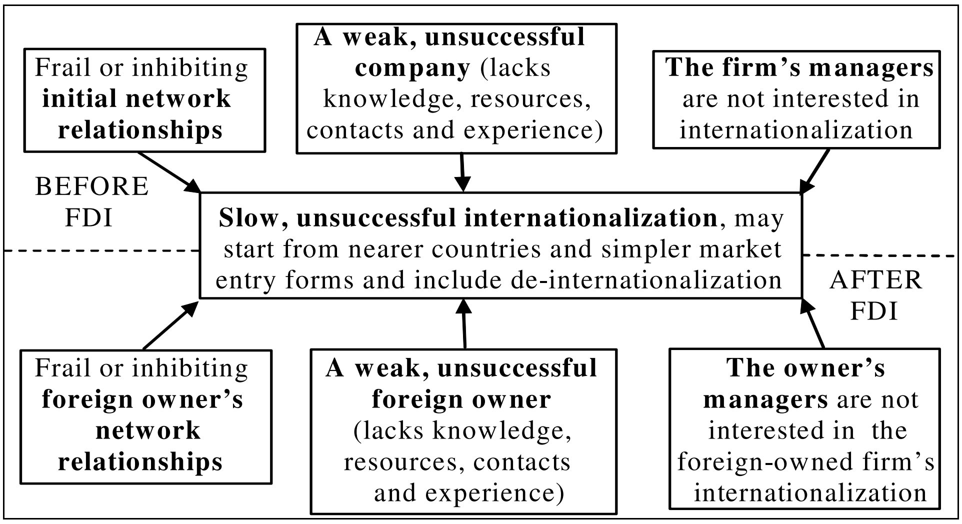

Figure 2. Slow, unsuccessful internationalization

Table 1. **Four internationalization paths depending on the firm's and its foreign owner's characteristics**

		Is a firm strong and successful and is its business environment favorable? Are its initial network relationships close and helpful and the company's managers interested in internationalization?	
		Yes	No
Is a foreign owner strong and successful and is its business environment favorable? Are its network relationships close and helpful? Are the enterprise's managers interested in the foreign-owned firm's internationalization?	Yes	a) **Fast, successful internationalization**. A firm might be internationally successful already before the foreign direct investment. The owner's and its network's assistance might quicken the process even more. **Example: Norma**. Autoliv, a worldwide leader in automotive safety, acquired 49.5% of Norma in 1999. Since 2000, 51 per cent of the company belongs to Autoliv. Norma was the leading seat belt supplier to the Russian car industry already before the takeover. It exported 75 per cent of its output to a number of Russian car manufacturers, mainly Avtovaz, whose partner it had been for over 25 years. Norma was also one of Autoliv's licensees and component suppliers. Still, it has clearly gained from the FDI: acquired access to new technology, improved its production quality and timeliness of supply and become able to offer new security systems to several car models. Its engineers have been included in Autoliv's R&D team. Moreover, the increased integration into Autoliv's production and marketing network has helped Norma in increasing its exports to some Western countries. In 2004, Norma exported 99 per cent of its turnover, 57 per cent of it to Sweden, 34 per cent to Russia and the rest to several other countries, including Germany, France, Ukraine, Italy and the USA.	b) **Quickening internationalization**. A company might have no (considerable) international activities before the foreign direct investment. The owner's and its network's assistance might quicken the internationalization process. **Example: Mootorreisi Group**. The firm has internationalized stage by stage. In 1994, it started with bus lines from Tallinn and then proceeded with opening new lines and foreign affiliates in Latvia (1995), Lithuania (1997), Russia (1999) and Belarus (2000). In 2005, it had about 70 percent of the Baltic international bus lines market. For Mootorreisi Group, involving a foreign investor (in 1994, 40 per cent of the company was sold to a large German bus firm Deutsche Touring) has been beneficial. The firm has improved its image, minimized risks and acquired easier access to financial resources and yet remained independent of the investor. The German partner almost does not interfere with the company's economic activities. Mootorreisi Group takes decisions about new bus routes and logistics itself. It is also very active in increasing its potential: developing new services and improving their quality, entering foreign markets where the competition is still relatively low and cooperating with several companies both inside and outside the owner's network in selling tickets and developing new bus lines.
	No	c) **Reversing internationalization**. An enterprise might be internationally successful before the foreign direct investment. On the other hand, the owner's and its network's constraints might slow down the process or even result in de-internationalization. **Example: AMP Eesti**. AMP Inc., one of the world's leading producers of electrical and electronic connectors, founded the company in 1997. It was the sole owner. AMP Eesti used modern technology. In 1998, it obtained the ISO 9002 certificate. In total, the foreign owner, registered in the USA, invested about 3 million USD to the firm. The enterprise earned a reasonable profit and exported almost all of its production. AMP Inc. planned to further increase its turnover. The situation changed in 1999 due to the parent corporation's hostile takeover by Tyco International. The new owner's strategy led to closing down all the production units in Northern Europe, as the firm's main customers were located outside this region and the transportation costs were relatively high. One of AMP Eesti's plants was closed down, the other sold. Only a sales department remained. In 2004, the firm was closed down completely.	d) **Slow, unsuccessful internationalization**. A firm might have no (considerable) international activities before the foreign direct investment. The owner's and its network's constraints might slow the process even more or lead to de-internationalization. **Example: Eesti Tubakas**. The firm, a successor of a state-owned company Leek, a local market leader, was founded in 1993. A Swedish firm Svenska Tobaks, the owner of two-thirds of the Estonian tobacco manufacturer Eesti Tubakas, promised to invest 20 million USD into the enterprise and export over a half of its production to Russia. Due to Russia's double tariffs on all Estonian products, it never became beneficial. In April 1996, Svenska Tobaks decided to end cigarette manufacturing in Estonia as in the beginning of that year, the new Estonian excise tax on locally produced cigarettes became the same as on imported cigarettes and the prices increased steeply (the price of the cheapest local cigarettes even tripled). The Estonian firm's turnover decreased two times and its market share shrunk to 33 per cent. The production of most popular local brands continued in Sweden. Only a marketing department remained in Estonia.

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